

**Paraguay: 2010 Article IV Consultation—Staff Report; Staff Supplement; Public Information Notice on the Executive Board Discussion; 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 2010 Article IV consultation with Paraguay, the following documents have been released and are included in this package:

- The staff report for the 2010 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on April 20, 2010, 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 May 21, 2010. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- A staff supplement of May 21, 2010 updating information on recent developments.
- A Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its June 4, 2010 discussion of the staff report that concluded the Article IV consultation.
- A statement by the Executive Director for Paraguay.

The document listed below has been or will be separately released.

Selected Issues Paper

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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INTERNATIONAL MONETARY FUND

PARAGUAY

**Staff Report for the 2010 Article IV Consultation**

Prepared by the Staff Representative for the 2010 Consultation with Paraguay

Approved by Rodrigo Valdés and Dominique Desruelle

May 21, 2010

**Executive Summary**

- **Context.** The Paraguayan economy performed very well in the period 2003–08, as sound demand policies supported by structural reforms helped real GDP grow by 5 percent a year. In 2009, a severe drought and the global financial crisis triggered a recession, although countercyclical demand policies helped contain the decline in real GDP to 3.8 percent. In concluding the 2009 Article IV consultation, Directors supported the shift to more accommodative demand policies, while preserving macroeconomic stability, and underscored the need to press ahead with structural reforms, especially in the financial sector and public enterprises.
- **Outlook for 2010.** The economy is expected to rebound from the 2009 recession, as real GDP would grow by 6.0 percent in 2010. Favorable weather conditions will help produce a record soy harvest, which—together with faster growth in key trading partners—will boost exports and private investment. With renewed momentum in domestic demand and rising international commodity prices, inflation is projected to increase from 1.9 percent in 2009 to 5 percent in 2010, and the external current account deficit would expand moderately to 1.7 percent of GDP on the back of rising imports. With continued net capital inflows, net international reserves would rise to US\$4.1 billion (25 percent of GDP). The authorities plan to continue supporting the recovery in 2010, although with some removal of the 2009 stimulus. All available indicators suggest that the level of the *guarani* is consistent with its fundamentals.
- **2010 Article IV consultation.** Discussions centered on the authorities' plan to advance their agenda of institutional reforms, drawing heavily on technical assistance from the Fund. These reforms include the adoption of a medium-term fiscal framework, an inflation targeting regime, and further enhancements to the macro-prudential framework. With these reforms, real GDP would grow by 4–5 percent a year over the medium term, while inflation would decline to 3 percent a year by 2014.
- **The 2010 Article IV consultation discussions were held in Asunción during April 12–20.** The mission comprised R. Rennhack (head), T. Dabán-Sánchez, S. Acosta-Ormaechea (all WHD), E. Crivelli (FAD), and Sylwia Nowak (MCM). T. Roy (Resident Representative) assisted the mission, and J. Maciel (OED) participated in the meetings. The mission met with Vice President Franco, Minister Borda, Central Bank Governor Corvalán, congressional leaders, senior government officials and representatives of the private sector and the donor community.
- **Other issues.** Paraguay maintains a flexible exchange rate regime, and has accepted the obligations of Article VIII, Section 2, 3 and 4. Its exchange system is free of restrictions on the making of payments and transfers for current international transactions. The anti-money laundering law is being implemented. The senate recently approved a law to combat the financing of terrorism.

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## I. CONTEXT AND RECENT DEVELOPMENTS

1. ***Paraguay's took advantage of the favorable global economic climate earlier this decade to strengthen economic performance.*** The government ran a sizable primary surplus in the period 2003–08, which cut public debt to less than 25 percent of GDP by end-2008. The central bank brought inflation down to 7.5 percent during 2008, while maintaining exchange rate flexibility. Structural reforms advanced in several areas, including financial supervision, budget management, and the tax system. These policy efforts were supported by two Fund arrangements. As a result, during 2003–08 real GDP rose by 5 percent a year, helping to reduce poverty. Net international reserves rose to almost US\$3 billion by 2008 and the financial sector recovered from a severe crisis.
2. ***In 2009, the global financial crisis coupled with a severe drought buffeted the economy, causing a 3.8 percent decline in real GDP.*** Exports fell sharply in response to the effect of the drought on agricultural production (about one quarter of the economy) as well as the depressing effect of the global crisis on world commodity prices and growth in trading partners. With the strong links between agriculture and the rest of the economy, real domestic demand declined. This, together with the reversion of international commodity prices, brought headline inflation down to 2 percent during the year and slowed the growth in credit to the private sector to 25 percent (y-o-y) by end-2009, down from a peak of 78 percent in May 2008. In addition, imports fell more sharply than exports, and the current account deficit narrowed significantly to 1.3 percent of GDP. The real effective exchange rate (REER) declined by 5 percent in the first half of the year, as the global crisis intensified. Interestingly, net capital inflows expanded to 5 ½ percent of GDP, reflecting in repatriations by residents seeking a safe haven for their assets. Overall, net international reserves rose by US\$1 billion, reaching US\$3.8 billion (340 percent of short-term debt on remaining maturity basis and 25 percent of GDP).
3. ***Drawing on the buffers built during the period 2003–08, demand policies in 2009 shifted to a countercyclical stance and helped limit the fall in real GDP.***
  - ***The central government scaled back the primary surplus.*** After running sizable primary surpluses in the period 2004–08 and reducing public debt below 25 percent of GDP by end-2008, the government had the space to boost public spending, especially on investment and conditional cash transfer programs. Government expenditures increased by 25 percent in real terms. The wage bill increased sharply from 7.1 percent of GDP in 2008 to 8.4 percent of GDP in 2009, reflecting an expansion in public employment, as well as a 5 percent wage increase in mid-2009. At the same time, total revenues rose by almost 2 percent of GDP, reflecting a jump in income tax collections (from the settlement of 2008 taxes). Also revenues from the sale of hydroelectric power rose to 3.1 percent of GDP, mainly as the depreciation of

the *guaraní* vis-à-vis the U.S. dollar boosted the domestic-currency value of these royalties.<sup>1</sup> All in all, the primary surplus fell from 3.1 percent of GDP in 2008 to 0.7 percent of GDP in 2009 and the overall balance registered a surplus of 0.1 percent of GDP. The fiscal impulse is estimated at 2 percent of GDP.

- ***The central bank focused on providing ample liquidity.*** During the peak of the global crisis, the central bank lowered the average policy interest rate<sup>2</sup> from 4.0 percent at end-2008 to 0.6 percent in April 2009, and then raised the rate to 2.0 percent by mid-year as the economy began to recover. It also reduced reserve requirements and opened a new short term liquidity facility. To smooth excess currency volatility, the central bank made partially sterilized purchases of foreign exchange, which also provided an additional source of liquidity to money markets. For the year as a whole, the *guaraní* depreciated by 13 percent vis-à-vis the U.S. dollar.
4. ***Banks held up well during the downturn but some signs of stress appeared in the cooperatives.*** Banks remained well capitalized (with an overall capital adequacy ratio of 16.4 percent and a Tier 1 capital ratio of 10.1 percent at end-2009) and highly liquid (with liquid assets equivalent to a third of total assets). The quality of the loan portfolio seems strong, as non-performing loans amounted to only 1.9 percent of total loans, although about 15 percent of total loans were restructured or refinanced to avoid payment delays. Cooperatives now account for one quarter of total financial system assets, but are lightly supervised, with less stringent capital and provisioning requirements than banks. Non-performing loans of cooperatives rose to 8 percent of total loans by end-2009.
5. ***The government's reform record has been mixed so far.*** Congress recently approved the law allowing the government to capitalize the central bank in up to 6¼ percent of GDP, through the transfer of interest-bearing Treasury notes, in line with previous Fund advice. Since the last Article IV consultation, progress has been made in other areas, including:
- strengthening tax administration by enforcing tax collection and re-establishing on-site tax audits;
  - improving the monitoring of public enterprises by re-establishing the supervisory council of public enterprises and creating a specialized unit in the ministry of finance; and
  - enhancing banking supervision, including by setting a generic provisioning requirement of 0.5 percent.

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<sup>1</sup> These revenues are paid in U.S. dollars and come from two hydroelectric plants—Itaipu and Yacyreta—situated on the Parana River.

<sup>2</sup> The average of interest rates of central bank sterilization bills, weighted by maturity.

6. ***The political situation poses significant challenges for policies.*** As the first government in 60 years to be headed by a political party other than the Colorado party, the government of President Lugo has no majority coalition in congress, which has strong powers and often opposes government initiatives. In April 2009 congress delayed for another three years the implementation of the personal income tax originally approved in 2004. These differences could intensify ahead of the November 2010 municipal elections.

## II. OUTLOOK AND RISKS

7. ***In 2010, the economy is expected to rebound from the 2009 recession.*** Real GDP is expected to grow by 6.0 percent. Favorable weather conditions will help produce a record soy harvest, which—together with faster growth in key trading partners—will boost exports and private investment. Other indicators in the first quarter—such as tax collections, imports of capital and durable consumer goods, and credit to the private sector—also point to renewed momentum in domestic demand. These trends, together with rising international commodity prices, are expected to push inflation up to 5 percent in 2010 and expand the external current account deficit moderately to 1.7 percent to GDP. With continued net capital inflows, net international reserves would rise to US\$4.1 billion (25 percent of GDP). Bank credit to the private sector—which at 25 percent of GDP is low by regional standards—would grow by 18 percent during 2010, while broad money would expand by 19 percent.

8. ***Highly dependent on agriculture and international trade, Paraguay is likely to remain exposed to swings in world commodity prices, demand in key trading partners and weather cycles.*** Other vulnerabilities stem from the still-high dollarization in the financial system, the limited oversight of cooperatives, and fiscal risks coming from losses of public enterprises. Inflation expectations for end-2010 have come down to 5 percent, although Paraguay's history of volatile inflation underscores the need to improve the credibility of policies further.

9. ***For these reasons, the authorities are firmly committed to continue to strengthen policy institutions, while maintaining prudent demand policies.*** With the economy in full recovery, they will manage fiscal and monetary policy carefully to keep inflation under control. Their reform agenda is broad and ambitious and includes the gradual adoption of a medium-term fiscal framework and inflation targeting, while continuing to strengthen financial supervision—all in line with recommendations from FAD and MCM. Other reforms would include broadening the tax ratio—one of the lowest in the region—to help fund additional spending on social programs and infrastructure and making public enterprises more efficient.

10. ***With these policies, staff projects that real GDP would grow by 4–5 percent a year in the period 2010–15.*** This pace of growth would be supported by the outlook for firm world commodity prices, robust growth in Brazil and the recovery in the global economy, as well as the rebound from the drought of 2009. By 2015, private investment and savings would recover to their levels in relation to GDP of 2004–05. The central bank is committed

to lowering annual inflation to 3 percent by 2014. The external current account would register small deficits, which—together with sustained capital inflows—would lead to steady gains in net international reserves. These trends would likely be accompanied by a gradual real appreciation of the *guaraní*, which—according to all available indicators—appears to be broadly in line with its fundamentals (Appendix 1). The authorities are closely monitoring developments in Europe, which could alter this outlook if commodity prices were to fall or growth in trading partners were to slow. However, they stand ready to adapt policies as necessary to preserve macroeconomic stability.

### III. POLICY DISCUSSIONS: INSTITUTIONAL REFORM TO STRENGTHEN POLICY MAKING

11. *Discussions focused on identifying and prioritizing key institutional reforms to further strengthen macroeconomic policy.* Institutional reforms would build a firmer anchor for confidence and support a more vigorous pace of sustainable economic growth. Discussions also included the most appropriate response to the state of the cycle and inflation pressures.

#### A. Short-term Demand Management

12. *The authorities and staff agreed that demand policies should continue supporting the recovery in 2010, with some removal of last year's stimulus to keep inflation under control.* The authorities expect the overall balance of the central government to be in equilibrium in 2010, compared with a surplus of 0.1 percent of GDP in 2009, which would bring the fiscal impulse to 0.3 percent of GDP. Total revenues would remain stable in relation to GDP. While tax revenues would raise moderately, the appreciation of the *guaraní* vis-à-vis the U.S. dollar would lower the domestic currency value of royalties. Spending would remain stable in relation to GDP, reflecting increased conditional cash transfers to low-income households and pension payments, together with scaled-back capital expenditures. The central bank intends to limit inflation to no more than 5 percent and intends to withdraw the excess liquidity as necessary, driving up the policy interest rate (which is now less than expected inflation).

#### B. Fiscal Reforms

13. *The authorities agreed that fiscal reforms should maintain a small primary surplus to keep public debt in the range of 20–25 percent of GDP over the medium term (Appendix 2).* Within this constraint, they would raise spending on infrastructure and social programs, while controlling the growth of current spending. There is an urgent need to upgrade transmission and distribution of electricity, improve the quality of telephone landlines and internet connectivity, and expand the road network. Poverty continues to be widespread at 40 percent of the population, and the rural poor were the most affected by last year's drought. The government increased the coverage of its conditional cash transfer program (Tekopora) from 15,000 to 100,000 families in 2009. A further extension of the program and improvements in the supply of basic health and education services are

warranted, provided that control mechanisms remain in line with best international practices and in line with financing constraints. To finance the additional spending, they would aim to raise the tax ratio to 15 percent of GDP over the medium term.

14. ***The key fiscal reforms include:***

- ***Medium Term Fiscal Framework (MTFF).*** Some progress has been made with the formulation of a macro-fiscal model, the reinforcement of human resources of the macro-fiscal unit, and the preparation of a document outlining the government's fiscal strategy. Staff emphasized that for the MTFF to be an effective management tool, it should be fully integrated in the budget process, include realistic medium-term revenue projections, allow for the reconciliation of line ministries ceilings and macroeconomic constraints and envisage regular debt sustainability analysis. Staff recommended that the authorities attach the MTFF and the government's fiscal strategy paper to the draft budget to help focus the legislative discussion of the budget on the medium-term constraints. The authorities stressed their commitment to implement the recommendations from FAD and have requested further assistance from the Fund, especially on debt management issues.
- ***Improve quality of spending.*** Staff encouraged the authorities to develop performance-based budgeting to measure the impact of expenditure. Staff noted that the increase in the government's wage bill during 2009 will lock in a higher level of current spending. The authorities explained that much of the additional employment was in social sectors where there was an urgent need to improve the delivery of services. However they agreed on the importance of restraining the growth of current spending going forward.
- ***Manage additional compensations from Itaipu.*** Revenues from hydroelectric power from Itaipu could rise by another 1.5 percent of GDP a year starting in 2010, once the Brazilian congress approves a 2009 agreement.<sup>3</sup> Staff fully supported the government's intention to de-politicize the use of these additional revenues by seeking approval of a law that would place them in a special fund, which would pay for high-return projects in infrastructure and technology and build up a countercyclical reserve fund. Furthermore, staff suggested that the law include a "permanent income clause" to allow the fund to provide a permanent source of income.<sup>4</sup> The authorities intend to channel a significant share of these payments to the reserve fund, which could achieve a comparable result.

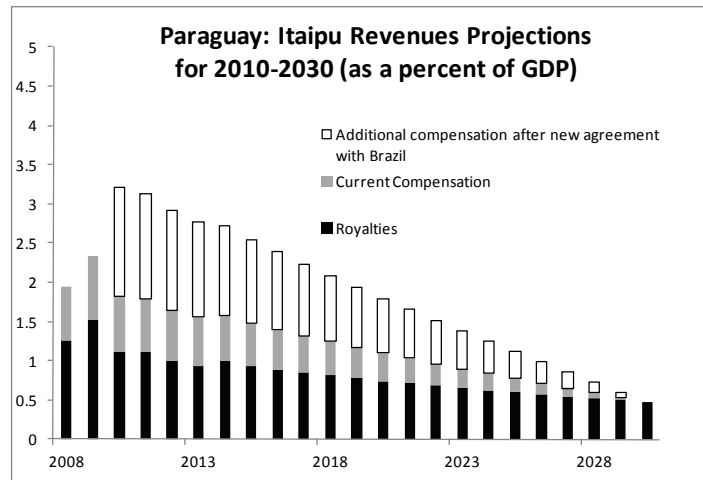
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<sup>3</sup> In July, 2009 the Brazilian and Paraguayan governments agreed to triple the price of the sale of Paraguay's share of the production from the Itaipu dam to Brazil.

<sup>4</sup> The Selected Issues Papers include a presentation of the application of the permanent income rule in this case.



- Additional tax effort (Box 1).**<sup>5</sup> Additional tax revenues would provide more fiscal space for spending on social programs and infrastructure. These would also help diversify revenue sources away from royalties from sales of hydroelectric power, which are projected to decline sharply in relation to GDP over the next 10–15 years.<sup>6</sup> To that end, the authorities are stepping up their efforts to improve tax administration, especially at the customs level, and have taken steps to broaden the tax base. In particular, in October 2008 the base of the income tax for the agricultural corporate sector (IMAGRO) was expanded by beginning to phase out the ability to deduct VAT payments from this tax. To eliminate the potential for fraudulent deductions from the IMAGRO, staff recommended the adoption of a clear deadline and an effective system to monitor these deductions. The authorities expect this step to raise revenues by 1 percent of GDP a year over the next 3–4 years.<sup>7</sup> With this measure and continued efforts on strengthening administration, staff estimates that tax revenues will grow by 1 to 1.5 percent of GDP by 2015. Going forward, staff supported the government’s intention to explore the introduction of a small tax on sales of agricultural products (as in Uruguay), while noting this was a second best measure. Staff encouraged the authorities to extend the VAT to agricultural products, which are now exempt, and to raise selective consumption taxes. The authorities cautioned that any attempt to extend the VAT to agricultural products would meet stiff political resistance. The authorities and staff agreed that, in spite of the recent decision by congress to delay its implementation, the personal income tax would be an important step toward a more efficient and fairer tax system and would enhance the administration of the VAT.



<sup>5</sup> The Selected Issues Papers include a comparative analysis of Paraguay’s tax system.

<sup>6</sup> These revenues would decline as local demand for electricity rises and reduces sales of excess electricity to Brazil (which earns a higher price per GWh). In addition, the price per GWh is adjusted monthly in line with the CPI and industrial production index in the United States, which will probably grow by less than economic activity in Paraguay.

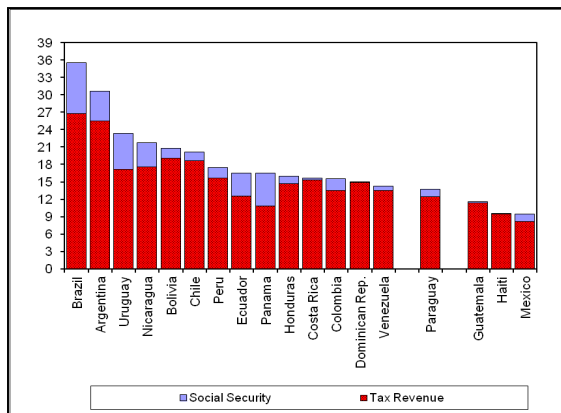
<sup>7</sup> Taxpayers may still deduct the stock of VAT payments outstanding as of October 2008 that had not been deducted from the payments under the IMAGRO, and they expect this stock to be fully deducted in this period.

### Box 1. Paraguay's Tax System from a Regional Perspective

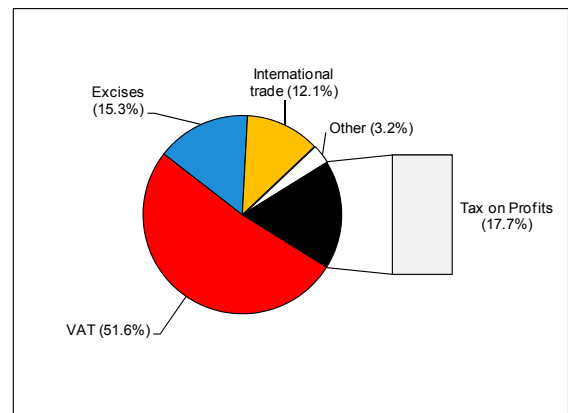
#### Paraguay's tax ratio is low and tilted towards indirect taxation by regional standards.

Paraguay's tax ratio (12.7 percent of GDP) increased only moderately during the recent period of high growth (2003–08), especially compared with similar countries. This reflects Paraguay's low rates, narrow bases—which practically exclude agribusiness activities—and weak tax administration. This could also result from an excessive reliance on indirect taxation. In fact, VAT, excises, and import duties account for about 80 percent of total tax revenue (9.4 percent of GDP), compared to about 60 percent on average (10.3 percent of GDP) in comparable countries. In Paraguay, taxes on profits account for less than 20 percent of total revenue, compared to 30 percent on average elsewhere.

Tax Revenue in Selected Latin American Countries, 2008  
(As percentage of GDP)



Paraguay: Tax Revenue Structure, 2008  
(As percentage of total tax revenue)



#### Efforts to bring Paraguay's tax ratio in line with peer countries should focus on improving administration further and broadening tax bases.

- *Taxation of agriculture:* Additional reforms of the income tax on agriculture (IMAGRO) could include disallowing deductions for expenses other than business costs and inventory losses, and implementing a unified regime for big and medium-size properties. As a complement, the authorities could consider a sales tax on some agricultural products (as in Uruguay) at a rate of 2–3 percent.
- *VAT:* The list of reduced-rate items (at 5 percent rate) and exemptions should be streamlined. The current large number of exempt items results in significant revenue losses, incentives for misclassification, and increased demand for refunds. It would be useful to phase out the exemption on agricultural products.
- *Excises:* These taxes could be applied to fewer products and the rates could be gradually increased to regional standards on the remaining products (especially on tobacco and alcohol). This will help simplify administration costs with very little revenue loss.
- *Personal Income Tax (PIT):* The PIT will help formalize the economy, strengthen tax administration, and improve tax mobilization. A PIT will also diversify the tax structure, and add progressivity to the tax system, which may help improve the distribution of income.

- **Public enterprise reform.** Currently, there are 9 major public enterprises in Paraguay in sectors ranging from the distribution of petroleum products to the production of cement. These enterprises operate complex subsidies, have excessive staffing and other inefficiencies, often run arrears with suppliers, and suffer from a lack of transparency in reporting their financial position. In August 2008, the Supervisory Council of State-Owned Enterprises<sup>8</sup> was re-established to set up and monitor performance agreements with the major public enterprises, and it has already helped improve the financial operations of several key enterprises. The authorities will propose a law to enhance the powers of this council by granting it stronger authority to require improvements in an enterprise's financial position, including publishing quarterly financial reports and rationalizing staffing levels. These enterprises would also have to explore a wide range of options to improve efficiency, including by investing in the context of public-private partnerships. Staff welcomed these steps and encouraged the authorities to consider other ways to increase private sector participation in the enterprises through capitalization or privatization and to expose the public enterprises to competition from the private sector.

### C. Monetary Policy Reforms

15. ***The central bank is fully committed to the adoption of an inflation-targeting (IT) framework over the medium term, relying on technical assistance from MCM.*** As a first step in this direction, in 2010, the central bank announced an inflation target of 5 percent with a band of +/- 2.5 percent. Staff agreed that a wide band was prudent at this stage, given the need to establish credibility and develop more effective instruments of monetary control.<sup>9</sup> The central bank also aims to maintain a flexible exchange rate regime, limiting foreign exchange intervention to counter disorderly markets. In this regard, they agreed to consider the staff recommendation to explore market-based mechanisms (e.g., auctions) to strengthen the transparency of intervention.

16. ***It was agreed that essential elements of a transition to an IT framework included continued fiscal discipline and careful control of the liquidity in the banking system.*** Specific areas for strengthening include:

- ***Recapitalization of the central bank.*** In the coming months, according to the recently approved law, the central bank and the ministry of finance will decide on key details of the transfer of Treasury bonds to capitalize the central bank, including the maturities and interest rates. The authorities agreed that the recapitalization should be completed in a way that safeguards the long-term solvency of the central bank. This

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<sup>8</sup> Members of this council include the Ministers of Finance, Industry and Commerce, Public Works and Communications and the Attorney General.

<sup>9</sup> The Selected Issues Papers include an analysis of Paraguay's monetary transmission mechanisms.

step will enhance the credibility of the central bank and give it more flexibility in the conduct of monetary policy.

- ***Central bank’s operational capacity.*** Staff welcomed the authorities’ plan to focus on (i) strengthening the coordination between the ministry of finance and the central bank; (ii) improving the central bank’s forecasting and analytical models; (iii) strengthening the domestic money market, especially by encouraging a secondary market in domestic government securities; and (iv) modernizing the payment system.
- ***Transparency and communication.*** The authorities intend to implement an effective communication strategy supported by an explicit, forward-looking framework.

#### **D. Financial Sector Reforms**

17. ***The authorities are committed to further strengthening banking supervision.*** In line with MCM recommendations, the central bank will modify regulations to improve information sharing among supervisors, strengthen licensing criteria for foreign banks, enhance credit risk assessments, set provisions for problem assets, establish exposure limits, improve internal control and audit within banks, and improve off-site supervision. These changes would bring banking supervision into compliance with about 50 percent of the Basel Core Principles. Additional gains in compliance with these principles would require amendments to the banking law to address the remaining shortcomings, such as weak bank governance; deficient sanctioning capacity of the superintendence of banks; and unclear “fit and proper” criteria. In addition, the authorities have continued making progress with the strengthening of the capital base of the deposit guarantee fund, although at a slower pace than envisaged.<sup>10</sup> Also the key public bank—the National Development Bank—remains well capitalized, with a capital adequacy ratio of 35 percent. Although its operations are restricted by law, it plans to focus on extending credit to small and medium enterprises, while continuing to comply with prudential norms.

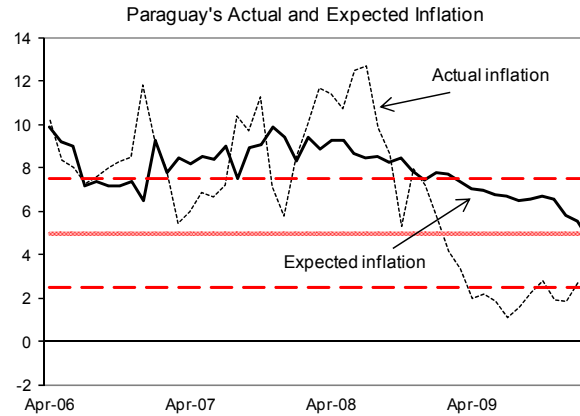
18. ***Steps are underway to strengthen the supervision of cooperatives.*** The supervisory agency for cooperatives (INCOOP) has started a program of institutional strengthening, with support from the IDB and the German association of cooperatives. INCOOP is developing an early warning system, strengthening reporting requirements and enhancing administrative and operational procedures. It also plans to establish a deposit guarantee fund and a lender of last resort facility for cooperatives. Staff welcomed these changes but urged the authorities to extend the prudential norms for banks to cooperatives to limit the scope for regulatory arbitrage. It also cautioned that INCOOP—which is governed by the cooperatives—lacked sufficient independence to provide effective supervision.

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<sup>10</sup> The fund is currently worth US\$87 million. According to the 2003 law governing the fund, the government is expected to contribute about US\$50 million in interest-free, non-negotiable bonds, but so far has only contributed US\$26 million.

## Box 2. Paraguay: The Transmission of Monetary Policy

*The Central Bank of Paraguay (BCP)'s monetary policy framework includes many sound practices.* The BCP's charter establishes that the Bank objectives are the preservation of price and financial sector stability. For 2010 the Bank announced an annual inflation target of 5 percent within a band of +/- 2.5 percent. The BCP's policy instruments include open-market operations with sterilization bills (*Instrumentos de Regulación Monetaria* (IRM)), reserve requirements, a short-term collateralized liquidity facility, and, on occasion, foreign exchange intervention.



*However, the implementation of monetary policy in Paraguay faces important challenges.* In particular, given the openness of the economy, imported inflation and the exchange rate can have an important effect on inflation. Also money markets are still relatively underdeveloped, with very little secondary market trading of government securities, which limits the ability to conduct monetary policy through repurchase and reverse repurchase operations. Because the stock of IRM is still relatively small, it is more difficult for the BCP to inject liquidity than to withdraw it. For this reason, the BCP relied on partially sterilized foreign exchange purchases in 2009 to help implement a countercyclical monetary policy.

*Staff analysis confirms that open market instruments, foreign exchange interventions and the exchange rate all play a role in the transmission of monetary policy.* Statistical analysis shows that:

- An increase in the stock of open market instruments (a contraction of credit) produces a reduction in the price level and output, as expected.
- An increase in the stock of net international reserves produces only a short-lived increase in output and prices, mostly likely capturing the effects of subsequent sterilization operations.
- Paraguay has a sizable exchange rate pass-through compared to Bolivia, Chile, Peru and Uruguay.

Exchange Rate Pass-through  
(In percentage)

	Bolivia	Chile	Paraguay	Peru	Uruguay
2-months	2.0	1.3	5.0	1.9	3.5
6-months	14.2	5.2	13.8	13.8	9.1
12-months	18.6	10.9	21.9	18.4	17.2

*These results suggest that a key challenge is to strengthen domestic money markets to enhance the effectiveness of open market operations and the policy interest rate.* Otherwise, the BCP will may face the temptation to limit exchange rate flexibility and rely on foreign exchange intervention to help control inflation, which could send a confusing signal about its commitment to low inflation.

19. ***It was agreed that continued macroeconomic stability provides the best way to reduce financial dollarization further.*** Many banks report that they avoid currency mismatches when lending to clients. The central bank sets a strict limit on banks' net open positions in foreign currency and applies higher reserve requirements to foreign currency deposits than those for domestic currency deposits.

#### E. Other Issues

20. ***While not the focus of this consultation, staff also reviewed other reforms to foster vigorous growth and reduce poverty further.*** FDI inflows could be promoted by improving the business climate, including by streamlining red-tape procedures for business registration, improving the effectiveness and predictability of the judicial system, reinforcing property rights, and upgrading creditor registries and bankruptcy procedures. The government is currently discussing an agreement with a private company, which is considering locating an aluminum smelter in Paraguay, which would lead to a sharp rise in FDI. It would also be useful to foster export diversification by supporting efforts to improving farming methods, and by encouraging the adoption of international quality standards.

#### IV. STAFF APPRAISAL

21. ***The authorities managed the challenges of the severe drought and global financial crisis in 2009 reasonably well.*** They successfully shifted demand policies to a countercyclical stance, and continued pressing ahead with structural reforms, including on tax administration, monitoring of public enterprises and financial supervision. By end-2009, inflation expectations for end-2010 had declined to 5 percent, in line with the central bank's objective, pointing to further gains in credibility. The prudent stance of demand policies, as well as the global recovery and the favorable weather conditions, will help the economy rebound in 2010. The central bank would signal its firm commitment to achieving its goal for inflation by beginning to withdraw quickly the excess liquidity from the banking system and lifting the policy interest rate above the expected rate of inflation. The central government could support these efforts to keep demand pressures in check by monitoring the growth of spending, and keeping the fiscal accounts in a balanced position.

22. ***It would be important to press ahead with the ambitious agenda of institutional reforms to provide an even firmer anchor for confidence and sustain vigorous economic growth.*** As in the past, the Fund stands ready to provide technical assistance to help implement these reforms. Provided this agenda advances, real GDP would grow by 4–5 percent a year over the medium term, supported by steady growth in exports and private investment, while inflation and the external position would remain under control.

23. ***Fiscal reforms should focus on increasing the tax ratio, strengthening fiscal management and reducing fiscal risks.*** A top priority is the development of a medium term fiscal framework to keep public debt in the range of 20–25 percent of GDP, while controlling the growth of current spending and pressing for higher taxes to preserve sufficient room for

public investment and social spending. Another priority is to continue strengthening tax administration and broadening the tax base, especially by increasing taxation on agribusiness activities. In that connection, staff welcomes the authorities' recent steps to broaden the base of the current tax on agriculture income and their success in improving customs administration. Other challenges ahead are to de-politicize the use of the additional revenues from Itaipu and enhance the efficiency of public enterprises. The poor operation of these enterprises makes the economy less competitive in electricity distribution, sales of petroleum products, telecommunications and other sectors critical for growth.

24. ***Staff welcomes the central bank's commitment to adopt an inflation-targeting framework in the next few years.*** This would further enhance the credibility of monetary policy, in part by providing a transparent framework for communication. It would be useful to implement without delay the recently-approved law for the recapitalization of the central bank. Liquidity management could be strengthened further through better coordination with the ministry of finance and the development of secondary markets for government securities. Staff supports the authorities' intention to maintain exchange rate flexibility for the *guarani*, which appears to be at a level consistent with its fundamentals.

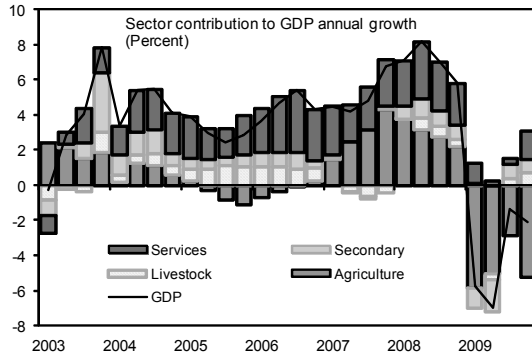
25. ***Efforts to improve financial supervision should continue to be strengthened.*** The financial system has coped well with the global financial crisis and continues to be solid and solvent, but there are still significant disparities with regard to regulatory and supervisory practices between banks and cooperatives. Staff welcomes the central bank's plan to improve the compliance with the Basel Core Principles through modifications in regulations, which will help preserve the quality of bank loans amid the ongoing recovery in credit. INCOOP, the supervising agency of the cooperatives, has achieved a few procedural advances, but the information provided by the cooperatives is still lacking in scope and timeliness. Moreover, technical advances are unlikely to translate into a qualitative improvement of supervision unless the potential for conflict of interest, which is inherent to the self-regulatory design of the cooperatives' regulatory framework, is addressed more clearly. Moreover, it would be advisable to extend prudential norms for banks to cooperatives to limit the scope for regulatory arbitrage and to move towards a unified supervisory framework for all financial institutions.

26. ***Consultation.*** The staff proposes that the next Article IV Consultation take place within the 12-month cycle.

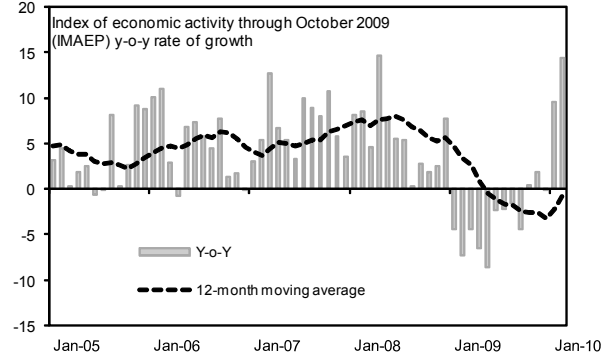
Figure 1. Paraguay: Real Sector Developments

After contracting by 6 percent by mid-2009, the economy started to stabilize in Q3, reflecting an improved external environment and countercyclical policies. Annual inflation, which declined significantly, has also started to pick up and with core inflation at 3.2 percent in April 2010. Under the expected good weather conditions, real GDP is projected to expand by 6 percent in 2010.

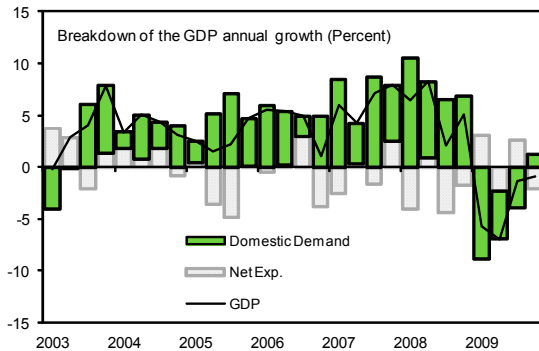
Mainly because of the drought, GDP contracted significantly through mid-2009...



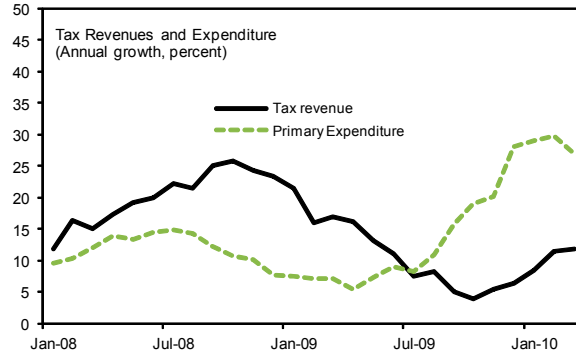
...but started to stabilize in the third quarter of 2009 and rebounded in the first quarter of 2010...



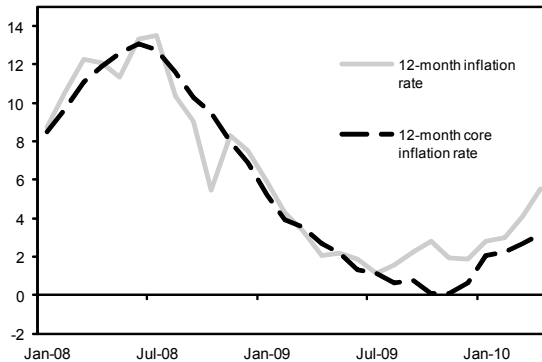
...reflecting the strong growth contribution of net exports and the recovery of domestic demand...



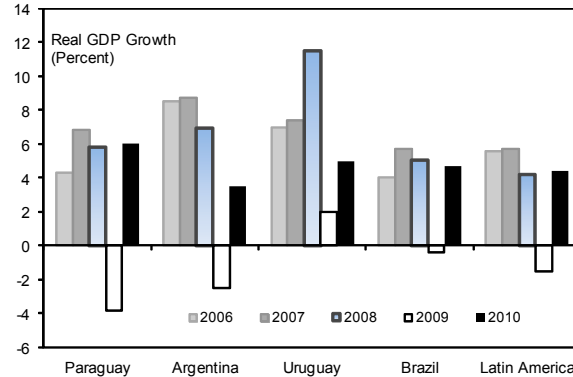
...and the acceleration of budget execution that took place in the second part of 2009 and first quarter of 2010.



Annual inflation, which also declined substantially, has also started to pick up, and is estimated to reach 5 percent in 2010.



In 2010, under the excellent prospects for a strong rebound in agriculture, real GDP is projected to grow by 6 percent.



Sources: Paraguayan Authorities and Fund staff estimates.

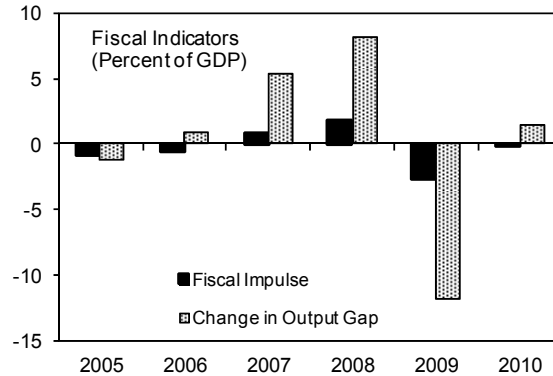
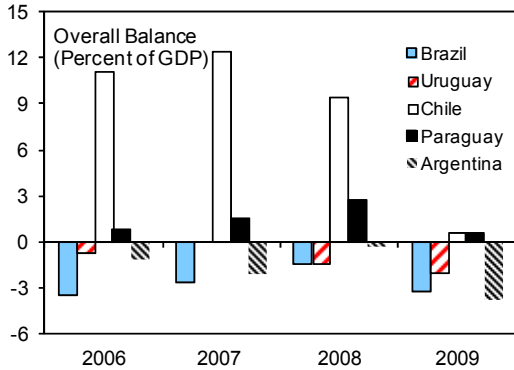


Figure 2. Paraguay: Fiscal Developments

To counter the downturn, in 2009 the authorities adopted a countercyclical budget, which helped to limit the GDP contraction at 3.8 percent. With the recovery taking place, tax collections are picking up and the fiscal stimulus will be gradually removed.

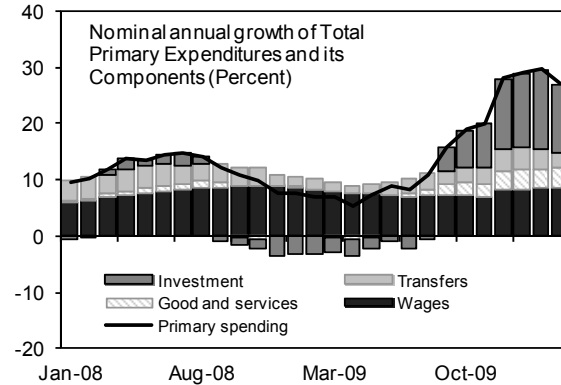
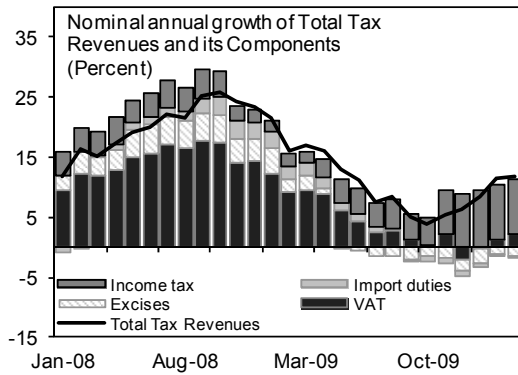
As other Latin American countries, in 2009 Paraguay adopted a countercyclical fiscal policy...

... which imparted a 2 percent fiscal stimulus into the economy, which will be removed in 2010.



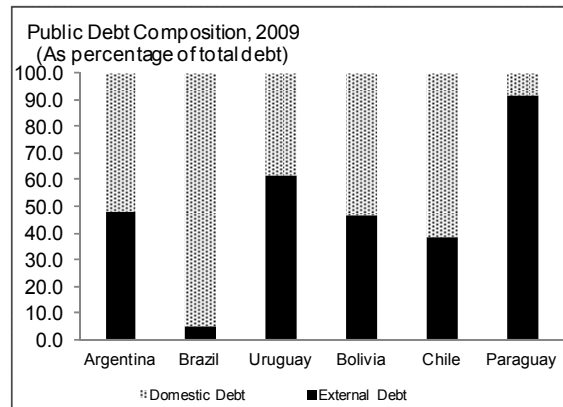
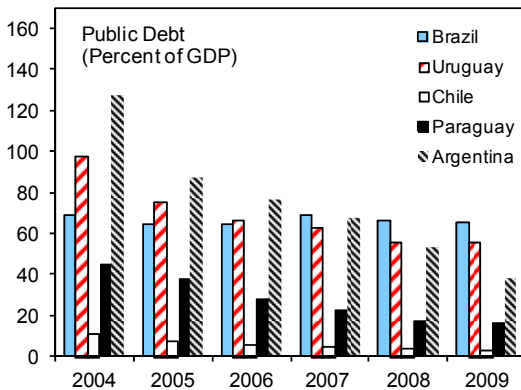
The impact of automatic stabilizers concentrated on VAT and custom duties, while the recovery is bringing tax collection up again.

Spending increases concentrated on capital expenditures, especially in the second half of 2009 and first quarter of 2010.



Paraguay's public debt remains low...

but remains concentrated on external debt, most of which is denominated in foreign currency-denominated loans.

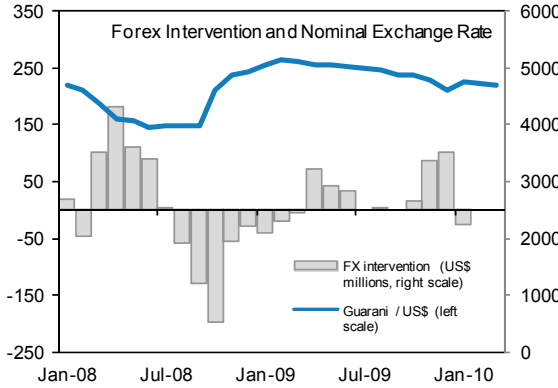


Sources: Paraguayan Authorities and Fund staff estimates.

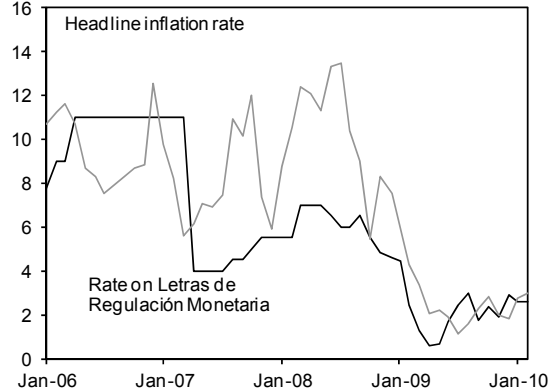
Figure 3. Paraguay: Monetary Developments

*In 2009 the authorities implemented a very accommodative monetary policy, which helped to reduce lending rates, although less than envisaged. The resulting excess liquidity will need to be mopped up in 2010.*

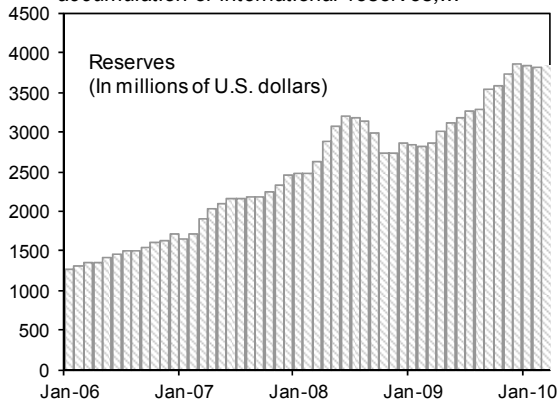
*Monetary policy in 2009 focused on providing ample liquidity, through interventions that were partially sterilized...*



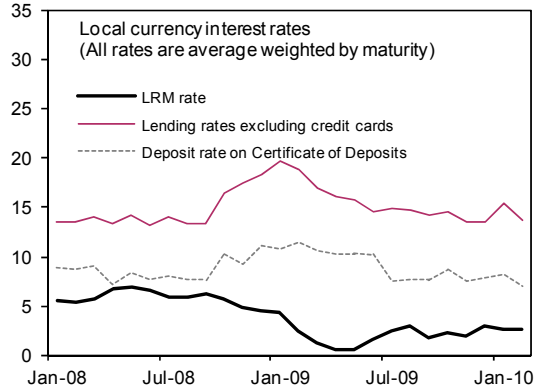
*...and reductions in the policy rate.*



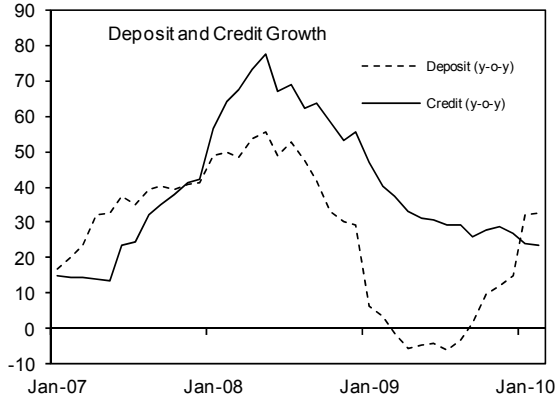
*This policy has contributed to a large accumulation of international reserves,...*



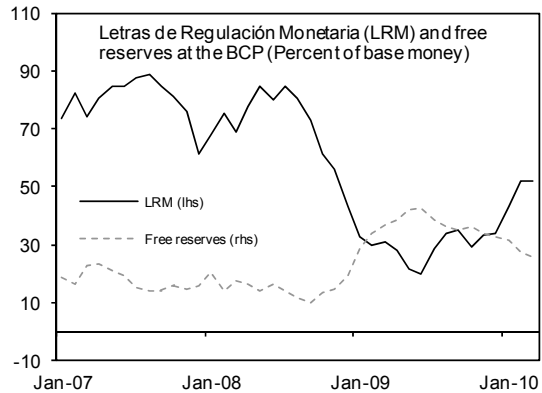
*...some reduction in the lending rates....*



*...an incipient recovery in the credit to the private sector and a strong revival of banking deposits...*



*....and to a large accumulation of liquidity in the banking system, which will need to be mopped up as the recovery gathers momentum.*

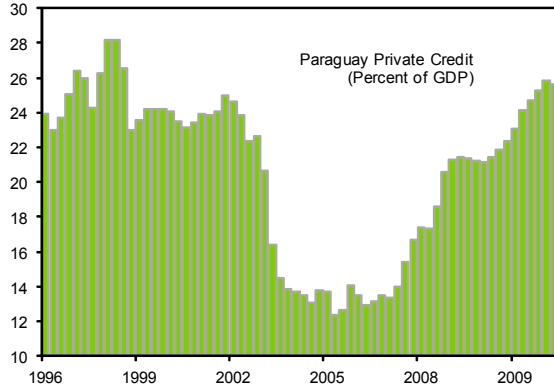


Source: Paraguayan Authorities and Fund staff estimates.

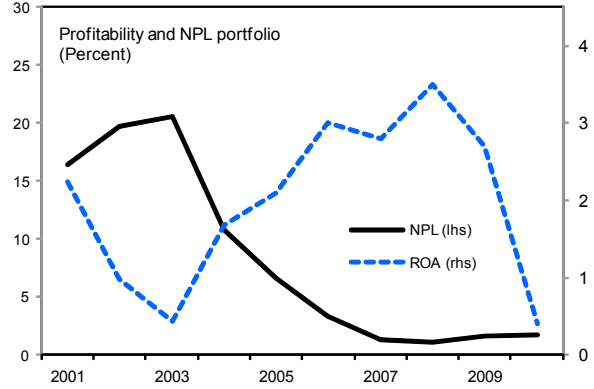
Figure 4. Paraguay: Financial System Developments

*The financial sector has held up relatively well during the downturn, reflecting Paraguay's low integration with international financial markets and recent improvements in prudential regulations. Important weaknesses remain regarding the lightly supervised and poorly monitored cooperatives.*

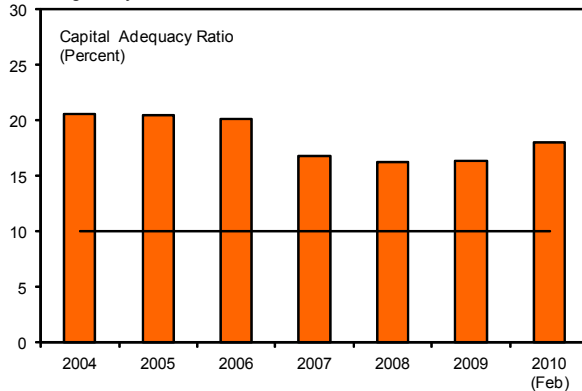
*Mainly reflecting the effects of the drought, the growth of the credit to the private sector stabilized in 2009.*



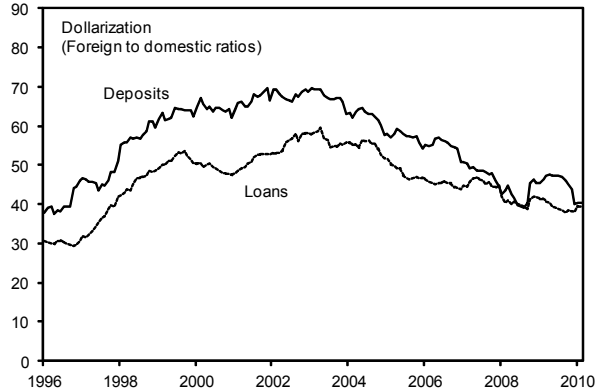
*The non-performing loan ratio increased slightly and banks profitability fell.*



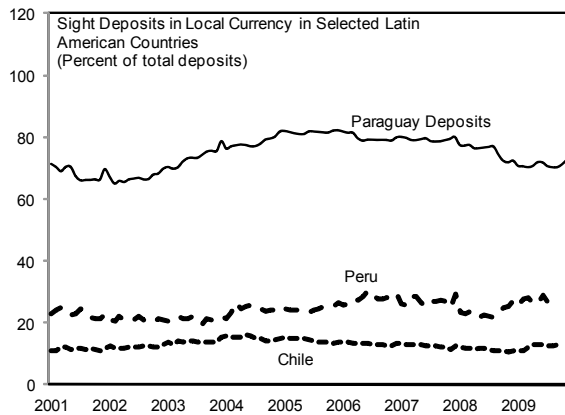
*But in general, the banking system remains well capitalized, with a capital adequacy ratio well above the 10 percent regulatory minimum.*



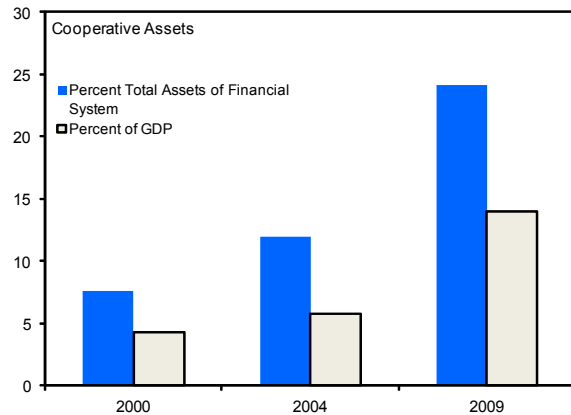
*The main risks are the financial dollarization of the banking system, which although declining, still remains high...*



*...the still quite low maturity of Paraguay's banking deposits, ...*



*...and the lightly supervised cooperative sector, which has grown significantly in the last few years.*

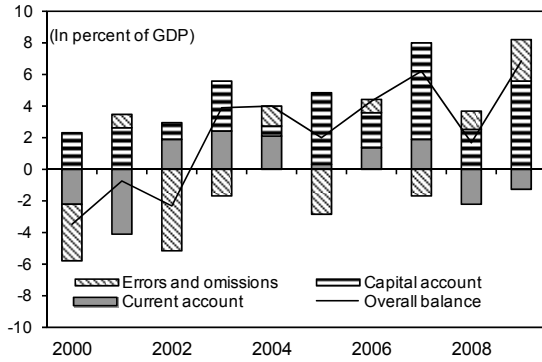


Sources: Paraguayan authorities and Fund staff estimates.

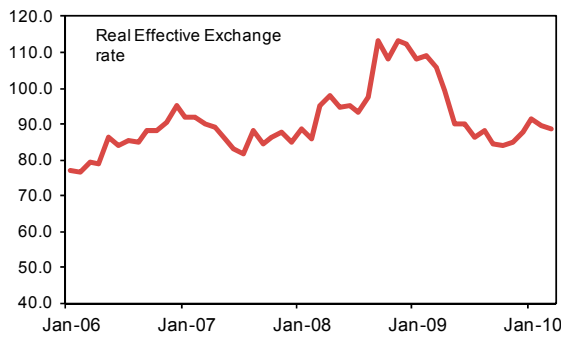
Figure 5. Paraguay: Balance of Payments Developments

*Paraguay's external position was significantly affected by the global crisis and the severe regional drought. Exports and imports have performed very strongly in the first quarter of 2010, especially imports. The current account balance is projected to post a small deficit of 1.7 percent of GDP in 2010.*

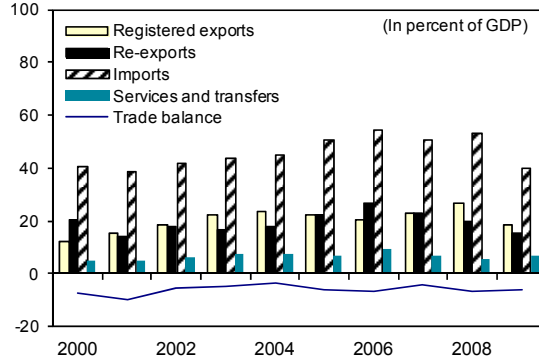
*The current account deficit narrowed significantly in 2009 while the surplus of the capital account expanded...*



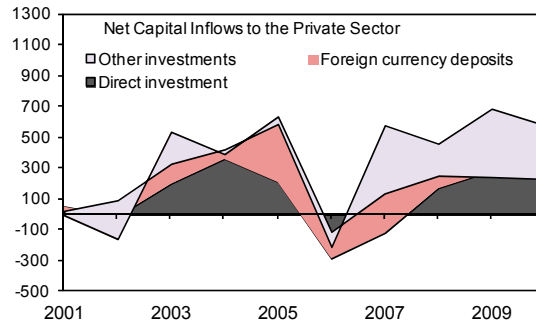
*The real effective exchange rate depreciated in 2009, and remains in line with fundamentals....*



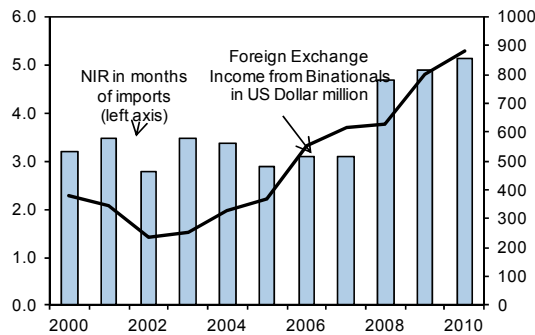
*...because of the weak performance of exports, which were more than compensated by a decrease in imports. More recently imports and exports are recovering rapidly.*



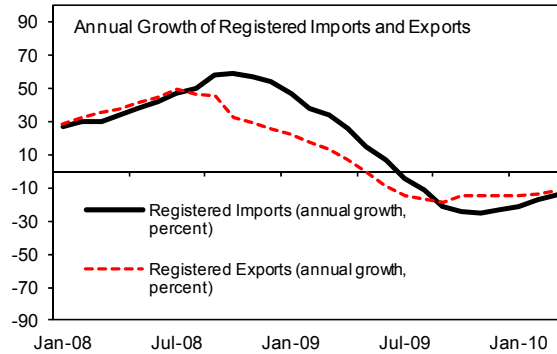
*...and FDI and other private capital inflows are expected to continue in 2010...*



*...the accumulation of reserves in 2009, which will continue in 2010 although at a more moderate pace than in 2009...*



*reflecting the small current account deficit projected for 2010, on account of the expected rebound of domestic demand, and the continuation of net capital inflows.*



Sources: Paraguayan Authorities and Fund staff estimates.

Table 1. Paraguay: Selected Economic and Social Indicators

I. Social and Demographic Indicators											
Population 2009 (millions)	6.2					Gini index (2007/2008)	58.4				
Unemployment rate (2009)	5.7					Life expectancy at birth (2007, Proj.)	71.7				
Percentage of population below the poverty line (2009)	37.9					Adult illiteracy rate (2008)	5.2				
Rank in UNDP development index (2008)	98 of 179					GDP per capita (US\$, 2009)	2,317.5				
II. Economic Indicators											
	2005	2006	2007	2008	Est. 2009	2010	2011	2012	2013	2014	2015
(Annual percentage change, unless otherwise indicated)											
<b>Income and prices</b>											
Real GDP	2.9	4.3	6.8	5.8	-3.8	6.0	4.0	4.0	4.5	4.5	4.5
Nominal GDP	11.2	13.2	17.7	19.7	-1.7	11.1	8.3	8.8	8.8	8.5	8.5
Nominal per-capita income growth (in U.S. dollars)	6.3	21.3	29.2	35.6	-15.6	15.6	3.1	4.4	5.0	5.3	5.4
Consumer prices (end of period)	9.8	12.5	5.9	7.5	1.9	5.0	4.5	4.0	3.5	3.0	3.0
<b>Monetary sector</b>											
Currency issue	17.6	15.3	28.3	15.0	11.3	10.4	9.1	9.0	8.9	8.8	8.7
M2	16.1	15.3	38.6	21.0	27.5	19.4	14.5	15.4	15.2	15.0	15.3
M5 2/	8.4	16.6	30.3	24.4	23.1	18.8	14.1	13.9	14.6	14.0	14.2
Credit to private sector	15.1	16.2	46.2	49.3	24.1	17.6	17.1	17.2	17.3	16.9	16.8
Liabilities to private sector	8.4	16.6	30.3	24.4	23.1	18.8	14.1	13.9	14.6	14.0	14.2
<b>External sector</b>											
Exports (fob)	17.4	31.2	28.5	37.5	-25.6	36.1	8.4	7.5	8.6	8.3	9.2
Imports (cif)	22.9	31.7	22.5	45.4	-23.6	28.6	7.9	6.7	7.6	7.6	8.5
Terms of trade	-14.1	-2.5	11.8	6.6	-4.6	-7.1	-1.7	-1.0	-0.3	-0.6	-1.3
Real effective exchange rate 1/	-6.4	13.0	10.7	16.7	-6.9	...	...	...	...	...	...
(In percent of GDP, unless otherwise indicated)											
<b>Current account</b>	<b>0.3</b>	<b>1.4</b>	<b>1.8</b>	<b>-2.2</b>	<b>-1.3</b>	<b>-1.7</b>	<b>-1.5</b>	<b>-0.8</b>	<b>-0.3</b>	<b>-0.1</b>	<b>0.1</b>
Trade balance	-6.1	-6.7	-4.1	-6.9	-7.2	-5.3	-5.3	-5.0	-4.5	-4.2	-4.0
Exports	44.7	47.4	46.2	46.0	39.8	45.9	47.3	47.8	48.4	48.8	49.6
Registered	22.5	20.5	23.0	26.4	21.8	27.0	27.7	28.2	28.7	29.1	29.3
Unregistered	22.2	26.9	23.2	19.6	18.0	18.9	19.6	19.5	19.7	19.8	20.3
Imports	50.9	54.1	50.3	52.9	47.0	51.2	52.6	52.7	53.0	53.0	53.5
Of which: Oil Imports	6.8	7.6	5.9	7.7	5.8	6.7	6.9	6.8	6.7	6.6	6.5
Other (export and import of services, income, current transfers)	6.4	8.1	5.9	4.7	5.9	3.7	3.8	4.2	4.3	4.1	4.1
Of which: Remittances	3.0	4.6	3.1	2.4	3.4	2.7	2.6	2.5	2.4	2.3	2.2
<b>Capital account and financial account</b>	<b>4.6</b>	<b>2.1</b>	<b>6.2</b>	<b>2.8</b>	<b>5.5</b>	<b>3.3</b>	<b>2.2</b>	<b>1.6</b>	<b>1.0</b>	<b>0.7</b>	<b>0.5</b>
General Government	-1.1	-0.4	-1.1	0.1	0.8	-0.1	-0.3	-0.2	-0.2	-0.2	-0.2
Of which: Disbursement	1.7	2.0	1.3	0.8	1.6	1.2	0.8	0.8	0.7	0.6	0.5
Amortizations	-2.3	-1.8	-1.5	-1.1	-1.5	-1.3	-1.1	-1.0	-0.9	-0.8	-0.7
Private Sector	5.6	2.5	7.3	2.7	4.7	3.4	2.5	1.7	1.2	0.9	0.6
Of which: Direct Investment	0.6	1.8	1.6	1.0	1.9	1.7	1.6	1.6	1.5	1.5	1.4
Foreign currency deposits	5.6	1.8	2.1	0.5	-0.3	-0.4	-0.5	-0.3	-0.4	-0.3	-0.4
Errors and Omissions	-2.9	0.8	-1.7	1.4	2.6	0.0	0.0	0.0	0.0	0.0	0.0
<b>Net international reserves (in millions of U.S. dollars)</b>	<b>1,298</b>	<b>1,703</b>	<b>2,462</b>	<b>2,864</b>	<b>3,861</b>	<b>4,133</b>	<b>4,257</b>	<b>4,404</b>	<b>4,554</b>	<b>4,689</b>	<b>4,828</b>
(Stock in months of next year imports of goods and services)	2.9	3.1	3.1	4.7	4.9	5.1	4.9	4.7	4.6	4.4	4.1
(Stock over total external short term debt)	2.0	2.6	4.3	2.9	3.4	...	...	...	...	...	...
<b>Gross domestic investment</b>	<b>19.8</b>	<b>19.6</b>	<b>18.0</b>	<b>18.1</b>	<b>15.5</b>	<b>17.1</b>	<b>18.6</b>	<b>19.6</b>	<b>19.5</b>	<b>19.6</b>	<b>19.8</b>
Private sector	14.8	14.7	13.4	14.3	10.1	12.1	13.4	14.2	14.3	14.3	14.4
Public sector	5.0	4.9	4.6	3.7	5.4	5.0	5.2	5.4	5.2	5.3	5.4
<b>Gross national saving</b>	<b>20.0</b>	<b>20.9</b>	<b>19.8</b>	<b>15.8</b>	<b>14.2</b>	<b>15.4</b>	<b>17.2</b>	<b>18.8</b>	<b>19.2</b>	<b>19.5</b>	<b>19.9</b>
Private sector	14.2	15.2	13.8	9.4	8.4	10.4	12.0	13.3	13.9	14.1	14.4
Public sector	5.8	5.7	6.1	6.4	5.8	5.0	5.1	5.5	5.3	5.3	5.5
<b>External saving (+) Disavings (-)</b>	<b>0.3</b>	<b>1.4</b>	<b>1.8</b>	<b>-2.2</b>	<b>-1.3</b>	<b>-1.7</b>	<b>-1.5</b>	<b>-0.8</b>	<b>-0.3</b>	<b>-0.1</b>	<b>0.1</b>
<b>Central Government revenues</b>	<b>18.2</b>	<b>18.3</b>	<b>17.6</b>	<b>17.3</b>	<b>19.2</b>	<b>19.1</b>	<b>19.0</b>	<b>19.1</b>	<b>19.2</b>	<b>19.3</b>	<b>19.5</b>
Of which: Tax revenues	11.8	12.0	11.4	11.8	12.7	12.9	13.0	13.2	13.5	13.7	14.0
<b>Central Government expenditures</b>	<b>17.6</b>	<b>18.3</b>	<b>16.7</b>	<b>14.8</b>	<b>19.1</b>	<b>19.0</b>	<b>19.2</b>	<b>19.3</b>	<b>19.4</b>	<b>19.5</b>	<b>19.6</b>
Of which: Wages and salaries	7.2	7.4	7.1	7.1	8.4	8.4	8.2	8.0	7.9	7.8	7.7
Transfers	3.8	4.0	3.8	3.5	4.1	4.4	4.5	4.6	4.6	4.6	4.7
Capital Expenditure	4.0	4.2	3.7	2.7	4.5	4.1	4.3	4.5	4.6	4.8	4.9
<b>Central Government primary balance</b>	<b>1.9</b>	<b>1.5</b>	<b>1.8</b>	<b>3.1</b>	<b>0.7</b>	<b>0.5</b>	<b>0.4</b>	<b>0.4</b>	<b>0.4</b>	<b>0.5</b>	<b>0.5</b>
<b>Central Government overall balance</b>	<b>0.6</b>	<b>0.1</b>	<b>0.9</b>	<b>2.5</b>	<b>0.1</b>	<b>0.0</b>	<b>-0.2</b>	<b>-0.2</b>	<b>-0.2</b>	<b>-0.1</b>	<b>-0.1</b>
<b>Consolidated public debt (in percent of GDP)</b>	<b>42.7</b>	<b>34.1</b>	<b>28.2</b>	<b>23.2</b>	<b>22.5</b>	<b>21.7</b>	<b>21.0</b>	<b>20.5</b>	<b>19.9</b>	<b>19.1</b>	<b>18.3</b>
Of which: External	34.3	25.3	19.9	16.8	15.0	14.0	12.7	11.5	10.3	9.2	8.3
Domestic	3.4	2.4	1.9	2.2	2.6	3.1	3.6	3.9	4.1	4.3	4.4
LRM 3/	5.0	6.4	6.4	4.2	4.9	4.7	4.7	5.1	5.5	5.6	5.6
<b>Memorandum items:</b>											
GDP (in billion of Guaranies)	46,169	52,270	61,512	73,622	72,347	80,361	87,037	94,736	103,039	111,836	121,300
GDP (in millions of U.S. dollars)	7,494	9,275	12,222	16,905	14,546	17,147	18,028	19,189	20,558	22,090	23,748

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

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

2/ Foreign currency items are valued at a constant exchange rate.

3/ Letras de Regulacion Monetaria.

Table 2. Paraguay: Central Government Operations

	2004	2005	2006	2007	2008	Prel. 2009	Projections	
							2010	2011
	(In billions of Guaranes)							
<b>Total revenues</b>	<b>7,637</b>	<b>8,419</b>	<b>9,588</b>	<b>10,837</b>	<b>12,748</b>	<b>13,915</b>	<b>15,315</b>	<b>16,565</b>
Tax revenues	4,929	5,471	6,295	7,019	8,656	9,208	10,371	11,309
Income taxes	880	967	1,009	1,229	1,381	2,140	1,931	1,999
Excises	1,000	1,007	1,049	1,310	1,555	1,398	1,532	1,713
Value added tax	1,939	2,372	2,786	3,318	4,313	4,128	5,261	5,739
Import Duties	904	843	938	853	1,055	977	1,318	1,501
Other	205	282	513	309	351	565	329	356
Nontax revenues 1/	2,696	2,946	3,262	3,794	4,064	4,705	4,942	5,253
Of which: Public pension contributions	440	541	560	752	907	1,014	1,113	1,205
Itaipu-Yacyreta	1,640	1,651	1,883	2,042	1,872	2,267	2,249	2,173
Capital revenues	12	2	31	25	28	2	1	2
<b>Current expenditures:</b>	<b>5,363</b>	<b>6,231</b>	<b>7,138</b>	<b>7,964</b>	<b>8,963</b>	<b>10,608</b>	<b>11,983</b>	<b>12,970</b>
Wages and salaries	2,984	3,334	3,857	4,360	5,216	6,079	6,748	7,119
Goods and services	447	546	674	704	713	1,055	1,260	1,365
Interest payments	483	560	519	515	449	443	387	520
Transfers	1,431	1,771	2,067	2,366	2,557	2,966	3,552	3,928
Of which: Pensions and benefits	940	1,126	1,207	1,264	1,370	1,475	1,840	1,993
Other	18	19	22	19	28	65	36	39
<b>Capital expenditures and net lending</b>	<b>1,625</b>	<b>1,860</b>	<b>2,185</b>	<b>2,280.3</b>	<b>1,954</b>	<b>3,246</b>	<b>3,303</b>	<b>3,778</b>
Capital formation	1,383	1,440	1,571	1,514	1,237	2,080	2,296	2,640
Of which: Net lending	-29	-24	99	-33	-14	50	105	113
Capital transfers and other	271	445	515	799	732	1,116	901	1,025
Statistical discrepancy 2/	181	-39	-216	-46	1	0	0	0
<b>Overall balance</b>	<b>830</b>	<b>289</b>	<b>48</b>	<b>547</b>	<b>1,831</b>	<b>61</b>	<b>29</b>	<b>-184</b>
<b>Financing</b>	<b>-830</b>	<b>-288</b>	<b>-48</b>	<b>-547</b>	<b>-1,830</b>	<b>-61</b>	<b>-30</b>	<b>183</b>
External debt (increase +)	103	-295	-123	-207	-334	42	-73	-289
Disbursements	763	658	832	724	495	1,136	997	660
Of which: Program loans	0	0	81	0	3	0	0	0
Amortizations	660	954	955	932	829	1,094	1,070	949
Domestic bonds (increase +)	-78	-137	147	186	23	396	508	579
New TB issues	0	0	318	382	167	712	936	772
Amortizations	78	137	171	196	144	316	428	193
Net credit from the banking system	-162	-44	-375	-832	-1,478	-980	-257	-106
Net credit from Central Bank	-114	55	-468	-837	-1,421	-784	-204	-106
Net credit from commercial banks	-48	-99	93	4	-57	-196	-53	0
Other	-693	188	303	307	-93	142	-492	0
	(In percent of GDP)							
<b>Total revenues</b>	<b>18.4</b>	<b>18.2</b>	<b>18.3</b>	<b>17.6</b>	<b>17.3</b>	<b>19.2</b>	<b>19.1</b>	<b>19.0</b>
Tax revenues:	11.9	11.8	12.0	11.4	11.8	12.7	12.9	13.0
Income taxes	2.1	2.1	1.9	2.0	1.9	3.0	2.4	2.3
Excises	2.4	2.2	2.0	2.1	2.1	1.9	1.9	2.0
Value added tax	4.7	5.1	5.3	5.4	5.9	5.7	6.5	6.6
Import duties	2.2	1.8	1.8	1.4	1.4	1.4	1.6	1.7
Other	0.5	0.6	1.0	0.5	0.5	0.8	0.4	0.4
Nontax revenues 1/	6.5	6.4	6.2	6.2	5.5	6.5	6.2	6.0
Of which: Public pension contributions	1.1	1.2	1.1	1.2	1.2	1.4	1.4	1.4
Itaipu-Yacyreta	3.9	3.6	3.6	3.3	2.5	3.1	2.8	2.5
Capital revenues	0.0	0.0	0.1	0.0	0.0	0.0	0.0	0.0
<b>Current expenditures</b>	<b>12.9</b>	<b>13.5</b>	<b>13.7</b>	<b>12.9</b>	<b>12.2</b>	<b>14.7</b>	<b>14.9</b>	<b>14.9</b>
Wages and salaries	7.2	7.2	7.4	7.1	7.1	8.4	8.4	8.2
Goods and services	1.1	1.2	1.3	1.1	1.0	1.5	1.6	1.6
Interest payments	1.2	1.2	1.0	0.8	0.6	0.6	0.5	0.6
Transfers	3.4	3.8	4.0	3.8	3.5	4.1	4.4	4.5
Of which: Public pensions and benefits	2.3	2.4	2.3	2.1	1.9	2.0	2.3	2.3
Other	0.0	0.0	0.0	0.0	0.0	0.1	0.0	0.0
<b>Capital expenditures and net lending</b>	<b>3.9</b>	<b>4.0</b>	<b>4.2</b>	<b>3.7</b>	<b>2.7</b>	<b>4.5</b>	<b>4.1</b>	<b>4.3</b>
Of which: Capital formation	3.3	3.1	3.0	2.5	1.7	2.9	2.9	3.0
Net lending	-0.1	-0.1	0.2	-0.1	0.0	0.1	0.1	0.1
Other	0.7	1.0	1.0	1.3	1.0	1.5	1.1	1.2
Statistical discrepancy 2/	0.4	-0.1	-0.4	-0.1	0.1	0.1	0.0	0.0
<b>Overall balance</b>	<b>2.0</b>	<b>0.6</b>	<b>0.1</b>	<b>0.9</b>	<b>2.5</b>	<b>0.1</b>	<b>0.0</b>	<b>-0.2</b>
<b>Financing</b>	<b>-2.0</b>	<b>-0.6</b>	<b>-0.1</b>	<b>-0.9</b>	<b>-2.5</b>	<b>-0.1</b>	<b>0.0</b>	<b>0.2</b>
External debt (increase +)	0.2	-0.6	-0.2	-0.3	-0.5	0.1	-0.1	-0.3
Disbursements	1.8	1.4	1.6	1.2	0.7	1.6	1.2	0.8
Amortizations	1.6	2.1	1.8	1.5	1.1	1.5	1.3	1.1
Domestic bonds (increase +)	-0.2	-0.3	0.3	0.3	0.0	0.5	0.6	0.7
Net credit from the banking system	-0.4	-0.1	-0.7	-1.4	-2.0	-1.4	-0.3	-0.1
Net credit from Central Bank	-0.1	-0.2	0.2	-1.4	-1.9	-1.1	-0.3	-0.1
Net credit from commercial banks	-0.3	0.1	-0.9	0.0	-0.1	-0.3	-0.1	0.0
Other	-1.7	0.4	0.6	0.5	0.0	0.7	-0.2	0.0
<b>Memorandum Items:</b>								
Primary balance	2.7	1.9	1.5	1.8	3.1	0.7	0.5	0.4
Average exchange rate	5,989	6,161	5,635	5,033	4,355	4,974	...	...
GDP (In billions of Guaranes)	41,522	46,169	52,270	61,512	73,622	72,347	80,361	87,037

Sources: Ministry of Finance; and Fund staff estimates.

1/ Includes receipts from the binational hydroelectric plants Itaipu and Yacyreta, and grants.

2/ Measurement error to reconcile above-the-line estimate with measure of the fiscal balance from the financing side.

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

	2004	2005	2006	2007	2008	Prel. 2009	Projections	
							2010	2011
(In billion of Guaranies)								
<b>Revenue</b>	<b>8,959</b>	<b>10,114</b>	<b>11,821</b>	<b>13,508</b>	<b>15,879</b>	<b>16,950</b>	<b>18,220</b>	<b>19,844</b>
Tax revenue	4,936	5,483	6,320	7,044	8,696	9,245	10,404	11,345
Nontax revenue and grants	4,010	4,596	5,469	6,432	7,137	7,547	7,809	8,490
Capital revenue	14	35	32	32	46	158	8	9
<b>Current expenditure</b>	<b>6,959</b>	<b>7,908</b>	<b>9,177</b>	<b>10,191</b>	<b>11,522</b>	<b>13,415</b>	<b>14,764</b>	<b>15,938</b>
Wages and salaries	3,634	4,087	4,711	5,357	6,407	7,455	8,148	8,635
Goods and services	755	994	1,200	1,194	1,314	1,896	1,944	2,101
Interest payments	678	751	858	910	829	585	580	693
Transfers	1,699	2,048	2,373	2,692	2,896	3,372	4,030	4,445
Other	193	27	35	38	75	108	63	64
<b>Capital expenditure and net lending</b>	<b>1,956</b>	<b>2,306</b>	<b>2,580</b>	<b>2,832</b>	<b>2,757</b>	<b>3,913</b>	<b>4,033</b>	<b>4,566</b>
<i>Of which:</i> Capital expenditure	2,189	2,550	2,844	3,085	3,059	4,479	4,355	4,916
<b>Primary balance</b>	<b>1,315</b>	<b>1,298</b>	<b>1,960</b>	<b>2,109</b>	<b>2,848</b>	<b>998</b>	<b>556</b>	<b>607</b>
<b>Public enterprises' operating surplus</b>	<b>593</b>	<b>646</b>	<b>1,039</b>	<b>715</b>	<b>689</b>	<b>792</b>	<b>553</b>	<b>575</b>
Statistical discrepancy 2/	119	-132	-689	-268	-30	0	0	0
<b>Overall balance</b>	<b>756</b>	<b>414</b>	<b>413</b>	<b>931</b>	<b>2,460</b>	<b>413</b>	<b>-24</b>	<b>-87</b>
<b>Financing</b>	<b>-756</b>	<b>-415</b>	<b>-413</b>	<b>-931</b>	<b>-2,460</b>	<b>-413</b>	<b>24</b>	<b>87</b>
External financing net	-42	-445	-258	-384	-346	22	-277	-481
Disbursements	808	771	939	724	593	22	-277	-481
Amortizations	850	1,216	1,197	1,109	939	1,114	1,274	1,141
Domestic financing net	72	-201	-476	-547	-2,022	-577	792	567
Bond financing	-78	-137	147	186	23	396	508	579
Net credit from the banking system	-183	-176	-728	-777	-2,261	-1,280	-202	-369
<i>Of which:</i> Net credit from commercial banks	-257	-146	-250	56	-840	-496	2	-263
Net credit from Central Bank	74	-30	-478	-832	-1,421	-784	-204	-106
Quasifiscal deficit financing	333	112	105	44	216	306	486	357
Other	-786	232	320	0	-93	142	-492	0
(In percent of GDP)								
<b>Revenue</b>	<b>21.6</b>	<b>21.9</b>	<b>22.6</b>	<b>22.0</b>	<b>21.6</b>	<b>23.4</b>	<b>22.7</b>	<b>22.8</b>
Tax revenue	11.9	11.9	12.1	11.5	11.8	12.8	12.9	13.0
Nontax revenue and grants	9.7	10.0	10.5	10.5	9.7	10.4	9.7	9.8
Capital revenue	0.0	0.1	0.1	0.1	0.1	0.2	0.0	0.0
<b>Current expenditure</b>	<b>16.8</b>	<b>17.1</b>	<b>17.6</b>	<b>16.6</b>	<b>15.6</b>	<b>18.5</b>	<b>18.4</b>	<b>18.3</b>
Wages and salaries	8.8	8.9	9.0	8.7	8.7	10.3	10.1	9.9
Goods and services	1.8	2.2	2.3	1.9	1.8	2.6	2.4	2.4
Interest payments	1.6	1.6	1.6	1.5	1.1	0.8	0.7	0.8
Transfers	4.1	4.4	4.5	4.4	3.9	4.7	5.0	5.1
Other	0.5	0.1	0.1	0.1	0.1	0.1	0.1	0.1
<b>Capital expenditure and net lending</b>	<b>4.7</b>	<b>5.0</b>	<b>4.9</b>	<b>4.6</b>	<b>3.7</b>	<b>5.4</b>	<b>5.0</b>	<b>5.2</b>
<i>Of which:</i> Capital expenditure	4.9	5.0	4.9	4.6	3.7	5.4	5.0	5.2
<b>Public enterprises' operating surplus</b>	<b>1.4</b>	<b>1.4</b>	<b>2.0</b>	<b>1.2</b>	<b>0.6</b>	<b>1.1</b>	<b>0.7</b>	<b>0.7</b>
Statistical discrepancy 2/	0.3	-0.3	-1.3	-0.4	0.0	0.0	0.0	0.0
<b>Overall balance</b>	<b>1.8</b>	<b>0.9</b>	<b>0.8</b>	<b>1.5</b>	<b>2.7</b>	<b>0.6</b>	<b>0.0</b>	<b>-0.1</b>
<b>Financing</b>	<b>-1.8</b>	<b>-0.9</b>	<b>-0.8</b>	<b>-1.5</b>	<b>-2.7</b>	<b>-0.6</b>	<b>0.0</b>	<b>0.1</b>
External financing net	-0.1	-1.0	-0.5	-0.6	-0.6	0.0	-0.3	-0.6
Disbursements	1.9	1.7	1.8	1.2	0.8	1.6	1.2	0.8
Amortizations	2.0	2.6	2.3	1.8	1.3	0.0	0.0	1.3
Domestic financing net	0.2	-0.4	-0.9	-0.9	-2.2	-0.8	1.0	0.7
<i>Of which:</i> Quasifiscal deficit financing	0.8	0.2	0.2	0.1	0.3	0.4	0.6	0.4
Other	-1.9	0.5	0.6	0.0	-0.1	0.2	-0.6	0.0
<b>Memorandum Item:</b>								
Primary balance	3.5	2.5	2.4	3.0	3.8	1.4	0.7	0.7

Sources: Ministry of Finance and Fund staff estimates.

1/ Public sector comprises only the nonfinancial public sector and the Central Bank.

2/ Measurement error to reconcile above the line estimate with estimates of the fiscal balance from the financing side.

Table 4. Paraguay: Summary Accounts of the Central Bank  
(In billions of Guaranies; end-of-period; valued at constant exchange rate)

	2004	2005	2006	2007	2008	2009	Projections	
							2010	2011
<b>Currency issue</b>	<b>2,488</b>	<b>2,925</b>	<b>3,371</b>	<b>4,326</b>	<b>4,974</b>	<b>5,538</b>	<b>6,113</b>	<b>6,668</b>
Growth	12.7	17.6	15.3	28.3	15.0	11.3	10.4	9.1
<b>Net international reserves</b>	<b>5,957</b>	<b>6,616</b>	<b>8,514</b>	<b>12,309</b>	<b>14,322</b>	<b>19,304</b>	<b>20,666</b>	<b>21,287</b>
(In millions of U.S. dollars)	1,168	1,297	1,703	2,462	2,864	3,861	4,133	4,257
<b>Net domestic assets</b>	<b>-3,469</b>	<b>-3,691</b>	<b>-5,142</b>	<b>-7,983</b>	<b>-9,348</b>	<b>-13,766</b>	<b>-14,553</b>	<b>-14,619</b>
Net nonfinancial public sector	1,066	1,101	703	91	-1,104	-1,794	-2,263	-2,369
Net credit to the central government	693	769	401	-260	-1,513	-2,154	-2,624	-2,730
Net credit to the rest of NFPS	373	332	302	351	408	360	360	360
Net credit to the banking system	-4,058	-4,695	-5,455	-7,421	-7,540	-10,401	-11,124	-11,387
Reserve requirements	-1,901	-2,032	-2,181	-3,051	-3,338	-4,175	-4,685	-4,632
Free reserves	-988	-651	-631	-1,019	-1,460	-3,308	-3,208	-3,208
Monetary control bills (LRM) 1/	-1,171	-2,014	-2,644	-3,352	-2,742	-2,918	-3,231	-3,548
Other	2	2	2	2	0	0	0	0
Other assets and liabilities (net)	-478	-96	-391	-653	-703	-1,571	-1,167	-863
Capital and reserves	-1,697	-1,345	-114	163	-40	355	864	1,231
Other assets net 2/	1,219	1,249	-277	-815	-663	-1,926	-2,030	-2,094
<b>Memorandum items:</b>								
Total stock of LRMs outstanding 1/	1,552	2,293	3,224	3,907	3,282	3,412	3,778	4,148
Quasifiscal balance 3/	-333	-112	-105	-44	-216	-306	-792	-357
In percent of GDP	-0.8	-0.2	-0.2	-0.1	-0.3	-0.4	-1.0	-0.4
Costs of monetary policy operations	181	179	331	386	375	140	328	169
In percent of GDP	0.4	0.4	0.6	0.6	0.5	0.2	0.4	0.2
Monetary base	4,006	4,180	4,724	6,390	7,548	10,113	10,821	11,151
Annual growth (in percent)	17.6	4.3	13.0	35.3	18.1	34.0	7.0	3.1
Narrow monetary base 4/	3,122	3,667	4,169	5,507	6,424	7,358	8,166	8,496
Annual growth (in percent)	5.7	17.5	13.7	32.1	16.7	14.5	11.0	4.0

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

1/ A fraction of LRM, about 15 percent, is held by non-bank institutions.

2/ Includes LRM held by the nonbanking sector.

3/ Cumulative since beginning of year.

4/ Narrow monetary base comprises currency issued plus legal reserve requirement deposits in guaraní held at the BCF.



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

	2004	2005	2006	2007	2008 1/	2009	Projections	
							2010	2011
I. Central Bank								
<b>Net international reserves</b>	<b>5,957</b>	<b>6,616</b>	<b>8,514</b>	<b>12,309</b>	<b>14,322</b>	<b>19,304</b>	<b>20,666</b>	<b>21,287</b>
(In millions of U.S. dollars)	1,168	1,297	1,703	2,462	2,864	3,861	4,133	4,257
<b>Net domestic assets</b>	<b>-3,469</b>	<b>-3,691</b>	<b>-5,142</b>	<b>-7,983</b>	<b>-9,348</b>	<b>-13,766</b>	<b>-14,553</b>	<b>-14,619</b>
Credit to public sector, net	1,066	1,101	703	91	-1,104	-1,794	-2,263	-2,369
Credit to banking system, net 2/	-2,888	-2,682	-2,811	-4,069	-4,798	-7,483	-7,893	-7,839
Central bank securities	-1,552	-2,293	-3,224	-3,907	-3,282	-3,412	-3,778	-4,148
Other	-97	184	189	-98	-163	-1,077	-619	-262
<b>Currency issue</b>	<b>2,488</b>	<b>2,925</b>	<b>3,371</b>	<b>4,326</b>	<b>4,974</b>	<b>5,538</b>	<b>6,113</b>	<b>6,668</b>
II. Monetary Survey								
<b>Net foreign assets</b>	<b>7,696</b>	<b>8,142</b>	<b>9,941</b>	<b>13,240</b>	<b>15,861</b>	<b>20,844</b>	<b>22,294</b>	<b>22,995</b>
(In millions of U.S. dollars)	1,509	1,597	1,988	2,648	3,172	4,169	4,459	4,599
<b>Net domestic assets</b>	<b>3,075</b>	<b>3,528</b>	<b>3,663</b>	<b>4,485</b>	<b>6,186</b>	<b>6,286</b>	<b>9,946</b>	<b>13,801</b>
Credit to the public sector	266	-16	-429	-1,675	-3,265	-5,143	-5,407	-5,365
Credit to the private sector	5,227	6,016	6,991	10,223	15,264	18,941	22,268	26,076
Other	-2,418	-2,473	-2,899	-4,063	-5,813	-7,511	-6,915	-6,910
<b>Broad Liquidity (M4)</b>	<b>10,770</b>	<b>11,670</b>	<b>13,603</b>	<b>17,725</b>	<b>22,047</b>	<b>27,130</b>	<b>32,240</b>	<b>36,796</b>
Bonds and issued securities	0	0	0	0	110	174	189	205
Other monetary liabilities	102	70	25	82	55	121	143	163
Central bank securities with private sector	381	280	580	555	540	494	547	601
<b>Broad liquidity (M3)</b>	<b>10,287</b>	<b>11,320</b>	<b>12,998</b>	<b>17,088</b>	<b>21,343</b>	<b>26,341</b>	<b>31,361</b>	<b>35,827</b>
Foreign currency deposits	4,313	4,382	5,000	6,000	7,929	9,237	10,938	12,450
<b>Money and quasi-money (M2)</b>	<b>5,974</b>	<b>6,938</b>	<b>7,998</b>	<b>11,088</b>	<b>13,413</b>	<b>17,104</b>	<b>20,423</b>	<b>23,377</b>
Quasi-money	1,482	1,472	1,668	2,339	3,884	4,961	5,856	6,807
Money (M1)	4,492	5,466	6,330	8,749	9,529	12,144	14,567	16,570
(Annual percentage change)								
M0 (Currency issued)	12.7	17.6	15.3	28.3	15.0	11.3	10.4	9.1
Credit to the private sector	15.0	15.1	16.2	46.3	49.3	24.1	17.6	17.1
M1	25.2	21.7	15.8	38.2	8.9	27.4	20.0	13.8
M2	24.6	16.1	15.3	38.6	21.0	27.5	19.4	14.5
M3	13.5	10.0	14.8	31.4	24.9	23.4	19.1	14.2
Of which: Foreign currency deposits	1.1	1.6	14.1	20.0	32.1	16.5	18.4	13.8
<b>Memorandum items:</b>								
Ratio of foreign currency deposits to M3 (percent)	41.9	38.7	38.5	35.1	37.2	35.1	34.9	34.7
Ratio of foreign currency deposits to private sector deposits in banks (percent)	52.1	49.5	49.8	44.8	45.3	41.6	41.7	41.3

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

1/ In January 2008, a financiera representing about 5 percent of total banking asset was converted into a bank and thus added to the monetary survey.

2/ Exclude LRM held by the banking sector.

Table 6. Paraguay: Balance of Payments  
(In millions of U.S. dollars)

	Est.										Projections				
	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015			
<b>Current account</b>															
Trade balance	143	19	128	221	-379	-190	-289	-265	-154	-57	-24	26			
Exports	-248	-459	-621	-496	-1,168	-1,046	-915	-931	-931	-931	-933	-940			
Imports	2,854	3,352	4,398	5,652	7,772	5,784	7,871	8,531	9,168	9,956	10,785	11,777			
Registered	1,627	1,688	1,903	2,817	4,463	3,167	4,636	5,002	5,417	5,904	6,421	6,952			
Unregistered	1,228	1,664	2,495	2,835	3,309	2,617	3,235	3,529	3,751	4,052	4,364	4,825			
Imports	-3,102	-3,811	-5,019	-6,149	-8,940	-6,830	-8,786	-9,482	-10,119	-10,887	-11,718	-12,717			
Registered	-2,658	-3,251	-4,614	-5,630	-8,609	-6,497	-8,401	-9,067	-9,676	-10,410	-11,204	-12,158			
Of which: Fuel products	-434	-507	-701	-723	-1,308	-838	-1,151	-1,242	-1,311	-1,382	-1,461	-1,544			
Unregistered	-444	-560	-404	-518	-331	-384	-334	-415	-443	-477	-514	-559			
Services (net)	327	313	414	499	546	702	497	505	512	515	518	541			
Transport	-77	-95	-112	-141	-179	-157	-239	-256	-274	-298	-324	-355			
Travel	-1	-1	-1	-7	-15	-24	-43	-45	-48	-50	-53	-54			
Other	405	408	527	646	740	883	779	806	834	864	895	950			
Factor income	-134	-58	-92	-155	-162	-345	-340	-295	-202	-140	-121	-101			
Transfers	194	224	426	373	405	500	470	495	488	499	511	526			
<b>Capital and financial account</b>															
General government	41	342	197	753	466	803	561	389	301	207	159	113			
Disbursements	-51	-79	-37	-140	9	118	-16	-60	-31	-42	-37	-40			
Amortization	139	126	184	153	142	231	213	137	154	138	135	129			
Other	-133	-175	-169	-184	-185	-220	-228	-197	-185	-180	-172	-169			
Private Sector 1/	-56	-30	-52	-109	53	107	0	0	0	0	0	0			
Direct investment	91	421	233	893	457	885	577	449	332	249	196	153			
Foreign currency deposits	32	47	167	199	171	281	289	297	306	316	325	338			
Other	29	423	165	251	77	-42	-63	-85	-62	-75	-73	-87			
Errors and Omissions	30	-49	-98	443	209	445	350	236	88	9	-56	-98			
<b>Overall Balance</b>	93	-214	77	-212	234	384	0	0	0	0	0	0			
Net International Reserves (increase -)	277	147	402	762	321	996	273	124	147	150	135	139			
Gross Reserves	-186	-129	-405	-759	-402	-996	-273	-124	-147	-150	-135	-139			
Reserve Liabilities	-185	-130	-405	-759	-402	-996	-273	-124	-147	-150	-135	-139			
Exceptional Financing	-1	1	0	0	0	0	0	0	0	0	0	0			
Arounds deferral (+)/clearance (-)	-92	-19	3	-2	81	0	0	0	0	0	0	0			
Reschedulings 2/	-92	-19	3	-2	81	0	0	0	0	0	0	0			
Memorandum items:															
Current account in percent of GDP	2.1	0.3	1.4	1.8	-2.2	-1.3	-1.7	-1.5	-0.8	-0.3	-0.1	0.1			
Gross reserves (in millions of U.S. dollars)	1,168	1,298	1,703	2,462	2,864	3,861	4,133	4,257	4,404	4,554	4,689	4,828			
In months of imports of GNFS	3.4	2.9	3.1	3.1	4.7	4.9	5.1	4.9	4.7	4.6	4.4	4.1			
External public debt in percent of GDP 3/	41.3	34.6	25.4	19.9	17.3	15.0	14.1	12.8	11.6	10.4	9.3	8.3			
Debt service in percent of exports GNFS	7.3	8.7	5.8	5.1	2.9	5.1	4.0	3.4	3.1	2.8	2.5	2.2			
Export Volume (percentage change) 4/	15.8	2.6	1.9	40.0	17.7	-14.9	43.4	7.3	8.0	8.1	8.2	8.4			
Import Volume (percentage change) 4/	17.1	12.9	30.7	9.8	27.1	-9.2	16.9	5.6	5.6	6.7	6.7	7.6			
Terms of trade (percentage change)	0.3	-14.1	-2.5	11.8	6.6	-4.6	-7.1	-1.7	-1.0	-0.3	-0.6	-1.3			

Sources: Central Bank of Paraguay, and Fund staff estimates.

1/ Includes public enterprises and binationals.

2/ Excludes disputed claims (Office National du Ducroire, PDI, \$8 million, BIVAC and SGS, \$77 million, Swiss bank syndicate, \$85 million) and unidentified creditors (D.B. Pty, \$0.03 million).

3/ Based on average exchange rate valuation of GDP.

4/ Registered trade.

Table 7. Paraguay: Indicators of External Vulnerability

	2003	2004	2005	2006	2007	2008	2009
<b>Monetary and financial indicators</b>							
Broad money (M3), percentage change 1/	18.3	13.5	10.0	14.8	31.5	24.9	23.4
Credit to the private sector, real (percentage change) 1/	-25.7	12.0	4.9	3.5	38.2	38.9	21.8
Share of nonperforming loans in total loans (percent) 2/	20.6	10.8	6.6	3.3	1.3	1.2	1.2
Average domestic lending rate, real	19.3	17.4	18.5	15.4	20.8	19.7	25.7
Central Bank bill yield, real	-1.2	1.0	-0.1	0.8	-2.3	-5.0	0.3
International reserves (millions of U.S. dollars)	983	1,168	1,297	1,703	2,462	2,864	3,861
Central bank foreign short-term liabilities (millions of U.S. dollars)	0.5	0.3	0.7	0.0	0.3	0.0	1.2
<b>External indicators</b>							
Merchandise exports (percentage change)	16.8	32.0	17.4	31.2	28.5	37.5	-25.6
Merchandise imports (percentage change)	14.4	27.0	22.9	31.7	22.5	45.4	-23.6
Merchandise terms of trade (percentage change)	-0.8	0.3	-14.1	-2.5	11.8	6.6	-4.6
Real effective exchange rate (percentage change)	-6.6	3.6	-6.4	13.0	10.7	16.7	-6.9
Current account balance (percent of GDP)	2.3	2.1	0.3	1.4	1.8	-2.2	-1.3
Capital and financial account (percent of GDP)	3.2	0.6	4.6	2.1	6.2	2.8	5.5
Net foreign direct investment (percent of GDP)	0.4	0.5	0.6	1.8	1.6	1.0	1.9
Inward portfolio investment (percent of GDP)	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other net investment (percent of GDP)	2.6	-0.1	3.7	0.0	4.3	1.6	3.2
External public debt (percent of GDP) 2/	48.1	41.3	34.6	25.4	19.9	17.3	15.0
Debt service (in percent of exports GNFS)	11.5	7.3	8.7	5.8	5.1	2.9	5.1
Gross reserves (in U.S. dollars)	984	1,168	1,298	1,703	2,462	2,864	3,861
In months of imports of GNFS	3.5	3.4	2.9	3.1	3.1	4.7	4.9
Over short-term external debt 3/	1.7	1.7	2.0	2.6	4.3	2.9	3.4
Over foreign currency deposits in domestic banks	1.0	1.2	1.3	1.5	1.9	2.1	2.7

Sources: Central Bank of Paraguay; and Fund 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. Excludes foreign currency deposits in banking system.

Table 8. Paraguay: Banking System Indicators

	2003	2004	2005	2006	2007	2008	2009	Feb. 2010
I. Total banking system (II+III+IV+V)								
Share in assets	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Capital adequacy ratio (percent) 1/	20.9	20.5	20.4	20.1	16.8	16.3	16.4	18.0
NPLs/total loans	20.6	10.8	6.6	3.3	1.3	1.1	1.6	1.7
Provisions/NPLs	54.8	54.6	57.7	59.1	78.2	77.7	78.8	74.4
Rate of return on assets (ROA)	0.4	1.7	2.1	3.0	2.8	3.5	2.7	0.4
Rate of return on equity (ROE)	4.5	18.3	22.6	31.7	34.7	31.4	25.6	4.2
Liquid assets/total assets 2/	32.6	30.8	26.6	23.3	24.3	31.9	32.8	35.3
Foreign exchange deposits/total deposits	61.7	55.0	52.7	49.1	44.3	44.4	40.3	39.6
II. Total foreign-owned banks								
Share in assets	47.4	35.8	31.3	29.1	28.4	21.9	9.4	8.9
Capital adequacy ratio (percent) 1/	20.4	26.0	27.2	25.5	20.6	17.9	26.9	28.5
NPLs/total loans	20.8	11.0	6.4	3.6	1.5	1.5	1.7	3.3
Provisions/NPLs	64.2	71.2	63.4	68.6	53.6	73.3	78.1	43.9
Rate of return on assets (ROA)	0.1	1.4	1.4	2.2	1.2	2.3	0.8	0.0
Rate of return on equity (ROE)	1.2	12.0	11.3	18.6	13.1	24.9	8.7	0.1
Liquid assets/total assets 2/	29.8	25.4	29.0	24.5	25.5	28.6	30.6	34.9
Foreign exchange deposits/total deposits	65.6	65.2	65.1	61.2	55.4	61.8	74.2	72.3
III. Total majority-owned foreign banks								
Share in assets	37.2	45.2	48.0	51.4	51.7	42.9	41.0	41.4
Capital adequacy ratio (percent) 1/	21.0	17.7	17.8	17.4	15.1	15.8	15.8	16.7
NPLs/total loans	12.3	3.7	2.3	1.8	0.9	0.8	1.2	1.2
Provisions/NPLs	52.1	56.9	87.2	83.0	91.5	87.6	92.3	90.7
Rate of return on assets (ROA)	1.3	2.2	3.0	3.9	4.1	4.1	3.6	0.6
Rate of return on equity (ROE)	15.5	25.8	35.3	45.8	53.5	36.4	33.8	5.7
Liquid assets/total assets 2/	35.3	28.8	22.6	18.5	21.1	35.1	35.2	36.6
Foreign exchange deposits/total deposits	62.3	53.8	51.7	48.8	42.8	48.3	43.2	43.7
IV. Total domestic-owned private banks								
Share in assets	7.4	8.2	9.4	9.9	11.3	28.1	42.2	42.5
Capital adequacy ratio (percent) 1/	14.1	13.3	13.4	15.6	12.2	14.9	14.5	16.4
NPLs/total loans	2.9	2.1	0.8	1.4	0.8	1.3	1.9	1.9
Provisions/NPLs	46.2	70.3	77.1	78.6	95.0	65.4	69.4	67.9
Rate of return on assets (ROA)	1.6	2.0	2.2	2.9	2.7	3.6	2.2	0.4
Rate of return on equity (ROE)	21.1	28.1	30.8	35.9	38.3	28.6	21.2	3.9
Liquid assets/total assets 2/	38.8	38.1	34.0	34.6	28.2	22.6	29.2	31.5
Foreign exchange deposits/total deposits	60.7	57.6	54.7	51.5	51.6	34.1	35.8	35.0
V. National Development Bank (BNF)								
Share in assets	8.0	10.7	11.3	9.5	8.5	7.2	7.4	7.2
Capital adequacy ratio (percent) 1/	30.0	25.0	26.5	32.2	35.5	31.4	34.5	42.2
NPLs/total loans	56.2	48.9	40.3	19.4	7.8	3.0	2.4	2.9
Provisions/NPLs	47.6	43.1	45.1	31.6	76.9	99.8	98.6	83.3
Rate of return on assets (ROA)	-2.8	0.5	0.4	0.5	0.4	3.2	2.2	0.2
Rate of return on equity (ROE)	-18.7	6.8	5.3	5.7	5.3	30.8	22.0	2.1
Liquid assets/total assets 2/	30.7	52.0	31.2	33.8	34.5	59.8	42.5	50.4
Foreign exchange deposits/total deposits	32.7	23.6	20.6	13.1	8.8	10.1	9.6	8.3

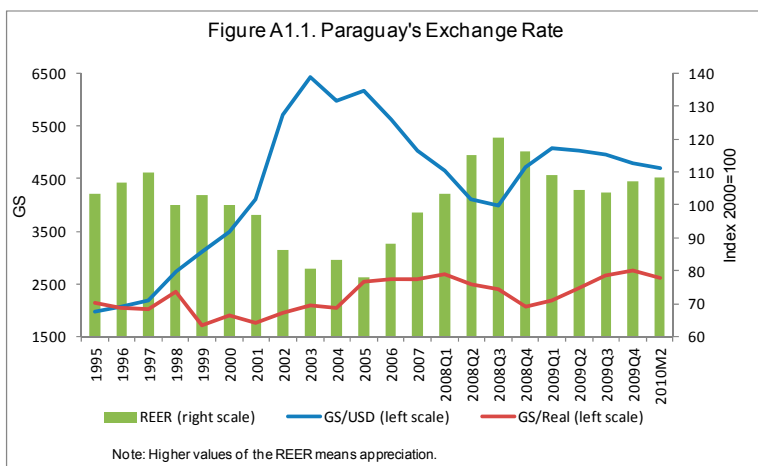
Source: Superintendency of Banks.

1/ Definition of CAR does not fully comply with international standards.

2/ Liquid assets are calculated as the sum of cash, reserves, accounts in banks and lending in interbank market.

## APPENDIX 1. PARAGUAY'S REAL EXCHANGE RATE ASSESSMENT

Several shocks have recently produced significant exchange rate developments in Paraguay. The appreciation trend that the REER experienced since 2005 was interrupted by the global financial turmoil and the severe drought that started to affect the Paraguayan economy around 2008Q3. In this context, the REER depreciated about 7 percent in 2009 y-o-y, mainly driven by the significant depreciation of the *guaraní* against the U.S. dollar in the period. Since mid-2009, and consistent with the recovery of the economy and the emergence of significant capital inflows, the *guaraní* started to appreciate against the U.S. dollar, and has remained stable since early 2010. The REER, which closely follows the nominal exchange rate movements against the U.S. dollar, has recently increased, reaching a level somewhat close to its historical average as of February 2010, and somewhat below its pre-crisis level.



Standard CGER methodologies suggest that Paraguay's REER is broadly in line with fundamentals, yet slightly biased towards an undervaluation. Although some differences arise depending on the applied methodology, none of them indicates a major misalignment (see Table A1.1).

Table A1.1. Real exchange rate deviation from equilibrium  
(In percent)

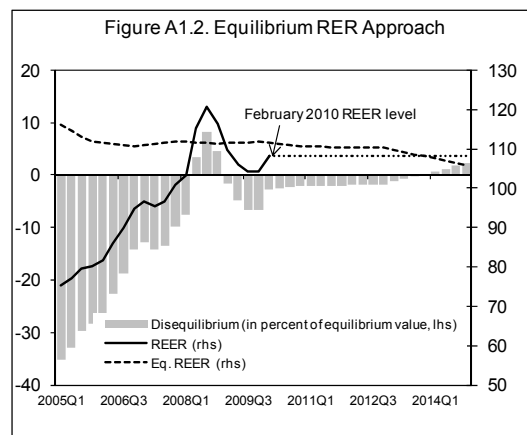
Overvaluation (+); Undervaluation (-)			
I. MB approach	II. ES approach	III. EREER approach	IV. Average I-III
-5.5	-1.9	2.9	-1.5

**The macroeconomic balance (MB) approach suggests that the *guaraní* is about 5.5 percent undervalued in real effective terms.** This estimation considers the difference between the underlying current account (CA) balance in 2009 (-0.4 percent of GDP)—which takes the CA balance in that year (-1.3 percent of GDP) stripping away several transitory factors such as the lower import and export values induced by the drought—and Paraguay's CA norm (-2.16 percent of GDP).

**The external sustainability (ES) approach also indicates that the REER is slightly undervalued.** In this estimation we have assumed that Paraguay's net foreign assets (NFA) position remains at its end-2009 level (-15 percent of GDP). Accordingly, the stabilizing CA

balance at the benchmark level of NFA, roughly -1 percent of GDP, requires a REER appreciation of about 1.9 to close the gap with the underlying CA.

**Finally, a direct estimation of the equilibrium real exchange rate (ERER) considering its long-run determinants indicates that the REER is slightly overvalued.** According to this methodology, the misalignment is only about 2.9 percent, and is obtained comparing the REER as of February 2010 against its *long-run* equilibrium level. However, and in line with previous results, this approach also points to a mild undervaluation—of about 1.4 percent—if one instead compares the REER against its *current* equilibrium level. This approach also illustrates that the appreciation of the REER that started in 2005 led to a moderate overvaluation relative to its equilibrium level around 2008, which was later reverted (see Figure A1.2).



## APPENDIX 2. DEBT SUSTAINABILITY ANALYSIS

*The dynamics of Paraguay's external and public debt levels are very similar given that 70 percent of total external debt is public debt and 85 percent of the public debt is denominated in foreign currency. Both external and public debt levels are low and robust to alternative scenarios for the underlying macroeconomic variables. Specifically, setting the key variables that determine the overall debt dynamics at their historical averages gives rise to debt levels below those of the baseline scenario. In addition, temporary negative shocks to key variables, such as interest rates, the exchange rate, and real GDP growth, lead to an increase in the level of public and external debt, but these ratios return to either a stable or declining path once conditions normalize.*

### ***Public Debt***

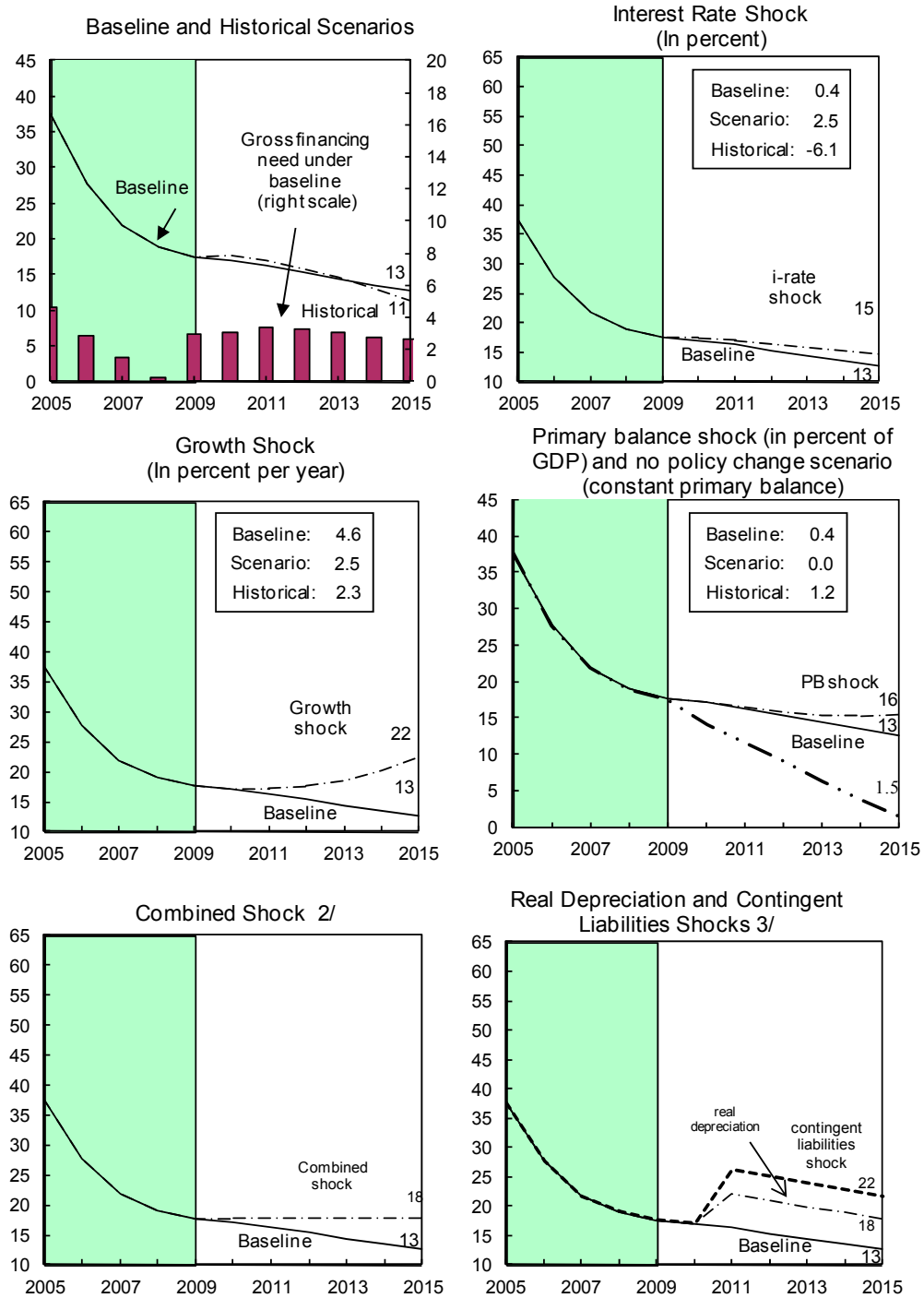
**Paraguay's gross public debt (domestic and external) is mostly long-term concessional debt denominated in foreign currency.** As of end-2009, total outstanding public debt (excluding central bank's bills) is about 18 percent of GDP, of which 85 percent corresponds to external debt held mostly by multilateral organizations. At present, Paraguay's government does not issue bonds in international markets nor finances its borrowing on the domestic capital markets on a routine basis.

**The public debt level is expected to remain sustainable through the projection period 2010–15.** Under the baseline scenario, and predominantly reflecting long maturities and concessional terms, Paraguay's debt service is expected to remain low, with the debt-to-GDP ratio declining to about 13 percent of GDP by 2015. Under a deterioration of the primary deficit, because of the authorities' failure to increase tax revenues from 12.9 to 14.0 percent of GDP, as assumed in the baseline scenario, the debt level would stay constant at about 16 percent. Under most adverse scenarios, such as low growth, a 30 percent depreciation of the exchange rate, and the emergence of contingent liabilities, the debt level would rise to the range of 18–22 percent of GDP by 2015, with some risks of reaching an explosive path in the case of persistent low growth.

### ***External Debt***

**The external debt level is projected to stay below 20 percent of GDP over the medium term.** Since 2002, and reflecting continuous sizeable primary surplus, Paraguay's external debt has continuously experienced a downward trend. This trend was interrupted in 2009, when the debt level rose moderately from 21 percent of GDP to 25 percent of GDP, as a consequence of the government's increased recourse to multilateral lending to fund its fiscal stimulus. Going forward, the external debt ratio is expected to decrease significantly, due to the expected fiscal discipline and the sustained growth projected for the coming years. Stress tests show that the most adverse shock would be a 30 percent currency depreciation, which would raise the debt to GDP ratio about 11 percentage points in that year or about 8 percentage points over the medium term.

Figure A2.1 . Paraguay: Public Debt Sustainability: Bound Tests 1/  
(Public 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.

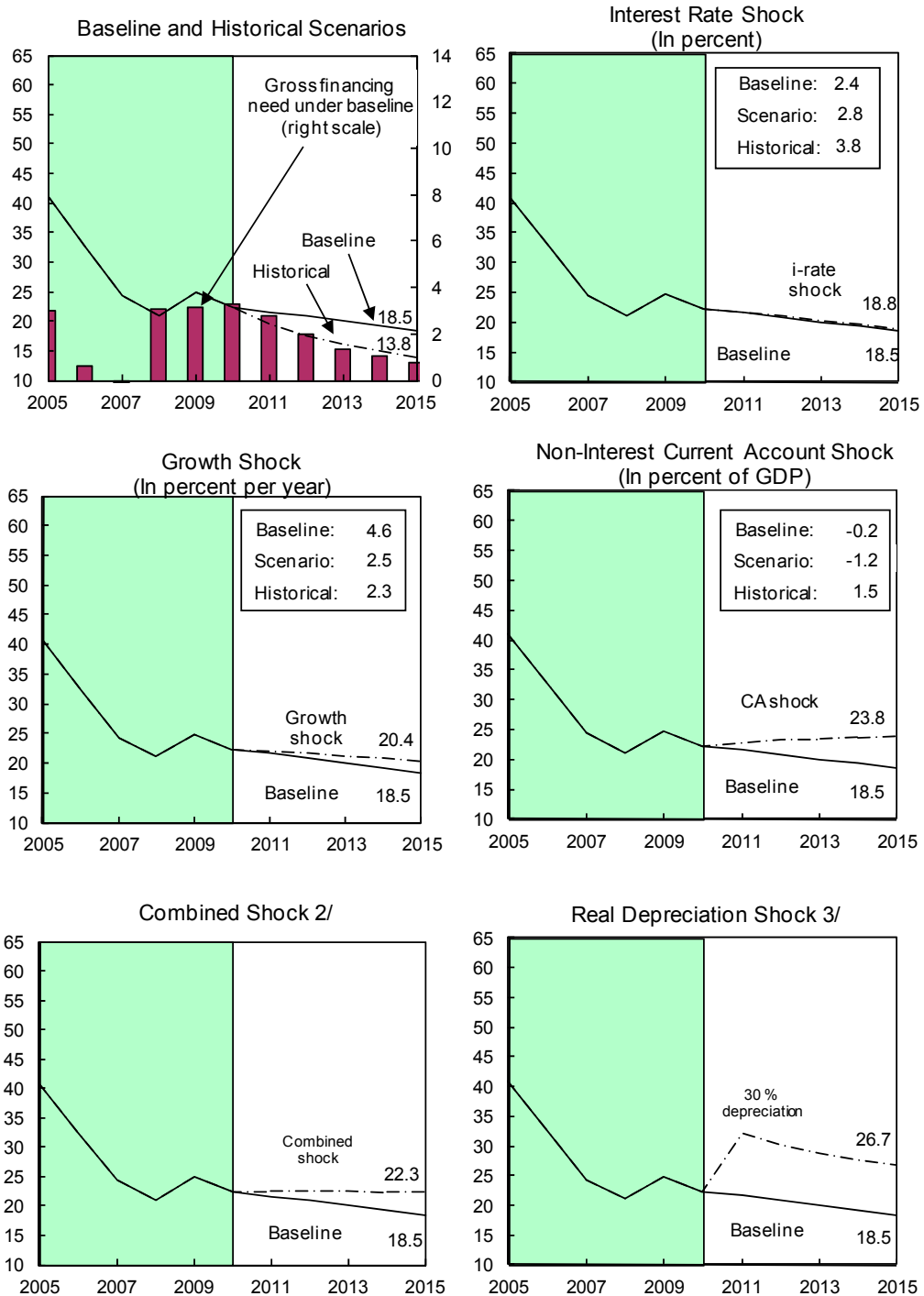
Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.

2/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and primary balance.

3/ One-time real depreciation of 30 percent and 10 percent of GDP shock to contingent liabilities occur in 2011, with real depreciation defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).



Figure A2.2. Paraguay: External Debt Sustainability: Bound Tests 1/  
(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/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.

3/ One-time real depreciation of 30 percent occurs in 2011.

INTERNATIONAL MONETARY FUND

PARAGUAY

**Staff Report for the 2010 Article IV Consultation—Informational Annex**

Prepared by the Staff Representatives for the 2010 Consultation with Paraguay

Approved by Rodrigo Valdés and Dominique Desruelle

May 21, 2010

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**ANNEX 1. PARAGUAY—FUND RELATIONS**  
(As of April 30, 2010)

**I. Membership Status:** Joined December 28, 1945; Article VIII

<b>II. General Resources Account:</b>	<b>In millions of SDRs</b>	<b>In percent of Quota</b>
Quota	99.90	100.00
Fund holdings of currency	78.43	78.51
Reserve position in Fund	21.48	21.50

<b>III. SDR Department:</b>	<b>In millions of SDRs</b>	<b>Percent of Allocation</b>
Net cumulative allocation	95.19	100.00
Holdings	110.37	115.95

**IV. Outstanding Purchases and Loans:** None

**V. Latest Financial Arrangements:**

Type	Approval Date	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

**VI. Projected Payments to Fund**

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

	Forthcoming				
	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>
Principal					
Charges/Interest		0.00	0.00	0.00	0.00
<b>Total</b>		<b>0.00</b>	<b>0.00</b>	<b>0.00</b>	<b>0.00</b>

**VII. Exchange Rate Arrangement:** The currency of Paraguay is the Paraguayan *guarani*. The exchange rate regime is classified as other managed arrangement. The exchange rate is determined in the interbank foreign exchange market, but the central bank intervenes in the foreign exchange and monetary markets to smooth out exchange rate fluctuations in real effective terms. The U.S. dollar is the principal intervention currency. On April 30, 2009, the average interbank rate for the U.S. dollar was G4,712 =US\$1. Paraguay has accepted the obligations of Article VIII, Sections 2(a), 3 and 4 of the Fund's Articles of Agreement.

**VIII. Article IV Consultation:** The Executive Board concluded the 2009 Article IV consultation on May 1, 2009.

**IX. Technical Assistance:**

<b>Department</b>	<b>Purpose</b>	<b>Date of Delivery</b>
MFD	Reorganization of the Central Bank and Monetary Operations	January 2004
FAD	Customs Administration Advisor	July 2004–May 2005
MFD	Monetary Operations and Monetary Policy Formulation	October 2004
MFD	Public Banking Restructuring	February 2005
FAD	Customs and Tax Administration	February 2005
MFD and WB	FSAP Mission	April 2005 and July 2005
FAD	Update of ROSC	September 2005
STA	ROSC	January–February 2006
MFD	Central Bank Recapitalization	March 2006
MFD	Peripatetic Banking Expert	October 2005, February and August 2006
FAD	Public Financial Management	March 2006
FIN	Safeguards Assessment	March 2006
STA	Consumer Price Index	April–May 2006
FAD and LEG	Tax Procedure Code	May 2006
LEG	Money Laundering	July 2006
STA	Monetary and Financial Statistics	August–September 2006
MCM	Payments System	October 2006
STA	Balance of Payments	November 2006
FAD	Revenue Administration	December 2006
FAD	Peripatetic Customs Advisor / Customs Administration	May, August, and December 2007
FAD	Tax Code Regulations	June 2007
MCM	Development of Local Capital Markets	June 2007
MCM	Banking Regulation and Supervision	June, August, and November 2007
STA	Quarterly National Accounts	August 2007
STA	Consumer Price Index	August 2007

<b>Department</b>	<b>Purpose</b>	<b>Date of Delivery</b>
STA	Monetary and Financial Statistics	November 2007
MCM	Bank regulation and supervision	February - March 2008, June 2008
FAD	Tax Administration Strategic Planning	April 2008
FAD	Tax Policy	August 2008
STA	Quarterly National Accounts	August 2008
FAD	Tax and Customs Administration	September 2008
STA	Monetary and Financial Statistics	March 2009
FAD	Performance Budgeting	February 2009
MCM	Banking Supervision	May 2009
MCM	Cooperatives	September 2009
MCM	Cooperatives	September 2009
FAD	Medium-Term Fiscal Framework	September 2009
STA	National Accounts	
FAD	Debt Management	February 2010
MCM	First Issuance Sovereign Bond	March 2010
STA	Monetary and Financial Statistics	April 2010
MCM	Banking Supervision	April 2010

**X. Safeguards Assessment:** Under the Fund's safeguards assessment policy, Central Bank of Paraguay (BCP) is subject to a full safeguard assessment in respect to the arrangement approved on May 31, 2006. A safeguards assessment of the BCP was completed in October 2006. The report stated that while the BCP has made some progress in strengthening the safeguards framework since the 2003 safeguards assessment, vulnerabilities remain in certain areas such as financial reporting and program data reporting to the Fund.

**XI. Resident Representative:** Mr. Tobias Roy has been a resident representative since December 2007.

**ANNEX 2. PARAGUAY—WORLD BANK RELATIONS<sup>1</sup>**  
(As of March 31, 2010)

The current Country Partnership Strategy (CPS) for Paraguay was approved in April 2009. Despite the limited implementation of the previous Country Assistance Strategy (CAS) approved in 2003, the Bank decided to step up its involvement in Paraguay under the current CPS, which has an envelope of US\$500 million over the five year period FY09-FY13 and includes a rich non-lending program in the Government's priority areas.

The preliminary results under the current CPS show that there have been major improvements from the previous CAS. In the area of lending, a total amount of \$275 million has already been approved by the Bank's Board of Directors and all these projects have been approved by Congress. This reflects an important joint effort between the Government and the Bank to improve the dialogue with Parliament and to involve its members up stream as investment operations are being prepared.

The policy dialogue with the current administration regarding the reform agenda and the macroeconomic framework has been very active and positive. This has enabled the launching of a programmatic development policy dialogue supported by a series of three development policy loans (DPL). The first one of US\$ 100 million was disbursed in September 2009, and the second phase operation is envisaged early for FY11 with a preliminary amount of \$75 million. The Bank program includes an investment component focused on the rural, energy and social sectors. An energy sector strengthening loan and a community productive initiatives loan are expected to be approved in FY11 for an overall amount of about \$110 million.

The three World Bank-financed projects presently under implementation have a total value of US\$175.5 million in commitments, of which US\$171.8 million remain undisbursed as of March 30, 2010. In addition, Paraguay has a portfolio of four grants for a total amount of US\$3.8 million, with an undisbursed balance of US\$2.8 million. The grants are supporting statistical development, the institutional strengthening of Congress, improvements in the management of indigenous lands and the promotion of development among indigenous communities. Other initiatives are being prepared with support from the GEF (Biodiversity Conservation) and IDF (Institutional Strengthening of the Congress – Phase 2).

The Bank has been playing an important role in the area of anti-corruption and governance. Paraguay is a governance and anti-corruption (GAC) pilot country and is receiving technical advice under the Stolen Asset Recovery (STAR) Initiative. In addition, the Bank program includes a number of Analytical and Advisory Activities (AAA) with the Government of Paraguay. During FY10 three AAAs were delivered \ including a Study on the Implications

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<sup>1</sup> Prepared by the staff of the World Bank.

of Trade Liberalization in Mercosur, a Transport Sector Assessment and a Revision of Poverty Measurement. AAAs currently under preparation include a Programmatic Poverty Assessment, a Social Protection Technical Assistance, and a Public Sector Reform Technical Assistance. The Bank completed a Fee for Services for the Payments System with the Central Bank of Paraguay and is considering a second phase for FY11.

### Financial Relations With The World Bank

(In millions of U.S. dollars)

#### I. IBRD/IDA Active Operations (as of March 30, 2010)

	Committed (Net of Cancellations)	Disbursed	Undisbursed
<b>Active loans</b>			
Road Maintenance	74.0	3.0	71.0
Sustainable Agricultural Development	37.5	0.5	37.0
Water Sector Modernization	64.0	0.2	63.8
<b>Total active loan</b>	175.5	3.7	171.8
<b>Total IBRD/IDA<sup>2</sup></b>		<b>966.03</b>	
<b>Repaid</b>		<b>685.59</b>	
<b>Total outstanding</b>		<b>279.19</b>	
O/w IBRD (including exchange rate adjustment)		264.65	
O/w IDA		14.54	

#### II. IFC Operations (as of March 30 2010)

	Loans/Gtees	Equity	Total
Commitments	106.8	6.2	113.0
Held by IFC	104.8	5.0	109.8
Undisbursed	2.0	1.2	3.2

#### III. IBRD/IDA Loan Transactions (calendar year)

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Disbursements	46.6	26.8	13.5	42.3	16.2	16.7	31.9	13.0	9.1	101
Repayments	20.2	15.3	16.8	21.0	34.8	26.6	27.5	27.5	29.9	34
Net Lending	26.4	11.5	-3.3	21.3	-18.5	-9.9	4.3	-14.5	-20.7	67

<sup>2</sup> As of March 30, 2010

**ANNEX 3. PARAGUAY—INTER-AMERICAN DEVELOPMENT BANK RELATIONS<sup>3</sup>**  
(As of March 31, 2010)

**Portfolio**

As of March 31, 2010, the active loan portfolio amounts to US\$875.8 million, with an undisbursed balance of US\$543 million. In addition, there is 1 non sovereign guarantee US\$16 million loan to be fully disbursed, 60 active Technical Cooperation operations (regular TCs, MIF, and Small Projects) for US\$30.7 million, of which US\$22.5 million are undisbursed. There are also 6 trade facilities with the private sector up to US\$22 million. Sovereign Guarantee Loan approvals in 2010 are expected to total US\$228 million.

**Strategy**

A new IDB country strategy for 2009-2014 was approved by the Board on Feb 24, 2010. It establishes a financial envelope of \$1 billion in approvals for the period. It is aligned with the government program (Programa Estrategico Economico y Social, PEES) with special emphasis on social programs for poverty alleviation, infrastructure and institutional capacity in the public sector. It is anchored by the existing portfolio and it is front loaded, with 2009 approvals of US\$227.6 million.

**Pipeline**

The lending program for 2010 includes the following sovereign guarantee operations:

- a. CBD Redevelopment, Public Transport Modernization and Government Offices, \$120 million.
- b. Population Census, US\$8 million.
- c. National Tourism Program, US\$10 million.
- d. Public Management Modernization Program – 2<sup>nd</sup> Programmatic, US\$50 million.
- e. Infant Development and Support Program, US\$30 million.
- f. BNF Modernization Program, US\$10 million

Expected total 2010: US\$228 million.

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<sup>3</sup> Prepared by the staff of the IDB.



#### ANNEX 4. PARAGUAY—STATISTICAL ISSUES

Data provision to the Fund has some shortcomings, but is broadly adequate for surveillance. Following a data ROSC mission in January–February 2006, the authorities' response to the report and the mission's recommendations were published on the Fund's website on June 30, 2006. The country is a GDDS participant.

##### A. Real Sector

National accounts estimates, broadly consistent with the guidelines of the *1993 SNA*, were released in 2005. However, no comprehensive regular program for data collection through economic censuses and surveys exists (an industrial survey was conducted in 2002) and source data for nonfinancial services, household consumption, and changes in inventories are insufficient. Major areas of concern include: (i) the 1994 reference year needs to be updated; (ii) excessive use is made of fixed coefficients for value added and household consumption; (iii) changes in inventories are obtained residually; (iv) informal activities are not monitored; and (v) supply and use tables have been compiled only until 1997. While the periodicity of annual GDP meets GDDS recommendations, timeliness does not because data are disseminated with a lag of 11 months. Several STA missions on the compilation of quarterly national accounts (QNA) were fielded in August 2007, August 2008 and November 2009. Production of definite QNA series would need to await a revision of the national accounts base year and the compilation of supporting basic data, which are tentatively scheduled for completion by 2009/10. The STA mission of November 2009 assisted the authorities in outlining a work program for updating the national accounts' base year.

Both the consumer (CPI) and producer price indices (PPI) are reported on a regular and timely basis. Since January 2008, the Central Bank of Paraguay (BCP) has been using a new CPI index based on the 2005–06 household budget survey. The geographic coverage of the CPI is limited to Asunción (the capital) and expenditure weights are representative of the consumption patterns of urban households. The PPI has a base weight period of December 1995 and its basket (150 items) is not fully representative of current national output; electricity, water, gas, and services are not covered.

Since the introduction of a regular household survey in 1998, the coverage and quality of employment and unemployment statistics have improved significantly. However, frequencies remain at the annual level, and the publication lag is close to one year. Wage indices are updated twice a year.

The data ROSC mission found that the resources are insufficient for real sector statistics and constrain further development, particularly the full adoption of the *1993 SNA*. The authorities have been trying to address these resource shortcomings in the context of the recent compilation of a new CPI and the production of provisional QNA series.

## B. Fiscal Sector

The Government finance statistics (GFS) used for internal purposes and for reporting to WHD is broadly consistent with the recommendations of the *Manual on Government Finance Statistics 1986 (GFSM 1986)*. The authorities have not yet prepared a plan to migrate to the *Government Finance Statistics Manual 2001 (GFSM 2001)*. Monthly data are available for the central administration (budgetary central government). The asset position of the social security system is available on a daily basis. Statistics on the central administration include data of the Postal Service Directorate (a nonfinancial public corporation) and the statistics of the nonfinancial public sector include data of financial public corporations—four employer social insurance schemes. These social insurance schemes 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. Domestic debt data are available on request, but need to be fully integrated with the external debt database. Deficiencies remain in recording short-term supplier and commercial credit of the public sector. Moreover, there is a discrepancy in the fiscal data reported by the monetary and fiscal authorities. Measures are being taken to make reporting more transparent.

Annual data covering general government for 2007 have been reported for publication in the *2008 edition of the GFS Yearbook*. However, since 1994 no outstanding debt data and no breakdowns for expenditure by function have been provided for publication in the *GFS Yearbook*. Monthly and quarterly data are not reported for publication in *IFS*.

## C. Money and Banking Sectors

Paraguay completed the establishment of a unified compilation and reporting system for the whole range of monetary data. This new system intends to harmonize monetary data for use within the BCP, for reporting to STA for publication in *IFS*, and for operational and monitoring purposes. A revision of the classification criteria has led also to a marked reduction in the discrepancies of interbank positions. However, the lack of coverage of the credit cooperatives remains a matter of concern since they account for around  $\frac{1}{4}$  of deposits and loans of the banking sector. The BCP, with assistance from STA, plans to include monthly data of the 20 largest credit cooperatives in the monetary survey during 2010. The Superintendency of Banks publishes a detailed and informative report on the soundness of the financial system.

## D. External Sector

The classification of the balance of payments and the international investment position (IIP) follows the recommendations of the *Balance of Payments Manual*, 5th edition. Quarterly and annual data on balance of payments and the IIP are available from 2001 onwards on the central bank website, and are reported only once a year to STA for publication in the *IFS*. Improvements have been made in the quality of the data on capital flows, especially in the coverage of foreign direct investment, and in the recording of external debt transactions.

Special studies by the central bank have improved the estimation methods for remittances of Paraguayans abroad and unregistered trade transactions, but serious deficiencies remain.

Also, there are deficiencies in the area of private capital outflows, which are difficult to register due to Paraguay's open capital account. An STA mission on Balance of Payments Statistics assisted the BCP in November 2006 in implementing recommendations of the ROSC mission. In particular, the mission focused on: (1) assessing the surveys used to capture data on services, direct investment, nonfinancial private sector portfolio investment, and other investment; (2) reviewing and updating the statistical techniques used to calculate unrecorded trade; (3) reassessing the treatment of the binational hydroelectric energy enterprises in the external sector accounts; and (4) reviewing and preparing a preliminary template for reporting data on international reserves and foreign currency liquidity.

Paraguay: Table of Common Indicators Required for Surveillance  
(As of April 30, 2010)

	Date of latest observation	Date received	Frequency of Data <sup>1</sup>	Frequency of Reporting <sup>1</sup>	Frequency of publication	Memo Items:	
						Data Quality Methodological soundness <sup>2</sup>	Data Quality Accuracy and reliability <sup>3</sup>
Exchange Rates	May. 2010	5/20/10	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities <sup>4</sup>	May. 2010	5/20/10	D	M	D		
Reserve/Base Money	Apr 2010	5/03/10	D	M	D	O, LNO, LO, O	O, O, O, LO, LO
Broad Money	Apr. 2010	5/03/10	M	M	M		
Central Bank Balance Sheet	Apr. 2010	5/03/10	D	M	D		
Consolidated Balance Sheet of the Banking System	Mar. 2010	5/03/10	M	M	M		
Interest Rates <sup>5</sup>	Mar. 2010	5/03/10	M	M	M		
Consumer Price Index	Apr. 2010	5/18/10	M	M	M	O, LO, O, O	O, LO, LNO, O, LO
Revenue, Expenditure, Balance and Composition of Financing <sup>6</sup> —General Government <sup>7</sup>	Mar. 2010	4/03/ 10	M	M	M	LO, LO, LO, LO	LO, LNO, O, LO, LO
Stocks of Central Government and Central Government-Guaranteed Debt <sup>8</sup>	Dec. 2009	4/03/10	Q	Q	Q		
External Current Account Balance	Dec. 2009	4/03/10	Q	Q	Q	O, LO, LO, LO	LO, O, LO, LO, LO
Exports and Imports of Goods and Services	Mar. 2010	4/03/10	M	M	M		
GDP/GNP	2009	4/03/10	A	A	A	O, LO, LO, LO	LO, O, LNO, O, LO
IIP	2009Q4	4/21/10	Q	Q			

<sup>1</sup> Daily (D); Weekly (W); Monthly (M); Quarterly (Q); Annually (A); Irregular (I); Not Available (NA).

<sup>2</sup> Reflects the assessment provided in the data ROSC published on June 30, 2006 and based on the findings of the mission that took place during January 25–February 8, 2006. 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), or not observed (NO).

<sup>3</sup> Same as footnote 7, 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.

<sup>4</sup> 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.

<sup>5</sup> Both market-based and officially-determined, including discounts rates, money market rates, rates on treasury bills, notes and bonds.

<sup>6</sup> Foreign, domestic bank, and domestic nonbank financing.

<sup>7</sup> The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.

<sup>8</sup> Including currency and maturity composition



INTERNATIONAL MONETARY FUND

*Public Information Notice*

EXTERNAL  
RELATIONS  
DEPARTMENT

Public Information Notice (PIN) No. 10/74  
FOR IMMEDIATE RELEASE  
June 10, 2010

International Monetary Fund  
700 19<sup>th</sup> Street, NW  
Washington, D. C. 20431 USA

## **IMF Executive Board Concludes 2010 Article IV Consultation with Paraguay**

On June 4, 2010 the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Paraguay.<sup>1</sup>

### **Background**

During 2003–08, Paraguay took advantage of the favorable global conditions to strengthen economic performance. The government ran a sizable primary surplus, which cut public debt to less than 25 percent of GDP by end-2008. The central bank maintained a prudent monetary policy, supported by exchange rate flexibility. Structural reforms advanced in several areas, including financial supervision, budget management, and the tax system. As a result, real GDP rose by 5 percent a year during 2003–08, inflation declined to 7.5 percent during 2008, and net international reserves reached almost US\$3 billion by end-2008.

In 2009, the global financial crisis coupled with a severe drought buffeted the economy, causing a 3.8 percent decline in real GDP. Exports fell sharply in response to the effect of the drought on agricultural production (about one quarter of the economy) as well as the depressing effect of the global crisis on world commodity prices and growth in trading partners. With the strong links between agriculture and the rest of the economy, real domestic demand declined and imports plummeted. This, together with the reversion of international commodity prices, brought

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<sup>1</sup> 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. 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>.

headline inflation down to 2 percent and slowed the growth in credit to the private sector. Banks held up relatively well during the downturn but some signs of stress appeared in the cooperative sector.

In 2009, the authorities shifted policies to support aggregate demand. The central government scaled back the primary surplus, resulting in a fiscal impulse of 2 percent of GDP. The central bank focused on providing ample liquidity to the banking system and made partially sterilized purchases of foreign exchange to smooth currency volatility, which depreciated by 7 percent in real effective terms in 2009. The capital account surplus expanded to 5½ percent of GDP, especially reflecting repatriations by residents seeking a safe haven for their assets, and net international reserves reached US\$3.8 billion (25 percent of GDP and 340 percent of short-term debt on remaining maturity basis).

In 2010, the prudent stance of demand policies, as well as the global recovery and the favorable weather conditions, are expected to help real GDP to grow by 6 percent. The projected rebound in agriculture production and faster growth in key trading partners will boost exports and private demand. These trends, together with rising international commodity prices, are expected push inflation up and widen moderately the external current account deficit. With continued net capital inflows, net international reserves would rise to US\$4.1 billion. The overall balance of the central government is expected to be in equilibrium, while the central bank intends to withdraw excess liquidity as necessary to limit inflation to no more than 5 percent.

### **Executive Board Assessment**

Executive Directors commended the Paraguayan authorities for preserving macroeconomic stability in 2009 in the face of a severe drought and the global financial crisis. Sound macroeconomic policies in recent years had permitted the timely shift to a countercyclical stance, which had helped limit the fall in real GDP. A rebound in growth is expected for 2010, underpinned by the continuation of prudent demand policies while keeping inflation under control. Directors noted, however, that the economy remains vulnerable to swings in commodity prices, weather-related shocks, and financial risks associated with high dollarization and the operations of savings and loans cooperatives. These highlight the need to continue to press ahead with the ambitious agenda of institutional reforms and export diversification, with Fund technical assistance as appropriate.

Directors emphasized the importance of fiscal reforms, aimed at increasing the tax ratio, strengthening fiscal management, and reducing fiscal risks. They supported the authorities' objective of keeping public debt at prudent levels, which would be facilitated by the adoption of a medium-term fiscal framework. This would require curtailing current spending, as well as continued efforts to strengthen tax administration and broaden the tax base, including further steps to increase taxation on agribusiness activities. These measures would help preserve sufficient fiscal space for public investment and social spending. Directors called for the implementation of the personal income tax without further delay. They also encouraged continued efforts to enhance the efficiency of public enterprises, including through public-private

partnerships, with a view to increasing the competitiveness of economic sectors critical for growth.

To keep inflation in check, Directors encouraged the authorities to begin to withdraw excess liquidity from the banking system and raise the policy interest rate above the expected rate of inflation. They supported the goal of adopting an inflation-targeting framework over the medium term, and looked forward to the early implementation of the recently-approved law for the recapitalization of the central bank—a step critical to increasing its credibility and operational flexibility. The development of secondary markets for government securities would also help strengthen the central bank's liquidity management. Directors welcomed the authorities' intention to maintain exchange rate flexibility for the guaraní, which appears to be at a level consistent with its fundamentals.

In the financial sector, Directors welcomed ongoing efforts to strengthen the supervisory and regulatory framework for cooperatives. They recommended extending prudential norms for banks to cooperatives to limit the scope for regulatory arbitrage, and moving toward a unified supervisory framework for all financial institutions. Measures to improve compliance with the Basel Core Principles through modifications in regulations would help preserve the quality of bank loans as credit picks up. Directors looked forward to the upcoming Financial Sector Assessment Program update.

**Public Information Notices (PINs)** form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case.

**Paraguay: Selected Economic Indicators**  
I. Social and Demographic Indicators

	2004	2005	2006	2007	2008	Est. 2009	Projections	
							2010	2011
(Annual percentage change, unless otherwise indicated)								
<b>Income and prices</b>								
Real GDP	4.1	2.9	4.3	6.8	5.8	-3.8	6.0	4.0
Nominal GDP	16.4	11.2	13.2	17.7	19.7	-1.7	11.1	8.3
Nominal per-capita income growth	23.0	6.3	21.3	29.2	35.6	-15.6	15.6	3.1
Consumer prices (end of period)	2.8	9.8	12.5	5.9	7.5	1.9	5.0	4.5
<b>Monetary sector</b>								
Currency issue	12.7	17.6	15.3	28.3	15.0	11.3	10.4	9.1
M2	24.6	16.1	15.3	38.6	21.0	27.5	19.4	14.5
M5 1/	12.6	8.4	16.6	30.3	24.4	23.1	18.8	14.1
Credit to private sector	15.0	15.1	16.2	46.2	49.3	24.1	17.6	17.1
<b>External sector</b>								
Exports (fob)	32.0	17.4	31.2	28.5	37.5	-25.6	36.1	8.4
Imports (cif)	27.0	22.9	31.7	22.5	45.4	-23.6	28.6	7.9
Terms of trade	0.3	-14.1	-2.5	11.8	6.6	-4.6	-7.1	-1.7
Real effective exchange rate 2/	3.6	-6.4	13.0	10.7	16.7	-6.9	...	...
(In percent of GDP, unless otherwise indicated)								
<b>Current account</b>	<b>2.1</b>	<b>0.3</b>	<b>1.4</b>	<b>1.8</b>	<b>-2.2</b>	<b>-1.3</b>	<b>-1.7</b>	<b>-1.5</b>
Trade balance	-3.6	-6.1	-6.7	-4.1	-6.9	-7.2	-5.3	-5.3
Exports	41.2	44.7	47.4	46.2	46.0	39.8	45.9	47.3
Imports	44.7	50.9	54.1	50.3	52.9	47.0	51.2	52.6
Of which: Oil Imports	6.3	6.8	7.6	5.9	7.7	5.8	6.7	6.9
Other (export and import of services, income, current transfers)	5.6	6.4	8.1	5.9	4.7	5.9	3.7	3.8
Of which: Remittances	2.8	3.0	4.6	3.1	2.4	3.4	2.7	2.6
<b>Capital account and financial account</b>	<b>0.6</b>	<b>4.6</b>	<b>2.1</b>	<b>6.2</b>	<b>2.8</b>	<b>5.5</b>	<b>3.3</b>	<b>2.2</b>
<b>Net international reserves (in millions of U.S. dollars)</b>	<b>1,168</b>	<b>1,298</b>	<b>1,703</b>	<b>2,462</b>	<b>2,864</b>	<b>3,861</b>	<b>4,133</b>	<b>4,257</b>
(Stock in months of next year imports of goods and services)	3.4	2.9	3.1	3.1	4.7	4.9	5.1	4.9
(Stock over total external short term debt)	1.7	2.0	2.6	4.3	2.9	...	...	...
<b>Gross domestic investment</b>	<b>19.2</b>	<b>19.8</b>	<b>19.6</b>	<b>18.0</b>	<b>18.1</b>	<b>15.5</b>	<b>17.1</b>	<b>18.6</b>
Private sector	14.5	14.8	14.7	13.4	14.3	10.1	12.1	13.4
Public sector	4.7	5.0	4.9	4.6	3.7	5.4	5.0	5.2
<b>Gross national saving</b>	<b>21.4</b>	<b>20.0</b>	<b>20.9</b>	<b>19.8</b>	<b>15.8</b>	<b>14.2</b>	<b>15.4</b>	<b>17.2</b>
Private sector	14.9	14.2	15.2	13.8	9.4	8.4	10.4	12.0
Public sector	6.5	5.8	5.7	6.1	6.4	5.8	5.0	5.1
<b>External saving (+) Disavings (-)</b>	<b>2.1</b>	<b>0.3</b>	<b>1.3</b>	<b>1.8</b>	<b>-2.2</b>	<b>-1.3</b>	<b>-1.7</b>	<b>-1.5</b>
<b>Central Government revenues</b>	<b>18.4</b>	<b>18.2</b>	<b>18.3</b>	<b>17.6</b>	<b>17.3</b>	<b>19.2</b>	<b>19.1</b>	<b>19.0</b>
Of which: Tax revenues	11.9	11.8	12.0	11.4	11.8	12.7	12.9	13.0
<b>Central Government expenditures</b>	<b>16.4</b>	<b>17.6</b>	<b>18.3</b>	<b>16.7</b>	<b>14.8</b>	<b>19.1</b>	<b>19.0</b>	<b>19.2</b>
Of which: Wages and salaries	7.2	7.2	7.4	7.1	7.1	8.4	8.4	8.2
Transfers	3.4	3.8	4.0	3.8	3.5	4.1	4.4	4.5
Capital Expenditure	3.9	4.0	4.2	3.7	2.7	4.5	4.1	4.3
<b>Central Government primary balance</b>	<b>2.7</b>	<b>1.9</b>	<b>1.5</b>	<b>1.8</b>	<b>3.1</b>	<b>0.7</b>	<b>0.5</b>	<b>0.4</b>
<b>Central Government overall balance</b>	<b>2.0</b>	<b>0.6</b>	<b>0.1</b>	<b>0.9</b>	<b>2.5</b>	<b>0.1</b>	<b>0.0</b>	<b>-0.2</b>
<b>Consolidated public debt (in percent of GDP)</b>	<b>48.8</b>	<b>42.7</b>	<b>34.1</b>	<b>28.2</b>	<b>23.2</b>	<b>22.5</b>	<b>22.2</b>	<b>22.3</b>
Of which: External	40.9	34.3	25.3	19.9	16.8	15.0	14.0	12.7
Domestic	4.2	3.4	2.4	1.9	2.2	2.6	3.1	3.6
LRM3 3/	3.7	5.0	6.4	6.4	4.2	4.9	5.1	6.0
<b>Memorandum items:</b>								
GDP (in billion of Guaranies)	41,522	46,169	52,270	61,512	73,622	72,347	80,361	87,037
GDP (in millions of U.S. dollars)	6,933	7,494	9,275	12,222	16,905	14,546	17,147	18,028

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

1/ Foreign currency items are valued at a constant exchange rate.

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

3/ Letras de Regulacion Monetaria.



**Statement by David Vogel, Alternate Executive Director for Paraguay,  
and Jose Maciel, Advisor to Executive Director  
June 4, 2010**

On behalf of the Paraguayan authorities, we would like to thank the staff for their candid and balanced reports, and wish to acknowledge the Fund's valuable advice and constant support in the implementation of the government's economic program. Paraguay's economic program has proved to be successful and macroeconomic stability has been fully maintained, despite last year's severe drought and the challenges presented by the global financial crisis.

**Latest Developments**

1. **Paraguay's economy has rebounded strongly after last year's recession.** Economic output fell by 3.8 percent in 2009, mainly due to a harsh drought that hit the agricultural sector at the beginning of the year, the drop in export commodity prices, and a contraction in domestic demand. The authorities' countercyclical response to the fall in economic activity was timely and decisive and, as a result, domestic demand began to recover during the second half of 2009. The Central Bank of Paraguay (BCP) acted promptly injecting liquidity to the financial system and fiscal policies were deliberately expansionary adding demand stimulus to the economy. Despite this loose stance, the fiscal accounts ended 2009 with a small surplus, supported by strong fiscal revenues.
2. **The current account deficit narrowed in 2009, while net inflows grew, mainly as a result of strong repatriation of capitals by residents.** This situation helped to boost the Central Bank's international reserves by a billion dollars, reaching US\$ 3.8 billion (near 25 percent of GDP) at end-2009. Given the still fragile state of the world economy, and with a view to protect the country's exposure to eventual external shocks, the Paraguayan authorities consider an appropriate level of reserves a necessary buffer to keep the economy stable in the short and medium term.
3. **GDP growth for 2010 is conservatively forecast at 6 percent.** A favorable climate and a significantly improved international environment have led to a strong recovery of the agricultural sector, which will be the main driver of economic growth in 2010. Monthly indicators of economic activities are promising: soybean harvests are reportedly high, meat production is flourishing, commerce and transports are experiencing greater volumes, but there is also increased activity in the construction and services sectors, suggesting that the recovery is broad-based. These increased activities will boost domestic demand which, in turn, will contribute to sustaining the economic recovery in 2010.

## Fiscal Sector

4. **Despite the considerable fiscal stimulus amounting to 2 percent of GDP, the central government accounts achieved a surplus of 0.1 percent of GDP.** Accordingly, public debt was kept low at 23 percent of GDP. The authorities' main focus to address the economic downturn in 2009 was the implementation of appropriate countercyclical policies while maintaining macroeconomic stability. Public spending was boosted by public investments and conditional cash transfers. Improved tax administration contributed to an increase of revenues equivalent to 2 percent of GDP.

5. **Within a challenging environment, the authorities are committed to maintaining disciplined fiscal policies.** Public investment and continued well-targeted and transparent conditional cash transfer programs are focal points in the 2010 budget, which aims at maintaining the fiscal position in balance. The authorities' fiscal reforms intend to enhance the efficiency of the tax system and to increase the tax revenue-to-GDP ratio to a level similar to that of their regional peers. Many of the key fiscal reforms mentioned in the excellent Selected Issues report prepared by the staff are already in progress, with the continued support from Fund experts.

6. **Currently, there are several IMF technical assistance missions underway or in the pipeline related to measures to enhance tax revenues and improve the management of public debt.** One of the priorities of the authorities is the adoption of a medium-term fiscal framework, which would provide an important anchor to avoid procyclical budgets. Considering future increases of revenues from the hydroelectric binational plant Itaipú, jointly owned with Brazil, the implementation of a medium-term fiscal framework would allow a wise use of these windfalls. Therefore, the authorities have sought the Fund's advice for the creation of a special sovereign fund for the additional resources from Itaipú. The proceeds of this fund would be used exclusively for three purposes, namely infrastructure, research and development, as well as countercyclical funds.

7. **With regard to the Personal Income Tax (PIT), which was already created in 2004 but is not yet fully in effect, the authorities are continuing their efforts to avoid a new postponement of its implementation.** Recently the Senate has voted to delay its application until 2013, and it is now up to the lower chamber of Congress to ratify the Senate's decision or reject the delay. The PIT is supported by the vast majority of the population, think tanks, and entrepreneurial organizations, but there is a strong political resistance from vested interests.

## Monetary Sector

8. **At 1.9 percent in 2009, inflation was among the lowest in South America.** Admittedly, inflation was slightly below the Central Bank's target of  $5 \pm 2.5$  percent, but it was in the context of an exceptional period of uncertainty so that the authorities

preferred to have a prudent approach, which has been the distinctive seal of the authorities' macroeconomic management. The inflation target for this year continues to be 5 percent with a fluctuation band of  $\pm 2.5$  percent.

9. **The BCP is committed to the adoption of a pure inflation-targeting (IT) regime and it has already taken several steps towards this end.** The recently approved law to recapitalize the Central Bank is critically important in this process, since it will provide the BCP with the needed flexibility to conduct its policies. In addition, there have been recent changes in the BCP's communication strategy. As of last month, the decisions adopted by the Open Market and Reserves Operations Executive Committee (CEOMA) are released to the public to improve the transparency of monetary policies. The authorities have requested technical assistance of the Fund, which they believe is critical to move toward full-fledged IT regimes.

10. **Consistent with the accommodative monetary policy stance, interest rates of the Central Bank's sterilization bills were kept low throughout 2009 and 2010.** In addition, domestic-currency treasury bonds were issued at longer maturities, reflecting the increased confidence in Paraguay's macroeconomic stability. To dissuade an eventual emergence of inflationary pressures, the Central Bank's authorities announced a tightening of its monetary policy stance, which will be reflected in gradual raises of its referential rate.

11. **Our authorities share the staff's view that the exchange rate is in line with its fundamentals,** and wish to reiterate their commitment to maintain the current flexible exchange rate system.

## **Financial Sector**

12. **The banking system remains solid, highly liquid, and strongly profitable.** While credits and deposits continue growing at a sound pace, the quality of banking assets is confirmed by low levels of non-performing loans, which remained at 1.66 percent as of end-April 2010. Excessive liquidity of the financial system has decreased since the beginning of the year, reflected in the gradual and continued reduction of the banks' current account balances within the Central Bank. This development has also relieved the pressure on monetary policies.

13. **The distress created by the global financial crisis did not have much effect on Paraguayan banks,** since they were shielded by their limited exposure to foreign banks and the strength of a well-regulated and supervised financial system. Several improvements have been achieved since the last Financial Sector Assessment Program (FSAP) took place in 2005, which is verified by an increased compliance with the Basel principles. Nevertheless, there is still a need to continue to advance with the envisaged reforms, for instance with those aimed at strengthening the legal and regulatory framework for banking supervision. The Fund's advice was critical for raising

compliance with these principles and more technical assistance is needed to achieve the authorities' goal to comply with at least 50 percent of the Basel Core Principles by the end of the year, a target achievable without legal changes. A new FSAP mission is planned for November 2010.

14. **An issue critical to the smooth functioning of the financial system is the strengthening of the supervision framework for loans and savings cooperatives,** which presently accounts for 20 percent of total deposits of the entire financial system. We would like to underline that critical and comprehensive reforms in this area constitute a high priority for our authorities. As part of the needed process, the supervisory agency for cooperatives is currently implementing a program of institutional capacity strengthening funded by multilateral institutions and bilateral donors, which will put the agency in a better position to perform its regulatory and supervisory roles.

### **Final Remarks**

15. **Paraguay has benefited both from programs supported by the IMF and from the Fund's technical assistance.** The Fund's advice to the authorities on their policies and reforms has critically contributed to put the country in a better position to withstand external shocks and take advantage of its growth opportunities. This is an excellent example of a country that values the presence of the Fund, takes full advantage of its advice, and recognizes the merit of it in the context of a huge improvement of the country's policies and institutions. However, this should be seen as the beginning of a process aimed at critically changing Paraguay's economy. It would be very unfortunate to lose the presence of such an important partner in the reform process so, once again, the authorities would like to ask Management to reconsider the decision of withdrawing the position of the Fund's Resident Representative in Paraguay.

16. **Our policy dialogue has been continuous and fruitful since the creation of the IMF office in 2005. Much of the success of the Fund's intense technical assistance in the country must be credited to the coordinating role of the Res Rep** (Paraguay is not covered by any Regional Technical Assistance Center—RTAC). Perhaps most importantly, the authorities appreciate the IMF Res Rep's capability to explain to a wider public the need to strengthen the institutional underpinnings of macro policies. In our view, the permanent and constructive voice of an IMF representative will be needed, and even more so than in the past, as we are moving toward inflation targeting and strengthening our financial systems.

17. **The IMF's medium-term budget plan to scale back Res Rep offices is a result of strategic decisions that were taken before the onset of the global financial crisis.** Since then, the IMF has resumed responsibility and relevance on a global scale. A working group on Fund Staff Presence in the field is currently reassessing the balance between staff in headquarters and staff posted in regional and country offices. The

authorities of Paraguay are confident that the study will confirm the value added by Res Reps. They also believe that it would be unwise to mechanically execute the closure of the successful Fund representation in Paraguay, which was decided under assumptions that are no longer valid.

Finally, the Paraguayan authorities would like to express their appreciation to the staff and Management for their continuous support and look forward to continuing a close and fruitful dialogue with the Fund.