The changing nature of the financial system: implications for resilience and long-term growth in EMEs: the Peruvian experience[1]

Adrian Armas, Miriam Luna, and Carlos Montoro
Central Reserve Bank of Peru

The structure of the Peruvian financial system has remained relatively stable in recent years, with private sector financing increasing moderately over the past 10 years. Historically, credit from deposit-taking institutions has served as the primary source of funding. However, there has been a shift towards greater diversification, particularly among families and small businesses, in contrast to the previous dominance of corporate credit. Concurrently, the Peruvian capital market has grown, largely attributable to the increased involvement of institutional investors and non-residents in the local sovereign bonds market, but still remains small and incipient compared to other Latin America economies. Recently, some regulatory measures impacting the portfolios of private pension funds pose a potential risk to the market's overall depth and stability.

Some features of the current financial system include the predominance of private financial institutions over state-owned ones in extending credit to the private sector, a decreasing trend in dollarisation due to measures implemented by the Central Reserve Bank of Peru (BCRP) over the past decade, and a significant growth in the microfinance sector facilitated by specialised institutions focusing on this segment. However, despite advancements, a substantial portion of the population remains excluded from the formal financial system, largely due to Peru's significant informal economy.

Therefore, technological innovations can play a pivotal role in promoting microfinance, as they enable cost-effective transactions and enhance access to financial services, especially for individuals residing in remote areas. The momentum of digital payments gained traction during the pandemic and continues to surge. This ongoing evolution aligns with advancements in retail payment methods, the modernisation of critical payment infrastructures, and the emphasis on efficiency and security through BCRP's regulations and oversight.

1. Evolution of the Peruvian financial system

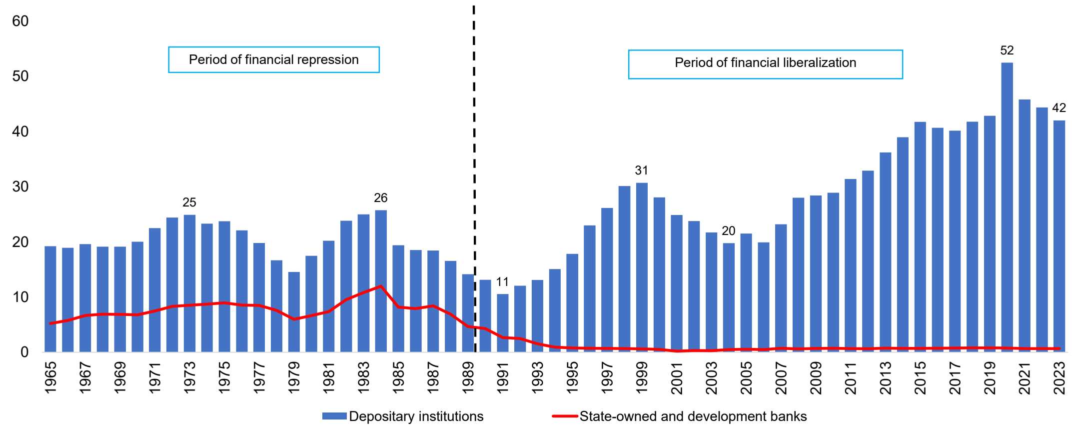
The Peruvian financial system has experienced a remarkable transformation from a severe case of financial repression and capital controls during the 1970s and 1980s to a liberalised financial system with an open financial account.

In the first phase, until the end of the 1980s, the financial system was plagued by multiple distortions. These included binding interest rate caps, direct

[1] Prepared for the BIS EME Deputy Governors meeting on "Finance, resilience and economic growth in EMEs", 18–19 March 2024.

allocation of loans based on portfolio coefficients, high reserve requirement rates (RRRs), freezing of foreign exchange (FX) deposits, mandatory investment directives for banks, and a range of taxes imposing burdens on financial intermediation (such as a 2% tax on chequing account debits and an excise tax on interest earnings). Consequently, Peru experienced significant financial disintermediation along with a hyperinflation process starting in 1988, substantial capital outflows, widespread scarcity of bank credit, rampant speculation and the emergence of informal credit intermediaries. Low formal intermediation, compounded by the inflation process, severely restricted the lending capacity of financial institutions and increased their operating costs by reducing the volume of lendable resources. By 1989, the monetisation ratio, reflecting the availability of national currency financial resources for supporting economic activity, fell to a historic low.

Total credit (as % of GDP) Graph 1



Sources: Central Reserve Bank of Peru.

In the second phase, starting in 1991, the authorities launched a comprehensive programme aimed at liberalising the financial system. The measures taken included: (i) the new Law on Banks, Financial Institutions and Insurance, seeking to establish a level playing field for domestic and foreign investments with an aim to promote free competition; (ii) freedom to hold FX; (iii) banks' freedom to set interest rates, commissions and fees; (iv) lower RRRs; (v) reform of state-owned financial intermediaries, consolidating them into one entity performing second-tier banking functions (*Corporación Financiera de Desarrollo*, known as COFIDE) and an agricultural development bank (Agrobanco); (vi) FX market liberalisation; (vii) redefinition of the role of the Central Reserve Bank of Peru (BCRP); (viii) elimination of taxes on intermediation; (ix) introduction of the new Securities Market Law; (x) enactment of the Private Pension System Law; and (xi) reinforcing regulatory and supervisory mechanisms aligning with Basel prudential criteria (1996).

During the 1990s, the financial system experienced a recovery, evidenced by an increase in the credit-to-gross domestic product (GDP) ratio from 11% in 1991 to 31% in 1999. During this period, the newly introduced regime of free capital mobility, the restructuring of public debt and other market-friendly reforms promoted capital repatriation and capital inflows. However, in September 1998, a sudden-stop episode was magnified by high financial dollarisation (78% of bank credit was FX-denominated) and bank' high dependence on short-term external debt

(5% of GDP and 25% of bank credit prior to the capital outflow). The credit crunch and the balance sheet effects caused by the sharp currency depreciation had a larger impact on corporates and medium-sized firms, as bank credit was concentrated in these segments.[2]

Financial depth in Peru increased following the above reforms and the achievement of low inflation by the end of the 1990s.[3] Financial system assets have grown consistently, from 37% to 58% of GDP between 2001 and 2023. They peaked at 79% of GDP in 2020, due to the extraordinary stimulus measures (especially a government-guaranteed loan programme known as "Reactiva Peru") implemented to address the impact of the Covid-19 pandemic.

In addition, the number of debtors surged from 1.4 million in 2001 to 8.0 million in 2023. At the same time, the number of financial institutions decreased from 63 in 2014 to 51 in 2023 due to spin-offs, mergers, acquisitions and liquidations among financial entities in recent years.

As part of the liberalisation process, the new financial regime from the beginning of the 1990s allowed free capital mobility and freedom to hold FX financial assets. Moreover, article 64 of Peru's 1993 Constitution established that the state guarantees the freedom to possess and dispose of foreign currency. This provision fostered an environment conducive to capital inflows from bank accounts held by Peruvians abroad. Given the country's history of hyperinflation and the persistence of high inflation rates at the time, the dollarisation coefficient remained significantly high.

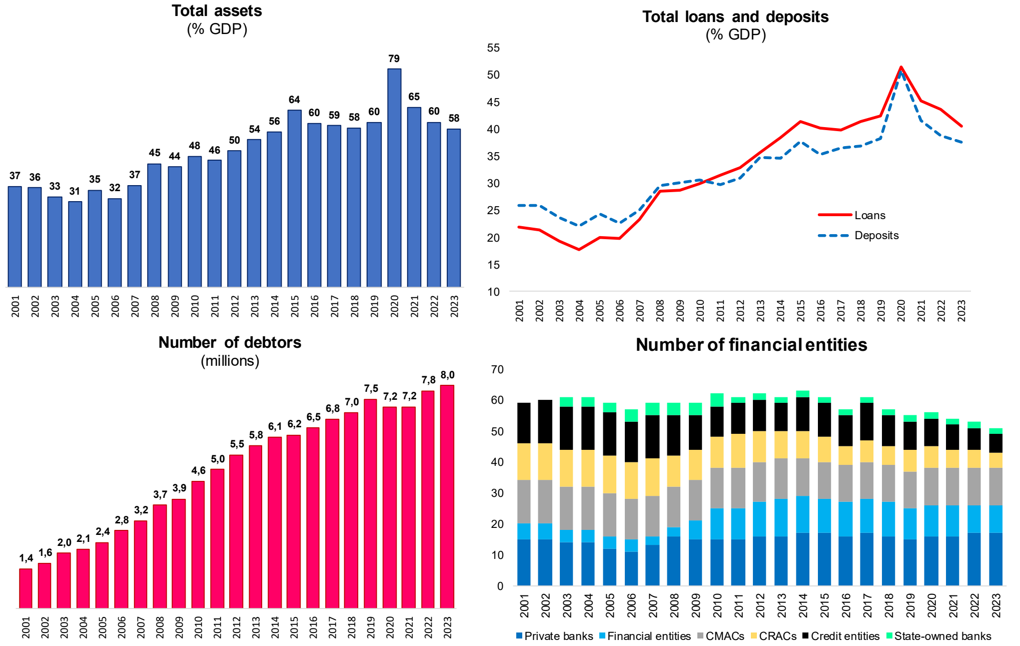
In this century, financial dollarisation has decreased continuously in parallel with keeping low inflation. Thus, the dollarisation coefficient for private sector obligations decreased from 82% in 2000 to 23% by December 2023. The decline in financial dollarisation has been facilitated by the inflation targeting framework adopted by the BCRP in 2002. This approach entails a permanent, clear and credible commitment to maintaining the purchasing power of the PEN over time, thereby restoring confidence in the domestic currency. Accordingly, the BCRP has implemented policies such as the credit de-dollarisation programme, which seeks to align incentives for financial entities through RRRs linked to the evolution of dollar credit, as well as currency repo operations, to continue promoting a gradual reduction in credit dollarisation over the long run[4].

2 The capital flow sudden stop was widespread in Latin America and other regions. Castillo and Barco (2009) provide more detail and an international comparison of economic costs and policy responses.

3 From 39.5% in 1993 to 6.01% in 1998 and to 3.7% in 2000. During 2001–22, the average inflation rate was 2.91%, the lowest among Latin American countries that issue their own national currencies.

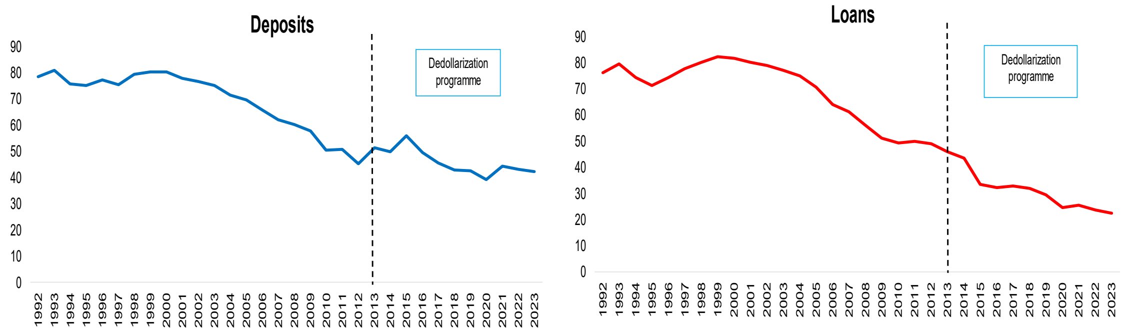
4 Armas (2016), Castillo, P, H Vega, E Serrano and C Burga (2016).

Peruvian financial system structure[5] Graph 2



Sources: Superintendency of Banking, Insurance and Private Pension Fund Administrators.

Financial dollarisation – banks Graph 3



Sources: Central Reserve Bank of Peru.

2. Structure of Peru's financial system

Total financing to the private sector has increased moderately over the last decade and credit from depository institutions remains the main funding source. The credit-to-GDP ratio augmented from 48% in 2011 to 57% in 2023, after

5 As of December 2023, the financial system is composed of 51 entities: 17 private banks, two state-owned banks, nine financial institutions, 12 municipal savings and loan banks (CMACs), five rural saving and loans associations (CRACs) and six credit entities.

peaking at 73% in 2020 driven by "Reactiva Perú" in response to the Covid-19 pandemic. Credit from depository institutions accounts for around three quarters of total financing, the share of external financing has varied between 17% and 27%, and funding from other financial sources (capital markets) has ranged between 7% and 10%.

Total financing to the private sector (as % of GDP and % share) Table 1

	% GDP		% Share	
	2011	2023	2011	2023
I. Credit of depositary corporations	**35**	**42**	**73**	**74**
Domestic currency	18	32	37	57
Foreign currency	17	10	11	5
Dolarization (%)	50	23	0	0
II, Credit of other financial corporations	**4**	**4**	**9**	**7**
Domestic currency	2	3	4	5
Foreign currency	2	1	2	1
Dolarization (%)	55	34	0	0
Of which:				
AFP's loans	3	1	6	2
Mutual fund's loans	0	0	1	0
Insurance companies' loans	1	2	2	3
III. External private indebtness	**8**	**11**	**17**	**19**
Short-term	3	2	2	1
Medium and long-term	6	9	3	4
IV. TOTAL (I+II+III)	**48**	**57**	**100**	**100**
Domestic currency	20	35	41	61
Foreign currency	28	22	18	10
Dolarization (%)	59	39		

Total funding to the private sector includes the credit provided by depository institutions, direct external loans to businesses and the resources provided by other financial institutions such as mutual funds, insurance companies and private pension funds.

Source: Central Reserve Bank of Peru.

2.1 Depository Institutions

Credit extended by depository institutions has increased substantially in the last three decades, from 14.1% of GDP in 1989 to 31% of GDP in 1999, further escalating to 52% of GDP in 2020.

Credit from depository institutions has diversified, moving from predominantly short-term financing for the corporate sector to loans extended to households and micro, small and medium-sized enterprises (MSMEs). In 1995, 92% of the loan portfolio was directed towards funding business activities, with only 8% allocated to individuals and households (consumer loans 6% and mortgages 2%). However, by 2005, household financing had soared to 30% of loans, primarily due to the expansion of mortgage lending. By 2023, the share of all financial system loans to individuals and MSMEs accounted for 41% and 28%, respectively. This highlights a substantial rise in the share of loans extended to individuals, mainly due to significant growth in mortgage financing associated with increased per capita income and employment, enabling families to access formal credit. In contrast, corporates and large enterprises gained greater access to international capital markets and foreign banks.

Total credit to the private sector (% GDP and % share)

Table 2

	% GDP			% Share		
	2001	2011	2023	2001	2011	2023
Businesses	22	10	25	82	53	59
Corporate and large companies	21	3	13	79	16	31
Medium-sized enterprises	0	2	5	0	10	13
Small businesses and micro businesses	1	5	6	4	27	15
Households	5	8	17	18	47	41
Consumer	3	6	10	9	35	25
Car loans	0	0	0	0	1	1
Credit card	0	2	2	0	12	4
Rest	0	4	8	0	22	19
Mortgage	5	2	7	18	12	16
Total	27	18	42	100	100	100

Source: Central Reserve Bank of Peru.

The largest part of bank credit to businesses is allocated to trade, manufacturing and services industries. Between 2001 and 2023, services industries increased their share of bank credit, while industries in other sectors, such as mining, external financing and capital markets, have been displacing bank credit.

Bank credit to businesses (% share)

Table 3

	2001	2023
a. Trade	22,2	24,9
b. Manufacturing Industry	28,0	22,7
c. Services*	14,3	19,3
d. Real state, business activities and renting	7,5	11,2
e. Agriculture, livestock, hunting and forestry	4,0	5,8
f. Financial intermediation	3,9	4,6
g. Mining	7,9	4,5
h. Electricity, gas and water	4,1	3,7
i. Construction	3,6	2,5
j. Fishing	3,4	0,7
k. Public andministration and defence	1,1	0,1
TOTAL - Bank Credit	**100,0**	**100,0**

*Includes transport, health, social, private household, hotels and restaurants, education and other activities and community services.

Source: Superintendency of Banking, Insurance and Private Pension Fund Administrators.

Box A

Reactiva Perú

In 2020, to mitigate the economic downturn resulting from quarantine measures and the looming threat of a recession, the Reactiva Perú programme launched government-guaranteed repurchase agreements (repos) to infuse liquidity into the market. This initiative bolstered businesses by replenishing working capital, with the aim of preserving credit market functionality and averting disruptions in payment flows. Resources were distributed through auctions, wherein financial entities proposing the lowest interest rates to their clients were granted access to the funds.

By the end of 2020, total credit operations under the programme amounted to 7.8% of GDP (PEN 6 billion) at historically low rates, reaching approximately 502,000 companies. The peak balance exceeded PEN 58 billion, and the year-end balance of PEN 56 billion reflected repayments by recipient companies in 2020. As of December 2023, the balance amounted PEN 6.4 billion (0.6% of GDP).

Balance – Reactiva Perú

Table A1

	Dec 2020	Dec 2021	Dec 2022	Dec 2023
Balance (PEN billion)	56.2	42.7	20.9	6.4
% GDP	7.8	4.9	2.2	0.6

Source: Central Reserve Bank of Peru.

2.2 Other financial institutions

The creation of a private pension system in 1993 was a key element in the development of the local capital market. The system, which was designed to replace the state-run social security system, introduced individual capitalisation accounts (CICs) managed by specialised private companies (AFPs). The latter enhanced formal sector savings and stimulated the development of the local capital market. Along with AFPs, mutual funds and insurance companies are also important institutional investors in Peru.

From 2020-2022, Congress-authorised pension fund withdrawals have impacted the local capital market. AFPs' portfolio value peaked at 22% of GDP in 2019 (PEN 173 billion) but decreased to 12% of GDP in 2023 (PEN 123 billion). During the pandemic (2020-2022), six extraordinary pension fund withdrawals, equivalent to 9.4% of GDP in 2022 (PEN 88.0 billion), were enacted by Congress and the Executive. Approximately 6.1 million affiliates withdrew funds between 2020 and 2022. In addition, between 2016 and 2022 there had been other withdrawals equivalent to 5.7% of GDP in 2022 (PEN 53 billion). In 2024, a seventh extraordinary pension fund withdrawal was approved.

Pension fund withdrawals (2016–22) Table 4

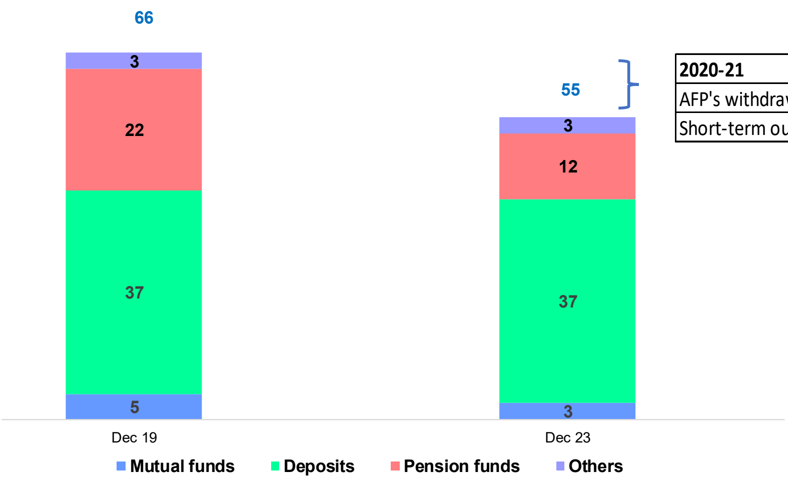
Withdrawal process	Number of affiliates (thousands)	Withdrawals (PEN billions)	% GDP
Law N° 30425 (21 April 2016) / 95.5% Retirement	503	50	5.3
Law N° 30478 (29 June 2016)/ 25% Housing	117	3	0.4
Emergency Decree N° 34-2020 (31 March 2020)	1 935	3	0.3
Emergency Decree N° 38-2020 (14 April 2020)	1 306	2	0.2
Law N° 31017 (1 May 2020)	3 775	20	2.1
Law N° 31068 (18 November 2020)	1 257	9	1.0
Law N° 31192 (7 May 2021)	3 218	32	3.4
Law N° 31478 (21 May 2022)	3 133	22	2.3
TOTAL	**6 133**	**141**	**15.0**

Source: Superintendency of Banking, Insurance and Private Pension Fund Administrators

The BCRP performed market operations to assist AFPs in accommodating the portfolio changes associated with pension fund withdrawals, with an aim to mitigate volatility in financial markets. In response to the withdrawals, AFPs managed liquidity by selling their more liquid assets, such as foreign investments and sovereign bonds. The BCRP performed repo operations with AFPs and provided a limited windows facility to conduct FX and government purchases.

The withdrawals from AFPs have significantly depleted financial savings in Peru. Between December 2019 and December 2023, total domestic savings plunged by 12 percentage points of GDP, of which 9.4% of GDP are explained by pension fund withdrawals. Additionally, political risk sentiment following the 2021 presidential election triggered a considerable short-term capital flight, with residents moving assets abroad, amounting to 7.3% of GDP.

Financial savings (% GDP) Graph 4

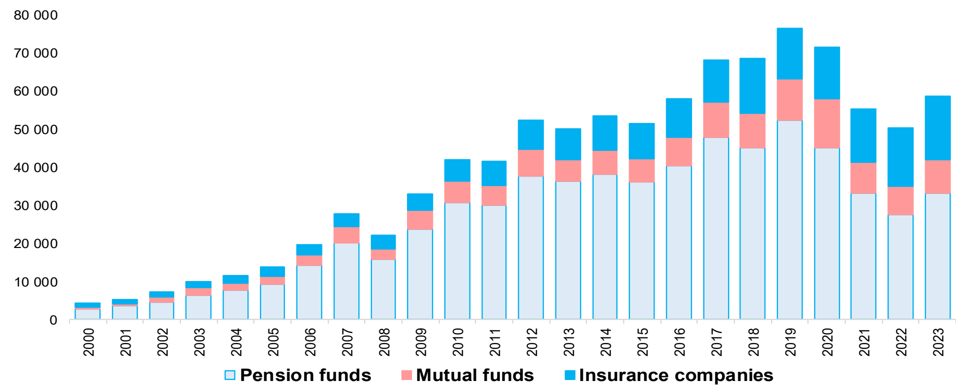


2020-21	%GDP
AFP's withdrawals	9.4
Short-term outflows - 2021	7.3

Sources: Superintendency of Banking, Insurance and Private Pension Fund Administrators; Central Reserve Bank of Peru.

Funding obtained by Peruvian companies through the domestic capital market, from institutional investors like AFPs, mutual funds and local insurance companies, rose from 4% to 6% of GDP between 2001 and 2020. Post-2020, however, there was a reversal in this trend, related to the reduction of AFPs associated with the pension fund withdrawals.

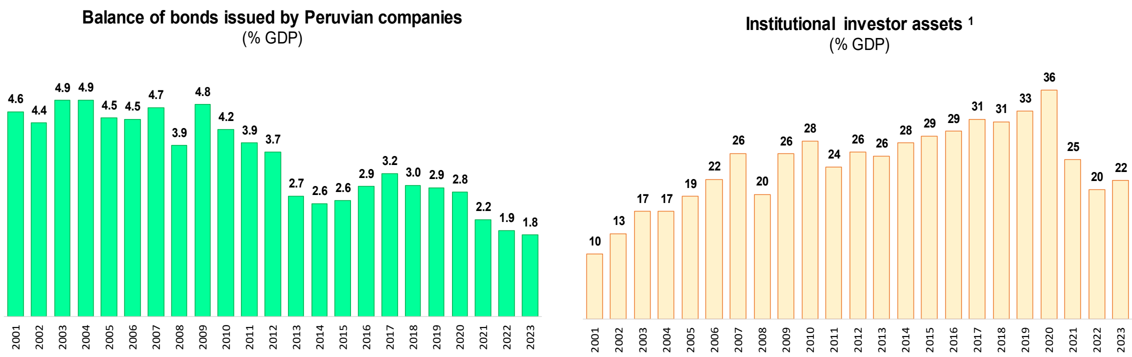
Institutional investor assets (USD million) Graph 5



Source: Superintendency of Banking, Insurance and Private Pension Fund Administrators; Cavali.

Financing through the bond market experienced rapid growth over the last two decades, although it has stalled since the pandemic. The balance of bonds issued by Peruvian companies, covering both local and foreign markets, surged from USD 2.4 billion in 2000 to USD 23.2 billion in 2019, a ninefold increase. However, Peruvian companies' participation in the local capital market dwindled from 2020 onwards, with bond issuance volumes in local markets dropping from USD 1.7 billion in 2019 to a historic low of USD 0.5 billion in 2020. As of December 2023, the balance was USD 24.1 billion. On the international front, issuances have resumed only since the third quarter of 2023, post-pandemic, influenced by tightened financial conditions in international dollar markets and escalating yields of Peruvian sovereign bonds. In the local market, the issuance trend mirrored this decline, from USD 1.7 billion in 2019 to USD 1.0 billion in 2023, with a historic low of USD 0.5 billion also in 2020. The institutional investor portfolio grew from 10% to 33% of GDP between 2001 and 2019, then fell to 22% by 2023.

Private sector Peruvian bonds and institutional investors Graph 6

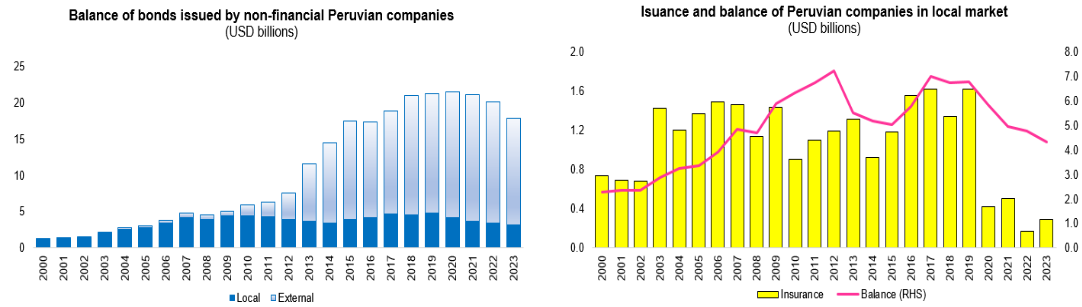


[1] Includes: Private pension funds, mutual funds and insurance companies.

Source: Superintendency of Securities Market and Superintendency of Banking, Insurance and Private Pension Fund Administrators

Private sector bond market

(amounts in USD billions and shares in %) Graph 7



Source: Superintendency of Securities Market.

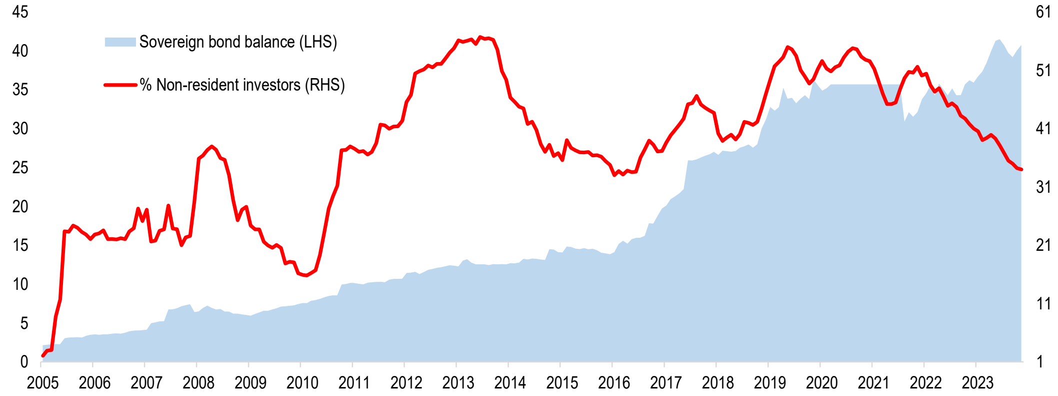
Mutual funds also faced a reduction in assets under management (AUM) and in the number of participants, coinciding with increased volatility in international financial markets due to pandemic-related uncertainties and later to higher local political risk. Notably, equity decreased from a peak of USD 50 billion in March 2021 to USD 33 billion in December 2023. This pattern is reminiscent of the trend seen in September 2008 during the Great Financial Crisis (GFC), although recovery in the current scenario has been faster.

In contrast, insurance companies saw a significant increase in the size of their portfolio after the pandemic. The surge in their portfolio value from PEN 3.9 billion in 2000 to PEN 61.5 billion in 2023 is attributed to the post-pandemic recovery in economic activity, leading to an upward trend in their portfolio valuation.

Foreign investors have been key players in Peru's local capital and FX markets, especially in public treasury bonds (BTPs). Their involvement in BTP balances has grown over time, influenced by capital flow cycles and the incorporation of Peruvian bonds into the JPMorgan GBI-EM index in 2006. These investors typically hedge their BTP positions partly through non-deliverable forwards, contributing to the development of the FX derivatives market. However, since 2020, foreign participation in BTPs has declined, falling from 50% in February 2020 to 34% in December 2023. This trend is consistent with patterns in other Latin American countries. In the past two years, local banks have become the primary BTP purchasers, while AFPs and non-residents have been sellers, indicating a shift in market dynamics and investment patterns within the local capital market.

Peruvian sovereign bonds

(amounts in USD billions and shares in %) Graph 8



Source: Ministry of Economy and Finance.

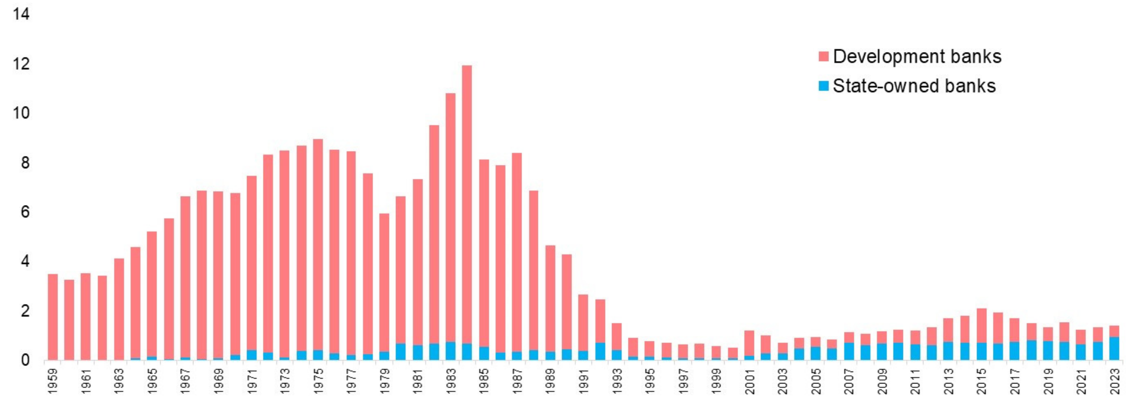
2.3 State-owned and development banks

The presence of state-owned and development banks is much smaller than in the 1970s and 1980s. Credit provided by these institutions averaged 0.6% of GDP in the last two decades, in contrast with 12% in 1984 during the financial repression period. Peru's Constitution stipulates that state-run business activities, whether direct or indirect, are authorised by law only when deemed of significant public interest or national convenience.

The public financial sector includes four key institutions: a sole state-owned bank, Banco de la Nación (BN); and three development banks, COFIDE, Agrobanco and Fondo Mivivienda. BN focuses on complementing, rather than competing with, commercial banks. BN offers services to public entities, enhances banking accessibility and promotes financial inclusion. Besides managing public funds, it provides various financial services to public sector employees, including savings and chequing accounts, and loan facilities. BN also plays a crucial role in implementing social and economic assistance programmes, distributing subsidies and benefits to vulnerable segments. COFIDE is a second-tier financial entity focused on promoting development in economic sectors such as manufacturing, commerce, agriculture and infrastructure. COFIDE manages funds from several government support programmes targeted at MSMEs, including those implemented during the Covid-19 pandemic such as the *Reactiva Perú* and *Fondo de Apoyo Empresarial* programs. Agrobanco finances projects in the agricultural sector. Lastly, Fondo Mivivienda focuses on facilitating access to housing among the population. In 2023, domestic credit provided by BN was 1.2% of GDP, while loans from development banks account for 0.5% of GDP.

Due to their operational scale and role in the economy, neither BN nor the development banks pose direct competition to the private sector. However, they contribute to long-term balanced growth by financing MSMEs and fostering financial inclusion through the payments system.

Credit by state-owned banks and development banks (% of GDP) Graph 9



Source: Central Reserve Bank of Peru. Since 2001 it includes COFIDE, Fondo MiVivienda and Banco Agropecuario.

Box B

The de-dollarisation process

The marked decrease in loan and deposit dollarisation since 2002 has been a key feature of Peru's financial system. The impact of hyperinflation during the 1980s and early 1990s continued to influence economic behaviour in the following years, resulting in persistently high financial dollarisation. The de-dollarisation process observed since then can be attributed to a combination of factors, such as the implementation of a set of successful macroeconomic stabilisation policies and the de-dollarisation programme implemented since 2013. Moreover, the adoption of inflation targeting by the BCRP in 2002 played a crucial role in economic stabilisation. This strategic shift contributed significantly to anchoring inflation expectations, ensuring a stable floating exchange rate with minimal fluctuations and accumulating significant international reserves.

In 2013, the BCRP launched a programme aimed at accelerating credit de-dollarisation to reduce risks from sudden depreciation for FX-indebted firms and households. Along these lines, in 2013 the BCRP established additional RRRs on FX liabilities aimed at: (i) moderating the expansion of USD credit and (ii) encouraging a shift from USD- to PEN-denominated debt. These additional RRRs were applied according to the evolution of mortgage and car loans and total USD credit. They became effective when financial entities failed to reach predetermined targets for FX loans established by the BCRP. They were intended to align incentives for financial entities by favouring domestic currency loans and facilitating coordination among financial entities seeking to de-dollarise credit, challenging traditional lending practices and addressing the mistaken belief that USD loans carry lower risk. These RRRs made USD credit more expensive for financial institutions, thereby breaking inertial credit practices determined by habit patterns or by borrowers' mistaken perception that USD loans carry a lower credit exchange risk.

These measures contributed to reducing dollarisation across all credit categories. Total credit dollarisation fell from 49% in September 2013 to 23% in December 2023. During the same period, household credit dollarisation declined significantly. Mortgage and car loan dollarisation fell from 49% to 8% and from 82% to 10%, respectively, as of December 2023. This remarkable shift was also influenced by the government housing financing programme, MiVivienda, encouraging loans in domestic currency, and by the efforts by Peru's financial supervisory authority (SBS) to monitor FX credit risk, particularly by the end of 2012. Regulatory actions compelled financial institutions to significantly increase their capital reserves for FX mortgage loans.

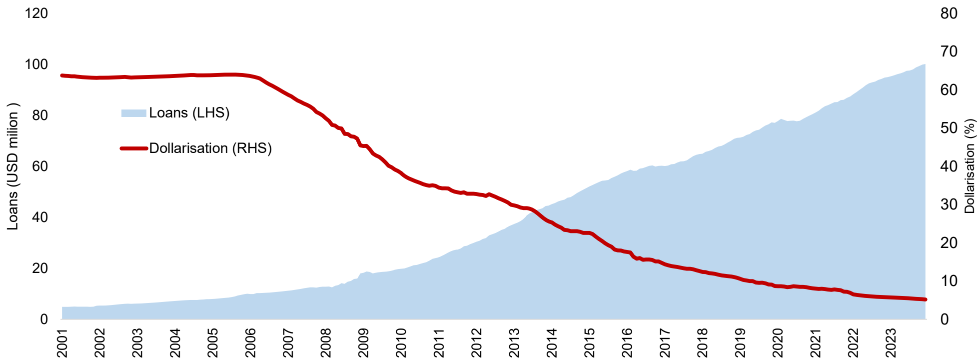
Several studies – including Castillo et al (2016), Infante (2018) and Contreras et al (2019) – assess the impact of the BCRP's de-dollarisation measures. These works calculate the decline in credit dollarisation at 6–14 percentage points (isolating the effect of other factors such as exchange risk variations) and conclude that the de-dollarisation programme contributed significantly to reinforcing financial stability and the transmission channel of monetary policy.

Box B

These macroprudential measures are currently in force, but since the dollarisation rate has decreased significantly, their marginal contribution is lower.

Mortgage loans

Graph B1



Source: Superintendency of Banking, Insurance and Private Pension Fund Administrators

Dollarisation of credit to private sector (%)[1]

Table B1

	Dec 01	Sep 13 (i)	Dec 23 (ii)	Gap (ii-i)
Households	68	29	6	-23
Consumer	44	13	5	-8
Car loans		82	10	-72
Credit card		10	12	2
Rest		8	4	-4
Mortgage	95	49	8	-41
Firms	82	59	35	-24
Corporate		70	53	-16
Large companies		21	29	8
Small businesses and micro businesses		8	3	-6
TOTAL	**79**	**49**	**23**	**-26**

[1] The balance in dollars is valued at the exchange rate as of December 2023. Does not include loans made by banks' branches of the local banks abroad.

Source: Central Reserve Bank of Peru.

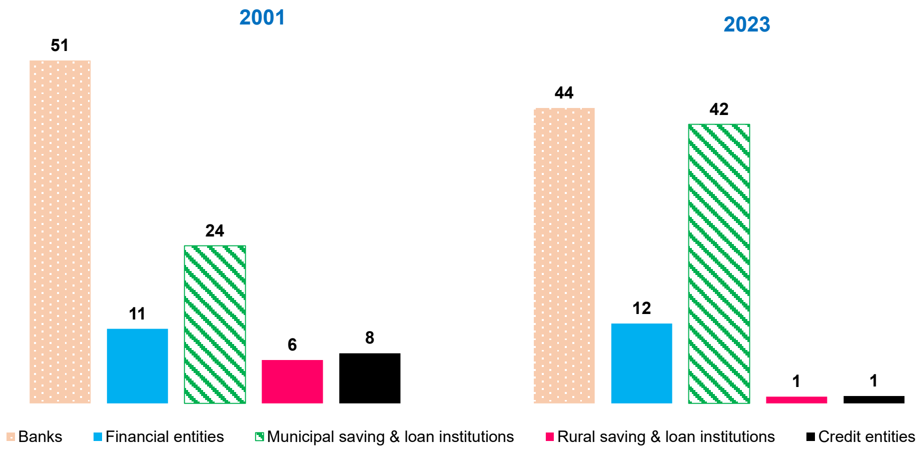
3. Microfinance

The microfinance segment in Peru has experienced rapid development in recent years. This progress has been supported by a favourable regulatory framework, including reasonable capital requirements, low entry barriers and supervision by the SBS. The inception of microfinance institutions began in 1983 with the creation of CMACs to foster fair and decentralised growth. However, the severe crisis of the late 1980s resulted in the disappearance of several institutions focused on microfinance, including CRACs, mutual funds, financial start-ups and development banks.

As the existing banks failed to adequately serve rural and urban micro enterprises across Peru, specialised private entities began to emerge in the mid-1990s. In 1992, CRACs were established, primarily targeting the agricultural sector. These entities partially filled the gap left by the collapse of the state-run Agricultural Bank (*Banco Agrario*), which was burdened with a substantial non-performing loan portfolio. Over time, CRACs gradually diversified the range of services they offered to encompass commercial credit lines and support for the micro and small enterprise (MSE) segment. In August 1997, micro credit was defined as a new loan category. Additionally, this period saw the emergence of MSE development companies (EDPYMEs), aimed at promoting institutions engaged in microfinance.

As of December 2023, the microfinance segment[6] in Peru comprised 25 institutions: one bank, five financial entities (empresas financieras), 12 CMACs, including the Municipal Popular Credit Bank of Lima, five CRACs and two credit institutions (previously named EDPYMEs). MSE credit balances have experienced significant growth. The MSE loan-to-GDP ratio increased from 1% in 2001 to 6% in 2023. Non-bank financial intermediaries have played a key role in extending credit to this segment, increasing their share from 49% in 2001 to 56% in 2023 (from 24% to 47% for CMACs).

Microbusinesses loans (% share) Graph 10



Source: Superintendency of Banking, Insurance and Private Pension Fund Administrators.

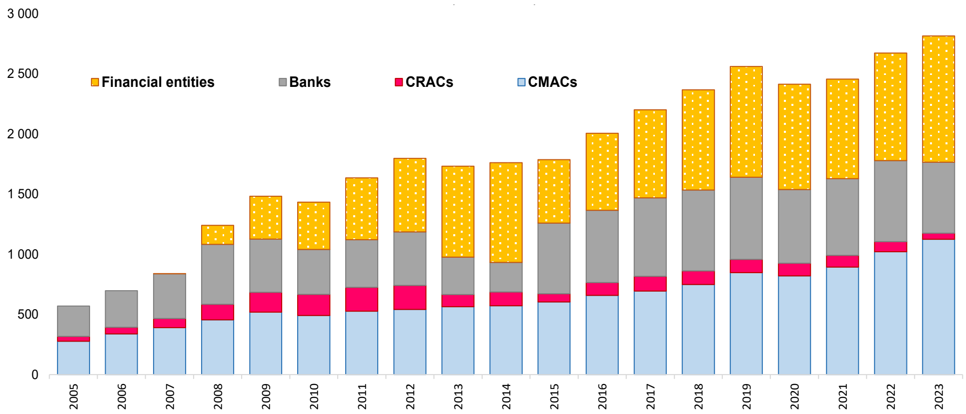
4. Financial inclusion, new digital technologies and retail payments

The number of micro business debtors has increased significantly over the last two decades. The number of debtors increased from 2.4 million in 2005 to 8.0 million in 2023. Nonetheless, a considerable segment of the population remains excluded from the formal financial system. Peru exhibits a high informal economy, estimated at around 70%, according to the International Labour Organization, offering potential for further growth and development in the microfinance sector. Technological advancements can play a crucial role in promoting microfinance by facilitating cost-

6 Financial institutions with more than 50% of their portfolio allocated to loans extended to micro and small enterprises.

effective transactions and improving access to financial services, particularly for individuals residing in remote areas.

Number of debtors – micro businesses (thousands) Graph 11



Source: Superintendency of Banking, Insurance and Private Pension Fund Administrators.

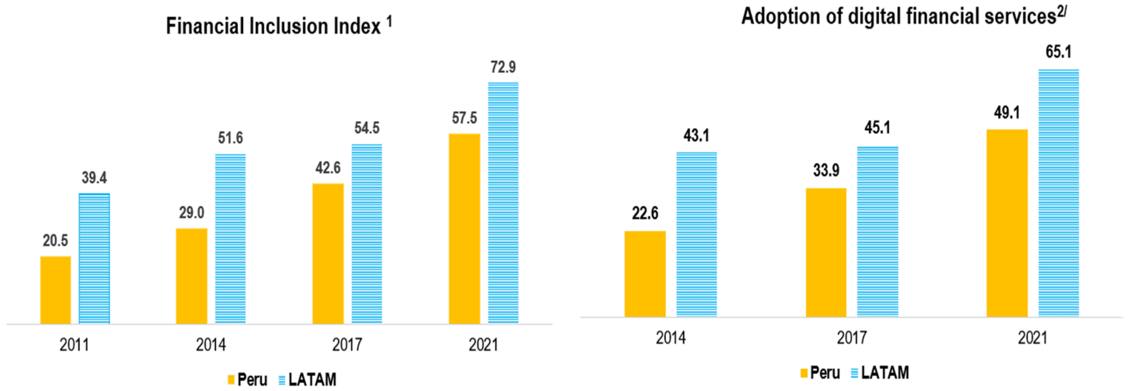
Financial inclusion has gradually improved in Peru over the last 20 years. The number of debtors has grown from 1.4 million in 2001 to 8.0 million in 2023. These market participants previously lacked access to credit or encountered significantly higher interest rates in informal credit markets. Between 2009 and 2019, the number of individuals with direct access to financial system loans increased by approximately 3.2 million, with 665,000 belonging to the two poorest quintiles, showing the highest average annual growth rates. According to the SBS, the average interest rate for a new low-income credit applicant decreases by half after building a two-year track record.

At the regional level, the Peruvian financial system still lags behind the Latin American average in terms of various metrics (see Appendix). According to the World Bank, Peru's financial index increased from 42.6% in 2017 to 57.5% in 2021, while the adoption of digital services rose from 33.9% to 49.14% during the same period. However, both metrics remain below the Latin American average.

The adoption of digital payments is outpacing traditional banking penetration. In the aftermath of the pandemic, there was a notable uptick in the percentage of adults with bank accounts, rising from 42% to 58% between 2020 and 2023. Amid the health crisis and mobility restrictions, many individuals recognised the necessity of utilising the financial system for saving and conducting digital transactions. Consequently, the use of digital payments surged from 29 to 266 transactions per year per capita between 2015 and 2023.

Financial inclusion indicators

Graph 12



[1] Percentage of individuals aged 15 and older who report having an account at a bank or other financial institution or personally using a mobile money service. [2] Digital payments made or received: the percentage of adults, aged 15 and older, who report using mobile money, a debit or credit card, or a mobile phone to make a payment from an account, or who report having used the internet to pay bills or purchase something online or in-store in the past year. This includes adults who report paying bills, sending or receiving remittances, receiving payments for agricultural products, receiving government transfers, receiving wages or receiving a pension from the public sector directly to or from a financial institution account or who report paying bills or sending remittances directly from a financial institution account or through a mobile money account in the past year.

Source: World Bank.

In recent years several trends associated with the adoption of new technologies are reshaping the landscape of financial services provision. Among these trends are the expansion of the fintech sector, the rapid pace of digitalisation and the potential advent of digital banks, along with the prospect of implementing open banking. These trends are poised to amplify the array of services available, potentially driving deeper banking penetration across diverse demographics and intensifying competition within the financial ecosystem.

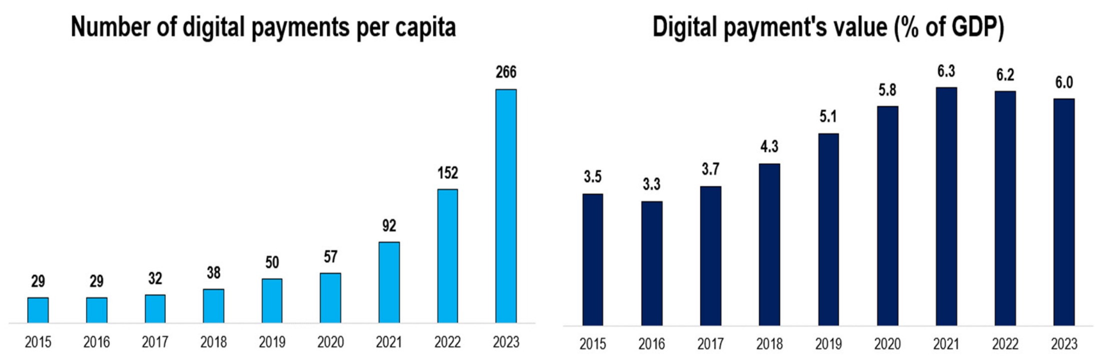
Internet access has improved over the years, a key factor for digital transformation in financial services for both fintech and traditional financial institutions. According to the National Institute of Statistics and Informatics (INEI), during the first quarter of 2023, the Lima Metropolitan Area displayed the highest rate of households with internet access, at 78%, while other urban areas recorded 59%. However, rural areas lagged at 19%. Concurrently, mobile internet usage has been consistently rising; statistics from the telecom supervisor (OSIPTEL) indicate a striking 92% of the population utilises their cell phones to connect to the internet (77% in rural areas as of 2022).

The growing trend of digital payments initiated during the pandemic continues. This evolution coincides with innovations in retail payment methods, modernisation of key payment infrastructures, and the efficiency and security promoted by BCRP regulations and oversight. However, challenges such as low financial inclusion, limited interoperability among payment systems and competition issues hinder further progress.

Payment digitalisation has grown exponentially. The number of payments per capita rose from 29 in 2015 to 266 in 2023 and the value of digital payments from 3.5% to 6.0% of GDP in the same period. More recently, the ratio of the value of digital payments as percentage of GDP seems to have remained stable in 2023, although the number of payments per capita increased, suggesting an extensive rather than an intensive increase. This surge in digital payments has been primarily propelled by small-value transactions, particularly facilitated through digital wallets and instant transfers. With increasing interoperability, these methods are emerging as the preferred instruments for instantaneous payments[7].

Digital payments

Graph 13

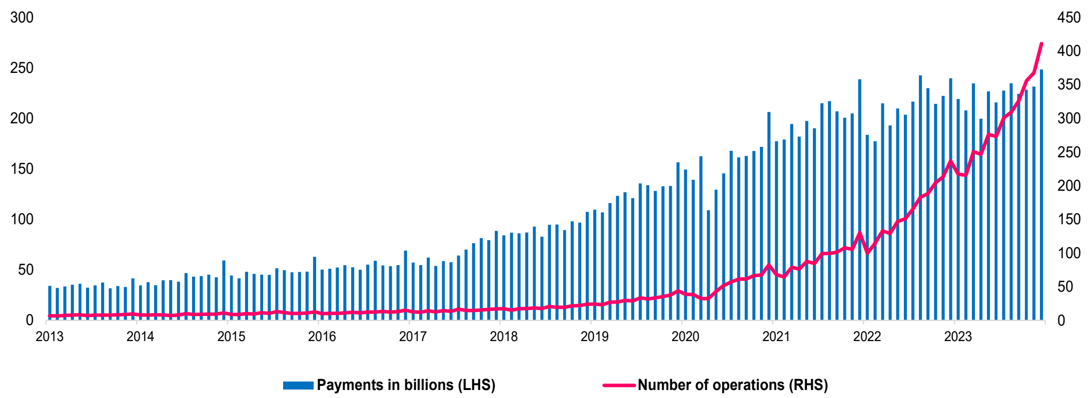


Source: Central Reserve Bank of Peru.

Virtual banking

(Payments in USD billions and number in millions)

Graph 14



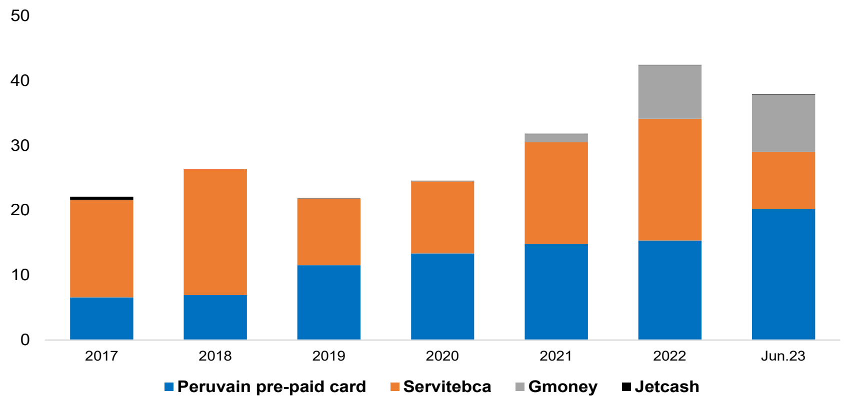
Source: Central Reserve Bank of Peru.

The role of electronic money in the payment system is also growing significantly. In 2023, the BCRP changed the regulation to allow electronic money issuing companies (EEDEs) to access the real-time gross settlement system (RTGS) and use the services of the Automated Clearing House (ACH) specially for immediate transfers, and to implement the interoperability of their payment services with other financial entities. Thus, the volume of electronic money issued by EEDEs has grown from around USD 20 million in 2017 to USD 49 million by December 2023. This initiative marks a significant step in enhancing interoperability between electronic

7 Central Reserve Bank of Peru (2023*): Financial Stability Report*, Nov.

money and traditional bank accounts. EEDEs' involvement is expected to accelerate digital payment adoption, particularly among the unbanked population, and encourage competition among immediate payment service providers.

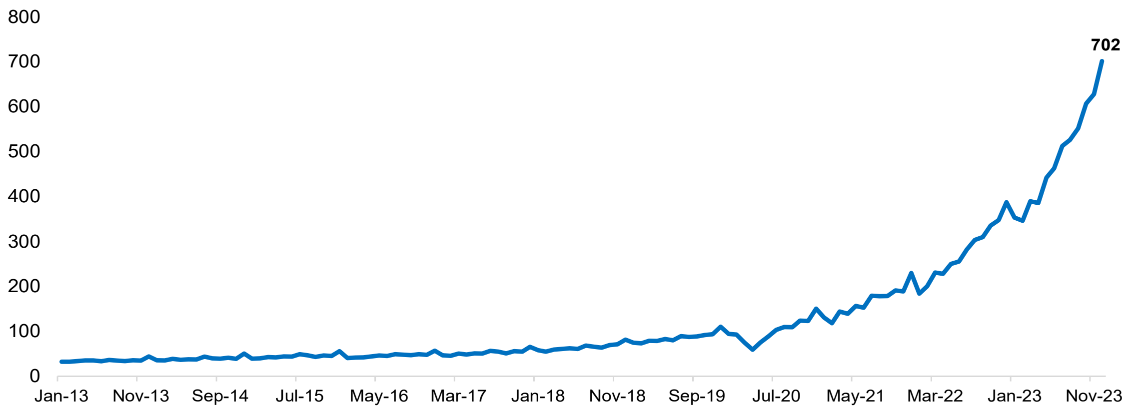
Electronic money (PEN millions) Graph 15



Source: Superintendency of Banking, Insurance and Private Pension Fund Administrators.

The number of daily digital transactions has experienced exponential growth since 2023 propelled by the widespread adoption of digital wallets and bolstered by enhanced interoperability. In September 2022, the BCRP started a strategy on the interoperability of retail payments, aimed at increasing digital payments. This interoperability empowers users to seamlessly transfer funds across various wallets and bank accounts, utilising either the recipient's cell phone number or the QR code from any issuer. Consequently, in 2023 the Digital Payments Index (DPI) experienced a remarkable 81% surge in the number of transactions, soaring to 702 million monthly operations, mainly due to greater use of digital wallets.

Peruvian Digital Payment Index – monthly number of operations (in millions) Graph 16

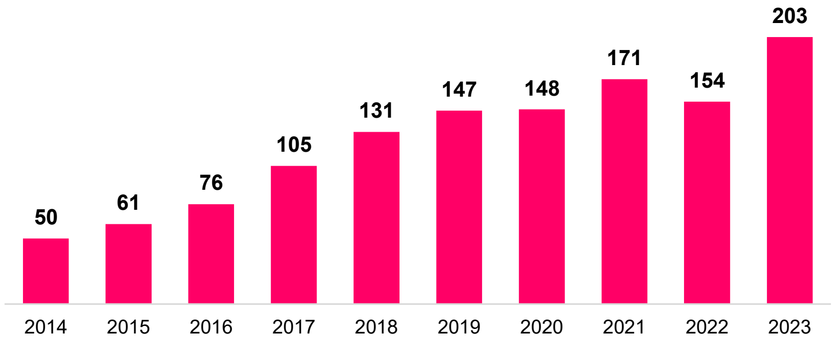


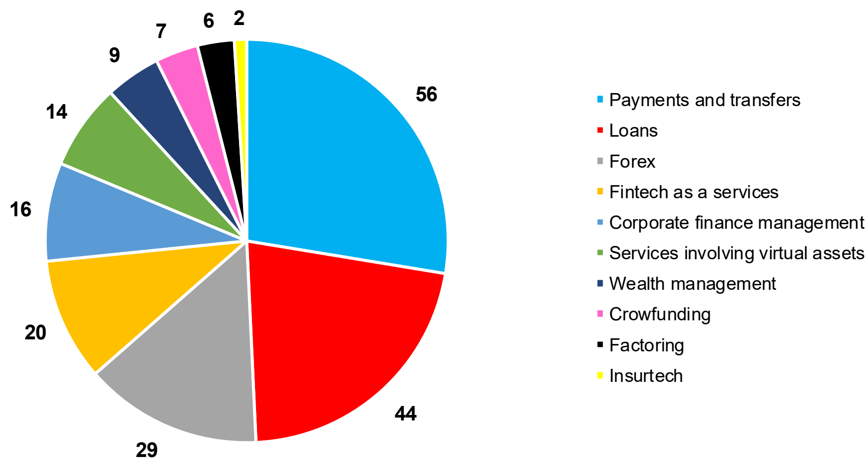
Source: Central Reserve Bank of Peru.

The fintech sector has also seen rapid growth in the last decade, although it is still small in comparison to other countries in the region. The number of fintech companies expanded from 50 in 2014 to 203 by October 2023, although it remains small compared with other Latin American countries[8] (Argentina 343, Brazil 771, Chile 300, Colombia 369 and Mexico 773). The number of fintech companies specialising in payments and transfers surged to 56, surpassing those focusing on loans (44). Currently, Peru's leading fintech companies specialise in payments and transfers, loans, and currency exchange (exchange houses). This expansion has propelled financial inclusion, extending accessible and affordable financial products to underserved populations. The pandemic further boosted this trend, leading to an increase in low-value payments and a shift towards more user-friendly payment instruments offering immediacy, 24/7 availability and low or zero cost. The market served by fintech firms predominantly targets the unbanked population (29% as of 2021) and banked SMEs (21% as of 2021), particularly in terms of revenue volume.

Fintechs in Peru

Graph 17





Source: EY Peru's Fintech Index 2023. October 2023.

8 https://www.finnovista.com/que-hacemos/insights/radares/

5. Challenges to long-term growth and financial intermediation

Several recent developments and policy measures are expected to have significant implications for long-term growth and financial intermediation in Peru.

Pension fund withdrawals: Previously, AFPs demanded about 30% of long-term bonds. Following recent withdrawals, their diminished presence has notably impacted long-term financing in domestic currency for both the private and public sectors, as well as mortgage rates.

AFPs play a crucial role in channelling resources into strategic sectors and investment projects. The reduction in their portfolios could constrain investment opportunities, potentially hampering economic recovery. This impact is evident in higher sovereign bond yields and increased mortgage rates.

Interest rate caps: In December 2020, Congress enacted Law 31143 (Law for the Protection of Financial Service Consumers Against Usury), which sets interest rate limits for consumer and SME loans. The BCRP, tasked with enforcing these limits, set the caps to minimise their impact on financial inclusion.[9] These caps have reportedly excluded[10] about 226,000 clients from the financial system during the first nine months of implementation, with 127,000 unable to access credit, thereby affecting financial inclusion efforts, as estimated by the BCRP. Additionally, according to the SBS, the number of debtors incorporated into the financial system has been decreasing, with around 33,000 fewer individuals included each year.

Technological advancements and fintech firms: Technological advancements and the emergence of fintech companies are transforming Peru's financial services sector. While enhancing efficiency and expanding financial inclusion, these developments also pose challenges to traditional banking models.

Foreign capital's role in economic development: Foreign capital significantly contributes to economic growth by stimulating job creation, transferring technology, enhancing production efficiency through foreign direct investment and opening international markets for local companies, thereby boosting exports. The presence of foreign companies also fosters local human capital development by providing training and education. Additionally, foreign capital injections, whether through direct or portfolio investment, help bolster financial stability by diversifying investment sources and providing additional financing avenues.

However, overreliance on foreign short-term capital and portfolio investments entails risks. Capital flows are volatile and can be affected by global economic conditions. Short-term foreign portfolio flows can lead to economic imbalances and heighten vulnerabilities during international crises. Thus, balancing and managing reliance on foreign capital is crucial for sustainable growth. Diversifying investment sources and attracting varied foreign investments can mitigate these risks. For

9 The maximum semiannual interest rate for consumer and SME loans is set at twice the system's average consumer loan rate.

10 Central Reserve Bank of Peru (2022): *Financial Stability Report*, May.

instance, the 1998[11] capital flow reversal[12] demonstrated that reliance on volatile capital flows leads to financial distress. Therefore, current macroprudential measures, such as reserve requirement management and limits on bank positions, are essential to prevent financial disturbances and promote stability.

Competition for deposits between local banks and offshore institutions: In stable times, residents usually repatriate deposits from offshore to local banks. In contrast, the 2021 political crisis triggered the largest outflow of residents' short-term capital, equivalent to 7.3% of GDP. Political stability is a key element for instilling confidence among the population and preventing capital reversals.

Factors influencing potential GDP growth: Potential GDP growth is determined by the accumulation of productive factors – labour and capital – and their productivity. The latter, which refers to the ability to produce more with these factors, depends on the efficiency of combining labour and capital. This efficiency is influenced by technological, regulatory and institutional factors. The 2016–22 slowdown is attributed to a lower contribution from capital and reduced total factor productivity (TFP). There is no clear evidence linking this slowdown to changes in the sectoral allocation of credit.

According to BCRP estimates, Peru's highest potential GDP growth rates were between 2002 and 2008, averaging 6.0% annually during the commodity price "supercycle." This trend declined to an average of 5.3% annually in 2009–15, then further to 2.3% in 2016–22.

Regulatory changes: Regulations aimed at strengthening the financial system could influence capital allocation essential for long-term growth. Such changes might affect the direction and flow of capital within the economy, impacting investment decisions and financing for long-term growth initiatives.

The following strategies could address these challenges to Peru's financial system.

Digital payments: Despite recent progress in payment digitalisation, 86% of transactions in Peru are still conducted in cash, reflecting limited financial inclusion. This is due to demand factors (high informality, low incomes, distrust in the payments system, limited financial inclusion) and supply factors (financial system concentration, lack of retail payment interoperability, limited competition, insufficient access points). Financial inclusion remains low, with about 52% of the population lacking access to digital payments, according to the 2021 National Household Survey (ENAHO).

The development of digital payments is hindered by closed payment schemes and the emergence of non-bank wallet schemes. Limited interoperability between deposit and electronic money accounts further restricts development. Some microfinance entities, despite having access to the RTGS system, do not participate in retail payment infrastructures.

To promote payment digitalisation, the BCRP has been focusing on financial inclusion, strengthening payment systems and enhancing competition.

[11] Velarde & Rodriguez (1999).

[12] Between September 1998 and December 1998, USD 885 million were lost in short-term credit lines from banks. Moreover, short-term loans to the non-financial sector decreased by USD 432 million in the fourth quarter of 1998.

Initiatives include assessing a central bank digital currency (CBDC), analysing open banking benefits and promoting interoperability. In October 2022, the BCRP issued the Payment Services Interoperability Regulation to expedite digital payment adoption. Additionally, a strategy launched in September 2022 focuses on interoperability of fiat accounts, QR code standardisation, electronic money interoperability, and including new participants like fintech and big tech companies.

In March 2023, the BCRP published a document entitled "CBDC: Promoting Digital Payments in Peru".[13] This publication focuses on furthering discussions about the advancement of digital payments and considering the potential introduction of a CBDC to stimulate development and promote financial inclusion. The BCRP has completed a research phase that will lay the groundwork for subsequent stages, including proof-of-concept, prototype development, pilot projects and eventual production, in collaboration with private sector partners and relevant authorities. The aim is to address a wide range of payment needs, encompassing consumer-to-business (C2B) transactions (eg payments for services, products or utilities across different regions or cities), as well as business-to-business (B2B) and business-to-small merchant (B2S) transactions.

In November 2023, the Regulation for Clearing and Settlement Service Companies was amended to grant access to the electronic clearing house (CCE) services for additional financial institutions, such as saving and credit cooperatives, including immediate transfers.

Capital markets enhancement: Despite witnessing positive evolution over time, the Peruvian capital market is characterised by low depth and liquidity compared to its counterparts in the region. Several factors might be impeding the development of the capital market, including lack of financial literacy, few stock market users, public distrust, and excessive market concentration marked by the presence of financial conglomerates, conflict-of-interest issues and a concentrated demand that restricts proper price formation. Consequently, larger corporate enterprises tend to seek access to more competitive international markets.

Labour informality and financial inclusion: According to Lahura (2016), by December 2014, there were 1.8 million informal workers who had at least obtained one credit line from a financial institution. This finding suggests that informality has not been a firm barrier to accessing credit in the financial system, although financial institutions apply a high credit risk to this segment. Additionally, the institutions with the highest rates of informality in terms of the number of clients and credit balances were CRACs, microfinance institutions and financial companies. Moreover, the distribution of informal clients and their credit balances shows that informality was concentrated in banks, financial institutions and CMACs, through credits for MSEs, consumer loans and credit cards.

In the same line, Aurazo and Gasmi's (2022) study highlights the relationship between labour informality and financial inclusion in Peru. Formalising labour positively impacts bank instrument ownership and formal financial system participation. Reducing labour informality increases financial inclusion, aiding economic development, poverty alleviation, digital payment system transformations and, therefore, monetary policy transmission to interest rates. The study shows that

13 https://www.bcrp.gob.pe/docs/Sistema-Pagos/cbdc/cbdc-presentacion.pdf

labour informality reduces the likelihood of entering the formal financial system by 8 percentage points and increases the chance of exiting by 9.3 percentage points. Conversely, individuals with formal jobs are 9 percentage points more likely to access banking services.

6. Concluding Remarks

The Peruvian financial system has undergone significant transformations, including a transition towards increased private sector financing, shifts in dollarisation and considerable growth in financial sector assets, thereby enhancing its depth and resilience. Sound monetary policies have countered the effects of financial crises since the Russian crisis impacted the Peruvian economy in 1998. Additionally, the deceleration in potential GDP growth, attributed to diminished contributions from capital and TFP, underscores the need for strategies focused on enhancing productivity and fostering sustainable, long-term growth.

Although still relatively low, financial inclusion in Peru is on an upward trend, spurred by the adoption of new technologies and the penetration of digital payments. Technological advancements and the emergence of fintech companies have significantly contributed to financial inclusion and innovation, promising greater accessibility to financial services and products.

The BCRP's strategy to promote digital payments is forward-looking and comprehensive, aiming to achieve interoperability across all payment services and infrastructures. This initiative began with the enactment of interoperability regulation. The BCRP maintains ongoing communication with regulated entities to facilitate compliance with the norms in place. Future phases of the strategy involve expanding the regulatory framework and incorporating new participants into the payment ecosystem, including EEDEs, fintech firms and big tech companies. The next phase will include introducing new regulatory changes and, depending on market developments, might involve the BCRP developing its own digital payment platform.

References

Armas, A (2016): "Dolarización y desdolarización en el Perú", Universidad del Pacifico, Capitulo 3.

Armas, A and M Singh (2022): "Digital money and central banks balance sheet", *IMF Working Paper*, no 22/206.

Aurazo, J and F Gasmi (2022): "Labor informality and financial inclusion transitions: evidence from Peru", *TSE Working Papers*, no 22-1349, Toulouse School of Economics.

Castillo, P and D Barco (2009): "Crisis Financieras y Manejo de Reservas en el Perú", *Revista Estudios Económicos*, no 17. BCRP.

Castillo, P, J L Vásquez, M García, M Fernández, C Ancalle, F Santos and F Saldaña (2023): "Interoperabilidad: acelerando la adopción y uso de los pagos digitales en el Perú". Banco Central de Reserva del Perú, no 193, pp 4–10.

Castillo, P, H Vega, E Serrano and C Burga (2016): "De-dollarisation of credit in Peru: the role of unconventional monetary policy tools", *Documento de Trabajo*, no 2016-2, BCRP.

Central Reserve Bank of Peru (BCRP) (2019, 2020, 2021 and 2022): *Annual Report*.

——— (2023): *Financial Stability Report*, November.

——— (2021): "Credit and Liquidity Report", *Nota de Estudio*, no 37.

Chávez, D, D Chicana and W Cuba (2020): "Diagnóstico y propuestas para desarrollar el mercado de capitales peruano," *Revista Moneda*, Banco Central de Reserva del Perú, no 181, pp 10–16.

Choy, M and G Chang (2014): "Medidas macroprudenciales aplicadas en el Perú," *Revista Estudios Económicos*, Banco Central de Reserva del Perú, no 27, pp 25–50.

Contreras, A, R Gondo, E Oré and F Pérez Forero (2019): "Assessing the impact of credit de-dollarisation measures in Peru", BCRP *Working Papers,* no 2019-005.

Ernst & Young (2023): "Guía de negocios fintech 2023/2024". Ernst & Young, Ministerio de Relaciones Exteriores.

Infante, F (2018): "De-dollarisation of credit in Peru with unconventional monetary policies between 2013–2017. Did it work?", mimeo, winning paper of the BCRP research contest of the year 2018.

Indecopi (2023): "Estudio de mercado del sector fintech en el Perú", September.

Lahura, E (2016): "Sistema financiero, informalidad y evasión tributaria en el Perú".

Revista Estudios Económicos, no 32, pp 55–70, BCRP.

Morris, F and F Polar (1994): "La reforma financiera en el Perú", *Apuntes*, no 34, pp 11–26. https://doi.org/10.21678/apuntes.34.389

Poggi, J, L Romero, M Luy and N Sotomayor (2015): "The Peruvian financial system from 1990–2014: balancing development and financial stability", in A Werner and A Santos, *Peru: staying the course of economic success*, chapter 15, International Monetary Fund.

Quispe, Z, D León and A Contreras (2012): "El exitoso desarrollo de las microfinanzas en el Perú," *Revista Moneda*, Banco Central de Reserva del Perú, no 151, pp 13–18.

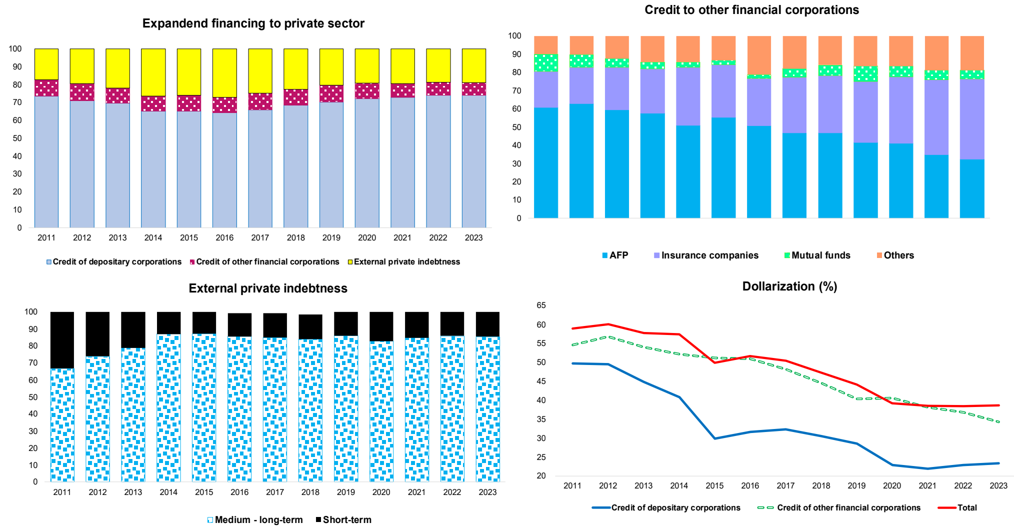
Velarde, J and C Montoro (2023): "20 years of inflation targeting in Peru: lessons and challenges ahead", *BIS Papers*, no 143, pp 55–67.

Velarde, J and Rodriguez, M (1999): "Efectos de la crisis financiera internacional en la economía peruana: 1997-1998", Investigaciones. Consorcio de Investigación Económica y Social.

Appendix

Non-financial private funding sources

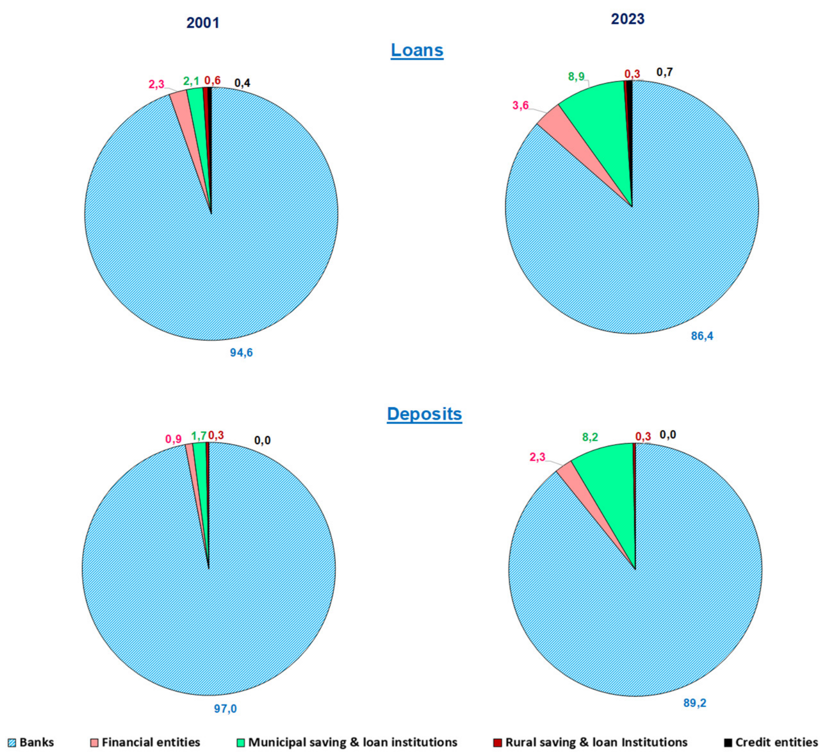
Graph A1



Source: Central Reserve Bank of Peru.

Financial system's market participation (in per cent)

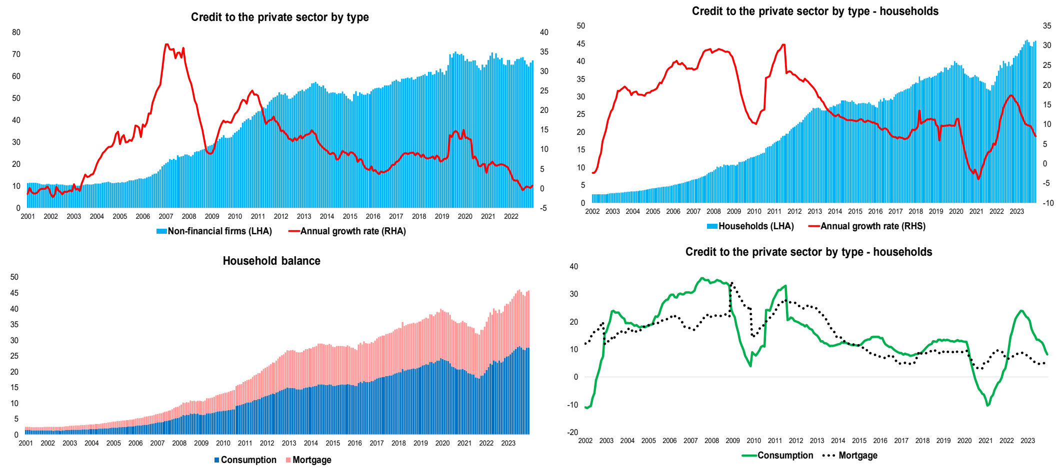
Graph A2



Source: Superintendency of Banking, Insurance and Private Pension Fund Administrators.

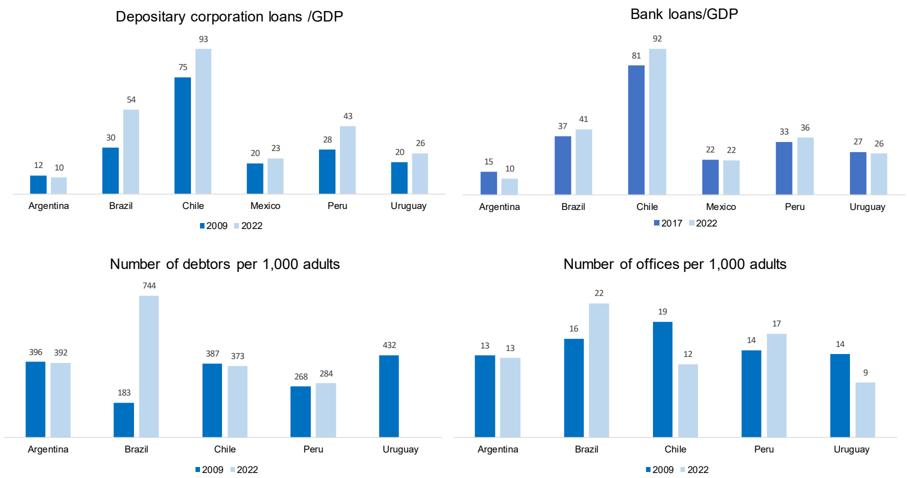
Credit to private sector

(USD billion) Graph A3



Source: Central Reserve Bank of Peru.

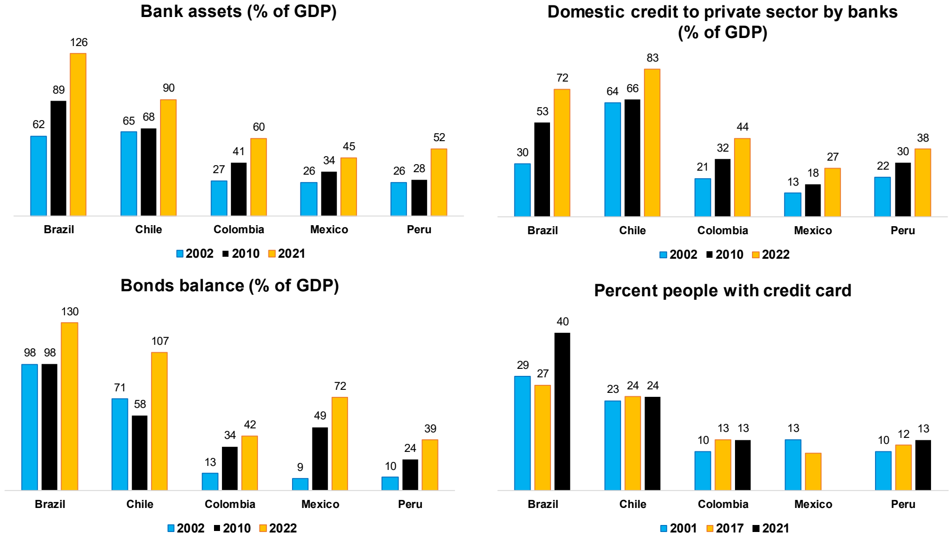
Financial inclusion Graph A4



Source: Financial Access Survey (2009, 2022).

Latin American financial market size

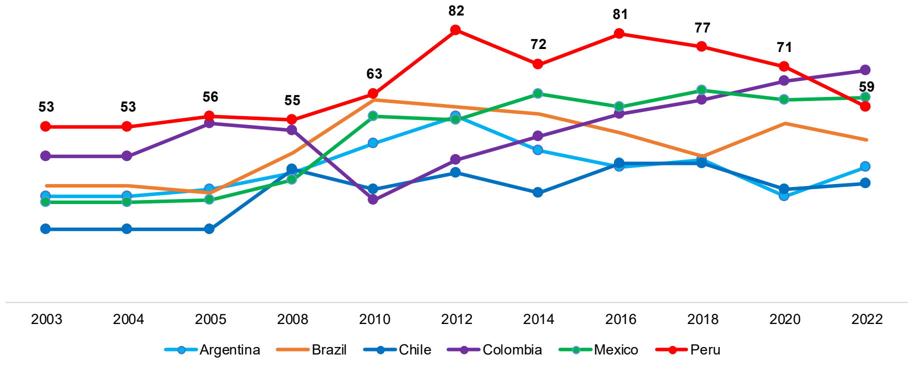
Graph A5



Source: Bank for International Settlements; World Bank.

E-Government Development Index (EGDI)

Graph A6



The EGDI is a composite measure of three important dimensions of e-government, namely provision of online services, telecommunication connectivity and human capacity. The index is based on a comprehensive survey of the online presence of all 193 United Nations member states. The survey assesses national websites and how e-government policies and strategies are applied in general and in specific sectors for delivery of essential services. The assessment rates the e-government performance of countries relative to one another as opposed to being an absolute measurement. The results are tabulated and combined with a set of indicators embodying a country's capacity to participate in the information society, without which e-government development efforts are of limited immediate use.

Source: United Nations

Credicorp Financial Inclusion Index

Graph A7

	Global		Access		Use		Perceived quality	
	2022	2023	2022	2023	2022	2023	2022	2023
Argentina	49.0	53.0	56.1	61.1	46.8	49.1	65.5	68.2
Chile	52.3	52.5	52.7	53.9	38.3	42.8	69.3	67.1
Panama	54.6	52,0	54.5	52.3	41.7	35.1	58.4	63.6
Ecuador	48.9	49.6	50.5	49.5	30.8	31.2	62,0	62.1
Colombia	44.7	45.6	47,0	48.6	26.5	26.5	55.9	57.6
Peru	39.8	43.3	41.5	46.5	25.2	26.3	55.5	56.2
Mexico	41.5	41.7	42.4	45.3	22,0	25.9	52.7	55.5
Bolivia	38.3	40.4	39.5	35.1	19,0	20.5	52.6	55.1

Source: Credicorp.