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INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

PROGRAM DOCUMENT FOR A PROPOSED LOAN

IN THE AMOUNT OF US$400 MILLION TO THE

REPUBLIC OF PERU

FOR THE

SECOND DISASTER RISK MANAGEMENT DEVELOPMENT POLICY LOAN

WITH A

CATASTROPHE DEFERRED DRAWDOWN OPTION

February 8, 2015

Social, Urban, Rural and Resilience Global Practice
Bolivia, Chile, Ecuador, Peru and Venezuela Country Management Unit
Latin America and the Caribbean Region

REPUBLIC OF PERU–GOVERNMENT FISCAL YEAR
January 1–December 31

CURRENCY EQUIVALENTS
(Exchange Rate Effective as of January 20, 2015)

Currency Unit = Peruvian Nuevo Sol
US$1.00 = PEN 3.02

ABBREVIATIONS AND ACRONYMS

ANA	*Autoridad Nacional del Agua* (National Water Authority)
BCRP	*Banco Central de Reserva del Perú* (Central Bank of Peru)
CA	Current Account
CAF	*Banco de Desarrollo de América Latina* (Development Bank of Latin America)
CAT-DDO	Catastrophe Deferred Drawdown Option
CENEPRED	*Centro Nacional de Estimación, Prevención y Reducción del Riesgo de Desastres* (National Center for the Estimation, Prevention and Reduction of Disaster Risk)
CFAA	Country Financial Accountability Assessment
CoP	Conference of the Parties
CPI	Consumer Price Index
CPS	Country Partnership Strategy
DUCPS	*Dirección–Unidad de Coordinación de Préstamos Sectoriales* (Directorate–Sectoral Program Coordination Unit)
DGETP	*Dirección General de Endeudamiento y Tesoro Público* (General Directorate for Debt and Public Treasury)
DPL	Development Policy Loan
DRM	Disaster Risk Management
ENAHO	*Encuesta Nacional de Hogares* (National Household Survey)
ENSO	El Niño Southern Oscillation
FEF	*Fondo de Estabilización Fiscal* (Fiscal Stabilization Fund)
GDP	Gross Domestic Product
GG	General Government
GNP	Gross National Product
GoP	Government of Peru
GTZ	German Agency for Technical Cooperation
IADB	Inter-American Development Bank
IFI	International Financial Institution

IBRD	International Bank for Reconstruction and Development
IDA	International Development Association
IFC	International Finance Corporation
IMF	International Monetary Fund
INDECI	*Instituto Nacional de Defensa Civil* (National Civil Defense Institute)
INEI	*Instituto Nacional de Estadística e Informática* (National Institute of Statistics and Informatics)
JICA	Japan International Cooperation Agency
JSAN	Joint Staff Advisory Note
LAC	Latin America and the Caribbean Region
LCU	Local Currency Unit
LDP	Letter of Development Policy
MDGs	Millennium Development Goals
MEF	*Ministerio de Economía y Finanzas* (Ministry of Economy and Finance)
MINAGRI	*Ministerio de Agricultura y Riego* (Ministry of Agriculture and Irrigation)
MINAM	*Ministerio del Ambiente* (Ministry of Environment)
MINEDU	*Ministerio de Educación* (Ministry of Education)
MINSA	*Ministerio de Salud* (Ministry of Health)
MTEF	Medium-Term Expenditure Framework
MVCS	*Ministerio de Vivienda, Construcción y Saneamiento* (Ministry of Housing, Construction and Sanitation)
NCCAS	National Climate Change Adaptation Strategy
NFPS	Non-Financial Public Sector
NPL	Non-performing Loan
PCM	*Presidencia del Consejo de Ministros* (Presidency of the Council of Ministers)
PDO	Project Development Objective(s)
PEFA	Public Expenditure and Financial Accountability Assessment
PER	Public Expenditure Review
PFM	Public Financial Management
PHRD	Japan Policy and Human Resources Development Trust Fund
PIP	Public Investment Project
PLANAGERD	*Plan Nacional de Gestión del Riesgo de Desastres* (National Disaster Risk Management Plan)
PMF	Performance Management Framework
PML	Probable Maximum Loss
PRONIED	*Programa Nacional de Infraestructura Escolar* (National School Infrastructure Program)
PSIA	Poverty and Social Impact Assessment
RNE	*Reglamento Nacional de Edificaciones*

	(National Building Regulations)
ROSC	Report on the Observance of Standards and Codes
SDC	Swiss Agency for Development and Cooperation
SDR	Special Drawing Rights
SINAGERD	*Sistema Nacional de Gestión del Riesgo de Desastres* (National Disaster Risk Management System)
SNIP	*Sistema Nacional de Inversión Pública* (National Public Investment System)
UNDP	United Nations Development Programme

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REPUBLIC OF PERU
SECOND DISASTER RISK MANAGEMENT DEVELOPMENT POLICY LOAN
WITH A CATASTROPHE DEFERRED DRAWDOWN OPTION

TABLE OF CONTENTS

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SUMMARY OF PROPOSED LOAN AND PROGRAM

REPUBLIC OF PERU
SECOND DISASTER RISK MANAGEMENT DEVELOPMENT POLICY LOAN WITH A CATASTROPHE DEFERRED DRAWDOWN OPTION

Borrower	Republic of Peru
Implementation Agency	Ministry of Economy and Finance
Financing Data	IBRD Loan Terms: Final maturity of 16 years (including a 12-year grace period) Amount: US$400 million
Operation Type	Development Policy Loan with a Catastrophe Deferred Drawdown Option
Pillars of the Operation and Program Development Objective(s)	The development objective of the proposed operation is to strengthen the institutional and legal framework to contribute toward the reduction of Peru's fiscal and physical vulnerability to disasters. This development objective will be achieved by supporting policy reforms under three operational pillars: (i) improving efficiency in public resource allocations for disaster risk management; (ii) strengthening vulnerability reduction policies in infrastructure for the education and housing sectors and flood protection measures; and (iii) increasing the Government's capacity for post-disaster recovery and reconstruction.
Result Indicators	*Pillar 1: Improving efficiency in public resource allocations for disaster risk management* • PA 1: (a) Annual budgetary performance report on the implementation of the National Disaster Risk Management Plan (*Plan Nacional de Gestión del Riesgo de Desastres,* PLANAGERD) under the results-based budgeting programs; and (b) Number of regional governments with approved regional plans for the prevention and reduction of disaster risk. *Pillar 2: Strengthening vulnerability reduction policies in infrastructure for the education and housing sectors and for flood protection measures* • PA 2: Share of seismic risk reduction in school infrastructure in the Lima Metropolitan Area as a result of the implementation of the National School Infrastructure Program (*Programa Nacional de Infraestructura Escolar*, PRONIED). • PA 3: Share of eligible low-income households covered by the Grant for Protection of Housing Vulnerable to Seismic Risk program. • PA 4: Number of approved studies on flood-risk prevention and mitigation in watersheds. *Pillar 3: Increasing the Government's capacity for post-disaster recovery and reconstruction* • PA 5: (a) Number of National Government sectors that approve sector guidelines for the post-disaster reconstruction process; (b) Number of National Government agencies with approved operational continuity plans in the event of disasters; and (c) Policies and procedures for financing post-disaster rehabilitation and reconstruction processes.
Overall risk rating	The overall risk associated with this operation is low.
Operation ID	P149831

IBRD PROGRAM DOCUMENT
FOR A PROPOSED
SECOND DISASTER RISK MANAGEMENT DEVELOPMENT POLICY LOAN
WITH A CATASTROPHE DEFERRED DRAWDOWN OPTION
TO THE REPUBLIC OF PERU

I. INTRODUCTION AND COUNTRY CONTEXT

1. **The proposed US$400 million Second Disaster Risk Management Development Policy Loan (DPL) with a Catastrophe Deferred Drawdown Option (CAT-DDO) will support the Government of Peru's (GoP's) efforts to mobilize resources in the aftermath of a disaster and strengthen disaster risk reduction and climate change adaptation measures in the country**. A first DPL with a CAT-DDO (P120860) in the amount of US$100 million was approved by the Board on December 9, 2010 and was renewed for three years in 2013.[1] The proposed operation builds on the successful achievements of the program supported by the first CAT-DDO and the dialogue and collaboration between the World Bank and the GoP on disaster risk management since 2007. As part of its broad disaster risk management strategy, the GoP has requested a second CAT-DDO. The proposed operation strengthens actions undertaken by the Ministry of Economy and Finance (*Ministerio de Economía y Finanzas*, MEF) to increase the availability of contingent lines of credit and to be able to quickly access resources and respond to disasters. Since 2011, the GoP has signed contingent lines of credit with the Bank, other international financial institutions (IFI), and bilateral cooperation.[2]

2. **Geological and climate-related risks pose major challenges for Peru's sustainable and resilient development.** According to the World Bank's Study of Natural Disaster Hotspots, Peru ranks twentieth among the world's economies most vulnerable to multiple natural hazards.[3] Peru lies in the "Pacific Ring of Fire," a highly seismic region where about 80 percent of the world's earthquakes occur.[4] The high seismic hazard zones are concentrated along the coastal region, home to the nation's capital, Lima. Furthermore, its location on the tropical west coast of South America exposes the country to El Niño oscillations, which are typically characterized by prolonged torrential rains that primarily affect Peru's northern coast.[5] The last two extreme El Niño events, which occurred in 1982–1983 and 1997–1998, had devastating social and economic impacts on

[1] The Bank and the GoP agreed on and established new target results under the same policy areas of the policy matrix, to be achieved by December 9, 2016.
[2] The catastrophe-contingent lines of credit currently contracted are: US$ 300 million with CAF, US$300 with the Inter-American Development Bank (IADB), US$100 million with the Japan International Cooperation Agency (JICA), and US$100 million from the first CAT-DDO.
[3] World Bank, Natural Disaster Hotspots 2005, Table 7.2: Countries at Relatively High Economic Risk from Multiple Hazards.
[4] In the last 40 years, the major earthquakes registered, based on data from the National Civil Defense Institute (*Instituto Nacional de Defensa Civil*, INDECI), are: Ancash 1970, Lima 1974, Nazca 1996, Arequipa 2001, Pisco 2007. Source: PLANAGERD 2014–2021.
[5] World Bank, Disaster Risk Management in Latin America and the Caribbean Region: GFDRR Country Notes Peru, 2010.

the country.[6] The Development Bank of Latin America (*Banco de Desarrollo de América Latina*, CAF) estimated that the 1997–1998 El Niño event produced losses equivalent to 4.5 percent of the gross domestic product (GDP). Based on the seismic risk profile recently finalized by MEF, the Probable Maximum Loss (PML) for a 100-year return period could generate losses of around 10 percent of the total exposed value of Government-owned assets and infrastructure.[7]

3. **Socioeconomic impacts of disasters can affect poverty reduction and inclusive growth targets in Peru**. With an estimated population of 30 million, Peru has been one of the best macroeconomic performers in Latin America over the past decade. During the 2002–2013 period, the Peruvian economy's average growth rate was close to 6.2 percent, the second-highest growth rate in Latin America, and the average inflation rate was 2.8 percent, the lowest in the region.[8] Furthermore, between 2004 and 2010 about four million people exited poverty,[9] and poverty rates decreased from 48.6 percent (2004) to 23.9 percent (2013), based on a recent study from the National Institute of Statistics and Informatics (*Instituto Nacional de Estadística e Informática*, INEI).[10] Extreme poverty also decreased by nearly 80 percent, from 17.1 percent in 2004 to 4.7 percent in 2013.[11] However, about 76 percent of the population lives in urban areas and 86.6 percent lives in the coastal and mountain regions, which are exposed to seismic, volcanic, flood, landslide and El Niño/La Niña phenomena, among others. Based on GoP estimates, the population is expected to reach 33 million by 2021, of which an estimated 63 percent has been identified as vulnerable to heavy rainfalls, frosts, droughts and seismic activity in the country's central and southern areas.[12]

4. **The proposed operation leverages and strengthens steps taken by the GoP over the last five years to reduce disaster and climate risks in order to benefit the most vulnerable population.** Moving ahead, the GoP will need to address the remaining challenges related to consolidating and deepening the implementation of risk-reduction measures in infrastructure sectors and planning. Specifically, the GoP will need to strengthen sectoral initiatives on infrastructure vulnerability reduction, actively promote seismic vulnerability reduction among the most vulnerable households, and substantially increase the institutional capacity to manage post-disaster recovery processes. In addition, the effective integration between disaster risk management (DRM) and Climate Change Adaptation policies remains a key challenge for a country highly exposed to climate variability and future climate change. The proposed operation

[6] In the 1982–1983 El Niño event, 512 people were killed, about 1.9 million were affected, and costs reached US$3.3 billion. In 1997–1998, 366 people were killed, and costs of damages reached US$3.5 million. Source: PLANAGERD 2014–2021.

[7] Preliminary numbers based on draft reports shared by MEF.

[8] Ibid.

[9] World Bank, Country Partnership Strategy (CPS) 2012–2016 for the Republic of Peru, Report 66187-PE, February 1, 2012.

[10] The poverty line used is a national average based on calculations from the National Institute of Statistics and Informatics: S/. 155 soles for extreme poverty (2013) and S/. 292 for poverty (2013). Source: National Institute of Statistics and Informatics (INEI), Technical Report: Evolution of Monetary Poverty 2009-2013, Lima, May 2014 (29-31)..

[11] Ibid.

[12] The criteria used to estimate the vulnerable population are: population growth rate, evolution of the population affected by disasters (2003–2012), high incidence of vulnerability of subgroups of the population, levels of poverty. Source: National Disaster Risk Management System (SINAGERD), Presidency of the Council of Ministers (PCM), "National Disaster Risk Management Plan (PLANAGERD) 2014–2021," January 2014 (36–37).

supports policy reforms that the GoP has prioritized under a medium-term perspective (three to five years) and are aligned with the newly established National Disaster Risk Management Plan (*Plan Nacional de Gestión del Riesgo de Desastres*, PLANAGERD) and the National Climate Change Adaptation Strategy (NCCAS). PLANAGERD is the guiding document whose aim is to actively reduce the vulnerability of the population and its livelihoods to disaster and climate risks. NCCAS is focused on policies and activities to better adapt and cope with climate change in Peru.

5. **The development objective of the proposed operation is to strengthen the legal and institutional framework to contribute toward the reduction of Peru's fiscal and physical vulnerability to disasters.** This objective will be achieved by supporting policy reforms that are aimed at strengthening: (a) the financing mechanisms for PLANAGERD's implementation; (b) vulnerability reduction in infrastructure for the education and housing sectors and for flood protection measures; and (c) the institutional capacity to effectively plan and implement post-disaster rehabilitation and reconstruction processes and guarantee the Government's operational continuity. The overall risk for the proposed operation is low. The GoP hosted the twentieth session of the Conference of the Parties (CoP). This demonstrated the Government's commitment to the climate change adaptation and disaster risk management agenda. The Bank will mitigate risks that may arise during implementation through close technical and policy dialogue with key stakeholders within the Government as part of the Bank's ongoing supervision and technical assistance.

6. **The design of the proposed operation builds on continuous collaboration on DRM with the GoP and the achievements of the first CAT-DDO program.** The proposed operation strengthens and expands policy reforms supported under the first CAT-DDO, which has three policy pillars: (i) risk-reduction policies in public investment through the development of a Strategic Budgetary Program for Disaster Vulnerability Reduction and Emergency Response; (ii) vulnerability reduction actions in the health, water and sanitation infrastructure sectors; and (iii) mechanisms for financial protection against disasters. The proposed program strengthens policy reforms in these areas by supporting the alignment of the DRM budgetary program and regional planning processes within PLANAGERD; expanding vulnerability reduction policies in additional infrastructure sectors such as education, housing and water resources management; and expanding the financial protection strategy mechanism against disasters to establish a post-disaster reconstruction framework and an operational continuity policy for government agencies and services.

II. MACROECONOMIC POLICY FRAMEWORK

A. RECENT ECONOMIC DEVELOPMENTS

7. **During the past decade, Peru became one of the region's fastest-growing economies.** Over the 2003–2013 period, GDP grew at an average annual rate of 6.2 percent (Figure 1). This impressive performance is the result of prudent macroeconomic policies, structural reforms, large foreign direct investments, and a favorable external environment for most of the decade.

Figure 1. Strong GDP growth
(real change, percent)

Source: BCRP

8. **Growth has been driven by private investment and consumption.** In 2013, economic activity grew by 5.8 percent, mainly driven by domestic demand, while weak external demand led to a deceleration of exports. Private consumption, the main contributor to GDP expansion, increased by 5.3 percent. Private investment growth decelerated from 15.6 to 6.4 percent between 2012 and 2013 due to weaker external conditions and declining macroeconomic expectations.

9. **In 2014, Peru's economy grew at an estimated 2.4 percent, much slower than in the last four years, but still faster than an average Latin American and Caribbean (LAC) country.** GDP growth slowed due to the weaker external environment partly explained by the uncertainty of the timing of the US Federal Reserve's tapering withdrawal and slowing investment dynamism domestically. In the first half of 2014, the natural resources sector grew at an average rate of 0.2 percent compared to the non-resource sector, which expanded by 3.9 percent due to higher dynamism of commerce and services. The lackluster performance of the natural resources sector was the result of declining commodity prices (especially copper and gold) combined with the postponement of large mining projects such as Toromocho. Peru's growth performance in 2014 has not been exceptional, as the LAC region grew at an estimated 0.8 percent in 2014.[13]

10. **Although inflation fell to within the target band in 2014, the Central Bank adjusted interest rates and reserve requirements to mitigate the slowdown and anchor inflationary expectations.** Supply shocks related to climate events generated pressures on food prices, bringing annual inflation to 3.5 percent in the first half of the year. Nevertheless, this trend was reversed in August because the consumer price index (CPI) grew at an annual rate of 2.7 percent, which is

[13] According to the January 2015 GEP; see http://www.worldbank.org/en/publication/global-economic-prospects/regional-outlooks/lac.

within the target band of 1 to 3 percent. The Peruvian Central Bank (Banco Central de Reserva del Perú, BCRP) reduced its policy rate from 4 to 3.5 percent to mitigate the effects of economic deceleration and to anchor inflation expectations. The Central Bank also loosened reserve requirements in local currency from 14 to 10.5 percent between January and October 2014 to encourage credit in local currency as the US dollar was steadily appreciating.

11. **The current account deteriorated in the first two quarters of 2014 to register a deficit of 5.7 and 7.3 percent of GDP, respectively, its highest deficits over the last 10 years.** Exports fell by 12.3 percent in the second quarter of 2014 due to decreasing terms of trade (in particular, gold and copper prices), which led to a trade deficit of 3.1 percent of GDP. The financial account registered surpluses of 2.1 and 4.7 percent of GDP in the first two quarters, respectively, but did not fully compensate for the current account imbalances. Consequently, international reserves declined while remaining relatively high (32.1 percent of GDP).

12. **The *Nuevo Sol's* depreciation accelerated in the last months of 2014, due to the deterioration of the current account balance and expectations of the tapering of continued quantitative easing (QE) in the United States.** In 2014, the *Nuevo Sol* depreciated by 6.3 percent and closed at 2.98 Soles per US$, its highest level since July 2009. To mitigate domestic currency depreciation, the Central Bank sold more than 4 billion *Nuevos Soles* in 2014 and significantly cut reserves requirements to free more than 4.9 billion *Nuevos Soles.*

13. **The General Government's (GG) fiscal surplus turned into a deficit in the third quarter of 2014.** The General Government in Peru usually runs surpluses in the first three quarters of the year and a deficit in the last quarter. However, in 2014, after running surpluses in the first and second quarters (6.1 percent of first quarter GDP and 3.6 percent of second quarter GDP), the General Government's deficit reached 2.2 percent of GDP in the third quarter. Several factors contributed to this: decreasing commodity prices, combined with an economic slowdown in the mining sector, generated a decrease in income tax collection of 0.3 percentage points of GDP compared to last year; and a series of fiscal and economic stimulus measures amounting to more than 1 percent of GDP were launched between May and November 2014 to support economic growth and to speed up budget execution. Furthermore, the Government launched a reform in June to boost investment and support potential GDP growth through tax adjustments and the easing of regulations, among others measures. At the end of November, the Congress approved an additional reform package aimed at stimulating public investments and cutting taxes.

14. **Peru's debt indicators show a robust position, helped by an active liability management policy.** Peru's total public debt stood at US$38 billion as of August 2014, or 19.2 percent of GDP, down from 39.3 percent in December 2005 (Figure 2). Peru's debt is lower than that of other Latin American countries (Figure 3). Debt reduction follows a decade of high real GDP growth and overall fiscal surpluses. There has also been an increase in the share of debt in domestic currency, from 15 percent of total debt in 2004 to about 46.8 percent in August 2014. Prudent fiscal and macroeconomic policies led to rating upgrades for Peru's debt. Moody's upgraded Peru's sovereign rating in July 2014 from Baa2 to A3, with a stable outlook, as a result of: (a) a continued strong fiscal position and good management of public debt; (b) the formulation of structural reforms (pensions, health care, education, etc.) to increase productivity and support economic growth; and (c) expectations of faster GDP growth until 2016. This increase placed Peru in line with Mexico and three steps below Chile.

Figure 2. Public debt by currency
(US$ million, percent of GDP)

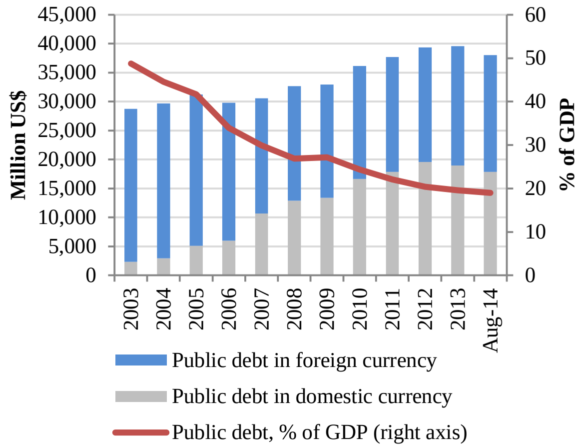
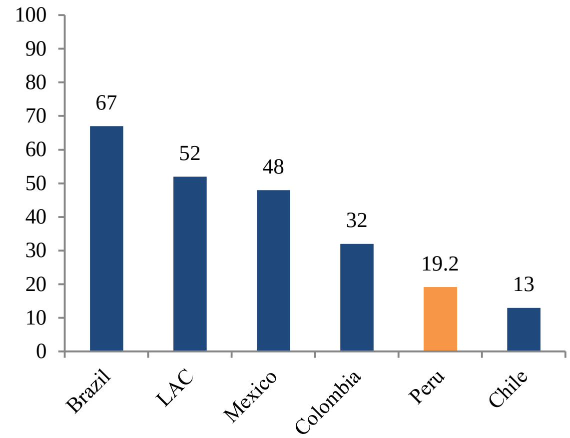


Figure 3. Public debt in LAC in 2014
(Percent of GDP)



Source: MEF, BCRP

15. **The banking sector is profitable and well capitalized, which makes it resilient to external shocks.** Peru's international liquidity position has increased significantly due to the increase in international reserves from 26 percent of GDP at the end of 2007 to the current 32 percent of GDP. The stability of the financial system has strengthened through the increase in the ratio of regulatory capital to risk-weighted assets from 11.7 percent in December 2007 to 13.9 percent in August 2014. The banking system's return on equity is among the highest in the region: it reached 20.1 percent in October 2014. In terms of asset quality, the non-performing loan (NPL) ratio remains low, although it increased slightly from 2.2 percent in October 2013 to 2.5 percent in October 2014. This is the highest rate since November 2005. However, the ratio of provisions to loans in arrears also remains high at 167. The highest rate of NPL, in October 2014, occurred in loans to small companies (8.8 percent). According to the Central Bank, the NPL ratio increased mainly in the categories of medium, small and micro enterprises, due to the lower quality of these portfolios and partly linked to the high growth rate of these loans between 2011 and 2012, which led to the incorporation of new customers with less ability to pay. The Central Bank projects that the NPL ratio will continue growing and may be close to four percent in February 2015.

Table 1. Macroeconomic Indicators

						Est.	Projections		
	2009	2010	2011	2012	2013	2014e	2015	2016	2017
(Percent of GDP unless otherwise specified)									
Nominal GDP (US$ million)	121,204	148,510	170,564	192,636	202,295	213,624	229,646	247,328	266,867
Real GDP growth rate	1.0	8.5	6.5	6.0	5.8	2.4	4.8	5.2	5.9
Nominal per capita GDP (US$)	4,189	5,075	5,759	6,424	6,660	6,944	7,370	n.a	
CPI inflation rate (eop, %)	0.2	2.1	4.7	2.7	2.9	3.2	2.7	2.5	2
Exchange rate variation: local currency unit (LCU)/US$ (annual % change)	2.9	-6.2	-2.5	-4.2	2.4	5.0	1.3	0.6	-
Investment (% of real GDP)	22.6	25.6	25.6	28.0	28.5	27.5	27.6	27.9	27.4
- Public (% of real GDP)	5.5	5.7	4.8	5.4	5.7	5.5	5.7	6.0	6.8
- Private (% of real GDP)	17.1	19.9	20.8	22.6	22.8	22.0	21.9	21.9	20.6
Fiscal									
GG Revenues	19.8	20.8	21.7	22.3	22.1	22.2	21.9	21.9	22.3
GG Non-financial expenditures	20.1	19.8	18.6	19.3	20.5	21.4	21.3	21.3	22
GG Interest payments on debt	1.3	1.2	1.2	1.1	1.1	1.1	0.9	0.9	0.9
GG Balance	-1.5	-0.1	2.0	2.1	0.7	-0.2	-0.2	-0.2	-0.6
Public Enterprises Balance	0.2	-0.2	0.0	0.2	0.1	0.1	-0.1	-0.3	0.4
NFPS Balance	-1.4	-0.2	2.0	2.3	0.9	-0.1	-0.3	-0.5	-0.2
Public Debt	27.2	24.3	22.1	20.4	19.6	19.2	18.6	18.2	17.7
- Foreign	16.1	13.2	11.4	9.8	8.8	7.2	7.1	7.2	7.6
- Domestic	11.0	11.2	10.7	10.6	10.8	12	11.5	11	10.1
BoP									
Current Account	-0.5	-2.4	-1.9	-3.3	-4.5	-4.8	-4.2	-3.9	-3.6
Exports of Goods	22.2	24.1	27.2	24.0	20.8	17.3	17.5	17.9	18.8
Imports of Goods	17.3	19.4	21.8	21.3	20.9	18.9	18.2	18.0	18.4
Financial Account	1.9	9.2	5.1	10.3	5.6	4.0	4.7	4.2	3.6
Overall Balance	0.9	7.5	2.7	7.7	1.4	-0.8	0.5	0.3	0.0
Memo									
Broad Money (annual percentage change)	6.8	21.7	15.1	12.2	14.6	11.3	13.5	-	-
Credit to Private Sector (annual percentage change)	8.9	21.2	19.4	15.4	13.2	11.3	13.1	13.7	
Exchange Rate LCU/US$ (eop)	2.89	2.81	2.70	2.55	2.80	2.96	3.10	3.15	3.15
Net International Reserves (US$ million)	33,135	44,105	48,816	63,991	65,663	62,308	65,662	67,662	-
International Reserves (months of imports)	18.9	18.4	15.8	18.7	18.7	18.5	18.8	18.2	-
Exchange Rate Regime /Monetary Regime	Managed float/Inflation targeting								

Note: Non-Financial Public Sector (NFPS) is composed of the General Government (GG) and public enterprises. GG is composed of the Central Government and subnational governments.

Source: Ministry of Finance, Peru’s Central Bank. Projections Revised MMM 2015–2017, IMF, GEP forecasts (January 2015).

B. MACROECONOMIC OUTLOOK AND DEBT SUSTAINABILITY

16. **Peru's macroeconomic policy stance is adequate to proceed with the proposed operation.** Thanks to a conservative fiscal stance, Peru has weathered the recent crisis very well, is showing a solid primary fiscal surplus and a low and declining level of debt, and has ample fiscal space to respond to external shocks if deemed necessary. Peru's monetary and exchange rate policy is prudent, and is reinforced by a generally well-balanced external account and export base that is diversified with respect to commodity price shocks. Public debt has remained below 20 percent of GDP since 2012. Net public debt is very low at 5 percent of GDP.

17. **Economic growth is estimated to have remained relatively strong in 2014, at 2.4 percent**. This growth is projected to accelerate in 2016–2017 to above 5 percent. Domestic demand slowed down in 2014 due to a contraction in private investment and slower dynamism of public investment at the subnational level. Nevertheless, Peru's economy is expected to grow well above the regional average of 0.8 percent.[14] Expected deceleration in 2014 was related to the postponement of mining investments, the deterioration of terms of trade, weather-related challenges in the fishing sector, and lower dynamism of public investment. In the next two years, private investment and exports are expected to rebound due to the implementation of mining projects (Antamina, Toromocho, Inmaculada, Invicta, Constancia, Shahuindo, Las Bambas and Cerro Verde) and an increase in external demand. Extractives and fishing industries are expected to rebound sharply in 2015, growing by 6.5 and 23.1 percent, respectively. However, this positive outlook is subject to downside risks from the large mining projects' uncertain starting dates.

18. **The current account (CA) deficit is expected to narrow progressively, and will remain financed by the long-term capital inflows.** The CA deficit was expected to close at 4.8 percent of GDP in 2014 but may gradually improve to 4.2 and 3.6 percent of GDP during the projection period (Table 1). Despite falling commodity prices, exports should benefit from the current depreciation of the domestic currency and the relatively higher dynamism of primary activities in 2016, due to the Las Bambas and Cerro Verde projects. Moreover, El Niño's impact on the fishing industry is expected to moderate in 2015, which will allow a recovery of anchovy exports. Despite a slowdown in capital inflows, the CA deficit will remain financed by the financial account, because long-term capital inflows are expected to exceed five percent of GDP at least until 2016.

19. **The fiscal balance was expected to reach a deficit of 0.1 percent of GDP in 2014, but will edge to a 0.3–0.5 percent deficit in 2015 and 2016.** Under the Law to Strengthen Fiscal Responsibility and Transparency, Peru has established a fiscal framework that mitigates the pro-cyclicality of fiscal policies related to natural resource revenues and strengthens the control of subnational expenditures. For 2014, the overall fiscal balance was projected to reach a deficit of 0.1 percent of GDP, because current revenues and non-financial expenditures of the General Government may have increased by 2.8 and 6.9 percent, respectively. Between 2015 and 2016, the former is expected to grow at an annual average rate of 5 percent, whereas the latter will increase by 6.2 percent.

[14] According to the January 2015 GEP; see http://www.worldbank.org/en/publication/global-economic-prospects/regional-outlooks/lac.

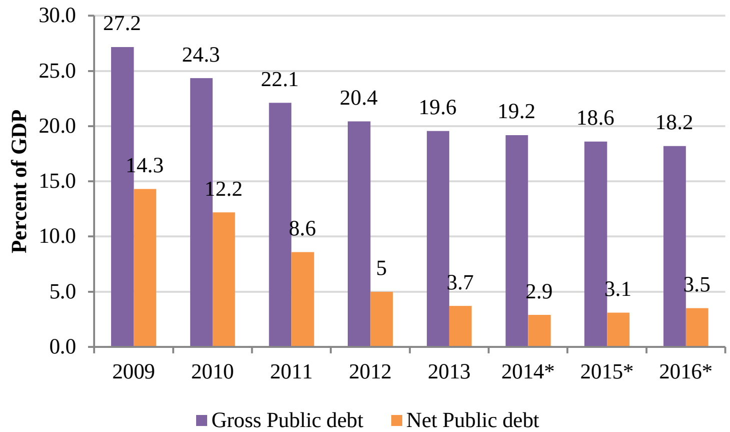
20. **The risks to this outlook are mostly external, with limited potential fiscal impacts.** Growth rates are vulnerable to external shocks to metal prices, unexpected global volatility transmitted through financial sector channels, and a slowdown in external demand for Peruvian exports. Domestic factors include the implementation of the public investment program and potential uncertainty related to the upcoming elections. Peru exports metals and hydrocarbons; copper and gold represented about 20 percent of total exports, and other commodities represented 30 percent of total exports in 2014. Copper prices have been on a declining trend since 2011, and represent a potential risk to the outlook, especially on the fiscal side. However, as prices fell, Peru has been able to increase copper production, and several large mining projects are coming on stream over the next two years. Commodities also represent a relatively small portion of Peru's fiscal revenues (around 12 percent), with the rest of the revenues coming from the non-commodity sectors. Therefore, a further 10 percent decline in copper prices would decrease fiscal balance *ceteris paribus* by 0.3 percentage points of GDP. At the same time, the decline in oil prices would be beneficial for growth and the fiscal account, compensating about 0.2 percentage points of GDP to the fiscal balance. As a result, the overall impact of a negative commodity price shock on the fiscal account would be small. The decline in oil prices would also increase potential growth and reduce other macroeconomic risks, such as inflation.

21. **These risks are manageable, given the Government's proactive policy stance and the tools that it has at its disposal to mitigate potential shocks.** These tools include a strategic approach to debt management, which has resulted in low debt levels and an effective liability management policy, high international reserves, growing non-commodity government revenues, and ample fiscal buffers. The rest of this section focuses on these policies in more detail.

22. **Public debt management strategy has been extremely successful.** Peru's sustainable debt level is the result of a tight coordination with fiscal and monetary policy combined with high-quality monitoring (monthly and quarterly statistical reports). A strategy document for asset and liability management has been published for 2013 to 2016. It displays the following policy guidelines: (a) consider public debt management as part of global management for assets/liabilities and reduce the cost of liquidity management thanks to active treasury management with public debt values; (b) reduce the share of public debt in dollars and diversify markets and investors to mitigate vulnerability and increase debt sustainability; (c) strengthen transparency, competition and liquidity in domestic capital markets and facilitate access to investment in public debt value; and (d) consolidate the growth of microfinance institutions by granting them access to public debt.

23. **Debt sustainability analysis indicates that the debt level is low and resilient to external shocks.** According to the strategy described above, total debt is expected to continue to decline further, at about 1.5 percentage points per year between 2014 and 2018, and to remain below 20 percent of GDP (Figure 4). Debt in foreign currency is projected to decrease from 8.9 to 6.1 percent of GDP between 2014 and 2018. In a constant primary balance scenario, public debt would decline further than in the baseline scenario and reach 10 percent of GDP, while in the historical scenario it would represent less than 5 percent of GDP. Despite GDP growth deceleration and declining commodity prices, rating agencies such as Moody's have stressed that the country's gradual pace of reform and diversification of tax revenues reflect positively on the outlook.

Figure 4. Public debt of the Non-financial Public Sector
(Percent of GDP)



Source: BCRP, Inflation report (October 2014)

24. **Peru's Central Bank commands a strong set of tools to manage any external shocks, and is well equipped and able to deal with depreciation pressures.** The US Federal Reserve tapering, combined with steady or softening commodity prices, is putting depreciation pressures on the local currency (the *Nuevo Sol*). The dollarization of the economy (40 percent of credit to the private sector and 30 percent of the deposits denominated in US dollars) is an important factor when one considers potential depreciation impacts because of its potential impact on the private sector's balance sheets and resulting volatility. However, the BCRP has managed to reduce volatility and avoid excessive currency mismatch by using the exchange rate as a shock absorber. Having accumulated more than US$60 billion (32.1 percent of GDP or more than 19 months of imports) in international reserves to mitigate external shocks, it has intervened in the foreign exchange market by selling US dollars, smoothed exchange rate movements, and thus sterilized its interventions to prevent a credit crunch. In addition, the BCRP has been active in using monetary tools, such as reserve requirements for credits, to sustain credit in local currency and mitigate local currency depreciation. It recently reduced reserve requirements from 120 to 95 percent for foreign institutions' deposits in national currency to compensate for the slowdown in capital inflows. As a result, it partly stimulated the de-dollarization process: the dollarization ratio of credit to the private sector fell slightly, from 41 to 39 percent, between January and October 2014. Furthermore, the Central Bank may also modify reserve requirements in domestic and foreign currencies as buffers in order to contain risks. The exchange rate should continue to be driven by fundamentals, while limited foreign exchange interventions and enhanced supervision could be necessary to limit volatility and contain risks to the balance sheets in a still highly dollarized economy.

25. **On the other hand, currency depreciation may have a positive impact on the current account balance, especially in a context of lower commodity prices**. The *Nuevo Sol's* depreciation may help improve the competitiveness of Peruvian exports in a context of lower copper prices. In this case, the exchange rate should work as a shock absorber, although as previously mentioned there are risks due to the financial system's significant dollarization.

26. **Given the tools available to the Central Bank, inflation is expected to be kept under control.** Despite the pressures in the first half of 2014, inflation forecasts for 2014 remained in

the upper bound of the target range as the probability of a strong El Niño declined. The *Nuevo Sol's* depreciation may affect imported inflation in 2015 but its effect will be compensated by decreasing commodity prices. Therefore, inflationary expectations for 2015 remain below the ceiling fixed by the Central Bank.

27. **Access to capital markets and ample fiscal space ensure that Peru has strong mitigation capacity in the face of a potential future crisis.** Peru has full access to international bond markets. The net public debt is below five points of GDP (one of the world's lowest). The profitability of the banking sector remains high and international reserves are sufficient to provide an additional buffer in case of a crisis. The risk of financial openness is also seen as limited because of the sector's limited exposure due to regulations concerning bank branches, and also because high profitability makes the sector resilient to global crises.

28. **The Fiscal Stabilization Fund (*Fondo de Estabilización Fiscal,* FEF) provides an additional buffer in case of an external shock.** The FEF was established in 1999 by the Fiscal Responsibility Act and is financed by fiscal surplus from the Treasury obtained at the end of each year, 50 percent of concessional fees and 75 percent of privatization proceeds. The FEF cannot exceed 4 percent of GDP. Any additional earnings are used for debt reduction. The FEF can be used if the current revenues in GDP terms fall by more than 0.3 percentage points below the average level of the last three years. In this event, the amount that exceeds the declining limit of 0.3 percent of GDP, and up to 40 percent of the FEF's current balance, will be used to cover poverty alleviation programs. In addition, the FEF can be used in exceptional situations such as an international crisis or emergency when there is evidence that GDP is decreasing. The FEF has risen from US$100 million as of December 2000 to US$9.2 billion as of November 2014 (4 percent of GDP).

C. IMF RELATIONS

29. **The Bank maintains an ongoing dialogue with the International Monetary Fund (IMF) on macroeconomic policy in Peru.** On January 24, 2014, the IMF's Executive Board concluded the Article IV consultation and determined that the state of the economy remains strong despite some commodity price turbulence, and that the outlook remains positive with balanced risks.[15] An IMF assessment (Peru Assessment Letter for the World Bank, dated December 22, 2014) of the current macroeconomic situation is presented in the Fund Relations Annex (see Annex 3).

III. THE GOVERNMENT PROGRAM

30. **Over the past five years, the GoP has taken significant steps to strengthen the legal and institutional framework to reduce disaster and climate risks.** Peru's National Agreement *(Acuerdo Nacional)* includes Policy 32 on Disaster Risk Management (Supreme Decree N° 111-2012-PCM), which aims to promote a culture of prevention and contribute directly to the sustainable development process at the national and subnational levels.[16] The national policies

[15] International Monetary Fund (IMF), IMF Executive Board Concludes 2013 Article IV Consultation with Peru, Press Release No. 14/26, January 24, 2014.
[16] Acuerdo Nacional Unidos Para Crecer: http://acuerdonacional.pe/.

define general guidelines for inclusive, equitable and sustainable development and affirm democratic governance in the country. In addition, the National Agreement Forum *(Foro del Acuerdo Nacional)*, composed of the three levels of government and the country's main political and social institutions, provides a space for dialogue and consensus building to advance the development agenda. At the national level, Peru's 2021 Bicentennial Plan 2021 *(Plan Bicentenario: el Perú hacia el 2021)* was approved in March 2011 (Supreme Decree N° 054-2011-PCM) and updated in December 2013.[17] This strategic development plan, which is part of an agreement among the country's major political parties, contains six strategic areas.[18] The proposed operation supports Area 6: Environment and Natural Resources, under which the GoP has identified adaptation to climate change as one of the five strategic priorities.

31. **In 2011, the establishment of the new National Disaster Risk Management System (*Sistema Nacional de Gestión del Riesgo de Desastres,* SINAGERD) allowed Peru to move from an emergency response-focused system toward a comprehensive disaster risk management system**. On February 19, 2011, Law N° 29664 on DRM was issued, creating SINAGERD.[19] This law promotes a comprehensive approach for DRM, mandating all public institutions at all levels of government to include DRM considerations in their sectoral and planning processes in order to avoid the creation of new risks and reduce existing risks. On May 26, 2011, the Regulations of Law N° 29664 were adopted through Supreme Decree N° 048-2011-PCM, which established the DRM institutional framework and defined the roles and coordination mechanisms for different actors involved in managing the country's disaster and climate risks. The DRM Secretariat, under the Presidency of the Council of Ministers (*Presidencia del Consejo de Ministros*, PCM), created by this law oversees SINAGERD's coordination. A new agency, the National Center for the Estimation, Prevention and Reduction of Disaster Risk (*Centro Nacional de Estimación, Prevención y Reducción del Riesgo de Desastres*, CENEPRED), was created to be responsible for disaster risk information, risk-reduction policies and reconstruction processes. The National Civil Defense Institute (*Instituto Nacional de Defensa Civil*, INDECI), an existing agency under the former institutional framework, remains responsible for emergency response. In addition, under the DRM law MEF is assigned the strategic role of defining and implementing a national financial protection strategy against disasters. The resources from the first CAT-DDO were the first contingent resources to be part of the GoP's national financial protection strategy.

32. **PLANAGERD 2014–2021 was approved in May 2014.**[20] **It established the policy framework to comply with the SINAGERD law.** PLANAGERD is a strategic document whose aim is to actively reduce the vulnerability of the population and its livelihoods to disaster and climate risks**.** Anchored in five strategic objectives, the Plan establishes a comprehensive set of specific objectives and priority actions for the main DRM processes: risk identification, risk reduction, emergency response, post-disaster recovery, and institutional development. The Plan

[17] CEPLAN submitted the updated Bicentennial Plan to the PCM for approval on December 2, 2013. Source: http://www.ceplan.gob.pe/noticias/ceplan-culmina-version-actualizada-del-plan.
[18] Peru Bicentennial Plan's strategic areas: (1) fundamental rights and people's dignity; (2) opportunities and access to services; (3) state and governance; (4) economy, competitiveness and employment; (5) regional development and infrastructure; and (6) environment and natural resources.
[19] Ley del Sistema Nacional de Gestión de Riesgo de Desastres; http://www.eird.org/imagenes/pdf/aprobacion-ley-GRD.pdf.
[20] Supreme Decree N° 034-2014-PCM dated May 12, 2014.

defines an implementation strategy to be achieved with the support and participation of all sectors and the three levels of government. In addition, the Plan identifies a financing scheme for the allocation of budget resources for DRM that involves national, regional and local government budgets. The Plan integrates the Disaster Vulnerability Reduction and Emergency Response Budget Program 068 (BP068),[21] which was created and has been managed by MEF since 2010, in order to increase the allocation of public resources for DRM and systematically monitor their outputs.

33. **In line with the progress described in the area of DRM, the Ministry of Environment (*Ministerio del Ambiente*, MINAM) is currently in the process of updating the National Climate Change Adaptation Strategy (NCCAS)**,[22] **which was originally approved in 2003.** The 2014 draft of the Strategy provides guidelines for the three levels of government to develop action plans, establish specific goals, and promote the participation of civil society, the private sector and indigenous organizations[23] in climate change adaptation. The NCCAS was approved in 2003 (Supreme Decree N° 086-2003-PCM), and a draft for public consultation was released in July 2014.[24] Furthermore, since 2004 the General Law on the Environment N° 28611 established a framework for climate change adaptation in Peru. This law, together with the National Environment Policy approved in 2009 (Supreme Decree N° 012-2009-MINAM), establishes the legal framework aimed at ensuring the country's sustainable development through the protection and restoration of the environment, and through the conservation and sustainable use of its natural resources.[25]

IV. THE PROPOSED OPERATION

34. **The design of the proposed operation's Policy Matrix builds on the achievements and lessons learned from the implementation of the first CAT-DDO (P120860).** The policy reforms included under the proposed program support the Government's objective to move toward a comprehensive DRM system by: (a) strengthening the alignment of the existing DRM Budget Program and regional planning processes with the SINAGERD policy framework and the PLANAGERD action plan; (b) expanding the number of infrastructure sectors to include education and housing vulnerability reduction programs, and improving the design of flood protection plans at the subnational level; and (c) strengthening the national financial protection strategy against disasters by incorporating a post-disaster reconstruction framework and developing operational continuity plans for all government sectors. The proposed Policy Matrix is well aligned with SINAGERD's framework and the National Plan. Finally, the expected results are grounded on ongoing institutional processes with adequate legal and budgetary bases.

[21] PP068 is under the Framework of the Results-Based Budget (PPE) Strategic Budgetary Program, which is specifically for integrated disaster risk management. Source: Inter-American Development Bank, "Program to Reduce the Vulnerability of the State to Disasters III (PE-L11138) Loan Proposal," June 18, 2014.
[22] Ministerio del Ambiente (MINAM), "Estrategia Nacional Ante el Cambio Climático," Borrador 2014.
[23] MINAM, Presentación "La ENCC Marco General: Antecedentes, Proceso y Contexto Actual," 22 de agosto 2014.
[24] Resolución Ministerial N° 227-2014-MINAM.
[25] Ministerio del Ambiente (MINAM), "Plan de Acción de Adaptación y Mitigación Frente al Cambio Climático," 2010.

A. LINK TO GOVERNMENT PROGRAM AND OPERATION DESCRIPTION

35. **The proposed operation's development objective is to strengthen the legal and institutional framework to contribute toward the reduction of Peru's fiscal and physical vulnerability to disasters.** This objective will be achieved through reforms under three pillars:

- ***Pillar 1: Improving efficiency in public resource allocations for disaster risk management:*** strengthening of the financing mechanisms for the implementation of PLANAGERD, and mainstreaming of disaster risk management policies into subnational planning;
- ***Pillar 2: Strengthening vulnerability reduction policies in infrastructure for the education and housing sectors and for flood protection measures:*** integration of vulnerability reduction policies in the education and housing sectors, and establishment of flood protection planning to reduce the impact of extreme weather events; and
- ***Pillar 3: Increasing Peru's capacity for post-disaster recovery and reconstruction:*** strengthening of the Government's institutional capacity to effectively plan and implement post-disaster rehabilitation and reconstruction processes and guarantee the Government's operational continuity.

36. **Disasters from adverse natural events could represent significant explicit and implicit contingent liabilities to the Government.** MEF recently finalized a seismic risk profile, which showed that the Probable Maximum Loss (PML) for a 100-year return period could generate losses of at least 10 percent of the total exposed value of public assets and infrastructure.[26] Based on this information, the Government's financial protection strategy against disasters prioritized the contracting of specific contingent lines of credit. The proposed second CAT-DDO for US$400 million will allow the Government to increase the availability of immediate liquidity in the aftermath of a disaster for up to US$1.2 billion. The CAT-DDO is a flexible financial instrument that provides rapid liquidity to the Government upon declaration of a state of emergency. Having these resources in place will enable the Government to focus its efforts on efficiently responding to the emergency and recovery, rather than spending valuable time and resources on fundraising activities.

37. **Drawdown condition, financial features and renewals are as follows:**[27]

- ***Drawdown Triggers.*** Funds may be withdrawn upon the declaration of a State of Emergency (*Estado de Emergencia)* through a Supreme Decree. The regulation that implements the SINAGERD DRM law includes Title VI: Declaration of State of Emergency and three articles: Article 67–Declaring a State of Emergency due to a Disaster, Article 68–Procedures to declare a State of Emergency, and Article 69-Extending a State of Emergency.
- ***Financial Features***. The financial features of the DPL with a CAT-DDO are similar to those available for the Deferred Drawdown Option for Development Policy Loans (DDO-

[26] Preliminary numbers based on draft reports shared by MEF.
[27] "Memorandum of the President to the Executive Directors. Subject: Proposal to Enhance the IBRD DDO and to Introduce a DDO Option for Catastrophic Risk (CAT-DDO)," Document No. 42396, World Bank, January 29, 2008.

DPLs), with one exception: the DPL with a CAT-DDO would have a revolving feature by which the amounts repaid prior to the closing date would be available for drawdown.

- ***Drawdown Period and Renewals***. The drawdown period for the proposed operation will be three years and may be renewed up to four times. The Bank will monitor the implementation of the disaster risk management program. If it is not being implemented in a satisfactory manner, the Borrower may not be eligible to submit a disbursement request. The adequacy of the macroeconomic framework is assessed at effectiveness and reconfirmed at renewal. Renewal would take place no earlier than one year, and no later than six months, before the expiration date. The renewal would be aligned with Bank procedures for extension of closing dates beyond two years. Renewals would require that the original program remain largely in place.

B. PRIOR ACTIONS, RESULTS AND ANALYTICAL UNDERPINNINGS

Pillar 1: Improving efficiency in public resource allocations for disaster risk management

38. **Reforms in this policy area focus on strengthening the financing mechanisms for the implementation of PLANAGERD and the mainstreaming of disaster risk management policies into regional planning.** The Policy reforms will be coordinated by the Secretariat for Disaster Risk Management of the Presidency of the Council of Ministers (PCM) and the National Center for the Estimation, Prevention and Reduction of Disaster Risk (CENEPRED).

39. ***Prior Action 1*****: The GoP The GoP has strengthened the financial mechanisms for the implementation of the National Disaster Risk Management Plan (PLANAGERD) by: (a) integrating the existing DRM budgetary program (BP068) in the new DRM policy framework; and (b) enabling the inclusion of disaster risk information in regional development planning.**

Legal Evidence: (a) Supreme Decree Nº 034-2014-PCM approving the 2014–2021 PLANAGERD (dated May 12, 2014); (b)) the 2015 National Budget Law N° 30281 (dated December 4, 2014), Annex 8: Allocations for the Budgetary Program (BP068); and (c) CENEPRED Administrative Resolution *(Resolución Jefatural)* Nº 044-2014-CENEPRED/J (dated May 23, 2014) approving the guidelines for the incorporation of DRM in Regional Development Plans.

40. **Through the integration of the DRM budget program (BP068) in the newly established DRM policy framework, the national and subnational governments can strategically allocate resources to prevent and reduce their vulnerability to disasters.** Until recently, MEF managed the BP068 in an ad hoc manner. Under the newly established PLANAGERD, the BP068 is aligned with the Plan’s strategic objectives. This will allow the GoP to measure how resources are spent and monitor them in a systematic manner. An annual financial evaluation of DRM-related projects in existing budgetary programs will allow tracking of both the change in resource allocation and the quality of the investments, to show their contribution to PLANAGERD’s implementation. At the subnational level, the program allows regional governments to increase the allocation of DRM resources for vulnerability reduction investments and disaster risk prevention activities. Table 2 shows the increasing allocation of the BP068 at national level since 2011.

Table 2. Budget Allocations for the Disaster Vulnerability Reduction and Emergency Response Budgetary Program 068

BP068	2011	2012	2013	2014
Budget Allocations	US$18.4 million	USD$47.1 million	US$240.2 million	US$277 million

Note: S/.54.4 m (2011); S/.138.9 m (2012); S/.708.7 m (2013); S/.820 m (2014).

41. **In addition, CENEPRED is supporting regional governments' efforts to integrate DRM considerations in the formulation of regional development plans**. Regional governments are accountable for the definition, prioritization and design of mitigation measures. To support them, CENEPRED has developed tools and is implementing a technical assistance program focused on gathering the necessary hazard and risk information and developing a methodology to formulate disaster risk management plans, which will inform the regional development plans.

42. **Results Indicators:** (a) Annual budgetary performance report of PLANAGERD implementation under the results-based budgeting programs. [Baseline 2014: None/Target 2018: Annual budgetary performance reports published for 2016 and 2017]; Coordination: Secretariat for Disaster Risk Management–Presidency of the Council of Ministers (PCM). (b) Number of regional governments that have approved regional plans for disaster risk prevention and reduction. [Baseline 2015: 0/Target 2018: 15/25]; Coordination: National Center for the Estimation, Prevention and Reduction of Disaster Risk (CENEPRED)–Presidency of the Council of Ministers (PCM).

Pillar 2: Strengthening vulnerability reduction policies in infrastructure for the education and housing sectors and for flood protection measures

43. **Under this pillar, the Government will consolidate and strengthen vulnerability reduction measures in the education and housing sectors, and for flood protection.** The policy reforms are being coordinated by the Ministry of Education (*Ministerio de Educación,* MINEDU), the Ministry of Housing, Construction and Sanitation (*Ministerio de Vivienda, Construcción y Saneamiento*, MVCS) and the National Water Authority (*Autoridad Nacional del Agua*, ANA) of the Ministry of Agriculture and Irrigation (*Ministerio de Agricultura y Riego*, MINAGRI).

44. ***Prior Action 2:*** **The GoP integrates seismic risk reduction considerations for existing and new infrastructure in the National School Infrastructure Program (*Programa Nacional de Infraestructura Escolar*, PRONIED).**

Legal Evidence: Supreme Decree N° 004-2014-MINEDU, establishing PRONIED.

45. **Reducing the high seismic vulnerability of the existing school infrastructure poses a complex challenge for MINEDU and the regional governments.** According to results from the recent School Infrastructure Census,[28] Peru has approximately 49,500 schools, of which 65 percent are in rural areas and 35 percent in urban areas. The majority of school facilities in rural areas are built with adobe or other artisanal materials, and often lack quality control. MINEDU estimates

[28] The School Infrastructure Census *(Censo Nacional de Infrastructura Educativa),* which was completed in March 2014, was led by MINEDU and INEI.

that most of these school buildings will need to be replaced with new buildings constructed using adequate materials and in compliance with the current seismic-resistant design standards**.** On the other hand, school facilities in urban areas concentrate 70 percent of Peru's school community, and high seismic structural vulnerability is one of the most relevant issues, along with functional and maintenance issues. A seismic risk assessment of 1,969 school facilities in Lima and Callao, conducted with World Bank support through a Reimbursable Advisory Service,[29] demonstrated that 8.6 percent of the portfolio has a high potential for collapse and 66 percent has the potential for high structural damage in the case of earthquakes with a magnitude higher than 7.6 Mw. In Lima, only about 18 percent of school buildings comply with the current seismic-resistant design standard. The assessment emphasized the need for an urgent intervention in at least 35 percent of the school infrastructure and for the establishment of a comprehensive disaster risk reduction program for school infrastructure in Peru: a critical sector for sustaining the development and current growth of Peru and closing prevalent social gaps. To be comprehensive in solving the problem, this strategy needs to be complemented with functional improvements that support the educational development of students nationwide.

46. **The recently established PRONIED provides the required framework for the definition of a broad intervention strategy that integrates and articulates risk reduction and functional improvement measures**. The results from the School Infrastructure Census have clarified the magnitude of existing infrastructure issues and allowed the establishment of the baseline for PRONIED's design. MINEDU faces the challenge of defining an articulated intervention strategy that addresses both short-term infrastructure needs, as well as medium- and long-term measures for better planning, efficiency and sustainability of school infrastructure. To help address these challenges, PRONIED will: (a) formulate the National School Infrastructure Plan for the construction, rehabilitation, replacement, improvement and maintenance of school infrastructure countrywide; and (b) identify, design, prioritize and implement the required public investments according to the Plan. In this context, vulnerability reduction measures such as structural retrofitting will be used. To date, PRONIED has defined a short-term action plan for the Lima Metropolitan Area, with an estimated total investment of US$17 million, that includes the replacement of 127 school facilities identified as highly vulnerable and the rehabilitation of 125 school facilities. For the medium- and long-term plan, MINEDU has made preliminary estimates that will require a US$500 million investment. The Bank is providing MINEDU with technical assistance on mainstreaming DRM in Peru's education sector (P152271).

47. ***Results Indicator:*** Share of seismic risk reduction in school infrastructure in the Lima Metropolitan Area as a result of PRONIED implementation [Baseline: Risk Indicator (RI)[30]=20.3 for a portfolio of 1,969 school facilities in the Lima Metropolitan Area)/Target 2018: 10 percent reduction].

48. ***Prior Action 3:*** **The GoP has established the financing mechanism for a pilot program to reduce the seismic vulnerability of low-income housing.**

[29] The World Bank provided support to PRONIED through a Reimbursable Advisory Service (RAS) on School Infrastructure Baseline (P150434).
[30] Risk Indicator (RI) is the ratio of the total average annual loss to the total exposure value times 1,000 , of the Lima school portfolio (reference: World Bank RAS [P150434] Report 2: Definition of criteria for the prioritization of intervention measures for the portfolio of public schools of the Metropolitan Area of Lima and Callao).

Legal Evidence**:** (a) Law 30191–Prevention, Mitigation and Attention to Disasters (dated May 9, 2014); and (b) Ministerial Resolution Nº 172-2014–VIVIENDA, which approves the operational rules for the Grant for the Protection of Housing Vulnerable to Seismic Risk.

49. **Some of the main drivers that have led to an increase in seismic vulnerability in the Peruvian housing sector include the poor quality of construction in households with the population's lowest income levels, and the concentration of construction in high seismic hazard urban zones such as Lima.** Sixty-five percent of a 7.8 million housing stock corresponds to the two lower income deciles in which housing is mostly informal, self-built and incremental. As a result, this housing stock has numerous structural weaknesses with the potential to collapse in case of an earthquake. Approximately 75 percent of the stock (5.8 million units) is located in urban areas and at least 50 percent in cities with high seismic hazard such as Lima, Arequipa, Moquegua, and Chincha, among others. The Lima Metropolitan Region concentrates the highest seismic risk, with 2.4 million homes, of which 37.9 percent pertain to the two lower income deciles. Finally, the quality of land-use planning and the regulatory framework, as well as the adequacy of enforcement mechanisms, remain a challenge. Land is typically not formally acquired, illegal settlements and invasion of public land by squatters are common, and the regularization of illegal settlements has been difficult and costly.

50. **The GoP is making important strides toward the establishment of a long-term seismic vulnerability reduction program for housing by launching a pilot program that provides low-income households with a grant dedicated to the seismic reinforcement of their homes.** With a US$37 million allocation to be managed by the MiVivienda Fund,[31] this first phase of the program will provide financing for structural retrofitting works to the most vulnerable segments of the population. The program provides technical and financial support to low-income homeowners to help reduce the seismic vulnerability of their houses[32]. Through eligible engineering firms, beneficiary homeowners will implement the structural retrofitting of their houses. The main objective of this pilot program is to establish the mechanisms to respond to the urgent need to reduce vulnerability in formal low-income constructions. Through the implementation of and lessons learned from this pilot program, MVCS will advance toward the design and establishment of a long-term housing vulnerability reduction policy. Furthermore, in the future MVCS envisions the program's expansion to the entire housing sector and the inclusion of services such as loans for retrofitting and the promotion of catastrophe insurance mechanisms for homeowners.

51. ***Results Indicator:*** Share of eligible low-income households covered by the Grant for Protection of Housing Vulnerable to Seismic Risk program [Baseline 2014: 0/Target 2018: 80 percent of 8,303 eligible households].

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[31] The MiVivienda Fund is the main entity through which the Government of Peru executes its social housing policy. It is aimed at helping low- to middle-income families achieve homeownership through different products, depending on their needs and income levels. The mission of the MiVivienda Fund is to facilitate access to housing, mainly for low-income families, through concerted efforts between the State and the financial and real-estate sectors. http://www.mivivienda.com.pe/

[32] Eligible low income households must meet the following criteria: 1) be the legal homeowner; 2) be within the socioeconomic classification level 1 to 5 set by the Household Targeting System (*Sistema de Focalización de Hogares*, SISFOH); 3) be within the list of housing to be intervened, according to the MVCS diagnostic. http://geo.vivienda.gob.pe/dnv/bono-proteccion.html.

52. ***Prior Action 4:*** **The Government of Peru has taken measures to improve the design of flood protection programs at national and subnational levels by: (a) expanding the mandate of the National Water Authority (ANA) to conduct hydraulic studies that support the design of regional and local flood protection programs; and (b) defining specific minimum standards for the preparation of pre-investment studies for flood protection public investment projects under the National Public Investment System *(Sistema Nacional de Inversión Pública,* SNIP) framework.**

Legal Evidence**:** (a) Supreme Decree N° 006-2014-MINAGRI (May 23, 2014), and (b) MEF Directorial Resolution N°006-2014-EF/63.01 (September 3, 2014).

53. **Among climate-related risks, flood events pose a major challenge to infrastructure, urban communities and rural economic activities.** Due to its location, Peru is highly impacted by hydro-meteorological hazards such as floods. Each year from September through May, the rainy season affects the Andean part of the country. During El Niño events (1982–1983, 1997–1998), heavy rains impacted the northern part of the country and affected agricultural exports; and in the high Andean plateau droughts caused food security issues. In the last two decades, heavy rains and flooding have caused major damages to public and private infrastructure, including sections of road networks and key bridges. Such damages can cut access and severely disrupt the flow of economic goods and the movement of the population. As a result of heavy rains and flooding, an estimated 29.43 percent of housing was destroyed between 2003 and 2012.[33] In addition, agricultural production is at high risk due to flooding, in particular in the departments of Huanuco, La Libertad and Pasco.[34] The identification, prioritization, design and implementation of flood protection programs remain a key challenge for the national and subnational governments in particular, due to the absence of necessary hydrological and hydraulic information and the lack of coordination among different government agencies (MINAGRI, ANA, Ministry of Transport and Communications, MINAM) and subnational governments involved in water resource management. Regional and local governments are ultimately responsible for the implementation of these measures.

54. **The proposed policy reforms expand the role of ANA to provide technical assistance to regional and local governments in the design of flood protection programs and integrate in the SNIP specific minimum standards for the formulation of flood protection projects.** Until now, ANA has only provided technical assistance to regional and local governments in the initial phase of diagnosis and identification of critical floodprone areas. Flood protection projects at the feasibility stage are designed and submitted by local and regional governments to the SNIP. However, once the SNIP has approved the feasibility stage, the project tends to stall because the subnational governments lack the capacity to continue carrying out the investments. This is due to the lack of technical and engineering capacity to define and conduct detailed hydrological and hydraulic studies and design the final flood protection measures. With the recently approved reforms, ANA will establish a technical assistance program to support subnational governments throughout the entire public investment project process, including design, formulation and implementation. ANA will use watershed studies to identify critical floodprone areas and provide

[33] PLANAGERD p. 12.
[34] PLANAGERD p. 32.

specific guidelines and technical recommendations for local and regional flood protection programs. In addition, the standard defined by MEF to clarify the scope of the project contents at the feasibility stage will facilitate the design of flood protection programs with estimated costs ranging from US$10 million to US$400,000.[35]

55. ***Results Indicator:*** Number of studies for flood risk prevention and mitigation in watersheds approved [Baseline 2014: 0/Target 2018: 4]. Coordination: National Water Authority (ANA).

Pillar 3: Increasing the Government's capacity for post-disaster recovery and reconstruction

56. **Reforms in this pillar address the need to increase the State's capacity to operate, plan and implement public investments under post-disaster reconstruction processes and guarantee the continuity of State services and operations.** By including this pillar, the proposed operation not only increases the availability of funds to be mobilized after a disaster, but also the Government's capacity to implement them. The policy reforms are being coordinated by the National Center for the Estimation, Prevention and Reduction of Disaster Risk (*Centro Nacional de Estimación, Prevención y Reducción del Riesgo de Desastres* CENEPRED), the Secretariat for Disaster Risk Management–Presidency of the Council of Ministers (*Presidencia del Consejo de Ministros*, PCM), and the Ministry of Economy and Finance (*Ministerio de Economía y Finanzas*, MEF).

57. ***Prior Action 5:*** **The GoP has taken measures to improve post-disaster recovery and reconstruction processes by: (a) establishing the regulatory and institutional framework for reconstruction, and (b) defining MEF's internal coordination mechanism to finance rehabilitation and reconstruction processes.**

Legal Evidence: (a) Supreme Decree Nº 034-2014-PCM approving PLANAGERD 2014–2021, and (b) MEF Ministerial Resolution Nº 034-2015-EF/10 (January 22, 2015) defining the internal coordination mechanism to finance rehabilitation and reconstruction processes.

58. **Past disasters have shown the need to strengthen Peru's institutional capacity to plan and manage post-disaster reconstruction.** In the last 15 years Peru faced three major disasters[36] that challenged the Government's capacity to plan and implement reconstruction processes. In the last major earthquake in Pisco (2007; magnitude 7.9 Mw), the Bank supported the initial activities to set up a new government agency (Fund for the Integrated Reconstruction of Zones Affected by the August 15, 2007 Earthquakes [*Fondo de Reconstrucción Integral de las Zonas Afectadas por los Sismos del 15 de Agosto de 2007*, FORSUR]) to manage the reconstruction. As first-hand participants, the Bank identified challenges that were not addressed at the time, such as lack of inter-institutional coordination mechanisms, temporary shelter management, and a "building back better" policy, among others. There have since been improvements. For example, MEF has defined fast-track procedures for post-disaster public investments under the SNIP, as defined under the

[35] The amounts in Peruvian Nuevos Soles are S/. 30,000,000 and S/. 1,200,000. Source: MEF Directorial Resolution N° 006-2014-EF/63.01 (September 3, 2014).
[36] El Niño 1997-1998; Arequipa earthquake 2001; Pisco earthquake 2007.

first CAT-DDO's expected results.[37] Another important step was the establishment of reconstruction as one of the DRM processes[38] and the definition of institutional roles and leadership under SINAGERD and specific objectives under PLANAGERD.

59. **The proposed program supports the development of policy reforms to increase the Government's capacity to coordinate, plan and finance reconstruction.** The program aims to develop reconstruction plans (policies and procedures) for five infrastructure sectors (transport, agriculture, health, education, water and sanitation) and housing. In addition, PLANAGERD will support the design and implementation of Operational Continuity Plans for National Government Agencies. These plans will reduce institutional vulnerability and increase the likelihood of continued provision of services by these agencies in the aftermath of a disaster. For the first time, an MEF task force will define policies and procedures to guide the financial strategy for rehabilitation and reconstruction. By advancing on these policies, the GoP will increase its capacity to manage post-disaster reconstruction in an integrated manner.

60. ***Results Indicators*:** (a) Number of National Government sectors that approve sector guidelines for the post-disaster reconstruction process [Baseline 2014: none/Target 2018: 6], Coordination: CENEPRED; (b) Number of National Government agencies with approved operational continuity plans in the event of disasters [Baseline 2014: 1/Target 2018:37], Coordination: Secretariat for Disaster Risk Management–PCM; and (c) Policies and procedures for financing post-disaster rehabilitation and reconstruction processes [Baseline 2014: None/Target 2018: An approved Operational Manual], Coordination: MEF.

DPO Prior Actions and Analytical Underpinnings

Table 3. DPO Prior Actions and Analytical Underpinnings

Prior Actions	Analytical Underpinnings
Pillar 1: Improving efficiency in public resource allocations for disaster risk management (DRM)	
Prior Action 1: The GoP The GoP has strengthened the financial mechanisms for the implementation of the National Disaster Risk Management Plan (PLANAGERD) by: (a) integrating the existing DRM budgetary program (BP068) in the new DRM policy framework; and (b) enabling the inclusion of disaster risk information in regional development planning **Legal Evidence:** *(a) Supreme Decree Nº 034-2014-PCM approving PLANAGERD 2014–2021 (May 12, 2014); (b) 2015 National Budget Law N° 30281 (December 4, 2014) Annex 8: Allocations for the Budgetary Program (BP068); and (c) CENEPRED Administrative*	Hyogo Framework of Action (HFA): http://www.unisdr.org/we/coordinate/hfa The SENDAI Report: Managing Disaster Risks for a Resilient Future; https://www.gfdrr.org/managing-disaster-risks-sendai-report PREDECAN–DRM and development plan analysis and guidelines

[37] Expected result: "MEF revised its current framework for implementation of post-disaster public investments."
[38] The DRM Law defines four main DRM processes: risk estimation; risk reduction and prevention; preparedness, response and rehabilitation; and reconstruction.

Resolution (Resolución Jefatural) Nº 044-2014-CENEPRED/J (May 23, 2014) approving the guidelines for the incorporation of DRM in Regional Development Plans	
Pillar 2: Strengthening vulnerability reduction policies in infrastructure for the education and housing sectors and for flood protection measures	
Prior Action 2: The GoP integrates seismic risk-reduction considerations for existing and new infrastructure into PRONIED ***Legal Evidence:*** *Supreme Decree N°004-2014-MINEDU establishing PRONIED*	"Evaluación del riesgo sísmico de la infraestructura de instituciones educativas del área metropolitana de Lima y Callao, Peru" 2013. Technical Assistance Project executed by the Pontifical Catholic University of Peru (*Pontificia Universidad Catolica del Perú,* PUCP), in partnership with the Bank (SFLAC–TF095953) for a school infrastructure seismic risk assessment in Lima and Callao RAS (P150434) 2014 deliverables: "Report 1: Review and validation of the methodology developed by OINFE to determine the intervention levels for school infrastructure;" "Report 2: Definition of criteria for the prioritization of intervention measures for the portfolio of public schools of the Metropolitan Area of Lima and Callao" United Nations: Safe School selected reports; http://www.unisdr.org/we/campaign/schools-hospitals; http://www.safe-schools-hospitals.net/en/InformationMaterials.aspx
Prior Action 3: The GoP has established the financing mechanism for a pilot program to reduce seismic vulnerability of low-income housing **Legal Evidence:** *(a) Law 30191–Prevention, Mitigation and Attention to Disasters (May 9, 2014); and (b) Ministerial Resolution Nº 172-2014-VIVIENDA approving the operational rules for the "Grant for the Protection of Housing Vulnerable to Seismic Risk"*	MEF: National seismic risk profile (2014) financed by the Inter-American Development Bank (IADB) Centro Peruano Japonés de Investigaciones Sísmicas y Mitigación de Desastres (CISMID): Seismic vulnerability of housing–recent studies; http://www.cismid-uni.org/index.php?option=com_docman&view=filteredlist&Itemid=243
Prior Action 4: The Government of Peru has taken measures to improve the design of flood protection programs at national and subnational levels by: (a) expanding the mandate of ANA to conduct hydraulic studies that support the design of regional and local flood protection programs; and (b) defining specific minimum standards for the preparation of pre-investment studies for flood protection public investment projects under the SNIP framework. **Legal Evidence**: *(a) Supreme Decree Nº 006-2014-MINAGRI (May 23, 2014); and (b) MEF Directorial Resolution Nº 006-2014-EF/63.01 (September 3, 2014*)	Segunda Comunicación Nacional de Cambio Climático (2010); Documents from UNFCCC and IPCC communications WPS5232: Assessing the Financial Vulnerability to Climate-Related Natural Hazards (Mechler et al., 2010); Fiscal Implications of Climate Change (Bones et al., 2012); 2011 "Global Assessment Report on Disaster Risk Reduction" (GAR) on Disaster Risk Reduction *is a resource for understanding and analyzing global disaster risk today and in the future*: http://www.preventionweb.net/english/hyogo/gar/2011/en/home/index.html
Pillar 3: Increasing the Government's capacity for post-disaster recovery and reconstruction	
Prior Action 5: The GoP has taken measures to improve post-disaster	World Reconstruction Conference; https://www.gfdrr.org/WRC2;

recovery and reconstruction processes by: (a) establishing the regulatory and institutional framework for reconstruction; and (b) defining MEF's internal coordination mechanism to finance rehabilitation and reconstruction processes ***Legal Evidence:*** *(a) Supreme Decree Nº 034-2014-PCM approving the 2014–2021 PLANAGERD; and (b) MEF Ministerial Resolution Nº 034-2015-EF/10 (January 22, 2015) defining the internal coordination mechanism to finance rehabilitation and reconstruction processes*	Disaster Risk and Disaster Risk Management Indicators for Peru. Notas Técnicas IDB-TN-169, September 2010: http://idbdocs.iadb.org/wsdocs/getdocument.aspx?docnum=35159995 ; WPS5429: Financial Protection of the State Against Natural Disasters (Ghesquiere and Mahul, 2010): http://elibrary.worldbank.org/doi/book/10.1596/1813-9450-5429; Improving the Assessment of Disaster Risk to Strengthen Financial Resilience: Joint G20 Publication by the Government of Mexico and the World Bank: https://www.gfdrr.org/G20DRM; Contingent Liabilities: Methodologies in Colombia, Ministry of Finance and Public Credit of Colombia (2012): http://www.minhacienda.gov.co/HomeMinhacienda/creditoydeudapublicos/Riesgo/Informes/ObligacionesContingentesIngles.pdf

C. LINK TO CPS AND OTHER BANK OPERATIONS

61. **The proposed operation is in line with the World Bank Group's Country Partnership Strategy (CPS) 2012–2016 (Report Nº 66187-PE) discussed by the Executive Directors on February 1, 2012**. The third strategic objective of the CPS is focused on sustainable growth and productivity. Results Area 3.4, in particular, is focused on improving disaster risk management and urban planning. Through the proposed operation the Bank will continue supporting the GoP to build its legal and institutional capacity to prepare for and manage climate and disaster risks. The proposed operation will help build a strong linkage between a comprehensive disaster risk management strategy at the national level and the capacity of subnational governments to implement activities to reduce vulnerability from climate and disaster risks. The Bank will continue providing support to the GoP in the design of policies and regulations to build safe infrastructure and resilient public services.

62. **The proposed operation complements other Bank lending and analytical work in Peru**, such as the Investments for Environmentally Sustainable Development (P147342) and the Environmental Development Policy Loan Program Series (P101471, P116152 and P118713), the Water Resources Management Modernization Project (P107666), the Higher Education Quality Improvement Project (P122194) and the Basic Education Project (P123151). In addition, since 2007 the Bank has been providing technical assistance, and recent activities include the Reimbursable Advisory Service for School Infrastructure Baseline (P150434) and a grant to support the mainstreaming of DRM in Peru's Education Sector (P152271).

D. CONSULTATIONS, COLLABORATION WITH DEVELOPMENT PARTNERS

63. **Consultations.** All laws and plans included in the proposed operation have undergone a consultation process either with Congress or civil society, or internally among the different sectors of the Government. In particular, for PLANAGERD a technical working group, composed of representatives from INDECI, CENEPRED, MEF, CEPLAN and SGRD-PCM, was formed to lead the consultation process. In 2013, the technical working group held more than 38 meetings and carried out two regional workshops. The first workshop was held in Piura, and the participants included regional and municipal officials from Tumbes, Piura, La Libertad, Lambayeque,

Cajamarca, Amazonas and San Martín. The second workshop was held in Lima, and representatives from all ministries, scientific technical institutions and universities were invited. The PLANAGERD draft was presented at both of these workshops, and suggestions and inputs were gathered to enrich the Plan. After these consultations, PLANAGERD was submitted for approval, by consensus, to the Vice-Ministerial Coordination Commission (*Comisión de Coordinación Viceministerial)* prior to its submission to the President of the Republic for final approval.

64. **Collaboration with other Development Partners.** The Bank maintains active dialogue and collaboration with various agencies engaged in disaster risk management projects and technical cooperation in Peru, including: the United Nations Development Programme (UNDP), the European Commission's Humanitarian Aid and Civil Protection Department (ECHO), the Inter-American Development Bank (IADB), the Japan International Cooperation Agency (JICA), the Swiss Agency for Development and Cooperation (SDC), and the German Agency for Technical Cooperation (GTZ). Under the framework of the first CAT-DDO, the Bank team collaborated with different agencies on initiatives that primarily support seismic risk assessment in schools and hospitals in the provinces of Lima and Callao. The proposed operation is part of the national financial strategy against disasters built by the GoP in the last three years. The GoP also has three additional disaster-triggered contingency loans from IADB, JICA and the Development Bank of Latin America (CAF) for up to US$800 million.

V. OTHER DESIGN AND APPRAISAL ISSUES

A. POVERTY AND SOCIAL IMPACT

65. **A Poverty and Social Impact Assessment (PSIA) was developed in accordance with World Bank guidelines to provide an analysis of the poverty and inequality outcomes of the policy actions outlined in the project.** For the PSIA, information was gathered from literature reviews. Specific quantitative analyses by region, gender and indigenous origin were also performed when possible. Through collaboration and the provision of evidence, the PSIA was also used to strengthen the policy dialogue with GoP counterparts.

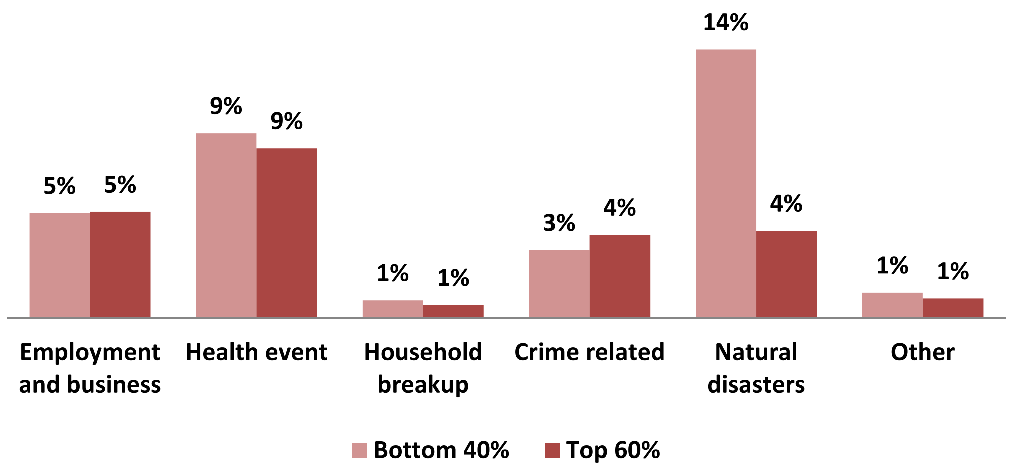
66. **Overall, the government policies supported by the Peru Second CAT-DDO are expected to have a positive poverty and social impact.** In line with the proposed operation's main objective of enhancing disaster risk management, reducing vulnerability in infrastructure sectors, and setting up a legal and institutional framework for post-disaster actions, positive impacts from each of the supported reforms are expected, given the strong links existing between poverty and vulnerability to natural hazards. The main results of the PSIA are summarized below.

I. Improving efficiency in public resource allocations for disaster risk management

67. **Prior Action 1:** Because the poorest households are the most vulnerable to disasters associated with adverse natural and weather-related events, the mainstreaming of disaster risk management into the planning process is expected to contribute toward boosting shared prosperity. The relevance of Prior Action 1 for poverty is supported by extensive research for developing countries and Peru that documents the two-way link between poverty and vulnerability to natural

disasters. Although the poorest households are most likely to be affected by natural hazards, these events may also increase poverty and even lead to poverty traps. For instance, in the case of Peru, Lucchetti (2011) finds negative effects on objective and subjective poverty after the 2007 earthquake in Ica. Rosemberg, Fort and Glave (2010) document a negative impact of disasters on per-capita consumption growth, larger for households at the bottom of the distribution. In Peru, households in the bottom 40 percent are more likely than the top 60 percent to suffer from natural disasters and climate change events, in comparison to other kinds of shocks (Figure 5). Moreover, National Household Survey (*Encuesta Nacional de Hogares*, ENAHO) data show that households that have experienced a disaster are 30 percentage points more likely to be in the bottom 40 compared to households that have not been affected by a disaster. Furthermore, losses of income or assets as a consequence of disasters are biased toward male-headed, indigenous and rural households.

Figure 5. Share of households reporting an event, by type of event and income group (2013)



Source: ENAHO 2013. Notes: Events are self-reported within the past 12 months. *employment or business* denotes an episode of a job loss or the loss of a family business by a household member; *health event* refers to a household member being sick; *natural disasters* include episodes of droughts, floods, pests, storms, etc.; *crime-related* refer to events in which a household member was robbed or mugged; *household breakup* refers to cases in which the household head left the household.

II. Strengthening vulnerability reduction policies in infrastructure for the education and housing sectors and for flood protection measures.

68. **Prior Actions 2 to 4:** Ex ante risk management policies are critical to increase resilience to disasters and weather-related shocks. Urban planning policies, quality standards for construction, and overall improvements in infrastructure (schools, health facilities, housing, etc.) are key challenges to reduce vulnerability to frequent natural hazards and climate change-induced events, such as earthquakes, floods (a consequence of El Niño Southern Oscillation [ENSO] phenomena) and landslides. Evidence from Peru documents the pervasive effects of disasters and climate change-induced hazards on infrastructure. Planned actions are expected to improve infrastructure in school facilities, thereby increasing communities' ability to cope with disasters. Moreover, evidence suggests that poor-quality housing increases the likelihood of suffering from

these shocks. Improvements to the quality of dwellings will also contribute to poverty reduction by making households less likely to suffer loss of assets in the event of a disaster. Climate change adaptation measures related to floods are critical in Peru. Large-scale infrastructure projects aimed at carrying out hydraulic mitigation are expected to play a key role in limiting the negative effects of water stress and floods, particularly for poor rural households.

III. Increasing the Government's capacity for post-disaster recovery and reconstruction

69. **Prior Action 5:** Ex post risk management depends on the establishment of a legal and institutional setting for post-disaster recovery and reconstruction, improving efficiency and coordination among different government levels, and increasing preparedness for a prompt and synchronized response in the event of a disaster. These actions are expected to have an indirect effect on poverty and shared prosperity because coordinated efforts and efficient management of resources are likely to reduce the unmet needs of the poorest households in the event of a disaster.

70. **Overall, the evidence presented so far documents a strong two-way link between poverty and natural hazards.** While poverty increases vulnerability to adverse natural events, disaster shocks also foster poverty and human capital losses, eventually leading to poverty traps. In this sense, the policy reforms supported by this operation are crucial to promote an efficient and coordinated National Disaster Risk Management policy and development strategy, which may contribute to break the existing links between poverty and natural shocks. Since the poorest households are the most vulnerable[39] to suffer from disasters associated with adverse natural events and weather related events, these reforms aim to support these vulnerable populations. Limited disaster risk management can push poor households to engage in undesirable coping responses that may have both short and long-term consequences on poverty, inequality and human capital accumulation. Efficient risk management policies may foster development, both because they may increase resilience of the population and because they might allow people to take advantage of new opportunities for improvement (World Bank, 2014).[40]

B. ENVIRONMENTAL ASPECTS

71. **Prior actions selected for the proposed operation are not likely to cause significant effects on Peru's environment, forests and other natural resources.** On the contrary, each pillar of the operation contains prior actions that can enhance proper natural resource and environmental management. Under Pillar 1, the prior action on enabling the inclusion of disaster risk information in regional development planning, will enable the integration of natural resource management and ecosystem protection as measures to reduce vulnerability to disaster risks at this strategic level. Under Pillar 2, improvement of existing school infrastructure offers the possibility of providing children with access to adequate water supply and sanitation in these environments, while also protecting this vulnerable population group. Policies supporting the development of a sound knowledge base to develop flood protection programs at national and sub national level would reduce vulnerability of the population, while also supporting the development of integrated

[39] According to the National Institute of Statistics of Peru (INEI), in 2012, 60.9 percent of the national population was vulnerable to suffer from a natural disaster. Moreover, vulnerable population is projected to increase faster than total population, in the next years.
[40] World Bank (2014). "World Development Report: Risk and Opportunity. Managing Risk for Development", The World Bank: Washington D.C.

watershed management, possibly including protection of forest and improved agricultural practices. Under Pillar 3, the establishment of a regulatory and institutional framework and coordination mechanisms to manage and finance post-disaster reconstruction processes will lead to environmentally friendly planning of critical reconstruction activities, including disposal of debris, location of shelters, and recovery of ecosystems.

C. PFM, DISBURSEMENT AND AUDITING ASPECTS

72. **In recent years, the Bank has reviewed Peru's public financial management (PFM) in the context of the preparation of a series of DPLs.** An assessment using the PFM Performance Measurement Framework (Public Expenditure and Financial Accountability, PEFA) was carried out with other development partners: the European Union and the IADB. The final PEFA report was published and disseminated in June 2009. This assessment reflects the findings of the 2009 PEFA plus updates made as a result of a desk review of several official reports[41] issued by Peruvian public institutions and international organizations during the last 12 months.

73. The results of the PEFA assessment, from the perspective of the six budget dimensions measured by the framework, concluded that, overall, PFM in Peru is functioning well and in several aspects is in line with international best practices. The main findings of the PEFA assessment are summarized below:

(i) **The Central Government's budget in Peru is a reliable and credible financial tool:** despite the reduced level of actual budget execution between the initial and final budgets, budget formulation follows international best practices. It is an orderly and institutionalized process; it is transparent; and the documentation attached to the Budget Bill submitted to Congress for scrutiny is comprehensive, with the public having timely access to annual budget documents, as well as to approved and executed budget and annual financial statements.

(ii) **The predictability of budget resources and the internal controls of budget execution are also working relatively well.** Budget execution is well documented and Consolidated Government Financial Statements *(Cuenta General de la República)* are prepared annually, within six months of the end of the year. These are comprehensive documents that contain information on revenues, expenditures, financial assets and liabilities, and are audited within the legally established time frames by the Supreme Audit Institution *(Contraloría General de la República,* CGR). The annual financial audit of public institutions contained in the *Cuenta General de la República* covered approximately 89.4 percent (for 2013) and 73 percent (for 2012) of public-sector expenditures, and it is conducted pursuant to the respective regulations and within the time frames established by law.[42]

(iii) **Legislative scrutiny of the annual budget bill is conducted in accordance with well-established procedures, which are also used in examining the *Cuenta General*.**

[41] Annual Official Audit to the *Cuenta General de la República*, issued by the General Comptroller's Office of Peru; Financial Audit Reports 2012 and 2013 to the Central Bank of Peru (BCR), issued by the firms Ernst & Young and Deloitte, respectively; IMF: Article IV–Peru.
[42] The time frame for the submission of the *Cuenta General de la República* and the corresponding audit report issued by the CGR, from the President to the Congress, has been modified to August 15.

The audit recommendations made to Congress by the General Comptroller's Office (CGR) have related to the same issues from previous years. However, there is limited capacity and political will to implement the actions required to address the recommendations.

74. Since 2009, Peru has undertaken critical reforms necessary to improve the management of public finances and the efficiency of public spending. A new budget classification system and a new accounting chart in line with international standards were adopted and are operating in all government ministries and agencies. The implementation of the Treasury Single Account (TSA) at the Central Government and subnational levels (regional and municipal government levels) has been implemented; it is working well and is in line with international best practices. In addition, the Treasury Directorate is currently working on the implementation of the TSA for external sources of funds. There has been steady progress in establishing the foundations for results-based budgeting, with the development of well-defined measures of performance that link priority policies and programs. Other ongoing efforts to continue modernizing the budget and improving PFM include: (a) the design and gradual implementation of a multi-annual budget framework; (b) the continued strengthening of the Budget Directorate; and (c) the design of a new Integrated Financial Management System (*Sistema Integrado de Administración Financiera del Estado*, SIAF II), whose conceptual framework was approved in March 2010; its implementation still in progress.

75. Overall, taking into account the GoP's commitment to reform in certain areas as described above, the PFM systems in Peru are considered to be adequate to support the proposed operation.

76. **There is no evidence that the banking control environment into which the DPL proceeds would flow is other than adequate.** The last IMF Safeguards Assessment was completed in 2004. A summary of the assessment, included in an IMF Country Report,[43] noted that there were no significant weaknesses in the Central Bank's safeguards framework. The Bank team also reviewed: (a) the latest external audit report on the Central Bank's 2013 financial statements, which does not reveal any significant issue related to the internal control environment; and (b) the IMF's latest Article IV Consultation with Peru (February 14, 2013), which revealed the Central Bank's sound monetary policy management.

77. **Once the Government has met all drawdown conditions, the full amount of the loan would be available as a line of credit that can be drawn down subject to satisfactory semi-annual reviews and the maintenance of the DRM program. The adequacy of the macroeconomic framework is assessed at effectiveness and reconfirmed at renewal.** The CAT-DDO allows countries to defer disbursements for up to three years and, upon renewal, for another three years, for up to a total of four renewal periods. Each renewal request would require the approval of the Bank's Regional Vice President. This product is deemed appropriate for the proposed operation because it is designed for countries that have no immediate need for funds but might need them suddenly to address a catastrophic event.

78. **The Bank would disburse the loan proceeds into an account at the Central Bank or any other bank acceptable to the Bank, denominated in US dollars, that forms part of the**

[43] IMF Country Report No. 07/241, Peru: First Review Under the Stand-By Arrangement, 2007.

country's official foreign exchange reserves. After the proceeds are deposited, the Central Bank will immediately credit the disbursed amounts to the Ministry of Finance's Treasury Single Account (*Cuenta General de la Republica*).[44] These amounts thus become available to finance budgeted expenditures and are fully incorporated in the Borrower's accounting records and financial statements. The Legal Agreement will include a clause for the provision of a written confirmation that the amount of the disbursement has been credited to an account that is available to finance budgeted expenditures. No additional fiduciary arrangements are deemed necessary for the Disaster Risk Management DPL with a CAT-DDO.

79. **Because the Borrower's PFM systems and the fiduciary arrangements for the proposed operation are considered adequate, the Bank will not require a dedicated account at the Central Bank for loan proceeds.** As such, no audit will be required for the deposit account, and no additional fiduciary arrangements are considered necessary at this time.

D. MONITORING AND EVALUATION

80. **The Ministry of Economy and Finance (MEF) will monitor the progress of the proposed operation during the entire drawdown period.** Under the first CAT-DDO, the GoP has been strongly committed to the implementation of a comprehensive DRM program. Progress in the three policy areas was highly satisfactory, and all seven expected policy results were achieved in 2014.

81. **MEF continues to exercise overall oversight for budget implementation in Peru.** MEF, as the coordinating body, will be supported by the General Directorate for Debt and Public Treasury (*Dirección General de Endeudamiento y Tesoro Público*, DGETP), the Directorate–Sectoral Program Coordination Unit (*Dirección–Unidad de Coordinación de Préstamos Sectoriales*, DUCPS), and the respective line ministries and agencies coordinating the policy reforms. The Bank will monitor both the macroeconomic environment and the implementation of the program supported by the DPL during the drawdown period. This will be done through frequent visits to the country and regular communications with MEF and key sectors.

VI. SUMMARY OF RISKS AND MITIGATION

82. **The overall risk associated with this proposed operations is Low.**

83. **Political and governance:** Low risk. At the program level, the political context is relatively stable and not likely to affect the operation's PDO. In addition, the Government of Peru hosted the twentieth session of the Conference of the Parties (CoP). This demonstrated the Government's commitment to the climate change adaptation and disaster risk management agenda and its recognition of the need to integrate resilience and disaster reduction efforts into development decisions.

84. **Macroeconomic:** Low risk. Peru is one of the region's fastest growing economies and is expected to remain as such in the medium term. The most recent estimates of real GDP growth for 2014 (2.4 percent) are above the regional average. The average growth rate in the last decade has

[44] Account established following Chapter 2 of Law Nº 28708: Ley General del Sistema Nacional de Contabilidad.

been at 6.4 percent. Inflation has been low because the inflation targeting mechanism is functioning and fiscal and monetary policies are well coordinated. Prudent macroeconomic policy and deep structural reforms have combined to support this high-growth, low-inflation scenario in Peru. Peru's debt strategy is conservative and focused on fiscal stability. The risks to this outlook are mostly external, with limited potential fiscal impacts. Growth rates are vulnerable to external shocks to metal prices, unexpected global volatility transmitted through financial sector channels, and a slowdown in external demand for Peruvian exports. Domestic factors include the implementation of the public investment program and potential uncertainty related to the 2016 elections. The most imminent concerns are negative commodity price shocks. However, these would have limited fiscal impact because commodities represent only around 12 percent of general government revenues (including royalties). There would also be mitigating impacts from the decline in oil prices. Overall, the combined fiscal effect of a 10 percent decline in copper and oil prices would be around 0.1 percentage point of GDP. Peru also has ample fiscal buffers, such as the stabilization fund, and has had a fiscal surplus for the past decade, a reflection of its stellar fiscal management. There are no provisions in the budget to mandate a prioritization of expenditures away from disaster risk management, and ample external financing sources are available to Peru in case of need. Other risks are also well mitigated by the corresponding policies in place, as described in this document. The resulting corresponding risk to this operation is therefore low, given the relatively minor potential impacts and an adequate, well-financed policy stance.

85. **Sector strategies and policies:** Low risk. At the program level, policies and strategies are evidence based and are articulated in the Government's national policies and programs, such as the National Plan for DRM and PLANAGERD, which are aligned with overall country development objectives and government priorities. Although the risk-reduction program is based on adopted legal policies, potential institutional changes in the PCM could bring uncertainty to its leadership in terms of effectively coordinating some of the policy areas.

86. **Technical design of project or program:** Low risk. The GoP and the Bank have experience with this type of instrument: a first CAT-DDO (P120860) was approved in December 2010 and renewed for an additional three years in December 2013. The proposed operation builds on the successful achievements of the first project and supports the GoP's efforts to continue moving the DRM agenda forward.

87. **Institutional capacity for implementation and sustainability:** Moderate risk. Over the past five years, the Government has taken significant steps to reduce climate and disaster risk, such as the approval of National Policy 32 on Disaster Risk Management, the DRM law and PLANAGERD. However, moving forward the Government will need to address challenges related to consolidating and deepening the implementation of risk reduction measures and post-disaster recovery policies. This will require coordination across government ministries and among national, regional and local levels of government. The various institutions and agencies involved will need to work together effectively and combine their respective mandates and comparative advantages to move the policies forward.

Systematic Operations Risk-rating Tool (SORT) Table

Risk Categories	**Rating (H, S, M or L)**
1. Political and governance	L
2. Macroeconomic	L
3. Sector strategies and policies	L
4. Technical design of project or program	L
5. Institutional capacity for implementation and sustainability	M
6. Fiduciary	L
7. Environment and social	L
8. Stakeholders	L
Overall	**L**

ANNEX 1: POLICY AND RESULTS MATRIX

OBJECTIVE	PRIOR ACTIONS	RESULTS INDICATORS to 2018
Pillar 1: Improving efficiency in public resource allocations for disaster risk management (DRM)		
Strengthen the financing mechanisms for the implementation of the National Disaster Risk Management Plan (PLANAGERD) at all levels of Government	**Prior Action 1:** The GoP has strengthened the financial mechanisms for the implementation of the National Disaster Risk Management Plan (PLANAGERD) by: (a) integrating the existing DRM budgetary program (BP068) in the new DRM policy framework; and (b) enabling the inclusion of disaster risk information in regional development planning *<u>Coordination</u>: Secretariat for Disaster Risk Management–Presidency of the Council of Ministers (PCM), and the National Center for the Estimation, Prevention and Reduction of Disaster Risk (CENEPRED)*	*(a) Annual budgetary performance report on PLANAGERD implementation under the results-based budgeting programs* *[Baseline 2014: None/Target 2018: annual budgetary performance reports published for 2016 and 2017]* *<u>Coordination</u>: Secretariat for Disaster Risk Management–Presidency of the Council of Ministers (PCM)* *(b) Number of regional governments that have approved regional plans for the prevention and reduction of disaster risk* *[Baseline 2014: 0/Target 2018: 15/25]* *<u>Coordination:</u> National Center for the Estimation, Prevention and Reduction of Disaster Risk (CENEPRED)–Presidency of the Council of Ministers (PCM)*
Pillar 2: Strengthening vulnerability reduction policies in infrastructure for the education and housing sectors and for flood protection measures		
Increase the education sector's capacity to implement disaster risk-reduction policies in school infrastructure	**Prior Action 2:** The GoP integrates seismic risk-reduction considerations for existing and new infrastructure in the National School Infrastructure Program (PRONIED) *<u>Coordination</u>: Ministry of Education (MINEDU)*	*Share of seismic risk reduction in school infrastructure in the Lima Metropolitan Area as a result of PRONIED implementation* *[Baseline: Risk Indicator (RI)=20.3 for a portfolio of 1,969 school facilities in the Lima Metropolitan Area)/Target 2018: 10% reduction]*
Increase the housing sector's capacity to support and facilitate the reduction of seismic vulnerability in low-income housing	**Prior Action 3:** The GoP has established the financing mechanism for a pilot program to reduce the seismic vulnerability of low-income housing *<u>Coordination</u>: Ministry of Housing, Construction and Sanitation (MVCS)*	*Share of eligible low-income households covered by the Grant for Protection of Housing Vulnerable to Seismic Risk* *[Baseline 2014: 0/Target 2018: 80% of 8,303 eligible households]*

Increase the institutional capacity to define and implement flood protection policies	**Prior Action 4:** The GoP has taken measures to improve the design of flood protection programs at national and subnational levels by: (a) expanding the mandate of the National Water Authority (ANA) to conduct hydraulic studies that support the design of regional and local flood protection programs; and (b) defining specific minimum standards for the preparation of pre-investment studies for flood protection public investment projects under the SNIP framework *<u>Coordination</u>: ANA and Ministry of Agriculture and Irrigation (MINAGRI)*	*Number of approved studies for flood risk prevention and mitigation in watersheds* *[Baseline 2014: 0/Target 2018: 4]* *<u>Coordination:</u> National Water Authority (ANA)*
Pillar 3: Increasing the Government's capacity for post-disaster recovery and reconstruction		
Strengthen the institutional capacity to effectively plan and implement post-disaster rehabilitation and reconstruction processes and guarantee the Government's operational continuity	**Prior Action 5:** The GoP has taken measures to improve post-disaster recovery and reconstruction processes by: (a) establishing the regulatory and institutional framework for reconstruction; and (b) defining MEF's internal coordination mechanism to finance rehabilitation and reconstruction processes *<u>Coordination</u>: National Center for the Estimation, Prevention and Reduction of Disaster Risk (CENEPRED), Secretariat for Disaster Risk Management–Presidency of the Council of Ministers (PCM), and Ministry of Economy and Finance (MEF)*	*(a) Number of National Government sectors that approve sector guidelines for the post-disaster reconstruction process* *[Baseline 2014: none/Target 2018: 6]* *<u>Coordination</u>: National Center for the Estimation, Prevention and Reduction of Disaster Risk (CENEPRED)* *(b) Number of National Government agencies with approved operational continuity plans in the event of disasters* *[Baseline 2014: 1/Target 2018:37]* *<u>Coordination</u>: Secretariat for Disaster Risk Management–Presidency of the Council of Ministers (PCM)* *(c) Policies and procedures for the financing of post-disaster rehabilitation and reconstruction processes* *[Baseline 2014: None/Target 2018: An Operation Manual approved]* *<u>Coordination</u>: Ministry of Economy and Finance (MEF)*

ANNEX 2: LETTER OF DEVELOPMENT POLICY

PERÚ | Ministerio de Economía y Finanzas | Despacho Ministerial

"DECENIO DE LAS PERSONAS CON DISCAPACIDAD EN EL PERÚ"
"AÑO DE LA DIVERSIFICACIÓN PRODUCTIVA Y DEL FORTALECIMIENTO DE LA EDUCACIÓN"

ALONSO SEGURA VASI
MINISTRO

Lima, 20 ENE. 2015

BANCO MUNDIAL
LIMA - PERU
20 ENE. 2015
RECIBIDO HORA: 3:40
FIRMA:
Reg: 51

OFICIO N° 132 -2015-EF/10.01

CARTA DE POLITICAS

Señor
Jim Yong Kim
Presidente
Banco Mundial
Av. Álvarez Calderón 185, San Isidro
Lima

Referencia: *Segundo Programa de Reducción de Vulnerabilidad del Estado ante Desastres (Segundo CAT-DDO)*

Estimado Señor Kim,

Mediante el presente le manifiesto a usted el compromiso del Gobierno del Presidente Ollanta Humala Tasso, de seguir impulsando los avances en el fortalecimiento de las capacidades del Estado peruano en gestión del riesgo con la finalidad de poder responder adecuadamente ante una situación de desastre.

En este marco, se ha venido desarrollando con el Banco Mundial (BM) el "Segundo Programa de Reducción de Vulnerabilidad del Estado ante Desastres (Segundo CAT-DDO)", el cual comprende acciones de reforma y compromisos para el periodo 2015 – 2018 y está compuesto por una línea de crédito contingente.

A continuación se describe el contexto internacional y el contexto económico del Perú y posteriormente los objetivos del Programa, así como las acciones realizadas en el marco del segundo Programa.

A. Contexto Internacional[i]

Indicadores de la economía mundial muestran resultados mixtos. EE.UU. continúa expandiéndose favorablemente, mientras que la Zona Euro y China presentan resultados desalentadores. El PMI[1] *manufacturero global (mayor a 50 puntos significa expansión) registró en promedio 51,9 puntos en el 4T2014, el menor resultado desde 3T2013. El FMI, en su reporte WEO de octubre 2014, recortó su pronóstico de crecimiento mundial para el 2014 de 3,7% en enero a 3,3% en octubre.*

En EE.UU., el PBI creció 5,0% T/T anualizado durante el 3T2014, el más alto desde el 3T2003. El PMI manufacturero de ISM avanzó a 57,7 puntos en el 4T2014 (mayor a 50

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[i] *Información al 13 de enero 2015.*
[1] *Índice de Gestores de Compras, se elabora mensualmente, a través de encuestas realizadas a los encargados de realizar las adquisiciones de materias primas en empresas privadas.*

puntos significa expansión), el más alto desde el 1T2011. El mercado laboral continuó mejorando, en el 2014 se han creado 2,8 millones de empleos, superiores a los 1,4 millones del 2013. Sin embargo, el sector inmobiliario aún muestra debilidad, en noviembre, las ventas de viviendas existentes cayeron -6,1% M/M SA a 4,93 millones de unidades, el menor nivel desde mayo 2014. El FMI espera un crecimiento para el 2014 en 2,2% y para el 2015 en 3,1%.

En la Zona Euro, se han generado preocupaciones sobre el crecimiento económico y riesgos de deflación, luego de registrar una baja tasa de crecimiento en el 3T2014 y con indicadores adelantados desalentadores, como el PMI manufacturero que registró 50,4 puntos en el 4T2014, el más bajo desde 2T2013. En diciembre, se registró deflación de -0,2% por primera vez desde octubre 2009 (meta de inflación del Banco Central Europeo-BCE es 2,0%); y los créditos a las empresas y familias se contrajeron en noviembre -2,2% y -0,6%, respectivamente. En este contexto, el BCE, en su informe trimestral de diciembre, redujo su proyección para el PBI del 2014 a 0,8% (de 0,9% previo) y el 2015 a 1,0% (de 1,6%). Además, el BCE evaluaría los resultados de sus políticas en su próxima reunión (22 de enero) y de ser necesario aplicaría más estímulos.

En China, en el 3T2014 la economía creció 7,3%, por debajo del 1S2014 (7,5%) y la meta del gobierno (7,5%), en medio de la corrección de vulnerabilidades financieras y la moderación de los indicadores de demanda interna. El sector inmobiliario continuó enfriándose, en noviembre los precios de nuevas viviendas residenciales de 70 ciudades cayó -3,6%, la mayor caída anual desde su registro en agosto 2005. El PMI Manufacturero de HSBC disminuyó a 49,6 puntos en diciembre, ingresando a zona de contracción y registrando como el más bajo desde mayo 2014 (mayor a 50 puntos significa expansión). El crecimiento económico se viene sosteniendo gracias a los estímulos monetarios y fiscales del gobierno, además de estar enfocados en las reformas (anunciadas en noviembre 2013). El PBoC redujo en noviembre las tasas referenciales de préstamos en 40 pbs a 5,6% de 6,0%, la primera reducción desde julio 2012. En el 2015, el gobierno chino anunció que aceleraría la construcción de 300 proyectos de infraestructura por US$ 1,1 billones (11,9% del PBI). El FMI, espera para el 2014 un crecimiento de 7,4% y se desacelere en el 2015 a 7,1%.

Desde inicios del 2014 a la fecha, los mercados financieros han mostrado volatilidad por la creciente preocupación en el crecimiento mundial, la desaceleración de China, el incremento de la tasa de interés en EE.UU., el menor precio de los commodities (petróleo) y la deflación en la Zona Euro. El índice de volatilidad financiera VIX se ubicó hasta en cuatro oportunidades por encima de 20 puntos: en febrero, cuando el PMI Chino ingresó a zona de contracción; en octubre, por preocupaciones por el crecimiento económico global; en diciembre 2014 y enero 2015, por la caída del precio del petróleo y preocupaciones de aumento de las tasas de interés en EE.UU.

Por su parte las cotizaciones de las materias primas han caído. El precio del cobre, desde inicios de 2014 (cUS$ 335 por libra) al 13 de enero 2015, cayó -20% a cUS$ 268 por libra, el menor precio desde octubre 2009. El oro, desde marzo 2014 (US$ 1 385 por oz.tr.) al 13 enero 2015 (US$ 1 232 por oz.tr.), disminuyó -11%. El petróleo desde julio 2014 (US$ 108 *por barril) al 13 de enero 2015 cayó -58% a US$ 45 por barril, el menor precio desde marzo 2009, debido a un exceso de oferta (mayor producción en EE.UU. del crudo y combustible no convencional) y la menor demanda global.*

B. Contexto Económico Nacional

La economía peruana en el periodo enero-octubre 2014, registró un crecimiento del PBI de 2,8%; con lo que se espera que para el 2014 la economía crezca 2,5%, ante un año de choques negativos y transitorios en el lado primario de la economía en los sectores agrícolas, pesquero, y minero. Sin embargo, y de manera alentadora, el PBI No Primario se espera que crezca 4.1% en el 2014.

Para el 2015 el crecimiento económico, de forma preliminar, se ubicaría en torno a 5,0%. La aceleración de 2,5 puntos porcentuales (p.p.) respecto al 2014 se descompone de la siguiente manera: i) 1,0 p.p. por mayor producción minera que se espera tenga un crecimiento de 5,4% en el 2015, luego de la caída de -1,9% en el 2014: la recuperación sería, principalmente, por Toromocho; ii) 1,0 p.p. por incremento en el gasto público (consumo público real crecería 8% e inversión pública real 16%[2]; y iii) 0,5 p.p. por otros factores adicionales como menor precio del petróleo, proyectos de infraestructura (parte privada), política monetaria, mejora de las expectativas de inversión, entre otros.

A nivel sectorial, en octubre, destacó el crecimiento de los sectores no primarios (3,3%) resaltando servicios (5,5%), electricidad, gas y agua (4,7%) y comercio (4,2%). Cabe indicar que el PBI primario se recuperó (0,5%), después de haber caído durante 5 meses consecutivos; esto se explica, principalmente, por el primer resultado positivo del sector minería e hidrocarburos (3,8%), después de 6 meses.

Cabe indicar que los últimos indicadores dan señales positivas sobre el desempeño económico a nivel interno de los próximos meses:

- *De acuerdo al COES[3], en diciembre, la producción de electricidad creció 5,0%, mayor a noviembre (4,9%) y similar al promedio de los tres meses previos (5,1%).*
- *Según cifras preliminares del BCRP, en noviembre, el consumo interno de cemento creció 5,0%, mayor al -0,9% del mes previo y al 1,4% del promedio de los últimos 3 meses.*
- *Según SUNAT, en diciembre las importaciones de bienes de consumo crecieron 5,7%, el mayor registro en 9 meses. En el mes se registraron mayores compras de alimentos (33,1%), electrodomésticos (12,5%) y vehículos (11,5%).*
- *Según SUNAT, las importaciones de bienes de capital para la industria crecieron 11,6% en diciembre, el mayor avance en 8 meses. Asimismo, las adquisiciones de materiales de construcción aumentaron 19,2%, el mayor crecimiento en 23 meses.*

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[2] *Cabe señalar que del crecimiento de 16% de la inversión pública, 6,2 puntos porcentuales se explican por la Modernización de la Refinería de Talara (S/. 2 022 millones o crecimiento real de inversión pública de Empresas Públicas de 137%) y otros 3,5 puntos porcentuales por la Línea 2 del Metro de Lima (S/. 1 100 millones: PPO).*

[3] *Comité de Operación Económica del Sistema Interconectado Nacional.*

OFICIO N° 132 -2015-EF/10.01

- *Según el BCRP, a la quincena de diciembre, el crédito en soles creció 19,0%, similar al mes anterior (19,1%) y superior a los tres meses previos (promedio 18,1%). El crédito en dólares creció 0,4%, menor hace un mes (0,7%) y a los tres meses previos (promedio 2,0%). El menor avance de los créditos en dólares ha permitido reducir la dolarización a 38,1%, -4,4 puntos porcentuales desde inicios del 2013. Por su parte, a diciembre, el circulante avanzó 10,4% A/A, la tercera tasa más alta del 2014.*
- *Según ARAPER, en diciembre, la venta de vehículos familiares nuevos creció 5,6% menor a noviembre (18,6%) y al promedio de los tres meses previos (7,1%).*
- *Según Apoyo Consultoría, en diciembre el índice de confianza del consumidor en Lima Metropolitana se ubicó en 56 puntos (por encima de noviembre: 53 puntos), el mayor registro desde julio 2014.*
- *Según APOYO Consultoría (semana 15/12 – 18/12) entre sus más de 300 empresas clientes, el indicador de confianza empresarial se recuperó y alcanzó su nivel más alto desde marzo 2014. El 24% de las empresas encuestadas afirmó que acelerarían el ritmo de ejecución de sus planes de inversión mientras que sólo 9% señaló que reduciría.*

Sin embargo, aún persiste el deterioro del sector externo debido a la mayor desaceleración de China, la Zona Euro, y la caída en los precios internacionales de los metales. En noviembre las exportaciones totales cayeron -10,9%. El resultado se explicó tanto por menores volúmenes (-2,9%) y precios de exportación (-8,3%). Las exportaciones tradicionales disminuyeron -14,8%, principalmente por menores envíos de productos mineros (-18,4%) como oro (-29,8%) y plomo (-32,9%). Las exportaciones no tradicionales disminuyeron 4,6% (primera caída en 13 meses) ante menores envíos textiles (-29,9%) y pesqueros (-10,7%). No obstante, la demanda de agropecuarios continuó dinámica (7,1%). Por su parte, de acuerdo a cifras de SUNAT, en diciembre las importaciones totales cayeron –1,9% (menor caída respecto a noviembre y al promedio de los tres meses previos). El resultado se explicó principalmente por menores precios importados (-5,0%).

Finalmente, de acuerdo al INEI, el mercado laboral de Lima Metropolitana en el trimestre móvil setiembre-noviembre 2014 tuvo los siguientes resultados: i) el ***empleo dependiente*** *creció 3,9% resultado superior al 3,5% previo y al promedio de los tres meses previos (3,6%); ii) el* ***empleo adecuado*** *creció 6,8% (5,7% previo); iii) la* ***tasa de desempleo*** *se ubicó en 5,4%, cifra inferior al 5,8% de hace un año; y iv) el* ***ingreso promedio mensual*** *creció 7,2% (8,2% previo). En tanto, el ingreso de los dependientes aumentó 6,5% (7,4% previo) y el del adecuadamente empleado 4,8% (5,3% previo).*

Según el Ministerio de Trabajo y Promoción del Empleo, en noviembre 2014, el ***empleo en empresas de 10 a más trabajadores del ámbito urbano*** *creció 1,5% (1,5% mes previo). Con este resultado se alcanzó 60 meses de incremento continuo del empleo. Los sectores servicios (3,7%), transportes, almacenamiento y comunicaciones (1,6%) y extractivas (1,5%) mostraron los mayores avances.*

C. Reformas asociadas al Segundo Programa de Reducción de Vulnerabilidad del Estado ante Desastres (Segundo CAT-DDO)

El Gobierno Peruano es consciente que el país, a pesar de los logros alcanzados, todavía tiene retos importantes que enfrentar para reducir la vulnerabilidad del Estado ante desastres.

En el marco de lo anterior, el Gobierno del Perú, con el apoyo del Banco Mundial, ha desarrollado el segundo crédito contingente como parte del Programa de Reducción de Vulnerabilidad del Estado ante Desastres, el cual está estructurado en tres pilares: i) Mejorar la eficiencia en la asignación de recursos públicos para la gestión del riesgo de desastres; ii) Fortalecer la reducción de la vulnerabilidad en la infraestructura para los sectores de educación y vivienda y las medidas de protección contra inundaciones; y iii) Aumentar la capacidad del Gobierno de recuperación y reconstrucción post-desastre.

C.1 Mejorar la eficiencia en la asignación de recursos públicos para la gestión del riesgo de desastres

El Gobierno Peruano con la finalidad de establecer las líneas estratégicas, los objetivos y las acciones de carácter plurianual necesarios para concretar lo establecido en la Ley y la Política Nacional de Gestión de Riesgos de Desastres (GRD) aprobó el Plan Nacional de Gestión del Riesgo de Desastres (PLANAGERD) 2014-2021, mediante Decreto Supremo N° 034-2014-PCM del 12 de Mayo de 2014. El PLANAGERD busca principalmente fortalecer, fomentar y mejorar permanentemente la cultura de prevención y el incremento de la resiliencia, con el fin de identificar, prevenir, reducir, prepararse, responder y recuperarse de las emergencias o desastres, así como propicia que se considere a la GRD como una acción transversal en todos los estamentos organizativos y de planificación en los tres niveles de gobierno y concordarlo con el proceso de descentralización del Estado.

Asimismo, desde el año 2012 se ha venido desarrollando el Programa Presupuestal 068-Reducción de Vulnerabilidad y atención de Emergencias por Desastres[4], el cual representa un medio para la articulación de políticas en gestión de riesgo de desastres a nivel regional. Actualmente se cuenta con la participación de diez sectores incluyendo Salud, Defensa, PCM, Agricultura, y Educación, entre otros, y se han articulado todos los Gobiernos Regionales y más de 500 Gobiernos Locales. Durante el 2014 se han implementado diversas acciones para mejorar el diseño del Programa Presupuestal, entre las que se cuenta la conformación de una comisión intersectorial para la revisión del Programa, el desarrollo de la tipología de proyectos del Programa Presupuestal, y la validación de indicadores de desempeño. Como una de las acciones prioritarias para el periodo 2015-2017, se considera la alineación del Programa Presupuestal al PLANAGERD, a fin de promover y apoyar la implementación del Presupuesto por Resultados a nivel de los Gobiernos Locales y Regionales.

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[4] Anteriormente, mediante Decreto de Urgencia N° 024-2010 se creó el Programa Presupuestal Estratégico Reducción de la Vulnerabilidad y Atención de Emergencias por Desastres, el cual constituye un antecedente del Programa Presupuestal 068.

Por otro lado, con el objetivo de orientar el procedimiento para la incorporación de la Gestión Prospectiva (GP) y Gestión Correctiva (GC) en los Planes de Desarrollo Concertados (PDC) y de esta manera asegurar su adecuada consistencia y coherencia de su estructura, contenido y alcance, en concordancia con la Política y el Plan Nacional de Gestión del Riesgo de Desastres 2014-2021, se aprobó mediante Resolución Jefatural N° 044-2014-CENEPRED/J la "Guía Metodológica para la Incorporación de la Gestión Prospectiva y Correctiva del Riesgo de Desastres en los Planes de Desarrollo Concertados".

C.2 Fortalecer la reducción de la vulnerabilidad en la infraestructura para los sectores de educación y vivienda y las medidas de protección contra inundaciones

El Gobierno busca aumentar la capacidad del sector Educación para implementar las políticas de reducción del riesgo de desastres en la infraestructura escolar a fin de contribuir a la mejora en la calidad de la educación del país, es así que mediante Decreto Supremo N° 004-2014-MINEDU del 30 de Mayo de 2014, publicado en El Peruano el 31 de Mayo de 2014, se creó el Programa Nacional de Infraestructura Educativa (PRONIED) con el objetivo de ampliar, mejorar, sustituir, rehabilitar y/o construir infraestructura educativa pública de Educación Básica y de Educación Superior Pedagógica, Tecnológica y Técnico-Productiva, incluyendo el mantenimiento y/o equipamiento de la misma.

Por otro lado, con el objetivo de aumentar la capacidad del sector Vivienda para apoyar y facilitar la reducción de la vulnerabilidad sísmica de la vivienda de interés social, se aprobó la Ley 30191 que establece medidas para la prevención, mitigación y adecuada preparación para la respuesta ante situaciones de desastre con el fin de prevenir y mitigar los factores de riesgo de desastre, así como para la adecuada preparación para la respuesta ante situaciones de desastre a nivel nacional, y se aprobó el Reglamento Operativo del Bono de Protección de Viviendas Vulnerables a los Riesgos Sísmicos mediante Resolución Ministerial N° 172-2014-VIVIENDA del 5 de Junio de 2014, publicada en El Peruano el 6 de Junio de 2014.

Adicionalmente, con la finalidad de aumentar la capacidad institucional para definir e implementar políticas de protección contra inundaciones, mediante Resolución Directoral N° 006-2014-EF/63.01 se han aprobado los "Contenidos mínimos específicos de estudios de preinversión a nivel de Perfil de Proyectos de Inversión Pública de Servicios de Protección frente a inundaciones" (CME 25), los mismos que han sido elaborados por la Dirección General de Inversión Pública en coordinación con la Presidencia del Consejo de Ministros (PCM), la Autoridad Nacional del Agua (ANA) y otras entidades públicas. Asimismo, se ha promulgado el Decreto Supremo N° 006-2014-MINAGRI, mediante el cual autorizan a la Autoridad Nacional del Agua a efectuar estudios definitivos para la ejecución de proyectos hidráulicos multisectoriales que permitan mejorar la gestión de recursos hídricos y que estén destinados a prevenir o mitigar los efectos de eventos hidrológicos extremos.

C.3 Aumentar la capacidad del Gobierno para la recuperación y reconstrucción post-desastre

El Gobierno de Perú con el objetivo de fortalecer el marco institucional y la capacidad para garantizar la continuidad operativa del gobierno en caso de desastre y una eficaz planificación *y ejecución de los procesos de reconstrucción, ha establecido bajo el SINAGERD el marco normativo e institucional para la identificación de los roles y el establecimiento de objetivos para la gestión y financiamiento eficaz de la rehabilitación y la reconstrucción, así como para desarrollar los planes de continuidad operativa sectoriales ante desastres.*

En este sentido, se aprobarán y se dispondrá la implementación de los lineamientos para la Gestión de la Continuidad Operativa en las Entidades de los tres niveles de Gobierno, de esta manera se podrá concretar la obligatoriedad, ya establecida en el marco de uno de los Objetivos Estratégicos del Plan Nacional de Gestión del Riesgo de Desastres, de que las Entidades Públicas integrantes del Sistema Nacional de Gestión del Riesgo de Desastres implementen la Gestión de la Continuidad Operativa adecuada a su alcance y a la complejidad de sus operaciones y servicios, tal como lo ha venido haciendo gradualmente el Ministerio de Economía y Finanzas. El CENEPRED viene desarrollando igualmente lineamientos técnicos para el proceso de reconstrucción, que además deberán tomar en cuenta las reglas específicas del SINAGERD relativas a los desastres de gran magnitud. De esta manera, se espera que las diversas entidades cuenten con una serie de instrumentos de gestión tales como planes de reconstrucción post-desastre y planes de continuidad operativa ante desastres, así como que el MEF desarrolle principios y procedimientos para el financiamiento de las actividades de rehabilitación y reconstrucción post-desastre; al respecto de esto último, el Comité de Riesgos del MEF, acordó crear el Grupo de Trabajo Permanente para la Articulación Financiera Post-Desastres de Gran Magnitud, que permitirá desarrollar dichos procedimientos y una mejor articulación con la PCM, el INDECI y el CENEPRED.

D. Conclusión

Como se desprende de lo descrito, el Gobierno Peruano viene realizando importantes acciones para fortalecer la gestión del riesgo en el país a través de mejorar la distribución de recursos en políticas de gestión de riesgo de desastre, la implementación de políticas de reducción de riesgo en los sectores prioritarios de educación y vivienda, construcción y saneamiento, así como en mejorar los mecanismos de protección financiera contra desastres y de financiamiento de procesos de reconstrucción.

El Gobierno se compromete a continuar avanzando en estos ámbitos, para lo cual requiere contar con el apoyo del Banco Mundial en las áreas señaladas.

En virtud de lo manifestado, por medio de la presente el Gobierno peruano solicita la aprobación del Segundo CAT-DDO por un monto de US$400 millones.

Sin otro particular, hago propicia la ocasión para reiterarle a usted mi especial consideración.

Atentamente,

(UNOFFICIAL/INFORMAL TRANSLATION)

REPÚBLICA DEL PERÚ (THE REPUBLIC OF PERU)
MINISTERIO DE ECONOMÍA Y FINANZAS (MINISTRY OF THE ECONOMY AND FINANCE)
DESPACHO MINISTERIAL (MINISTER'S OFFICE)
JIRÓN JUNÍN 319, LIMA
TEL.: 311-9900/311-5930

"Decade of Persons with Disabilities in Peru"
"Year of the Diversification of Production and Strengthening of Education"

Alonso Segura Vasi
Minister

Lima, January 20, 2015

Official Letter 132-2015-EF/10.01

POLICY LETTER

Mr. ***Jim Yong Kim***
President
World Bank
Av. Álvarez Calderón 185, San Isidro
Lima, Peru

Reference: *Second Program to Reduce the State's Vulnerability to Disasters (Second CAT-DDO)*

Dear Mr. Kim,

I herewith express to you the commitment of the Government of President Ollanta Humala Tasso to continue promoting the advances in strengthening the Peruvian State's risk management capacities in order to be able to respond adequately to a disaster situation.

Under this framework, the "Second Program to Reduce the State's Vulnerability to Disasters (Second CAT-DDO)" is being developed with the World Bank (WB;, it is a contingent credit line and includes reform actions and commitments for the 2015–2018 period.

Below is a description of the international context and Peru's economic context, followed by the Program objectives, as well as the actions implemented as part of the second Program.

A. International Context[45]

International economic indicators show mixed results. The United States continues to expand favorably, while the Euro Zone and China present discouraging results. The global manufacturing PMI[46] *(higher than 50 points means expansion) registered an average of 51.9 points in 4Q2014, the lowest result since 3Q2013. The IMF, in its WEO report dated October 2014, decreased its global growth forecast for 2014 from 3.7% in January to 3.3% in October.*

[45] *Information as of January 13, 2015.*
[46] *Purchasing Managers' Index, prepared monthly via surveys taken among those responsible for the purchase of raw materials in private enterprises.*

In the United States, GDP grew by 5.0% T/T annualized during 3Q2014, the highest rate since 3Q2003. The ISM's manufacturing PMI rose to 57.7 points in 4Q2014 (higher than 50 points means expansion), the highest since 1Q2011. The labor market continued to improve, with 2.8 million jobs created in 2014, greater than the 1.4 million in 2013. However, the real estate sector is still weak. In November, existing housing sales fell by -6.1% M/M SA to 4.93 million units, the lowest level since May 2014. The IMF expects 2.2% growth for 2014, and 3.1% for 2015.

In the Euro Zone, concerns have arisen regarding economic growth and deflation risks, after a low growth rate in 3Q2014, with discouraging leading indicators, such as the manufacturing PMI, which registered 50.4 points in 4Q2014, the lowest since 2Q2013. In December, deflation of -0.2% was registered for the first time since October 2009 (the inflation goal of the European Central Bank [ECB] is 2.0%); and credits to enterprises and families contracted in November by -2.2% and -0.6%, respectively. In this scenario, the ECB, in its quarterly report issued in December, reduced its GDP forecast for 2014 to 0.8% (from a previous 0.9%) and for 2015 to 1.0% (from 1.6%). The ECB will also evaluate its policy results in its next meeting (January 22), and, if necessary, it may apply more stimuli.

In China, the economy grew by 7.3% in 3Q2014, lower than in 1H2014 (7.5%) and the government's goal (7.5%), in the midst of the correction of financial vulnerabilities and the moderation of internal demand indicators. The real estate sector continued to cool off, with prices for new residential housing falling in 70 cities in November by -3.6%, the greatest annual drop since August 2005. HSBC's manufacturing PMI fell to 49.6 points in December, entering the contraction zone and registering the lowest score since May 2014 (higher than 50 points means expansion). Economic growth has been sustained thanks to the government's monetary and fiscal stimuli, as well as its focus on reforms (announced in November 2013). In November, the PBoC reduced loan reference rates by 40 pbs from 6.0% to 5.6%, the first reduction since July 2012. In 2015, the Chinese government announced that it will accelerate the construction of 300 infrastructure projects for US$1.1 trillion (11.9% of GDP). The IMF expects a growth of 7.4% for 2014, slowing in 2015 to 7.1%.

From the start of 2014 to date, the financial markets have exhibited volatility due to the growing concern over global growth, China's deceleration, the increase in the U.S. interest rate, the lower price of commodities (oil), and deflation in the Euro Zone. The VIX financial volatility index rose above 20 points on up to four occasions: in February, when the Chinese PMI fell into the contraction zone; in October, due to concerns over global economic growth; and in December 2014 and January 2015, due to the drop in oil prices and concerns over the increase in the U.S. interest rate.

For their part, raw material prices have fallen. The price of copper, from the start of 2014 (cUS$335 per pound) to January 13, 2015, fell by -20% to cUS$268 per pound, the lowest price since October 2009. Gold dropped by 11% from March 2014 (US$1,385 per oz.t.) to January 13, 2015 (US$1,232 per oz.tr.). Oil fell by -58% from July 2014 (US$108 per barrel) to January 13, 2015, to US$45 per barrel, the lowest price since March 2009, due to excess supply (higher production of crude and non-conventional fuel in the U.S.) and lower global demand.

B. Domestic Economic Context

During the January–October 2014 period, the Peruvian economy registered a GDP growth of 2.8%. Consequently, it is expected that the economy will grow 2.5% in 2014, a year marked by temporary negative blows on the primary side of the economy, in the agricultural, fishing, and mining sectors. However, it is encouraging to note that the non-primary GDP is expected to grow by 4.1% in 2014.

For 2015, economic growth—on a preliminary basis—will be around 5.0%. The acceleration of 2.5 percentage points (pp) over 2014 may be broken down as follows: i) 1.0 pp for greater mining production, which is expected to experience a growth of 5.4% in 2015, after a drop of -1.9% in 2014; this recovery would be due primarily to Toromocho; ii) 1.0 pp due to an increase in public spending (real public consumption is predicted to grow by 8%, and real public investment by 16%);[47] and iii) 0.5 pp due to other additional factors, such as the lower price of oil, infrastructure projects (private part), monetary policy, and improved investment expectations, among others.

[47] *It should be noted that of the 16% growth in public investment, 6.2 percentage points may be explained by the upgrading of the Talara Refinery (S/. 2.022 billion or real growth of public investment in public companies of 137%); and another 3.5 percentage points by Line 2 of the Lima Metro (S/. 1.1 billion: PPO).*

At the sector level, the growth of non-primary sectors (3.3%) was notable in October, especially services (5.5%), electricity, gas, water (4.7%), and trade (4.2%). The primary GDP recovered (0.5%), after falling for five consecutive months. This may be explained primarily by the first positive results for the mining and hydrocarbons sector (3.8%), after six months.

The most recent indicators provide positive signals on the internal economic performance for the coming months:
- *According to the COES,[48] electricity production grew by 5.0% in December, higher than in November (4.9%) and similar to the average for the previous three months (5.1%).*
- *According to preliminary figures from the Peruvian Central Reserve Bank (BCRP), internal cement consumption grew by 5.0% in November, higher than the -0.9% of the previous month and the 1.4% average of the last three months.*
- *According to the National Superintendency of Tax Administration (SUNAT), imports of consumer goods grew by 5.7% in December, the highest rate in nine months. During this month, higher consumption of food (33.1%), electrical appliances (12.5%), and vehicles (11.5%) was registered.*
- *According to the SUNAT, imports of capital goods for industry grew by 11.6% in December, the biggest increase in eight months. Likewise, procurements of construction materials rose by 19.2%, the highest increase in twenty-three months.*
- *According to the BCRP, as of December 15, credit in nuevos soles had risen by 19.0%, similar to the previous month (19.1%) and higher than the previous three months (average 18.1%). Credit in dollars grew by 0.4%, less than a month ago (0.7%) and the previous three months (average 2.0%). The lower growth of credits in dollars has made it possible to reduce dollarization to 38.1%, -4.4 percentage points since the start of 2013. For their part, as of December, current liabilities rose by 10.4% A/A, the third-highest rate of 2014.*
- *According to ARAPER, the sale of new family vehicles grew by 5.6% in December, lower than November (18.6%) and the average for the previous three months (7.1%).*
- *According to Apoyo Consultoría, the consumer confidence index in Metropolitan Lima was situated at 56 points in December (above November: 53 points), the highest index registered since July 2014.*
- *According to Apoyo Consultoría (week of Dec. 15–Dec. 18), among its more than 300 client companies, the business confidence index had recovered and reached its highest level since March 2014. A total of 24% of all companies surveyed claimed that the execution of their investment plans would accelerate, while only 9% said they would be reduced.*

However, there is still some deterioration in the external sector due to the greater deceleration in China, the Euro Zone, and the drop in international metal prices. In November, total exports fell by -10.9%. This result may be explained by both lower volumes (-2.9%) and export prices (-8.3%). Traditional exports fell by -14.8%, mainly due to fewer shipments of mining products (-18.4%), such as gold (-29.8%) and lead (-32.9%). Non-traditional exports dropped by 4.6% (first decrease in thirteen months) as a result of lower textile (-29.9%) and fishing (-10.7%) shipments. The demand for agriculture and livestock products continued to rise, however (7.1%). According to figures from the SUNAT, total imports fell by -1.9% in December (lower than the drop in November and the average for the previous three months). This result may be explained primarily by lower import prices (-5.0%).

Finally, according to the National Institute of Statistics and Informatics (INEI), the job market in Metropolitan Lima during the mobile quarter of September–November 2014 showed the following results: i) ***dependent employment*** *grew by 3.9%, higher than the previous 3.5% and the average for the previous three months (3.6%); ii)* ***adequate employment*** *grew by 6.8% (previously 5.7%); iii)* ***the unemployment rate*** *was 5.4%, lower than last year (5.8%); and iv) the* ***average monthly income*** *rose by 7.2% (previously 8.2%). Meanwhile, the income of dependent employees grew by 6.5% (previously 7.4%) and of the adequately employed by 4.8% (previously 5.3%).*

According to the Ministry of Labor and Job Promotion, in November 2014, ***employment in companies of ten or more workers in urban areas*** *grew by 1.5% (1.5% for the previous month). This result marked sixty months of continuous increases in employment. The service sector (3.7%), transport, storage, and communications (1.6%), and extractives (1.5%) displayed the highest growth.*

[48] Economic Operating Committee of the National Interconnected Grid System.

C. Reforms Associated with the Second Program to Reduce the State's Vulnerability to Disasters ("Second CAT-DDO")

The Peruvian Government is aware that, despite the achievements to date, the country still faces significant challenges to reduce the State's vulnerability to disasters.

Given the framework that has been described, the Government of Peru, with support from the World Bank, has developed the second contingent credit line as part of the Program to Reduce the State's Vulnerability to Disasters, which is based on three pillars: i) improving efficiency in public resource allocations for disaster risk management; ii) strengthening vulnerability reduction in infrastructure for the education and housing sectors and flood protection measures; and iii) increasing the Government's capacity for post-disaster recovery and reconstruction.

C.1 Improving Efficiency in Public Resource Allocations for Disaster Risk Management

In order to establish the strategic guidelines, objectives, and multi-year actions necessary to comply with the provisions of the law and the National Disaster Risk Management (DRM) Policy, the Government of Peru approved the National Disaster Risk Management Plan (PLANAGERD, for its acronym in Spanish) 2014–2021, through Supreme Decree (Decreto Supremo) 034-2014-PCM, dated May 12, 2014. The PLANAGERD seeks primarily to strengthen, foster, and permanently improve the culture of prevention and increase resilience, in order to identify, prevent, reduce, prepare, respond to, and recover from emergencies or disasters, as well as to foster a view that considers DRM to be a cross-cutting action for all organizational and planning bodies at the three levels of Government, and to be aligned with the State's decentralization process.

Also, since 2012 the Government has developed the Disaster Vulnerability Reduction and Emergency Response Budget Program 068,[49] which represents a medium through which disaster risk management policies can be articulated at the regional level. This program currently includes the participation of ten sectors, including Health, Defense, PCM, Agriculture, and Education, among others, and has incorporated all of the Regional Governments and more than 500 Local Governments. During 2014, a range of actions were implemented to improve the design of the Budget Program, including the formation of an inter-sectoral commission to review the Program; the development of project typologies for the Budget Program; and the validation of performance indicators. One of the priority actions for the 2015–2017 period is the alignment of the Budgetary Program to the PLANAGERD in order to promote and support the implementation of Results-Based Budgeting in Local and Regional Governments.

Furthermore, Administrative Decree (Resolución Jefatural) 044-2014-CENEPRED/J approved the "Methodological Guide for the Incorporation of Prospective and Corrective Disaster Risk Management into Concerted Development Plans." The objective is to guide the process of incorporating Prospective Management (PM) and Corrective Management (CM) into the Concerted Development Plans (PDCs, for their acronym in Spanish) to ensure alignment of the structure, contents, and scope, in accordance with the National Disaster Risk Management Policy and Plan 2014–2021.

C.2 Strengthening Vulnerability Reduction in Infrastructure for education and housing Sectors and for Flood Protection Measures

The Government seeks to increase the capacity of the education sector to implement disaster risk reduction policies in school infrastructure, in an effort to improve the quality of education in the country. Through Supreme Decree 004-2014-MINEDU, dated May 30, 2014, published in the Official Gazette "El Peruano" on May 31, 2014, the National School Infrastructure Program was created (PRONIED, for its acronym in Spanish). The objective is to expand, improve, replace, rehabilitate, and/or build public school infrastructure for Basic Education and for Higher Pedagogical, Technological, and Vocational/Productive Education, including their maintenance and/or equipping.

Moreover, with the goal of increasing the capacity of the housing sector to support and facilitate the seismic vulnerability reduction of low-income housing, Law 30191 was approved, establishing measures for the prevention, mitigation, and adequate preparation for disaster response, in an effort to prevent and mitigate disaster risk factors,

[49] Previously, Emergency Decree (Decreto de Urgencia) 024-2010 created the Strategic Budgetary Program for Disaster Vulnerability Reduction and Emergency Response, which is a precedent for Budgetary Program 068.

as well as to adequately prepare for disaster response nationwide. The Operating Regulations for the Grant for the Protection of Vulnerable Housing to Seismic Risk were approved by Ministerial Resolution 172-2014-VIVIENDA, dated June 5, 2014, and published in the Official Gazette "El Peruano" on June 6, 2014.

In addition, with the goal of increasing the institutional capacity to define and implement flood protection policies, Directorial Resolution 006-2014-EF/63.01 approved the "Minimum Specific Content for Pre-Investment Studies for Flood Protection Public Investment Projects" (CME 25), which was prepared by the General Directorate of Public Investment, in coordination with the Presidency of the Council of Ministers (PCM), the National Water Authority (ANA, for its acronym in Spanish), and other public entities. Furthermore, Supreme Decree 006-2014-MINAGRI authorizes the National Water Authority to conduct conclusive studies for the execution of multi-sector hydraulic projects that will help improve water resource management, aimed at preventing or mitigating the impact of extreme hydrological events.

C.3 Increasing the Government's Capacity for Post-Disaster Recovery and Reconstruction

The Government of Peru, in order to strengthen the institutional framework and capacity to guarantee the operational continuity of the Government in case of a disaster and to effectively plan and implement the reconstruction processes, has established under the SINAGERD, the regulatory and institutional framework. This measure will support the identification of roles and the establishment of objectives to effectively manage and finance rehabilitation and reconstruction, as well as the development of sector operational continuity plans against disasters.

As part of the foregoing, the implementation of guidelines will be approved and set forth to manage the Operational Continuity for Entities at the three levels of Government. This will help enforce the obligatory nature—already established in the framework of one of the Strategic Objectives of the National Disaster Risk Management Plan—for the implementation and management of Operational Continuity plans by the public entities that form part of the National Disaster Risk Management System to adapt their scope and the complexity of their operations and services, similar to what the Ministry of Economy and Finance has been gradually doing. The CENEPRED has also been developing technical guidelines for the reconstruction process, which will also take into account the specific rules of the SINAGERD related to large-magnitude disasters. Thus, it is expected that the different entities will have a series of management instruments, such as post-disaster reconstruction plans and operational continuity plans in case of disasters, and that the MEF will develop policies and procedures for financing post-disaster rehabilitation and reconstruction activities. With regard to this last aspect, the MEF Risk Committee agreed to create the Permanent Working Group for the Coordination of Large-Magnitude Post-Disaster Financing, which will make it possible to develop said procedures and ensure better coordination with the PCM, the National Institute of Civil Defense (INDECI), and the CENEPRED.

D. Conclusion

As set forth above, the Government of Peru is carrying out important actions to strengthen risk management in the country by improving the distribution of resources for disaster risk management policies; implementing risk reduction policies in the prioritized sectors of education and housing, construction and sanitation; and improving financial protection mechanisms against disasters and financing of reconstruction processes.

The Government is committed to continue moving forward in these matters, for which it requires the support of the World Bank in the abovementioned areas.

In light of the foregoing, the Government of Peru hereby requests the approval of the Second CAT-DDO in the amount of US$400 million.

Thank you in advance for your time.

Sincerely,

(signature)

ANNEX 3: FUND RELATIONS ANNEX

PERU—ASSESSMENT LETTER FOR THE WORLD BANK

(Documentation to support the proposal of the Second Social Inclusion Development Policy Loan and the Disaster Risk Management Development Policy Loan)
December 22, 2014

1. **Peru's good economic growth performance over the past decade was recognized by the Executive Board of the IMF at the conclusion of 2013 Article IV Consultation.** Directors commended Peru's impressive macroeconomic performance, underpinned by strong fundamentals and sound policy management. The country achieved high growth, low inflation and low public debt, and made progress in reducing poverty and improving living standards. Directors emphasized the importance of continued implementation of flexible and coordinated policies as well as structural reforms to maintain macroeconomic stability and foster more inclusive long-term growth.

2. **The pace of economic activity slowed markedly in 2014 due to a combination of adverse external and domestic factors.** The economy grew at 2.8 percent in the first three quarters of 2014—the slowest pace since the global financial crisis—reflecting softer terms of trade and a slowdown in both private and public investment. Furthermore, lower external demand and domestic supply side shocks, including a crackdown in illegal gold mining, have led to a sharp drop in exports. Consequently, staff revised down growth projections for the October WEO to 3.6 percent in 2014 and 5.1 percent in 2015 (Table). Downside risks prevail.

3. **The external position has deteriorated due to weak export performance and lower capital inflows.** The current account deficit widened to about 5.5 percent of GDP in the first three quarters of 2014, and long-term capital inflows have not been sufficient to finance the current account deficit, leading to an overall balance of payments deficit. It should be noted that the current account deterioration is due to developments in metals markets, and not to oil price movements, as Peru's net oil balance is close to zero. Exchange rate policy has been more flexible over the past year, although the central bank intervened both in the spot and forward markets to limit excessive volatility. A depreciation of the nuevo sol of about 6 percent in nominal terms so far in 2014 has helped absorb the terms of trade shock. The real exchange rate is assessed to be broadly in line with fundamentals and the stock of NIR is adequate by any metric at US$63.3 billion (31.5 percent of GDP) as of November 2014.

4. **The financial sector remains solid and healthy.** Despite some weaknesses identified in non-bank depository institutions, the overall health of the financial system remains solid with a capital to risk-weighted asset ratio of 14.5 percent, a non-performing loan ratio of 3 percent, and return on equity of 18.5 percent. Credit growth slowed, but continues to be robust at 12 percent y/y in October 2014. A relatively high rate of financial dollarization (39 percent of credit) remains a material risk to the financial system.

5. **Against well-anchored inflation expectations, the central bank has eased monetary policy.** Inflation has been marginally outside the central bank's target range for most of 2014 due to supply shocks, but it remains within target excluding energy and food, and inflation expectations are well-anchored. Looking forward, some easing of inflationary pressures is likely as gasoline prices fall. The central bank cut the reference rate by 50 bps, in two steps, to 3.5 percent by September and successively reduced reserve requirements on local currency deposits to 9.5 percent by December 2014.

6. **The authorities have also taken fiscal and structural measures to stimulate the economy and remove investment bottlenecks.** In mid-2014, Congress approved a reform package aiming to improve the business climate and stimulate aggregate demand. In November, a second package included lower corporate and personal income taxes and steps to speed up investment approvals. Taken together, the fiscal and structural measures amount to about 2 percent of GDP. The fiscal position will remain broadly in balance in 2014, consistent with an expansionary stance compared to a surplus of nearly 1 percent of GDP in 2013. For 2015, the budget envisages a deficit of 0.5 percent of GDP, but with the recently approved fiscal measures, a deficit of up to 2 percent of GDP could emerge, requiring the application of an exceptional clause under the new fiscal rule. Gross public debt could grow to 22 percent of GDP (percent of GDP in 2013), which is still very low by regional standards.

7. **The current policy mix is broadly adequate and downside risks are manageable given large international reserves and fiscal buffers.** Growth will remain vulnerable to terms of trade shocks, unexpected turbulence in global financial markets, continued under-spending of public investment and uncertainties created by the upcoming election cycle. While part of the ongoing slowdown is due to short term supply shocks, the economy will need to adjust to lower growth in China (one of Peru's main trading partners) and a generally less favorable external environment over the medium term. The immediate priority is to implement the reform package already announced, while ensuring that the fiscal measures are temporary, including to contain any risk of undermining the credibility of the new fiscal rule. Persevering with structural reforms is key to enhance long-term inclusive growth.

Peru: Selected Economic Indicators

(October 2014 WEO projection)

	2010	2011	2012	2013	Proj. 2014	Proj. 2015
Social Indicators						
Life expectancy at birth (years)	73.8	74.0	74.2	...	...	...
Infant mortality (per thousand live births)	17.0	16.0	17.0	...	...	...
Adult literacy rate	92.6	92.9	...	...	...	...
Poverty rate (total) 1/	30.8	27.8	25.8	...	...	...
Unemployment rate	7.9	7.7	6.8	6.0	6.0	6.0
	(Annual percentage change; unless otherwise indicated)					
Production and prices						
Real GDP	8.5	6.5	6.0	5.8	3.6	5.1
Real domestic demand	14.9	7.7	8.0	7.0	3.9	4.9
Consumer Prices (end of period)	2.1	4.7	2.6	2.9	2.9	2.2
Consumer Prices (period average)	1.5	3.4	3.7	2.8	3.2	2.3
External sector						
Exports	32.3	29.5	0.0	-9.0	-5.3	5.5
Imports	37.1	28.9	10.7	2.6	-0.7	3.8
Terms of trade (deterioration -)	21.0	7.3	-2.1	-4.7	-3.0	0.9
Real effective exchange rate (depreciation -)	2.1	-1.4	8.1	-0.2	...	...
Money and credit 2/						
Broad money	21.7	15.1	12.1	14.8	13.8	13.5
Net credit to the private sector	16.7	21.6	13.3	18.4	14.0	14.5
	(In percent of GDP; unless otherwise indicated)					
Public sector 3/						
NFPS Revenue	26.1	27.2	27.7	27.1	26.4	26.9
NFPS Primary Expenditure	25.1	24.1	24.2	25.2	25.4	26.3
NFPS Primary Balance	1.0	3.1	3.4	1.9	1.0	0.6
NFPS Overall Balance	-0.2	1.9	2.3	0.8	0.0	-0.4
External Sector						
External current account balance	-2.4	-1.9	-3.3	-4.5	-5.2	-5.0
Gross reserves						
In millions of U.S. dollars	44,150	48,859	64,049	65,710	66,210	67,710
Percent of short-term external debt 4/	342	559	494	540	771	791
Percent of foreign currency deposits at banks	241	228	301	275	251	225
Debt						
Total external debt	27.4	25.6	27.2	24.7	24.6	24.5
NFPS Gross debt (including CRPAOs)	25.2	23.2	21.2	20.0	19.3	19.1
External	13.2	11.5	9.8	9.1	8.4	8.4
Domestic	12.1	11.7	11.4	10.9	10.9	10.7
Savings and investment						
Gross domestic investment	25.2	25.7	26.7	28.3	27.8	28.4
Public sector	5.9	4.8	5.4	5.8	6.1	6.8
Private sector 5/	19.3	20.9	21.3	22.5	21.6	21.6
National savings	22.8	23.9	23.5	23.8	22.5	23.5
Public sector	6.3	7.4	7.9	6.8	6.2	6.6
Private sector	16.5	16.5	15.6	17.0	16.3	16.9
Memorandum items						
Nominal GDP (S/. billions)	419.7	469.9	508.2	546.9	582.4	598.2
GDP per capita (in US$)	5,027	5,685	6,323	6,541	6,625	6,817

Sources: Central Reserve Bank of Peru (BCRP); Ministry of Economy and Finance (MEF); National Statistical Institute (INEI); UNDP Human Development Indicators; and Fund staff estimates/projections.

1/ Defined as the percentage of households with total spending below the cost of a basic consumption basket.
2/ Corresponds to depository corporations. Foreign currency stocks are valued at end-of-period exchange rates.
3/ Does not reflect the fiscal measures announced in December 2014.
4/ Short-term debt is defined on a residual maturity basis, and includes amortization of medium- and long-term debt.
5/ Including inventories.