

MULTIANNUAL MACROECONOMIC FRAMEWORK



2020-2023

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ACRONYMS AND ABBREVIATIONS

APEC	Asia-Pacific Economic Cooperation	Fogape	Fondo de Garantía para Pequeños Empresarios (Guarantee Fund for Small Entrepreneur)
BCRP	Banco Central de Reserva del Perú (Central Reserve Bank of Peru)	Fonadin	Fondo Nacional de Infraestructura (National Infrastructure Fund)
BEPS	Base Erosion and Profit Shifting	Fonafe	Fondo Nacional de Financiamiento de la Actividad Empresarial del Estado (National Fund for the Financing of the Public Sector Companies)
CAF	Compromisos de Ajuste Fiscal (Fiscal Adjustment Commitments)	Fondes	Fondo para intervenciones ante la ocurrencia de desastres naturales (Fund for the Intervention in the event of Natural Disasters)
Capeco	Cámara Peruana de la Construcción (Peruvian Chamber of Construction)	F-Trivar	Filtro semiestructural trivariado (Semi-structural Trivariate filter)
Capex	Capital Expenditure	GDP	Gross Domestic Product
CdPE	Comprobante de Pago Electrónico (Electronic Tax Invoice)	IADB	Inter-American Development Bank
CNCF	Consejo Nacional de Competitividad y Formalización (National Competitiveness and Formalization Council)	IAPM	Informe de Actualización de Proyecciones Macroeconómicas (Macroeconomic Projections Update Report)
CNI	Consejo Nacional para la Infraestructura (National Council for Infrastructure)	ICSID	International Centre for Settlement of Investment Disputes
COES	Comité de Operaciones del Sistema Interconectado Nacional (National Interconnected System Operating Committee)	IEC	Informe Económico de la Construcción (Economic Report of Construction)
CTPP	Comités Técnicos Público-Privados (Public-private Technical Committees)	IGG	Ingresos del Gobierno General (General Government Revenue)
Dgaeicyp	Dirección General de Asuntos de Economía Internacional, Competencia y Productividad (General Directorate of International Economic Affairs, Competence and Efficiency)	Ilzsg	International Lead and Zinc Group
DGCP	Dirección General de Contabilidad Pública (General Department of Public Accounting)	IMAG	Ingresos Mínimos Anuales Garantizados (Annual Minimum Income Guaranteed)
Dgetp	Dirección General de Endeudamiento y Tesoro Público (General Directorate of Public Indebtedness and Treasury)	IMF	International Monetary Fund
DTA	Double Tax Agreement	Imarpe	Instituto del Mar del Perú (Peruvian Marine Institute)
ECB	European Central Bank	INEI	Instituto Nacional de Estadística e Informática (National Institute of Statistics and Informatics)
Egiap	Estrategia de Gestión Integral de Activos y Pasivos (Strategy for Asset and Liability Integral Management)	Invierte.pe	Sistema Nacional de Programación Multianual y Gestión de Inversiones (National System for Multi-annual Programming and Investment)
EIA	Environmental Impact Assessment	IPE	Instituto Peruano de Economía (Peruvian Institute of Economics)
Enfen	Comisión Multisectorial Encargada del Estudio Nacional del Fenómeno El Niño (Multisectoral Commission in charge of the National Study of the “El Niño” Phenomenon)	IR	Impuesto a la Renta (Income Tax)
EPNF	Empresa Públicas del Sector Público No Financiero (Public Companies of the Non-Financial Public Sector)	ISC	Impuesto Selectivo al Consumo (Excise Tax)
EsSalud	Seguro Social de Salud (Social Health Insurance)	LGN	Líquido de Gas Natural (Natural Gas Liquid)
FCEE	Fondo de Contingencias de las Entidades Estatales (Contingency Fund of State Entities)	LG	Local Governments
FED	Federal Reserve System	LRTF	Ley de Responsabilidad y Transparencia Fiscal (Fiscal Responsibility and Transparency Law)
FEF	Fondo de Estabilización Fiscal (Fiscal Stabilization Fund)	LFRTF	Ley de Fortalecimiento de la Responsabilidad y Transparencia Fiscal (Strengthening of Fiscal Responsibility and Transparency Law)
FEN	Fenómeno El Niño (El Niño phenomenon)	ME	Mesas Ejecutivas (Executive Boards)
FDI	Foreign Direct Investment	MEF	Ministerio de Economía y Finanzas (Ministry of Economy and Finance)
		Minagri	Ministerio de Agricultura y Riego (Ministry of Agriculture and Irrigation)

Minem	Ministerio de Energía y Minas (Ministry of Energy and Mines)
MinInter	Ministerio del Interior (Ministry of the Interior)
Mipyme	Micro, pequeña y mediana empresa (Micro, Small and Medium-sized Enterprises)
MML	Municipalidad Metropolitana de Lima (Metropolitan Municipality of Lima)
MMM	Marco Macroeconómico Multianual (Multiannual Macroeconomic Framework)
MN	Moneda Nacional (National Currency)
MRTF	Marco de la Responsabilidad y Transparencia Fiscal (Fiscal Responsibility and Transparency Framework)
MSCI	Índice Mundial de Minería y Metales (World Metals and Mining Index)
MTC	Ministerio de Transportes y Comunicaciones (Ministry of Transport and Communications)
MVCS	Ministerio de Vivienda, Construcción y Saneamiento (Ministry of Housing, Construction and Sanitation)
NEC	New Engineering Contract
NFPS	Non-financial Public Sector
NG	National Governments
NOAA	National Oceanic and Atmospheric Administration
OAD	Operación de administración de deuda pública (Liabilities Management Operations)
OECD	Organization for Economic Co-operation and Development
ONP	Oficina de Normalización Previsional (Social Security Office)
OP	Objetivos Prioritarios (Priority Objectives)
OPEC	Organization of the Petroleum Exporting Countries)
OxI	Obras por Impuestos (Public Works Taxes Deduction)
PAO	Pago Anual por Obras (Annual Payment for Works)
PBC	People's Bank of China
Pemex	Empresa estatal Petróleos Mexicanos (Mexican state-owned petroleum company)
PetroPerú	Empresa Estatal Petróleos del Perú
PIA	Presupuesto Institucional de Apertura (Institutional Opening Budget)
Pidiregas	Proyecto de infraestructura productiva de largo plazo (Long-term Productive Infrastructure Projects)
PIM	Presupuesto Inicial Modificado (Institutional Modified Budget)
PJ	Poder Judicial (The Judiciary)
PMI	Purchasing Manager's Index
PMO	Project Management Office
PMRT	Proyecto de Modernización de la Refinería de Talara (Modernization Project of Talara Refinery)

PNCP	Política Nacional de Competitividad y Productividad (Competitiveness and Productivity National Policy)
PNIC	Plan Nacional de Infraestructura para la Competitividad (National Infrastructure Plan for Competitiveness)
PPP	Public Private Partnership
ProInversión	Agencia de Promoción de la Inversión Privada (Private Investment Promotion Agency)
PTAR	Planta de Tratamiento de Aguas Residuales (Wastewater treatment plant)
REPO	Condición de liquidez bancaria de China (Bank Liquidity conditions of China)
RG	Regional Governments
RSL	Reserva Secundaria de Liquidez (Secondary Liquidity Reserve)
R+D	Research and Development
Sanipes	Organismo Nacional de Sanidad Pesquera (National Fisheries Health Agency)
SBS	Superintendencia de Banca, Seguros y AFP (Superintendency of Banking, Insurance and Private Pension Fund Administrators)
SEIA	Sistema Nacional de Evaluación de Impacto Ambiental (National System of Environmental Impact Assessment)
Sicreci	Sistema de Coordinación y Respuesta del Estado en Controversias Internacionales de Inversión (State Coordination and Response System for International Investment Disputes)
Sinagerd	Sistema Nacional de Gestión de Riesgos de Desastres (National System for the Management of Risks and Disasters)
SNP	Sistema Nacional de Pensiones (National Pension System)
SPOT	Sistema de pago de obligaciones tributarias (detracciones del IGV) (Tax Obligatory Payment System (VAT deductions)
SPP	Sistema Privado de Pensiones (Private Pension System)
ST	Secretaría Técnica (Technical Secretariat)
Sunat	Superintendencia Nacional de Aduanas y Administración Tributaria (National Customs Superintendency of Peru)
S&P	Standard & Poor's Global Ratings
TIP	Tabla Insumo Producto (Input-output table)
TSA	Treasury Single Account
UNCITRAL	United Nations Commission on International Trade Law
US	United States of America
VAT	Value Added Tax
WB	World Bank
WEF	World Economic Forum
WEO	World Economic Outlook

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EXECUTIVE SUMMARY



This document contains the official multiannual macroeconomic projections, approved at Session of the Council of Ministers on 21 August, 2019, with the preliminary opinion of the Fiscal Council. These projections are used to draft the Public Sector Budget Law for Fiscal Year 2020.

Macroeconomic projections

International scenario

The international risk scenario outlined in the "Macroeconomic Projections Update Report 2019-2022" (IAPM) has materialized. At the date of presentation of the Multiannual Macroeconomic Framework 2020-2023 (MMM), the uncertainty resulting from the trade tensions between China and the United States has intensified.

Reflecting this more volatile environment, growth projections for the world economy and major economic regions have been adjusted downwards. By 2019 the growth of the world economy has been revised from 3.4% to 3.2%, the lowest growth rate since 2009, and by 2020-2023 it has been adjusted from 3.5% to 3.4% on average. This growth correction has occurred in both advanced and emerging economies. In the case of advanced economies, the downward revision is mainly explained by lower growth in the United States, affected by moderate non-residential investment, deteriorating confidence, and higher tariff costs; while in emerging economies, the change is explained by slower growth in the Chinese economy (from 6.2% to 6.1% by 2019) and Latin America and the Caribbean (from 1.9% to 1.0% by 2019). The largest economies in the region (Brazil, Mexico, and Argentina) will show low growth rates in 2019.

The observed deceleration of the global economy and greater international volatility have negatively affected the evolution of commodity prices, consequently a greater moderation of export prices is projected for 2019 (-3.4%) regarding what was contemplated in the IAPM (-0.5%). A gradual recovery of export prices is expected in the coming years.

Faced with this scenario of a global slowdown, central banks have chosen to relax their monetary policy position. Thus, on July 31, the United States Federal Reserve System (FED) reduced its policy rate for the first time in 11 years and the European Central Bank has maintained an expansive monetary stimulus in the euro area. As of July and August 2019, more than 15 central banks from advanced and emerging economies have lowered their policy interest rates. Similarly, some countries have opted for an expansive fiscal policy. Despite these responses, the risks of a further global slowdown remain.

Local scenario

The Peruvian economy registered a moderate growth of 1.7% in 1H2019, associated with an unfavorable external environment and to the persistence of temporary supply shocks that negatively influenced the primary GDP, which registered a contraction of 3.1%, the biggest fall in the last five years. Despite the deterioration of the primary sectors, the non-primary component of GDP remained resilient and reached a growth rate of 3.3% in 1H2019, a level close to the potential growth. The lower GDP growth observed in April and May 2019 severely affected the economic agents expectations, who significantly adjusted their growth forecasts for 2019 and 2020.

In this context of weak growth in the first semester due to greater uncertainty of the international scenario, deterioration of the expectations of the economic agents and supply shocks in the primary sectors, the GDP growth projection for 2019 was revised from 4.2% to 3.0%.

The growth projection for 2019 is consistent with an acceleration of economic activity and a recovery of expectations in the second half of the year, due to the dissipation of supply shocks and the impulse of domestic demand in the face of greater private investment in infrastructure projects, such as the Lima and Callao Metro Line 2, the General San Martín Port Terminal, the expansion of the Jorge Chávez Airport, among others. On the other hand, the continuity of execution of large mining projects (Quellaveco, Mina Justa, and Toromocho expansion) will favor this recovery. In effect, the advanced indicators of July and August have accelerated with respect to what was observed in previous months.

As for public investment, acceleration is expected due to the further execution of the Reconstruction works and the modernization of Talara Refinery, in an environment of measures adopted to improve the performance of subnational governments. As a result of these measures, public investment showed an important recovery in 2Q2019 (6.1%), after falling 10.9% in 1Q2019. Although the accumulated result of the January-July period remains in negative territory (-3.2%), there is a considerable improvement in the public investment dynamism compared to other years marked by the beginning of the subnational governmental management, in which for the same period (January-July) there were declines close to 20%. By the end of 2019, public investment is projected to grow by 2.5%.

With regard to private consumption, greater dynamism is expected to occur in the second half of the year, in the context of recovery of private and public investment, which will boost the generation of formal employment and improve household incomes in an environment of favorable financial conditions.

Despite the slower growth expected for the Peruvian economy at the end of 2019, Peru will still continue to lead in growth compared to its regional peers, such as Colombia (3.0%), Chile (2.8%), Mexico (1.1%) and Brazil (1.0%), and would stand above the average for Latin America (1.4%).

For the 2020-2023 period, the Peruvian economy will reach average growth rates of 4.4% with a gradual acceleration trend from 4.0% in 2020 to 5.0% in 2023. This growth acceleration will be driven mainly by domestic demand, reflected in the strengthening of private and public investment, and by the effect of economic policy measures aimed at improving the country's productivity and competitiveness. Thus, it is expected that Peru will continue to lead growth in the region in the coming years, despite the turbulence dictated by the international environment. Nevertheless, in order to reach the standards of developed countries in the next twenty years, it is essential to continue working with the purpose of growing the Peruvian economy at rates greater than 5%.

Along these lines, and within the framework of the integral strategy to improve the country's competitiveness and productivity and promote medium and long-term economic growth, the Government presented the National Plan for Competitiveness and Productivity in July 2019. This plan presents an articulated and consensual synthesis of a prioritized set of policy measures with the objective of advancing the achievement of the country vision established in the nine priority objectives (PO) of the Competitiveness and Productivity National Policy (PNCP), whose implementation will allow laying the foundations for higher and sustained economic growth in the medium and long-term.

As part of one of the priority objectives of the PNCP, the Infrastructure National Plan for Competitiveness (PNIC) has also been approved, which represents the first effort of the Peruvian State to align the vision of a more competitive country through the prioritization of infrastructure projects necessary for economic development, with a sectoral and territorial perspective.

The objective of the PNIC is to close infrastructure gaps and seek to i) develop the internal market by promoting the development of an infrastructure network that responds to present and future production needs and that has a direct impact on the country's aggregate productivity levels; ii) foster access to the external market, and boosting the development of ports, airports, and logistics chains that promote the access of Peruvian products to international markets with lower costs; and iii) improve the quality of life of citizens by promoting projects that cover people's basic needs (running water connections, solid waste management, and sewerage) to strengthen human capital in the country.

The implementation of the PNIC will close infrastructure gaps in the amount of S/ 99 billion through 52 prioritized projects, which will close around 30% of the long-term gap (S/ 109 billion) in the next ten years. The execution of the PNIC will be a major boost that will strengthen the recovery of public and private investment in the coming years.

The well-known historical record of the Peruvian economy characterized by favorable growth prospects for the medium term, its fiscal strength reflected in the low public debt ratios and the history of prudent macro-fiscal management, and the

resilience of the economy to face adverse shocks of different nature; allowed Moody's to ratify Peru's credit rating at A3 with a stable outlook.

Public Finances

The fiscal projections in this Multiannual Macroeconomic Framework 2020-2023 have been prepared in accordance with the current macro-fiscal framework for the Non-Financial Public Sector (NFPS). They are also consistent with the strengthening of fiscal accounts and fiscal sustainability, pillars for the country's macroeconomic stability. Consistent with this, an orderly and gradual consolidation process of the fiscal deficit is foreseen, which will converge 1.0% of GDP in 2021 and will allow to maintain the sustainability of the fiscal accounts.

In 2019, the NFPS fiscal deficit will reach 2.2% of GDP, below its fiscal rule (2.9% of GDP), mainly due to better results in fiscal revenues. After the notable advance of revenues in 2018 (11.0% real growth or equivalent to an increase of 1.1% of GDP), it is expected that, by 2019, they will continue their expansion (4.2% real) and reach 19.7% of GDP. As for public expenditure, the largest current expenditure (4.3% real) is in line with its fiscal rule and is aimed at meeting the needs in health, education, and security, which will continue to strengthen the capacities of human capital and provide adequate maintenance of public infrastructure. Meanwhile, public investment is expected to register a real 2.5% growth in 2019, mainly due to the development of a set of projects related to Reconstruction, the Pan American and Parapan American Games, and the Modernization Project of Talara Refinery (PMRT), which together have programmed resources equivalent to 1.7% of GDP.

In 2020, in line with fiscal convergence, the fiscal deficit will be reduced to 2.0% of GDP due to the greater effect of the measures on revenue collection, which will allow the expansion of public expenditure, especially for the mobilization of public investment. Thus, the revenues of the general government are expected to grow by 6.7% in real terms and reach 20.3% of GDP, in an environment of better economic prospects, moderation of export prices, normalization of tax returns and the greater effect of tax policy and administration measures.

Subsequent to 2020, in an environment of economic growth close to the potential and maturity of tax measures, fiscal revenues will continue to consolidate, which will expand the spending track to provide quality services and public infrastructure. Thus, the convergence of the fiscal deficit towards 1.0% of GDP in 2021 will be mainly driven by the increase in the level of permanent income. Therefore, in the context of the integral application of tax measures, the revenues of the general government will be around 20.7% of GDP by 2021 and will remain at that level by 2023.

Due to the permanent increase in fiscal revenues, the general government non-financial expenditure is expected to grow by an average of 4.6% in real terms between 2021 and 2023, above that recorded in the 2011-2018 period (+4.4% in real terms), and it will stabilize at around 20.5% of GDP by 2023, in a context of greater emphasis on transparency and efficiency, through the modernization of the State's administrative systems. This will make it possible to reduce infrastructure gaps and improve the country's welfare.

Consistent with the gradual fiscal trajectory, in 2019, the public debt of the NFPS will reach 26.9% of GDP and, and from 2020, it will have a decreasing tendency towards 25.3% of GDP in 2023, below its fiscal rule (30% of GDP).

In this manner, within the framework of a gradual reduction of the fiscal deficit to 2023, Peru will continue to record the lowest debt in the region, below the median of countries with similar credit rating (31.8% of GDP) and emerging economies (59.8% of GDP). In addition, in terms of public debt management, in line with the Strategy for Asset and Liability Integral Management (Egiap), efforts will continue to focus on reducing the financial risks which debt is exposed. In this sense, it has proactively sought to increase the "solarization" of debt, while strengthening the local capital market and issue debt with terms that do not generate pressure on financing needs.

It is important to note that 2019 marks the twentieth anniversary of the fiscal institutional framework, which has shown remarkable performance in the management of public finances, a key tool to hold fiscal sustainability and contributing to

the country's economic stability. In these lines, the fiscal projections of the MMM 2020-2023 are consistent with current fiscal rules, compliance with which will strengthen the credibility of economic policy, a key pillar of the Peruvian economy.

The present MMM incorporates a section on the evaluation of macro-fiscal risks, and considers their importance for better management of fiscal policy, with the objective of ensuring the sustainability of public finances. This section presents a retrospective and prospective analysis of macro-fiscal risks. With respect to the retrospective analysis, it is shown, among other aspects that the one-year fiscal projections of public debt and economic performance of the previous MMM are conservative from a risk perspective, which has contributed to the prudent and sustainable management of public finances. The prospective analysis shows, among others, the exposure of public finances to macroeconomic and financial risks, tax expense pressures due to demographic changes and the stock of explicit contingent liabilities amounting to 10.22% of GDP at the end of 2018 (of which 6.64% of GDP comes from judicial, administrative and arbitration processes; 1.43% of GDP from international investment controversies; and 2.15% of GDP from explicit contingencies assumed in contracts of Public-Private Partnership-PPP).

Finally, the projections presented in the MMM 2020-2023 differ slightly from the MMM 2020-2023 Project, sent to the Fiscal Council on July 31, 2019. These revisions have been performed as a consequence of the further deterioration of the international economy and the advances in the outcome of economic activity.

2

ECONOMIC POLICY GUIDELINES



The economic policy guidelines are linked to a strategy that the Government has been implementing to achieve sustained economic growth in the medium and long-term through the promotion of investment, competitiveness, and productivity, which will improve the quality of life and provide access to fairer opportunities for all Peruvians. The main objective of the economic policy guidelines is to promote the potential GDP through three main lines:

- **Macroeconomic:** The Government will promote the consolidation of economic growth in the short, medium and long-term. This growth will be accompanied by prudent and responsible management of fiscal accounts in order to reduce poverty and increase social welfare in the country. Therefore, the Government's commitment is to continue promoting public investment to accompany the acceleration of private investment, and this, in turn, spreads towards a greater generation of formal employment and improves the consumption conditions of families.

In addition, current management will continue to work on measures to strengthen the dynamism of private investment. One of the key measures will be the National Infrastructure Plan for Competitiveness, which will help prioritize projects that generate a high social and competitive impact in the country for the short, medium and long-term. This plan will present institutionalization mechanisms that will allow the timely execution of the 52 prioritized projects and the validity of good practices to make planning based on the objectives of the State. Similarly, the Government has passed legislative decrees to improve the system of public investment called Invierte.pe and the regulatory framework for PPPs and Public Works Tax Deductions (OxI), consolidate the rules and processes applied during the development phase of projects and promote the efficient use of public resources. In addition, ProInversión has been applying other measures to encourage private investment, such as legal stability agreements, tax reimbursement and early recovery of the VAT. The latter has been used in investment commitments of more than US\$ 43 billion in the last 12 years (2007-2018).

- **Microeconomic:** According to international experience, the accumulation of capital through greater investments is important, but it is not sufficient to achieve sustained growth in the medium and long-term. It is, therefore, necessary to implement growth strategies to boost the country's competitiveness and productivity. Within the framework of this strategy, on December 31, 2018, the Government published the PNCP, in which nine priority objectives have been identified. Additionally, in July of this year, the National Plan for Competitiveness and Productivity was launched, composed of a set of 84 policy measures. These measures, organized according to the nine priority objectives of the PNCP, allow us to understand their specific objectives, their rationality (how they contribute to the priority objectives) and the materialization deadlines (classified in short, medium and long-term according to the estimated milestone year of their development). Among the measures are the implementation of a PNIC, the fight against anemia, the creation of sectoral councils, the implementation of institutes of excellence at the national level, the extension of tax benefits for research, the implementation of a package for the formalization and business development, the modernization of the National Employment Service and the Labor Inspection System.

In addition, as part of the improvement of competitiveness and productivity, the Government continues to promote sectoral Executive Boards (ME), which seek to generate new engines of growth through product diversification. The MEs provide a space for public-private coordination that allows for the identification and overcoming of development barriers in sectors with economic potential, and which have room to increase productivity. Currently, eight MEs have been implemented, including aquaculture, forestry, and public procurement, which have been generating good results..

- **Public Sector Modernization:** The primary objective is to provide quality goods and services to citizens. To this end, on September 2018, the legal framework was approved that will allow modernizing the financial administration of the public sector, in a framework of fiscal responsibility and sustainability, following the best international practices. Modernization is managed under a multi-year perspective, in compliance with the current macro-fiscal framework, and is linked to national, sectoral and institutional plans and/or policies in the short, medium and long-terms, such as the Strategic Planning System, the general government Policy and the Multiannual Macroeconomic Framework.

To date, significant progress has been made in the publication of the regulations, which will make it possible to opera-

tionalize different aspects of the approved norms. This implies efforts to strengthen the integration, articulation, and interoperability among the systems that make up the financial administration: public budget, treasury, public indebtedness, accounting, supply, multiannual programming and investment management, and fiscal management of human resources. The implementation of modernization will be carried out gradually and will be reflected in an improvement in the management of fiscal resources allocated to human capital employed in the State, which is complemented by a strategy of meritocracy in hiring through the advancement of the Civil Service.

Finally, the strategy implemented by the Government is a means to continue advancing on our path towards a developed country with welfare for all citizens, in line with international best practices, which will allow Peru to become a member of the OECD.

3

TAX POLICY STATEMENT



The main fiscal policy guidelines considered in the Multiannual Macroeconomic Framework 2020-2023 are as follows:

- **Ensure fiscal sustainability through prudent, responsible and transparent management of fiscal accounts, contributing to the country's macroeconomic stability.** In a global context of uncertainty, it is vital to maintain fiscal strength because it allows the country to mitigate both internal and external risks, as well as preserve the State's capacity to respond to shocks that affect the dynamism of the economy.

In keeping with the commitment to sustainability and the macro-fiscal framework, an orderly and gradual consolidation process of the fiscal deficit is being carried out, which will converge to 1.0% of GDP in 2021. Considering the fiscal deficit path, the NFPS debt will stabilize at around 25.3% of GDP, below the limit of its fiscal rule (30% of GDP), the lowest debt in the region. It should be noted that the increase in the level of permanent income will explain much of this fiscal consolidation, which will avoid affecting the growth of public expenditure and economic growth.

In this regard, it is important to mention that the fiscal performance observed during 2018 and the advance of fiscal measures to the first half of 2019 have reinforced the credibility of the proposed fiscal consolidation, basically explained by a rebound in fiscal revenues, in a context of implementation of tax measures aimed at reducing tax evasion and avoidance. This, together with the measures aimed at optimizing the efficiency of public expenditure, will make it possible to sustain the levels of spending needed to continue reducing infrastructure gaps and improving the quality of public services.

- **Increase long-term structural fiscal revenues.** In a context of consolidation of the fiscal deficit, it is essential to continue strengthening revenue collection through the measures undertaken in recent years in order to maintain the provision of infrastructure and public services. Revenue consolidation is feasible and efficient given the high level of tax non-compliance and tax exemptions that are ineffective and focused on a few beneficiaries. Therefore, between the end of 2017 and the beginning of 2018, measures were adopted aimed at broadening the tax base and aligning the Excise Tax (ISC) based on negative externalities. In this sense, the system of tax deductions (advance payments of taxes) was improved and the modification of the ISC of a set of goods was approved, for which the degree of negative externality and detriment indices were considered. Additionally, measures were implemented to increase the use of electronic payment vouchers, an anti-avoidance framework was adopted in the Tax Code following OECD standards, and exemptions were rationalized to finance public investment projects, among other measures. During 2018 and 1H2019, the application of such measures has had a favorable effect on revenues and it is expected that the comprehensive implementation, in particular, of those measures aimed at reducing tax evasion and avoidance will increase tax revenues by 1.0% of GDP by 2023 (from 19.7% of GDP in 2019 to 20.7% of GDP in 2023). It is important to mention that in the scenario of maturation of the measures, towards 2023, the tax pressure will continue being one of the lowest of the countries of the region; thus, there is margin to increase the collection and continue financing the expenditure demands in priority sectors such as education, health, security, and sanitation. Therefore, in the medium term, it will be key to continue implementing measures that increase structural revenues, without violating the principles of sufficiency, efficiency, equity, neutrality and simplicity of the tax system, and to reduce the cost of compliance.
- **Improve the public investment management process to reduce infrastructure gaps.** Public investment is an effective instrument for boosting economic activity. When properly conducted, it generates long-term synergies that promote private sector participation and foster competitiveness. In order to deploy an investment that promotes economic growth and has a lasting effect over time, it is necessary to concentrate efforts to achieve objectives of optimizing the quality of works, contracting and execution deadlines, as well as aligning incentives between the public and private sectors to develop projects with social impact. In this sense, legislative decrees and regulations have already been approved in the investment systems of Invierte.pe, PPP and Oxl, which seek to streamline processes, reduce times, increase efficiency and quality of projects.

The roll-out of investment in public infrastructure will be developed with a focus on closing gaps, essentially in infrastructure for sanitation, transport, health, education, and public safety. This is part of the reforms approved to stren-

gthen and improve the investment management process that implements regulatory changes to optimize processes and execute resources efficiently, through the integration of the investment system with the budget system, and the adoption of new digital project modeling methodologies (BIM-Peru Plan). On the other hand, the strategic participation of the private sector will continue to be promoted through the optimization of the National System for the Promotion of Private Investment and Oxl.

The achievement of these objectives will make it possible to generate traceability throughout the investment cycle and reduce infrastructure gaps, while at the same time ensuring the quality of investments. All this will take place in an environment of intergovernmental coordination, transparency, accountability, predictability and prudent management of public finances.

- **Strengthen the management of public finances of regional and local governments.** The proper management of subnational finances and their relevant components, such as the financial management of liabilities and their own revenues, is of paramount importance for macro-fiscal stability. For this reason, it is essential to establish a framework that facilitates the accompanying of entities in order to provide technical assistance in the management of subnational public finances and improve the capacity to collect their own revenues. It is also necessary to strengthen the fiscal responsibility of sub-national governments that do not comply with the fiscal rules established in Legislative Decree No. 1275. Along these lines, the Ministry of Economy and Finance (MEF) has been implementing the Fiscal Adjustment Commitments (CAF) that consider commitments that regional and local governments should implement to return to the path of compliance with fiscal rules and strengthen fiscal responsibility at the subnational level. It should be noted that the MEF has deployed accompanying activities and technical assistance in order to implement this tool in fiscal management. Thus, the CAF have been implemented starting in the second semester of 2019, which should be evaluated in May 2020.
- **Strengthen the management of public assets and liabilities within an integral analysis that contemplates the underlying fiscal risks.** The materialization of fiscal risks, in an international context with high uncertainty, can have unexpected and non-linear impacts on fiscal accounts, which requires maintaining solid public finances. In this sense, within the framework of the Egiap, a strategy will be continued that combines an active and efficient management of both assets and liabilities of the State, through the diversification of the portfolio of financing sources (firm and contingent) and the investor base, “solarization” of the public debt, deepening of the domestic capital market, improvement of the public debt profile, and minimization of financial costs and associated risks.

As such, this Multiannual Macroeconomic Framework contains a section on fiscal risk assessment. The comprehensive record and assessment of fiscal risks contribute to designing a more efficient strategy for managing fiscal policy and its assets and liabilities. This, in turn, will allow the maintenance of various financial instruments, prudent levels of public savings and sustainable levels of public debt in order to strengthen the State's capacity to respond to scenarios of stress in financial markets, natural disasters or other contingencies.

- **Improve the quality of public services through the modernization of the State and the efficient use of resources.** In a context of prudent management of fiscal accounts, it is essential to design effective public policies for the provision of quality public goods and services. Thus, it is necessary to efficiently allocate and execute resources along the entire logistics chain necessary to meet the multiple needs of the population. This implies an improvement in human capital with emphasis on meritocracy; the adequate and timely acquisition of materials, furniture and equipment; and the deployment of public infrastructure with a focus on closing gaps.

4

TAX POLICY GUIDELINES



In a context of recovering fiscal revenues, which remain low and insufficient to guarantee the financing of public expenditure in the medium term, it is essential to continue strengthening the revenue collection from the measures approved in recent years and in the generation of permanent resources through other measures that broaden the tax base, reduce smuggling and reduce tax evasion and avoidance.

Since the main objective of the tax policy is to strengthen the National Tax System, based on the principles of sufficiency, efficiency, equity, neutrality, and simplicity, the measures implemented should guarantee the generation of new permanent fiscal revenues to finance public expenditure needs. In addition, the widespread use of payment vouchers and electronic books should continue, as well as the reduction of compliance costs and evasion, in such a way as to promote the tax formalization of economic activities and reduce tax compliance costs for taxpayers.

On the other hand, in order to continue improving the system, the effects of the modifications made within the framework of the delegation of powers of Law No. 30823 will be evaluated on a permanent basis. The objective of this law is to modernize the tax system around three axes: i) adapt our legislation to the best international practices, to increase transparency and reduce tax evasion and avoidance; ii) carry out a digital transformation, to reduce compliance costs and improve the control and inspection of the National Customs Superintendency of Peru- Sunat; and iii) facilitate the investment climate by granting greater predictability to the system.

Outlook 2020-2023

- The strengthening of the control capacities of the tax administration and the mass use of electronic payment vouchers will continue, implementing measures designed to stimulate demand by economic agents, therefore they become partners of the State in the process of formalization of economic activities and contribute to broadening the tax base.
- A regulatory project will be presented to simplify tax regimes for smaller companies. The main objective of this proposal will be to adequately focus labor and business formalization efforts and the incorporation of these companies into national value chains. It will also seek to avoid the atomization of enterprises, generate the right incentives in small and micro enterprises, and reduce the space for arbitration that is currently observed in our tax system.
- Strategies to limit the creation of new tax benefits and rationalization of existing ones will continue, for which their elimination or substitution by direct resource allocations will be evaluated. And, just as there is transparency in the allocation of public resources, this transparency must also be extended to tax expenditure, taking into account the limits established by the tax reserve; in this sense, work will be done on the online publication of the list of taxpayers benefited with these and other variables related to their application.
- In the case of income tax (IR), measures will be dictated to strengthen the tax base and combat elusive schemes or practices, in order to achieve greater neutrality and equity. To this end, international standards will be taken into account, as well as the recommendations of the Inclusive Framework of the OECD's BEPS Project (Base Erosion and Profit Shifting).
- With respect to the Value Added Tax (VAT), the revision of national legislation will continue in order to broaden the tax base. In addition, the improvement of the VAT payment systems and the associated control actions will continue, for the purpose of combat evasion and ensure compliance with tax obligations, seeking a higher level of neutrality in the application of the tax.
- In the case of the Excise Tax (ISC), in addition to being an important tax policy tool that helps combat negative externalities, discouraging or modifying the consumption of the goods or services on which it is applied, it will make it possible to generate resources to help finance public expenditure needs. In this sense, goods and services subject to ISC should in no case be subject to tax benefits.

- Regarding municipal taxation, regulatory improvements will be proposed with the objective of optimizing the main taxes regulated by the Municipal Taxation Law, such as property tax, alcabala tax, and vehicle patrimony tax. In addition, technical assistance will continue to be provided aimed at increasing the tax collection by local governments.
- Agreements to avoid double taxation (CDI) will continue to be negotiated in order to help attract new investments and technologies to the country. The next CDI to be negotiated will incorporate the minimum standards and recommendations of the actions of the BEPS plan related to this matter.
- The regulatory framework on international standards for the on-demand and automated exchange of information will be improved. Priority will also be given to expanding the network of information exchange agreements. The automatic exchange of tax information contained in the Country by Country Report will be carried out with jurisdictions that have signed Multilateral Mutual Administrative Assistance Agreements or with countries with which Peru has signed bilateral agreements or CDI, which will allow the tax administration to carry out more effective control actions and generate risk profiles.
- Efforts will be made to improve tax regulations in order to implement mechanisms that allow for an adequate taxation of new business models based on the digital economy, based on international standards and guidelines developed by the OECD, in order to guarantee a neutral, simple and efficient treatment that does not discourage or distort its normal development in the economy

5

MACROECONOMIC PROJECTIONS



5.1. INTERNATIONAL OUTLOOK

5.1.1. Global growth

Compared with the projections presented in the IAPM, the growth prospects for the world economy have deteriorated for 2019 (from 3.4% in the IAPM to 3.2%) and for the coming years (from 3.5% in the IAPM¹ to 3.4% on average between 2020 and 2023). This, in a context where risks of greater trade tensions between the United States (US) and China have materialized as projected in the IAPM, which has increased global uncertainty and its potential escalation towards other economies. In 2019, global GDP is expected to grow by 3.2% - the lowest rate since 2009 - due to the general moderation of global economic activity, affected by deteriorating investment expectations and the lower dynamism of global trade. In response, the main central banks (FED, ECB, among others) have shown signs of a more flexible monetary policy, and in some countries, expansive fiscal policy measures are being implemented. For the following years (2020-2023), global GDP is expected to grow by around 3.4%, following the easing of trade tensions and the progressive recovery of private investment. In this context, the growth of our trading partners is adjusted to 3.1% in 2019 (IAPM: 3.3%), given the lower growth prospects of the US, China, and Latin America; and for the next few years (2020-2023) it is expected to remain at around 3.2%.

Global GDP growth
(% real annual change)

	2018	IAPM 2019-2022				MMM 2020-2023				
		2019	2020	2021	2022	2019	2020	2021	2022	2023
World Output	3.6	3.4	3.5	3.5	3.5	3.2	3.4	3.4	3.4	3.4
Advanced Economies	2.2	1.8	1.7	1.6	1.6	1.6	1.6	1.6	1.6	1.6
United States	2.9	2.3	1.9	1.8	1.8	2.1	1.8	1.8	1.8	1.8
Euro Area	1.9	1.1	1.5	1.5	1.5	1.1	1.4	1.4	1.4	1.4
Emerging Markets and Developing Economies	4.5	4.6	4.7	4.7	4.7	4.3	4.5	4.6	4.6	4.6
China	6.6	6.2	6.1	6.0	6.0	6.1	6.0	5.9	5.8	5.8
Latin America and the Caribbean	1.0	1.9	2.5	2.6	2.7	1.0	2.1	2.4	2.5	2.5
Trade partners¹	3.7	3.3	3.3	3.3	3.3	3.1	3.2	3.2	3.2	3.2

1/ Weightings corresponding to 2018.
Source: IMF (WEO), MEF forecasts.

1. Advanced economies

In 2019, the advanced economies are expected to register a growth of 1.6%, lower than projected in the IAPM (1.8%), due to slower progress, mainly in the US, associated with moderation in private investment. For the period 2020-2023, these economies are expected to continue expanding at a rate of 1.6% (IAPM: 1.6%); however, the dynamics of growth would be differentiated from country to country. On the one hand, US growth is expected to continue at a moderate pace due to the gradual adjustment of public expenditure and the absence of measures to boost productivity, and on the other hand, a recovery is expected in the euro area, in line with higher private investment growth, less political uncertainty and the easing of global trade tensions.

The United States

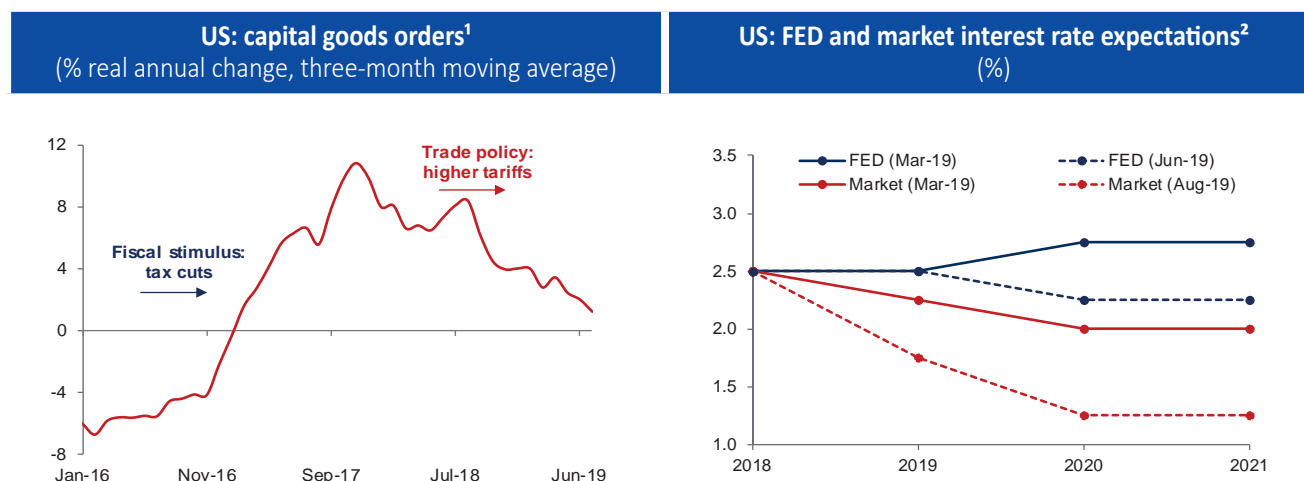
US economic growth is adjusted downwards from 2.3% in the IAPM to 2.1% by 2019 - the lowest rate in three years - in the face of less progress in non-residential private investment in a context of deteriorating business confidence and higher

¹ Throughout the document, the IAPM projections refer to the period 2020-2022.

tariff costs. In the coming years (2020-2023), growth should moderate to 1.8% (IAPM: 1.8%) due to the dissipation of the fiscal stimulus and the absence of productivity-enhancing measures.

Different indicators of domestic demand show that US economic activity will continue moderating for the remainder of the year. Indeed, in 1H2019, non-residential investment grew 3.8%- the lowest rate since 2H2016- due to deteriorating business confidence and higher capital costs. Thus, investment in structures shrank 2.0% (the lowest rate since 1H2016) and investment in equipment grew by 3.0% (the lowest rate since 1H2017). In addition, the uncertainty resulting from trade tensions with China has caused companies to delay their capital spending, especially those with greater exposure to exports. For example, in June 2019, new capital goods orders continued to deteriorate and, on July 2019, the manufacturing PMI² stood at 50.4 points, the lowest level since September 2009. Along the same lines, private consumption and the labor market have also shown initial signs of moderation. As a result, consumption of durable goods grew 3.8% in 1H2019, the lowest record since 2H2011; and job creation, measured by non-agricultural payrolls, averaged 165,000 jobs in 1H2019³, below the average registered in 2018 (223,000 jobs).

In this context of slowing economic activity and higher risks, the FED authorities have shown a more flexible monetary policy stance. At the last meeting in July, the FED committee decided to cut the reference interest rate from [2.25%-2.50%] to [2.00%-2.25%] for the first time since December 2008. The FED could reduce its interest rate for the remainder of the year if the uncertainty surrounding trade tensions persists, moderation in domestic demand is greater and/or inflation expectations are not anchored to the target (2.0%). In effect, the market consensus expects two additional cuts of the interest rate for this year. Furthermore, according to estimations by JP Morgan, in 2019, the reduction of the FED balance sheet will be at a slower pace compared to that registered in previous years⁴, which translates into a less restrictive posture of liquidity in the economy.



1/ Excluding orders from the aeronautical industry.

2/ FED data refer to the median of FED committee expectations and market data refer to Bloomberg consensus expectations.

Source: Bloomberg, FED.

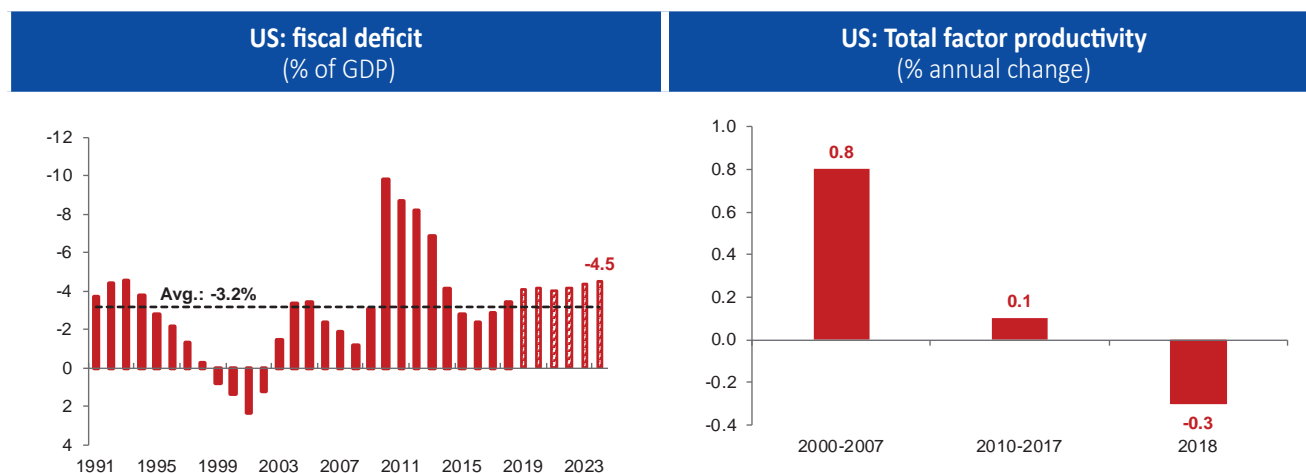
For the coming years, the growth of economic activity will be constrained by a progressive adjustment of public expenditure and by the absence of measures to boost productivity. For the period 2020-2023, the Congressional Budget Office expects the fiscal deficit to rise to 4.6% of GDP - one of the highest in advanced economies - and public debt to 83.5% of GDP. This would limit fiscal space and deteriorate domestic demand prospects. In this regard, the US

² Purchasing Manager's Index (PMI) measures the level of private sector activity based on variables such as sales, employment, inventories and prices. The July 2019 preliminary PMI was used.

³ Refers to average monthly data for 1H2019. In July 2019, agricultural payrolls were 164,000 jobs.

⁴ According to JP Morgan, the balance sheet was reduced by US\$ 385 billion in 2018 and is expected to be reduced by US\$ 312 billion this year; however, this would increase by US\$ 5 billion in 2020.

Treasury Department is expected to progressively adjust federal government spending⁵. Growth will also be constrained by deteriorating productivity. Indeed, according to The Conference Board, total factor productivity contracted by 0.3% in 2018, below that recorded in the periods 2000-2007 and 2010-2017 (0.8% and 0.1%, respectively).



Source: Bloomberg, The Conference Board.

Euro area

For 2019, the euro area growth projection remains at 1.1% in a context of the widespread deterioration of private investment and exports in the face of high commercial and political uncertainty. Average growth of 1.4% is projected for the period 2020-2023, which would be sustained by the dissipation of international trade risks and political tensions, as well as the impact of new monetary and fiscal measures.

In 2019, the moderation of growth in the euro area will be undergone to the widespread slowdown in investment in the main countries of the region due to increased trade and political uncertainty. The latent risks of global trade⁶, BREXIT (exit of the United Kingdom from the European Union)⁷ and the political tensions in countries such as Italy and Germany⁸ have deteriorated the economic outlook, especially in industry and exports. As a result, in July 2019, the region's manufacturing PMI reached its lowest level in more than six years (46.5 points) in the face of falling production indicators and export orders. In Germany, the manufacturing PMI fell for the seventh consecutive month (43.2 points) and in Italy for the tenth consecutive month (48.5 points). Moreover, the region's economic sentiment indicator reached 102.7 points in July 2019, its lowest level since March 2016. In this context, consumer resilience - reflected in the strength of the labor market, with the lowest unemployment rates since 2008 and rising wages - will be an important factor in sustaining growth.

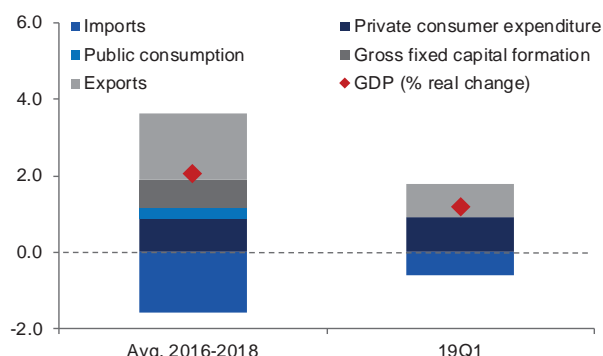
⁵ However, on August 01, 2019, the Senate approved increasing public expenditure and the public expenditure ceiling until 2021.

⁶ In July 2019, US President D. Trump announced a possible introduction of tariffs on products from the European Union of approximately US\$ 4 billion.

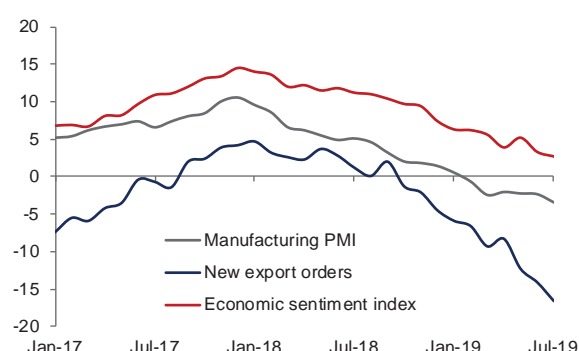
⁷ In July 2019, Boris Johnson assumed the position of Prime Minister of the United Kingdom, following the resignation of Theresa May. Although Johnson has spoken out in favor of renegotiating the exit agreement with the European Union, there is uncertainty as to whether it will be carried out in an orderly manner.

⁸ Internal tensions within the parties that make up the government coalitions have affected the political landscape in both countries. Moreover, in Germany growth prospects remain low in the face of weak economic and industrial activity data in 1H2019. For its part, Italy faces a complicated fiscal situation, with high levels of indebtedness and fiscal deficit.

Euro area: GDP and components (% real change, percentage points)



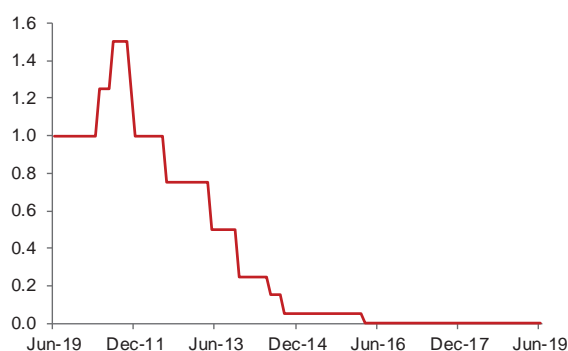
Euro area: economic activity indicators¹ (Points)



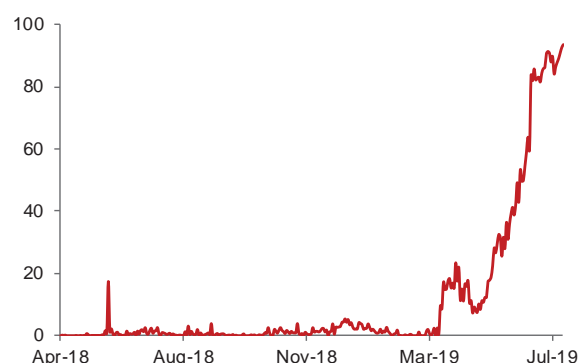
1/ The data for the economic sentiment indicator and the manufacturing PMI were adjusted to make the scale.
Source: Eurostat, Central Bank of Austria, Markit.

In this context, a more flexible monetary policy on the part of the ECB is expected, as well as the introduction of fiscal impulse measures. As regards monetary policy, the ECB is likely to adopt a more flexible stance in order to keep inflation close to its target rate of 2.0%. Thus, in 2019 and 2020 it would maintain its interest rate around the current level (0.0%) and continue its quantitative expansion program. In addition, in September 2019 the ECB will implement the third round of its targeted longer-term refinancing operations program (TLTRO III), through which it will offer long-term financing to commercial banks at preferential rates. In addition to the monetary impulse, the fiscal policy orientation would change from neutral to moderately expansive, given the reduction of direct taxes and greater social transfers in countries such as Germany and France.

Euro area: ECB reference interest rate (%)



Euro area: probability of ECB reference rate cut, 2019 (%)



Source: Bloomberg.

Growth of 1.4% is projected for the period 2020-2023 due to the gradual recovery of exports and investment, and economic policy measures. Despite the lower dynamism of the industrial sector than expected in the IAPM, exports will be favored by greater global demand and less uncertainty regarding international trade. Moreover, the resolution of the BREXIT and less political tensions will improve investment expectations. In addition, monetary and fiscal stimulus measures will also help stabilize growth in the medium-term.

2. Emerging and developing economies

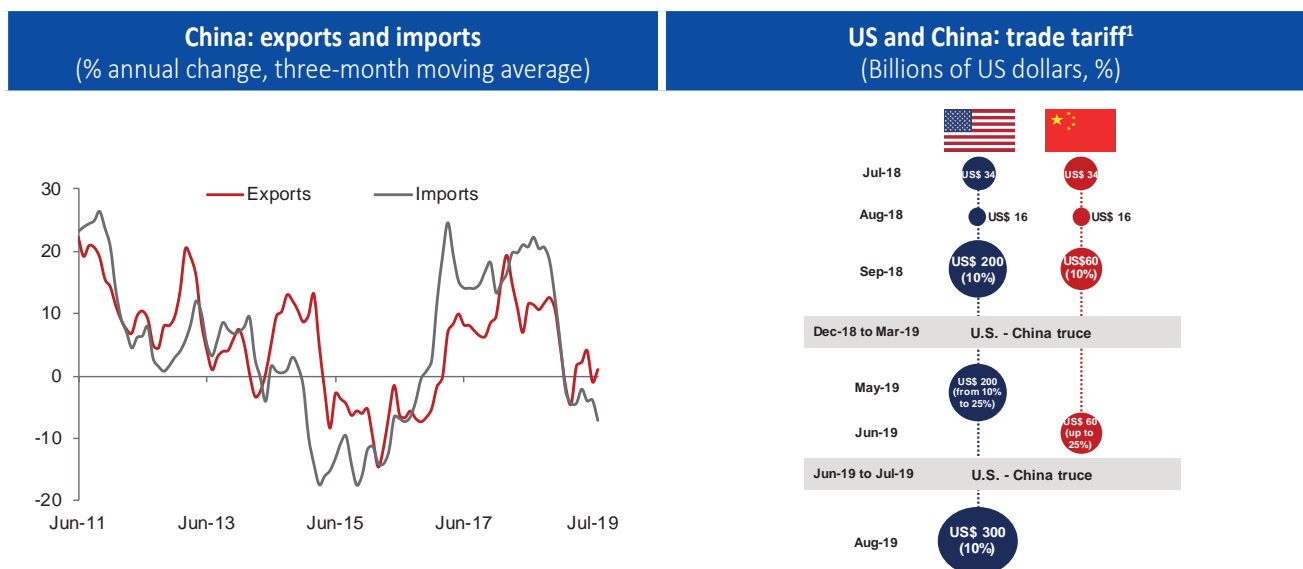
The growth projection for the emerging and developing economies is revised downwards from 4.6% in the IAPM to 4.3% by 2019, due to the moderation of growth in China and Latin America and the Caribbean. In China, GDP is likely to be affected by the deterioration in global trade as a result of trade tensions with the US, while in Latin America and the Caribbean a slower pace of growth is expected, mainly in Brazil, Mexico, and Argentina. For the period 2020-2023, the growth of the bloc would be around 4.6%, favored by the progressive recovery of some countries, such as Argentina and Turkey, after overcoming their domestic economic crises, and by the greater dynamism of the other economies of Latin America and the Caribbean.

China

China's economic activity will continue to moderate and should grow by 6.1% in 2019 (IAPM 6.2%), affected by an adverse environment for its exports resulting from trade tensions and moderation in domestic demand. This could be partially offset by the fiscal and monetary stimulus measures being implemented. For the next few years, economic growth is expected to be around 5.9%, below the projected IAPM (6.0%).

So far in 2019, the Chinese economy has continued to slow down. As a result, the economy went from growing 6.4% in 1Q2019 to 6.2% in 2Q2019 (the lowest since 1990). The structural slowdown of the economy has been affected by the negative impact of higher tariffs and weak external demand. In fact, in 1H2019, private investment grew 5.7% (2018: 8.7%) and industrial production grew 6.0% on average (2018: 6.3%). Furthermore, in July 2019, the manufacturing PMI, according to Markit, stood at 49.9 points, associated with the fall in employment to its lowest level in ten years, and the official manufacturing PMI was reduced to 49.7 points, for the third consecutive month in the pessimistic tranche.

Higher US-imposed tariffs will negatively affect China's total exports. The increase in US tariffs from 10% to 25% on products from China in the amount of US\$ 200 billion affected more than five thousand Chinese products associated with the mining, food and textile sectors. Indeed, between January and July 2019, exports grew by an average of 0.7% (2018: 10.6%), while imports contracted by 4.4% (2018: 16.6%). Moreover, China's exports to the US have fallen by an average of 8.4% so far this year⁹. Moreover, after the trade truce reached by both countries at the G-20 summit at the end of June this year, a worsening of trade tensions was observed at the beginning of August after the imposition of 10% tariffs by the US on China's remaining imports in the amount of US\$ 300 billion, a measure that would enter into force in 2H2019.



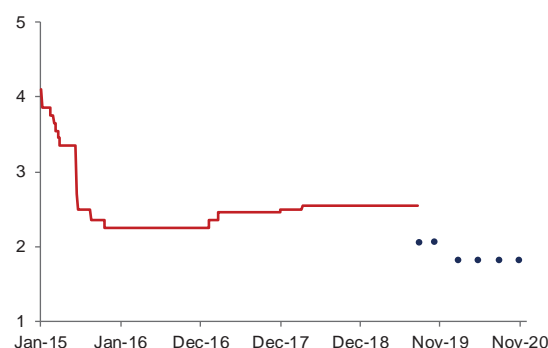
1/ US tariffs on Chinese imports announced in aug-19 will take effect on 19H2.
Source: Capital Economics, Bloomberg.

In this context, the Chinese government has announced a set of fiscal and monetary stimulus measures; however, these would not be sufficient to counteract the adverse effects of trade tensions on exports or the reduced dynamism of domestic demand. At the fiscal policy level, the government announced an impulse consisting of tax cuts¹⁰, increased investment in railways and the implementation of measures to facilitate investment in infrastructure in local governments. According to Bloomberg, the issuance of local government bonds for infrastructure investment would reach its highest level this year. At the monetary policy level, access to credit for small and medium enterprises is becoming more flexible¹¹. The People's Bank of China (PBC) is also expected to cut the seven-day repo rate¹² by 50 basis points (bps) for the remainder of the year.

China: financial system loans
(% annual change, three-month moving average)



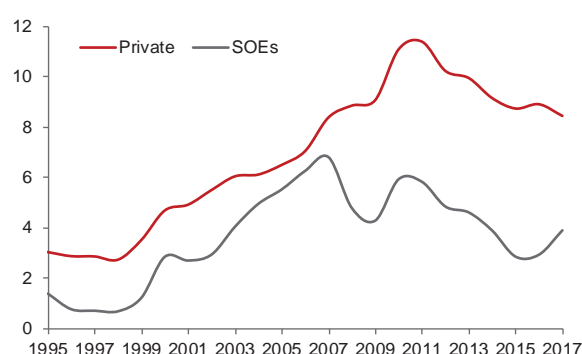
China: seven-day repo rate¹
(%)



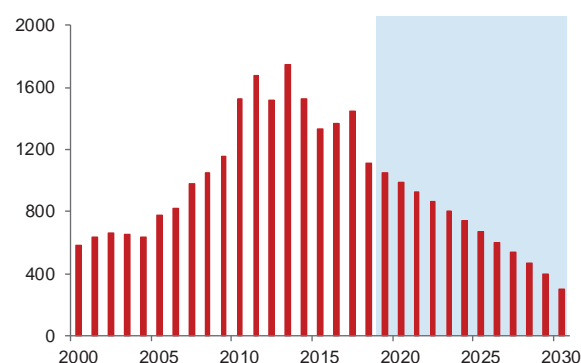
1/ A partir de agosto del 19 son proyecciones.
Fuente: Capital Economics, Bloomberg.

A moderation of China's economic activity is projected for the coming years, mainly due to structural factors. These include i) lower demand for urbanized housing in the real estate sector, ii) slow productivity growth in public sector industrial firms and iii) high entry barriers faced by Chinese exports in foreign markets. Added to this are problems such as the high level of indebtedness of some sectors of the economy and the vulnerability of the financial system.

China: return on assets of industrial firms
(%)



China: urban housing demand¹
(Million square meters)



1/ The shaded area corresponds to estimates by Capital Economics.
Source: CEIC, Wind, Capital Economics.

¹⁰ Tax cuts of US\$ 298 billion (2.6% of GDP) and 10.2% increase in investment in railways (from US\$ 108 billion in 2018 to US\$ 119 billion in 2019).

¹¹ Measures would include: (i) deepen reforms to improve financial services and (ii) increase credit to companies that use intellectual property.

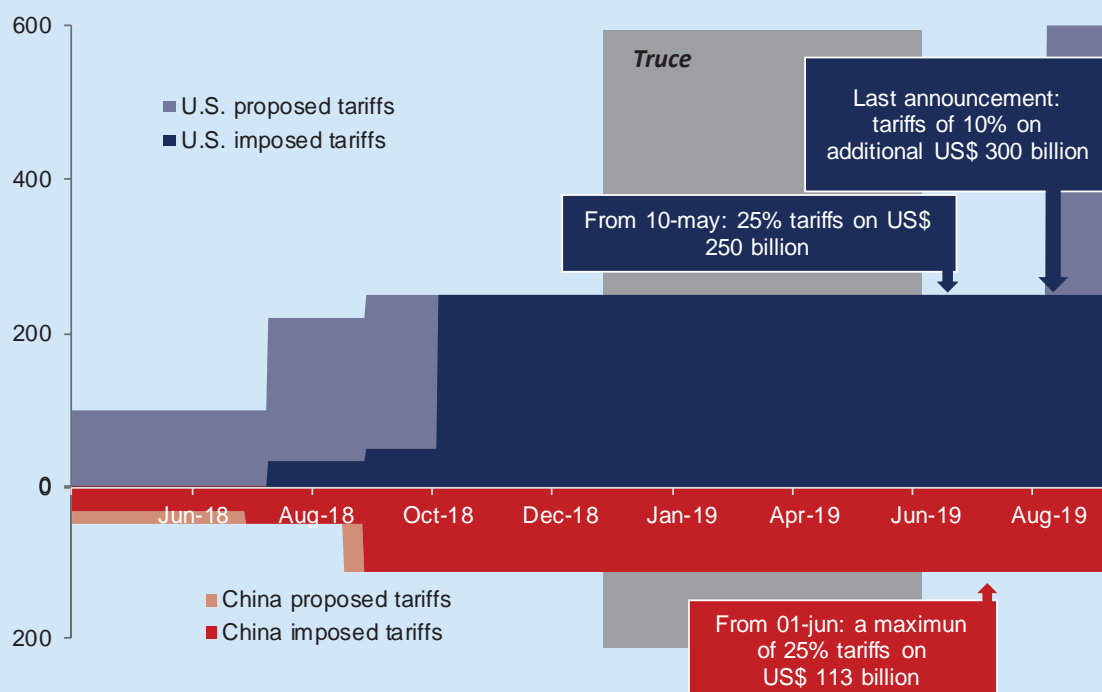
¹² This rate reflects the liquidity condition in the banking system and plays an active role as a market reference rate. Although the Central Bank of China has not confirmed that it is the policy interest rate, analysts consider it as a benchmark.

Box 1: Escalating trade tensions

The escalating trade tensions – embodied in the recent imposition of US tariffs on China - have created turbulence in global financial markets. As a result, stock markets have suffered significant losses, commodity prices such as copper and oil have declined significantly, currencies in emerging economies have depreciated and investors have turned to low-risk assets such as gold and treasury bonds. In this context, despite the greater easing of the monetary policy of the world's central banks, the intensification of trade tensions could further deteriorate the current fragile global growth.

After a brief trade truce between the US and China reached at the G20 summit in June this year, trade tensions between the two countries have entered a new phase which, if sustained, could be difficult to reverse and trigger a sharp global economic slowdown. In early August 2019, trade tensions worsened after the US imposed 10% tariffs on China's remaining imports (in the amount of US\$ 300 billion), a measure that would come into effect in 2H2019. In response, the Chinese government announced a restriction on US agricultural purchases and mentioned a possible imposition of new tariffs. The PBC also reduced the band in which its currency fluctuates to ¥6.9225 per dollar (+/- 2.0%).

US and China: proposed and imposed tariffs
(Billions of US dollars)



Fuente: Financial Times.

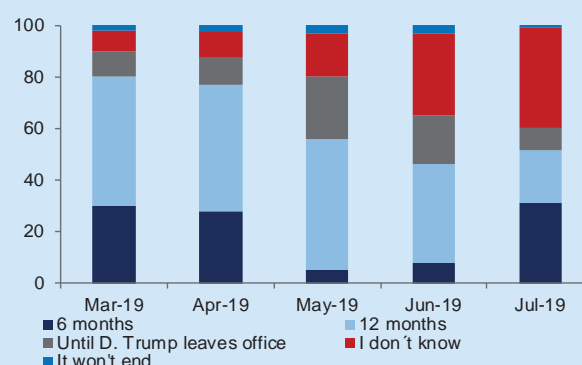
These events have affected global financial markets, mainly equities, commodities, and currencies. In fact, in the first week of August 2019¹³, the global MSCI index- the stock market indicator of the main international markets- fell 3.7%, the price of copper reached its lowest level in more than two years (€US\$/lb. 254) and the yuan reached its lowest level in 11 years. In this environment of uncertainty, investors opted for the fixed income market and refuge assets such as gold. Thus, the 10-year sovereign bond yield of the US Treasury reached its lowest level since October 2016 and all points on the German sovereign bond yield curve were on a negative territory for the first time in history. Gold prices reached their highest level since April 2013 (US\$/oz.tr. 1,509).

¹³ The information used is from August 1 to August 7.

VIX index and copper price reaction to announcements of new tariffs¹ (Points, €US\$/lb.)



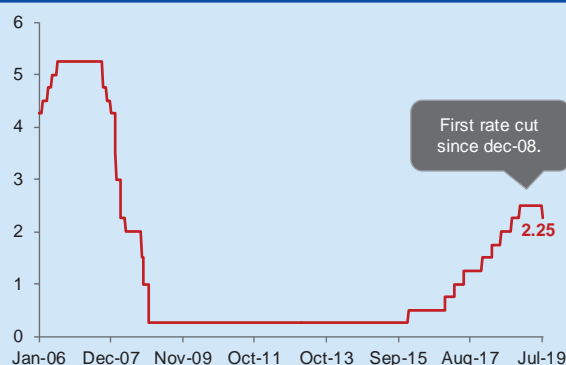
Survey expectations on the duration of US-China trade dispute (% of respondents)



1/ As of 7 August 2019. The red lines indicate the dates on which a new tariff was announced.
Source: Bloomberg, Financial Times.

In this context, the world's central banks have shown a more expansive stance; however, they would have little room to counter the negative effects of trade tensions. Indeed, financing costs are relatively low in advanced economies. For example, central bank interest rates in the euro area and Japan stand at 0.0% and -0.1%, respectively. In addition, the US Federal Reserve (FED) cut the reference rate from [2.25%-2.50%] to [2.00%-2.25%] at its last meeting on July 2019. In the same vein, more than 15 central banks from emerging economies have reduced their monetary policy rate so far this year.

FED: reference interest rate (Upper limit, %)



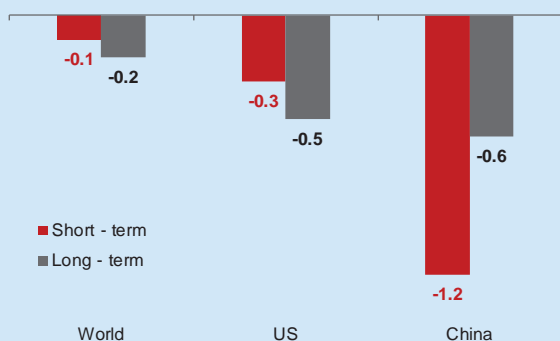
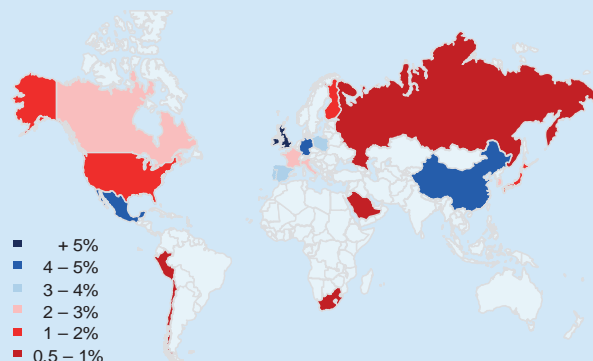
World: interest rates of central banks (%)

Country	Previous	Latest	Note
US	[2.25 - 2.50]	[2.00 - 2.25]	First rate cut since dec-08
Russia	7.50	7.25	Second rate cut in three months
India	5.75	5.40	Lowest level in nine years
New Zealand	1.50	1.00	Historically low level
Brazil	6.50	6.00	First rate cut since mar-18
Peru	2.75	2.50	First rate cut since mar-18

Source: FED, Bloomberg, Central Banks.

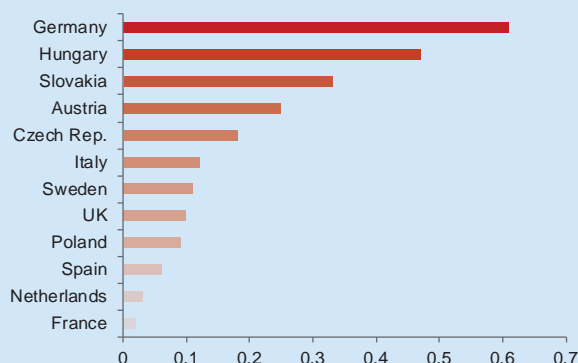
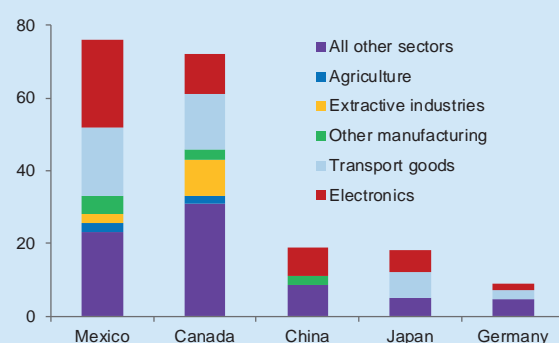
Impacts from trade tensions:

If trade tensions between the US and China continue to rise, the economies of both countries could suffer a slowdown that would spread to other economies. According to the IMF, in a scenario of 25% tariffs on all goods traded between the US and China, US GDP would fall by 0.3% in the short-term and 0.5% in the long-term, while China's GDP would fall by 1.2% and 0.6%, respectively. In addition, a trade war scenario would have a strong impact on other economies, such as Germany and Mexico.

IMF: impact of the trade war
(% of global GDP)Share of global GDP exposed to trade world risks¹
(%)

1/ The considered risks include: the increment of the trade tensions between the US and China, the imposition of tariffs on the automotive sector and the Brexit.
Source: IMF, Bloomberg.

Possible trade tensions with other countries in the short term could further deteriorate international trade. In September 2019, the US could impose tariffs on the automotive sector that would mainly affect the euro area and Japan¹⁴. For this reason, the European Union has declared that it would implement tariffs on a list of US products for approximately US\$ 39 billion if the US were to implement the proposed measure. The US announced the establishment of a tariff of 5%-a rate that would progressively increase to 25%- on all imports from Mexico in May 2019. However, these are subject to compliance with the migration agreement signed between the two countries on June 2019.

Euro area: impact of automotive tariffs on GDP¹
(% of GDP)Trade exposure to the US
(% of total exports by sector)

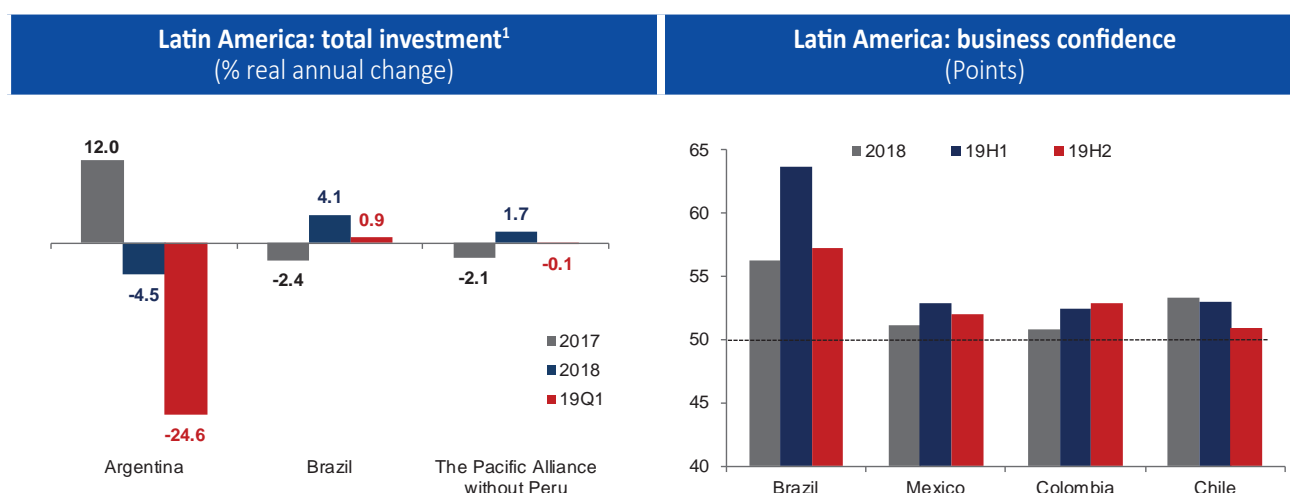
1/ Scenario considering the imposition of a US tariff on imports from the European automotive sector.
Source: Bloomberg, IMF.

Latin America and the Caribbean

Latin America and the Caribbean are expected to grow by 1.0% in 2019, below the projected IAPM (1.9%) and in line with other economic regions. The review of growth is explained by the lower outlook for economic activity – mainly in Brazil, Mexico, and Argentina – due to the deterioration in private investment affected by low business expectations and idiosyncratic factors. On the contrary, for the 2020-2023 period, region growth should rebound by around 2.4% (IAPM: 2.6%), in line with the recovery of private investment in economies such as Brazil and Argentina. Particularly:

¹⁴ The decision on the imposition of tariffs on the automotive sector was postponed from May to September 2019.

- Brazil: the growth projection is revised to 1.0% in 2019 (IAPM: 2.3%), due to the lower dynamism of private investment affected by the uncertainty surrounding the approval of structural reforms.** The economy grew 0.5% in 1Q2019 - the lowest rate since 1Q2017 - due to a fall in the mining sector, which contracted 6.3% due to lower iron production affected by unfavorable weather factors¹⁵. Additionally, at the beginning of the year, it was expected that the pension reform based on the increase of the retirement age and the years of contribution, which would raise tax collection by approximately US\$ 250 billion in the next ten years, would be approved in 1H2019. However, the reform will just be approved in October¹⁶, which has negatively affected business expectations. As a result, business confidence¹⁷ fell from 64.7 points in January 2019 to 57.4 points in July 2019. In this context, the government plans to implement a fiscal stimulus package of approximately US\$ 16.8 billion in order to reactivate economic activity.
- Mexico: the growth projection is adjusted to 1.4% in 2019 (IAPM: 2.0%) in the light of the deterioration of exports and private investment.** The economy contracted 0.7% in 2Q2019 (1Q2019: 1.3%) - the lowest since 4Q2009 - due to the lower performance of the investment in the oil¹⁸ and manufacturing sectors, and the uncertainty in government policies. Moreover, trade uncertainty is a latent risk for Mexico's exports, given that approximately 76.5% of total exports are to the US.
- Argentina: GDP is expected to contract by 1.2% in 2019 (IAPM: -0.9%) due to the fragility of domestic demand.** The economy contracted 5.8% in 1Q2019 due to high-interest rates and inflation affecting private consumption and investment in the context of adjustment of public expenditure. Henceforth, an improvement in agricultural production is expected, which will allow a recovery of exports, and also a recovery of private investment, albeit at a slower pace. However, the projection is subject to the results of the upcoming presidential elections in October, which could generate political buzz and further affect business confidence. Former President Cristina Fernández de Kirchner is running as vice president of candidate Alberto Fernández, who was her advisor during her term, while current President Mauricio Macri is seeking re-election.¹⁹



Source: Central Banks, Bloomberg.

In this environment of fragile domestic demand, central banks have shown a more flexible stance in their monetary policy.

In particular, the Central Bank of Brazil announced that it will analyze the available instruments and intervene in the market when liquidity problems arise. According to this scenario, the market²⁰ expects the reference rate to reach 5.0% by the end of

¹⁵ In January 2019, heavy rains caused the collapse of a dam that affected the iron production of the Feijao mine in Minas Gerais, which represented 2% of the production of Vale (the world's largest iron ore producer).

¹⁶ On August 7, 2019, the Chamber of Deputies approved the pension reform in a second round, although it will have to be approved by the Senate in October.

¹⁷ It considers the industrial confidence indicator of the National Confederation of Industry of Brazil.

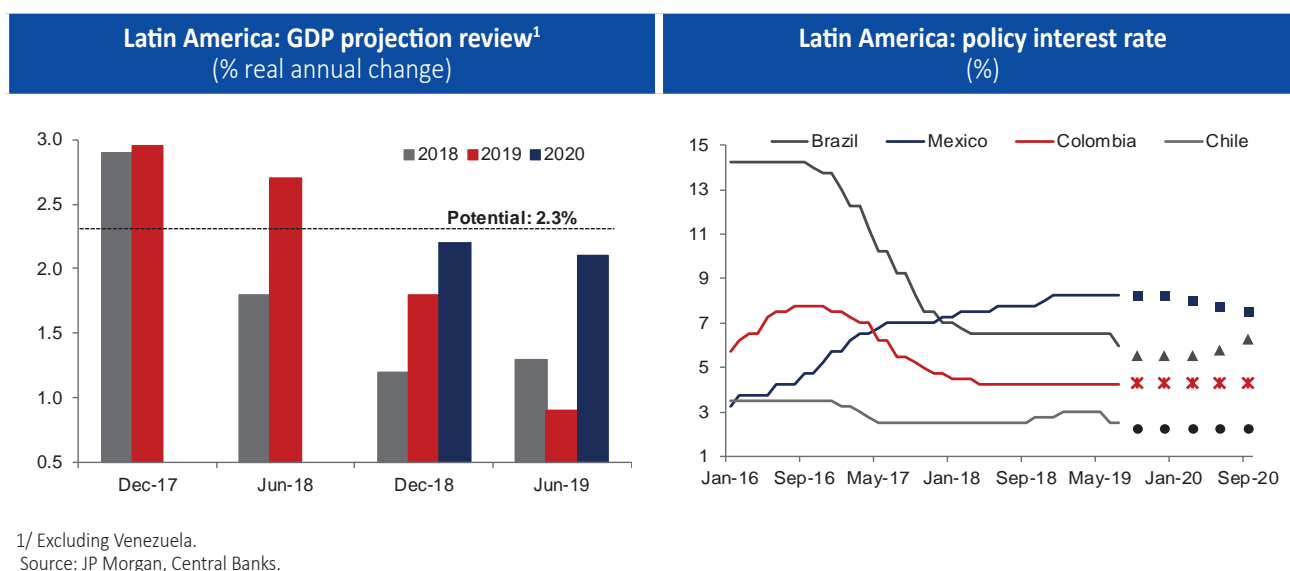
¹⁸ State-owned Enterprise Petróleos Mexicanos (Pemex) is in financial and production crisis. However, the Mexican government agreed to restructure the debt with national and international banks (HSBC, JP Morgan and Mizuho Securities), as well as extend revolving credit lines and tax exemptions.

¹⁹ On 12 August 2019, opposition candidate Alberto Fernández won the national primary against current President Macri. In this context, the Argentine peso fell significantly by 17.0% and the stock market index (Merval) fell by 36.5%.

²⁰ According to surveys of specialists prepared by the Central Bank of Brazil.

2019 (July: 6.0%). Moreover, in Colombia, analysts surveyed by the Central Bank in July 2019 expect the monetary adjustment to be delayed until March 2020, which contrasts with the result of previous surveys where an increase in the rate in 4Q2019 was expected. Finally, the Central Bank of Chile, in a surprise move, cut the reference interest rate by 50 bps to 2.5% in June 2019.

For the 2020-2023 period, there would be a marked recovery in the growth rate of around 2.4%, in line with the acceleration of private investment in economies such as Argentina and Brazil. Improved macro-fiscal fundamentals and business confidence will boost private investment, which will generate positive linkages in other variables such as employment and private consumption. It is worth mentioning that some countries in the region have little room to implement fiscal stimulus and, on the contrary, need to make adjustments in the management of their public finances.



5.1.2. Commodity prices

The terms of trade projections have been revised downwards from the IAPM projections, mainly because of escalating trade tensions and geopolitical conflicts, which had an impact on commodity prices. In 2019, the terms of trade would contract by 2.0% (IAPM: +1.0%), consistent with a fall in export prices of 3.4% (IAPM: -0.5%) and import prices by -1.4% (IAPM: -1.4%). For the period 2020-2023, the terms of trade would not vary significantly.

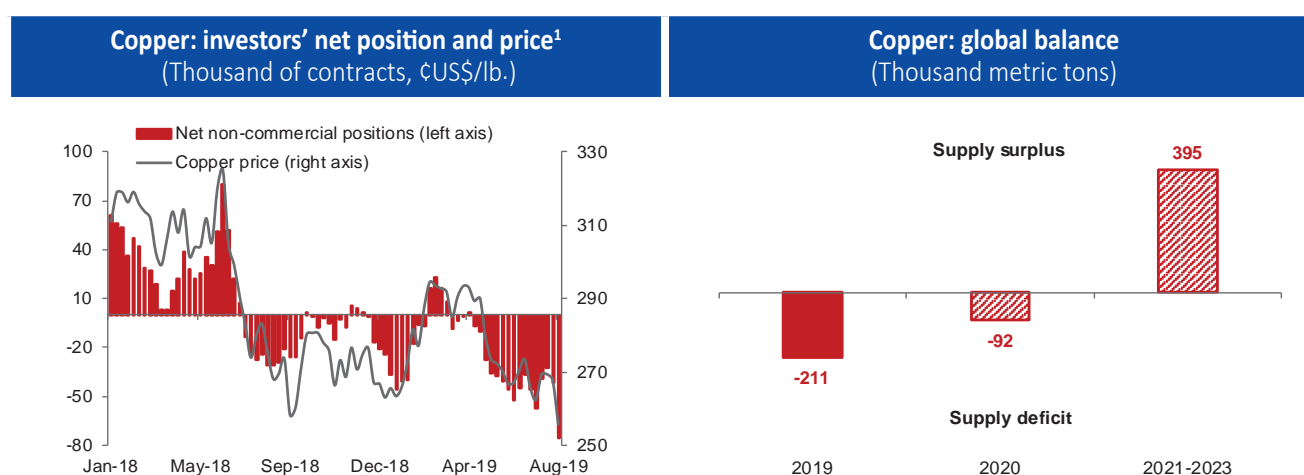
Terms of trade and commodity prices ¹										
	2018	IAPM 2019-2022				MMM 2020-2023				
		2019	2020	2021	2022	2019	2020	2021	2022	2023
Terms of trade (% annual change)	-0.2	1.0	0.3	0.0	0.0	-2.0	-0.3	0.0	0.0	0.0
Export prices (% annual change)	6.3	-0.5	1.8	0.5	0.0	-3.4	1.5	0.0	0.0	0.0
Copper (cUS\$/lb.)	297	300	305	305	305	275	285	285	285	285
Gold (US\$/oz.tr.)	1,269	1,300	1,315	1,315	1,315	1,345	1,370	1,370	1,370	1,370
Zinc (cUS\$/lb.)	133	122	110	110	110	122	115	115	115	115
Import prices (% annual change)	6.5	-1.4	1.5	0.5	0.0	-1.4	1.8	0.0	0.0	0.0
Oil (US\$/bar.)	65	58	58	58	58	58	60	60	60	60

1/ Los precios de las materias primas hacen referencia al precio promedio anual.
Fuente: Bloomberg, BCRP, proyecciones MEF.

Copper

The evolution of commodity prices has been affected by the materialization of the risk scenario contemplated in the IAPM 2019-2022. Thus, the price of copper is revised to ¢US\$/lb. 275 (IAPM: ¢US\$/lb. 300) due to the commercial tensions between the US and China, the uncertainty about the next commercial decisions of the US government and the lower expectations of global growth, especially from China (45% of global demand). Despite the metal's physical deficit (estimated at 211 thousand metric tons this year), trade tensions are expected to continue to affect investors' net positions in the short term.

For the period 2020-2023, the price of copper should be in line with its fundamentals, consequently, a slight recovery is expected at ¢US\$/lb. 285 on average, due to the recovery of growth in some emerging economies and the supply deficit of the metal. However, starting in 2021, the price could be affected by higher mining production and/or the entry of new projects in Indonesia, Chile, Peru, the Democratic Republic of Congo, China, and Mongolia.



1/ Commodity prices refer to the average annual price.
Source: Bloomberg, BCRP, MEF forecasts.

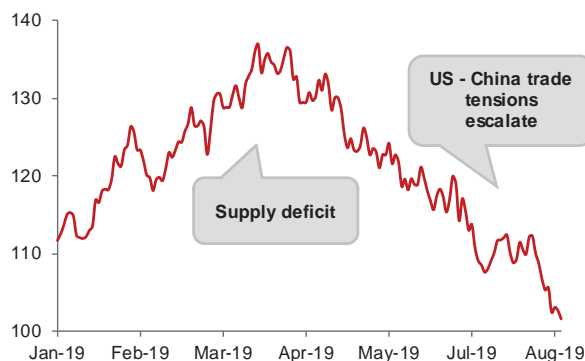
Zinc

In 2019, the price of zinc was also affected by trade tensions, a factor that has been offset by the deficit recorded in the first months of the year. The price of zinc is expected to remain at around ¢US\$/lb. 122, similar to that projected in the IAPM. According to the International Lead and Zinc Group (ILZSG)²¹, between January and April 2019 a physical deficit of 97 thousand metric tons was reported as a result of environmental measures in China, which continued to restrict the smelting of the metal. However, the upward trend was limited by the escalation of trade tensions between the US and China.

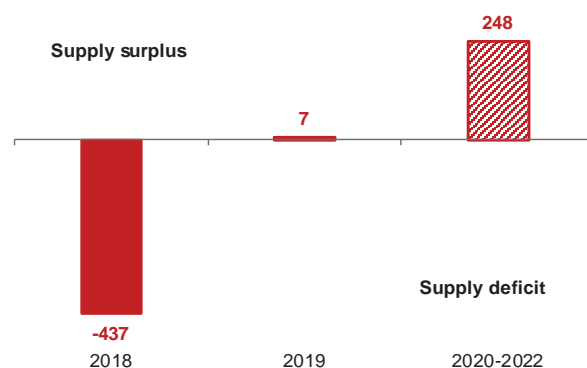
A decrease in the price of zinc is expected for the period 2020-2023 due to the entry into production of new mines. The price is expected to reach ¢US\$/lb. 115, due to the greater physical supply mainly from Australia, India, and Kazakhstan. According to Bloomberg Intelligence, an average production surplus of around 248 thousand metric tons is expected over the next three years.

²¹ Report from 19 June 2019.

Zinc: price, 2019
(cUS\$/lb.)



Zinc: global balance
(Thousand metric tons)

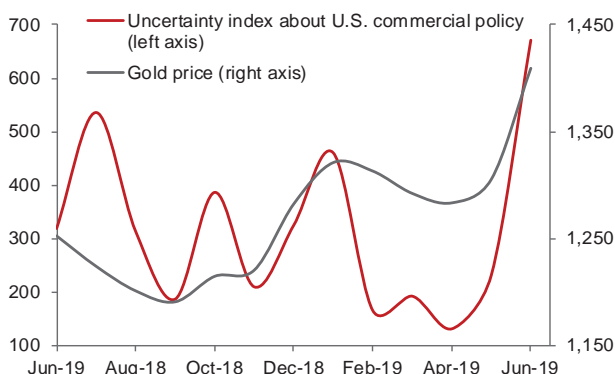


Fuente: Bloomberg, Bloomberg Intelligence.

Gold

In 2019, the price of gold will be driven by an increased demand in the face of growing global risks and expectations of lower interest rates. The price is revised upwards to US\$/oz.tr. 1,345 (IAPM: US\$/oz.tr. 1,300) due to greater demand from investors, who seek to protect their assets in the face of global uncertainty and expectations of lower interest rates. In this context, there has been a rise in the demand of central banks for the acquisition of gold, especially from emerging economies such as China, India, Turkey, and Russia, which increased their demand by 68% in 1Q2019. **In the 2020-2023 period, the price of gold is expected to remain high in the context of lower physical metal supply.** The price is revised to US\$/oz.tr. 1,370 (IAPM: US\$/oz.tr. 1,315) due to the lower physical supply, given the end of the production cycle of some mines and the greater demand of the technological sector.

US trade uncertainty and gold price
(Points, US\$/oz.tr.)



Relationship between gold price and US dollar¹
(US\$/oz.tr., index)



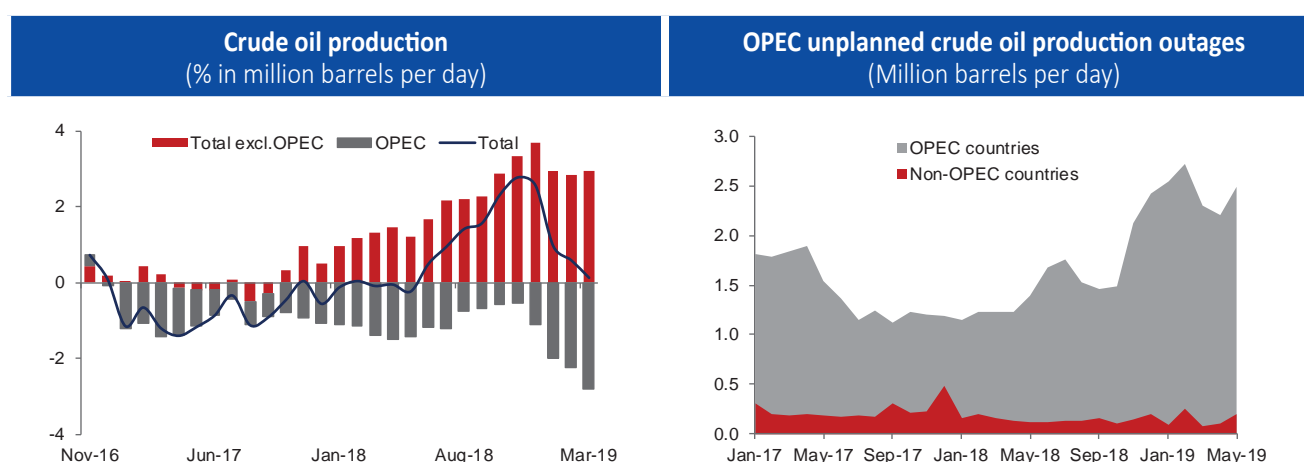
1/ DXY index, which reflects the value of the US dollar against a basket of currencies. The weightings of each currency are euro 57.6%, yen 13.6%, pound sterling 11.9%, Canadian dollar 9.1%, Swedish krona 4.2% and Swiss franc 3.6%.
Source: Bloomberg.

Oil

For year 2019 the price of oil will be benefited through the continuance of the cut in production agreement by the Organization of Petroleum Exporting Countries (OPEC), despite moderation in world demand. The price of oil remains at

US\$/bar. 58, similar to the forecast in the IAPM, in a context in which OPEC and its allies led by Russia, on July 2019, agreed to extend the cutback on oil production until March 2020 (1.2 million barrels per day). This agreement aims to counteract the adverse effects of trade tensions and slower global growth. In addition, there exists a geopolitical risk premium in the petroleum market in view of the recent tensions in Iran and Libya.

For the period 2020-2023, the price is expected to rise due to environmental restrictions and lower production in some countries. The price of oil is expected to increase to US\$/bar. 60 (IAPM: US\$/bar. 58) due to difficulties in the commercialization of oil by sea at the beginning of January 2020, as a new regulation of the International Maritime Sulfur Organization will enter into force, which seeks to restrict maritime transport, which produces high levels of pollution. Besides, less oil production is expected in countries with infrastructure problems and/or geopolitical conflicts, such as Venezuela, Iran, and Libya.



Source: World Bank, Energy Information Administration (EIA)..

5.2. LOCAL LANDSCAPE

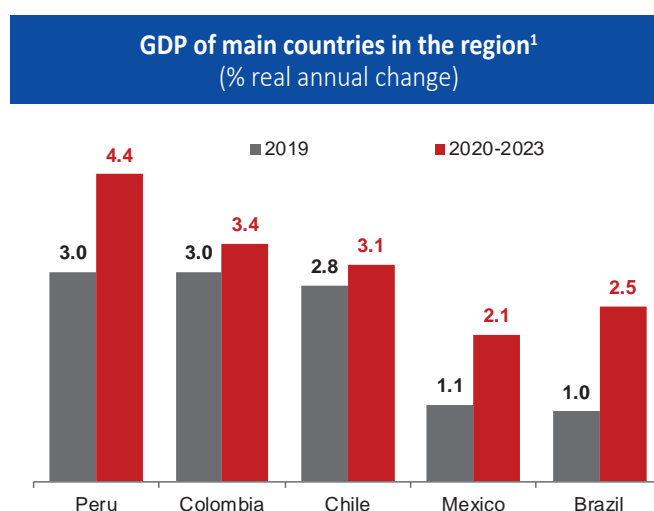
The projection of GDP growth for 2019 is revised to 3.0% (IAPM: 4.2%), in line with a lower advance of economic activity during the first semester of the year, period in which the Peruvian economy was severely affected by transitory factors that generated a contraction of the primary sectors (-3.1% in 1H2019), particularly in fishing, mining and primary manufacturing. Additionally, the international environment negatively influenced growth, mainly in the sectors oriented to external demand and in the dynamics of non-mining investment.

An acceleration of GDP growth is expected for 2H2019, after the dissipation of supply shocks and recovery of domestic demand. For the 2020-2023 period, the Peruvian economy will reach growth rates above 4.0%, driven mainly by the strengthening of private and public investment, and by the effect of economic policy measures aimed at improving the country's productivity and competitiveness. With this, Peru will continue to lead growth in the region in 2019 and in the coming years.

In a context of growing international and local uncertainty, there are risks associated with a slower than expected recovery of economic agents' expectations with respect to the present MMM, which could affect investment and consumption decisions and would be reflected in a lower projection of economic activity growth.

Domestic demand and GDP (% real annual change)						GDP by sector (% real annual change)					
	Structure % of GDP, 2018	2018	2019	2020	Average 2021-2023		Weight base, 2017	2018	2019	2020	Average 2021-2023
I. Domestic demand	97.9	4.3	3.4	4.3	4.5	Agriculture and Livestock	6.0	7.8	3.8	4.0	4.0
1. Private expenditure	82.6	4.0	3.5	4.0	4.3	Agriculture	3.8	9.4	3.3	4.0	4.0
a. Private consumption	65.0	3.8	3.3	3.8	4.0	Livestock	2.2	5.5	4.5	4.1	4.0
b. Private investment	17.6	4.4	4.0	4.8	5.3	Fishing	0.7	39.7	-17.5	8.4	2.4
2. Government expenditure	16.4	3.4	2.6	5.3	4.3	Mining and fuel	14.4	-1.3	0.9	2.7	4.8
a. Public consumption	11.5	2.0	2.6	3.8	3.6	Mining	12.1	-1.5	0.5	2.6	5.5
b. Public investment	4.8	6.8	2.5	9.0	5.8	Fuel	2.2	0.0	3.1	3.6	0.6
II. Net external demand						Manufacturing	16.5	6.2	-0.9	3.4	4.0
1. Exports ²	25.0	2.5	0.8	3.5	4.8	Primary	4.1	13.2	-7.7	3.4	4.2
2. Imports ²	23.0	3.4	2.1	4.5	4.6	Non primary	12.4	3.7	1.9	3.4	3.9
III. GDP	100.0	4.0	3.0	4.0	4.5	Electricity and water	1.7	4.4	4.3	4.8	4.9
						Construction	5.1	5.4	4.6	6.0	5.9
						Commerce	10.2	2.6	2.8	3.6	3.8
						Services	37.1	4.5	4.4	4.8	5.0
						GDP	100.0	4.0	3.0	4.0	4.5
						Primary GDP	25.2	3.3	0.1	3.3	4.4
						Non-primary GDP ³	66.5	4.2	3.9	4.5	4.8

1/ Include inventories. 2/ Non-financial goods and services. 3/ Not includes import duties or other taxes on products.
Source: BCRP, MEF forecasts.



1/ It is used MEF forecasts for Peru GDP and LatinFocus forecasts of august 2019 for the rest of the region.
Source: LatinFocus Consensus Forecasts, MEF forecasts.

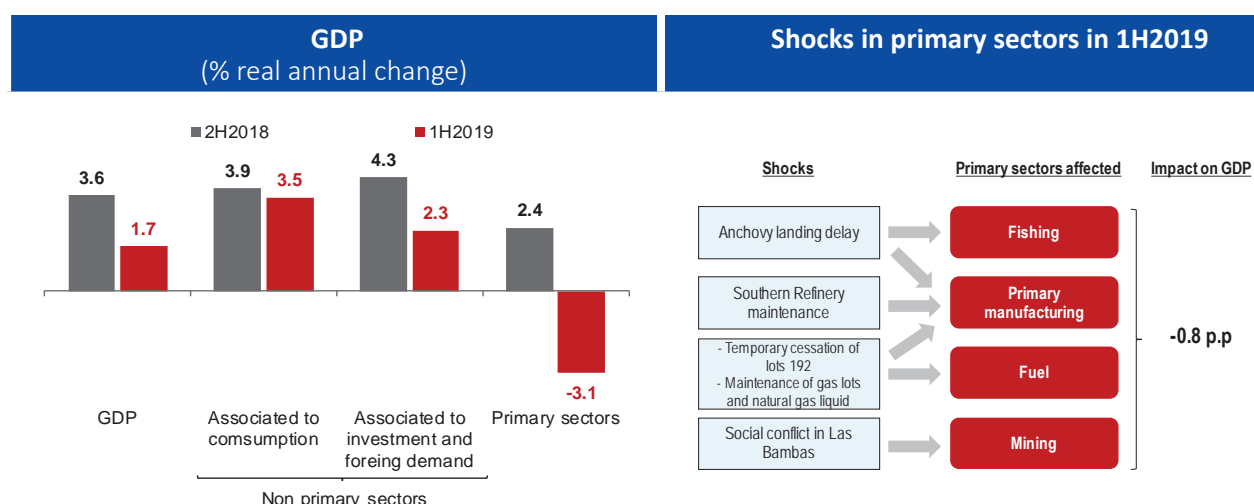
5.2.1. From 1H2019 to 2H2019: recovery of economic activity

In 1H2019, the Peruvian economy grew 1.7%, lower than the growth registered in 2018 (4.0%), affected by transitory factors in the primary sectors, which collectively subtracted around 0.8 p.p. from the the first semester growth. In 1H2019, the primary sectors fell 3.1% mainly due to i) the maintenance of Southern's metallurgical plant, which affected the refining of copper used in primary manufacturing in the first months of the year; ii) the social conflicts in Las Bambas, lower molybdenum production-grade²², and operational and environmental problems in the Southern and Shougang mines, which affected mining production; iii) the spill from the North Peruvian Oil Pipeline, which paralyzed petroleum production from lot 192 in June, and the maintenance of lots Z-2B, 88, 56 and 57 of natural gas liquids (LNG) and natural gas in April and June; and iv) the lower landing of anchovy in the first season of the north-central zone, due to the increase in sea temperature and salinity related to the weak El Niño event 2018-2019, which in turn had a negative impact on the processing and conservation of primary manufacturing fish.

On the other hand, the non-primary sectors remained more resilient (1H2019: 3.3%) and helped to cushion the fall of the primary sectors, despite an adverse international context. The non-primary sectors were supported by the positive dynamic of the sectors associated with consumption (trade and services), which together increased 3.5% in 1H2019 in an environment where the generation of private formal employment at the national level continued to grow at significant rates (1H2019: 3.7%). Expectations of the future economic situation of families in Metropolitan Lima remained on the

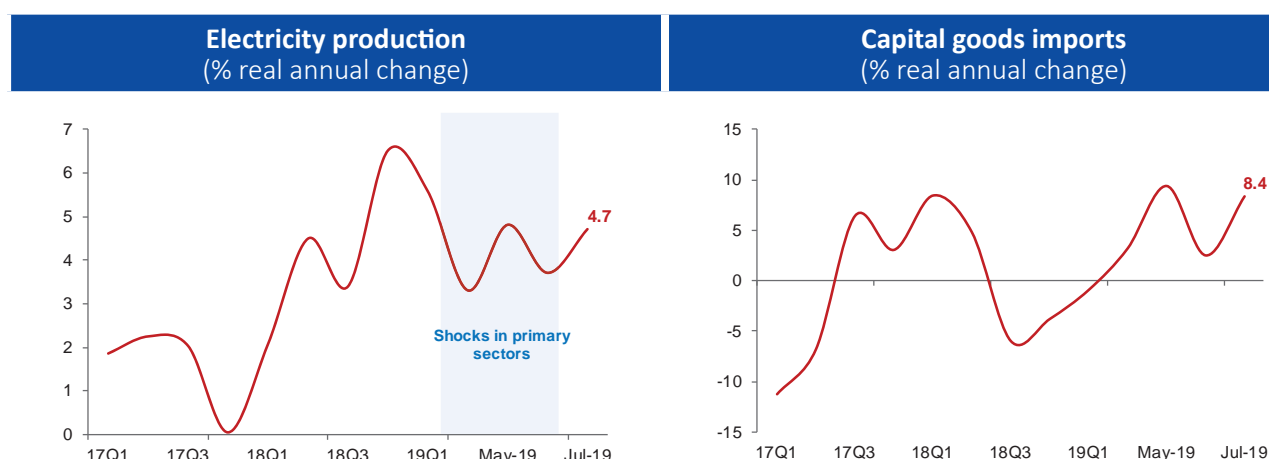
²² Lower molybdenum production grades were recorded between January and April in Toromocho and Antamina.

optimistic range (July 2019: 61 points) and suitable employment in Metropolitan Lima reached the highest rate in the last two years (2Q2019: 3.9%). However, the sectors associated with investment (construction and non-primary manufacturing) grew at a rate of 2.3% in 1H2019, in line with less progress in public investment. In addition, the moderation of external demand affected the manufacturing products oriented to the external market, such as textiles, clothing, petrochemicals, among others.



Source: BCRP, MEF estimations.

The July's indicators suggest that the economy is entering a recovery phase. Indeed, electricity production accelerated to 4.7% in July from 3.7% in June 2019. The landing of anchovy recovered from the drops recorded in April (-89.8%) and May (-36.2%), and grew consecutively in June (19.7%) and July (186.8%). Private investment indicators also showed favorable results in July, such as capital goods imports (8.4% real, the second-highest rate since May 2018) and domestic cement consumption (10.2%, the second-highest rate since May 2013)²³.



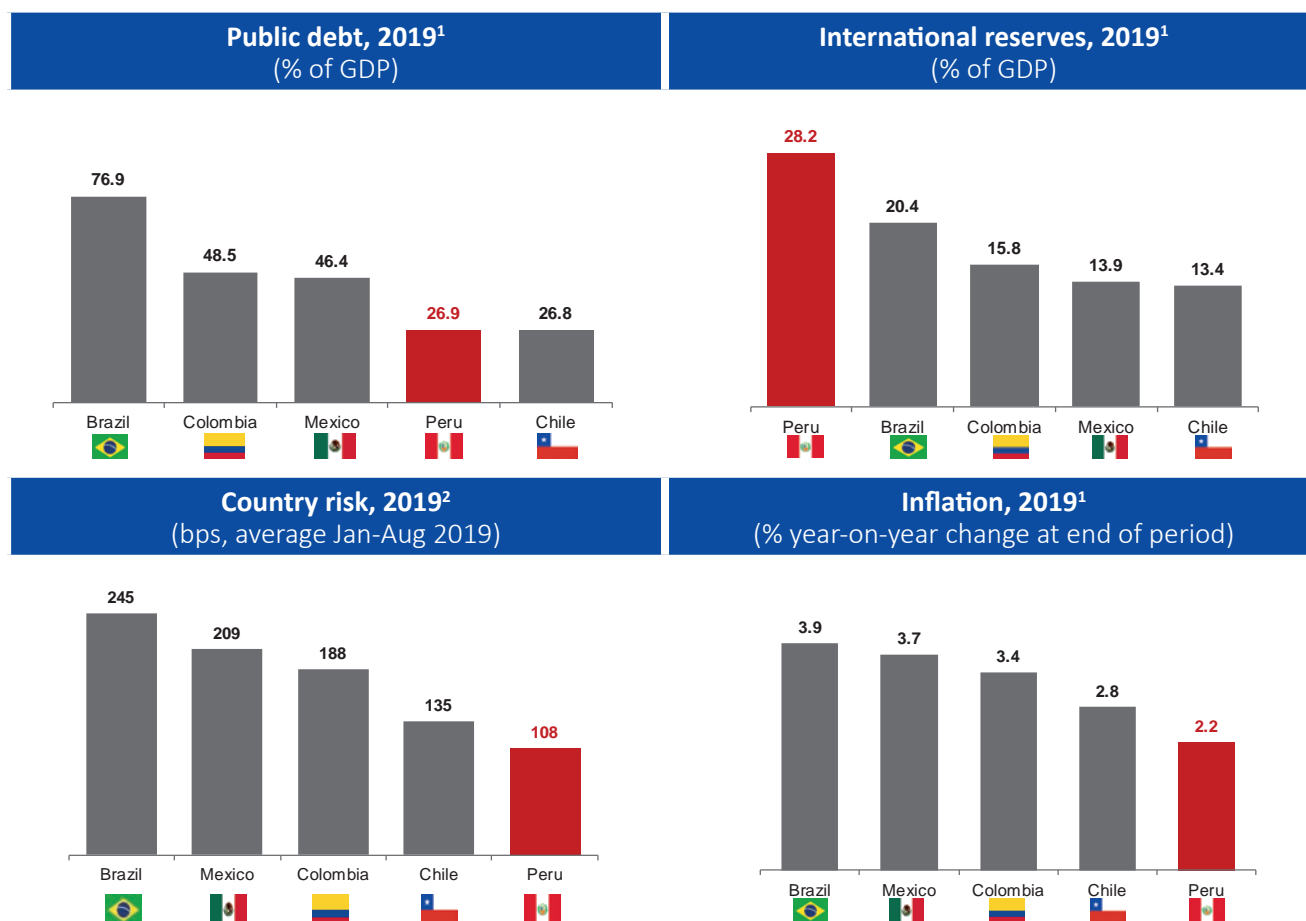
Source: MEF, BCRP, COES, Sunat.

Thus, economic growth is expected to accelerate in the second half of the year (2H2019: 4.2%), after the dissipation of supply shocks, by the greater private investment impulse mainly non-mining and the recovery of public investment. The primary sectors are expected to grow around 3.3% in 2H2019, due to the normalization of production at the Southern metallurgical plant, the Las Bambas and Shougang mines, and the hydrocarbon blocks (192, Z-2B, 88, 56 and 57). On the other hand, internal demand will accelerate due to greater private investment in infrastructure projects, such as Line 2 of the Lima and Callao Metro, the General San Martín Port Terminal and the expansion of the Jorge Chávez Airport, in addition to the continued execution of large mining projects (Quellaveco, Mina Justa and expansion of Toromocho). Besides that, the public

²³ July domestic cement consumption data estimated by the BCRP - Presentation of the Monetary Program, August 2019.

investment will be recovered due to a greater execution of the Reconstruction works and the modernization of Talara Refinery, in an environment in which the measures taken by the government (increase of the budget, training, advanced payment of the canon, program of incentives to the local governments) will help to improve the execution of the subnational governments. These investments will boost the growth of the construction and non-primary manufacturing sectors, which in turn will boost employment creation and household consumption, and will make it possible to promote the trade and services sectors.

Despite the transitory factors and the less favorable external environment that affected the Peruvian economy; Peru will continue to be one of the fastest-growing economies in 2019 compared to its regional peers, such as Colombia (3.0%), Chile (2.8%), Mexico (1.1%) and Brazil (1.0%), and should be above the average for Latin America (1.4%)²⁴. Peru's economic growth has been accompanied by its solid macroeconomic fundamentals, which allows it to face an adverse external context. Indeed, Peru stands out for the low level of public debt (2019: 26.9% of GDP)²⁵, country risk (2019: 108 bps, average January-August 2019)²⁶ and inflation (2019: 2.2%)²⁷ and high international reserves (2019: 28.2% of GDP)²⁸. Moreover, Peru is one of the few countries in the region that has maintained its credit rating in the midst of an adverse external scenario. On June 25, Moody's ratified Peru's credit rating in A3 with a stable outlook and highlighted the favorable growth prospects for the medium-term accompanied by the National Plan for Competitiveness and Productivity, and the fiscal strength reflected in low public debt ratios and prudent macro-fiscal management. It also highlighted the resilience of the Peruvian economy to face shocks of different natures (El Niño phenomenon, corruption scandals, and falling of raw materials prices).



1/ For Peru, the public debt data considers MEF forecasts; the international reserves data considers the Inflation Report of June 2019, and the inflation data considers the Report of the Monthly Survey of Macroeconomic Expectations of July 2019.

2/ Daily average from January 1 to August 21, 2019.

Source: IMF, LatinFocus Consensus Forecast for August 2019, BCRP, Bloomberg, MEF forecast.

²⁴ LatinFocus Consensus Forecast of August 2019.

²⁵ MEF forecasts.

²⁶ Bloomberg, daily average from January 1 to August 21, 2019.

²⁷ July 2019 Monthly Macroeconomic Expectations Survey Report.

²⁸ Inflation Report June 2019.

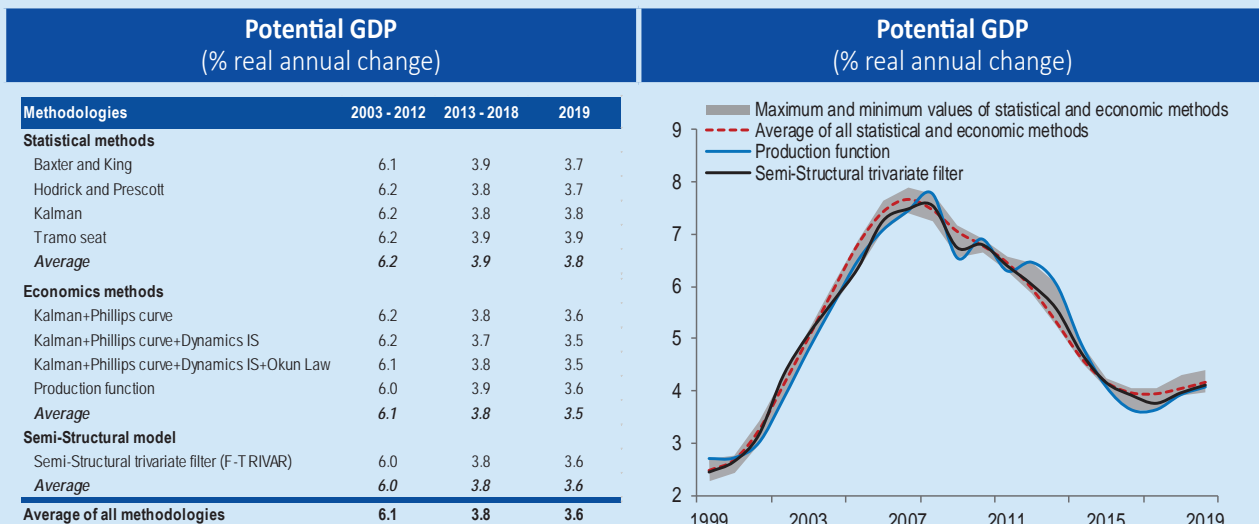
Box 2: Estimates of potential growth for the Peruvian economy

Potential GDP is one of the most relevant concepts for economic analysis and economic policy decisions. This indicator is defined as the number of goods and services that can be produced when the available production factors are used at their maximum capacity or efficiently. Due to their importance, especially for emerging economies, multiple methodologies are developed for their estimation, each with its own characteristics and particularities. In Peru, during the last years, the potential GDP has been estimated through different statistical and economic techniques in order to have a more solid and unbiased estimate. In this process of giving greater solidity to the calculation, the methodology of the trivariate semi-structural filter (F-TRIVAR²⁹) has been implemented.

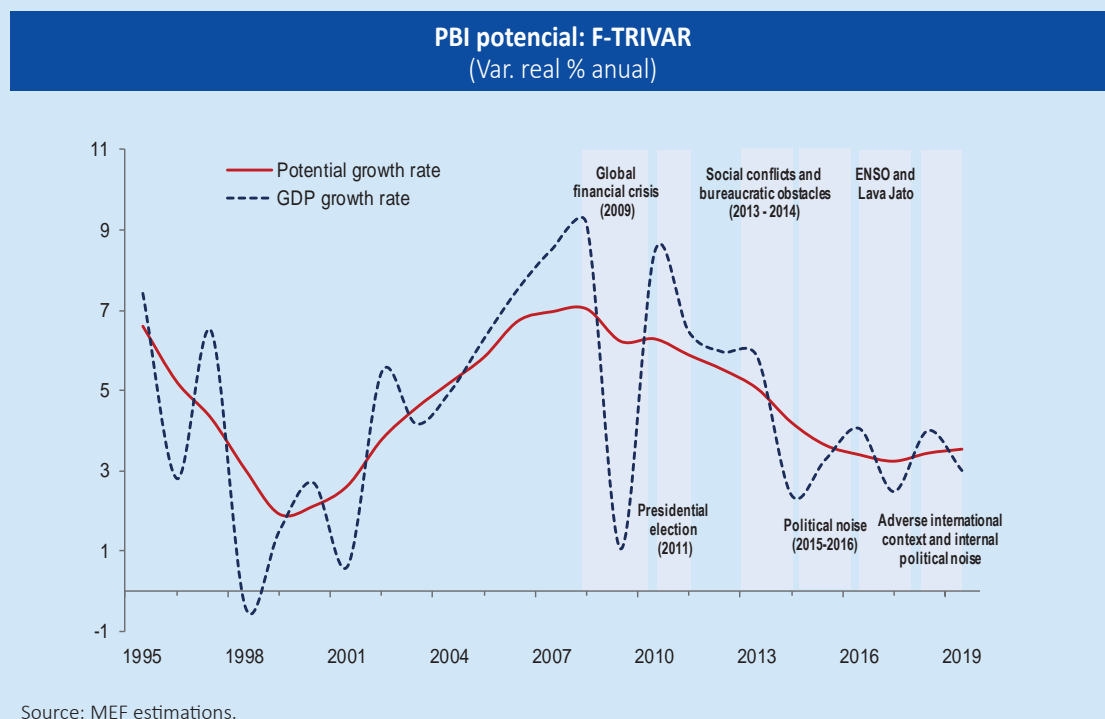
The F-TRIVAR is a methodology that has been implemented in developed countries such as the United States and Canada, and in some Latin American countries such as Argentina and Chile. Indeed, according to Blagrove and others (2015)³⁰, the potential GDP for the US and Canada is estimated through the F-TRIVAR, which is not far from the results obtained by statistical and structural methods. Besides that, in Argentina³¹, using the same methodology, they obtain significant results almost indistinct to the method of the production function. In Chile,³² the Central Bank uses this methodology to update its potential GDP and include migratory shocks. It is worth mentioning that this tool provides greater statistical rigor in the identification of optimal parameters for projections of non-observable variables (product gap and trend GDP), and allows to base fluctuations by innovation shocks, population density and degree of efficiency of capital to which emerging economies are exposed³³.

In Peru, its potential economic growth, which amounts to 3.6% by 2019, has been estimated using the F-TRIVAR methodology. This result is within the range of estimates of the potential GDP of the other methodologies (potential GDP 2019: between 3.5% and 3.8%). Furthermore, the results of the methodology are also in line with the results obtained through conventional methods of estimating potential over the last thirty years. It is important to highlight, according to Butler (1996)³⁴ and Laubach and Williams (2003)³⁵ that the combined use of statistical filters and structural models³⁶, such as F-TRIVAR, provide a greater criterion of economic rationality and statistical rigor to base the fluctuations of the potential GDP. For example, for Peru, in the period of the raw material price boom -between 2003 and 2012-, the growth of potential GDP calculated with this methodology results in 6.0% (statistical and economic methods: 6.2%). Furthermore, for the period 2013-2018, all the methodologies show that there is a clear deceleration of potential growth; nevertheless, a stabilization is seen in 2019, when there is potential growth around 3.6% (F-TRIVAR: 3.6%, statistical methods: 3.8% and economic methods: 3.5%).

- ²⁹ Initially proposed by Benes, J., Clinton, K., García-Saltos, R., Johnson, M., Laxton, D., Manchev, P. B., & Matheson, T. (2010). Estimating potential output with a multivariate filter. IMF Working Papers, 1-37.
- ³⁰ Blagrove, P., García-Saltos, M. R., Laxton, M. D., & Zhang, F. (2015). A simple multivariate filter for estimating potential output (No. 15-79). International Monetary Fund.
- ³¹ Krysa, A. and Lanteri, L. (2018). Estimation of the potential product and the product gap for Argentina: approximations from a multivariate filter and the production function method. Economic research. Working Paper No. 80. Central Bank of the Argentine Republic.
- ³² Bullano F., Fornero J. and R. Zuñiga (2018), "Estimation of potential growth and the gap". Minute annexed Report of the Monetary Policy (IPoM) September 2018 and Bullano and others (2019), "Estimation of structural parameters of the Chilean economy". Minutes annexed (IPoM) June 2019.
- ³³ Mishkin, F. (2007). "Estimating potential output. In speech delivered at the Conference on Price measurement for monetary policy, sponsored by the Federal Reserve Bank of Dallas", (24).
- ³⁴ Butler, L. (1996). "A semi-structural method to estimate potential output: combining economic theory with a time-series filter".
- ³⁵ Laubach, T., & Williams, J. C. (2003). Measuring the natural rate of interest. Review of Economics and Statistics, 85(4), 1063-1070.
- ³⁶ As the method of the production function, methodology that was implemented to estimate the potential GDP by the MEF, as part of the calculation of the structural accounts, approved by Ministerial Resolution N° 024-2016-EF/15.



Source: MEF estimations.



Source: MEF estimations.

With respect to the F-TRIVAR methodology, this involves a stochastic process involving the dynamic integration of a set of behavioral equations³⁷ for small and open economies. This methodology employs Bayesian techniques to identify the optimal parameters and make the model converge to a unique equilibrium. In this sense, it addresses the end-of-sample problem presented by other statistical filters and considers the need for sufficient information that structural models require. In addition, obtaining a better identification of population parameters reduces the projection error of the model. Finally, without prejudice to other methodologies, the minimization of usual uncertainty ranges is considered in order to estimate potential growth.

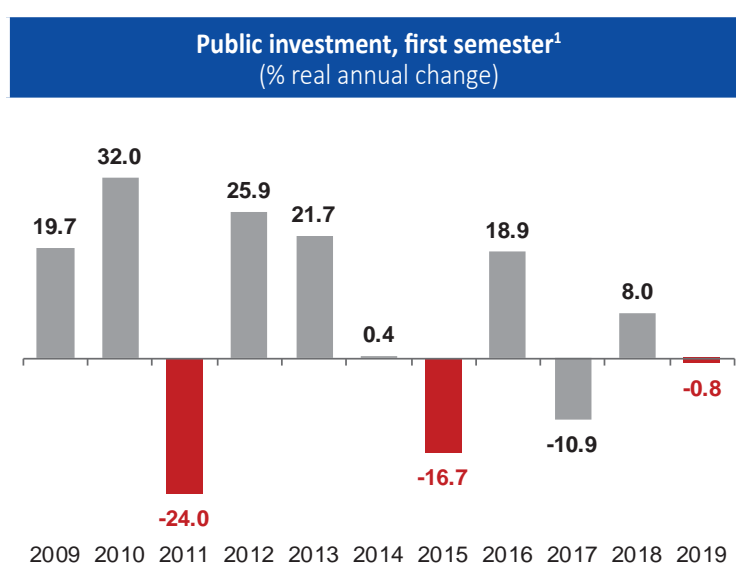
³⁷ The behavior equations to be considered are the IS curve, the Phillips curve, the Euler equation and Okun's Law.

5.2.2. 2H2019-2020: return to the sustained economic growth path

a. Public expenditure

Public expenditure is expected to grow 2.6% in real terms in 2019 and contribute 0.41 p.p. to GDP growth, higher than the average for the 2014-2018 period: 0.37 p.p. Public consumption should reach a rate of 2.6% due to greater resources for the maintenance of public infrastructure (highways, roads and bridges), and expenses related to the provision of goods and services provided by the State³⁸. On the other hand, public investment is expected to grow 2.5% due to a significant advance in works related to Reconstruction, the Pan American Games, the Talara Refinery, among others (1.7% of GDP in 2019). It is also important to note that the management measures approved since the beginning of the year have allowed regional and local governments to accelerate their learning about the State's administrative systems, which has mitigated the fall in spending in the first half of the year and will be key to boosting spending in the second half of the year.

In 1H2019, the execution of public expenditure shows an improvement with respect to similar periods of the beginning of term of sub-national governments. Thus, public investment registered a real reduction of 0.8% in 1H2019, an improvement over what was observed in 2011 (-24.0%) and 2015 (-16.7%). This is due to progress in the execution of important projects, such as the Reconstruction works (S/ 1 billion), the Pan American Games (S/ 0.7 billion) and the Talara Refinery (S/ 0.8 billion), as well as budgetary and management measures implemented since the beginning of the year. These measures have been adopted to soften the impact of the learning process of new authorities of the State's administrative systems (budget, investment, public procurement, among others). Among these measures are the expansion of the budget for sub-national governments, the advancement of resources, and management measures, such as the establishment of follow-up committees and training in administrative systems³⁹.



1/ Expenditure recorded in GDP. The public investment comprises the general government (national, regional and local) and non-financial public enterprises.
Source: BCRP, MEF.

In 2H2019, public expenditure is expected to increase by about 4.1% in real terms driven by the recovery in public investment (4.4%). The impulse of public expenditure on economic activity will be more noticeable in the second half of the year due to the continuity of important projects, such as Reconstruction (it has resources for 1.2% of GDP for the whole year,

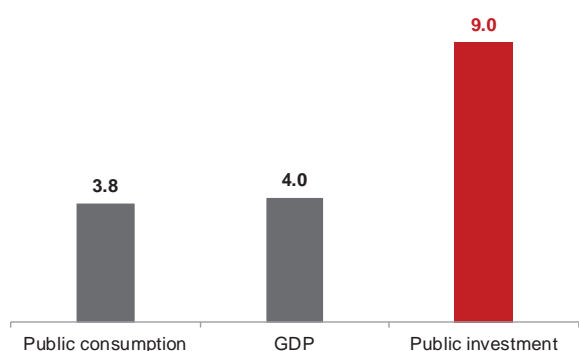
³⁸ In the framework of the 2019 Budget Law.

³⁹ Around two hundred training events and around six thousand technical assistance sessions in administrative systems have been held for around 17 thousand public officials. More details on budgetary and management measures can be found in the Macroeconomic Projections Update Report 2019-2022 published in April 2019.

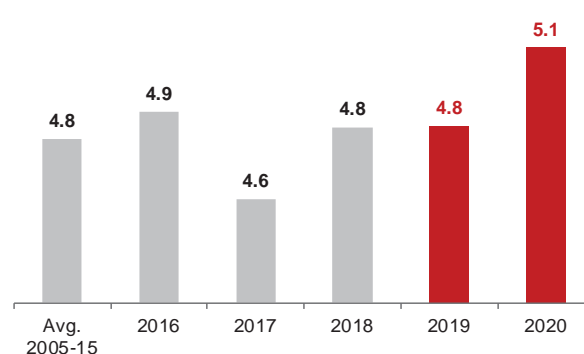
mainly for capital spending), the Talara Refinery (0.3% of GDP) and the Pan-American Games (0.2% of GDP, including road works). Moreover, public expenditure will be driven by the improvement in execution capacity by sub-national governments as a result of the measures adopted in 1H2019 and the continuity of technical assistance and training. It is important to mention that between 2016 and 2018 more than 60% of public investment was executed in the second half of the year, consequently the expected acceleration of public investment for 2H2019 would counteract the lower dynamics of public investment in the first six months of the year.

In 2020, public expenditure is expected to grow by 5.3% in real terms, explained by a recovery in public investment (9.0%) and public consumption (3.8%), which will enable the efficient provision of quality public services and the continued closure of infrastructure gaps. As a result, public investment is expected to grow 9.0% and reach 5.1% of GDP (average 2016-2019): 4.8% of GDP in view of i) the continuity of Reconstruction projects (which will have resources for 0.6% of GDP⁴⁰) and the modernization of Talara Refinery (for 0.3% of GDP); ii) greater spending capacity of subnational governments due to greater knowledge of the State's administrative systems; iii) better articulation in the programming of investments with the public budget, which seeks to allocate resources for projects efficiently and in a timely manner and an expansion of the investment budget. For its part, public consumption is expected to grow by 3.8%, which will finance wage commitments and the efficient provision of goods and services provided by the State to the population.

GDP, public consumption and public investment, 2020¹
(% real annual change)



Public investment¹
(% of GDP)



1/ Investment accounted in the GDP. The public investment comprises the non-financial public sector: general government (national, regional and local) and non-financial public enterprises.

Source: BCRP, MEF, MEF forecasts.

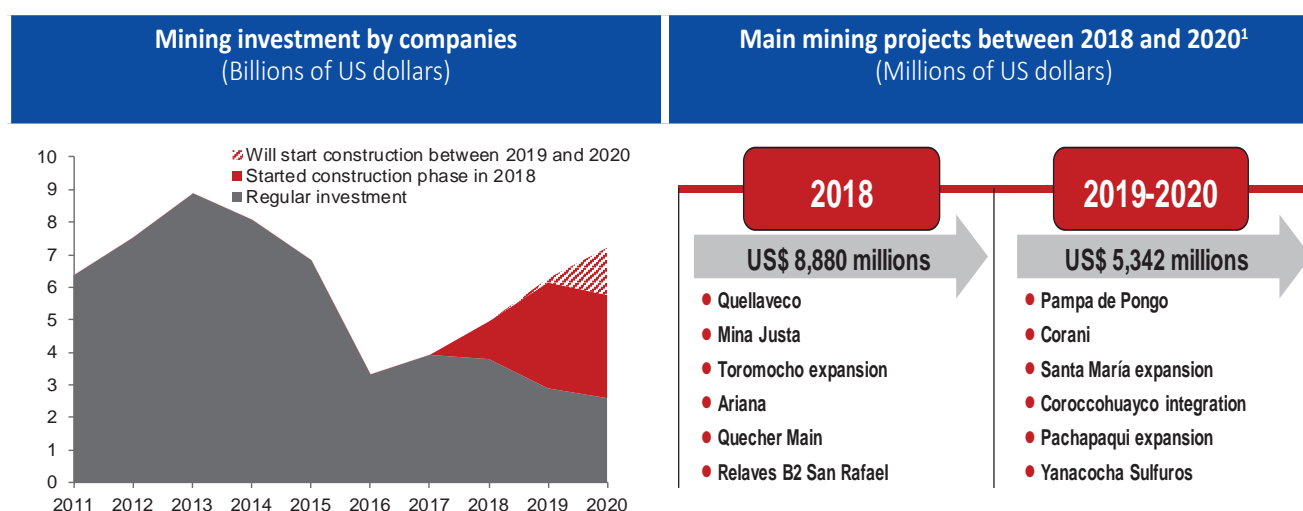
b. Private investment

After a moderate growth of private investment in 1H2019 (around 4.0%), the private investment will accelerate its growth rate in 2H2019 and will continue to expand at significant rates in 2020 (4.8%), explained by the increased investment of large mining projects that began construction in 2018 and the reactivation of non-mining investment, among which stand out infrastructure projects, hydrocarbons, retail, real estate, among others.

Private investment will be favored by the expansion at double-digit rates of mining investment, due to the continuity of large mining projects that began construction in 2018, such as Quellaveco and Mina Justa. Mining investment will continue to grow in 2019, driven by the execution of large projects, which bid for important works. For example, the Quellaveco project has tendered the construction of its dams in May 2019, and the building and facilities of the primary crusher and the tailings dam in June 2019. With it, Quellaveco would disburse around US\$ 900 million in capex in 2H2019. In the case of the Mina Justa project, it has been awarded the construction of its sulfide concentrates plant in April 2019. Finally, the Santa Maria

⁴⁰ Preliminary information corresponding to the expansion of the fiscal deficit authorized by Law No. 30637, which provides for the application of the exception clause to the macro-fiscal rules of the Non-Financial Public Sector. It does not include the incorporation of balance sheet balances from previous years.

Expansion project (US\$ 110 million) completed its first phase in May 2019 and should move forward with its second stage of construction in the remainder of the year, according to the Ministry of Energy and Mines (Minem). By 2020, in addition to these large projects, the plan is to begin construction of new mining projects, such as i) Corani (US\$ 585 million), which would begin in 2H2020 to carry out basic works, such as landmarking, drilling points and beginning of access works (previously scheduled for 3Q2019); ii) Pampa de Pongo (US\$ 2.2 billion), which already has all the environmental permits and is in the process of acquiring financing; and iii) Yanacocha Sulfuros (US\$ 2.1 billion), which obtained EIA⁴¹ approval on June 2019 and is now in the feasibility stage.



1/ The total investment amounts of the projects are taken into account.
Source: Minem, MEF forecasts.

In addition, the Government is constantly working to improve the regulatory framework to promote the competitiveness of the energy mining sector. In effect, 119 Minem administrative procedures were ratified during 1H2019⁴², after they complied with the principles of legality, necessity, effectiveness, and proportionality that make up the regulatory quality analysis. Among the procedures that corroborated their suitability, as part of the improvement of regulatory quality, are i) those referred to authorizations for the installation and operation of pipelines; ii) the establishment of easements; iii) the evaluation of mine closure plans and environmental liabilities; iv) concessions for the generation, transmission, and distribution of electricity; and v) the procedures referred to the Integral Mining Formalization Registry. Moreover, in June 2019, Minem established trusts as a mechanism to guarantee the closure of mines for 100% of the real estate (formerly 50%)⁴³, which will help the mining owners to face the existing difficulties in the bankruptcy procedure and will simplify the process of converting the guarantees to money⁴⁴. In addition, Minem has been promoting the process of promoting mining formalization, and therefore resources have been transferred to regional governments⁴⁵ to train mining companies in the development of the Environmental Management Instrument for Formalization (Igafo), as an indispensable requirement to streamline the formalization process.

⁴¹ Corresponds to the acronym of environmental impact study.

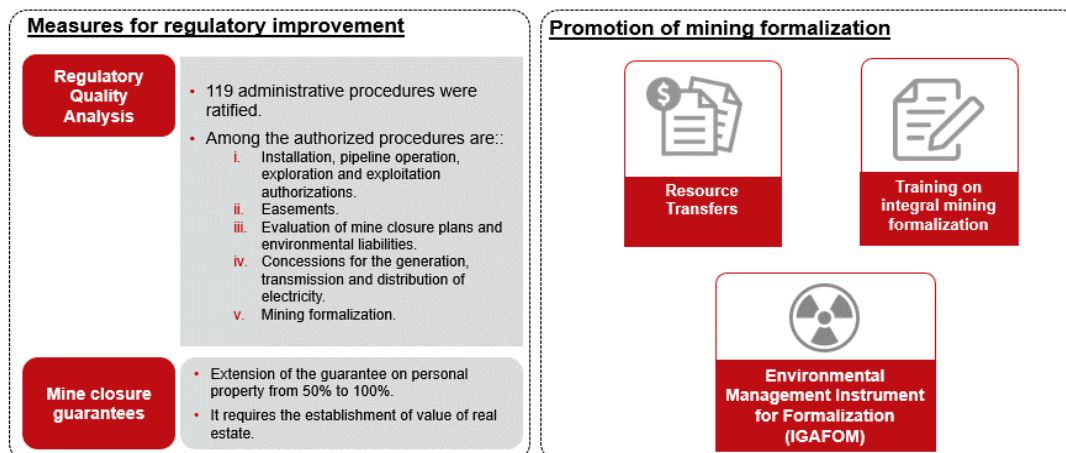
⁴² According to Supreme Decree No. 117-2019-PCM, this occurs within the framework of Legislative Decree No. 1310, which provides that Executive Branch entities analyze the regulatory quality of all their administrative procedures with the purpose of identifying, eliminating or simplifying those procedures that are unnecessary, ineffective, unjustified, disproportionate or redundant.

⁴³ The mining companies must constitute guarantees, through trusts, to cover the costs of the operations of the final closing and post-closure of mines. This ensures that the holder of the mining activity will comply with the obligations of the closure of activities or that Minem, as the case may be, will execute the guarantees to carry out such closure work.

⁴⁴ This occurs when introducing the stipulation that the value of the real estate given in guarantee will be determined on the basis of the commercial appraisal, for which the maximum value will be considered (in the previous regulation a maximum value was not specified) the amount equivalent to two thirds of that appraisal.

⁴⁵ For example, in May 2019, Minem transferred S/ 844,276 to the regional governments of Apurímac, Ayacucho, Piura, Ucayali and Áncash, an amount that will be used exclusively to strengthen the process of integral mining formalization in their respective jurisdictions.

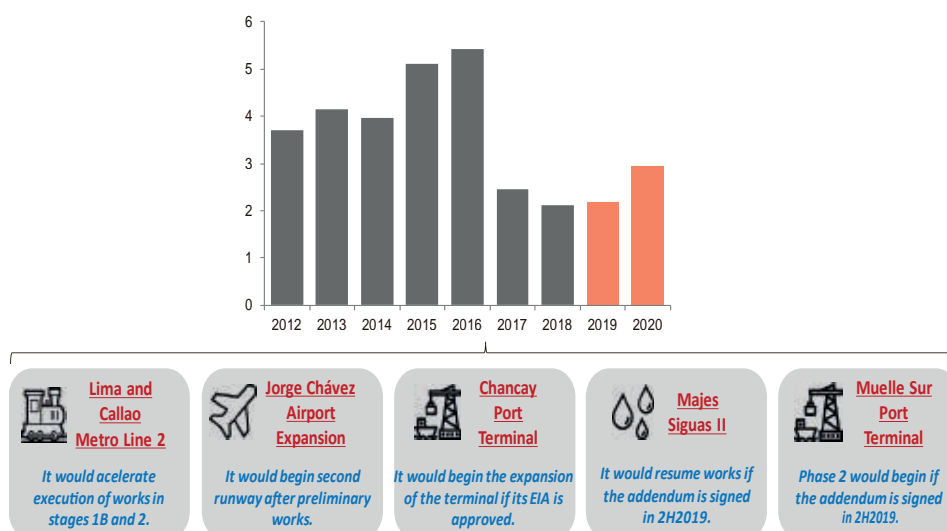
Measures to simplify and boost the energy mining sector competitiveness



Source: Minem.

For its part, the non-mining investment will be driven by the construction and acceleration of large infrastructure projects mainly in the transport sector, which will present important advances in 2H2019 and 2020. Non-mining investment will increase in 2019 and will gain momentum in 2020 due to higher disbursements in infrastructure projects, including i) Lima and Callao Metro Line 2 (total investment: US\$ 5.3 billion) in view of the greater execution from 2H2019 due to the acceleration of the delivery of land. In 2020, the stage 1A of the project will be completed and the stages 1B will be executed (which presents advances in the Circunvalación and San Juan de Dios stations and 2 stage). ii) The General San Martín Port Terminal (US\$ 249 million), whose first stage should end in September 2019. iii) The expansion of the Jorge Chávez Airport (US\$ 1.5 billion), which would continue with the earthmoving works begun at the end of 2019 and would begin construction of its second runway in 2020. iv) The Chancay Port Terminal (US\$ 3 billion), which would begin with the construction of the terminal expansion in 2020 after the approval of its EIA. v) The expansion of the container terminal Muelle Sur del Callao (US\$ 627 million), which after the subscription of its addendum in 2H2019 will begin phase 2 of the project in 2020, which consists in extending the pier by 300 meters, expanding the container yard by 7 additional hectares, among others. vi) Majes Sigüas II, which would resume its works in 2020, after signing the addendum in 2H2019.

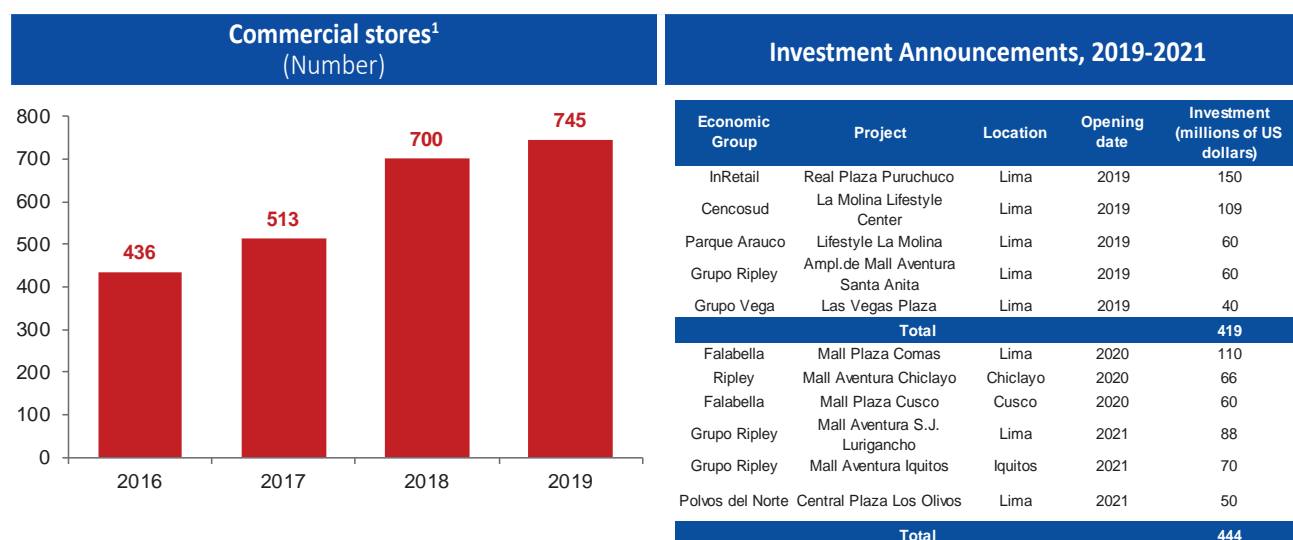
Investment in infrastructure (Billions of US dollars)



Source: MEF forecasts.

Additionally, hydrocarbons investment will increase due to higher capital expenditures in lots III, 58, 95 and 64 in a context of regulatory improvements that contribute to predictability in environmental assessment. The drilling in lots III, 58, 95 and 64, which already have exploration contracts in force, will allow greater investment in hydrocarbons in 2020. Moreover, Minem has been working to promote investment in hydrocarbons, and on June 2019 it decided to create investment promotion committees to seek and develop a series of measures aimed at strengthening Perupetro and improving administrative simplification. Besides that, the project to modify the Regulation for Environmental Protection in Hydrocarbon Activities⁴⁶, was pre-published, whose objective is to generate predictability in the environmental evaluation of the National System of Environmental Impact Assessment (SEIA) for activities in this sector.

The investments outlook in the modern retail sector continues to be favorable due to the country's potential to attract investments, in the context of important investment announcements in Lima and provinces. According to the latest ranking of the Country RepTrack Pulse 2019⁴⁷, prepared by the Reputation Institute of the US, Peru is the country with the best reputation in Latin America for making investments, which thanks to its good performance rose two steps over the previous year (current position: 25 of a total of 55 countries⁴⁸). In this context, as of 1Q2019, 745 commercial stores of the main operators⁴⁹ were registered and a greater opening of stores is foreseen with the inauguration of five projects in 2H2019 (US\$ 419 million) and six projects for the period 2020-2021 (US\$ 444 million).



1/ For 2019 the stock corresponds to 1Q2019.
Source: APOYO Consultoría, media.

Finally, investment in the real estate market will be driven by the expansion of mortgage loans, mainly due to the continuity of the Mivivienda Green Bond scheme and the entry of the new Mi Alquiler Bond program, given the context of favorable financial conditions. The good dynamism of mortgage loans (June 2019: 9.1%) to acquire or buy homes in 2020, mainly in Metropolitan Lima (2019: 17 thousand homes⁵⁰ equivalent to an increase of 8%), would be maintained. In particular, the Mivivienda Fund expects a placement of 13 thousand Mivivienda credits by 2020 (January-July 2019: 6,758 loans⁵¹, equivalent to 43.5% growth) thanks to the continuity of the Mivivienda Green Bond scheme⁵² and the launch of the

⁴⁶ Approved by Supreme Decree No. 039-2014-EM.

⁴⁷ The Country RepTrack Pulse Index measures topics such as admiration, esteem, trust and good impression that reflects a country in relation to others. The weights of the variables that influence the reputation of Latam countries are quality of life (36.2%), institutional quality (37.2%) and level of development (26.5%).

⁴⁸ The study includes a sample of 55 countries with the highest GDP in the world.

⁴⁹ It includes department stores (Ripley, Saga Falabella, and Paris), self-service stores (Tottus, SPSA, and Cencosud) and home improvement (Maestro and Sodimac).

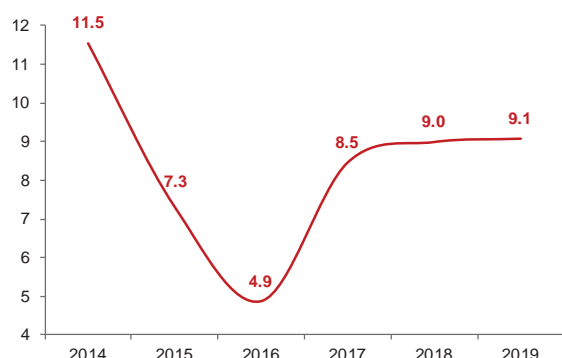
⁵⁰ The projection of home sales is considered according to Apoyo Consultoría, BBVA Research and Scotiabank Research.

⁵¹ The expansion of credits from January to July 2019 is explained by the good dynamism of social housing through the Mivivienda Green Bond and the subsidy of the Bono Familiar Habitacional (House Family Allowance) (BFH). The BFH, which corresponds to the Techo Propio Program, is a direct subsidy granted by the State to a family free of charge as a reward for its savings effort and is not returned. It also has three modalities: to buy (S/ 33,600), to build (S/ 22,890) and to improve (S/ 9,660) your house.

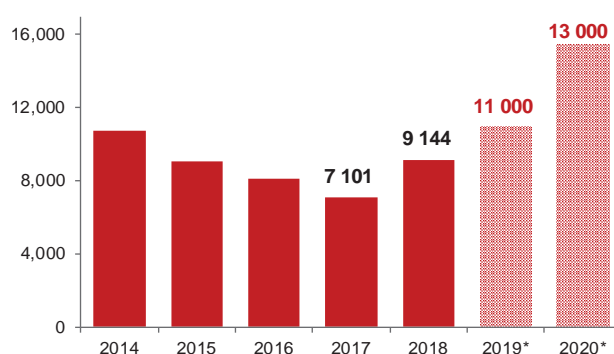
⁵² The Mivivienda Green Bond provides financing of between 3% and 4% of the value of the home that meets criteria of sustainability in its construction and reduction of negative environmental impact. These criteria are distinguished by lighting system (LED), water heater, taps and toilets with low consumption system, and independent water meters.

Mi Alquiler or Young Renter Bond program⁵³. On one side, the placement of the Mivivienda Green Bond accumulated 2,778 bonds between January and July 2019 (January-July 2018: 611 bonds); and, on the other hand, the Ministry of Housing, Construction, and Sanitation (MVCS) expects to place 9,000 bonds in its first year with the Mi Alquiler Bond Program. It should be noted that, according to statistics from the Superintendency of Banking, Insurance and Private Pension Fund Administrators (SBS), mortgage financing costs (January-July 2019: 7.8%) remain below the average between 2014 and 2018 (8.5%), and there is a reduction in the initial payment from 30% to 10% depending on the credit profile and modality⁵⁴, which would boost the demand for mortgages. As a result, the real estate market responded with more attractive investment announcements in 1H2019 (US\$ 1,035 billion), including residential projects, land acquisitions, among others.

Mortgage credits of the Deposit Societies¹
(% annual change)

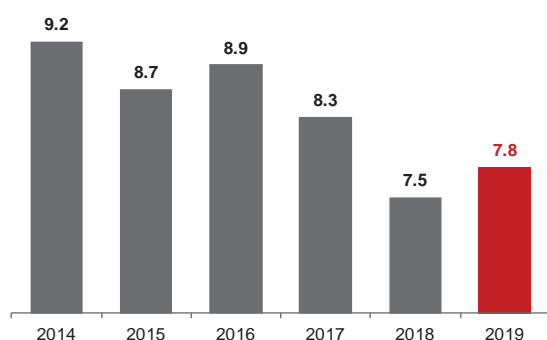


Credits "Mivivienda"
(Number)

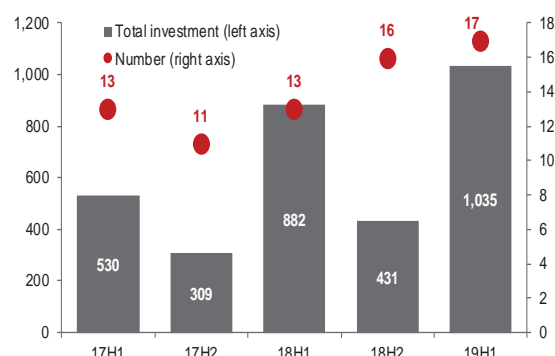


1/ Mortgage credits – June 2019.
(*) Forecasts of the Mivivienda Fund.
Source: BCRP and Fondo Mivivienda.

Tasa de interés de créditos hipotecarios¹
(%)



Evolución de anuncios de inversión en el sector inmobiliario
(US\$ millones, número)



1/ Average active interest rate of banking companies in national currency. For 2019, the average rate corresponds to the January-July period has been considered.
Source: SBS, Apoyo Consultoría.

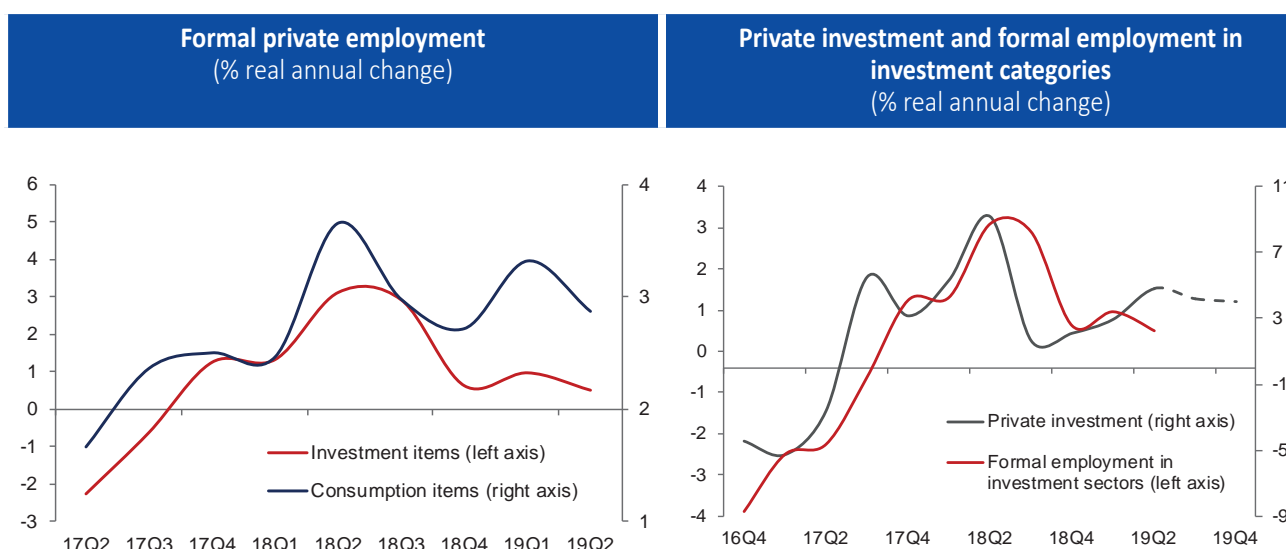
⁵³ Bill approved by Congress through Law No. 30952. The Bono Renta Joven is a subsidy that will be granted to rent real estate and generate savings, in order to facilitate access to the purchase of housing for people between 18 and 40 years. It is given free of charge by the beneficiaries and constitutes a savings incentive to promote access to housing and improvement of habitability conditions.

⁵⁴ For example, there are banks that ask for initial instalments of up to 5% for loans from the Mivivienda Program "Techo Propio" and up to 10% for other mortgages.

Private consumption

Private consumption is expected to show greater dynamism in the beginning of the second half of the year (from around 3.0% in 1H2019 to 3.5% in 2H2019 and 3.8% in 2020) in a context of private and public investment recovery – which will boost the generation of formal employment and improve household income – and favorable financial conditions.

The investment recovery will support an increase in formal employment and family incomes. Formal recruitments in the private sector continued to grow at significant rates between January and June 2019 (3.7%)⁵⁵, sustained by the resilience of the sectors associated with consumption (commerce and services)⁵⁶. However, recruitments in the sectors associated with investment was moderated by the low dynamism of investment in the first part of the year. In the coming quarters, a significant advance in employment is expected, in line with the acceleration of investments, which will allow for an improvement in household income and consumption. Moreover, this recovery will be accompanied by favorable expectations of household consumption for the next 12 months, which would continue in the optimistic tranche (July 2019: 61 points). It should be noted that Metropolitan Lima is already seeing a recovery of formal hiring, since adequate employment reversed its downward trend and has shown a moderate growth since April 2019.



Source: BCRP, Sunat- electronic payroll, MEF forecasts.

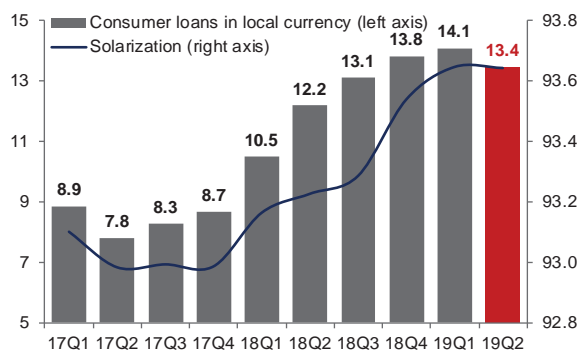
In addition, the financial conditions will favor the consumption by families through the granting of greater consumer credits in the context of a more flexible monetary policy. In 2Q2019, the growth of consumer credit remained dynamic and was driven by personal loans and credit cards, mainly in the national currency (MN)⁵⁷. This recovery was sustained by lower interest rates in the context of expansive monetary policy. Indeed, interest rates on consumer loans in local currency decreased from an average of 46.9% in 2017 to 40.4% in July 2019, in an environment in which the BCRP maintained its reference interest rate at 2.75% from March 2018 until August 2019, when it reduced it to 2.50% (the lowest rate since July 2010).

⁵⁵ Considers information on jobs in the formal private sector published by the BCRP.

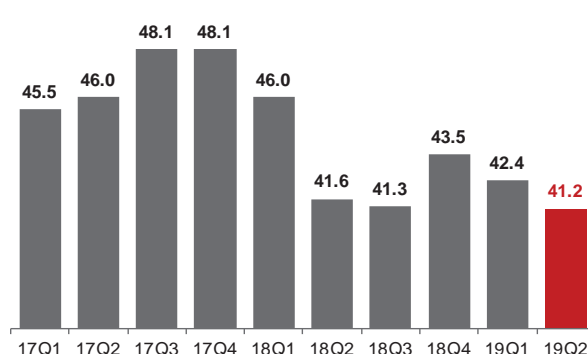
⁵⁶ Hiring in non-primary sectors represents 58% of total formal hiring; and consumption-related sectors, 45% of total formal employment.

⁵⁷ Consumer loans have a high rate of solarization (93.6% of the total as of June 2019), which reduces their exposure to foreign exchange risk.

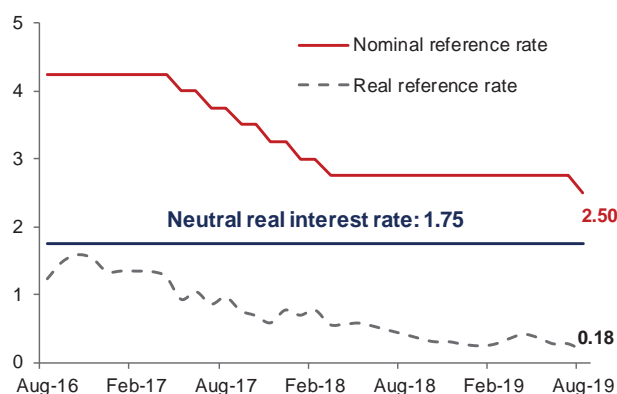
Consumer loans in local currency and solarization (% annual change)



Interest rates on consumer loans in local currency (%)



Monetary policy reference rate (%)



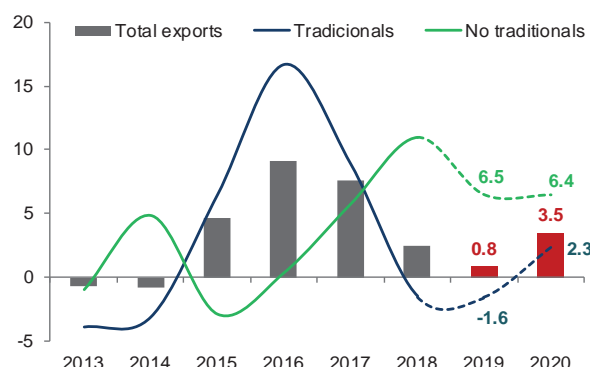
Source: BCRP, SBS.

c. External demand

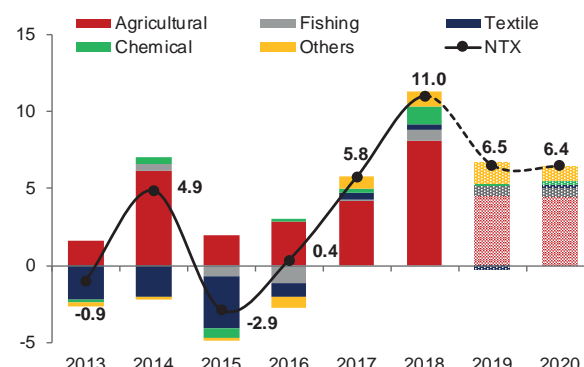
Exports of goods and services will grow from 0.8% in 2019 to 3.5% in 2020, due to the dissipation of primary shocks that would boost traditional exports despite a slight slowdown in non-traditional exports (XNT). On one side, traditional exports would increase by 2.3% in real terms in 2020, above the result of 2019 (-1.6% in real terms), due to higher shipments of i) fishmeal, given the normalization of wheater conditions that would favor the landing of anchovy; ii) mining products, such as copper and zinc, due to the higher production of Las Bambas, and the Toromocho, Toquepala and Mina Justa expansions; and (iii) oil derivatives, in light of increases in the production of crude oil and NGL. Furthermore, the XNT would slow slightly from 6.5% in 2019 to 6.4% in 2020, in line with the moderation of the growth rate of agro-export crops such as blueberries. However, agricultural shipments (44% of XNT⁵⁸) will remain the main non-traditional export products. In addition, in 2020, a gradual recovery in the growth of our trading partners, among which Latin America and the Euro Area stand out, would to a certain extent favor external demand for fish, chemical and textile products.

⁵⁸ Percentage of participation in 2018.

Exports of goods and services, traditional and non-traditional (% real annual change)



Non-traditional exports by sector (% real annual change and percentage points)



Source: BCRP, Sunat-Aduanas, MEF forecasts.

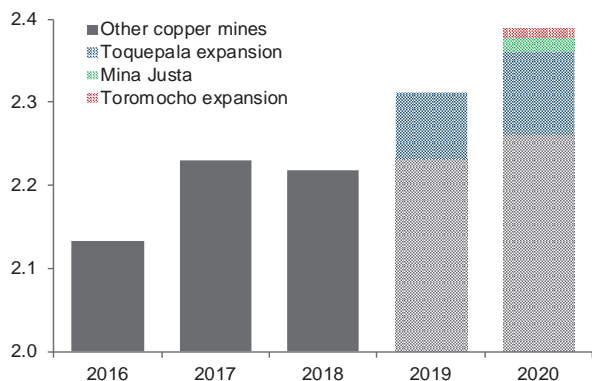
GDP by sector

a. Primary sectors

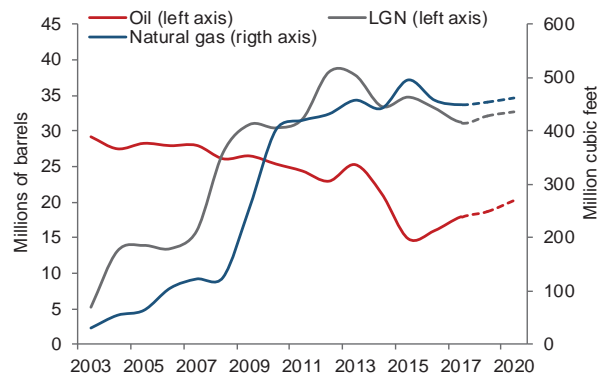
The primary sectors are expected to grow 0.1% in 2019, affected by the temporary shocks that occurred in 1H2019 (-3.1%), but compensated by the greater impulse of the mining, hydrocarbons and primary manufacturing sectors in 2H2019 (3.3%), after the normalization of operations and the beginning of production of some mining expansions. In 2020, the primary sectors will continue with their recovery and would reach a growth of 3.3% due to the higher production of the sectors i) mining and hydrocarbons, given the first full year of production of the expansions and the beginning of new projects; ii) agriculture, due to greater water availability and new plantations; and iii) fishing, due to the normalization of the landing of anchovy.

On one side, mining and hydrocarbon production is expected to grow by 0.9% in 2019 and to accelerate its growth rate to 2.7% in 2020, after the dissipation of transitory adverse factors that occurred in 1H2019 and the beginning of the mine production phase. The mining sector is expected to recover in 2H2019 (2.8%) due to the dissipation of transitory factors that affected mining production in 1H2019 (social conflicts in Las Bambas, and technical and environmental difficulties in Southern and Shougang) and the entry into operation of the Quecher Main (gold) and Bofedal 2 (tin) projects in 4Q2019. In 2020, the mining sector will continue to accelerate at a rate of 2.6%, due to the recording of the first full year of production of the Toquepala (+100 thousand MT of copper) and Shougang (+6 million MT of iron) expansions, and the start of production of the Toromocho (+75 thousand MT of copper) and Mina Justa (+110 thousand MT of copper) expansions in the 4Q2020. On the other hand, the hydrocarbons sector is expected to increase 5.9% in the second part of the year (1H2019: 0.3%), due to a higher production of NGL and natural gas in lots 57, 56 and 88 (64% of the hydrocarbons GDP) due to the positive statistical effect caused by the maintenance works carried out in the 3Q2018 of the Malvinas plant. In 2020, the hydrocarbons GDP would grow 3.6% due to the higher oil production, due to the repair of the Norperuano Pipeline, which would counteract the moderation of the growth in the production of NGL (1.6%) and natural gas (3.1%).

Copper production (Millions metric tons)



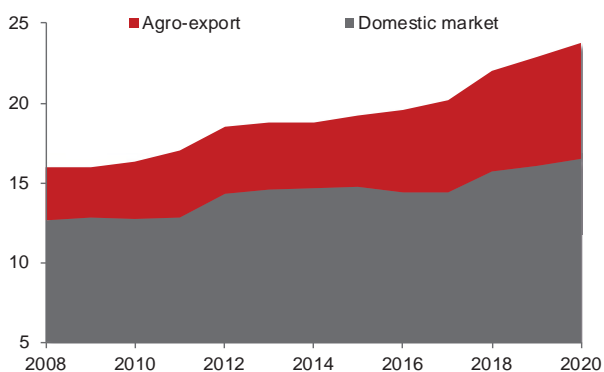
Production of oil, LGN and natural gas (Millions of barrels, billion cubic feet)



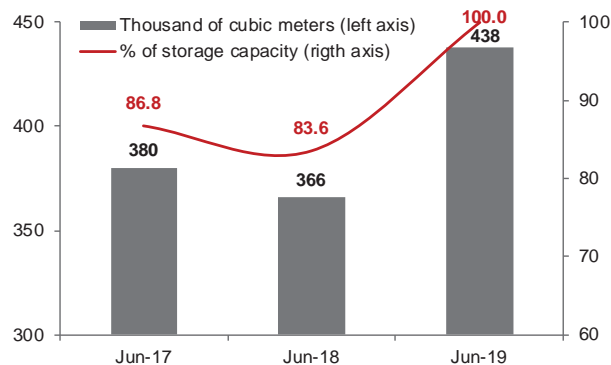
Source: Minem, BCRP, MEF forecasts.

Meanwhile, the agricultural sector is expected to grow by 3.8% in 2019, favored by the greater availability of water for crops destined for the domestic market and will accelerate to 4.0% in 2020, sustained by the dynamism of crops for agro-export. The agricultural sector is expected to increase 5.0% in 2H2019 (1H2019: 3.3%), due to the increased production of crops for the domestic market, such as rice and cotton, which will have greater water availability from the expansion of the Poechos reservoir in Piura in 3Q2019. In 2020, the agricultural production is expected to grow 4.0%, mainly explained by the higher yields of new hectares planted between 2017 and 2018 for agro-export products, such as blueberries, avocados, grapes and cocoa (+18 thousand additional ha), which will enter into total production mainly in the regions of La Libertad, Lambayeque, Ica and Lima.

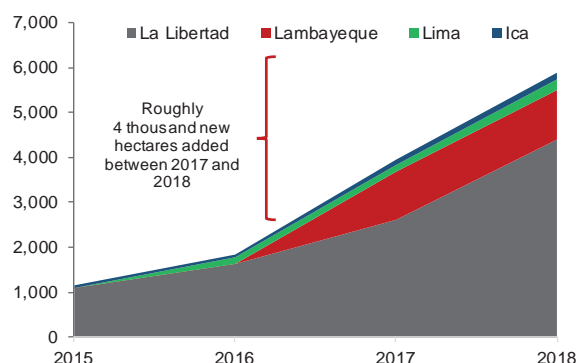
Production of the agricultural sector (Millions of soles 2007)



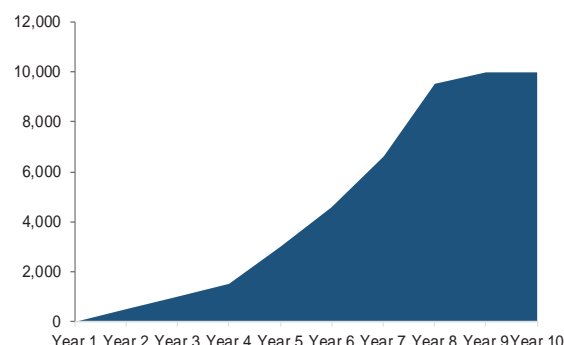
Poechos reservoir water storage (Thousands cubic meters, % of storage capacity)



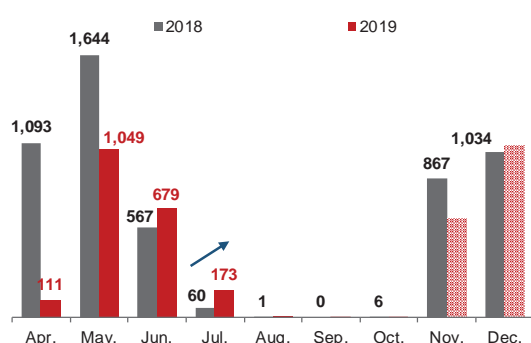
Source: Minagri, BCRP, MEF forecasts

Blueberry harvested area by region
(ha)


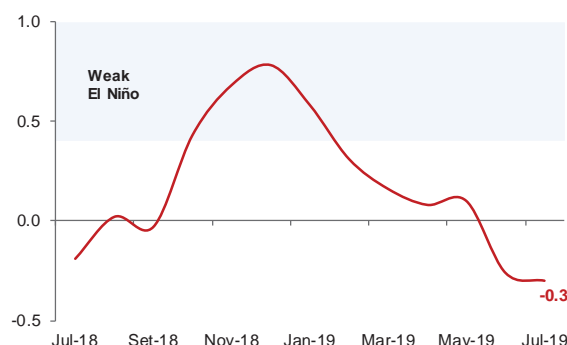
Source: Minagri, BCRP.

Evolution of the field performance of the cranberry
(kg / ha)


Moreover, fishing should recover in 2H2019 due to the greater availability of anchovy in the second season under neutral weather conditions and should accelerate to a rate of 8.4% in 2020 by the normalization of anchovy landing, which in turn would boost primary manufacturing. Fishing is expected to register a smaller decline in 2H2019 (-2.2%) compared to 1H2019 (-26.9%), due to the dissipation of the high temperatures registered in 1Q2019⁵⁹. In 2020, the sector is expected to accelerate due to the greater landing of anchovy, which will return to its historical patterns (median 2006-2018: 4.7 million MT). This recovery of the fishing sector in 2H2019 and its acceleration in 2020 should have a direct impact on the dynamism of primary manufacturing, which is expected to grow by 3.4% in 2020 (2019:-7.7%) due to the increased processing of fishmeal.

Peruvian anchovy landing
(Thousands of metric tons)


Fuente: Imarpe, Enfen, NOAA, proyecciones MEF.

Sea temperature anomalies of the coast of Peru
(Difference in °C in relation to the historical average)


b. Non-primary sectors

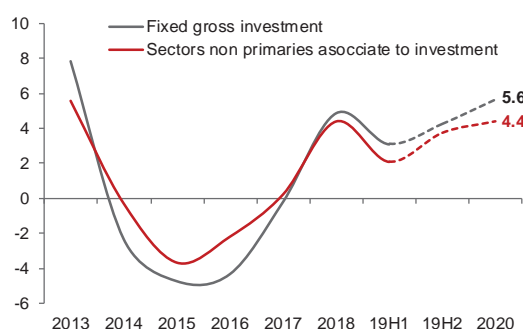
Non-primary sectors are projected to grow by 3.9% in 2019 and accelerate to 4.5% in 2020, associated with an improvement in domestic demand (higher investments and favorable conditions for household consumption) and a slight recovery in external demand.

The non-primary sectors associated with the investment (construction and non-primary manufacturing) are projected to increase by 3.0% by the end of 2019 and accelerate by 4.4% in 2020, in line with an expansion of both public and private

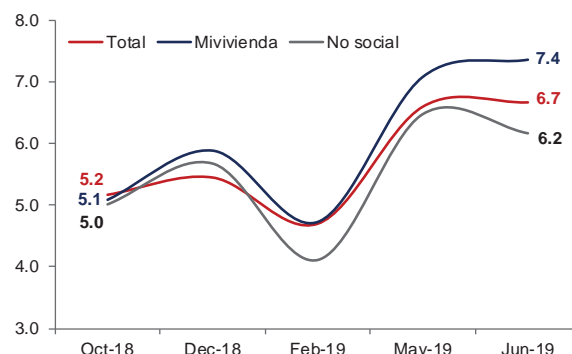
⁵⁹ This affected the spawning cycle of the anchovy and limited its presence in 1H2019.

investment. In addition to public investment in reconstruction works and private investment in infrastructure and mining projects, the construction sector will benefit from increased housing and office construction activity, which has favorable prospects for the coming years. Indeed, according to Capeco, construction companies expect home sales to grow 6.7% this year, mainly due to the increase in the Mivienda Fund segment⁶⁰. In particular, the construction of apartments should maintain a favorable pace due to excess demand⁶¹ in almost all price segments. According to Capeco and BBVA Research, in Metropolitan Lima, households interested in buying an apartment in the next two years amounted to 58 thousand, while the available supply of apartments reached 27 thousand units in 2018. For its part, according to Colliers International, the prime office market⁶² would be reactivated in 2020 –after several years of recession- in line with the new office offer that would reach 82 thousand square meters (2019: 31 thousand square meters), driven by the entry of five new exclusive buildings for rental. The growth of the construction sector will be accompanied by greater dynamism in the non-primary manufacturing sectors, such as the iron and steel industry, cement, machinery and equipment, and transportation material. It is worth mentioning that non-primary manufacturing-mainly textiles, iron and steel, and apparel- will also be favored by the gradual recovery of the growth of trading partners as of 2020.

Fixed gross investment and non-primary sectors associate to investment
(% real annual change)

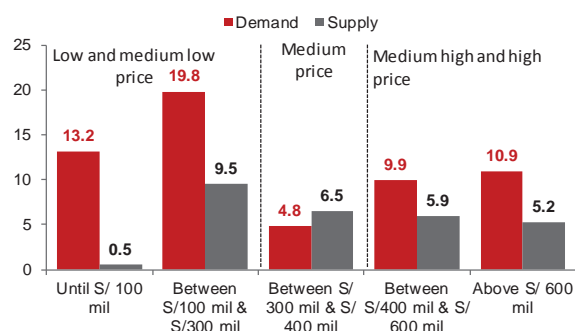


Expectation of housing sales by segment, 2019
(% real annual change)

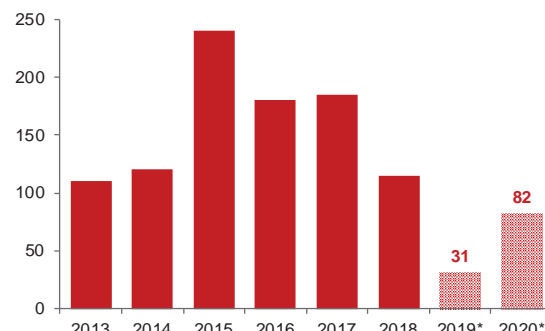


Source: BCRP, INEI, Capeco (July 2019).

Offer available and department demands¹
(Thousands of units)



New offer of prime offices
(Thousands of square meters)



1/ The graph shows the available supply in 2018 and demand (purchase intention) for the next two years.

(*) Forecasting by Colliers International.

Source: Capeco, BBVA Research, Colliers International.

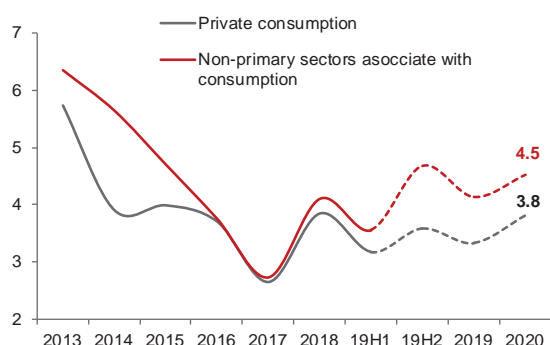
⁶⁰ Construction Economic Report (IEC) July 2019.

⁶¹ The demand considers those households interested in buying an apartment in the next two years that have the down payment to purchase the desired apartment and the monthly installment they would pay does not exceed 30% of their net income.

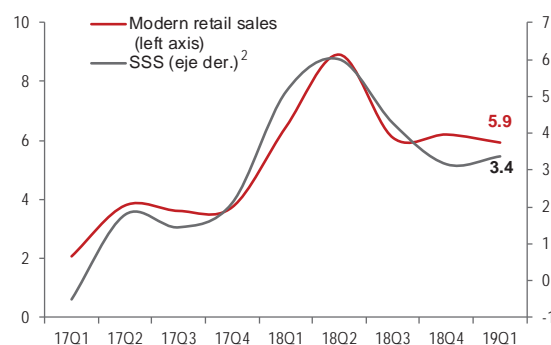
⁶² Prime offices are type A+ and A, and are located in areas of San Isidro, such as San Isidro Golf (around the business center) and Sanhattan (which covers Canaval and Moreyra, Navarrete and Javier Prado avenues), Miraflores, San Borja, Magdalena and Nuevo Este (Surco and La Molina).

The non-primary sectors associated with consumption (commerce and services) are expected to grow 4.1% in 2019 and 4.5% in 2020, in the context of private consumption recovery and driven by the development of the Pan American and Parapan American Games, the dynamism of modern retail and favorable credit conditions. Between 2H2019 and 2020, household consumption spending will improve in line with increased investment and employment generation. In addition, the development of the Pan American and Parapan American Games will boost both the commerce sector (through retail sales) and services (lodging and restaurant, transportation and telecommunications) in 2H2019. According to the National Chamber of Tourism (Canatur) and the Commission for the Promotion of Exports and Tourism (Promperú), 50,000 to 72,000 foreign visitors are expected to arrive, which would generate revenues of around S/ 200 million. For its part, the modern retail sector would continue to grow due to the opening of new shopping centers (five in 2H2019 and three in 2020). The progressive incorporation of new shopping centers will increase the supply of goods (through supermarkets and department stores) and services (restaurants, movie theaters, beauty salons, and bank agencies), which will boost the dynamism of the items of the commerce sector (retail sales) and services (restaurant and financial services). In this context, sales in the modern retail sector are expected to continue growing (1Q2019: 5.9%), as well as in same-store sales⁶³ (1Q2019: 3.4%). Additionally, according to Kantar WorldPanel, the non-conventional modern channel, made up of convenience stores, discount stores, and cash and carry, has favorable prospects for the coming years. In particular, convenience stores would exceed 700 points of sale in 2022 and would double the estimate for 2018 (350 stores). It is worth mentioning that, according to the Development Finance Corporation (Cofide), the Fondo Crecer (Grow Fund)⁶⁴ would guarantee loans to more than 400 thousand MSMEs (micro, small and medium enterprises), which would boost the commerce and services sectors.

Private consumption and sectors non-primary associate to consumption
(% real annual change)



Modern retail sales same-store sales (SSS)¹
(% real annual change)



1/ It includes the sales of the main operators: department stores (Ripley, Saga Falabella and Paris), self-services (Tottus, SPSA and Cencosud) and home improvement (Maestro and Sodimac). 2/ SSS: Sales store sales or sales without counting new stores
Source: BCRP, Apoyo Consultoría, MEF forecasts.

5.2.3. 2021-2023: economic growth with competitiveness

In the 2021-2023 period, economic activity is expected to grow by an average of 4.5%, underpinned by increased private spending and economic policy measures aimed at improving the country's productivity and competitiveness.

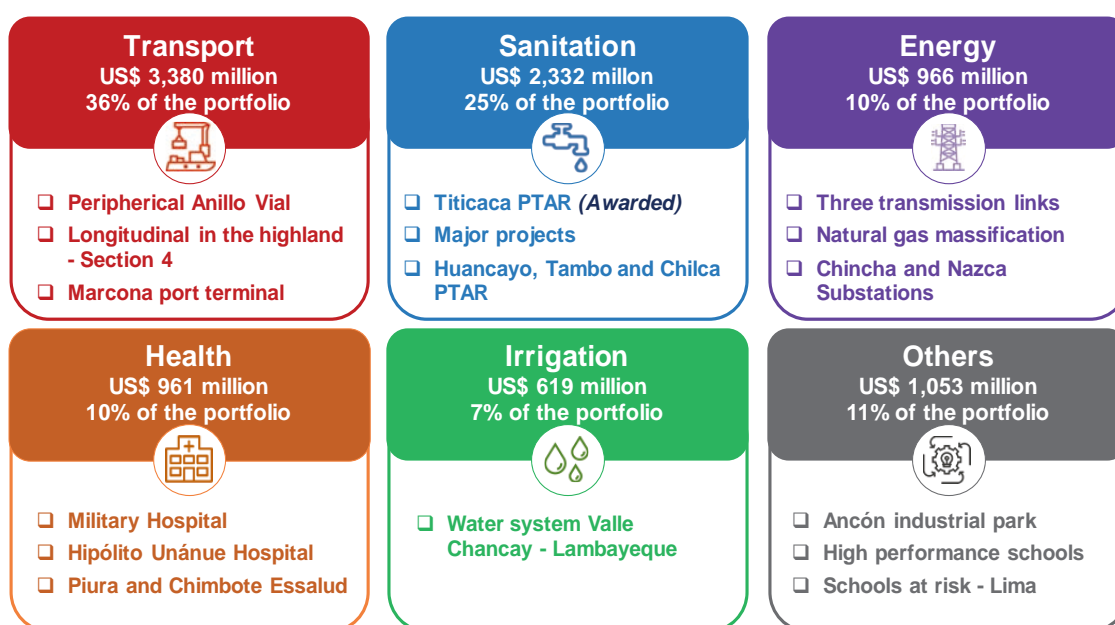
Private investment is expected to increase by an average of 5.3% for the 2021-2023 period, mainly due to the growth in non-mining investment associated with greater investment in infrastructure for road and port projects. Furthermore, mining investment should continue to register favorable rates between 2021 and 2023, but at a slower pace than in 2020, given the completion of the construction phase of large mining projects.

⁶³ Sales without new stores.

⁶⁴ According to S.D. 007-2019-EF the regulation of Legislative Decree No. 1399 (January 2019) was approved, which promotes the strengthening of MSMEs and the Fondo Crecer. This fund covers up to 75% of micro and SME loans through the Good Payer Bond (up to S/ 15 thousand).

Non-mining investment is expected to continue to accelerate at an average rate of 4.7% between 2021 and 2023 due to the execution of large infrastructure projects. Among these we can highlight: i) Line 2 of the Lima and Callao Metro, which includes ten districts between Ate and Callao; ii) the expansion of the Jorge Chávez Airport, through the construction of a new landing strip and a new terminal, which will encourage greater investment in commercial and cultural areas; and iii) the Chancay Port Terminal, whose first stage (port resizing) involves an investment of US\$ 1.300 billion, and from now on the construction of the tunnel and maritime platforms, which would make Peru a port hub on the Pacific coast. In addition, ProInversion expects to award a set of infrastructure projects for more than US\$ 9 billion between 2019 and 2022. Finally, the PNIC will also promote the execution of infrastructure projects, given that this includes an important group of PPA projects, in order to contribute to the closing of infrastructure gaps, given their highly competitive and social impact.

Portfolio of projects to be awarded by ProInversion between 2019 and 2022



Source: ProInversión

In addition, mining investment is expected to reduce its growth rate between 2021 and 2023 (8.1% on average 2021-2023 vs. 19.8% on average 2019-2020), due to the completion of the construction phase of large mining projects, which would be partially offset by the start of construction of smaller projects. The large mining projects that began construction in 2018, such as Quellaveco, Mina Justa and Toromocho expansion, will complete their construction phase between 2020 and 2022, and then enter into operation. However, Peru has a portfolio of forty mining projects for around US\$ 49 billion, which are in previous phases of construction, of which a group of projects for almost US\$ 8 billion would begin their construction phase between 2021 and 2023, as they are prioritized by their parent companies as regards the completion of feasibility and pre-feasibility studies between 2019 and 2020. These projects include Pukaqaqa, Magistral, Macusani, and San Luis.

Portfolio of mining projects by phases (Millions of US dollars)				
N°	Advance stage	Mining projects	Total investment (Millions of US\$)	Total investment
1	Construction	Toquepala expansion, Quecher Main, Relaves B2 San Rafael, Toromocho expansion, Ariana, Mina Justa, Quellaveco	10,135	10,135
2	Detail Engineering	Santa María expansion, Lagunas Norte optimization, Pampa de Pongo, Corani, Tía María	4,935	4,935
3	Feasibility	Pachapaqui expansion, Coroccohuayco integration, Zafranal, Fosfatos Pacífico, Magistral, Bayovar expansion, Cañariaco (North), Cañón Florida (Ex Bongará), Conga, El Padrino e Hilarión, Ollachea, Quechua, Río Blanco, San Luis	14,627	14,627
4	Pre-feasibility	Yanacocha Sulfuros, Anubia, Los Chancas, Quicay II, San Gabriel (Ex Chucapaca), Haquira, Michiquillay, Antilla, AZOD (Accha y Yanque), Bayovar 12, Cotabambas, Don Javier, El Galeno, Fosfatos Mantaro, Hierro Apurímac, La Granja, Los Calatos, Macusani, Pukaqaqa, Racaycocha Sur, Rondoní, Trapiche	29,439	29,439

Source: Minem.

Box 3: The multiplier effect of the mining sector. Measuring the impacts of mining project investment on the economy

Mining investment generates chains, both backward and forwards, in the economy. On the one hand, **backward chains** refer to the demand for mining project inputs from other industries (direct effects). Thus, a mining project in the exploration and construction phase will demand inputs from the mining industry itself (borehole studies and others that allow verification of mineral reserves) and other industries, such as oil refining (diesel, industrial oil, oils and lubricating greases), chemical (chemicals and rubber), machinery and equipment (tools, machinery for industry such as excavators and trucks), land transport (cargo transport services), among others. These industries, in turn, will require inputs from the other industries as well (indirect and induced effects). For example, the oil refining industry will require inputs from the extraction of hydrocarbons (crude oil and natural gas liquid). On the other hand, **forward chains** are generated when the product extracted from a mining project is consumed by other industries. For example, the precious metal refining industry demands mining production (concentrates) for smelting and refining processes.

According to international evidence, mining investment generates multiplier effects in the economy. In Australia⁶⁵, Satchwell (2014) determined that the resource economy (mining) represents 18% of the gross value added of the Australian economy, of which 63.9% are direct effects from extraction and processing, and 36.1% indirect effects in other sectors that provide inputs to mining. Similarly, this sector has generated ten out of every hundred jobs generated in the economy, of which three are for direct effects and seven for indirect effects. In Chile⁶⁶, Pinto et al. (2017) estimated that each dollar invested in a project in the construction phase will generate an additional US\$ 0.80 in production (multiplier 1.80), which has a direct effect of 1.42 and an indirect effect of 0.38. In the production phase, each dollar invested generates an estimated additional of US\$ 0.49 (multiplier 1.49), from which there is a direct effect of 1.29 and an indirect effect of 0.20.

In the Peruvian case, the multiplier effects generated by mining activity have been considerable. According to the Peruvian Institute of Economy (2017)⁶⁷, an increase of S/ 1,000 soles in mining exports would generate S/ 1.2 thousand in the national economy, if the direct, indirect and induced effects are taken into account (considering the input product table of 2012). In terms of economic sectors, mineral extraction accounts for 57% of the total effect, followed by construction (6%), land transport (3%), financial services (3%), agricultural crops (3%) and mining support activities (2%). Similarly, the employment multiplier indicates that for every billion soles of mining exports more than 21 thousand jobs are created if direct, indirect and induced effects are considered. Moreover, for each job directly generated in mining, an additional 6.25 jobs would be generated in the rest of the economy.

Comparative summary of studies using the input output table

Country	Author	Model	Effects	Matrix year	Previous jobs		Observations
					Scope		
Chilean	Pinto, P y otros.	Input output table	Direct and indirect	2013	Regional		-Considers an average annual investment in the construction phase. -For the production stage, an average amount associated with mining is considered.
Peruvian	IPE	Input output table	Direct, indirect and induced	2012	National		-Consider the impact of mining exports and their multiplier effects on the economy.
Peruvian	MEF estimates	Input output table	Direct and indirect	2007	National		-Consider annual investments in the construction phase. -Consider independent multiplier effects for each year of investment. -The total multiplier effect is the aggregate of all the effects of annual investments.

Source: MEF staff.

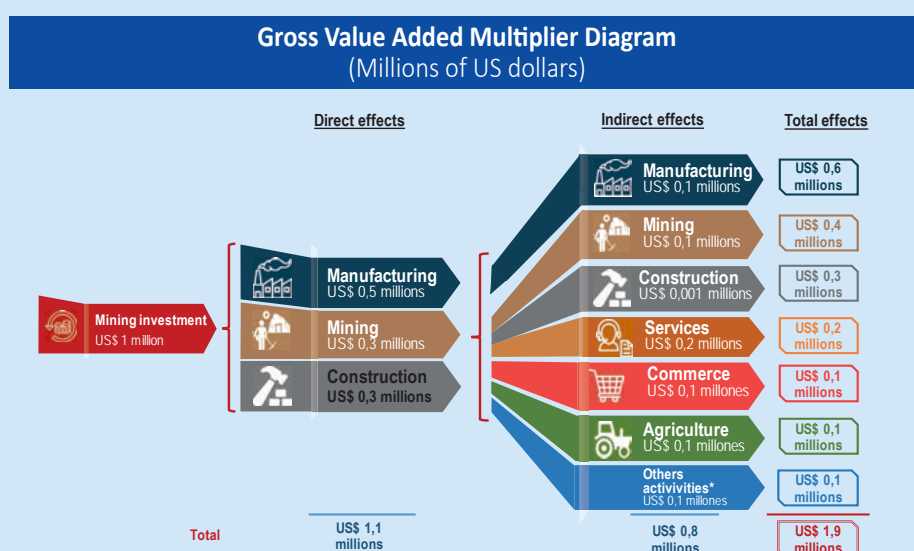
⁶⁵ Satchwell, I., (2014). *Mining and sustainability: the Australian experience*. International Mining for Development Center.

⁶⁶ Pinto, P., Morales, C., Sfeir, R. y Honores, G., (2017). *Economic impact of mining investment projects: analysis of the input-output matrix applied to the Coquimbo region*.

⁶⁷ Peruvian Institute of Economics (2017). *The added value of mining in Peru*.

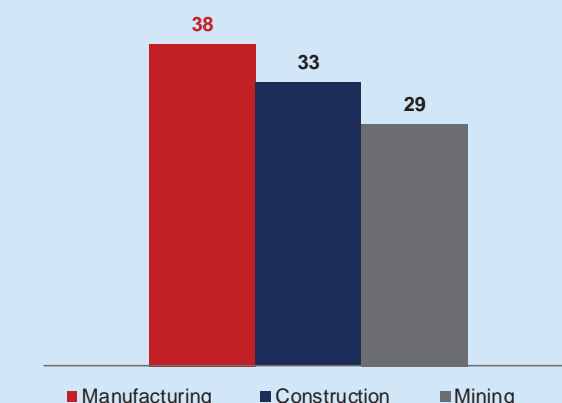
Gross value-added and employment multipliers using input-output table⁶⁸

Mining investment generates a multiplier effect in the medium and long-term. To calculate this multiplier, the investment structure for the construction phase of a mining project was determined based on information from projects under construction between January and May 2019⁶⁹. Each component of this structure was then correlated with the classification of economic activities in the input-output table. For example, investment in ancillary components infrastructure, such as chimneys, ventilation ducts, and electricity systems, correlated with manufacturing. Subsequently, the impacts were calculated using the Leontief multiplier from the input-output table, for which information on national production in 2007 was taken into account⁷⁰. The results obtained indicate that for every US\$ 1 million invested in the construction phase, approximately US\$ 1.9 billion would be generated in the economy (US\$ 1.1 billion as a direct effect and US\$ 0.8 million as indirect effects). Furthermore, for each job created in the mining sector during the construction phase, nine additional jobs could be generated.



* Other activities include fishing and electricity.
Source: INEI, Minem, MEF estimates.

Structure of the investment in a mining project in the construction phase (Participation %)



Source: Minem, MEF estimates.

⁶⁸ The national input-output table used is that of 2007 at basic prices, prepared by INEI.

⁶⁹ It considers the following mining projects: Quellaveco, Marcobre (Mina Justa) and Southern (Toquepala expansion). Estimates can be improved if investment information is available from a portfolio of mining projects in the broader construction phase.

⁷⁰ The input-output table (TIP) 2007 prepared by INEI is the official matrix, disseminated among national and international agencies, for example, OECD, APEC, among others.

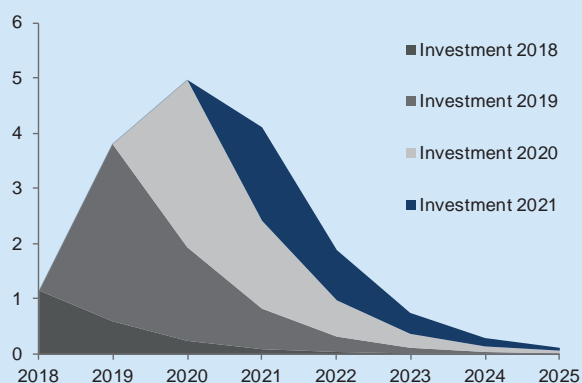
In particular, investment in the large mining projects that began construction in 2018⁷¹ is estimated to generate an aggregate impact of nearly US\$ 17 billion on the economy in the coming years. The investment in new mining projects that began construction in 2018, which amounts to US\$ 9 billion between 2018 and 2021, is estimated to generate an aggregate impact of US\$ 17 billion (59.9% in direct effects and 40.1% in indirect effects) on the economy over the next seven years (2019 and 2025). Among the sectors where mining investment would have the greatest impact are manufacturing (US\$ 5.4 billion), the mining sector itself (US\$ 3.9 billion), construction (US\$ 3.1 billion), trade (US\$ 1.2 billion), agriculture (US\$ 1.2 billion), services (US\$ 1.9 billion) and other activities⁷² (US\$ 0.5 billion). Moreover, the results obtained an estimate that almost 99,000 jobs would be generated⁷³, of which 34,000 would be created directly and 65,000 indirectly.

Gross value added multiplier by economic activities (Billions of US dollars)

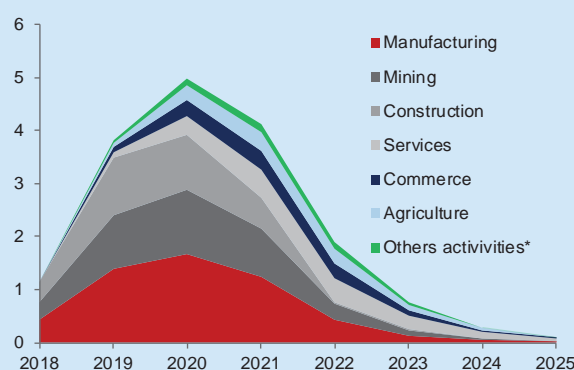
Description	Directs effects	Indirects effects	Total effects
Agriculture	0.0	1.2	1.2
Mining	2.7	1.2	3.9
Manufacturing	4.4	1.0	5.4
Construction	3.1	0.0	3.1
Commerce	0.0	1.2	1.2
Services	0.0	1.9	1.9
Others activities*	0.0	0.5	0.5
Total	10.3	6.9	17.1

* Other activities include fishing and electricity.
Source: INEI, Minem, MEF estimates.

Total impact of investments in the economy for each year of investment (US\$ miles de millones)



Total impact of investments on economic activities (US\$ miles de millones)



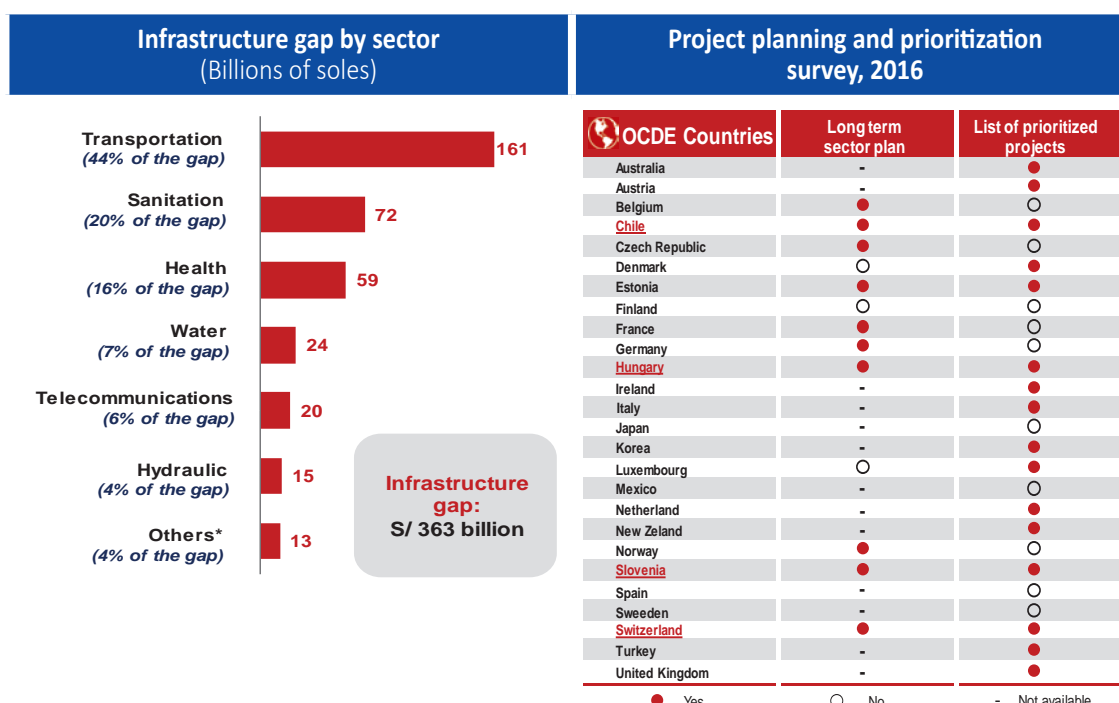
* Other activities include fishing and electricity.
Source: INEI, Minem, MEF estimates.

⁷¹ In 2018, the investment made in these projects was US\$ 1.1 billion. For 2019, an investment of US\$ 3.2 billion is estimated; in 2020, US\$ 3.0 billion; and in 2021, US\$ 1.7 billion.

⁷² Fishing and electricity activities are considered.

⁷³ Each year the investments made would generate jobs until 2025. For example, the investment made in 2018 in these projects would generate 12 thousand jobs between 2019 and 2025; the investment of 2019 would generate 35 thousand jobs between 2020 and 2025, among others.

The Government published the PNIC, which will allow articulating projects to promote competitiveness in the short, medium and long-term, as part of the National Competitiveness and Productivity Plan. The purpose of the PNIC is to provide an input to elaborate a work agenda with a transparent and articulated development by State agents, in order to contribute to the closing of the infrastructure gap in different sectors, which is currently estimated at S/ 363 billion (mainly in the transport sector: 44% of the gap), seven times the annual public investment budget. This plan has a portfolio of 52 projects of high economic, competitive and social impact with an investment value of S/ 99 billion in different execution modalities (PPP and public works), which are distributed nationally in six zones in the north, center and south of the country, and aims to close about 30% of the infrastructure gap in the next ten years.



(*)Other sectors include education and electricity.
Source: MEF, Survey of Infrastructure Governance (2016).

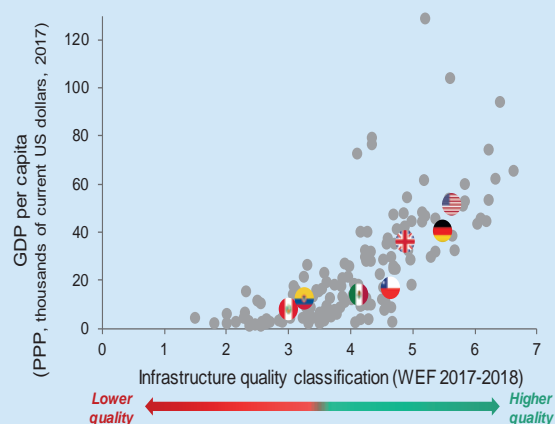
Box 4: The National Infrastructure Plan for Competitiveness

The objective of the PNIC is to provide the Peruvian State with an input to build a transparent and consensual development agenda that allows closing key gaps for the economic and social development of the country. The PNIC follows a sectorial and territorial logic that has an impact in the short term but is guided by a long-term strategy to contribute to improving productivity and competitiveness that will result in better development conditions for the country.

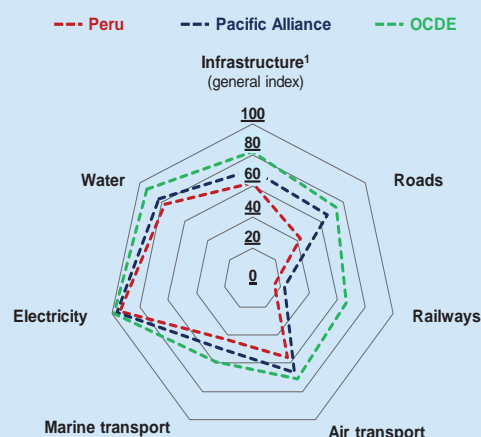
A country's competitiveness depends, to a great extent, on access to and quality of infrastructure. Improving these factors not only increases connectivity with domestic and international markets but also boosts the development of the country's human capital, which contributes to greater economic growth. For this reason, a solid infrastructure network makes it possible to reduce transaction costs, increase information flows and reduce freight transport times, thereby enabling the development of economic activities and productive sectors that have a direct impact on competitiveness, as well as connecting citizens with their workplaces and guaranteeing access to public services, such as medical posts and schools.

Empirical evidence shows that there is a positive relationship between GDP per capita and the World Economic Forum (WEF) infrastructure quality rating, and being aware of this important relationship, the role of public investment was energized and increased on average to 5.2% of GDP between 2008 and 2018 (average 1999-2008: 3.7% of GDP). However, infrastructure development in Peru is still lagging behind regional peers and OECD countries, as investments in the country are still dispersed and have not necessarily been developed with a logic that enhances synergies. At that sense, the PNIC emerges as a proposal to create a road map-a development agenda- that will help the State to increase productivity and competitiveness by progressively closing the infrastructure gap, and improving access to local and international markets in order to benefit the population.

GDP per capita and infrastructure quality
(Thousands of current US dollars of 2017, classification)



Infrastructure quality indicator
(scale from 0 to 100, where 100 is the highest value)



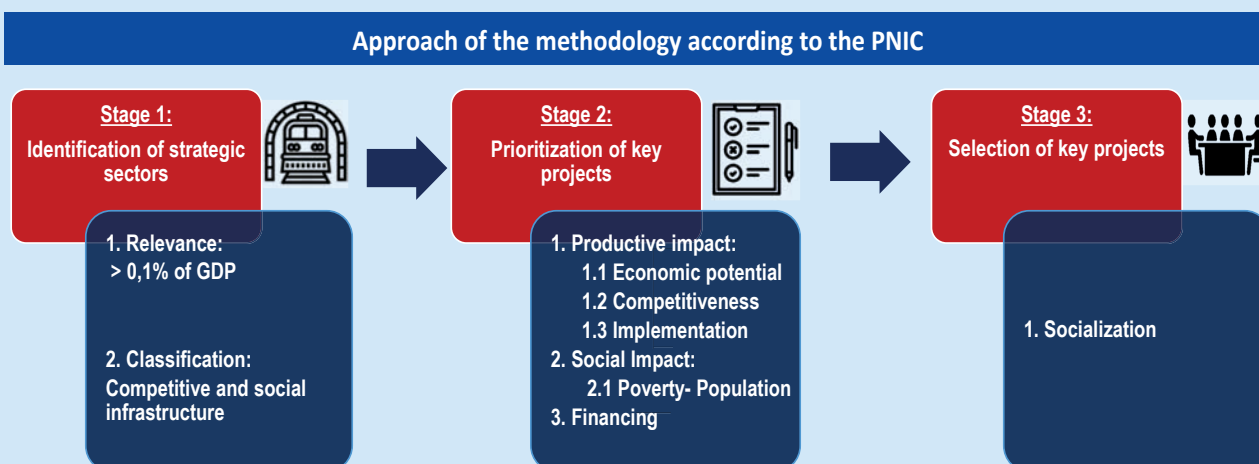
1/ The General Infrastructure Index of the WEF considers the access and quality of transport infrastructure (roads, railways, maritime transport) and public services.

Source: World Economic Forum (WEF) 2017, The Global Competitiveness Report 2017.

To achieve the objective of closing infrastructure gaps, the PNIC will seek to i) develop the internal market by promoting the development of an infrastructure network that responds to present and future production needs and that has a direct impact on the country's aggregate productivity levels; ii) foster access to the external market by promoting the development of ports, airports, and logistics chains that promote the access of Peruvian products to international markets with lower costs; and iii) improve the quality of life of citizens by promoting projects that cover the basic needs of the population (water connections, solid waste management, and sewerage) in order to strengthen human capital in the country. Along these lines, with the fulfillment of the objectives of the PNIC, the following benefits would be achieved:

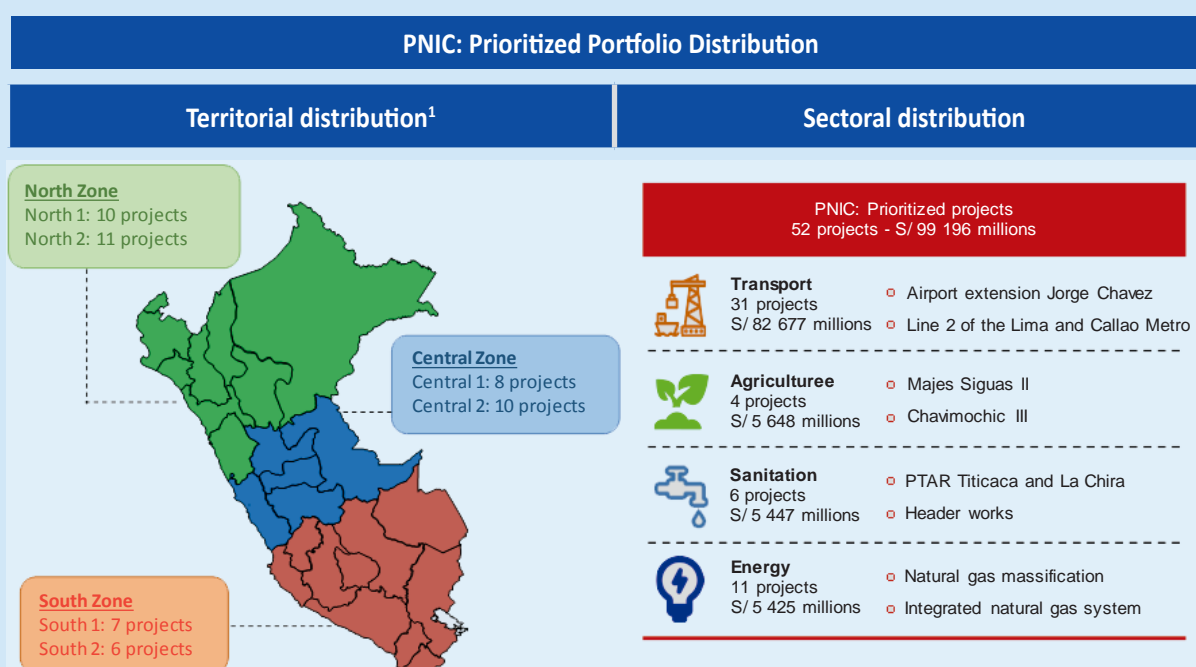
- 1. Country Agenda:** a development agenda will be developed, with sectoral and territorial considerations, in the short term and, in addition, tools will be provided to build a long-term vision.
- 2. Predictability for investors:** there will be a portfolio of short-term projects, selected through a transparent and consensual methodology, which will attract more investors, with better technology and knowledge.
- 3. Efficiency in the use of resources:** will allow planning and prioritization of projects with a greater impact on society, in which each sol invested is used for the best available purpose and ensures an efficient allocation of public resources.
- 4. Disincentives to corruption:** having an institutionalization mechanism and an identified portfolio of projects with national impact will reduce the incentives to promote poorly conceived projects that do not necessarily meet the needs of the population.

To achieve all these goals, the Government received technical and specialized advice from the British Government and the Inter-American Development Bank (IADB) to design a methodology for prioritizing infrastructure projects in a transparent, neutral and technical manner. The methodology is summarized and governed in three stages:



Source: MEF.

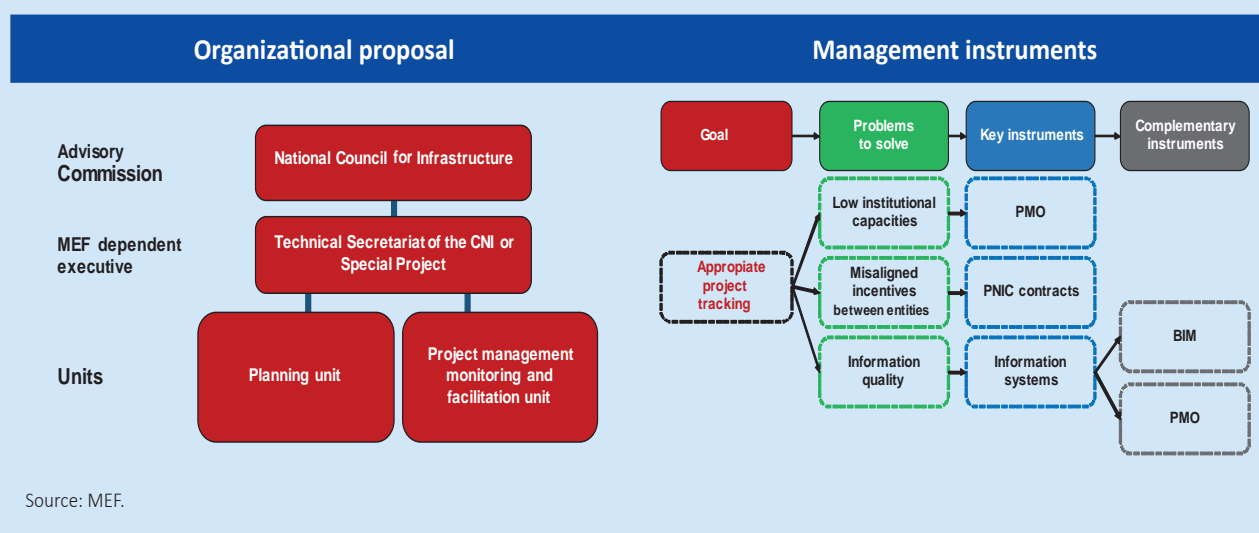
According to this approach, a portfolio of projects was structured and validated by the sectors involved. As a result, the PNIC materialized the Government's strategy to close infrastructure gaps and prioritized 52 projects for S/ 99 billion, which will close around 30% of the long-term gap (S/ 109 billion) in the next ten years. These projects are distributed transversally among the diverse zones of the country, diverse economic sectors, and consider all modalities of execution. Thus, government's support is established for this set of projects that are highly linked to the productive process of the regions and, therefore, to the development of our competitiveness at the national level.



1/ The northern zone includes Tumbes, Piura, Cajamarca, Amazonas, Loreto, San Martín, Lambayeque, La Libertad, Áncash, Huánuco, Ucayali. The central zone includes Lima, Huánuco, Pasco, Junín, Ucayali. The southern zone includes Ica, Huancavelica, Ayacucho, Apurímac, Cusco, Madre de Dios, Arequipa, Moquegua, Puno, Tacna.

Source: MEF.

Finally, it is necessary to institutionalize in the State the approach of portfolio follow-up and planning. Due to this reason, the PNIC proposes the creation of a consultative commission with the name of National Council for Infrastructure (CNI), whose main functions would be i) to approve and update infrastructure plans, and ii) to propose an agenda of new investment opportunities in projects and methodological improvements in the management of these projects. This council would have regular competencies, formulate from different stages of the projects, and coordinate with the competent sectors and different levels of government. The mechanisms for strengthening capacities in the execution of projects included in the PNIC are the following: i) Project Management Offices (PMO) and NEC contracts⁷⁴, which will allow for technical support in highly complex projects, and ensure flexibility in the contracts; ii) creation of PNIC contracts⁷⁵, which aligns incentives among all participants in the investment process, based on the fulfillment of project process goals; iii) macro-regional planning dialogues, which will allow knowledge transfers between government levels (national, regional and local), in addition to having a typology of standardized projects that will promote savings in the design (formulation and evaluation of projects); iv) BIM modeling, which is a virtual modeling of the follow-up of projects in all their phases, from conception to completion and operation; and v) standard contracts for PPPs, which will provide predictability on the contractual framework in the execution of this modality of projects, as well as setting clear rules regarding issues of risk allocation, guarantees, expiration, among others.



Within the framework of the integral strategy to improve the country's competitiveness and productivity and promote medium and long-term economic growth, the Government presented the Competitiveness and Productivity National Plan in July 2019⁷⁶. This plan presents an articulated and consensual synthesis of a prioritized set of policy measures with short, medium and long-term milestones to advance the achievement of the country vision established in the nine priority objectives (PO) of the PNCP⁷⁷. In particular, the plan contains 84 specific measures, among which the following stand out: i) the implementation of a PNIC (PO1. Infrastructure); ii) territorial management for the fight against anemia and early childhood development, the creation of sectoral competence councils and the implementation of institutes of excellence (IDEX) at the national level (PO2. Human capital); iii) the extension of the tax benefit for research and development (R&D) in companies, and articulation of existing public funds for investments in science and technology (PO. Innovation); iv) the implementation of a package for business formalization and development, and of the Crecer Fund, with more than S/ 1 billion to constitute credits, guarantees and investments for the benefit of micro and SME's (PO4. and PO6. Financing and favorable business environment, respectively); v) modernization of the National Employment Service and the Labour Inspection System, which will be accompanied by measures geared to new technological trends, such as teleworking and part-time work (PO5. Labour market); vi) support for exporting MSMEs and creation of a service platform to develop the exportable supply and internationalization of enterprises (PO7. Foreign trade); vii) reform of the National System of Justice Administration, and creation of

⁷⁴ Type of contract: New Engineering Contract.

⁷⁵ The PNIC contracts are a scheme of budgetary incentives to national, regional and local government entities to facilitate the execution of the projects prioritized in the PNIC.

⁷⁶ Approved by S.D. No. 237-2019-EF.

⁷⁷ Approved by S.D. No. 345-2018-EF.

a digital repository that facilitates timely and reliable access to judicial decisions issued by judges at different levels of courts and specialties (PO8. Institutionalility); and viii) clean production agreements in the industry, fishing and agriculture sectors, as well as the design of a Scrap Bond program (PO9. Environmental sustainability). It is important to note that the measures have been systematized in such a way that, in all cases, the relevant information is available to carry out monitoring and evaluation procedures for accountability.

Box 5: Competitiveness and Productivity National Plan

In July 2019, the government approved and made available to the citizenry the Competitiveness and Productivity National Plan⁷⁸, which contains 84 prioritized and high-impact policy measures aligned with the nine POs of the PNCP⁷⁹. This instrument is the result of effort and dialogue between the public and private sectors, academia, and civil society. In order to prepare the plan, the public-private articulation platform called Public-Private Technical Committees (CTPP) was implemented, with the purpose of identifying specific problems and defining concrete measures. Within the framework of these CTPPs, more than twenty workshops and fifty working meetings were conducted by various ministries and public sector entities, with technical support from the National Competitiveness and Formalization Council (CNCF).

The objective of the National Plan for Competitiveness and Productivity is to serve as a link between the vision of the country formulated and designed from the PNCP, and the implementation of policy measures necessary to guide the challenges in the economic and social plan of Peru towards a scenario of greater welfare for its inhabitants. The benefits of the implementation of the plan will be reflected in the increase of the medium and long-term growth capacity of the Peruvian economy. Moreover, the gains in competitiveness will allow elevating the quality in the provision of public services, to stimulate investments, as well as to grant a greater dynamism to the labor force and to the diverse business units that compose the productive fabric of the country.

The elaboration of the plan took into consideration the application of a structured logical framework to design transversal policy measures, which is constituted by i) transversal-universal component, through which the bases and structural conditions are laid to develop the economic activity, and are of reach for all the population; ii) transversal-integration component, which promotes the greater spatial and digital connectivity of citizens and businesses; and iii) transversal-enabling component, by means of which action programs are established specially focused with the purpose of triggering interventions of greater scope and reach. In this regard, it is worth mentioning that the transversal-integration component considers the productive potentialities and regional needs, which will allow the development of regional competitiveness and productivity plans, based on the guidelines established in the PNCP. These plans will be prepared by the regional governments with the support and technical assistance of the CNCF.

As a result of the application of this logical framework, 84 policy measures were defined that form part of the plan and each one of them has concrete and deliverable products distributed in temporary milestones that cover the short term (until July 2021), medium-term (until July 2025) and long-term (until July 2030), which allows the monitoring, follow-up, and evaluation of each one of the milestones and products established in the plan.

The implementation of the Competitiveness and Productivity National Plan will have positive effects on potential GDP growth through three channels. The first channel is linked to the increase in the contribution of total factor productivity, which will derive from the implementation of policy measures that promote innovation and technological adoption within companies, the development of a productive business environment, the facilitation of trade in goods and services to new international markets, and the strengthening of the country's institutionalility and governance. This greater efficiency in the allocation of resources will also be complemented by efforts to promote the sustainable use of the country's production factors. The second channel is related to the increase of physical capital, derived from the development of measures that improve management and increase the endowment of productive and social infrastructure throughout the national territory, as well as measures that facilitate access to sources of financing for the development of investments or accumulation of capital within companies. Finally, the third channel consists of increasing employment and strengthening human capital, the result of policy proposals aimed at improving the skills and competencies of Peruvians, as well as promoting the employability and formalization of the labor force.

⁷⁸ By S.D. No. 237-2019-EF.

⁷⁹ Approved on December 2018 by SD. No. 345-2018-EF.

Certainly, the implementation of the plan presents a clear challenge for public management, since it will require institutional backing through effective public-private coordination spaces to make the implementation of policy measures to improve competitiveness and tangible and sustainable productivity. To this end, it is planned to institutionalize the public-private technical committees (CTPPs), whose technical secretariat is the CNCF, hence they become the platform for articulation, coordination, and dialogue from which the implementation of the 84 measures of the plan will materialize. In this way, the CTPP will be configured as the institutional platform in charge of developing the activities to comply with the different milestones contemplated in the policy measures of the plan. The MEF, through the technical secretariat of the CNCF, will channel and articulate the efforts of the public and private sectors in the implementation, follow-up, monitoring, evaluation, as well as in the accountability of the progress of the measures. The institutional framework for implementing the plan is complemented by the inclusion, in the strategic plans of the sectors, of those activities that will make it possible to comply with the measures of the plan.

The fulfillment of the first milestones of the plan in the coming months will allow generating confidence in the economic agents to assure the continuity of the implementation of the plan in the next administrations, and thus to guarantee greater well-being for the future generations. This requires the joint and articulated work of the public sector, private, academia and civil society.

At the same time, the government has reactivated the executive boards (ME), which are an important tool for promoting greater product diversification, as they promote high potential sectors. The ME are a space in which public and private actors meet to discuss obstacles and opportunities and to promote measures that allow for the development of sectors with high potential, but which still have room to increase their competitiveness. To date, eight ME have been implemented: tourism, forestry, aquaculture, river logistics and infrastructure, public procurement, mining and energy, innovation, and urban transit and mobility. Among the measures promoted by the ME, those aimed at the tourism, forestry and aquaculture sectors stand out. With regard to the tourism ME, work is being done to improve air connectivity (opening of three new domestic routes⁸⁰ and two international routes⁸¹), travel safety (strategy for Safe Tourism 2019-2021) and the infrastructure of regional airports. In the aquaculture ME, the entry of prawns into new markets is promoted, such as the Chinese, Australian and Brazilian markets. In addition, the implementation process of the single window for aquaculture has begun; the regulations for environmental management of fishing and aquaculture will be published, which will guarantee compliance with environmental standards and reduce informality; and the protocol for inspection and occupational health in aquaculture will be published, which will provide greater predictability for workers and entrepreneurs. Moreover, the forestry ME is working on the conservation of forests and the promotion of plantations for commercial purposes. Thus, between 2018 and 2019, two million hectares were preserved, involving 208 native and peasant communities, and 18.8 thousand hectares of commercial forest plantations were registered. In addition, in order to promote investment in the forestry sector, a bill was passed to amend Law No. 29763, the Forestry and Wildlife Law, which proposes suspending the obligation to have forest zoning as a condition for the granting of licenses. Finally, a comprehensive regulatory proposal will be presented in the coming months to extend the exclusive benefits for forestry⁸². The purpose of this proposal is to promote the forestry sector through i) the simplification of sanitation and zoning processes; ii) financing and technological innovation; iii) tax and labor benefits; and iv) strengthening of forestry institutions, such as the National Forest and Wildlife Service (Serfor), the Agency for Supervision of Forest Resources and Wildlife (Osinfor) and the Center for Productive Innovation and Technology Transfer (CITE).

⁸⁰ Domestic routes: Iquitos-Cusco, Pisco-Cusco, Lima-Ilo.

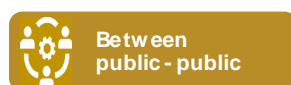
⁸¹ International routes: Santiago-Cusco and Santiago-Arequipa

⁸² Currently, forestry activity is covered by the work and tax incentives of Special Agrarian Law 27360, which remains in force until 2021.

Mesas ejecutivas

Objectives:

- Solve bottlenecks.
- Bring together public and private actors to discuss obstacles and opportunities.



- Improves intergovernmental coordination
- Optimize regulation
- Interoperability



- Aligns interventions and regulatory framework to the reality of the sector.
- It promotes transparency
- Continuous accompaniment.



Tourism

- Opening of new national and international routes
- Safe Tourism Strategy(2019-2021): seeks to ensure a safe travel and stay experience in national destinations
 - This program will complement the operational capacity of the tourism police.

Aquaculture

- Entrance to new markets
- Strengthening SANIPES through three mechanisms:
 - Inter-laboratory testing program.
 - Verification program for the analysis of fishery and aquaculture products.
 - Inspection carried out by the product support entities for the Official Health Certificate and Control for the national and international market.

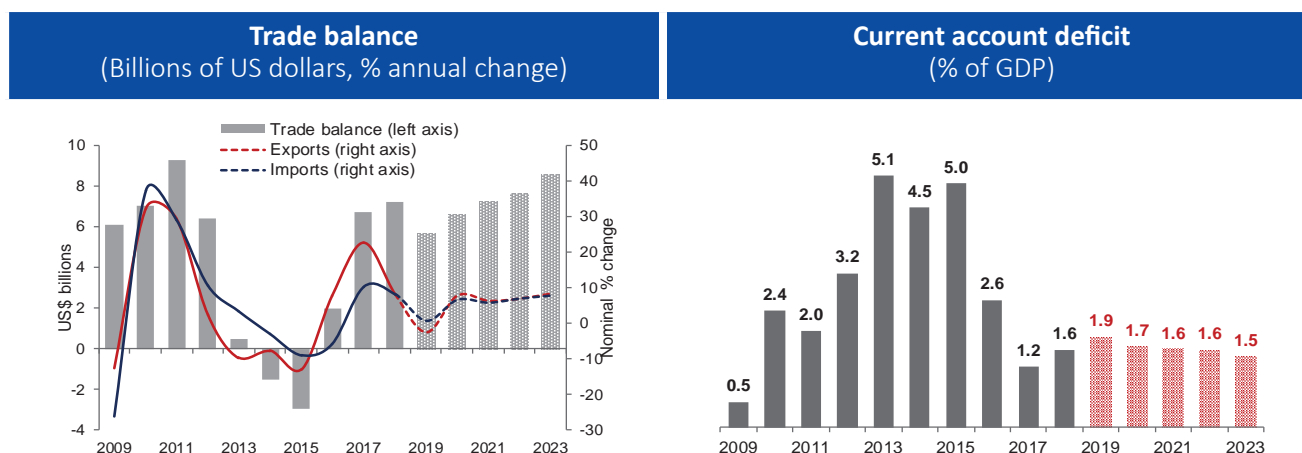
Forest

- Improvement of the regulations and logistics of the sector..
 - Investments will be made for US\$ 300 million.
 - Greater support and coordination between regional governments and forestry agencies.
- It is expected to obtain with these measures one million hectares of forest plantations by 2030.

Source: MEF.

5.2.4. Macroeconomic balance

The current account balance is expected to close with a deficit of 1.9% of GDP in 2019 and reduce to an average rate of 1.6% of GDP between 2020 and 2023, below the average of the last ten years (-2.8% of GDP), favored by the recovery of domestic demand and the start of production of new mines. In 2019, despite less favorable external conditions, reflected in the downward revision of commodity prices and partner growth, the goods trade balance will continue to be in surplus (2.4% of GDP) for the fourth consecutive year and will be the main component keeping the deficit at stable levels. This surplus, lower than expected in the IAPM, is explained by the fall in traditional exports affected by transitory primary shocks and an external context of lower export prices; in contrast to the moderation of imports affected by lower growth in domestic demand and the contraction of import prices. From now on, the trade balance of goods will continue to show surplus amounts and will converge at an average rate of 2.7% of GDP in the 2020-2023 period, as a result of increases in export levels due to greater mining supply and a stable growth of our trade partners, which will partially compensate for the higher imports coming from the reactivation of domestic demand. Thus, the current account deficit will remain at low levels equivalent to 1.6% of GDP between 2020 and 2023 and will converge at a rate of 1.5% of GDP in 2023, before the start of production of Quellaveco, which will allow new historical amounts of exports to be reached.



Fuente: BCRP, proyecciones MEF.

Investment income would register a negative balance equivalent to a ratio of 4.7% of GDP for the entire projection horizon. In 2019, given the context of lower terms of exchange and moderation in the dynamism of private internal demand, it is estimated that there will be a less negative balance of factor income through the expenditure channel of non-resident companies in the country, which will report lower profits than expected, mainly in the case of mining companies (31.4% share of total profits 2018) and industrial companies (16.5% share of total profits 2018). Between 2020 and 2023, the higher growth of the economy will offset the lower contribution of export prices; in addition, the increase in public interest payments in line with the higher debt issuances will be reflected in higher public expenditures, which will allow total factor income to remain with negative balances equivalent to 4.7% of GDP.

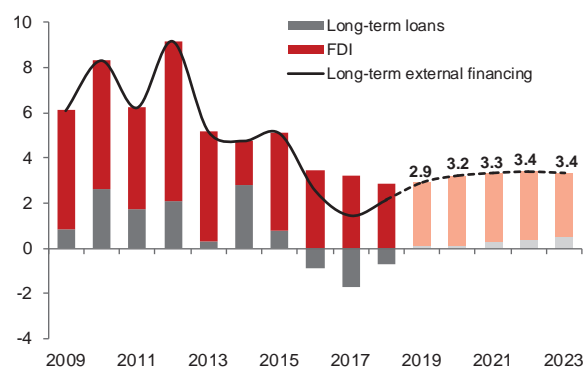
Finally, the execution of the portfolio of large mining investment projects will continue to attract foreign capital and higher foreign direct investment (FDI) flows, which will make it possible to finance the entire current account deficit over the projection horizon. Although FDI is expected to moderate due to the downward revision of the terms of trade and the dynamism of private investment, these private capitals are expected to continue financing the current account deficit. By 2019, the expected level of FDI is in line with the greater amounts of investment in large mining projects (Quellaveco, Mina Justa and the Toromocho expansion), and in the period 2020-2023, the greater execution of these mining projects are added to the large infrastructure projects (port terminals of Chancay, Salaverry, among others). In this context of accelerated private investment and moderation in financing costs (relatively low-interest rates), there will be an increase in long-term loans, coming from greater disbursements to execute the large projects in the portfolio. Thus, long-term external financing⁸³ would reach an average level of 3.2% of GDP between 2019 and 2023.

It should be noted that Peru is recognized as one of the countries best prepared to face external shocks due to its solid macroeconomic strengths. In addition to the greater accumulation of international reserves that are expected to be achieved as a result of the positive balance of payments result, our country stands out as one of the most solid economies to face adverse shocks. Indeed, according to Moody's external vulnerability indicator⁸⁴, Peru is the fourth-best prepared country, above countries such as China, Poland and Qatar, and other regional peers such as Chile and Mexico, to face adverse external episodes of massive capital outflows or cuts in sources of financing. This result is due to the fact that the country has a high level of net international reserves and a low level of external indebtedness compared to other countries with similar credit ratings.

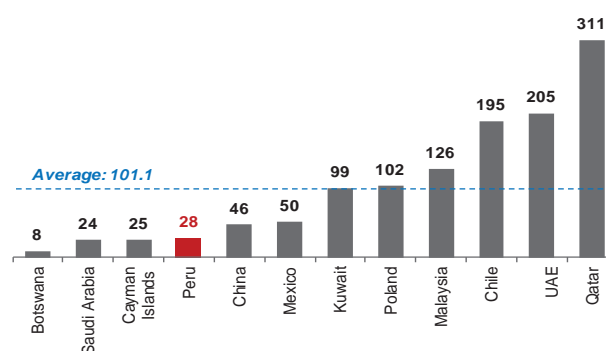
⁸³ Comprises the sum of foreign direct investment and long-term loans.

⁸⁴ External vulnerability indicator = (short-term external debt + current long-term external debt + non-resident deposits of more than one year)/ official foreign exchange reserves.

Long-term external financing (% of GDP)



Moody's: External vulnerability indicator for emerging countries, 2019¹



1/ For emerging economies with a rating [Aaa- A3].

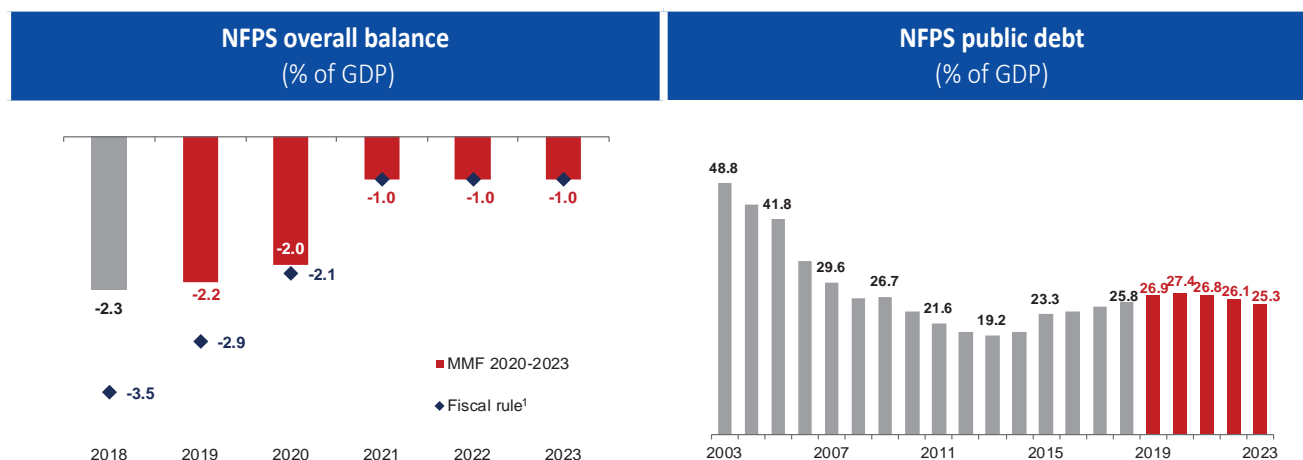
Source: BCRP, Moody's (Statistical Handbook-May 2019), MEF forecasts.

6

PUBLIC FINANCES

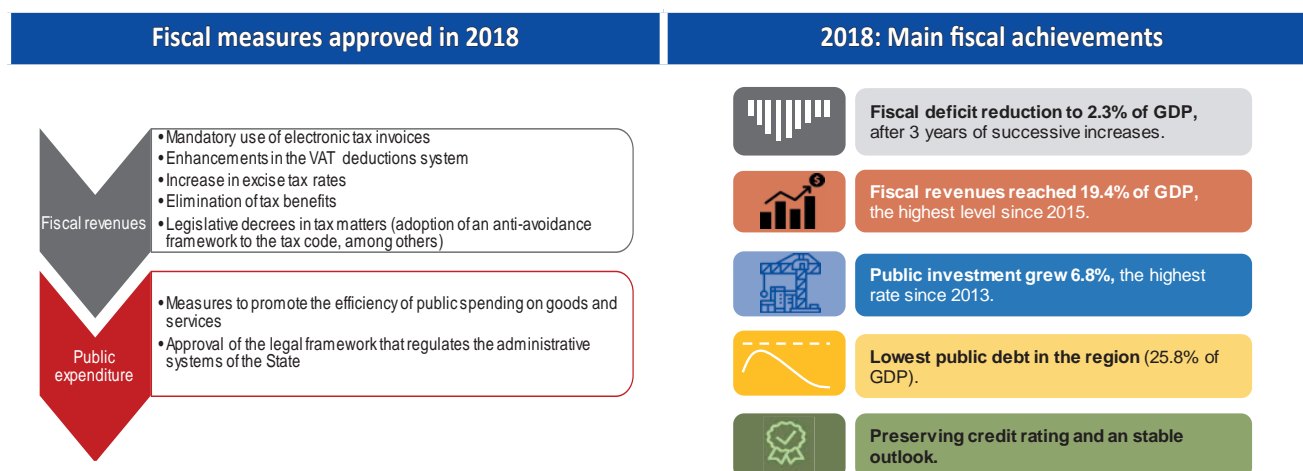


The fiscal forecasts of the present Multiannual Macroeconomic Framework 2020-2023 have been prepared in accordance with the current macro-fiscal framework⁸⁵ for the NFPS. Thus, these are consistent with the strengthening of the fiscal accounts and fiscal sustainability, pillars for the country's macroeconomic stability. Accordingly, an orderly and gradual consolidation process of the fiscal deficit is being developed, which will converge to 1.0% of GDP in 2021 and will allow to keep the sustainability of the fiscal accounts.



1/ According to Law No. 30637, which provides for the application of the exception clause to the macro-fiscal rules of the Non-Financial Public Sector.
Source: BCRP, MEF, MEF forecasts.

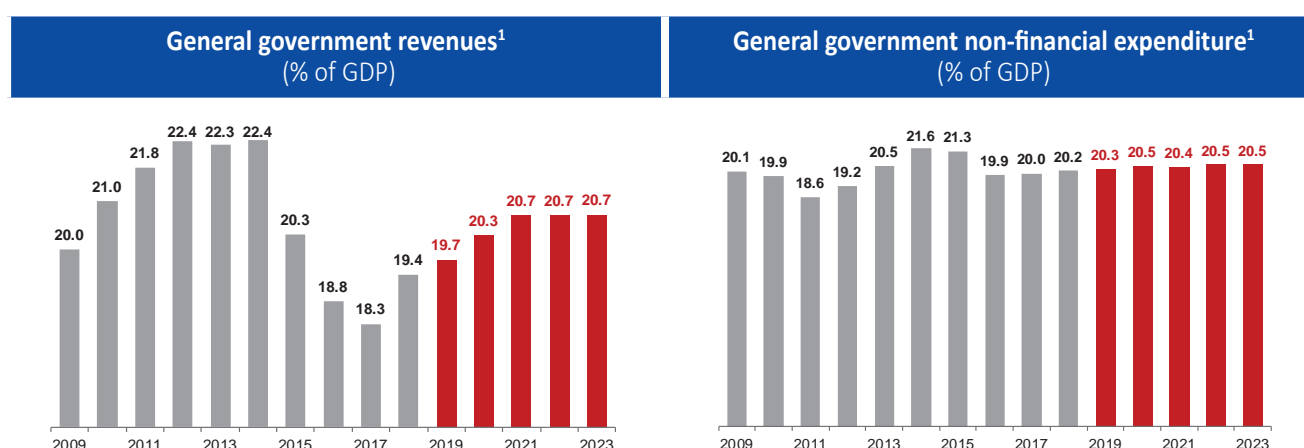
In line with the current macro-fiscal framework, the important advances registered in 2018 and the measures implemented, it is possible to set a path with lower deficits than those legally allowed. Last year a significant improvement in the fiscal position was achieved, by going from a deficit of 3.0% of GDP in 2017 (the highest in the last 17 years) to 2.3% of GDP in 2018, below the established fiscal rule of 3.5%. This result was possible due to a solid recovery of revenues, in a context of implementation of tax measures for combating tax evasion and avoidance, substitute tax benefits in the Amazon and adapt excise taxes rates to negative externalities; as well as adopting policies to improve the efficiency of public spending. Therefore, it is estimated that the NFPS fiscal deficit will be 2.2% of GDP in 2019, lower than that allowed by the rule (2.9% of GDP); fall to 2.0% of GDP in 2020 (rule: 2.1% of GDP); and converge to 1.0% of GDP in 2021. Considering the fiscal deficit path, the NFPS debt will stabilize at around 25.3% of GDP by 2023, below the limit of its fiscal rule (30% of GDP).



Source: MEF.

⁸⁵ Legislative Decree No. 1276, that approves the Framework for Fiscal Accountability and Transparency of the Non-Financial Public Sector; Supreme Decree No. 150-2017-EF (regulation of Legislative Decree No. 1276); and Law No. 30637, which provides for the application of the exception clause to the macro-fiscal rules of the Non-Financial Public Sector.

The improvement in public accounts due to the implementation of measures has continued in 1H2019 by reaching a deficit of 1.5% of GDP, which reinforces the credibility of the proposed fiscal path. In 2018 alone, fiscal revenues grew 11.0% real and increased by 1.1% of GDP (from 18.3% of GDP in 2017 to 19.4% of GDP in 2018), the highest growth since 2011, in a year in which VAT and Income Tax non-compliance indices registered their first fall in three years. Fiscal revenues maintained this dynamic in 1H2019 and grew 5.9% real, despite a context of falling export prices. Consequently, it is expected that the maturation of the set of tax measures, particularly those aimed at reducing tax evasion and avoidance, will increase fiscal income by 1.0% of GDP by 2023 (from 19.7% of GDP in 2019 to 20.7% of GDP in 2023). Such increase will allow for further expansion of public spending, in order to continue reducing infrastructure gaps and to improve the quality of public services. In addition, the progressive implementation of measures addressing the modernization of the State's administrative systems, approved in 2018, will contribute to enhance the efficiency of public spending. Due to the progress of the measures and their favorable effects on public accounts, fiscal convergence would be achieved without affecting public expenditure growth or economic growth. It should be noted that the fiscal deficit trajectory includes temporary expenditures, such as Reconstruction and the Pan American Games, which will dissipate along the established fiscal path.



1/ Includes the three government levels and budgetary and extra budgetary entities (EsSalud, SBS, among others).
Source: BCRP, MEF forecasts.

In 2019, the NFPS fiscal deficit will reach 2.2% of GDP, below the fiscal rule (2.9% of GDP), mainly due to better results in fiscal revenues. After the remarkable advance of revenues in 2018, it is expected that by 2019 these will continue their expansion (4.2% real) and reach 19.7% of GDP. As for public spending, the largest current expenditure (4.3% real) is in line with its fiscal rule and is aimed at meeting health, education and security needs. This increase will also make it possible to continue strengthening the capacities of human capital and provide adequate maintenance of public infrastructure. On the other hand, public investment is expected to register a real growth of 2.5%, mainly due to the development of a set of projects related to Reconstruction, the development of the Pan American and Parapan American Games, and the PMRT, which together have resources programmed of 1.7% of GDP.

As of 1H2019, the NFPS annualized fiscal deficit stood at 1.5% of GDP, mainly explained by an expansion of fiscal revenues. As a result, fiscal revenues grew 5.9% real and reached 20.0% of annualized GDP, an increase of 0.6% of GDP with respect to what was recorded in 2018 (19.4% of GDP). On the other hand, general government spending remained almost stable (1H2019: 20.1% of annualized GDP vs. 20.2% of observed GDP in 2018), in a context of new regional and municipal authorities.

In 2H2019, the fiscal deficit is expected to expand to 2.2% of GDP year-end, due to the upturn in public spending and a more moderate dynamism of fiscal revenues. The boost in public spending during the second half of the year stems from both higher current spending and public investment. The expansion of current expenditure is associated with the continuity of the wage policy, the increase in pensions and expenditure on maintenance. On the other hand, it is expected that public investment will accelerate and contribute to economic growth, due to the execution of infrastructure projects (Reconstruction, completion of the Pan American Games, and the advance of the PMRT), the accentuation of the investment cycle during the second half of the year⁸⁶, and the adoption of support measures to improve the management of public finances of regional

⁸⁶ On average, investment execution is concentrated in the second half of the year (more than 60% of the total)

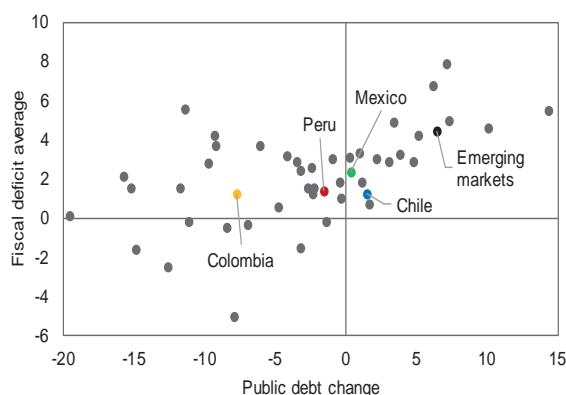
and local authorities. It should be noted that revenues are expected to register a moderate growth, in a context in which favorable factors, such as the recovery of domestic demand and imports, will be attenuated by the increase in tax refunds and the effect of lower export prices.

In 2020, in line with fiscal convergence, the fiscal deficit will reduce to 2.0% of GDP because of the greater effect of measures on tax collection, which will allow for the expansion of public expenditure, especially for the deployment of public investment. Next year, general government revenues are expected to grow by 6.7% in real terms and reach 20.3% of GDP, in an environment of better economic prospects and moderation of export prices, normalization of tax refunds and the greater effect of tax policy and administration measures. In this context, public spending will grow by 5.3% (consumption: 3.8% and investment: 9.0%) and will contribute significantly to the growth of economic activity. This dynamism will be explained by the acceleration of the execution in regional and local governments and the continuity of large-scale projects, such as Reconstruction and the PMRT, which will prevent the withdrawal of the fiscal impulse from affecting economic growth.

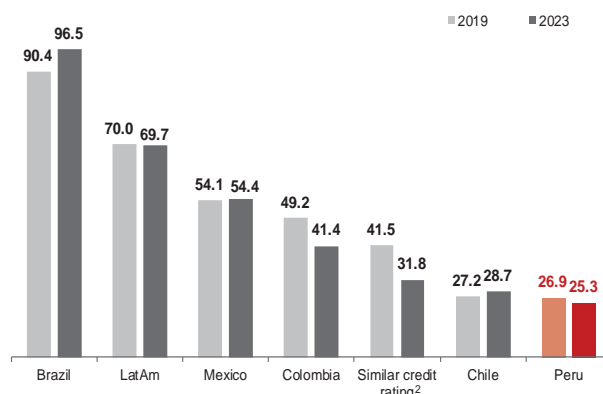
Subsequent to 2020, in a context of economic growth around its potential and the maturity of tax measures, fiscal revenues will continue to expand, which will increase the spending path to provide quality services and public infrastructure. In this sense, the convergence of the fiscal deficit towards 1.0% of GDP in 2021 will be mainly explained by the increase in the level of permanent revenues. Thus, in the context of the integral application of tax measures, general government revenues will be around 20.7% of GDP by 2021 and will remain at that level by 2023. Considering the permanent increase of fiscal income, the general government's non-financial expenditure would grow by an average of 4.6% in real terms between 2021 and 2023, above that recorded in the 2011-2018 period (+4.4% real) and would stabilize at around 20.5% of GDP by 2023, in a context of greater emphasis on transparency and efficiency through the modernization of the State's administrative systems. This will make it possible to reduce infrastructure gaps and improve the country's well-being.

Consistent with the gradual fiscal trajectory, in 2019, the public debt of the NFPS will reach 26.9% of GDP and, from 2020, it will have a decreasing tendency towards 25.3% of GDP in 2023, below its fiscal rule (30% of GDP). It should be noted that between 2019 and 2023, 65% of emerging countries are considering adopting a strategy to reduce public debt, due to a deterioration of their fiscal position, as well as negative revisions in their credit rating. Thus, in the context of public debt consolidation in these countries, by 2023 Peru will continue to register the lowest debt in the region, below the median of countries with similar credit rating (31.8% of GDP) and emerging markets (59.8% of GDP). Moreover, in terms of public debt management, in line with the Egiap, efforts continue to focus on reducing the financial risks to which the debt is exposed. In this sense, it has proactively sought to increase the solarization of debt, while strengthening the local capital market and issue debt with terms that do not generate pressure on financing needs.

Fiscal deficit and public debt, 2019-2023¹
(% of GDP)

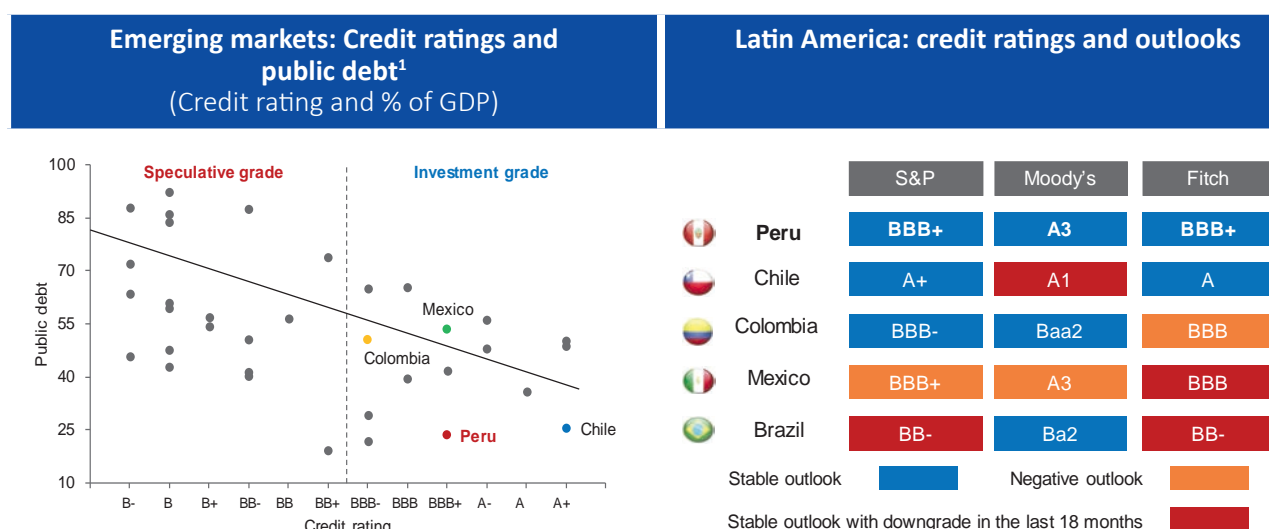


Public debt
(% of GDP)



1/ Considers 51 emerging markets, according to the IMF, and countries with a similar credit rating than Peru. 2/ Countries with A3 credit rating, according to Moody's, and BBB+, according to Standard & Poor's Global Ratings and Fitch Ratings.
Source: IMF, S&P, Moody's, Fitch Ratings, BCRP, MEF, MEF forecasts.

It is important to note that 2019 marks the twentieth anniversary of the fiscal institutional framework, which has shown remarkable performance in the management of public finances⁸⁷, a key tool for preserving fiscal sustainability and contributing to the country's economic stability. Along the strengthening of the macrofiscal framework, it is observed that, in every historic milestone, its designed responded to the fiscal policy priorities, as well as the structural characteristics of the Peruvian economy (see box 6: Twenty years of the Peruvian macro-fiscal framework). The macro-fiscal framework was institutionalized in 1999, and has been strengthened and refined in terms of its main elements, such as macro-fiscal rules and exception clauses, fiscal rules for regional and local governments, countercyclical instruments, such as the Fiscal Stabilization Fund (FEF); fiscal transparency tools, such as the Multiannual Macroeconomic Framework (MMM) and the Fiscal Council.



1/ Considers credit ratings of S&P, Fitch Ratings and Moody's equivalent, and general government public debt for 2018 of 35 emerging markets. Source: IMF-WEO (April 2019), S&P, Moody's, Fitch, MEF, MEF forecasts.

During this period, responsible fiscal management has allowed the construction of important fiscal strengths, which have contributed to the country's macroeconomic stability. As a result, the public debt of the NFPS was reduced from 51.1% of GDP in 1999 to 25.8% of GDP in 2018 (general government: 23.7% of GDP), the lowest in the region, which positions the country as one of the few emerging markets that has maintained the soundness of its fiscal position. Along the same lines, Peru is the only country in the region that has maintained its credit rating and stable outlook in the three main risk rating agencies since 2013, the year after which negative reviews of credit ratings have been recorded more frequently. In general, the rating agencies refer that fiscal strengths and the good credibility history of macroeconomic policies are key factors that allow Peru to maintain investment grade. Moreover, due to a more favorable credit rating, the country has the possibility of accessing a larger portfolio of institutional investors and lower interest rates, which reduces the burden of interest payments and provides space for greater productive spending with a focus on closing infrastructure gaps. In fact, in June 2019, consistent with the Egiap, Peru successfully placed sovereign bonds in the international market for US\$ 2.5 billion, with historic minimum rates, in soles and dollars. This operation has generated significant savings due to lower interest payments, has improved the public debt profile and has increased the level of solarization.

Moving forward, it is essential to continue efforts to preserve fiscal sustainability, especially in view of the risks to which the economy is exposed. Strong macroeconomic stability attracts investment in different productive sectors. In addition, fiscal strength allows the country to mitigate vulnerabilities derived from internal and external risks, particular to the Peruvian economy (see the section on Macro-fiscal Risks).

It is also important to mention that efforts to continue increasing permanent fiscal revenues and enhance the efficiency of public spending will allow the recomposition of the State's financial assets, crucial resources in the face of adverse events. Since 2016, the financial assets of the NFPS have been used, within the framework of a comprehensive financing strategy, to

⁸⁷ The Fiscal Accountability and Transparency Law, Law No. 27245, was enacted in 1999.

mitigate the impact of the fiscal deficit on public debt. As of June 2019, the financial assets of the NFPS amount to 15.5% of GDP, of which the FEF is equivalent to 2.5% of GDP. For this reason, fiscal accounts must continue to be strengthened, especially through actions aimed at generating higher permanent revenues, in order to restore the level of assets and preserve the State's capacity to respond to shocks that affect the dynamism of the economy (see Box No. 10: Financial assets of the NFPS).

Although Peru has a stable credit outlook, there is still room to improve credit ratings by adopting measures to boost the country's development. The main strength of the Peruvian economy is the history of responsible management of fiscal accounts. This has made it possible to obtain investment grade and maintain credit ratings, in a context in which revisions of ratings have been presented in the region in recent years. In order to continue improving the credit rating, it is essential to preserve this responsible management and take complementary actions. In effect, the three rating agencies highlight that Peru could obtain a higher rating if it mainly manages to show i) the consolidation of economic growth and ii) the improvement of the institutional capacity that drives the effectiveness of economic and social policies; for example, through the frontal fight against corruption and the reduction of the informal economy. Such actions would not only improve the perspective of the Peruvian debt but are also indispensable to achieve the country's development.

Peru: Credit rating outlook				
Agency	Rating	Outlook	Ratings rationale	Superior rating
S&P June 2018	BBB+	Stable	Fiscal evaluation: flexibility, performance and debt	A-
			Institutional evaluation	
			Economic evaluation	
			External evaluation	
Fitch Ratings March 2019	BBB+	Stable	Macroeconomic factor	A-
			Public finances	
			External accounts	
			Structural aspects	
Moody's June 2019	A3	Stable	Economic strength	A2
			Fiscal strength	
			Resilience to shocks	
			Institutional strength	

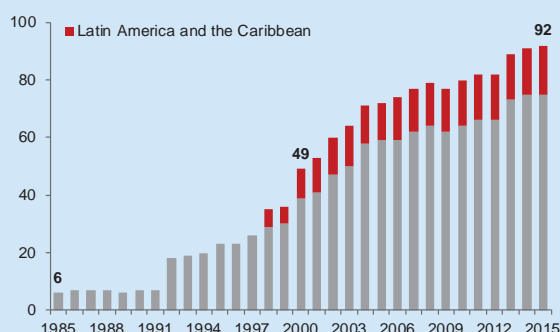
Source: S&P, Moody's, Fitch, MEF. Note: Highlight shades show performance of rating rationale.
■ Strength ■ Neutral ■ Weakness

Box 6: Twenty years of the Peruvian macro-fiscal framework

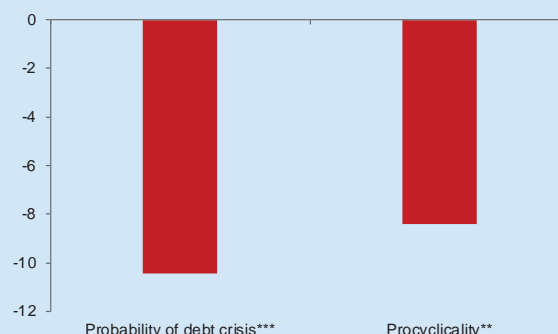
Macro-fiscal frameworks based on fiscal rules have been adopted by a growing number of both advanced and emerging markets. In fact, since the 1990s, the adoption of fiscal rules began to extend in a context of reforms of macro-fiscal frameworks around the world. According to IMF statistics, the number of countries with fiscal rules increased from 6 in 1985 to 49 in 2000 and 92 in 2015. It should be noted that the main benefits of adopting fiscal rules include (i) strengthening fiscal sustainability through sustainable levels of fiscal deficit and public debt (implementation of fiscal rules reduces the probability of a debt crisis by 10.5 percentage points and the degree of procyclicality by 8.4 percentage points⁸⁸); (ii) contributing to macroeconomic stability, with less procyclicality or an increase in the countercyclical capacity of fiscal policy; (iii) strengthening the design and implementation of fiscal policy; and (iv) improving intergenerational equity.

88 IADB (2018) "Better spending for better lives: How Latin America and the Caribbean can do more with less".

Adoption of fiscal rules (Number of countries)



Effects of fiscal rules adoption¹ (Percentage points)



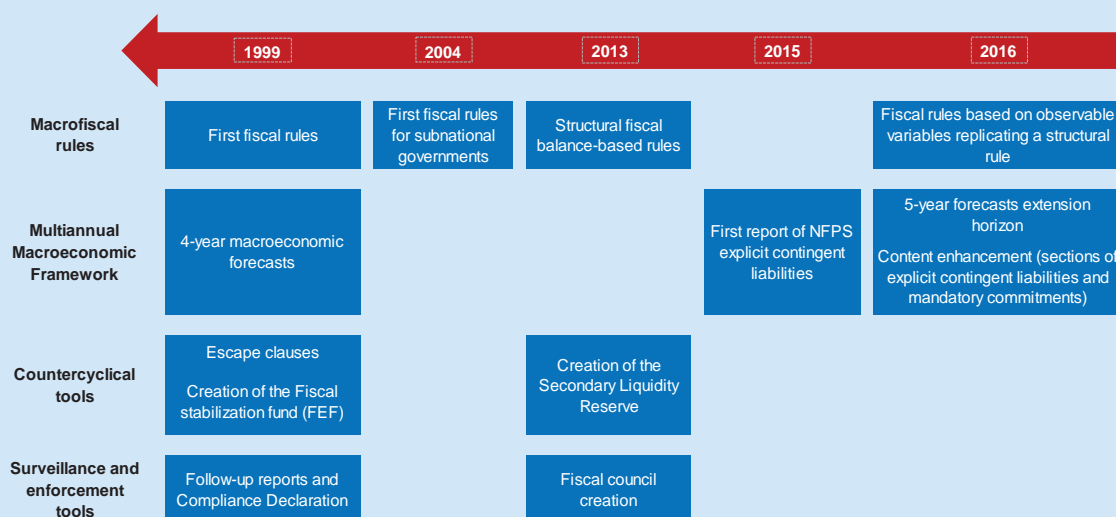
1/ Bars represent the associated coefficient between each dependent variable and the fact of having a fiscal rule. Statistical significance: *** p<0.01; ** p<0.05; * p<0.1.

Source: IMF, Fiscal Rules Dataset (2016) and IADB (2018), "Better Spending for Better Lives. How Latin America and the Caribbean Can Do More with Less".

In Latin America and the Caribbean, the implementation of macro-fiscal frameworks in the late 1990s responded to a context in which most countries were exposing problems of fiscal sustainability. Laws based on fiscal rules and other control tools were implemented in order to restore the credibility of the State in its capacity to manage public finances, ensure the sustainability of public debt, improve the transparency of fiscal policy, and increase macroeconomic stability, fiscal accountability, and transparency. Peru was one of the first countries in the region to institutionalize its macro-fiscal framework.

In the Peruvian case, the macro-fiscal framework was institutionalized in 1999⁸⁹, which was fundamental for economic recovery and for establishing an orderly management of public finances. It is important to mention that the current regulation under which the country's fiscal policy is conducted is the result of a continuous process of strengthening that encompasses two decades of efforts and that has sought to strengthen fiscal sustainability, one of the main pillars of macroeconomic stability. Achieving this objective is an essential element for implementing other structural reforms. Thus, without the disciplined fiscal management implied by such commitment, Peru would not have accumulated sufficient fiscal strengths to mitigate the effects of adverse shocks, such as the global financial crisis in 2008-2009 and the Coastal El Niño phenomenon in 2016-2017.

Continuous improvement of the macro-fiscal framework in line with international standards



Source: MEF.

⁸⁹ Through the Fiscal Responsibility and Transparency Law (LRTF), Law No. 27245. It should be noted that this law was initially called the Fiscal Prudence and Transparency Law and entered into force on January 01, 2000.

In line with this strengthening, Legislative Decree No. 1276 was promulgated in 2016, approving the **Fiscal Responsibility and Transparency Framework (MRTF) of the Non-Financial Public Sector**. The purpose of this regulation is to provide a prudent, responsible, transparent and predictable macro-fiscal framework that facilitates the monitoring and accountability of public finance management and allows adequate administration of the State's assets and liabilities under a fiscal risk management approach. The design of this framework responded to the identification of difficulties in the application of the Strengthening of Fiscal Responsibility and Transparency Law (LFRTF)⁹⁰. The LFRTF mainly aimed at making public spending more predictable and stable by applying structural fiscal rules based on non-observable variables, such as potential GDP and long-term export prices.

It should be noted that, in order to permanently guarantee fiscal sustainability, the predictability of public spending and the transparent management of public finances, the current macro-fiscal framework establishes that the NFPS is subject to joint compliance with fiscal rules based on observable variables. These rules set limits for public debt, fiscal deficit, non-financial expenditure, and current expenditure, excluding maintenance. It should be noted that the design of the country's macro-fiscal rules takes into account the composition of public spending, in line with the IADB's recommendations (2018). In particular, this agency stresses the importance of supplementing the aggregate fiscal rules with double-condition fiscal rules, that is, those that avoid negative bias against public investment. In this way, the rules of growth for total and current expenditure seek to limit increases of inflexible spending while preserving levels of public investment, especially in the context of fiscal consolidation. According to the IADB, the evidence suggests that these rules are desirable, since the countries that have applied them registered greater growth and reduced the volatility of their economic fluctuations.

Current fiscal rules

Public debt

No more than 30% of GDP¹.

Fiscal deficit

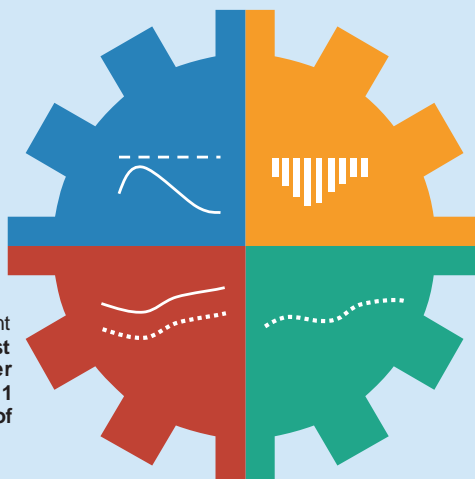
No more than 1% of GDP².

Non-financial expenditure

Real growth of general government non-financial expenditure **must not be greater than the upper limit of the range between +/- 1 p.p. 20-year moving average of real annual GDP growth³**.

Current expenditures (excluding maintenance)

Real growth of general government current expenditures excluding maintenance, **must not be greater than the lower limit of general government non-financial expenditure rule range**, and in no cases is greater than its growth rate⁴.



1/ Exceptionally in financial volatility cases and provided that compliance of the other macrofiscal rules, public debt may have a temporary deviation of no more than 4 p.p. of GDP.

2/ Law No. 30637 provided for the application of the exception clause to the NFPS macro-fiscal rules. Thus, the annual fiscal deficit for 2018, 2019, 2020 and 2021 fiscal years must not exceed 3.5, 2.9, 2.1 and 1.0 of GDP, respectively.

3/ This rule will be applied starting 2020.

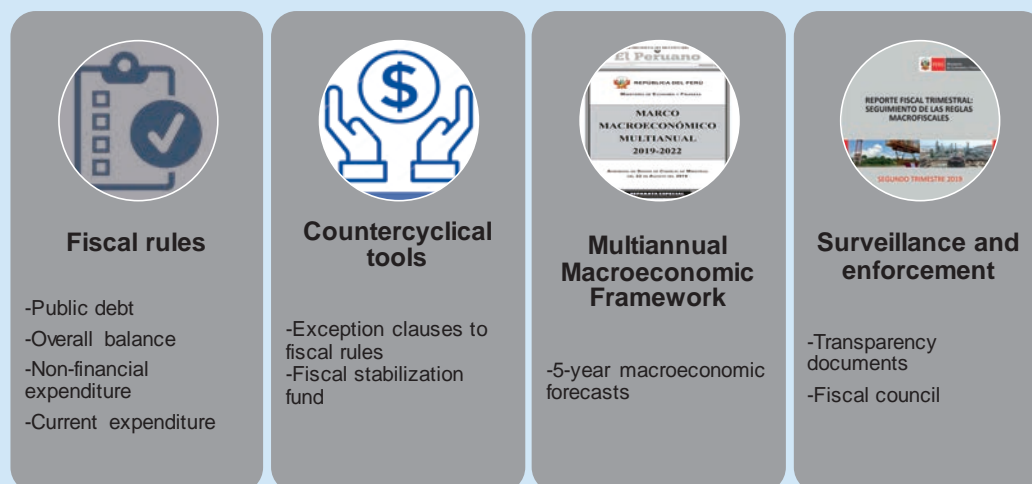
4/ For 2020 and 2021, the growth of this expenditure is obtained by subtracting 1.5 p.p. from the long-term growth of the economy.

Source: MEF.

In addition to fiscal rules, the macro-fiscal framework contains other important elements that drive the transparent and accountable management of public finances. As a result of the strengthening of the fiscal framework, its main elements were institutionalized: rules on fiscal aggregates; countercyclical instruments, such as exception clauses to macro-fiscal rules and contingency funds; fiscal transparency tools, such as the MMM; and other monitoring and control tools and institutions. Since then, these elements have been evaluated and strengthened taking into account the structural characteristics of the economy and policy priorities, in accordance with international best practices.

90 Enacted in 2013 by Law No. 30099.

Main elements of the macro-fiscal framework



Source: MEF.

Multiannual Macroeconomic Framework

The Multiannual Macroeconomic Framework (MMM) is the most relevant document issued by the Government of Peru in economic matters and is prepared and published by the MEF. This document was instituted by the first macro-fiscal framework and has been published since 2000. It mainly includes macroeconomic forecasts and assumptions for the international environment and the local economy; macroeconomic, fiscal and tax policy guidelines; the determination of fiscal rules, as well as the prospective analysis of revenues, expenditure, and financing.

Given the importance of the MMM as a tool for fiscal transparency and its link with the budget, measures have been taken to strengthen it in line with regional standards. Thus, for example, the MMM presents forecasts for a five-year period, which includes the year for which the budget is being prepared and at least the following three years. With respect to the content, new sections have been incorporated referring to the evaluation of explicit contingencies of the NFPS, macro-fiscal risks and the fiscal scenario that contemplates long-term mandatory fiscal commitments⁹¹. In addition, the MMM is approved at the end of August and is complemented with a report updating the main macroeconomic and fiscal variables of the current MMM, which is published in April on MEF's institutional portal.

Countercyclical tools

The macro-fiscal framework includes exception clauses that allow for temporary modification of fiscal rules, in order to provide a flexible framework for the occurrence of unexpected adverse situations, such as disasters or significant external shocks. This aspect allows a timely response of fiscal policy to the effects of adverse scenarios, which contributes to stabilizing the dynamism of the economy. Additionally, the application of exception clauses enables the use of FEF resources. Thus, for example, in 2017, the expansion of the fiscal deficit was approved and the use of FEF resources was enabled in order to finance the Reconstruction process faced after the Coastal El Niño⁹².

The objective of the FEF is to generate fiscal savings that will increase the State's capacity to respond to scenarios that would have a significant impact on the economy, such as crisis situations or contingencies; for example, natural

⁹¹ The estimation of mandatory expenditure in the medium term and its comparison with the limits established under a macroeconomic scenario make it possible to estimate the fiscal room, which indicates the degrees of freedom available to implement new public policies without compromising macroeconomic stability, fiscal sustainability or market access. See more details in MMM 2018-2021 (August 2017).

⁹² By means of Law No. 30637, which provides for the application of the exception clause to the macro-fiscal rules of the Non-Financial Public Sector.

disasters⁹³. The FEF is attached to the MEF and is managed by a board composed of the Minister of Economy, who presides over it; the president of the BCRP; and a representative Appointed by the President of the Council of Ministers. The resources of the FEF are mainly conformed of i) the freely available budget balance of the Public Treasury obtained at the end of each fiscal year in the source of financing of Ordinary Resources; ii) 10% of the income from the sale of assets through privatization; and iii) 10% of the liquid income from the initial payment for State concessions. These FEF resources can only be used when exception clauses are activated.

The institutional framework of the FEF has been preserved and strengthened. Thus, in 2013 a technical secretariat (ST) was created, which falls under the General Department of Public Indebtedness and Treasury (Dgetp) of the MEF. The role of the technical secretariat is important, since, mainly, it has the function of proposing to the board of directors the investment guidelines and directives according to which the FEF is administered, the budgetary use of its resources and the necessary administrative procedures, considering the Dgetp's Strategy for Asset and Liability Integral Management (Egiap). In addition, the ST must periodically inform the Board of Directors regarding the performance of the investments made, as well as maintain an updated section where information on the FEF's management is published in the institutional portal of the MEF.

Monitoring and control tools

In order to promote fiscal transparency and accountability, besides to the MMM, the macro-fiscal framework contains a Fiscal Responsibility Compliance Statement. This document evaluates compliance with the macro-fiscal rules set forth in the MMM, which were proposed in the year prior to the exercise to be evaluated. In addition, the situation of public finances and macroeconomic indicators is presented, and comparisons are made with the MMM's forecasts. The report is published in the institutional portal of the MEF, within the first semester of each year and is sent to the Congress of the Republic and the Fiscal Council. It should be noted that, in the event of deviations, the detailed substantiation of the causes and the corrective measures to be adopted must be included.

In addition, in order to monitor public finances more continuously, the MEF publishes on its institutional portal a quarterly report on the degree of compliance with macro-fiscal rules for the NFPS. This document contains a section analyzing the evolution, at the end of the respective quarter, of the main macrofiscal accounts corresponding to revenues, expenses, interest payments, the primary balance of EPNF and public debt, and another section in which the progress in compliance with the current macrofiscal rules is developed.

On the other hand, in 2013, in order to strengthen the institutionality of fiscal policy, the Fiscal Council was created as an autonomous commission attached to the MEF, whose purpose is to contribute with the independent technical analysis of macro-fiscal policy. The creation of the Fiscal Council in Peru marked a new milestone in the institutionalization of fiscal policy, in line with the countries of the Pacific Alliance, and was placed at the level of developed countries in fiscal matters, such as Belgium, Germany, United Kingdom, Denmark, among others⁹⁴.

Achievements of the macro-fiscal framework

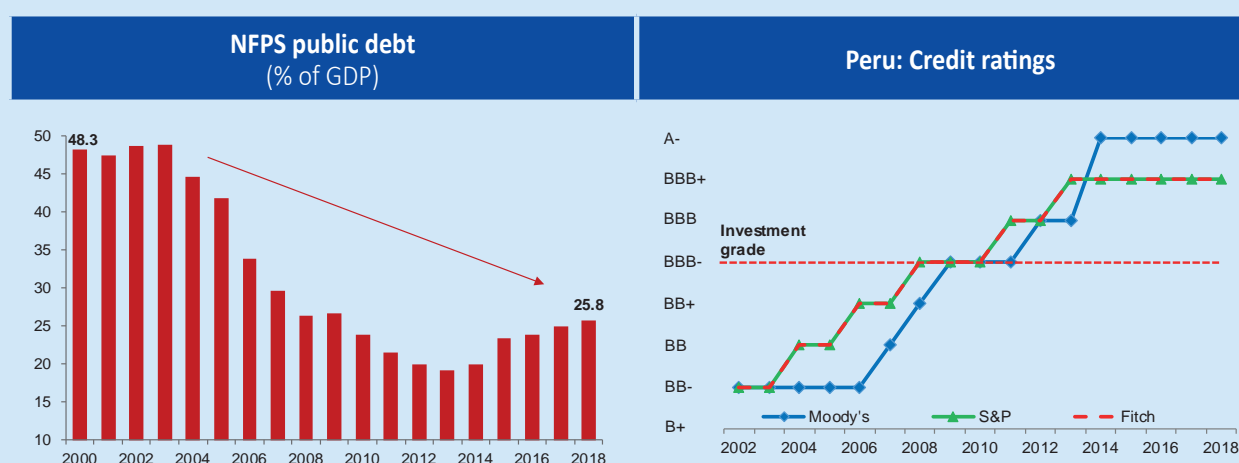
Prudent and responsible fiscal management since the late 1990s and favorable economic performance have allowed building fiscal strengths, which are reflected in various indicators. Among the most notable are:

- *Macroeconomic stability and predictability of public spending.* The institutionality of the macro-fiscal framework has provided stability to public spending and GDP. As a result, in the two decades of strengthening this framework, these two indicators have gained greater predictability than in the two preceding decades. Between 1980 and 2018, GDP and public spending volatility have been reduced by a third.

⁹³ There is also a Secondary Liquidity Reserve (RSL). The RSL is intended to deal with situations that affect the liquidity of Ordinary Resources or Resources from Official Credit Operations that finance the expenses considered in the annual public sector budget law, in the event that the revenues from the indicated sources of financing are lower than those considered in the initial opening budget of the same year.

⁹⁴ It should be noted that the first fiscal councils date back more than fifty years ago, such as Holland (1945), followed by Denmark (1962), Austria (1970) and the USA. (1974). In the Pacific Alliance countries, Mexico has the oldest fiscal council (1998), followed by Colombia (2012), Chile (2013) and Peru (2013)

- *The reduction of the public debt of the NFPS by half, from 48.3% of GDP in 2000 to 25.8% of GDP in 2018, making it currently the lowest debt in the region and below the median of countries with similar credit ratings (41.5% of GDP).*
- *The best use of public resources in public debt service.* As a result, this expenditure was reduced from 5.0% of GDP in 2000 to 2.9% of GDP in 2018.
- *The accumulation of significant levels of NFPS financial savings, which rose from 8.6% of GDP in 2001 to 14.5% of GDP in 2018.* In particular, FEF resources rose from 0.3% of GDP in 2001 to 2.6% of GDP in 2018.
- *Continuous improvements and ratifications of credit ratings.* From 2004 to 2014, the main risk rating agencies⁹⁵ have improved Peru's credit rating from B+ to BBB+. An important milestone in this period is that in 2008 and 2009 the country obtained the investment grade, in the midst of the global financial crisis, basing this advance in the improvement of its external and fiscal accounts. Subsequent to 2014, the markets have continue shown their confidence in the country's macro-fiscal fundamentals. Thus, Peru is currently the only country in the region that has preserved its credit rating and stable outlook in recent years.
- *Improved yield curves, which has translated into more favorable interest rates for the country.* Currently, interest rates on Peru's sovereign bonds are among the lowest in emerging markets, allowing the public and private sectors to access better financing conditions to promote projects that improve the country's productive capacity and well-being.

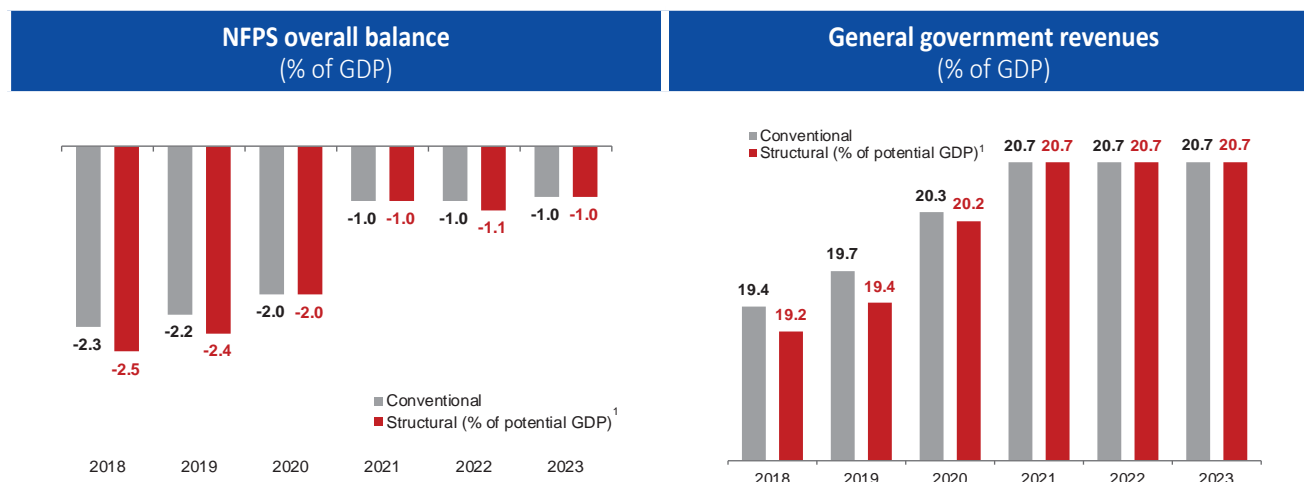


Source: BCRP, S&P, Moody's, Fitch Ratings, MEF.

Towards the future, it is crucial to consolidate the fiscal achievements mentioned above and to further strengthen the macro-fiscal framework, which will enhance the impact of fiscal policy on the economy. In particular, there is room for improvement in the consistency between fiscal rules and the budgetary process at both the formulation, approval, and implementation stages. At the same time, fiscal policy coordination among the different levels of government must continue to be strengthened in order to meet fiscal goals. Working on the above-mentioned measures will make it possible to address the sources of budgetary deviations and provide greater predictability and credibility to public finances. It is important to emphasize as well that the integral development of the modernization of administrative systems will be a key complement to increase the capacity of fiscal policy.

In structural terms, a fiscal deficit of 2.4% of potential GDP is projected for 2019, which will converge to 1.0% of potential GDP in 2021, in a context of a closing GDP gap and a level of commodity prices below its potential. This projection considers an increase in structural revenues of 1.3 percentage points of GDP, as a result of the integral application of tax policy and administration measures. This increase is progressive. Thus, permanent income will rise from 19.4% of potential GDP in 2019 to 20.7% of potential GDP in 2023.

⁹⁵ Standard & Poors, Moody's and Fitch Ratings.



1/ Considers the methodology for the calculation of the structural accounts approved by Ministerial Resolution N° 024-2016-EF/15 of January 31, 2016. For 2018 and 2019, extraordinary income from the repatriation of capital, large sales of non-domiciled assets, among others, are excluded from the calculation.

Source: BCRP, Sunat, Perupetro, EsSalud, MEF, MEF forecasts.

Summary of the fiscal accounts of the Non-Financial Public Sector							
	2018	2019	2020	2021	2022	2023	Avg. 2020-2023
I. General government revenues	143,785	153,244	167,128	182,167	195,140	209,726	188,540
% of GDP	19.4	19.7	20.3	20.7	20.7	20.7	20.6
General Government structural revenues¹	141,978	151,676	166,991	182,251	194,325	209,726	188,324
% of potential GDP	19.2	19.4	20.2	20.7	20.7	20.7	20.6
II. General government non-financial expenditures	149,364	157,345	168,673	179,094	192,902	207,596	187,066
% of GDP	20.2	20.3	20.5	20.4	20.5	20.5	20.5
1. Current expenditures	113,145	120,681	127,846	134,995	143,436	152,353	139,657
% of GDP	15.3	15.5	15.5	15.4	15.2	15.1	15.3
2. Capital expenditures	36,219	36,664	40,827	44,099	49,467	55,243	47,409
% of GDP	4.9	4.7	5.0	5.0	5.3	5.5	5.2
III. Non-financial public enterprises primary balance	-1,463	-2,050	-2,728	291	1,035	1,418	4
% of GDP	-0.2	-0.3	-0.3	0.0	0.1	0.1	0.0
IV. Primary balance (I - II + III)	-7,042	-6,152	-4,273	3,364	3,273	3,548	1,478
% of GDP	-1.0	-0.8	-0.5	0.4	0.3	0.4	0.1
V. Interests	10,013	10,733	11,976	12,580	13,145	13,666	12,842
% of GDP	1.4	1.4	1.5	1.4	1.4	1.4	1.4
VI. Overall balance (IV - V)	-17,055	-16,885	-16,249	-9,217	-9,873	-10,118	-11,364
% of GDP	-2.3	-2.2	-2.0	-1.0	-1.0	-1.0	-1.3
VII. Structural overall balance	-18,862	-18,452	-16,386	-9,132	-10,687	-10,118	-11,581
% of potential GDP ¹	-2.5	-2.4	-2.0	-1.0	-1.1	-1.0	-1.3
VIII. Public debt stock	190,741	208,979	226,108	235,717	245,776	256,230	240,958
% of GDP	25.8	26.9	27.4	26.8	26.1	25.3	26.4

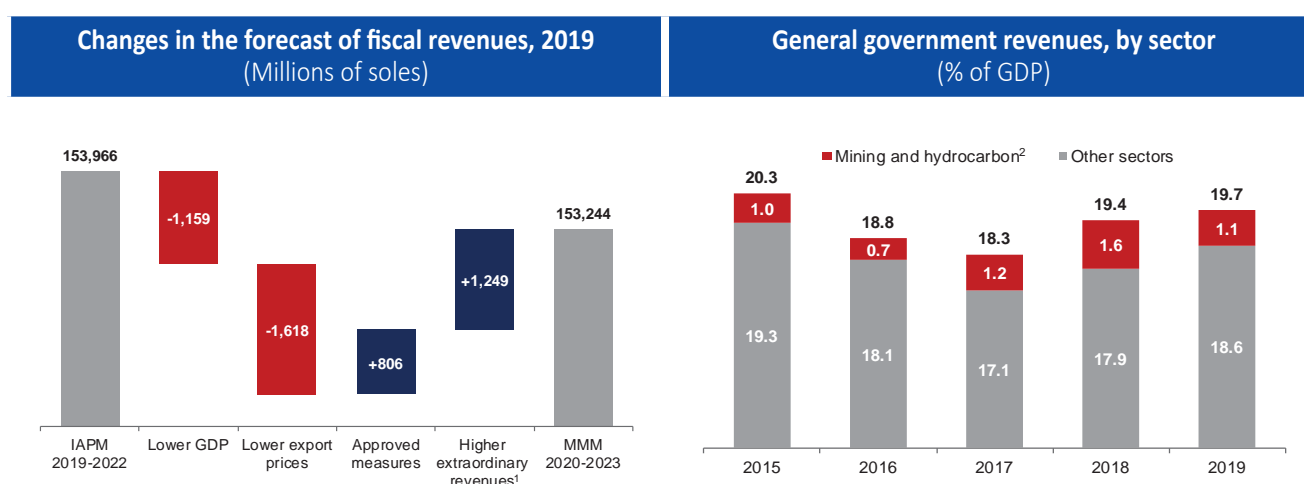
1/ For the calculation of the structural balance, the methodology approved by Ministerial Resolution No. 024-2016-EF/15 was used. Extraordinary revenues of the 2018-2019 period from the repatriation of capital, large sales of non-domiciled assets, among others, are excluded.

Source: BCRP, Sunat, MEF, MEF forecasts.

6.1. REVENUES

Between 2019 and 2023, general government revenues will maintain a growth rate that will allow them to expand from 19.7% planned for this year to reach 20.7% of GDP at the end of the projection horizon. This forecast will be supported by the growth of economic activity around its potential, the normalization of export prices, reduction of tax refunds and the beginning of the payment of a corporate income tax (CIT) of new mining projects. It incorporates also the expected effect of the tax measures undertaken since 2018, which are mainly based on the fight against tax evasion and avoidance by improving the international tax framework and the massification of electronic tax invoicing. It should be mentioned that, in the last year, the levels of tax non-compliance of the CIT and Value-Added Tax were reduced by 1.0 and 3.8 pp, respectively; and it is expected that by 2023 the non-compliance with said taxes will be reduced by around 3 percentage points.

In 2019, the general government revenues (GGR) will grow 4.2% real and reach 19.7% of GDP (central government tax burden: 14.2% of GDP). The estimated growth for this year is based on the collection of taxes from the measures adopted, which would go from 0.2% of GDP reached in 2018 to 0.5% of GDP in 2019 due to the maturity of those approved in the middle of last year⁹⁶, the improvements in the control actions and audits by Sunat, and the extraordinary income achieved (close to S/ 3 billion in the 1H2019⁹⁷). These factors would be mitigated by the fall in export prices (-3.4%), which would reduce revenues associated with mining and hydrocarbon companies (-24.6%), and by higher refunds due to exceptional court rules and balances. in favor of investment projects. It should be noted that this forecast represents a slight downward review with respect to the projections of the IAPM of April (4.6% real), due to the negative effect of the review of key variables such as GDP (from 4.2% to 3.0%) and export prices (from -0.5% to -3.4%), which will be mitigated by the collection related to Sunat's audit actions and extraordinary revenues. In addition, it is worth noting that the measures will allow fiscal revenues of sectors not associated with natural resources to continue expanding, which reduces the dependence of fiscal accounts on volatile sources.



1/ In the second quarter of 2019, S/ 371 million were recorded due to the execution of the guarantee clause of a broadband project in Piura, Tumbes and Cajamarca, S/ 180 million in accumulated mining royalties from past periods, S/ 300 million from assets sellings, S/ 252 million from profits of the BCRP, among others. 2/ Corporate income tax, regularization and royalties from mining and hydrocarbon companies, as well as special mining tax and special mining levy, and remnant of mining profits. Source: BCRP, EsSalud, Perupetro, Sunat, MEF, MEF forecasts.

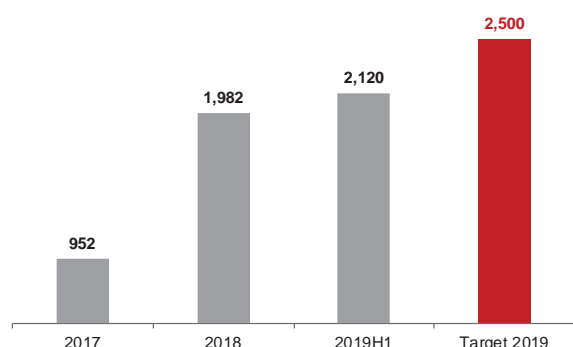
The estimated performance of fiscal revenues for this year will be largely due to the growth observed in the first half of 2019 (6.0% real). According to Sunat, only in the first semester about S/ 2.1 billion of tax debt were recovered (exceeding that recorded during all 2018), as the result of the application of new control and audit schemes, which go hand in hand with the

⁹⁶ Between April and May 2018, measures were adopted that improved VAT deductions systems and adjusted excise tax rates to negative externalities. However, their effect on last year's collection was proportional to the date they were approved.

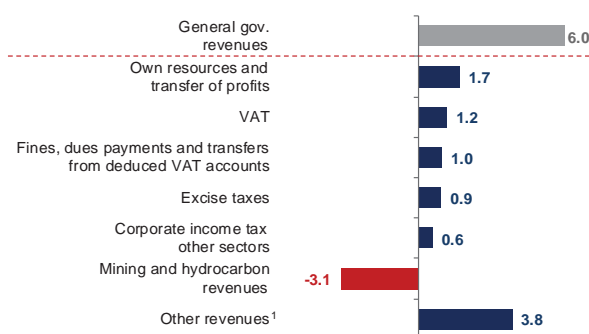
⁹⁷ Of which about S/ 1.5 billion are tax (S/ 701 million from assets sellings in past periods, S/ 434 million from the payment of Odebrecht's debt, among other revenues associated with audit actions) and about S/ 1,500 million are non-tax (mainly S/ 500 million from the transfer of profits of Fonafe provided in the Law of Financial Equilibrium of the Public Budget; S/ 371 million from the execution of the guarantee clause of a broadband project in Piura, Tumbes and Cajamarca; and S/ 252 million from profits of the BCRP).

technology and the mass use of electronic tax invoices and books. These measures and actions achieved a reduction of the default ratio from 2.5% in 2016 to 1.7% in 2018 (the lowest historical level) and the levels of tax non-compliance for the first time in the last three years (see box 7: Advances and achievements of the tax measures implemented). This was accompanied by the good performance of companies from the services and financial intermediation sectors, the effect of the tax measures adopted between April and May of 2018 (VAT deductions system and the increase of excise tax rates), and the registration of extraordinary non-tax revenues. Such factors were mitigated by the fall in the price of commodities such as copper (-10.8%) and WTI crude oil (-12.4%), which affected mining and hydrocarbon revenues (-34.5%), as well as higher refunds. (4.9%).

Recovery of tax debts associated with control actions and audit work (Millions of soles)



General government revenues growth, 2019H1 (% real annual change and real contribution)



1/ Includes tariffs, other tax revenues, local government tax revenues, social contributions, other non-tax revenues and capital revenues.
Source: BCRP, Sunat, EsSalud, Perupetro, MEF.

Meanwhile, for the 2019H2, revenues are expected to grow at a more moderate pace (2.3% real).

For the second half of the year, revenues are expected to be driven by the recovery of domestic demand (4.8%) and imports (3.1%). Additionally, the implementation of the measures approved in 2018⁹⁸ to tackle and reduce tax avoidance and evasion will continue. In fact, at the end of June, Sunat pre published the Superintendency Resolution draft on the application of the general anti-avoidance rule and, since July, taxpayers who have had annual incomes equal to or greater than 300 tax units (UIT) are required to issue electronic tax invoice (CdPE). However, it is expected that these factors will be mitigated by the fall in mining and hydrocarbon revenues (-10.1%), which will reflect the lagged effect of lower commodity prices observed in the first half of the year, and because of higher refunds (4.3%), due to the attention of court rules and balances in favor of large investment projects⁹⁹.

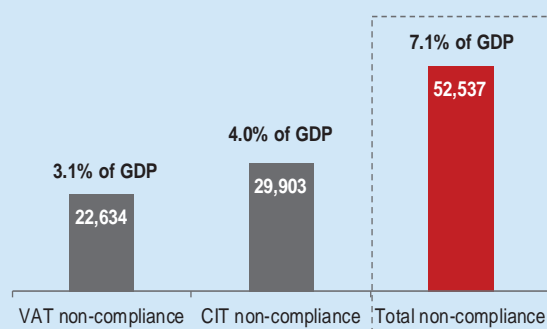
⁹⁸ It refers to the measures contained in the legislative decrees approved in 2018, of which the following stand out: the implementation of a review committee for the application of the general anti-avoidance rule, mandatory use of electronic tax invoices, improvements in the VAT deductions system (SPOT), improvement of conditions for the indirect sale of shares, among others aimed at fighting tax evasion and expanding the tax base.

⁹⁹ It refers to the refunds for balances in favor of exporters and VAT reimbursement of investments from Talara's refinery modernization project (Petroperú) and Quellaveco (Anglo American).

Box 7: Advances and achievements of the tax measures implemented

During 2018, measures were approved to increase permanent revenues, which had effects in the short term and will have a greater impact in the medium term. It should be noted that the design of the fiscal consolidation path implies increasing permanent fiscal revenues, thence it allows to continue the expansion of public spending to provide additional services and public infrastructure. This is especially feasible given the high degree of tax evasion and avoidance, which amounts to 7.1% of GDP and is one of the highest in the region, as well as market distortions and other negative effects that entails on the economy. In that sense, the measures approved last year were aimed at fighting tax evasion and avoidance, through the digitalization of the tax system and adaptation of the Tax Code to the best practices of the OECD, to which others were added with the objective of aligning taxes to externalities, eliminate tax benefits and to improve services in favor of the taxpayer.

VAT and CIT non-compliance of General¹, 2018
(Millions of soles, % of GDP)

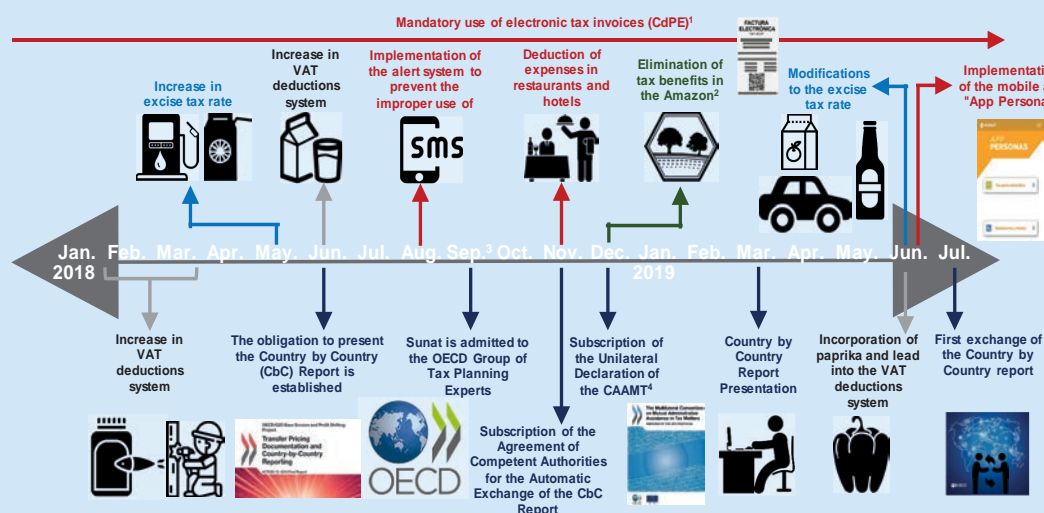


VAT and CIT non-compliance ranking^{2,3}
(% of the potential collection)

	VAT	CIT
Peru (2018)	32,9	48,5
Peru (2014)	29,0	44,1
Chile (2017)	20,0	31,0
Mexico (2016)	16,4	19,2
Colombia (2015)	20,1	34,4

1/ Difference between the estimated potential tax and the tax paid, net of the effect of tax expenditures. 2/ For Peru it corresponds to the ratio between the estimated non-compliance and the potential determined tax, net of the effect of tax expenditures. 3/ In the case of Chile and Colombia, corporate income tax non-compliance corresponds to 2009 and 2012, respectively.
Source: Sunat.

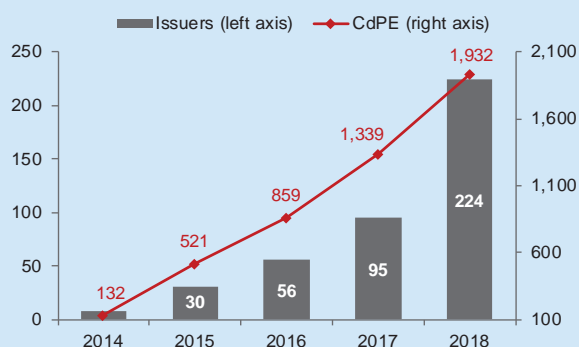
Tax measures approved between January 2018 and July 2019



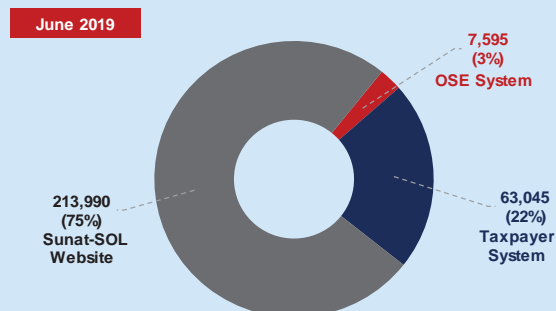
1/ In 2018, the mandatory use of electronic tax invoices was implemented progressively in January, April, May, July, August and November. Additionally, since March 2019, companies that declared income greater than or equal to 150 tax units (\$/ 607,500) in the tax period of 2017 and since July 2019 companies in the financial sector that carry out operations taxed with VAT are required. 2/ The VAT refund in Loreto and the VAT exemption for the importation of goods destined for consumption in Loreto and the Amazon were eliminated. 3/ Between August and September 2018, 27 tax measures were published in 18 Legislative Decrees. 4/ Convention on Mutual Administrative Assistance in Tax Matters.
Source: El Peruano, Sunat.

The electronic tax invoice (CdPEs) are the basis of tax digitization, and in recent months significant advances in coverage and use of available information have been achieved. These electronic tax invoices reduce compliance costs and allow Sunat to access, in real time, the details of the operations carried out by taxpayers. In order to spread its use, its obligation was extended, it was arranged that workers can use them to deduct from their income tax up to 3 additional tax units (UIT) (S/ 12 600) for expenses in sectors that show high evasion and a mobile application was implemented (PPP Personas), through which workers can verify the deductible expenses they have made so far this year. As a result, the number of electronic issuers¹⁰⁰ went from 7 thousand in 2014 to more than 224 thousand in 2018 and 300 thousand as of June 2019. This has allowed more than 6 million CdPE to be issued daily through the Sunat portal, electronic service operators (OSE)¹⁰¹ or from the taxpayer's own systems¹⁰². The digital information obtained with this type of invoices has served to design tools that facilitate compliance and risk management. For example, an SMS alert system was developed that alerted about 58 thousand taxpayers for 256 thousand invoices at risk, as they would correspond to personal expenses not deductible to the business, at an average value of S/ 62 million per month between September from 2018 and March 2019.

Number of issuers and CdPE issued
(Miles y millones)



Number of issuers according to electronic emission system



Source: Sunat

On the other hand, a set of legislative decrees on international taxation was approved according to the recommendations of the OECD's BEPS Plan. They seek to: i) exchange standardized reports on tax and financial matters with other countries to increase the transparency of operations; ii) strengthen the tax administration's capacity for action against elusive acts and provide legal certainty to taxpayers; and iii) prevent avoidance schemes. Thus, this year Sunat began the exchange, with 38 tax administrations, of the Country by Country Report, which provides consolidated tax information on multinational groups in the field of transfer pricing; and was admitted to integrate the Group of Experts of Aggressive Tax Planning of the OECD, which will allow it to adapt its strategies to the new modalities of transferring benefits to places of low or no taxation.

These measures have been accompanied by others that correct the alignment of taxes that tax externalities, overcome non-compliance from other fronts, substitute tax benefits for public investment and others in favor of citizenship. In the middle of last year, measures that correct the excise tax rates applied to six goods were approved, thence they better reflect the negative externalities that they generate. This was joined by a set of measures that enhance VAT deductions system, since this regime allows formal buyers to ensure the tax compliance of their suppliers. In addition, at the end of the year the elimination of value-added tax exemptions for imports of consumer goods in the Amazon and the tax refund in Loreto were approved, in exchange for annual transfers of more than S/ 300 million for investment in infrastructure works. Moreover, in recent months, Sunat implemented mobile applications and virtual platforms that

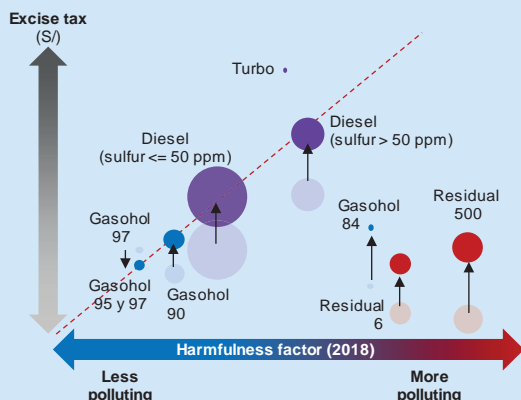
¹⁰⁰ Including sales tickets, invoices, credit and debit notes, among others

¹⁰¹ The purpose of an OSE is to verify and authorize the issuance of electronic payment vouchers in accordance with the electronic emission system. To date there are 14 operators accredited to the Sunat.

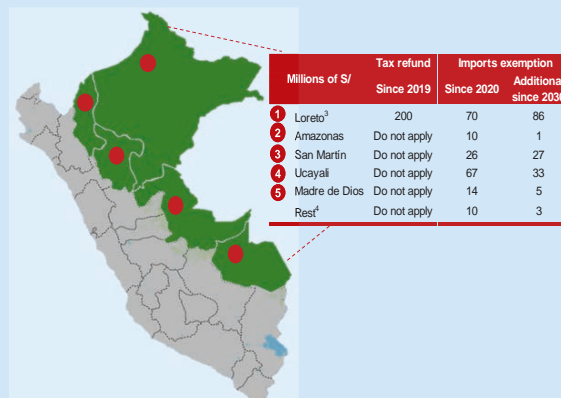
¹⁰² Through an electronic service provider (PSE), aimed at issuers of large volumes

help users to carry out procedures, issue and consult CdPE, submit statements, and receive alerts and reminders, to close the gaps in the processes of registration, documentation, transaction log, declaration and payment.

Modifications to the fuel's excise tax, 2018¹



Amazon: Transfer to regional governments due to the elimination tax of exemptions² (Millions of soles)



1/ Referential scales 2/ Under laws No. 30896 and 30897. 3/ The transfer to Loreto for the VAT exemption began in 2019 and the additional increase will be delivered since 2029. 4/ Consider the provinces and districts of the others departments of the Amazon.
Source: Sunat, Minam, MEF.

Digital tools and services to facilitate tax compliance

Internal taxes operations

RUC data update

App Emprendur Sunat (Medium and small enterprises)

Foreign trade operations

Microsite of import times

Merchandise arrival alert and debt payment

Virtual platform for the declaration of Aeronautical Use Material

Attention to taxpayers

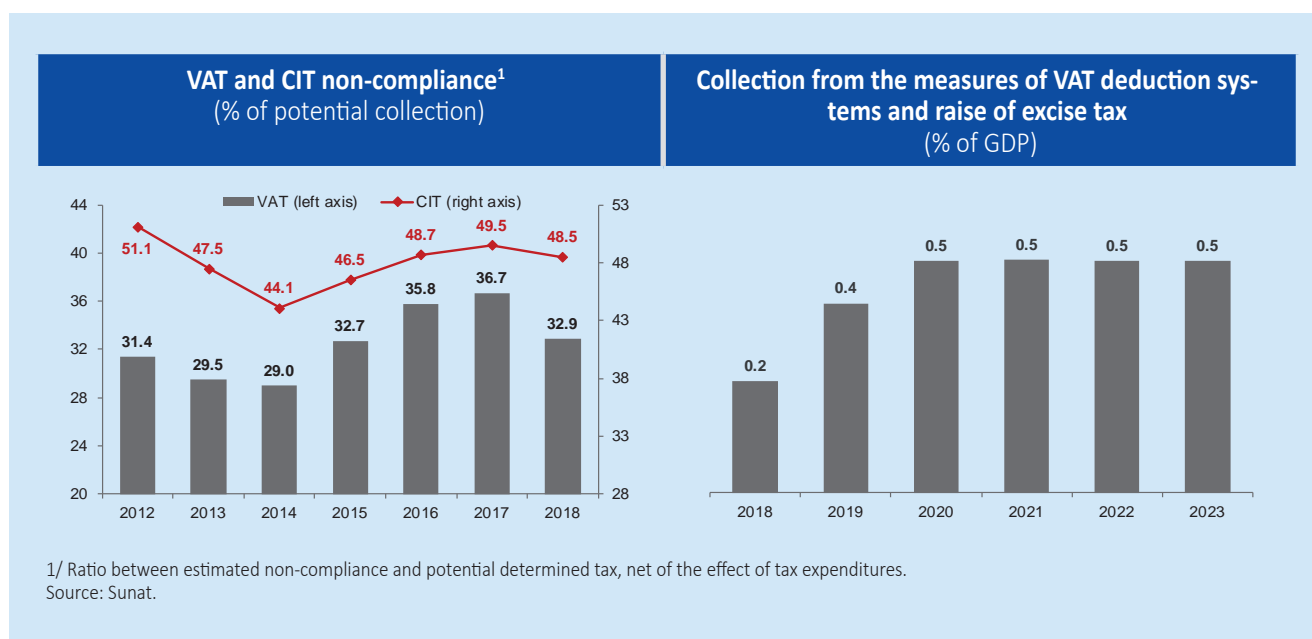
Computer and tax virtual chat

App Sunat

Virtual orientation assistant

Source: Sunat.

In this context of approval of tax measures, last year, significant collection gains and a reduction in non-compliance indicators were recorded. In 2018 alone, fiscal revenues grew 13.8% in real terms, while the levels of CIT and VAT non-compliance were reduced by 1.0 and 3.8 percentage points, respectively, after accumulating three years of consecutive increases. In addition, as a result of control and audit actions, the tax default ratio fell from 2.5% in 2016 to 1.7% last year (lowest historical level). It is estimated that the fall in non-compliance, including the improvement of VAT deductions system and the raise in excise taxes, would have explained about 60% of the collection growth in the last year. In fact, only the direct effect of the VAT deductions system and the raise of excise taxes would have implied additional income of 0.2% of GDP in 2018, and would have a potential impact of 0.5% of GDP by 2023.

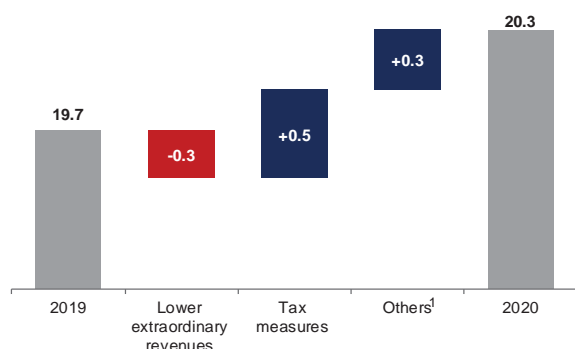


In 2020, fiscal revenues will grow 6.7% real and will be equivalent to 20.3% of GDP, in a context of greater economic growth (4.0%) and stabilization of export prices (1.5%) and of tax refunds. On one hand, Sunat will persist with induction actions, which allowed it to make great progress in reducing the default ratios and non-compliance levels in 2018. On the other hand, the tax administration will initiate the international exchange of financial information with The Common Reporting Standard, obtained through the measures that regulate access to bank secrecy, and will receive the results of the first cross-section of tax information in the Country-by-Country Report. This, together with the operability of the general anti-avoidance rule and the membership in the OECD's Group of Aggressive Tax Planning Experts, will increase the sense of risk of taxpayers, which will encourage tax compliance. In addition, for 2020 it is expected to implement complementary measures to increasing the operational efficiency of the Sunat, among which are the coverage expansion of the VAT deductions system in high evasion sectors, the improvements in the risk management systems and the strengthening of human capital.

Therefore, the growth of 2020 will come from the higher tax revenue collection of the central government (8.9%), such as value-added tax (6.4%) and income taxes (7.4%), which together would contribute to more than half of the expected growth for the year. It is expected that the approved measures (including changes in the VAT deduction system, the adequacy of the excise tax ISC rates according to externalities, the mass use of the electronic tax invoices and anti-avoidance measures) represent 1.0% of the GDP (2019: 0.5% of the GDP), which is equivalent to a reduction of VAT and CIT non-compliance between 2 and 3 pp each. In addition, a normalization of tax refunds is expected (after exceptional payments of 2019¹⁰³) and the start of payments of the CIT of mining projects that began operation between 2015 and 2016, and whose greatest impact would be given on 2021. Excluding the impact of less tax refunds, extraordinary revenues and the effect of tax measures, it is estimated that the revenues would grow 4.6% real.

¹⁰³ It refers to the attention of judicial judgments and balances in favor of large investment projects, which would be registered in 2019.

Evolution of general government revenues (% of GDP)



Approved tax measures that will have an impact on the fiscal revenues of 2020

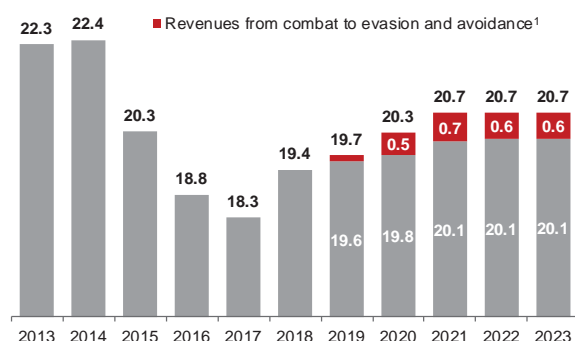


1/ Mainly as an effect of the normalization of tax refunds and greater economic growth.
Source: BCRP, Sunat, EsSalud, Perupetro, MEF, MEF forecasts.

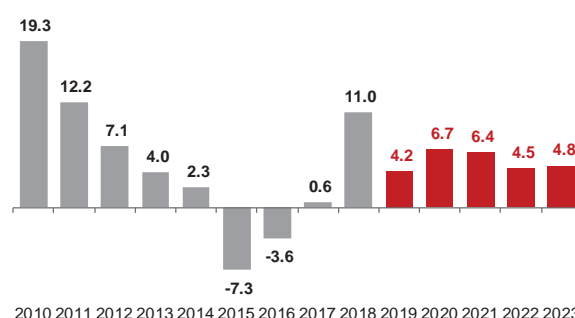
Towards the 2021-2023 period, the measures for reducing tax non-compliance will consolidate and, consequently, the revenues of the general government will grow at an annual average of 5.3% real until reaching 20.7% of GDP in 2023.

The estimated growth for these years considers a context of greater economic dynamism (4.5% on average) and stable export prices. It is also expected that collection gains from the lessen of evasion and avoidance will accentuate, especially with the maturity of international taxation measures. With this, it is considered that the approved anti-avoidance framework, the massive use of CdPEs and the measures of VAT deductions system and excise rates will reach a potential of 1.1% of the GDP. It is important to mention that for these years the coverage of the CdPEs and digitalization will reach their potential, which will make it possible to strengthen the risk management system, making it more sophisticated. During this period, the general anti-avoidance rule, the limit on the deduction of interests and those based on the exchange of information according to the BEPS framework will also be in full force and application. In fact, Sunat has planned that the use of CdPE would reach 95% of taxpayers by 2021, which will allow real-time tax information for almost all transactions in the economy. As long as it is expected that the payments on account and regularization of the income tax of the mining projects that started operation between 2015 and 2016, such as Las Bambas and Cerro Verde, will continue to be recorded.

General government revenues (% of GDP)

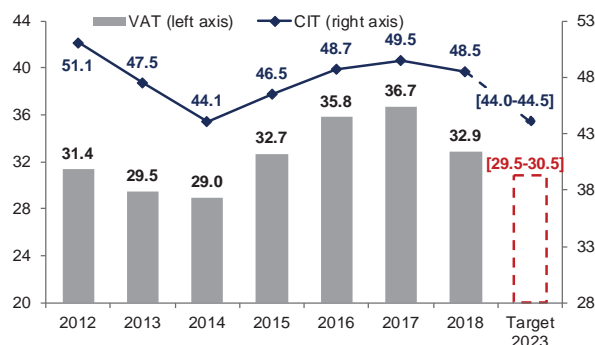


General government revenues (% real annual change)

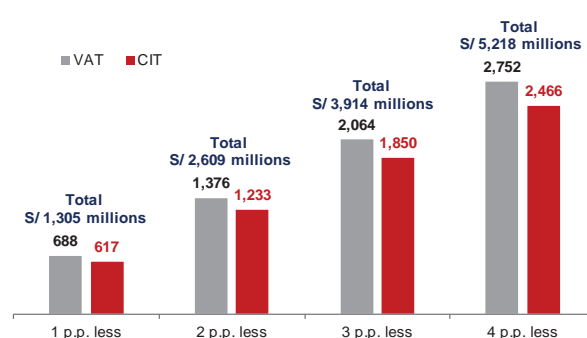


1/ Revenues obtained as a result of measures approved through delegation of powers and additional ones, which will allow to expand the tax base and tackle against tax evasion and avoidance.
Source: BCRP, Sunat, EsSalud, Perupetro, MEF, MEF forecasts.

Expected reduction of tax non-compliance in VAT and CIT¹ (% of potential collection)



Additional collection for lower non-compliance of VAT and CIT² (Millions of soles)

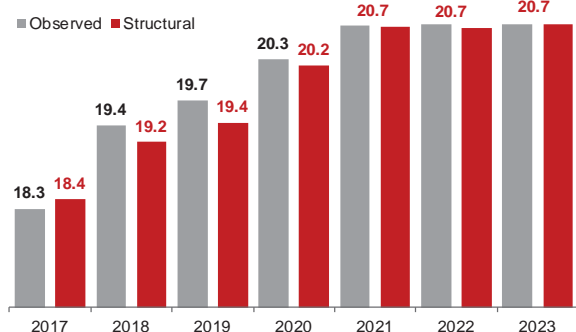


1/ Ratio between the estimated non-compliance and the potential determined tax, net of the effect of tax expenditures. 2/ Estimated with the potential collection of 2018.

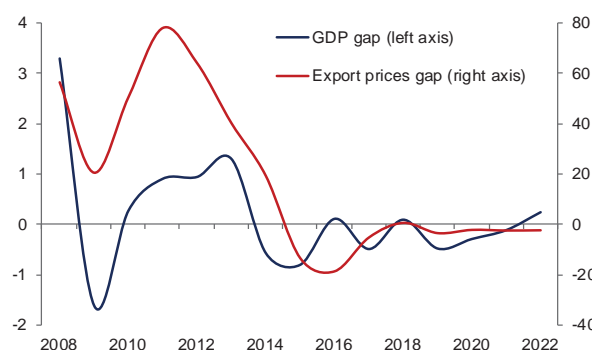
Source: BCRP, Sunat, EsSalud, Perupetro, MEF, MEF forecasts.

However, the observed revenues will be at similar levels to the structural ones in a context in which the GDP and export price gaps are almost nil. Thus, in 2019, the observed revenues will be slightly higher than the structural ones, reflecting the extraordinary revenues recorded this year. Henceforth, the difference between structural and observed will be minimal, in a context of mining export prices and hydrocarbons convergent to their potential estimates in the projection horizon. Furthermore, it is worth emphasizing that the income from the tax measures will be permanent and will allow to increase the structural income.

Observed and structural revenues of the general government¹ (% of GDP and % of potential GDP)



GDP and export prices gap regarding their potentials^{1,2} (% of potential GDP, % of potential prices)



1/ Considers the methodology for the calculation of the structural accounts approved by Ministerial Resolution No. 024-2016-EF/15 of January 31, 2016. 2/ Mining and hydrocarbon export prices.

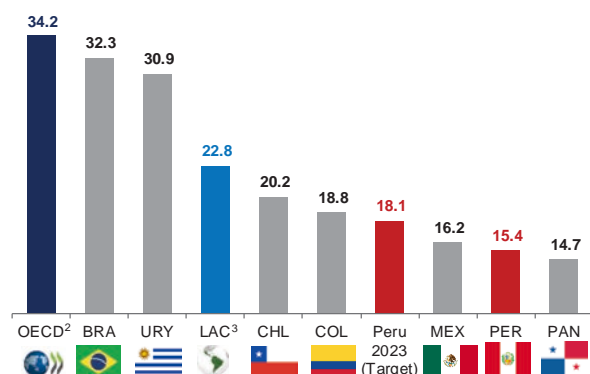
Source: BCRP, MEF, MEF forecasts.

On the other hand, even in the scenario of maturity of tax measures, by 2023, tax burden¹⁰⁴ will continue to be one of the lowest in the countries of the region. This difference is mainly due to the high levels of non-compliance, tax exemptions whose benefits could be more effective through targeted spending programs and the low return of some taxes, such as municipal taxes. Therefore, here is room to increase collection and finance the demands of spending in key sectors, such as security, health, education and sanitation. In addition, it is necessary to remember that taxes are part of a social contract between

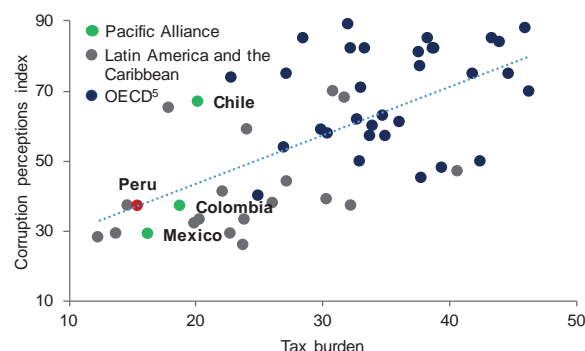
¹⁰⁴ For comparative purposes with the registers of the region, revenues from social contributions is included in the measurement.

the State and citizens, and there are studies that show that the motivation of individuals to pay taxes¹⁰⁵ is negatively related to dissatisfaction with public services and low confidence in the institutions¹⁰⁶. In that sense, strengthening the institutional framework will be key to ensuring that increases in tax pressure are accompanied by greater public spending.

ALatin America and the Caribbean, OECD: Tax burden, 2017¹ (% of GDP)



Corruption perceptions index⁴ vs. tax burden, 2017 (Points, % of GDP)



1/ Includes tax revenues of the central government, local governments and social contributions. In the case of Peru, it excludes social contributions to the Police and Military Pension Fund. 2/ Represents the unweighted average of the 36 OECD member countries. Chile and Mexico are also part of the OECD group. 3/ Represents the unweighted average of the 24 Latin American and Caribbean countries. 4/ The corruption perception index classifies countries according to the perceptions that experts and business executives have on the degree of corruption that exists in the public sector. The score ranges from 0 to 100, where 0 implies that the country is perceived as highly corrupt and 100 means that the country is perceived as very transparent. 5/ Includes 34 OECD member countries, as data from Australia and Japan are not available. Chile and Mexico are also part of the OECD group.

Source: OECD, Transparency International, MEF.

¹⁰⁵ The willingness of individuals to comply with established tax regulations is known in the economic literature as tax morale.

¹⁰⁶ Barone, G. y Mocetti, S. (2009). *Tax morale and public spending inefficiency*. Daude, et al. (2012). *What drives tax morale?* Sjöberg, et al (2019). *Voice and Punishment: A Global Survey Experiment on Tax Morale*.

Box 8: Tax expenditures in Peru¹⁰⁷

Tax expenditures are fiscal revenues that the State ceases to receive as a result of mechanisms that reduce the tax burden of a particular group of taxpayers. These expenditures represent an allocation of public resources, since they arise from incentives and benefits that seek to achieve economic and social¹⁰⁸ policy objectives in a manner similar to direct public expenditure programs. In line with what the OECD and the IMF point out, the quantification and submission of these expenditures is a basic requirement of tax transparency, since it allows for a more complete picture of the way in which public resources are allocated. Therefore, since 2002 Peru publishes an estimate of tax expenditures, and as of 2003, annually sends to Congress, together with the draft budget law, an evaluation of the tax system that includes the quantification of tax expenditures and their impact.

Currently, Sunat calculates two types of tax expenditures: potential and short-term¹⁰⁹. The first one measures the revenue not collected by the application of tax benefits. In contrast, the short-term tax expenditure estimates the collection that would be obtained immediately after the benefit was eliminated. The difference between the two is explained by the restrictions that the tax administration would face to make effective the collection of said revenue, in case there were no such tax benefits.

By 2020, the estimated potential tax expenditures amount to S/16,715 million (2.01% of GDP). Depending on the type of tax, most of that expenditure is allocated in the value-added tax (76.4%), mainly in the exemption of agricultural products, the exemption of the VAT in the Amazon, and in the exclusion of educational products and services, as well as in the personal income tax of individuals (9.4%), specifically in the unaffection of the CTS of workers. It should be noted that the projection of the potential tax expenditure of 2020 has been reduced by S/525 million compared to the estimate for 2019. This fall is concentrated in the value added tax (S/ 381 million) and in the income tax (corporate: S/278 million, individuals: S/55 million), and is diminished by the increase in estimated expenditure for ad valorem tax (S/135 million) and excise tax (S/55 million).

Potential tax expenditures by tax
(Millions of soles and % of GDP)

Tax	Benefit	Millions of S/			% of GDP		
		2018 ¹	2019 ²	2020	2018 ¹	2019 ²	2020
1) VAT	Exoneración of agricultural products	3,306	3,734	3,892	0.44	0.46	0.47
	VAT exemption in the Amazon	2,272	2,288	2,172	0.30	0.28	0.26
	Exclusion of the import and provision of educational services	1,921	2,243	1,703	0.25	0.28	0.20
	Others	5,131	4,879	4,996	0.68	0.60	0.60
2) PIT ³	Exclusion of the CTS	1,190	1,281	1,176	0.16	0.16	0.14
	Others	272	352	402	0.04	0.04	0.05
3) Ad Valorem	Drawback refund	857	827	961	0.11	0.10	0.12
	Others	24	23	23	0.00	0.00	0.00
4) Other taxes ⁴		1,525	1,613	1,390	0.20	0.20	0.17
Total		16,498	17,240	16,715	2.19	2.13	2.01

1/ Corresponds to the information submitted by Sunat for the preparation of the Multiannual Macroeconomic Framework (MMM) 2018-2021. 2/ Corresponds to the information submitted by Sunat for the preparation of the MMM 2019-2022. 3/ Income tax for natural persons. 4/ Specific rights, income tax of legal entities and excise taxes.
Source: Sunat.

¹⁰⁷ Current regulations that provide for the quantification of tax expenditures, among other aspects, is regulated by Legislative Decree No. 1276, Legislative Decree that approves the Fiscal Responsibility and Transparency Framework of the Non-Financial Public Sector, published in December 2016.

¹⁰⁸ Encourage savings, stimulate employment, protect national industry, promote regional or sectoral development, encourage investment, among others.

¹⁰⁹ The detail of the methodology for the quantification of tax expenditures is available at <https://www.mef.gob.pe/es/sistema-tributario-lineamientos-de-politica-tributaria/del-gobierno-central>

At the sector level, most of the tax expenditure is concentrated on benefits aimed at goods and services of general application (32.1%), followed by specific sectors such as agriculture (32.0%), financial intermediation (13.8%) and education (10.2%). With respect to 2019, the projection of tax expenditure has increased mainly in the agricultural sectors (S/ 286 million), financial intermediation (S/ 202 million) and manufacturing (S/ 130 million), while it has been reduced in goods and services of general application and in the education sector (S/ 524 million and S/ 535 million, respectively).

Potential tax expenditures by sectors (Millions of soles and % of GDP)

Sector	Millions of S/			% of GDP		
	2018 ¹	2019 ²	2020	2018 ¹	2019 ²	2020
General application	6,070	5,897	5,373	0.81	0.73	0.65
Agriculture and livestock	4,380	5,062	5,348	0.58	0.63	0.64
Financial intermediation	2,054	2,102	2,304	0.27	0.26	0.28
Education	1,925	2,244	1,709	0.26	0.28	0.21
Transport	436	411	459	0.06	0.05	0.06
Other services	446	498	429	0.06	0.06	0.05
Other sectors ¹	1,186	1,027	1,093	0.16	0.13	0.13
Total	16,498	17,240	16,715	2.19	2.13	2.01

1/ Corresponds to the information submitted by Sunat for the elaboration of the MMF 2018-2021. 2/ Corresponds to the information submitted by Sunat for the elaboration of the MMF 2019-2022. 3/ Hydrocarbon, manufacturing, health, medium and small enterprises (MYPE), construction, culture and sport, mining, agriculture and livestock, manufacturing, and commerce.
Source: Sunat.

Most tax expenditures are classified as exemptions, exclusions and rate reductions, followed by other types such as refunds, deferrals, allowances or credits As mentioned earlier, it is estimated that in 2020 the exemptions will be concentrated in the agricultural sector and the exclusions in the education sector. Besides, a greater expenditure is expected in the form of refunds from drawback and a reduction of corporate the income tax rate to 15%.

Classification of tax expenditures

Credits: Direct tax reductions.

Allowances: Reductions in the tax bases.

Refunds: Rebate of taxes.

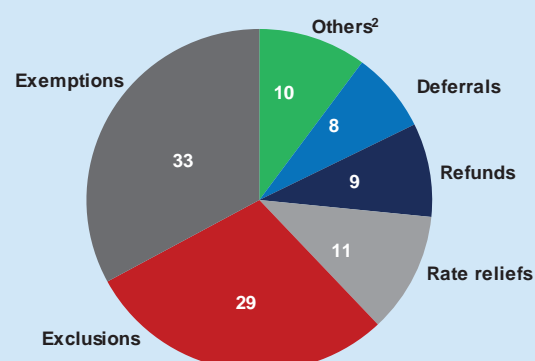
Deferrals: Postponement or delay in the tax payment.

Exemptions: Exclusion of the payment of the tax to a taxed activity for a certain period.

Exclusions: Exclusion of the payment of the tax to an activity that, by its nature, is outside the scope of the tax.

Rate reliefs: Preferential tax rates to those generally applied.

Structure of potential tax expenditure¹ (%)



1/Figures corresponding to the estimate of the year 2020. 2/ Includes allowances and credits.
Source: Jorrott (2010), Sunat, Tribunal Fiscal, MEF.

It is important to mention that tax expenditures are not necessarily the most efficient tools for achieving economic and social objectives. Unlike public spending programs, tax expenditures: i) involve less visible¹¹⁰ costs that increase the tax burden of society; ii) cannot be easily budgeted or delimited; and iii) do not ensure that the taxes no longer received have been effectively destined for the intended purposes. In fact, these expenditures are usually perpetuated without performing a cost-benefit analysis that evaluates the fulfillment of the objectives for which they were created. For example, in 2019, 16 of the 19 tax expenditures that expired in 2018 continued in effect. If these benefits were not maintained in 2020, the tax collection for that year would increase by S/ 5,648 million (0.68% of GDP).

On the other hand, there is evidence that suggests that the allocation of direct public spending constitutes a more efficient and effective tax policy. This is the case of the San Martín region, in which a study finds that the economy of that region grew 2.6 pp additional per year since 2006¹¹¹ after the replacement of tax benefits with transfers to finance public infrastructure works.

Estimated tax expenditures that expired in 2018 and were extended until 2019
(Millions of soles and % of GDP)

Tax	Benefit description	Type of expenditure	Potential estimated 2020 ¹	% of GDP ²
VAT	Appendix I: Agricultural products	Exemption	3,892	0.47
VAT	Appendix II: Public passenger transport service within the country, except air transport.	Exemption	459	0.06
CIT ³	Affected foundations and non-profit associations	Exemption	371	0.04
VAT	Appendix I: Agricultural inputs	Exemption	304	0.04
VAT	Import and sale of books and publishing products - Book Democratization Law	Exemption	233	0.03
VAT	Imports destined for the Amazon	Exemption	111	0.01
VAT	Appendix I: First sale of real estate whose value does not exceed 35 tax units	Exemption	70	0.01
VAT	Appendix II: The income received by the MIVIVIENDA Fund for credit operations made with banking and financial entities	Exemption	52	0.01
VAT	Mining - refund to holders of the mining activity (exploration phase)	Refund	40	0.00
VAT	Foreign grants - International Technical Cooperation	Refund	37	0.00
VAT	Tax refund - Book Democratization Law	Refund	25	0.00
VAT	The construction and repair of the Naval Forces Units that carry out the Industrial Services of the Navy	Exemption	23	0.00
VAT	Hydrocarbon - activities related to exploration (internal purchases)	Refund	17	0.00
VAT	VAT refund for purchases made by Diplomatic Missions, Consular and International Organizations	Refund	9	0.00
CIT	Tax credit for reinvestment in favor of publishing companies - Book Law	Credit	8	0.00
Excise tax	Hydrocarbon - activities related to exploration (internal purchases)	Refund	0	0.00
Total			5,648	0.68

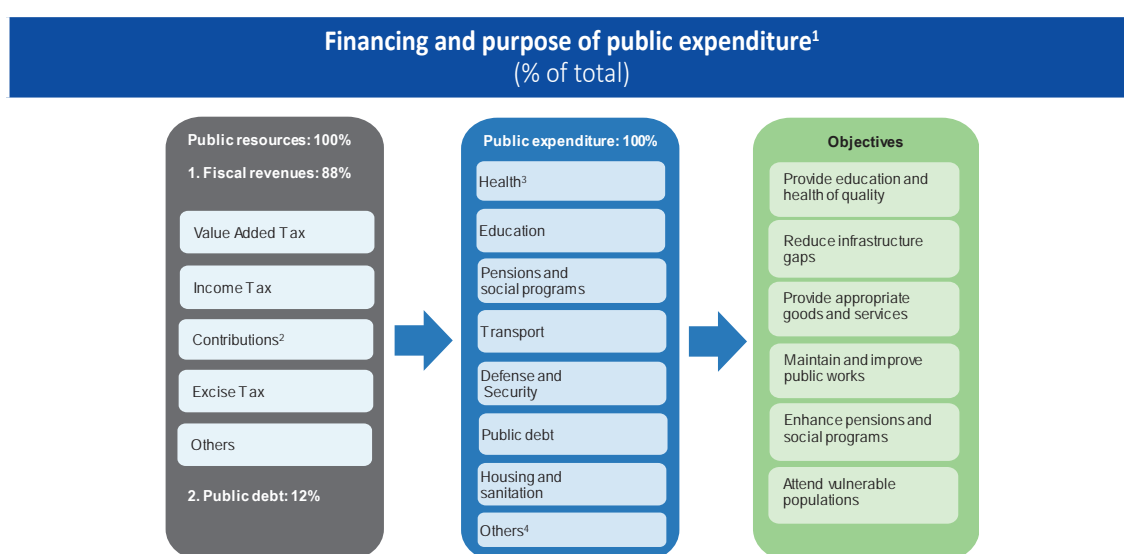
1/ Considers the latest macroeconomic assumptions submitted by the MEF on June 25, 2019. 2/ The percentages shown have been calculated based on a nominal GDP estimated at S/ 832,629 million for the year 2020 reported by the MEF on June 25, 2019. 3/ Corporate income tax.
Source: Sunat

¹¹⁰ The less visible costs of tax expenditures are: the complexity they impose on tax regulations, the higher compliance costs assumed by certain taxpayers, the resources that Sunat reallocates to control and control to avoid the misuse of benefits, between others.

¹¹¹ Escobar, J. (2017). *Impact of the waiver of tax exemptions in the San Martín region*.

6.2. EXPENSES¹¹²

Public expenditure estimates are compatible with compliance of the current macro-fiscal rules¹¹³. The growth of tax revenues in a context of gradual reduction of the fiscal deficit will allow, between 2019 and 2023, non-financial expenditure of the general government to expand at a real average rate of 4.3% and reach 20.5% of GDP in 2023 (above the 2009-2018 average of 20.1% of GDP). This level of expenditure will allow to achieve the appropriate supply of public goods and services to be financed, to continue closing infrastructure gaps and to continue strengthening the capabilities of human capital, which will contribute to strengthening the institutionality of the State. This expenditure will be developed in a context of modernization of the administrative systems of the State and the implementation of the Civil Service, which will improve the efficiency of public spending.



1/ Corresponds to 2018. 2/ Considers contributions of EsSalud. 3/ Consider expenses of EsSalud. 4/ Mainly Planning, Management and Contingency Reserve.
Source: MEF

In 2019, the non-financial expenditure of the general government will continue to contribute to the growth of economic activity¹¹⁴, despite the context of gradual decrease of fiscal impulse and the first year of management of regional and local authorities. Thus, spending would amount to S/ 157,345 million (20.3% of GDP), almost double what was recorded in 2011 (S/ 87.6 billion). Current expenditure would grow 4.3% real and would be used mainly to maintenance public infrastructure (roads, bridges and buildings), the provision of goods and services to the population and the financing of salary and pension commitments, within the framework of the Budget Law. Furthermore, the public investment will increase 2.5% real¹¹⁵ explained by an important advance of the projects of Reconstruction, Pan American Games and Modernization of the Talara Refinery (1.7% of the GDP in total). In the same way, since the beginning of the year, budgetary and management measures were implemented that seek to accelerate the learning process of the State's administrative systems, in a context of the first year of management of the authorities of regional and local governments.

It should be noted that between 2011 and 2018, the non-financial expenditure of the general government increased by S/ 62 billion, from 18.6% of GDP to 20.2% of GDP. By main sectoral components, health expenditures were the fastest growing (S/

¹¹² In this section, the coverage of non-financial expenditure corresponds to general government entities, unless otherwise indicated. That is, it comprises the three levels of government (national, regional and local), and budget and extra-budgetary entities are considered (EsSalud, SBS, among others). It should be noted that non-financial public companies are not considered.

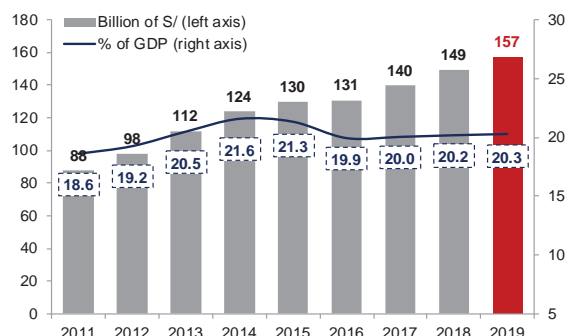
¹¹³ The current fiscal rules are defined in Law No. 30637, which provides for the application of the exception clause to the macro-fiscal rules of the Non-Financial Public Sector, provided in Legislative Decree No. 1276, which approves the Framework of Responsibility and Transparency Public Prosecutor of the Non-Financial Public Sector.

¹¹⁴ Public spending accounted for in GDP would grow 2.6% real in 2019 and contribute 0.41 pp to growth, higher than the average contribution of the 2014-2018 period (0.37 pp).

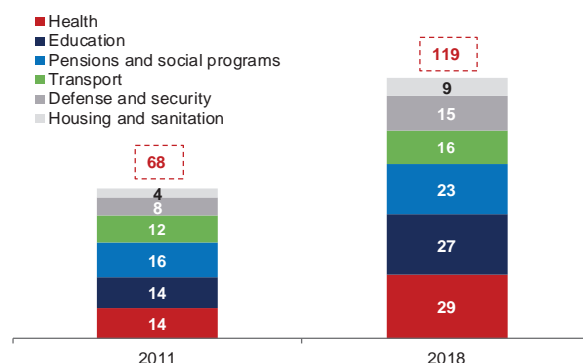
¹¹⁵ Includes the investment of the NFPS (general government and non-financial public companies). The general government comprises the three levels of government (national, regional and local). For its part, the investment of non-financial public companies includes PetroPerú, companies that are under the scope of Fonafe, municipal companies and decentralized public bodies. It should be noted that the general government investment is estimated to increase 1.8% real in 2019.

15 billion), followed by spending on education (S/ 13 billion), pensions and social programs (S/ 7 billion) and transportation (S/ 3 billion). On the other hand, at the level of main items, at the end of 2019, a stabilization of current expenditure is expected around 15.5% of GDP, similar to that recorded in 2001 (15.4% of GDP); however, an increase in general government investment is estimated from 2.9% of GDP in 2001 to 4.3% of GDP in 2019.

Non-financial expenditure of the general government¹ (Billions of soles and % of GDP)



Public expenditure by main components² (Billions of soles)



1/ It includes extrabudgetary entities such as EsSalud, SBS, among others.

2/ Corresponds to the functional division of budget expenditure. The health item includes the expenditure of Essalud, the pension item includes social programs and expenditure of the Police Military Pension Fund. The Housing item includes sanitation.

Source: BCRP, MEF, MEF forecasts.

Non-financial expenditure of the general government by main items¹ (% of GDP)

	2001	2006	2011	2016	2017	2018	2019
Total (I + II)	18.5	17.1	18.6	19.9	20.0	20.2	20.3
I. Current expenditures	15.4	13.8	13.4	15.3	15.3	15.3	15.5
1. Wages and salaries	5.8	5.6	4.9	6.0	6.1	6.2	6.5
2. Goods and services	5.3	4.7	5.1	6.1	6.0	5.7	5.7
3. Transfers	4.3	3.6	3.5	3.2	3.2	3.3	3.3
II. Capital expenditures	3.1	3.2	5.2	4.7	4.7	4.9	4.7
1. Gross capital formation	2.9	3.0	4.5	4.2	4.1	4.3	4.3
2. Others	0.2	0.2	0.7	0.5	0.7	0.6	0.4

1/ Includes extrabudgetary entities such as EsSalud, SBS, among others.

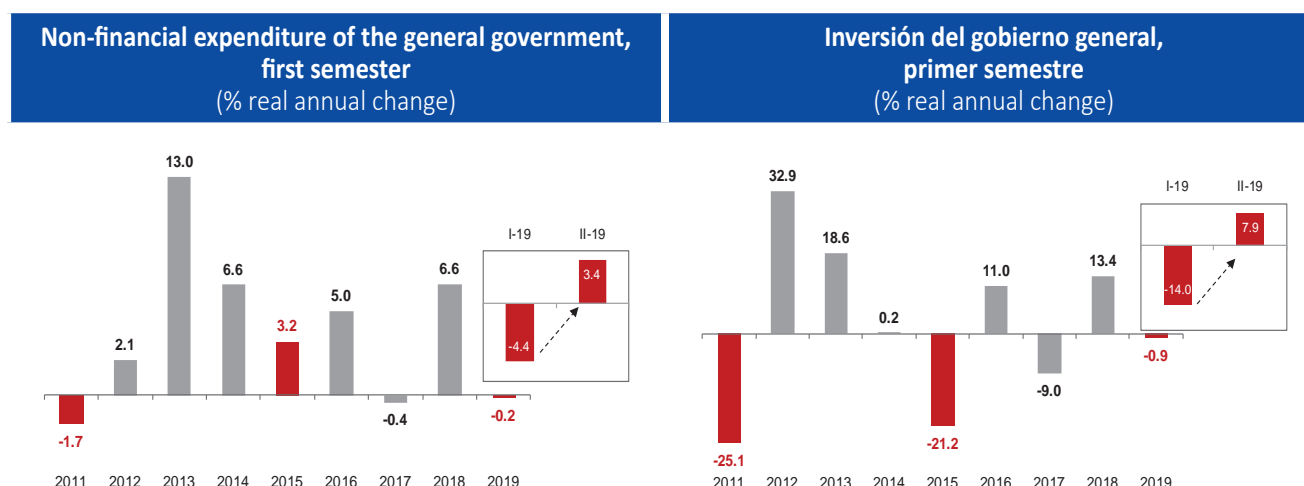
Source: BCRP, MEF, MEF forecasts.

In the 1H2019, the non-financial expenditure of the general government registered a better performance compared to similar periods of start of subnational management. Thus, the general government investment registered a drop of 0.9% real, a better result compared to what happened in 2011 (-25.1% real) and 2015 (-21.2% real), the first year of Government of regional and local authorities. This is due to the progress in the execution of the Reconstruction (S/ 1 billion) and Pan American Games (S/ 0.7 billion), as well as budgetary and management measures implemented since the beginning of the year to accelerate the learning process of the authorities and soften its impact on spending. These measures included an expansion of the budget for subnational governments, advancement of resources and management measures, such as the formation of monitoring committees and training in administrative systems (budget, investment, public purchases, among others¹¹⁶). It

¹¹⁶ More details of the budgetary and management measures can be found in the IAPM 2019-2022 published in April 2019.

should be noted that there have been around two hundred training events and around six thousand technical assistance in investment management, Multiannual Investment Programming and Invierte.pe aimed at about 17 thousand public officials.

As a result, in the second quarter, the expenditures began a recovery that will be sustained in the second half of the year. Thus, the non-financial expenditure of the general government went from falling 4.4% real in the first quarter to growing 3.4% real in the second quarter. This is essentially explained by the recovery of the general government investment, which reversed the real 14.0% real fall between January and March, and recorded a real 7.9% real growth between April and June.



Source: BCRP.

In the 2H2019, the non-financial expenditure of the general government would grow 5.8% real, due to the recovery of public investment and the greater dynamism of current expenditure. In that sense, the general government investment is expected to reverse the fall recorded in the first half of the year and grow 3.3% real in the second half of the year, due to the continuity of Reconstruction works, which have resources by 1.2% of GDP for 2019, mainly for capital expenditure; and of the Pan American Games (0.2% of GDP, including road works). Additionally, during the remainder of the year, regional and local governments will have greater knowledge of the administrative systems of the State, as a result of the measures taken since the beginning of the year and that public servants will continue to be trained on issues related to the phases of the cycle of investments, administrative systems and computer applications. In this regard, 210 training events and nearly 3 thousand technical assistance are scheduled for almost 10,000 officials on issues related to investment management and public procurement. On the other hand, current expenditures will focus on the continuity of the salary and pension policy¹¹⁷, infrastructure maintenance, provision of services to citizens, as well as the acquisition of goods and services necessary for the operation of public entities

In 2020, in a context of higher tax revenues, public spending will maintain an expansive path and grow 4.9% real, led by investment, while current expenditures will grow in compliance with the fiscal rule. The general government's non-financial expenditure is expected to reach 20.5% of GDP (S/ 168,673 million), higher than the 2016-2019 ratio (20.1% of GDP), and will be led by the dynamism of the public investment (+9.0% real)¹¹⁸. This would reduce infrastructure gaps, expand the coverage of public services and strengthen the capabilities of human capital, in an environment of fiscal discipline.

¹¹⁷ In May, Supreme Decree No. 139-2019-EF was published, authorizing the readjustment of the amount of pensions defined in Decree Law No. 19990. In that line, in July, Supreme Decree No. 201-2019 was published- EF, which authorizes a transfer of items, charged to the contingency reserve, for up to S/ 304.1 million in favor of the ONP to finance the established readjustment.

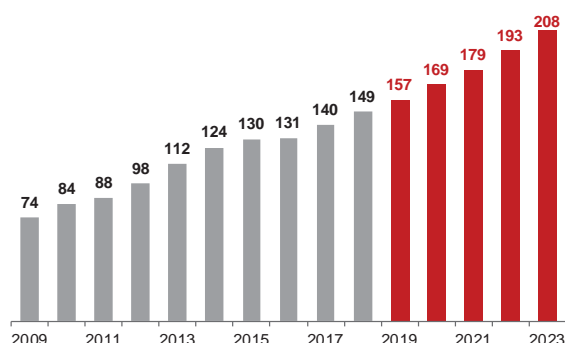
¹¹⁸ Includes the investment of the NFPS (general government and non-financial public companies). The general government comprises the three levels of government (national, regional and local). For its part, the investment of non-financial public companies includes PetroPerú, companies that are under the scope of Fonafe, municipal companies and decentralized public bodies. It should be noted that the general government investment is estimated to increase 8.3% real in 2020.

Current expenditure will grow 3.7% real, consistent with the fiscal rule, in a context in which measures that promote the efficiency and quality of public spending will materialize. In this way, current expenditure will amount to 15.5% of GDP, slightly higher than the average for the 2016-2019 period (15.3% of GDP). This expense will be focused on meeting the population's service needs, the maintenance of decentralized public works, and the salary and social commitments assumed by the State. This in a context of progressive progress in the modernization of administrative systems and efficient use of resources. For example, the monitoring of the salaries of public officials and pensions will continue to improve, and there will be a strengthened recruitment process, as well as a more articulated supply system that will help supply quality goods and services in the public sector¹¹⁹.

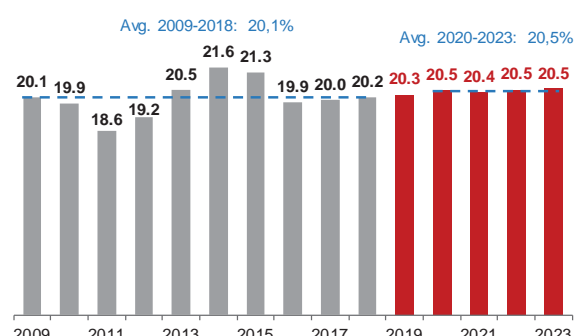
Besides that, public investment will increase 9.0% real¹²⁰ and promote the closing of infrastructure gaps. In this way, public investment will reach 5.1% of GDP, higher by 0.3 percentage points regarding the average for the 2016-2019 period (4.8% of GDP). In effect, the growth of public investment will be explained by the continuity of the Reconstruction works (0.6% of GDP)¹²¹, the Modernization of the Talara Refinery (0.4% of GDP), the progress of Line 2 of the Lima Metro, among others. Meanwhile, the dissipation of the learning process of the first year of subnational management, due to a greater knowledge of administrative systems, will improve the dynamism of decentralized public works. Finally, it is noteworthy that, by 2020, there will be a better coordination in the programming of investments with the public budget, which seeks to allocate resources efficiently and timely for projects.

In the period 2021-2023, the non-financial expenditure of the general government will grow at an average rate of 4.6% real and will settle in around 20.5% of GDP. Thus, expenditure growth will be slightly higher than the average for the 2011-2018 period (4.4% real) and will have expanded at an average rate of S/ 13 billion per year (average 2011-2018: S/ 8.2 billion), focused on closing infrastructure gaps, the adequate supply of goods and services, and the improvement of human capital. This will be developed in line with the progress of modernization and articulation of the State's administrative systems, which promotes efficient and transparent management of public resources, and will be complemented with the PNIC, which aims to improve the country's productivity and competitiveness.

Non-financial expenditure of the general government¹
(Billions of soles)



Non-financial expenditure of the general government¹
(% of GDP)



1/ Includes extrabudgetary entities such as EsSalud, SBS, among others.
Source: BCRP, MEF, MEF forecasts.

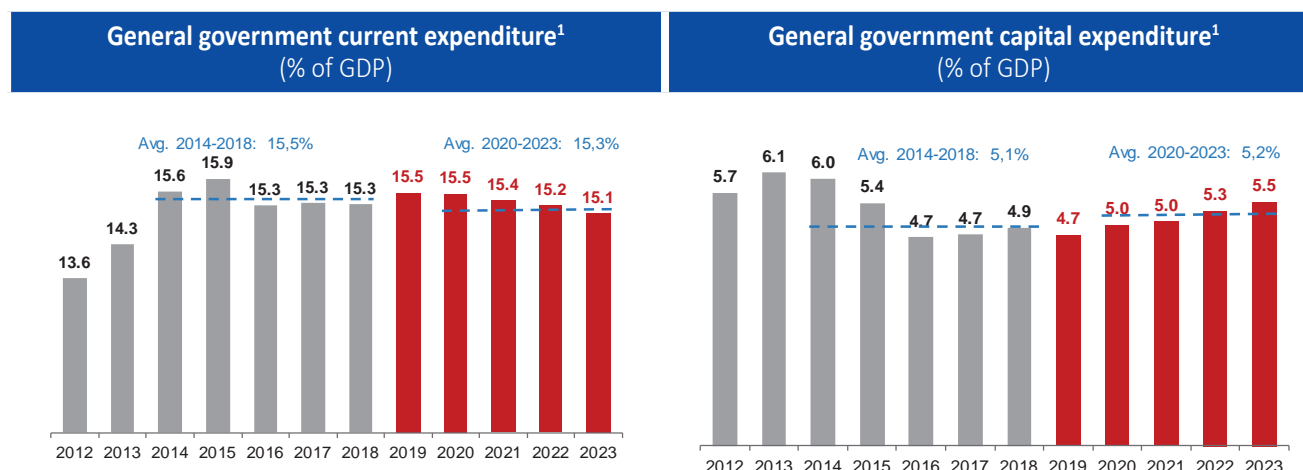
Current expenditures will continue to expand in compliance with its fiscal rule, which allows having an orderly trajectory that promotes the efficiency of public spending. Between 2021 and 2023, this expense will increase S/ 8.2 billion on average (average growth of 3.5% real) and will reach 15.2% of GDP, slightly higher than the average observed between 2012 and 2018

¹¹⁹ On July 15, 2019, Supreme Decree No. 217-2019-EF was published, approving the regulation of Legislative Decree No. 1439, of the National Supply System

¹²⁰ Includes the investment of the NFPS (general government and non-financial public companies). The general government comprises the three levels of government (national, regional and local). For its part, the investment of non-financial public companies includes PetroPerú, companies that are under the scope of Fonafe, municipal companies and decentralized public bodies.

¹²¹ Preliminary estimate consistent with the expansion of the fiscal deficit provided by Law No. 30637. It does not consider the incorporation of balance balances.

(14,8% of GDP). Thus, current expenditure will continue to finance the maintenance of infrastructure and the strengthening of human capital, with the objective of providing quality public services. This will be accompanied by the articulation and coordination between the administrative systems, which will allow an optimal management of state logistics and will be complemented by an efficient fiscal administration of human resources, which will have as its central axis the computer application of the single form, in addition to an orderly transition to the Civil Service.



1/ It includes extrabudgetary entities such as EsSalud, SBS, among others.
Source: BCRP, MEF, MEF forecasts.

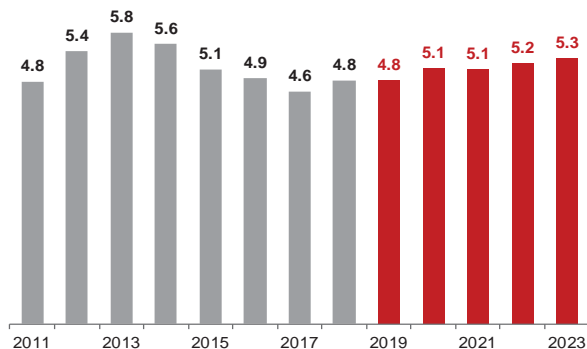
For its part, public investment will continue to focus on reducing infrastructure gaps within the context of improved management and efficient use of public resources. By 2023, public investment will expand by S/ 15.8 billion compared to the 2019 estimate, at an average rate of S/ 3.9 billion, and will represent 5.3% of GDP¹²², above the average from the 2011-2018 period (5.1% of GDP). This expansion takes place in a context of strengthening the management and institutionality of the State, focused on the modernization of administrative systems, by articulating the investment system with that of the public budget; and in the implementation of the Civil Service, which will allow for better trained public servants. In addition, the promotion of public investment will be complemented with the strengthening of modalities for the promotion of projects with private sector participation through the PPP and Oxl modality, and with the implementation of the PNIC, which has a prioritized portfolio of S/ 100 billion (52 projects). With the impulse of the investment it is sought to reduce the infrastructure gaps of short (S/ 117 billion) and long-term (S/ 363 billion), which are mainly in sectors such as transport infrastructure, health, sanitation, education, among others. Additionally, the investment will be complemented with furniture, equipment and adequate and timely maintenance in the operating stage.

In that sense, investments will promote economic growth for the benefit of citizens. According to the IADB¹²³, relatively small increases in efficiency in infrastructure investment can produce significant benefits for economic growth. Thus, in the face of 5% efficiency increases, on average, Latin American countries would experience 3.6 percentage point increase in growth rates over ten years. It is worth mentioning that improving infrastructure efficiency benefits lower income households to a greater extent, therefore it would help reduce income inequality. In that context, the PNIC includes measures to enhance project management and ensure timely completion and proper functioning, by authorizing efficient institutional schemes, such as project management offices (PMO) and NEC contracts, standardized contracts in PPPs and knowledge transfers between levels of Government.

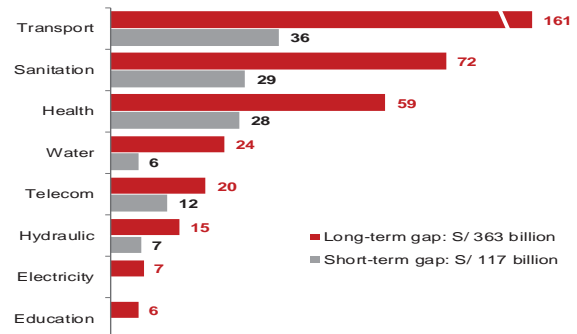
¹²² NFPS investment, which includes the general government and non-financial public companies.

¹²³ Inter-American Development Bank (2019). Building opportunities to grow in a challenging world

Public investment¹ (% of GDP)



Infrastructure gaps² (Millions of soles)



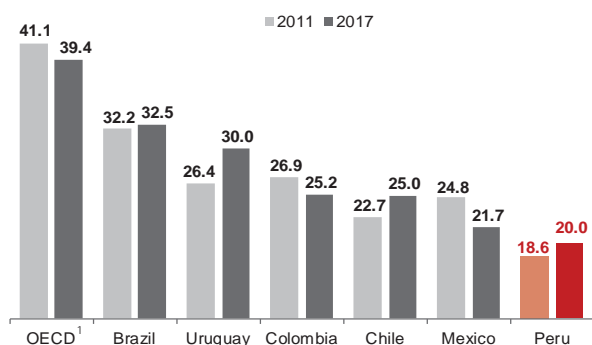
1/ Includes the investment of the NFPS (general government and non-financial public companies). The general government comprises the three levels of government (national, regional and local). For its part, the investment of non-financial public companies includes PetroPerú, companies that are under the scope of Fonafe, municipal companies and decentralized public organisms.

2/ The short-term infrastructure gap is the investment that needs to be made in Peru to reach the basic infrastructure access levels that a country with our socio-economic and geographical characteristics should have. Corresponds to an estimate of five years. The long-term gap is the difference between an infrastructure indicator in Peru with respect to an average among high-income countries. This gap is calculated for a period of twenty years.

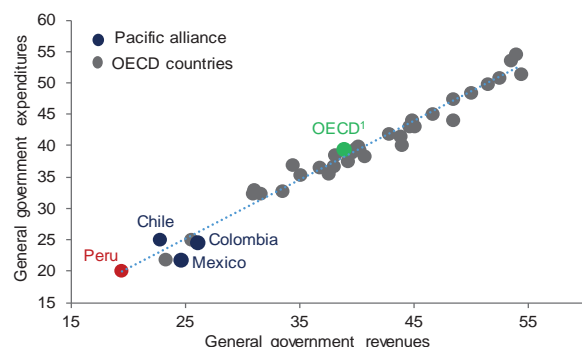
Source: BCRP, MEF, PNIC, MEF forecasts.

It is important to mention that, despite its expansion in recent years, public expenditure in Peru remains below the levels observed in Latin American countries and in developed countries. Thus, between 2011 and 2017, the non-financial expenditure of the general government increased by S/ 52 billion, and went from 18.6% of GDP to 20.0% of GDP. However, this figure is lower than the average for Latin America (26.9% of GDP)¹²⁴ and half of that observed in OECD countries (39.4%). Therefore, it is important to continue efforts to increase tax collection through measures that reduce non-compliance and tax exemptions. This will continue to expand the coverage of public services and increase their quality for the benefit of citizens.

Latin America and OECD: Non-financial expenditure of the general government (% of GDP)



Latin America and OECD: Non-financial expenditure and revenues of the general government, 2017 (% of GDP)



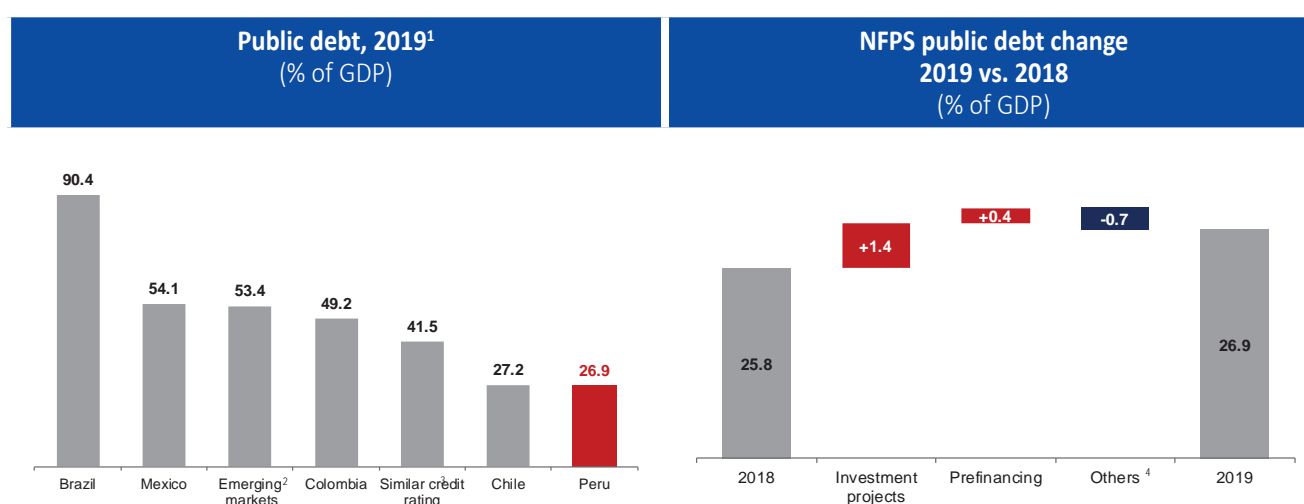
1/ It represents the simple average of the 36 OECD member countries. Chile and Mexico are also part of the OECD group.
Source: OCDE, IMF, BCRP.

¹²⁴ It corresponds to 2017 and includes the following countries: Brazil, Uruguay, Colombia, Chile and Mexico.

6.3. FINANCING

Consistent with the Egiap and a trajectory of lower fiscal deficits, the NFPS public debt will be equivalent at 26.9% of GDP in 2019 and will fall to 25.3% of GDP in 2023, and will remain at sustainable levels and below the fiscal rule (30% of GDP). Thus, the commitment to keep fiscal accounts sustainable will contribute to macroeconomic stability, a fundamental pillar for economic growth. Besides, strengthening the sustainability of public accounts, together with a larger portfolio of specific financial instruments and a more efficient management of financial assets, will provide the country with a solid fiscal position that allows it to face adverse scenarios, such as financial crises or natural disasters. In addition, the sovereign security market will continue to be deepened to generate more liquid and efficient yield curves that allow a better allocation of financial resources in the economy.

In 2019, for the third consecutive year, the NFPS public debt will be ratified as the lowest in the region. Thus, the 2019 public debt is projected to be equivalent to 26.9% of GDP, below the median of emerging markets (53.4% of GDP) and countries with similar credit ratings (41.5% of GDP). It should be noted that compared to what was recorded in 2018, the public debt will increase by 1.1 pp of GDP, mainly due to disbursements for investment projects (1.4% of GDP) and pre-financing for the year 2020 (0.4% of GDP), which will be mitigated by other macro-fiscal factors (-0.7% of GDP)¹²⁵. In relation to the provisions of the IAPM, the projection is increased by 0.4 pp of GDP, mainly explained by a lower dynamics of GDP.



1/ It considers General Government. Peru takes into account NFPS. 2/ Median of middle-income emerging market according to IMF. 3/ Median of countries with BBB+ credit rating according to S&P and Fitch, and A3 according to Moody's. 4/ Of which -1.2% of GDP corresponds to GDP nominal growth, -0.1% of GDP due to a lower exchange rate and 0.6% of GDP due to other disbursements net of amortizations.

Source: IMF, S&P, Moody's, Fitch, BCRP, MEF.

By 2020, according to financing needs, the NFPS public debt corresponding to that year will be located at 27.4% of GDP. The 0.5 pp increase of the GDP with respect to the estimate for 2019 is explained by disbursements for 1.8% of the GDP destined to finance the fiscal deficit, which will be amortized by other macro-fiscal factors (-1.3% of the GDP)¹²⁶. It should be noted that the fiscal deficit of that year (2.0% of GDP) will be financed through indebtedness (1.8% of GDP) and use of financial assets (0.2%). The indebtedness will consist of bond issuance (1.3% of GDP) and loan disbursements (0.5% of GDP), while the use of financial assets will be based on pre-financing made in 2019 (0.2% of GDP).

¹²⁵ Of which -1.2% of GDP corresponds to nominal GDP growth, -0.1% of GDP due to a lower exchange rate and 0.6% of GDP due to other net amortization disbursements.

¹²⁶ Of which -1.6% of GDP corresponds to nominal GDP growth, 0.1% of GDP due to a higher exchange rate and 0.2% of GDP due to other net amortization disbursements.

Box 9: Public debt management under the strengthening of the macro-fiscal framework

With the strengthening of the macro-fiscal framework, rules were defined on fiscal deficit, public expenditure and public debt, with the aim of strengthening fiscal sustainability. With this, among other aspects, public debt levels were significantly reduced as a percentage of GDP, and fiscal savings were generated in favorable times to be used in periods with less growth through a countercyclical fiscal policy without affecting fiscal sustainability.

However, to ensure fiscal sustainability, efficient management of public debt is also important. This efficient management allows three relevant aspects to be achieved: i) it strengthens the resilience of fiscal accounts in the face of adverse shocks, ii) it contributes to macro-financial stability and iii) it promotes the development of the capital market.

- o An inappropriate public debt structure is a source of vulnerabilities for the economy¹²⁷. The public debt structure of an economy is weak when it is composed of instruments with short-term maturities, with variable interest rates and/or in foreign currencies. This is due to the fact that they generate greater exposure to refinancing, interest rate and exchange rate risks, respectively. Such vulnerabilities constitute important channels of transmission of adverse shocks against the real economy and the financial system; they can also exacerbate their effects and / or prolong the recovery, reduce the effectiveness of macroeconomic policies, increase the risk of negative credit reviews and increase the interest payment burden.
- o On the other hand, an internal capital market developed based on the issuance of sovereign bonds in local currency allows diversifying financing alternatives and, therefore, reducing dependence on external and/or short-term indebtedness¹²⁸. It also makes it possible to reduce the cost of financing local agents, because it can attract foreign capital¹²⁹ since a greater amount of transactions would allow interest rates to better reflect the opportunity costs of resources¹³⁰, in line with a complete yield curve, liquid and efficient.

At the beginning of the last decade, the public debt was at high levels as a percentage of GDP, with a structure very exposed to financial risks and with a low contribution to the development of the local capital market Thus, in 2001, the NFPS public debt amounted to 47.4% of GDP. Regarding its structure, 91.7% of the public debt was in foreign currency and 65.8% at a variable rate, while the average life was 8.0 years. On the other hand, 1.4% of the public debt (0.7% of GDP or S/ 1.2 billion) corresponded to sovereign bonds, which had a low contribution to the development of the local capital market.

According to this context, and in accordance with the strengthening of the macro-fiscal framework, there has been an active management of public debt, in order to mitigate its exposure to risks, contributing to fiscal sustainability and developing the local capital market. Thus, in 2003, the “Strategy for placements and operations of public debt management” and the first regulation of the Market Makers Program¹³¹ were approved, in order to promote the development of the domestic public debt market, mainly at a fixed rate and in national currency, and the active negotiation of sovereign bonds in the secondary stock market. On the other hand, in 2005, Law No. 28563, General Law on the National Indebtedness System¹³² was published, which was improved with complementary rules to adapt public debt management to the greater integration of the country with international financial markets. This law was developed to harmonize public debt processes with the macro-fiscal framework, and thus consolidate prudent fiscal policy management to ensure the sustainability of public finances.

Along these lines, the main actions in public debt management were the following:

- a) **Prioritization of indebtedness by issuing bonds in local currency for the development of the capital market.** In recent years, public debt has been prioritized through the issuance of sovereign bonds in local currency and Public

¹²⁷ Das, Papapioannou, Pedras, Ahmed y Surti (2010), *Managing public debt and its financial stability implications*.

¹²⁸ IMF and World Bank (2016), *Development of local currency bond markets*.

¹²⁹ Laeven (2014), *The development of local capital markets: rationale and challenges*.

¹³⁰ Jeanneau and Tovar (2007), *Latin America's local currency bond markets: an overview*.

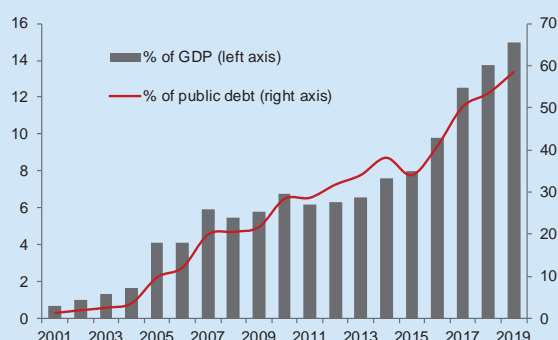
¹³¹ Approved by Ministerial Resolution No. 106-2003-EF/75 and Supreme Decree No. 037-2003-EF, respectively

¹³² This law replaced Legislative Decree No. 5-Law on External Public Indebtedness, published in 1980.

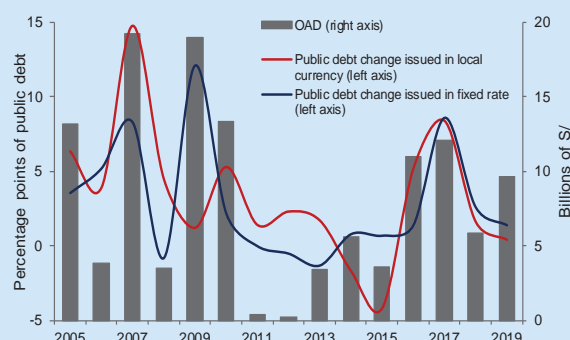
Treasury bills, in order to form a more complete and liquid yield curve that serves as a reference for the private sector to access better financing conditions. This contributes to a more efficient allocation of resources in the economy. Thus, the participation of sovereign bonds in the public debt increased, and went from 1.4% of the total public debt in 2001 to 58.5% as of June 2019.

- b) Liabilities Management Operations (OAD).** In addition, to optimize the public debt profile, OADs have been actively carried out, the majority of which consisted of restructuring (exchange) of debt in foreign currencies, at a variable and short-term rate, through issuance of sovereign bonds and in terms that do not generate pressures on financing needs. In this way, between 2005 and 2018, OADs were carried out for an average amount of S/ 8.2 billion per year, which contributed to increasing the participation of public debt in local currency, at a fixed rate, as well as extending its half-life¹³³

Treasury bonds in domestic currency
(% of GDP and % of public debt)



OAD and change in public debt profile
(Billions of soles and pp of public debt)



Note: 2019 data shows June information of that year.
Source: BCRP, MEF.

- c) Strategy for Asset and Liability Integral Strategy (Egiap).** On the other hand, an important milestone in public debt management is the set-up of the Egiap¹³⁴ in 2013, whose main objectives are i) to define the guidelines on the Government's financial strategy to deepen the development of the public debt stock market, which contributes to ensuring fiscal sustainability, and ii) becoming an effective multi-year planning instrument for the management of the State's financial balance. This document establishes, among others, public debt management policies in harmony with the MMM macroeconomic and fiscal policy guidelines.
- d) Euroclear.** Within the framework of the Egiap, in 2015, the State signed an agreement with the Euroclear platform, with the objective of contributing to the greater liquidity and depth of the public debt market, as well as to continue diversifying the investor base. Euroclear is one of the largest international securities depositories in the world. This platform makes it easier for non-resident investors to access sovereign debt instruments in local currency¹³⁵, and, on the other hand, allows local investors to diversify their list of counterparties and negotiate with a greater number of international investors, which contributes to Peruvian public debt market development. This reduces financing costs, since the transaction cost of accessing international capital markets is minimized.

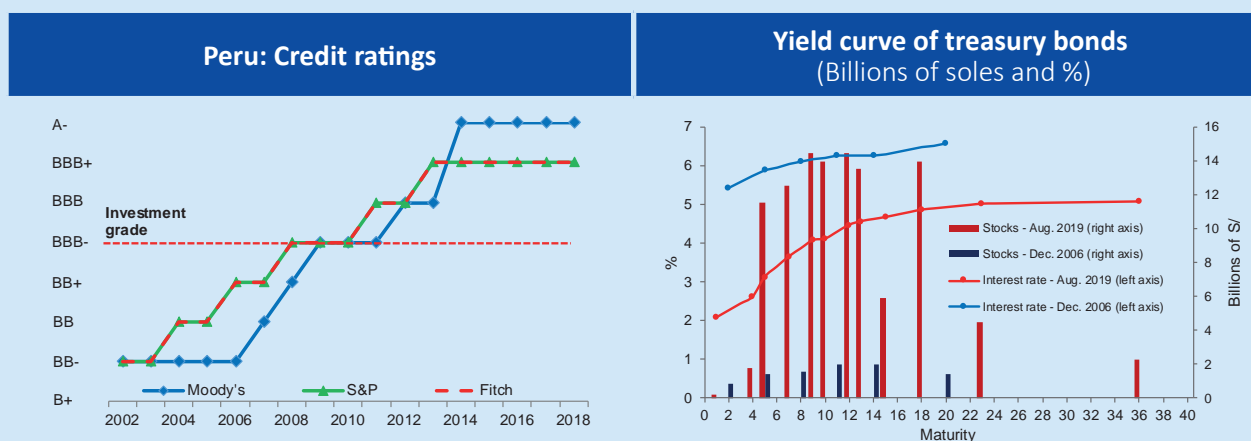
Based on the active management of public debt made in recent years, significant progress was made in reducing the exposure of public debt to financial risks (thus contributing to fiscal sustainability) and in the development of the domestic capital market:

¹³³ It is worth mentioning that less exposure to financial risks reduces the need to generate large reserves for precautionary purposes, then these resources can be allocated more efficiently in the real economy to underpin economic growth and well-being.

¹³⁴ In the beginning, this document was called "Global asset and liability management strategy".

¹³⁵ This allows Euroclear participants (more than two thousand financial institutions from more than ninety countries) to have immediate access to sovereign bonds issued by the State.

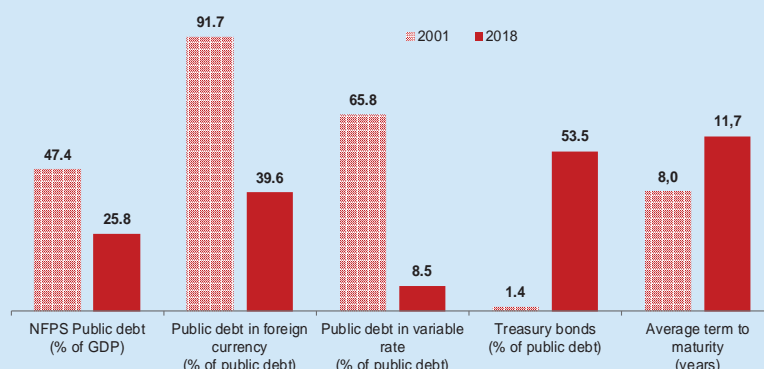
- **A more complete and liquid yield curve to develop the capital market.** Based on the Market Makers Program and the Egiap, there is currently a more complete and liquid yield curve, which translates it as an efficient reference for private sector debt issues. Also, in line with the achievements of the macro-fiscal framework, there is a more favorable interest rate structure.
- **Optimization of the public debt profile.** Due to an active management of public debt, based on the guidelines of the Egiap, its exposure to financial risks has been reduced, which significantly contributes to fiscal sustainability. Thus, the public debt in Soles went from 8.3% of the total public debt in 2001 to 60.4% as of June 2019, while the fixed-rate public debt went from 34.2% to 91.5%. Also, in that period, the half-life was increased from 8.0 years to 11.6 years. In this way, the exposure of the public debt to exchange rate, interest rate and refinancing risks was reduced. Thus, for example, in accordance with the analysis performed in the macro-fiscal risks section of this MMM, the sensitivity of the public debt to an increase in the exchange rate by 10% was reduced from 4 pp of GDP at just under 1 pp of GDP.
- **Continuous improvements in credit rating based on a lower exposure of public debt to financial risks and a solid macro-fiscal position.** Additionally, one of the main factors that led to better credit ratings in the country, in addition to a more favorable macro-fiscal position, is the reduction of public debt exposure to financial risks, an aspect highlighted by the main risk rating agencies.



Source: S&P, Moody's, Fitch Ratings, BCRP, MEF.

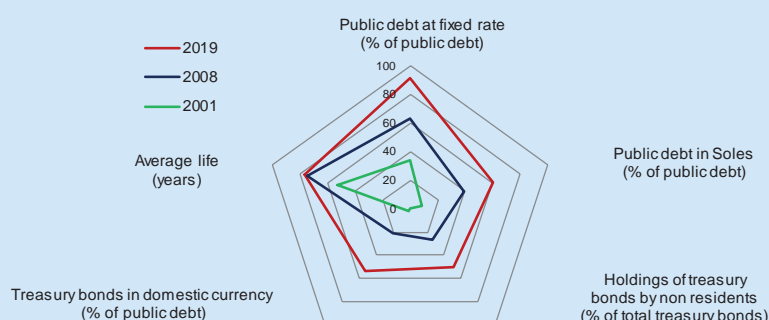
- **Greater diversification of investors and participation of non-residents.** Based on a greater opening of the country to international financial markets and the linking of sovereign securities to Euroclear, in recent years it has been possible to diversify the portfolio of sovereign bond investors. The greater participation of non-residents as holders of sovereign bonds is highlighted, which are mostly made up of investors who hold structural investment positions (purchase of sovereign securities to keep them in the medium and long-term).
- **International awards for successful sovereign bond issues.** In recent years, sovereign bond issues under OAD were awarded by journals with high prestige in the capital market industry. Thus, in January 2018, LatinFinance magazine recognized the successful issuance of the 2032 Sovereign Bonus as Best Sovereign Bonus of 2017. Similarly, the 2024 Sovereign Bonus (issued in October 2014) was awarded in January 2015 by the International Financing Review in the Domestic Currency Bonus category and, in January 2016, by LatinFinance magazine as Best Transaction in Local Currency. These facts show the confidence of the financial markets in the macro-fiscal solidity of the country and the efficient management of public debt.

Public debt indicators (% of GDP, % of public debt and years)



Source: BCRP, MEF.

Public debt profile¹ (% of public debt, % of total treasury bonds and years)



1/ Average term to maturity have been standardized, 100 value is equivalent to 15-years. Rest of indicators are percentages of their respective total. 2019 data shows June information.

Source: BCRP, MEF.

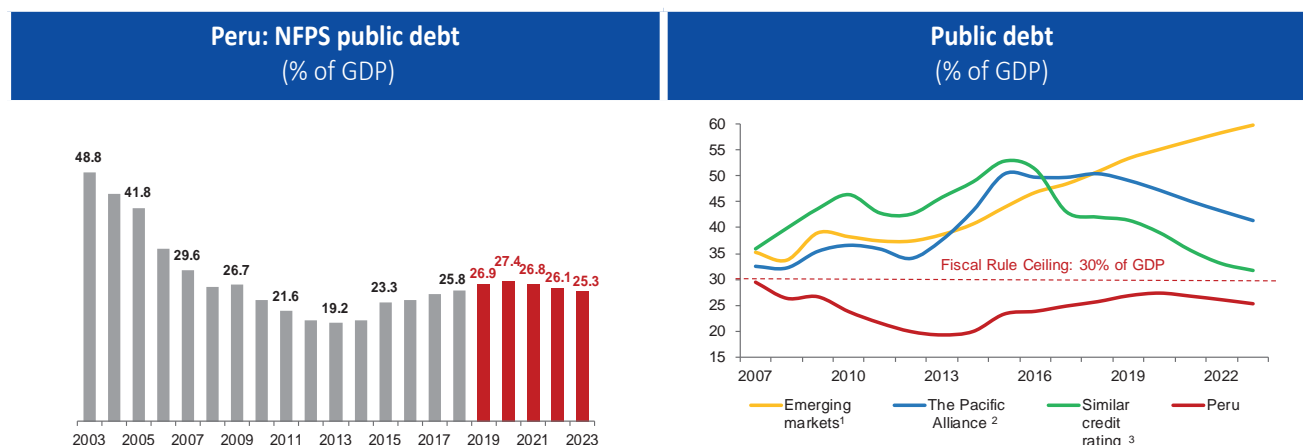
From now on, in accordance with the modernization of the State Administrative Systems, a greater deepening of the local capital market and the Egiap, an active management of the public debt will continue, prioritizing debt in soles, at a fixed rate and in terms that do not generate pressure on financing needs. It is important to note that, in 2018, Legislative Decree No. 1437-Legislative Decree of the National Public Indebtedness System¹³⁶ was enacted, which adapts the management of public debt to a more interconnected international financial environment and with a more complete management approach of fiscal risks that includes a comprehensive management of the State's financial balance.

In that sense, the exposure of public debt to financial risks will continue to be mitigated through the prioritization of sovereign bond issues in soles and in terms that do not generate pressure on financing needs. In turn, within the framework of the Egiap, the portfolio of investors will continue to be diversified, and measures will be implemented to increase the liquidity and depth of the public debt market in local currency (with greater dynamism in the secondary market).

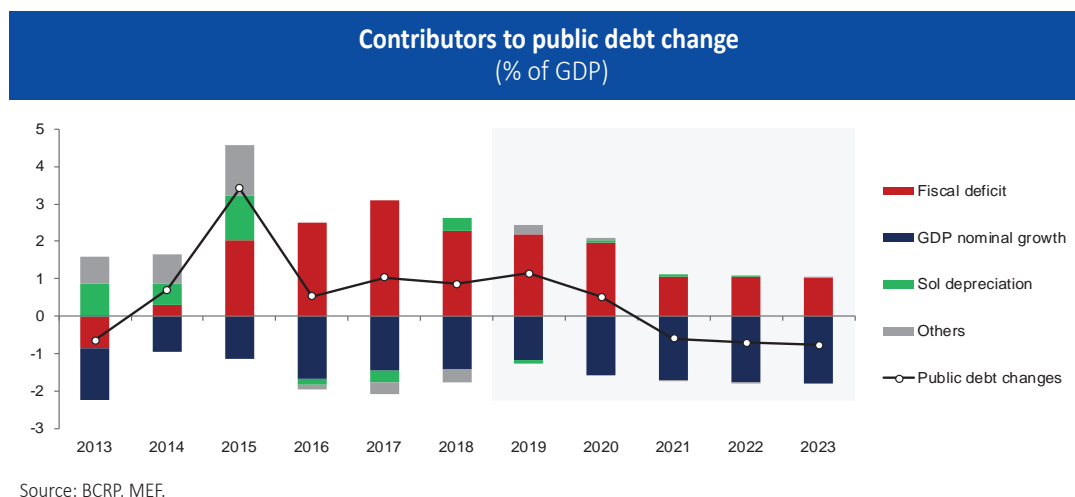
As of 2021, the NFPS public debt will show a decreasing dynamic until it reaches 25.3% of GDP in 2023, which will allow the country to strengthen the sustainability of its public finances while preserving the lowest debt in the region and inferior to countries with similar credit rating. This level of indebtedness is consistent with the path of reduction of the fiscal

¹³⁶ Passed within the framework of Legislative Decree No. 1436-, legislative decree Framework of the Public Sector Financial Administration, considering a new comprehensive and multi-year approach to the financial administration of the public sector. Legislative Decree No. 1437 replaced Law No. 28563.

deficit and with the guidelines of the Egiap. Therefore, it is expected that the public debt fiscal rule (debt less than 30% of GDP) will be fulfilled along the projection horizon, which demonstrates the commitment with a responsible management of public finances and the strengthening of Fiscal sustainability. On the other hand, it is important to mention that GDP growth is one of the main factors that contributes to reducing public debt in the projection horizon, since, on average, it contributes to reducing public debt by 1.6 pp of GDP per year.



1/ Median of middle-income emerging market according to IMF. 2/ Median of the Pacific Alliance countries excluding Peru. 3/ Median of countries with BBB+ credit rating according to S&P and Fitch, and A3 according to Moody's.
Source: IMF, S&P, Moody's, Fitch, BCRP, MEF.



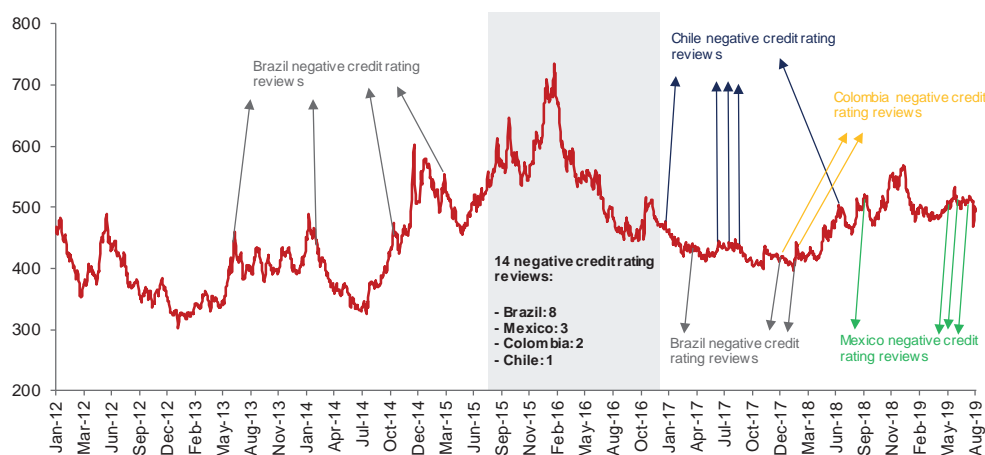
Source: BCRP, MEF.

The solid track record and credibility of Peru's macroeconomic policies have allowed it to be the only country in the region that has managed to preserve its credit rating and perspective, in a context in which credit outlooks have been reviewed since 2013. In episodes of high volatility in emerging markets, credit ratings and/or outlooks of countries in the region, such as Brazil, Chile, Colombia and Mexico, were revised downwards. Thus, of the 32 negative reviews of the credit outlooks of these countries¹³⁷ carried out between 2013 and year to date, approximately half were carried out between July 2015 and December 2016, a period of marked volatility in emerging markets. In contrast, Peru's credit rating and perspective have been continuously ratified by the three main risk rating agencies¹³⁸, based on the country's macro-fiscal strength and resilience in the face of adverse scenarios.

¹³⁷ The following actions carried out by S&P, Moody's or Fitch are considered as negative review of the credit scenario: i) change of credit perspective from stable to negative, ii) credit rating reduction, or iii) both simultaneously

¹³⁸ In June and March 2019, Moody's and Fitch Ratings ratified Peru's credit rating at BBB + and A3 with a stable outlook, respectively. Additionally, in June 2018, S&P ratified the rating to Peru at BBB + with a stable forecast.

EMBIG LATAM and negative credit rating reviews¹ (Basic points)



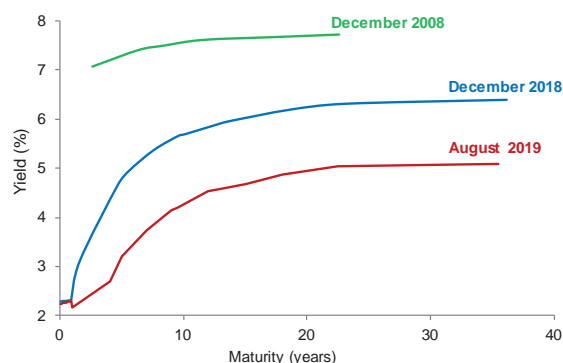
1/ It considers as negative credit rating reviews to the following actions of S&P, Moody's or Fitch: i) changes in the credit outlook from stable to negative, ii) credit rating downgrade, or iii) both scenarios simultaneously.

Source: Bloomberg, S&P, Moody's, Fitch.

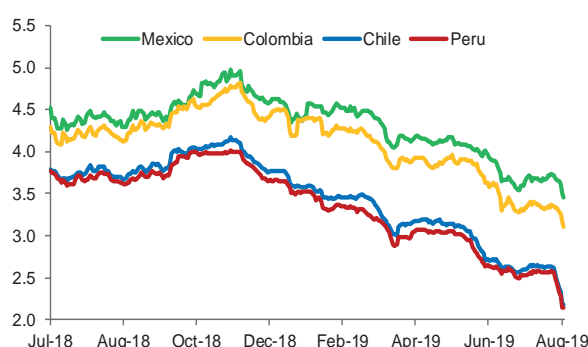
The macro-fiscal strength of the country also makes it possible to obtain more favorable yield curves, which allows sectors, both public and private, to access lower interest rates to boost the dynamism of the economy. As of August 2019, the yield curve of sovereign bonds has been reduced by an average of approximately 110 bps compared to December 2018. In particular, taking as a reference the yield of the sovereign bond in ten-year dollars, the rate of return of the global bond Peruvian has remained at 130, 95 and 5 bps below Mexico, Colombia and Chile, respectively. These lower interest rates have allowed Peru to be one of the emerging economies with the lowest interest payment burden, and this is expected to be maintained along the projection horizon. With this, the State obtains more space for productive spending in favor of the well-being of citizens, such as closing infrastructure and social gaps.

In addition, as a reflection of the responsible management of public finances and the efficient management of the State's financial balance, Peru's financing needs will continue to be one of the lowest among comparable economies. In that sense, Peru's financing needs¹³⁹ for 2020 are 2.3% of GDP, lower than in countries with similar credit ratings (6.8% of GDP) and emerging countries (10.2% of GDP).

Yield curve (%)

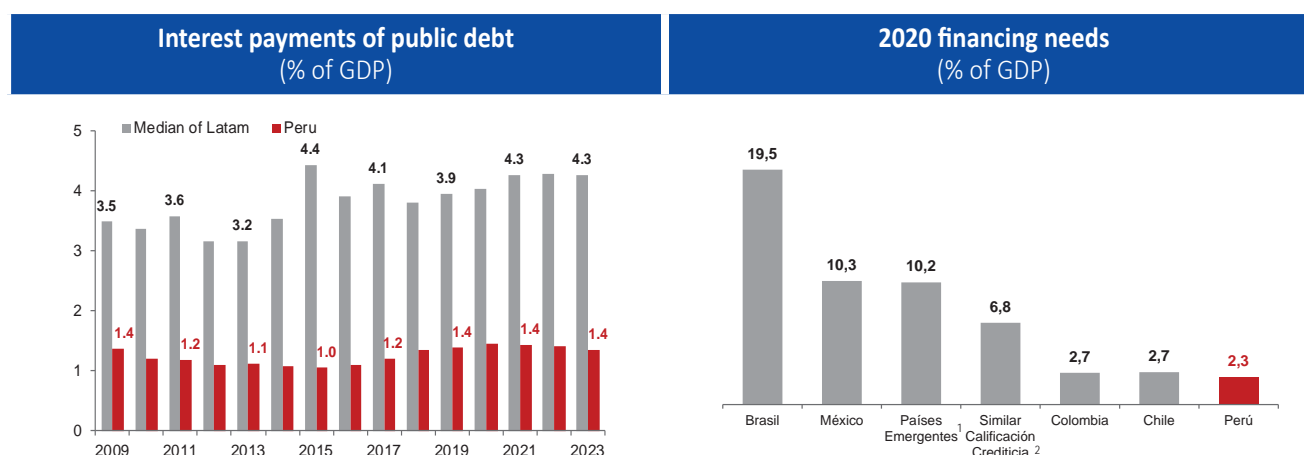


10-year treasury bonds yields in US dollars (%)



Source: Bloomberg, BCRP, MEF.

¹³⁹ The financing needs are calculated as the sum of the fiscal deficit plus the repayments of the public debt.



1/ Median of middle-income emerging market according to IMF. 2/ Median of countries with BBB+ credit rating according to S&P and Fitch, and A3 according to Moody's. Source: IMF, S&P, Moody's, Fitch, BCRP, MEF, MEF forecasts.

To continue strengthening the sustainability of public finances, and in consistency with the Egiap, the structure of the State's financial balance will continue to be refined through i) the most efficient use of financial assets in budget programming, ii) the expansion of the portfolio of financial instruments that serve as a source of financing for adverse events and iii) reducing the exposure of public debt to financial risks Thus, the regulations related to the modernization of the administrative systems of the State will allow consolidating the approach of integral management of financial assets and liabilities of the State to promote the fungibility of resources through the Treasury Single Account (TSA). In this way, complemented by better budgetary programming of resources, liquidity costs will be reduced and the profitability of financial assets will be improved.

On the other hand, the main financial instruments against adverse events include: i) NFPS financial assets (15.5% of GDP as of June 2019), among which there is the FEF (2.5% of GDP); ii) access to financial markets in favorable conditions thanks to the continuous improvement in the credit rating and macro-fiscal strength of the country; iii) contingent credit lines for US\$ 3.650 billion for financial crises and / or natural disasters and iv) insurance against earthquake losses with coverage of up to US\$ 200 million¹⁴⁰. Regarding earthquake insurance, it is important to note that a coverage of US\$ 60 million was activated to address the consequences of the earthquake in Loreto in May this year¹⁴¹. From now on, the portfolio of financial instruments that preserve the State's capacity to respond to adverse scenarios will continue to expand.

Regarding the management of public debt, the responsible and sustainable management of public finances has allowed the optimization of the public debt profile to reduce its exposure to financial risks. Thus, debt will continue to be prioritized in soles, at a fixed rate and in terms that do not generate pressure on financing needs. Further to this, the Egiap plans to continue deepening the sovereign securities market through a greater bond issuance, according to the financing needs of the State, and a greater diversification of the portfolio of investors in these instruments.

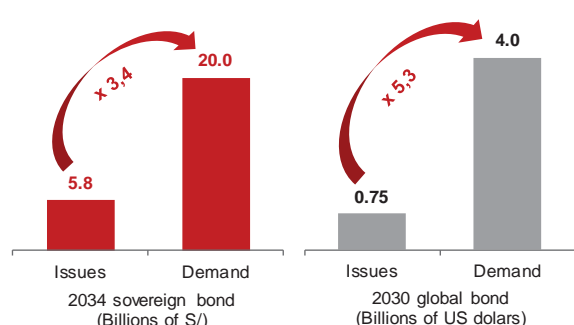
In that sense, considering the guidelines of the Egiap and the favorable access of the country to the financial markets, in June 2019 a successful bond issuance was carried out under an OAD. In this way, exchange rate and refinancing risks are mitigated, and the sovereign securities market continues to deepen. The total amount of the issuance was approximately S/ 8,330 million (S/ 5,828 million of the 2034 sovereign bond and US\$ 750 million of the 2030 global bond). Of this amount,

¹⁴⁰ This insurance was contracted in association with the other countries of the Pacific Alliance and through the issuance of a CAT Bond by the World Bank. If there is an earthquake that activates this insurance, disbursements may be from 30% to 100% of the amount contracted and will be transferred to the Fund for interventions in the event of natural disasters (Fondes), to respond in a timely manner to the emergency. The insurance allows the transfer of the risk of this type of event to the international financial markets and complements the portfolio of financial instruments within the national risk management policy. Unlike traditional indemnity insurance, these are structured with activation parameters and event intensity.

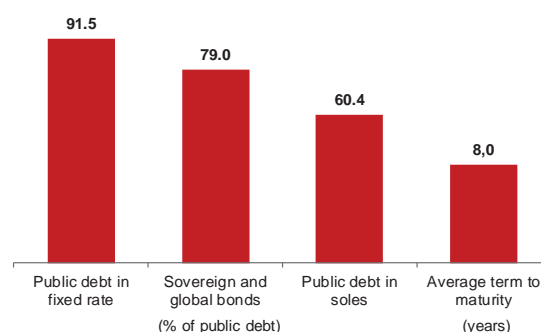
¹⁴¹ On June 20, the WB informed the MEF that it began the evaluation process of the earthquake data that occurred in Loreto on May 26, 2019. To do this, it commissioned the modeling agent to evaluate the event taking into account the data of the Geological Service of the United States (USGS) stabilized after twenty business days of the event. The parameters evaluated were i) the magnitude of the earthquake, ii) the location (latitude and longitude) and iii) the depth, reported by the USGS. With this, the WB sent a communication to the Government of Peru, in which it informed that the modeling agent had notified that the activation of catastrophic insurance corresponds to up to 30% of the insured amount (US\$ 60 million).

around S/ 2,250 million were allocated to pre-finance the financing needs of the year 2020, while S/ 6,080 million were destined to the repurchase and exchange of sovereign and global bonds of lower maturity and/or greater financial cost. In addition, the demands of the sovereign bond and the global bond configured 3.4 and 5.3 times the amount of their issues, respectively, reflecting the confidence of the financial markets in the country's macro-fiscal strengths. Thus, the results of this operation have allowed to increase the average life of the debt by 0.3 years and solarization by 0.2 pp.

Issues and demand of 2034 sovereign bond and 2030 global bond (Billions of soles and billions of US dollars)



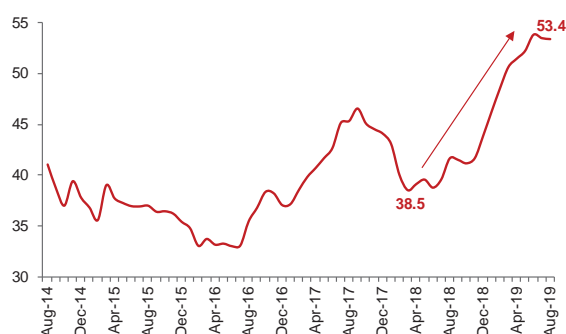
Public debt profile (% of public debt and years)



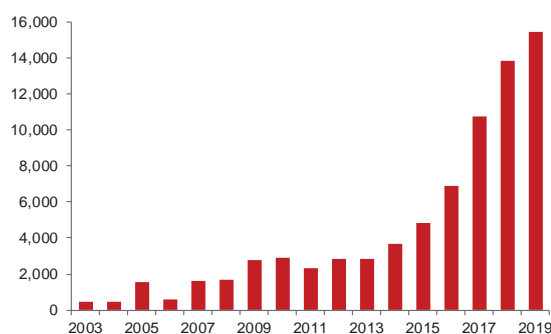
Source: BCRP, MEF.

It is also important to highlight the increase in the possession of sovereign bonds held by non-residents, mainly investors who take structural positions, which confirms the confidence of the financial markets in the country's macro-fiscal strengths. Thus, from March 2018 to date, the possession of sovereign bonds held by non-residents increased from 38.5% to 53.4%. A relevant aspect of this increase, in addition to the diversification of the portfolio of investors, is that it has been mainly given by agents that take structural positions (long-term). Thus, for example, approximately 70% of the investors who acquired bonds in the international issuance made in June, within the framework of the OAD, were pension and insurance funds that have passive investment strategies in line with their long-term objectives. It is also important to note that the Euroclear platform, coupled with the macro-fiscal solidity of the country, allows greater dynamism of the sovereign securities market, as this platform reduces the transaction costs of accessing that market, which also leads to lower financing costs.

Treasury bond holdings by non-resident (% of the total treasury bonds)



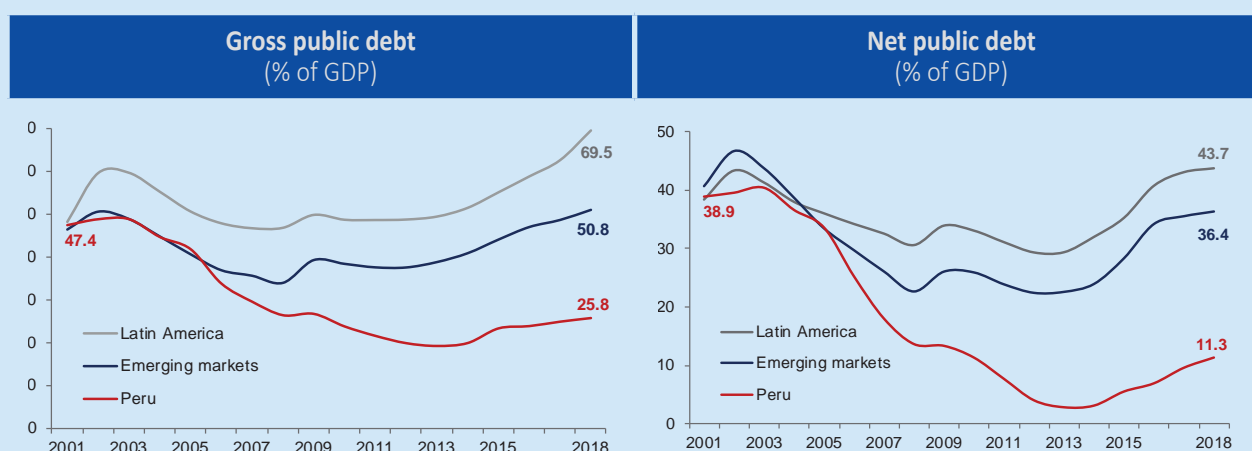
Monthly average of secondary treasury bond market transactions (Millions of soles)



Source: BCRP, MEF.

Box 10: NFPS financial assets¹⁴²

Peru's net public debt, calculated as the difference between gross public debt and financial assets¹⁴³, remains one of the lowest among emerging and regional economies Thus, the net public debt is 11.3% of GDP at 2018, below that of Latin America (43.7% of GDP) and that of emerging countries (36.4% of GDP). Net public debt was reduced by 27.6 pp of GDP from 2001 to 2018. This result is explained both by the reduction of gross public debt (from 47.4% of GDP to 25.8% of GDP in that period), as well as by the increase in the financial assets of the NFPS (from 8.6% of GDP to 14.5% of GDP in that period). This increase in the financial assets of the NFPS was the product of a prudent fiscal policy in line with the strengthening of the macro-fiscal framework, which accumulated fiscal savings in times of high GDP growth rates and favorable terms of trade, and then used in times of less dynamism of the economy



Source: IMF, BCRP, MEF.

In recent years, and in line with what happened in emerging economies, the NFPS financial assets decreased as a percentage of GDP, as part of its resources were used to finance fiscal policy actions in response to adverse events that affected the economy. On average, the financial assets of emerging countries fell from 16.8% of GDP in 2014 to 14.4% of GDP in 2018. During this period, the Peruvian economy was also affected by several adverse events¹⁴⁴, which required timely actions of fiscal policy to boost the dynamism of the economy¹⁴⁵. As a consequence, financial assets decreased from 16.9% of GDP at the end of 2014 to 15.5% of GDP at the second quarter of 2019. Also, in the same period, FEF resources increased from US\$ 9,160 million to US\$ 5,675 million (from 4.8% of GDP to 2.5% of GDP). In this regard, in 2017 and 2018, FEF resources were withdrawn for a total of approximately US\$ 2.5 billion, to be used mainly for the reconstruction process of the areas affected by the 2017 Coastal El Niño Phenomenon¹⁴⁶.

However, it is important to note that although financial assets as a percentage of GDP have fallen during the last years, in nominal terms it is among the highest amounts historically. This difference is due to the fact that, in nominal terms, financial assets grew at a slower rate than the GDP in recent years.

¹⁴² Section 5 of article 6 of the Regulation of Supreme Decree No. 150-2017-EF (Supreme Decree that approves the Regulation of Legislative Decree No. 1276, Legislative Decree that approves the Fiscal Responsibility and Transparency Framework of the Non-Financial Public Sector) It is pointed out that the MMM must include, among others, information on the financial assets of the NFPS and its main characteristics.

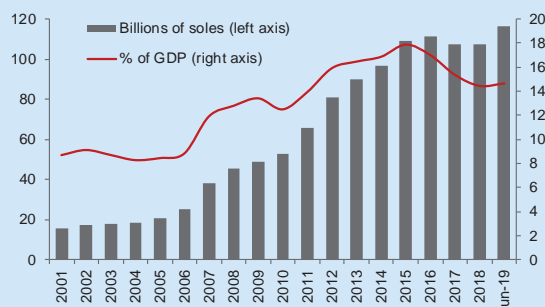
¹⁴³ IMF (2014), Manual of Public Finance Statistics 2014

¹⁴⁴ In Peru, public finances were affected by the high volatility observed in emerging markets (2013-2016) and the Coastal El Niño Phenomenon (2017).

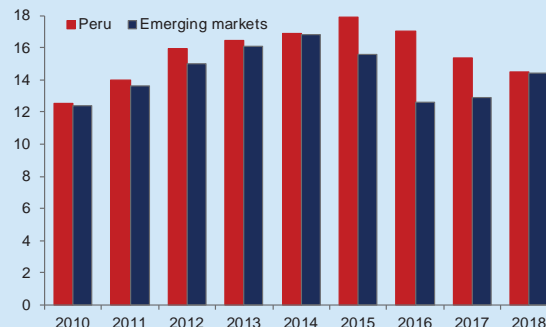
¹⁴⁵ During this period, fiscal impulse measures were carried out through extensions of the fiscal deficit rule. Thus, the last one was carried out in 2017, due to the El Niño Phenomenon that occurred in that year, through Law No. 30637 (Law that provides for the application of the exception clause to the macro-fiscal rules of the Non-Financial Public Sector). In that law the fiscal deficit fiscal rule was extended to 3.5%; 2.9%; 2.1% and 1.0% of GDP for 2018, 2019, 2020 and 2021, respectively.

¹⁴⁶ In accordance with Legislative Decree No. 1276 (Legislative Decree approving the Fiscal Responsibility and Transparency Framework of the Non-Financial Public Sector) and Law No. 30637, the use of FEF resources was authorized for that purpose.

NFPS Financial assets (Billions of soles and % of GDP)



Financial assets¹ (% of GDP)



1/ Emerging markets financial assets stock is computed as the difference between gross public debt and net public debt. These fiscal accounts were published by the IMF Fiscal Monitor, April 2019.

Source: IMF, BCRP, MEF.

Within the framework of the Egiap, improvements have been made to the management of financial assets in recent years, which were focused on improving the profitability of financial assets and a greater centralization of public resources in the TSA:

- o In 2012, the “Guidelines for the global management of assets and liabilities” and the “Deposit regulations”¹⁴⁷ were approved, through which the NFPS entities, based on good practices, prepare their asset management policies and make them profitable considering the nature of its activities (according to a greater or lesser need for liquidity).
- o In addition, in 2014, the Public Funds Auction Module¹⁴⁸ started operations, with the objective of being a mechanism that centralizes the temporary liquidity surpluses of the NFPS entities to facilitate and favor their profitability, while obtaining greater transparency in that process¹⁴⁹. Moreover, the Treasury has been profiting its temporary liquidity surpluses in the financial system through auctions of deposits coordinated with the BCRP.
- o The coverage of the TSA¹⁵⁰ also continued to be expanded with the objective of consolidating the State’s cash balances, supervising cash flows, and improving budgetary control and monitoring. The establishment of an efficient TSA considerably reduces the costs of public debt service and the needs of liquid reserves, and helps maximize the return on investments of excess cash¹⁵¹.

Current status of the NFPS financial asset stock

As of June 2019, NFPS financial assets are equivalent to 15.5% of GDP, a percentage of which the FEF is located at 2.5% of GDP. Of this level of financial assets, 4.7% of GDP corresponds to Public Treasury resources, which, mainly, are intended to cover public budget expenditures; 3.2% of GDP corresponds to public funds whose resources are destined for specific purposes according to regulations, among which is the FEF; 3.0% of GDP, to resources administered by the Public Treasury, but belonging to other budget documents; and 4.6% of GDP, to resources of entities that are in the private financial and non-financial sector, and that are mostly intangible.

¹⁴⁷ By Directorate Resolution No. 016-2012-EF/52.03.

¹⁴⁸ By Directorate Resolution No. 083-2013-EF/52.03

¹⁴⁹ The use of this virtual and automated mechanism allows to reduce the operational risk of carrying out these auctions in the traditional way and, in addition, it favors the collection of centralized and consolidated information to build the main reference of the yield curve of public funds in the financial system. Similarly, it allows measuring and monitoring the level of risk assumed with each counterparty, the degree of concentration of deposits, among other indicators, for a better management of the treasury contemplated in the directives issued on asset management and liabilities in public entities.

¹⁵⁰ The TSA can be defined as a unified structure of the Government’s bank accounts that facilitates the consolidation and optimal use of the Government’s cash resources. IMF (2011), The Treasury Single Account: An essential tool for government treasury management.

¹⁵¹ According to the IMF (2011), the absence of an efficient TSA generates, among others, that i) inactive cash balances in bank accounts often do not receive remuneration linked to market interest rates, and ii) the Government, which is unaware of the availability of these resources, incur unnecessary borrowing costs by raising funds to cover what it perceives as a cash shortage.

Regarding its composition by currency, financial assets in national currency represent 66.2% (10.3% of GDP) of total financial assets, while financial assets in foreign currency, 33.8% (5.2% of GDP). Regarding its composition according to deposit entity, 61.9% (9.6% of GDP) of financial assets is in the BCRP; 33.2% (5.1% of GDP), in the private financial and non-financial system; and the remaining 4.9% (0.8% of GDP), at the Banco de la Nación.

NFPS Financial assets, June 2019 (Millions of soles and % of GDP)

	Millions of S/	% of GDP	Description
NFPS Financial Assets (1+2+3+4)	116,559	15.5	
1. Public Treasury Own Resources	35,423	4.7	Resources of the Public Treasury in BCR and BN, which are mainly aimed at covering budgeted expenditures. It includes pre-financing and resources coming from indebtedness aimed at covering expenses of investments projects. These resources correspond to short term deposits (less than one year).
1.1 Deposits in Central Reserve Bank of Peru (BCRP)	31,127	4.1	
1.2 Deposits in Banco de la Nación (BN)	196	0.0	
1.3 Deposits in commercial banks	4,100	0.5	
2. Funds and Liquidity Secondary Reserve (LSR)	23,696	3.2	Public funds with specific purposes by law. In addition, includes LRS, which are mainly aimed at covering temporal liquidity needs by Ordinary Resource or from Debt Operations that covers budgeted expenditures.
2.1 Fiscal Stabilization Fund (FSF)	18,652	2.5	
2.2 Liquidity Secondary Reserve (LSR)	222	0.0	
2.2 Others Funds	4,822	0.6	
3. Resource of public entities in the public Treasury	22,897	3.0	Resources allocated in Public Treasury, but that corresponds to public entities budget. They mainly come from RDR and RD transfers to subnational governments (canon, sobrecanon, among others). Most of these resources are found in the Treasury Single Account (TSA).
3.1 Directly Collected Resources (RDR)	5,895	0.8	
3.2 Specified Resources (RD)	11,517	1.5	
3.3 Donations and Transfers	706	0.1	
3.4 Other resource	4,779	0.6	
4. Resources of Public entities in the Private Financial and Non Financial System	34,542	4.6	Public financial assets allocated in commercial banks. They are mainly intangible. For instance, the resources from the CRF are to fulfill the obligations related to pension schemes managed by ONP. Regarding EsSalud, the resources correspond to revenues to cover expenditures on health services.
4.1 Directly Collected Resources	3,461	0.5	
4.2 Rest of resources in the Private Financial and Non Financial System	31,081	4.1	
State owned Enterprises - FONAFE	5,133	0.7	
ONP	531	0.1	
Consolidated Reserve Funds (CRF)	18,467	2.5	
ESSALUD	4,483	0.6	
Others	2,467	0.3	
Note:			
			% of total financial assets
1. By currency			
NFPS Financial Assets (I+II)	116,559	15.5	100.0
I. Domestic Currency	77,203	10.3	66.2
II. Foreign Currency	39,356	5.2	33.8
2. By entities source			
NFPS Financial Assets (I+II+III)	116,559	15.5	100.0
I. Central Reserve Bank of Peru	72,205	9.6	61.9
II. Banco de la Nación	5,712	0.8	4.9
III. Private financial and non financial system	38,642	5.1	33.2

Fuente: BCRP, MEF.

Pending Agenda

It is important to rebuild and maintain safe levels of financial assets to respond in a timely manner to future adverse events, improve access conditions to capital markets and strengthen the sustainability of public debt.

- o An adequate level and composition of financial assets facilitates the implementation of countercyclical policies during adverse events, mainly in countries exposed to commodity price volatility¹⁵². With this, the availability of financial assets alleviates future liquidity needs and reduces the need for other types of strategies, such as the diversion of resources previously earmarked for productive purposes or the significant issuance of new debt
- o Additionally, a high level of financial assets allows reducing the cost of public financing and the probability of facing significant increases in public debt¹⁵³. This is because financial assets serve as signals about the reputation and responsibility of fiscal policy. It should be noted that this effect varies among financial assets according to their degree of liquidity¹⁵⁴.

¹⁵² IMF (2018), Fiscal Monitor 2018: managing public wealth. This document also indicates that if an economy with a high level of financial assets faces a recession, that recession will be less deep and will last less than if it had occurred in an economy with a low level of financial assets.

¹⁵³ Henao-Arbelaez y Sobrinho (2017), Government financial assets and debt sustainability; Hadzi-Vaskov y Ricci (2016), does gross or net debt matter more for emerging market spreads?; y Gruber y Kamin (2012), Fiscal positions and government bond yields in OECD countries.

¹⁵⁴ Thus, the more liquid the fiscal asset, the greater its impact on the reduction of sovereign spreads and the likelihood of public debt being restructured, because it is more likely to be available to meet the financing needs of the public debt or fiscal deficit service.

Additionally, in the framework of the modernization of the financial administration systems of the public sector, the profitability of financial assets and the fungibility of resources will continue to be improved, considering the optimization of the State's financial balance. In 2018, regulations were issued to modernize the financial management systems of the public sector¹⁵⁵. With this, among other aspects, a more efficient management of resources is sought considering a better financial programming of the budget, maximizing the profitability of financial assets and minimizing their liquidity costs, in accordance with an optimal structure of the State's financial balance. In this framework, standards will continue to be issued and the management of financial assets will be improved with the following objectives:

- **Strengthening of information systems and consolidation of TSA coverage.** It is important to have complete, timely and reliable information on financial flows, as well as the position of the State's financial assets and liabilities in order to determine the distribution of resources, guarantee compliance with commitments and design an efficient financing structure. For this, it is necessary to continue expanding and consolidating TSA coverage, as well as strengthening and integrating treasury information systems.
- **Optimize the financial programming of the budget through fungibility and priority of funding sources.** Many entities have accumulated balances of own and transferred resources¹⁵⁶, which are mostly maintained in the financial system with low execution of the allocated resources, which reduces the management capacity of the Treasury over the assets and limits efficient financial programming. Therefore, it is necessary to establish a priority in the use of resources, which promotes the efficient execution of accumulated balances by the NFPS entities and, thus, allows the release of resources for other entities that do not have this type of savings. This will reduce the need for public indebtedness, while eliminating the financing imbalance due to lack of fungibility in other financing sources.
- **Greater profitability of public resources and reduction of the cost of liquidity.** With the centralization of resources in the TSA and the implementation of fungibility, temporary liquidity surpluses can be identified in a timely manner, thereby determining the best profitability option based on their opportunity cost. Besides, NFPS entities will make their resources profitable based on the guidelines of the Egiap and according to the nature of their operations.

6.4. DETERMINATION OF THE FISCAL RULES FOR THE PREPARATION OF THE PUBLIC SECTOR BUDGET ¹⁵⁷

The fiscal forecasts of this document have been prepared in compliance with the current macro-fiscal rules set forth by Legislative Decree No. 1276, which approves the Fiscal Responsibility and Transparency Framework of the Non-Financial Public Sector, and by Law No. 30637, which provides for the application of the exception clause to the macro-fiscal rules of the Non-Financial Public Sector According to this regulatory framework, the annual budget, indebtedness and financial balance laws; supplementary credits; and the NFPS budget execution are subject to compliance with fiscal rules.

The current MRTF has as a general principle to permanently ensure fiscal sustainability, the predictability of public spending and the transparent management of public finances. In effect, in accordance with Legislative Decree No. 1276 and Law No. 30637, the NFPS¹⁵⁸ is subject to joint compliance with macro-fiscal rules concerning public debt, economic result, Non-Financial Expenditure of the general government, and general government Current Expenditure, consistent with the following:

- a) **The public debt must not exceed 30.0% of GDP.** In exceptional cases of financial volatility, and provided that the other rules are complied with, it may temporarily deviate up to 4 pp of GDP.

¹⁵⁵ Within the framework of Legislative Decree No. 1436, Framework Legislative Decree of the Financial Administration of the Public Sector, Legislative Decree No. 1441, Legislative Decree of the National Treasury System was issued.

¹⁵⁶ Mainly from levies, royalties, among others.

¹⁵⁷ The calculation of the fiscal rules presented in this section is consistent with the Instruction for Calculation of the Macro-Fiscal Rules, published in annex 2 of the regulation of Legislative Decree No. 1276, approved by Supreme Decree No. 150-2017-EF.

¹⁵⁸ Comprised by public budgetary and extra-budgetary entities of the general government (national, regional, local) and non-financial public companies.

- b) **The fiscal deficit should not be greater than 1.0% of GDP.** For the 2018-2021 period, the fiscal deficit cannot be greater than 3.5%, 2.9%, 2.1% and 1.0% of GDP, respectively.
- c) **The annual growth of the Non-Financial Expenditure of the general government will be limited within a range of plus and minus one percentage point (+/- 1 pp) of the real annual long-term growth of the economy.** For fiscal years 2020 and 2021, the real annual growth of Non-Financial Expenditure should not be greater than the upper limit of the range of plus and minus one percentage point (+/- 1 pp) of the real annual long-term growth of the economy (average growth rate of twenty years). Compliance with this rule presupposes joint compliance with macro-fiscal rules a) and b)¹⁵⁹.
- d) **The growth of the general government Current Expenditure, without maintenance, may not exceed the real annual long-term growth rate of the economy, to which 1 pp. is reduced.** By 2020 and 2021, that reduction is 1.5 pp¹⁶⁰.

Determination of Non-Financial Expenditure of the general government

The Non-Financial Expenditure path of the general government is consistent with the joint compliance with the aforementioned macro-fiscal rules, that is, it is the minimum level that results from assessing the joint compliance with those rules. Thus, the Non-Financial Expenditure of the general government for 2020 amounts to S/ 168,673 million. On the other hand, for the years 2021, 2022 and 2023, the expenditure is projected to amount to S/ 179,094 million, S/ 192,902 million and S/ 207,596 million, respectively. Consistent with the joint compliance with fiscal rules, the growth of the Non-Financial Expenditure of the general government for the years 2020, 2021, 2022 and 2023 is 4.9%, 3.7%, 5.1% and 5.0%, respectively, below the real long-term growth of the economy, approximated by an average of twenty years according to what the fiscal rule provides (6.0% for the period 2020-2022 and 5.9% for 2023).

Fiscal Accounts of the Non-Financial Public Sector (Millions of soles, % real annual change and % of GDP)

	2020	2021	2020	2023
I. General government revenues	167,128	182,167	195,140	209,726
% of GDP	20.3	20.7	20.7	20.7
II. General government non-financial expenditures	168,673	179,094	192,902	207,596
% real annual change	4.9	3.7	5.1	5.0
% of GDP	20.5	20.4	20.5	20.5
Current expenditures excluding maintenance	123,036	129,770	137,759	146,185
% real annual change	3.5	3.0	3.6	3.5
III. Non-financial public enterprises primary balance	-2,728	-291	-1,035	-1,418
% of GDP	-0.3	0.0	0.1	0.1
IV. Primary balance (I-II+III)	-4,273	3,364	3,273	3,548
% of GDP	-0.5	0.4	0.3	0.4
V. Interests Payments	11,976	12,580	13,145	13,666
% of GDP	1.5	1.4	1.4	1.4
VI. Overall balance (IV-V)	-16,249	-9,217	-9,873	-10,118
% of GDP	-2.0	-1.0	-1.0	-1.0
VII. Public debt stock	226,108	235,717	245,776	256,230
% of GDP	27.4	26.8	26.1	25.3

Source: MEF, MEF forecasts

¹⁵⁹ Section c) of paragraph 2.2 of article 2 of Law No. 30637

¹⁶⁰ Section d) of paragraph 2.2 of article 2 of Law No. 30637

General Government non-financial expenditures growth rule (% real annual change)

	2020	2021	2022	2023
GDP ¹	5.0	5.0	5.0	4.9
Adjusted GDP by rule ²	6.0	6.0	6.0	5.9
CPI ³	134.8	138.1	141.5	145.1

1/ Corresponds to GDP real growth 20-year moving average, including the projection horizon of this MMF 2020-2023. 2/ According to Legislative Decree 1276. 3/ Consumer price index. A 131.9 CPI is expected to 2019. 2021-2023 estimation are according to BCRP survey of macroeconomics expectations, published in August 2019.

Source: MEF, MEF forecasts.

Determination of the growth rule of the general government current expenditure

The general government current expenditure growth rule is calculated according to the long-term growth of the adjusted GDP in accordance with the provisions of paragraph 2 d) of Article 2.2 of Law No. 30637. The growth rule of the general government current expenditure excluding maintenance is 3.5% real by 2020, while for the years 2021, 2022 and 2023 the growth rates are 3.5%, 4.0% and 3.9%, respectively. It is important to indicate that the current expenditure of the general government, excluding maintenance, estimated for 2020 is equivalent to S/ 123,036 million, while for the period 2021-2023 it would reach S/ 129,770 million, S/ 137,759 million and S/ 146,185 million, respectively.

General government current expenditure growth rule (% real annual change)

	2020	2021	2022	2023
GDP ¹	5.0	5.0	5.0	4.9
Adjusted GDP by rule ²	3.5	3.5	4.0	3.9
CPI ³	134.8	138.1	141.5	145.1

1/ Corresponds to GDP real growth 20-year moving average, including the projection horizon of this MMF 2020-2023. 2/ For years 2020 and 2021 are reduced by 1.5 percentage point to GDP real growth 20-year moving average. For 2022 and 2023 are reduced by 1.0 percentage point. 3/ Consumer price index. A 131.9 CPI is expected to 2019. 2021-2023 estimation are according to BCRP survey of macroeconomics expectations, published in August 2019. Source: MEF, MEF forecasts

7

MACRO-FISCAL RISKS

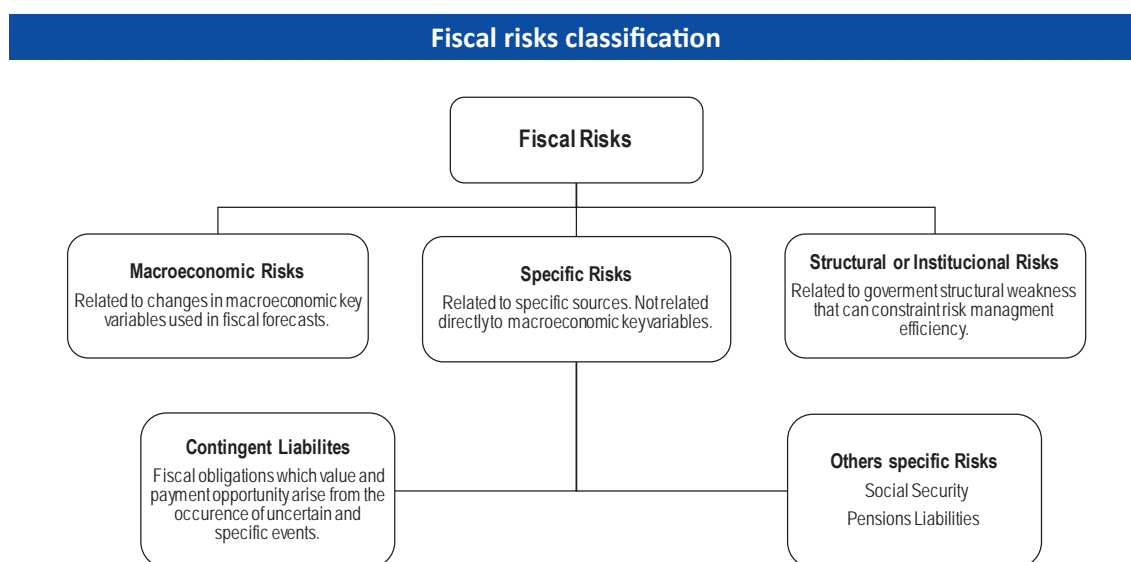


7.1. CONCEPTUAL FRAMEWORK

7.1.1. Definition and classification of fiscal risks

In general, fiscal risks are defined as unexpected deviations from the fiscal variables used to prepare the public budget or for longer-term fiscal projections. This definition, based on the IMF and other authors¹⁶¹, considers that fiscal risks are usually associated with macroeconomic shocks or the materialization of contingent liabilities. It also includes fiscal risks associated with demographic changes, rigidities in the management of fiscal policy, among others.

Thus, fiscal risks can be classified into three groups:



Source: IMF (2016), Analyzing and Managing Fiscal Risks: Best Practices; Curristine, T., Baldrich, J., Montecinos y Villarreal, R. (2014), Improving the reporting and management of Fiscal Risk and Contingent Liabilities; IMF (2008), Fiscal Risks: Sources, Disclosure, and Management.

- o **Macroeconomic risks** refer to the exposure of public finances to variations in the key macroeconomic parameters used in the projections (GDP growth, prices of tradable goods relevant to the domestic economy, interest rates, depreciation of the local currency, among others). The evaluation of these risks considers the analysis of different macroeconomic scenarios, and their consequent impacts on fiscal accounts and on the sustainability of public debt.
- o **Specific fiscal risks**, in contrast, are not directly related to macroeconomic parameters or projection assumptions, but are more restricted and arise from specific sources, such as the potential fiscal costs derived from the execution of government guarantees; the possible need to provide fiscal support to a state-owned company, subnational government or financial sector; or unscheduled expenses that are allocated to social and pension assistance transfer programs, among others.

In this regard, the IMF indicates that scenarios of exchange rate depreciation of the local currency and the materialization of contingent liabilities originated the largest unexpected increases in public debt in emerging economies in the last 15 years.¹⁶²

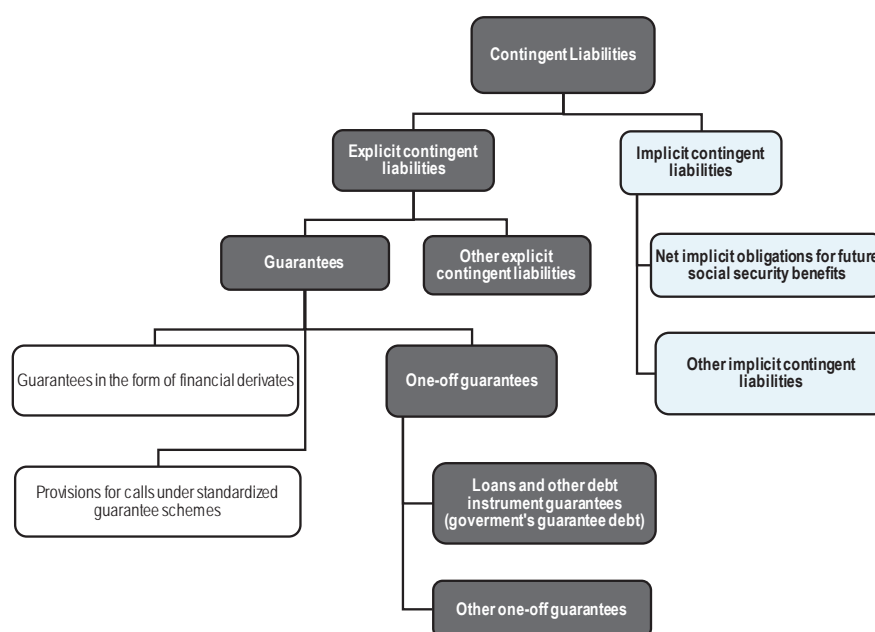
¹⁶¹ IMF (2016), Analyzing and managing fiscal risks: Best practices; Kopits, G. (2014), Coping with fiscal risk: Analysis and practice; Curristine, T., Baldrich, J., Montecinos y Villarreal, R. (2014), Improving the reporting and management of fiscal risk and contingent liabilities; IMF (2008), Fiscal risks: Sources, disclosure, and management.

¹⁶² IMF (2008), Kopits (2014) and IMF (2016).

The IMF defines as contingent liabilities¹⁶³ obligations whose timing and magnitude will depend on the occurrence of an uncertain future event beyond government control. This definition highlights the uncertainty regarding the timing and magnitude of the payment, and includes the possibility that the payment will not be made at all¹⁶⁴. It is important to note that uncertainty about the value of liabilities does not make them contingent liabilities¹⁶⁵.

The IMF also distinguishes and defines two types of contingent liabilities: i) explicit, defined as “legal or contractual financial mechanisms that give rise to a conditional requirement to make payments of economic value”; and ii) implicit, which “do not have a legal or contractual origin, but are recognized after a certain condition is met or a certain event occurs”. The following scheme shows the classification of contingent liabilities presented by the IMF 2014 *Public Finance Statistics Manual* (MEFP 2014).

Classification of contingent liabilities¹



1/ Graphic adapted from the 2014 Public Finance Statistics Manual.

2/ It includes legal money and deposits; technical reserves of non-life insurance; life insurance rights and annuities; rights to retirement pensions; rights of pension funds against sponsors and rights to benefits of non-pension funds (includes liabilities for non-autonomous pension systems not based on funds allocated managed by an employer); equity and investment fund holdings; other financial derivatives; and stock purchase options by employees.

Source: IMF, 2014 *Manual of Public Finance Statistics*.

According to the literature and in accordance with the provisions of the regulation of Legislative Decree No. 1276¹⁶⁶, for the purposes of this section, explicit contingent liabilities or explicit contingencies are defined as possible fiscal obligations derived from binding documents, such as laws or contracts, and whose existence has to be confirmed only by the occurrence, or not occurrence, of one or more specific future and uncertain events that are not entirely under the control of the treasury.

¹⁶³ It should be noted that there are many alternative definitions of “contingent liabilities”, but they are not valid for the economic analysis of fiscal risks. For example, according to the Statistical Office of the European Union (Eurostat), liabilities are called “quotas” in the sense that, by nature, they represent only potential and non-real liabilities; while, according to the International Public Sector Accounting Standard (IAS SP 19), a contingent liability is a) a possible obligation, arising from past events and whose existence has to be confirmed only because they happen, or not happen, one or more uncertain events in the future, which are not entirely under the control of the entity; or, b) a present obligation arising from past events, which has not been recognized in accounting because i) an outflow of resources that incorporate economic benefits or service potential is not likely to be required, establishing an obligation; or, ii) the amount of the obligation cannot be measured with sufficient reliability.

¹⁶⁴ Cebotari, Aliona (2008), *Contingent Liabilities: Issues and Practice*. IMF.

¹⁶⁵ IMF (2013). *Public sector debt statistics: Guide for compilers and users*.

¹⁶⁶ Approved by Supreme Decree No. 150-2017-EF

- **Structural or institutional risks** are related to the structural or institutional weaknesses of the State, which may limit the effectiveness of fiscal risk management or increase the likelihood of a negative event. For example, economies whose fiscal revenue is highly concentrated in natural resources are more vulnerable; or when there is a high degree of rigidity in public spending, as it limits the optimization of its efficiency.

Other structural weaknesses include excessive allocations of fiscal revenues to specific expenditure programs or difficulties in coordinating fiscal policy between different levels of the government. These limit the ability to perform fiscal policy measures in response to a shock, which can amplify the impact of the materialization of risk. Further, the limitations to identify and manage fiscal risks are themselves a source of risk, as it makes it difficult to assess the impacts of risks on fiscal accounts.

For the identification, quantification and management of fiscal risks it is important to determine their nature. Thus, the nature of fiscal risks can be determined in terms of endogeneity, persistence and frequency of occurrence.¹⁶⁷

- **Endogenous or exogenous fiscal risks.** Endogenous fiscal risks are those generated by fiscal policy actions or with a significant probability that the event was influenced by State actions. In this case, correspondingly, these risks can be mitigated by greater control or better public management. Regarding exogenous fiscal risks, these are associated with events beyond the control of the State such as international financial crises, natural disasters, among others. Strategies to mitigate the effect of these risks are usually associated with instruments that allow the transfer of risk to other agents, such as insurance, and to maintain a prudent fiscal space that allows for quick and timely actions by the State.
- **Transitional or permanent fiscal risks:** The persistence of the impact of fiscal risks has relevant implications for fiscal policy decisions. For example, the increase in the fiscal deficit due to short-term macroeconomic factors does not have a significant impact on fiscal sustainability, since automatic stabilizers tend to correct them. However, permanent shocks that significantly affect fiscal sustainability require more aggressive and / or structural fiscal policy measures.
- **Frequent or discrete fiscal risks.** Frequent fiscal risks refer to regular events that generate deviations from fiscal estimates with respect to the baseline scenarios. These can be incorporated into the tax projection set easily, for example by adopting conservative assumptions. On the other hand, discrete fiscal risks refer to events that occur irregularly or that are expected to occur without a history, such as natural disasters associated with climate change.

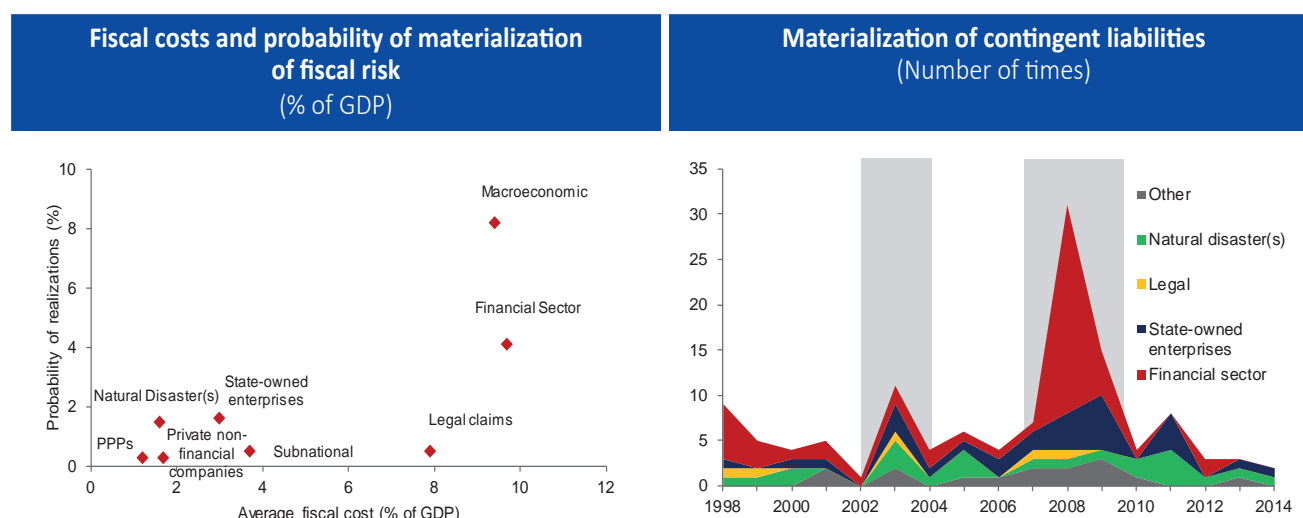
It is important to consider the international experience regarding the materialization of fiscal risks in order to have an adequate management and fiscal policy response to these events. Thus, the materialization of fiscal risks has usually had the following characteristics:

- **Materialization of fiscal risks tend to be significant:** Although the volatility of macro-fiscal variables is usually small over a one-year horizon, there are times when there is a significant deterioration of the macroeconomic and financial environment, which leads to significant increases in fiscal deficits and public debt. Thus, according to the IMF (2016), on average, the materialization of fiscal risks has generated fiscal costs of 6% of GDP and 9% of GDP every 12 and 18 years, respectively. On the other hand, according to Bova et al. (2016)¹⁶⁸, the average fiscal costs of contingent liabilities related to the financial sector, court decisions, subnational governments and public companies are 9.7%, 7.9%, 3.7% and 3.0% of GDP, respectively.
- **Materialization of fiscal risks tend to be correlated.** Usually periods of low economic growth or recession tend to trigger the materialization of other negative shocks, such as a crisis in the financial sector, bankruptcy of public enterprises, unsustainability of public finances of subnational governments, among others. Thus, according to information from Bova et al. (2016), in 2003 and 2009, years in which financial crises were registered, fiscal risks associated with public enterprises, judicial sentences, among others, also materialized in a greater number of events than in other years. In

¹⁶⁷ IMF (2008) and IMF (2016).

¹⁶⁸ Bova, E., Ruiz-Arranz, M., Toscani, F. y Ture, H. (2016). *The fiscal costs of contingent liabilities: A new dataset*.

addition, according to the IMF (2016), while the average direct cost of materializing a contingent liability is 6% of GDP, the average increase in the ratio of public debt to GDP is greater than 15% of GDP.



Source: IMF.

- **Impacts of the materialization of fiscal risks are asymmetric and non-linear:** Although there are positive fiscal shocks, normally negative fiscal shocks have greater impacts. In addition, governments usually tend to incorporate positive shocks more quickly than negative shocks into their projections. On the other hand, while macro-fiscal scenario analyzes usually assume that the impacts of macroeconomic shocks are linear depending on the size of the shock, large shocks tend to have more than proportional effects on fiscal accounts with respect to small shocks.

According to the IMF (2016), these non-linear and asymmetric impacts are due to particularities in public spending and fiscal revenues. Regarding public spending, its rigidities mean that it is difficult to reduce, in years after the shock, the increase in public spending made in times of significant negative shocks. Regarding fiscal revenues, shocks can have disproportionately large effects as company profits fall and losses are perceived for several years, which, coupled with the increase in tax evasion and avoidance, leads to a reduction of fiscal revenues as a proportion of GDP. Thus, for example, emerging economies had fiscal surpluses temporarily during the period 2005-2008, after having consistently had fiscal deficits. These positive results were based on high GDP growth rates and favorable terms of trade during that period. However, given the occurrence of the financial crisis of 2009 and the significant shock of the terms of trade in the 2013-2015 period, emerging economies again had significant fiscal deficits, which remained at around 4% of GDP until 2018.

Considering the nature of fiscal risks and international experience regarding their materialization, Kopits (2014) and the IMF (2012) propose the following approaches to quantify their impacts:

- **Direct estimates:** It consists of identifying and quantifying the materialization of fiscal risks on the public budget or on other macroeconomic variables, such as GDP, employment, among others. While it is ideal to make these types of estimates to determine their direct impact on the public budget, there is usually difficulty in carrying them out, for example, due to the availability of information, and asymmetric and non-linear behaviors of the materialization of fiscal risks.
- **Sensitivity analysis:** Considering the possible inherent complications of direct estimates, sensitivity analysis emerges as an alternative. This analysis involves estimating deviations from fiscal forecasts in the face of discrete changes in relevant macroeconomic variables. The sensitivity analysis has as its main advantage its simplicity of calculation and ease of communication. However, its main drawback is not considering the interrelationships between macroeconomic variables and correlations in the materialization of fiscal risks.

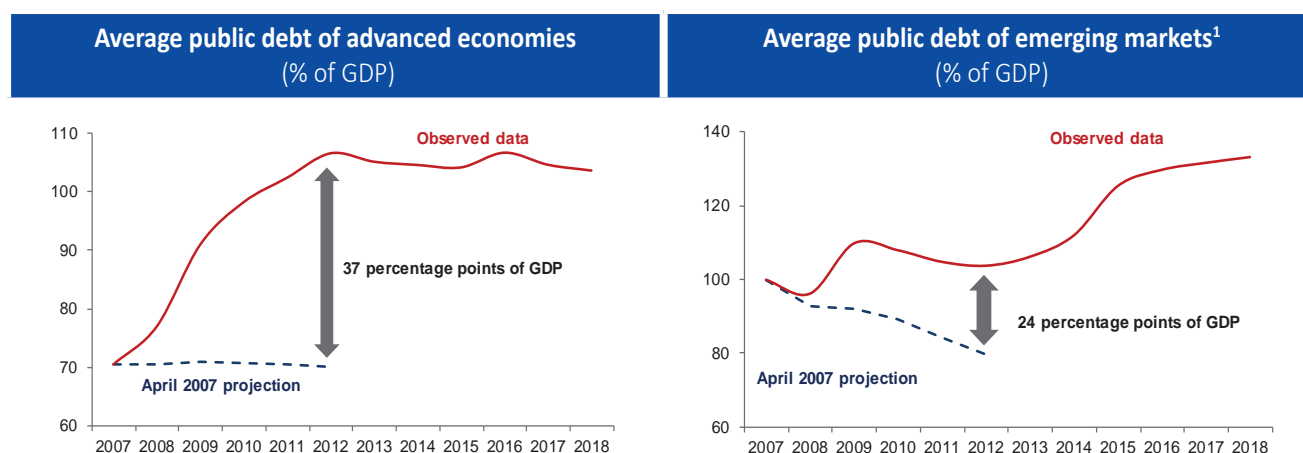
- **Stochastic estimates:** Estimates using stochastic methodologies, in addition to incorporating uncertainty, capture the interactions between the relevant macroeconomic variables and allow calculating probabilities of occurrence based on historical information. However, their results are usually not easy to explain, and sometimes that approach can be costly in terms of the complexity of the analysis and information requirements.

7.1.2. Importance of assessing fiscal risks

The importance of identifying, quantifying and managing fiscal risks, according to international experience and the development of the global economy, is summarized in the following points:

- **Transparency and accountability.** A relevant aspect is transparency and accountability to the population on the basis of a democratic society¹⁶⁹. In addition, transparency in the publication of fiscal risks allows feedback for its evaluation, quantification and management with relevant economic agents, such as academia, the private sector, among others. In this way, greater transparency leads to greater credibility of fiscal policy.
- **Strengthening fiscal management.** It provides policymakers with a broader picture of the impacts and risks of fiscal policy decisions, as it provides a better understanding of how fiscal risks are interrelated with the other relevant macroeconomic variables to their materialization. In this way, it configures a guide for the strategy of management and transfer of risks in the event of adverse shocks, and identifies their nature, thereby reinforcing fiscal sustainability in the face of these events.
- **High fiscal costs caused by the materialization of fiscal risks.** Fiscal balance often differ substantially from budget projections or others with a higher horizon, due to deviations in economic growth expectations, shocks in terms of trade, natural disasters, the need to honor the guarantees given by the Government, or unexpected legal demands. In many cases, the limitations to identify and react in a timely manner to these risks generated additional costs for the State, significant increases in public debt, financing difficulties and even fiscal crises.

For example, in 2007, prior to the financial crisis, it was projected that by 2012 the average public debt of advanced and emerging economies (excluding China) would be 70% and 80% of GDP, respectively. However, in 2012, after the financial crisis, the average public debt of advanced and emerging economies (excluding China) was 107% and 104% of GDP, respectively, which shows that the materialization of fiscal risks can have significant impacts on fiscal sustainability and in the baseline forecast scenarios.



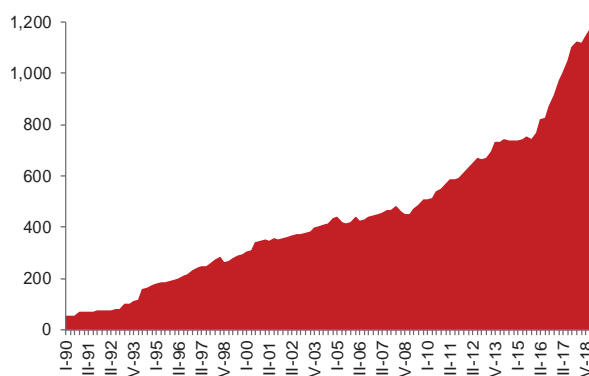
1/ Excluding China.
Source: IMF

- **Increased frequency of evaluation to emerging economies by rating agencies and investors, as result of their greater access to international financial markets.** The greater dynamism in the negotiation of emerging sovereign

¹⁶⁹ Kopits (2014).

securities in secondary markets has generated a greater frequency of evaluations by rating agencies and investors. In addition to this, the greater sensitivity of the financial markets, following the financial crisis of 2009, leads to a better identification, quantification and management of fiscal risks to access favorable financing conditions in international capital markets.

Sovereign bonds stock in emerging market economies issued in international markets (Billions of US dollars)



Source: BIS.

7.2. RETROSPECTIVE ANALYSIS OF FISCAL RISKS

7.2.1. Macroeconomic risks

In the last 15 years, the Peruvian economy was affected by both external and internal factors; despite this, it reached an average growth of 5.4%. External factors include the international financial crisis (between 2008 and 2009) and a new balance of the international context (period 2012-2015), after the boom in commodity prices. On the other hand, among the internal factors, the most relevant are associated with supply shocks in the primary sectors (yellow rust in 2013 and the El Niño phenomenon in 2014), and the occurrence of the coastal El Niño phenomenon and the paralysis of large infrastructure projects linked to Brazilian companies in 2017.

- **The international financial crisis between 2008 and 2009 was severe and deteriorated the economic growth of both advanced and emerging economies.** This crisis resulted in a sharp deterioration of the financial markets, contraction of the labor force and high levels of debt. However, the rapid reaction in the implementation of expansive fiscal and monetary policies worldwide prevented the duration of this crisis from being prolonged.
- **Between 2012 and 2015 a new balance of the international context was presented, which went from being favorable to a period of lower growth.** After expansionary monetary policies were applied- liquidity injections and reduction of policy rates to levels never seen before- to counteract the effects of the international financial crisis, between 2012 and 2015 there was a process of liquidity reduction and rate increase of international interest that increased financing costs, especially in emerging markets. In addition to the withdrawal of the monetary stimulus, there was a lower dynamism in China's economic activity- due to a change in its economic model, which seeks to maintain a balanced growth focused on domestic demand- that caused the fall in the price of metals, the output of capital from emerging markets and greater volatility in international markets.
- **Less dynamism in the primary sectors between 2013 and 2014, given the adverse effects of supply shocks, such as the yellow rust plague and the El Niño phenomenon.** Yellow rust affected coffee plantations in 2013 (after two campaigns in which historical levels of coffee production were achieved, this contracted 18.5%). The rust plague also

had repercussions in agricultural exports, since coffee shipments in 2013 were reduced by 32% compared to 2012. Also, the presence of another transitory factor such as the El Niño Phenomenon in 2014 reduced agricultural production (contractions in products such as mango, paddy rice, hard yellow corn, among others) and fisheries (lower anchovy landings), and added to the yellow rust that persisted during 2014, that year's primary GDP deteriorated by -2.3%, the largest contraction since 1992.

- **In 2017, economic growth was affected by the coastal El Niño Phenomenon, which destroyed crops and infrastructure, mainly in the north of the country, and by the paralysis of large infrastructure projects linked to Brazilian companies.** The coastal El Niño Phenomenon had negative impacts on the primary sectors, as it led to postponing the crop harvest, such as avocado, lemon, mango, corn, among others; and limited the transport of minerals. In addition, heavy rains damaged public infrastructure (roads, educational centers, hospitals) and private (housing, commercial premises), which restricted the commercialization and services activity (transport, tourism, among others). On the other hand, the projects linked to Brazilian companies registered an almost zero investment in 2017, which compares with the more than US\$ 1.2 billion (0.6% of GDP) invested in these projects in 2016.

7.2.2. Specific risks

7.2.2.1. Explicit contingent liabilities

Peru has been reporting its contingent liabilities in multiple public documents. In the pre-election reports of the periods 2001-2005, 2006-2010 and 2011-2016, the situation of explicit fiscal contingencies derived from government activities that could compromise the use of future public resources was incorporated, among other aspects. This is due to compliance with article 35 of the Law on Transparency and Access to Public Information (Law No. 27806).

MMM the main fiscal contingencies of the NFPS were presented in the 2012-2014, which were accounted for at 7.4% of the GDP of 2010, with the purpose of better assessing the sustainability of the fiscal accounts in the following years. The most relevant were those related to lawsuits (3.4% of GDP) and PPP contracts (2.1% of GDP). Subsequently in 2015 and 2016, the NFPS explicit contingency reports were published. These documents estimated the maximum exposure of the NFPS to explicit contingent liabilities, calculated as the nominal sum, which was around 8.21% of the 2014 GDP and 9.70% of the 2015 GDP, respectively.

Finally, in line with Legislative Decree No. 1276, the evaluation of explicit contingencies of the NFPS for 2016 was incorporated in the MMM 2018-2021, in which a maximum exposure of the NFPS was estimated at around 10.81% of the GDP. It should be noted that the maximum NFPS exposure of explicit contingencies for 2016 was revised down by 0.53% of GDP, compared to the one published in the MMM 2018-2021. This reduction is fully explained by the change in the presentation of the explicit contingencies of the NFPS, which would not include the source derived from guarantees, endorsements or the like granted by the national government to regional or local governments or (EPNF). This modification responds to the fact that this explicit contingency of the national government would not represent an explicit contingency of the NFPS, since the activations of these guarantees or instruments would have no effect on the overall amount of the NFPS liabilities, because it is only a transfer of the payment obligation on an existing debt. This criterion was also used to prepare the evaluation of explicit contingencies of 2017 and 2018. In the latter, a maximum exposure of the NFPS amounting to 10.22% of the GDP of 2018 was recorded.

Box 11: Report of contingent liabilities in countries of the Pacific Alliance

i. Experience in Chile

In December 2018, in compliance with the provisions of the Decree Law on Financial Administration of the State, the Chilean Budget Directorate published the 2018 Contingent Liabilities Report¹⁷⁰. The document estimated the maximum exposure of the following contingent liabilities: i) minimum income guarantees under the concession system¹⁷¹ (1.40% of GDP), ii) state guarantee for the debts of public companies (0.85% of the GDP), iii) guarantees for higher education credits (1.28% of GDP), iv) state guarantee for deposits¹⁷² (2.13% of GDP), v) disputes to the concession system (0.18% of GDP), vi) lawsuits against the Treasury (7.13% of GDP), vii) risk hedge funds of the Production Development Corporation¹⁷³ (0.00% of GDP) and viii) guarantee fund for small entrepreneurs¹⁷⁴ (0.15% of GDP). Additionally, in compliance with the aforementioned regulatory framework, this report includes a section that describes the guarantees associated with pension systems, although these are not considered as contingent liabilities.

ii. Experience in Colombia

In June 2019, in accordance with the regulatory framework for the management of contingent obligations, the Ministry of Finance and Public Credit published in the Medium-Term Fiscal Framework (MFMP) the list of contingent liabilities. In this report, explicit contingent liabilities were added that add up to an estimated value of 3.48% of GDP: i) judgments and conciliations¹⁷⁵ (2.08% of GDP), ii) risks arising from infrastructure contracts (0.55% of GDP), iii) callable capital¹⁷⁶ (0.32% of GDP) and iv) guarantees for public credit operations¹⁷⁷ (0.21% of GDP). Contingent liabilities were also reported for disasters derived from events of nature (earthquake: 3.1% of GDP and La Niña: 1.9% of GDP) and of non-explicit debts (pension debt and retroactive severance payments¹⁷⁸).

On the other hand, it is worth mentioning that Colombia is the only country in the region that has had a specific fiscal mitigation mechanism since 1998, the Contingency Fund for State Entities (FCEE), which is used to meet contingent obligations and give continuity to Projects. The FCEE has an accumulated balance of \$2.7 billion Colombian pesos¹⁷⁹ and mainly corresponds to contributions for contingent obligations generated by contracts to develop infrastructure projects.

iii. Experience in Mexico

The Ministry of Finance and Public Credit of the Federal Government publishes the “Quarterly report on the economic situation, public finances and public debt.” This document reports¹⁸⁰, among others, the guarantees for long-term productive infrastructure projects (Pidiregas), the obligations guaranteed by the federal government to the liabilities derived from the National Infrastructure Fund (Fonadin) and those corresponding to the programs of support to debtors, which have explicit quotas. At the end of 2018, the contingent liabilities of Pidiregas are equivalent to 0.7% of the GDP, while the commitments for the Fonadin and the debtor support programs amount to 1.1% and 0.2% of the GDP, respectively.

¹⁷⁰ According to said report, a contingent liability has the following characteristics: i) high level of uncertainty in the amount of the obligation and / or the opportunity to be executed; ii) once the obligations have been established, they cannot be modified by unilateral actions of the government, that is, they are exogenous to the government; and iii) are established by some legal instrument that specifies its scope and terms, usually of a contractual or legal nature.

¹⁷¹ This amount corresponds to a scenario in which the State would have to pay in case there is no traffic on the roads that have minimum income guarantees.

¹⁷² The General Banking Law defines that the State guarantees 90% of deposits and time deposits held by natural persons in banks and financial institutions

¹⁷³ Corfo is an executing agency for government policies in the field of entrepreneurship and innovation, dependent on the MEF

¹⁷⁴ The Guarantee Fund for Small Business (FOGAPE) is intended to guarantee loans, leasing operations and other financing mechanisms granted by public and private financial institutions to small entrepreneurs. This fund is managed by the Banco del Estado de Chile

¹⁷⁵ Corresponds to possible judicial decisions against state entities.

¹⁷⁶ Corresponds to possible contribution requirements from multilateral organizations for their capitalization. In this case, Colombia as a member country of multiple multilateral organizations may be required to make extraordinary contributions. These contributions are configured through the effective payment of a certain amount subject to the occurrence of an exceptional event.

¹⁷⁷ It corresponds to guarantees granted by the nation to state entities (regions, municipalities, districts, state-owned companies, and decentralized entities of the national and territorial order).

¹⁷⁸ According to MFMP of 2018, both concepts generate a liability that is known in the methodology of construction of fiscal accounts as non-explicit debt, because it is not included in the public debt service or in accounts payable.

¹⁷⁹ The balance of the FCEE corresponds to the cut-off date in March 2019.

¹⁸⁰ Corresponding to the report on the economic situation, public finances and public debt as of the fourth quarter of 2018.

This subsection presents the explicit fiscal contingencies that materialized during the last years:

a) Explicit contingencies for judicial, administrative and arbitration proceedings:

From the point of view of the judicial process and its relationship with the accounting record, the lawsuits against the entities can be found in one of the following three situations:

- o **Claims in process** corresponds to those in process without any judgment. The amount of the economic claim of the lawsuits is recorded in order accounts as a contingency.
- o **Claims with appealable judgment** are those that have a sentence at least in the first instance. The accounting record corresponds to the demands with judgment and with a high probability of being unfavorable to the State. The amounts of the judgments in the first judicial instance are recorded in the liability for provisions.
- o **Claims with non-appealable judgment** are those with sentences as res judicata¹⁸¹ or consented. The corresponding amount of the sentence plus interest and other payments are recorded in the liability accounts in accounts payable.

Lawsuit can go through this phases before becoming an appealable decision for the entities, which can take several years until the issuance of a favorable or unfavorable final judgment. Claims with an unfavorable final judgment will generally entail the need for entities to provide resources to the claimant in terms and conditions of payment as dictated by the court. In that sense, it will be up to the entities, within their budgetary allocations, to prioritize the resources, in order to meet those claims and carry out the subsequent execution of the expenditure (certification, commitment, accrual and payment).

i. Claim without judgment

Between 2010 and 2018, the **claims without judgment** of the general government have experienced significant growth, since an average increase of S/ 3.337 billion¹⁸² is observed, with the national government and the local government being the parties that, on average, have shown a greater acceleration.

Evolution of Claims without judgment, maximum exposure (% of GDP)						
According to government levels	2014	2015	2016	2017	2018	Average variation
Total	4.28	4.13	5.28	5.53	5.78	0.38
National Government	3.80	3.60	4.32	4.62	4.82	0.26
Regional Governments	0.25	0.33	0.55	0.34	0.25	0.00
Local Governments	0.23	0.20	0.40	0.57	0.71	0.12

Source: DGCP-MEF.

It is observed that in 2016 there was the largest increase (1.15% of GDP) during the last five years, which represented 3.04 times the average variation of that same horizon. That year it was decided to reactivate the commission¹⁸³ evaluating the debts of the State generated by judicial decisions issued and it was arranged that the entities must register them in the software application "Judicial and Arbitral Demands against the State".

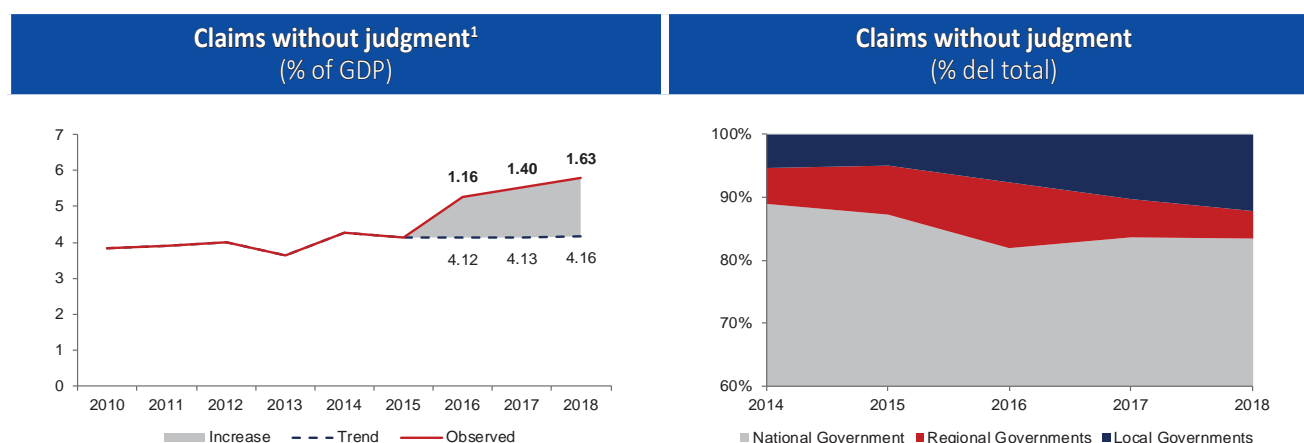
In that sense, the increase observed in part is due to the fact that public entities have been implementing the registration of all their lawsuits for the preparation of the General Account of the Republic. Thus, this is consistent with higher average growth

¹⁸¹ Article 123 of the Civil Procedure Code defines that a resolution acquires the authority of res judicata when: i) no other challenge means are applied against it than those already resolved or ii) the parties expressly waive to file an appeal or allow the deadlines to pass without formulating them. It also indicates that the resolution acquired by the authority of res judicata is immutable

¹⁸² According to government levels, the average increase observed is as follows: national government, S/ 2,612 million; regional governments, S/ 141 million; and local governments, S/ 585 million.

¹⁸³ The commission was created through the 69th final complementary provision of Law No. 29812, Public Sector Budget Law for Fiscal Year 2012. The creation of the evaluation commission was arranged in order to propose a bill that allows reduce pending payments by specifications according to a social and sectoral prioritization. Along these lines, Law No. 30137 was issued in December 2013, Law that establishes criteria for prioritizing the payment of judicial sentences, whose regulations were approved in February 2014 by Supreme Decree No. 001-2014-JUS.

between the 2016 and 2018 horizon, as well as with a restructuring in the participation of the different levels of government, in which there is a downward trend in the case of regional and upward government for the local government.



^{1/} The trend was elaborated with the average growth of years 2010-2015
Source: DGCP-MEF.

ii. Claims with appealable judgment

Between 2016 and 2018, the claims with appealable judgment from the general government have experienced an average increase of S/ 595 million¹⁸⁴, with the national government showing the greatest acceleration.

Evolution of Claims with appealable judgment, maximum exposure (% of GDP)

According to government levels	2016	2017	2018	Average variation
Total	0.42	0.49	0.54	0.06
National Government	0.36	0.37	0.39	0.02
Regional Governments	0.04	0.04	0.05	0.01
Local Governments	0.03	0.08	0.09	0.03

Source: DGCP-MEF.

It can be noted that there would have been a similar effect due to the reactivation of the state debt assessment commission; however, its acceleration has been lower, which is consistent with the increase observed in appealable judgments.

These types of claims may be subject to impugnatory means, hence they are not yet immutable.

iii. Claims with non-appealable judgment

It should be noted that claims with non-appealable judgment do not represent an explicit contingency; however, because these are the materializations of explicit contingencies due to judicial, administrative and arbitration claims, their presentation has been considered for descriptive purposes.

Between 2016 and 2018, the claims with non-appealable judgment from the general government have experienced an average increase of S/ 1,367 million¹⁸⁵, with the regional government being the part that has shown the greatest acceleration.

¹⁸⁴ According to government levels, the average observed is as follows: national government, S/ 284 million; regional governments, S/ 70 million; and local governments, S/ 240 million.

¹⁸⁵ According to government levels, the average observed is as follows: national government, -S/ 288 million; regional governments, S/ 1.433 billion; and local governments, S/ 222 million.

Evolution of Claims with non-appealable judgment
(% of GDP)

According to government levels	2016	2017	2018	Average variation
Total	1.16	1.32	1.40	0.12
National Government	0.42	0.35	0.30	-0.06
Regional Government	0.61	0.78	0.93	0.16
Local Government	0.12	0.19	0.17	0.02

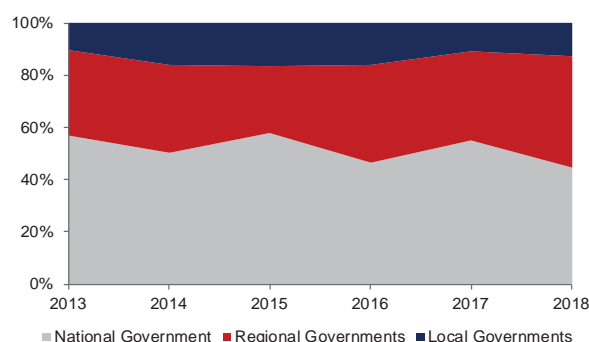
Source: DGCP-MEF.

Additionally, during the last years it has been paying for court orders and arbitration awards, which has contributed to reduce the balance of these liabilities.

Balance and expenditure of the GG by court orders and arbitral awards
(% of GDP)

According to government levels	2016	2017	2018
1. Non-appealable Judgements¹	1.16	1.32	1.40
National Government	0.42	0.35	0.30
Regional Governments	0.61	0.78	0.93
Local Governments	0.12	0.19	0.17
2. Payments for Judgements²	0.10	0.16	0.16
National Government	0.04	0.09	0.07
Regional Governments	0.04	0.05	0.07
Local Governments	0.02	0.02	0.02
3. Ratio (2/1)	8.4%	12.1%	11.2%

Distribution of the expense of the GG by court orders and arbitral awards³
(% of total)



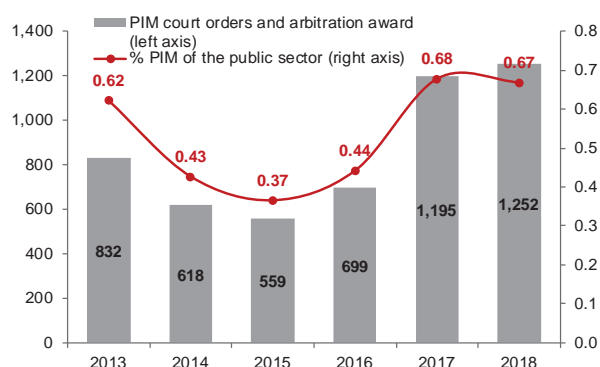
1/ Considers the information reported by the entities for the preparation of the General Account of the Republic for the years 2016, 2017 and 2018. 2/ It is the pre-cancellation total amount. 3/ It is the pre-cancellation total amount
Source: MEF.

In the process to prioritize payments, through the Sixty-ninth Final Complementary Provision of Law No. 29812, Budget Law of the Public Sector for Fiscal Year 2012, an evaluation commission of the State's debts generated by court orders issued was established, in order to propose a bill that allows to reduce the outstanding payments by budgetary entity. Consequently, Law No. 30137 was issued, a law that establishes prioritization criteria for the attention of the payment of court orders, which aims to establish prioritization criteria to pay court orders as judgments in order to reduce costs to the State.

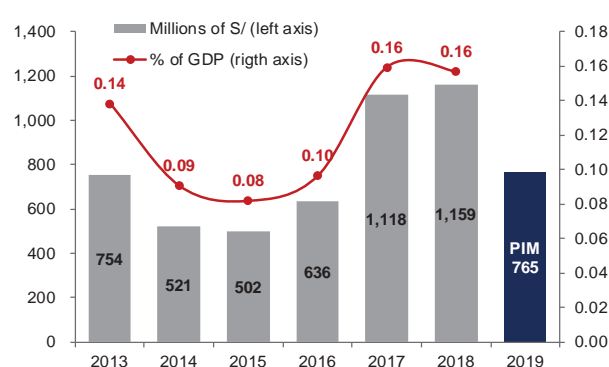
The procedure provided for in this regulatory framework requires that each budgetary entity has a permanent committee, which must meet in the first quarter of each year to prepare and approve the prioritized list of these obligations. In that line, between 2016 and 2018, the evaluation commission¹⁸⁶ of the State's debts generated by court orders issued was reactivated, which received the lists approved by the permanent committees of each budget entity, in order to prepare a complementary list of debts generated by court orders as res judicata and in execution as of 03.31.2016, 03.31.2017 and 03.31.2018. That Commission has also been reactivated in 2019, through the Twelfth Final Complementary Provision of Law No. 30879, Public Sector Budget Law for Fiscal Year 2019. Thus, since 2016, additional credits have been authorized in the Public Sector Budget in favor of various specifications of the national government and regional governments (Supreme Decrees No. 239-2016-EF, 143-2017-EF and 126-2018-EF), which has contributed to the growing behavior of budgeting and payment of judicial claims.

¹⁸⁶ By the Seventy-Third Complementary Final Provision of Law No. 30372, Budget Law for Fiscal Year 2016, and the Fifty-ninth Complementary Final Provision of Law No. 30518, Public Sector Budget Law for Fiscal Year 2017 is reactivated the referred commission.

GG budget for court orders and arbitration awards (Millions of soles and % of PIM)



GG expense for court orders and arbitration awards¹ (Millions of soles and % of GDP)



1/ It is the pre-cancellation total amount. In the case of year 2019, the amount is the MIB 09.07.2019. Source: MEF

Finally, by way of exercise, considering the three levels of government described above and the amounts paid, the historical evolution of the transition between the explicit contingency phase (quality of contingent liabilities) and non-appealable judgment (quality of liabilities) can be estimated.

Evolution of explicit contingencies of the GG by judicial, administrative and arbitration processes (% of GDP)

Explicit Contingencies ¹	2016	2017	2018
Initial balance	4.16	5.34	5.70
To non-appealable judgment by judicial, administrative and arbitral award ²	0.27	0.39	0.30
New processes ³	1.79	1.07	0.92
Final balance	5.68	6.02	6.32

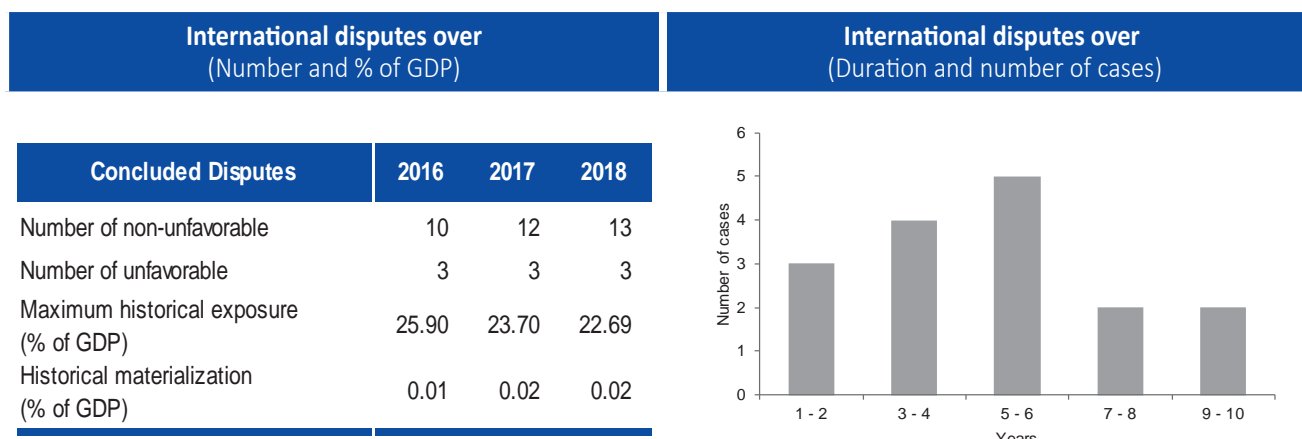
Evolution of non-appealable judgments by judicial, administrative and arbitration awards¹ (% of GDP)

Non-appealable judgment	2016	2017	2018
Initial balance	0.98	1.09	1.25
From Explicit Contingencies ²	0.27	0.39	0.30
Payments for Judgements ⁴	0.10	0.16	0.16
Final balance	1.16	1.32	1.40

1/ Corresponds to the claims without sentence and with appealable judgment. 2/ The net effect is assumed. 3/ It is assumed that they correspond to new processes, since they could also represent increases in requests. 4/ It is the pre-cancellation total amount.
Source: MEF

b) Explicit contingencies due to international controversies in investment matters

At the end of 2018, the State had 16 completed cases of international investment arbitrations, of which only 3 had unfavorable results for the State. All arbitrations were initiated before the International Center for Settlement of Investment Disputes (ICSID), with the exception of Renco 1 and Exeteco, whose arbitrations were carried out ad hoc in accordance with the arbitration rules of the United Nations Commission for International Trade Law (Cnudmi). Of all the cases concluded, a small portion of unfavorable cases (three cases) are observed, of which there has only been a materialization that represents 0.09% of the total historical exposure. Also, on average the cases have lasted approximately five years.



Source: Dgaeicyp-MEF.

The longest proceedings have lasted about nine years and in most cases, have been resolved through awards from arbitral tribunals. Also, payments that have originated from unfavorable sentences have been found at levels far below the claims of the plaintiffs (for example, the amount of the Beer Creek case judgment represented 3.5% of the intention).

Results of cases concluded by international arbitration (% of GDP)						
Plaintiff	Start year	End year	Result	Maximum exposure	Arbitration awards in favor of investor	Arbitration awards in favor of government
Compagnie Minière	1998	2006	With termination resolution	ND	0.00	0.00
Luchetti	2003	2007	With arbitration award	0.07	0.00	0.00
Duke Energy	2003	2011	With decision	0.02	0.01	0.00
Aguaytia Energy	2006	2008	With arbitration award	0.07	0.00	0.00
Convial Callao	2010	2013	With arbitration award	0.04	0.00	0.001
Renée Rose Levy de Levi	2010	2014	With arbitration award	3.10	0.00	0.0003
Renco Group	2010	2016	With arbitration award	0.44	0.00	0.00
Caraveli Cotaruse	2011	2013	With arbitration award	0.01	0.00	0.002
Renée Rose y Gremcitel	2011	2015	With arbitration award	18.65	0.00	0.001
Tza Yap Shum	2011	2015	With arbitration award	0.01	0.0004	0.00
Bear Creek Mining Corporation	2011	2017	With arbitration award	0.23	0.01	0.00
Isolux Corsán	2012	2013	With arbitration award	0.00	0.00	0.00003
Pluspetrol Perú Coporation	2012	2015	With arbitration award	ND	0.00	0.03
Caraveli Cotaruse	2013	2013	With termination resolution	0.02	0.00	0.02
Exeteco International Company	2013	2018	With decision	0.03	0.00	0.00
APM Terminals Callao	2016	2017	With termination resolution	ND	0.00	0.00

Source: Dgaeicyp-MEF.

c) Explicit Contingencies in PPP Agreements

In the framework of PPPs, it can distinguish two types of commitments¹⁸⁷ that the State can assume in contracts: firm commitments and contingent commitments..

- o The firm commitment is a commitment to pay an agreed amount to be made by the grantor (the public entity) in favor of the private party to pay the investment and/ or the operation and maintenance costs of the PPP.

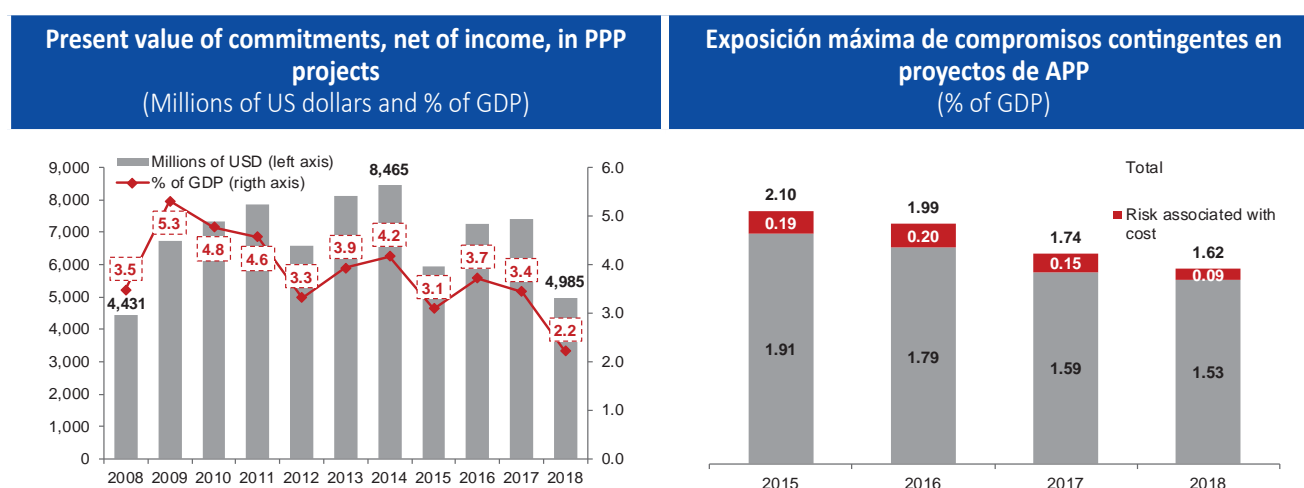
¹⁸⁷ The Article 24 of Legislative Decree No. 1362 defines firm commitments as “the obligations of payment of specific or quantifiable amounts in favor of its counterpart, corresponding to a consideration for the performance of the acts provided for in the PPP Agreements” and contingent commitments as “the potential payment obligations in favor of its counterpart stipulated in the PPP contract that derive from the occurrence of one or more events corresponding to the risks of PPP projects”

Firm commitments can be generated effectively when the concessionaire (the private company) fulfills its obligations and, therefore, requires the certification of its work progress/completion, through the issuance of the respective work progress certificates, which confirm the fulfillment of their obligations. In the meantime they are only contractual commitments, which become liabilities when the (private)¹⁸⁸ concessionaire performs the periodic provision of the service or executes the respective work progress.

- o The contingent commitment is a payment engagement that is activated under certain conditions established in the contract, which, in general, respond to unforeseen reductions in public service demand and, therefore, has a potential nature.

The numeral 27.1. of article 27 of Legislative Decree No. 1362, Legislative Decree that regulates the Private Investment Promotion through Public Private Partnerships and Assets Projects, establishes that the *stock* accumulated by firm commitments and net quantifiable contingent commitments minus incomes, assumed by the NFPS in the PPP contracts, calculated at present value, may not exceed 12% of GDP.

Since 2008, the MEF has been monitoring the aforementioned *stock* of commitments, which reached its historical maximum, in terms of GDP percentage, in 2009.



Fuente: Dgetp-MEF.

The aforementioned *stock* contains, among others, the present value of the expected flows of the contingent commitments of the PPP Agreements, whose maximum exposure has been decreasing over time, mainly due to the reduction of the term of the agreement's guarantees.

7.2.3. Structural or institutional risks

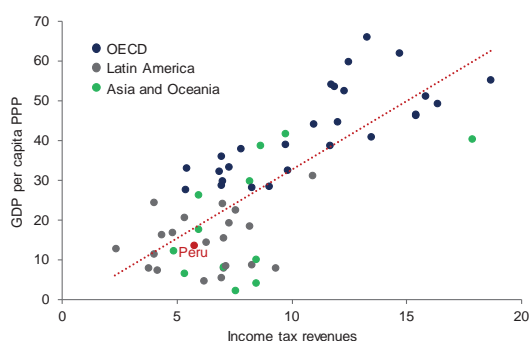
7.2.3.1. Fiscal revenue: tax evasion and avoidance, and income related to natural resources

The composition of fiscal revenues constitutes a structural fiscal risk that is inherent in the characteristics of an economy such as Peru. Peru is a small, open and exporting country of commodities, mainly mining, which makes its economy and its tax collection (75% of fiscal revenues) dependent on external factors, such as the variation in international prices, which affect to the sectors that generate the largest inflow of foreign currencies to the country. However, Peru is also a developing economy with a high degree of informality and, like other countries in the same condition, sustains most of its collection in indirect

¹⁸⁸ Contractual counterpart of the State in the framework of PPP Agreements.

taxes, such as VAT, rather than direct taxes, such as income taxes¹⁸⁹. With this, the tax collection starts from a poorly diversified base, concentrated in few large and formal taxpayers linked to the export sector, which amplifies the effect of international cycles on tax revenues.

PGDP per capita and income tax collection¹ (Thousands of current US dollars PPP and % of GDP)



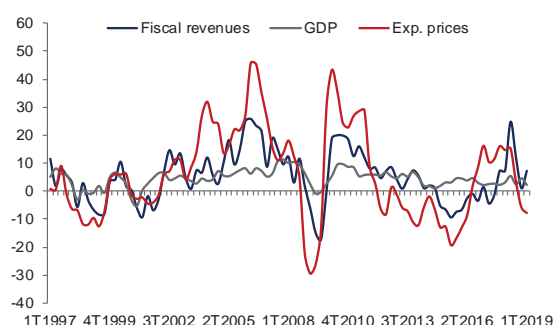
1/ Tax income, utilities, capital gains of natural and corporate persons.
Source: World Bank, OECD, Sunat.

Taxpayers structure and collection according to company size (% of total)

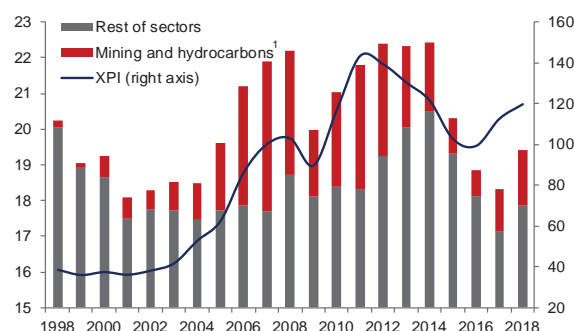
	Taxpayers proportion	Contribution on tax collection
Microenterprises	94.8	7.1
Small	4.5	14
Medium	0.2	2.4
Corporate	0.6	76.5
Total	100	100

The evidence shows that most of the volatility of fiscal revenues has been associated with changes in export prices. Even though the GDP grew at a rate between 4% and 5% in real terms in the last twenty years, fiscal revenues did it at an average higher than 5% as a result of the dynamism of export prices, which grew close to 6% in these years. Thus, revenues from the mining and hydrocarbon sectors, the most linked to *commodity* prices, represented the most volatile source of income, ranging from 1% to 20% of total revenues (from 0,1% to 4, 2% of GDP).

General government revenues, GDP and export prices (% real annual change and % annual change)



General government revenues, of mining and hydrocarbon, and exports prices (% of total)



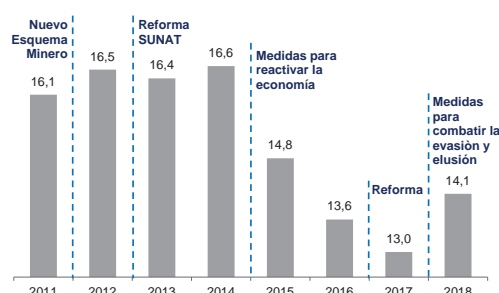
1/ Corporate income tax, regularization, mining and hydrocarbons royalties, special mining tax and special mining tax burden.
Source: BCRP, Sunat, Perupetro, MEF.

Tax collection has been subject to variations in tax rates and other changes to the Tax Code that are linked to combating non-compliance. For example, in five of the eight years between 2011 and 2018, tax measures were taken that responded to different policy objectives. For example, the administrative regimes of the VAT, which are aimed at preventing tax evasion in

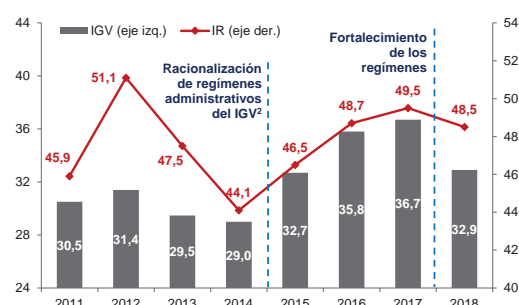
¹⁸⁹ According to Tresch in *Public finance, a normative theory* (2015), the administration and compliance facilities explain why less developed countries depend mostly on sales taxes, imports or other taxes on business activities.

the formal stages of the value chains, were streamlined between 2014 and 2015 with the purpose of granting more liquidity to taxpayers. However, from that year the estimated levels of non-compliance of the VAT and IR increased for three consecutive years (from 29.4% and 44.1% in 2014 to 36.7% and 49.5% in 2017) until 2018, year in which these regimes were strengthened.

Tax revenue of the central government
(% of GDP)



Breach of the VAT and the IR of 3rd¹
(% of total)



1 / Ratio between the estimated failure and certain potential tax, the net effect of tax expenditures.

2 / Regimes consider perceptions, deductions and detractions.

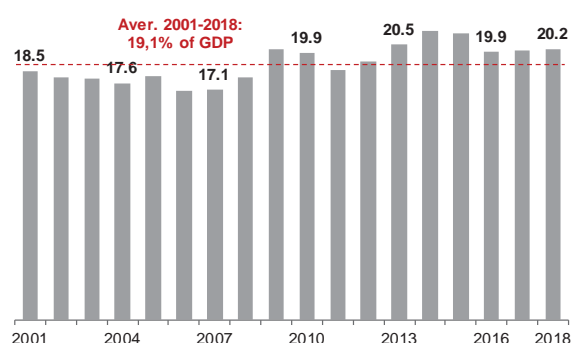
Source: BCRP, Sunat.

7.2.3.2. Public Expenditure: spending rigidities and low investment execution capacity

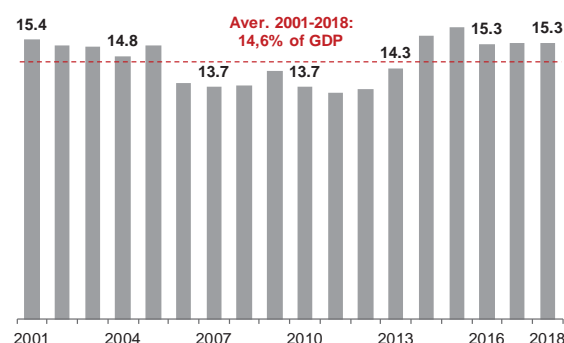
The creation of fiscal rules has allowed public expenditure to be executed in a responsible manner without compromising fiscal sustainability. In this way, the dynamics of public expenditure have been aligned with the availability of resources and compliance with fiscal rules. It is important to mention that, in general, fiscal rules have been complied with despite contexts in which the expansion of public expenditure has sought to address State policy priorities (such as the reduction of extreme poverty, the strengthening of the staff capacity of teaching and health, and infrastructure needs); the implementation of stimulus plans, when there have been significant adverse shocks, such as natural phenomena and international crises; and the attention of mandatory commitments from the materialization of contingent liabilities, attention to the implementation of legislative initiatives, among others.

Considering this, between 2001 and 2018, current expenditure remained stable, on average around 14.6% of GDP and general government investment increased from 2.9% of GDP to 4.3% of GDP.

General government non-financial expenditure¹
(% of GDP)



General government current expenditures¹
(% of GDP)



1/ Includes extrabudgetary entities, such as EsSalud, SBS, among others.

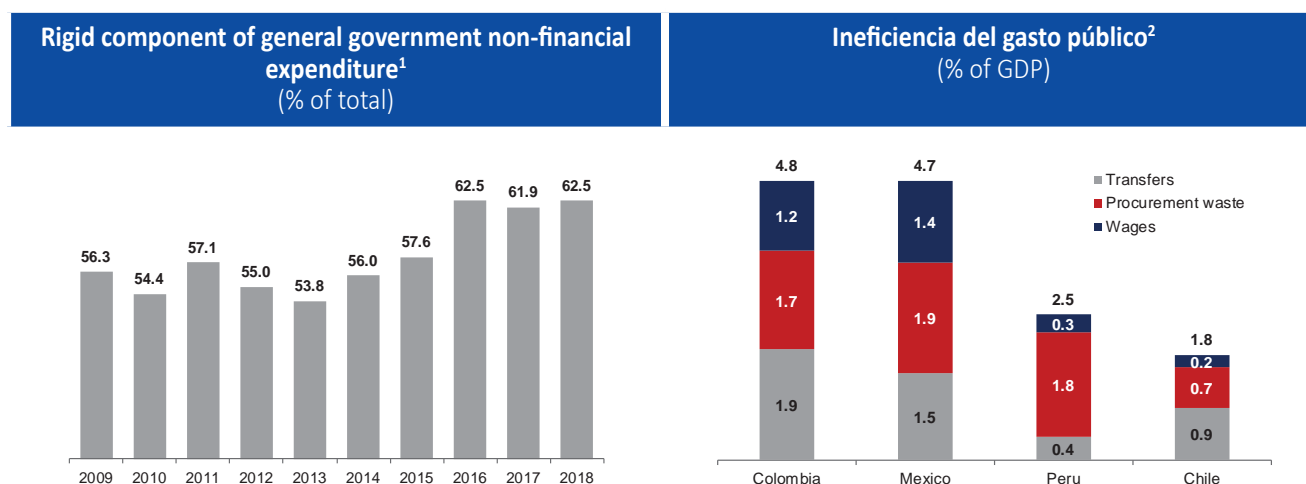
Source: BCRP, MEF.

Although the macro-fiscal framework has allowed the preservation of fiscal sustainability, in recent years the rigid expenditure has increased, which represents a risk that limits the actions of fiscal policy management. Thus, between 2011 and 2018, the non-flexible expenditure component (rigid expenditure) increased from 57.1% to 62.5% of the general government non-financial expenditure, which reduces the Government's ability to maneuver to take policy measures fiscal in response to the materialization of fiscal risks. During this period, reforms in the Education and Health sectors were carried out to improve citizen care. On the one hand, the reform of the Teaching Public Career included a salary increase, the creation of High Performance Colleges, among others. In that context, the education budget doubled (+ 132% nominal) and went from 2.8% of GDP in 2011 to 3.7% of GDP in 2018. On the other hand, the budget was expanded to expand the public offering of health and supply with quality medical supplies, which was complemented by salary increases. In this way, the health budget also doubled (+ 134% nominal) and went from 1.7% of GDP to 2.2% of GDP.

In contrast, current expenditure was also increased by the approval of legislative initiatives, which did not take into account budgetary balance criteria and represented a risk for fiscal responsibility. Thus, these measures authorized the increase of the budgetary framework not contemplated in the annual laws of the Public Budget. Among the main ones are Law No. 30478, which allows the provision of 95.5% of the AFP funds (which has caused high amortizations of recognition bonds); Law No. 30555, which incorporates payroll to EsSalud CAS staff; Law No. 30683, which authorizes the increase of pensions for military and police personnel; and Law No. 30745, Law of the Career of the Judicial Worker.

In that sense, it is essential to avoid continuing to increase rigid expenditures, which are not in a budgetary framework aligned with macro-fiscal rules. In addition, measures must be continued to improve the efficiency of public expenditure, in order to reduce the risks associated with rigid expenses. In this regard, the IADB¹⁹⁰ notes that Peru is the second country with the lowest inefficiency in the region; however, items of public expenditure have been identified in which there is considerable space to manage resources more efficiently and thus contribute to improving the quality of life of citizens. According to this study, fiscal savings could be obtained through efficiency improvements in public procurement (1.8% of GDP), targeted transfers (0.4% of GDP) and wages (0.3% of GDP).

For this reason, at the end of 2018, measures were approved to modernize the administrative systems of the State, which will contribute to institutional strengthening, which promotes the efficient and transparent use of resources to provide better public services for the benefit of the population.

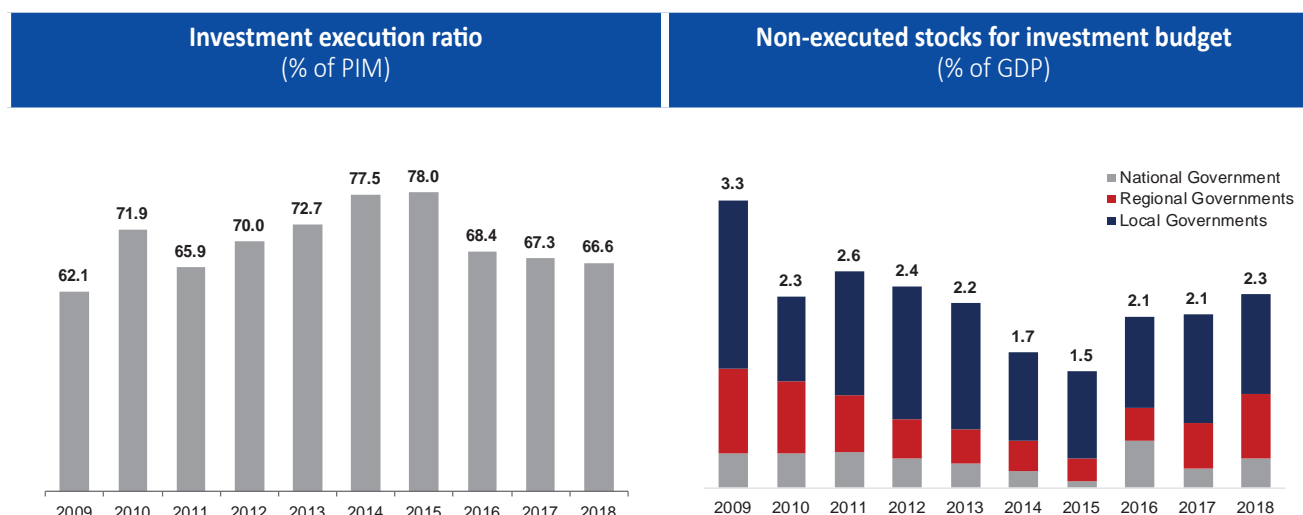


1/ Includes payroll, basic services (electricity, water, rentals, among others), pensions, infrastructure maintenance and the payment of contractual obligations linked to PPPs. 2/ Inter-American Development Bank, 2018. "Better spending for better lives". Data shows 2015 or 2016, or last year available. Inefficiency can be measured by determining the amount of public resources wasted in delivering outcomes of a given quality, compared to countries with the best practices. Source: IADB, MEF.

190 Inter-American Development Bank, 2018. "Better spending for better lives".

Additionally, another important institutional risk is management problems in the execution of public investment, which limits the capacity of fiscal policy, such as implementing an effective fiscal impulse for the economy, in the event of an adverse event. Thus, between 2009 and 2018, the low execution of public investment has been evidenced, observing that on average only 70% of the resources allocated in the Public Budget have been executed. Moreover, the non-executed resources came to represent on average 2.2% of GDP (national government: 24% of the total and subnational governments: 76% of the total). Execution problems tend to be greater in periods of early management of new authorities, because there is a learning curve of the State's administrative systems, among other aspects.

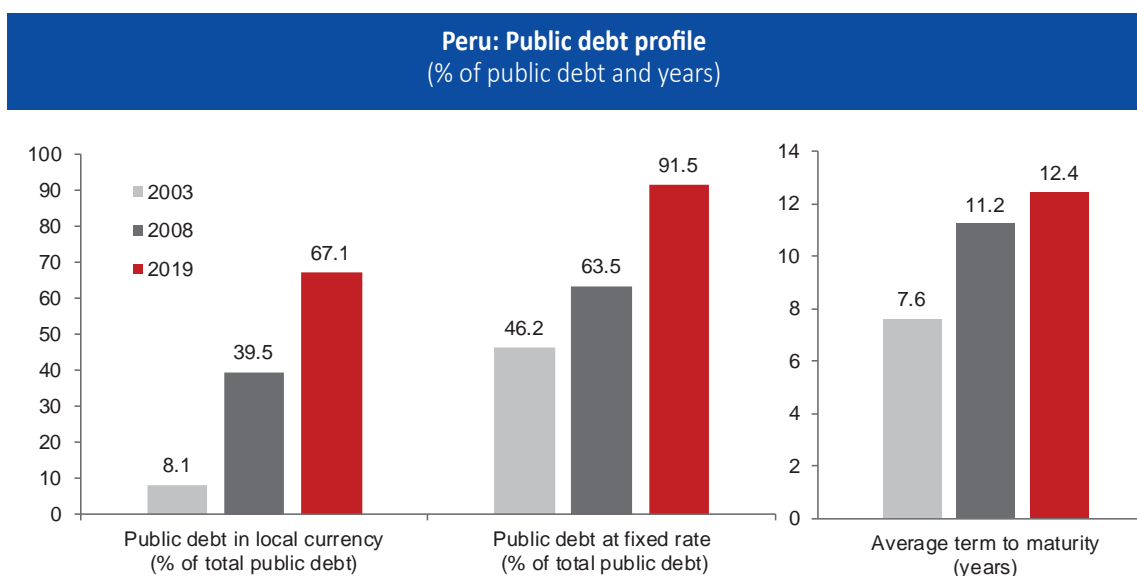
It is important to note that, in recent years, the Government has implemented actions to strengthen investment management capacity. With this, it is expected that investment spending will be more stable and efficient in the coming years as a result of the progressive progress of the Civil Service, which will allow for better-trained and incentivized public employees, with less turnover, from the perspective of meritocracy. Besides, the regulatory frameworks of the main systems related to public investment (Invierte.pe) and public-private (PPP and Oxl) have been strengthened. Hence, it is estimated that in the future institutional risks due to the low capacity to execute investment resources are minimized.



Source: MEF.

7.2.3.3. Public Debt: Structure of Public Debt

The public debt profile constitutes a structural risk that has been mitigated in recent years based on an active and efficient management of public debt, in accordance with the guidelines of the Egiap. Thus, the public debt in soles went from representing 8.1% of the total debt in 2003 to 67.1% in 2019. As for the fixed-rate public debt, it went from representing 46.2% of the total of the debt in 2003 to 91.5% in 2019. Regarding the average life of the public debt, it has increased from 7.6 years to 12.4 years in that period. In this way, the exposure of the public debt was reduced to significant increases in the exchange rate, to variations in interest rates and to refinancing risks. From now on, active public debt management will continue, within the framework of the Egiap, in which indebtedness will be prioritized in soles, at a fixed rate and in terms that do not generate pressure on financing needs.



Note: The 2019 data corresponds to June.
Source: MEF

7.2.4. Fiscal Performance Balance

7.2.4.1. Overall balance

The retrospective analysis of the NFPS overall balance forecasts consists in decomposing its projection error to one year based on the forecast errors of the general government revenues and non-financial expenditure, as well as other factors.

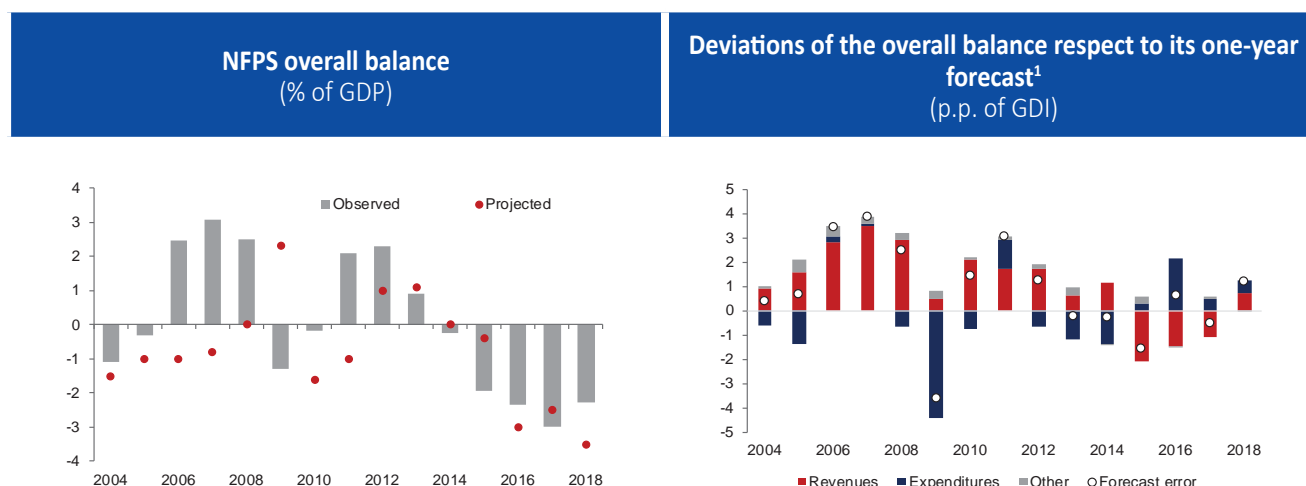
The projection error of the NFPS overall balance on GDP will depend on the forecast errors of general government revenues, general government non-financial expenditure and other factors, which correspond to the non-financial public enterprises primary balance and interest payments. To determine the projection error of year “t”, the estimates of NFPS overall balance fiscal result estimates for year “t” made in the MMM of August of year “t-1” are considered.

In the last 15 years, the forecasts for the overall balance at one year had a conservative bias, since in 10 years the recorded overall balances were greater than their forecasts. During the 2004-2018 period, the overall balance was on average higher than its forecast at 0.8 p.p. of GDP. This, through their accounting identity, is explained because fiscal revenues were recorded on average 1.0 p.p. of GDP above its expected values, while the non-financial public expenditure observed was on average 0.4 p.p. GDP higher than its forecast. Also, in relation to the component of other factors¹⁹¹, it is observed that they were on average 0.2 p.p. of GDP higher than expected.

In particular, of the 10 years in which a greater overall balance than the forecasted one was registered (average annual difference of 1.9% of GDP), several were accompanied by fiscal revenues higher than their projections (average annual difference of 1.6% of GDP). The underestimation of the overall balance in the periods 2004-2008 and 2010-2011 corresponds to a conservative and prudent position of fiscal policy with respect to the effect of favorable commodity prices on fiscal revenues. Also, in the 2011-2012 period, there was a greater economic result due to the withdrawal of the economic stimulus plan, carried out to face the crisis of 2009, and the sub-execution by subnational governments, which is a recurring characteristic in post-election periods. On the other hand, in 2016 a fiscal result was higher than expected, due to the rationalization measures of public expenditure. Finally, in 2018, the overall balance was also underestimated, due to the recovery of economic activity and the impact of the tax measures implemented.

¹⁹¹ They include the primary result of non-financial public companies and the interests of the NFPS.

On the other hand, the five years in which a lower overall balance than the forecasted one was obtained (average of -1.2% of GDP) are characterized by corresponding to extraordinary events, which generated lower fiscal revenues than expected (average annual difference of 0.2% of GDP) and/or higher public expenditure compared to the projected (average annual difference of 1.2% of GDP). These events refer to the financial crisis of 2009, the year in which the Economic Stimulus Plan was implemented and that involved, among others, the increase in non-financial public expenditure; the high volatility in emerging markets between 2013 and 2015, and the fall in commodity prices between 2014 and 2016, which significantly limited the growth of fiscal revenues; and the El Niño phenomenon in 2017.



1/ Calculated as the difference between registered and forecasted overall balance. If the difference is positive, it means that the economic result was underestimated, while if it is negative, the economic result was overestimated.
Source: BCRP, MEF.

7.2.4.2. Public Debt

The retrospective analysis of public debt forecasts consists in decomposing its projection error at one year based on the forecast errors of its macro-fiscal determinants. The structure of the public debt makes its dynamics influenced by macro-fiscal factors (nominal GDP growth, exchange rate and fiscal deficit) and other particular factors (uses or accumulations of financial assets, pre-financing, among others). Therefore, the forecast error of the public debt ratio on GDP will depend on the projection errors of these factors. To determine the forecast error of year “t”, estimates of public debt for year “t” made in the MMM of August of year “t-1” are considered.

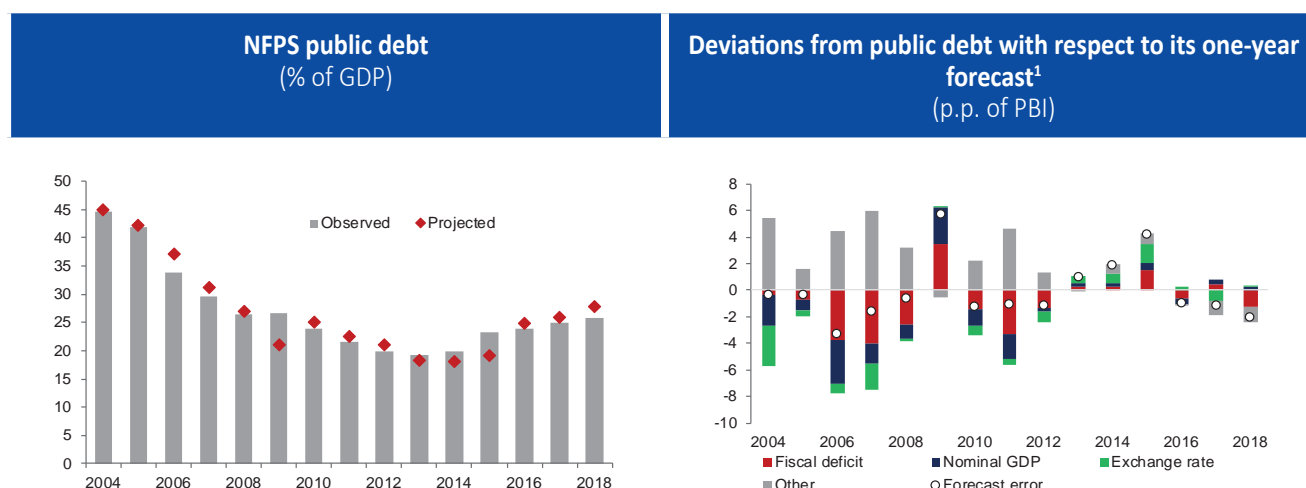
In the last 15 years, the forecast of the one-year public debt had a conservative bias, since in 11 years a debt lower than the projected one was observed and only in 4 years a debt greater than the forecasted one was registered. The latter are explained by extraordinary events, such as the financial crisis of 2009 or the high volatility in emerging markets between 2013 and 2015. In that period and on average, the public debt forecasted at one year was equal to the registered public debt. The average contributions of the forecast errors of nominal GDP growth, exchange rate, fiscal deficit and other factors in the public debt projection error were -0.6%, -0.4%, -0.9% and 1.8% of GDP, respectively. Thus, the dynamics of macro-fiscal factors significantly reduced the pressures of obtaining resources through indebtedness.

Particularly in the 11 years in which the public debt was overestimated (period 2004-2008, 2010-2012 and 2016-2018), the public debt registered was, on average, lower by 1.2 p.p. of GDP in comparison to its one-year forecast. In this period, the “other factors” component has had an important contribution because the fiscal surpluses in those years were not entirely intended to reduce public debt, but also to accumulate financial assets, such as the FEF. These measures corresponded to

a prudent fiscal policy that was aimed at strengthening fiscal accounts, with the objective of facing future adverse events without significantly affecting fiscal sustainability.

On the other hand, in the four years in which the public debt was underestimated, the public debt realized was on average higher by 3.2 p.p. of the GDP with respect to the forecasted. In these four years, the deviations from the projected correspond to the effects of the international financial crisis (2009) and the high financial volatility registered in emerging markets (2013-2015).

- o Respect to 2009, there was an important impact on the lower GDP growth and a greater public expenditure boost that led to a greater fiscal deficit.¹⁹².
- o In addition, in the 2013-2015 period, the main macrofiscal factor that contributed to the forecast error was the significant increase in the exchange rate and, to a lesser extent, the lower levels of GDP growth compared to the expected. To this is added the contribution of the “other factors” component, which were mainly associated with taking advantage of favorable windows in emerging markets to carry out more pre-financing¹⁹³, in a context of uncertainty about the dynamics of international interest rates. Pre-financing becomes part of the financial assets in the year in which they are disbursed and then used in the following year in the form of the use of financial assets to cover financing needs.



1/ Calculated as the difference between current and projected public debt. If the difference is positive, public debt was underestimated; if it is negative, public debt was overestimated.

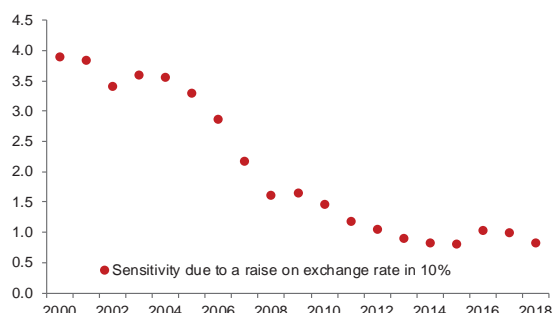
Source: BCRP, MEF.

Moreover, it is important to note that the sensitivity of the ratio of public debt to GDP to macro-fiscal factors has been reducing in recent years, due to the active management of public debt to optimize its profile and reduce its exposure to financial risks. Thereby, between 2000 and 2018, the sensitivities of the public debt ratio to a decrease in economic growth by 1 p.p. or an increase in interest rates on public debt by 100 bps has been reduced from 0.5 p.p. of GDP at less than 0.3 p.p. of GDP. For the same period, the sensitivity of public debt to an increase in the exchange rate by 10% has been consistently reduced in recent years, from around 4 p.p. of GDP at less than 1 p.p. of GDP, which evidences the improvement of the public debt profile.

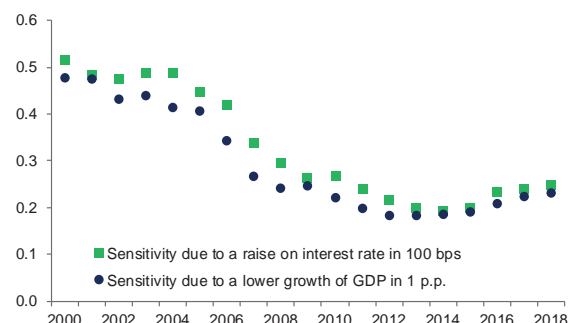
¹⁹² For 2009, in the revised MMM 2009-2011, a fiscal surplus of 2.3% of GDP was expected. However, the data was a fiscal deficit of 1.3% of GDP.

¹⁹³ In 2014 and 2015, pre-financing was carried out for 0.5% and 1.6% of GDP, respectively.

Sensitivity of public debt to exchange rate variations (% of GDP)



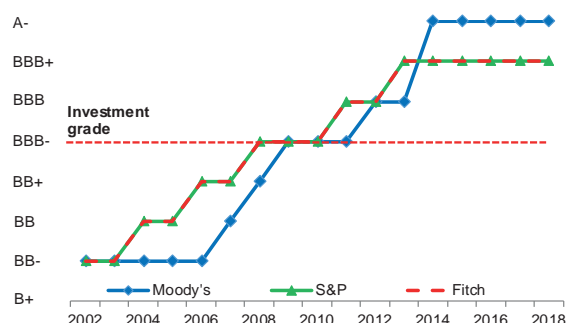
Sensitivity of public debt to GDP and interest rate variations (% of GDP)



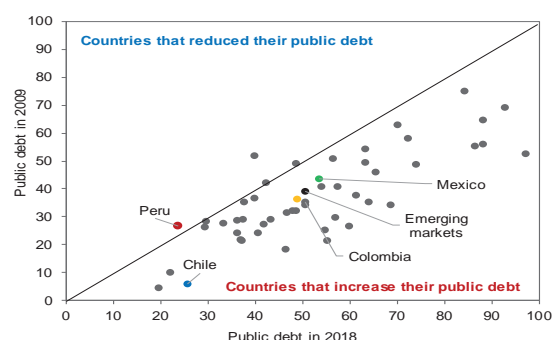
Source: BCRP, MEF.

Thereby, in the last 15 years, despite adverse shocks, prudent and responsible management of public debt has allowed it to be positioned as one of the strongest, among emerging economies, in the face of financial risks. This fact has been recognized with continuous improvements in credit rating and in more favorable access to international financial markets. Public debt fell from almost 50% of GDP in 2004 to 25.8% of GDP in 2018, while optimizing its profile and reducing its exposure to financial risks¹⁹⁴. Furthermore, the lower ratio of public debt to GDP and its better profile were accompanied by continuous improvements in the country's credit ratings, based on investor confidence in macro-fiscal strengths. These facts led to more favorable access to financial markets, with lower interest rates, and positioned the country as one of the strongest emerging markets, even in the face of the effects of adverse scenarios, such as the international financial crisis. Thus, the annual interest payment burden was also reduced from 2.3% of GDP in 2004 to 1.4% of GDP in 2018, thus providing more space for productive public spending in favor of the welfare of citizens.

Peru: Credit ratings



Public debt in emerging markets 2009-2018 (% of GDP)



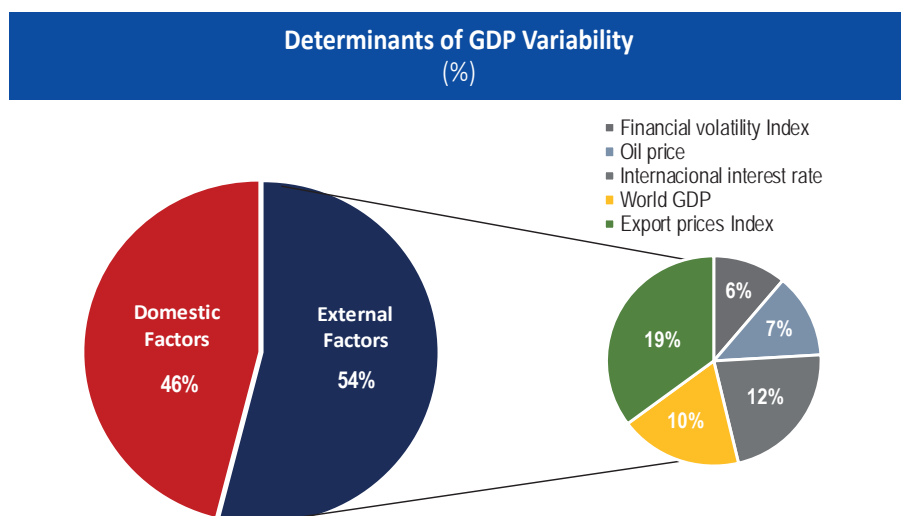
Fuente: FMI, S&P, Moody's, Fitch Ratings, BCRP, MEF.

¹⁹⁴ In the same time horizon, the public debt profile was consistently improved: i) the half-life was extended in 4,1 years (from 7.6 years to 11.7 years), which reduced the risk of refinancing; ii) the degree of solarization grew from 8.1% to 60% of total debt, which reduced its exposure to foreign exchange risk; and iii) the proportion of fixed-rate debt increased from 46.2% to 90.1% of total public debt, which mitigated the interest rate risk.

7.3. PROSPECTIVE EVALUATION OF FISCAL RISKS

7.3.1. Macroeconomic Risks

The Peruvian economy being small and open to the world depends on both external and internal factors. In this regard, when analyzing the role of external factors in economic growth, according to MEF estimates, it is found that 54% of Peru's GDP growth variability in the last 15 years is explained by external factors and 46% by internal factors. These results are in line with that obtained for Latin America (55% of the growth variability of the block is explained by external factors)¹⁹⁵.



Source: BCRP, MEF estimations and forecasts.

In this MMM there are latent risks in the international and local economic environment, which could affect the growth of economic activity with respect to the baseline scenario.

International Risks

In the international environment, the latent risks that could exacerbate global growth are mainly associated with (i) a possible increase in protectionism at a global level, (ii) political uncertainty, (iii) the sharp deceleration of economic activity in China and (iv) the significant deterioration of global financial conditions. Regarding a possible increase in protectionism at a global level, the prolonged trade war between the US and its main trading partners could intensify. In particular, trade disputes with China could be exacerbated as long as a favorable settlement is not reached for both countries. They could also impose tariffs on imports from Mexico, subject to breach of an Immigration Agreement, as well as the establishment of new tariffs on imports of vehicles from the euro area and Japan.

In the case of political uncertainty, political tensions could deteriorate the confidence of economic agents and affect the dynamics of global growth; for example, political tensions in the US could develop around discrepancies between the executive and legislative branches, as well as uncertainty about the outcome of the 2020 presidential elections. In Europe, internal tensions in government coalitions in Italy and Germany, and the risk associated with a disorderly *BREXIT*, could continue to affect the dynamics of global growth. On the other hand, in Latin America, the general elections of October 2019 in Argentina, and the uncertainty regarding the policies of the new governments of Mexico and Brazil could also continue to reduce the growth expectation of the region.

¹⁹⁵ Izquierdo, Romero and Talvi (2007). *Booms and busts in Latin America: The role of external factors*. The authors use the following variables: GDP LAC7 (Argentina, Brazil, Chile, Colombia, Mexico, Peru and Venezuela), G7 industrial production index, index of terms of trade and variables of external financial conditions (bond rates of the American Treasury to ten years, EMBI).

On the other hand, in relation to the abrupt deceleration of China, this could be related to the high level of corporate indebtedness and local governments- it is currently implementing expansive monetary and fiscal policies- which could trigger an episode of financial stress and compromise the Future growth of economic activity. This deterioration in economic activity could have a negative impact on the growth of the world economy and the prices of commodities.

Finally, global financial conditions could worsen in the face of a negative reaction of the financial markets to a less flexible monetary policy than expected by the Federal Reserve System, which would trigger a deterioration of the unstable equilibrium in which the market is currently located. In addition, the increase in uncertainty regarding trade and political tensions around the world could exacerbate volatility in financial markets. In addition to the aforementioned risks, the IMF, in its latest update of the world economy outlook of July 2019, shows a concern about i) the increasing disinflationary pressures that have been reactivated¹⁹⁶, due to slow global growth and lower core inflation both in emerging and advanced economies, which could make adverse shocks more persistent; and ii) the risks of climate change, which is a threat to health and means of livelihood.

Local Risks

Greater deterioration of investment expectations in a context of growing international and internal risks. The intensification of commercial tensions between the US and China in May 2019 caused a general fall in investment expectations globally. Thereby, the index of business confidence of the OECD countries recorded in 2Q2019 its lowest level since 3Q2016 and is in a neutral position after being located for ten quarters in the optimistic section. In line with the unfavorable external scenario and lower growth prospects for Peru, six-month investment expectations¹⁹⁷ recorded a negative result in 2Q2019 (-6 points, the lowest level since 4Q2015), which would affect the dynamism of the investment. At the local level, the perception of uncertainty due to social and political conflicts would explain part of the adjustment in investment expectations.

Idiosyncratic shocks in mining and hydrocarbon activities. These activities are subject to *shocks* related to mineral laws, technical problems and social conflicts. In particular regarding social conflicts, according to the Ombudsman's Office, as of July 2019 there are 93 socio-environmental conflicts, of which 79 are related to mining and hydrocarbon activities (14.4% of GDP). Particularly, the mining sector concentrates 66.7% of total conflicts (62 cases) and involves large copper companies¹⁹⁸, which represent around 40% of the mining GDP. For its part, the hydrocarbons sector has been affected by the social conflicts registered in Loreto against the company Frontera Energy, operator of Lot 192, due to the spills produced in the Norperuano Pipeline. According to the risks mentioned in the two subsectors, the primary supply could deteriorate further, and would affect not only the growth of local economic activity, but also shipments to foreign markets.

Possible Occurrence of the El Niño Phenomenon for the Summer of 2020. According to the latest statement from the Multisectoral Commission in charge of Enfen¹⁹⁹, there is 13% probability that a weak El Niño phenomenon will occur and 1% that it will be a moderate-strong Niño phenomenon or strong in the summer of 2020. If this phenomenon occurs, it would have repercussions on anchovy biomass, which would influence the setting of the first fishing quota in 2020. As a result, the landing of anchovy (0.5% of GDP) lose dynamism and detract from the growth of the fishing sector, which in turn would impair the performance of the processing and conservation of fish of primary manufacturing (0.9% of GDP). The last El Niño phenomenon that occurred in Peru was the Coastal 2017, which affected economic growth and generated severe damage in several regions, mainly in the north of the country.

¹⁹⁶ After the period of cyclical expansion recorded between mid-2016 and mid-2018.

¹⁹⁷ According to the latest survey of Support Consulting (June 2019), which brings together three hundred companies (approximately 50% of private investment in Peru).

¹⁹⁸ Companies such as Southern, Las Bambas, Antamina and Constancia.

¹⁹⁹ Published on August 15, 2019.

7.3.2. Specific Risks

7.3.2.1. Explicit Contingent Liabilities

At the end of 2018, a maximum exposure of the NFPS to explicit fiscal contingencies, calculated as the sum of the nominal value, of 10.22% of GDP has been calculated²⁰⁰. The sources of fiscal risks of these explicit contingencies are the following: i) judicial proceedings in national and international courts, administrative and national arbitrations²⁰¹ (6.64% of GDP); ii) international controversies on investment issues (1.43% of GDP); and iii) guarantees granted to the private sector with the signing of PPP Agreements (2.15% of GDP).

Summary of explicit contingencies of the NFPS, 2017 and 2018
(% of GDP)

Type of explicit fiscal contingencies	Maximum exposure (ME)		Expected contingency	Difference
	2017	2018	2019	2018/2017
Total	9.86	10.22	0.68	0.35
1. Judicial, administrative and arbitration proceedings ^{1,2}	6.45	6.64	0.59	0.19
2. International controversies on investment issues - ICSID	1.10	1.43	0.00	0.33
3. Explicit contingencies assumed in PPP contracts	2.31	2.15	0.09	-0.17

1/ The maximum exposure of 2017 was developed with the information reported by the Entities for the preparation of the General Account of the Republic corresponding to 2017. 2/ The maximum exposure of 2018 was developed with the information reported by the Entities for the preparation of the General Account of the Republic corresponding to 2018.

Source: DGCP, Dgetp, Dgaecyp, Fonafe, PetroPerú.

On the other hand, it can find explicit contingents assumed by the national government, but whose activation would have a null effect on the overall amount of the Non financial Public Sector liabilities. This is the case of guarantees, endorsements or similar, granted by the national government to regional governments, local governments or public companies of the Non financial Public Sector, which constitute a commitment of the former to partially or totally pay the outstanding amount of a loan in case of there is a default by the original debtor (GR, GL or EPNF). In that sense, because it is only a transfer of the payment obligation on an existing debt, it has been decided not to consider that source as an explicit contingency for the Non financial Public Sector. In the same way, there are other instruments, such as resource transfer agreements that are considered as an explicit contingency for the GN.

The increase in the NFPS explicit fiscal contingencies in 2018 (0.35% of GDP) compared to 2017 is mainly explained by the increase in contingencies due to international investment disputes (0.33% of GDP). In the case of contingencies due to judicial, administrative and arbitration²⁰² processes, an increase of 0.19% of the GDP was presented, while for the explicit contingencies assumed in PPP Agreements a reduction of 0.17% of the GDP was observed. However, for the most part, this reduction is the result of the increase in the GDP base.

²⁰⁰ To prepare this report, the nominal GDP of 2018 published by the BCRP was used.

²⁰¹ This report does not present explicit contingencies for lawsuits with unquantifiable claims, for example, claims for work restitution.

²⁰² To prepare this section, the MEF requested information from Fonafe, as well as PetroPerú in a standard and pre-established format.

Variation of explicit contingencies of the NFPS, 2017 and 2018
(% of GDP)

Type of explicit fiscal contingencies	Incr. o red. ME ³	Effect of Exchange Rate and GDP ⁴	Difference ME 2018/2017
Total	0.82	-0.47	0.35
1. Lawsuits and arbitrages ^{1,2}	0.49	-0.31	0.19
2. Disputes over international investments - ICSID	0.40	-0.07	0.33
3. Explicit contingencies assumed in PPP contracts	-0.07	-0.10	-0.17

1/ The maximum exposure of 2017 was developed with the information reported by the Entities for the preparation of the General Account of the Republic corresponding to 2017. 2/ The maximum exposure of 2018 was developed with the information reported by the Entities for the preparation of the General Account of the Republic corresponding to 2018. 3/ The nominal variation is considered, and the exchange rate and GDP of 2017 are used. 4/ Contribution for the depreciation of the exchange rate and use of the GDP 2018.
Source: DGCP, Dgetp, Dgaecyp, Fonafe, PetroPerú.

Finally, for 2019 it is estimated that the expected materialization of explicit contingencies would amount to approximately 0.68% of the GDP of 2018²⁰³, in contrast to the 0.69% observed for 2017. Currently, the MEF only has an official methodology approved by Ministerial Resolution No. 048-2015-EF/52 to evaluate quantifiable contingent commitments and the flow of income derived from PPP Agreements.

a) Explicit Contingencies for Judicial, Administrative and Arbitration Proceedings

This section distinguishes three types of processes that could represent an explicit contingency for the non financial public sector:

- o **Judicial proceedings:** These processes are aired in judicial organs that are within the scope of the Judiciary. Thus, these are lawsuits against entities of the Peruvian State held in courts, rooms of the Superior Courts of Justice and/or rooms of the Supreme Court of Justice. Considering the total amount of processes (without judgment, with appealable and non-appealable judgment), the sum of GN, GR and GL amounts to 5.51% of GDP.
- o **Administrative processes:** These processes are aimed at applying sanctions to entities of the Peruvian State for infractions committed in compliance with administrative regulations, which may result in the payment of a fine. Considering the total amount of processes (without judgment, with non-firm and firm judgment), the sum of GN, GR and GL amounts to 1.36% of GDP.
- o **Arbitration proceedings:** These processes, by agreement of the parties (arbitration agreement), are submitted to arbitral tribunals, in order to resolve disputes of a litigious nature. Considering the total amount of processes (without judgment, with non-firm and firm judgment), the sum of GN, GR and GL amounts to 0.89% of GDP.

In that context, judicial, administrative and arbitration proceedings against the State represent an explicit contingency²⁰⁴ for the non financial public sector, since there is the possibility of obtaining negative judgments and, consequently, the plaintiff must

²⁰³ The expected materialization of the explicit contingencies was estimated, with the available information, adding the following items: i) judicial, administrative and arbitration processes, and the provisions recorded in the liabilities of the corresponding public entities of processes that have an appealable judgment (unfavorable) in different instances; ii) controversies in Ciadi, for the expected materialization two factors are determined for each case in process: the expected time of duration of a case, average duration of cases with unfavorable sentences, and the expected amount, multiplication of the amount of exposure of a case case in the arbitral tribunal for the severity (average ratio between firm payments/claims in ICSID cases); and iii) PPP contingencies correspond to the contingent commitments of the State valued (expected values), in accordance with the guidelines approved by Ministerial Resolution No. 048-2015-EF/52, given the activation of the non-financial guarantees granted in the PPP Agreements and the materialization estimated by the entities.

²⁰⁴ From the point of view of the judicial process and its relation to the registration in public accounting, lawsuits against government agencies can be found in any of the following three situations:

- i. Claims in process: Corresponds to the demands pending without any sentence. The amount of the economic claim of the claim is recorded in accounting accounts as an accounting contingency.
- ii. Claims with non-appealable judgment: Those that have a sentence, at least, in the first instance. The accounting record corresponds to the claims with judgment and with the probability of being unfavorable to the State. The amounts of claims with judgments are recorded in the liabilities in the provisions account.
- iii. Claims with appealable judgment: Those with sentences as judged or consented. The amount of the judgment plus interest and other payments, if any, are recorded in the liabilities of the public entity as an account payable.

For the present evaluation, the claims in process and with appealable (non-appealable) are considered as explicit contingencies.

be compensated and/ or compensated. Moreover, the State's obligation to pay is established through legal instruments, such as the case of the judgment or the arbitration award. Considering this, in a similar way that in the Multiannual Macroeconomic Framework 2019-2022, the demands in process without any judgment and with appealable judgment, in any instance, have been included in the maximum exposure.

In general, the defendant State entities must prepare strategies, plans and actions for their defense through public prosecutors, which are responsible for the legal defense of the State. Thus, it can be deduced that the work carried out by the attorneys can have an impact on the probability of success (failures in favor) of the processes in question, therefore, the strengthening of the State Legal Defense System can contribute to the observe a smaller amount of liabilities for that concept. Along these lines, in 2017 Legislative Decree No. 1068, Legislative Decree of the State Legal Defense System was published, whose purpose is to strengthen, unify and modernize the legal defense of the State at the local, regional, supranational and international levels, in judicial headquarters, military arbitration, Constitutional Court, administrative bodies and instances of similar nature, arbitrations and conciliations; the governing body being the State Attorney General.

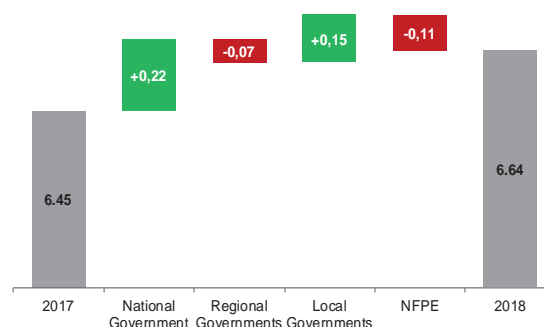
The amounts reported below correspond to the source of information reported by 933²⁰⁵ public entities. Information on the explicit contingencies associated with judicial, administrative and arbitration processes submitted by (National Fund for the Financing of the Public Sector Companies) Fonafe²⁰⁶ and PetroPerú was also considered.

Thereby, at the end of 2018, the maximum exposure²⁰⁷ to explicit contingencies associated with judicial, administrative and arbitration processes represents 6,64% of the GDP of 2018, higher than the 6,45% recorded in 2017. The main increase was observed in the lawsuits in process of the national government (0.20% of GDP), which reached an amount equivalent to 4.82% of GDP. The greatest contribution to this value comes from the proceedings against the Judiciary (PJ), Previsional Normalization Office (ONP), Ministry of Interior (MinInter), Ministry of Housing, Construction and Sanitation (MVCS) and MEF, which represent around 59% of the total amount of that item. On the other hand, in the case of local governments, the main increases were observed in the Metropolitan Protransporte Institute of Lima and the Provincial Municipality of Lima 0.08% and 0.04% of GDP, respectively.

Explicit contingencies of NFPS associated with lawsuits and arbitrations (% of GDP)

According to government levels	Maximum exposure (ME)		Difference 2018/2017
	2017 ¹	2018 ²	
Total	6.45	6.64	0.19
National Government	4.99	5.22	0.22
Regional Governments	0.38	0.30	-0.07
Local Governments	0.65	0.80	0.15
EPNF ^{3, 4}	0.43	0.32	-0.11

Explicit contingencies of NFPS associated with lawsuits and arbitrations (% of GDP)



1/ The maximum exposure of 2017 was developed with the information reported by the Entities for the preparation of the General Account of the Republic corresponding to 2017. 2/ The maximum exposure of 2018 was developed with the information reported by the Entities for the preparation of the General Account of the Republic corresponding to 2018. 3/ To prepare this section, the MEF requested information from Fonafe and PetroPerú in a standard and pre-established format. 4/ The amount includes the estimate of the provision in cases of ongoing litigation of the construction balances of the business treatment entities, which remit for the preparation of the General Account of the Republic.
Source: DGCP, Fonafe, PetroPerú.

²⁰⁵ Of the universe of 2504 public sector entities, only 37% of them have reported contingencies due to lawsuits and arbitrations for purposes of the General Account of the Republic.

²⁰⁶ A total of 29 companies National Fund for the Financing of the Public Sector Companies and EsSalud were reported.

²⁰⁷ The maximum exposure corresponds to the amount of the claimant's claim and accounting provisions, which may vary by sentence and/or the payment requirement (the amounts demanded decrease because claims at one of its ends are declared unfounded or increased because, in labor matters, the judge has ultra petite powers or also orders to pay interest, procedural costs and costs). Besides, this quantification is preliminary, because there are judicial processes that are not reported to public accounting because they are considered non-monetary claims or unquantified amounts.

Also, at the end of 2018, the greatest exposure comes from any judgment in proceedings of type, without civil, administrative, social security and national arbitration judgment. Civil, administrative and pension lawsuits are concentrated in the national government, while national arbitrations and labor lawsuits are dispersed among the three levels of government.

2018: Lawsuits without any judgment, according to type of lawsuit
(% del total)

Type of lawsuit	National Government	Regional Governments	Local Governments	Total
Total	83.4	4.4	12.2	100.0
Civil	33.1	0.8	3.3	37.2
Administrative	20.9	0.0	0.0	20.9
Pension ¹	12.8	0.0	0.0	12.9
National arbitrages	8.7	1.5	5.2	15.4
Labor	5.6	1.4	3.3	10.3
Others	2.3	0.6	0.4	3.3

2018: Lawsuits without any judgment, according to type of lawsuit
(% of GDP)

Type of lawsuit	National Government	Regional Governments	Local Governments	Total
Total	4.8	0.3	0.7	5.8
Civil	1.9	0.0	0.2	2.2
Administrative	1.2	0.0	0.0	1.2
Pension ¹	0.7	0.0	0.0	0.7
National arbitrages	0.5	0.1	0.3	0.9
Labor	0.3	0.1	0.2	0.6
Others	0.1	0.0	0.0	0.2

1/ Oficina de Normalización Previsional (ONP)
Source: DCGP-MEF.

In the case of the national government, mainly the exposure is concentrated in the Judiciary²⁰⁸ (24,7%), ONP (15,4%), MinInter (7,4%) and MVCS (6,0%), while the In the case of local governments, mainly the exhibition is in the Provincial Municipality of Lima²⁰⁹ (35%) and the Metropolitan Protransporte Institute of Lima (11%).

Additionally, at the end of 2018, the amount of lawsuits with judgment is concentrated on labor, civil, administrative and social security claims; most of it is found in regional governments.

2018: Lawsuits with appealable judgment, according to type of lawsuit
(% del total)

Type of lawsuit	National Government	Regional Governments	Local Governments	Total
Total	35.8	50.6	13.6	100.0
Labor	8.0	45.2	6.0	59.3
Civil	10.3	2.0	4.5	16.7
Administrative	7.2	0.6	0.0	7.9
Pension ¹	1.5	1.3	0.0	2.8
Others	8.7	1.4	3.1	13.3

2018: Lawsuits with appealable judgment, according to type of lawsuit
(% of GDP)

Type of lawsuit	National Government	Regional Governments	Local Governments	Total
Total	0.7	1.0	0.3	1.9
Labor	0.2	0.9	0.1	1.1
Civil	0.2	0.0	0.1	0.3
Administrative	0.1	0.0	0.0	0.2
Pension ¹	0.0	0.0	0.0	0.1
Others	0.2	0.0	0.1	0.3

1/ Oficina de Normalización Previsional (ONP)
Source: DCGP-MEF.

b) Explicit contingencies due to international controversies in investment matters

Disputes regarding investment issues are resolved before the International Center for Settlement of Investment Disputes (ICSID) or other international ad hoc center, in accordance with the Arbitration Rules of the United Nations Commission for International Commercial Law (Cnudmi). Similar to the contingencies derived from judicial, administrative and arbitration proceedings, the cases before the ICSID represent an explicit contingency of the NFPS in view of the possibility of obtaining unfavorable awards, therefore, the plaintiff must be compensated and/or compensated (in this case, to the foreign investor).

²⁰⁸ Considering the PIM 08.12.2019 of the Judiciary, that value represents about 3.21 times the PIM.

²⁰⁹ Considering the PIM 08.12.2019 of the Metropolitan Municipality of Lima, that value represents about 0.93 times the PIM.

In the framework of Law No. 28933, the State Coordination and Response System for International Investment Disputes (Sicreci) was created with the objectives of i) optimizing the response and coordination within the public sector against international investment disputes, to allow timely and appropriate attention; and ii) centralize information on investment agreements and treaties signed by the Peruvian State that refer to international dispute resolution mechanisms, among others. The Technical Secretariat of the Special Commission, created by the aforementioned law, is the entity in charge, among others, of i) initially assessing the dispute and preparing a preliminary report to be submitted to the other members of the special commission; and ii) prepare reports related to the courses of action, strategy to be followed and others that are necessary for the special commission to fulfill its functions.

Thereby, at the end of 2018, the maximum exposure derived from explicit contingencies due to international controversies in investment matters, presented as the claimants' claim amounts, amounted to 1.43% of the 2018 GDP, greater than the 1.10% reported in 2017. This increase is mainly derived from the start of Case No. ARB/78/26 Enagás SLU, from the increase in the claims of the plaintiffs of the proceedings against Gramercy Funds Management LLC and Metro de Lima Line 2 S.A. At the end of 2018 there are three processes with claim amounts not specified by the respective claimants, consequently the maximum exposure is expected to be greater than 1.43% of GDP.

Explicit Contingencies due to Investment Controversies (% of GDP)			
Plaintiffs	Maximum exposure ¹		Difference
	2017	2018	2018/2017
Total	1.10	1.43	0.33
1. DP World Callao	0.05	0.05	0.00
2. Exeteco International Company	0.00	PC	0.00
3. Gramercy Funds Management	0.74	0.80	0.06
4. Lidercon Perú	0.05	0.04	0.00
5. Metro de Lima 2	0.25	0.30	0.04
6. Aunor	NI	ND	0.00
7. Enagás	NI	0.23	0.23
8. Chinchero	NI	ND	0.00
9. Renco	NI	ND	0.00
10. IBT	NI	0.01	0.01

1 / The maximum exposure presented in this table represents the claims amounts of the plaintiffs, which, in some cases, are over-sized amounts and without greater economic support (for example, see ICSID case No. ARB / 11/2017) . PNI: Not started; PC: Process completed; ND: Not determined. Source: Dgaicyp-MEF.

In this regard, it is important to keep in mind that in some cases the economic claims presented before the ICSID are about oversized amounts and without greater economic support. An example is the ICSID case No. ARB/11/17 Rene Rose Levy & Gremcitel against the Republic of Peru, which involved an economic claim of the investor of approximately 20.7% of the GDP of 2014. For that case, the ICSID's arbitration board declared the process closed in November 2014 and issued the favorable award to Peru on January 9, 2015.

At the end of 2018, Sicreci reports that 16 arbitration proceedings have been concluded before the ICSID, with good results. In 11 arbitrations, favorable results were achieved for Peru and only in the cases ICSID No. ARB / 03/28 Duke Energy International Peru Investment (completed in 2011), ICSID No. ARB/07/6 Tza Yap Shum (completed in 2015) and ICSID No. ARB/14/21 Bear Creek Mining Corporation (completed in 2017) awards were obtained that recognized payments in favor of investors, which amounted to 0.01% of the 2011 GDP, 0.0004% of 2015 GDP and 0.01% of 2017 GDP, respectively. It should also be noted that the amount of compensation represented less than 50%, 3% and 3.5% of the applicants' claim in those cases. In all three cases, Peru's defense succeeded in getting the arbitral tribunal to dismiss substantial parts of the claims.

c) Explicit Contingencies in Public-Private Partnership Settlements.

At the end of 2018, the explicit contingencies assumed in the PPP contracts decreased compared to 2017, mainly due to the increase in the GDP base, and the reduction in the stock of contingencies associated with cost risk and financial guarantees.

In the framework of Legislative Decree No. 1362, a rule that regulates the Promotion of Private Investment through Public Private Partnerships PPP and Assets Projects, the national government can grant financial guarantees²¹⁰ or assume contingent commitments²¹¹ (associated with demand risks or cost risks) in infrastructure investment projects for public use or that provide public services.

Both the financial guarantees granted by the State and the contingent commitments assumed by the State²¹² and the contingent commitments²¹³ assumed by the State in PPP contracts represent explicit contingencies to the extent that their materialization would generate future budget commitments to honor those guarantees or increases in debt levels, which do not They are entirely under the control of the Treasury.

Explicit contingencies due to PPP contracts (% of GDP)

Type of contingency	Maximum exposure		Difference
	2017	2018	2018/2017
Total	2.31	2.15	-0.17
1. Financial guarantees	0.57	0.53	-0.04
a) In force	0.15	0.13	-0.02
b) To be requested ¹	0.42	0.40	-0.02
2. Contingent commitments	1.74	1.62	-0.13
a) Risk associated with demand and income ²	1.59	1.53	-0.06
Transportation projects	1.13	1.09	-0.04
Sanitation projects	0.46	0.44	-0.02
b) Risk associated with cost ^{3,4,5}	0.15	0.09	-0.06

1/ Guarantees to be requested in 2019 established in article 5 of Law No. 30881-Public Sector Indebtedness Law for Fiscal Year 2019. 2/ Includes contingent commitments derived from non-financial guarantees of guaranteed minimum annual income (IMAG), guaranteed demand and minimum fund guarantee. 3/ Mainly includes geological events and emergency maintenance. 4 / Estimations made by the MTC, Minsa, GR La Libertad and GR of Arequipa. 5/ In the case of risks associated with costs, the same level is being taken for both maximum exposure and expected contingency; however, the value represents the estimate of the expected amount made by the grantors. These risks respond to coverage of excess amounts at a certain level derived mainly from geophysical / geotechnical events.

Source: Dgetp-MEF.

²¹⁰ They are those unconditional and immediate execution assurances, whose granting and contracting by the State are intended to support the obligations of the counterpart of the ministry, regional government or local government, derived from loans or bonds issued to finance PPP projects, or to support state payment obligations.

²¹¹ These are the potential payment obligations of the State in favor of its contractual counterpart stipulated in the PPP Agreement, which derive from the occurrence of one or more events corresponding to the risks of the PPP project.

²¹² In the framework of Legislative Decree No. 1362, a rule that regulates the Promotion of Private Investment through Public Private Partnerships and Assets Projects, and according to Legislative Decree No. 1437, Legislative Decree of the National Public Indebtedness System, the MEF is authorized to grant or contract guarantees, at the request of ProInversión, in case the project incorporated in the private investment promotion process requires it. In the scenario that these guarantees are activated, the MEF could be the one that attends to the payment of the obligations of the public entity (subnational government or public company) or of the private one (concessionaire). Financial guarantees are considered public debt operations and are recorded as public debt once the honor of that guarantee has been activated.

²¹³ They are not considered as guarantees or endorsements of the State within the framework of Legislative Decree No. 1437, Legislative Decree of the National Public Indebtedness System. Therefore, in the event that the project's own risk materializes, the contingent commitments that originate from it are not recorded as public debt.

i. Financial Guarantees

At the end of 2018, the current coverage balance (maximum exposure) of the financial guarantees amounted to **0.13% of GDP (not including the VAT)**. By means of Supreme Decree No. 105-2006-EF, the contracting by the National Government of a partial guarantee with the IADB was approved to ensure the annual payment for works (PAO) in the IIRSA North project, in support of the Ministry of Transport and Communications (MTC). The granting of the sovereign guarantee to the obligations of the Regional Government of Lambayeque in the Olmos project was approved by means of Supreme Decree No. 014-2006-EF.

Stock of financial guarantees due to PPP contracts (% of GDP)							
According to government levels	Public entity	Project	Rule	Type of guarantees		Stock	
				Partial risk	Sovereign ^{1,2}	2017	2018
Total				0.05	0.21	0.15	0.13
National Government	Ministry of Transportation and Communications	IIRSA Norte	D.S. N° 105-2006-EF	0.03		0.03	0.03
Regional Governments	Regional Government of Lambayeque	Olmos Project	D.S. N° 014-2006-EF	0.01	0.21	0.12	0.10

1/ Este monto corresponde al pago asegurado de la retribución al concesionario (no incluye ajustes establecidos en el contrato de concesión), así como de la ocurrencia de un evento geológico, de ser el caso. 2/ Este monto no considera la garantía de riesgo parcial del proyecto Olmos, porque esta garantía respalda el pago de la garantía soberana. Fuente: Dgetp-MEF.

In this regard, the current financial guarantees of the national government do not support any private indebtedness. The national government only supports payment obligations arising from PPP contracts under the responsibility of the MTC and the Regional Government of Lambayeque.

ii. Contingent Commitments

- Associated Risks with Demand and Income

At the end of 2018, the maximum exposure of the State for contingent commitments associated with demand risks in 12 projects²¹⁴ under the PPP modality is equivalent to **1.53% of the GDP of 2018, which corresponds to the sum of nominal values without netting the income**. Thus, this amount includes contingent commitments assumed in road transport PPPs (IMAG), which amounted to a maximum exposure level at nominal value of 0.89% of GDP, while the minimum guaranteed demands of port projects amounted to 0.20% of GDP. Similarly, the contingent commitments assumed in the sanitation projects totaled 0.44% of GDP.

Explicit contingencies derived from contingent commitments in present value represent around 1.14% of GDP. Contingent commitments assumed in transport projects amounted to 0.81% of GDP, while contingent commitments assumed in sanitation projects represented 0.33% of GDP. In particular, the Taboada Wastewater Treatment Plant project (signed in August 2009) shows the highest exposure in nominal value (0.20% of GDP) and in present value (0.15% of GDP). Among the transportation projects, the concessioned roads Red Vial No. 4, Red Vial No. 6, Autopista del Sol together represent 0.55% of GDP in nominal value and 0.41% of GDP in present value.

²¹⁴ The Vía Expresa Sur project was not included, because the Metropolitan Municipality of Lima did not submit complete information on that project for its corresponding evaluation.

Explicit Contingent commitments from demand risks assumed in PPP agreements (% of GDP)

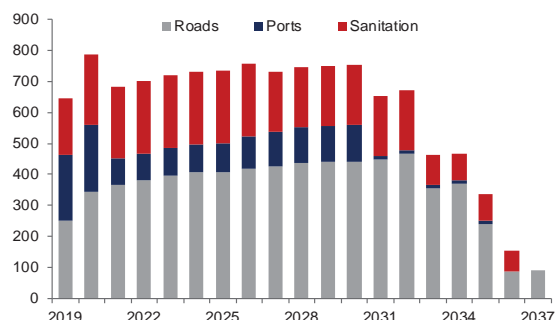
Project	Maximum exposure		Net contingent	
	Nominal value	Present value	Nominal value	Present value
Total (I+II)	1.53	1.14	0.00	0.00
I. Transport (A+B)	1.09	0.81	0.00	0.00
A. Roads	0.89	0.65	0.00	0.00
Road Network N° 4	0.20	0.15	0.00	0.00
Road Network N° 5	0.00	0.00	0.00	0.00
Road Network N° 6	0.16	0.12	0.00	0.00
Autopista del Sol	0.19	0.14	0.00	0.00
IIRSA Center	0.18	0.13	0.00	0.00
Section Quilca - La Concordia	0.16	0.11	0.00	0.00
B. Ports	0.20	0.16	0.00	0.00
TP Callao - Zona sur	0.04	0.04	0.00	0.00
TP Paita	0.16	0.13	0.00	0.00
II. Sanitation	0.44	0.33	0.00	0.00
Provisur	0.10	0.07	0.00	0.00
La Chira WWTP	0.09	0.06	0.00	0.00
Taboada WWTP	0.20	0.15	0.00	0.00
Huascacocha-Rimac ¹	0.05	0.04	0.00	0.00

1/ On June 18, 2019, through Vice Ministerial Resolution No. 02-2019-VIVIENDA/VMCS, the expiration of agreement of the Huascacocha Derivation project was declared. It has been considered in the presentation because by the end of 2018 this project was still in force.
Source: Public entities. Elaboration: Dgetp-MEF.

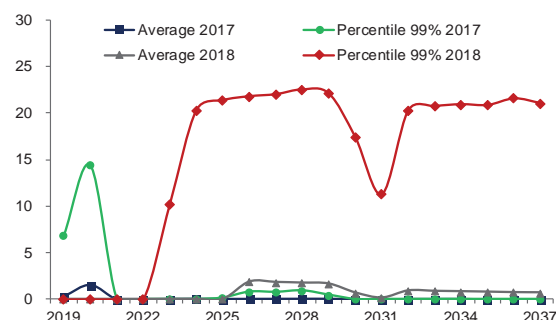
Finally, using the methodology developed by the MEF General Directorate of Public Indebtedness and Treasury, with assistance from the WB, it was estimated that the net income commitments (net contingent) associated with demand and income risks assumed in the PPP agreements, in nominal terms, are not significant in the short or medium term.

During the 2019-2038 period, the expected materialization of contingent commitments derived from demand risks would represent annual payments to privates of less than S/ 1.89 million. It is also expected that at 99% confidence, payments in case of activation of the aforementioned contingents do not exceed S/ 22.74 million annually. It is important to specify that PPP projects have had delays in the execution of the works, for that reason the start of their operations is also delayed, therefore, contingent commitments are postponed. In these cases its present value is reduced, but not necessarily the nominal value.

Maximum exposure of explicit Contingents derived from Demand Risks Granted in PPP agreements (Millions of soles)



Expected Materialization of explicit Contingencies granted in PPP agreements (Millions of soles)

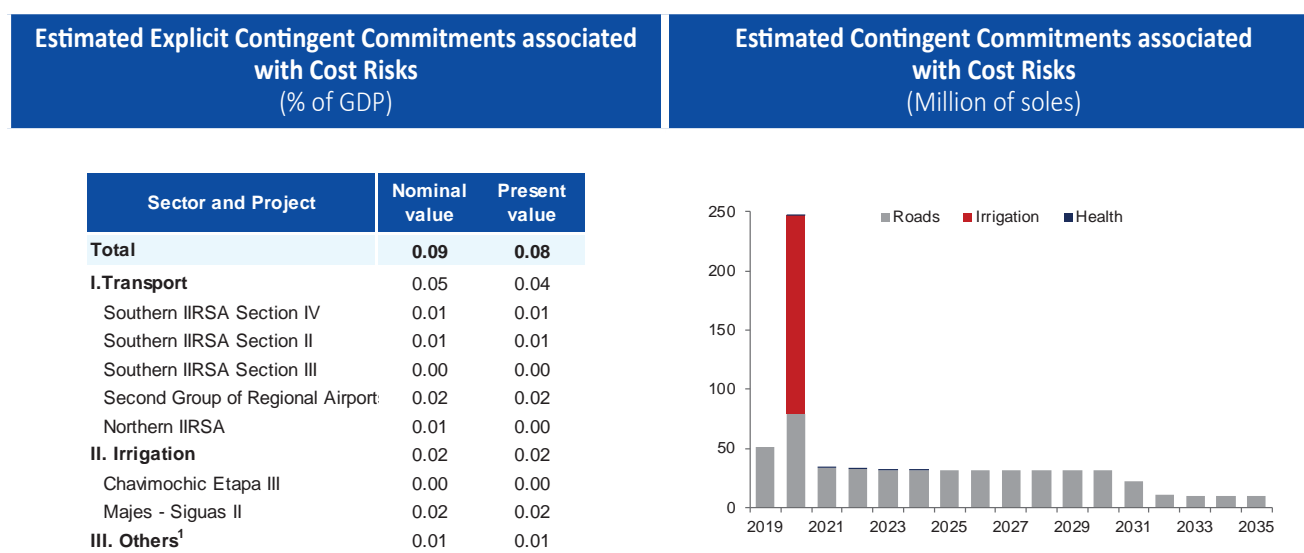


Source: MTC, MVCS, MML. Elaboration: Dgetp-MEF.

Finally, in relation to the activation of guarantees in PPP agreements, it is pertinent to indicate that in the last 15 years only the tariff guarantee²¹⁵ granted in the Red Vial concession contract No. 6 in September 2007 was activated, given the occurrence of an earthquake in the concession zone (Pisco), that is why the MTC had to pay the concessionaire S/ 8.8 million (0.00% of GDP). This is not an explicit contingency, because there is previously a provision issued by the State to reduce the rate.

- *Associated Risks with costs*

The contingent commitments for each project and by sector, provided by the MTC, Minsa, GR La Libertad and GR of Arequipa, amount to US\$ 209 million at nominal value (which represents 0.09% of the GDP of 2018) or US\$ 169 million at present value (which represents 0.08% of GDP in 2018).



1/ Includes contingent commitments associated with cost risks of Southern IIRSA Section I and V, IIRSA Center, Huaral-Acos, Mocupe-Cayaltí, Buenos Aires-Canchaque, Longitudinal Road of the Highlands Section 4 and Management of the National Institute of Child Health.
Source: MTC, MVCS, Minsa. Elaboration: Dgetp-MEF.

In addition, in the framework of Legislative Decree No. 1362, the MEF tracks the stock accumulated by firm and contingent quantifiable commitments, net of income, assumed by the Non financial Public Sector in PPP agreements²¹⁶. It is established that the evaluation of these commitments must be made net of income; therefore, from the committed payments, the income generated in the PPPs due to the collection of tolls, fees or price, remuneration, co-financing reimbursement, among others, as established by the PPP agreements, must be deducted. Along these lines, and as reported by the Dgetp, as of December 31, 2018, the total nominal flow of firm and contingent commitments, net of revenues, derived from PPP amounted to 1.53% of GDP, whose present value reached 2.21% level of the GDP of 2018, while in 2017 3.44% of the GDP of 2017 was reached.

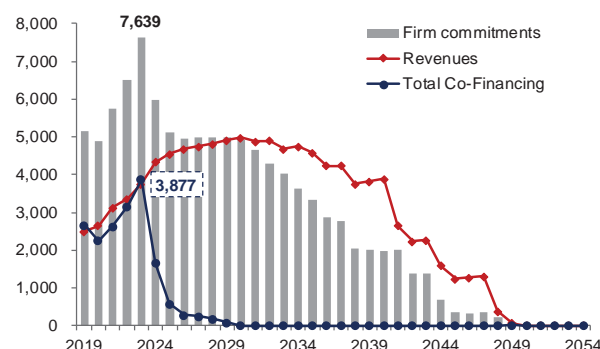
²¹⁵ This guarantee is triggered when, by the disposition of any public entity or due to force majeure, the concessionary company is prevented from charging the toll provided for in the contract, and therefore proceeds to charge a lower toll or not charge The toll. Unless the cause that originates this situation is attributable to the concessionary company, the grantor will recognize and pay the concessionary company the tariff difference.

²¹⁶ According to the provisions of article 27 of Legislative Decree No. 1362, it is established that the stock accumulated by the firm and contingent quantifiable net income commitments assumed by the NFPS in PPP contracts, calculated at present value, may not exceed 12% of GDP.

Stock of commitments, net income, in PPP projects (% of GDP)

Commitments/revenues	Nominal value	Present value
1. PPP Commitments	15.28	10.81
Firm Commitments ¹	13.66	9.59
Direct payments	8.84	6.01
Deferred payments	4.82	3.58
Contingent Commitments ¹	1.62	1.22
2. PPP revenues	13.74	8.60
Revenues ²	10.35	6.46
Retribution ³	3.39	2.14
3. Net Commitments	1.53	2.21

Total Government Co-Financing in PPP Projects (Million of soles)



1/ According to the definition contained in Decreto Legislativo N° 1362. 2/ / Income from tolls, fees, price or equivalent. 3/ Retributions to be paid for concessionaries to concedents.
Source: Dgetp-MEF.

The largest number of net commitments are concentrated in the national government, where the MTC and MVCS concentrate 97% of the total. Revenues from tolls, fees or equivalent are used to cover part of the firm commitments in the majority of PPP co-financed, with the grantor assuming the demand risk. In an extreme scenario (zero income), the total resources required by the grantors would amount to 13.66% of GDP, which represents an equivalent value close to 50% of the stock of public debt.

Finally, to date there is a PPP Agreements Module, in which public entities must enter information regarding firm and contingent quantifiable commitments, net of income. However, due to the complexity of the calculation of the commitments for its use, the MEF Risk Management Department coordinates with each public entity, in order to ensure that more reliable estimates are obtained on the risk of activation of the Contingent Commitments.

Box 12: Explicit contingencies of the national government for endorsements, guarantees and the like

For informational purposes, the explicit contingencies for guarantees, endorsements and the like granted by the national government and the resource transfer agreements are presented, which, in both cases, do not represent an explicit contingency for the Non Financial Public Sector, because, in the first In this case, they correspond to guarantees in which the national government undertakes to pay, partially or totally, the outstanding amount of a loan in the event of a default by the original debtor (GR or GL or EPNF), that is why they only represent a transfer of payment obligation on an existing debt in the Non Financial Public Sector, while in the second case they correspond to an instrumentalization to provide funds on an existing debt in the Non Financial Public Sector. In that sense, the activations of both instruments would have a null effect on the overall amount of the Non Financial Public Sector liabilities. Moreover, both the debts that are backed by the guarantees and those agreed upon in the framework of a resource transfer agreement are already considered in the public debt statistics.

i) Guarantees

Notwithstanding the foregoing, guarantees, endorsements and the like do represent an explicit contingency for the national government, which amounts to 0.46% of GDP for 2018, less than 0.48% of GDP for 2017.

In the framework of Legislative Decree No. 1437, Legislative Decree of the National Public Debt System, the MEF, through the Dgetp, acts as the sole financial agent of the State in the national government's debt operations, which includes

guarantees, endorsements, bonds and the like. In that sense, the only one that can grant State guarantees is the national government. It is also necessary to specify that, according to paragraph 29.2 of article 29 of that standard, the national government will not grant the guarantee to private sector operations. On the other hand, the granting of the guarantee by the national government must be done by ensuring that the public entity benefiting from the guarantee grants or delivers the necessary counter-guarantees, which must be permanently updated as to their value, in order to serve as a mechanism mitigation.

Peru has a prudent policy in handling the guarantees that the national government grants to regional or local governments. At the end of 2018, only the Metropolitan Municipality of Lima (MML) has the guarantee of the national government, granted by Supreme Decree No. 194-2003-EF, for two loans of US\$ 45 million each, contracted by this local government with the IADB and the International Bank for Reconstruction and Development (IBRD) to finance the Urban Transportation Program of Metropolitan Lima North-South Subsystem. The MML maintains a balance payable for these loans of S/ 96.3 million (0.01% of GDP) at the end of 2018, as a result the maximum exposure of the national government against these explicit contingencies would be equivalent to that amount.

National Government contingencies associated with guarantees, guarantees and the like
(% of GDP)

According to government levels	Maximum Exposure		Difference
	2017	2018	2018/2017
Total	0.48	0.46	-0.02
1. Regional Governments	0.00	0.00	0.00
2. Local Governments	0.02	0.01	-0.00
3. Non-Financial Public Enterprises	0.46	0.44	-0.02

Source: Dgetp-MEF.

It is necessary to specify that the MML maintains a risk rating of Baa1 and BBB+, according to the international risk classifiers Moody's and Fitch Ratings, respectively. This implies a low probability of activating the guarantee of the national government. Indeed, to date, the guarantee of the national government has not been activated as long as the MML has been complying with its payments in accordance with the provisions of their respective loan agreements.

As a mitigation mechanism for loans guaranteed to the MML²¹⁷, the General Department of Public Indebtedness and Treasury verifies, with the trustee, the provision of resources and controls the balance of the hedge debt. In case there is a mismatch, it coordinates with the trustee and the beneficiary entity to carry out the respective steps to meet the commitment. This contingency is recorded in a control account, and in the event that the endorsement of the guarantee procedure is finalized, it would proceed with the registration within the public debt statistics.

On the side of non-financial state-owned companies, through Law No. 30130, Law that declares the execution of the modernization of the Talara Refinery of public necessity and national interest, PetroPerú S.A. was granted. the national government guarantee for up to US\$ 1 billion, which can be executed for an amount of US\$ 200 million annually. This is intended to support the financial obligations contracted by PetroPerú S.A. through structured loans, bonds or other financing operations, in accordance with the provisions of the Engineering, Procurement and Construction (EPC) contract to execute the PMRT and provided that the financial flows of the company are not enough to assume those payments. Regarding the credit rating, the local risk rating agency Apoyo & Asociados, affiliated with Fitch Ratings, assigned a risk rating of AA- (pe) to the long-term debt obligations of PetroPerú SA, a rating that corresponds to a high timely payment capacity of obligations, reflecting a low counterparty risk. Similarly, Standard & Poor's and Fitch assigned BBB- and BBB+, respectively.

²¹⁷ In accordance with article 22 of Law 28563, this guarantee has the respective counter-guarantee. The trust agreement states that some resources that are part of the trust assets, which could serve as counter-guarantee, are i) 100% of the resources of the Foncomun; ii) 100% of the resources of the mining, fishing, hydro-energy, betting taxes, among others; iii) 100% of future funds that the national government allocates to the MML; and iv) 100% of the credits of the MML to the national government by arbitration, among others.

At the end of 2018, the explicit contingencies for guarantees, endorsements and the like granted by the national government decreased compared to 2017, mainly due to the combined effect of GDP growth and the reduction of the guaranteed balance of the MML's debt operations.

ii) Resource Transfer Agreements

In Peru there are the agreements for the transfer of resources, whose purpose is to transfer to the regional governments, local governments and public companies the resources of a debt operation, under the same conditions that the national government has concluded with its creditors. Debt service is served by the national government (MEF) from the resources that regional governments, local governments and public companies must transfer. In that sense, there is a counterparty risk for the national government in these agreements, since the debt service is serviced with the resources provided by the beneficiary entities under the same conditions in which the debt has been contracted.

In this type of operations a liability and an asset are generated in the balance sheet for the same amounts and with the same financial conditions (currencies and rates). Under normal conditions there would be a perfect fit on both sides of the balance sheet, and only the counterparty risk would be latent. However, it is always worrying that public entities are exposed to exchange rate risk, as this could impact the counterparty risk. At the end of 2018, the national government maintains agreements for the transfer of active resources for the following amounts:

Exposure of national government due to Resource Transfer Agreements (% of GDP)				Resource Transfer Agreements, according to mitigation mechanisms (% of GDP and % of total)		
According to government levels	Maximum Exposure		Difference 2018/2017	Mechanism	Maximum Exposure	
	2017	2018			% of GDP	% of total
Total	0.91	0.76	-0.16	Total	0.76	100.0
National Government	0.15	0.12	-0.03	1. Escrows	0.35	45.5
Regional Governments	0.32	0.27	-0.04	With Financial Allocation	0.05	6.9
Local Governments	0.06	0.06	-0.00	Without Financial Allocation	0.29	38.6
Non-Financial State Owned Enterprises	0.33	0.29	-0.04	2. Financial Allocation Only	0.37	49.4
Financial State Own Enterprises	0.05	0.02	-0.03	3. Others	0.04	5.1

Source: Dgetp-MEF.

Of the total resource transfer agreements, about 94.9% have a trust or operate directly with a financial allocation²¹⁸, which supports the payment of the obligations contracted, which constitutes a mitigation mechanism against a potential counterparty risk. Additionally, at the end of 2018, resource transfer agreements, which have as a guarantee, irrevocable letters of automatic debit tied to bank accounts, represent around 5.1% of the total. This group of agreements would represent a potentially greater counterparty risk as it is a less solid guarantee mechanism than trusts

iii) Bonds of the Social Security Office

To date there are recognition bonuses, complementary minimum pension bonuses, complementary early retirement bonuses and complementary recognition bonuses of Decree Law No. 19990, Law of the National Pension System, which issues the Social Security Office and has the National Government guarantee. These bonuses represent compensation to workers who, among other legal requirements, chose to join the Private Pension System (SPP), but who previously made contributions to the National Pension System (SNP).

These guaranteed bonds, as well as resource transfer agreements, are included in the debt statistics, therefore they do not represent an explicit contingency for the Non Financial Public Sector, but for the national government.

²¹⁸ The Article 24 of Legislative Decree No. 1437, Legislative Decree of the National Public Debt System, states that when the granting of the resources provided for making debt service payments is made through financial allocations, the Dgetp is entitled to deduct the amounts necessary to meet the aforementioned obligations and transfer them directly to the accounts provided for payment, for which this public entity must issue the certification of the respective budget credit in advance.

Guaranteed debt by ONP bonds (% of GDP)

Total	2015	2016	2017	2018
Domestic debt				
ONP Bonds	0.87	0.84	0.78	0.61

Source: Dgetp-MEF.

iv) Unsecured debt

The public sector entities that can arrange indebtedness operations without guarantees of the national government are i) sub-national governments and ii) public companies (financial and non-financial).

In the case of subnational governments, article 75 of the Political Constitution of Peru gives them autonomy to borrow without requiring prior authorization from the national government. This only refers to internal indebtedness, since the external can only be done with the endorsement of the national Government.

Regarding public companies, it should be noted that they are legal entities other than their shareholders that have economic and financial autonomy to develop their business, consequently obtaining external and internal financing must be in accordance with the capacity of attend the liabilities, being the responsibility of the respective public company to acquire obligations that can be supported with its economic solvency²¹⁹.

Unsecured debt of the national government¹ (% of GDP)

State Owned Enterprises	2015	2016	2017	2018
Total	2.34	2.00	2.70	3.09
Financial enterprises	2.06	1.79	1.77	1.61
Non-financial enterprises	0.28	0.21	0.92	1.48

1/ Considers medium and long-term operations.
Source: Dgetp-MEF.

According to *the Annual Debt Report*²²⁰, at the end of 2018, only public sector companies have unsecured debt operations of the national government, which amount to 3.09% of GDP.

It should be noted that the payment obligations derived from the indebtedness operations that the subnational governments and public companies celebrate without the endorsement of the national government are in charge of them. Consequently, it is not feasible to consider them as an explicit contingency of the national government.

v) Natural Disaster Risks

In the framework of the National Disaster Risk Management System (Sinagerd), the MEF has one of its powers to establish the Financial Management Strategy for Disaster Risk (Egfrd), with national coverage.

Along these lines, in the framework of the Pacific Alliance, Peru participated in a disaster risk transfer operation (due to an earthquake), through an insurance contract associated with the issuance of catastrophic bonds by the World Bank, by the which issued a total of US\$ 1,360 million, of which the insured sum of US\$ 200 million²²¹ corresponded to Peru.

²¹⁹ It is pertinent to indicate that when the company manages the respective Prior Report before the Comptroller, it must support its economic solvency.

²²⁰ https://www.mef.gob.pe/contenidos/deuda_publ/documentos/Informe_Deuda_Publica_2018.pdf

²²¹ Approved by Supreme Decree No. 009-2018-EF.

Additionally, by the end of 2018, other instruments that are available are contingent credit lines for US \$ 800 million (exclusive to deal with disasters) and the FEF for US\$ 5,769.8 million.

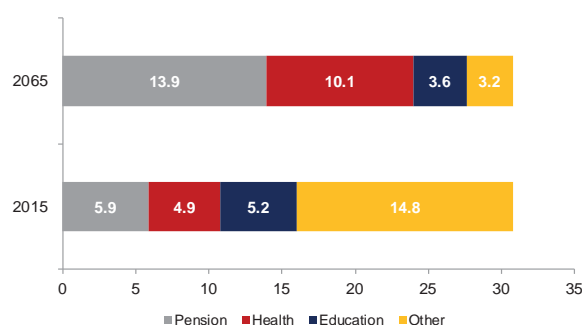
On the other hand, in the framework of the Pacific Alliance, it is mandated to improve the assurance of public goods, which would also mitigate the fiscal risks arising from natural disasters.

7.3.2.2. Public Spending Pressures by Demographic Pressures

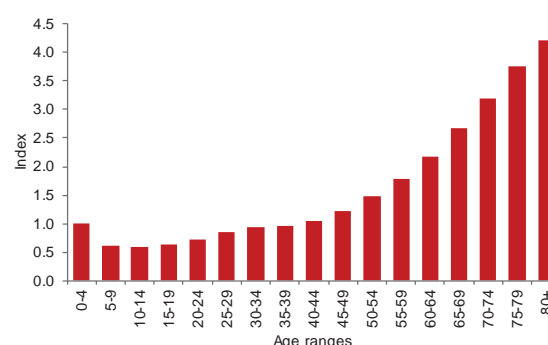
The change in the dynamics of the population in the medium and long-term has an effect on public finances through upward pressures on public spending, especially in the areas of education, health and social security. According to an IMF study²²², demographic changes in Latin America have resulted in increasing dependency ratios²²³, which have affected the sustainability of public pension systems and have generated constant increases in that expenditure. Similarly, the costs associated with the development of new health care technologies, intensively exploited by older cohorts, are also adding substantial pressures to public finances.

It should be noted that although the region still currently has a “demographic dividend,”²²⁴, that demographic window would last until 2035-2040²²⁵. According to IADB estimates for the region, between 2015 and 2065, on average, pension spending would increase 2.5 times and health spending would double, 27% due to demographic factors and the rest due to the excessive growth of others. costs In a scenario without reforms, the IADB expects aging-related expenses in the region to increase by 12 p.p. of GDP (from 16% to 28% of GDP) by 2065, with pension expenditure being the item with the highest contribution (8 p.p. of GDP). Similarly, health spending is expected to rise 5.2 p.p. of GDP (from 4.9% to 10.1% of GDP), while education spending would decrease by 1.6 p.p. of GDP (from 5.2% to 3.6% of GDP).

IADB: Composition of public expenditures in 2015 and projection for 2065 in LAC
(%)



IMF: Health expenditure average by age group
(Index)



Source: IADB (2018) “Better spending for better lives”; IMF (2017) “Demographic Changes in Latin America”, INEI, MEF forecasts.

²²² Acosta-Ormaechea, S., Espinosa-Vega, M., y Wachs, D. (2017). “Demographic changes in Latin America” IMF Working Paper.

²²³ It is defined as the relationship between dependent elderly people and the working-age population.

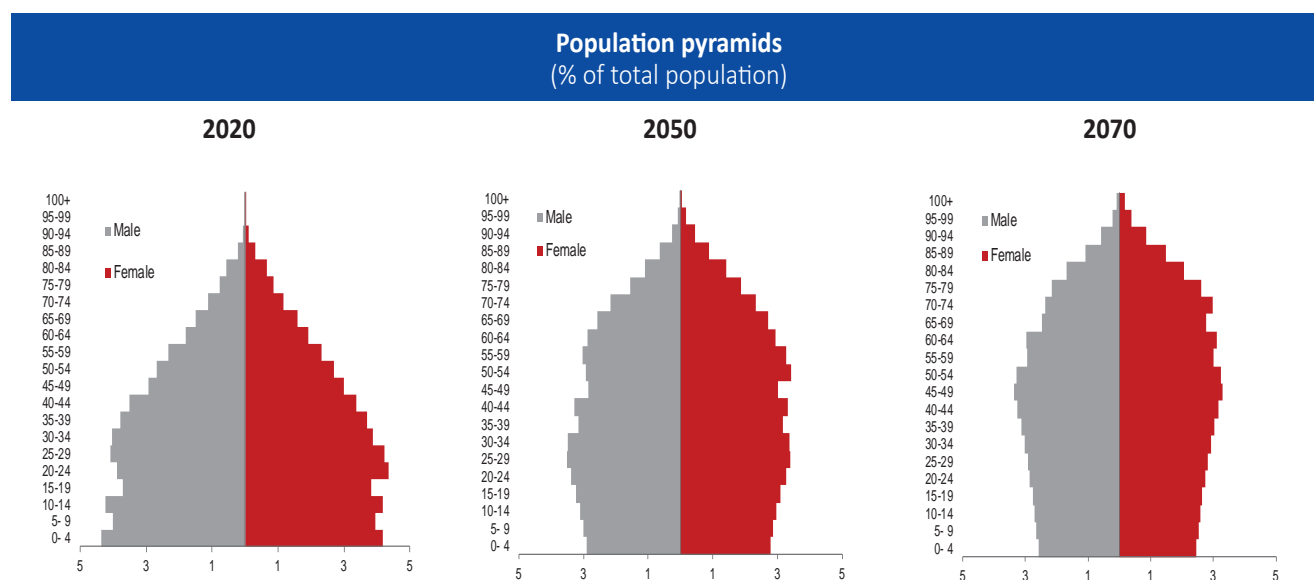
²²⁴ It is defined as the temporary and proportionally greater growth of the population of working age in relation to the economically dependent population (Mason and Lee, 2006).

²²⁵ Inter-American Development Bank (2018). “Better spending for better lives.”

According to the literature, medium and long-term expenditures are mainly affected by the demographic transition²²⁶. Thus, for the Peruvian case, the shrinking of the population pyramid by 2070 would have implications on public spending, mainly in the areas of education, health and pensions.

In the case of education, a decrease in spending would be expected, because there will be a smaller proportion of the population to be educated; in contrast, the expenses associated with health and pensions would increase, due to the greater proportion of the adult population. It should be noted that the expenditure on education and health is transversal to several components of expenses, mainly remuneration, and goods and services.

According to the INEI²²⁷, the Peruvian population will grow at a rate of 0.5% by 2070 (annual average 2010-2070), below the growth of the last forty years (2.0% annual average 1970-2010). Thus, the population will reach its maximum value at 39.8 million in 2061, period after which it will begin to decline to 39.5 million in 2070. In terms of population structure it is estimated that the proportion of people aged 0 to 14 years decrease from 25.0% in 2010 to 15.5% in 2070, consistent with the lower projected fertility rates. From the economic point of view, the most relevant change refers to the proportion of the population of working age (15-64 years), which will be reduced from 63.5% in 2010 to 60.6% in 2070. In fact, that age group will grow at an average rate of 2.6% between 2010 and 2070, below the growth between 1970 and 2010 (13.1%). In contrast, between 2010 and 2070, the proportion of adults (65-79 years) will increase from 5.1% to 15.4% and the older population segment (over 80 years) will increase from 1.2% to 8.6%, in line with the expected increase in life expectancy. In this way, the population over 65 will increase considerably and by 2070 it will represent 24% of the total population (9.5 million).

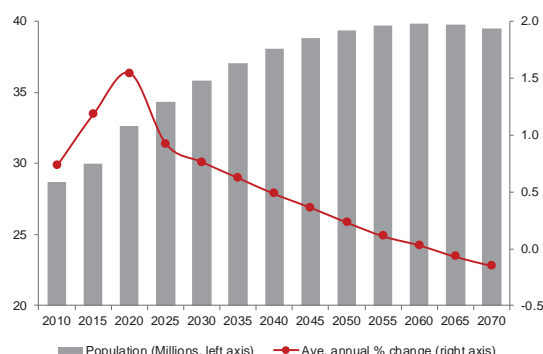


Source: INEI.

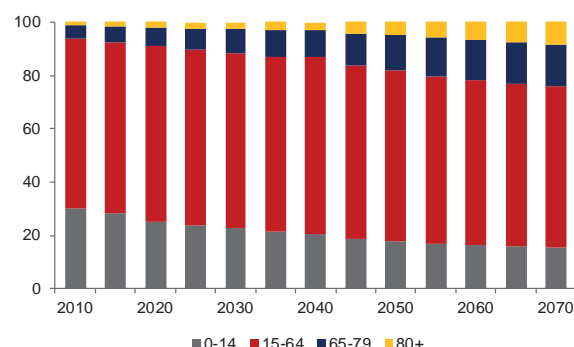
²²⁶ Acosta-Ormaechea, S., Espinosa-Vega, M. y Wachs, D. (2017). "Demographic changes in Latin America" IMF Working Paper; Panadeiros, M. y Pessino, C. (2018). "Fiscal consequences of population aging", Inter-American Development Bank.
For a more extensive literature review, see the Scenario of mandatory fiscal commitments and fiscal space 2021-2050 section of the Multiannual Macroeconomic Framework of August 2017.

²²⁷ INEI (2019). *Peru: Estimates and projections of the national population, 1950-2070*.

Total population (Millions of people and % change)



Population distribution according to age groups 2010-2070 (% of the total)

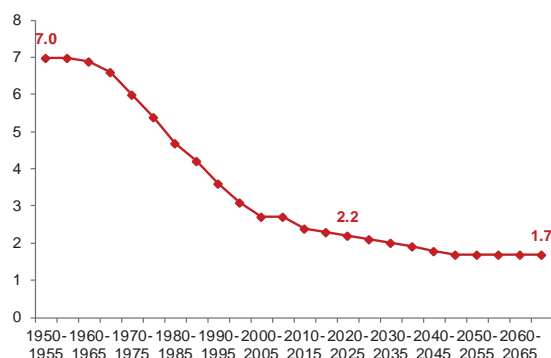


Source: INEI.

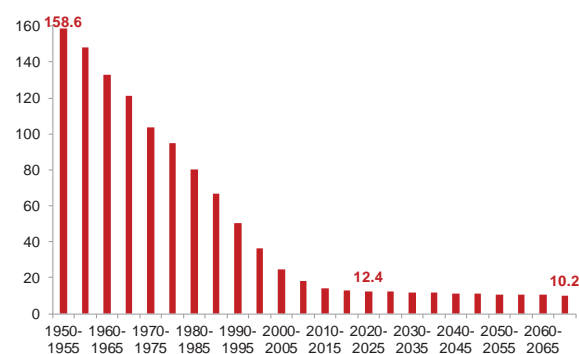
To explain demographic forecasts, it is important to analyze the pattern of its main determinants: fertility, mortality and migration. Fertility and mortality indicators are associated with population aging, one of the most important social transformations of the 21st century. Thus, in the process of the demographic transition, one goes from a state characterized by high mortality and fertility rates, and the predominance of a young population, to a state in which the mortality and fertility rates are significantly lower, and in the one that predominates the greater population²²⁸.

Thus, it is estimated that the total fertility rate will be reduced from 2.2 children per woman in the five-year period 2020-2025 to 1.7 children in 2065-2070. In addition, in accordance with the demographic transition, it is expected that between the five-year periods 2020-2025 and 2065-2070 the infant mortality rate will continue to show a decreasing trend of 12.4 to 10.2 per thousand born and that life expectancy at born better from 77.2 years to 81.5 years. Regarding the forecast of migration, by 2070 the negative migratory balance (immigrants less emigrants²²⁹) would continue to decline, in a context of improvement of social welfare expected for the country and higher income of migrants from abroad.

Global fertility rate over time (Children per woman)



Child mortality rate (For every 1,000 live births)

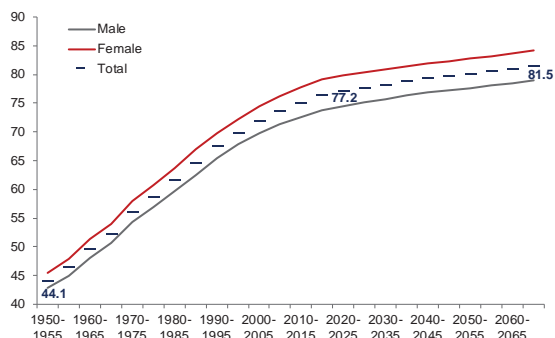


Source: INEI.

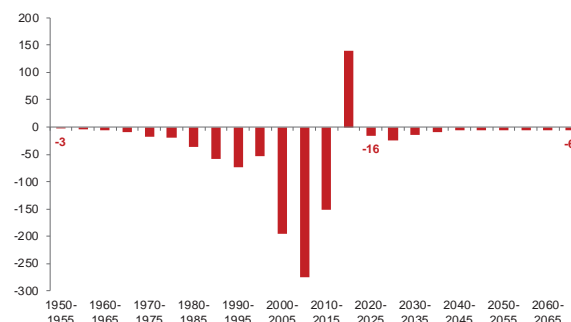
²²⁸ United Nations (2015). *World Population Ageing 2015*.

²²⁹ The estimate of the migratory balance considers Peruvian and foreign immigrants and emigrants residing in the country.

Life expectancy at birth (Years)



Net migration flows (Thousands of people)



Source: INEI.

7.3.3. Institutional risks associated with public expenditure: under-execution of investment and rigidities of expenditures

From now on it is important to continue improving and consolidating the governance of public investment at all levels of government, in order to be an effective fiscal policy instrument to accelerate the closing of gaps in physical, productive and social infrastructure. Public investment is an instrument that allows to boost economic activity, especially in emerging markets. Thus, when the investment is properly managed, it generates synergies in the long-term, which promote the participation of the private sector and foster competitiveness. In an adverse scenario, where the lack of capacity persists, the stock and quality of public investment would be affected, consequently the infrastructure deficit would be reduced with less speed. Thus, according to an IADB study²³⁰ for countries in the region, poor execution capacity contributes to poor project management throughout its life cycle, which limits the capacity to increase public and private investment in infrastructure. To implement effective governance of public investment, the OECD recommends coordination between levels of government, capacity building of operators responsible for managing public investment and establishing the appropriate regulatory conditions. This will allow public investment to have the expected social and economic effects, in line with national priorities.

The optimization of the efficiency of public expenditure must be accompanied by the strengthening of institutional capacity and a better evaluation of policy measures or legislative initiatives that may affect fiscal sustainability. This is due to the fact that, given the increase in rigidities in public expenditure and the inertial expansion of non-productive expenditure, the policy maneuver margin to implement a countercyclical fiscal response would be reduced. Given this, greater attention and pertinent evaluation of legislative initiatives and / or measures that affect the sustainability of public finances are required. In that sense, the opinion of an autonomous and technical body such as the Fiscal Council is valuable, since it allows for a deeper analysis of the norm and communication with the public. On the other hand, if the inefficiencies of public expenditure are taken into account, public sector entities must preserve the practices of prioritization and efficiency of spending. For this, it will be vital to achieve the integral implementation of the modernization of the administrative systems of the State.

7.3.4. Effects of Risks on Fiscal Accounts

7.3.4.1. Fiscal revenues: Sensitivities to Macroeconomic Variables, and tax evasion and avoidance

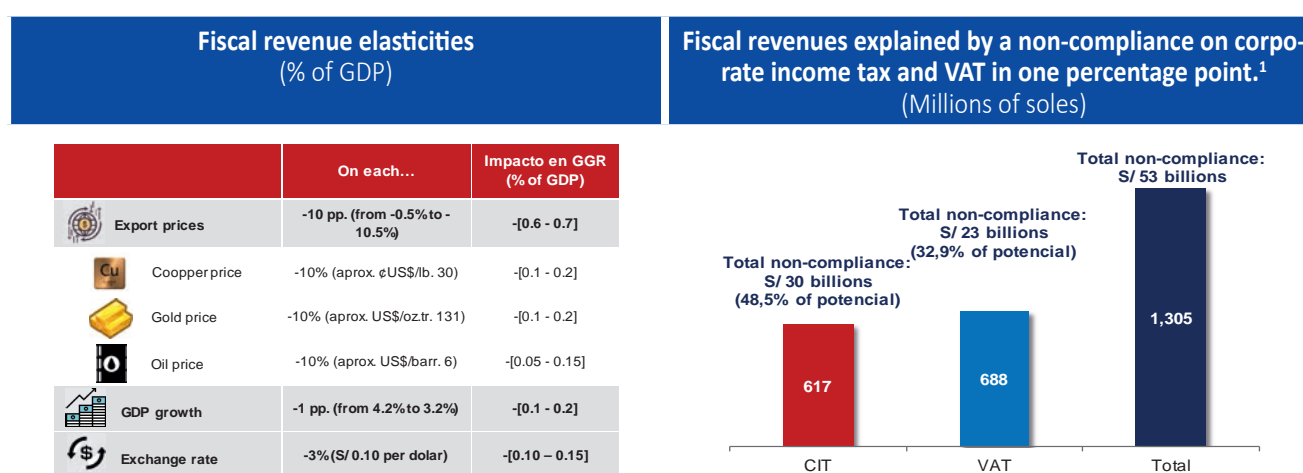
The fiscal revenues forecast is sensitive to changes in macroeconomic assumptions, especially those from the external sector. To the extent that the primary and export sectors are relevant to the rest of the activities, export prices will be an

²³⁰ IADB (2019), *Building opportunities for growth in a challenging world*, 2019 Latin American and Caribbean Macroeconomic Report.

indicator that affects the performance of tax collection. Therefore, it is estimated that a ten-point drop in the export price index would reduce fiscal revenues between 0.6% and 0.7% of GDP. If this is joined by a lower GDP growth in 1 p.p. regarding the projected, fiscal revenues could be reduced between 0.7% and 0.9% of GDP when both effects are combined.

In the same way, the projection is not exempt from changes in the levels of evasion and avoidance of the main taxes.

According to Sunat, it is estimated that the tax breach of the VAT and IR would amount to S/ 53 billion, equivalent to 7.1% of the GDP, and that indicator is negatively related to the performance of fiscal revenues. In this way, each point of lower non-compliance with these two taxes would increase fiscal revenues by around S/ 1,305 million (VAT: S / 688 million; IR(Income Tax): S/ 617 million).



1/ Estimated non-compliance of VAT and corporate income tax respect to a potencial determined base with tax expenditures net effect. Data updated with information of 2018.

Source: BCRP, Sunat, MEF forecasts.

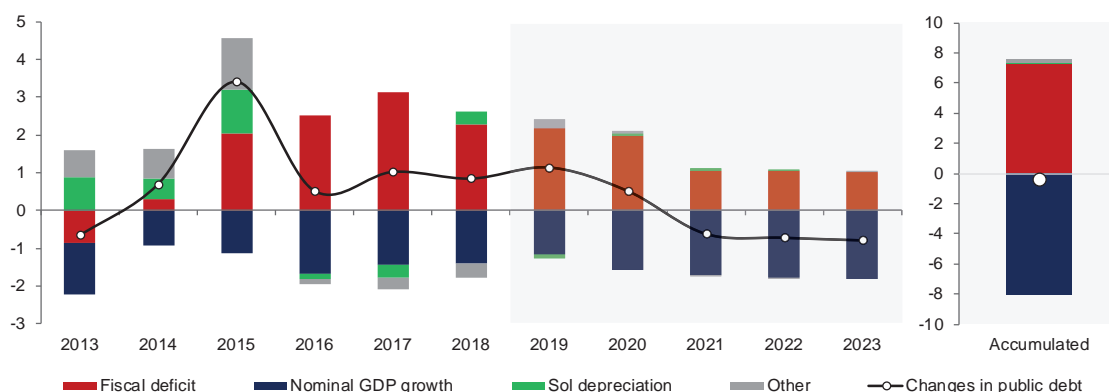
7.3.4.2. Public Debt: sensitivities to macroeconomic variables, and medium-term deterministic and stochastic projections

The public debt dynamics is exposed to shocks in their main macro-fiscal determinants, such as GDP growth, exchange rates, interest rates and fiscal deficits, and to the materialization of other specific risks, such as explicit contingent liabilities. This section presents public debt sensitivities to changes in their main macro-fiscal determinants in the MMM forecast horizon. In addition, a ten-year deterministic and stochastic forecast is developed under shocks in the main macro-fiscal determinants of public debt, and given the expected realization and maximum realization of explicit contingent liabilities.

Public Debt Sensibilities

In the forecast horizon of the MMM, and considering its macro-fiscal assumptions, the growth of GDP and the path of fiscal deficits are the main factors that explain the public debt dynamics. Thus, between 2019 and 2023, the public debt will go from 26.7% of GDP to 25.0% of GDP. In this forecast horizon, GDP growth contributes, on average, to reducing public debt by 1.6 p.p. of GDP per year. For its part, the fiscal deficit contributes on average to increase public debt by 1.4 p.p. GDP.

Contributions to the public debt change (% of GDP)



	2013	2014	2015	2016	2017	2018	MMF 2020-2023					Average 2014-2018	Average 2019-2023
							2019	2020	2021	2022	2023		
NFPS Public Debt	19.2	19.9	23.3	23.9	24.9	25.8	26.9	27.4	26.8	26.1	25.3	23.6	26.5
Changes in public debt	-0.6	0.7	3.4	0.5	1.0	0.9	1.1	0.5	-0.6	-0.7	-0.8	1.3	-0.1
Contribuciones:													
Fiscal deficit	-0.9	0.3	2.0	2.5	3.1	2.3	2.2	2.0	1.0	1.0	1.0	2.0	1.4
Nominal GDP growth	-1.4	-0.9	-1.1	-1.7	-1.4	-1.4	-1.2	-1.6	-1.7	-1.8	-1.8	-1.3	-1.6
Sol depreciation	0.9	0.6	1.2	-0.2	-0.3	0.3	-0.1	0.1	0.1	0.0	0.0	0.3	0.0
Other	0.7	0.8	1.3	-0.1	-0.3	-0.4	0.3	0.1	0.0	0.0	0.0	0.3	0.1

Source: BCRP, MEF.

Considering that MMM's macro-fiscal assumptions are exposed to risks, it is estimated that the sensitivity of the public debt to 10% variation in the exchange rate, 1 p.p. of GDP and 100 bps in interest rates is 0.9 p.p., 0.27 p.p. and 0.26 p.p. of GDP, respectively. It should be noted that the changes related to the increase in the exchange rate correspond to scenarios that have already occurred in the past²³¹. On the other hand, the 1% increase in the interest rate represents a very unlikely situation, because currently more than 90% of the total public debt is denominated at a fixed rate. In terms of standard deviations, a reduction in GDP growth in a standard deviation, an increase in the exchange rate in a standard deviation and an increase in interest rates in a standard deviation lead to a public debt increase of 0.6 p.p., 0.5 p.p. and 0.1 p.p. of GDP, respectively.

Sensitivity of public debt (% of GDP)

	For each...	Debt variation (% of GDP)	For each...	Debt variation (% of GDP)
GDP growth	-1 percentage point	+ [0.25 – 0.30]	-1 standard deviation	+ 0.6
Exchange rate	+10% sol depreciation	+ [0.9 – 1.0]	+1 standard deviation	+ 0.5
Interest rate	+ 100 basic points	+ [0.25 – 0.27]	+1 standard deviation	+ 0.1

Source: MEF.

²³¹ Increases observed in the 1997-1999 period before the Russian crisis and in the 2013-2015 period due to the high financial volatility registered in emerging markets.

Medium-term deterministic and stochastic forecast of public debt

The MRFT establishes that the public debt of the NFPS should not be greater than 30% of GDP, except in cases of financial volatility in which it may be temporarily increased to no more than 34% of GDP. In that sense, a public debt sustainability analysis is carried out according to the deterministic and stochastic approaches considering the determinants of public debt dynamics, with the objective of identifying their vulnerabilities and the risks of exceeding the limits established in the MRTF. In this way, the deterministic analysis²³² makes it possible to obtain particular paths of the ratio of public debt to GDP to shocks in its macro-fiscal determinants. For its part, the stochastic analysis²³³ allows to build distributions and determine probabilities of exceeding established thresholds of that ratio.

The forecast horizon is the period 2019-2028. The baseline scenario for both approaches considers the macro-fiscal assumptions of this MMM for the period 2019-2023, while for the period 2024-2028 the following assumptions are used

- Annual real GDP growth of 3.8% (in line with the historical average 1951-2018)
- NFPS overall balance of -1% of GDP for each year, consistent with the MRTF
- The annual inflation rate is equivalent to 2%
- Interest rates on internal and external debt of 7% and 6%, respectively

The following shocks are presented for both analyzes:

- **Sol depreciation shock:** Average depreciation of 10% for the 2019-2021 period (similar to that observed in the 1997-1999 period in the face of the Russian crisis and that observed in the 2013-2015 period due to the high financial volatility recorded in the emerging markets).
- **Primary balance shock:** Lower primary balance in 0.5% of GDP for each year in the 2019-2021 period. This shock is equivalent to one of lower fiscal revenues in that magnitude.
- **GDP shock:** Lower GDP growth in 1 p.p. for each year included in the 2019-2021 period.
- **Combined shock:** It simultaneously adds the three previous shocks plus an increase in 100 bps in internal and external interest rates for the 2019-2021 period.

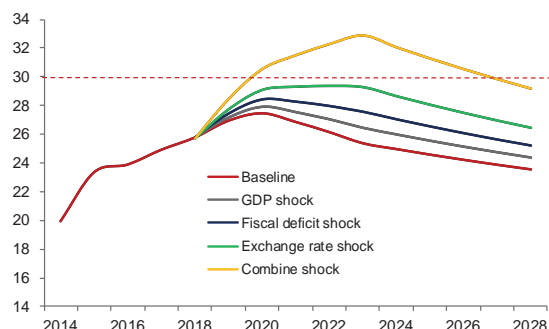
The deterministic analysis of the public debt shows that the shock with the greatest impact on the trajectory of the public debt ratio on the GDP is the exchange rate. This impact is due to the fact that there is still an important share of the public debt in foreign currency. Therefore, within the framework of the Egiap, this risk will continue to be mitigated through the solarization of public debt.

For its part, the stochastic analysis shows that under the baseline scenario the public debt stabilizes around 25% of GDP and, in addition, it obtains a 30% and 15% probability of being greater than 30% of GDP and 34% of GDP, respectively. However, given the occurrence of the severe exchange rate shock, those probabilities increase to 40% and 23%, respectively. Furthermore, given the joint occurrence of all shocks, these probabilities increase to 50% and 35%, respectively.

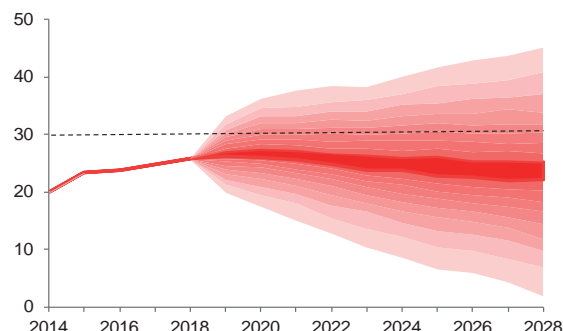
²³² For more detail, see Buiter (1985). *A guide to public sector debt and deficits*, Blanchard (1990) *Suggestions for a new set of fiscal indicators* y IMF (2013) *Staff guidance note for public debt sustainability analysis in market-access countries*.

²³³ For more detail, see Celasun, Debrun y Ostry (2007). *Primary surplus behavior and risks to fiscal sustainability in emerging market countries: A "Fan-Chart" approach*.

Deterministic forecast of public debt (% of GDP)



Stochastic forecast of public debt



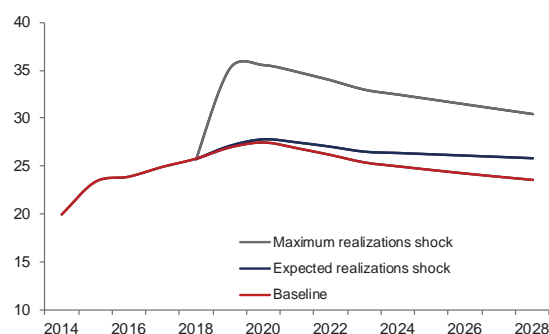
Source: BCRP, MEF.

Because the fiscal situation can also be affected by the realization of contingent liabilities, it is simulated under the deterministic and stochastic analysis of the expected realization and the maximum exposure of explicit contingent liabilities. Thus, the deterministic analysis shows that the expected activation of explicit contingent liabilities generates a slightly higher public debt path of 1.5 p.p. to that of the baseline scenario, while the materialization of the maximum exposure, a very low probability event, would lead to public debt up to 35.5% of GDP (lower than the median number of emerging countries: 56.7% of the GDP). In relation to the stochastic analysis, given the expected realization of the explicit contingent liabilities, a probability of 36% is obtained that the public debt is greater than 30% of the GDP, whereas, given the materialization of the maximum exposure of the contingent liabilities explicit, that probability amounts to 75%. It is worth mentioning that these estimates consider that only public debt finances payments for the realization of explicit contingencies, without affecting the NFPS financial assets.

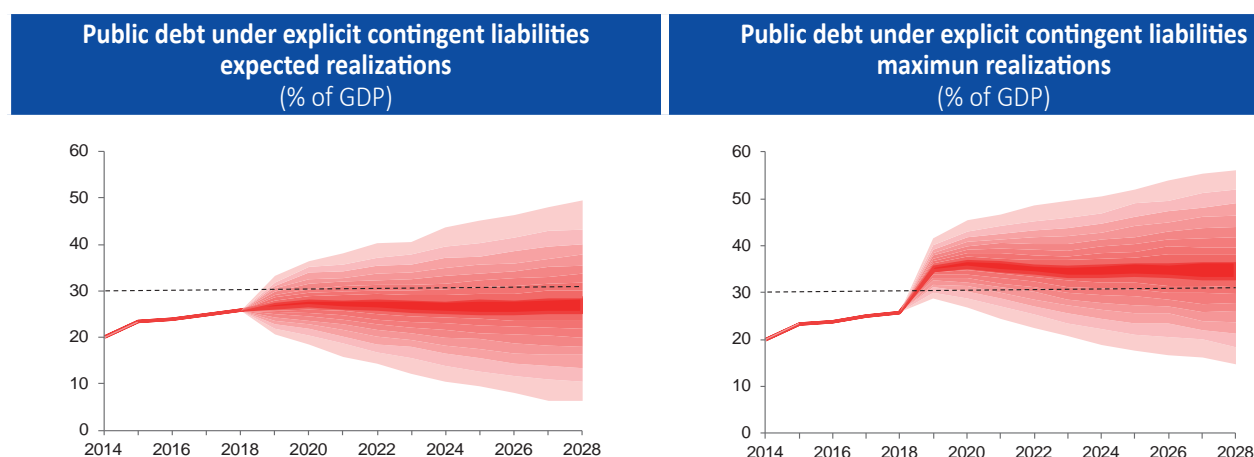
Summary of NFPS explicit contingencies (% of GDP)

Type of explicit fiscal contingencies	Maximum exposure	Expected contingency
	2018	2019
Total	10.22	0.68
1. Lawsuits and arbitrages	6.64	0.59
2. Disputes over international investments - ICSID	1.43	0.00
3. Explicit contingencies assumed in PPP contracts	2.15	0.09

Public debt under explicit contingent liabilities realizations (% of GDP)



Source: DGCP, Dgetp, Dgaicyp, Fonafe, PetroPerú, BCRP, MEF, MEF forecasts.



Source: BCRP, MEF.

It should be noted that the MRTF allows, in case of events that significantly affect the economy, to modify the fiscal rules exceptionally, provided that the gradual return to the set of established rules is explicitly determined. Thus, among these eventualities, it considers natural disasters or significant external shocks that affect fiscal revenues, or when economic activity due to exogenous factors requires modifying the economic result. It also establishes that, in cases of financial volatility, the public debt may be temporarily increased to no more than 34% of GDP.

To mitigate the impacts of macroeconomic risks and contingent liabilities on public finances, a strong fiscal position is required that allows timely response to these shocks, without significantly affecting fiscal sustainability. For this, it is essential to ensure the consolidation of the fiscal deficit and expand the tax base to obtain a greater fiscal space that allows timely response to these adverse events. It is also important to continue optimizing the public debt profile, in addition to recomposing and maintaining prudent levels of financial assets, and diversifying the portfolio of financial instruments to face these events (contingent loans, catastrophe insurance, among others).

8

FISCAL COUNCIL'S OPINION ON THE 2020-2023 MMM PROJECT





"Decenio de la Igualdad de Oportunidades para Mujeres y Hombres"
"Año de la Lucha Contra la Corrupción y la Impunidad"

Carta N° 09 – 2019 – CF

Lima, 15 de agosto de 2019

Señor
CARLOS AUGUSTO OLIVA NEYRA
Ministro de Economía y Finanzas
Presente.-



Asunto : Remisión de la opinión del Consejo Fiscal sobre el proyecto del Marco Macroeconómico Multianual 2020 - 2023 remitido por el Ministerio de Economía y Finanzas

Ref. : Oficio N° 3012-2019-EF/10.01 que remite el Proyecto del Marco Macroeconómico Multianual 2020 - 2023

Estimado señor Ministro,

Tengo el agrado de dirigirme a usted, con la finalidad de remitirle la opinión del Consejo Fiscal sobre el proyecto del Marco Macroeconómico Multianual 2020 – 2023; de acuerdo a lo establecido en el artículo 15.1. del Decreto Legislativo N° 1276, "Marco de la Responsabilidad y Transparencia Fiscal del Sector Público No Financiero".

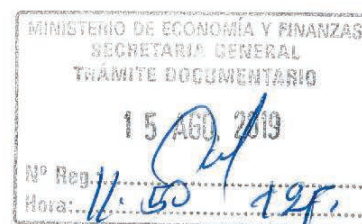
Es importante señalar que, de acuerdo a lo dispuesto en el Decreto Legislativo N° 1276, el Consejo Fiscal contribuye con el análisis técnico independiente de la política fiscal, mediante la emisión de opinión no vinculante sobre las proyecciones macroeconómicas contempladas en el Marco Macroeconómico Multianual; la modificación y cumplimiento de las reglas macrofiscales y de las reglas fiscales de los gobiernos regionales y locales; así como la evolución de las finanzas públicas de corto, mediano y largo plazo, entre otras materias.

En ese sentido, adjunto la opinión colegiada del Consejo Fiscal sobre el Proyecto del Marco Macroeconómico Multianual 2020 - 2023.

Aprovecho la oportunidad para expresarle a usted las muestras de mi especial consideración.

Atentamente,

WALDO MENDOZA BELLIDO
Presidente
Consejo Fiscal



Contralmirante Montero N° 411 - Oficina 1402 - Magdalena del Mar
Teléfonos: 6411020 - 6411021

9

STATISTICAL CHARTS



Table 1
MAIN MACROECONOMIC PROJECTIONS

	2018	2019	2020	2021	2022	2023	Avg. 2020 -2023
GROSS DOMESTIC PRODUCT OF TRADE PARTNERS							
World (% real annual change)	3,6	3,2	3,4	3,4	3,4	3,4	3,4
United States (% real annual change)	2,9	2,1	1,8	1,8	1,8	1,8	1,8
Euro Area (% real annual change)	1,9	1,1	1,4	1,4	1,4	1,4	1,4
China (% real annual change)	6,6	6,1	6,0	5,9	5,8	5,8	5,9
Trade partners (% real annual change)	3,7	3,1	3,2	3,2	3,2	3,2	3,2
COMMODITY PRICES							
Gold (US\$/oz.tr.)	1 269	1 345	1 370	1 370	1 370	1 370	1 370
Copper (¢US\$/lb.)	297	275	285	285	285	285	285
Lead (¢US\$/lb.)	102	90	90	90	90	90	90
Zinc (¢US\$/lb.)	133	122	115	115	115	115	115
Oil (US\$/bar.)	65	58	60	60	60	60	60
TERMS OF TRADE							
Terms of trade (% annual change)	-0,2	-2,0	-0,3	0,0	0,0	0,0	-0,1
Export price index (% annual change)	6,3	-3,4	1,5	0,0	0,0	0,0	0,4
Import price index (% annual change)	6,5	-1,4	1,8	0,0	0,0	0,0	0,5
GROSS DOMESTIC PRODUCT							
GDP (Billion Soles)	741	776	824	878	941	1 011	914
GDP (% real annual change)	4,0	3,0	4,0	4,2	4,5	5,0	4,4
Domestic demand (% real annual change)	4,3	3,4	4,3	4,2	4,6	4,6	4,4
Private consumption (% real annual change)	3,8	3,3	3,8	3,9	4,0	4,1	4,0
Public consumption (% real annual change)	2,0	2,6	3,8	3,4	3,7	3,7	3,7
Private investment (% real annual change)	4,4	4,0	4,8	5,0	5,4	5,5	5,2
Public investment (% real annual change)	6,8	2,5	9,0	3,6	7,0	6,7	6,6
Private investment (Percent of GDP)	17,6	17,9	18,1	18,2	18,4	18,5	18,3
Public investment (Percent of GDP)	4,8	4,8	5,1	5,1	5,2	5,3	5,1
EXTERNAL SECTOR							
Current account (Percent of GDP)	-1,6	-1,9	-1,7	-1,6	-1,6	-1,5	-1,6
Trade balance (Million US dollars)	7 197	5 643	6 525	7 073	7 456	8 299	7 338
Exports (Million US dollars)	49 066	47 769	51 400	54 501	58 131	62 865	56 724
Imports (Million US dollars)	-41 870	-42 126	-44 875	-47 428	-50 675	-54 566	-49 386
NON-FINANCIAL PUBLIC SECTOR							
General government revenues (Percent of GDP)	19,4	19,7	20,3	20,7	20,7	20,7	20,6
Interest Payments (Percent of GDP)	1,4	1,4	1,5	1,4	1,4	1,4	1,4
Primary balance (Percent of GDP)	-1,0	-0,8	-0,5	0,4	0,3	0,4	0,1
Overall balance (Percent of GDP)	-2,3	-2,2	-2,0	-1,0	-1,0	-1,0	-1,3
Estructural overall balance (Percent of GDP) ¹	-2,5	-2,4	-2,0	-1,0	-1,1	-1,0	-1,3
BALANCE OF PUBLIC DEBT							
External (Percent of GDP)	8,8	8,9	9,2	9,1	8,8	8,4	8,9
Domestic (Percent of GDP)	16,9	18,0	18,2	17,8	17,3	17,0	17,6
Total (Percent of GDP)	25,8	26,9	27,4	26,8	26,1	25,3	26,4
<i>Memo: forecasts from the Monthly Survey of Macroeconomic Expectations of the BCRP.</i>							
CPI (% annual change, end of period) ²	2,2	2,2	2,4	2,5	2,5	2,5	2,5
Average exchange rate (USD to PEN) ³	3,29	3,31	3,33	3,37	3,37	3,37	3,36

1/ Based on the methodology for calculating the structural accounts approved by Ministerial Resolution No. 024-2016-EF / 15.

2/ 2019-2021, data from the BCRP Monthly Survey of Macroeconomic Expectations of July 2019, published on August 8, 2019. The same value of 2021 is assumed for 2022 and 2023.

3/ 2019-2021, the projection is consistent with the end-of-period exchange rate of the BCRP Monthly Survey of Macroeconomic Expectations of July 2019, published on August 8, 2019. The same value of 2021 is assumed for 2022 and 2023.

Source: IMF, BCRP, MEF, MEF forecasts.

Table 2
GROSS DOMESTIC PRODUCT BY SECTORS
(% real annual change)

	Weights base year 2007	2018	2019	2020	2021	2022	2023	Avg. 2020 -2023
AGRICULTURE AND LIVESTOCK	6,0	7,8	3,8	4,0	4,0	4,0	4,0	4,0
Agriculture	3,8	9,4	3,3	4,0	4,0	4,0	4,0	4,0
Livestock	2,2	5,5	4,5	4,1	4,0	4,0	4,0	4,0
FISHING	0,7	39,7	-17,5	8,4	2,3	2,4	2,6	3,9
MINING AND FUEL	14,4	-1,3	0,9	2,7	3,4	3,4	7,5	4,3
Metals	12,1	-1,5	0,5	2,6	3,8	4,0	8,7	4,8
Fuel	2,2	0,0	3,1	3,6	1,7	0,0	0,0	1,3
MANUFACTURING	16,5	6,2	-0,9	3,4	3,7	4,0	4,2	3,8
Primary	4,1	13,2	-7,7	3,4	4,2	4,0	4,3	4,0
Non- primary	12,4	3,7	1,9	3,4	3,6	4,0	4,2	3,8
ELECTRICITY AND WATER	1,7	4,4	4,3	4,8	4,8	4,9	5,0	4,9
CONSTRUCTION	5,1	5,4	4,6	6,0	5,4	6,0	6,2	5,9
COMMERCE	10,2	2,6	2,8	3,6	3,7	3,9	4,0	3,8
SERVICES	37,1	4,5	4,4	4,8	4,9	5,1	5,2	5,0
GDP	100,0	4,0	3,0	4,0	4,2	4,5	5,0	4,4
PRIMARY GDP	25,2	3,3	0,1	3,3	3,7	3,6	6,1	4,1
NON- PRIMARY GDP¹	66,5	4,2	3,9	4,5	4,5	4,8	4,9	4,7

1/ It does not consider import duties and other taxes.

Source: BCRP, MEF Forecasts.

Table 3
GLOBAL DEMAND AND OUTPUT
(% real annual change)

	Estructure of GDP, 2018	2018	2019	2020	2021	2022	2023	Avg. 2020 -2023
I. DOMESTIC DEMAND¹	97,9	4,3	3,4	4,3	4,2	4,6	4,6	4,4
1. Private expenditure	82,6	4,0	3,5	4,0	4,2	4,4	4,5	4,3
a. Private consumption	65,0	3,8	3,3	3,8	3,9	4,0	4,1	4,0
b. Private investment	17,6	4,4	4,0	4,8	5,0	5,4	5,5	5,2
2. Public expenditure	16,4	3,4	2,6	5,3	3,5	4,7	4,6	4,5
a. Public consumption	11,5	2,0	2,6	3,8	3,4	3,7	3,7	3,7
b. Public investment	4,8	6,8	2,5	9,0	3,6	7,0	6,7	6,6
II. FOREIGN DEMAND								
1. Exports²	25,0	2,5	0,8	3,5	4,4	4,2	5,9	4,5
a. Traditional	15,8	-1,5	-1,6	2,3	3,5	3,2	5,9	3,8
b. No Traditional	5,9	11,0	6,5	6,4	6,3	6,3	6,3	6,4
2. Imports²	23,0	3,4	2,1	4,5	4,4	4,7	4,8	4,6
III. GDP	100,0	4,0	3,0	4,0	4,2	4,5	5,0	4,4

1/ Include inventories.

2/ Non-financial goods and services.

Source: BCRP, MEF forecasts.

Table 4
GLOBAL DEMAND AND OUTPUT
(% of GDP)

	2018	2019	2020	2021	2022	2023	Avg. 2020 -2023
I. Domestic demand ¹	97,9	98,7	99,1	99,2	99,3	99,1	99,1
1. Private expenditure	82,6	83,4	83,5	83,6	83,5	83,2	83,5
a. Private consumption	65,0	65,5	65,5	65,4	65,1	64,7	65,2
b. Private investment	17,6	17,9	18,1	18,2	18,4	18,5	18,3
2. Public expenditure	16,4	16,4	16,6	16,5	16,5	16,5	16,5
a. Public consumption	11,5	11,5	11,5	11,4	11,4	11,2	11,4
b. Public investment	4,8	4,8	5,1	5,1	5,2	5,3	5,1
II. Foreign demand							
1. Exports ²	25,0	23,6	23,5	23,4	23,0	22,7	23,1
2. Imports ²	23,0	22,4	22,6	22,6	22,2	21,8	22,3
III. GDP	100,0	100,0	100,0	100,0	100,0	100,0	100,0

1/ Include inventories.

2/ Non-financial goods and services

Source: BCRP, MEF forecasts.

Table 5
BALANCE OF PAYMENTS
(Millions of US dollars)

	2018	2019	2020	2021	2022	2023	Avg. 2020 -2023
I. CURRENT ACCOUNT BALANCE	-3 594	-4 338	-4 103	-4 159	-4 385	-4 331	-4 245
1. Trade balance	7 197	5 643	6 525	7 073	7 456	8 299	7 338
a. Exports	49 066	47 769	51 400	54 501	58 131	62 865	56 724
b. Imports	-41 870	-42 126	-44 875	-47 428	-50 675	-54 566	-49 386
2. Services	-2 532	-2 497	-2 756	-2 991	-3 088	-3 374	-3 052
a. Exports	7 365	7 812	8 505	9 308	9 836	10 571	9 555
b. Imports	-9 897	-10 309	-11 260	-12 299	-12 924	-13 945	-12 607
3. Investment income	-11 814	-11 129	-11 737	-12 365	-13 125	-13 978	-12 801
4. Current transfers	3 556	3 645	3 864	4 124	4 372	4 722	4 271
II. FINANCIAL ACCOUNT	-36	8 333	8 252	8 491	9 247	9 946	8 984
1. Private sector	917	3 000	5 950	8 050	8 525	8 830	7 839
2. Public sector ¹	2 122	6 533	3 102	1 041	1 022	1 016	1 545
3. Short term capital ²	-3 075	-1 200	-800	-600	-300	100	-400
III. TOTAL (I+II) ³	-3 629	3 996	4 149	4 332	4 862	5 615	4 740

1/ Include exceptional financing.

2/ Include net errors and omissions.

3/ Change in Central Bank reserves and valuation effect and gold monetization.

Source: BCRP, MEF Forecasts.

Table 6
BALANCE OF PAYMENTS
(% of GDP)

	2018	2019	2020	2021	2022	2023	Avg. 2020 -2023
CURRENT ACCOUNT BALANCE	-1,6	-1,9	-1,7	-1,6	-1,6	-1,5	-1,6
1. Trade balance	3,2	2,4	2,6	2,7	2,7	2,8	2,7
a. Exports	21,8	20,4	20,7	20,9	21,0	21,1	21,0
b. Imports	-18,6	-18,0	-18,1	-18,2	-18,3	-18,4	-18,2
2. Services	-1,1	-1,1	-1,1	-1,1	-1,1	-1,1	-1,1
a. Exports	3,3	3,3	3,4	3,6	3,6	3,6	3,5
b. Imports	-4,4	-4,4	-4,5	-4,7	-4,7	-4,7	-4,7
3. Investment income	-5,2	-4,7	-4,7	-4,7	-4,7	-4,7	-4,7
4. Current transfers	1,6	1,6	1,6	1,6	1,6	1,6	1,6
II. FINANCIAL ACCOUNT	0,0	3,6	3,3	3,3	3,3	3,3	3,3
1. Private sector	0,4	1,3	2,4	3,1	3,1	3,0	2,9
2. Public sector ¹	0,9	2,8	1,3	0,4	0,4	0,3	0,6
3. Short term capital ²	-1,4	-0,5	-0,3	-0,2	-0,1	0,0	-0,2
III. TOTAL (I+II)³	-1,6	1,7	1,7	1,7	1,8	1,9	1,7
<i>Note:</i>							
<i>Long-term external financing⁴</i>	2,2	2,9	3,2	3,3	3,4	3,4	3,2

1/ Include exceptional financing. 2/ Include net errors and omissions. 3/ Change in Central Bank reserves and valuation effect and gold monetization.

4/ Foreign direct investment (FDI) plus long-term loans.

Source: BCRP, MEF Forecasts.

Table 7
SUMMARY OF FISCAL ACCOUNTS - NON FINANCIAL PUBLIC SECTOR
(Millions of S/ and % of GDP)

	2018	2019	2020	2021	2022	2023	Avg. 2020 -2023
I. GENERAL GOVERNMENT REVENUES	143 785	153 244	167 128	182 167	195 140	209 726	188 540
% of GDP	19,4	19,7	20,3	20,7	20,7	20,7	20,6
GENERAL GOVERNMENT STRUCTURAL REVENUES^{1,2}	141 978	151 676	166 991	182 251	194 325	209 726	188 324
% of potential GDP	19,2	19,4	20,2	20,7	20,7	20,7	20,6
II. GENERAL GOVERNMENT NON-FINANCIAL EXPENDITURE	149 364	157 345	168 673	179 094	192 902	207 596	187 066
% of GDP	20,2	20,3	20,5	20,4	20,5	20,5	20,5
2.1. CURRENT EXPENDITURE	113 145	120 681	127 846	134 995	143 436	152 353	139 657
% of GDP	15,3	15,5	15,5	15,4	15,2	15,1	15,3
2.2. CAPITAL EXPENDITURE	36 219	36 664	40 827	44 099	49 467	55 243	47 409
% of GDP	4,9	4,7	5,0	5,0	5,3	5,5	5,2
III. NON-FINANCIAL PUBLIC ENTERPRISES PRIMARY BALANCE	-1 463	-2 050	-2 728	291	1 035	1 418	4
% of GDP	-0,2	-0,3	-0,3	0,0	0,1	0,1	0,0
IV. PRIMARY BALANCE (I-II+III)	-7 042	-6 152	-4 273	3 364	3 273	3 548	1 478
% of GDP	-1,0	-0,8	-0,5	0,4	0,3	0,4	0,1
V. INTEREST PAYMENTS	10 013	10 733	11 976	12 580	13 145	13 666	12 842
% of GDP	1,4	1,4	1,5	1,4	1,4	1,4	1,4
VI. OVERALL BALANCE (IV-V)	-17 055	-16 885	-16 249	-9 217	-9 873	-10 118	-11 364
% of GDP	-2,3	-2,2	-2,0	-1,0	-1,0	-1,0	-1,3
VII. STRUCTURAL OVERALL BALANCE	-18 862	-18 452	-16 386	-9 132	-10 687	-10 118	-11 581
% of potential GDP ^{1,2}	-2,5	-2,4	-2,0	-1,0	-1,1	-1,0	-1,3
VII. PUBLIC DEBT STOCK	190 741	208 979	226 108	235 717	245 776	256 230	240 958
% of GDP	25,8	26,9	27,4	26,8	26,1	25,3	26,4

1/ The estimation was based on the methodology approved in Ministerial Resolution N° 024-2016-EF/15.

2/ Percentage of potential GDP.

Source: BCRP, SUNAT, MEF forecasts.

Table 8
GENERAL GOVERNMENT CURRENT REVENUES
(Millions of S/)

	2018	2019	2020	2021	2022	2023	Avg. 2020 -2023
I. GENERAL GOVERNMENT TAX REVENUES	107 431	113 541	126 218	139 158	149 112	160 342	143 708
1. Income tax	41 598	43 322	47 556	52 045	56 153	60 403	54 039
a. Advanced payments	35 230	37 437	41 249	45 594	47 327	53 024	46 799
- Personal income tax	12 474	13 652	14 132	15 139	16 216	17 425	15 728
- Corporate income tax	22 756	23 784	27 118	30 455	31 111	35 599	31 071
b. Clearing	6 368	5 885	6 306	6 451	8 826	7 379	7 241
2. Import tax	1 455	1 492	1 584	1 717	1 785	1 924	1 753
3. Value-added tax	60 666	63 795	69 330	74 825	80 690	86 858	77 926
a. Domestic	35 125	37 475	40 644	43 771	47 076	50 601	45 523
b. Imports	25 541	26 320	28 686	31 053	33 613	36 257	32 402
4. Excise tax	6 860	8 460	9 832	10 681	11 429	12 269	11 052
a. Fuels	2 543	2 911	3 310	3 720	3 990	4 284	3 826
b. Others	4 317	5 549	6 521	6 961	7 439	7 985	7 227
5. Other tax revenues ¹	13 435	14 208	15 310	16 991	17 366	18 511	17 044
6. Tax refunds	-16 583	-17 736	-17 393	-17 102	-18 310	-19 622	-18 107
II. GENERAL GOVERNMENT NON-TAX REVENUES	35 196	38 415	39 758	41 905	44 924	48 281	43 717
III. TOTAL (I + II)	142 627	151 957	165 977	181 063	194 037	208 623	187 425

1/ Considers tax revenues of local governments.
Source: BCRP, SUNAT, PERUPETRO, MEF forecasts.

Table 9
GENERAL GOVERNMENT CURRENT REVENUES
(% of GDP)

	2018	2019	2020	2021	2022	2023	Avg. 2020 -2023
I. GENERAL GOVERNMENT TAX REVENUES	14,5	14,6	15,3	15,8	15,9	15,9	15,7
1. Income tax	5,6	5,6	5,8	5,9	6,0	6,0	5,9
a. Advanced payments	4,8	4,8	5,0	5,2	5,0	5,2	5,1
- Personal income tax	1,7	1,8	1,7	1,7	1,7	1,7	1,7
- Corporate income tax	3,1	3,1	3,3	3,5	3,3	3,5	3,4
b. Clearing	0,9	0,8	0,8	0,7	0,9	0,7	0,8
2. Import tax	0,2	0,2	0,2	0,2	0,2	0,2	0,2
3. Value-added tax	8,2	8,2	8,4	8,5	8,6	8,6	8,5
a. Domestic	4,7	4,8	4,9	5,0	5,0	5,0	5,0
b. Imports	3,4	3,4	3,5	3,5	3,6	3,6	3,5
4. Excise tax	0,9	1,1	1,2	1,2	1,2	1,2	1,2
a. Fuels	0,3	0,4	0,4	0,4	0,4	0,4	0,4
b. Others	0,6	0,7	0,8	0,8	0,8	0,8	0,8
5. Other tax revenues ¹	1,8	1,8	1,9	1,9	1,8	1,8	1,9
6. Tax refunds	-2,2	-2,3	-2,1	-1,9	-1,9	-1,9	-2,0
II. GENERAL GOVERNMENT NON-TAX REVENUES	4,8	4,9	4,8	4,8	4,8	4,8	4,8
III. TOTAL (I + II)	19,3	19,6	20,1	20,6	20,6	20,6	20,5

1/ Considers tax revenues of local governments.

Table 10
GENERAL GOVERNMENT CONVENTIONAL AND STRUCTURAL REVENUES ¹
(Millions of S/)

	2018	2019	2020	2021	2022	Avg. 2020 -2022
General government structural revenues (A+Bi+C)	141 978	151 676	166 991	182 251	194 325	181 189
A. Adjustment of revenues related to natural resources by export prices (a + b)	-102	540	397	449	463	436
a. Adjustment of mining sector (i) - (ii)	-132	75	44	68	64	59
(i) Structural	6 625	4 762	4 885	5 762	6 084	5 577
(ii) Conventional	6 756	4 687	4 841	5 694	6 020	5 518
<i>Remaining of mining profits</i>	42	20	0	0	0	0
b. Adjustment of hidrocarbons sector (i) - (ii)	30	465	352	381	399	283
(i) Structural	4 781	4 652	4 852	5 118	5 333	5 101
(ii) Conventional	4 751	4 188	4 500	4 737	4 934	4 723
B. Adjustment of current total revenues by GDP cycle (i) - (ii)	-1 705	-2 107	-533	-364	-1 278	-725
(i) Structural	140 921	149 850	165 443	180 699	192 759	179 634
(ii) Conventional	142 627	151 957	165 977	181 063	194 037	180 359
<i>Extraordinary revenues²</i>	<i>1 541</i>	<i>3 100</i>	<i>1 204</i>	<i>664</i>	<i>664</i>	<i>844</i>
C. Capital revenues	1 158	1 287	1 151	1 104	1 104	1 119

1/ The estimation was based on the methodology approved in Ministerial Resolution N° 024-2016-EF/15. Tax refunds higher than 1.9% of GDP and extraordinary revenues 2016-2018 from capital repatriation and sales of non-domiciled assets are excluded.

Source: BCRP, SUNAT, MEF forecasts.

Table 11
GENERAL GOVERNMENT CONVENTIONAL AND STRUCTURAL REVENUES ¹
(% of potential GDP)

	2018	2019	2020	2021	2022	Avg. 2020 -2022
General government structural revenues (A+Bi+C)	19,2	19,4	20,2	20,7	20,7	20,5
A. Adjustment of revenues related to natural resources by export prices (a + b)	0,0	0,1	0,0	0,1	0,0	0,0
a. Adjustment of mining sector (i) - (ii)	0,0	0,0	0,0	0,0	0,0	0,0
(i) Structural	0,9	0,6	0,6	0,7	0,6	0,6
(ii) Conventional	0,9	0,6	0,6	0,6	0,6	0,6
<i>Remaining of mining profits</i>	0,0	0,0	0,0	0,0	0,0	0,0
b. Adjustment of hidrocarbons sector (i) - (ii)	0,0	0,1	0,0	0,0	0,0	0,0
(i) Structural	0,6	0,6	0,6	0,6	0,6	0,6
(ii) Conventional	0,6	0,5	0,5	0,5	0,5	0,5
B. Adjustment of current total revenues by GDP cycle (i) - (ii)	-0,2	-0,3	-0,1	0,0	-0,1	-0,1
(i) Structural	19,0	19,2	20,0	20,5	20,5	20,4
(ii) Conventional	19,3	19,5	20,1	20,6	20,7	20,4
<i>Extraordinary revenues²</i>	<i>0,2</i>	<i>0,4</i>	<i>0,1</i>	<i>0,1</i>	<i>0,1</i>	<i>0,1</i>
C. Capital revenues	0,2	0,2	0,1	0,1	0,1	0,1

1/ The estimation was based on the methodology approved in Ministerial Resolution N° 024-2016-EF/15. Tax refunds higher than 1.9% of GDP and extraordinary revenues 2016-2018 from capital repatriation and sales of non-domiciled assets are excluded.

Source: BCRP, SUNAT, MEF forecasts.

Table 12
GENERAL GOVERNMENT NON-FINANCIAL EXPENDITURE
(Millions of S/)

	2018	2019	2020	2021	2022	2023	Avg. 2020 -2023
NON-FINANCIAL EXPENDITURES	149 364	157 345	168 673	179 094	192 902	207 596	187 066
I. CURRENT EXPENDITURES	113 145	120 681	127 846	134 995	143 436	152 353	139 657
1. Wages and salaries	46 186	50 571	54 067	57 170	60 170	63 170	58 644
2. Goods and services	42 297	44 293	47 526	51 109	55 620	60 494	53 687
3. Transfers	24 662	25 818	26 252	26 715	27 645	28 689	27 325
II. CAPITAL EXPENDITURES	36 219	36 664	40 827	44 099	49 467	55 243	47 409
1. Gross capital formation	31 916	33 236	36 800	40 720	45 671	50 032	43 306
2. Others	4 303	3 428	4 028	3 379	3 795	5 211	4 103

Source: BCRP, MEF, MEF forecasts.

Table 13
GENERAL GOVERNMENT NON-FINANCIAL EXPENDITURE
(% of GDP)

	2018	2019	2020	2021	2022	2023	Avg. 2020 -2023
NON-FINANCIAL EXPENDITURES	20,2	20,3	20,5	20,4	20,5	20,5	20,5
I. CURRENT EXPENDITURES	15,3	15,5	15,5	15,4	15,2	15,1	15,3
1. Wages and salaries	6,2	6,5	6,6	6,5	6,4	6,2	6,4
2. Goods and services	5,7	5,7	5,8	5,8	5,9	6,0	5,9
3. Transfers	3,3	3,3	3,2	3,0	2,9	2,8	3,0
II. CAPITAL EXPENDITURES	4,9	4,7	5,0	5,0	5,3	5,5	5,2
1. Gross capital formation	4,3	4,3	4,5	4,6	4,9	4,9	4,7
2. Others	0,6	0,4	0,5	0,4	0,4	0,5	0,4

Source: BCRP, MEF, MEF forecasts.

Table 14
GENERAL GOVERNMENT OPERATIONS
(Millions of S/)

	2018	2019	2020	2021	2022	2023	Avg. 2020 -2023
I. CURRENT REVENUES	142 627	151 957	165 977	181 063	194 037	208 623	187 425
a. Tax revenues	107 431	113 541	126 218	139 158	149 112	160 342	143 708
b. Contributions and others ¹	35 196	38 415	39 758	41 905	44 924	48 281	43 717
II. NON-FINANCIAL EXPENDITURES	149 364	157 345	168 673	179 094	192 902	207 596	187 066
a. Current expenditure	113 145	120 681	127 846	134 995	143 436	152 353	139 657
b. Capital expenditure	36 219	36 664	40 827	44 099	49 467	55 243	47 409
III. CAPITAL REVENUES	1 158	1 287	1 151	1 104	1 104	1 104	1 115
IV. PRIMARY BALANCE (I-II+III)	-5 579	-4 102	-1 545	3 073	2 238	2 131	1 474
V. INTEREST PAYMENTS	9 243	10 065	11 604	12 245	12 705	13 127	12 420
VI. OVERALL BALANCE (IV-V)	-14 822	-14 167	-13 149	-9 172	-10 467	-10 997	-10 946
VII. NET FINANCING	14 822	14 167	13 149	9 172	10 467	10 997	10 946
a. External	-2 578	8 004	5 189	4 428	4 915	4 723	4 814
b. Domestic ²	17 401	6 162	7 960	4 744	5 551	6 274	6 132

1/ Includes non-tax revenues of general government.

2/ Includes savings and dissavings of Public Treasury Accounts.

Source: BCRP, MEF, MEF forecasts.

Table 15
GENERAL GOVERNMENT OPERATIONS
(% of GDP)

	2018	2019	2020	2021	2022	2023	Avg. 2020 -2023
I. CURRENT REVENUES	19,3	19,6	20,1	20,6	20,6	20,6	20,5
a. Tax revenues	14,5	14,6	15,3	15,8	15,9	15,9	15,7
b. Contributions and others ¹	4,8	4,9	4,8	4,8	4,8	4,8	4,8
II. NON-FINANCIAL EXPENDITURES	20,2	20,3	20,5	20,4	20,5	20,5	20,5
a. Current expenditure	15,3	15,5	15,5	15,4	15,2	15,1	15,3
b. Capital expenditure	4,9	4,7	5,0	5,0	5,3	5,5	5,2
III. CAPITAL REVENUES	0,2	0,2	0,1	0,1	0,1	0,1	0,1
IV. PRIMARY BALANCE (I-II+III)	-0,8	-0,5	-0,2	0,3	0,2	0,2	0,2
V. INTEREST PAYMENTS	1,2	1,3	1,4	1,4	1,4	1,3	1,4
VI. OVERALL BALANCE (IV-V)	-2,0	-1,8	-1,6	-1,0	-1,1	-1,1	-1,2
VII. NET FINANCING	2,0	1,8	1,6	1,0	1,1	1,1	1,2
a. External	-0,3	1,0	0,6	0,5	0,5	0,5	0,5
b. Domestic ²	2,3	0,8	1,0	0,5	0,6	0,6	0,7

1/ Includes non-tax revenues of general government.

2/ Includes savings and dissavings of Public Treasury Accounts.

Source: BCRP, MEF, MEF forecasts.

Table 16
NPFS FINANCING NEEDS
(Millions of US dollars)

	2018	2019	2020	2021	2022	2023	Avg. 2020 -2023
I. USES	8 669	9 067	5 777	3 630	4 058	5 842	4 827
1. Amortisation	3 482	3 969	892	897	1 155	2 866	1 452
2. Fiscal Deficit	5 187	5 098	4 885	2 733	2 904	2 976	3 374
II. SOURCES	8 669	9 067	5 777	3 630	4 058	5 842	4 827
1. External	1 735	2 513	2 244	1 469	1 599	1 474	1 697
2. Domestic ¹	6 933	6 554	3 533	2 160	2 459	4 367	3 130

1/ Includes, among others, saving or dissavings of Treasury.
Source: BCRP, MEF, MEF forecasts.

Table 17
NPFS FINANCING NEEDS
(% of GDP)

	2018	2019	2020	2021	2022	2023	Avg. 2020 -2023
I. USES	3,8	3,9	2,3	1,4	1,5	2,0	1,8
1. Amortisation	1,5	1,7	0,4	0,3	0,4	1,0	0,5
2. Fiscal Deficit	2,3	2,2	2,0	1,0	1,0	1,0	1,3
II. SOURCES	3,8	3,9	2,3	1,4	1,5	2,0	1,8
1. External	0,8	1,1	0,9	0,6	0,6	0,5	0,6
2. Domestic ¹	3,1	2,8	1,4	0,8	0,9	1,5	1,2

1/ Includes, among others, saving or dissavings of Treasury.
Source: BCRP, MEF, MEF forecasts.

Table 18
NPFS PUBLIC DEBT
(Millions of S/)

	2018	2019	2020	2021	2022	2023	Avg. 2020 -2023
TOTAL PUBLIC DEBT	190 741	208 979	226 108	235 717	245 776	256 230	240 958
I. EXTERNAL PUBLIC DEBT	65 505	69 275	76 162	79 759	82 693	84 603	80 804
CREDITS	19 260	23 099	27 608	30 838	33 573	35 483	31 875
1. Multilateral Organizations	11 525	15 057	18 904	21 858	24 839	27 359	23 240
2. Paris Club	3 550	3 910	4 545	5 208	5 367	5 178	5 074
3. Commercial Banks	4 168	4 127	4 160	3 772	3 367	2 947	3 561
4. Others	16	5	0	0	0	0	0
BONDS	46 246	46 176	48 554	48 921	49 120	49 120	48 929
II. DOMESTIC PUBLIC DEBT	125 236	139 704	149 946	155 958	163 083	171 627	160 154
1. Long-term	112 209	125 883	136 133	143 072	149 943	157 887	146 759
CREDITS	3 902	2 069	1 845	1 525	1 128	1 076	1 394
BONDS	108 307	123 814	134 289	141 547	148 815	156 811	145 365
1. Treasury Bonds	102 009	118 720	129 621	137 278	145 033	153 510	141 360
2. Others	6 298	5 094	4 668	4 269	3 782	3 301	4 005
2. Short-term	13 027	13 821	13 813	12 886	13 140	13 740	13 395

Source: BCRP, MEF, MEF forecasts.

Table 19
NPFS PUBLIC DEBT
(% of GDP)

	2018	2019	2020	2021	2022	2023	Avg. 2020 -2023
TOTAL PUBLIC DEBT	25,8	26,9	27,4	26,8	26,1	25,3	26,4
I. EXTERNAL PUBLIC DEBT	8,8	8,9	9,2	9,1	8,8	8,4	8,9
CREDITS	2,6	3,0	3,3	3,5	3,6	3,5	3,5
1. Multilateral Organizations	1,6	1,9	2,3	2,5	2,6	2,7	2,5
2. Paris Club	0,5	0,5	0,6	0,6	0,6	0,5	0,6
3. Commercial Banks	0,6	0,5	0,5	0,4	0,4	0,3	0,4
4. Others	0,0	0,0	0,0	0,0	0,0	0,0	0,0
BONDS	6,2	5,9	5,9	5,6	5,2	4,9	5,4
II. DOMESTIC PUBLIC DEBT	16,9	18,0	18,2	17,8	17,3	17,0	17,6
1. Long-term	15,2	16,2	16,5	16,3	15,9	15,6	16,1
CREDITS	0,5	0,3	0,2	0,2	0,1	0,1	0,2
BONDS	14,6	16,0	16,3	16,1	15,8	15,5	15,9
1. Treasury Bonds	13,8	15,3	15,7	15,6	15,4	15,2	15,5
2. Others	0,9	0,7	0,6	0,5	0,4	0,3	0,4
2. Short-term	1,8	1,8	1,7	1,5	1,4	1,4	1,5

Source: BCRP, MEF, MEF forecasts.

Table 20
PUBLIC DEBT-SERVICE PAYMENTS FORECASTS
(Millions of US dollars and % of GDP)

	Debt-service payments (Millions of US dollars)		Debt-service payments (% of GDP)	
	Amortisation	Interests	Amortisation	Interests
2017	5 534	2 555	2,6	1,2
2018	3 482	3 045	1,5	1,4
2019	3 969	3 241	1,7	1,4
2020	892	3 600	0,4	1,5
2021	897	3 730	0,3	1,4
2022	1 155	3 866	0,4	1,4
2023	2 866	4 019	1,0	1,4
2024	5 021	3 949	1,5	1,2
2025	3 196	3 709	0,9	1,1
2026	7 038	3 544	1,9	1,0
2027	3 077	3 099	0,8	0,8

Source: BCRP, MEF, MEF forecasts.

Table 21a
COMMITMENTS AND OBLIGATIONS OF STATE PAYMENT BY PARTICIPATION IN
PUBLIC-PRIVATE PARTNERSHIP CONTRACTS^{1, 2, 3}
(Millions of US dollars, included VAT)

	2020	2021	2022	2023	Avg. 2020-2023
1 TABOADA WWTP	39.1	39.0	38.9	39.9	39.2
2 WATER SUPPLY FOR LIMA: HUASCACocha - RIMAC ⁴	13.6	13.4	13.7	13.7	13.6
3 WWTP AND MARINE OUTFALL OF LA CHIRA	11.8	11.8	11.7	12.0	11.8
4 CHILLON RIVER WATER	16.1	16.1	16.0	16.0	16.0
5 PROVISUR SEAWATER DESALINATION	17.2	17.0	16.9	16.9	17.0
6 TITICACA WWTP ⁵	0.4	0.2	0.2	32.7	8.4
7 OLMOS IRRIGATION	42.0	42.4	43.1	43.7	42.8
8 NORTHERN IIRSA ROAD	87.1	74.1	69.0	51.3	70.4
9 SOUTHERN IIRSA ROAD SECTION 1	37.2	32.3	31.3	31.5	33.1
10 SOUTHERN IIRSA ROAD SECTION 2	72.1	76.2	64.2	42.6	63.8
11 SOUTHERN IIRSA ROAD SECTION 3	84.3	80.5	81.9	59.7	76.6
12 SOUTHERN PANAMERICAN ROAD: SECTION QUILCA-LA CONCORDIA	109.1	83.2	72.7	50.6	78.9
13 SOUTHERN IIRSA ROAD SECTION 5	107.5	55.0	29.9	30.4	55.7
14 COAST - HIGHLANDS (Buenos Aires-Canchaque)	13.8	11.3	10.1	10.2	11.3
15 COAST - HIGHLANDS (Huaral-Acos)	6.8	5.3	5.3	4.7	5.5
16 COAST - HIGHLANDS (Mocupe-Cayalti)	9.3	3.1	2.1	2.2	4.2
17 HIGHWAY SECTION: TRUJILLO - SULLANA	253.5	205.2	46.0	46.7	137.8
18 IIRSA CENTER SECTION 2	35.1	25.3	24.1	24.6	27.3
19 ROAD NETWORK N° 4	82.5	156.5	160.6	110.4	127.5
20 ROAD NETWORK N° 5	61.3	43.0	0.9	0.0	26.3
21 ROAD NETWORK N° 6	121.1	99.9	21.2	21.2	65.9
22 SOUTHERN PANAMERICAN ROAD: SECTION QUILCA-LA CONCORDIA	24.6	31.5	46.6	37.7	35.1
23 LONGITUDINAL ROAD OF THE HIGHLANDS SECTION 2	103.5	72.3	67.2	64.6	76.9
24 SOUTHERN HIGHWAY	21.2	23.2	23.2	23.2	22.7
25 NATIONAL OPTICAL FIBER BACKBONE NETWORK	57.4	57.8	58.2	58.7	58.0
26 JORGE CHAVEZ INTERNATIONAL AIRPORT	5.5	5.6	5.7	5.9	5.7
27 FIRST GROUP OF REGIONAL AIRPORTS	74.0	59.5	71.1	93.3	74.5
28 SECOND GROUP OF REGIONAL AIRPORTS	44.3	24.7	17.5	29.5	29.0
29 SOUTHERN DOCK	40.4	0.0	0.0	0.0	10.1
30 PAITA PORT TERMINAL	23.3	24.5	25.4	26.3	24.9

Table 21b
COMMITMENTS AND OBLIGATIONS OF STATE PAYMENT BY PARTICIPATION IN
PUBLIC-PRIVATE PARTNERSHIP CONTRACTS^{1, 2, 3}
(Millions of US dollars, included VAT)

	2020	2021	2022	2023	Avg. 2020-2023
31 YURIMAGUAS PORT TERMINAL	13.4	13.4	3.0	3.0	8.2
32 NORTHERN DOCK	0.5	5.4	0.0	0.0	1.5
33 GENERAL SAN MARTIN PORT TERMINAL	1.6	0.9	0.0	0.0	0.6
34 AMAZON WATERWAY	0.0	7.8	32.4	46.9	21.8
35 SALAVERRY PORT TERMINAL	2.1	2.4	1.4	1.4	1.8
36 KUELAP URBAN GONDOLA SYSTEM	1.1	1.1	1.2	1.2	1.2
37 VILLA MARIA DEL TRIUNFO HOSPITAL III	107.4	106.8	108.3	110.7	108.3
38 CALLAO HOSPITAL III	106.8	106.3	107.8	110.2	107.8
39 TOWER TRECCA MEDICAL CENTER	0.0	87.1	105.9	108.2	75.3
40 LOGISTICS MANAGEMENT OF WAREHOUSES AND PHARMACIES	2.4	0.0	0.0	0.0	0.6
41 MANAGEMENT OF THE NATIONAL INSTITUTE OF CHILD HEALTH	14.4	14.6	14.7	15.1	14.7
42 LIMA METRO LINE ONE	165.7	165.8	166.8	169.2	166.9
43 LIMA METRO LINE TWO ⁶	731.5	455.8	758.3	744.7	672.6

1/ The projections of the commitments (firm and contingent) and payment obligations associated with each project correspond to estimates proposed by the entities and enterprises of the SPNF, which will be subject to the evaluation of their corresponding budgetary capacity.

2/ The projections of the contingent commitments derived from the PPP processes represent the maximum exposure that the State could pay, which are materialized if the income or demand does not exceed the guaranteed minimum, emergency maintenance is required for specific events or arise geological events.

3/ The projections do not include the following projects: i) New Chinchero International Airport, because of the expiration date was declared and is currently being carried out under the Public Works modality; ii) Emfapatumbe, because the MVCS declared the expiration of the Concession Contract in November 2018; iii) Majes-Siguas II, which is suspended, also has an investment amount of US \$ 550 million and a physical advance of 19% in 1Q2019; and iv) Chavimochic III, which is paralyzed, also has an investment amount of US \$ 684 million and a physical advance of 37% in 1Q2019.

4/ The MVCS declared the expiration of the Concession Contract in June 2019, so that only the payment of the Retribution for Investments (RFI) is considered an obligation.

5/ Project awarded and pending contract subscription.

6/ The projections include the modifications made in Addendum N° 2 signed in December 2018.

Source: PROINVERSION, MTC, MVCS, MINCETUR, MINSA, ESSALUD, MML, PROTRANSPORTE, Regional Government of Arequipa and Regional Government of Lambayeque.

10

ATTACHMENTS



10.1. PORTFOLIO OF PUBLIC INVESTMENT PROJECTS WITH EXTERNAL FINANCING - JUNE 2019

Public Entities	Funding Source	Loan Amount (Equivalent in thousand of USD)
MINISTRY OF AGRICULTURE	IBRD, IADB, IFAD, CAF, JICA	384,494
MINISTRY OF ENVIRONMENT	IBRD, IADB, JICA	115,338
MINISTRY OF ECONOMY AND FINANCE	IADB	130,000
MINISTRY OF EDUCATION	IADB	75,000
MINISTRY OF FOREIGN TRADE AND TOURISM	IADB	20,000
MINISTRY OF LABOUR AND EMPLOYMENT PROMOTION	IADB	30,000
MINISTRY OF HEALTH	IBRD, IADB	250,000
MINISTRY OF TRANSPORT AND COMMUNICATIONS	IBRD, IADB, KFW, AFD	1,200,000
MINISTRY OF HOUSING, CONSTRUCTION AND SANITATION	IBRD, IADB, KFW	244,670
MINISTRY OF PRODUCTION	IBRD, IADB	115,000
OFFICE OF THE PRESIDENT OF THE COUNCIL OF MINISTERS	IBRD, IADB	145,000
OFFICE OF THE COMPTROLLER GENERAL OF THE REPUBLIC	IADB	70,000
TOTAL DISBURSEMENTS OF CENTRAL GOVERNMENT (1)		2,779,503
AMAZONAS REGIONAL GOVERNMENT	JICA	25,732
AREQUIPA REGIONAL GOVERNMENT	CAF	80,804
CUSCO REGIONAL GOVERNMENT	IBRD	155,000
LA LIBERTAD REGIONAL GOVERNMENT	CAF	153,813
TOTAL DISBURSEMENTS OF REGIONAL GOVERNMENTS (2)		415,349
TOTAL DISBURSEMENTS OF GENERAL GOVERNMENT (3) = (1) + (2)		3,194,851
SEDAPAL	IBRD, KFW, JICA	198,543
LOCAL GOVERNMENT ENTERPRISES	KFW, JICA	70,508
TOTAL DISBURSEMENTS OF NON FINANCIAL PUBLIC ENTERPRISES (4)		269,051
TOTAL DISBURSEMENTS (5) = (3) + (4)		3,463,902

Note: International Bank for Reconstruction and Development - IBRD, Inter-American Development Bank - IADB, International Fund for Agricultural Development - IFAD, Corporación Andina de Fomento - CAF (Development Bank of Latin America), Kreditanstalt für Wiederaufbau - KFW, Japan International Cooperation Agency - JICA.

Source: General Directorate of Public Debt and Treasury - MEF.

10.3 COMPARATIVE TABLE OF THE MAIN TAX EXPENDITURES 2019-2020

ESTIMATION OF THE MAIN TAX EXPENDITURES 2019-2020

COMPARATIVE SUMMARY TABLE

(Millions of S/)

	Tax Expenditure 2019 ¹		Tax Expenditure 2020 ²	
	Potential	Short term	Potential	Short term
I. Estimated expenditures for the years 2019 and 2020	17 240	12 201	16 532	11 479
II. Expenditures incorporated for the first time in the 2020 estimate	-	-	183	183
III. Total tax expenditures (I + II)	17 240	12 201	16 715	11 662
IV. As % of GDP (nominal GDP with base for 2007)³	2,13	1,51	2,01	1,40

1/ Corresponds to the estimate of the main Tax Expenditures 2019 published in the Multiannual Macroeconomic Framework 2019-2022 approved in the Session of the Council of Ministers of 08/22/2018.

2/ Consider the latest macroeconomic assumptions submitted by the MEF on 06/25/2019.

3/ The percentages shown for the 2020 Tax Expenditure have been calculated on the basis of a nominal GDP estimated at S/ 832,629 million for the year 2020 reported by the MEF on 06/25/2019.


Source: Sunat.




MINISTERIO DE ECONOMÍA Y FINANZAS

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