"DECADE OF PEOPLE WITH DISABILITIES IN PERU"
"YEAR OF THE INVESTMENT FOR RURAL DEVELOPMENT AND FOOD SECURITY"

MINISTRY OF ECONOMY AND FINANCE

STRATEGY FOR GLOBAL ASSET AND LIABILITY MANAGEMENT *

2013 - 2016

* It includes the Annual Indebtedness Program and Debt Management, referred to in Article 14 of Law No. 28563, specifying its policies, objectives and goals, from a long term perspective, which is compatible with the fiscal targets and the debt sustainability.

MINISTER OF ECONOMY AND FINANCE
Luis Miguel Castilla Rubio

VICE MINISTER OF FINANCE
Carlos Augusto Oliva Neyra

GENERAL DIRECTOR OF INDEBTEDNESS AND PUBLIC TREASURY
Carlos Adrián Linares Peñaloza

DIRECTOR OF ANALYSIS AND STRATEGY
Renzo Antonio Jiménez Sotelo

TECHNICAL TEAM
Eduardo Olavegoya Hurtado
Luis Cubas Huallpa
Óscar Pinedo Meza
Josué Sifuentes Rodríguez
Fanny Tenicela Mendoza

Original title
ESTRATEGIA DE GESTIÓN GLOBAL DE ACTIVOS Y PASIVOS
Hecho el Depósito Legal en la Biblioteca Nacional del Perú N° 2013-08103
Ministerio de Economía y Finanzas

JEL Classification: G18, H63, H74, H81
Keywords: Public Debt, Financial Strategy, Asset and Liability Management, Financial Policy, Treasury

INFORMATION

Investor Relations Office
Phone (511) 311-5933; fax (511) 626-9921
E-mail: investor@mef.gob.pe
Website: http://www.mef.gob.pe/inversionistas

General Directorate of Indebtedness and Public Treasury
Phone (511) 311-5930 ext. 2802
Jr. Junín 319, 8th floor Lima 1 – Peru
Website: http://www.mef.gob.pe

April 30, 2013

Message from the Minister of Economy and Finance

The year 2012 was very encouraging with favorable results for Peru, in a context of high uncertainty about the direction of the world economy due to the continuing effects of the recent global financial crisis. However, despite these circumstances, Peru's economic growth reached 6.3%, the second highest in Latin America, generating major strengths in an environment of price stability, budget surplus and an appropriate public debt management, which increases investors' confidence and improves Peru's sovereign risk ratings.

One of the main objectives of the Government is to stay growing consistently, for which we estimate a GDP growth over 6%, supported by the sustained momentum in domestic demand and particularly, the private investment growth of around 10%. We also expect a debt-to-GDP ratio reduction, which will be around 15% by 2016, and a budget surplus of 1%. These achievements will strength the Republic solvency and generating valuable savings for the future.

In this context, it is essential to implement a responsible management of the Government's assets and liabilities, in order to consolidate the balance and sustainability of public finances in the long term. We will seek to improve the execution of financial transactions applying the performance/cost versus risk approach in order to streamline the management of public savings and debt, which will focus on maintaining and managing enough liquidity reserves to meet any situation of instability, funding high-priority and strategic interest projects for the country, and contributing to the further development of the debt securities market in Peruvian soles.

The Strategy for Global Asset and Liability Management, which includes the Annual Indebtedness and Debt Management Program (within the new strategic framework of financial management that we are implementing), is the tool that provides essential objectives, policies and goals which will guide the responsible execution of the Central Government's financial asset and liability operations in the long term. The Central Government's debt is evaluated and rated by different risk agencies worldwide.

Therefore, from this year on, following the best international practices and standards related to the public sector finances, the main objective of the strategy will be the development of the government securities market in local currency which is part of the capital market reform; this is a commitment that government cannot postpone.

Luis Miguel Castilla Rubio
Minister of Economy and Finance

Message from the Director General of Indebtedness and Public Treasury

It is a great pleasure to introduce the Strategy for Global Asset and Liability Management for 2013-2016, which reflects our deep commitment to strengthen the transparency and access to the Government securities market as well as our commitment to improve relations with different financial institutions in the country. With this vision, we will guide the Republic's debt policy within the framework of a global asset and liability management with responsibility.

We are currently consolidating a very important period of transition, which began with the merger of the former National Directorate of Public Treasury and the former National Directorate of Public Indebtedness in 2011. The new Directorate-General of Indebtedness and Public Treasury has adopted measures in order to implement a strategic management of net debt, which will help to reflect better the financial situation of the Central Government balance. This includes the refinement of the mechanisms that allow us to make profitable the savings of the Public Treasury efficiently and effectively and also to formalize the development of secondary liquidity reserves; these reserves are a basic element of a liquidity contingency plan for situations of instability caused by a slowdown in the economic-financial cycle.

Also, we are in the process of implementing a series of reforms to improve the functioning of the Government securities market in the local currency, according to the best international practices. For example, the bills will be issued to complete the short segment of the sovereign yield curve and retail investors could access to the bills. Moreover, new regulations of bonds and new regulations for the entities wishing to hold the position of Market Makers will come into effect; the regulations introduce key measures to boost competition, liquidity and access to public securities.

On the other hand, in order to further promote transparency and a good behavior in the market, it has been established that the Government securities market is henceforth under the supervision of the Securities Market Regulator. At the same time, the active participation of the Public Treasury in authorized centralized trading mechanisms will be promoted, with the purpose of boosting the market liquidity and preserving the stability in adverse conditions, within the framework of the new policies.

Finally, I would like to express my full conviction that the fulfillment of the objectives set will strengthen the confidence of the markets and investors about the approach that, henceforth, will guide the management of the assets and liabilities that compound the net debt of the Republic.

Carlos Linares Peñaloza
Director General of Indebtedness and Public Treasury

CONTENTS

1. INTRODUCTION

The Strategy for Global Asset and Liability Management has been formulated to give an insight into the policies, goals and objectives of public debt management and the public savings fund in accordance with new approved policies for the Central Government asset and liability management.

The aim of the Strategy is to become an effective tool for multiannual planning and to improve the communication on government financial strategy. This will help to develop the public debt securities market and to promote a healthy and diversified investment of public funds, while ensuring the sustainability of the total net debt.

Therefore, the traditional Annual Indebtedness and Debt Management Program has been included in the Strategy for Global Asset and Liability Management, as the debt management cannot be seen in isolation from other Government's financial assets and liabilities because the operations are interrelated and often have common counterparts.

Due to the merger of the former National Directorate of Public Indebtedness and the former National Directorate of Public Treasury, the new Directorate-General of Indebtedness and Public Treasury is implementing the new framework for global financial asset and liability management; the goal is to manage more efficiently the balance sheet mismatches during the economic cycle. This will not only determine the opportunity to improve the debt profile, but also the investment or the divestment of savings required in a counter-cyclical manner.

This new framework, which will strengthen the management of the net public debt within the guidelines of the macroeconomic policy in general, will become the central point to reduce the vulnerability of public finances against adverse external shocks in financial markets, to strength the State's net worth and to consolidate the development of the domestic securities market in soles.

Therefore, long-term goals for the global management of the debt and savings will also help the Republic to expect the consolidation of additional improvements in the sovereign credit ratings already obtained.

To this end, during the period 2013-2016, the strategy will take into account various specific and fully articulated actions relating to the securities issue, the granting of public credit, asset management, liability management and development of the market structure.

In securities issuance, the strategy is designed to increase diversification, to generate periodic signs on key vertices of the yield curve, to generate attractive debt volume for each segment, to avoid interest rate instability in the auctions and to stabilize the interest payment on all debt securities.

Also, the strategy aims to the agreement, authorization and financing of public credit in the asset and liability global management. In this way, we could ensure the viability and sustainability of direct and contingent credit and its counter guarantee, regardless of the debt or funds that finance them.

In asset management, the strategy will implement progressively a secure and transparent active cash management, reduce its liquidity cost, and maintain financial stability. This involves the consolidation of the public debt securities market in local currency as a fundamental pillar for determining the transfer rate or opportunity cost of various sources of funding and entities' investments management.

In liability management, the strategy aims to reduce the future liquidity risk that could be generated from the concentration of maturities, by reducing the maturity profile. In addition, the strategy points at enhancing flexible financial cost associated with the interest rate risk that –unnecessarily– could originate a higher volume of refinancing to the financial markets.

In market structure, the strategy primarily aims to optimize the government securities market structure in soles. To this end, it is necessary to strengthen the infrastructure of the systems with which the market operates, the role of the entities considered as market makers, the ability to generate a more competitive and contestable market, the direct access to public debt for individuals as a means of saving, the establishment of profitability references that are risk-free in soles for mutual funds and pension funds, and the reduction of the systemic risk in offsetting and liquidation transactions under the Peruvian law.

Finally, the document details the components of the financial assets and liabilities of the Central Government, which is the smallest relevant institutional unit from an economic point of view for preparing financial statements. This is important not only for accounting but especially for decision making according to the International Public Sector Accounting Standards. Risk rating agencies evaluate and qualify the Central Government's ability to repay.

In addition, the document details the structural balance sheet risks, the associated costs and returns and the quantitative targets that are expected to achieve, including the analysis of the services provided, the traditional sustainability ratios and the gross debt profile.

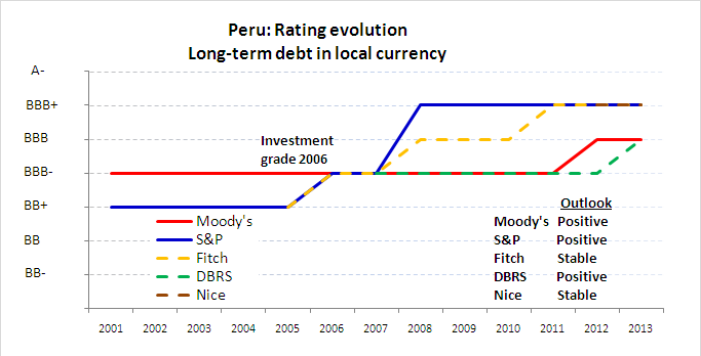
2. REGULATORY AND STRATEGIC FRAMEWORK

To determine the policies, objectives and targets that the strategy for global asset and liability management should take into account it is necessary to respect the economic fund established by the principal regulations related to the management of the Public Treasury financial strategy as a reference for the Public Treasury.

According to Article 14 of Law No. 28563, the General Law for the National Indebtedness and amendments, the Directorate-General of Indebtedness and Public Treasury, has, as part of its authority, the power to create the Annual Indebtedness and Debt Management Program of the Central Government, specifying their policies, objectives and goals compatible with fiscal targets and debt sustainability, from a long term perspective.

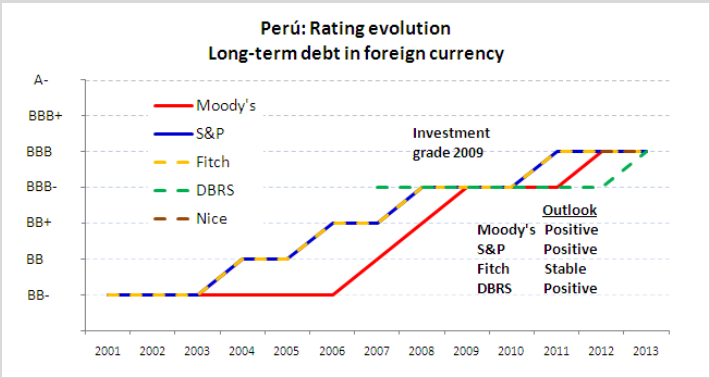
BOX N° 1
EVOLUTION OF THE REPUBLIC'S CREDIT RISK RATINGS

The long-term credit rating in local and foreign currency of the Republic has improved significantly in the last decade.



Source: MEF-DGETP

At present, three of five credit risk agencies (S&P, Fitch and Nice) graded BBB+ to Peru for long-term local currency credit rating while the long-term foreign currency credit rating is BBB in the five risk agencies.



Source: MEF-DGETP

Also, under the sub-paragraphs p), q), and r) of Article 6 of Law No. 28693, the General Law on the National Treasury System, the Directorate-General of Indebtedness and Public Treasury has the exclusive power, to execute all operations that contribute to the development of the securities market, to establish a secondary reserve to meet financial instability situations that could affect the liquidity of the resources that are part of the Budget execution or the securities market and credit

markets' liquidity which are commonly used to raise funds and to establish the policies and criteria for the management of funds of non-financial companies and other public sector entities through all kinds of investments, as part of the global asset and liability management.

And according to Article 9 of Legislative Decree No. 1012, the Framework Law on Public-Private Partnerships, the investment projects classified as co-financed must comply with the Law on the National Public Investment System and the Law on the National Debt System and its amendments and other relevant standards. In this regard, the last paragraph of the Article 54 of the Law No. 28563 establishes that the auction terms for a project or program guaranteed by the Government requires the favorable opinion of the Directorate-General of Indebtedness and Public Treasury about the financing structure before its approval.

Furthermore, according to the Article 2 of Law No. 27245, the Law of Fiscal Prudence and Transparency and amendments, should be noted that, as a general principle, the State must ensure the economic equilibrium or fiscal surplus in the long term, by accumulating fiscal surpluses during favorable periods and only allowing a moderate and non-recurring fiscal deficit during periods of slower growth.

Finally, according to Articles 7 and 8 of Law No. 28112, Framework Legislation on the Public Sector Financial Administration, the Public Treasury centralizes, guards, and channels the funds and securities of Public Indebtedness and the Treasury. It allows obtaining external and internal funding in order to meet part of the requirements established in the Public Budget, according to the payment capacity.

The Ministerial Resolution No. 807-2011-EF/41 Multiannual Sectorial Strategic Plan for 2012-2016 (PESEM), the Ministerial Resolution No. 880-2011-EF/41 Institutional Strategic Plan for 2012-2016 (PEI) and the Ministerial Resolution No. 009-2013-EF/41 "Goals and Performance Indicators of the Economy and Finance Sector Development 2013" have been considered to establish strategic goals and indicators for the Economy and Finance Sector in general, for the Ministry of Economy and Finance in particular, and for the formulation of the strategy,

3. FINANCIAL POLICY GUIDELINES

Considering the strategic policy framework described above as the main criteria of legitimacy, the main financial policy guidelines of debt and treasury management are:

3.1 Develop the securities market increasing the public debt in soles

The public debt securities market in local currency is one of the most important pillars for the development of the financial system. However, despite of the significant efforts made in previous years to reduce the level of dollarization of direct public debt, which in 2002 reached 85%, Peru still has an average level of 50%, one of the highest dollarization levels among countries with a similar risk rating. In addition, the size of the public debt securities market in soles, which in 2002 equaled to 3% of gross domestic product, now almost equals to 6% and it is not traded on supervised centralized trading systems.

To reduce these gaps, regular public debt securities auctions will be established and also trading will be encouraged through authorized centralized systems where Public Treasury will participate with the specific purpose of further develop the market as the principal means to obtain domestic savings and financial inclusion. Thus, in 2016 we expect to reduce the public debt dollarization to 30%, closer to the average of countries rated BBB, and to increase the size of the public debt market in soles up to 10% of GDP. This effort also shows our will to reduce financial dollarization of credit granted to the private sector, which does not only represent a non-diversifiable systemic vulnerability for the country's financial stability, but also it is an obstacle to achieve higher risk rating levels.

3.2 Maintain liquidity reserves to face situations of instability

To strength the development of the public debt securities market allows the Public Treasury, as a positive externality, to reduce the financial costs of the treasury's savings liquidity management and the financial system in general, because it reduces the uncertainty of the securities holders about future liquidity and price risk of those securities. This also generates an improvement in the State's funding and refinancing capacity, minimizing costs that are directly associated to securities issue. However, there are situations of financial instability that could jeopardize this virtuous circle.

Therefore, the best international practices suggest not only the maintenance of a primary reserve or basic cushion of liquid resources for ordinary times and an active management of financial liabilities to maintain the interest of the financial markets, but also the constitution of a secondary reserve. It will be an additional liquidity cushion that can be used in times of instability, as part of a contingency plan, when ordinary income fund may be insufficient or when fund raising markets are closed.

3.3 Make profitable the public funds and reduce the cost of its liquidity

To ensure fiscal balance in the long term, it is necessary to accumulate surplus savings during the favorable periods of the economic and financial cycle in or-

der to use them later in periods of slower growth. However, in order to maintain the purchase capacity of these savings and reduce the cost of liquidity, it is necessary to implement appropriate mechanisms so that these funds generate return according to its opportunity cost on the market, and to diversify the systemic risk through the elimination of counterparty concentration, from the day in which they are paid by each taxpayer.

In this regard, all necessary steps will be taken in order to make the revenue collection through index-linked deposits directly on bank accounts in the name of the Public Treasury. Through these deposits, the tax agent can automatically identify the nature of the income, as well as all the taxpayer characteristics. Thus, it will be easier to implement an active cash management in the market, just as public treasuries of many countries do. It will help to generate significant additional revenues that will enable the Treasury to accelerate its modernization process and reduce the difference in the level of infrastructure between the State and the private sector.

3.4 Maintain a sound financing structure of the indirect debt

In a country such as Peru, with a big infrastructure deficiency and a prudent goal of maintaining the direct debt stabilized at a maximum level of 15% of gross domestic product, public works concessions with the private sector becomes inevitable. However, in cases where concession projects are not self-sustaining, indirect debt- that includes guarantees, bonds or other financial guarantee by the Government- must be limited to those co-financed projects that ensure a sound economic and financial balance during the time each operation last, according to the best international practices.

From the beginning, the goal is to count with effective contractual mechanisms that allow to reestablish an adequate distribution of incentives and risks over time, ensuring an average return to the private participation based on the risk associated with the sector involved, only if private sector meet all the responsibilities. Also, they will ensure that the indirect public debt could transform into direct public debt according to the current financial strategy. In addition, in order to enhance transparency, it is necessary to accelerate the process that unit control and equity accounting of all public works concessions, following the best international practices and the international public sector accounting standards.

3.5 Reduce the procyclicality of the external debt as a cause of vulnerability

In a context in which the Peruvian private sector has increased rapidly its external debt in recent years, maintaining the current account deficit financed by foreign investments -that will not be infinite- it is necessary to promote that private and public financing should rely on domestic savings rather than foreign savings.

The promotion of domestic savings will also help to the further development of the local securities market in soles. This is a key element to achieve a more developed financial system and reduce foreign savings, which are an important factor of vulnerability that can affect the financial stability that has benefited our country. Thus, by 2016 it is expected that external public debt reduce to a level similar to or lower than the average of the BBB countries.

3.6 Ensure the sustainability of the net public debt

In an environment of high export prices of raw materials and fiscal surpluses, the maintenance of at least a minimum amount of gross public debt is mainly justified by the greater need to maintain a yield curve free of risks. This will facilitate the access of local firms to the local securities market for obtaining financing and will support the liquidity and the development of the market in national currency.

The savings that come from accumulated surplus will lower the net public debt stock and will ensure public debt sustainability, even in future stress scenarios, because we will anticipate the ability to pay the advance gross debt. We avoid the necessity for increasing gross debt in the worst moments to look for financing in the markets; this is, when the risk premium soars, as it happened in the recent international financial crisis. In a countercyclical way, by then, we expect to count with large credit lines granted by multilateral agencies, as part of the liquidity contingency plans that are being implemented.

Box N° 2

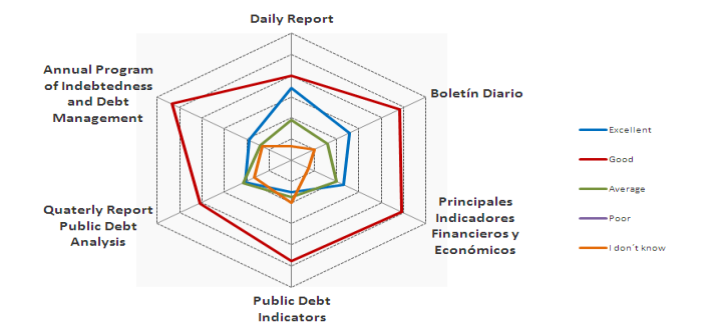
INVESTOR SATISFACTION SURVEY

In July 2012, the Investor Satisfaction Survey for the period of June-2012 / June-2011 was taken to gather relevant information in order to improve the quality of information services that have been reported regularly to the market. To this end, we used a database with more than 500 contacts of the main financial market entities and participants, national and international, such as credit agencies, pension funds, investment funds, global portfolio managers, and other institutional investors.

During the evaluation, the Investor Relations Office website (www.mef.gb.pe/investors and www.mef.gob.pe/investor) in Spanish and English experienced a number of changes such as: the creation of simplified access routes to the main reports, the reorganization and standardization of links, updating and improvement on the quality of the available information, and the establishment of optimal response times for queries received by the mailbox enabled as a direct communication channel with investors(inversionistas@mef.gob.pe and investor@mef.gob.pe).

The results obtained in the survey were very positive, in over 80% of the cases the reports were considered as "useful" and "very useful", reflecting a favorable overall assessment for the main reports evaluated.

It should be noted that the realization of this survey has also been a determining factor in the improvement of Peru in this subject, as stated in the last report about "Assessing and Managing Investor Relations and Information accountability" elaborated by the Institute of International Finance (IIF). According to the report, Peru raised its rating from 35 to 36 points within a total of 38 evaluable aspects, changing the compliance level from 92.1% to 94.7%. Therefore, the survey helped to reach a more favorable score in the category of self-assessment activities that should be performed by the Investor Relation Offices.



Source: MEF-DGETP

This report also emphasizes that, since the formal establishment of the Investor Relation Office in 2006, Peru has strengthened its good practices in this area mainly by spreading reports tailored to the investor needs, generating more confidence and less volatility on the market. In addition, the recent improvements in risk ratings obtained by the Republic in a context of deterioration in global economic conditions are highlighted.

4. MAIN OBJECTIVE AND GOALS

The main objective of the financial asset and liability global management that will be implemented from now on, considering the legal and strategic changes introduced during the last year, is formulated as follows:

> **To enhance the development of the public debt securities market in local currency and meet financial requirements derived from the management of the debt and treasury, within the framework of a responsible and sustainable public finance management.**

This new main objective is framed and complemented by the general strategic guidelines formulated within the framework of Multiannual Sectoral Strategic Plan 2012-2016 in the long term:

To maintain fiscal balance and financial efficiency:

- Incorporate public debt management as part of the State's global financial asset and liability management.
- Reduce the cost of the Public Treasury' liquidity management through active management of the treasury with public debt securities.

To maintain macroeconomic and financial stability:

- Increase the debt dedollarization in order to reduce macroeconomic vulnerability to credit crises and currency crisis.
- Diversify markets and investors in order to ensure debt sustainability and improve the negotiating capacity of the State.

To enhance the development of the securities market:

- Strengthen transparency, competitiveness and liquidity of the public debt securities market operations.
- Minimize the differences of access to public debt securities investment between credit institutions and securities firms.

To develop the financial system with a greater financial inclusion:

- Consolidate the growth of microfinance institutions, through the participation in public debt securities so they could manage their liquid assets.
- Development of money market through repo operations with public debt securities and other financial instruments backed by financial collateral arrangements.

On the other hand, in both the PESEM and the PEI there is a range of goals already approved that are applicable to debt and treasury management. To this end, Public Treasury should develop a strategy in order to achieve a balance between predictability –that the issuer needs to measure market development –and opportunistic flexibility required to face financial markets (which become more volatile and integrated), covering the financial requirements associated with debt and treasury management (see Table 1).

Moreover, according to Article 13 of Legislative Decree No. 1012, the balance of contingent and non contingent obligations that are part of the net incomes, assumed by the Non Financial Public Sector calculated at present value, should not exceed 7% of the Gross Domestic Product.

Table Nº 1
Goals Approved in the PESEM and the PEI

General objectives	Indicators	Base 2012	Goal 2016
Responsible fiscal and financial policy	Public debt as percentage of Gross Domestic Product (GDP).	21%	15%
Integral development of the financial system	Trading frequency of referential public debt securities under normal conditions.	70%	80%
Specific objectives	**Indicators**	**Base 2012**	**Goal 2016**
Strengthen liquidity of the public debt market in order to maintain financial stability	Issues with a minimum amount of S/. 3 billion above the total reference issues for non-residents.	57%	75%
Efficient public debt management as part of a global asset and liability management.	Growth of local currency public debt.	48%	70%
Improvement of the treasury management conditions of non-bank entities.	Number of treasury auctions.	12	48
Strengthen the treasury management modernization process	Participation of entities in centralized mechanisms for public funds auctions	20%	80%
Institutional strengthening of financial management capacity	Number of treasurers that received at least 8-hour training per year.	300	500

Source: MEF – DGETP

Finally, according to the National Policies of Mandatory Compliance approved by Supreme Decree No. 027-2007-PCM, the following goals are established: (i) develop a project that will allow people to save money by buying public debt securities on Internet, (ii) elaborate a study about technological infrastructure improvements for the public debt securities market, (iii) organize a financial education website aimed at spreading knowledge about public debt securities market among young people, (iv) disseminate newsletters and daily reports by e-mail to investors, and (v) publish the results of the public-sector securities auctions monthly.

5. STRATEGY 2013 - 2016

Having formulated the policy, objectives and goals framework, the most important public aspects of the strategy for global asset and liability management to be implemented between 2013 and 2016 are described below:

5.1 Securities issue

Regarding to securities issue, the strategy is designed to increase debt diversification among various counterparties, to generate signals on key vertices of the yield curve periodically, to generate attractive debt volumes for each segment, avoid interest rates instability that may be caused by the auctions and to stabilize the interest payments on the debt overtime.

Thus, the securities issue strategy will take into account the following main lines of work:

a) To increase the number of entities that can access to the primary market regular auctions in order to diversify the investor base

The new bond and bill regulations will allow brokerage, mutual funds, municipal funds, and insurance companies, among others, to enter directly to the regular auctions of the primary market; in this way, they will have the opportunity to develop greater competition and stimulate different segments or public debt securities market niches. Such entities may participate with both competitive bids (setting a minimum return) and non-competitive bids (accepting the auction's average return), broadening the local investors' base directly and the local potential liquidity of public debt securities indirectly.

BOX 3
TYPES OF PUBLIC TREASURY AUCTIONS

Regardless of the system used, auctions of Public Treasury' bills and bonds have two types:

Regular Auctions: Those that have the express purpose of achieving the public debt securities market development. To this end, it establishes an auction schedule and a referential minimum or maximum amount, in order to give greater predictability to market participants.

Special Auctions: Those that have the traditional purpose of achieving the financial requirements arising from debt and treasury management when opportunities appear on the market, this is why they do not have a predefined calendar. The special auctions can either be issuance, repurchase or resale auctions.

b) To offer bills to complete the short end of the sovereign curve in nominal soles to encourage retail savings

Both real sector companies and the financial sector companies may count on a periodical and accessible reference to improve the access to securities market for local private debt, it will facilitate the issuance of certificates, bills, notes and papers. To do so, the bills representing maturities of 3, 6, 9 and 12 months (4 vertices) will be issued fortnightly in the Treasury's regular auctions with a benchmark of maximum S/. 15 million each and a maximum total amount of S/. 400 million at the end of the budget year 2013, and may vary in the following years. The issuance will be a predictable and constant in order to encourage the

local retail savings using bills, which have a limited exposure to the market because they are short-term instruments.

c) To offer benchmark bonds for the middle and long stretch of the sovereign curve in nominal soles

In the new regular auctions that will be implemented by the Public Treasury, benchmark bonds will be issued biweekly in nominal soles, representing the periods of 5, 10, 15 and 30 years (4 vertices) with a referential amount of at least S/. 15 million each bond to complete the middle and long stretch of the curve, according to the approved schedule. Such bonds could also be issued on special auctions, which are aimed at big institutional investors and non-resident investors, when there is a market opportunity. In any case, the outstanding amount of benchmark bonds will not exceed S/. 2,000 million in the case of securities under 10 years maturity, neither S/. 4,000 million in the case of securities with more than 10 years of remaining life.

BOX 4

MEETINGS WITH MARKET PARTICIPANTS ABOUT TREASURY BILLS REGULATION

The issuance of bills by the Public Treasury is a key point that will help to develop local public debt securities market, to complete the short end of the yield curve in soles and to broad the investor base. All these objectives have been set out in guiding plans of the Strategy for Global Asset and Liability Management. Bills will be directed at local retail investors who would like to change their excess of liquidity into short-term and low risk instruments.

The implementation of this project has required close coordination with the main entities of the market such as the Lima Stock Exchange, the Societies of Stockbrokers, the Securities Market Regulator (Superintendencia del Mercado de Valores) and CAVALI. The results of the meetings were very positive because the Lima Stock Exchange approved a S/. 0 commission for Treasury bill trading through Stock Exchange Sessions for a period of year and CAVALI approved a S/1 commission for investor and treasury bill trading during the first year. In addition, the SMV approved a contribution of S/.0 for all types of debt securities operations issued by the Central Government until 2016.

In this context, the “Regulations of the Public Treasury Bills” was approved by Supreme Decree No. 051-2013-MEF. For the year 2013, it is expected that bills issuance reach 400 million soles and fortnightly, for each of the periods of 3, 6, 9 and 12 months.

d) New signals to the private debt securities market with benchmark bonds in the sovereign curve in real or inflation-indexed soles

For the corporate sector, inflation indexed debt securities have an advantage: to connect the magnitude of the debt financial cost with the ups and downs of selling prices and the real value of its fixed assets in a procyclical way. Similarly, for the government sector, the advantage of this type of securities is that, they facilitate the achievement of a debt to GDP ratio stability, because they are correlated to tax collection. In any case, these instruments provide valuable information about the inflation expectations. For this reason, on the regular auctions we will issue bonds of 5 and 30 years maturity (2 vertices) with a maximum monthly amount of S/. 15 million each. In this way, we expect to help with the creations of new opportunities for diversification in the local market for both issuers and investors.

BOX 5

AVERAGE STRUCTURAL DEMAND FOR BONDS IN 2013-2016

According to the previous regulatory framework of the public debt securities market, the structural demand for sovereign bonds 2016 by major institutional investors (pension funds, mutual funds, insurance companies and banks) for the period of 2013-has been projected on the basis of the estimated growth of their investment portfolios and the average share that sovereign bonds have in these portfolios. Measuring is important because it gives a clearer view of the feasibility of replacing a larger share of the ordinary financial needs of the Central Government in local currency, and it helps to forecast the moments for changing and rising the debt composition denominated in soles to develop the public debt securities market.

Demand forecast for sovereign bonds in Peru

Years	Pension Funds	Banks	Insurances	Mutual Funds	Total
2013	**2,040**	**1,179**	**193**	**138**	**3,550**
2014	1,983	959	189	76	3,205
2015	2,642	2,020	184	248	5,094
2016	2,232	1,169	179	80	3,661

Source: MEF-DGETP

From the estimations, we can see that the annual average amount of structural demand for bonds for the period 2013-2016, easily exceeds the amount of S/. 3,000 million per year thanks to the organic growth only, without considering the positive impact of the new rules, These estimations are conservative considering that the major institutional investors participations in Peru are well below than similar investor participations in other Latin American countries with similar qualification, where public and private bond market are greater than the equity markets.

Sovereign bonds in the portfolio of local investors in 2011

Business	Brasil	Mexico	Colombia	Peru
Pension Fund	49%	49%	18%	**14%**
Banks	37%	16%	36%	**6%**
Insurance	30%	31%	22%	**9%**
Mutual Funds	45%	37%	12%	**11%**

Source: MEF and central banks of Colombia, Mexico and Brazil

It is important to highlight that this analysis did not consider the potential demand by the non-bank credit institutions, non-financial companies or other local investors which currently have no access to auctions of sovereign debt securities in soles.

e) Stabilization of the debt interest payments with the standardization of coupons

Following the best international practices implemented by other countries with more developed public debt securities markets, and with the objective of facilitating macroeconomic forecasts, 10 to 30 year government bonds issued for the first time will be standardized with a non-amortizing principal and coupon rates of 6% for nominal soles and 4% for indexed soles. These rates correspond to the implicit yields expected in the long-term in the Peruvian market and are consistent with the current inflation goal. The new bonds in nominal soles will reach maturity in odd years, while the soles-indexed bonds will reach maturity in even years. This standardization will also facilitate the future programming of the debt service and its dynamic progress over time, minimizing the transaction costs.

5.2 Public credit

The Public credit agreement, provision and financing will be incorporated as part

of the global asset and liability management, ensuring the viability and sustainability of both direct and contingent loans and the guarantees, regardless of the debt or funds that finance them.

Thus, the public debt strategy will take into account the following main lines of work:

a) Optimize the use of loans, financed with debt from international financial institutions according to the economic cycles

The use of the funding provided by international financial organizations will henceforth be harmonized with the main objective of the strategy for further development of local securities market in soles. This implies that in periods of financial stability, as at present, the financing through the local securities market will be considered as a priority, in order to reduce the external debt and to release credit lines that can be used in the future cycles of restricted liquidity or volatility in the financial markets. One of the objectives of these organizations is to finance to its members in a countercyclical way.

BOX NO 6
EUROPEAN BEST PRACTICES FOR PUBLIC WORK'S CONCESSION

For almost 20 years, public-private partnerships (PPP) are the new formula that is used in several developed countries to promote investment in public works and services as well as for general infrastructure development. This formula is not only used by Central governments of different countries, but also by regional and local governments. Given the important experience in those developed countries, there is a broad consensus on specific recommendations to be taken into account in the tendering process for construction, financing and operation of infrastructure in terms of concession. According to this experience, there must be:

Stable distribution of risks between the Government and the concessionaire
- Maintain economic and financial stability and to count with contractual arrangements to correct imbalances that create losses to any of the parties during the concession.

Determining the minimum and the average yield
- The minimum yield for the concessionaire should not exceed the risk-free rate.
- The average yield should include risk premium associated with the investment sector.
- Profitability agreed according to the functional currency of the grantor (State).
- Nominal profitability or profitability related to inflation.

Compensation scheme against demand risk
- The State should compensate the concessionaire in case of non-minimum demand.
- The State should be considered in the distribution of benefits when the concessionaire obtains revenue from above the average profitability agreed due to an excess of demand

Establish an efficient evaluation system in order to ensure provisions of services.
- Rewarding or punishing significantly the benefits of the concessionaire, under assessable criteria, the state of preservation and availability of the infrastructure service.
- It requires high technical staff to ensure quality supervision.

Investments made by concessionaires with high technical and economic standards
- Concessionaires should provide an optimum service. In order to achieve this goal, they must improve constantly their service according to the needs of users during the concession period.
- The State should have the power to redefine the concessionaire's responsibilities to maintain high standards of service.

Strong and sustainable financial structure
- 30% limit for capital contributions, to avoid losses due to devaluation of assets, the consequences of these situations were faced by countries in crisis.
- Capital expenditures: at least 75% in the first year and the remaining 25% before the second year of signing the contract.

- The deadlines for funding must be shorter than the life of the real assets to ensure financial sustainability.
- The Government will provide surety and other guarantees in the same currency than the revenues resulting from the use of the infrastructure, trying to avoid currency mismatches.

To guarantee the real risk transfer to the concessionaire
- Ensure the actual transfer of construction risk, demand risk and availability risk, so that the concession debts do not affect the public debt neither the risk rating.

b) Prioritize funding of infrastructure development projects, at national level, with public debt securities in local currency

In the framework of targets and performance indicators of the National Policies of Mandatory Compliance, the majority of public loan disbursements for economic and social sectors will be used for national infrastructure. The goal is to finance the loans with a maturity date less than the life of real assets built to ensure sustainability. To execute these projects, ”puente” credits granted by development banks can be used or the treasury’s liquidity surpluses, which may or may not be consolidated with any combination of domestic bond issuance considered in the current strategy, either with a public or private issuance. Thus, the funding of infrastructure works and public investment projects will increase, in proportion with the direct emission of bonds included in the strategy for bond issuance, or using their own temporary excess of free availability.

c) Continuous assessment of the sustainability of contingent public debt given with guarantee, bonds or other financial guarantees.

An assessment and monitoring of credit risk involved in these operations should be carried out as well as an assessment of counter guarantees that are necessary to support the counterparty’s ability to pay. The counterparty cannot belong to the private sector, unless it participates in the process relating to private investment and concessions. The amount and term of the guarantor, sureties or guarantee should be constantly checked to determine if they are properly limited, and covered by the guaranties. Furthermore, in order to avoid distortions or perverse incentives on debt sustainability, the currency in which indirect loans are granted shall be the same functional currency available for users who pay for the use of infrastructure, or the currency of regional or local government grantor, either in terms of nominal or real soles.

d) To contract technical assistance for projects and programs with credits through development banks that do not require public debt

Various public sector entities could hire consulting with international financial institutions and similar entities to benefit from these specialized services in development banking for the implementation of projects and public credit programs granted by the Treasury, using its approved current or future budget, and therefore do not require public debt.

5.3 Asset management

The strategy is designed to progressively implement a secure and transparent active cash management, from the same day that taxpayers fulfill their payment obligations, through the management of treasury operations. The strategy is also designed to reduce the liquidity cost, and will help to maintain financial stability by strengthening the role of the public debt securities market in local curren-

cy, which will become a cornerstone for determining the rate of transfer, or the opportunity cost of the various sources of funding and of the management of their own investments.

BOX NO 7
ESTIMATION OF SECONDARY LIQUIDITY RESERVE

According to Article No 6º of Law No. 28693, The General Law on the National Treasury, two components were estimated for the secondary reserve. The first aims to hedge the cash flows of the Public Treasury, ensuring a normal operation in a situation of economic contraction. The second is intended to provide liquidity to the market in a context of financial instability where financing channels may have closed.

The first component was calculated on the basis of an estimate of the tax gap that would be generated in a stress scenario during a year, for which were necessary projections of expenses and income. In the case of expenditure, since it is a decision variable of economic policy, we have used MMM (multiannual macroeconomic framework) projections.

With respect to the income, two different techniques were applied. For the first situation the collection was estimated on the basis of its main determinants, which are then simulated under a stress scenario. In the second situation, a simulation of the monthly variations of seasonally adjusted revenue was made through a random process.

For the second component, it was necessary to estimate the amount necessary to stabilize the public debt market in a crisis. The value at risk (VaR) method was used on this regard. Based on the daily information of the yield curve in Nuevos soles since 2006, we estimated the highest annual moving range of the yield curve. Additionally, we valued the amount of sovereign bonds issued in nominal soles at market prices, and estimated their modified duration.

Reserves	MCO	Random Processes
Estimate income from regular resources	12,164	8,569
Estimate for market liquidity	10,225	10,225
Secondary liquidity reserve	**22,389**	**18,794**
Secondary liquidity reserve / Gross domestic product	**4.25%**	**3.57%**

Source: MEF-DGETP

In conclusion, considering both components, the total amount estimated for the secondary liquid reserves could reach S/. 22,389 million, which is largely covered by the total of Central Government's available financial assets at the end of 2012.

Thereby, the asset management strategy will consider mainly the following lines of work:

a) Constitution of available liquidity reserves to ensure solvency and liquidity even in situations of financial instability

Under the global management of assets and liabilities, preserving the solvency of public finances requires a strategic assurance of liquidity: A primary reserve for possible variations in normal situations, and a secondary reserve to address situations of economic or financial instability, which may lead to individual or systematic liquidity crisis.

The use of reserves will be properly supported by a liquidity contingency plan previously approved, so that it can ensure the fulfillment of budget commitments previously approved and promote the liquidity for the government securities market, avoiding any pro cyclical action.

BOX NO 8

MODULE OF PUBLIC FUNDS AUCTIONS

Within the framework of the "Multiannual Sectoral Strategic Plan for 2012-2016", it is planned to strengthen the global management of financial assets and liabilities of non-financial public entities and companies. In this line, the Treasury has set a target to achieve the active participation of these entities in centralized trading mechanisms to auction their excess liquidity, as one of its strategic indicators. To this end, and after considerable efforts to establish coordination between different departments in the Ministry of Economy and Finance and public entities and financial institutions, we have achieved a significant progress in the design and implementation of the Module of Public Funds Auctions, a process that will allow auctions of funds over the Internet, becoming a more orderly, efficient and transparent system.

The use of this virtual and automated mechanism will reduce operational risk, which is present in today's traditional auctions. In addition, this new system will allow to gather centralized and consolidated information to build the main reference of the yield curve of public funds in financial entities. Similarly, we can measure and monitor the level of risk assumed with each counterparty, the degree of concentration of deposits, among other indicators for proper treasury management covered by Directives about the global management of assets and liabilities in public entities. On the other hand, as contemplated by the Act of Treasury, the Public Treasury is authorized to perform all types of financial transactions that contribute to the development of the securities market, including unconditional repurchase and resale of bills and bonds already issued by the national government and all types of repo operations with these securities. In accordance with this purpose, it is planned to incorporate functions into the module to issue bonds, bills or other Public Treasury instruments, which will place us at the same level of financial development of other countries in the region.

In addition, we have been working on the improvement and adaptation of a module of financial information registration, with which public entities and non-financial enterprises must periodically record the relevant information about the assets and liabilities, cash flows and other relevant information requested by the DGETP. The coming into operation of the auctions module is planned for mid-2013, this mechanism will contribute significantly to the modernization of national public finances management.

b) Gradual direct collection of public funds, through tax or non-tax revenue in the Treasury's accounts

The Public Treasury function is to pay all the obligations of the State and raise their collection rights, as well as to take over the management of the treasury and debt. In that sense, the collection of their tax and non-tax rights, should be made directly in the accounts that each trust and loan entity, (banks, saving banks, etc.) holds on behalf of the Treasury. This collection should be reflected directly and in detail in its own financial statements, according to international accounting standards for the public sector, which will also facilitate the process of monitoring and controlling the collection process in the Central government.

c) Higher skills, diversification and transparency in the auctions of public funds

With the new deposits regulations, not only public companies and entities will access to auctions funds, but also banks and securities firms that previously could not participate in public funds auctions. In addition, in order to reduce the concentration risk, and avoid distortions in interest rates, the maximum limits per counterparty were adjusted, depending on the capital adequacy ratio and risk rating which depends on its exposure to credit risk, which derives from foreign exchange risk. The improvement in the profitability of these funds will generate additional income due to the transfers of wealth from the private to the public sector, as other countries do. The auctions will be conducted by centralized electronic means of the Treasury, which will ensure a great transparency, competition and diversification.

Box No 9

IMPLEMENTATION OF FINANCIAL ASSET AND LIABILITY MANAGEMENT IN THE STATE

The current ROF (Functions and Organization Regulations) was approved by Ministerial Resolution No. 223-2011-EF/43 of the Ministry of Economy and Finance. This resolution highlighted the merger of the former National Directorate of Public Debt (DNEP) and the former National Directorate of Treasury (DNTP), which resulted in the current Directorate-General of Indebtedness and Public Treasury (DGETP) responsible for proposing policies and designing the rules and procedures for the global management of financial assets and liabilities.

The global management of assets and liabilities must be associated to the set of techniques and procedures that ensure a proper and timely investment and indebtedness decisions, taking into account the relationships between the various components that are on and off balance sheet that define the profile of structural balance sheet risk. This risk is the possibility of facing losses when mismatches of interest rates, currency, maturity or concentration between assets and liabilities are unfavorable.

In 2012, the main actions to implement this new strategy were:

- Approval of the guidelines for a Comprehensive Management of Assets and Liabilities through Resolution N ° 016-2012-EF/52.03, whereby companies and public sector entities that have financial assets of more than S/. 10 million should form a Committee of Assets and Liabilities and adopt a Policy Manual. Also, by the same resolution, the Regulation of Deposits for these institutions was approved.

- Development of IT tools (spreadsheets) that help financial public entities and companies to quantify their risk exposure, which are published on the website of the Ministry of Economy and Finance (www.mef.gob.pe/tesoro/activos-y-pasivos.php). Bibliographic material has been placed on the mentioned website to help treasurers to enhance their knowledge about financial asset and liability management.

- Training of senior officials of non-financial public institutions and companies related to the implementation of their Asset and Liability Committee, and the development of its corresponding Policy Manual.

d) Implementation of an active cash management for collateralized deposits and public debt securities repos.

The first step is to make collateralized deposits and repos of public debt securities in order to improve the profitability of the public funds, creating a derived demand for public debt securities which will be used as collateral, making the excess liquidity profitable, at market prices. The excess of liquidity are generated by temporary differences between collection revenue and expenditures without affecting the monetary policy. The change of ownership of the funds in the accounts (from the public to the Treasury, and from Treasury to the public) of depositary institutions (banks, building societies, etc.), will decrease the unfavorable impact that these mismatches generate today on the liquidity of the entities, following the best international practices already implemented by other countries.

e) Implementation of passive investment management, with repurchases and resales of debt securities and money reports

The Treasury will repurchase and resale public debt securities as a market participant, in order to give greater dynamism to the public debt securities market, to reduce the volatility of the yield curve, and to capitalize the savings accumulated during favorable periods of the cycle, at market prices. These operations, in turn, will generate a greater liquidity in the public debt securities market, especially in a countercyclical manner. In addition, money reports will be imple-

mented to facilitate a greater or lesser temporal availability of public debt securities in the market, using collateral money.

5.4 Liability management

In liability management, the strategy is aimed at mitigating future liquidity risk generated from the concentration of maturities, improving the debt maturity profile, and improving the financial cost -in a more flexible manner- related to interest rate risk that unnecessarily would result in a highest refinancing volume for the financial markets.

Thus, the strategy for liability management will take into account the following main lines of work:

a) Improvement of the debt maturity profile to avoid excessive concentration of debt maturities

Special auctions of debt securities exchange in national currency will be held, in order to increase the outstanding balance of securities qualified as benchmark bonds, according to the regular schedule auctions, and to reduce the securities that eventually may present excessive concentrations within the target profile. These operations will allow to each type of investor to adjust their holdings, based on the profiles or objectives of their portfolios.

b) Provision of liquidity for holders of public debt securities to reduce risk aversion

There will be a special repurchase auctions in order to assure minimum liquidity to the holders of securities in national currency. The securities that will be repurchased can be resold later in the market, with or without auctions, unless they are target of an exchange offer with a public or private offering, as part of the improvement of the debt maturity profile directly, without the traditional participation of financial intermediaries which generates expensive costs.

c) Gradual replacement of the debt in dollars through special auctions, complementing the regular auctions, but independent of it

According to the framework of policies and goals adopted, there will be a gradual replacement of debt in dollars to debt in domestic currency, through various special auctions, complementing the regular auctions, but independent of it, in order to develop the market. For this purpose, we should choose between the long-term debt in dollars of higher relative cost, and the debt in soles. The most important is to choose the alternative that will help best to maintain or achieve the debt profile, in accordance with the objectives and goals defined in the Strategy

5.5 Market structure

The strategy is primarily aimed at optimizing the structure of the public debt securities market in soles. To this end, it is necessary to implement or improve the infrastructure of the system the markets operate, the role of entities considered as market-makers, the ability to generate a competitive and contestable market, people access to public debt for saving, development of references of risk-free

return in soles for mutual funds and pension funds, and a systemic risk reduction of clearance and settlement of transactions under the Peruvian law.

Thus, the market structure strategy will take into account the following main lines of work:

a) Conduct a study of the technological infrastructure for the operation systems of the public debt securities market, to determine gaps or lags compared to the international best practices

The aim of the study is to conduct an independent diagnosis to identify competitive opportunities to improve the technology and regulations in the current operations systems of the public debt securities market, based on international best practices and models. This evaluation will focus on the securities issuance process (primary market), intermediation and execution of orders (secondary market), communication, registration, clearing and settlement of trading, and securities deposit. This study is part of the goals and performance indicators of the National Policies for Mandatory Compliance approved by D.S. N ° 027-2007-PCM.

b) Sale of special public debt securities for people to save money

It is necessary to continue working on the project so that people can start saving with public debt securities, by purchasing these instrument directly from Treasury online, as other countries of the region do as part of a comprehensive financial education program, following the example set by developed countries. The ultimate goal is simply to promote savings for small and medium savers nationwide; however, at the same time, it will establish the basis for a bigger diversification of the investor base, and a long-term growth for domestic holdings. The sale of government securities via Internet is one of the main goals of the Economy and Finance Sector as part of the National Policies for Mandatory Compliance, with the goal of promoting a more inclusive policy.

BOX NO 10
SALE OF PUBLIC SECURITIES VIA INTERNET

The sale of government securities through Internet, according to international best practices, is the best alternative for Peruvian people to save money easily by buying Treasury securities in the form of certificates specially designed for those who may not have access to bonds or Treasury bills due to economies of scale or scope.

The main features of the program will be:
- Accessibility, as the minimum investment amount will be S/. 100.
- Diversity, because the depositor could choose the security and the term more in line with his profile.
- Easiness, since the platform will provide an easy way to make operations.
- Comfort, people will access to the sales from any terminal with Internet connection.
- Transparency, because it will provide real-time information about operations already done.
- Flexibility, as investment options will be automatic and charged to the depositor account.

The implementation and dissemination of the program will contribute to: i) promote greater financial education in the population, ii) encourage the culture of saving, iii) develop the public securities market at the retail level and, iv) promote a higher dedollarization, by incentivizing the use of sol-denominated instruments.

c) Increase the level of transparency, competition and liquidity in the formation of market prices of public debt securities

In this respect, the new regulations of bonds and Treasury bills established the minimum requirements that centralized trading mechanisms for public debt securities should met, and also, from now on, these mechanisms will be under the supervision of the SMV. Additionally, repos of bonds and treasury bills will be offered with the objective of increasing the structural demand for these instruments by local investors, assuring a minimal liquidity of funds and securities. With securities repos, the security holder could get free disposal of money; and with the repos of money, the holder may obtain free disposal of securities. Both types of operations will be offered through a "blind" centralized trading mechanism, which will give greater transparency to the price formation in equal terms, unlike private operations traded internationally.

d) Repowering the role of financial institutions that have the status of Market Makers of Public Debt Securities

To achieve this purpose a new Regulation for Market Makers with requirements, rights and more appropriate duties in line with international best practices and experiences, has been created. Therefore, with the new scoring system, the entities that hold such status are encouraged to achieve greater liquidity and the investor base will be greater, as a necessary condition for the development of the domestic financial system. Hopefully, this will become a new opportunity for the different investment brokerage firms to participate in the public debt securities market facing a future integration of fixed income markets in the later stages of MILA (Latin America Integrated Market). The regulations clearly establish the additional requirements that the centralized trading mechanisms of public debt must comply if, besides of including a "general level" for the secondary market (any participant could buy or sell treasury bonds), they would like to be eligible to develop Market Makers activities.

BOX NO 11

STRUCTURE OF COSTS IN THE PUBLIC DEBT SECURITIES MARKET

Within the framework of the reform of the capital market in Peru, the high transaction costs faced by investors have gained great relevance, and this factor reduces the competitiveness of the local market. In this context, the Ministry of Economy and Finance has identified the negative impact that the current structure has on the retail market of public debt.

Current Scenario:
Assuming a flat yield curve of 4% annual cash, it can be seen in the box how the current rate structure for fixed yield (we have considered for the exercise: SAB: 0.5%, SMV: 0.005%, CAVALI: U.S. $ 5, BVL: S/. 2 or S/. 10 and VAT 18%) generates a significant negative impact on the trading of smaller amount.

Sums	Total Commissions				Profitability			
	3 Months	6 Months	12 Months	24 Months	3 Months	6 Months	12 Months	24 Months
S/. 100	19	19	19	19	-49.28%	-27.60%	-13.50%	-5.46%
S/. 1,000	25	25	25	24	-5.79%	-1.05%	1.40%	2.65%
S/. 10,000	78	77	76	74	0.79%	2.38%	3.18%	3.59%
S/. 100,000	618	613	601	579	1.44%	2.71%	3.35%	3.68%

Because of this problem, it is necessary to create a space for discussion in order to reframe how the commissions, rewards and contributions of these operations might be applied. In this regard, we present the following alternatives:

Alternative 1: Structure with relative rates per operation and investment
The box shows that, by applying a total aggregate rate of 0.10% on the absolute amount of the transaction, there is a greater impact on the net profitability of the instruments with shorter maturities. However, it would create the possibility that the holders of instruments with longer maturities get more possibilities to negotiate such securities more than once in the secondary market, affecting their net profitability of transaction costs in a lower extent.

Sums	Total Commissions				Profitability			
	3 Months	6 Months	12 Months	24 Months	3 Months	6 Months	12 Months	24 Months
S/. 100	0.12	0.12	0.11	0.11	3.51%	3.75%	3.88%	3.94%
S/. 1,000	1.17	1.16	1.13	1.09	3.51%	3.75%	3.88%	3.94%
S/. 10,000	11.68	11.57	11.35	10.91	3.51%	3.75%	3.88%	3.94%
S/. 100,000	116.85	115.71	113.46	109.10	3.51%	3.75%	3.88%	3.94%

Alternative 2: Structure with effective rates per operation and investor
Another alternative is to estimate the rates in terms of annual effective yield. In this way, if we take as a reference a total aggregate rate of 0.10% annual cash, this would ensure that, regardless of the amount and maturity, investors would receive the same levels of net profitability from transaction costs because it is assumed that each investor operates in their preferred niche.

Sums	Total Commissions				Profitability			
	3 Months	6 Months	12 Months	24 Months	3 Months	6 Months	12 Months	24 Months
S/. 100	0.03	0.06	0.11	0.22	3.88%	3.88%	3.88%	3.88%
S/. 1,000	0.29	0.58	1.13	2.18	3.88%	3.88%	3.88%	3.88%
S/. 10,000	2.92	5.78	11.35	21.83	3.88%	3.88%	3.88%	3.88%
S/. 100,000	29.20	57.84	113.46	218.30	3.88%	3.88%	3.88%	3.88%

In both alternatives it is necessary to validate an optimal balance of total fees or costs that do not conflict significantly with retail operations of public debt securities and, at the same time, do not conflict with the distribution structure of these fees between the actors involved, which can be calculated based on the average trading history.

Finally it should be noted this changes that are already in the implementation process should generate a significant initial boost to this new niche market, as well as more transactions and liquidity of government securities in the secondary market. Eventually, this will result in a higher income for intermediaries due to a higher trading volume generated from a market that, nowadays, it is virtually non-existent.

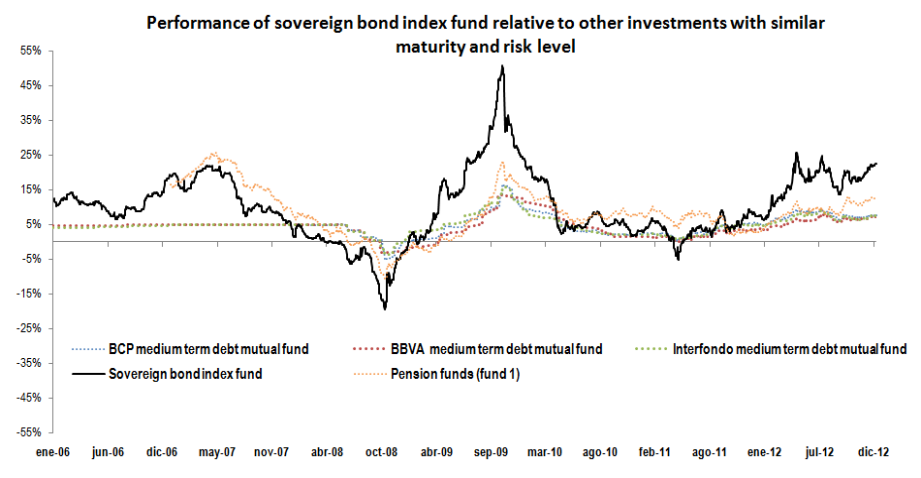
e) Creation of the Treasury Index Fund as a risk-free reference for the market of pension funds and mutual funds

The constitution of the index fund will provide a major performance reference of free credit risk yield to participants, and the managers of mutual and pension funds in the local market. This will help to generate more competition in the market and more local structural demand for public debt securities in the institutional investor market. As part of the first stage, since last year we have been working in the daily publication and spreading of the sovereign bond index, its performance and composition. In the second stage, the Fund Treasury Index will be established and managed with the intervention of COFIDE, the fiduciary bank of the State, as part of an investment process of the Public treasury's liquidity buffers. In a third stage, the Fund would be accessible to the public just like any mutual fund does, as many Treasuries of other countries do.

BOX NO 12
SOVEREIGN BOND INDEX

Based on December 2004 (base = 1,000), the index of bonds in nominal soles issued by the Republic of Peru was calculated, with a methodology that can be found in the appendixes. The results showed a very favorable performance -except in a short period, during the 2008 crisis- that

demonstrates a good profitability of the public debt instruments of Peru. This good performance is reflected in the evolution of the annual yield, obtained by the index between 2006 and 2012 with a historic average profitability of 9.7% during this period.



Source: MEF-DGETP

The comparison with alternative investments of similar risk and maturity profile revealed that the performance of index fund profitability during the last year has been higher than the three representative mutual funds that have as a policy to invest in debt instruments in soles in the medium or long term. The index fund profitability was also higher than the returns earned by pension funds with lower risk, as we can see in the picture.

f) Reduce clearing and settlement risks to limit the effects of sudden risk aversion that may cause crisis

As already happened in other countries, the approval of a law on financial collateral arrangements and its compensation clauses, would form part of a process for protecting the State, since it would help to: (i) reduce the systemic risk in case of intervention or liquidation of any financial institution that has acquired Treasury deposits. (ii) reduce contagion risk in the case of default, (iii) reduce credit risk in institutions perceived as weak or less creditworthy, with or without reasons, (iv) validate bilateral liquidation methods using compensation clauses, even in case of substitution of guarantees or usage of complementary guarantees, (v) avoid the risk of judicial reclassification , for example to secure a single loan, or any condition that includes a financial collateral arrangement, with or without dispossession, (vi) help to establish a balance between the market efficiency and the safety of the parties involved, (vii) simplify the use of financial guarantees between financial institutions and enhance their ability to compete, reducing the moral hazard in institutions that are considered too big to let them go bankrupt, (viii) protect the fast execution and validity of financial collateral arrangements, (ix) provide tools for credit risk management, even in cases of insolvency and in case of flight to quality, (x) help to preserve financial stability against economic situations of typical risk aversion in markets that could generate liquidity crisis (xi) increase liquidity in the securities market that are subject to financial guarantee, particularly in the public debt securities market, (xii) provide liquidity to entities that do not have marketable securities but have credit claims in its favor, and (xiii) reduce great costs generated by any credit default, including liquidation cases, in order to not search for domiciles and foreign laws that include a legal framework that protects financial collateral arrangements.

6. FINANCIAL ASSETS AND LIABILITIES OF THE CENTRAL GOVERNMENT

The direct financial assets and liabilities that made up the financial statement of the Central Government constitute the basis for determining the gross and net debt of the Republic. The Central Government definition corresponds to the smallest unit, economically relevant to the preparation of financial statements, in accordance with the International Accounting Standards of Public Sector and whose credit worthiness is evaluated and classified by risk agencies.

According to the international standards for fiscal statistics, the definition of Central Government used here to determine the coverage of relevant financial assets and liabilities, corresponds to the Budgetary Central Government[1] from the Manual of Statistics for Public Finances 2001 of the IMF, excluding the social security, that is, the assets and liabilities of the entity responsible for the provision of contributory health (EsSalud), and of the agency responsible for contributory pension (ONP)[2] are not included.

Also, following the principles established by the International Accounting Standards and International Financial Reporting Standards, all measurements are expressed in national currency, because it is the functional currency of the Central Government and the State approves its budget in soles. Moreover, the vast majority of the tax and non-tax income are denominated in national currency.

6.1 Financial assets (gross savings)

On December 31, 2012, the total amount of financial assets[3] of the Central Government reached S/. 51,256 million, of which S/. 27,725 million belonged to assets in local currency, and S/. 23,531 millions in foreign currency[4]. This quantity is obtained principally from restricted funds. The implementation of the fiscal rule to maintain balance or to generate surpluses, along with the prevailing context of the upward cycle, have allowed the Treasury to accumulate this important level of savings, which represents a strong endorsement for any adverse events that may occur in the future.

Thus, the gross savings balance at the end of 2012 represents an increase of 33% compared to the balance at the end of 2011. Currently, these funds are deposited in demand deposits accounts and fixed term deposits (Table Nº 2).

[1] According to this standard, the definition of Budgetary Central Government budget includes all units that are part of the executive, legislative and judiciary but does not include entities such as universities, charities, supervisor organisms or other autonomous units that are part of the extra budgetary Central Government.
[2] It does not include any asset (such as savings managed in the FCR) or liability (such as liability estimates for recognition bonds ONP) in order to facilitate comparison with other countries, which do not include assets (savings) neither liabilities (debt) related to social security tax.
[3] Strictly speaking, it is necessary to incorporate to the total financial assets of the Central Government, the value of its shareholding in different enterprises, which have not been included because there is not audited information available, by the end of 2012. Thus, this total does not include the financial assets of the Regional Governments or Local Governments, nor those of financial or non-financial public companies, nor those of extra budgetary entities of the Central Government.
[4] The Fiscal Stabilization Fund is equivalent to 88% of the total restricted funds at the end of 2012.

Table Nº 2
Position in Financial Assets

	2011			2012		
	Balance (MM US$)	Balance (MM S/.)	Part. (%)	Balance (MM US$)	Balance (MM S/.)	Part. (%)
By Availability						
Disposable income	**6,325**	**17,058**	**44.2**	**10,863**	**27,691**	**52.6**
Demand Deposits	4,096	11,048	28.6	5,070	12,923	24.5
Term Deposits	2,228	6,009	15.6	5,794	14,768	28.0
Accounts receivables	**1,281**	**3,455**	**9.0**	**1,131**	**2,883**	**8.1**
Transfers	1,250	3,370	8.7	1,129	2,877	8.1
Derivatives	31	84	0.2	2	6	0.0
Restricted funds	**6,705**	**18,083**	**46.9**	**8,114**	**20,682**	**40.4**
Demand Deposits	836	2,256	5.8	947	2,413	4.7
Term Deposits	5,868	15,827	41.0	7,167	18,269	35.7
TOTAL	**14,310**	**38,595**	**100.0**	**20,108**	**51,256**	**100.0**

Source: MEF- DGETP

6.2 Financial liabilities (gross debt)

At the end of 2012, the total amount of financial liabilities[5] of the Central Government reached S/. 86,900 million, this amount is similar to the amount obtained at end of 2011. By jurisdiction, the external debt represents 58.4% of the total debt while 67.5% are outstanding securities in the markets.

Table Nº 3
Position in Financial Liabilities

	2011			2012		
	Balance (MM US$)	Balance (MM S/.)	Part. (%)	Balance (MM US$)	Balance (MM S/.)	Part. (%)
By origin						
Securities	**20,990**	**56,609**	**64.9**	**23,000**	**58,627**	**67.5**
Sovereign bonds	10,841	29,239	33.5	12,650	32,244	37.1
Global bonds	9,245	24,935	28.6	9,462	24,119	27.8
Other bonds	903	2,435	2.8	888	2,264	2.6
Credit and loans	**11,069**	**29,853**	**34.2**	**10,676**	**27,212**	**31.3**
Multilaterals	7,803	21,045	24.1	7,537	19,211	22.1
Paris Club	2,638	7,116	8.2	2,426	6,185	7.1
Others	627	1,692	1.9	712	1,816	2.1
Payables	**281**	**759**	**0.9**	**416**	**1,061**	**1.2**
TOTAL	**32,340**	**87,220**	**100.0**	**34,092**	**86,900**	**100.0**

Source: MEF- DGETP

This year, the access to capital markets on favorable terms has continued, especially in local currency, at long terms and fixed rates, which has helped to improve and maintain the position of the indicators of gross public debt, at similar levels of the previous year (Table Nº 3).

[5] The Annual Public Debt Report, includes not only the Central Government' gross debt but also the debt of Regional Governments, Local Governments and financial and non-financial public enterprises, as well as liabilities of pension reserves from the ONP, which correspond to the recognition of the contributions of workers, transferred from public to the private pension system.

6.3 Net public debt

At the end of 2012, gross debt (financial liabilities) of the Central Government was reduced due to the accumulated savings (financial assets); and its gap determines the structural balance sheet risk.

Table Nº 4
Central Government Net Debt

Currency	Financial Assets		Financial Liabilities		Net Debt	
	Balance 2011 (MM S/.)	Balance 2012 (MM S/.)	Balance 2011 (MM S/.)	Balance 2012 (MM S/.)	Balance 2011 (MM S/.)	Balance 2012 (MM S/.)
Nuevos soles	17,574	27,725	34,236	37,542	16,662	9,817
Dollar	18,348	21,173	44,532	42,180	26,184	21,007
Euros	197	227	2,502	2,428	2,305	2,201
Yen	2,462	2,120	5,248	4,443	2,786	2,322
Others	15	10	702	307	687	297
Total	**38,595**	**51,256**	**87,220**	**86,900**	**48,625**	**35,644**
Position / GDP	7.9%	9.7%	17.9%	16.5%	10.0%	6.8%

Source: MEF – DGETP.

In this sense, net debt represents around 41% of gross debt and 6.8% of GDP (Table Nº 4). Net debt would be lower if the Central Government's equity participation in various public companies and entities that belong to the State, could have been included[6].

[6] At the end of 2011, the Central Government's net worth, considering financial and nonfinancial companies and entities, was equivalent to approximately 4% of GDP.

7. STRUCTURAL BALANCE SHEET RISK

The structural balance sheet risk is defined as the possibility of suffering potential losses due to adverse movements that affect the interest rate, exchange rate, or the relative liquidity of the markets due to interest rate, currency, and maturity mismatches in the asset and liability management. It is also due to asset and liability concentrations, which is the result of sudden changes in financial conditions in the different markets.

We have monitored the Central Government's assets and liabilities with the objective of recommending actions to manage risks related to the market movements.

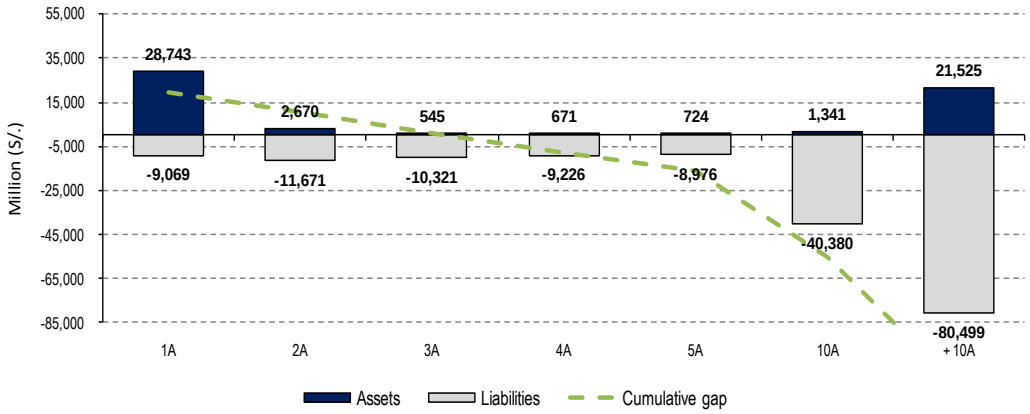
7.1 Liquidity risk

The liquidity risk is the possibility of incurring losses when it is not possible to increase the volume of assets, or to meet obligations through cash or another financial asset. For measuring and monitoring the liquidity risk, we have used: a liquidity gap table (matching), that includes the financial assets and liabilities[7] and shows the gaps generated by maturities distributed in time periods, and the Liquidity Coverage Ratio (LCR)[8] which includes available, liquid and high quality assets to meet cash outflows.

a. Asset-liability matching according to the residual term

Considering the analysis of the liquidity gap, we note that the total[9] mismatch (in a time period of 3 years) is positive, with a total of S/. 896 million. It means that the Central Government has enough slack to cover its financial obligations (principal and interest) for the next three years, by using the liquid assets that are available at the end of 2012[10].

Figure N° 1
Table of Liquidity based on Maturity



Source: MEF- DGETP

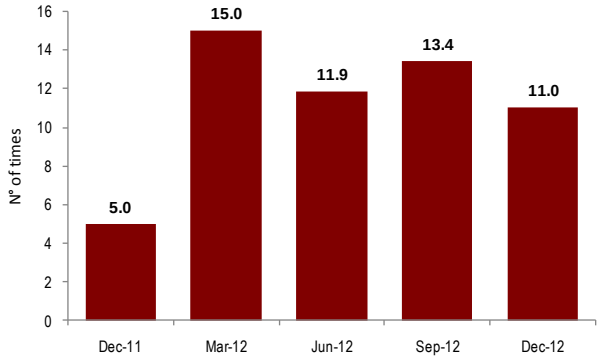
[7] For measuring, we have included the asset and liability balance and future interest flows receivable and payable, under a conservative criterion.
[8] Measure recommended by the Committee on Banking Supervision of Basilea to monitor and control liquidity risk in financial institutions
[9] Assets and liabilities in local and foreign currency.
[10] In the analysis of liquidity by time periods, the resources of the Fiscal Stabilization of Funds (FEF) have been placed in the latest time period in order to measure the capacity of the central government to cover their liabilities with the liquidity resources, although the FEF could be used in a crisis scenario.

It is important to note that the slack levels are higher than the last year when the positive mismatch was located in a 2 year time period, with a total of S/. 992 million.

b. Liquidity coverage ratio (LCR)[11]

At the end of December 2012, the LCR was greater than 1, with a value of 11, showing a considerable increase compared to the end of last year. This result shows a liquidity level that gives enough margin to the Central Government, to deal with some short-term unexpected event, and enough capacity to establish and manage an important secondary reserve of liquidity.

Figure N° 2
Liquidity Coverage Ratio (LCR)



Source: MEF- DGETP

7.2 Interest rate risk

From a short-term perspective, the movements in the market interest rates have an effect on the Central Government results and, from a long-term perspective; it also affects the economic or equity value, becoming a significant risk in the Central Government financial activity, and at the same time, an opportunity to create value.

The main source of risk is the maturity mismatch between interest rate rise and Central Government's financial asset and liability maturities that are exposed to interest rate movements. As an initial approach to temporal mismatch of assets and liabilities[12], we consider the duration as an indicator. The duration of the assets has had a slight increase over last year, less than one year duration (Table N° 5). Furthermore, the duration of the liabilities has had an increase of 0.7 years compared to the end of 2011; in this sense, the indicator represented 8.1 years at the end of 2012 (Table N° 6).

[11] The numerator of the ratio includes high quality and available funds, while the denominator includes the outflows in the short term. The liquidity is considered sufficient when the indicator is greater or equal to 1.

[12] This is equivalent to the average term of repayment of the principal and the interest in present value terms.

Table Nº 5
Duration of financial assets

	Balance 2011 (MM S/.)	Duration (years)	Balance 2012 (MM S/.)	Duration (years)
By availability				
Cash and deposits	**17,058**	**0.1**	**27,691**	**0.2**
Demand deposit	11,048	0.0	12,923	0.0
Term deposit	6,009	0.2	14,768	0.3
Accounts receivable	**3,455**	**4.5**	**2,883**	**4.6**
Credits	3,370	4.5	2,877	4.6
Derivates	84		6	
Restricted Funds	**18,083**	**0.4**	**20,682**	**0.5**
Demand deposit	2,925	0.0	2,413	0.0
Term deposit	15,158	0.4	18,269	0.6
TOTAL	**38,595**	**0.68**	**51,256**	**0.72**

Source: MEF-DGETP

Table Nº 6
Duration of Financial Liabilities

	Balance 2011 (MM S/.)	Duration (years)	Balance 2012 (MM S/.)	Duration (years)
By instrument				
Securities in circulation	**56,609**	**8.4**	**58,627**	**9.1**
Global bonds	24,935	8.5	24,119	9.6
Sovereign bonds	29,239	8.3	32,244	8.8
Other bonds	2,435	7.4	2,264	7.8
Debit	**29,853**	**5.0**	**27,211**	**5.1**
Multilateral organizations	21,045	5.2	19,211	5.3
Club of Paris	7,116	5.1	6,185	5.3
Others	1,692	2.7	1,815	2.7
Accounts Payable	**759**		**1,061**	
TOTAL	**87,220**	**7.4**	**86,900**	**8.1**

Source: MEF-DGETP

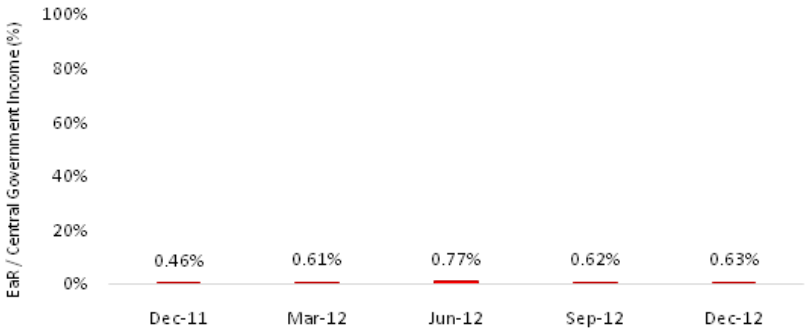
Moreover, to carry out these operations, we have been monitoring the impact of interest rate risk exposure in the short term by using the Earnings at Risk indicator and, in the long term, we used the equity value indicator at Risk, using in both cases, a standard deviation rate in the interest of + / -200 basis points, as well as the periodic stress testing simulation.

a. Earnings at Risk (EAR)

At the end of 2012, the Earnings at Risk indicator showed that, the standard variation of the interest rate used, would generate an impact on the financial margin of the Central Government (Earnings at Risk) of S/. 611 million equivalent to 0.63% of Central Government Revenue, or 0.12% of GDP[13]. The current level and trend of interest rates, along with positive gap of assets over liabilities of the Central Government in the short term, means that the possibility of a negative impact resulting from an adverse movement in interest rates, is low; on the contrary, it becomes an opportunity to create value for debt securities in soles.

13 The revenue and GDP used in the risk indicators are the projected ones at the end of 2012 according to the MMM 2013-2015.

Figure N° 3
Earnings at Risk (EaR)



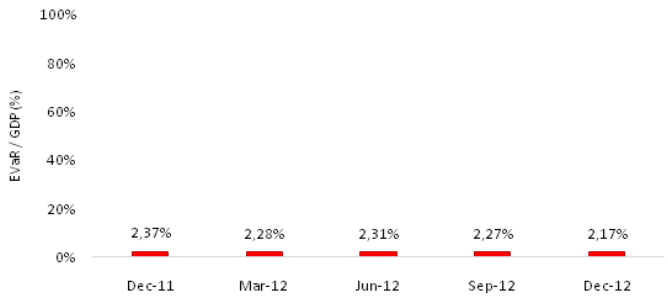
Source: MEF- DGETP

b. Sensitivity of the equity's net worth

The measurement and monitoring of the structural interest rate risk in the long term is based on the analysis of exchange rate to the present value of assets and liabilities when there are movements of the interest rate curve. Such variation will be reflected in the market value of Central Government's net worth.

At the end of 2012, in response to the standard variation used interest rate, the sensitivity of the equity's net worth was S/. 11,460 million, equivalent to 2.2% of GDP. According to the structure of Central Government balance, Central Government would be modestly exposed to a decrease in the level of interest rates. However, since the interest rates in the world are very low, there are few probabilities that risk becomes a reality; instead, it would become a countercyclical alternative, which could increase the future economic value of the Central Government. Thus, based on the management made, the indicator has been declining over time, maintaining a downward trend during 2012.

Figure N° 4
Sensitivity of the equity's net worth



Source: MEF- DGETP

7.3 Exchange rate risk

The structural exchange risk occurs when the Central Government suffers losses because of changes in the value of national currency in relation to another currency. It exists when there are gaps between the maturity of assets and liabilities in foreign currency.

According to the currency composition of assets, most assets are denominated in

Nuevo Sol: 54.2% of the total amount. This percentage is 8.6% higher than the end of last year, when the dollar denominated assets were the principal component.

Most of the liabilities are denominated in U.S. dollar with a share of 48.5% of the total. U.S. dollar liabilities have decreased in 3% since last year, while the participation of the Nuevo Sol (42.5%), increased in 3.7% compared to last year.

Table Nº 7
Currency composition of financial assets

	Participation 2011 (%)	Participation 2012 (%)
Assets	**S/. 38,511 MM**	**S/. 51,250 MM**
Cash and deposits	**44.3** %	**54.0%**
Nuevos Soles	39.2%	51.0%
Dollar	5.1%	3.0%
Euros	0.0%	0.1%
Accounts receivable	**8.8%**	**5.6%**
Nuevos Soles	0.5%	0.8%
Dollar	1.5%	0.4%
Euros	0.5%	0.3%
Yen	6.2%	4.1%
Others	0.0%	0.0%
Restricted Funds	**47.0%**	**40.4%**
Nuevos Soles	5.9%	2.4%
Dollar	41.1%	38.0%
Euros	0.0%	0.0%
TOTAL	**100.0%**	**100.0%**

Source: MEF-DGETP

The current global situation, especially expansionary monetary policies in developed countries have generated an appreciation of local currencies in developing countries with strong fundamentals, like Peru. For this reason, we have monitored the currency market and its impact on the Central Government balance by using stochastic tools, such as Value at Risk (VaR) and various stress scenarios.

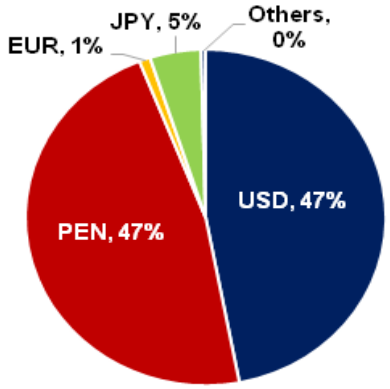
Table Nº 8
Currency composition of financial liabilities

	Participation 2011 (%)	Participation 2012 (%)
Liabilities	**S/. 86,462 MM**	**S/. 85,838 MM**
Securities	**65.5%**	**68.3%**
Nuevos soles	36.1%	39.6%
Dollar	28.2%	27.5%
Euros	1.2%	1.2%
Credit and loans	**34.5%**	**31.7%**
Nuevos soles	2.7%	2.9%
Dollar	23.3%	21.7%
Euros	1.7%	1.6%
Yen	6.1%	5.2%
Others	0.8%	0.4%
TOTAL	**100.0%**	**100.0%**

Source: MEF - DGETP

Including derivatives operations, the participation of the Nuevo Sol in the liability composition reached 47%, while the U.S. dollar share reduced to 47%.

Figure N° 5
Composition of Liabilities and Derivatives



Source: MEF - DGETP

a. Balance position in foreign currencies

At the end of 2012, the Central Government's foreign currency position is equivalent to S/. 25,833 million composed mainly in US dollars. In addition, the present value of derivatives and the interests generated by active and passive operations have been included in the analysis in order to consider the existence of temporary mismatches in these operations. Thus, at the end of 2012, the Central Government global overselling position (net liabilities) was equivalent to S/. 24,299 million, composed mainly in US dollars.

Table N° 9
Foreign Currency Position at the end of 2012

	Amount (Milllions S/.)
Currency Position (Assets- Liabilities) (A)	-25,833
Foreign Currency Position (Derivatives + Interest Receivable –Interest Payable) (B)	-36,328
Total Position (C) = (A) + (B)	-62,161
Global Position (Present Value of (C))	**-24,299**

Source: MEF- DGETP

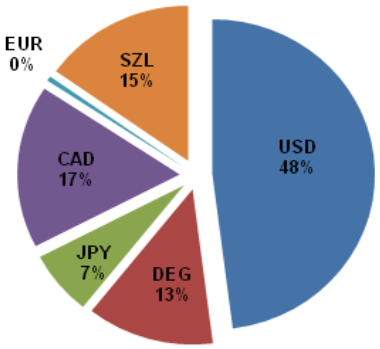
b. Value at exchange risk

To measure and monitor the currency risk we will use a model of Value at Risk (VaR) which calculates the maximum loss expected from the volatility of returns of the currencies that make up the balance, in a period of 90 days, by the Monte Carlo simulation; the model is based on a sample of 10 years and a confidence level of 99%.

In accordance with the analysis, the maximum expected loss caused by the exchange rate is S/. 1,114 million at the end of 2012, equivalent to 0.2% of GDP, and the dollar was the currency that most contributed to the level of VaR, due to its prevalence in the global position. With the objective of generating profits by

exchange rate as in 2012, and based on the previous results, policies and guidelines that prioritize local currency debt over the long term have been established.

Figure N° 6
Currencies participation to VaR, at the end of 2012



Source: MEF- DGETP

7.4 Concentration risk

The concentration risk has many angles and different effects on asset and liability management. Mismatches can be measured by market concentration, counterparties, exposure to credit risk arising from currency risk, among others. The common denominator is not only the loss of the ability to diversify, but also the possible generation of a potential systemic vulnerability, which eventually might also affect the strength of the public finances. Concentration also generates less flexibility and especially, less negotiating skills that will not allow debtors to obtain higher returns of assets, also creditors will not achieve lower costs.

Table N° 10
Concentration of assets by debtors

Counterparts	Sum (MMS/.)	Participation %
Cash and Deposits	**27,691**	**54.0%**
Central Reserve Bank of Peru	23,982	46.8%
Banco de la Nación	3,709	7.2%
Accounts Receivable	**2,882**	**5.6%**
Nonfinancial public entities	2,876	5.6%
Investment Entities	6	0.0%
Restricted Funds	**20,682**	**40.4%**
Central Reserve Bank of Peru	20,532	40.1%
Banco de la Nación	150	0.3%
Total	**51,256**	**100.0%**

Source: MEF- DGETP

Currently, we are monitoring debtors concentration in asset operations, and monitoring the concentration of creditors in regard to liability operations, in order to increase diversification in all associated risk factors. In this regard, as part of the investment strategy, it is essential to generate sufficient and diversified competition to maintain an attractive return and liquidity. So we are monitoring

the structure of debtors of the Central Government in order to make changes that would improve the investment structure.

Table N° 11
Liabilities Concentration based on Creditors

Creditors	Sum (MMS/.)	Participation %
Securities	**58,627**	**67.5%**
Resident holders	19,010	21.9%
Non-resident holders	39,616	45.6%
Credit and loans	**28,273**	**32.5%**
Multilateral Organizations	19,211	22.1%
Club of Paris	6,185	7.1%
Other entities	1,816	2.1%
Investment entities	1,061	1.2%
Total	**86,900**	**100,0%**

Source: MEF- DGETP

Also as part of the debt strategy, it is essential to maintain adequate diversification of funding sources, and have permanent access to international financial markets for the benefit of the Republic. Therefore, we monitor the structure of the Central Government creditors in case it would be necessary to make changes to strengthen the structure of the public debt.

8. RETURN AND EQUIVALENT COSTS

The equivalent return and cost presented below have been calculated as the national cash that the Central Government obtained and disbursed during 2012 for their investments and obligation agreements, taking into account the effect of the exchange rate variation on the return and the cost of foreign currency operations, as well as variable interest rate and indexed instruments.

In the case of financial assets (Table N° 12), the low return of the foreign currency worldwide, mainly the US dollar, due to low interest rates that followed the outbreak of the international financial crisis, and its depreciation against national currency, caused that the equivalent average performance of the total assets, denominated in Nuevos soles, were -0.9% in 2012.

However, these factors, principally the appreciation of national currency against external debt currencies have generated that, during the year, the equivalent average cost of the total liabilities (Table No. 13) expressed in soles, had an increase of 1.9% due to the cost of derivatives agreements, reaching a level of 2.8%.

Table Nº 12
Performance of Financial Assets 2012

	Balance 2012 (MM S/.)	Yield in Nuevos soles (%)	Yield in original currency (%)
Cash and deposits	**27,691**	**2.1%**	
Soles	26,113	3.1%	3.1%
Dollar	1,525	-5.3%	0.1%
Euros	53	-4.9%	0.2%
Accounts Receivable	**2,877**	**-5.4%**	
Nuevos Soles	380	5.2%	5.2%
Dollar	199	-1.8%	3.7%
Euros	168	-2.8%	2.4%
Yen	2,120	-15.3%	1.8%
SCP	10	-1.8%	2.9%
Restricted Funds	**20,682**	**-4.6%**	
Nuevos soles	1,226	3.0%	3.0%
Dollar	19,450	-5.4%	0.1%
Euros	7	-4.9%	0.1%
TOTAL	**51,250**	**-0.9%**	

Source: MEF - DGETP

Table Nº 13
Cost of Financial Liabilities 2012

Liabilities	Balance 2012 (MM S/.)	Cost in Nuevos soles (%)	Cost in Nuevos soles with derivative (%)	Cost in original currency (%)
Securities	**58,627**	**4.9%**	**5.0%**	
Soles	34,033	7.3%		7.3%
Dollar	23,579	1.9%		7.5%
Euros	1,015	1.6%	4.9%	7.5%
Credit and Loans	**27,211**	**-3.4%**	**-2.1%**	
Soles	2,448	5.5%		5.5%
Dollar	18,602	-0.6%	0.0%	2.7%
Euros	1,413	-3.0%	-2.7%	2.6%
Yen	4,443	-15.2%	-15.1%	2.5%
Others	307	-1.5%		1.4%
TOTAL	**85,838**	**1.9%**	**2.8%**	

Source: MEF - DGETP

Also, the table Nº 14 shows the equivalent net cost faced by each currency during 2012, measured as the difference between the average return and the average cost in Nuevos soles.

Calculation does not take into account the differences of the average term, neither by type of rate or counterparty involved[14].

Table Nº 14
Net Cost based on Currency 2012

Currency	Financial Assets		Financial Liabilities		
	Balance (Millions S/.)	Return % (A)	Balance (Millions S/.)	Cost % (B)	Net Cost % (B)-(A)
Soles	27,725	3.2%	37,542	7.0%	3.8%
Dollar	21,173	0.3%	42,180	5.3%	5.1%
Euros	227	0.8%	2,428	4.6%	3.8%
Yen	2,120	1.9%	4,443	2.5%	0.7%
Others	10	2.5%	307	1.4%	-1.0%
Total	**51,256**		**86,900**		

Source: MEF – DGETP

[14] These differences could be considered in the use of derivatives, but this would require to take certain assumptions that are not necessarily true, especially if the counterparties involved belong to countries with different levels of sovereign risk.

9. QUANTITATIVE GOALS FOR GROSS DEBT STRUCTURE

Based on three alternative scenarios fully consistent with the prospective analysis of Multiannual Macroeconomic Framework for 2014-2016, it has been estimated a reference range of targets for the indicators of Central Government's gross debt at the end of 2016. The goal is to quantify the impact of key tactical actions to be carried out as part of the implementation of debt management. These scenarios consider some assumptions about the economy evolution, the amount of funding necessary to meet fiscal needs and to implement potential debt management operations, as well as the perspectives of local and international financial markets which will define the access and conditions for the new debt.

9.1 Current context and perspectives

The Peruvian economy registered annual growth of 6.3% in 2012. The development of the country's economic activity was explained by the dynamism of domestic and external demand. During the first three quarters, the growth of this indicator was higher than the one presented by its regional peers, being exceeded only by Chinese economy. In the future, we expect the recovery of the world economy, particularly in developed economies (U.S., Euro Zone) and emerging economies (Brazil).

During 2012 the central banks of the major developed economies (Bank of Japan, Federal Reserve and European Central Bank) have kept short- term reference rates close to zero. In the U.S., the decision to increase the monetary policy interest rate has been explicitly tied to the positive evolution of economic indicators related to unemployment, not just to inflation. This excess of international liquidity and the search for profitability in emerging countries, by investors, predict that the reference rate in Peru will not increase soon, in order to prevent further influx of dollars to our economy, and thus a greater appreciation of the Sol versus the dollar.

In 2012, Peruvian currency was appreciated 5.4% versus the dollar, a trend that has been held for the past ten years. The further weakening of the dollar is due to the stimulus packages or monetary injection implemented by the Federal Reserve over recent years, from QE1 announcements in November 2008, the QE2 in November 2010, the "Operation Twist" in September 2011, and finally QE3 in September 2012. To reduce this tendency, the Central Reserve Bank of Peru (CRBP) intervened in the foreign exchange market, by increasing the average reserve ratio in domestic currency and, (to a greater extent) in the foreign currency, and also by increasing the limit of pension funds investment abroad.

With regard to major global currencies, it is worth noting that in the last 10 years there has been a greater volatility in exchange rates of the euro and the yen in relation to the dollar, instead of the dollar in relation to the Sol. This lower volatility is the result of the CRBP intervention in the exchange market.

During 2012, there was a continued decline in the sovereign debt return thanks to strong fundamentals and the search for profitability by non-residents, in a context of high international liquidity and global uncertainty due to monetary stimulus performed by the major central reserve banks of the world, as a result of the sovereign debt crisis in the euro zone, the weak recovery in the U.S., and the China's economic slowdown.

Considering the expectations and assumptions relating to the movement of the yield curves and the differentials between currencies for the short and long term in 2013, the following table (Table No 15) shows the expected behaviour of the sovereign curves of the Republic in Nuevos soles and U.S. dollars

Table Nº 15
Expected evolution of the Yield Curve for Peru in 2013

Concept	Short term	Long term	Slope of the curves
Dollar sovereign curve	⇧	⇧	⇧
Soles Sovereign curve	⇩	⇧	⇧
Differential between soles and dollars	⇩	⇧	

Source: MEF – DGETP

9.2 Scenarios to quantify the range of quantitative targets

To define the range of sensitivity of the various indicators related to public debt, three scenarios were considered. Each scenario reflects different assumptions of economic and financial variables, and debt management operations planned for the next four years.

The baseline scenario assumes that, according to market expectations for 2013, the domestic economic growth observed in the previous year equivalent to more than 6% per year will continue, which will have a positive impact on the Central Government revenues. For 2014 and thereafter, we assume a consolidation of this growth at a similar level to that observed in 2013. We forecast that the economic outcome will be 0.5% in 2013 with an improving trend of 1.1% on average, until 2017. This scenario is consistent with the moderate growth prospects of our business partners, due to uncertainty regarding the sustainability of global economic recovery, the consequences of fiscal adjustment measures adopted by the most advanced countries, as well as an adjustment in the prices of raw materials and commodities.

The optimistic scenario assumes that Peruvian economy will register an economic growth of around 8% per year from 2013 even until 2016, which would attract more revenue to the Treasury and, therefore, it is possible to obtain an average economic outcome of 2.8% for this period. This scenario assumes a more dynamic economy, improving the performance of private demands, focused on major implementations of projects announced for the next years.

The pessimistic scenario assumes a less favorable evolution of macroeconomic variables and a slower global economic recovery than expected. Thus, the GDP will remain at levels of about 3.5% annually, during 2016; while on the other hand, the world economic recovery will be lower than expected. This would affect agents' expectations, resulting in a slowdown in the private spending, mainly due to lower investments or postponements thereof.

Therefore, given this context, and having these scenarios as a basis, it has been established the indicated referential range of goals for the end of 2016.

Table Nº 16
Quantitative Referential Goals by the end of 2016

Indicator	Range at the end of December 2016
Percentage of Nuevos soles in the portfolio.	56.4% - 70.2%
Percentage of fixed rate debt in the portfolio	73.9% - 79.0%
Average life (years)	12.2 - 14.9
Average time to refixing (years)	10.8 - 13.8
Concentration of depreciation over the next 12 months 1_/	5.9% - 5.7%
Percentage of the flow of local currency funding 2_/	63.1% - 75.0%

Source: MEF- DGETP
1_/ Indicator that measures the immediate pressure of payments.
2_/ It includes the funding of debt management operations.

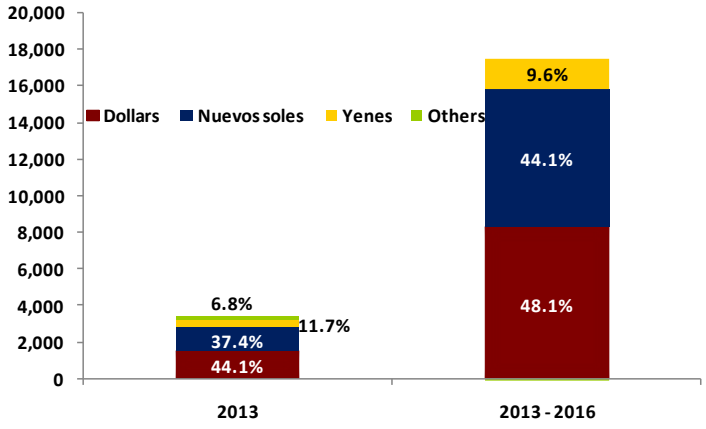
10. GROSS DEBT PROJECTIONS FOR 2013-2016

The analysis to estimate the evolution of gross debt until the end of 2016 reflects the assumptions that support the development of the base scenario

10.1 Debt service

Because the amortization service in 2013 represents about 4% of the total debt (S/. 3,450 million), and the annual amortizations until 2016 represent similar levels of payments, currently, the debt service does not represent a concern for the national treasury, because the pressure in the Budget of the Republic will continue to decrease, as it already happened in relation to previous years.

Figure Nº 7
Currency of Debt Maturities
(Expressed in millions of S/.)

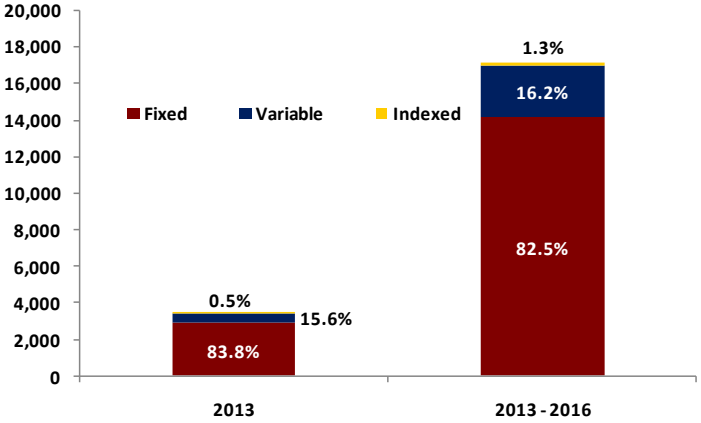


Source: MEF- DGETP

About 80% of payments in 2013 will be made in different currencies other than Nuevos Soles, improving by 53% in the accumulated maturities for the next four years (Figure Nº 7). However, the strong appreciation of the local currency is circumstantially favoring the budget for the public debt service, and it is temporarily reducing the potential impact of exchange rate risk. However, the vision of the management debt is in the long-term, therefore efforts to prioritize new borrowing in local currency should continue.

On the other hand, the inflation rate is still in historically low levels, and market analysts predict that this scenario will continue for one or two more years. It is also noted that the structure of the interest rates of the Central Government debt does not represent a significant risk in the next 12 months, either for the subsequent four years, because 91,1% and 86,2% of the maturity dates in these periods of time, respectively, correspond to obligations agreed at fixed rates (Figure 8).

Figure Nº 8
Interest Rates of Debt Maturities
(Expressed in millions of S/.)

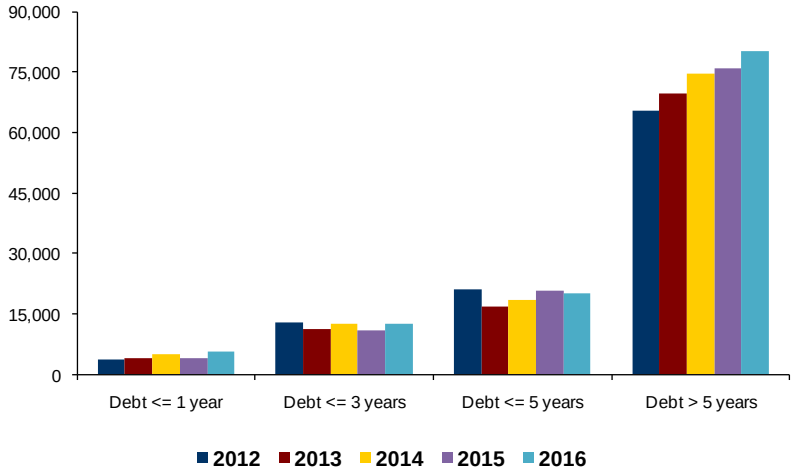


Source: MEF- DGETP

10.2 Maturity composition

It is expected that the maturity profile of public debt continue in favor of a rise in long-term installments debt.

Figure Nº 9
Maturity of Gross Debt
(Expressed in millions of S/.)



Source: MEF- DGETP

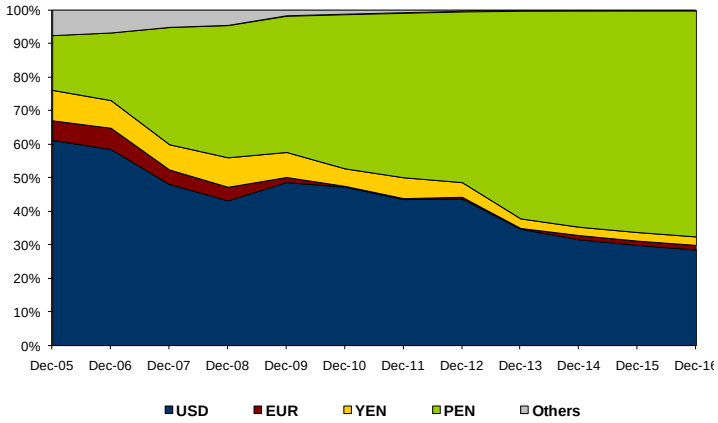
Indeed, in the baseline scenario, the percentage of debt maturities longer than five years until December 2016 is projected at around 80.0%, taking into account the corresponding value of approximately 75.5% in December 2012. The factors that support this change are related to the debt management operations, whose financing are based on the issuance of long-term government bonds.

10.3 Currency Composition

To increase the participation of Nuevos soles in the total gross debt is one of the most important objectives of this strategy. The local currency composition of the countries of the region with the same credit rating as Peru (BBB) are higher than the Republic of Peru so far. In this respect, this indicator is expected to reach a

level of about 70% at the end of 2016, a goal that is also referred to in the Institutional Strategic Plan for 2012-2016.

Figure Nº 10
Currency Composition of Gross Debt

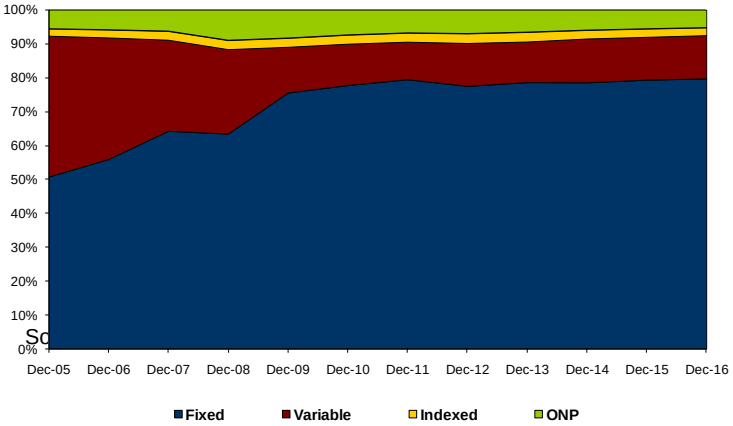


Source: MEF- DGETP

10.4 Interest rate composition

On the other hand, it is estimated that the fixed interest rate debt will not vary much maintaining its current level and it will reach approximately to 79.0% at the end of 2016; in this way it gives predictability to the payment of the debt interest.

Figure Nº 11
Interest Rate Composition of Gross Debt



Source:

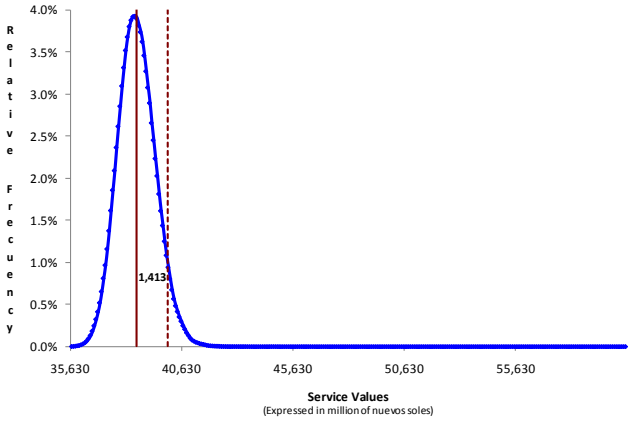
10.5 Debt Service risk

The analysis of debt service risk (SeR[15]) shows that the estimated debt service for the next four years (from 2013 to 2016 even), with a confidence level of 95%, reaches approximately S/. 38,620 million. The risk attributable to fluctuations in interest rates and exchange rates, which could involve additional expenditures in the expected debt service (measured by the difference between the 95% percentile and the average), reaches the value of S/. 1,413 million, this is a 3.7%

15 This model assumes that each variable interest rates and types of exchange follow a variable of the geometric Brownian motion, and are correlated with each other. From this premise, an adequate number of Monte Carlo simulations are generated, with possible joint paths of these variables, with which it constructs a distribution of accumulated debt service in the chosen period.

increase in the payment for the estimated debt service. (Figure Nº 10).

Figure Nº 12
Risk of Gross Debt Service for the next 4 years

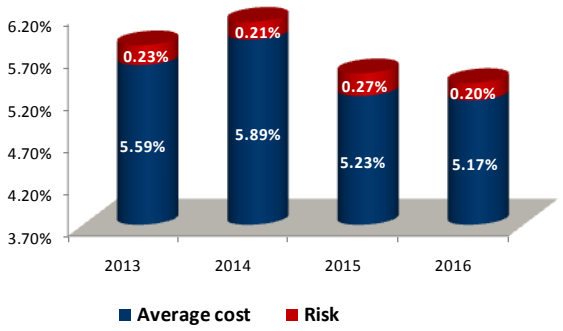


Source: MEF- DGETP

10.6 Costs analysis

The average annual cost of gross debt in terms of Nuevos soles is defined as the payment of debt interest plus the additional amount that could be generated as a result of fluctuations in the exchange rate and interest rates[16]. This excess, defined as risk, was determined with the stochastic evolution of interest rates and exchange rates as well as their correlation[17].

Figure Nº 13
Cost and Risk of Gross Public Debt for the period 2013-2016



Source: MEF- DGETP

16 The financial cost takes into account the interest rates rise of contracted loans using variable rates of passive debt, and fixed rates of the new financing, and the expected stability in the exchange rate, which would increase the cost of debt in the coming years.

17 The risk of the financial cost in terms of Nuevos soles is defined as the difference between the maximum cost (at 95% confidence) and the average cost.

11. SUSTAINABILITY AND GROSS DEBT PROFILE

In relative terms, we have estimated some indicators of the debt as a percentage of GDP expected for the coming years in order to analyze its sustainability and budget viability. Table No. 17 shows the trend of these ratios, for the case of the base scenario, whose behavior is decreasing, due to the level of the growth rate of the projected GDP, and the effect of debt management operations, planned for the analyzed period.

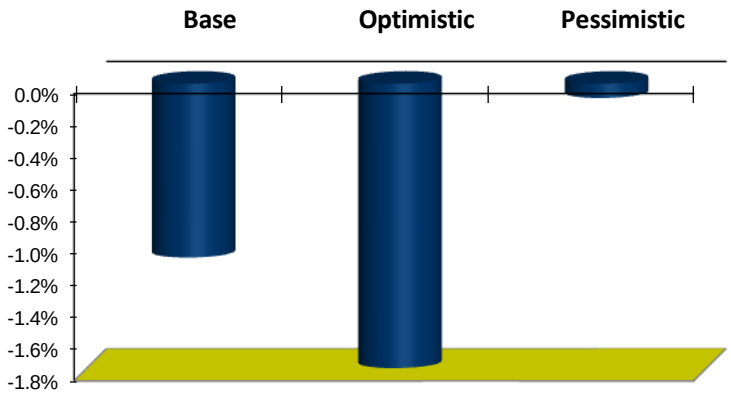
Table Nº 17
Gross Debt Ratios of Central Government
(GDP expressed as a percentage)

	2012	2013	2014	2015	2016
Base Scenario					
Central Government Debt./GDP	18.4%	16.6%	16.2%	15.4%	14.6%
Central Government Debt Service/GDP	1.7%	1.6%	1.5%	1.3%	1.4%
Central Government Amortization /GDP	0.7%	0.7%	0.7%	0.6%	0.8%
Central Government Interest /GDP	0.9%	0.9%	0.8%	0.7%	0.7%

Source: DGETP - MEF

The analysis of the behavior of the Central Government public debt ratio, using the sustainability indicator[18] shows that debt is sustainable in the base and optimistic scenarios. This result reflects the favorable growth perspectives of the country, and the good management of fiscal policies, which will allow to continue reducing financing needs and therefore the relative amount of public debt. In the pessimistic scenario, which means a less favorable growth of macroeconomic variables and negative conditions in the prices of financial variables in the future, debt would not be sustainable according to this indicator.

Figure Nº 14
Indicator of Sustainability of the Central Government Public Debt



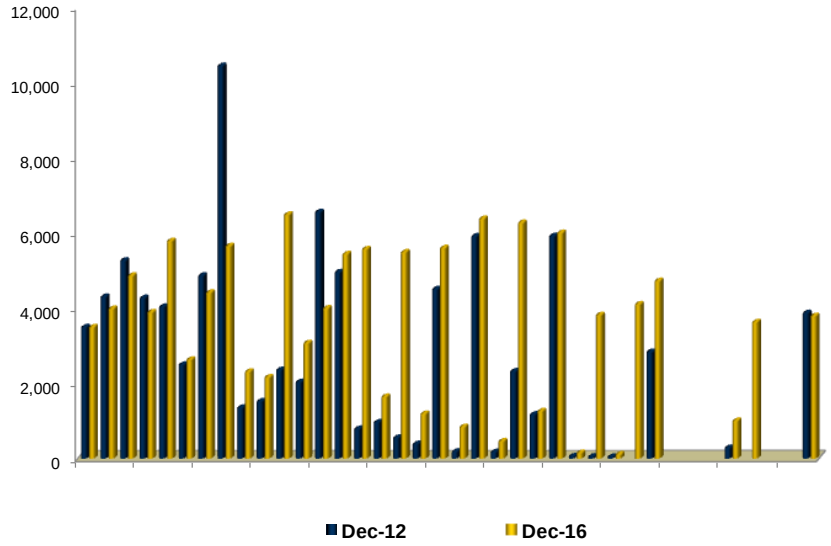
Source: MEF- DGETP

One of the objectives of this strategy is to improve the maturity profile of the Central Government debt to avoid excessive concentrations of payments. Thus, Figure No. 15 shows the debt maturity profile of the Central Government debt, which includes

[18] This indicator is defined as the difference of the "equilibrium" primary surplus and the weighted average of the projected primary surplus, as GDP ratios. The "equilibrium" surplus ensures that debt ratio is constant over time. If the indicator is negative, then the public debt is sustainable (and eventually decreasing).

the projected debt flows, generated by the new indebtedness in 2013-2016 to fund the financial requirements and liability management operations that have been planned for this year. One of the most important aspects is the mitigation of concentration in payments in the year 2020, as well as a redistribution of the maturities in the long term, in order to develop stability in the coming years. This policy goes in line with the fact of privileging the issuance of some sovereign bonds at the long end of the curve in order to give them more liquidity.

Figure Nº 15
Dynamic Projection of the Public Debt Amortizations
(Expressed in millions of Nuevos Soles)



Source: MEF- DGETP

12. ASSESSMENT OF THE STRATEGY EXECUTION IN 2012

The high volatility of international markets observed in 2011, particularly in fixed income instruments, increased uncertainty for obtaining the necessary resources to address the debt service payments during 2012. In this context, on January 25, 2012, Peru participated in the international market with a sovereign bond issuance (reopening of sovereign bond 2031) of S/. 1,615 million, equivalent to U.S. $ 600 million, and a global bond issue (reopening of global bond 2050) for U.S. $ 500 million. This context eventually stopped the regular emissions of sovereign bonds until June 2012, when a new sovereign bond with maturity in 2023 was issued.

On the other hand, none of the planned debt management operations could be implemented, while the uncertainty generated by the unfolding of developed economies continued during 2012. Thus, these events had an impact on the results achieved in the indicators for debt management, at the end of the period. The Table No. 18 shows the results, we can see that most of the indicators are within the expected range, while the management of the Central Government debt in 2012 continued prioritizing funding in soles at a fixed-rate, and with longer terms than 10 years.

Table Nº 18
Assessment of the Referential Quantitative Goals from PAEAD 2012

Concept	Target until Dec 2012	Running until Dec 2012
Percentage of Nuevos Soles in the portfolio	48.1% - 53.7%	51.0%
Percentage of fixed rate debt in the portfolio	74.4% - 76.3%	76.8%
Average life (years)	12.7 - 13.4	12.8
Average reprising (years)	11.3 - 12.2	11.7
Amortization concentration over the next 12 months	4.1% - 3.7%	4.0%
Concentration ratio of annual amortizations payment	8.9% - 3.9%	0.0%
Percentage of financing in local currency	52.7% - 70.9%	58.4%

Source: MEF - DGETP

APPENDIX 1

Methodology of the Bond Index Fund

The index will be calculated on a daily basis estimating the total rate of return of a portfolio composed of all bonds of the Peruvian Republic denominated in today's nominal soles (RTt) multiplied by the index value of the previous day.

$$Vindex = Vindex_{(t-1)} \times (1 + RT_t)$$

Where:
V index: Index value of period t
V index t-1: Index value during period t-1
RT(t): Total Return of the portfolio, consisting of bonds denominated in soles, which is obtained from:

$$RT_{(t)} = \sum_{i=1}^{N} w_i(t) \times retot_i(t)$$

Where:
$W_{i(t)}$: Participation percentage of each bond in the portfolio.
$retot_{i(t)}$: is the overall performance of a particular bond

The total return of each bond ($retot_{i\ (t)}$) is obtained from the sum of:
- Price return: by market movements.
- Coupon return: for the coupons received.
- Amortization return: amortizations for the principal.
- Prepayment return: for payments made.
- Extraordinary return: for extraordinary payments (payment protection or similar).

The participation of each bond in the bond portfolio is obtained from:

$$W_i(t) = \frac{VP_i(t-1)}{VP_{cash}\,(t-1) + \sum_k VP_k(t-1)}$$

Where:
VP_i: present value of unpaid flows of each bond.
$VP_{\text{cash (t-1)}}$: accumulated cash flow in t-1, it includes interest payments and amortizations.

APPENDIX 2
Schedule of the Regular Treasury Auctions Program

July 2013 1

S	M	T	W	Th	F	Sa
	1	2	3	4	5	6
7	8	9	10	11	12	13
14	15	16	17	18	19	20
21	22	23	24	25	26	27
28	29	30	31			

August 2013 2

S	M	T	W	Th	F	Sa
				1	2	3
4	5	6	7	8	9	10
11	12	13	14	15	16	17
18	19	20	21	22	23	24
25	26	27	28	29	30	31

September 2013 3

S	M	T	W	Th	F	Sa
1	2	3	4	5	6	7
8	9	10	11	12	13	14
15	16	17	18	19	20	21
22	23	24	25	26	27	28
29	30					

October 2013 4

S	M	T	W	Th	F	Sa
		1	2	3	4	5
6	7	8	9	10	11	12
13	14	15	16	17	18	19
20	21	22	23	24	25	26
27	28	29	30	31		

November 2013 5

S	M	T	W	Th	F	Sa
					1	2
3	4	5	6	7	8	9
10	11	12	13	14	15	16
17	18	19	20	21	22	23
24	25	26	27	28	29	30

December 2013 6

S	M	T	W	Th	F	Sa
1	2	3	4	5	6	7
8	9	10	11	12	13	14
15	16	17	18	19	20	21
22	23	24	25	26	27	28
29	30	31				

January 2014 7

S	M	T	W	Th	F	Sa
			1	2	3	4
5	6	7	8	9	10	11
12	13	14	15	16	17	18
19	20	21	22	23	24	25
26	27	28	29	30	31	

February 2014 8

S	M	T	W	Th	F	Sa
						1
2	3	4	5	6	7	8
9	10	11	12	13	14	15
16	17	18	19	20	21	22
23	24	25	26	27	28	

March 2014 9

S	M	T	W	Th	F	Sa
						1
2	3	4	5	6	7	8
9	10	11	12	13	14	15
16	17	18	19	20	21	22
23	24	25	26	27	28	29
30	31					

April 2014 10

S	M	T	W	Th	F	Sa
		1	2	3	4	5
6	7	8	9	10	11	12
13	14	15	16	17	18	19
20	21	22	23	24	25	26
27	28	29	30			

May 2014 11

S	M	T	W	Th	F	Sa
				1	2	3
4	5	6	7	8	9	10
11	12	13	14	15	16	17
18	19	20	21	22	23	24
25	26	27	28	29	30	31

June 2014 12

S	M	T	W	Th	F	Sa
1	2	3	4	5	6	7
8	9	10	11	12	13	14
15	16	17	18	19	20	21
22	23	24	25	26	27	28
29	30					

First Tuesday of each month: Issuance of bills for a maximum amount of S/. 15 million in the referential period of 3 months and 9 months.

Second Tuesday of each month: Issuance of bonds with a minimum amount of S/. 15 million, from the benchmark bonds SB12AGO2017, SB12FEB2029 and SB12FEB2018 (VAC).

Third Tuesday of each month: Issuance of bills to a maximum amount of S/. 15 million in the referential period of 6 months and 12 months.

Fourth Tuesday of each month: Issuance of bonds with a minimum amount of S/. 15 million, from the benchmark bonds SB12SET2023, SB12FEB2042 and SB12AGO2046 (VAC).

Terms and conditions of the information contained in this appendix: Should any of the regular auction dates coincide with a holiday, whether to the public or the private sector, the auction will be held the next business day. Special Auctions will have no schedule, amounts, nor predefined titles. This information will be announced in the due course, when

the auction will be about to start, depending on the market conditions. In any case, the Directorate-General of Indebtedness and Public Treasury has the authority to modify the schedule of regular auctions of public debt securities.

APPENDIX 3

Annual Indebtedness Program and Debt Management 2013

According to the Article 14º of Law N º 28563, General Law on the National Debt, the Directorate-General of Indebtedness and Public Treasury formulates the Annual Indebtedness Program and Debt Management, specifying its objectives, policies and targets, from a long-term perspective, which is compatible with the fiscal targets of the budgetary year and debt sustainability.

In this regard, the objectives, policies and goals of the Annual Indebtedness Program and Debt Management 2013 are included in the Strategy for Global Asset and Liability Management 2013-2016 whose essential elements also support the Multiannual Macroeconomic Framework 2014-2016.

Therefore, the public debt management for 2013 will be aimed at further improving the structure of gross debt, through a greater preference for debt in local currency, as well as strengthening the government securities market maintaining a profile of obligations that do not to jeopardize the national treasury.

The main objective during the period 2013 is the development of public debt securities market in local currency and meet financial requirements associated with debt and treasury management, under a responsible and sustainable management of fiscal affairs.

Finally, by performing operations that observe the policies and objectives formulated for the strategy, it is expected to achieve the following reference range of quantitative targets at end of 2013:

Quantitative Referential Goals by the end of 2013

Indicator	Range at the end of December 2013
Percentage of Nuevos soles in the portfolio.	56.6% - 63.6%
Percentage of fixed rate debt in the portfolio	76.6% - 77.8%
Average life (years)	13.0 - 13.5
Average reprising (years)	11.9 - 12.5
Concentration of depreciation over the next 12 months 1_/	4.6% - 4.5%
Percentage of the flow of local currency funding 2_/	80.4% - 83.7%

Source: MEF- DGETP
1_/ Indicator that measures the immediate pressure of payments.
2_/ It includes the funding of debt management operations.