MINISTRY OF ECONOMY AND FINANCE

ANNUAL PROGRAM OF INDEBTEDNESS AND DEBT MANAGEMENT

2012

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ANNUAL PROGRAM OF INDEBTEDNESS AND DEBT MANAGEMENT 2012

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INTRODUCTION

The Annual Indebtedness and Debt Management Program is reported and published annually in the portal of the Ministry of the Economy and Finance (MEF), in order to disseminate the main guidelines for the management of public debt and the actions to be implemented to reach the quantitative goals set for the end of the period. This information helps provide transparency and predictability to the market on the orientation of the indebtedness policy to be applied in assisting operators with their investment decisions and cash management. It also provides the elements needed for a better understanding of the reasons behind the actions being taken.

The recent merger of the former National Directorate of Indebtedness and the former National Directorate of Public Treasury into the new General Directorate of Public Indebtedness and Public Treasury will close the loop for a better management of the risk affecting the net public indebtedness, by enhancing the natural match in the balances of the National Government's assets and liabilities, seeking to cushion the impact which could be caused in the budget, given any external shocks which may adversely affect the cost of the net debt service.

Therefore, the overall management of assets and liabilities as from this year will be an essential tool for decision making and to provide a better view in determining the amount and the timing to access external and internal financing in the financial markets. Thus, the decisions to be taken will be most consistent and optimal, considering the cost and risk levels that the Government is willing to assume.

This context, which will strengthen public debt management without losing sight of the guidelines of macroeconomic policy in general, will become the backbone to reduce the vulnerability of public finances against adverse external shocks in the financial markets, to help strengthen Government's assets and especially to strengthen the development of the domestic securities market. Thus, debt management will also continue to help the country maintain its expectant position to keep improving in the risk rating scales obtained.

The Annual Program is made up of six sections. The first section provides a glimpse of the gross and net public debt situation. The second section states the Program's purpose, policies and the fundamental guidelines of the strategy to follow with respect to the debt management. The third section provides a brief analysis of the external and internal financial markets' context and the reference range of the quantitative goals to be achieved by December 2012 is hereby defined. The fourth section includes the gross debt risks as of the end of the year 2012. The fifth section presents some additional indicators to analyze the public debt's behavior in the long term. Finally, the sixth section contains an assessment of the strategy compliance proposed for the 2011 financial year.

1. STATUS OF GROSS AND NET PUBLIC DEBT

1.1 Gross public debt

As of December 31, 2011, the National Government's gross public debt reached an amount equivalent to US$ 34.844 billion (S/. 93,974 million). By residence, foreign debt represented 57.5% of the total, while by origin, 58.8% related to securities issued in the national and international capital markets.

Increased access to capital markets on favorable terms has not only made it possible to improve and maintain the position of the public debt indicators at expectant levels (see Table Nº 1 and Annex 1), but also to strengthen the interest of economic agents to take new positions in Government's securities, especially in local currency, long-term and at fixed rates.

Table Nº 1
National Government's gross public debt: Position and indicators

	Debt balance (million US$)	Debt balance (million S/.)	Share (%)	Average Life (years)1_/	Duration (years)2_/	Average repricing (years)3_/	Implicit rate (%) 4_/
BY ORIGIN							
Market (Negotiable)	**20 472**	**55 214**	**58,8**	**16,1**	**8,3**	**16,0**	**7,5**
Global bonds	9 429	25 430	27,1	17,0	8,4	17,0	7,4
Sovereign bonds	10 841	29 239	31,1	15,5	8,3	15,5	7,7
Other bonds	202	545	0,6	6,9	4,9	3,0	6,2
Non-market (Non negotiable)	**14 372**	**38 761**	**41,2**	**7,2**	**5,2**	**4,0**	**2,8**
Multilateral	7 904	21 316	22,7	6,9	5,1	2,1	2,7
Paris Club	2 630	7 092	7,5	7,1	5,1	7,1	2,5
Other	3 839	10 353	11,0	8,8	5,7	8,7	7,1
TOTAL	**34 844**	**93 974**	**100,0**	**12,8**	**7,3**	**11,6**	**5,9**
BY RESIDENCE							
External debt	20 052	54 080	57,5	11,7	7,0	9,8	4,9
Domestic debt	14 792	39 894	42,5	14,6	8,0	14,6	7,6
TOTAL	**34 844**	**93 974**	**100,0**	**12,8**	**7,3**	**11,6**	**5,9**

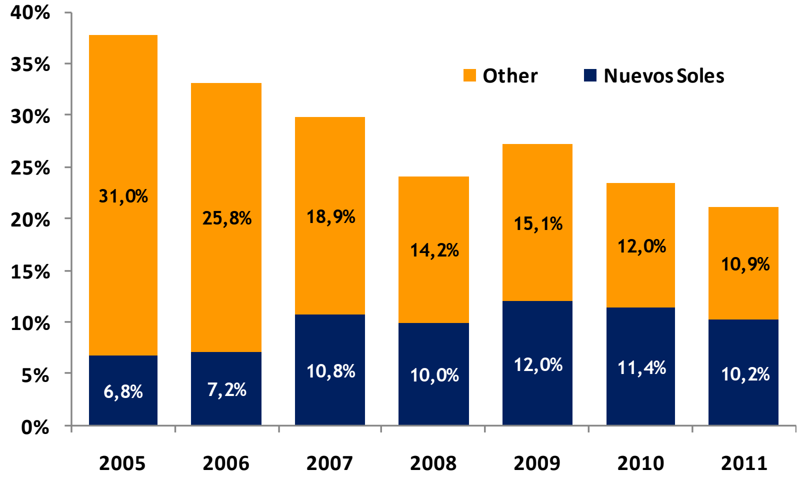
1_/ Average Life: Weighted average term (in years) for the reimbursement of debt nominal principal.
2_/ Duration: Average term for the reimbursement of principal and interest at present value.
3_/ Average repricing: Weighted average term to set a new debt interest rate.
4_/ Implicit rate: Implicit weighted average rate in Nuevos Soles, of interest payments made in 2011.
Source: MEF- National Directorate of Indebtedness and Public Treasury (DGETP)

In relative terms, the gross debt of the non-financial public sector over GDP[1] continues to show a downward trend[2] being one of the lowest ratios among the countries of the region currently having a risk rating of "BBB"[3]. Additionally, one must highlight the growing involvement of Nuevos Soles in the gross debt, which helps alleviate fiscal vulnerability to adverse exchange rate movements (See Chart Nº 1).

By structure, 52.1% are exposed to fluctuations in exchange rates, while 22.5% are exposed to variations in interest rates (see Chart Nº 2).

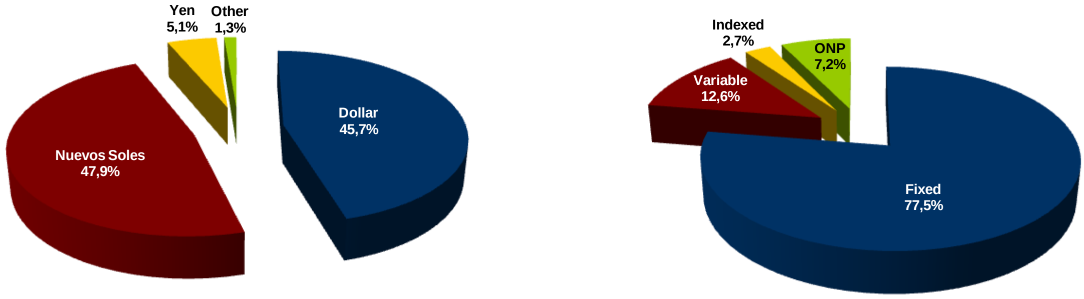
[1] It includes short, medium and long-term debt of the national government and COFIDE, the Municipality of Lima and the former CPT, which – together - represent 1.2% of the total.
[2] It was only interrupted in 2009 as a result of the 2008 international financial crisis.
[3] See the Fitch comparison chart published in September 2011.

Chart Nº 1
Non-financial public sector's gross debt versus GDP



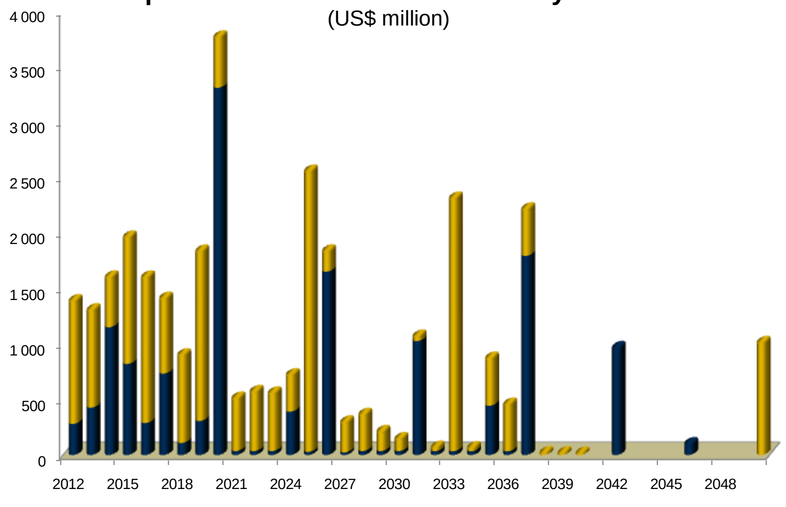
Source: MEF – DGETP

Chart Nº 2
National Government's gross public debt: Position by currencies and interest rate



The proactive approach to public indebtedness management implemented in recent years has gradually changed the amortization profile of gross public debt to reasonable levels (see Chart Nº 3).

Chart Nº 3
Gross public debt: Amortization flow by currencies
(US$ million)



Source: MEF - DGETP

1.2 Net public debt

In April 2011, National Directorate of Public Indebtedness merged with the National Directorate of Public Treasury, and one of the main objectives became the consolidation of integrated management of Government's structural balance through a natural match between the flows of its financial assets and liabilities.

In this new context, it is important the concept of net debt, where the incorporation of assets plays a role of natural mitigation on the exposure of the gross debt in relation to fluctuations of exchange rates and interest rates. At the end of 2011, the total financial assets of the National Government reached an amount equivalent to US$ 14.791 billion (S/. 39,892 million) with which the exposure of net debt, represents approximately 58% of the gross debt balance and 11.6% of GDP.

Table Nº 2
National Government's asset, liability and net debt position by currency

Currency	Financial asset		Financial liability		Net debt	
	Balance (million S/.)	Share %	Balance (million S/.)	Share %	Balance (million S/.)	Share %
Nuevos soles	18 957	47,5%	45 051	47,9%	-26 094	48,2%
Dollars	18 346	46,0%	42 952	45,7%	-24 605	45,5%
Euros	197	0,5%	491	0,5%	-294	0,5%
Yens	2 377	6,0%	4 778	5,1%	-2 401	4,4%
Other	15	0,0%	702	0,7%	-688	1,3%
Total	**39 892**	**100,0%**	**93 974**	**100,0%**	**-54 082**	**100,0%**
Position / GDP	8,6%	-	20,2%	-	11,6%	-

Source: MEF – DGETP

1.3 Gross public debt structure for the years 2012 - 2014

The principal payment for the next 12 months amounts to approximately US$ 1.377 billion (S/. 3,711 million), representing about 4% of the total debt, keeping around this level –as well- for the years 2013 and 2014[4]. This payment level is not a concern for the treasury as, in relative terms, there is a lower pressure on the nation's budget, compared to previous years.

79.6% of the payments in 2012 will be made in currencies other than the Nuevo Sol. A better position by currency is observed in the maturities for the next 3 years (see Chart Nº 4) in which, Nuevos Soles represent 43.0%. However, the extent of the American currency share in these maturities, circumstantially supports the budget allocated to take for care of the debt service, allocating fewer resources in domestic currency equivalent given the significant appreciation of our currency versus the US dollar, a situation, which given the international context, could be maintained at least in the coming quarters[5], temporarily reducing the potential impact of this risk. However, debt management's vision is long term; thus efforts continue to be channeled in favor of the new debt being in domestic currency.

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4 The analysis covered only the three immediate years to make the analysis compatible with the temporary horizon covered by the Multiannual Macroeconomic Framework (MMF), a document published annually by the Ministry of the Economy and Finance, including macroeconomic projections for the year for which the budget is being prepared, and for the next two years.

5 By effect of the capital inflow into emerging markets

With respect to the structure of interest rates for the next 12 months and the following three years, respectively, 91.1% and 86.2% of the maturities to be addressed within these time periods, relate to obligations agreed at a fixed rate (see Chart Nº 5). While there would be a lower risk margin in the percentages maintained at a variable rate and in currency indexed, both the market rate levels and the inflation rate are currently at all-time low levels, it being projected to remain so for one or two years.

Chart Nº 4
Maturities by currency
(US$ million)

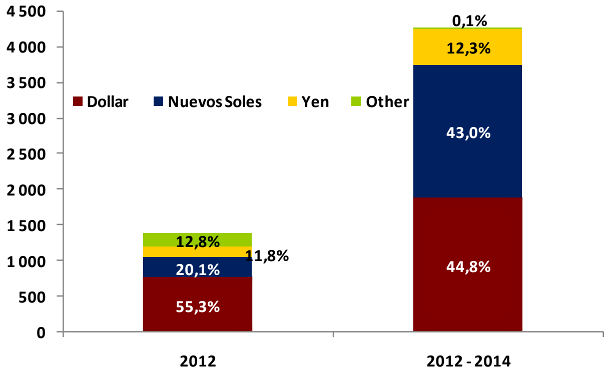
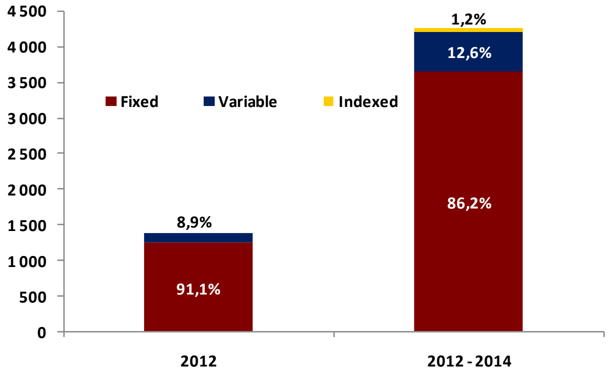


Chart Nº 5
Maturities by interest rate
(US$ million)



Source: MEF- DGETP

2. DEBT MANAGEMENT STRATEGY

Considering the lower financing needs of the fiscal requirements, the main objective of public debt management, as from this year, will focus on strengthening and stimulating the public debt securities market and associated instruments and trades, as a reference backbone to further develop the domestic financial system in general[6].

As such, under the 2012-2016 Multiannual Sectorial Strategic Plan, the strategy of debt management will observe the following policies and principles:

To maintain tax balance and financial efficiency:

- ❖ Integrate public debt management as part of Government's global financial asset and liability management.
- ❖ Reduce the cost of managing liquidity of the Public Treasury through active management of treasury debt securities.

To maintain macroeconomic stability and financial stability:

- ❖ Increase the de-dollarization of the debt, to reduce macroeconomic vulnerability to exchange rate and credit crises.

[6] The limited depth of the domestic financial market and the restricted amount of public debt securities, which the Central Bank is allowed to acquire, as well as the still high level of financial dollarization, are the main limiting factors to obtain additional improvements in risk rating for Peruvian public debt securities, according to risk rating companies, such as DBRS and Moody's.

- Diversify markets and investors to ensure the sustainability of debt and improve Government's bargaining power.

To further develop the securities market:

- Strengthen trade transparency, competitiveness and liquidity in the public debt securities market.

- Minimize unequal access to investment in public debt securities between credit institutions and securities entities.

To develop the financial system with greater financial inclusion:

- Consolidate the growth of microfinance institutions by providing access to public debt securities for their treasury management.

- Develop the money market through repo transactions with public debt securities and other financial instruments backed by collateral arrangements.

The integration of financial asset and liabilities management on a consolidated basis in the Public Treasury, already commenced in April 2011, will also result in greater efficiency for determining the conditions best suited to interact –on a complementary and opportunistic basis- in international financial markets.

Thus, without prejudice to compliance with the quantitative targets set for the reference debt structure, the following is a brief summary of the main tactical actions expected to be deployed in 2012, in management public debt's various fields of competence:

2.1 Indebtedness operations

2012-2014 Multiannual Macroeconomic Framework provisions revised for the financing of 2012 fiscal requirements, totaled approximately US$ 3.566 billion (approximately S/. 9,800 million)[7] to be obtained through bilateral or multilateral loans and securities issues in the market (see Table Nº 3). Part of this financing will cover debt repayments in 2012 amounting to approximately US$ 1.377 billion (see Chart Nº 6). Any financing exceeding the prescribed requirements will be used to finance debt management operations and to pre-finance the following year.

Furthermore, as part of a preventive policy to address the impact on financing needs which may involve the occurrence of financial crises or natural disasters, the aim will be to maintain sufficient comfort in the contingent lines available with these multilateral institutions, which at end of 2011, amounted to the equivalent of US$ 1.9 billion (approximately S/. 5,225 million).

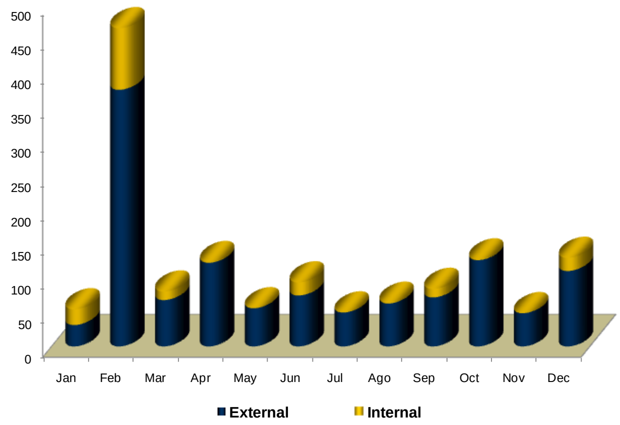
[7] January 25 saw the issuing of US$ 500 million and US$ 600 million equivalent in Nuevos Soles in the international market, as part of the total of such provisions. The resources included in the MMM relate to disbursements made with respect to debt operations arranged for and to be arranged for.

Table Nº 3
2012 Financial requirements to be financed with indebtedness
(US$ million)

Sources	Amounts
External 1_/	**2 226**
Free availability	1 389
Investment projects	837
Internal	**1 340**
Bonds 2_/	1 087
Credits 2_/	253
Total	**3 566**

1_/ Not included US$ 19 million condonations
2_/ Exchange rate: S/. 2.75
Source: MEF-DGPM

Table Nº 6
Public debt: Monthly amortizations flow
(US$ million)



In any case, under normal market conditions, we will seek to strengthen the role of the public debt securities market in domestic currency, as a cornerstone for determining the rate of transfer or equivalent cost comparable as a reference, for the use of alternative fiscal financing sources:

- Bonds issues in domestic currency up to S/. 2,989 million (approximately US$ 1.087 billion) will be sought in accordance with the maximum amount authorized by Law No. 29814[8], assigning S/. 1,925 million (about US$ 700 million)[9] for the financial requirements and S/. 1,064 million for projects in Regional Governments as part of Urgency Decree (DU) 040-2009[10]. In the case of bond issues under DU 040-2009, funds will be gathered according to the pace of works execution.

- In addition, there is a possibility of contracting domestic credit for up to S/. 606 million, mainly from local development banks, with priority to investment project financing.

- As from this year, bills will start being issued in domestic currency, which year-end balance is not to exceed S/. 400 million, in line with the maximum amount authorized by Law No. 29814 - Law of the Public Sector Debt for the 2012 financial year.

- Credit financing for investment projects will be given priority through technical assistance and experience in development banks, provided by multilateral agencies, in a manner consistent with the debt management strategy.

- It is also anticipated that the financing for the investment projects should be begun via the issuance of public debt securities in the domestic mar-

[8] Law of the Public Sector Debt for the 2012 financial year

[9] January 25 saw the issuing of US$ 600 million in Nuevos Soles in the international market, as part of this authorization.

[10] Issued within the scope of the Economic Stimulus Program implemented by Government in order to add dynamism to the economy

ket.

- In the foreign stock market, the only financing to be made will be in an opportunistic manner, in line with the country's strategic objectives, favoring issues in Nuevos Soles.

- For debt which forms part of the structural position in foreign currencies, priority will be given to favor diversification into markets and investors in foreign currencies which exchange risk are not in all-time low records, both accepting credits and for the eventual issuance of securities.

- Supreme Decree No. 033-2006-EF, which sets forth the procedure for the hiring of legal counsel and financial advice services for public indebtedness transactions, will emphasize the level of demonstrable commitment to the public debt securities market in domestic currency and the level of alignment with the interests of the country demonstrated in the proposals for services received and the cost-benefit analysis they represented for the Republic, or to other sovereign issuers involved, transactions identified as support of relevant experience.

- Finally, the idea will be to increase communication with local and foreign investors in order to provide direct information on the performance of the public debt market in domestic currency and the evolution of the national debt's main compared indicators.

2.2 Debt management operations

In order to put forth opportunistic strategic actions that will make it possible to further improve the structure of the net public debt; in future there will be a more granular follow up on the variations of the various prices in the financial markets, and their impact on the structure of financial assets and liabilities of the Public Treasury. With this orientation in mind:

- Priority will be given to transactions to allow for an increase of the domestic currency share within the total stock of the public debt.

- In the loan agreements signed with multilateral agencies efforts will be made to identify the opportunity and convenience of execution of certain financial options included, to the extent permitted by efficiently managing the structural risk of the balance.

- Attempts will be made to replace obligations contracted or issued in previous years with less favorable conditions, and which in essence represent an improvement in the financial conditions added to the entire balance structure. In special situations concerning liability management, and when it is not possible or desirable to perform the operation directly in the market, consideration will be given to placing securities through the syndication mechanism[11], to which effect the conditions under which this mechanism is to be implemented will be reported timely, as well as the

[11] Issues featuring the participation of several financial institutions grouped in a syndicate, which liability will be assumed by a single institution acting as a leader. Unlike the case of an auction, the Republic would offer an indicative price.

requirements and the target holders segment.

- Only in exchange transactions or through repurchase of securities under market conditions may there be an increase in the nominal stock of the debt measured in domestic currency, in lieu of reducing by the same amount the present value of the future budget financial burden that will generate the values subject matter of exchange or repurchase, if the result is a reduction of the global structural foreign exchange risk. However, the new nominal balance in domestic currency should not be greater than the nominal balance expressed in foreign currency at historical exchange rate of its issuance or disbursement, unless it is economically and financially convenient.

- In the procurement of legal services and financial debt management transactions within the framework of the Supreme Decree No. 033-2006-EF, an emphasis will be given to the demonstrable commitment with the public debt securities market in domestic currency, the level of alignment with the interests of the Republic and the cost-benefit analysis of the transactions identified as support for experience in the proposed service.

- There will be aim to maintain a more granular control over the concentration risk in both financial assets and liabilities –on and off the balance sheet, so that there will be an adequate diversification of markets, partners and other relevant risk factors.

- Finally, there will be an individualized management of the credit risk assumed by the country in derivative trades performed with various financial institutions; thus, a better contractual economic and financial equilibrium will be established with each of the counterparties based on their relative risk, the quality of their capitalization under the new international standards and the collateral offered, without prejudice to the establishment of credit limits or quotas based on their risk rating assigned, the average price of their credit derivatives and other financial and economic variables and comparable individual considered relevant.

2.3 Promotion of development for public debt securities market

Given the fact that in recent years, public debt management has established priorities in the management of risks, and one of the most important vehicles being the issuing of long-term bonds in domestic currency, the current environment becomes conducive for the Public Treasury to develop a more active promoting role in the short and middle sections of the sovereign curve, without neglecting or compromising the quantitative debt structure goals.

In this regard, the main purpose of the exercise of a more active role by the Public Treasury is to help the further development of the domestic public debt and to boost its role as the diffuser if reference information for the participants of the rest of the financial system. To this end:

- Access will be given to a greater number of financial institutions, in the primary market's auctions relating to bonds and bills of exchange, allowing for the participation of brokerage firms, mutual funds, saving banks, insurance companies, and others, affording them a real opportunity to revitalize different segments of this market, depending on their scale, and to increase the number of institutional investors in public debt securities.

- Complementary, there will be a provision to the local market, information signals for the sovereign curve segments which did not exist before. To this end, in the short end of the nominal Nuevos Soles curve, there will be the monthly issuing of treasury bills, representing the 3, 6 and 12-month terms, in the most granular and diversified manner possible.

- In addition to the above, in the middle and long segments of the curve, the 2015 bonds (3-year bonds), the 2017 bonds (5-year bonds), the 2023 bonds (new 10-year bonds) and the 2042 (30-year bonds) will be established as reference bonds for the local market, with an obligation to be quoted by the entities recognized as Public Debt Securities Market Makers. The minimum target issue balance for each of these bonds will be set on a monthly basis.

- By contrast, only in the long segment of the curve will there be an attempt for at least four instruments issued in nominal Nuevos Soles (2026, 2031, 2037 and 2042) to reach and maintain an individual balance due greater than S/. 3,000 million, so they may be considered liquid bonds, aimed at large institutional investors and non-resident investors.

- On the other hand, there will again be a diffusion of periodic information to participants in the market of public debt in indexed Nuevos Soles or VAC Nuevos Soles, with the sole purpose that non-financial firms may again have a reference for the issuing of their debt in instruments which are better matched with the dynamism facing their selling prices or the real value of their assets while meeting the demand for these instruments especially by life insurance companies.

- An increase in the level of competition among bidders of periodic auctions in the primary market will be sought, as well as in the level of transparency in the fixing of market prices in the secondary market, to which effect, new Treasury Bonds and Bills Regulations will be published, which will set forth – undoubtedly – that from now on, trading in public debt securities must be performed in centralized mechanisms through the delivery versus payment method, in the secondary market under the behavioral supervision of the SMV.

- Simultaneously, there will be an attempt to boost and heighten the role of financial institutions recognized as Public Debt Securities Market Makers, to which effect, new market makers regulation will be published, with more adequate requirements, privileges and obligations and in line with international best practices, which is also expected to provide a new opportunity for the participation of brokerage firms in the public debt securities market with a view to a future integration of the bond markets in the later MILA stages.

- According to international best practices[12], repo transactions will be of-

12 In line with the recommendations made by the World Bank, the International Monetary Fund and the Interamerican Development Bank.

fered, using Treasury bonds and bills,[13] with the aim of increasing the structural demand for these instruments by local investors, assuring a minimum liquidity of both funds and securities, even under stressful situations in the public debt securities market.

- As a complement, it will create a Treasury Index Fund, which will initially, must become one of the main references as to the risk-free credit performance for participants and for mutual fund management companies in the local market, helping generate greater market competitiveness and a greater structural demand for these securities in the institutional investor market segment. Subsequently, the Fund will try to be accessible to the public in a manner similar to how any mutual fund will do so.

- Furthermore, a program will be designed for retail sales of Treasury bonds and bills to the public, in order to promote financial inclusion and savings for small and medium-size saving persons at the national level; and at the same time, lay the foundations for a further diversify of the investors' base and long-term growth for public debt in domestic holdings.

- There will be debt securities exchanges in order to ease the debt amortization profile and increase the outstanding balance of the securities classified as reference bonds for the local market or liquid bonds for non-resident and large investors; as well allow for each type of holder to be able to adjust accrued positions in accordance with the profiles or objectives of their investment portfolios.

- Finally, starting this year, the Public Treasury will begin to make repurchase and resale of bonds in the market, either through auctions or discretionally, as a regular participant, in order to help attach greater dynamism to the market, reduce excess volatility in its performance and take advantage of opportunities to perform debt management transactions without incurring into the traditional high costs.

All these actions will also have additional tools to further improve the management of public resources, allowing as well reduce the gap between the cost to be paid by the fiscal obligations and the profitability which may be obtained as a result of managing investments, properly controlling the liquidity risk of treasury transactions and debt structure.

3. QUANTITATIVE GOALS FOR DEBT STRUCTURE

An estimate has been drawn for a reference range of targets for risk indicators relating to the National Government's gross debt in order to quantify the impact of the major tactical actions to be carried out as part of the implementation of debt management. Such indicators are those which have been monitored in recent years, the same ones which have charted the successful management of public debt accomplished thus far, on the basis of general guidelines which are now being widened.

[13] Repo transactions can be of two types: i) The traditional repo transaction used to obtain freely available temporary liquidity; and ii) The cash repo transaction used to obtain freely available public debt securities, to reach a target similar to that of a securities lending transaction, but safer for both counterparties, as per the recommendations of the World Bank. Both types of transactions will be offered in a direct and inverse mode, via a centralized trading mechanism, which will provide greater transparency to price fixing under equal conditions, unlike the case of transactions which are internationally traded in the private ambit.

To define this reference range of goals for debt structure three alternative scenarios were built, considering certain assumptions as to the evolution of the economy, the financing amounts which would be required to meet the fiscal needs and implement potential debt management transactions as well as the outlook for the local and international financial markets to define access and the conditions under which the new debt will be captured.

3.1 Current context and outlook

The slow recovery of the U.S., coupled with its high level of debt, the debt crisis in the European Union and the natural disasters in Japan[14] caused short-term interest rates in the respective currencies to remain at all-time lows in 2011, in order to avoid a further slowdown of their economies.

For this year, the expectation is that short-term rates will remain low, since it is not deemed likely for monetary policy reference rates will increase in the major developed countries. Moreover, the U.S. Federal Reserve (FED) [15] has decided to keep its policy reference rate within the all-time low 0% - 0.25% range until at least 2014.

Table Nº 4
Projection of main short-term interest rates (%)

Dates	FED Rate	BCE Rate	BoJ Rate	LIBOR 3 months ($)	LIBOR 3 months (€)	LIBOR 3 months (¥)
Current	0.25	1.00	0.10	0.57	1.42	0.20
I-12	0.25	0.88	0.10	0.43	1.05	0.25
II-12	0.25	0.75	0.10	0.46	1.00	0.25
III-12	0.25	0.75	0.10	0.48	0.99	0.26
IV-12	0.25	0.75	0.10	0.49	1.05	0.26

Source: Bloomberg

In turn, 10 to 30-year U.S. Treasury bond rates showed a sharp downward trend, especially in late 2011, given the higher demand for riskless assets caused by the worsening debt problems prevailing in the Euro area and by the slow recovery of the U.S. economy. This trend was further accentuated with the Maturity Extension Program and Reinvestment Policy implemented by the Fed in September 2011.

However, long-term interest rates in the U.S. would tend to increase, although they would remain below the levels reached in early 2011, while the instruments issued by Euro area countries would still remain high.

At the local level, GDP growth showed a slowdown in 2011 as a result of the negative external outlook and the political noise generated in the first half of the election process. However, the variation of this economic activity indicator has remained above 5%, and this has afforded slack to the authorities responsible for the country's economic policy country in implementing counter-cyclical policies.

With respect to monetary policy, the Central Reserve Bank (BCRP) as from early 2011 began to withdraw part of the monetary stimulus through successive increases

[14] Earthquake and tsunami took place in March 2011
[15] The measure was adopted in the FOMC Committee meeting held in January 2012.

in its reference interest rate[16], which had an adverse impact on the price of sovereign bonds, because of this pressure on the yield curve.

The lower economic growth expected, coupled with a less expansionary monetary policy, would cause a reduction in interest rates in Nuevos Soles at both, short and long-term, with this effect being reinforced by an increased demand for foreign investors to invest in Nuevos Soles-denominated instruments, in order to take advantage of the domestic currency appreciation against the US Dollar.

However, in the case of a worsening of the debt crisis in the Euro Zone or of the U.S. economy slipping back into recession, there would be a sharp decline in the demand for foreign investors with respect to instruments from emerging countries, which would raise interest rates in Nuevos Soles and in US Dollars, at all terms thereof.

3.2 Scenarios to quantify the quantitative goals range

The baseline scenario assumes a conservative position on market expectations for 2012, where one expects to have moderate growth in our major trading partners; and therefore, a fall in the terms of trade which will affect the level of economic growth and the amount of tax revenues. This scenario envisages a fiscal surplus with an average of 0.8%, with a tendency to improve slightly through to 2014, allowing for coverage of financing of the year's fiscal requirements under comfortable conditions.

The optimistic scenario assumes that the Peruvian economy will post a growth very similar to that of 2011, with an estimated 6.5%, which will enable the capture of more revenues to the Treasury; and thus, achieving an average fiscal surplus of 2.2%, which would occur as from 2012. While this scenario assumes that the uncertain international environment would still prevail, the greater dynamism of the economy would be take place mainly due to a better performance of the private demand for, especially as a result of a higher volume of investment projects announced for the coming years. As there is a probability that all variables may turn positive for the interests of the country, not only the financing of fiscal requirements is facilitated, but there is also an expansion of the possibilities of carrying out debt management operations under more favorable conditions, in terms of cost and risk.

The pessimistic scenario assumes a less favorable macroeconomic and a slower global than expected economic recovery. This would affect agents' expectations, resulting in a slower growth in private expenditure, mainly due to a lower level of investments or the postponement thereof. The conditions under which financing would be obtained for fiscal requirements and for liability management operations, would be less advantageous.

Therefore, given this context and based on these scenarios, for the closing of 2012, the following goals reference range has been set:

[16] Remaining at 4.25% levels from May 2011 to this date

Table Nº 5
Reference quantitative goals as of the closing of 2012

Item	December 2012
Percentage of Nuevos Soles in the portfolio	48.1% - 53.7%
Percentage of fixed rate debt in the portfolio	74.4% - 76.3%
Average life (years)	12.7 - 13.4
Average repricing (years)	11.3 - 12.2
Concentration of amortizations in the next 12 months 1_/	4.1% - 3.7%
Annual amortization payment concentration rate 2_/	8.9% - 3.9%
Percentage of financing flow with local currency 3_/	52.7% - 70.9%

Source: MEF- DGETP
1_/ Indicator that measures the most immediate pressure on payments
2_/ Measures the deviation of the portfolio's amortizations payments over and above predetermined maximum levels. This indicator allows for an evaluation of the payments pressure for the next 5 years (refinancing risk), representing an additional element to define policy over the terms for the new debt to be contracted.
3_/ Includes the financing of the debt management transactions.

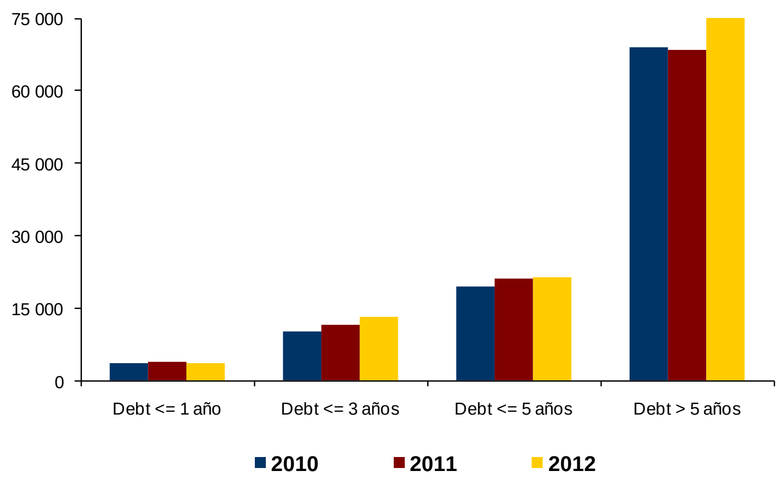
4. GROSS DEBT RISKS ESTIMATED AT THE CLOSING OF 2012

The analysis for estimating the risk of gross debt at the end of 2012 is based on the assumptions supporting the development of the baseline scenario.

4.1 Maturities structure

At the end of the period, there would be a slight increase in the payments to be made in the next 3 years, as a result of the new strategy aimed at issuing debt in the short and medium sovereign curve within the context of strengthening the development of the domestic stock market. The magnitudes of this increase would be manageable, since they would both represent 13.2% of the total debt, a percentage slightly higher than the 12.8% reported in the previous year. This increase in relative terms is diluted, given the fact that the currency structure of these payments would involve less risk. In terms of total gross debt, the expectation is for the average life to be approximately 13 years, one of the longest in the region.

Chart Nº 7
Debt portfolio maturity term
(Nuevos Soles million)



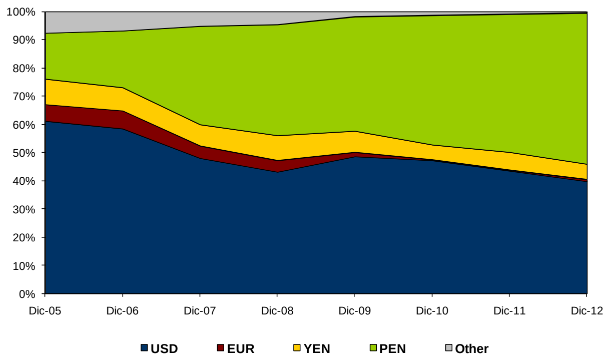
Source: MEF- DGETP

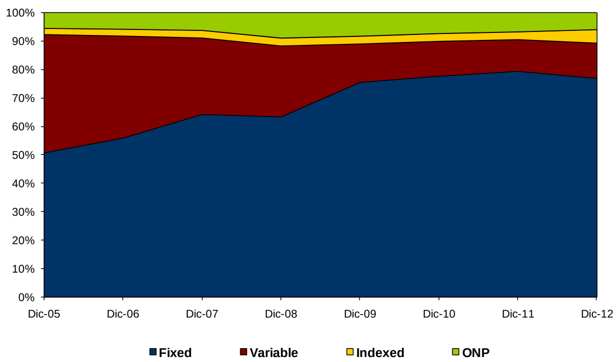
4.2 Market risk

Increasing the Nuevos Soles share of the total gross debt is one of the most important objectives of this strategy, anticipating reach levels of around 54% at the end of 2012, a percentage which is still not sufficient to consolidate a low risk position, according to the references managed by risk rating agencies[17] (See Chart No. 8).

This challenge becomes more urgent within a context of lower borrowing necessities and a significant pace of financing of investment projects using external resources from multilateral and bilateral credit sources. Nonetheless, as from the year 2012, the possibility of financing investment projects in domestic currency has been considered, as well as using other financially viable mechanisms that would make it possible to increase this position.

Chart Nº 8
Evolution of gross debt composition by currency and by interest rate





Source: MEF- DGETP

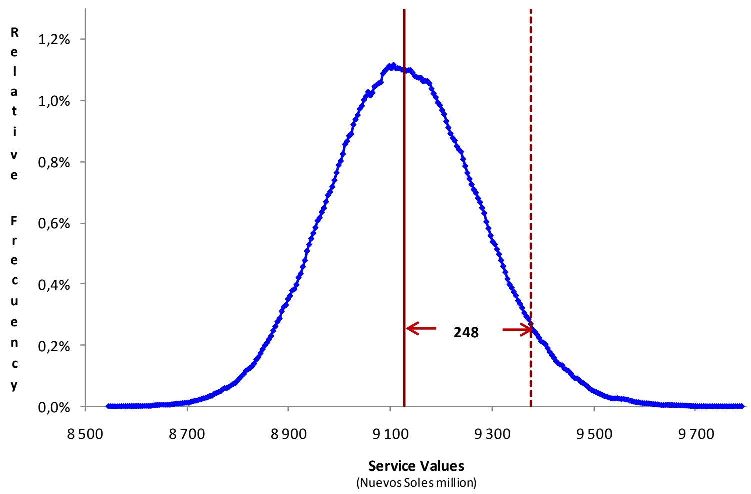
On the other hand, it is estimated that the agreed fixed rate debt would remain at roughly its current 77.0% rate, thus providing predictability to the payment of interest on the debt.

Furthermore, under the assumptions made, risk analysis in the debt service, with a confidence level of 95%, yields an estimate for the year 2011, of about S/.9,127 million. The expected volatility and the correlation between rates and currencies that are part of the maturities to be dealt with, could potentially involve an expenditure higher than the expected service of approximately S/. 248 million (2.7% of estimated payments)[18]

[17] Standard & Poor's (according to the "Sovereign Government Rating Methodology and Assumptions") is of the opinion that it is a significant exchange rate exposure factor to have more than 40% of a country's obligations denominated in currencies other than the local currency

[18] For the 2012-2014 period, the estimated amount of the debt service would be S/. 29,857 million and the additional amount which could be incurred, would be approximately S/. 1,213 million

Chart Nº 9
National Government's gross public debt: Debt service risk for 2012



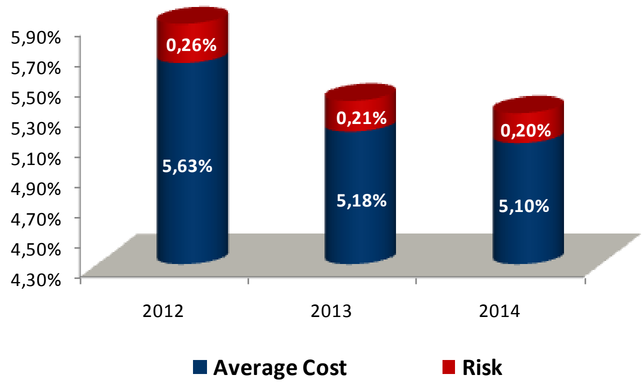
Source: MEF- DGETP

4.3 Cost Analysis

Moreover, an exercise was conducted to assess the cost, in terms of Nuevos Soles, of the 2012 gross debt and in preliminary fashion, for 2013 and 2014, based on the balance due at the end of 2011, in Nuevos Soles. The financing cost takes into account the potential growing development of interest rates[19] and the exchange rates' expected stability.

The annual average cost of the gross debt is defined as the interest payments on the debt plus the additional amount which could be generated as a result of variations in exchange rates and interest rates. This excess, which is defined as a risk, was determined taking into account the stochastic pattern of interest rates and exchange rates as well as their joint correlation[20].

Chart Nº 10
Cost and risk of public debt
period 2012-2014



Source: MEF- DGETP

[19] Variable outstanding debt rates and fixed rates related to the new financing, which would increase the debt cost in the coming years.

[20] The financial cost risk in Nuevos Soles terms, is defined as the maximum cost (at 95% confidence), less the average cost.

Consequently, the average cost estimated for 2012 is 5.6% equivalent in Nuevos Soles, same which could reach a peak of 5.9%, at a 95% confidence level. The average cost of gross debt would tend to diminish in the next two years as a result of debt management strategy that would give priority to taking on new debt or converting from existing debt at fixed rates, which reduces volatility and therefore risk.

5. DEBT RATIOS, SUSTAINABILITY INDICATOR AND AMORTIZATIONS PROFILE

Table No. 6 shows the expected behavior under baseline scenario assumptions, for some ratios relating to the National Government's public debt versus GDP, from a dynamic perspective. These indicators provide a vision, in relative terms, of the debt's budget sustainability.

The National Government's gross debt ratios maintain the same trend observed in previous years, mainly due to the significant growth of GDP, while the level of indebtedness in absolute terms has not changed significantly. This behavior would tend to remain in the coming years given the positive economic result projected for the period.

Table Nº 6
Ratios of the National Government's public debt
(In GDP percentage)

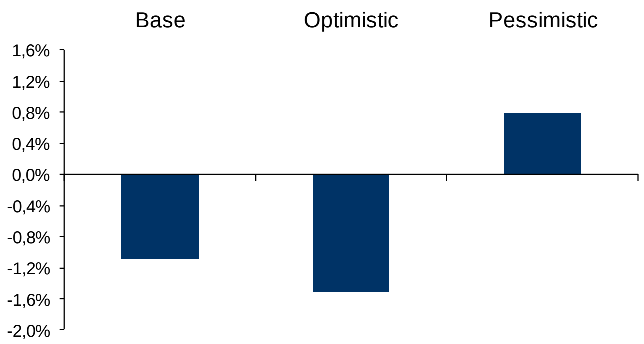
	2011	2012	2013	2014
Base scenario				
Debt /GDP	20.2%	19.7%	18.3%	16.6%
Service /GDP	1.7%	1.7%	1.6%	1.6%
Amortizations /GDP	0.6%	0.7%	0.6%	0.8%
Interest /GDP	1.1%	1.0%	0.9%	0.8%

Source MEF - DGETP

An analysis of the National Government's public debt ratio behavior through the sustainability indicator[21], shows that the debt is sustainable in the basic and optimistic scenarios. This result reflects the favorable growth prospects of the country and the sound management of fiscal policy, which will further reduce financing requirements and therefore the relative weight of the public debt. In the pessimistic scenario which represents a less favorable growth of macroeconomic variables and negative conditions in the prices of financial variables in the future, the debt is not sustainable under this indicator.

[21] This ratio is defined as the difference between the primary equilibrium surplus and the weighted average result of the projected primary surpluses, as ratios of GDP. The equilibrium surplus is that which ensures that the debt ratio remains constant throughout time. If the ratio has a negative sign, then, the public debt is sustainable (and eventually decreasing).

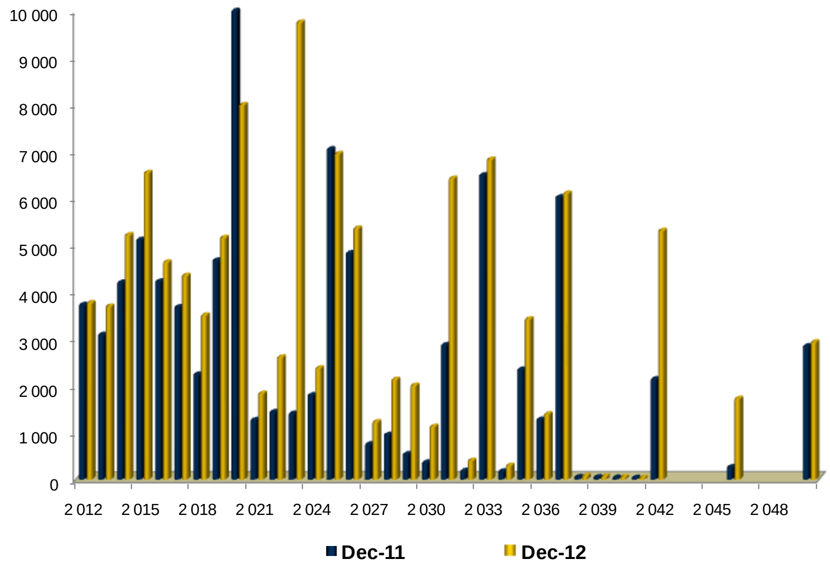
Chart Nº 11
Sustainability indicator of the National Government's public debt
(GDP percentage)



Source: MEF- DGETP

Chart No. 12 shows the maturity profile of the dynamic public debt, which includes projected debt flows generated by the new indebtedness that would be incurred in 2012 to finance any financial requirements and the liability management operations planned for this year. As noted, in line with the new strategy that would be followed to strengthen especially the short end and medium end of the local sovereign curve, there would be a slight increase in debt service payments in the coming years regarding the gross debt position reported in December 2011, but this does not represent a greater financial pressure since the funds raised will be made profitable and available as part of an active cash management undertaking. A greater amount of maturities can be also observed in years further away, as a result of the policy favoring the issuance of certain sovereign securities in the long end of the curve, to instill more liquidity in them.

Chart Nº 12
Projection of dynamic public debt amortizations
(Nuevos soles million)



Source: MEF- DGETP

6. EVALUATION OF 2011 DEBT STRATEGY

2011 was an unusual year in that market expectations were focused on the election context (domestically) and on the spread of the crisis spreading to Europe, as well as on the slow U.S. economic recovery (externally). This scenario did not allow for all of the resources scheduled for financing financial[22] requirements to be received, complementing this deficit with temporary loans from the Public Treasury. Moreover, given the temporary implications of the changes that occurred within the merged DGETP, and the new vision leaning towards the implementation of global asset and liability management, not all the transactions planned in the 2011 PAEAD were implemented, affecting the results achieved in the indicators with regard to debt management at the end of the period.

However, about 40% of the fundraising took place in the local market, in Nuevos Soles and at fixed rate, which not only helped to reduce the financial cost of the debt, but also managed to provide an additional impetus on the efforts being made to increase the share of this currency in the gross debt, as an essential element to further reduce the vulnerability of public finances through a better match between government's assets and liabilities.

Table No. 7 provides a view of the impact of policies applied in 2011 and contribution thereof to achieving the goals set for some of the portfolio's risk indicators at year end.

Table Nº 7
Evaluation of reference quantitative goals of 2011 PAEAD

Item	December 2011 PAEAD Goal	December 2011
Percentage of Nuevos Soles in the portfolio	49.6% - 54.0%	47.4%
Percentage of fixed rate debt in the portfolio	76.6% - 77.9%	76.9%
Average life (years	12.7 - 13.3	12.7
Average repricing (years)	11.3 - 12.0	11.5
Concentration of amortization in the next 12 months	4.1% - 3.9%	4.2%
Rate concentration of annual amortization payment	0.3% - 0.0%	0.0%
Percentage of financing in local currency	64.4% - 73.4%	40.4%

Source: MEF - DGETP

The results show a moderate advance in the goals set at the beginning of the evaluation period, as the levels of some indicators have improved over what was achieved at the end of 2010, but have not been consolidated within the range established in the 2011 PAEAD. This applies to the position of Nuevos Soles in the total gross debt, which in December 2010 closed at 46.0%; and at 47.4% in December 2011, being therefore outside the range established in the 2011 PAEAD.

Consistent with these results, the percentage of funding in Nuevos Soles decreased from the previous year (46.8% to 40.4%), reflecting the problems experienced in the local and international context.

On the other hand, the fixed rate debt was within the minimum range prescribed -

22 No bonds were issued in the international market. The resources used were those originating from the 2050 global bond issued placed in 2010 as pre-financing for 2011.

76.9%, a level considered by some of the rating agencies as an indicator that denotes a low risk position against potential fluctuations in rates interest. The value of the indicator to re-fix interest rates (average repricing) reinforces this view, which was 11.5 years, a level which is also within the expected range.

Meanwhile, the average life remains high (12.7 years), one of the longest in the entire region. This comfort makes it possible to more actively reinforce the new borrowing at shorter maturities, especially issues of securities, making sure to do so in limited amounts only to further develop the government bonds market in order to avoid the pressure of payments for the next few years. In that sense, the amortization payments concentration indicator, for the next 12 months, would be by year end, at 4.2%, slightly above the expected range.

In addition, the amortization variation factor, which measures the deviation of the amortization portfolio service over and above the maximum levels pre-determined for the next 5 years, indicates that the weight of debt in this section of the profile defined in the 2011 PAEAD, has not been outweighed; thus the result is 0.0% according to the range set.

For 2012, it is expected that the levels of these indicators will be strengthened to maintain the behavior shown in recent years, therefore reflecting the effectiveness of the actions being implemented by public debt management.

ANNEX 1

Table Nº 1
Public debt: Outstanding by financing source

Financial Source	Amount Mill.US$)	Amount (Mill. S/.)	%	Average life (years)	Duration (yearr)	Average Repricing (years)	Equiv. Rate (%)
External Debt	**20,052**	**54,080**	**100.0**	**11.7**	**7.0**	**9.8**	**8.9**
Bonds	9,483	25,575	47.3	16.9	8.4	16.9	11.5
Multilateral	7,904	21,316	39.4	6.9	5.1	2.1	6.4
Paris Club	2,630	7,092	13.1	7.1	5.1	7.1	6.7
Other	36	97	0.2	4.0	3.5	3.5	7.3
Internal Debt	**14,792**	**39,894**	**100.0**	**14.6**	**8.0**	**14.6**	**7.6**
Bonds	14,200	38,298	96.0	15.2	8.3	15.2	7.7
- ONP	2,510	6,769		0.0	1.0	2.0	3.0
- Sovereign	10,841	29,239		15.5	8.3	15.5	7.8
- Other	849	2,290		12.2	7.3	12.2	7.2
Credits	592	1,596	4.0	3.0	2.7	2.9	5.9
Total Debt	**34,844**	**93,974**		**12.8**	**7.3**	**11.6**	**8.4**

Source: DGETP - MEF

Table Nº 2
Public debt: Outstanding by currency

Currency	Amount (Mill.US$)	Amount (Mill. S/.)	%	Average life (years)	Duration (years)	Average Repricing (years)	Equiv. Rate (%)
External Debt	**20,052**	**54,080**	**100.0**	**11.7**	**7.0**	**9.8**	**8.9**
Dollars	15,793	42,595	78.8	13.3	7.6	10.9	9.5
Yen	1,772	4,778	8.8	6.7	4.8	6.7	7.0
Nuevos Soles	2,045	5,514	10.2	4.1	3.5	4.1	6.5
Other	443	1,193	2.2	8.8	5.8	8.5	4.7
Internal Debt	**14,792**	**39,894**	**100.0**	**14.6**	**8.0**	**14.6**	**7.6**
Nuevos Soles	14,660	39,537	99.1	14.8	8.1	14.8	7.6
Dollars	132	357	0.9	4.0	3.4	4.0	11.1
Total Debt	**34,844**	**93,974**		**12.8**	**7.3**	**11.6**	**8.4**

Source: DGETP - MEF

Table Nº 3
Public debt: Outstanding by interest rate

Rates	Amount (Mill.US$)	Amount (Mill. S/.)	%	Average life (year)	Duration (years)	Average Repricing (years)	Equiv. Rate (%)
External Debt	**20,052**	**54,080**	**100.0**	**11.7**	**7.0**	**9.8**	**8.9**
Fixed	15,688	42,311	78.2	12.4	7.1	12.4	9.7
Variable	4,364	11,769	21.8	9.2	6.5	0.5	6.2
- Libor	2,883	7,776	14.4	8.3	6.0	0.5	6.4
- Multilateral	1,425	3,843	7.1	10.7	7.6	0.5	5.7
- Other	56	150	0.3	14.7	9.0	0.5	7.6
Internal Debt	**14,792**	**39,894**	**100.0**	**14.6**	**8.0**	**14.6**	**7.6**
Fixed	11,324	30,540	76.6	14.3	7.9	14.3	7.5
VAC	943	2,544	6.4	18.4	9.2	18.4	9.0
ONP	2,510	6,769	17.0	0.0	1.0	2.0	3.0
Total Debt	15	40	0.1	1.6	1.6	0.5	3.2

Source: DGETP - MEF

ANNEX 2

2012 Tentative Issuance Schedule

- Public Treasury Bills Auction
- Sovereign Bonds Auction
- Market Makers Meeting