INTERNATIONAL MONETARY FUND

IMF Country Report No. 21/45

PARAGUAY

March 2021

2020 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR PARAGUAY

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2020 Article IV consultation with Paraguay, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its February 12, 2021 consideration of the staff report that concluded the Article IV consultation with Paraguay.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on February 12, 2021, following discussions that ended on November 13, 2020, with the officials of Paraguay on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on January 27, 2021.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for Paraguay.

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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International Monetary Fund
Washington, D.C.

IMF Executive Board Concludes 2020 Article IV Consultation with Paraguay

FOR IMMEDIATE RELEASE

Washington, DC – **March 4, 2021:** On February 12, 2021, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Paraguay.

In early 2020, Paraguay was rebounding strongly from the bad weather induced downturn in 2019 and full-year growth was forecast at over 4 percent. The Covid-19 epidemic halted the recovery. An early lockdown, which kept the death toll among the lowest in the region, led to a sharp economic contraction, with women, informal sector workers and service workers particularly hard hit.

Swift and forceful government action helped contain the health, social and economic impact of the crisis. To mitigate the health impact, the government quickly expanded medical resources. To alleviate the social impact the government started two new and temporary social assistance programs and temporarily expanded a third. And to dampen the economic impact, the government increased investment and other spending, while the central bank lowered interest rates, increased liquidity provision, and allowed banks to renew, refinance and restructure loans without penalty. Emergency spending, together with a fall in tax revenues, led to a further increase of the deficit to 6½ percent of GDP, well above the ceiling set by the Fiscal Responsibility Law

Real GDP is likely to have shrunk by about 1 percent in 2020 and to rebound by 4 percent in 2021, but downside risks are significant, with the Covid-19 epidemic posing the highest risk. Inflation hit a historical low in mid-2020 before recovering to 2.2 percent in December 2020 and is projected to remain below the midpoint of the central bank's target range through 2021.

Executive Board Assessment[2]

Directors commended the Paraguayan authorities for their response to the COVID-19 pandemic, which limited the number of cases and deaths and mitigated the negative economic and social impact. Downside risks remain substantial, however, including from a worsening of the COVID-19 pandemic and negative weather shocks. In this context, Directors encouraged the authorities to pursue policies geared toward supporting macroeconomic stability, strengthening governance and transparency, improving the business climate to promote diversification, and developing human capital.

Directors agreed that the widening of the fiscal deficit in 2020 had been appropriate. They noted that fiscal support should not be withdrawn prematurely, in particular if risks such as a

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.IMF.org/external/np/sec/misc/qualifiers.htm.

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worsening of the COVID-19 pandemic or negative weather shocks were to materialize. It would be important to uphold health and social spending while protecting public investment. Directors encouraged a gradual return to lower deficits once the pandemic abates, to maintain fiscal sustainability. In this regard, they welcomed the authorities' plan to return to the deficit ceiling under the fiscal responsibility law by 2024. Directors agreed that improving expenditure efficiency and transparency and domestic tax revenue mobilization would be important to cover Paraguay's social and investment spending needs.

Directors noted that monetary and financial sector policies were appropriately accommodative. They encouraged the authorities to closely monitor the financial sector stability while gradually phasing out emergency measures. Exchange rate flexibility should be allowed in line with fundamentals, and foreign exchange interventions should be limited to prevent disorderly market conditions.

Directors emphasized the need to press ahead with structural reforms to improve governance, business climate, and human capital. In this regard, they welcomed the authorities' reform agenda as formulated in their Economic Recovery Plan.

Directors commended the authorities' efforts to safeguard the integrity of the use of COVID-19 funds for social transfers and emergency spending. They took note of the newly adopted anti-corruption plan, which is partly based on recommendations from the staff's governance assessment project. Directors also welcomed recent progress in the AML/CFT regulatory framework and encouraged the authorities to further strengthen their institutional capacity for its effective implementation.

Paraguay: Selected Economic Indicators

I. Social and Demographic Indicators

Population 2018 (millions)	7.1	Gini index (2018)	46.2
Unemployment rate (2019)	6.5	Life expectancy at birth (2018)	74.1
Percentage of population below the poverty line (2018)	24.2	Adult literacy rate (2018)	94.0
Rank in UNDP development index (2019)	98 of 189	GDP per capita (US$, 2019)	5,451

II. Economic Indicators

	2017	2018	Prel. 2019	Proj. 2020	2021	2022	2023	2024	2025
	(Annual percent change, unless otherwise indicated)								
Income and prices									
Real GDP	5.0	3.4	0.0	-0.9	4.0	4.0	4.0	3.5	3.5
Nominal GDP	7.2	5.6	2.8	2.9	9.5	6.9	7.6	6.8	6.8
Per capita GDP (U.S. dollars, thousands)	5.7	5.7	5.3	5.0	5.2	5.5	5.7	6.0	6.2
Consumption (contribution to real GDP growth)	3.1	3.1	0.4	-2.2	4.4	3.9	2.7	2.7	2.4
Investment (contribution to real GDP growth)	2.5	2.5	-0.4	-0.1	1.4	0.7	0.9	0.8	1.0
Net Exports (contribution to real growth)	-0.7	-2.2	0.0	1.4	-1.8	-0.6	0.4	0.0	-1.5
Consumer prices (end of period)	4.5	3.2	2.8	2.3	3.5	3.5	3.5	3.5	3.5
Nominal exchange rate (Guarani per U.S. dollar, eop)	5,590	5,961	6,453	...	...	...	...	...	...
Monetary sector									
Credit to private sector 1/	4.9	14.1	9.7	5.7	8.1	5.7	5.4	5.6	5.7
Monetary policy rate, year-end	5.3	5.3	4.0	...	...	...	...	...	...
External sector									
Exports (fob, values)	11.8	3.2	-9.3	-13.7	27.0	7.3	7.5	4.4	4.1
Imports (cif, values)	17.8	12.1	-4.6	-23.5	30.2	12.6	6.0	4.9	4.5
Terms of trade	-1.9	-1.6	-4.9	2.9	7.2	-1.2	0.3	-0.5	-0.5
Real effective exchange rate 2/	-0.8	3.2	-3.0	...	...	...	...	...	...
	(In percent of GDP, unless otherwise indicated)								
External current account	**3.1**	**0.0**	**-0.6**	**1.4**	**1.5**	**0.3**	**0.8**	**0.6**	**0.4**
Trade balance	4.1	1.4	-0.3	2.5	2.8	1.6	2.1	1.9	1.7
Exports	34.3	34.2	32.9	29.8	36.0	36.4	36.7	36.3	35.9
Of which: Electricity	5.4	5.2	4.5	4.4	4.3	4.2	4.0	3.9	3.8
Imports	-29.5	-32.0	-32.3	-26.0	-32.2	-34.1	-33.9	-33.7	-33.5
Of which: Oil imports	-3.0	-4.0	-3.5	-2.5	-2.8	-2.8	-2.8	-2.8	-2.7
Capital account and financial account	**1.1**	**1.9**	**2.2**	**2.2**	**-0.8**	**0.5**	**1.0**	**1.3**	**1.4**
Of which: Direct investment	1.3	1.2	1.2	0.4	0.7	1.0	1.1	1.0	1.0
Gross international reserves (in millions of U.S. dollars)	**8,145.7**	**8,004.0**	**7,996.1**	**8,496.1**	**8,496.1**	**8,496.1**	**8,996.1**	**9,546.1**	**10,096.1**
In months of next-year imports of goods and services	6.9	7.1	8.9	7.5	6.7	6.4	6.4	6.5	6.6
Ratio to short-term external debt	2.6	2.2	2.2	2.2	2.2	1.8	2.2	2.4	2.5
Gross domestic investment	**21.2**	**22.8**	**22.4**	**22.3**	**22.2**	**22.2**	**22.2**	**22.2**	**22.4**
Gross domestic saving	**24.3**	**22.8**	**21.8**	**23.6**	**23.7**	**22.4**	**23.0**	**22.7**	**22.8**
Central government revenues	**14.2**	**13.9**	**14.1**	**13.1**	**13.1**	**13.7**	**13.9**	**13.9**	**14.0**
Of which: Tax revenues	9.9	9.9	9.9	9.2	9.3	9.9	10.0	10.1	10.2
Central government expenditures	**15.3**	**15.3**	**16.9**	**19.6**	**17.1**	**16.5**	**16.0**	**15.4**	**15.4**
Of which: Compensation of Employees	6.3	6.6	6.9	7.3	6.8	6.4	6.1	5.8	5.7

Of which: Net Acquisition of Nonfinancial Assets	2.4	2.0	2.9	3.0	2.8	2.6	2.4	2.2	2.2
Central government net lending/borrowing	**-1.1**	**-1.4**	**-2.8**	**-6.5**	**-4.0**	**-2.8**	**-2.1**	**-1.5**	**-1.4**
Central government primary balance	-0.5	-0.7	-2.0	-5.5	-2.7	-2.7	-1.4	-0.7	-0.1
Public sector debt (excl. central bank bills)	**19.8**	**22.2**	**25.6**	**34.9**	**35.4**	**36.3**	**36.3**	**36.1**	**35.7**
Of which: Foreign currency	15.8	18.0	21.2	30.1	30.6	31.4	31.2	31.0	30.6
Of which: Domestic currency	4.0	4.2	4.4	4.8	4.7	4.9	5.1	5.1	5.1
Memorandum items:									
GDP (billions of Guaranies) 3/	219,188	231,489	238,054	244,955	268,105	286,678	308,567	329,550	351,880
GDP (US$ billions)	39.4	40.4	38.1	…	…	…	…	…	…

Sources: Central Bank of Paraguay; Ministry of Finance; and IMF staff estimates and projections.

1/ Includes local currency credit and foreign currency credit valued at a constant exchange rate.

2/ Average annual change; a positive change indicates an appreciation.

3/ Historical GDPs were revised in 2018, including a 30 percent upward revision in nominal GDP for 2017.

INTERNATIONAL MONETARY FUND

PARAGUAY

STAFF REPORT FOR THE 2020 ARTICLE IV CONSULTATION

January 27, 2021

KEY ISSUES

In the past two decades, Paraguay has seen strong growth and a sharp reduction in poverty. Strong GDP growth was the result of sound macro policies (with low inflation and low fiscal deficits and debt) and an agricultural commodity price boom which spilled over to the non-tradable sector. Growth was not just high but also volatile, as bad weather shocks led to poor harvests, which spill over to the broader economy.

In early 2020, Paraguay was rebounding strongly from another weather shock, and full-year growth was forecast at over 4 percent. In 2019, bad weather had reduced the harvest, and GDP growth had come to a near standstill. A recovery started in the second half of 2019 and gathered strength in early 2020—in February economic activity was 7 percent higher than a year earlier.

The Covid-19 epidemic halted the recovery. An early lockdown—which kept the death toll among the lowest in the region—led to a sharp contraction in economic activity, with April activity levels at 20 percent below those in February. Women, informal sector workers, and workers in the service sector were particularly hard hit; while children were severely affected by the closing of the schools until the end of 2020.

Swift and forceful government action helped contain the health, social and economic impact of the crisis. To mitigate the health impact, the government quickly expanded medical resources. To alleviate the social impact the government started two new and temporary social assistance programs and temporarily expanded a third. And to dampen the economic impact, the government increased investment and other spending, while the central bank lowered interest rates, increased liquidity provision, and allowed banks to renew, refinance and restructure loans without penalty.

Staff now projects real GDP to shrink by about 1 percent in 2020 and to rebound by 4 percent in 2021, but downside risks are significant. The relatively modest decline compared with other countries in the region is the result of the rebound in agriculture. Near-term risks are dominated by the economic impact of the Covid-19 epidemic. Weather poses another risk: the current la Niña could reduce the harvest, with spillovers to the rest of the economy.

Two subsequent shocks have raised the fiscal deficit to 6½ percent of GDP, well above the ceiling set by the Fiscal Responsibility Law (FRL). Last year, when parliament approved an exemption clause that allows the deficit to exceed the FRL ceiling in "case of an economic downturn", a decline in tax revenues and an increase in government investment had raised the deficit to 3 percent of GDP. This year, the deficit was slated to return to the ceiling, but a combination of falling tax revenues and emergency measures instead led to its further increase.

The government plans to reduce the deficit to 4 percent of GDP in 2021 and gradually return to the FRL limit by 2024, but if downside risks materialize, the reduction of the deficit in 2021 will need to be scaled back. The expiration of the temporary Covid-19 related expenses in and of itself would reduce government expenses by 3 percent of GDP. It is important to keep fiscal policy under review so as not to withdraw fiscal support prematurely. If the Covid-19 epidemic were to significantly worsen, more spending would be needed, including for health care and for social protection of vulnerable workers. If the current La Niña cycle were to reduce the harvest and economic growth, tax revenues would likely disappoint. In all these cases, it would be important to protect investment; and the reduction of the deficit in 2021 would need to be commensurately smaller.

To foster growth, Paraguay will not only need to continue with its policies focused on macro-economic stability, but also improve governance, the business climate, and human capital. Paraguay scores poorly on these indicators, not only compared with advanced countries, but also with emerging market countries, including in the region. Income inequality, which has been falling but remains high, may need to be reduced further, while risks emanating from climate change also need to be addressed.

The government's "Economic Recovery Plan" is appropriately focused on these issues. The plan aims to strengthen the recovery in 2020 and 2021 by boosting public investment spending, ensuring sufficient financing for the private sector, and removing supply-side bottlenecks; protect the vulnerable by further raising social benefit spending this year; and implement a new Fiscal Responsibility Law. In addition, the plan contains many reform proposals but also includes many reforms to improve governance and increase efficiency of public spending; improve the business climate; and facilitate new business creation and formalization of existing businesses.

The banking sector is stable, but the impact of the crisis remains to be seen. NPL ratios are low and capital adequacy ratio is high. However, official statistics may not yet show the impact of the crisis, as loans that fell due were allowed to be rolled over at a lower capital weight.

Approved By
Patricia Alonso-Gamo (WHD) and Sanjaya Panth (SPR)

Discussions took place online during November 2–13, 2020. The staff team comprised of Bas Bakker (head), Tobias Roy, Natasha Che, Manuk Ghazanchyan (all WHD), and Ramon Hurtado Arcos (FAD). Research assistance was provided by Vibha Nanda, and editorial support by Patricia Delgado. Jorge Corvalan (OED) attended the policy meetings. The team met with Central Bank of Paraguay (BCP) President José Cantero, Minister of Finance Óscar Llamosas, Minister of Public Health Julio Mazzoleni, Minister of Industry and Commerce Liz Cramer, and other senior officials, and representatives from the private sector, think tanks, and the donor community.

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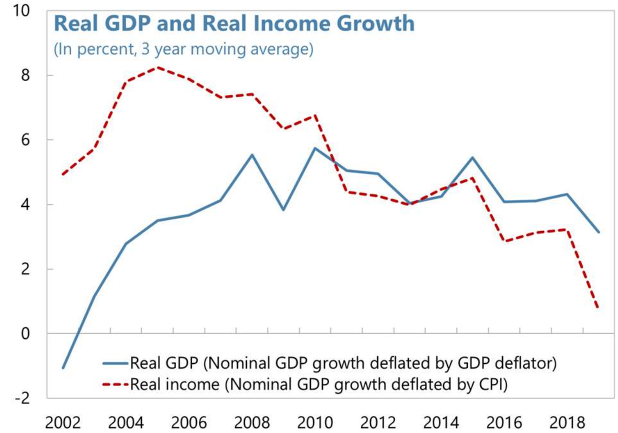
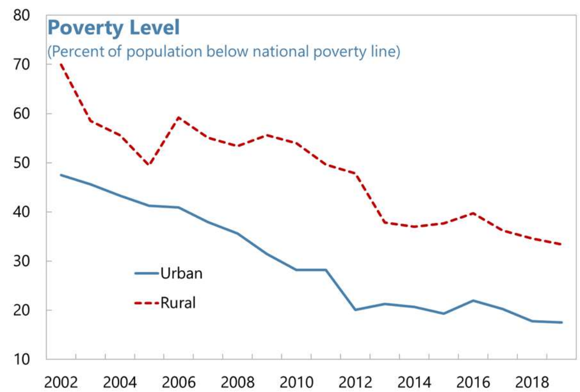
PRE-COVID LANDSCAPE

1. In the past two decades Paraguay has seen strong growth and a sharp reduction in poverty. Strong GDP growth was the result of sound macro policies (with low inflation and low fiscal deficits and debt) and an agricultural commodity price boom which spilled over to the non-tradable sector. *Income* growth in the 2000s was further boosted by terms of trade gains. Between 2002 and 2019 the poverty rate more than halved.



Sources: WEO and IMF staff calculations.

2. Growth was not just high but also volatile. Bad weather leads to poor harvests, which spill over to the broader economy. Previous downturns in 2009 and 2012 were the result of bad weather. They were followed by strong recoveries: GDP in 2010 and 2013 grew by 11 and 8½ percent respectively.



Sources: DGEEC.

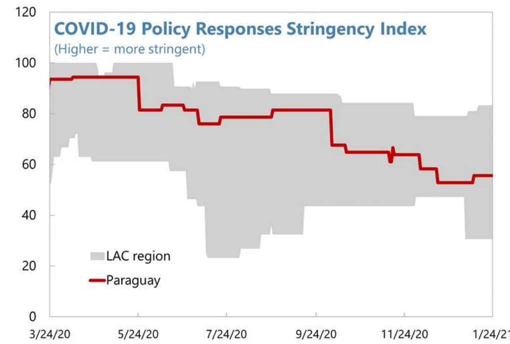
3. In 2019, another weather shock reduced full-year growth to near zero. A severe drought early in the planting season reduced agricultural exports and electricity production. Subsequent flooding further hurt agriculture, livestock, and construction. Exports also suffered from economic weakness in Argentina and Brazil and the sharp depreciation of the Argentinean peso. Inflation fell from 4 percent in 2018 to 2.8 percent in 2019. The Central Bank reacted to the economic downturn by lowering its policy rate in five steps from 5¼ to 4 percent.

4. As a result of the downturn and the policy reaction, the fiscal deficit rose to almost 3 percent of GDP. To boost the economy, the government stepped up public investment**.** Together with the shortfall in fiscal revenue, this led to a widening of the deficit to 2.8 percent of GDP, above the 1½-percent ceiling under the Fiscal Responsibility Law (FRL). The deficit overrun did not violate the FRL, as parliament approved the FRL's emergency escape clause, which allows a deficit of up to 3 percent of GDP in case of a "decline in economic activity".

5. The economy was rebounding strongly in the first few months of 2020, before the COVID-19 crisis hit. Favorable weather pushed the soybean harvest for the 2019–20 season to a historical high. Hydro-energy production has also rebounded. Growth was further boosted by higher growth in Brazil. And the negative impact on border trade from the earlier depreciation of the Argentinian peso was being offset by higher inflation in Argentina.

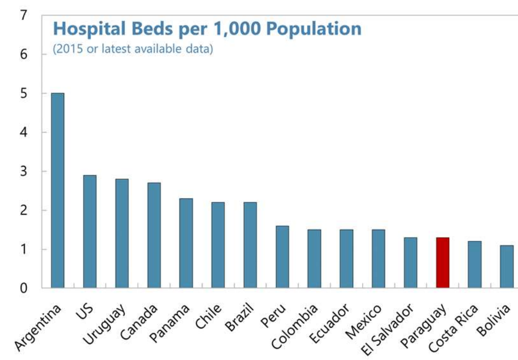
THE COVID SHOCK

6. **Paraguay responded to the COVID-19 crisis with an early lockdown.** Schools were closed three days after the first domestic case was discovered in early March, and a nation-wide quarantine was in place from March 20 until May 3. This helped prevent the health system from being overwhelmed and kept the death toll per million in the first few months of the pandemic to among the lowest in the region.

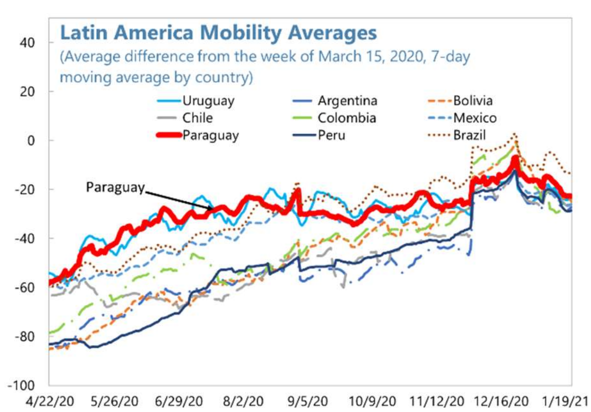


Sources: Oxford COVID-19 Government Response Tracker.

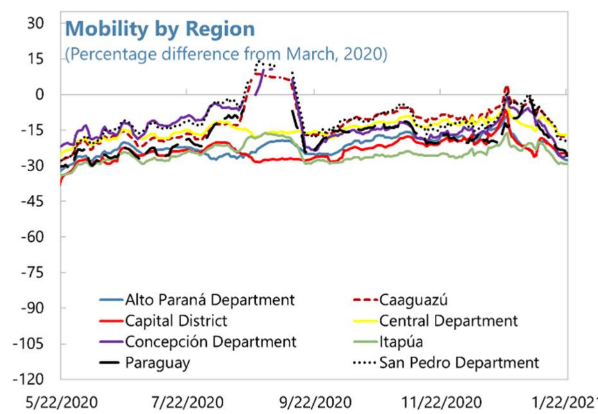
7. **The lockdown led to a sharp drop in activity.** Mobility dropped by 60 percent, and cross-border trade with Argentina and Brazil, an important income source for local economies such as the Alto Paraná Department, dried up when the borders were closed. In April, the main economic activity index was 20 percent below the February level. Second quarter GDP was a seasonally adjusted 10.1 percent below the first quarter level.



Sources: World Development Indicators.



Sources: Global Mobility Report and staff calculations.



Sources: Google mobility report.

8. **The impact of the crisis was uneven.** Women, informal sector workers and service sector workers were particularly hard hit (Box 1), as were children who were severely affected by the closing of the schools until the end of 2020. The large cities were much more affected than the countryside, as is also reflected in regionally diverging mobility indicators.

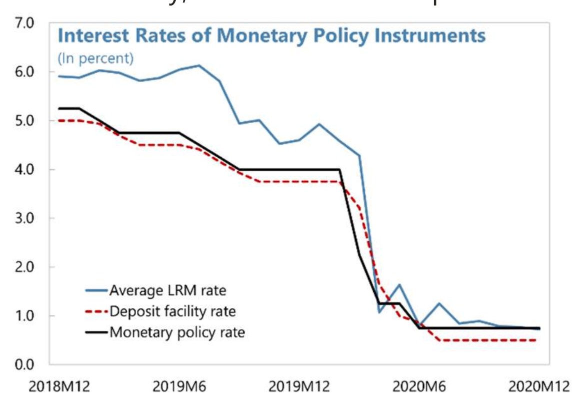
9. Swift and forceful government action helped contain the health, social and economic impact of the pandemic:

- To mitigate the *health* impact, the government bought medical supplies, expanded medical staff and built new hospitals. It also set up hostels near the borders, where returning Paraguayans could be quarantined.

- To mitigate the *social* impact, the government started two new and temporary social assistance programs (Pytyvõ and Ñangareko) and temporarily expanded a third (Tekoporã) (Box1). Pytyvõ was targeted at informal and self-employed workers affected by the Covid-19 crisis, who had never been covered by the social security system before. *Ñangareko* supported food security of vulnerable families in the subsistence economy whose livelihoods had been affected by the COVID-19 crisis. The government also increased allocations to the established *Tekoporã* social assistance program and provided a one-off additional payment to beneficiaries of the program.

- To mitigate the *economic* impact, the government increased investment in public works and social housing. The government also reduced VAT rates on selected goods and deferred corporate income tax payments for three months. The fiscal responsibility law was temporarily suspended.

- The monetary policy rate was reduced by 325 bps cumulatively, to the current 0.75 percent.[1] Liquidity provision to the financial sector was strengthened[2], and banks could renew, refinance, and restructure loans without penalty, and with a lower risk weight. An MSME Guarantee Fund (FOGAPY) was capitalized to provide credit guarantees on new loans to MSMEs. The Development Finance Agency (AFD) relaxed refinancing conditions for housing loans and established new credit lines targeting micro, small & medium enterprises (MSMEs).



Sources: BCP and IMF staff calculations.

10. Budget support by IFIs and a US$1 billion sovereign bond issuance helped finance the crisis response. In early April, when financial markets were closed, the government had to seek support from the IMF and other IFIs. But shortly after the IMF Executive Board approved an RFI of US$274 million (100 percent of quota) in late April, and helped by the signaling effect of the RFI,

[1] Inflation fell below the target band, to 0.5 percent in June, and is projected to remain below the midpoint of the central bank's target range through 2021.

[2] The liquidity measures include lowering the legal reserve requirements for both domestic and foreign currencies for an amount equivalent of US$957 million (around 6 percent of banks' short-term liabilities) and creating a new liquidity window of US$760 million (about 5 percent of banks' short-term liabilities).

Paraguay managed to issue a US$1 billion sovereign bond at favorable terms.[3] Since the overall envelope of external borrowing has been met by the bond issuance and financing by other IFIs, and given the constraints on external borrowing put in place by congress, the government has recently communicated that it is no longer planning to draw on the RFI.

11. The crisis and the associated policy responses raised this year's fiscal deficit to about 6½ percent of GDP. Emergency spending and accelerated investment increased spending by about 3½ percentage points of GDP in 2020, with 1.3 percentage points coming from an increase in social benefits, 0.7 percentage point from medical supplies and other emergency purchases, and 0.9 percentage points from higher investment. Spending is also higher than was envisaged at the time of the RFI, largely on account of higher investment and higher social benefits.

Fiscal Spending in 2020

	2020 Article IV (Oct.)		2020 RFI (Apr.)	
	In bn guaranies	Percent of GDP	In bn guaranies	Percent of GDP
Total revenue	**32,104**	**13.1**	**33,300**	**13.4**
Total expenditure	**48,052**	**19.6**	**44,546**	**18.0**
Expense	**40,734**	**16.6**	**39,464**	**15.9**
Compensation of employees	17,856	7.3	18,671	7.5
Purchases of goods and services	4,500	1.8	4,484	1.8
Interest	2,459	1.0	2,131	0.9
Social benefits	9,305	3.8	8,196	3.3
Other current expense	6,614	2.7	5,982	2.4
Net acquisition of nonfinancial assets	**7,318**	**3.0**	**5,083**	**2.0**
Net lending/borrowing	**-15,948**	**-6.5**	**-11,246**	**-4.5**
Memo item: Projected nominal GDP in bn gs.	244,955	...	248,149	...

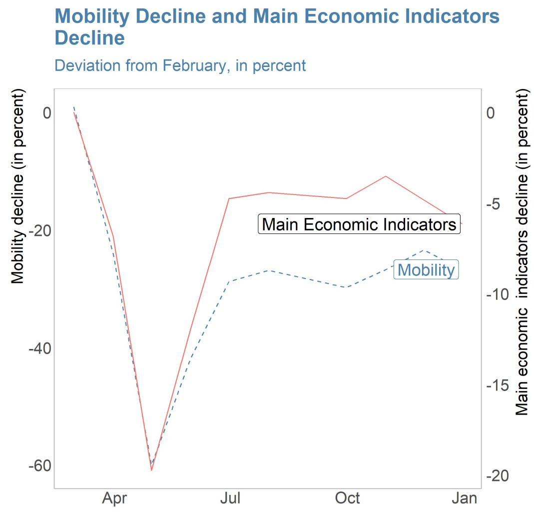
Sources: Paraguay authorities and IMF staff estimates.

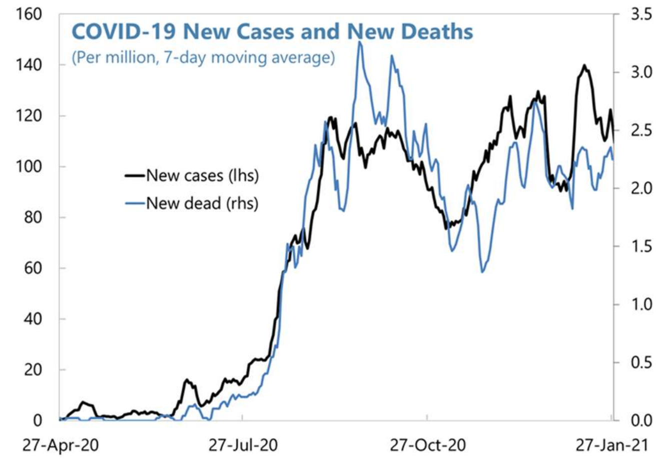
12. Strong measures were put in place to ensure that the crisis funds were well spent. The legislative branch created a bicameral commission to oversee COVID-19 spending. The government established a public portal "Rindiendo Cuentas"[4], where all COVID-19 expenditures are reported. Public tenders have been reviewed *ex-ante* by a newly-established inter-institutional committee and audited *ex-post* by the Contraloria. The *Contraloría* and the *Auditoría General del Poder Ejecutivo* plan to conduct an audit covering the entire COVID-19 spending, with results expected in mid-2021. Strong efforts were also made to ensure that the new social transfer programs, Ñangareko and Ptyvõ, were well targeted (Box 1). Few instances of fraud or irregularities were reported despite the large scale of the programs.

13. An easing of lockdown restrictions led to an economic rebound. Lockdown restrictions were eased in four phases, starting in early May. The Main Economic Activity index increased from May onwards, in tandem with the pick-up in mobility. The recovery was further supported by a strong bounceback of the agricultural sector from last year's drought.

[3] The bond had a 10-year maturity, at a yield of 4.95 percent. This was in addition to the US$450 million international bonds issued in January 2020.

[4] See https://www.rindiendocuentas.gov.py/. The portal includes includes the contracts, names of awarded companies, a whistleblower section, and access to the register of civil servants' sworn statements.

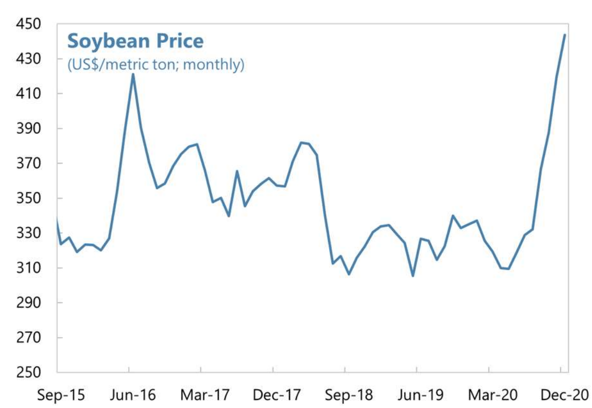




Sources: Google open data, Ministry of Finance and IMF staff calculations.

14. The pandemic also picked up. In July, new cases and deaths started to accelerate; and by mid-December the death toll had risen to 261 per million. Still, Paraguay has one of the lowest death rates from COVID-19 in the region, aided by a young population.

15. Inflation fell to below the target band. Inflation fell from 2.8 percent y/y in December to 0.5 percent in June. Much of the decline was driven by a decline in oil prices, but domestic sectors contributed as well, particularly hotels and restaurants. In the second half of the year, inflation started to increase, and by November had increased to 2.2 percent, as activity picked up and the guarani depreciated.

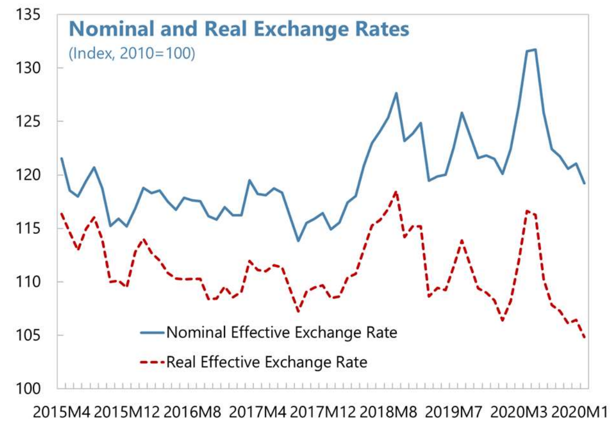


Source: Haver.

16. The current account is in surplus and capital inflows are limited. The trade balance improved this year on account of the recovery in soybean exports. The drying up of cross-border trade has resulted in a sharp decline in non-registered exports but this is largely offset by a fall in associated imports. Capital inflows largely consist of private sector FDI and bonds issued by the government.

17. The real effective exchange rate has appreciated by about 2 percent during the first ten months of 2020. In the Spring, there was an appreciation, as neighboring countries saw a sharp depreciation vis-à-vis the dollar, and the guaraní remained stable. The appreciation has since reversed, with the guarani depreciating vis-à-vis both the US dollar and neighboring countries. Reserves have increased by US$1.2 billion this year, buoyed by the sovereign bond issue in April, and are now at 8.9 billion.

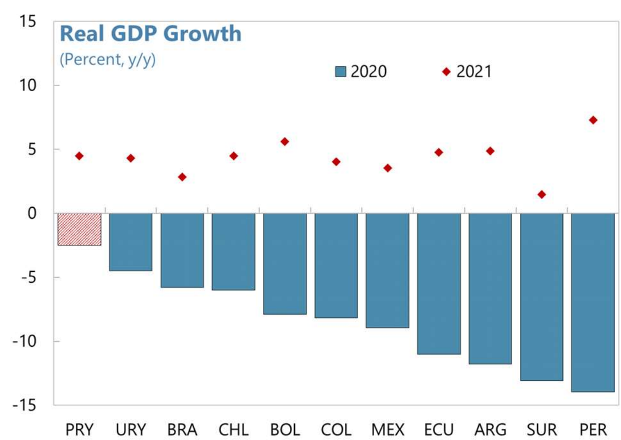
18. Political tensions have reduced the government's space of maneuver. There is popular discontent with remaining COVID-19 restrictions, in particular in the frontier areas with Brazil and Argentina, where only limited border traffic has been re-allowed. Revelations about irregularities in the emergency purchase of medical equipment at the height of the pandemic led to a public perception of corruption, even though all misused funds were subsequently recovered. These setbacks have reduced support in congress for the government's recovery plan and the government's intention to finance it with more debt. Looking ahead, Paraguay's internal politics may increasingly become loaded with pre-electoral disputes in the run-up to the 2021 municipal and 2022 primary elections.



Sources: INS.

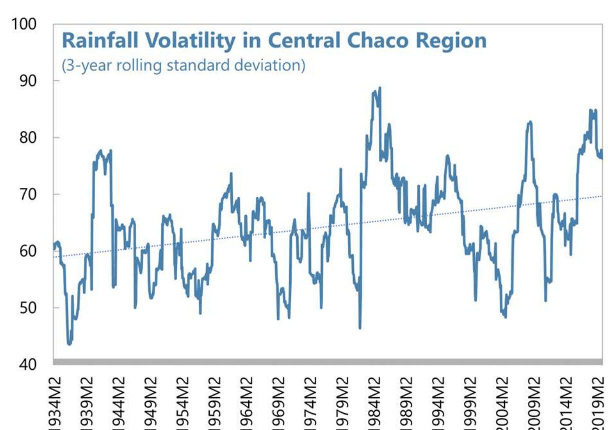
OUTLOOK

19. Staff projects real GDP to shrink by about 1 percent in 2020 and rebound by 4 percent in 2021. The relatively modest decline compared with other countries in the region is mainly the result of the rebound in agriculture. For 2021 growth of around 4 percent is projected. Inflation is projected to remain below the midpoint of the central bank's target range through 2021.



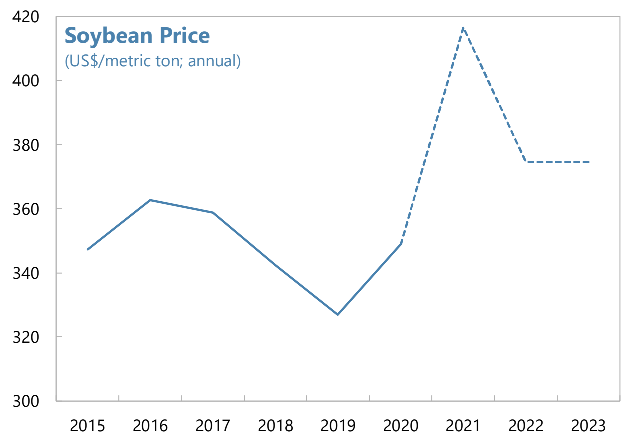
Sources: WEO and IMF staff estimates.

20. Near-term risks are dominated by the economic impact of the Covid-19 epidemic. An explosion of daily deaths might suppress mobility and could trigger renewed lockdowns. The epidemic could linger longer-than-expected, particularly if the roll-out of vaccines is slow. Cross-border trade with Brazil and Argentina will only resume in full if the epidemic in these countries is brought under control. Bad weather (which would affect the harvest) is another important near-term risk—a new La Niña cycle has started. Moreover, rainfall volatility in the central Chaco region is rising. On the upside, the impact on domestic demand of the sharp rise in soybean prices in recent



Sources: Filadelphia weather station and staff calculation.

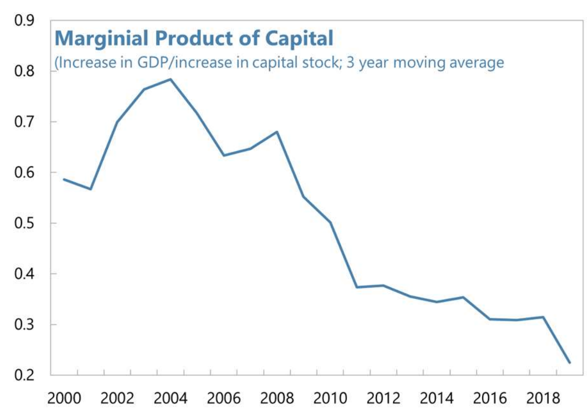
months may be stronger than expected. There has also been interest of foreign investors, and new foreign investment projects, e.g. in paper pulp and clean energy, may provide a boost to growth, if materialized in the near term.



Source: World Economic Outlook.

21. If downside risks materialize, the exchange rate should act as a shock absorber, while plans to start reducing the deficit would need to be scaled back. If renewed lockdowns were necessary, direct spending on health related to controlling the pandemic and income support should remain the first and foremost priority. Further easing of monetary policy could provide additional, albeit modest, support—interest rates are already below 1 percent.

22. Staff currently estimates medium-term potential output *growth* at 3½ percent—2 percent in per capita terms. Real GDP growth had been on a downward trend even before the Covid-19 crisis, reflecting a declining marginal product of capital and low TFP growth in recent years. The Covid-19 has further reduced potential output *levels* as the growth of the capital stock slowed, labor participation dropped, and some firms have gone under.



Sources: Ministry of Finance and IMF staff calculations.

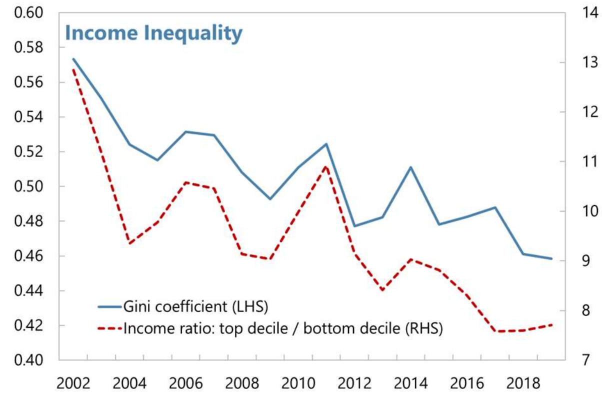
Authorities' Views

23. The authorities were cautiously optimistic about the economic outlook. They noted that the economy had rebounded strongly after it had been reopened, and that this had not been derailed by the uptick in Covid-19 cases. At the time of the mission, they projected a GDP decline of 1.5 percent in 2020 and 4 percent growth in 2021—slightly above the potential growth rate, which they estimated to be around 3.6-3.8 percent. In late December, they adjusted their forecast to -1 percent in 2020 and 4 percent in 2021. They recognized that downside risks were significant, and that the Covid-19 pandemic and the weather posed particular risks.

24. The authorities argued that the unusually low inflation in the second quarter of 2020 was in large part explained by the the large depreciation of the currencies of neigboring countries, which had supressed import prices. They expected inflation to rebound as exchange rates continue to normalize.

Box 1. The Pandemic's Impact on Inequality

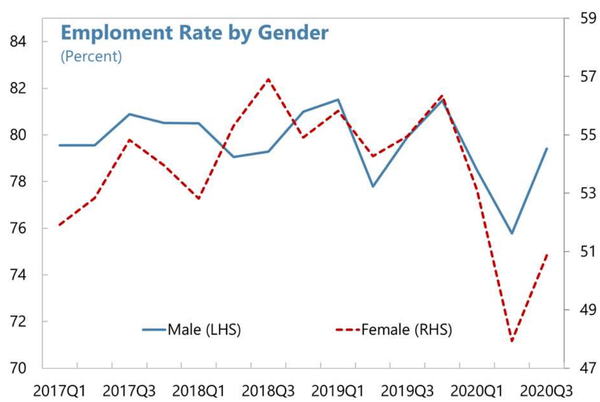
Paraguay has made significant progress in reducing income inequality. Over the past two decades, the Gini index and the income ratio for top/bottom income tiers have both dropped, aided by strong GDP growth, favorable terms of trade movements during the 2000s and poverty reduction efforts of the government.



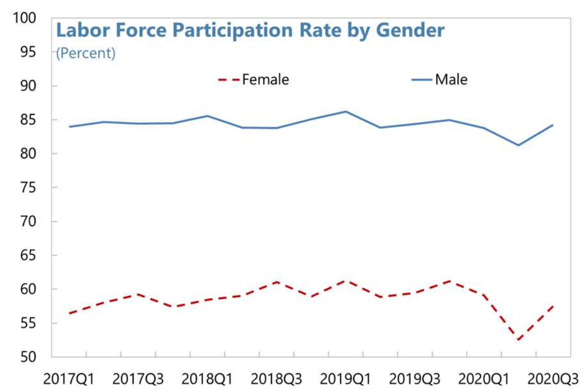
Sources: DGEEC.

The COVID-19 crisis is threatening to revert some of this progress. The pandemic's economic impact on the population has been very uneven across different demographic groups, as the disadvantaged economic groups have been more severely affected by the pandemic.

The crisis affected female employment more than male employment. Even before the crisis, the employment rate for women was over 25 percentage point lower than for men. The female labor participation rate was also much lower. The pandemic has raised unemployment of both genders, but the increase is sharper for female workers. Moreover, the labor participation rate for women dropped by 9 percentage points in 2020, in contrast to the 4-percentage-point drop for men.

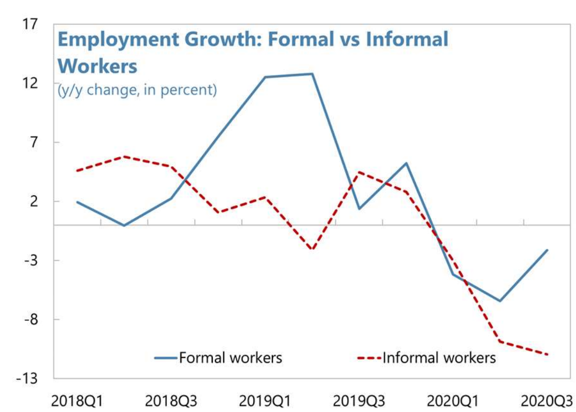


Sources: DGEEC and IMF staff calculations.



Sources: DGEEC and IMF staff calculations.

The crisis also hit the informal sector workers much harder. Paraguay has a large informal sector (over 60 percent of total employment). Informal workers tend to be self-employed or concentrate in low-paying jobs in smaller firms in the service sectors. For the first two quarters of 2020, both formal and informal employment took a hit. But the reduction in informal employment was twice as big as the formal sector.



Sources: DGEEC and IMF staff calculations.

Box 1. The Pandemic's Impact on Inequality (Concluded)

Service sector workers were most affected. Employment in the tertiary sector (which is concentrated in cities) saw a y/y decline of more than 10 percent in the second quarter. In contrast, the primary and secondary sectors had positive employment growth in 2020, thanks to the rebound in agricultural harvest and accelerated implementation of public works which boosted construction sector employment.

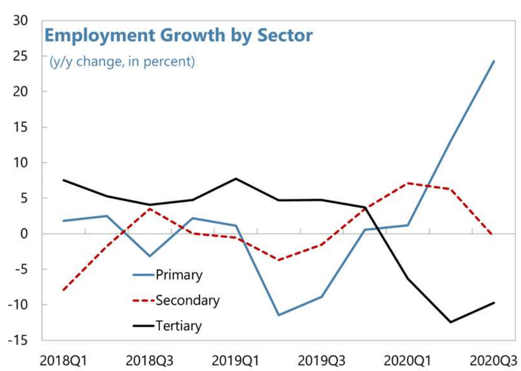
Private sector workers were affected much more than those in the public sector. Public sector employment (around 12 percent of total employment) has held up relatively well so far during the pandemic. The bulk of worker displacement happened in the private sector, with employment dropping by 13 percent in Q2, 2020.

New temporary government social assistance programs. The government started two new social assistance programs and temporarily expanded a third:

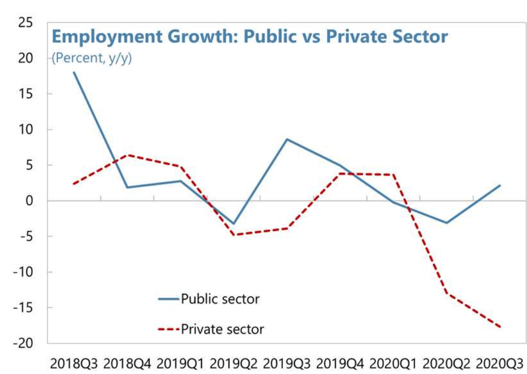
- *Pytyvõ* is targeted at informal and self-employed workers affected by the Covid-19 crisis, providing them with a payment of 25 percent of the minimum wage. It was originally announced as a one-off payment, but it has been repeated a second time. Authorization of a third payment is pending in Congress. The first and second trenches of the program collectively reaches about 3 million people.
- *Ñangareko* supports food security of vulnerable families in the subsistence economy whose livelihoods have been affected by the COVID-19 crisis through one-time payments. *Ñangareko* was motivated by the fact that nearly 93 percent of Paraguayan informal workers are outside the safety net system
- The government increased allocations to the established *Tekoporã* social assistance program and provided a one-off additional payment to beneficiaries of the program.

Strong safeguards were put in place to ensure effectiveness and proper targeting of the new programs:

- Potential beneficiaries were required to register online or through the program mobile apps, which allowed for greater traceability, transparency, and avoided problems of mass gathering that in-person registration would have created. Digital registrations also helped track beneficiaries and ensured that applicants of the new programs were not from households with public employees or beneficiaries of other existing social transfer programs.
- The three waves of disbursements were tailored to reach those sectors deemed to be most affected in the current situation. For example, whereas the first wave of Pytyvõ was extended to all informal sector workers, the second wave focused on those in the severely affected border areas and on service workers.
- Money transfers for the programs were carried out through digital payment instruments, which improved transparency and ensured the timely delivery of funds. Recipients without cell phones were reached by tying the benefits to their national identity card. In addition, the beneficiary lists of these programs were published online.



Sources: DGEEC and IMF staff calculations.



Sources: DGEEC and IMF staff calcualtions.

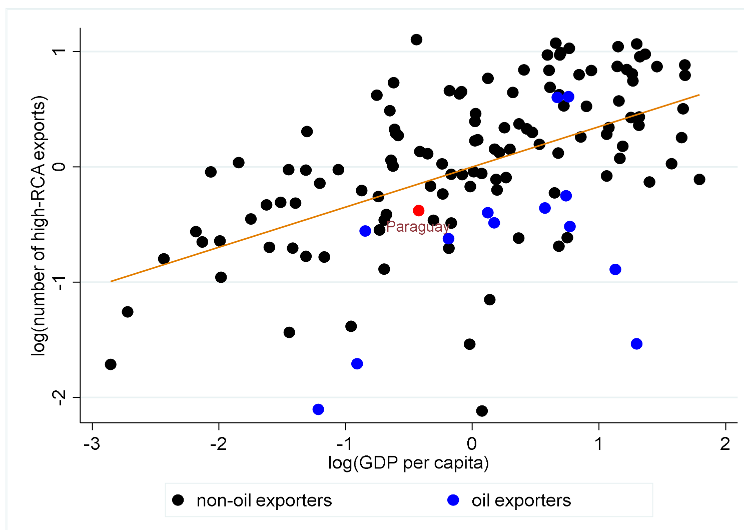
POLICY ISSUES

25. **In the coming months, the emphasis will be on recovering from Covid-19, trying to revive activity, and recovering lost ground in social protection, poverty reduction, education, etc.** Although the forceful government reply with the introduction of new benefits for hitherto uncovered workers has mitigated its impact (Box 1), the social damage from the epidemic has been considerable, while children's education is affected by the almost full year closing of all schools.

26. **Policies should prepare for a scenario where the recovery from Covid-19 is slower than expected.** Despite the positive development in Covid-19 vaccines, the eventual rollout of vaccines may take longer than expected due to various logistical, financial, and socioeconomic bottlenecks. In the meantime, withdrawing monetary and fiscal support from the economy prematurely may hinder both the recovery and medium-term growth prospects. Paraguay needs a better infrastructure, and thus government investment; while investments in educational infrastructure may be required to boost the country's long-term human capital.

27. **Once Paraguay has recovered from the Covid-19 crisis, the key question going forward is how to sustain rapid growth of real incomes**, as the factors that propelled growth in the last decade are likely to provide less support going forward. Despite the recent rebound, agricultural prices are off previous highs and may come under further pressure as China's demand growth slows down. And agricultural land cannot continue to expand rapidly.

Export Diversification vs Country Income Level



Source: UN COMTRADE and IMF staff calculations.

28. **Future growth will increasingly need to come from the non-energy/nonagricultural sector, which is growing rapidly but is still small**. Indeed, Paraguay is less diversified than countries of similar income levels. The under diversification is even more pronounced if oil exporters are taken out of the comparison sample. The dependence on the agricultural sector also makes the country vulnerable to climate change: if extreme weather events increase, future harvests face higher risks and uncertainties. A machine learning model analyzing Paraguay's export structure suggests that Paraguay couldfurther expand its comparative advantages in the agro commodity sector by increasing export varieties of agricultural products and primary materials, and by increasing basic manufacturing exports that involve the processing of primary materials. Using more of its cheap and abundant hydro-electric energy domestically, the country also has potential for expansion of the manufacturing of machinery and equipment.

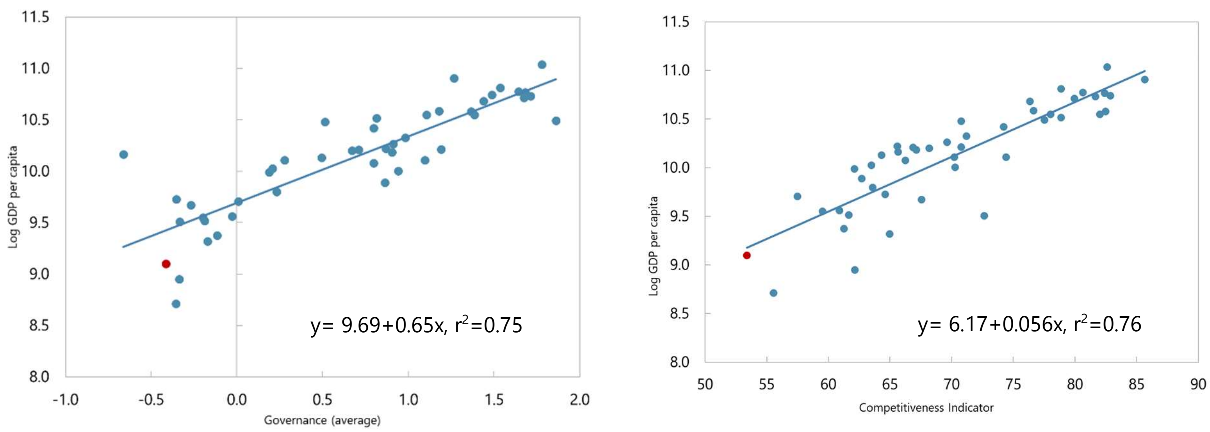
29. To foster growth, Paraguay will need to continue with its policies focused on macro-economic stability, but also improve governance, business climate, and human capital. The deficit will need to be brought back to the FRL ceiling to ensure debt dynamics remain favorable and buffers exist when a new shock hits. Macroeconomic stability is a necessary but not sufficient condition for sustained convergence. A recent IMF working paper[5] argues that strong governance, good business climate and human capital matter for convergence. Poor countries with these attributes tend to see sustained convergence, while countries without these attributes do not. Paraguay scores poorly on these indicators, not only compared with advanced countries, but also with emerging market countries, including in the region. Income inequality, which has been falling but remains high, may need to be reduced further, while risks emanating from climate change, such as increased weather volatility, also need to be addressed, including by reducing the dependence of the economy on the agricultural sector.

30. The government's Economic Recovery Plan is appropriately focused on these issues. The plan, which was finalized in October, aims to strengthen the recovery in 2020 and 2021 by boosting public investment spending, ensuring sufficient financing for the private sector, and removing supply-side bottlenecks; protect the vulnerable by further raising social benefit spending this year; and implement a new Fiscal Responsibility Law. The plan also contains many reform proposals:

- To safeguard macro-economic stability, the plan includes an update of the Fiscal Responsibility Law (which codifies the new target date for the return to the deficit ceiling and sets stricter limits on growth of current spending).; and the creation of a unit for proactive and risk-based public debt management (shortly after the publication of the plan, the law for this was approved by Congress).
- To improve governance and increase efficiency of public spending, the plan includes reforms of the state and the civil service system, and an improvement of the public procurement framework.
- To improve the business climate, the plan includes new insolvency and factoring laws to promote credit growth and private sector dynamism; and improvements in approval procedures and training to facilitate new business creation and formalization of existing businesses.
- To improve human capital, a roadmap for educational reform will be developed by end-2021, and there are plans to restructure the health system. Finally, a new attempt would be made to establish a law for pension fund supervision and regulation.

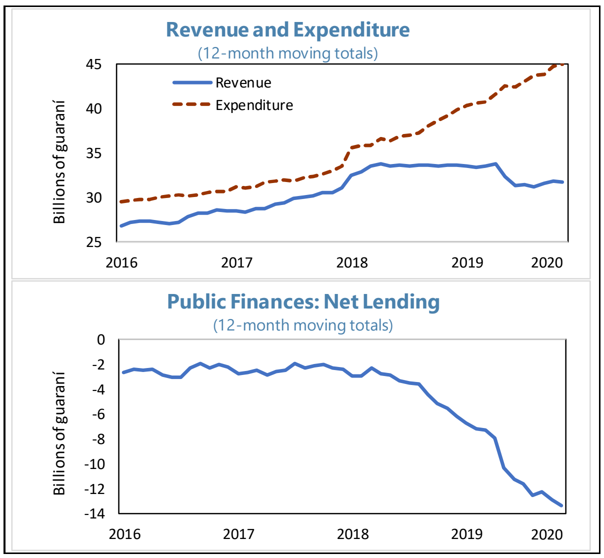
[5] See Bakker et. al. (2019).

GDP per Capita, 2017 against Governance and World Competitiveness Indicators



Source: Penn World Tables 9.1, Worldwide Governance Indicators and World Competitiveness Indicators.

A. Fiscal Policy: Getting Back to the FRL Ceiling Over Time



31. The significant increase in the deficit this year is appropriate but going forward fiscal deficits should be gradually brought back to the FRL ceiling. The fiscal policy response—together with monetary policy easing—has helped mitigate the impact of the Covid-19 crisis. In the short term, it is important to ensure adequate fiscal support for a full recovery from the pandemic. But over the medium term, fiscal deficits should be reduced. The deficit is now at 6½ percent of GDP while public debt is exceeding 35 percent of GDP. While in terms of GDP, this is still modest, it is less so in terms of fiscal revenue. Still, public debt is sustainable under the authorities' plan, peaking at 36 percent of GDP in 2022 and gradually declining thereafter (Annex III). To mitigate the impact of tighter fiscal policy, monetary policy can remain loose.

32. For 2021, the government targets a deficit of 4 percent of GDP. The decline in the deficit is entirely the result of the expiration of most of the temporary Covid-19 expenditures, which would in and of itself reduce spending by 3 percentage points of GDP (table), but this is partially offset by an increase in interest payments of 0.4 percent of GDP).[6] Public investment would remain high, similar to the levels of 2019 and 2020.

Net impact of execution and expiration of COVID-19 emergency measuress

	2020		2021		Net impact on 2021 fiscal balance
	In mn USD	Percent of GDP	In mn USD	Percent of GDP	
Total current emergency expenditure	**1,432**	**3.9**	**353**	**0.9**	**3.0**
Temporary social programs and subsidies	610	1.7	0	0.0	1.7
Medical Equipment (including vaccines)	181	0.5	230	0.6	-0.1
Additional medical staff and bonus payments	201	0.6	123	0.3	0.2
Capitalization of FOGAPY	100	0.3	0	0.0	0.3
Other temporary emergency expenditure	340	0.9	0	0.0	0.9
Memo items:					
- Total public investment	1,090	3.0	1,087	2.8	
- Projected nominal GDP in mn USD	36,496	...	38,335	...	

Sources: Paraguay authorities and IMF staff estimates

33. If downside risks materialize, a slower reduction of the deficit in 2021 would be called for. It is important to closely monitor the situation so as not to withdraw fiscal support prematurely. If the Covid-19 epidemic were to significantly worsen, more spending would be needed, including for health care and for social protection of vulnerable workers. If the current La Niña cycle were to reduce the harvest and economic growth, tax revenues would likely disappoint. In all these cases, it would be important to protect investment; and the reduction of the deficit in 2021 would need to be commensurately smaller.

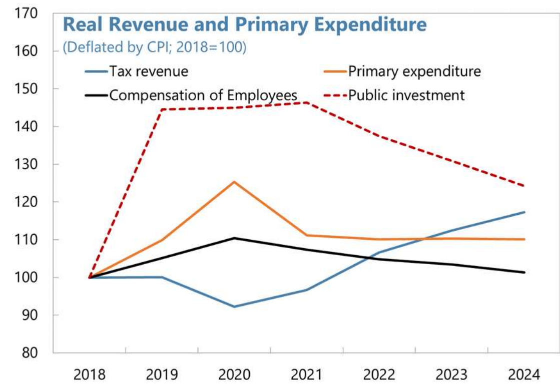
34. Beyond 2021, the government's goal to return the deficit to the FRL ceiling by 2024 is appropriate. Returning to the ceiling is important to ensure that debt dynamics remain favorable, to ensure the continued credibility of the fiscal framework, and to build up buffers for when new shocks hit.

35. It would be useful to codify the new target date for return to the deficit ceiling in an updated version of the Fiscal Responsibility Law, together with stricter limits on growth of current spending. Parliament only approved an exemption to the FRL deficit ceiling for 2020. Next year's deficit should therefore remain below the ceiling, unless the government asks for another exemption. As repeated calls for an exemption would hurt the credibility of the FRL, the government plans to change the law and legislate that the deficit would need to return to the ceiling by 2024. The new law would also cap increases in current real primary spending at 2 percent (compared to 4 percent plus inflation in the old law); and introduce an additional ceiling on central government debt.[7] Annex I discusses the proposed revisions to the FRL.

[6] Not all Covid19-related expenditures expire. The under-execution of medical spending in 2020 has been added to the 2021 budget, and part of it will be used for the purchase of vaccines. In 2021, Paraguay will receive 4 million doses under the COVAX initiative, at a price tag of $40 million. The government is also negotiating with foreign companies to purchase 3 million additional doses.

[7] The precise debt ceiling is still in flux. The latest proposal envisages a ceiling of 40 percent of GDP, with lower deficit ceilings once the debt exceeds 36 percent of GDP. The debt concept used by the authorities is narrower than the one used by the IMF and therefore about 2 percentage points of GDP lower.

36. The government plans to bring the deficit back toward the ceiling through expenditure compression only. The government's focus on making government spending more efficient is certainly appropriate. And successful implementation of reform of the state, civil service reform, and rationalization of public procurement would help reduce current spending. But its contribution is unlikely to be sufficient to bring the deficit back to the ceiling—let alone create room for much needed other spending in areas as education and infrastructure. Public investment would likely need to be cut as well in order to meet the target. Indeed, current medium-term fiscal projections envisage a fall in public investment from 3 to 2.2 percent of GDP.



Sources: Ministry of Finance, Central bank of Paraguay and IMF staff estimates.

37. However, spending needs are large, and investment may need to be increased rather than reduced. According to OECD and Global Infrastructure Outlook, total infrastructure investment needs are US$1 billion to 3 billion per year (3 to 8 percent of GDP). The 2017 Article IV report identified infrastructure investment needs of about 20 percent of GDP over the next five years for electricity distribution, roads, sanitation, and other large transportation projects. For education, the World Bank has estimated that over US$1 billion is needed for investment in schools. Even if state reform measures will be implemented successfully, improving public services will require more resources.

Operations of the Central Government
(In percent of GDP)

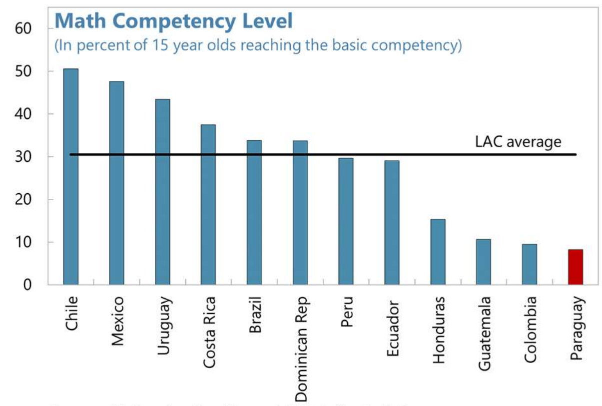
			Proj.				
	2018	2019	2020	2021	2022	2023	2024
Revenue	**13.9**	**14.1**	**13.1**	**13.1**	**13.7**	**13.9**	**13.9**
of which: Tax revenue	9.9	9.9	9.2	9.3	9.9	10.0	10.1
Expenditure	**15.3**	**16.9**	**19.6**	**17.1**	**16.5**	**16.0**	**15.4**
Primary current expenditure	12.6	13.2	15.6	13.0	12.5	12.2	11.8
of which: Social benefits	2.3	2.4	3.8	2.6	2.6	2.7	2.7
of which: temporary Covid-19 related	...	...	1.7	...	...	...	...
Interest	0.7	0.8	1.0	1.3	1.4	1.4	1.4
Investment expenditure	2.0	2.9	3.0	2.8	2.6	2.4	2.2
Net lending/borrowing (overall balance)	**-1.4**	**-2.8**	**-6.5**	**-4.0**	**-2.8**	**-2.1**	**-1.5**
Public debt	**22.2**	**25.6**	**34.9**	**35.4**	**36.3**	**36.3**	**36.1**

38. Revenues from Itaipú might increase from 2023 onwards, but the magnitude is uncertain and will depend on a renegotiation of the treaty with Brazil. The current tariff for energy paid to the Itaipú binational entity covers both operational costs and the annual costs of debt service, which will fall from about US$2 billion to zero, once the debt is paid off. Should the tariff remain unchanged, the windfall will be equally shared between both governments, which would yield 1½ percent of GDP in additional annual revenue for Paraguay. Should the tariff be adjusted downward to reflect the reduction in debt service costs, Paraguay would benefit only through lower tariffs on the electricity it consumes, and there would be no additional fiscal revenue.[8]

[8] In this case, most of the windfall would go to Brazil, as Paraguay sells 70 percent of its share of Itaipú's electricity to Brazil.

There could also be additional gains for Paraguay if the renegotiation of the electricity selling agreement results in a higher energy export price.

39. Tax revenue will need to rise as well. Tax revenue in Paraguay is very low by international standards. While further curbing tax evasion would help create additional resources, the near-term scope is likely to be modest–Paraguay has already been working for the past decade and a half on improving tax administration, including with Technical Assistance of the IMF. The potential of further tax administration improvements is likely not enough to close the revenue gap.[9]



Sources: National authorities and IMF staff calculations.

40. Education needs to improve. Despite significant increases in education spending over the last decade, learning outcomes have not improved[10] and PISA scores are low. The Covid-19 crisis threatens to further increase the gap with regional peers. Public schools were closed in March 2020 until the end of the school year (December 2020). Education reform needs to address qualification criteria for new teachers, training, and performance assessment. About half of Paraguay's teachers are bound to retire within the next five years. While this represents a window of opportunity for reform, it is unclear whether there will be sufficient supply of qualified teachers, and even more so as Paraguay needs to reduce its students-per-teacher ratio, which is high compared to peers with better SDG performance on education.

41. The pension system requires supervision and needs to be reformed. Currently, there is no financial supervision and regulatory oversight of pension fund activities. Introducing a pension fund supervisor and abolishing outdated legal restrictions would help safeguard the public's long-term savings and more effectively channel long-term savings into investment. In addition, the pension system insuring private sector employees needs to expand its coverage among uninsured informal workers. In the longer term, parametric adjustments are needed to strengthen its equity and financial sustainability. The system insuring public civil servants (*Caja Fiscal*) is severely underfunded and requires even more urgent reforms.

Authorities' Views

42. The authorities noted that fiscal policies had been successful in mitigating the economic and social impact of the Covid-19 pandemic. Targeted social transfers had been established quickly and alleviated the loss of employment and income for formal and informal workers alike. This had also helped mitigate the impact of the pandemic on reversing the progress

[9] The government's medium-term tax projections do not envisage a significant increase in the revenue-to-GDP ratio above pre-Covid levels.

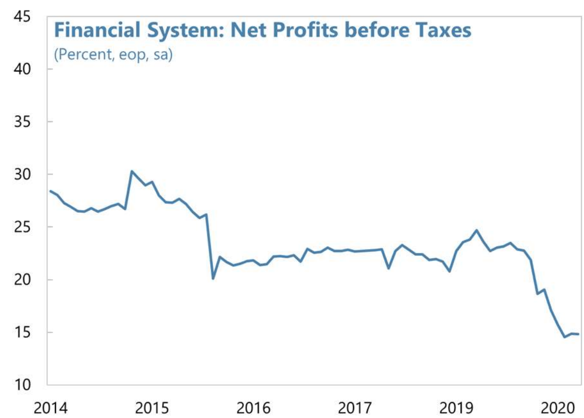
[10] See Paraguay - Country Partnership Framework for the Period FY19-FY23.

Paraguay had made in reducing income inequality. The accelerated execution of public investment and construction projects further contributed to stabilizing employment and economic activity.

43. They emphasized the importance of bringing the fiscal deficit back to the FRL ceiling. Reducing deficits was important, as public debt had been rising rapidly in recent years. Their strategy focused on expenditure consolidation, which would be made feasible by state and civil service reforms that would boost the efficiency of the public sector. The tax reform of 2019 had streamlined the system, but its revenue impact was modest and would be felt gradually only. Further revenue measures would be considered only after they had implemented the reforms on the spending side. They also agreed with the need for parametric pension reform and noted that they were in the process of preparing reform roadmaps, both for the *Caja Fiscal* as well as for the broader private-sector pension system.

B. Monetary and Exchange Rate Policy

44. The room for further policy rate cuts is limited, as policy rates are already below 1 percent. Moreover, a further reduction in interest rates may further depress bank profitability, which has fallen sharply this year. In the case of a downside scenario where a second or third wave of the pandemic would significantly affect economic activity, fiscal policy would be a more important instrument for alleviating the downturn.



Sources: Haver analytics.

45. Inflation has been increasing since June and is projected to return to the target band in 2021, aided by the rebound in activity and the depreciation of the guarani. The pickup of soybean prices in recent months may further help; traditionally soybean price increases have been associated with higher inflation. It is likely that inflation will be close to the lower bound of the target, as it has been most of the time since 2015.

46. Paraguay's exchange rate did not come under pressure during the global markets turmoil in March and April,[11] but it has depreciated by about 8 percent vis-the US dollar since April. The initial stability likely reflects the absence of foreign investors in domestic currency-denominated assets, which helped avoid the large portfolio outflows that neighboring countries experienced, and the issuance of a US$1 billion bond by the government, which boosted supply in the FX-market. The more recent depreciation may be a correction to the sharp appreciation vis-à-vis neighboring currencies that occurred during the turmoil in the spring.

[11] The stability likely reflects the absence of foreign investors in domestic currency-denominated assets, which helped avoid the large portfolio outflows that neighboring countries experienced.

47. There was, however, a severe risk premium shock in the spring, similar to other countries in the region, with a sharp rise in the EMBIG sovereign spread, and the yield on US-dollar denominated government bonds jumped by 300 basis points. Interest rates on foreign currency-loans to the private sector rose sharply in April.

48. Bank credit fell in the Spring but has since rebounded. The initial decline likely reflected a decline in both credit *supply (*due to banks' desire to hoard liquidity in the face of uncertainty) and credit *demand*. Subsequent central bank policy actions to improve liquidity provision (see par. 9) may have helped restore the flow of credit, while credit demand picked up as the economy reopened.

49. Foreign exchange sales by the central bank this year largely consisted of on-selling of the government's dollar-denominated revenue and bonds proceeds.[12] Foreign exchange sales

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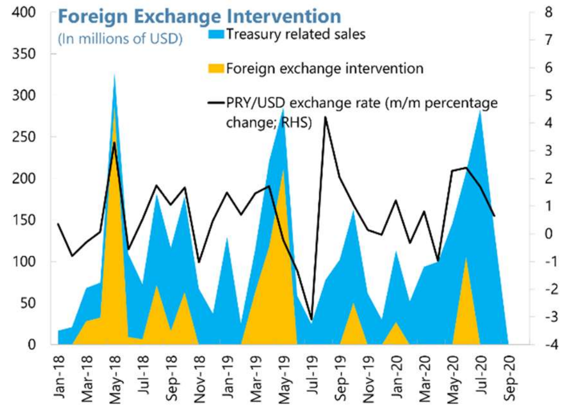
[12] The BCP is the Treasurer for the government's foreign exchange proceeds. When the government issues a foreign currency denominated bond or when it receives FX income from the Binationals, the dollar proceeds are deposited at

(continued)

aimed at preventing disorderly market conditions have been lower than in previous years. With a shallow foreign exchange market (daily transactions average around US$50 million only), the central bank's declared policy is to intervene only to prevent disorderly market conditions. Reserves have increased as a result of the two sovereign bond issuances, and as of December were at 213 percent of the IMF's reserve metric.



Sources: Ministry of Finance, BCP and IMF staff calculations.

50. Paraguay's external position in 2019 was stronger than implied by economic fundamentals and desirable policies (see Annex II). From a saving-investment perspective, the lower current account deficit than the norm is the result of lower investment levels—not higher saving. If economic reforms were to lead to an improvement of the business climate and governance, capital inflows and investment would pick up, and the gap with the current account "norm" would close. For 2020, the external position is likely to be stronger than implied by economic fundamentals as well, although the only partial availability of data and the impact of the Covid-19 shock makes this judgement subject to large uncertainty.

51. External stability risks remain contained. The net international investment position deteriorated somewhat in 2019. Externally issued government bond debt has increased steadily since 2012 and currently stands at US$5.4 billion; 15 percent of GDP. The external debt sustainability analysis shows that the debt trajectory is overall robust to standard shocks.

Authorities' Views

52. In the authorities' view, the strong monetary policy actions during the Spring had played an important role in mitigating the impact of Covid-19 on the economy. They thought that the current policy stance provided sufficient stimulus for the recovery, but there was still some room to further reduce interest rates if downside risks materialized. They were not concerned about the compression of interest rate margins this year and did not expect interest rate margins to bounce back in the future.

53. The authorities explained that the decline in FX-denominated credit growth this year was mainly the result of demand side factors. With a good harvest, the agricultural sector (which is the main user of FX-denominated credit) had been paying back outstanding loans to banks, and used new loans from other funding sources (such as trade credit from suppliers), which were more readily available this year given the good harvest. The reduction in imports due to lower aggregate

the central bank. Over time, the proceeds are sold to the private sector. The BCP refers to these sales as the "ventas compensatorias." Foreign exchange sales that are aimed at preventing disorderly market conditions are referred to as "ventas complementarias." In practice, the difference between the type of sales is not as clear-cut, as the timing of the "ventas compensatorias" also depends on market conditions.

demand had further dampened the demand for FX credit. Growth of domestic currency-denominated credit had been relatively stable this year, growing at around 10 percent.

54. The authorities attributed the stability of the exchange rate in the Spring to the FX sales from the sovereign debt issuances. Going forward, they expected the exchange rate to move in line with underlying fundamentals.

C. Financial Sector Policy

55. According to FSI indicators, the banking system is well capitalized and NPLs are low, but policy actions to secure the flow of finance during the crisis make it difficult to assess to what extent these statistics are reflective of the underlying situation. The non-performing loan ratio is modest, at 3.0 percent, and the Tier I capital-to-asset ratio is at 14.9 percent—well above the regulatory minimum of 8 percent. However, the underlying situation is likely to be worse: a third of all loans has been renewed, refinanced, or restructured, and it is unclear how many of these loans will eventually become nonperforming, especially if the pandemic impact lingers longer than expected.[13]

56. Supervisory activities should continue to focus on assessing underlying asset quality including under adverse shocks to ensure that future capital and liquidity buffers will be appropriate. Information on loan restructurings will be critical for assessing rescheduled or delayed loan payments once the forbearance ends. If a problem emerges in the quality of restructured loans, supervisors will need to focus on restoring capital and liquidity positions of financial institutions. To adjust policies effectively, it is key to adopt a comprehensive stress testing program that would also delineate the solvency risks.

57. Good progress has been made with implementation of the FSSR recommendations. One of the key successes was the establishment, by a decree issued in July 2019, of the National Financial Stability Committee. The SIB has also consolidated its approach to risk-based supervision, documented its Supervisory Policy and Process (SPP), revised its supervisory risk matrix, and finalized several internal guidelines. Work has also progressed on strengthening the stress-testing framework for the banking sector and, for the first time, introducing stress-testing and conducting training for the INCOOP, the regulator of financial cooperatives (credit unions). However, efforts to re-organize and strengthen supervisory systems in the Superintendency of Insurance have been delayed due to Covid-19. Efforts to upgrade systemic risk assessments, crisis resolution and to upgrade anti-money laundering systems in preparation for the GAFILAT assessment have also been delayed, as IMF TA was postponed because of the pandemic.

58. The extension of supervision to the non-bank financial sector remains a work in progress. A study initiated by the central bank to evaluate the scope and feasibility of implementing the supervisory regime for the *casas de crédito*, which are largely unregulated, is still underway.

[13] The restructuring, refinancing and rewnewing occurred not only during the Covid-19 epidemic but also during the bad harvest in 2019.

Given the large number of institutions involved, it might be more effective to group all the individual institutions into one association, which could then be supervised by the BCP. Strengthening the institutional and crisis preparedness frameworks and improving the deployment of macroprudential tools will be also be key going forward. The IMF will provide TA on bank resolution and the deposit guarantee fund in FY21.

59. Several AML-CFT laws have been passed in preparation for the upcoming GAFILAT AML/CFT assessment. The authorities have been concerned about the potential impact of the upcoming GAFILAT anti-money laundering review on the financial sector, in particular correspondent banking relationships. To mitigate this risk, several laws have been amended to further strengthen AML/CFT provisions. The GAFILAT assessment, which is delayed owing to the COVID-19 crisis, will focus mainly on the effectiveness of the AML/CFT regime established to prevent money laundering and fight terrorist financing.

60. Pension fund supervision should also be strengthened. Currently, there is no regulatory oversight of their activities. There are legal restrictions on pension funds' assets allocations (which prohibit investment in government bonds), but these have led to low-yielding pension fund investments, mainly short-term claims on banks. Introducing a pension fund supervisor and abolishing legal restrictions would help safeguard the public's long-term savings and more effectively channel long-term savings into investment, and also give a boost to the domestic capital market.

Authorities' Views

61. The authorities did not expect a sharp increase in NPLs as a result of the Covid-19 crisis. They also had not seen any significant concentration of covid-related exposure in the banking sector. They acknowledged, however, that it was difficult for supervisors to distinguish between liquidity and solvency risks and agreed that continued monitoring and data collection were essential to keep abreast of the underlying situation. They also aimed to further improve their stress test capabilities, for which forthcoming IMF TA would be helpful. At the time of the mission, the authorities had not yet taken a decision about an extension of the forbearance measures beyond the end of 2020. They explained that this would depend also on what happened with the Covid-19 pandemic. At the end of 2020, they extended the measures to end-June 2021.

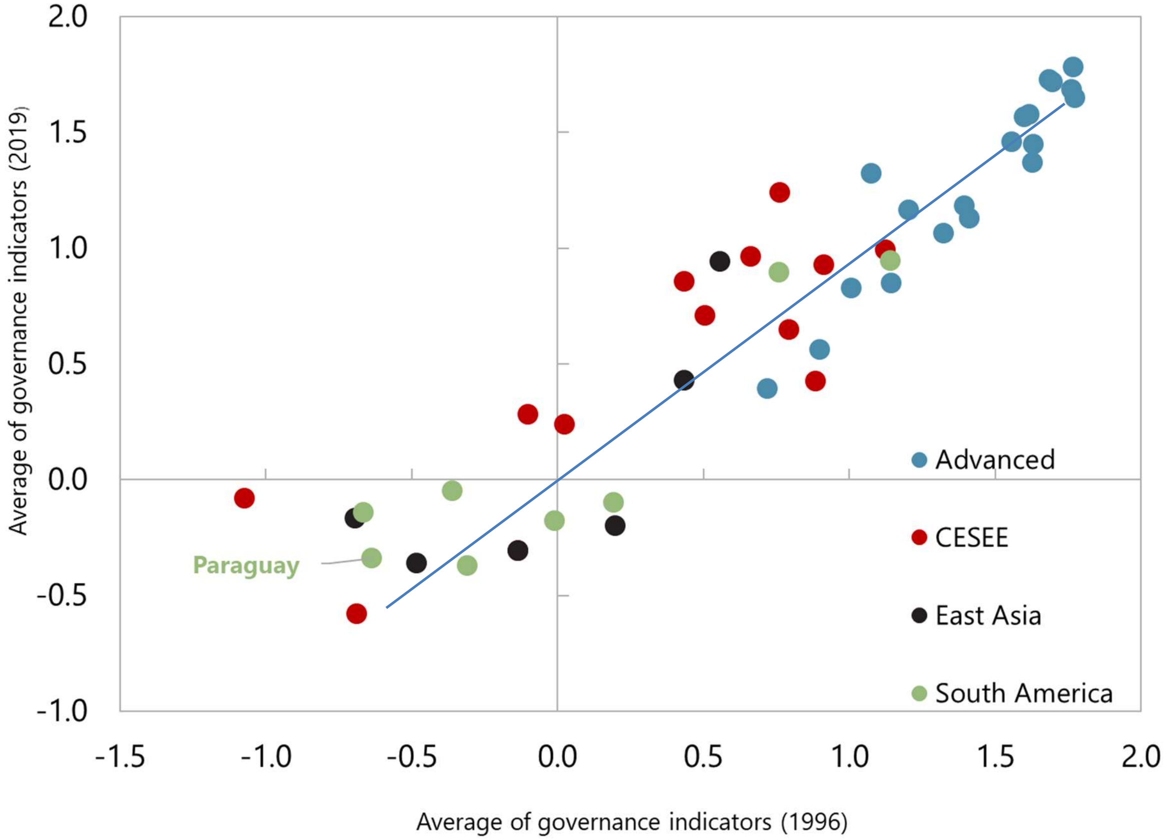
D. Governance

62. Paraguay has seen an improvement in governance indicators the past two decades, but the *levels* remain low, including by regional standards (text Figure).[14] Key governance institutions and processes are incipient and fragmented, and political influence has hampered

[14] 2016 Transparency International brief on Paraguay concluded that "…corruption in Paraguay is widespread and involves multiple sectors of government and private enterprise).

progress in strengthening civil service rules and procedures. These vulnerabilities open spaces for inefficiency and corruption in core state functions.[15]

Changes and Average Levels of Worldwide Governance Indicators, Grouped by Region



Source: Worldwide Governance Indicators and IMF staff calculations.

63. In early 2020, an IMF mission with support from the IABD identified the following governance problems:

- **Administrative capacity is weak and fragmented.** Institutional and procedural fragmentation creates excessive red-tape, unnecessary public-private interactions, loopholes and exceptions, and poor coordination and information exchange across control agencies.[16] This hampers control over public funds and undermines effective combat of money and asset laundering. The civil service suffers from a clientelist tradition.

[15] Core functions with significant vulnerabilities include the regulatory framework, fiscal governance; financial sector oversight, money laundering prevention, protection of the rule of law, and anti-corruption.

[16] For example, Contraloría, Anti-Money Laundering State Secretariat (SEPRELAD) and National Institute of Cooperatives (INCOOP).

- **The perception of impunity, created mostly by an ineffective judicial system, generates distrust in the governance institutions**, reinforcing a lenient social norm towards corruption. There is large uncertainty about the outcome of legal cases against the public sector, the result of a judicial branch that is poorly designed, outdated, and perceived as corrupt and vulnerable to political intervention.

- **The tax and customs administrations are afflicted by institutional weaknesses and corruption cases due to a discretionary legal framework.** For example, customs officials that were separated due to allegations of corruption or severe underperformance found ways to sue themselves back into service through the judicial system. The customs code is outdated, and the customs needs more cooperation with other agencies to effectively combat smuggling.

- **Public Financial Management suffers from** problems in the SOEs and public procurement management and lack of effective oversight from internal and external audit institutions.

- **Smuggling, counterfeiting, money laundering**, trade of illicit goods (drugs and guns), and weak enforcement of the laws facilitate corruption and the laundering of proceeds from illegal activities related to the Triple Frontier (Paraguay, Brazil, Argentina).

64. The report includes recommendations to address vulnerabilities related to the fragmentation of institutions and processes. These include establishing a medium-term governance strategic plan to increase coordination across governance agencies; promoting transparency and efficiency of governance procedures and establishing a legal integrity framework for the whole public service; and reviewing, automating, and integrating governance processes across the public administration in particular by strengthening internal and external control. Regarding the rule of law, the judicial system should be strengthened to ensure effective control of administrative acts and regulations. A joint approach by the executive and judicial branches in fighting corruption could be a very powerful tool to reinforce Paraguay's commitment to advancing its governance reforms.

65. It also includes recommendations to strengthen fiscal governance institutions and processes:

- **Tax and Customs Administration**: make the access to management positions more transparent and the internal control function more independent; simplify processes, reduce ad-hoc interventions, and avoid transactions outside IT systems; increase information exchange across institutions to combat smuggling; strengthen the enforcement collection process.

- **Special Tax Regimes**: eliminate participation of private sector representatives with conflict of interest in councils deciding on tax benefits; assess the cost-benefits of existing tax regimes; establish all core tax elements in law (instead of delegating discretion to the executive branch).

- **Public Financial Management**: reduce institutional fragmentation and increase coordination across agencies that have a leading role in governance—notably procurement and investment governing entities; establish a fiscal risk unit and reinforce the oversight over State Owned Enterprises (SOE) (in particular Itaipú and Yacyretá); undertake a comprehensive audit on FONACIDE; improve the information exchange between the two binational SOEs and the Ministry of Finance on the use and beneficiaries of the "social funds" financed by these entities; and establish mandatory use of the single treasury account by all 17 provinces.

66. The approval of a governance and anti-corruption plan as recommended in the IMF report will help ensure continuation of reforms. SENAC (the National Anti-Corruption Secretariat) has amended the current Government National Plan on Integrity, Transparency and Anticorruption, incorporating a large number of recommendations suggested in the IMF's Governance Assessment report both at the strategic and the institutional level. The new plan was presented by the government to the public on December 9. However, the SENAC's capacities and role within the regulatory framework need to be strengthened further.

Authorities' Views

67. The authorities agreed on the need to continue with reforms to improve the governance and anticorruption framework. They noted that some of the measure taken to ensure the integrity of the COVID-19 spending have contributed to strengthening the governance and anti-corruption framework. The recently adopted new Plan for Integrity, Transparency and Anticorruption would ensure further progress over the medium term.

STAFF APPRAISAL

68. Before the Covid-19 pandemic hit, Paraguay's economy was rebounding from the 2019 downturn, and growth was expected to be strong in 2020. An early lockdown—which kept the death toll low by regional standards—halted the recovery and led to a sharp drop in activity. Swift and forceful government action helped contain the health, social and economic impact of the crisis. Paraguay's external position is stronger than the level implied by fundamentals and desirable policies, and external stability risks are contained.

69. In the near term, the focus will be on recovering from Covid-19, trying to revive activity, and recovering lost ground in important areas such as poverty reduction and education. The social damage from the epidemic will likely be considerable, while children's education is affected by an almost full year's closing of most schools.

70. It is important to keep fiscal policy under review so as not to withdraw fiscal support prematurely. If the Covid-19 epidemic were to significantly worsen, more spending on health care and social protection would be needed. In case of a negative weather shock, tax revenues would likely disappoint. In all these cases, it would be important to protect investment; and the reduction of the deficit in 2021 would need to be commensurately smaller. Further easing of monetary policy could provide additional, albeit modest, support.

71. Beyond 2021, the government's goal to return the deficit to the FRL ceiling by 2024 is appropriate. Returning to the ceiling is important for maintaining the macroeconomic stability that has served the country well. It would be useful to codify the new target date for return to the deficit ceiling in an updated version of the Fiscal Responsibility Law, along with stricter limits on growth of current spending.

72. Tax revenue needs to be raised. The government's focus on making government spending more efficient is certainly appropriate. But its contribution may not be enough to reduce the deficit sufficiently, let alone create room for much needed other spending in areas as education and infrastructure. While further curbing tax evasion would help create additional resources, the near-term scope is likely to be modest.

73. To foster growth, Paraguay will need to continue with its policies focused on macro-economic stability, but also improve governance, business climate, and human capital. Efforts are also needed to further reduce social inequality and improve education, and risks emanating from climate change need to be addressed This would also help diversify the economy and reduce its dependence on the agricultural sector. Cheap and green hydro-energy is abundantly available and using more of it domestically would have a greater value added for the economy than exporting it at low prices.

74. The government's Economic Recovery Plan is appropriately focused on these issues. It not only comprises measures to strengthen the near-term recovery in 2020 and 2021, focusing on social protection, continued high public investment, and financing for the private sector, but also contains many reforms to boost longer-term growth. These include plans to improve governance and increase efficiency of public spending; improve the business climate; and facilitate new business creation and formalization of existing businesses.

75. The actions being undertaken to address Paraguay's governance weaknesses and tackle corruption are encouraging, but continued efforts are vital. Several measures were introduced to monitor the appropriate use of emergency funds disbursed during the first phase of the Covid-19 crisis. Following the IMF's governance assessment mission in early 2020, the government is implementing plans to reform civil service and public procurement process, as well as measures to strengthen fiscal institutions and processes.

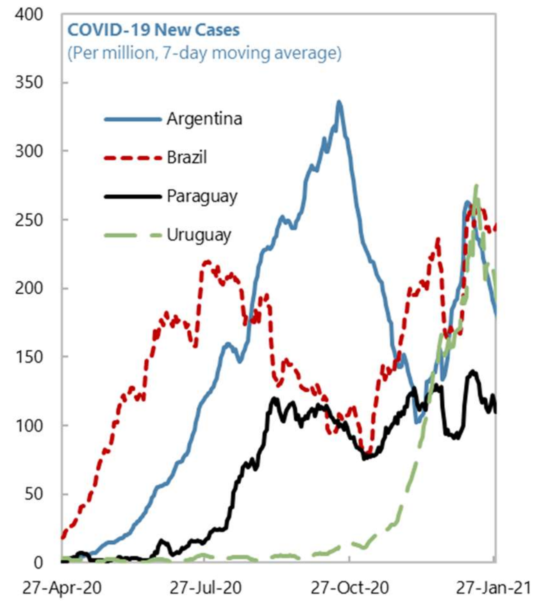
76. Continued monitoring and data collection of the banking system are needed to better assess the crisis' impact. According to Financial Stability indicators, the banking system is well capitalized and NPLs are low. However, policy actions to secure the flow of finance during the COVID-19 crisis make it difficult to assess to what extent these data correctly reflect the underlying situation. A continuous assessment of asset quality, including under adverse shocks, will help ensure that future capital and liquidity buffers will remain appropriate.

77. The pension system requires supervision and needs to be reformed. Introducing a pension fund supervisor would help safeguard the public's long-term savings. In the medium term, the pension systems for both private and public employees require parametric adjustments—the former one can be reformed taking advantage of Paraguay's demographic window of opportunity, but the latter one is severely underfunded and requires even more urgent reforms.

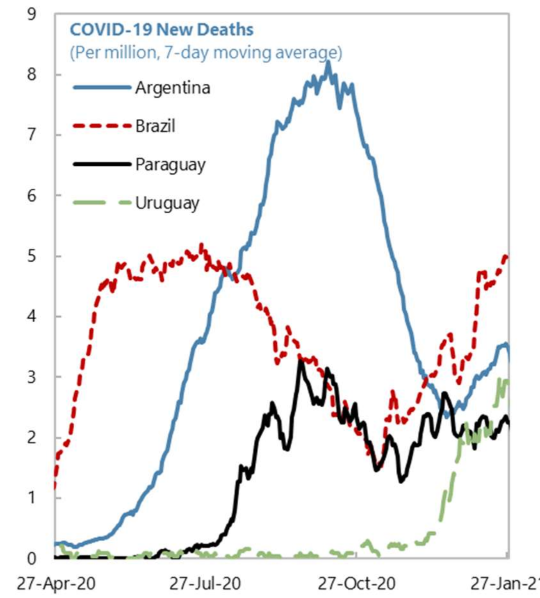
78. Staff proposes that the next Article IV consultation with Paraguay follows the standard 12-month cycle.

Figure 1. Paraguay: Covid-19 Progression

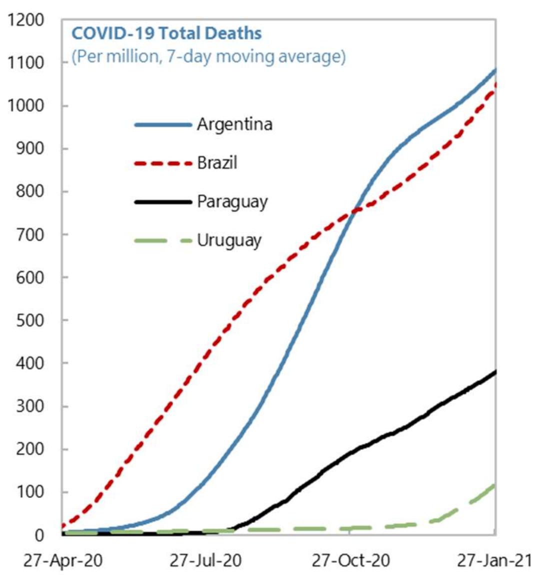
Case number was initially low, but has picked up since July…



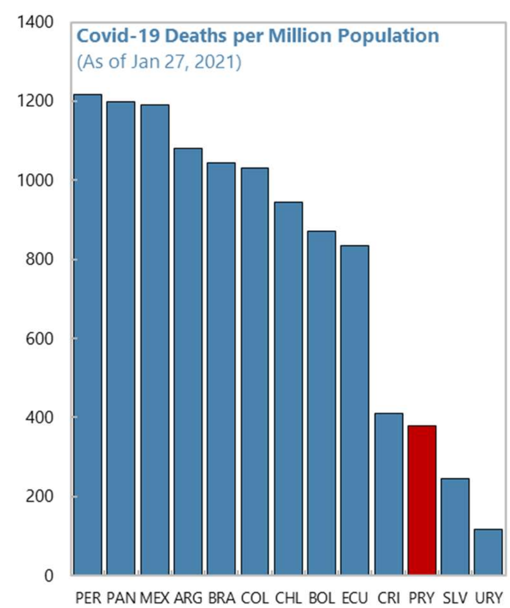
…and new death count has increased substantially as well.



Although total deaths are still much lower than Paraguay's larger neighbors…



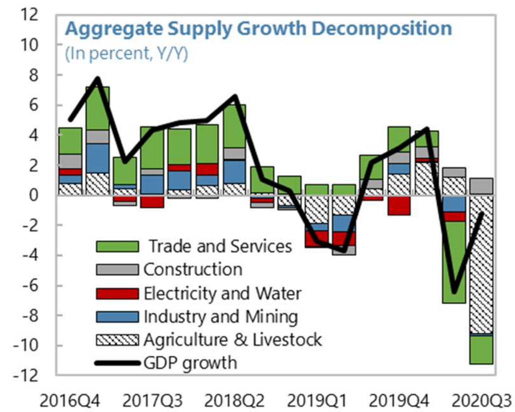
…deaths per million is one of the lowest in the LAC region.



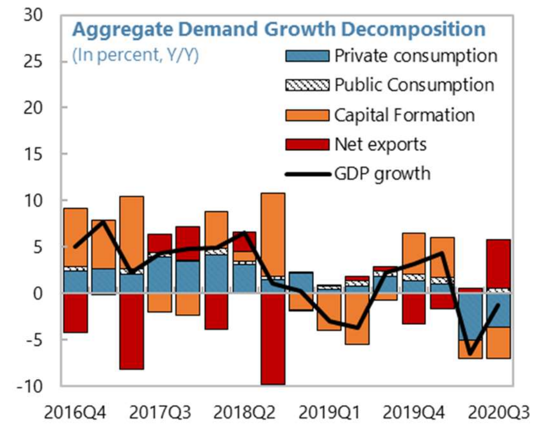
Sources: Global mobility report, Google open data, John Hopkins University; and IMF staff calculations.

Figure 2. Paraguay: Recent Developments

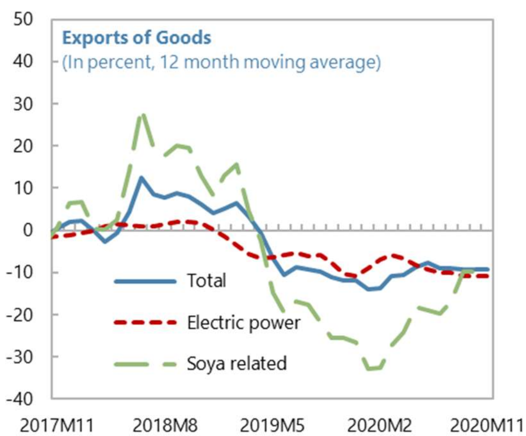
The pandemic had a significant impact on growth in Q2, 2020, especially in services and manufacturing…



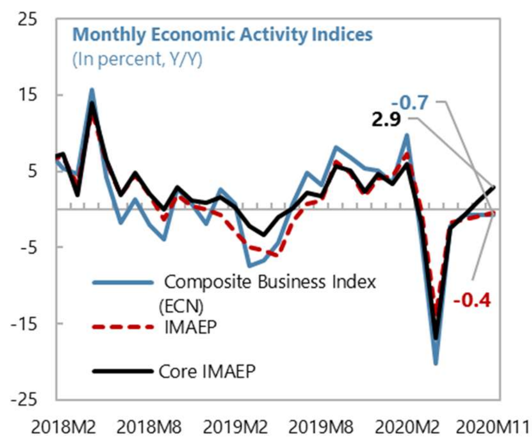
Private consumption and investment were both hard hit.



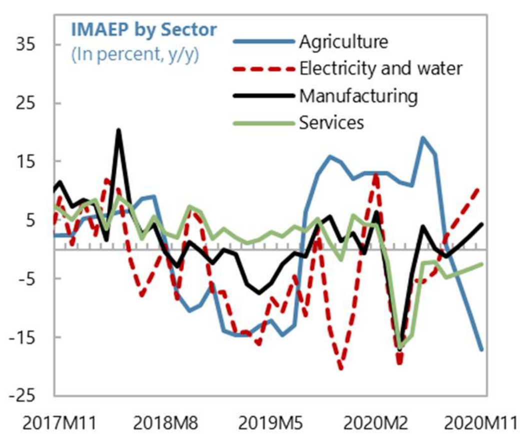
The recovery in agricultural exports mitigated the negative growth impact of COVID-19.



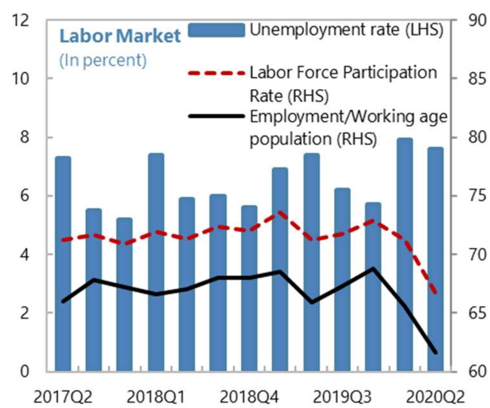
The economy started to bounce back in May, 2020…



…and the recovery seems broad-based across all sectors.



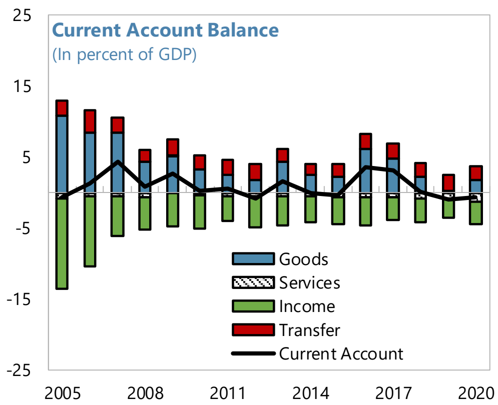
Unemployment increased sharply during the pandemic while labor force participation went down.



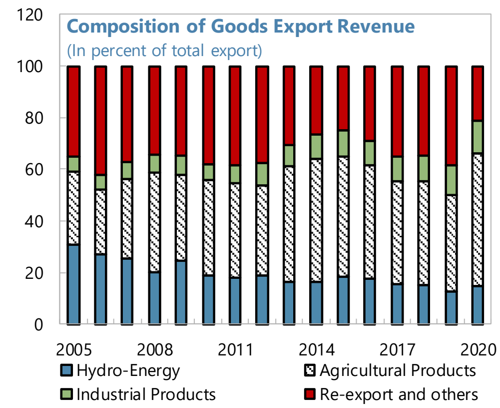
Sources: BCP, Ministry of Finance and IMF staff calculations.

Figure 3. Paraguay: External Sector

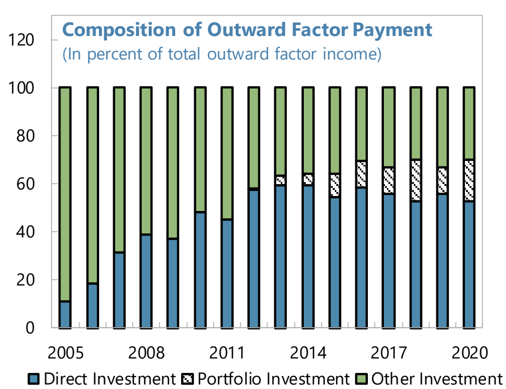
The current account has been stable…



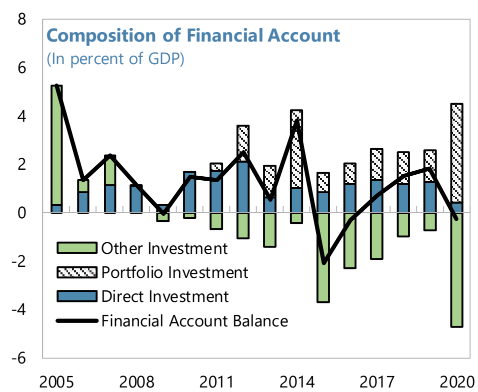
…as agricultural exports are holding up.



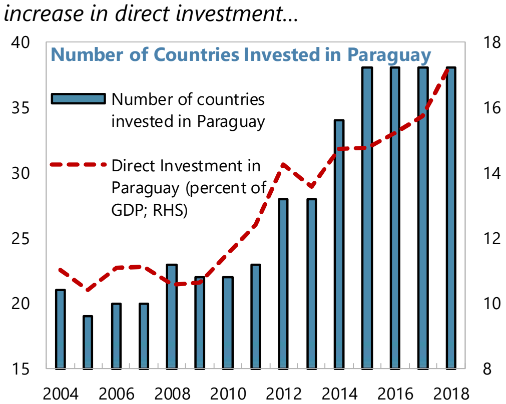
Profit payments continue to be the major source of outward factor payments…



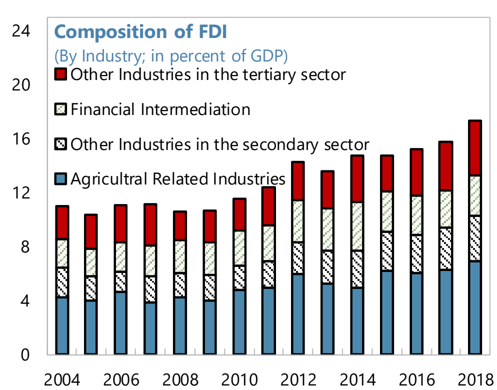
…but the government's overseas bond issuance has become a significant source of foreign capital in the last few years and in 2020.



The foreign investor base is expanding along with the increase in direct investment…



A large portion of foreign capital has invested in agricultural related industries, from production to trade.

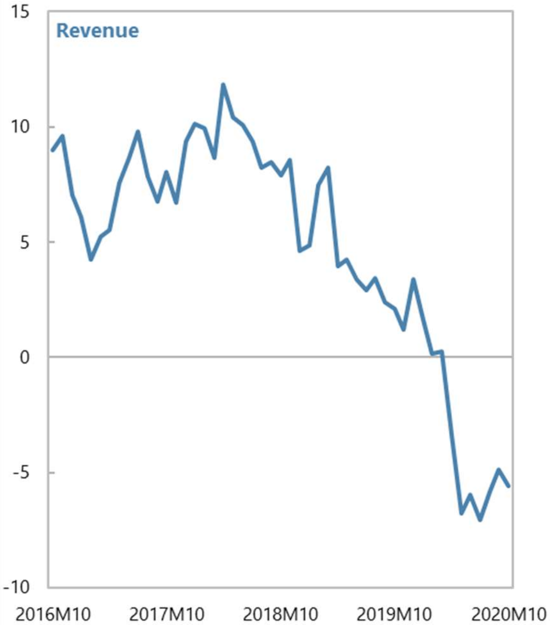


Sources: BCP, Ministry of Finance and IMF staff calculations.

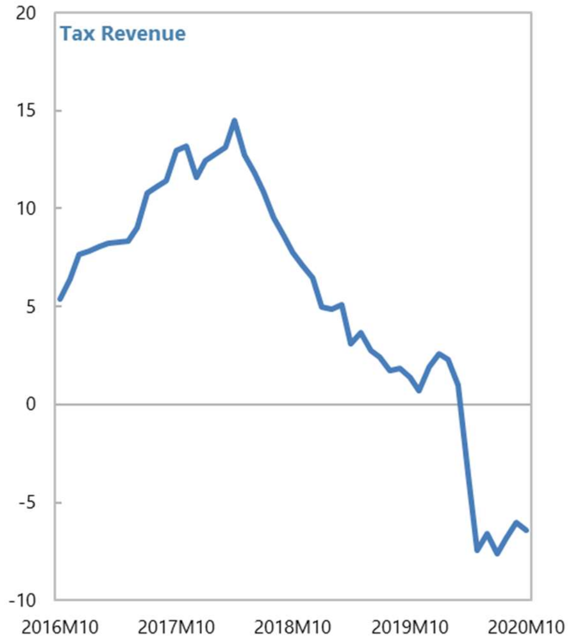
Figure 4. Paraguay: Revenue and Expenditure

(Growth rate of last 12 months over previous 12 months)

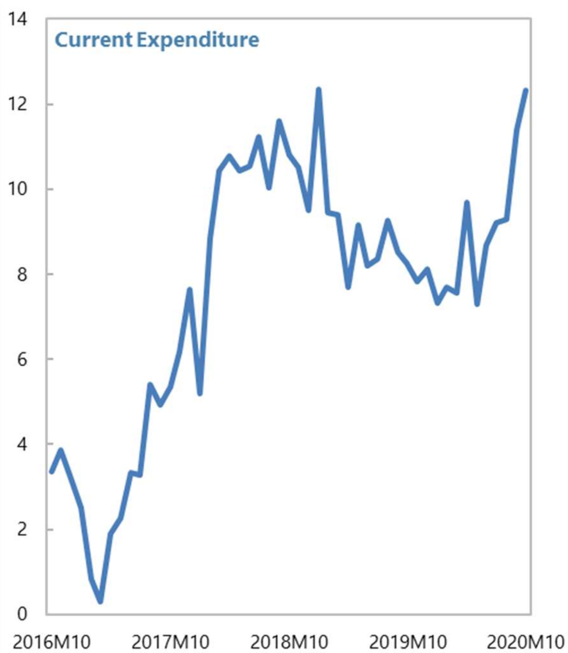
Fiscal revenue was badly hit by the pandemic…



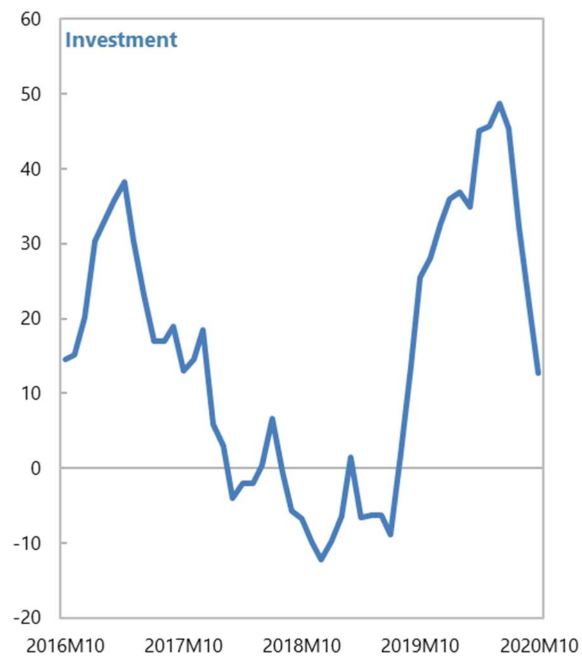
…mostly on behalf of tax revenue.



Current expenditure growth remains at high levels…



…and there has been a jump in public investment.

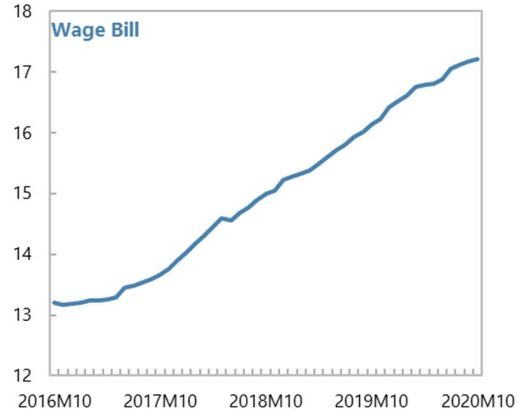


Source: WEO database.

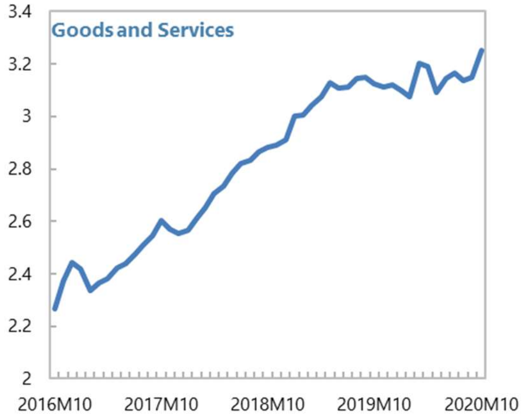
Figure 5. Paraguay: Expenditure

(Twelve month moving total)

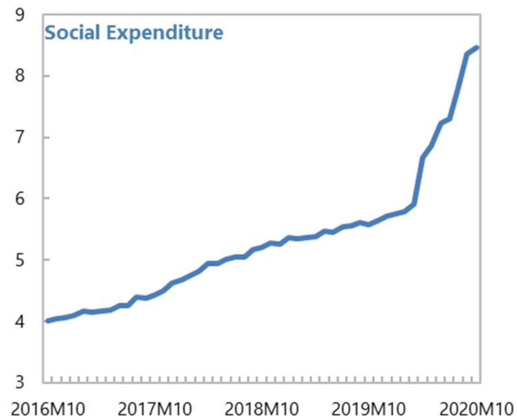
The rise in wages during the pandemic extends a trend that started earlier…



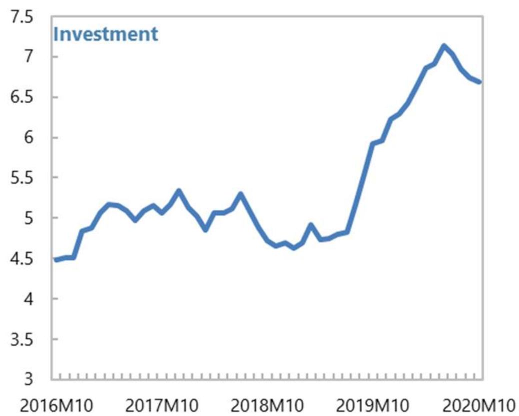
…whereas purchases of goods and services have stabilized.



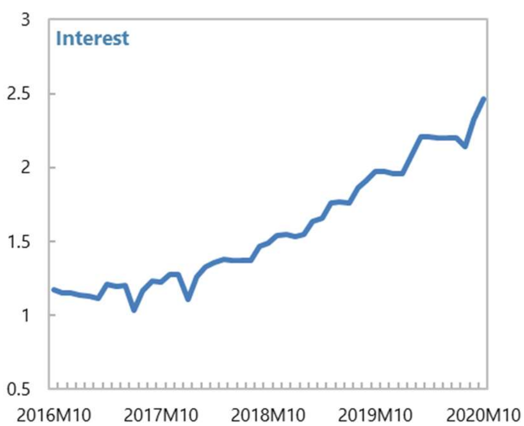
Social expenditure increased as a response to the pandemic….



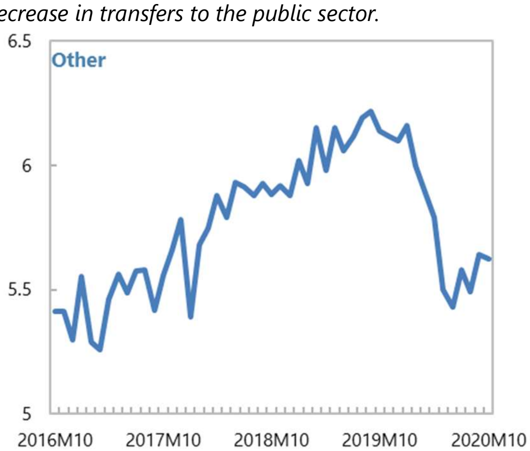
….as did public investment.



With rising debt, the interest bill has been increasing, too…



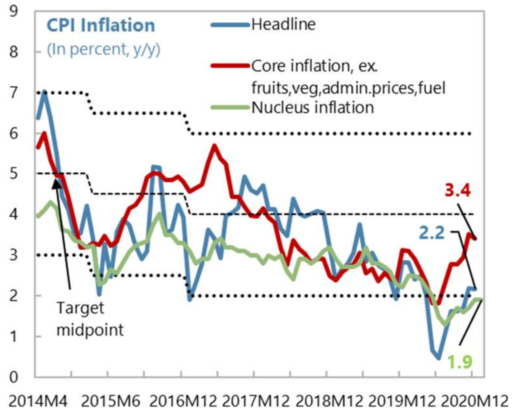
….whereas other expenditure went down on behalf of a decrease in transfers to the public sector.



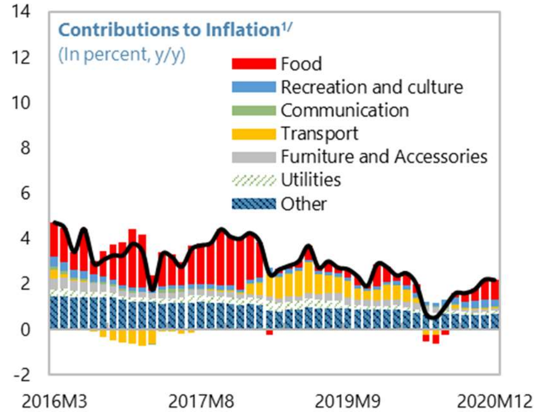
Source: CEIC database.

Figure 6. Paraguay: Monetary Indicators

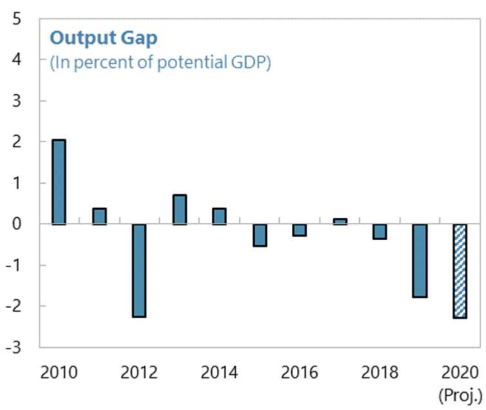
Inflation declined to historical lows in the first two quarters of 2020, before bouncing back in June…



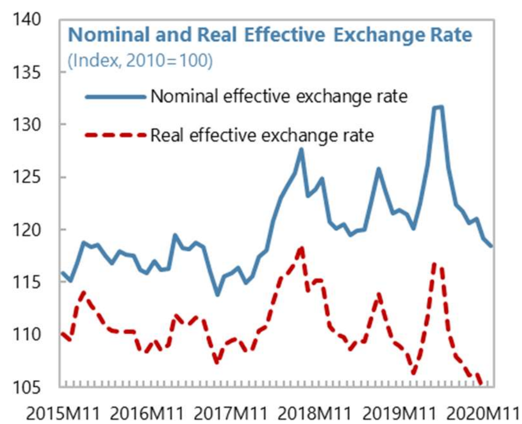
The drop was led by significant declines in food and fuel prices.



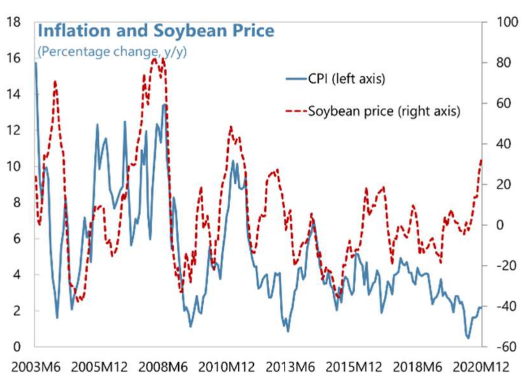
The large negative output gap also suppressed inflation.



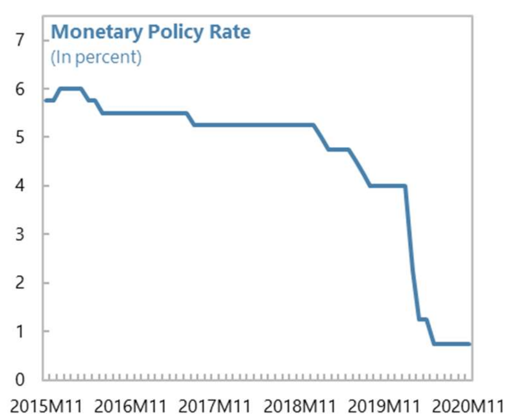
So did appreciation against regional trade partners in the first half of the year.



The uptick in soybean prices may help boosting inflation to some extent going forward.



The central bank this year lowered the monetary policy rate to historic lows.

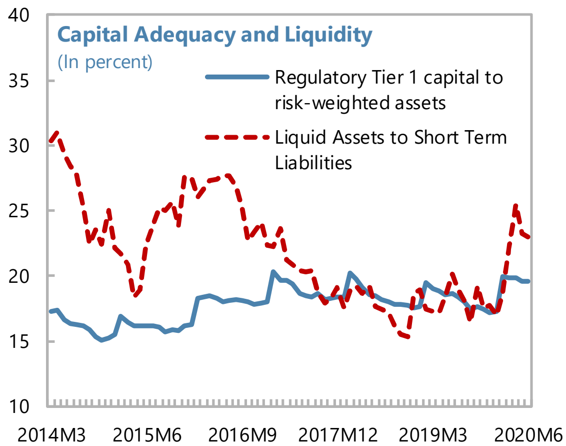


Sources: BCP, Ministry of Finance and IMF staff calculations.

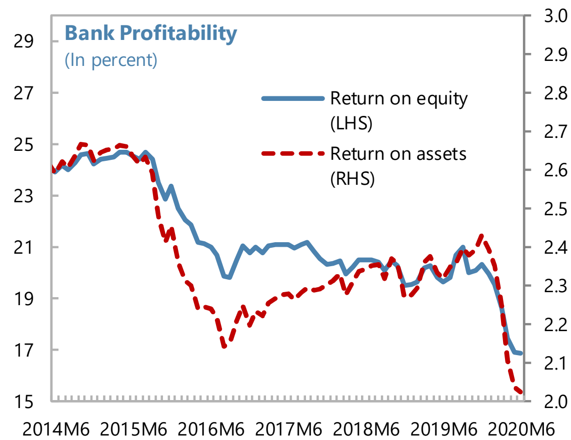
1/ Includes alcoholic beverages, tobacco, apparel, health, education and hospitality.

Figure 7. Paraguay: Financial Sector Development

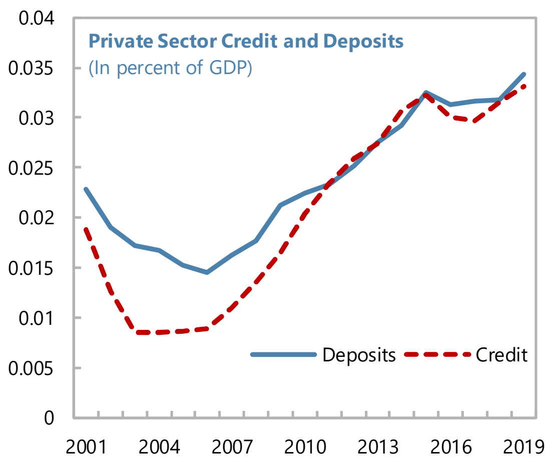
According to FSI indicators banks are liquid and well capitalized.



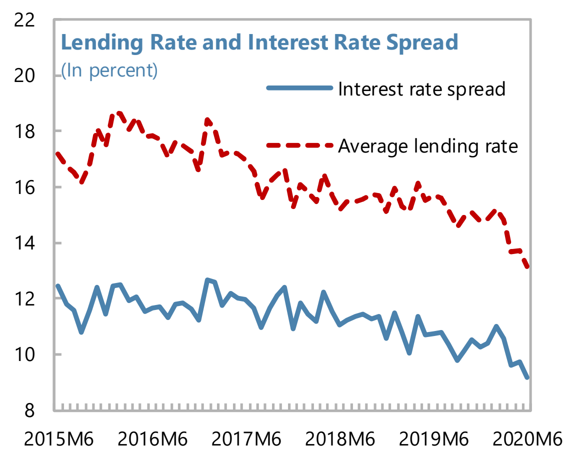
Bank profitability has fallen this year.



Private sector credit declined in the first part of the year but has since rebounded.

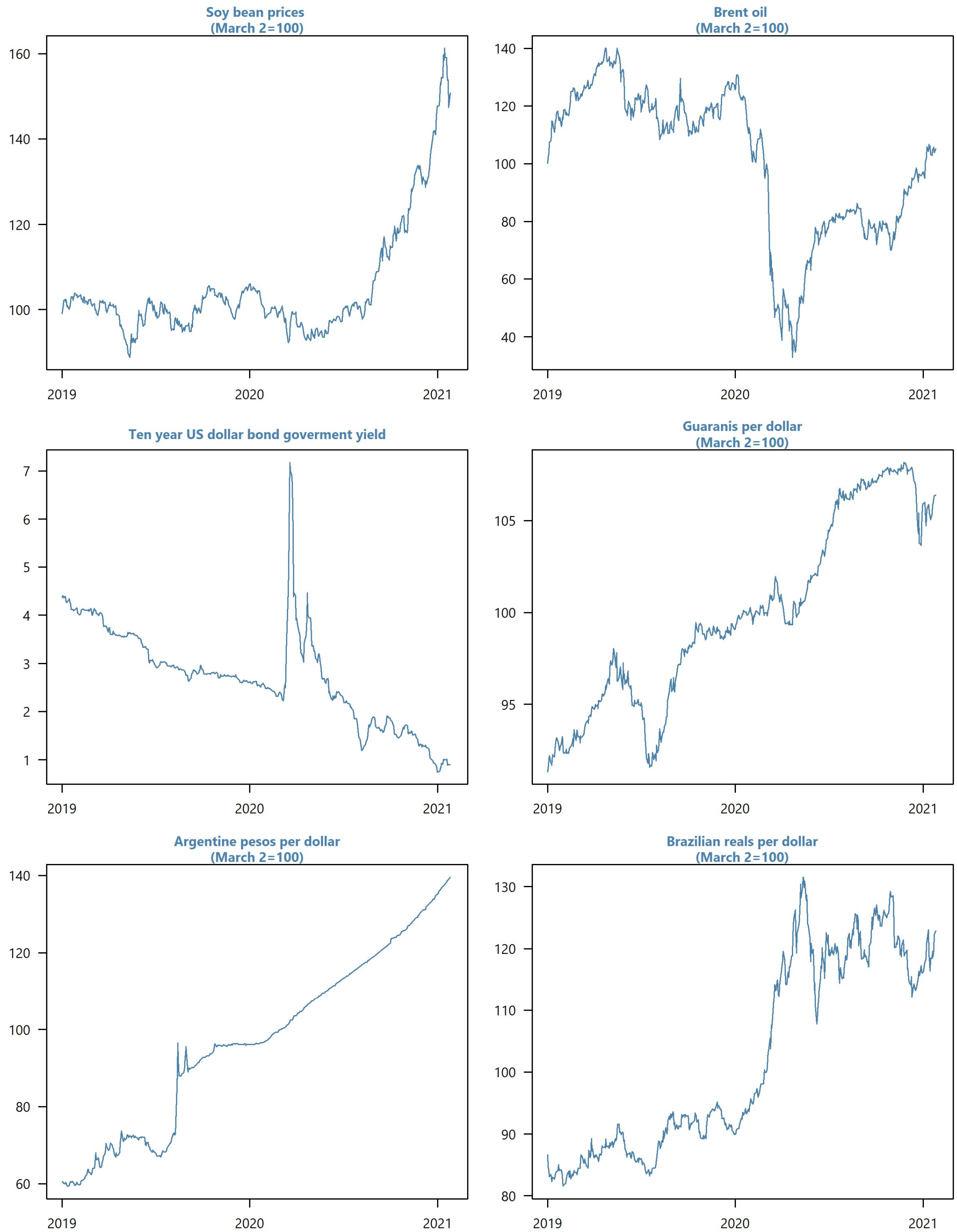


Lending and interest rates spreads continue to come down.



Sources: BCP, Ministry of Finance and IMF staff calculations.

Figure 8. Paraguay: Financial Indicators



Source: Bloomberg.

Table 1. Paraguay: Selected Economic and Social Indicators

I. Social and Demographic Indicators

Population 2018 (millions)	7.1	Gini index (2018)	46.2
Unemployment rate (2019)	6.5	Life expectancy at birth (2018)	74.1
Percentage of population below the poverty line (2018)	24.2	Adult literacy rate (2018)	94.0
Rank in UNDP development index (2019)	98 of 189	GDP per capita (US$, 2019)	5,451

II. Economic Indicators

			Prel.			Proj.			
	2017	2018	2019	2020	2021	2022	2023	2024	2025
			(Annual percent change, unless otherwise indicated)						
Income and prices									
Real GDP	5.0	3.4	0.0	-0.9	4.0	4.0	4.0	3.5	3.5
Nominal GDP	7.2	5.6	2.8	2.9	9.5	6.9	7.6	6.8	6.8
Per capita GDP (U.S. dollars, thousands)	5.7	5.7	5.3	5.0	5.2	5.5	5.7	6.0	6.2
Consumption (contribution to real GDP growth)	3.1	3.1	0.4	-2.2	4.4	3.9	2.7	2.7	2.4
Investment (contribution to real GDP growth)	2.5	2.5	-0.4	-0.1	1.4	0.7	0.9	0.8	1.0
Net Exports (contribution to real growth)	-0.7	-2.2	0.0	1.4	-1.8	-0.6	0.4	0.0	-1.5
Consumer prices (end of period)	4.5	3.2	2.8	2.3	3.5	3.5	3.5	3.5	3.5
Nominal exchange rate (Guarani per U.S. dollar, eop)	5,590	5,961	6,453	…	…	…	…	…	…
Monetary sector									
Credit to private sector 1/	4.9	14.1	9.7	5.7	8.1	5.7	5.4	5.6	5.7
Monetary policy rate, year-end	5.3	5.3	4.0	…	…	…	…	…	…
External sector									
Exports (fob, values)	11.8	3.2	-9.3	-13.7	27.0	7.3	7.5	4.4	4.1
Imports (cif, values)	17.8	12.1	-4.6	-23.5	30.2	12.6	6.0	4.9	4.5
Terms of trade	-1.9	-1.6	-4.9	2.9	7.2	-1.2	0.3	-0.5	-0.5
Real effective exchange rate 2/	-0.8	3.2	-3.0	…	…	…	…	…	…
			(In percent of GDP, unless otherwise indicated)						
External current account	**3.1**	**0.0**	**-0.6**	**1.4**	**1.5**	**0.3**	**0.8**	**0.6**	**0.4**
Trade balance	4.1	1.4	-0.3	2.5	2.8	1.6	2.1	1.9	1.7
Exports	34.3	34.2	32.9	29.8	36.0	36.4	36.7	36.3	35.9
Of which: Electricity	5.4	5.2	4.5	4.4	4.3	4.2	4.0	3.9	3.8
Imports	-29.5	-32.0	-32.3	-26.0	-32.2	-34.1	-33.9	-33.7	-33.5
Of which: Oil imports	-3.0	-4.0	-3.5	-2.5	-2.8	-2.8	-2.8	-2.8	-2.7
Capital account and financial account	**1.1**	**1.9**	**2.2**	**2.2**	**-0.8**	**0.5**	**1.0**	**1.3**	**1.4**
Of which: Direct investment	1.3	1.2	1.2	0.4	0.7	1.0	1.1	1.0	1.0
Gross international reserves (in millions of U.S. dollars)	**8,145.7**	**8,004.0**	**7,996.1**	**8,496.1**	**8,496.1**	**8,496.1**	**8,996.1**	**9,546.1**	**10,096.1**
In months of next-year imports of goods and services	6.9	7.1	8.9	7.5	6.7	6.4	6.4	6.5	6.6
Ratio to short-term external debt	2.6	2.2	2.2	2.2	2.2	1.8	2.2	2.4	2.5
Gross domestic investment	**21.2**	**22.8**	**22.4**	**22.3**	**22.2**	**22.2**	**22.2**	**22.2**	**22.4**
Gross domestic saving	**24.3**	**22.8**	**21.8**	**23.6**	**23.7**	**22.4**	**23.0**	**22.7**	**22.8**
Central government revenues	**14.2**	**13.9**	**14.1**	**13.1**	**13.1**	**13.7**	**13.9**	**13.9**	**14.0**
Of which: Tax revenues	9.9	9.9	9.9	9.2	9.3	9.9	10.0	10.1	10.2
Central government expenditures	**15.3**	**15.3**	**16.9**	**19.6**	**17.1**	**16.5**	**16.0**	**15.4**	**15.4**
Of which: Compensation of Employees	6.3	6.6	6.9	7.3	6.8	6.4	6.1	5.8	5.7
Of which: Net Acquisition of Non Financial Assets	2.4	2.0	2.9	3.0	2.8	2.6	2.4	2.2	2.2
Central government net lending/borrowing	**-1.1**	**-1.4**	**-2.8**	**-6.5**	**-4.0**	**-2.8**	**-2.1**	**-1.5**	**-1.4**
Central government primary balance	-0.5	-0.7	-2.0	-5.5	-2.7	-2.7	-1.4	-0.7	-0.1
Public sector debt (excl. central bank bills)	**19.8**	**22.2**	**25.6**	**34.9**	**35.4**	**36.3**	**36.3**	**36.1**	**35.7**
Of which: Foreign currency	15.8	18.0	21.2	30.1	30.6	31.4	31.2	31.0	30.6
Of which: Domestic currency	4.0	4.2	4.4	4.8	4.7	4.9	5.1	5.1	5.1
Memorandum items:									
GDP (billions of Guaranies) 3/	219,188	231,489	238,054	244,955	268,105	286,678	308,567	329,550	351,880
GDP (US$ billions)	39.4	40.4	38.1	…	…	…	…	…	…

Sources: Central Bank of Paraguay; Ministry of Finance; and IMF staff estimates and projections.

1/ Includes local currency credit and foreign currency credit valued at a constant exchange rate.

2/ Average annual change; a positive change indicates an appreciation.

3/ Historical GDPs were revised in 2018, including a 30 percent upward revision in nominal GDP for 2017.

Table 2. Paraguay: Operations of the Central Government
(In percent of GDP unless specified otherwise)

	2016	2017	2018	Prel. 2019	Proj. 2020	2021	2022	2023	2024	2025
Revenue	**13.9**	**14.2**	**13.9**	**14.1**	**13.1**	**13.1**	**13.7**	**13.9**	**13.9**	**14.0**
Taxes	9.5	9.9	9.9	9.9	9.2	9.3	9.9	10.0	10.1	10.2
Income taxes	2.2	2.3	2.3	2.4	2.5	2.4	2.5	2.5	2.5	2.6
Excises	1.3	1.3	1.3	1.2	1.2	1.3	1.3	1.3	1.3	1.3
Value added tax	5.1	5.1	5.1	4.7	4.2	4.1	4.4	4.6	4.6	4.6
Import duties	0.8	1.0	1.1	1.0	0.9	1.1	1.2	1.2	1.2	1.2
Other	0.2	0.2	0.2	0.5	0.4	0.4	0.4	0.5	0.5	0.5
Social contributions	1.0	1.1	0.9	0.9	0.9	1.0	0.9	0.9	0.9	0.9
Other revenue	3.4	3.2	3.1	3.3	3.1	2.9	2.9	2.9	2.9	2.9
Grants	0.7	0.5	0.8	0.6	0.7	0.6	0.6	0.6	0.6	0.6
Itaipu-Yacyreta hydroelectric plants	1.5	1.3	1.4	1.7	1.5	1.4	1.4	1.4	1.4	1.3
Other nontax revenue	1.2	1.4	1.0	1.0	0.9	0.9	0.9	0.9	0.9	0.9
Expenditure	**15.0**	**15.3**	**15.3**	**16.9**	**19.6**	**17.1**	**16.5**	**16.0**	**15.4**	**15.4**
Expense	**12.8**	**12.8**	**13.3**	**14.0**	**16.6**	**14.3**	**13.9**	**13.6**	**13.2**	**13.2**
Compensation of employees	6.5	6.3	6.6	6.9	7.3	6.8	6.4	6.1	5.8	5.7
Purchases of goods and services	1.2	1.2	1.3	1.3	1.8	1.2	1.2	1.3	1.2	1.2
Interest	0.6	0.6	0.7	0.8	1.0	1.3	1.4	1.4	1.4	1.4
Grants	2.2	2.1	2.1	2.0	2.1	1.8	1.7	1.7	1.7	1.7
Social benefits	2.0	2.1	2.3	2.4	3.8	2.6	2.6	2.7	2.7	2.7
Other expense	0.4	0.5	0.5	0.6	0.6	0.5	0.5	0.5	0.5	0.5
Gross operating balance	**1.1**	**1.3**	**0.6**	**0.1**	**-3.5**	**-1.1**	**-0.2**	**0.3**	**0.7**	**0.8**
Net acquisition of nonfinancial assets	2.2	2.4	2.0	2.9	3.0	2.8	2.6	2.4	2.2	2.2
Net lending/borrowing (overall balance)	**-1.1**	**-1.1**	**-1.4**	**-2.8**	**-6.5**	**-4.0**	**-2.8**	**-2.1**	**-1.5**	**-1.4**
Net financial transactions	**1.1**	**1.1**	**1.4**	**2.8**	**6.5**	**4.0**	**2.8**	**2.1**	**1.5**	**1.4**
Net acquisition of financial assets	0.5	1.0	1.1	1.5	0.0	0.0	0.0	0.0	0.0	0.0
Financial investments	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net lending	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net incurrence of liabilities	1.9	2.4	3.2	3.6	6.5	4.0	2.8	2.1	1.5	1.4
Domestic	-0.2	0.6	1.2	1.5	0.2	1.0	0.3	0.4	0.2	0.2
Debt securities	-0.2	0.0	0.0	0.1	0.3	0.3	0.3	0.4	0.2	0.2
New issues	0.2	0.4	0.4	0.3	1.0	0.7	1.0	1.0	0.8	0.9
Amortizations	-0.5	-0.4	-0.3	-0.2	-0.7	-0.4	-0.6	-0.6	-0.7	-0.7
Net credit from the banking system	0.3	0.7	0.8	1.0	-0.1	0.7	0.0	0.0	0.0	0.0
Net credit from the Central bank 1/	0.3	0.7	-0.2	0.7	-0.1	0.7	0.0	0.0	0.0	0.0
Net credit from the commercial banks	0.1	0.0	0.0	0.0	-0.1	0.0	0.0	0.0	0.0	0.0
Other accounts payable	-0.3	0.0	0.4	0.4	0.0	0.0	0.0	0.0	0.0	0.0
External	2.1	1.8	2.0	2.0	6.4	3.0	2.5	1.8	1.3	1.2
Disbursements	2.6	2.2	2.5	2.6	7.1	3.8	3.3	4.4	2.4	2.4
Amortizations	-0.5	-0.5	-0.5	-0.6	-0.7	-0.8	-0.9	-2.6	-1.1	-1.2
Statistical Discrepancy 2/	-0.3	-0.3	-0.7	0.8	0.0	0.0	0.0	0.0	0.0	0.0
Financing Gap	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:										
Primary balance	-0.5	-0.5	-0.7	-2.0	-5.5	-2.7	-1.4	-0.7	-0.1	0.0
Output gap 3/	-0.3	0.1	-0.4	-1.8	-2.1	-1.3	-0.7	-0.1	-0.1	-0.1
Central government gross debt	16.0	15.9	17.8	20.7	28.6	29.5	30.7	30.8	30.8	30.6
Nominal GDP (in billions of Guaranies)	204,447	219,188	231,489	238,054	244,955	268,105	286,678	308,567	329,550	351,880

Sources: Ministry of Finance; Central Bank of Paraguay; and IMF staff estimates and projections.

1/ Includes mainly use of government deposits at the Central Bank.

2/ Captures the discrepancy between above-the-line calculations and financial accounts.

3/ In percent of potential GDP.

Table 3. Paraguay: Operations of the Consolidated Public Sector 1/

(In percent of GDP)

	2016	2017	2018	Prel. 2019	Proj. 2020	2021	2022	2023	2024	2025
Revenue	**19.1**	**18.6**	**18.9**	**19.1**	**17.8**	**17.9**	**18.4**	**18.5**	**18.4**	**18.5**
Tax revenue	9.9	10.0	10.2	10.2	9.5	9.6	10.2	10.3	10.4	10.5
Nontax revenue and grants 2/	8.3	8.1	8.1	8.5	8.0	8.0	7.8	7.9	7.7	7.6
Public enterprises operating surplus	0.9	0.6	0.5	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Expenditure	**19.5**	**19.5**	**20.5**	**22.8**	**25.1**	**23.1**	**22.4**	**21.8**	**21.1**	**21.1**
Expense	**16.1**	**16.0**	**17.2**	**18.7**	**20.9**	**19.1**	**18.6**	**18.3**	**17.8**	**17.7**
Compensation of employees	8.6	7.9	8.7	9.0	9.4	8.9	8.5	8.1	7.8	7.7
Purchases of goods and services	2.2	2.0	2.3	2.4	2.9	2.3	2.3	2.3	2.2	2.2
Interest payments	0.9	1.0	1.1	1.2	1.4	1.8	1.8	1.8	1.8	1.9
Transfers 3/	3.5	4.4	4.4	4.4	5.6	4.6	4.6	4.6	4.5	4.5
Current transfers	3.6	3.8	4.2	4.3	5.5	4.5	4.5	4.5	4.4	4.4
Capital transfers	-0.1	0.6	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Other expense	0.8	0.7	0.7	1.6	1.6	1.5	1.5	1.4	1.4	1.4
Gross operating balance	**3.0**	**2.6**	**1.7**	**0.3**	**-3.1**	**-1.2**	**-0.3**	**0.2**	**0.6**	**0.8**
Net acquisition of nonfinancial assets	3.4	3.5	3.3	4.1	4.2	4.0	3.8	3.5	3.3	3.4
Net lending/borrowing (overall balance)	**-0.4**	**-0.9**	**-1.7**	**-3.8**	**-7.3**	**-5.2**	**-4.0**	**-3.3**	**-2.7**	**-2.6**
Net financial transactions	**0.4**	**0.9**	**1.7**	**3.8**	**7.3**	**5.2**	**4.0**	**3.3**	**2.7**	**2.6**
Net acquisition of financial assets	1.9	2.5	2.4	1.7	0.2	0.2	0.2	0.2	0.2	0.2
Net incurrence of liabilities	2.3	3.4	4.1	5.5	7.5	5.4	4.2	3.5	2.9	2.8
External	2.3	1.9	2.2	2.1	6.4	2.9	2.4	1.7	1.2	1.2
Disbursements	2.9	2.4	2.7	2.7	7.2	3.8	3.3	4.4	2.4	2.4
Amortizations	-0.6	-0.5	-0.6	-0.6	-0.8	-0.8	-0.9	-2.7	-1.1	-1.2
Domestic	0.3	1.5	1.5	3.0	1.1	2.5	1.9	1.8	1.7	1.6
Domestic debt	-0.2	0.0	0.0	0.1	0.3	0.3	0.3	0.4	0.2	0.2
Disbursements	0.2	0.4	0.4	0.3	1.0	0.7	1.0	1.0	0.8	0.9
Amortizations	-0.5	-0.4	-0.3	-0.2	-0.7	-0.4	-0.6	-0.6	-0.7	-0.7
Deposits	0.1	1.1	1.2	1.9	-0.3	0.8	0.2	0.2	0.3	0.2
Change in net deposits com.bks	-0.2	0.4	1.4	1.2	-0.2	0.2	0.2	0.2	0.3	0.2
Change in net deposits CBP	0.3	0.7	-0.2	0.7	-0.1	0.7	0.0	0.0	0.0	0.0
Quasi-fiscal deficit financing 4/	0.4	0.4	0.3	1.0	1.1	1.3	1.3	1.2	1.2	1.2
Other accounts payable	-0.3	0.0	0.4	0.4	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:										
Primary balance	0.5	0.1	-0.6	-2.5	-5.9	-3.4	-2.2	-1.5	-0.9	-0.7
Public sector debt (excl. central bank bills)	19.4	19.8	22.2	25.6	34.9	35.4	36.3	36.3	36.1	35.7
Domestic public debt	4.1	4.0	4.2	4.4	4.8	4.7	4.9	5.1	5.1	5.1
Foreign public debt	15.4	15.8	18.0	21.2	30.1	30.6	31.4	31.2	31.0	30.6

Sources: Ministry of Finance; and IMF staff estimates and projections.

1/ Includes the nonfinancial public sector and the central bank.
2/ Includes social contributions and grants.
3/ Includes social benefits, grants, and capital transfers.
4/ Corresponds to net losses of CB capital which are not automatically compensated by the government.

Table 4. Paraguay: Balance of Payments
(In millions of US dollars)

	2016	2017	2018	Prel. 2019	RFI 2020	Proj. 2020	2021	2022	Proj. 2023	2024	2025
Current account	**1,305**	**1,214**	**9**	**-229**	**498**	**-337**	**559**	**109**	**349**	**268**	**213**
Trade balance	1,976	1,599	568	-97	899	82	1,083	658	902	854	807
Exports	11,984	13,396	13,819	12,540	10,818	9,959	13,740	14,745	15,850	16,543	17,218
Hydro-Electricity	2,131	2,105	2,109	1,722	1,607	1,574	1,658	1,703	1,744	1,782	1,822
Agricultural Products	5,258	5,310	5,547	4,582	5,058	5,008	6,922	6,797	7,024	7,285	7,543
Industrial Products and others	1,113	1,265	1,386	1,502	1,336	1,305	1,450	1,531	1,610	1,698	1,785
Unregistered	1,201	1,347	1,526	1,148	786	771	1,159	1,472	1,709	1,805	1,872
Re-Export	2,282	3,370	3,251	3,586	1,354	1,300	2,551	3,241	3,763	3,973	4,195
Imports	-9,787	-11,524	-12,918	-12,322	-9,428	-9,403	-12,272	-13,820	-14,650	-15,368	-16,064
Of which: Fuel products	-987	-1,183	-1,631	-1,352	-916	-915	-1,079	-1,144	-1,205	-1,262	-1,319
Services (net)	-221	-273	-334	-315	-490	-474	-384	-266	-298	-321	-346
Transport	-306	-376	-430	-416	-508	-487	-466	-409	-441	-467	-494
Travel	26	38	27	29	-42	-44	17	74	75	76	77
Other	59	66	69	73	59	57	65	68	68	70	71
Factor income	-1,447	-1,207	-1,361	-1,018	-1,119	-1,111	-1,280	-1,351	-1,408	-1,488	-1,545
Transfers	775	823	801	885	718	693	756	801	855	902	951
Capital and financial account	**55**	**436**	**766**	**823**	**798**	**1,285**	**-287**	**213**	**449**	**602**	**651**
Capital transfers	163	166	153	140	138	133	145	154	164	173	182
Direct investment	425	526	481	473	132	142	275	397	459	451	475
Portfolio investment	300	500	530	487	1,450	1,450	500	500	0	0	0
Other investment	-834	-756	-398	-276	-922	-441	-1,207	-838	-174	-22	-6
Errors and omissions	**-403**	**-774**	**-957**	**-602**	**-448**	**-448**	**-312**	**-308**	**-299**	**-323**	**-319**
Overall balance	**957**	**877**	**-183**	**-8**	**848**	**500**	**-40**	**13**	**499**	**547**	**545**
Financing											
Net international reserves (increase -)	-944	-1,002	142	8	500	-500	0	0	-500	-550	-550
Change in Gross Reserves	-957	-877	183	8	-500	-500	0	0	-500	-550	-550
Other factors affecting reserve balance	14	-125	-41	0	0	0	0	0	0	0	0
Exceptional financing	0	0	0	0	0	0	0	0	0	0	0
Financing gap	N.A.	N.A.	N.A.	N.A.	-348	0	0	0	0	0	0
Memorandum items:											
Current account in percent of GDP 1/	3.6	3.1	0.0	-0.6	1.4	-1.0	1.5	0.3	0.8	0.6	0.4
Gross reserves (in millions of U.S. dollars)	7,144	8,146	8,004	7,996	8,496	8,496	8,496	8,496	8,996	9,546	10,096
In months of imports of GNFS	6.7	6.9	7.1	8.9	7.5	8.0	6.7	6.4	6.4	6.5	6.6
External public debt in percent of GDP 1/	15.4	15.8	18.0	21.2	30.1	32.1	30.6	31.4	31.2	31.0	30.6
Debt service in percent of exports GNFS	11.9	11.1	10.7	14.1	16.8	18.2	14.6	14.2	18.1	13.9	12.1
Export volume (percent change)	9.8	7.8	-2.0	-4.1	-10.7	-14.7	15.3	8.3	5.8	3.1	3.0
Import volume (percent change)	1.4	11.0	4.5	-4.5	-15.7	-15.9	24.0	10.6	4.9	3.1	2.9
Terms of trade (percent change)	4.1	-1.9	-1.6	-4.9	2.9	0.1	7.2	-1.2	0.3	-0.5	-0.5

Sources: Central Bank of Paraguay; and IMF staff estimates and projections.
1/ Based on average exchange rate valuation of GDP.

Table 5. Paraguay: Summary Accounts of the Central Bank
(In billions of Guaranies; end-of-period; valued at constant exchange rate)

				Prel.	Proj.					
	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
Currency issued	**11,457**	**12,954**	**13,757**	**14,349**	**14,846**	**15,806**	**16,828**	**17,916**	**19,074**	**20,308**
Growth	4.9	13.1	6.2	4.3	3.5	6.5	6.5	6.5	6.5	6.5
Net international reserves	**39,731**	**44,188**	**46,206**	**48,022**	**55,385**	**55,756**	**56,274**	**60,357**	**65,169**	**70,079**
Net domestic assets	**-28,275**	**-31,234**	**-36,437**	**-34,575**	**-40,538**	**-39,949**	**-39,446**	**-42,441**	**-46,095**	**-49,772**
Net nonfinancial public sector	-7,624	-8,386	-8,855	-7,160	-7,341	-5,510	-5,510	-5,510	-5,510	-5,510
Net credit to the central government	-7,624	-8,386	-8,854	-7,159	-7,340	-5,509	-5,509	-5,509	-5,509	-5,509
Net credit to the banking system	-22,610	-25,811	-25,411	-25,571	-32,367	-36,911	-39,811	-46,256	-53,401	-60,916
Reserve requirements	-10,834	-11,895	-12,420	-12,513	-13,456	-17,217	-20,720	-24,495	-26,424	-28,754
Free reserves	-3,701	-2,636	-2,394	-2,742	-2,958	-2,977	-3,004	-3,031	-3,071	-3,111
Monetary control instruments 1/	-9,321	-12,611	-11,883	-11,742	-17,385	-18,149	-17,520	-20,164	-25,341	-30,486
Other	1,246	1,331	1,286	1,426	1,432	1,432	1,433	1,434	1,435	1,436
Other assets and liabilities (net)	1,963	2,966	-2,171	-1,844	-830	2,471	5,875	9,325	12,816	16,654
Capital and reserves	3,562	4,617	-790	-851	1,813	5,390	9,154	12,930	16,921	21,288
Other assets net 2/	-1,599	-1,650	-1,381	-994	-2,643	-2,919	-3,280	-3,605	-4,105	-4,634
Memorandum Items:										
Total stock of IRMs outstanding 1/	9,247	12,682	11,960	12,919	17,385	18,149	17,520	20,164	25,341	30,486
Monetary base 3/	16,058	18,391	19,740	20,420	21,091	22,240	23,457	24,747	26,175	27,752
Monetary base, annual growth	6.9	14.5	7.3	3.4	3.3	5.4	5	6	6	6
Quasi-fiscal balance	914	958	601	2,408	2,731	3,583	3,772	3,784	4,003	4,379
In percent of GDP	0.4	0.4	0.3	1.0	1.1	1.3	1.3	1.2	1.2	
Cost of monetary policy operations	652	882	920	966	967	1,227	1,277	1,247	1,403	1,702
In percent of GDP	0.3	0.4	0.4	0.4	0.4	0.5	0.4	0.4	0.4	0.5

Sources: Central Bank of Paraguay; and IMF staff estimates and projections.

1/ Includes overnight-deposit facility and central bank bills (LRM). A fraction of LRM is held by non-bank institutions.
2/ Includes LRM held by the non-banking sector.
3/ Monetary base comprises currency issued plus legal reserve requirement deposits in guaraní held at the BCP.

Table 6. Paraguay: Summary Accounts of the Financial System 1/
(In billions of Guaranies; end-of-period; valued at constant exchange rate)

				Prel.	Proj.					
	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
I. Central Bank										
Net international reserves	**39,731**	**44,188**	**46,206**	**48,022**	**55,385**	**55,756**	**56,274**	**60,357**	**65,169**	**70,079**
In millions of U.S. dollars	7,144	8,146	8,004	7,996	8,496	8,534	9,065	9,840	10,256	
Net domestic assets	**-28,275**	**-31,234**	**-36,437**	**-34,575**	**-40,538**	**-39,949**	**-39,446**	**-42,441**	**-46,095**	**-49,772**
Credit to public sector, net	-7,624	-8,386	-8,855	-7,160	-7,341	-5,510	-5,510	-5,510	-5,510	-5,510
Credit to banking system, net 2/	-13,289	-13,200	-13,528	-13,828	-14,982	-18,762	-22,291	-26,092	-28,060	-30,429
Credit	1,246	1,331	1,286	1,426	1,432	1,432	1,433	1,434	1,435	1,436
Deposits	14,535	14,531	14,813	15,254	16,414	20,194	23,724	27,526	29,495	31,865
Central bank securites	-9,247	-12,682	-11,960	-12,919	-17,385	-18,149	-17,520	-20,164	-25,341	-30,486
Other	-735,380	-754,099	-786,460	-848,410	-830	2,471	5,875	9,325	12,816	16,654
Currency issued	**11,457**	**12,954**	**13,757**	**14,349**	**14,846**	**15,806**	**16,828**	**17,916**	**19,074**	**20,308**
II. Monetary Survey										
Net foreign assets	**37,211**	**41,594**	**41,499**	**43,504**	**50,508**	**50,861**	**51,350**	**55,405**	**60,195**	**65,131**
In millions of U.S. dollars	6,431	7,387	7,001	6,745	7,246	7,248	7,250	7,753	8,309	8,872
Net domestic assets	**52,968**	**57,828**	**65,299**	**74,931**	**74,669**	**79,517**	**84,589**	**86,269**	**89,035**	**93,406**
Credit to the public sector	-14,076	-15,314	-16,112	-15,250	-15,281	-13,442	-13,436	-13,430	-13,425	-13,420
Credit to the private sector	84,619	88,753	101,290	111,097	117,381	126,923	134,138	141,375	149,234	157,685
Other	-17,574	-15,611	-19,879	-20,916	-27,426	-33,958	-36,107	-41,671	-46,768	-50,854
Broad liquidity (M4)	**90,179**	**99,423**	**106,792**	**118,406**	**125,159**	**130,324**	**135,851**	**141,611**	**149,179**	**158,486**
Bonds and issued securities	0	0	6	30	31	31	31	32	32	32
Other monetary liabilities	5,616	5,617	5,445	6,360	6,883	7,152	7,442	7,743	8,155	8,671
Central bank securities with private sector	0	71	77	1,177	0	0	0	0	0	0
Broad liquidity (M3)	**84,563**	**93,734**	**101,265**	**110,838**	**118,245**	**123,141**	**128,378**	**133,837**	**140,992**	**149,782**
Foreign currency deposits	33,537	33,360	36,011	40,889	45,756	47,675	49,802	52,012	55,098	58,907
Money and quasi-money (M2)	**51,026**	**60,374**	**65,254**	**69,949**	**72,489**	**75,466**	**78,576**	**81,824**	**85,894**	**90,875**
Quasi-money	26,464	29,186	32,394	34,474	35,715	36,965	38,259	39,598	41,380	43,656
Money (M1)	24,562	31,188	32,859	35,476	36,774	38,501	40,317	42,227	44,514	47,220
(Annual percent change)										
M0 (Currency issued)	4.9	13.1	6.2	4.3	3.5	6.5	6.5	6.5	6.5	6.5
Credit to the private sector	3.6	4.9	14.1	9.7	5.7	8.1	5.7	5.4	5.6	5.7
M1	8.3	27.0	5.4	8.0	3.7	4.7	4.7	4.7	5.4	6.1
M2	11.8	18.3	8.1	7.2	3.6	4.1	4.1	4.1	5.0	5.8
M3	7.4	10.8	8.0	9.5	6.7	4.1	4.3	4.3	5.3	6.2
Of which: Foreign currency deposits	1.3	-0.5	7.9	13.5	11.9	4.2	4.5	4.4	5.9	6.9
Memorandum items:										
Ratio of foreign currency deposits to M3 (percent)	39.7	35.6	35.6	36.9	38.7	38.7	38.8	38.9	39.1	39.3
Ratio of foreign currency deposits to total private sector deposits (percent)	41.3	37.5	37.6	38.6	41.7	41.9	42.1	42.4	42.7	43.0

Sources: Central Bank of Paraguay; and IMF staff estimates and projections.

1/ Includes banks, finance companies, and the 20 largest cooperatives.

2/ Excludes LRM held by the banking sector.

Table 7. Paraguay: Indicators of External Vulnerability

(In percent of GDP, unless otherwise indicated)

	2016	2017	2018	Prel. 2019	Proj. 2020	2021	2022	2023	2024	2025
Monetary and financial indicators										
Broad money (M3), percentage change 1/	7.4	10.8	8.0	9.5	6.7	4.1	4.3	4.3	5.3	6.2
Credit to the private sector, real (percent change) 1/	-0.3	0.4	10.6	6.7	2.6	4.7	2.3	2.0	2.2	2.3
Share of nonperforming loans in total loans (percent)	2.8	2.7	2.4	2.5	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Average domestic bank lending rate, real	12.0	11.3	11.3	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Central Bank bill yield, real	2.2	2.4	1.6	0.0	-2.0	-0.1	0.8	0.7	1.0	1.0
Central bank foreign short-term liabilities (millions of U.S. dollars)	1.2	0.0	48.6	54.7	54.7	54.7	54.7	54.7	54.7	54.7
External indicators										
Merchandise exports (percentage change)	-4.3	2.0	4.0	-7.5	1.3	9.1	-3.8	-0.1	0.2	0.2
Merchandise imports (percentage change)	-5.1	3.5	6.8	0.4	-6.2	1.2	0.1	1.0	1.7	1.6
Merchandise terms of trade (percentage change)	0.8	-1.5	-2.6	-7.8	8.0	7.8	-4.0	-1.1	-1.5	-1.4
Real effective exchange rate (percentage change)	0.1	0.1	5.0	-6.0	-7.0	0.5	0.5	0.5	0.0	0.0
Current account balance (percent of GDP)	3.6	3.1	0.0	-0.6	1.4	1.5	0.3	0.8	0.6	0.4
Capital and financial account (percent of GDP)	0.2	1.1	1.9	2.2	2.2	-0.8	0.5	1.0	1.3	1.4
Net foreign direct investment (percent of GDP)	1.2	1.3	1.2	1.2	0.4	0.7	1.0	1.1	1.0	1.0
Other net investment (percent of GDP)	-2.3	-1.9	-1.0	-0.7	-2.5	-3.2	-2.1	-0.4	0.0	0.0
External public debt (percent of GDP) 2/	15.4	15.8	18.0	21.2	30.1	30.6	31.4	31.2	31.0	30.6
o/w: Central Government External Debt (percent of GDP) 2/	12.8	12.9	14.9	17.8	25.4	26.3	27.3	27.4	27.3	27.2
Total external debt (percent of GDP) 2/	44.1	40.1	41.0	42.8	49.5	46.3	43.9	40.9	36.7	36.3
Excluding debt of binational companies 2/	20.2	20.6	23.2	26.9	35.8	36.4	37.1	36.9	36.7	36.3
External Debt service (in percent of exports GNFS)	11.9	11.1	10.7	14.1	16.8	14.6	14.2	18.1	13.9	12.1
International reserves (in millions of U.S. dollars)	7,144	8,146	8,004	7,996	8,496	8,496	8,496	8,996	9,546	10,096
In months of imports of GNFS	6.7	6.9	7.1	8.9	7.5	6.7	6.4	6.4	6.5	6.6
Ratio to short-term external debt 3/	2.3	2.6	2.2	2.2	2.2	2.2	1.8	2.2	2.4	2.5

Sources: Central Bank of Paraguay; and IMF staff estimates.

1/ Foreign-currency components are valued at the accounting exchange rate.
2/ Based on end-of-period exchange rate conversion of U.S. dollar-denominated debt.
3/ Private and public external debt with a residual maturity of one year or less.

Table 8. Paraguay: Medium-Term Outlook
(In percent of GDP, unless otherwise indicated)

		Est.			Proj.				
	2017	2018	2019	2020	2021	2022	2023	2024	2025
National accounts and prices									
Real GDP growth (in percent)	5.0	3.4	0.0	-0.9	4.0	4.0	4.0	3.5	3.5
Output gap 1/	0.1	-0.4	-1.8	-2.1	-1.3	-0.7	-0.1	-0.1	-0.1
Gross domestic investment	21.2	22.8	22.4	22.3	22.2	22.2	22.2	22.2	22.4
Gross domestic savings	24.3	22.8	21.8	23.6	23.7	22.4	23.0	22.7	22.8
Consumer prices (end of period; in percent)	4.5	3.2	2.8	2.3	3.5	3.5	3.5	3.5	3.5
Public finances									
Central government primary balance	-0.5	-0.7	-2.0	-5.5	-2.7	-2.7	-1.4	-0.7	-0.1
Central government net lending/borrowing	-1.1	-1.4	-2.8	-6.5	-4.0	-2.8	-2.1	-1.5	-1.4
Central government debt	15.9	17.8	20.7	28.6	29.5	30.7	30.8	30.8	30.6
Public sector debt	19.8	22.2	25.6	34.9	35.4	36.3	36.3	36.1	35.7
External sector									
Terms of trade (annual percent change)	-1.9	-1.6	-4.9	0.1	7.2	-1.2	0.3	-0.5	-0.5
Current account	3.1	0.0	-0.6	1.4	1.5	0.3	0.8	0.6	0.4
Foreign direct investment	1.3	1.2	1.2	0.4	0.7	1.0	1.1	1.0	1.0
Gross international reserves (in US$ billion)	8.1	8.0	8.0	8.5	8.5	8.5	9.0	9.5	10.1

Sources: Central Bank of Paraguay; Ministry of Finance; and IMF staff estimates and projections.
1/ In percent of potential GDP

Annex I. Recommendations on FRL

1. Since it came into force in 2015, Paraguay's Fiscal Responsibility Law (FRL) has served the country well. The law, which set a deficit ceiling of 1.5 percent of GDP, formalized the country's commitment to sound fiscal policy. The law and its successful implementation have bolstered the credibility of Paraguay's macro framework, including with international bond investors.

2. Even before the COVID-19 crisis, some flaws in the FRL that weakened its effectiveness became apparent. In 2019, drought, floods, and poor economic performance in Brazil and Argentina reduced economic growth to zero, and the government successfully invoked the escape close under the FRL, which states that, subject to congressional approval, the deficit ceiling can be raised to up to 3 percent of GDP in the case of a "fall in domestic economic activity". But the FRL did not provide a technical definition of what exactly constitutes a "fall in economic activity".

3. The lack of distinction between "ex-ante" vs. "ex-post" compliance with the deficit ceiling has also led to problems. Article 11 of the FRL (law 5098) can be understood as implying that congressional approval is mainly needed when the *ex-ante* formulation of the budget exceeds the deficit ceiling. The unintended consequence was that budgeted fiscal deficits always became pegged to the 1.5-percent ceiling, effectively converting what was meant to be a "ceiling" into a "target". Moreover, corrections to the budget are usually made in mid-fiscal year, usually authorizing additional spending when revenue exceeds expectations, thereby pulling back up the targeted deficit closer to the ceiling. These design flaws introduced an element of pro-cyclicality into the fiscal rule, as any fiscal shortfall caused by factors *not* covered by the escape clauses would have to be answered by expenditure cuts—mainly in the public investment program, which has less built-in rigidity in terms of legally mandated expenses.

4. Well-defined escape clauses can provide flexibility to deal with exceptional events, without undermining the credibility of the rule. To be effective, such escape clauses should be specified to provide clear and transparent definitions on the following dimensions:

- **The nature and the size of the triggers.** Rigidity and flexibility of the triggers need to be finely balanced. Overly rigid formulas make it difficult to respond to unforeseen situations, but overly flexible ones (such as: "the national government decides by decree what is a triggerable situation") undermine the credibility of the rule.

- **The authority and procedures to activate and monitor the escape clause.** Activating an escape clause typically requires parliamentary approval, subject to endorsement by an independent fiscal council.

- **The procedure for returning to rule compliance.** Escape clauses should ideally predefine the timeframe for: (i) re-instating rule compliance and/or (ii) correcting for the cumulative deviation attained during the rule suspension.

5. **On these dimensions, the new draft FRL provides significant improvements.** It adds clearer guidance on the transition back toward compliance with the fiscal rule in case of a breach or invocation of the escape clause. It strengthens the legal standing of the Fiscal Council. It better specifies the conditions under which the rule should be activated in case of economic activity below historical trends. And it introduces a fiscal stabilization fund that will be able to build assets based on eventual undershooting of the deficit below the ceiling.

6. **The proposed amendments will strengthen the fiscal framework, but there are some implementation challenges.** For example, the fiscal position needed to return the deficit below its ceiling within the transition period may be different from the one needed for returning debt below the new debt ceiling: If a cyclical shock occurs while public debt is already close to its ceiling, the fiscal path to converge debt below the ceiling will in many cases be tighter than the path required for deficit convergence. That may introduce another element of procyclicality to the rule. Also, the potential of the stabilization fund to collect surpluses will be weak, as long as mid-year budgetary revisions continue to prevent the emergence of fiscal space through automatic stabilizers. Finally, the language on sanctions in the case of non-compliance by the officials could benefit from further strengthening.

Table 1. Paraguay: Key Proposals for a New Fiscal Responsibility Law

Aspect of Fiscal Rule	Existing FRL (Law 5098)	Proposed new FRL (submitted to Congress December 2020)
Expenditure Rule	The annual increase of primary current expenditure cannot exceed the rate of **4 percent** plus the annual inflation rate.	The annual increase of primary current expenditure cannot exceed the rate of **2 percent** plus the annual inflation rate.
Salaries	Salaries cannot rise by more than the increase of the minimum wage in the previous year.	Salaries cannot rise by more than the increase of the minimum wage in the previous year. In fiscal years after the escape clause was triggered, there can be no salary increase at all.
Election-year spending	In years of general national elections, primary current expenditure between January and July cannot exceed 60 percent of the envelope approved by the budget for this year.	Same as in existing Law.
Deficit rule	The fiscal deficit of the Central Government cannot exceed 1.5 percent of GDP, as estimated at the time of budget preparation.	Same as in existing Law, but further restriction when approaching new debt ceiling (see debt rule).
Debt rule	No rule on public debt.	Public Sector Debt is capped at 40 percent of GDP. Only if the escape clause is triggered, can public debt temporarily exceed this ceiling. If public debt exceeds 36 percent of GDP, the fiscal deficit ceiling will be further restricted and cannot exceed 1.0 percent of GDP.
Escape clause triggers	In cases of national emergency, an international crisis, or a fall in domestic economic activity, at the request of the Government, Congress may suspend the application of the expenditure and the deficit rule, as well as the election-year rule, for the corresponding fiscal year. Under no circumstances can the deficit exceed 3 percent of GDP.	The esclape clause is triggered by (i) a Declaration of National Emergency by Congress or (ii) the BCP estimates real GDP growth at 75 percent less than the average of the preceding 10 years. Under no circumstances can the deficit exceed 3 percent of GDP.
Transition rules after breach or suspension	No transition rule.	After invocation of the escape clause, the fiscal deficit must be gradually reduced and return to or below the 1.5-percent ceiling within **three** years. During the transition period, current primary expenditure and civil servant salary levels will be frozen. If public debt exceeds the 40-percent ceiling, the Minister of Finance, together with the Fiscal Council, will present a convergence plan, to be approved by the Congress.
Ex-ante vs ex-post compliance	All rules must be obeyed in the formulation of the budget (ex-ante). However, it is unclear how a breach of the rules in the execution of the budget (ex-post) is to be treated.	Same as in existing Law.
Medium-term budget rule	A three-year medium-term budget must be presented to Congress together with the annual budget. The medium-term average deficit of the central government cannot exceed 1.0 percent of GDP.	A three-year medium-term budget must be presented to Congress together with the annual budget. It must be accompanied by a debt-sustainability analysis consistent with the debt ceiling.
Constraints on expenditure projects with fiscal implications	No rule.	Any Congress bill with fiscal implication must inevitably have a favorable technical report from the Ministry of Finance for its consideration. Should Congress go ahead with the Law without such favorable assessment, the Law must contain measures that ensure its financing either by additional revenue or by re-programming expenditures.
Sanctions	Failure to comply with this Law by responsible officials at the corresponding level of public administration will be considered as poor performance of their functions and the sanctions provided in the relevant legal provisions will be applied.	Same as in existing Law.
Stabilization Fund	None.	The Law creates a new Sovereign Wealth Fund, in order to contribute to national economic stability. It also stipulates a rule by which eventual budget surpluses and resources from other special laws feed into the Fund.
Fiscal Council	This was not part of the 2013 FRL, the Fiscal Council was regulated by a separate presidential decree from 2016.	The Law reconfirms the Fiscal Council, composed by three idoneous experts in the field of macroeconomics and fiscal policy. Its objective is to monitor fiscal policy and its adherence to the FRL and to provide its findings to Congress and the public at large.
Transition rules after Covid-19	Not applicable.	Given the severity of the Covid-19 crisis and of the measures of the emergency law of March 2020, the convergence period to compliance with the fiscal deficit ceiling and the debt ceiling is exceptionally extended from three years to four years. Current primary expenditure and civil servant salary levels will be frozen during the transition period.

Annex II. External Sector Assessment

The external position of Paraguay has weakened in 2019 but remains stronger than the level implied by fundamentals and desirable policies. For 2020, the external position is likely to be stronger than implied by economic fundamentals as well, subject to data uncertainty. External stability risks remain contained.

External Balance Sheets

1. Paraguay's net international investment position (NIIP) has improved in the past decade and a half, the result of an increase in foreign reserves and a decline in external debt. The reduction in external debt, from nearly 215 percent of GDP in 2002 to 43 percent of GDP in 2019, was the result of the amortization of the debt of the binational hydroelectric company (ITAIPU; about 17 percent of GDP in 2019), which was only partly offset by an increase in external government debt.

2. Currently, FDI (mainly in the agrobusiness sector) is the largest source of liabilities of the private sector, at around 19.4 percent of GDP.

Assessment

3. In 2019 and 2020, the downward trend in external debt was interrupted, but going forward it is projected to resume. The decline in external debt before 2019 was the result of the decline in the debt of the binational hydroelectrical company. The increase in debt in 2019 and 2020 resulted from the increase in the government deficit, which was largely financed externally. Going forward, with the projected decline in the fiscal deficit, external debt will return to a declining path. The external position remains sustainable under a range of adverse shocks.

Current Account

Background

4. Paraguay's current account has been in surplus over the last 20 years, averaging 1.2 percent of GDP. The current account surpluses in 2016 and 2017 were particularly strong, the result of record hydro-electricity exports and a surge in agricultural exports. The current account balance deteriorated in 2019 owing to large agricultural shock associated with a drought, and lower hydro-electricity production because of lower water levels in the Paraná river. The deterioration was the result of a sharp decline in the trade balance despite a gradual fading of last year's appreciation. While national savings have remained relatively stable as a share of GDP through 2019, investment has increased somewhat. With the COVID pandemic onset, the current account balance in 2020 is expected to improve owing to sharp decline in imports and lower oil prices. Over the medium-term, the current account balance is expected to increase to around 0.3 percent of GDP, reflecting the rebound in soybean production, relatively lower oil price levels, and the decline in interest payments to the binational loan.

Assessment

5. **The current account balance of Paraguay in 2019 was stronger than the multilaterally consistent cyclically-adjusted current account norm and is broadly consistent with last's year's results**. The estimated current account gap is 3.6 percent of GDP. The current account gap consists of the policy gap (0.2 percent of GDP) and the residual from the current account regression model (3.9 percent of GDP).[17] The current account balance in 2020 was likely stronger than implied by fundamentals as well, although this is subject to data uncertainty.

Summary of the EBA-lite Current Account (CA) Regression Results for 2019 1/

(percent of GDP)	Total CA	CA minus amortization to binationals
Current Account Balance (CA)	-0.6%	-2.4%
Export of Goods and Services	35.9%	35.9%
Import of Goods and Services	36.6%	36.6%
Cyclical Contributions (from model)	-0.7%	-0.7%
Multilaterally Consistent Cyclically adjusted CA Norm	-3.9%	-3.9%
CA-Gap	3.6%	1.8%
Policy gap	0.2%	1.0%
Natural Disasters and Conflicts	0.0%	-0.2%
Residual	3.9%	2.1%
Elasticity of current account to REER 2/	-0.26	-0.26
Implied REER Gap	-14.0%	-6.8%

1/ The current account balance is based on IMF staff projection.
2/ The elasticity of current account is calculated as Export of Goods and Service/GDP multiplied by an export elasticity of -0.44 minus Import of Goods and Services/GDP multiplied by import elasticity of 0.29.

6. **Staff's preferred approach to assess the current account position is based on the current account balance that nets out the amortization to binationals.** Paraguay has borrowed heavily in the past to build the binational hydro-electric plant (which showed as a large current account deficit in the 1980s). It uses less than the half of Itaipu's electricity production that it is

[17] The policy gap is mainly the result of the low level of public health expenditure in 2019 and the gap between Paraguay's productivity growth and the world (measured by relative GDP, in PPP terms, per worker). Despite the relaxation of the FRL in 2019, all spending except salaries was frozen in 2019, contributing to subdued public health expenditures in 2019. Closing the productivity gap will require structural reforms, see Bakker et al (2020) for details.

entitled to and exports the remainder to Brazil. Paraguay also needs to service the debt of Itaipu to Brazil. It pays off the debt through electricity exports. These transactions generate a positive current account item, and an offsetting capital outflow, with no impact on the rest of the economy.[18]

Summary of the EBA-lite Current Account (CA) Regression Results for 2020 1/

(percent of GDP)	Total CA	CA minus amortization to binationals
Current Account Balance (CA)	1.4%	-0.4%
Export of Goods and Services	32.3%	32.3%
Import of Goods and Services	29.9%	29.9%
Cyclical Contributions (from model)	-0.1%	2020.0%
Multilaterally Consistent Cyclically adjusted CA Norm	-4.3%	-4.3%
CA-Gap	6.0%	4.2%
Policy gap	4.0%	4.8%
Natural Disasters and Conflicts	-0.1%	-0.3%
Residual	2.3%	0.5%
Elasticity of current account to REER 2/	-0.25	-0.25
Implied REER Gap	-23.8%	-16.6%

1/ The current account balance is based on IMF staff projection.
2/ The elasticity of current account is calculated as Export of Goods and Service/GDP multiplied by an export elasticity of -0.44 minus Import of Goods and Services/GDP multiplied by import elasticity of 0.29.

7. The real exchange rate regression approach is consistent with the results of the current account regression approach.

Summary of the EBA-lite REER Regression Results for 2019, 2020

	2019	2020
Actual REER (in log)	4.70	4.65
Fitted REER (in log)	4.79	4.78
REER Norm (in log)	4.84	4.84
REER Gap	-14.2%	-18.6%
Residual	-9.0%	-13.0%
Policy Gap	-5.0%	-4.8%
Natural Disasters and Conflicts	-0.2%	-0.8%

8. There is a strong link between dollar-denominated agricultural commodity export prices and Paraguay's real exchange rate. When commodity prices weaken, as shown in recent year, the real exchange rate tends to depreciate, and when they strengthen, as shown in earlier years, so does the REER.

[18] As the construction of the binationals finished and Paraguay started to pay off the debt, the current account position started to strengthen. Such strengthening, however, is not a consequence of undervalued real exchange rate).

Capital and Financial Flows

Background

9. Foreign direct investment has been the major source of capital inflows in last few years. In addition, the government has been tapping funding from the international markets with a placement of bonds in the amount of about $500 million each year from 2016 to 2020. To finance Covid-related emergency measures, an additional $1,000 million sovereign bond was issued at end-April in 2020. These international offerings have become another stable source of capital inflow.

Assessment

10. Paraguay has a fully open capital and financial account, but still shallow financial markets. Paraguay has enjoyed a stable flow of FDI in the last decade, and despite the economic turmoil mainly in Argentina in 2019, FDI inflows remained strong, constituting about 1.3 percent of GDP compared to 1.2 percent in 2018. However, with Covid-19 in 2020, this figure has declined to an estimated 0.3 percent of GDP in 2020. Vulnerabilities to the financial flows remain contained as the major source of capital is direct investment and government's external borrowing, which has been received well by markets, given the still low level of public debt.

Reserves

Background

11. International reserves have been relatively stable in the last two years with US$7,996 million at end-2019 and an estimated US$8.5 billion in 2020. Strong accumulation of international reserves occurred between 2016–18. But intervention intensified after the first quarter of 2018 and during 2019, with sales of about US$1.3 billion in each year to contain excessive depreciation pressures on the Guaraní. After the Covid-19 pandemic began, reserves increased by US$1,000 million between February and July of 2020, reaching US$9,000 million, reflecting the sovereign bond issue in April. By end-year, the BCP had sold about US$500 million.

Assessment

12. Measured in prospective months of imports, reserves increased significantly in 2019 compared to 2018, owing to the sharp decline in imports in 2020 as part of the economic lockdown and border closures. Import coverage increased from 7.1 to 9.1 months, which is comfortably above the Fund's metrics for a small open economy. A flexible exchange rate should remain the first line of defense against external shocks. Staff recommends continuing with a rules-based approach for regular dollar sales and to limit discretionary interventions to exceptional situations of disorderly market conditions.

Table 1. Paraguay: External Debt Sustainability Framework, 2015-2025

(In percent of GDP, unless otherwise indicated)

	Actual					Projections						
	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	**Debt-stabilizing non-interest current account 6/**
Baseline: External debt	43.8	43.0	39.9	39.4	42.1	**50.2**	**49.5**	**46.7**	**43.5**	**38.8**	**38.4**	**-1.8**
Change in external debt	3.2	-0.8	-3.0	-0.5	2.7	8.2	-0.8	-2.8	-3.3	-4.6	-0.4	
Identified external debt-creating flows (4+8+9)	-1.8	0.1	-4.2	-3.8	-0.8	1.7	-2.9	-3.5	-3.6	-3.0	-2.7	
Current account deficit, excluding interest payments	-1.4	-5.4	-4.6	-1.5	-1.1	-1.0	-2.1	-2.8	-2.8	-2.6	-1.7	
Deficit in balance of goods and services	-1.5	-5.4	-4.1	-1.4	0.3	-0.2	-1.3	-2.0	-2.1	-1.9	-1.7	
Exports	33.0	35.4	36.4	36.6	35.9	31.0	36.6	38.8	38.7	38.3	37.9	
Imports	31.5	30.0	32.3	35.2	36.2	30.8	35.2	36.8	36.7	36.5	36.2	
Net non-debt creating capital inflows (negative)	-1.1	-0.8	-1.1	-1.3	-1.3	-0.4	-0.8	-1.0	-1.2	-1.0	-1.0	
Automatic debt dynamics 1/	0.7	6.4	1.5	-1.0	1.5	3.1	0.1	0.3	0.3	0.7	0.0	
Contribution from nominal interest rate	1.6	2.0	1.6	1.5	1.6	2.0	2.2	2.2	2.1	2.1	1.3	
Contribution from real GDP growth	-1.2	-2.1	-2.1	-1.3	0.0	1.1	-2.2	-1.9	-1.7	-1.4	-1.3	
Contribution from price and exchange rate changes 2/	0.3	6.5	2.0	-1.2	-0.1	...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	5.0	-1.0	1.1	3.3	3.5	6.5	2.1	0.7	0.4	-1.7	2.3	
External debt-to-exports ratio (in percent)	132.9	121.4	109.8	107.8	117.1	162.1	135.4	120.5	112.2	101.3	101.4	
Gross external financing need (in billions of US dollars) 4/	2.7	1.3	1.3	2.6	3.1	3.3	3.1	2.8	3.6	3.0	3.1	
in percent of GDP	7.4	3.5	3.4	6.3	8.4	9.7	9.0	8.1	9.6	7.5	7.5	
Scenario with key variables at their historical averages 5/						**41.5**	**38.2**	**35.4**	**32.5**	**27.5**	**25.8**	**-1.7**
Key Macroeconomic Assumptions Underlying Baseline												
Nominal GDP (US dollars)	36.3	36.3	39.4	40.4	37.6	34.1	34.0	34.9	37.2	39.5	41.7	
Real GDP growth (in percent)	3.1	4.3	5.0	3.4	0.0	-2.5	4.5	4.0	4.0	3.5	3.5	
GDP deflator in US dollars (change in percent)	-0.8	-12.9	-4.4	3.1	0.2	-6.9	-4.5	-1.5	2.5	2.7	2.1	
Nominal external interest rate (in percent)	4.0	4.1	3.8	3.9	4.1	4.4	4.6	4.7	4.8	5.1	3.5	
Growth of exports (US dollar terms, in percent)	-14.5	7.5	11.4	3.0	-8.5	-19.7	21.5	13.0	6.7	4.5	4.2	
Growth of imports (US dollar terms, in percent)	-13.4	-4.6	16.9	11.5	-4.2	-20.9	18.0	11.2	6.6	5.0	4.7	
Current account balance, excluding interest payments	1.4	5.4	4.6	1.5	1.1	1.0	2.1	2.8	2.8	2.6	1.7	
Net non-debt creating capital inflows	1.1	0.8	1.1	1.3	1.3	0.4	0.8	1.0	1.2	1.0	1.0	

1/ Derived as [r - g - r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as [-r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock. r increases with an appreciating domestic currency (e > 0) and rising inflation (based on GDP deflator).

3/ For projection, line includes the impact of price and exchange rate changes.

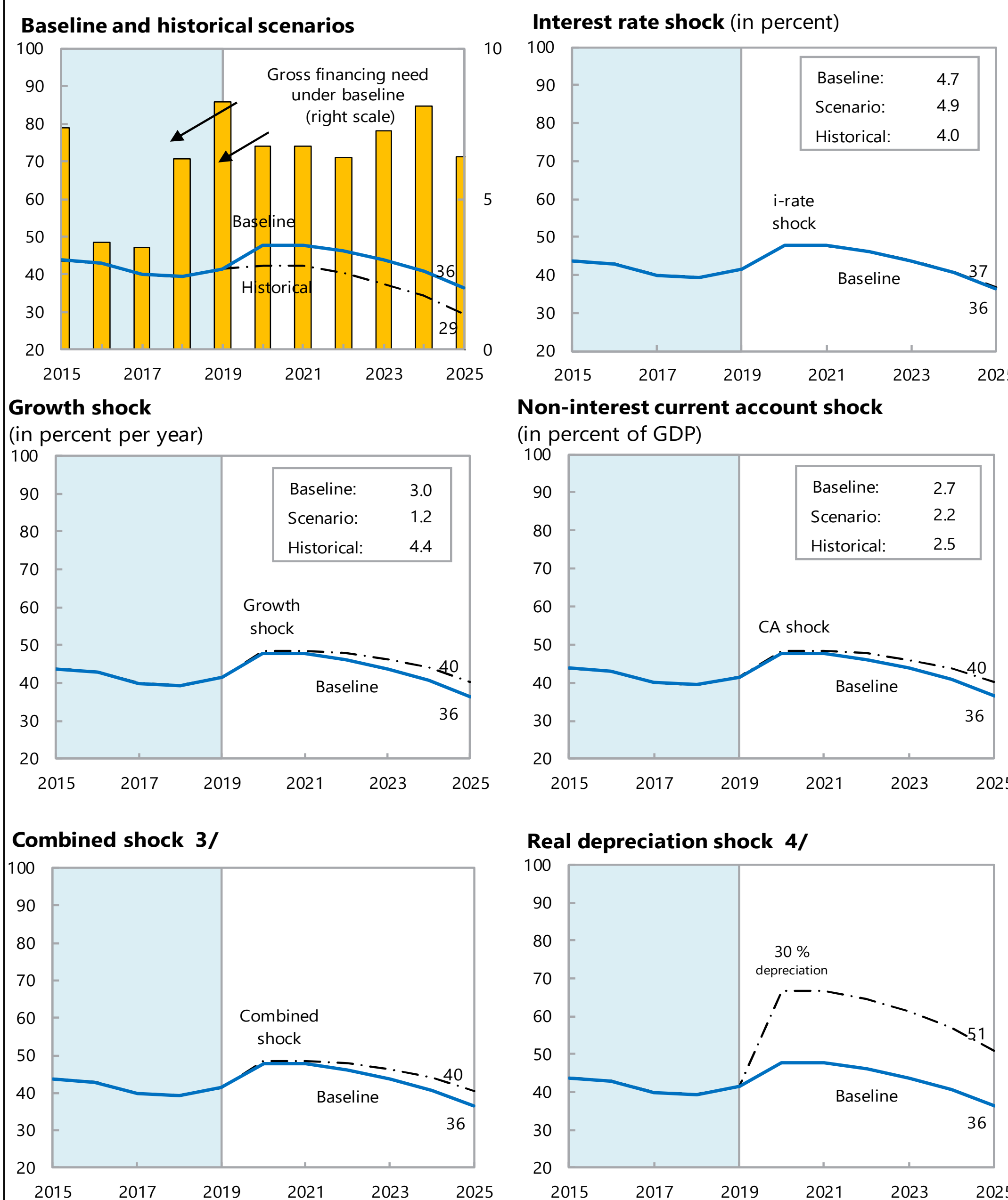
4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Figure 1. Paraguay: External Debt Sustainability: Bound Tests 1/ 2/

(External debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.
3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
4/ One-time real depreciation of 30 percent occurs in 2010.

Annex III. Public Sector Debt Sustainability Analysis

Table 1. Paraguay: Public Sector Debt Sustainability Analysis – Base Scenarios
(in percent of GDP unless otherwise indicated)

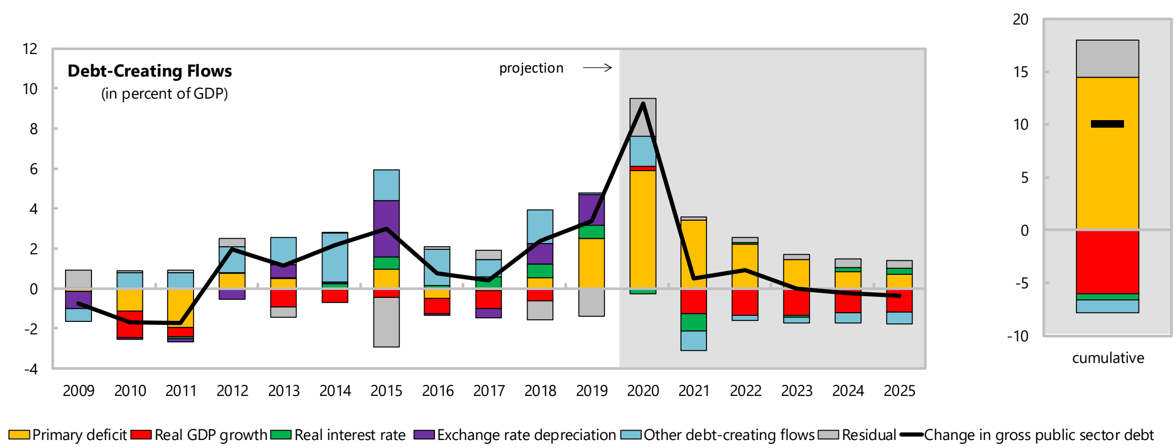
Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2009-2017	2018	2019	2020	2021	2022	2023	2024	2025
Nominal gross public debt	15.0	22.2	25.6	34.9	35.4	36.3	36.3	36.1	35.7
Public gross financing needs	1.4	2.5	4.6	7.8	5.3	4.6	5.6	3.5	3.6
Real GDP growth (in percent)	4.5	3.4	0.0	-0.9	4.0	4.0	4.0	3.5	3.5
Inflation (GDP deflator, in percent)	3.7	2.2	2.9	3.8	5.2	2.8	3.5	3.2	3.2
Nominal GDP growth (in percent)	8.3	5.6	2.8	2.9	9.5	6.9	7.6	6.8	6.8
Effective interest rate (in percent) [2/]	4.9	5.8	5.8	2.6	2.8	3.2	3.5	3.9	4.2

As of December 08, 2020		
Sovereign Spreads		
EMBIG (bp)		221
5Y CDS (bp)		...
Ratings	Foreign	Local
Moody's	Ba1	Ba1
S&Ps	BB	BB
Fitch	BB+	BB+

Contribution to Changes in Public Debt

	Actual			Projections							
	2009-2017	2018	2019	2020	2021	2022	2023	2024	2025	cumulative	debt-stabilizing primary balance [8/]
Change in gross public sector debt	0.6	2.4	3.4	9.2	0.5	0.9	0.0	-0.2	-0.4	10.1	
Identified debt-creating flows	0.7	3.3	4.8	7.3	0.3	0.7	-0.3	-0.6	-0.8	6.7	
Primary deficit	-0.2	0.6	2.5	5.9	3.4	2.2	1.5	0.9	0.7	14.5	-1.5
Primary (noninterest) revenue and grants	17.3	18.9	19.1	17.8	17.9	18.4	18.5	18.4	18.5	109.5	
Primary (noninterest) expenditure	17.1	19.4	21.6	23.7	21.3	20.5	20.0	19.3	19.2	124.0	
Automatic debt dynamics [3/]	-0.3	1.1	2.2	-0.1	-2.1	-1.2	-1.4	-1.0	-0.9	-6.7	
Interest rate/growth differential [4/]	-0.4	0.0	0.6	-0.1	-2.1	-1.2	-1.4	-1.0	-0.9	-6.7	
Of which: real interest rate	0.2	0.7	0.6	-0.3	-0.8	0.1	-0.1	0.2	0.3	-0.6	
Of which: real GDP growth	-0.6	-0.6	0.0	0.2	-1.3	-1.3	-1.3	-1.2	-1.2	-6.1	
Exchange rate depreciation [5/]	0.2	1.0	1.5	…	…	…	…	…	…	…	
Other identified debt-creating flows	1.1	1.7	0.1	1.5	-1.0	-0.3	-0.3	-0.5	-0.6	-1.2	
NFPS asset accumulation [6/]	1.1	1.7	0.1	1.5	-1.0	-0.3	-0.3	-0.5	-0.6	-1.2	
Residual [7/]	-0.1	-0.9	-1.4	1.9	0.2	0.3	0.3	0.4	0.4	3.4	



Source: Fund staff estimates and projections.

1/ Public sector is defined as consolidated public sector. It includes the non-financial public sector and the central bank. The stock of public debt excludes central bank bills.

2/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

3/ Derived as $[(r - \pi(1+g) - g + ae(1+r)]/(1+g+\pi+g\pi))$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

4/ The real interest rate contribution is derived from the numerator in footnote 3 as $r - \pi (1+g)$ and the real growth contribution as $-g$.

5/ The exchange rate contribution is derived from the numerator in footnote 3 as $ae(1+r)$.

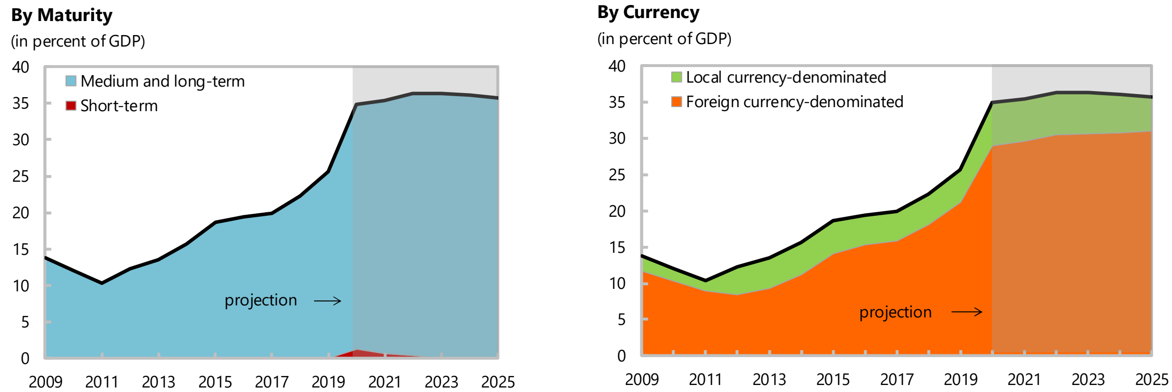
6/ Includes social security surplus, accumulation of deposits from the sovereign bond issuance in 2014, and financing of the national development bank.

7/ Includes asset changes and interest revenues (if any). For projections, it includes the impacts of exchange rate changes.

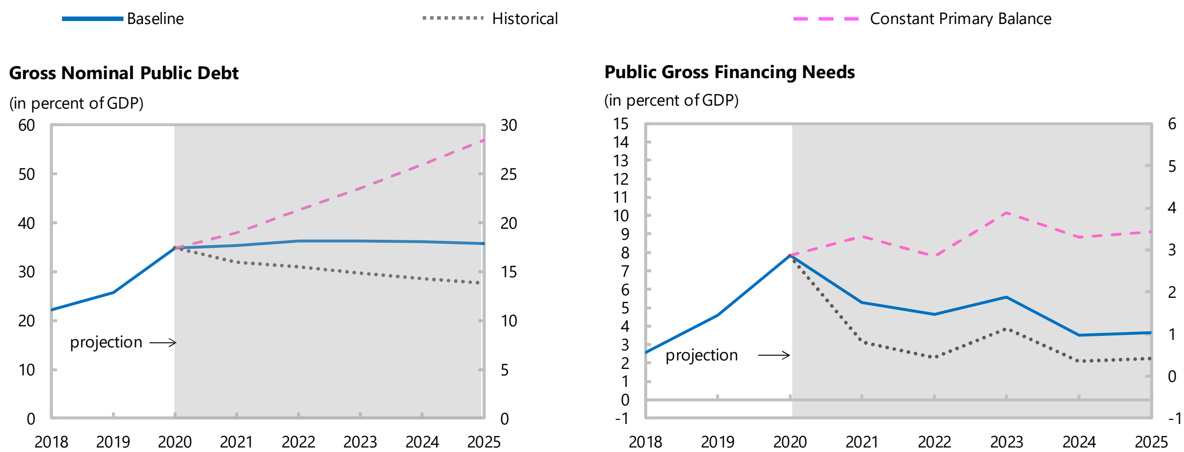
8/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Figure 1. Paraguay: Public DSA – Composition of Public Debt and Alternative Scenarios

Composition of Public Debt



Alternative Scenarios



Underlying Assumptions
(in percent)

Baseline Scenario	2020	2021	2022	2023	2024	2025
Real GDP growth	-0.9	4.0	4.0	4.0	3.5	3.5
Inflation	3.8	5.2	2.8	3.5	3.2	3.2
Primary Balance	-5.9	-3.4	-2.2	-1.5	-0.9	-0.7
Effective interest rate	2.6	2.8	3.2	3.5	3.9	4.2
Constant Primary Balance Scenario						
Real GDP growth	-0.9	4.0	4.0	4.0	3.5	3.5
Inflation	3.8	5.2	2.8	3.5	3.2	3.2
Primary Balance	-5.9	-5.9	-5.9	-5.9	-5.9	-5.9
Effective interest rate	2.6	2.8	3.5	3.9	4.5	4.9

Historical Scenario	2020	2021	2022	2023	2024	2025
Real GDP growth	-0.9	4.4	4.4	4.4	4.4	4.4
Inflation	3.8	5.2	2.8	3.5	3.2	3.2
Primary Balance	-5.9	-0.2	-0.2	-0.2	-0.2	-0.2
Effective interest rate	2.6	2.8	3.3	3.4	4.1	4.3

Source: Fund staff estimates and projections.

Annex IV. Risk Assessment Matrix

Source/nature of risk (Likelihood / Time horizon)	Expected impact and recommended response
External Risks	
Unexpected shift in the Covid-19 pandemic (**High / ST**): The disease could prove harder to eradicate (e.g., due to difficulties in finding/distributing a vaccine), requiring more containment efforts and impacting economic activity directly and through persistent behavioral changes (prompting costly reallocations of resources).	**Medium.** If the pandemic lingers on globally for extended periods of time, it may further dampen external demand, foreign inflows, and border trades. Potential output may take a permanent hit with more firm exits, lower labor force participation and reduced TFP. The exchange rate should be allowed to adjust, and monetary policy should remain accommodative.
Widespread social discontent and political instability. (**High / ST, MT**): Social tensions erupt as the pandemic and inadequate policy response cause economic hardship (including unemployment, higher incidence of poverty, and shortages and higher prices of essentials) and exacerbate preexisting socioeconomic inequities. Economic activity is disrupted. Growing political polarization and instability (e.g., contested elections) weaken policy-making and confidence. **Intensified geopolitical tensions and security risks (High / ST, MT):** (e.g., in response to pandemic) cause socio-economic and political disruption, disorderly migration, higher commodity prices (if supply is disrupted), and lower confidence.	**Medium.** Social unrest in the region may disrupt external demand from neighboring countries. It may also lead to higher risk premium of financial assets in the region, resulting in tighter financial conditions for Paraguay. Social policies need to continue supporting the low-income population most affected by the pandemic, including informal workers. Governance reforms need to move forward to strengthen the transparency, equity and effectiveness of public sector operations. Exchange rate should be allowed to depreciate in response to negative demand shocks. Though if commodity prices increase from higher global uncertainties, terms of trade may improve.
Higher frequency and severity of natural disasters related to climate change (**Medium to Low / MT, LT**): cause severe economic damage to smaller economies susceptible to disruptions.	**High.** Agriculture and hydro energy production would be the sectors most affected by climate change. Exchange rate depreciation would serve as a short-term buffer for climate-related production shocks. More accommodative monetary conditions can also help. In the medium term, reducing export concentration and diversifying into non-energy, non-commodity tradable sectors would be important.
Domestic Risks	
Weather-related shocks (**Medium** to **High / ST**): Agriculture and energy sector may be adversely impacted by weather.	**Medium** to **High.** Shocks to the agriculture sector not only affect GDP growth, export performance and exchange rate, but also the financial sector, due to banks' agricultural lending. Shocks to the energy sector will negatively affect government revenue. The exchange rate could absorb much of the shock. Foreign exchange interventions can be used to avoid disorderly market conditions.
Deterioration of fiscal sustainability (**Medium / ST, MT**): After the large deficit spike in 2020 due to the pandemic, the path for returning to the FRL stipulated deficit ceiling remains uncertain.	**Medium** to **High**. Fiscal stability is the cornerstone of macroeconomic stability in Paraguay, which significantly impacts investor confidence, financing costs, and growth performance. The government needs to strengthen its ability to raise revenues and control expenditure increases, reform civil services and public procurement processes.

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INTERNATIONAL MONETARY FUND

PARAGUAY

STAFF REPORT FOR THE 2020 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

January 27, 2021

Prepared By

The Western Hemisphere Department
(In consultation with other departments)

CONTENTS

FUND RELATIONS

(As of December 30, 2020)

Article VIII

Membership Status: Joined: December 28, 1945

General Resources Account:	**SDR Million**	**% Quota**
Quota	201.40	100.00
IMF's Holdings of Currency (Holdings Rate)	154.55	76.74
Reserve Tranche Position	46.85	23.26

SDR Department:	**SDR Million**	**% Allocation**
Net cumulative allocation	95.19	100.00
Holdings	96.84	101.73

Outstanding Purchases and Loans: None

Latest Financial Arrangements:

Type	Date of Arrangement	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
Stand-By	May 31, 2006	Aug 31, 2008	30.00	0.00
Stand-By	Dec 15, 2003	Nov 30, 2005	50.00	0.00
Stand-By	Jan 01, 1969	Dec 31, 1969	7.50	0.00

Outright loans

Type	Date of Arrangement	Date Drawn	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
RFI	April 21, 2020	N/A	201.40	0.00

Projected Payments to Fund[1]

(SDR Million; based on existing use of resources and present holdings of SDRs):

		Forthcoming			
	2020	2021	2022	2023	2024
Principal					
Charges/Interest		0.00	0.00	0.00	0.00
Total		0.00	0.00	0.00	0.00

Exchange Arrangement: The de jure exchange rate arrangement is floating as Article 47 of Law No. 489/95 establishes that the exchange rate is determined by market forces. The BCP publishes

[1] When a member has overdue financial obligations outstanding for more than three months, the amount of such arrears will be shown in this section.

information on its foreign exchange interventions on its website. The BCP intervenes occasionally in the market to smooth the effects of undue fluctuation. The BCP, as the government's financial agent, receives U.S. dollars from the government flowing from the royalties and compensation paid by the binational hydroelectric entities and exchanges them for guaranies at the request of the government for the purpose of public expenditures. The de facto exchange rate arrangement is classified as "crawl like" under the IMF exchange rate arrangement classification system.[2] Paraguay has accepted the obligations of Article VIII, Sections 2(a), 3, and 4 of the Fund's Articles of Agreement. Its exchange system is free of restrictions and multiple currency practices on the making of payments and transfers for current international transactions.

Safeguards Assessment: The last safeguards assessment for Banco Central del Paraguay (BCP) was conducted and finalized in 2006. The Bank has not been subject to monitoring in the recent years as there was no credit outstanding. Under the RFI approved in April 2020, the authorities committed to undergoing a safeguards assessment and to: (i) provide staff with access to the central bank's most recently completed external audit reports; (ii) authorize the central bank's external auditors to hold discussions with staff; and (iii) establish a framework agreement between the central bank and the government on responsibilities for servicing financial obligations related to the RFI instrument. These documents have not yet been received by FIN staff. Additionally, the safeguards policy requires an update assessment to be completed before Board approval of any subsequent arrangement.

Article IV Consultation: The Executive Board concluded the 2019 Article IV consultation on April 24, 2019.

Technical Assistance 2011–20

DPT	Purpose	Date of Delivery
FAD	Public-Private Partnerships	February 2011
STA	National Accounts Statistics	March–April 2011
FAD	Medium-Term Macro-Fiscal Framework and Public Investment Management	March–April 2011
MCM	Monetary Policy, Central Bank Operations, and Accounting	April 2011
FAD	Public Transport Subsidies	June–July 2011
MCM	Financial Soundness Indicators and Financial Oversight	November 2011
FAD	Improve Fiscal Projections and Financial Planning	December 2011
FAD	Modernization of the Customs Administration	December 2011
FAD	Debt and Cash Management	March 2012
FAD	Tax Policy	March 2012
MCM	Monetary Policy, Central Bank Operations, and Accounting	April 2012

[2] The classification criteria for exchange rate arrangement can be found in the IMF Annual Report on Exchange Arrangements and Exchange Restriction.

DPT	Purpose	Date of Delivery
FAD	Tax and Custom Administration	December 2012
FAD	Debt and Public Investment Management	May 2013
MCM/LEG	Launch of the AML/CFT	June 2013
MCM	Inflation Targeting and Central Bank Operations	August 2013
FAD	Revenue Administration	September 2013
FAD	Tax Administration	December 2013
STA	ROSC	February 2014
FAD	Tax and Customs Administration	Apr, May, Jul, Sep
MCM	Bank Supervision and Regulation	July 2014
MCM	Monetary and FX Policy	July 2014
LEG	Anti Money Laundering Activities	May, Jun, Sep 2014
FAD	Public Financial Management	July 2014
STA	Producer Price Index Statistics	August 2014
STA	Balance of Payments and IIP Statistics	September 2014
MCM	Central Bank Monetary and Foreign Exchange Operations	October 2014
MCM	Insurance Supervision	December 2014
FAD	Budget Preparation and Execution	December 2014
LEG	Anti Money Laundering Activities	February 2015
STA	Government Financial Statistics Mission	March 2015
MCM	Risk-Based Bank Supervision	April 2015
LEG	Anti Money Laundering Activities	April 2015
FAD	Customs Administration	May 2015
MCM	Bank Stress testing	May 2015
FAD	Tax Revenue Administration	July 2015
MCM	Risk-Based Bank Supervision	August 2015
LEG	Anti Money Laundering Activities	September 2015
MCM	Risk-Based Bank Supervision	November 2015
LEG	Anti Money Laundering Activities	December 2015
MCM	Foreign Exchange Operations	February 2016
FAD	Tax Revenue Administration	March 2016
FAD	Fiscal Responsibility Law	March 2016
LEG	Anti Money Laundering Activities	March/April 2016
MCM	Review of Insurance Supervision	May 2016
MCM	Risk-Based Bank Supervision	July 2016
MCM	Central Bank Accounting and Related Systems	October 2016
FAD	Customs Administration	October 2016
FAD	Structural Balance Rule and a Public Debt Objective	November 2016
STA	Government Finance Statistics	December 2016
STA	Enhanced General Data Dissemination	February 2017
STA	National Accounts Statistics	March 2017
MCM	Risk-Based Bank Supervision	April 2017

DPT	Purpose	Date of Delivery
STA	Balance of Payments Statistics	May 2017
FAD	Tax Revenue Administration	May 2017
MCM	Financial Sector Stability Review - Scoping Mission	May 2017
MCM	Risk-Based Bank Supervision	July 2017
MCM	Financial Sector Stability Review	October 2017
MCM	Adoption of IFRS Accounting Standards	October 2017
MCM	Risk-Based Bank Supervision	December 2017
FAD	Tax Policy	June 2018
MCM	Insurance Regulation and Supervision	July 2018
MCM	Adoption of IFRS	August 2018
STA	National Accounts Statistics	October 2018
MCM	Stress Testing (Banking System)	November 2018
FAD	Customs Administration	December 2018
MCM	Risk-Based Banking Supervision	January 2019
MCM	Contingency Planning for Crisis Preparedness	February 2019
MCM	Cybersecurity Strategy assessment	March 2019
MCM	FSSR: Stress Testing Banking/Credit unions	March 2019
MCM	FSSR Follow-up Risk-based Supervision	April 2019
MCM	FSSR: Risk Based Supervision	May 2019
FAD	Customs Administration	September 2019
FAD/LEG	TA Governance Project FAD/LEG/WHD Mission	February 2020
FAD	Governance Assessment	March 2020
FAD	Customs Risk Assessment	July 2020
MCM	Adoption of IFRS	October 2020
FAD	Tax Revenue Administration	November 2020
MCM	Bank Resolution Framework	November 2020
LEG	AML/CFT Best Practices	December 2020

Resident Representative: There is currently no resident representative in Paraguay.

RELATIONS WITH OTHER INTERNATIONAL FINANCIAL INSTITUTIONS

Information on the activities of other IFIs in Paraguay can be found at:

https://www.worldbank.org/en/country/paraguay

https://www.iadb.org/en/countries/paraguay/overview

STATISTICAL ISSUES

(As of January 19, 2021)

Assessment of Data Adequacy for Surveillance

In general, data provision to the Fund has some shortcomings, but is broadly adequate for surveillance. Paraguay has made significant improvements in the compilation and dissemination of macroeconomic statistics, but some shortcomings persist.

National accounts. National accounts with base year 2014, broadly consistent with the guidelines of the *2008 SNA*, were released in 2018. The rebased GDP series disseminated currently cover national accounts data from 1991 to 2019.

Price statistics. Both the consumer (CPI) and producer price indices (PPI) are reported on a regular and timely basis. The geographic coverage of the CPI, both in terms of expenditure weights and price collection, is limited to urban households living in Greater Asunción (the capital and metropolitan area). According to metadata published on the CBP website, PPI coverage includes imported items; however, imported items are out of scope for a PPI. There is a need to review and confirm PPI compilation methods.

Government finance statistics. The government finance statistics (GFS) used for internal purposes and for reporting to WHD are broadly consistent with the recommendations of the *Government Finance Statistics Manual 2001* (GFSM 2001). In early 2015, the Ministry of Finance introduced GFSM 2001 classifications and presentation for monthly budgetary central government statistics, which are published regularly on the Ministry's website. The asset position of the social security system is available on a daily basis. Statistics of the nonfinancial public sector include data of four employer social insurance schemes, which are treated as financial corporations in the monetary and financial accounts. Data on medium- and long-term external debt are reliable and available on a monthly basis. Deficiencies remain in recording short- term supplier and commercial credit of the public sector.

Monetary and financial statistics. Paraguay reports monetary data for the central bank and other depository corporations (ODCs) using the standardized report forms (SRFs). An integrated monetary database meeting the data needs of the BCP and the Fund staff is in operation. Coverage of the ODC survey is complete, including data on credit cooperatives. The Superintendence of Banks reports 11 of the 12 core and seven of the 13 encouraged financial soundness indicators for deposit takers to STA on a monthly basis. Paraguay reports data on some key series and indicators of the Financial Access Survey (FAS), including the two indicators (commercial bank branches per 100,000 adults and ATMs per 100,000 adults) adopted by the U.N. to monitor Target 8.10 of the Sustainable Development Goals.

External sector statistics (ESS). Quarterly balance of payments and international investment position (IIP) data, which follow the recommendations of the fifth edition of the Balance of Payments Manual (BPM5), are available from 2000 onwards. The BCP needs to improve the compilation methods of some financial account components such as transactions related to intercompany lending within direct investment in the reporting economy, external deposits of the non-financial private sector, and external debt liabilities of banks as recommended by the last TA mission on ESS conducted in May 2017.

Data Standards and Quality

Paraguay became a participant in the Fund's General Data Dissemination System (now e-GDDS) in September 25, 2001 and published a National Summary Data Page on March 2, 2017. Paraguay disseminates 14 of the 15 data categories recommended under the IMF's enhanced General Data Dissemination System (e-GDDS) which are broadly aligned with the Table of Common Indicators Required for Surveillance, with timeliness and periodicity prescribed under the e-GDDS. Paraguay is in the process of improving the coverage for central and general government operations, the central bank and depository corporations survey, and external debt. Paraguay's data ROSC was published on August 18, 2014.

Paraguay: Table of Common Indicators Required for Surveillance
(As of January 5, 2021)

	Date of Latest Observation	Date Received	Frequency of data[8]	Frequency of Reporting[8]	Frequency of Publication[8]	Memo Items: Data Quality – Methodological Soundness[9]	Memo Items: Data Quality Accuracy and Reliability[10]	Memo Items: Year of metadata update
Exchange Rates	12/31/20	12/31/20	D	D	D			2020
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	Nov-2020	Dec-2020	M	M	M			2020
Reserve/Base Money	Nov-2020	Dec-2020	M	M	M	O, LNO, LO, O	O, O, O, LO, LO	2020
Broad Money	Nov-2020	Dec-2020	M	M	M			2020
Central Bank Balance Sheet	Nov-2020	Dec-2020	M	M	M			2020
Consolidated Balance Sheet of the Banking System	Nov-2020	Dec-2020	M	M	M			2020
Interest Rates[2]	Oct-2020	Dec-2020	M	M	M			2014
Consumer Price Index	Dec-2020	Jan-2021	M	M	M	O, LO, O, O	LO, LO, O, O, LO	2019
Revenue, Expenditure, Balance and Composition of Financing[3] – CG	Nov-2020	Dec-2020	M	M	M	LNO, LNO, LNO, LO	LO, LO, LO, LO, LO	2019
Revenue, Expenditure, Balance and Composition of Financing – CPS[4]	Dec-2019	06/30/20	A	A	A	LNO, LNO, LNO, LO	LO, LO, LO, LO, LO	not disseminated
Stocks of CG Debt[5]	Nov-2020	Dec-2020	M	M	M			2019
International Investment Position[6]	Q3 2020	01/05/21	Q	Q	Q			2019
External Current Account Balance	Q3 2020	01/05/21	Q	Q	Q	LO, LO, LO, LO	LO, O, LO, O, LO	2019
Exports and Imports of Goods and Services[7]	Nov-2020	01/05/21	M	M	M			2019
GDP/GNP	Q3 2020	11/24/20	Q	Q	Q	LO, LNO, LO, LO	LNO, LO, LNO, O, LO	2019
Gross External Debt	Q3 2020	01/05/21	Q	Q	Q			2019

[1] Any reserve assets that are pledged or otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.

[2] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.

[3] Central government (CG) revenue, expenditure, balance, and composition of financing data are available monthly.

[4] The consolidated public sector consists of the central government, social security funds, state and local governments, public financial institutions, and nonfinancial public enterprises.

[5] Debt guaranteed by the central government. Includes debt by the central administration and decentralized administration (central bank, autonomous entities, nonfinancial public enterprises, social security, and financial public institutions).

[6] Includes external gross financial asset and liability positions vis-à-vis nonresidents.

[7] Monthly frequencies for goods only.

[8] Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A); Irregular (I); Not Available (NA).

[9] Reflects the assessment provided in the data ROSC published in August 2014 and *based* on the findings of the mission that took place during February 12–26, 2014 for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning (respectively) concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O), largely observed (LO), largely not observed (LNO), not observed (NO), or not available (NA).

[10] Same as footnote 9, except referring to international standards concerning (respectively) source data, assessment of source data, statistical techniques, assessment and validation of intermediate data and statistical outputs, and revision studies.

Statement by Mr. Chodos and Mr. Corvalan Mendoza on Paraguay
February 12, 2021

On behalf of the Paraguayan authorities, we would like to thank the mission chief Bas Bakker and the western hemisphere team for the candid and constructive dialogue during the 2020 Article IV Consultation and the interesting staff report and selected issues paper, as well as all area departments for their close engagement with the country during these challenging times.

Background Information

For almost two decades, various governments embraced the idea of laying the foundations to reduce poverty and inequality in a sustainable manner. Technical assistance from regional and international organizations, as well as development partners, proved handy on this long-term quest to improve the social indicators of Paraguay. Between 2002 and 2019 the poverty rate more than halved.

The benign super-cycle of commodity prices from the early 2000's offered a unique opportunity for Paraguay to modernize its fiscal, monetary, and financial sectors. Progress was possible in all these sectors, buttressed by a precautionary Stand-By Arrangement in 2003. Since then, the country was able to implement a Fiscal Responsibility Law (FRL), an inflation-targeting regime, and strengthen the financial system regulation and supervision in line with international best practices. Macroeconomic variables have experienced continuous improvements and allowed the country to buildup buffers to mitigate climate-change-related shocks (mainly droughts and floods), regional and global volatilities, and more recently the COVID-19 pandemic.

In April 2020, during the time of great uncertainty created by the pandemic and the challenges to tap domestic and foreign markets, the authorities made a request for a purchase under the Rapid Financing Instrument (RFI) in the amount of SDR 201.4 million (100 percent of quota). Shortly after the IMF Executive Board approved the RFI, Paraguay managed to issue a US$ 1 billion sovereign bond at favorable terms and is continuing to do so.[1] The Fund's swift action may have produced a signaling effect that helped the country catalyze enough financial resources from capital markets and reinvigorated the pace of disbursements from other multilaterals, regional, and bilateral sources. As a result, the authorities advised the Fund of their plan not to draw on the RFI.

As a result of the COVID-19 pandemic, certain weaknesses resurfaced in sensitive areas, such as promoting inclusive growth to reduce poverty and informality, enhancing the preparedness of the

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[1] The last sovereign bond issuance was in January 2021, with a maturity of 12 years and 2.7 percent yield.

health system, and the quality of education. The authorities are aware of the ample room for improvement in these sensitive areas, and efforts are now being focalized on governance, transparency, the civil service system, public procurement, and the FRL update, among others, to enhance the effectiveness and efficiency of the state provision of quality services to citizens. In this regard, the government's Economic Recovery Plan is appropriately focused to tackle these challenges.

Governance Assessments

In August 2019, the authorities requested a full-fledged assessment on governance, which was positively responded to by a collaboration with the IMF and the Inter-American Development Bank (IADB). The team was deployed to Asunción in February and early March 2020 (right before the country's lockdown) to start discussions with the principal stakeholders. Later, the discussions on governance continued online throughout 2020, and a report was recently submitted to the authorities for their attention. The authorities recognize there is ample room to improve the country's institutions and seek to close the income gap relative to well-performing economies. The surge of the COVID-19 pandemic clearly signaled to policy makers, that going forward, society will demand stronger governance.

Two Consecutive Years with Adverse Scenarios and the Use of Buffers

In 2019, the economy was significantly affected by a drought, which reduced agricultural production, especially soybean, which also led to a weakening of some branches of the manufacturing sector and various sectors linked to agriculture. The drought also severely influenced the generation of electricity from binational hydroelectric dams. By the second half of the year, floods also negatively impacted livestock and construction sectors. Nevertheless, a swift recovery economic plan was deployed in 2019 to mitigate the fall, from an initial forecast of 4.0 percent of annual GDP growth to 0 percent. Positive signals of recovery started to build GDP momentum from July onwards. In this context, the fiscal deficit inched up to 2.8 percent of GDP. It is worth mentioning that the fiscal deficit in 2019 was also largely the result of a significant increase in public investments. Therefore, the composition of expenditures was moving in the right direction, with more resources being deployed to capital investments, while keeping current expenditure in check.

In early 2020, the country experienced a robust growth driven by a recovery in agriculture, electricity generation, manufacturing, services, and construction, and the data collected in January and February of 2020 was consistent with the initial forecast of 4.1 percent of annual GDP growth. With the surge of COVID-19, supply and demand shocks affected the nascent economic recovery, and the country ended up with a contraction of GDP (-0.9 percent) in 2020. The two consecutive shocks in 2019 (climate related) and 2020 (the pandemic) consumed part of the country's buffers. The fiscal deficit reached 6.5 percent of GDP in 2020, but with the caveat that public investments were still an important component of the final outturn. Public debt was 35.4 percent of GDP and gross international reserves touched US 8.5 billion (or the equivalent of 6.7 months of imports).

At the onset of the COVID-19 pandemic the authorities acted quickly and forcefully and helped prevent the health system from collapsing, while keeping the death toll per million in the first few months to among the lowest in the region. They also swiftly implemented two novel social temporary assistance programs for vulnerable families and for the informal sector with positive results. In addition, their swift actions helped contain the economic situation from further deterioration; even though it ended up in negative territory, it was one of the lowest in the region.

The Authorities' Commitments

To enhance the transparency and accountability of the state regarding the use of public funds, the authorities made specific commitments to ensure that related expenditures authorized last year, related to the emergency law during the COVID-19 pandemic, were subject to robust budgetary procedures. The Court of Accounts of Congress, the Office of the Comptroller, and the Anti-Corruption Secretariat performed an audit of all crisis-mitigation spending, which is all available to the public online. Transparency reinforces the engagement of civil society with the public sector.

The authorities are continuing with the accommodative stance in 2021, with fiscal, monetary, and financial policies in order to promote an environment for economic recovery of 4.0 percent.

A gradual return to the FRL is envisaged with 1.5 percent of the GDP deficit ceiling by 2024, while continuing the analysis in Congress on new ways to enhance the FRL. A proposal for more stringent measures on current expenditure is now under consideration with the addition of a debt ceiling mechanism in the FRL.

Full implementation of the inflation-targeting regime will allow the exchange rate mechanism to act as the first line of defense against shocks. The level of inflation remained well anchored, and this environment was conducive for the Central Bank of Paraguay (BCP) monetary policy rate to be reduced by 325 bps cumulatively in 2020 to the current rate of 0.75 percent.

Regarding the vigilance of the financial system, last year, liquidity provision to the financial sector was strengthened by the BCP, and banks could renew, refinance, and restructure loans without penalty, and with a lower risk weight. A Micro Small and Medium Enterprises (MSMEs) Guarantee Fund (FOGAPY) was capitalized to provide credit guarantees on new loans to MSMEs. The Development Finance Agency (AFD, a second-tier public institution) eased financing conditions for housing loans and set in place new credit lines targeting MSMEs. On top of that, the BCP made a sizable share of the legal reserve requirement in domestic and foreign currency accessible to the banking system and created a special liquidity window to pump-up liquidity to the financial system. The overall size of the monetary and financial stimulus represented roughly 4 percent of GDP in 2020, among other measures.

Actions are underway to speed up a digital agenda for the public sector, which aims to improve the competitiveness of the economy and the quality of public services provided to citizens and corporations.

Implementation is underway of more than ten new laws related to AML/CFT mitigation risks. These include court sentencing, criminal appeal (all specialized in money laundering, drug trafficking, anti-kidnapping, financing terrorism, corruption, and organized crime), along with the creation of punishable acts of transnational bribery.