STRATEGY FOR GLOBAL ASSET AND LIABILITY MANAGEMENT 2020 – 2023

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Message from the Minister of Economy and Finance

During 2019, the performance of the world financial markets has been marked by uncertainty due to a number of factors such as persistent trade tensions; geopolitical risks and concerns on the effectiveness of the monetary policies applied by the main central banks. In addition to this, more recently, in the first quarter of 2020, uncertainty further increased due to the economic fallout from COVID-19, declared as a pandemic by the World Health Organization (WHO). All these factors will have different effects on the economic growth worldwide, which has triggered fears of a global downturn, undermining progress in economic sectors and, consequently, weakening the potential growth in the emerging economies.

In response to this, the International Monetary Fund (IMF) estimates a global recession in 2020 with a negative annual growth rate of -3.0% and of -5.2% for Latin America. In order to face this adverse situation, similarly to other reference countries in Latin America, Peru has taken fiscal and monetary policy measures such as reducing its reference interest rate at historically low levels. In the case of Peru, a responsible fiscal and monetary policy management has been a key pillar over the last years, which has raised confidence and credibility, evidenced by the favorable credit ratings and outlooks that the main credit rating agencies have assigned to the country.

In this context, guidelines, challenges and strategic actions are of great significance in order to guide the financial management of the Treasury; and the Strategy for Global Asset and Liability Management is the instrument that embraces all this, allowing decision-making on the matter at the Non-Financial Public Sector level. The guidelines established in this Strategy has contributed to managing public finances on a mid-term basis, supporting the development of the domestic public debt securities market, the prioritization of the debt in local currency and the management of the Government financial assets, all this under an appropriate management of their financial risks.

Accordingly, an effective management of the financial assets and liabilities of the Non-Financial Public Sector is essential, mainly in the current state of affairs. To this end, it is mandatory to maintain an optimal balance-sheet structure to ensure that financing dovetails with budgetary expenditure; to strengthen the fungibility of the public funds in order to avoid existing rigidities and to achieve the profitability that allows them to be used in lower growth periods at an appropriate liquidity cost.

Thus, the challenges posed in this Strategy are mainly aimed at managing public funds to finance the budget, based on a prudent management of the public debt.

María Antonieta Alva Luperdi
Minister of Economy and Finance of Peru

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EXECUTIVE SUMMARY

The Strategy of Global Asset and Liability Management (EGIAP, in Spanish)[1] is the document that guides both the financial asset and liability management of the Non-Financial Public Sector and the actions to strengthen public finances, especially in a context of high uncertainty across the world. In 2019, global financial markets have shown higher volatility with strong risk-aversion periods amid rising trade tensions and monetary control by central banks in developed economies, making investors seek protection in fixed-income assets, commodities and low risk foreign currencies.

Faced with this scenario, the world undergone a radical change at earlier 2020 when the coronavirus (COVID-19) emerged and spread. Several regions around the world were prompted to take health emergency measures (social distancing and lockdown) in order to prevent and mitigate the virus, causing economic fallout.

In Peru, the effects of the international securities market volatility in 2019 caused a rally in the market of sovereign bonds given that non-resident investors had entered into the fixed-income domestic market when the world was experiencing high financial uncertainty. Moreover, the sol-dollar exchange rate became, on average, lower in 1.7% in 2019, in year-on-year terms, while at the end of the first quarter of 2020, it increased by 3.6% due to an increased investor-risk aversion.

Similarly, the Peruvian economy has witnessed uncertainty, recording a lower-than-expected economic growth rate of 2.2% in 2019. Nevertheless, Peru has been resilient in view of this adverse situation, showing one of the highest growth rates in the region in 2019.

In this situation, the NFPS financial assets position stood at S/ 111.37 billion in February 2020, (a -2.6% decrease) against the financial asset balance that stood at S/ 114.31 billion in December 2018. From this, the General Government concentrates 94.4% and the Non-Financial Companies, the remaining 5.6%. By instrument, 62.8% of the financial assets are term deposits; investments represent 16.4% and demand deposits, 16.3%. Similarly, the local currency accounts for 61.1% of the asset portfolio, followed by the dollar with 38.3%.

Meanwhile, the financial liabilities reached S/ 194.44 billion in February 2020, 9.1% up since December 2018. By origin, securities in circulation account for 86.8%, in particular, sovereign bonds (62.6% of the total), loans from multilateral organizations and the Paris Club (13.2%), among others. By creditor's jurisdiction, domestic debt represents 65.1% in line with 65.1% of the debt in soles. Thus, the NFPS net debt was S/ 83.07 billion as of February 2020, a rise of 29.9%.

Regarding debt, financial risks are stable and the portfolio did not decrease as of February 2020. Until 2023, the concentration on amortization payments has been estimated in 5% of the NFPS total debt, liabilities are at 89.4% fixed rate, reducing the refinancing risk. On the other hand, as of February 2020, the ratio in soles rose to 65.1%

[1] As specified by the Legislative Decree N°1441 of the National System of Treasury, the Strategy for Global Asset and Liability Management is part of the public funds managing process of the Public Sector Financial Administration and it must be in line with the financial planning guidelines.

against 63.7% in December 2018; in particular, through liability management operations in June and December 2019.

Managing the financial liability portfolio under the EGIAP has allowed maintaining financial indicators that enable the Republic to provide early warning and protect itself from major financial shocks or high volatility scenarios. This seventh edition of the EGIAP, therefore, confirms its commitment to the fiscal responsibility and the financial management guidelines updated in the previous edition, as follows:

a. Strengthening the public debt securities market in soles, taking into consideration an appropriate maturity profile.
b. Financial planning consistently with the multiannual public budget expenditure, following an optimal balance-sheet composition.
c. Promotion of an efficient use of public funds through fungibility and prioritization when using financing sources.
d. Maintenance of liquidity reserves, contingent credit lines or assessment of other financial instruments to face eventual financial instability.
e. Capitalization of public funds and reduction of their liquidity cost.
f. Identification of fiscal risks and assessment of alternatives to mitigate the effect on the public finances.
g. Strengthening automated payment mechanisms and the availability of timely financial information that is both comprehensive and reliable.

Considering this, eight challenges have been posed, covering different issues that the Treasury intends to deal with regarding the management of the financial assets and liabilities of the NFPS. Although progress has been made with the 2019-2022 EGIAP, the challenges listed therein must still be taken into consideration, together with other new challenges and their corresponding strategic actions.

Consequently, the challenges and strategic actions set on this updated EGIAP will focus on:

- Strengthening the use of public funds.
- Modernizing the Treasury.
- Implementing financial planning to structure the public budget.
- Strengthening the Treasury governance concerning debt operations.
- Improving fiscal risk management.
- Assessing new options aiming at boosting the public debt securities market development.
- Modernizing the management of the financial risks to which the NFPS debt is exposed.
- Improving timeliness and quality of the financial information from NFPS entities.

In this regard, the financial management for the 2020 – 2023 period will be mainly focused on the prioritization of the use of the NFPS entities' own resources[2] over public debt, taking into account the domestic public debt securities market and considering the opportunity cost of using the financial assets and liabilities that are available.

[2] Financial assets that come from financing sources such as Ordinary Resources, Specified Resources, Directly Collected Resources, Donations and Transfers.

Finally, this Strategy includes additional information on the Sovereign Bond Regular Auction Program from the second half of 2020 and the main achievements made concerning the guidelines set in the Strategy for the 2019 – 2022 period.

INTRODUCTION

The Strategy for Global Asset and Liability Management introduces, with a short-term and long-term vision, the guidelines, challenges and strategic actions for the Treasury financial management, providing the NFPS entities with guidance for an efficient management of their public funds. Therefore, its main objective is to promote a responsible and sustainable management of the public finances by minimizing the opportunity cost in the use of public funds.

Since the first edition in 2013, the Strategy has been promoting stability in the financial asset and liability management, making meaningful progress on this. The present state of affairs requires reaffirming the commitment established in this Strategy in line with the fiscal responsibility and the prudent management of the public finances.

This Strategy is divided into six sections and introduces the challenges set out for the 2020 – 2023 period and the strategic actions that will guide the Treasury to face them. The last part contains supplementary information forming two appendices to this document.

The first section assesses the financial and economic situation of the financial markets in 2019 and in the first quarter of 2020, as well as possible scenarios that would come onwards, focusing particularly on fixed-income markets and the domestic economy. It is worth noting that the announcement of the state of emergency due the COVID-19 pandemic has also caused disruption of the information so that this document will use the most updated information available as of February 2020.

The second and third section deal with the situation of the NFPS financial assets and liabilities, in which their structure is described, identifying the financial risks to which the Treasury is exposed, such as currency, interest rate or concentration. Thus, such risks are assessed through several indicators, including the NFPS net debt.

In the fourth section, the EGIAP reaffirms its commitment to managing the NFPS assets and liabilities in line with the Republic fiscal responsibility by following the guidelines set out in the 2019 – 2020 Strategy. Thus, in the fifth section, the 2020 – 2023 Strategy poses challenges that the Treasury must take up in this period in order to continue working on the modernization of the NFPS financial administration. Additionally, the strategic actions that are crucial to meet these challenges are included herein.

The sixth section reviews the situation of the main borrowing sources the Treasury can have access; that is, the global and sovereign bonds and loans from the multilateral lending agencies.

Finally, the EGIAP confirms the importance of promoting a responsible and sustainable public finance management in accordance with the guidelines of the financial asset and liability management; to this end, meaningful actions have been considered.

I. CURRENT SITUATION

The world economy recorded a 2.9%[3] growth rate at the end of 2019. The year was marked by high uncertainty in the global financial markets and more pessimism about the state of the world economy. Likewise, developed markets were affected by: (i) tension between the US and its trade partners; in particular, the lasting impact of the trade conflict with China; (ii) the actions taken by the main central banks in response of a global economic slowdown; (iii) the risks of an unstructured Brexit and the world economic downturn in developed countries in Europe and Asia; and (iv) a weaker international demand and a higher volatility that impacted negatively on the price of commodities. At the end of 2019, the situation improved on the trade side when the start of the negotiations to reach an agreement on the US-China "phase one" trade deal was announced.

Under the circumstances, when the main financial markets saw higher volatility, investors went for lower risk assets like fixed-income instruments. From May to early October 2019, in the US fixed-income market the yield curve was flattened off and also registered inversion at some key points of the curve, causing higher pessimism about the situation of the US economy and a possible global slowdown. Nevertheless, in October the yield curve ceased to be inverted, reducing fears of recession. The change was mainly explained by the optimism about the US-China trade negotiations.

With the aim of avoiding an economic downturn, the Federal Reserve (Fed) reduced its federal funds rates for the first time since 2008, adopting a more expansionist position in 2019. Then the Fed cut its interest rate three times by 25 bps each in July, September, and October, lowering the target range to between 1.50% and 1.75% while the European Central Bank (UCB) maintained its reference rate in 0%.

On the other hand, the situation of the global financial markets favored the domestic debt market showing positive externalities and making the Peruvian Treasury securities more attractive for investment. This was evidenced by an increase of the non-resident capital inflow[4] and the rally in the secondary market of sovereign bond in soles, experiencing a yield drop of 139 bps on average.

Nevertheless, even with the situation described earlier and the lower-than-expected economic growth in 2019, the main credit rating agencies maintained their grades and perspectives as stable for Peru, highlighting its record of responsibility for the management of the country's fiscal and monetary policy. Similarly, such agencies focus attention on the capacity of the Government to keep the public debt at low levels, especially compared to our reference countries in the region, becoming the country with the lowest level of debt among LA5 countries (see Table N°1).

[3] Source: World Economic Outlook: January 2020, IMF

[4] Peruvian sovereign bonds held by non-resident investors grew from 44.3% in December 2018 to 48.7% in December 2019. In March 2020, it grew to 50.5%.

Table 1
Fiscal Indicators: Peru and Reference Countries for 2019[5] - IQ2020
(In %)

Indicator (%)	Peru	Latin America*				Averaged Countries	
		Brazil	Chile	Colombia	Mexico	A-	OECD
Public Debt (% GDP)	**26.1**	87.9	25.6	51.2	53.6	43.4	65.7
Domestic Public Debt (% GDP)	**17.1**	75.8	17.2	25.8	26.3	27.8	43.8
Debt in LCY (% Gross debt)	**65.7**	94.5	79.2	65.6	81.8	83.4	93.7
Debt (% Revenues)	**127.1**	297.6	118.6	190.7	235.5	137.9	169.4
Interest (% Revenues)	**7.0**	17.0	4.2	11.9	11.3	5.3	4.4
Interest (% GDP)	**19.8**	30.5	21.5	28.5	22.5	33.4	39.9
Fiscal Deficit (% GDP)	**-2.6**	-5.9	-2.7	-2.4	-2.7	-1.9	-0.7
Deposits in the FS in LCY (% total deposits in the FS)	**60.8**	100.0	87.3	100.0	82.9	88.1	86.3

Source: MEF, BCRP, SBS, IMF, Fitch Ratings, Moody's and Standard & Poor's.
(*)Data for Latin America comes from the estimate that the IMF forecast on April 2020. Just GDP growth indicators and fiscal balances have been included due to the current level of uncertainty. For the OECD, data applies to November 2019, and indicators for Peru were updated in the first quarter of 2020.

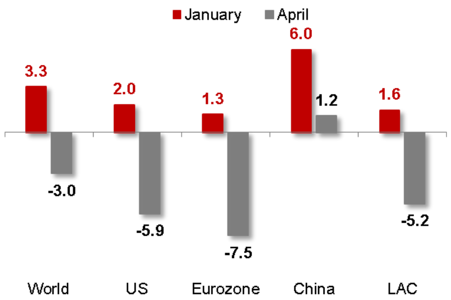
Meanwhile, as for the year 2020 it is worth noting that it is being marked by the COVID-19 effects. The shock has a particular impact on the economy both on the international front in terms of a global economic slowdown, and on the domestic front in terms of the adoption of measures to curb the spread of the pandemic.

The spreading of the COVID-19 is causing a higher uncertainty due to its extent and impact in the affected countries. Considering this, the IMF forecast a global GDP fall by -3.0% in April. Thus, several consulting firms are expecting a global recession for 2020 (Moody's, 2.1%; Goldman Sachs, -2.4%; Wells Fargo, -3.8%; JP Morgan Chase, -3.8%; Fitch Rating, -3.9%; Capital Economics, -5.5%). The estimations are, however, subject to extreme uncertainty, as there are various factors that prove to be difficult to predict.

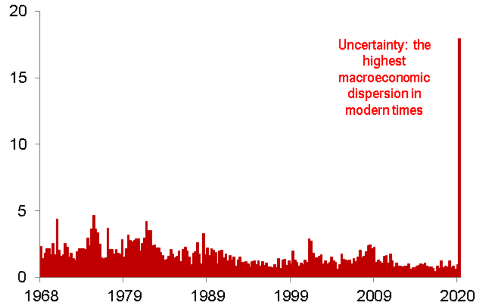
[5] Information on Peru comes from Government official sources. Debt estimations are based on the Non-Financial Public Sector and on the General Government current revenues. Information on reference countries comes from the General Government to ensure comparability in line with the International Monetary Fund estimations. The averaged countries with A- ratings refer to all countries that, at the end of 2019, maintained a long-term debt rating in domestic currency or in foreign currency of A-, as assigned by S&P or Fitch or the equivalent of A3 as assigned by Moody's. Information on domestic debt for reference countries comes from the latest available. The IMF provides information on Peru that differs from the official figures due to the scope level.

Chart 1
COVID-19 Impact on the Economic Growth

IMF: GDP Projections before and after the COVID-19, 2020[1] Spreading
(% Annual Real Chg.)



Dispersion of the Economic Growth Projections[2]
(p.p.)



Source: IMF, Philadelphia Federal Reserve.
1/ LAC: Latin America and the Caribbean.
2/ this dispersion measurement represents the difference between the 75th and 25th percentile of the projections for the US quarterly growth and reflects uncertainty in the current economic projections.

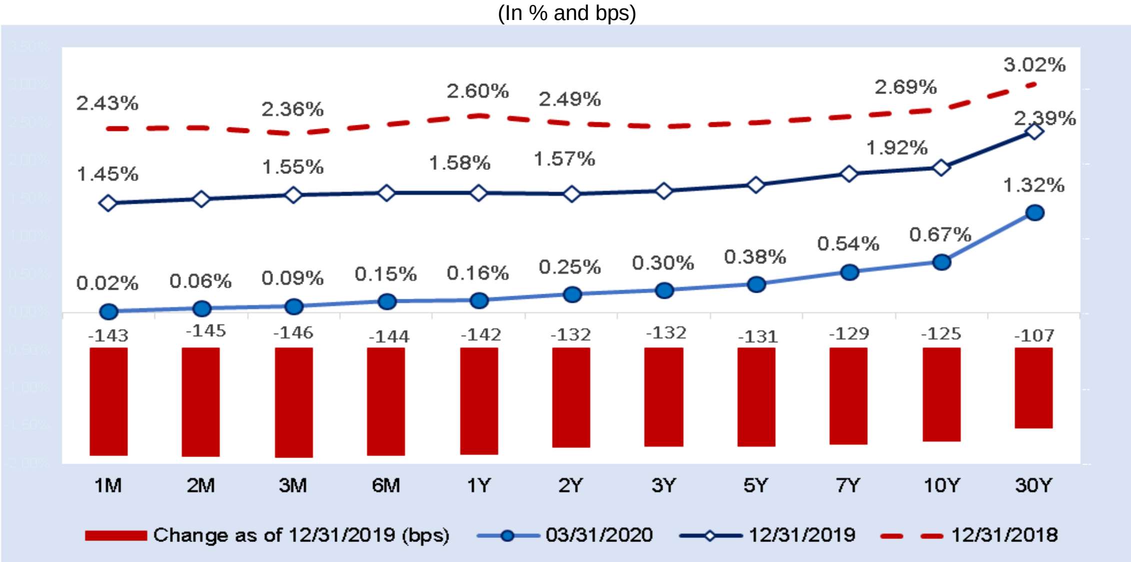
Additionally, countries are implementing unprecedented economic policy measures to deal with the COVID-19-related health emergency, taking into account that one the main health measures adopted by the countries has been the lockdown on a total or partial basis. In terms of monetary policy, reference interest rates have been dramatically reduced and non-conventional measures such as major liquidity injections have been carried out. In terms of fiscal policy, important measures have been implemented notably to increase public expenditure on health, along with direct subsidies, and tax relief to families and businesses. Thus, some countries are implementing unprecedented economic stimulus packages that surpass 30% of GDP.

For instance, the United States adopted monetary policy measures and reduced its reference interest rate to 150 bps twice at the range of 0.0%-0.25% and it approved a fiscal package of around US$ 2 trillion (10% of GDP) in order to face the restrictive effects of the coronavirus lockdown. In the meantime, the Fed pledged to purchase assets with no limit.

On the domestic front, the COVID-19 is affecting the Peruvian economy: prices of commodities are low, financial markets are volatile, international trade is declining and some key activities in the domestic economy appear to be less dynamic. Furthermore, health policy measures such as social distancing and the lockdown to contain the pandemic have magnified the COVID-19 economic effects. This singular shock has an impact on the supply and the aggregate demand of the economy.[6] Thus, the policy responses to minimize the economic effects require a coordinated use of the fiscal and monetary policy.

[6] For further information,see: "Macroeconomic Implications of Covid-19: Can Negative Supply Shocks Cause Demand Shortages?" https://economics.mit.edu/files/19351

Chart 2
US Treasury Yield Curve
(In % and bps)

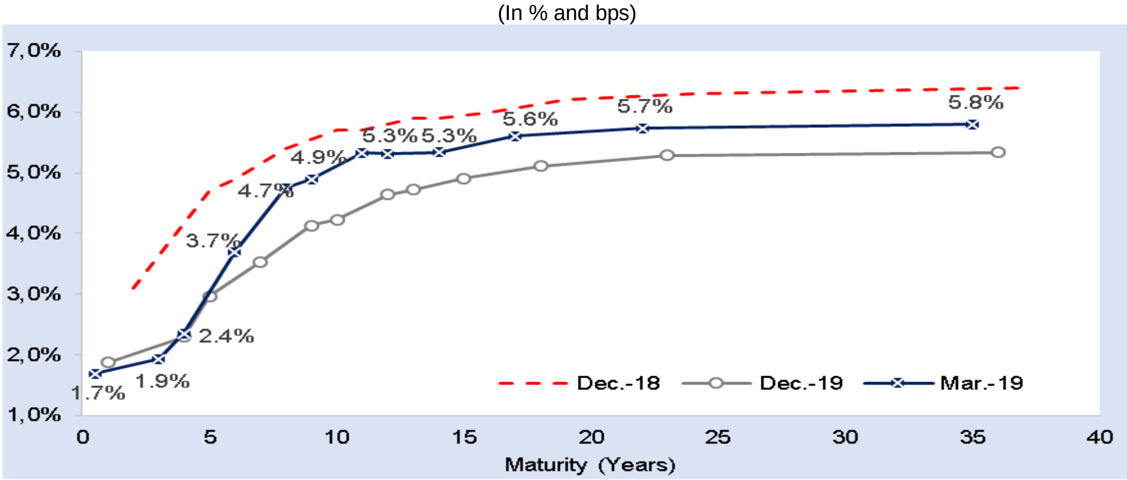


Source: Bloomberg.

* **Note**: In the first quarter of 2020, the US Treasury bond yield has decreased, on average, 131.8 bps reaching new historic lows, as the investors demanded this high quality instruments.

As a matter of example, the yield curve for sovereign bonds in soles for two-year and up was volatile in the first quarter of 2020, partly due to the economic policy measures adopted by the Government to alleviate difficult times and the investors' response to foreign economic policy measures. For the same period, the sovereign bond yield rose by 29.6 bps, growing significantly for medium and long-term references.

Chart 3
Yield Curve for the Peruvian Sovereign Bonds
(In % and bps)



Source: DGTP – MEF.

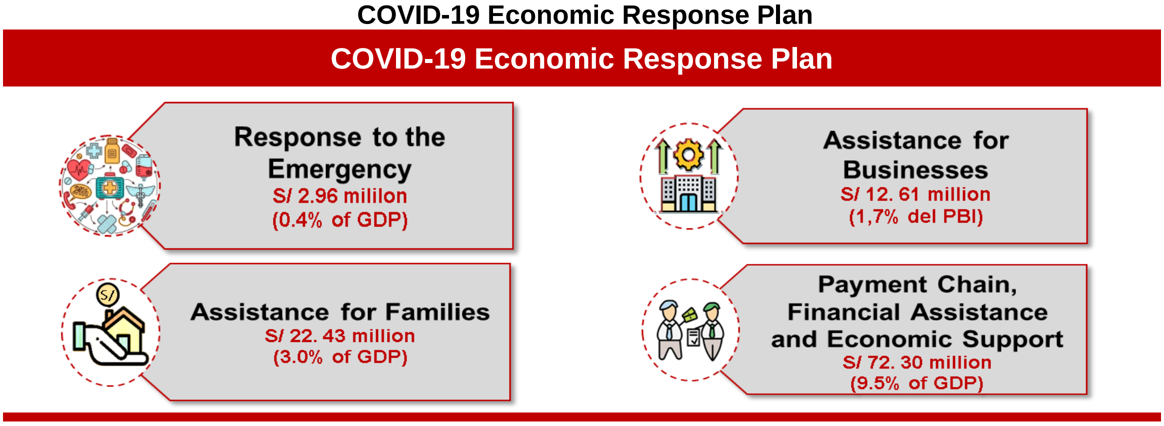
Under these circumstances, the Government has launched an unprecedented economic plan named PECOVID to deal with the COVID-19 with the aim of minimizing its social and economic effects on the Peruvian economy. The objective of this plan is to increase the health system response on the shortest-term basis; to provide relief to families and businesses given the social distancing; to secure the payment chain; and finally to bring back a gradual economic growth adopting a citizen-oriented approach.

A responsible fiscal management has led to major fiscal strengths and has contributed to the macroeconomic stability of the country, which has benefited the country with a substantial fiscal buffer to face the health emergency. A history of solvency and fiscal prudency reflected on the lowest fiscal deficit and public debt levels in the region represents an important strength in this crisis. Similarly, Peru has several financing sources due to our fiscal robustness, that is, financial assets; the Fiscal Stabilization Fund (FEF, in Spanish); contingent credit lines; financing from multilateral agencies; and access to capital markets under favorable conditions, with low interest rates for our sovereign bonds.

Consequently, the Government can implement the PECOVID plan by using a set of diversified policy instruments. Thus, the COVID-19 negative effects on health, employment and the economic activity can be minimized. To this end, there are tax and public expenditure instruments and other liquidity instruments as well: citizens have access to their private savings and Treasury credit guarantees are available for businesses to meet their working capital requirements.

As of June 03, 2020 decisions taken in the scope of PECOVID amounted for S/ 110.29 billion (14.5% of GDP) through instruments centralized on four lines of action: the first line of action addresses the emergency immediately (S/ 2.96 billion) by strengthening cleaning and healthcare services, the education sector, transport, public areas and taking actions to maintain public order. The second line of action is focused on providing dwellings with financial aids (S/ 22.43 billion), that is, subsidies to vulnerable families, tax relief, liquidity through provisional funds (pension funds) and service compensation funds (CTS, in Spanish), tax payment deadline extension and a continued operation of public entities. The third line of action provides liquidity to businesses (S/ 12.61 billion), mainly to micro and small businesses (Mypes, in Spanish), which includes subsidies to payroll, postponement of CTS deposits, tax payment deadline extension and liquidity from detraction account release. Finally, the fourth line of action implements a mechanism to secure payment chain and bring support to the economy (S/ 72.30 billion) by the establishment of the Business Support Fund (S/ 800 million to ensure credits for S/ 4 billion); the *Reactiva Perú* Program (S/ 60 billion); the Credit Guarantee Program for the credit portfolio of entities in the financial system (S/ 7 billion); a wide access of factoring companies to the *Fondo Crecer* fund; and additional measures in terms of tax and private and public investment to boost the economy, among other measures are considered.

Chart 4
COVID-19 Economic Response Plan



Source: MEF, El Peruano official newspaper.

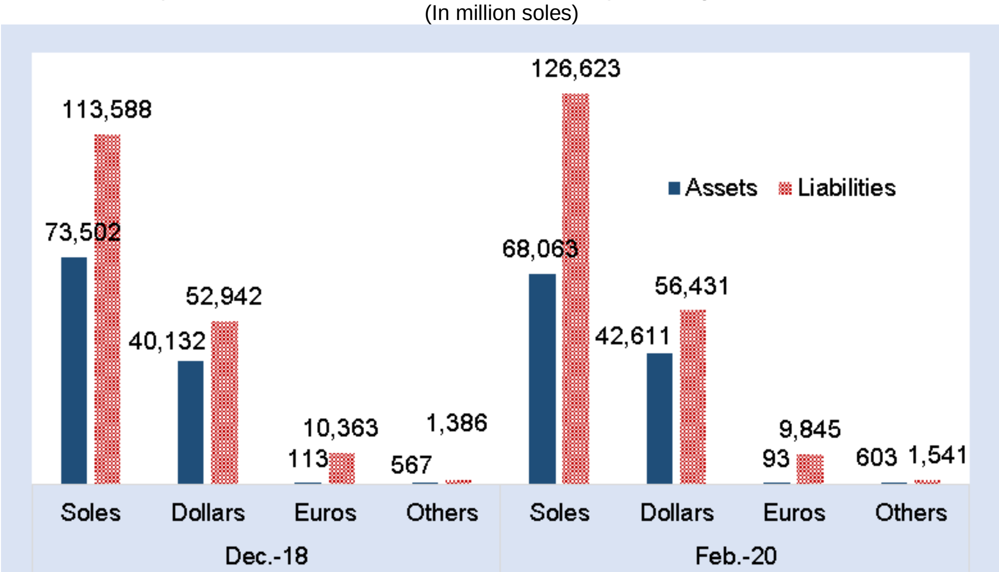
The economic measures adopted by the Government have played a significant role in safeguarding citizens' health on a short-term basis and the economy activity on the medium term basis. Measures have been adopted in due time, avoiding the health system collapse, protecting the population health. It is worthwhile to note that these measures include temporary fiscal instruments that can be reverted in line with the fiscal discipline and responsibility in a short time frame, allowing the gradual implementation of a strategy for bringing back economic growth and fiscal sustainability, considering an approach that gives priority to the citizens' well-being.

Because of the great deal of uncertainty, resulting from the effects of the current macroeconomic context on the country fiscal and macroeconomic variables, this EGIAP only introduces the main guidelines for the asset and liability management for the 2020 – 2023 period. The NFPS requirements and financing sources, as well as the estimations of the NFPS debt indicators for 2023 will be updated on the Multiannual Macroeconomic Framework (MMF) to be published in August 2020. Nevertheless, it is noticeable that the history of solvency and fiscal prudency reflected in the lowest levels of fiscal deficit and public debt in the region is an important asset to face the current crisis. Similarly, Peru has several financing sources due to our fiscal robustness, that is, financial assets; the Fiscal Stabilization Fund (FEF, in Spanish); contingent credit lines; financing from multilateral organizations; and access to capital markets under favorable conditions. Consequently, the current health emergency can be faced with a substantial fiscal buffer.

II. POSITION OF THE FINANCIAL ASSETS AND LIABILITIES OF THE NFPS

In the current stage, the NFPS financial asset and liability situation is presented as follows:

Chart 5
Summary of the Financial Asset and Liability Management of the NFPS
(In million soles)



Source: DGTP – MEF.

2.1 Situation of the Financial Assets

As of February 2020, the NFPS financial assets accounted for S/ 111.37 billion, lower in -2.6% compared to December 2018 (S/ -2.94 billion). The NFPS financial asset level reached in February was 14.5% of GDP.[7]

Table 2
Financial Assets by Government Level[8]
(In Million S/)

By Government Level	Dec.-18		Dec.-19		Feb.-20	
	Balance	PART. (%)	Balance	PART. (%)	Balance	PART. (%)
General Government	**106,987**	**93.6**	**112,503**	**93.7**	**105,137**	**94.4**
National Government	**104,500**	**91.4**	**108,722**	**90.5**	**101,604**	**91.2**
Treasury 1/	71,956	62.9	75,044	62.5	69,557	62.5
Consolidated Reserve Fund	17,880	15.6	19,085	15.9	19,246	17.3
EsSalud	4,750	4.2	4,903	4.1	4,743	4.3
Others	9,914	8.7	9,690	8.1	8,058	7.2
Regional Governments	**573**	**0.5**	**1,502**	**1.3**	**1,407**	**1.3**
Local Governments	**1,914**	**1.7**	**2,279**	**1.9**	**2,126**	**1.9**
Non-financial PublicCompanies	**7,327**	**6.4**	**7,568**	**6.3**	**6,232**	**5.6**
FONAFE	1,554	1.4	1,665	1.4	1,219	1.1
Other companies	5,772	5.0	5,903	4.9	5,013	4.5
TOTAL SPNF	**114,314**	**100**	**120, 071**	**100**	**111,370**	**100**

Source: MEF - DGTP.
1/ corresponds to financial assets from all financing sources, transfer of resources, the FEF and the FDS.

At the Government level, the Treasury concentrates 62.5% of the funds that includes all financing sources, transfers of resources, the Sovereign Debt Fund (FDS, in Spanish) and the Fiscal Stabilization Fund (FEF, in Spanish). The Consolidated Reserve Fund (FCR, in Spanish) represents 17.3% and EsSalud, 4.3%, respectively. Thus, the General Government represents 94.4% of the NFPS financial asset portfolio.

Furthermore, the non-financial companies' public funds attained to S/ 6.23 billion, notably the National Fund for the Financing of State Entrepreneurial Activities (FONAFE, in Spanish) with assets for S/ 1.22 billion (1.1% of the total).

In addition, it is worth pointing out that in the last year the Ministry of Economy and Finance (MEF) launched the Module of Financial Instruments (MIF, in Spanish) to collect information on the NFPS financial assets and liabilities.[9] All NFPS entities are entering data into the MIF, contributing with timely and meaningful information to developing a strategy for financial asset and liability management and to analyzing, assessing and identifying financial risks. For further information on the MIF, see Box 1 below.

[7] Nominal GDP in annualized terms as of December 2019.
[8] Assets held by FONAFE for S/ 18.68 billion in February 2020 are not included.
[9] The MIF has been implementing since 2018 and the NFPS entities have been gradually accessing to it since then. Given that some entities are still updating their information, past balances are subject to updates.

Box 1
The Module of Financial Instruments (MIF*)

The MIF is a web-based application developed by the MEF through which NFPS entities and other entities specified by the Ministry are registering, on a monthly basis, information on their financial asset and liability balances and the funds they manage.

The objective is to unify and standardize in one database the information on the financial assets and liabilities held by the NFPS entities in line with details and characteristics set by the National Treasury and Accounting System regulations in order to improve the quality and the scope of the analysis and the monitoring of the public finances.

Related applicactions

The Module has replaced:
- The Module of Public Fund Balance (SAFOP **).
- The Module of Public Fund Data.
- Registration of monthly information in the Module of Placement and Investment

It has integrated:

The Module use information from:
- CUT***
- SIAD****
- The Banco de la Nación statement (Current account in soles)

The Module provides information to:

* Module of Placement and Investment

Legal Framework and Mandatory Registration
The RD N° 012-2018-EF/52.05 (Directorial Resolution) approving the Directiva N° 001-2018-EF/52.05 - *Procedimiento para el Registro de Información de los Activos y Pasivos Financieros de las Entidades del SPNF en el MIF* (Directive – Guidelines for the Registration of the Financial Assets and Liabilities by the NFPS entities in the MIF), was published on March 21, 2018.

The registered information reported by the NFPS Executing Units and the Spending Units is considered as an affidavit. Every Executing Unit that fails to register information on its assets and liabilities into the MIF, on a timely basis, is reported to be an "evader". The evaders' list is being published on the MEF website since May 2019.

Notice
Since 2018, the MIF has been being gradually deployed to all NFPS entities, and a "period trial" was introduced for one year in order that the entities were getting used to registering and reporting the financial information that they are managing.

To date, meaningful progress has been made in terms of the number of entities that are entering information into the MIF, improving timeliness, quality and scope of the information on financial assets and liabilities that is available for analysis by the Treasury.

The MIF is an IT tool that is intended to keep an updated database on the financial assets and liabilities of the NFPS entities in terms of accounting and financial information. Thanks to this, the MEF can assess and do analysis on the structural balance and related risks, and the entities can keep an organized database for a better control and monitoring of their financial an accounting information.

* Spanish acronym for "Módulo de Instrumentos Financieros" (Module of Financial Instruments)
** Spanish acronym for "Saldos de Fondos Públicos" (Public Funds Balance)
*** Spanish acronym for "Cuenta Única del Tesoro" (Treasury's Single Account)
**** Spanish acronym for "Sistema Integrado de Administración Financiera" (Integrated Financial Management System)

2.2 Situation of the Financial Liabilities

At February 2020, the NFPS financial liabilities amounted for S/ 194.44 billion, an increase of 9.1% against the end of 2018, totalizing 25.3% of GDP.[10] The gross debt rise is explained by a higher sovereign bond balance, (19.2% increased) compared to the end of 2018 and by loans from multilateral agencies that grew 14.8%. Treasury bills dropped by -72.5% compared to December 2018

Table 3
NFPS Financial Liabilities by Origin, Jurisdiction, Currencies and Rates
(In Million S/)

	Dec.-18		Dec.-19		Feb.-20	
	Balance	PART. (%)	Balance	PART. (%)	Balance	PART. (%)
BY ORIGEN						
Securities in Circulation	**150,696**	**84.50%**	**167,706**	**87.00%**	**168,854**	**86.84%**
Global Bonds	46,188	25.90%	45,049	23.40%	46,417	23.87%
Sovereign Bonds	102,009	57.20%	121,612	63.10%	121,614	62.55%
Treasury Bills	2,317	1.30%	867	0.50%	,638	0.33%
Other bonds	181	0.10%	178	0.10%	,185	0.10%
Loans	**27,583**	**15.50%**	**25,023**	**13.0%**	**25,585**	**13.16%**
Multilaterals	11,555	6.50%	12,689	6.60%	13,266	6.82%
Paris Club	3,547	2.00%	3,820	2.00%	3,675	1.89%
Others	12,481	7.00%	8,514	4.40%	8,644	4.45%
TOTAL	**178,279**	**100%**	**192,729**	**100%**	**194,439**	**100%**
BY JURISDICTION						
Foreign Debt	65,666	36.80%	65,798	34.10%	67,816	34.88%
Domestic Debt	112,613	63.20%	126,931	65.90%	126,623	65.12%
TOTAL	**178,279**	**100%**	**192,729**	**100%**	**194,439**	**100%**
BY CURRENCY						
PEN	113,588	63.70%	126,931	65.90%	126,623	65.12%
USD	52,942	29.70%	54,212	28.10%	56,431	29.02%
EUR	10,363	5.80%	9,998	5.20%	9,845	5.06%
Others	1,386	0.80%	1,588	0.80%	1,541	0.79%
TOTAL	**178,279**	**100%**	**192,729**	**100%**	**194,439**	**100%**
BY RATE						
Fixed	159,605	89.50%	172,599	89.60%	173,841	89.41%
Floating	10,631	6.00%	12,761	6.60%	13,299	6.84%
VAC	4,067	2.30%	4,121	2.10%	4,132	2.13%
ONP	3,977	2.20%	3,247	1.70%	3,166	1.63%
TOTAL	**178,279**	**100%**	**192,729**	**100%**	**194,439**	**100%**

Source: DGTP – MEF.

By creditors' jurisdiction, an increase in 12.4% of the domestic debt is remarkable, standing at 65.1%. The domestic debt growth is in line with the debt portfolio in

[10] The nominal GDP percentage is the annualized rate reported by the Central Reserve Bank of Peru (BCRP, in Spanish) as of December 2019. Furthermore, there are methodological differences when the BCRP and the MEF measure the NFPS gross debt, such differences concern the valorization of the Previsional Normalization Office (ONP, in Spanish) recognition bonds, the foreign exchange rate used and the short-term credits considered by the BCRP.

soles, which rose to 65.1%. This is mainly due to the conduction of the Treasury Securities Auction Program and the liability management operations carried out in 2019.

Regarding the debt by interest rate, 89.4 % of the NFPS financial liabilities are agreed at fixed rate and 6.8% of them, at floating rate, reducing the refinancing risk and the debt exposure to unforeseen financial shocks.

2.3 Situation of the Net Debt

According to the financial asset and liability position described earlier, at February 2020, the NFPS net debt reached S/ 83.07 billion, representing a 29.9% increase against the end of 2018.

Table 4
NFPS Net Debt
(In Million S/)

By Currency	Financial Assets			Financial Liabilities			Net Debt[11]		
	Dec.-18 Balance	Dec.-19 Balance	Feb.-20 Balance	Dec.-18 Balance	Dec.-19 Balance	Feb.-20 Balance	Dec.-18 Balance	Dec.-19 Balance	Feb-20 Balance
Soles	73,502	75,422	68,063	113,588	126,931	126,623	40,086	51,509	58,560
Dollars	40,132	44,006	42,611	52,942	54,212	56,431	12,810	10,206	12,425
Euros	113	96,1297	93	10,363	9,998	9,845	10,250	9,901	9,752
Others	567	546,649	603	1,386	1,588	1,541	819	1,042	938
TOTAL	**114,314**	**120,071**	**111,370**	**178,279**	**192,729**	**194,439**	**63,965**	**72,658**	**83,069**
Position / GDP	14.90%	15.60%	14.5%	23.20%	25.10%	25.30%	8.30%	9.50%	10.81%

Source: DGTP – MEF.

III. FINANCIAL RISKS OF THE NFPS

3.1 Analysis on the Financial Assets

Instrument-Based Structure

Concerning the financial assets by type of instrument, term deposits correspond to 62.8% of the total NFPS financial assets and can be mainly found in the BCRP (79.8%), while investments (16.4%) and demand deposits (16.3%) make up the largest part of the financial assets; and 55.9% of the Public funds are concentrated in the BCRP.

Table 5
NFPS Financial Assets by Government and Instrument Level
(In Million S/)

By Instrument	Dec.-18		Dec.-19		Feb-20	
	Balance	PART. (%)	Balance	PART. (%)	Balance	PART. (%)
Cash	**21**	**0.0**	**24**	**0.0**	**15**	**0.0**
Demand deposits	**21,873**	**19.1**	**23,187**	**19.3**	**21,254**	**16.3**
BCRP	8,734	7.6	8,509	7.1	6,821	5.7
BN	7,019	6.1	7,735	6.4	7,092	5.3
FPS	6,121	5.4	6,944	5.8	7,341	5.2
Term Deposits	**66,226**	**57.9**	**68,940**	**57.4**	**63,234**	**62.8**
BCRP	51,778	45.3	54,403	45.3	50,438	50.2
BN	557	0.5	18	0.0	0	0.0
FPS	13,890	12.2	14,519	12.1	12,796	12.5
Investment	**20,891**	**18.3**	**22,227**	**18.5**	**21,142**	**16.4**
Bonds	7,181	6.3	7,624	6.3	7,371	6.1
Other Investments	13,710	12.0	14,603	12.2	13,771	10.3
Account Receivables	**5,303**	**4.6**	**5,629**	**4.7**	**5,687**	**4.5**
Financial Derivatives [1/]	**0**	**0.0**	**64**	**0.1**	**38**	**0.1**
TOTAL SPNF	**114 314**	**100**	**120 071**	**100**	**111 370**	**100**

Source: MIF – MEF.

The Sovereign Debt Fund (FDS, in Spanish) is included on Other Investments. At nominal level, it reached S/ 419.3 million at February 2020, with an increase of 10.5% against December 2018.

Currency-based Structure

The financial assets are mostly in soles and in dollars, accounting for 99.4% of the asset portfolio. The soles represent 61.1% of the assets, lowering -7.4% compared to December 2018 and the dollars represent 38.3%. Finally, the yen, the euro and other currencies posted the remaining 0.6%.

Table 6
NFPS Financial Assets by Currency
(In Million S/)

By Currency	Dec.-18		Dec.19		Dec.-20	
	Balance	PART. (%)	Balance	PART. (%)	Balance	PART. (%)
Soles	73,502	64.3	75,422	62.8	68,063	61.1
Dollars	40,132	35.1	44,006	36.7	42,611	38.3
Euros	113	0.1	96	0.1	93	0.1
Yens	565	0.5	544	0.5	603	0.5
Others	2	0.0	2	0.0	0	0.0
TOTAL SPNF	**114,314**	**100**	**120 071**	**100**	**111,370**	**100**

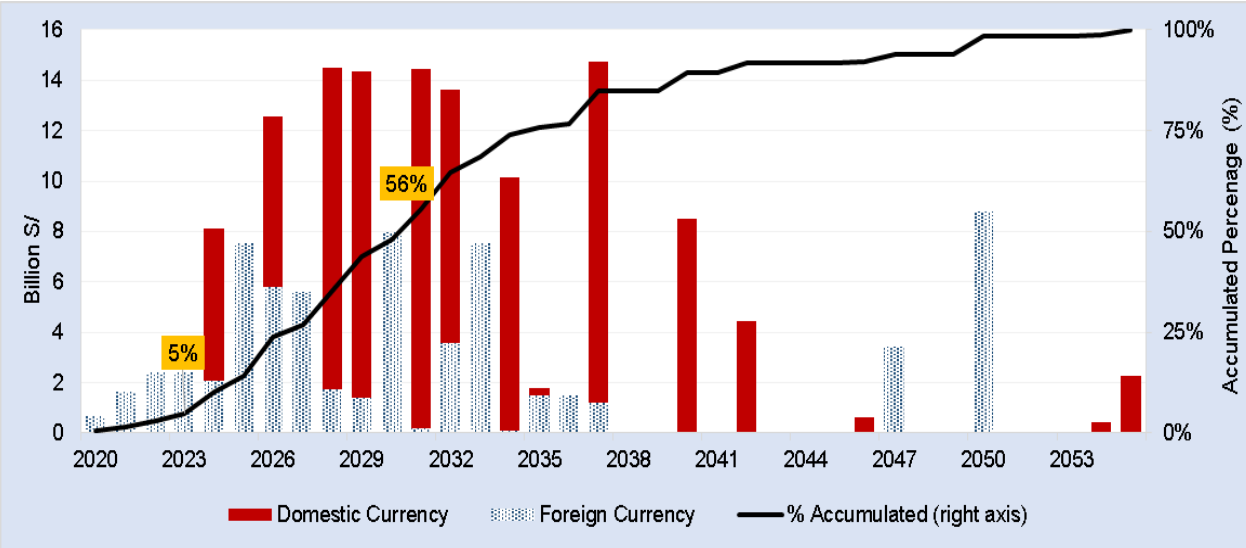
Source: MIF – MEF.

3.2 Analysis on the Financial Liabilities

Debt Concentration Structure

The NFPS debt amortization profile is heavily concentrated in the medium and long-term maturity of its liabilities (from 2020 to 2037). The maturity concentration of the liabilities until 2023 only represents 5%, thus the concentration of the debt principal payment is low on relative basis. Despite the projected concentration for 2020 is not meaningful (0.5%), it is important to make a continuous monitoring of the debt concentration to avoid refinancing risks. Additionally, the total debt average maturity attains 12.4 year at February 2020,[12] higher than 12.0 years recorded in December 2018, while the debt average maturity both in domestic and foreign currency was 12.4 years.

Chart 6
NFPS Debt Amortization Profile



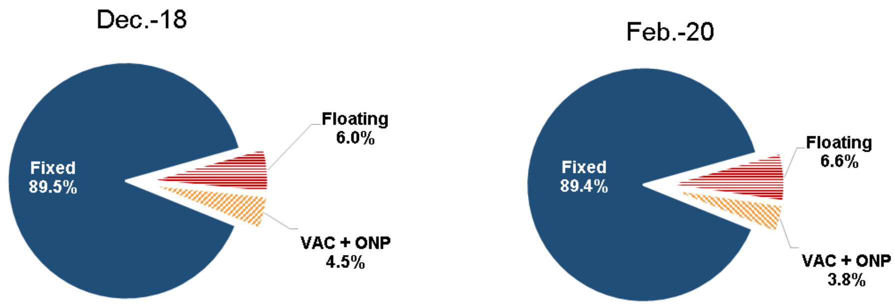
Source: DGTP – MEF.

Interest Rate Structure

The debt exposure to floating rates has slightly grown up to 6.8%, but it is still a small percentage of the debt portfolio as a whole. Maintaining debt at fixed rate is remarkable as it reduces financing risks, protecting the debt against interest rate volatility in the financial markets and providing support to the budgetary predictability of the debt flows.

[12] Calculation of the average term-to-maturity debt considers the Treasury bills balance in line with the debt information sets out on the document.

Chart 7
NFPS Debt Structure by Type of Rate
(In %)



Source: DGTP – MEF.

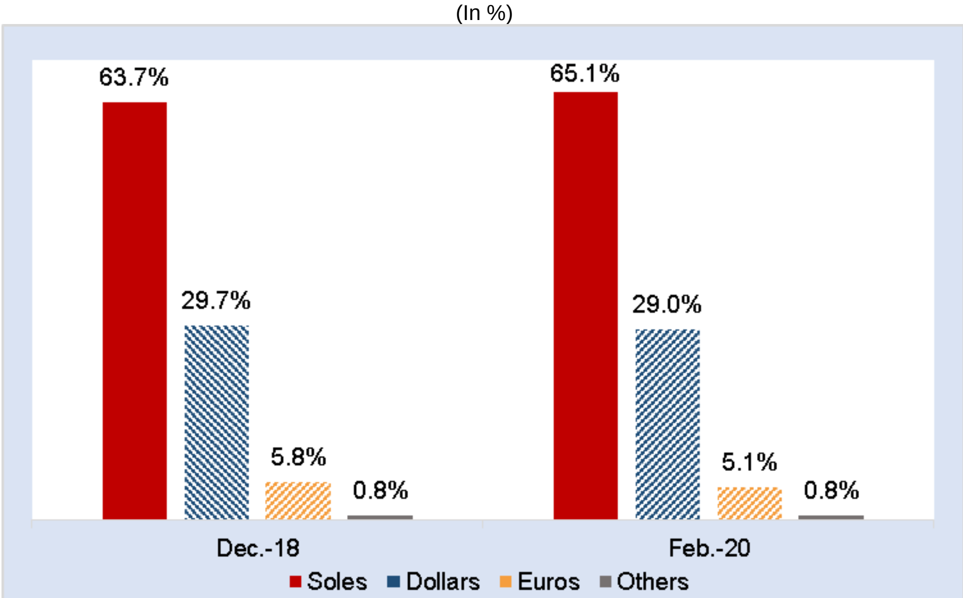
Through a one-year analysis, using the value at risk (VaR) metric (historical method) at a one-week interval, at 99% of confidence level, six-month Libor rate increases are believed to cause debt to rise by S/ 64.5 million.

<u>Currency-based Structure</u>

Regarding the currency-based structure of the liabilities and foreign exchange risk, there is a continued and gradual rise of the debt in soles from 63.7% in December to 65.1% in February 2020.

Nevertheless, a major part of the debt is still in foreign currency, being the dollar (28.5% of the total) and the euro (5.0%), the most representative currencies, exposing the Treasury to foreign exchange risk.

Chart 8
NFPS Debt Structure by Currency
(In %)



Source: DGTP – MEF.

In analyzing the foreign exchange rate volatility, using the Value at Risk (VaR) metric (historical method) at one-week interval, at 99% of confidence level, on a one-year-time horizon, the NFPS public debt in foreign currency could rise by S/ 8.63 billion (1.1% of GDP) at maximum. This increase of 98.4% would be caused by the dollar.

Similarly, the analysis on the foreign exchange risk of the NFPS public debt service annual payment through the VaR will lead to an increase of this indicator of S/ 740.7 million at a 12-months interval, at 99% confidence level.

Summarizing, the NFPS financial liabilities monitoring indicators are as follows:

Table 7
Summary of the NFPS Financial Liability Monitoring Indicators

Indicator	Dec.-18	Dec.-19	Feb-20
% of Soles in the Gross Balance	63.7%	65.9%	65.1%
% Nominal Fixed Rate Debt in the Gross Balance	89.5%	89.6%	89.4%
% of Domestic Debt in the Gross Balance	63.2%	65.9%	65.1%
Average term-to- maturity (years)	12.0	12.5	12.4
Average term-to-reprice (years)	11.7	12.2	12.1
Accumulated Amortizations over the Following 12 Months[/]	4.2%	0.6%	0.6%

Source: DGTP – MEF.
1/ includes the Treasury bill balance.

3.3 Global Exchange Position

Based on information collected, the NFPS has a global exchange oversold position of S/ -24.51 billion at February 2020 and it is mainly composed of dollars and euros; representing both 96.2% of the position. The position has slightly grown compared to December 2018 when it recorded S/ -23.88 billion.

Table 8
Global Exchange Position in Foreign Currency
(In Million S/)

By Currency	Financial Assets in FC			Financial Liabilities in FC			Global Change Position		
	Dec.-18 Balance	Dec.-19 Balance	Feb.-20 Balance	Dec.-18 Balance	Dec.-19 Balance	Feb.-20 Balance	Dec.-18 Balance	Dec.-19 Balance	Feb.-20 Balance
Dollars	40,132	44,006	42,611	52,942	54,212	56,431	-12,810	-10,206	-13,820
Euros	113	96	93	10,363	9,998	9,845	-10,250	-9,901	-9,752
Yens	565	544	603	1,245	1,449	1,381	-681	-905	-778
Others	2	2	0	141	139	160	-138	-137	-160
TOTAL	40, 812	44,649	43,307	64,691	65,798	67,817	-23,879	-21,149	-24,510

Source: DGTP – MEF.

In analyzing the foreign exchange risk of this position through the VaR (historical method), at 99% of confidence level and at one-week interval, the exchange position would rise by S/ 3.22 billion.

IV. GUIDELINES FOR THE GLOBAL FINANCIAL ASSET AND LIABILITY MANAGEMENT

The guidelines for the financial asset and liability management were updated in 2018 The objective of this change was to re-shape the MEF's role; in particular, the General Directorate of the Public Treasury[13] role in managing the financial assets and liabilities, the scope and the operational modernization of the Treasury and Indebtedness System, as stipulated in the Legislative Decrees N°1437 and 1441 that had just been enacted.

Similarly, in line with the modernization of the Public Sector Financial Administration (Legislative Decree N°1436), it was pertinent to set out new guidelines to update the EGIAP and support new strategic actions to respond to these guidelines.

Nevertheless, it is wise that such updates are made on a medium-term basis and not on a short-term one as the challenges and actions set out on the EGIAP need time for development and implementation that leads to its suitable application, in addition to producing continuity and stability for the Treasury to manage the financial assets and liabilities. Accordingly, it is convenient that the 2020 – 2023 EGIAP update preserves the same guidelines for the financial assets and liabilities as follows:

a. Strengthening the public debt securities market in soles, taking into consideration an appropriate maturity profile.
b. Financial planning that is consistent with the multiannual public budget expenditure, following an optimal balance-sheet composition.
c. Promotion of an efficient use of public funds through fungibility and prioritization when using financing sources
d. Maintenance of liquidity reserves, contingent credit lines or assessment of other financial instruments to face eventual financial instability.
e. Capitalization of public funds and reduction of their liquidity cost.
f. Identification of fiscal risks and assessment of alternatives to mitigate the effect on the public finances.
g. Strengthening automated payment mechanisms and the collection of timely, reliable and comprehensive financial information.

V. STRATEGY FOR THE 2020-2023 PERIOD

5.1 Challenges for the Period

Three challenges were posed in the 2019 – 2022 EGIAP,[14] in line with the above guidelines. They have been updated in this edition, as the gaps have not been completely closed; furthermore, new challenges have been posed to:

[13] Formerly named as the General Directorate of Indebtedness and Public Treasury.
[14] To improve the timeliness and reliability of the financial information on the NFPS entities; to manage public funds from different budgetary financing sources for timely allocation and disbursement; and to continue improving the public debt securities market development.

a. Optimize the use of public funds

To achieve greater efficiency in managing public funds, as long as their use must not be based on the financing source of the budget, but on the need to use them and their opportunity cost, resulting in a reduced financial cost of the public debt.

To continue identifying the Public Treasury temporary surplus cash and their profitability, assessing the use of the financial instruments that are available.

b. Modernize the Public Treasury

To redesign the Treasury processes to improve the efficiency and effectiveness of their operations, bringing modernization to them, in accordance with international standards and minimizing the operational risks by using IT systems that allow the integration of the National Treasury System (SNT, in Spanish) and the National Indebtedness System (SNE, in Spanish)

c. Implement financial planning for a structural public budget

To identify information sources and their relevant features and to implement processes and tools in support of the role of the Treasury in financial planning. Additionally, coordination between different units within the Ministry and other public entities to collect timely and reliable information must be strengthened.

d. Strengthen the Public Treasury Governance concerning indebtedness

To strengthen the capacity of the Treasury for decision-making on the financial structuring feasibility of the investment projects in order to control the public debt level that might have an impact on the macrofiscal rules.

e. Improve global fiscal risk management

To promote the global fiscal risk management in order to consolidate the fiscal sustainability in line with the new vision of the public sector financial administration[15].

To adopt preventive measures to mitigate the impact of the fiscal risks on the public finances, based on their identification and quantification, by continuously monitoring such measures that will contribute to assessing their efficiency, and if possible, making the necessary adjustments to obtain the expected results.

f. Assess new alternatives to boost the public debt securities market development

To launch exchange-traded funds (ETF) promoted by the Treasury, considering underlying sovereign debt instruments that help develop the public debt market

[15] The macroeconomic fiscal risks (macroeconomic variables); the specific fiscal risks (contingencies related to the execution of guarantees by the Government, lawsuits and arbitration claims, Public-Private Partnerships (PPP) contracts, natural disasters, among others) are considered. Structural and institutional risks (State weaknesses that may limit the effectiveness of the fiscal risk management or increase the probability of the occurrence of a negative event) are also taken into account.

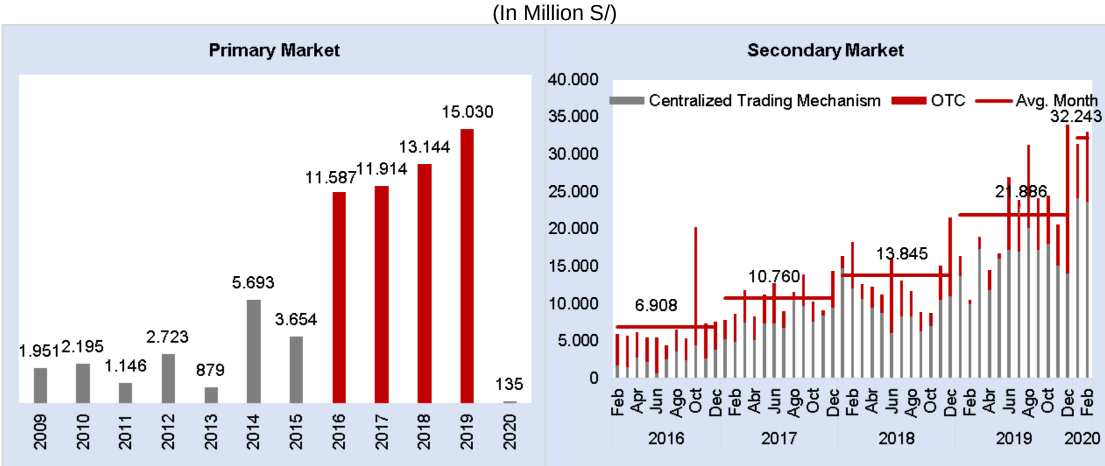
To promote the development of repo transactions through securities issued by the Public Treasury to increase the public debt market's depth and liquidity.

To give priority to the restructuration of the debt maturity profile in order to minimize potential refinancing risks that might be posed, managing the liquid references on the sovereign bond yield curve. The domestic public debt securities market has gradually grown which is reflected in a significant increase in the trading levels of these securities in the secondary market (see Chart N°9)

To consider and propose actions, on a permanent basis, to mitigate financial risks of the NFPS public debt, so as not to exacerbate financial needs that might affect the public debt service payment.

To assess the opportunity to **issue green bonds or sustainable bonds** to fund investment projects that fulfill the requirements for the best environmental, social and good governance practices.

Chart 9
Domestic Public Debt Securities Market
(In Million S/)



Source: Datatec, CAVALI

g. <u>Modernize the management of the financial risks to which the NFPS net debt is exposed</u>

To adopt good international practices when managing financial risks concerning debt, in the extent that the financial assets and liabilities are exposed to market risk factors, in order to minimize possible losses if risks arise.

h. <u>Improve timeliness and reliability of the financial information on the NFPS public entities</u>

Efficiency in management and allocation of public funds and honoring financial obligations **demand that the Treasury has timely and reliable information** on the flows and balances of the NFPS financial assets and liabilities.

To consolidate the Treasury financial asset and liability information systems in order to have timely and reliable information for analysis and decision-making. Similarly, this will lead to **the implementation of modern IT tools for timely analysis and assessment** of the assets and liabilities accordingly.

5.2 Strategic Actions

Having reaffirmed the management guidelines and after updating the Treasury challenges, the strategic actions that contribute to setting the direction and lines of action in order to meet such challenges must be posed to:

a. Optimize the use of the public funds

To establish the legal and operational framework to facilitate the mobilization of funds that the Treasury manages in order to serve public debt and fund investment projects. As long as the Treasury public funds are used, sovereign bonds will be issued, mainly for transactions that are intended to bring back public funds that were not used in public debt management operations, and to maintain an active participation on the domestic public debt securities market.

To establish investment plans approved by the Public Treasury for the maximization of the adjusted-risk return of the temporary cash surplus through investment in financial instruments. The investment plans may be revised periodically.

b. Modernize the Treasury

To review and improve processes in the National Treasury System and the National Indebtedness System in order to strengthen integration within and between them, encouraging the implementation of IT processes and control measures for ensuring management quality. Additionally, systems that will provide support to these processes will be enhanced.

c. Implement financial planning for structuring public budget

To establish technical and legal mechanisms that ensure efficiency in the generation of information on revenues based on financing sources that provide fundamentals for the financial structuration of the multiannual public budget, including the necessary changes in legislation to fulfill this function, as well as the development of IT support tools. Similarly, methodologies that make consistent, timely and reliable projections of revenues must be adopted and implemented. Diagnosis, sensitivity analysis and financial projections of the public budget must be made as well.

d. Strengthen the Treasury Governance concerning indebtedness

To adapt the legal framework to strengthen the role of the Treasury in public debt transactions to fund investment projects. To do this, an eligibility committee made up of various areas within the MEF will be established with the aim of recommending the feasibility of such transactions. Furthermore, **disbursement programming must be in line with a need of use** in order to avoid keeping public debt unused balances that result in unnecessary financial costs.

e. Improve the global fiscal risk management

To prepare guidelines, methodologies, models and the necessary regulation for the identification, measurement, mitigation and monitoring of fiscal risks. This management will be gradually implemented in coordination with different areas in charge of providing the information on every risk set out on the legislation in force.

To prepare regular reports and an Annual Report based on compiled information consolidating different fiscal risks; probabilities that risks will materialize and their potential impact will be assessed individually or as a whole, and the efficiency of different mitigation strategies, adopted for every case, will be monitored. Thus, authorities will be warned about the levels of exposure of public finances to fiscal risks so that they can make decision that can help reduce their effects.

To reduce fiscal vulnerability will contribute to maintaining and/or occasionally improving the credit rating assigned to the country, due to an efficient fiscal risk management.

f. Assess new alternatives to promote the public debt securities market

To complete the implementation process of the phase 2 of the "Secondary Market Link" with Euroclear. In addition, coordination with Clearstream must continue to implement its global platform system, facilitating the access of non-resident investors to the Peruvian public debt market

To complete the implementation of the ETF product under the "Issuer-Driven ETF" program, in association with the International Bank for Reconstruction and Development (IBRD), which is intended to become a negotiable instrument in the stock exchange market, thereby, expanding the investor base.

To complete the implementation process of repo operations such as the Temporary Transfer of Securities, also known as Securities Lending, which will temporarily provide public debt securities through operations with securities or cash as collateral to stimulate the public debt market.

To continue with a gradual prioritization of benchmarks in soles to de-concentrate the maturity profile and update the cost to the current market conditions. Apart from this, it is necessary to carry out exchange and/or repurchase operations of public debt securities in domestic currency with the aim of not only improving the gross debt profile, but of helping investors rebalance their holdings, depending on the profiles or objectives of their investment portfolios.

To assess the windows of opportunities offered by the domestic and foreign capital market to carry out debt management operations, as part of a vulnerability reduction policy to which the liability portfolio is exposed. For this, assessment and a constant monitoring of the NFPS debt financial structure is required.

To make the necessary analysis that leads to the issuance of green bonds in soles, as a funding alternative for investment projects under environmental, social and governance (ESG) criteria.

g. Modernize the financial risk management to which the NFPS net debt is exposed

To manage the net debt through the structural balance-sheet risk, defining monitoring indicators of gaps of interest rates, currencies or maturities on the assets and liabilities management, as well as through several concentration sources among assets and liabilities that cannot compensate each other due to sudden changes in the financial conditions existing in different markets.

h. Improve the timeless and quality of the financial information on the NFPS entities

To enhance the Module of Financial Instruments as a tool for registration of information on the accounting and financial position to improve the NFPS asset and liability database. Furthermore, **to get a new IT tool** to facilitate relevant analysis and assessment of the NFPS financial asset and liability position based on the information entered into the Module of Financial Information

To implement a unique IT system that makes online all the operational activities made by the Treasury concerning financial asset and liability management, bringing all balance-sheet position and flow operations into an automation process to secure timely and reliable information in the corresponding analysis and assessment for decision-making.

VI. INDEBTEDNESS OF THE NON FINANCIAL PUBLIC SECTOR

6.1 Sovereign Bonds

The domestic securities market has exponentially grown over the last 6 years, due to the priority the Treasury has given to it. The amount of sovereign bonds in circulation has risen 3.4 times since 2013, from S/ 35.25 billion to S/ 120.40 billion at the end of February 2020, representing 15.7% of GDP.

With the aim of achieving the new targets of the fiscal deficit set for a year, under this newly context of the COVID-19 and making a better use of the financial assets by the Treasury, the concept of fungibility is expected to be applied to these funds to cover part of the expected expenditures with Resources from Official Credit Operations (ROOC, in Spanish), as a financing source.

Likewise, considering the last issuances made in 2016, the demand for international issuances in domestic currency has been, on average, 5.7 times the amount issued, showing thereby investors' preference for debt securities in soles.

Table 9
The Latest International Sovereign Bond Issuance in Soles[1/]
(In Million S/)

	2016	2017	2018	2019		
	BS 2028	BS 2032	BS 2029E	BS 2034	BS 2034 [3/]	BS 2040
Amount issued	1,599	10,000	5,912	1,050	1,354	1,992
Demand [2/]	12,589	32,272	10,840	13,126	6,151	8,201
Demand Ratio / Issuance	**7.9**	**3.2**	**1.8**	**12.5**	**4.5**	**4.1**

Source DGTP - MEF.
1/ from 2017, new issuances were settled through the Euroclear platform.
2/ demand for bond exchange operations are not included.
3/ bond reopening.

6.2 Global Bonds

At the end of February 2020, the Treasury has 6 bonds in dollars amounted for US$ 9.29 billion and 2 bonds in euros totalized € 2.10 billion, the ones that are considered benchmarks.

A new benchmark in dollars was issued in June 2019 for US$ 750 million to mature in 2023, which was used to finance the debt management operation announced by the MEF. This issuance was recognized as the one in dollars with the lowest coupon rate (2.844%) made by an emerging country, showing the investors’ preference for Peruvian debt securities and the good country profile as well

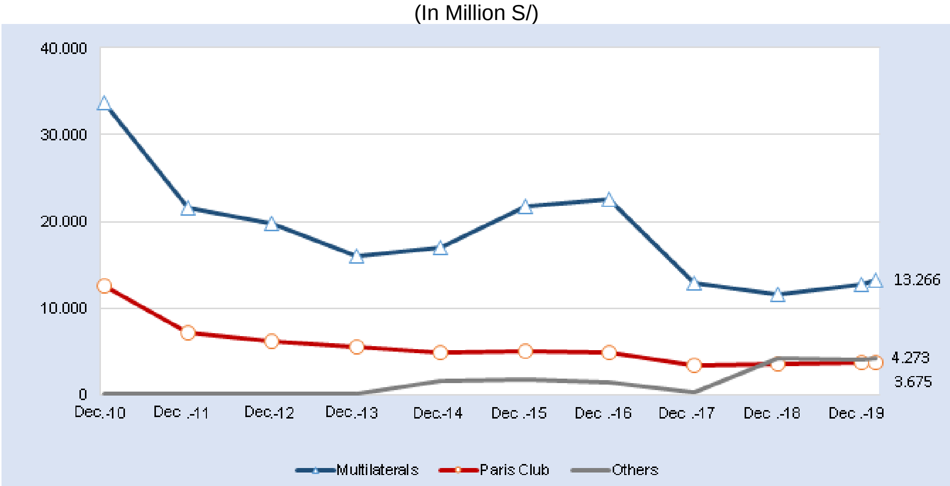
To the extent that a need for collecting resources in US dollars in the international market becomes evident, due both to a lower demand or to higher costs that lead to issuing bonds in soles, a comparison between this alternative and the fact of taking loans in dollars from bilateral and multilateral lending agencies should be made.

6.3 Loans from Bilateral and Multilateral Lending Agencies

As of February 2020, loans from bilateral and multilateral lending agencies amounted for 8.7% of the NFPS financial liabilities, showing a downward trend since 2010 because of the development of the local debt securities market, being a financing alternative for the Republic and an instrument to reduce the exposure to foreign exchange rates. In recent years, these loans have been mainly used for funding investment projects.

The level of loans for 2020 from bilateral and multilateral lending agencies could be increased, since more financing resources to meet the COVID-19 financial needs may be required.

Chart 10
Balance Due by the NFPS Loans
(In Million S/)



Source: DGTP – MEF.

Finally, the minimum level of contingent lines that Peru must have to tackle different risk events to which it might be exposed will be evaluated to finance, as a first coverage, the emergencies caused by natural disasters, financial crisis, among others. Such contingent lines, which should be part of a major financial structure for these events, must be evaluated under a comprehensive global vision of fiscal risks that helps identify the required amount and, accordingly, the related costs.

APPENDIX 1: Schedule on the 2020 Treasury Securities Regular Auction Program

July 2020

S	M	T	W	T	F	S
			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 2020

S	M	T	W	T	F	S
						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 2020

S	M	T	W	T	F	S
		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 2020

S	M	T	W	T	F	S
				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 2020

S	M	T	W	T	F	S
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 2020

S	M	T	W	T	F	S
		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		

Sovereign bond auction.

Pursuant to the Emergency Decree N°016-2019, Emergency Decree on Public Sector Indebtedness for the 2020 Fiscal Year, internal debt operations up to S/ 11.814 billion can be agreed.

Terms and conditions of the information contained in this appendix: Before each auction takes place, the General Directorate of Public Treasury will specify the bonds to be issued in the auction. The General Directorate of Public Treasury reserves the right to modify the dates of any of the auctions without prior notice based on the financing needs that are required.

APPENDIX 2: Main Achievements Concerning the Guidelines set in the 2019-2020 EGIAP

In updating the 2019-2022 EGIAP, the guidelines of the MEF were reformulated in terms of financial management on a short and mid-term basis. In addition, new challenges and strategic actions were set to orient the Treasury's role within the framework of the Legislative Decree N°1441, Legislative Decree on the National Treasury System. Over the past year, progress on these guidelines have been made, mainly the ones listed below:

a. <u>Strengthening of the public debt securities market in soles through a suitable maturity profile</u>

- New benchmarks in soles were issued through the Euroclear platform. In December 2018, June and December 2019, the 2029E, 2034 and 2040 sovereign bonds were issued, respectively. As they are Euroclearable bonds, they help diversify the investor base in sovereign bonds in soles and show the attractiveness of the Peruvian securities in soles in the international financial markets. Both issuances contributed to financing liability management operations to manage the debt maturity profile, further supporting the financial liability portfolio in soles of the Republic.

- The Sovereign Debt Fund (FDS, in Spanish) continued being managed with the aim of contributing to the dynamism of the Peruvian public debt secondary market, being a credit risk-free reference yield for participants in the domestic market.

- A cooperation agreement has been reached with the International Bank for Reconstruction and Development (IBRD) within the framework of the Issuer-Driven ETF Program to create an ETF based on the FDS fund.

b. <u>Planning the financing consistently with the multiannual public budget expenditure in line with an optimal balance-sheet structure</u>

- Since late 2018, the General Directorate of Public Treasury has been making projections of various financing sources for the preparation of the Annual Commitment Programming (PCA, in Spanish) in order to report to the General Directorate of Public Budget about these sources and, therefore, the expenditure ceilings, with the budget in line with the cash programming.

c. <u>Promotion of an efficient use of public funds through fungibility and prioritization when using financing sources</u>

- The Directorial Resolution N°042-2019-EF/52.03 was approved, which states provisions for the suitable registration of transactions affecting the balance-sheet balance in the case of financing sources that are not public entities' Ordinary Resources, boosting prioritization of the use of the resources.

- Operating mechanisms to implement temporary fungibility of public funds were set, regardless their financing sources.

d. Preservation of liquidity reserves and contingent credit lines or the exploration of other financial instruments to face unstable financial situations

- In February 2018, within the framework of the "Comprehensive Strategy for Financial Protection against Natural Disasters," in association with the International Bank for Reconstruction and Development (IBRD) as issuer, this multilateral institution issued a Catastrophe Bond for US$1.36 billion. From this, Peru was granted a sum insured of up to US$ 200 million for a three-year period.

- Because of the earthquake in Loreto in May 2019, the World Bank catastrophe bond coverage, assigned to Peru in virtue of the agreement reached with the Pacific Alliance country members, was partly activated. As a result, Peru was granted US$ 60 million (30% of the sum insured) that went to the Fund for Interventions to Face Natural Disasters (FONDES, in Spanish). The Technical Secretariat (the National Civil Defense Institute – (INDECI, in Spanish)) of the Multisectoral Committee of this Fund is responsible for this allowance, based on priority criteria.

e. Capitalization of public funds and reduction of liquidity costs

- Thanks to the Module of Public Fund Auctions, public entities and the FONAFE non-financial companies auctioned their temporary surpluses with promptness and transparency. Similarly, the Treasury capitalized its temporary liquidity surpluses through auctions in which financial entities took part.

- In addition, the NFPS public entities (the Treasury is excluded) hold public funds in various financial instruments, which contributes to the capitalization of unused funds.

f. Identification of fiscal risks and assessment of alternatives to mitigate their impact on public finances

- The Supreme Decree N°224-2019-EF approved the text of the International Swap Dealers Association Inc. (ISDA) Master Agreement (1992 version), together with its appendix (Schedule) for financial risk hedging operations.

- With support from the World Bank, the Term of Reference for hiring a risk modeling agency, which can evaluate the feasibility of a risk transfer instrument if a hydrometereological event occurs, has been defined in conjunction with the Pacific Alliance member countries.

g. Strengthening of automated payment mechanisms and the collection of comprehensive, timely and reliable financial information

- Since early 2019, a pilot project has been being implemented by the General Office of Information Technology (OGTI, in Spanish) within the MEF, the Banco de la Nación and some Public Sector executing units to use electronic payment orders (OPE, in Spanish) as a payment mechanism for cash availability from public funds. This will made through various channels provided by Banco de la Nación and with the aim of gradually eliminating the use of checks by the Public Sector entities.