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Latam Daily: Peru's MoF to Restore the Fiscal Stabilization Fund in Q1

- **Peru: Ministry of Finance seeks to restore the Fiscal Stabilization Fund to its pre-COVID-19 levels**

PERU: MINISTRY OF FINANCE SEEKS TO RESTORE THE FISCAL STABILIZATION FUND TO ITS PRE-COVID-19 LEVELS

In a press release on Monday (January 10), the Ministry of Finance officially announced its intention to allocate over PEN 18 bn (USD 4.56 bn) to the Fiscal Stabilization Fund (FEF or Fondo de Estabilización Fiscal). The resources, equivalent to approximately 2% of GDP, are to be deposited on an unspecified date during Q1 2022.

This deposit would restore the FEF to its pre-COVID-19 levels, although it would remain lower than its all-time high of PEN 29.5 bn in 2016 (chart 1). The FEF funds were all but used up during 2020–2021 to provide resources to counter the impact on the economy of the COVID-19 pandemic and the accompanying lockdowns and mobility restrictions.

The announcement came as a surprise, especially as the deposit will occur when Peru has a fiscal deficit. In the past, the FEF grew only in years in which there was a fiscal surplus. The press release did not provide too much insight into what the Ministry of Finance has in mind, outside of one key phrase, namely that "The FEF is one of the main elements of countercyclical fiscal policy, as it accumulates resources mainly during scenarios of rising fiscal revenue associated to… favourable commodity prices…" (our translation). In the past, Minister of Finance Pedro Francke had stated the convenience of taxing mining operations while commodity prices are high. Thus, Minister Francke appears to have in mind the importance of the current commodity cycle and the need to take advantage of it for long-term fiscal sustainability, as part of a Keynesian countercyclical policy approach. Rebuilding the FEF during a period of high metal prices would be part of this philosophy.

The press release did not state from whence these resources stem from, however. In the past, the FEF grew based on funds available when Peru registered a fiscal surplus. This is clearly not the case now. The magnitudes of the increments are also much different. In the past, the FEF would increase around PEN 5 bn to PEN 6 bn per year in its better years. This year's proposed increment is 3x greater. The release did not state how the PEN 18 bn amount was determined. It is broadly in line with PEN 16 bn in fiscal investment funds that had been budgeted for 2021 but went unspent. It is also broadly in line with the fiscal debt issued in 2021. Both may just be a coincidence, except in that they both add to the availability of funds in general. What hasn't escaped our attention is that the proposed increment will take the FEF back to pre-COVID-19 levels, as this was a message that was stressed in the press release. Thus, part of the aim of the Ministry of Finance may be to show just how resolute it is in its intention to put the country back in the fiscal position it was in before COVID-19. As such, restoring the FEF would be in line with another message that has been given repeatedly by the Ministry of Finance, namely that the fiscal rule (1% of GDP deficit) would be restored by 2025.

There is a bit of discussion on whether it would not have been better to use these funds to finance the 2022–2023 budgets, thus reducing the need to issue debt. After all, the yield of the FEF is likely to be lower than the cost of the same amount in fiscal debt. Note, however, that the decision is in line with the spirit behind the FEF, namely, for the fund to grow when metal prices are high (as they are now), so as to be available for use in times of crisis. The difficulty: normally high metal prices mean a fiscal surplus, and this is not the case now.

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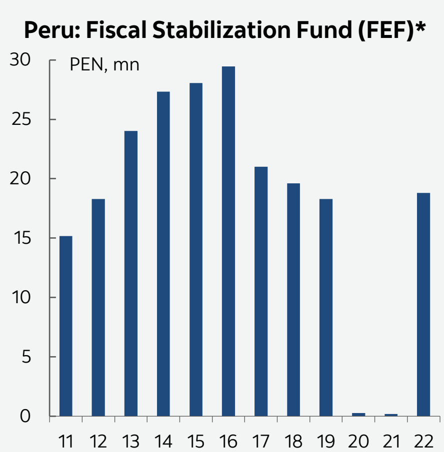
Chart 1



*Includes Secondary Liquidity Reserve (RSL)
Sources: Scotiabank Economics, MEF.

Nonetheless, the decision to restore the FEF to past levels underlines a stance of fiscal management that is unexpected in a government otherwise viewed as more in tune with leftist policies. It sends a message that may help reinforce the vision of Peru as a country with healthy fiscal accounts to back up its fiscal debt levels. As such, the decision could also make it more difficult for rating agencies to downgrade Peru debt going forward, and may actually lead them to improve their view on the debt outlook.

—Guillermo Arbe

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