PERU

1. General trends

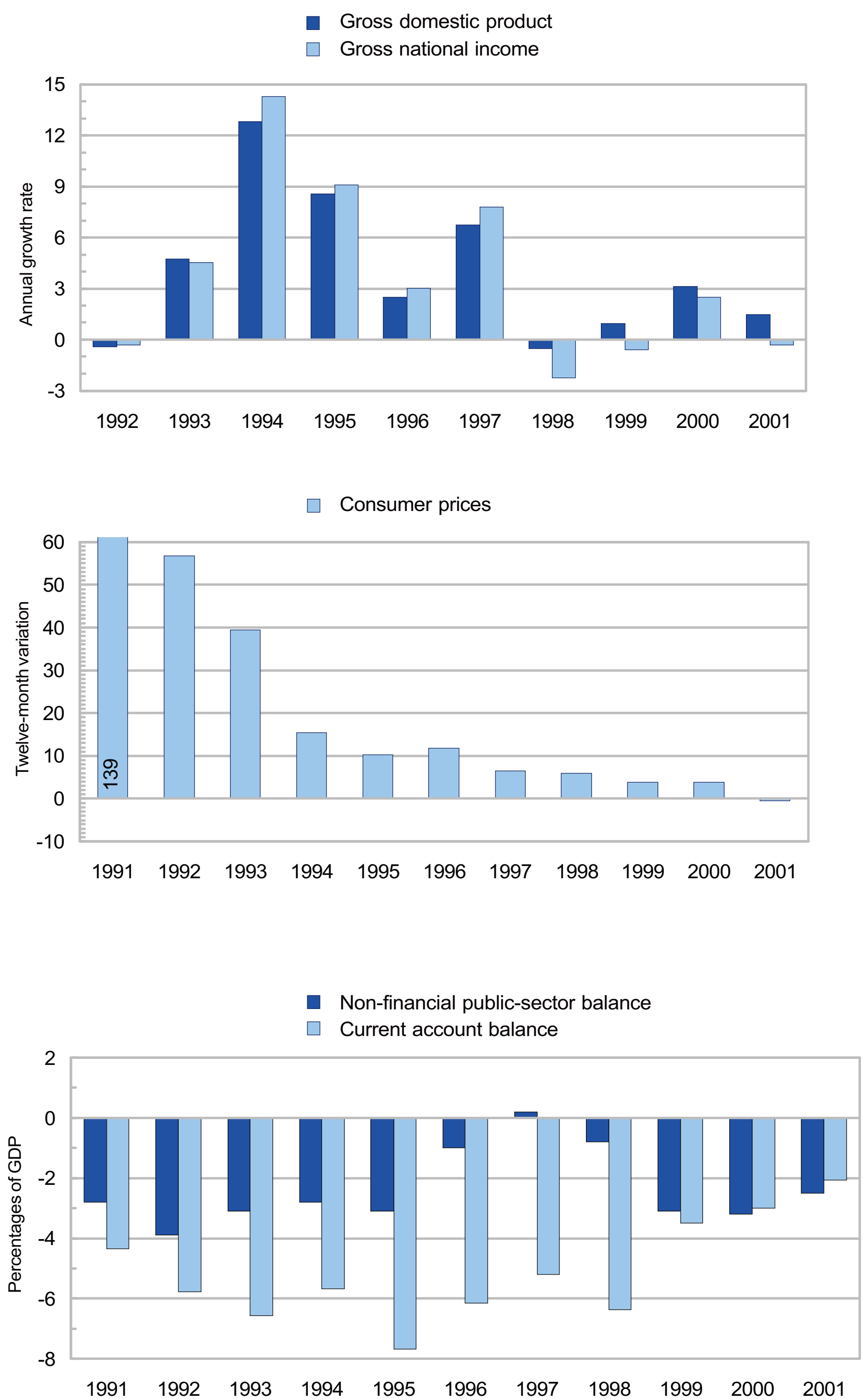
Economic performance in 2001 varied markedly between the first and second semesters. During the first half of the year, the transitional government was forced to adopt a policy of austerity to deal with inherited economic imbalances and political uncertainty, which prolonged the recession that had begun at the end of 2000. As the political situation stabilized in mid-year, however, the authorities were able to take a more expansionary stance. In addition, a large mining project came on stream in the second semester, which helped to boost GDP. The year therefore finished with a modest growth rate of 0.2%, which nevertheless meant a downturn in per capita GDP. External conditions were unfavourable as falling demand dealt a blow to the prices of the main Peruvian exports. Even so, economic instability in the Latin American region did not affect the main macroeconomic variables.

EVEN WITH THE increase in fiscal expenditure towards the end of the year, the non-financial public-sector deficit fell to 2.5% of GDP. Interest rates were high and volatile in the first few months, but declined throughout the second semester. Inflation trended steadily downwards and recorded a negative annualized rate in December. The nominal exchange rate also declined in the second semester, however, which generated a moderate real appreciation of the new sol at the end of the year. Owing to the weakness of domestic demand, most economic activities failed to record any upturn, while credit stagnated, job creation was virtually nil, unemployment rose and real salaries fell.

The current-account deficit on the balance of payments decreased to 2% of GDP, which was easily financed by a surplus recorded on the financial account, thanks to an increase in direct investment. As a result, net international reserves increased by more than US$ 450 million.

The economy is expected to grow by between 3% and 3.5% in 2002, led by mining and construction. The government elected in mid-2001 reached a new agreement with the International Monetary Fund (IMF), which included among its targets a fiscal deficit of 1.9%, although strong social pressure may ultimately widen that deficit slightly. Deflationary pressure should ease off altogether in the course of 2002, while the rate of inflation should stay within the government's projected range of 1.5% to 3.5%.

Figure 1
PERU: MAIN ECONOMIC INDICATORS



Source: ECLAC, on the basis of official figures.

2. Macroeconomic policy

The transitional government, which came to power in late 2000 amid political and economic uncertainty, focused economic policy on attaining fiscal and exchange-rate stability. These had come under pressure from the increase in pre-electoral spending in 2000, together with the political events that culminated in an abrupt end to the Fujimori government and new elections in 2001, which brought greater stability to the political arena only in the second round. The transitional government signed a stand-by agreement with IMF and cut fiscal spending, while restricting liquidity expansion. The authorities also took measures to increase the transparency of public administration. Fiscal and monetary policy, which was in general rather austere, was complemented with a number of measures to boost the economy, such as a lowering of the rate of income tax on reinvestment and tariff reductions.

After the elections, the political uncertainty abated and, thanks to a sounder fiscal position and the decrease in inflation, in the second half of the year the new authorities were able to apply more expansionary fiscal and monetary policies. These included an increase in spending on infrastructure and wages, a reduction in the special solidarity tax, and a higher level of primary money creation. The overall policy stance of taking advantage of macroeconomic stability to introduce economy-boosting measures was continued in 2002. Monetary policy in 2002 shifted towards inflation targeting, with a central target of 2.5% and floor and ceiling rates of 1.5% to 3.5%, respectively. With the international markets taking a brighter view of developments in the Peruvian economy, in February 2002 the government issued sovereign bonds in the amount of US$ 1.45 billion, a portion of which were swapped for outstanding Brady bonds.

(a) Fiscal policy

During the first semester, the transitional government maintained an austere fiscal policy as it sought to increase receipts and reduce spending in order to correct the downturn in the balance of the non-financial public sector (NFPS). Tax income did, in fact, increase despite the weakness of internal demand, but non-tax revenues declined significantly, which meant that central government income shrank. Central government current expenditure decreased from 14.6% of GDP during the first semester of 2000 to 14% during the same period of 2001, which was mainly due to lower outlays on payroll. Since capital spending also decreased (4.2% and 3%, respectively), expenditure contracted more sharply than income and the NFPS deficit narrowed from 2.4% of GDP in the first semester of 2000 to 0.8% in the same period of 2001.

The main objective of this strategy was to secure macroeconomic stability in a highly uncertain political situation. The reference point for this was the Fiscal Prudence and Transparency Act approved at the end of 1999, which capped the expansion of non-financial spending and of the public-sector deficit. Slack domestic demand, however, led the authorities to take some expansionary measures, which affected the fiscal position later. These measures included a cut in the rate of corporate income tax to 20% for reinvested income and a reduction in the tariff rate on inputs produced outside Peru from 12% to 4%.

Building on its success in securing macroeconomic stability in the first semester, the new government implemented a number of additional fiscal measures to stimulate domestic demand. Specifically, it cut the rate of the special solidarity tax from 5% to 2% of gross wages, increased the pay of public-sector employees by around 9% and created a temporary employment programme. As a result, during the second semester both current and capital spending increased.

In order to increase fiscal revenues, the rate of income tax for legal persons was raised again, to 27% for reinvested income and to 31% for distributed income. For natural persons, an income tax scale of 15%, 21% and 27% replaced the former rates of 15% and 20%. Fuel tax was also raised. Receipts stagnated in the second semester of 2001, however, given that some of those measures would not have an impact until 2002.

At the end of the year, the NFPS deficit was 2.5% of GDP, compared to 3.2% in 2000, owing to lower capital expenditure (which decreased from 4.1% to 3.5% of GDP) and a larger surplus in the current account of other NFPS entities (especially public enterprises). Central government current spending also decreased, from 14.9% to 14.7% of GDP, but this saving was countered by a downturn in current revenues, from 14.7% to 14.1% of GDP, which was a reflection of the downturn in non-tax income, especially transfers from state enterprises and payments from petroleum companies. A quarter of the deficit was financed by income from privatizations and the rest was covered, in similar

Table 1
PERU: MAIN ECONOMIC INDICATORS

	1993	1994	1995	1996	1997	1998	1999	2000	2001[a]
	Annual growth rates [b]								
Growth and investment									
Gross domestic product	4.8	12.8	8.6	2.5	6.7	-0.5	0.9	3.1	0.2
Per capita gross domestic product	2.9	10.8	6.7	0.7	4.9	-2.2	-0.7	1.5	-1.3
Gross domestic product, by sector									
Goods	7.5	18.0	7.7	2.0	7.3	-0.6	2.8	4.2	0.0
Agriculture	8.6	13.8	7.5	4.5	5.0	0.7	12.6	6.4	-1.5
Mining	10.2	12.0	4.2	5.1	9.0	3.8	12.9	2.4	11.2
Manufacturing	3.4	16.6	5.5	1.5	5.3	-3.2	-0.5	6.7	-1.1
Construction	17.9	36.1	17.4	-2.3	14.9	0.6	-10.5	-4.3	-6.0
Basic services	6.2	7.9	9.2	5.7	6.9	0.9	2.3	4.3	...
Electricity, gas and water	14.2	10.9	0.2	5.9	12.7	8.3	2.5	4.7	...
Transport, storage and communications	4.4	7.2	11.5	5.6	5.6	-1.0	2.2	4.3	...
Other services	2.8	9.7	8.1	2.6	6.1	-0.9	0.5	2.7	...
Commerce, restaurants and hotels	3.3	15.4	9.6	1.4	7.5	-2.7	-1.2	4.6	0.0
Financial establishments, insurance, real estate and business services	2.7	7.3	11.8	5.3	8.1	0.4	-1.1	1.4	...
Consumption	3.4	9.7	9.5	3.2	4.7	-0.5	0.1	4.0	1.1
General government	3.1	8.7	8.5	4.4	7.6	2.5	3.5	5.1	-0.5
Private	3.4	9.8	9.7	3.1	4.3	-0.8	-0.4	3.9	1.3
Gross domestic investment	11.7	33.0	20.3	-4.9	14.9	-2.0	-13.5	-3.7	-8.0
Exports of goods and services	3.1	19.4	5.5	8.9	13.1	5.6	7.6	7.9	6.9
Imports of goods and services	3.8	26.6	27.1	0.1	12.2	2.3	-15.2	3.6	1.6
	Percentages of GDP [c]								
Gross national income	96.0	97.3	97.8	98.3	99.2	97.5	96.0	95.5	95.1
Gross domestic investment	19.1	22.5	24.8	23.1	24.8	24.5	21.0	19.6	17.9
National saving	13.3	16.9	17.2	16.9	19.5	17.9	17.7	16.9	16.0
External saving	5.7	5.6	7.7	6.2	5.3	6.6	3.3	2.8	1.9
	Percentages								
Employment and wages									
Labour force participation rate [d]	60.8	59.7	62.4	60.3	63.3	...	...	...	...
Open unemployment rate [e]	9.9	8.8	8.2	8.0	9.2	8.5	9.2	8.5	9.3
Real average wage (index: 1995=100) [f]	94.4	109.2	100.0	95.2	94.5	92.7	90.7	91.4	90.6
	Growth rates								
Prices (December-December)									
Consumer prices	39.5	15.4	10.2	11.8	6.5	6.0	3.7	3.7	-0.1
Wholesale prices	34.1	10.5	8.8	11.4	5.0	6.5	5.5	3.8	-2.2
External sector									
Terms of trade (index: 1995=100) [c]	89.1	95.7	100.0	96.5	103.2	89.7	83.3	80.9	77.5
Nominal exchange rate (new soles per dollar)	1.99	2.20	2.25	2.45	2.66	2.93	3.38	3.49	3.51
Real effective exchange rate for imports (index: 1995=100)	105.7	100.2	100.0	98.7	99.3	100.8	109.7	108.4	104.7
	Millions of dollars								
Balance of payments									
Current account	-2,289	-2,550	-4,115	-3,429	-3,059	-3,634	-1,817	-1,627	-1,101
Trade balance (goods and services)	-1,181	-1,499	-2,928	-2,673	-2,488	-3,059	-1,216	-1,104	-834
Exports	4,354	5,662	6,720	7,312	8,369	7,505	7,635	8,603	8,637
Imports	5,535	7,161	9,648	9,985	10,857	10,564	8,851	9,707	9,470
Capital and financial accounts [g]	2,317	3,917	3,540	4,439	5,621	2,263	1,024	1,495	1,509
Overall balance	28	1,367	- 575	1,010	2,562	-1,371	- 793	- 132	408
Variation in reserve assets (- indicates an increase)	- 657	-2 978	- 929	-1 932	-1 733	1,006	775	190	-449

Table 1 (concluded)

	1993	1994	1995	1996	1997	1998	1999	2000	2001[a]
					Percentages				
External debt									
Gross debt (as a percentage of GDP)	78.8	67.2	62.3	60.6	48.6	51.7	55.2	52.2	52.1
Net interest (as a percentage of exports) [h]	34.1	28.6	24.5	16.8	11.0	13.7	14.5	12.5	11.2
					Percentages of GDP				
Central government									
Current income	13.6	14.6	15.2	15.7	15.9	15.7	14.5	14.7	14.1
Current expenditure	13.5	13.7	14.5	13.9	13.2	13.8	14.6	14.9	14.7
Saving	0.1	0.9	0.7	1.8	2.7	1.9	-0.1	-0.2	-0.6
Capital expenditure (net)	3.8	4.1	4.0	3.3	3.6	3.1	3.1	2.5	2.2
Financial balance	-3.7	-3.2	-3.3	-1.5	-0.9	-1.2	-3.2	-2.7	-2.8
Non-financial public sector	-3.1	-2.8	-3.1	-1.0	0.2	-0.8	-3.1	-3.2	-2.5
					Millions of new soles				
Money and credit									
Monetary balance of banking system									
Net international reserves	6,255	13,109	15,461	23,040	21,710	22,472	26,934	26,596	28,374
Net domestic credit	5,699	4,532	7,232	8,335	15,364	18,476	19,487	20,838	20,846
To non-financial public sector	-844	-5,754	-7,825	-14,709	-16,535	-18,529	-16,352	-13,741	-10,822
To private sector	8,444	13,934	19,834	29,314	38,639	46,745	49,868	48,330	46,175
Money (M1)	2,399	3,792	4,678	5,523	6,590	6,623	7,468	7,342	7,897
Local currency savings and time deposits	1,297	2,545	3,785	4,793	6,365	6,021	6,642	7,116	8,581
M2	3,696	6,337	8,463	10,316	12,955	12,644	14,110	14,458	16,478
Foreign-currency deposits (millions of dollars)	3,841	5,185	6,161	8,100	8,867	8,985	9,205	9,342	9,518
					Growth rates				
Real interest rate (annualized, %)									
Deposit rate	-22.6	-11.4	-1.3	-1.2	1.6	3.4	7.9	5.3	5.2
Lending rate	29.9	24.9	22.5	17.9	20.5	23.6	30.3	24.7	22.2
Equivalent interest rate in foreign currency [i]	14.9	9.9	8.7	10.0	11.4	10.7	11.7	9.8	8.1

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. [b] Based on constant 1979 new soles. [c] Based on constant 1995 dollars. [d] Percentages of the working-age population. [e] Percentage of the economically active population in Lima metropolitan area. [f] Private-sector workers in Lima. [g] Includes errors and omissions. [h] Refers to net interest as shown in the balance of payments, divided by exports of goods and services. [i] Interest rate on deposits, deflated by the variation in the exchange rate.

proportions, by domestic and external sources (especially international organizations and, to a lesser degree, bilateral cooperation). In addition, sovereign bonds were issued in new soles for the first time, which were also expected to boost the securities market.

This was the second year of operation of the fiscal stabilization fund, which is financed by a percentage of privatization income. Although monies were drawn from the fund for the first time, the balance rose to US$ 182.5 million.

(b) Monetary and foreign-exchange policy

During the first semester, monetary policy was geared towards preventing developments in the political arena from heightening interest- and exchange-rate volatility, with an approach to inflation control based on an operational target for the expansion of primary money and a floating exchange rate. Until May the real exchange rate trended gradually downwards at an annual rate of 3.7%, and the prime rate on local-currency loans for corporate clients rose from 13.8% in January to 15.5% in May. As a result, and in combination with a tight fiscal policy and sluggish domestic demand, at the end of the first semester primary money had expanded by a mere 1.6%. M1 even contracted slightly, reflecting a decrease in sight deposits.

After the second round of presidential elections the uncertainty surrounding the political and economic outlook subsided and, thanks to increased revenues from

Table 2
PERU: MAIN QUARTERLY INDICATORS

	1999				2000				2001 [a]				2002 [a]
	I	II	III	IV	I	II	III	IV	I	II	III	IV	I
Gross domestic product (change from same quarter of previous year) [b]	-0.4	1.2	-1.5	4.6	5.4	5.5	3.2	-1.5	-2.4	-0.8	1.2	3.0	3.0
Consumer prices (12-month variation, %)	3.4	2.9	3.4	3.8	3.9	3.2	3.9	3.8	3.6	2.5	0.9	-0.1	-1.1
Exports (millions of dollars)	1,412	1,409	1,585	1,712	1,651	1,681	1,847	1,849	1,663	1,740	1,913	1,784	1,575
Imports (millions of dollars)	1,549	1,614	1,694	1,893	1,786	1,836	1,781	1,946	1,849	1,762	1,849	1,741	1,617
Net international reserves (millions of dollars)	8,822	8,704	8,627	8,404	8,803	8,710	8,744	8,180	8,111	8,342	8,679	8,613	8,786
Real effective exchange rate [c] (index: 1995=100)	111.6	109.2	107.3	110.6	110.4	109.6	106.9	106.8	106.2	106.3	103.7	102.5	100.5
Money (M1) (change from same quarter of previous year)	-5.9	-6.2	9.6	8.6	4.3	5.2	-4.6	-5.3	-4.4	-3.1	0.5	6.7	14.2
Real interest rates (annualized, %)													
Deposit rate	8.4	9.8	7.9	5.6	5.7	5.6	4.9	5.1	4.8	5.5	5.4	4.7	0.6
Lending rate	30.7	32.7	31.4	26.5	26.5	26.0	24.0	22.2	20.8	22.6	23.3	21.8	18.0
Central government economic result (as a percentage of GDP)	-0.9	-2.7	-5.0	-3.9	-2.5	-2.4	-2.8	-3.1	0.2	-2.6	-2.9	-5.4	-1.5

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. [b] Based on local currency figures at constant 1977 prices. [c] Refers to exchange rate for imports.

exports and capital flows, the exchange rate trend took a turn for the better in the second semester. As a result, although the new sol depreciated against the dollar as an annual average, the currency ended the year up 0.7% with respect to the dollar and 4.3% with respect to a basket of currencies of the main trading partners. In addition, in the absence of inflationary pressures and with domestic demand still slack, the authorities eased monetary policy and at the year's end primary money recorded an expansion of 7.9%. The main channels were the purchase of dollars and a reduction in public-sector deposits in the Central Reserve Bank, which was only partially offset by the issue of deposit certificates. Macroeconomic developments also led to a sharp decrease in prime corporate lending rates, from a high of 15.5% to 5% in December. Lending rates for non-prime borrowers, however, came down by much less –from a high of 26.6% in July to 23% in December for local-currency loans and from 13.2% in February to 10.2% in December for dollar-denominated loans– which reflected the high risks inherent in the persistently fragile capital structure of many firms. In fact, the rate of non-performing loans in banking institutions declined only very slightly, from 9.8% at the end of 2000 to 9% a year later.

Quasi-money expanded at high rates throughout the year and, in the context of growing currency stability, low inflation and declining interest rates, liquidity in dollars declined from 59% to 55%. Private-sector local-currency deposits in banking institutions increased by 17%, whereas foreign currency-denominated deposits expanded by only 1% (measured in dollars). Meanwhile, demand for credit remained subdued and tended towards a slight de-dollarization, with dollar loans down by 3.4% at the end of the year while loans in new soles expanded by 1.9%.

A number of banking institutions were weakened by the outflow of dollar deposits which took place in late 2000 amid political uncertainty. In order to avert more serious consequences, the authorities encouraged the merger of four banks to form two new ones and, in the framework of the programme to consolidate the financial system, the treasury issued over US$ 300 million in bonds.

(c) Trade policy and reforms

The transitional government cut tariffs on inputs and parts produced outside Peru to 4% with a view to making local production more competitive. The average tariff therefore decreased, although tariff dispersion increased.

The privatizations continued, although at a slower rate than before. Together with concessions, they generated revenues by approximately US$ 253 million, which was 46% of the year's target. The largest operation in terms of volume was the sale of 100% of the shares in Empresa de Electricidad de los Andes. One particularly significant concession was Lima international airport, which had been agreed in 2000 but went through in 2001. The terms of this concession carried an investment commitment worth US$ 1.2 billion, and provided for electrical transmission in the central provinces.

Both the transitional government and the new government-elect took measures to re-establish the independence of the arms of government, and to guarantee citizens' rights. At the same time, efforts were made to achieve greater transparency in public administration by improving, for example, the availability of information on macroeconomic policy.

3. The main variables

The new government was moderately successful in its efforts to stimulate economic activity without jeopardizing macroeconomic stability. In the second semester, the recession that had begun in late 2000 came to an end. This was partly attributable to the government's more expansionary monetary and fiscal policies, although a number of supply factors played an even more important role. Many activities, however, did not see an upturn until the end of the year. Certain external and domestic factors (such as fuel prices and weak demand, respectively) conspired to restrict price increases. The sluggish domestic demand dampened the performance of imports, and exports were the main engine of growth.

(a) Economic activity

The recession that had set in at the end of 2000 carried over into the first semester of 2001, with GDP down by 1.6% with respect to the year-earlier period. In the following six months this trend was broken, which translated into an annualized growth rate of 2.1%. This represented a slight increase in annual GDP (0.2%) and a decline of approximately 1.3% in per capita GDP.

The end of the recession and the slight upturn were attributable to several factors. Work began on the Antamina deposit, the largest combined copper-zinc mine in the world, and other mining companies also expanded their activities. As a result, production of gold, copper, zinc, silver and lead reached record levels. By contrast, the production of hydrocarbons decreased again, owing to the depletion of petroleum reserves. During the year, however, preparations began for the operation of the Camisea natural gas field, which is expected to increase gas production from 2004 on. As a whole, the mining and drilling sector grew by more than 11% in 2001.

The agriculture and livestock sector recorded a downturn in the first semester, but expanded slightly in the second. Even so, over the year as a whole the sector contracted by 0.6%, owing to adverse weather conditions and financing problems. The fishing industry saw a downswing in the second semester, and contracted by more than 13%. Nevertheless, this fall came after several years of strong growth, and the fisheries output remained relatively high from a historical perspective.

Trade also recorded only a slight upturn during the second semester, which translated into a stagnation in annual production. Activity declined in other large sectors that depend mainly on domestic demand, namely construction and the manufacturing industry. After sharp contractions in previous years, construction did not begin to grow until the fourth quarter of 2001, as a result of increased public investment, and ended the year with a further contraction of 6%. Manufacturing failed to bounce back, declining 1.1% over the year as a whole. Lastly, services expanded slightly (0.4%) thanks to the increase in public spending towards the end of the year.

GDP growth of 1.9% in the primary sectors thus contrasted with a decline of 0.2% in the other sectors. The modest growth in demand was driven by exports, with an expansion of 7.2%, while domestic demand contracted by 0.7%. Private consumption rose in proportion to population growth, while investment declined sharply (8%), down in both the private and public sectors.

(b) Prices, wages and employment

Against a backdrop of weak domestic demand, exchange-rate instability and positive external price conditions, the rate of inflation decreased constantly throughout the year and in December posted a slight annualized deflation of 0.1%. The prices of tradable goods were down by 1% at the end of the year, while non-tradable prices rose slightly, by 0.5%. Wholesale prices posted an even heavier fall than consumer prices, with a drop of 2.2%. Excluding the impact of the large drop in fuel prices, the underlying rate of inflation was mildly positive, at 0.7%.

Although the minimum salary remained unchanged, in the first semester the sluggish economic growth resulted in a decline in real average wages in the formal sector. In the second semester average wages recovered slightly, but the annual average posted a real decrease of 1.5%.

Economic performance was reflected in the demand for labour among large firms in metropolitan Lima, which stagnated in the first semester and expanded slightly in the second. Overall, this demand increased by 2.1% between December 2000 and December 2001 and by 0.7% as an annual average. Including urban areas and small and medium-sized enterprises, however, formal employment creation was more negative in 2001. In the category of private firms with 10 or more workers, employment declined by 1.1% between December 2000 and December 2001. The weak demand for labour also translated into an increase in open unemployment, from 8.5% to 9.3%, and in underemployment, from 45.5% to 46.4% (metropolitan Lima).

(c) External sector

The goods trade deficit narrowed from US$ 320 million to US$ 100 million, owing to a contraction in the value of imports (-2%) and a modest expansion in exports (1%). Both imports and exports increased in volume but recorded declines in prices. The heavier fall was sustained by exports, because of weak global demand for commodities, and the terms of trade deteriorated by 4%.

Sluggish investment activity led to a downturn in imports of capital goods, while the decline in international petroleum prices reduced expenditure on fuel imports. By contrast, imports of consumer goods and raw materials increased. Sales of traditional export products were down by 1.5%, as a considerable increase in production, especially of copper, iron, zinc, gold and silver, was offset by a sharp decline in prices. Traditional agricultural exports also contracted, which was attributable to lower coffee prices while the decline in the value of marine products (fishmeal and fish oils) was due to lower volumes. The negative growth in traditional exports was offset, however, by expansion in some non-traditional products, especially agricultural goods (fruit and vegetables), metallurgy and chemicals.

The current-account deficit narrowed from 3% of GDP in 2000 to 2% in 2001, thanks to improved trade performance, a stable non-factor services deficit and transfers surplus and lower payments for factor services, due mainly to a decrease in interest payments by the private sector.

The surplus on the financial account remained stable, which was the result of two opposing trends. On the one hand, foreign direct investment increased and the cost of servicing external public debt decreased. On the other, long-term loans to both the public and private sectors were down and outflows of short-term capital expanded. The overall balance thus recorded a surplus of over US$ 400 million, which resulted in an increase in net international reserves of US$ 449 million. External debt decreased slightly, owing to a reduction in the stock of short-term debt in the private sector and, to a lesser degree, the medium- and long-term debt of the public sector.