



INTERNATIONAL MONETARY FUND  
WASHINGTON, D. C. 20431

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INTERFUND

September 18, 2009

Ms. Alicia S. Ritchie  
General Manager  
Inter-American Development Bank  
1300 New York Ave. NW  
Washington, D.C. 20557

Dear Ms. Ritchie:

Attached is the assessment letter requested by the Inter-American Development Bank in the context of the presentation to your Board of Directors of the two Programmatic Loans for Peru: Sanitation III and Development of Policy Instruments for Sustainable Poverty Reduction.

The attached letter cannot be included in any documents intended for publication, unless the Peruvian authorities consent to its publication.

Sincerely yours,

A handwritten signature in dark ink, appearing to read "Nicolás Eyzaguirre", is positioned above the printed name.

Nicolás Eyzaguirre  
Director  
Western Hemisphere

Attachment

cc: Mr. Hendrick

**PERU—ASSESSMENT LETTER TO THE INTER-AMERICAN DEVELOPMENT BANK**  
(Board discussion of two Programmatic Loans: Sanitation III and Development of Policy  
Instruments for Sustainable Poverty Reduction)  
September 3, 2009

1. ***Peru's strong economic performance and commitment to a sound policy framework has been recognized by the Executive Board of the IMF.*** In January, the Executive Board concluded the 2009 Article IV consultation and the final review of Peru's 25-month Stand-By Arrangement, in an amount equivalent to SDR 172.4 million (about US\$257.2 million)(see the Public Information Notice at <http://www.imf.org/external/np/sec/pn/2009/pn0912.htm>). The authorities treated the arrangement as precautionary. The next Article IV consultation is expected to take place on the standard 12-month cycle.
2. ***In the midst of the global financial crisis and economic slowdown, Peru's growth has decelerated sharply in recent months.*** Following a 10-year long expansion period which peaked at 9.8 percent in 2008, economic growth started to decelerate in the last quarter of 2008. Growth was nearly flat in the first half of 2009, at about 0.3 percent year-on-year. Inflation fell to 2.7 percent in July (within the 1–3 percent target range of the Central Bank) from a peak of 6.7 percent in December 2008.
3. ***The strong buffers built in recent years have allowed Peru to launch a significant countercyclical policy response, which is expected to support economic activity.*** The authorities announced an economic stimulus plan last December, with a discretionary fiscal stimulus of about 3 percent of GDP over 2009–10. The fiscal balance is projected to register a deficit in 2009, consistent with the amended Fiscal Responsibility and Transparency Law. This deficit, reflecting both discretionary measures and the full operation of the automatic stabilizers, would be financed with fiscal savings accumulated in recent years.
4. ***The central bank has acted proactively to ease monetary conditions through cuts in the reference policy rate and a reduction in reserve requirements.*** The policy interest rate has been reduced by 525 bps since the beginning of this year, to 1¼ percent. Financial sector indicators remain sound, with existing buffers expected to be able to absorb the cyclical increase in nonperforming loans anticipated over the coming months. Peru's external position remains comfortable, with foreign reserves at US\$32 billion, equivalent to 110 percent of the sum of short-term external debt, foreign currency deposits with the banking system, and the external current account deficit.
5. ***The combination of monetary stimulus and fiscal impulse is expected to support economic activity in the second half of this year and into 2010.*** Growth for 2009 is projected at around 2 percent, with downside risks arising from private investment dynamics and the timing of execution of public investment projects. Growth is expected to pick up next year toward potential rate, in the context of the envisaged improvement in global conditions.
6. ***Sustained advancement with Peru's structural reform agenda remains key to maintaining progress with respect to growth and poverty reduction.*** Strengthening the tax base and enhancing the current fiscal framework, including possibly with a structural balance measure, would allow entrenching the prudent fiscal policies of recent years. To strengthen poverty reduction, the authorities' ongoing efforts to assess existing programs, improve targeting, and link public expenditures to efficiency are welcomed steps to deepen progress made in recent years.