June 2008
IMF Country Report No. 08/177

Paraguay: First Review Under the Stand-By Arrangement—Staff Report; Staff Supplement; and Press Release on the Executive Board Consideration

In the context of the first review under the Stand-By Arrangement with Paraguay, the following documents have been released and are included in this package:

- The staff report for First Review Under the Stand-By Arrangement, prepared by a staff team of the IMF, following discussions that ended on August 1, 2006, 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 September 14, 2006. 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 September 29, 2006 updating information on recent developments.

- A Press Release summarizing the views of the Executive Board consideration of the staff report that completed the review.

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

Letter of Intent sent to the IMF by the authorities of Paraguay*
*Also included in Staff Report

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

Copies of this report are available to the public from

International Monetary Fund • Publication Services
700 19th Street, N.W. • Washington, D.C. 20431
Telephone: (202) 623-7430 • Telefax: (202) 623-7201
E-mail: publications@imf.org • Internet: http://www.imf.org

Price: $18.00 a copy

International Monetary Fund
Washington, D.C.

INTERNATIONAL MONETARY FUND

PARAGUAY

First Review Under the Stand-By Arrangement

Prepared by the Western Hemisphere Department
(In consultation with other departments)

Approved by José Fajgenbaum and Matthew Fisher

September 14, 2006

- **Arrangement**. The Executive Board approved a 27-month Stand-By Arrangement (SBA) for SDR 65 million (65 percent of quota) on May 31, 2006, covering the remainder of President Duarte-Frutos' term. The authorities are treating the arrangement as precautionary. The program aims at reducing remaining vulnerabilities, consolidating macroeconomic stability, and deepening the structural reform process to create conditions for higher sustained growth and poverty reduction.
- **Developments**. The program is on track. All performance criteria for end-June 2006 were observed. The June 2006 structural benchmark on the design of an expenditure control plan was observed and diesel prices were raised 6¼ percent in June. Program objectives for the year as a whole are within reach.
- **Policies**. The main macroeconomic challenges for the rest of the year are to: (i) maintain fiscal discipline by adhering to the financial plan; (ii) respond flexibly to the continued strengthening of the balance of payments; and (iii) maintain the momentum on the implementation of the structural reform agenda. For 2007, the authorities have submitted to Congress a budget with a small deficit, mostly explained by increases in capital expenditure.
- **Discussions**. These took place in Asunción during July 19–August 1. The mission met with President Duarte-Frutos, Finance Minister Bergen, Central Bank President Pérez dos Santos, Education Minister Ovelar, Social Minister Andraschko, Deputy Finance Minister von Horoch, senior officials, and representatives of the international and banking communities. The staff team comprised A. Santos (head), F. Frantischek, T. Roy (all WHD), P. Breuer (PDR), and J. Gasha (MFD). L. Duran-Downing, the Fund's senior resident representative in Asunción, assisted the team. The mission liaised with the World Bank and IDB offices in Asunción.

List of Acronyms

ANDE	National Electricity Company
BCP	Central Bank of Paraguay
BNF	National Development Bank
CADEF	Ranking of Financial Institutions
CAR	Capital Adequacy Ratio
COPACO	Telephone Company
DSA	Debt Sustainability Analysis
ESSAP	Water and Sewage Company
FAD	Fiscal Affairs Department
FSAP	Financial Sector Assessment Program
GDP	Gross Domestic Product
GNFS	Good and Nonfactor Services
IDB	Inter-American Development Bank
IFS	International Financial Statistics
IMAE	Monthly Indicators of Economic Activity
INC	National Cement Company
IPS	Social Security System
JBIC	Japan Bank for International Cooperation
LEG	Legal Department
LOI	Letter of Intent
LRM	Central Bank Bills
MEFP	Memorandum of Economic and Financial Policies
MFD	Monetary and Financial Systems Department
NDA	Net Domestic Assets
NIR	Net International Reserves
NPL	Nonperforming Loans
PC	Performance Criteria
PDR	Policy Development and Review Department
PFM	Public Financial Management
PETROPAR	Petroleum Company
ROSC	Report on the Observance of Standards and Codes
SAS	Undersecretary of Social Action
SBA	Stand-By Arrangement
SDR	Special Drawing Rights
TMU	Technical Memorandum of Understanding
VAT	Value Added Tax
WB	World Bank
WHD	Western Hemisphere Department

Contents Page

Appendices

Attachment

Executive Summary

Recent Developments and Program Performance

- **The program remains on track.** All quantitative performance criteria for end-June 2006 were met. The June 2006 structural benchmark on the design of an action plan to strengthen budget preparation, develop expenditure controls and streamline the Treasury account system was observed.

- **Macroeconomic conditions have surpassed expectations.** GDP grew by 5 percent in the first quarter of 2006 before slowing somewhat in the second quarter. For 2006 as a whole, real GDP is expected to grow at or slightly faster than the 3½ percent program objective. After rising to 17 percent in the first quarter of 2006, annualized inflation dropped to virtually zero in the second quarter, suggesting that the 7 percent objective for end-2006 is within reach. The budget surplus was almost 1 percent of GDP higher than programmed in the first half of 2006, and the expectation is that the zero balance objective for the year will be achieved. Net international reserves reached a new historic peak in August, well above the end-year objective. The *guaraní* appreciated by over 10 percent *vis-à-vis* the U.S. dollar in the first eight months of 2006.

Policy Discussions and Staff Appraisal

- **There was broad agreement on the need to continue implementing strong macroeconomic policies.** The authorities intend to continue restraining current spending while stepping up the implementation of investment outlays financed with external resources, as envisaged in the financial plan for 2006. The staff and the authorities are concerned about the rapid currency growth and its potential impact on inflation, while recognizing that money demand could be higher than programmed and that the external position was much stronger than anticipated. The authorities need to be prepared to tighten monetary policy further if there is evidence of renewed inflationary pressures.

- **The authorities submitted to Congress a budget with a small deficit for 2007, driven by conservative tax revenue projections and an increase in social and capital expenditures**. The 2007 budget proposal included a deficit of ⅔ percent of GDP, reflecting budgeted spending to address social needs (especially in the health sector) and higher capital expenditure to support growth. The authorities reiterated their commitment to preserve fiscal discipline and contain expenditure to the absorptive capacity of the economy.

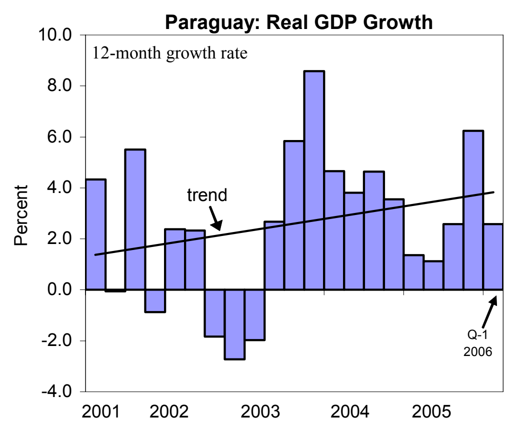
- **There is momentum in implementing the structural reform agenda.** The authorities have established internal mechanisms to ensure that structural reform measures are implemented, and they have made progress in all areas of the structural reform agenda.

- **Staff supports completion of the program review**. In light of the authorities' strong commitment to the program and satisfactory performance, the staff supports the completion of this review.

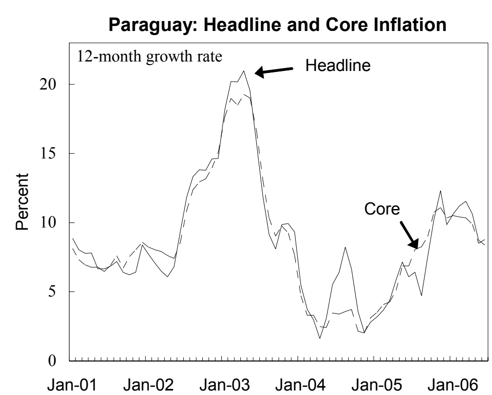
I. Program Performance and Developments

1. **A 27-month Stand-By Arrangement was approved in May 2006 to support the authorities' program, aimed at entrenching macroeconomic stability, removing impediments to growth, and alleviating poverty**. Following the successful completion of the previous SBA (2003–05)—mainly aimed at stabilizing the economy, the authorities requested a successor arrangement (for SDR 65 million or 65 percent of quota) to support their economic program, which covers the remainder of President Duarte-Frutos' term (2006–08). The program is based on a strong fiscal policy, to reduce the debt-to-GDP ratio to 30 percent by the end of the decade, and a tight monetary stance, to reduce inflation to industrial country levels. The program also contains an ambitious structural reform agenda, including measures to reform the public sector, strengthen the financial system, reinvigorate growth and reduce poverty. The authorities are treating the arrangement as precautionary. Outstanding Fund credit to Paraguay is zero.

2. **Against the background of difficult conditions, the program is off to a good start.** All performance criteria and a structural benchmark for end-June 2006 were observed, although the SBA commitment fee for SDR 107,500 was paid with a three month delay on August 28, 2006, due to unanticipated difficulties arising from new budgetary procedures at the Central Bank.

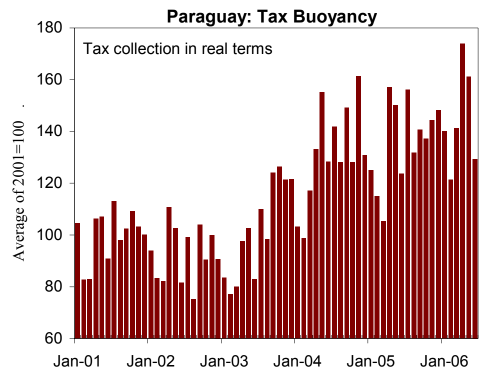


3. **Despite negative supply shocks, economic activity is growing considerably.** Notwithstanding a third consecutive drought this year and increasing international oil prices, real GDP grew by 5 percent in the first quarter of 2006. Non-traditional exports (mostly meat products), services, forestry, and manufacturing were among the most dynamic sectors. Preliminary indicators suggest that economic growth during the second quarter continued—albeit at a slightly more moderated pace—supported mainly by investment in the telecommunications sector.



4. **Inflationary pressures have been greatly reduced**. Following a considerable tightening of monetary conditions in early 2006, and lower imported goods prices stemming from the pass-through of the stronger currency, the 12-month inflation rate dropped from 11½ percent in March 2006 to 8 percent in August. More strikingly, annualized inflation fell from 17 percent in the first quarter to virtually zero in the five months through August.

5. **Fiscal discipline facilitated the observance of targets with large margins**. The strong performance of the central government and the consolidated public sector resulted in a larger-than-programmed surplus in the first half of 2006. Most of the over-performance relative to the program was due to buoyant tax revenues.

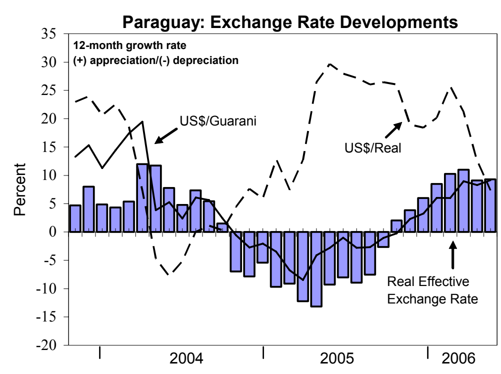


- ***Revenues.*** Tax revenues increased by 20 percent in the year through July. This outcome reflects both continued efforts to improve tax administration, and the implementation of the tax reform (the fiscal adjustment law passed in July 2004), which in early 2006 introduced a personal income tax and broadened the VAT base.[1]

- ***Expenditures***. The wage bill ceiling for the central administration was observed, helped by a freeze on new civil service positions. Other current outlays have also been contained and, as in previous years, the execution of investment programs has been below program projections for the whole public sector.

- ***Financing***. The larger-than-programmed fiscal surplus reduced the financing requirement of the public sector and thereby supported monetary policy efforts. The Ministry of Finance re-opened the domestic bond market after three years, and issued Treasury bonds for US$20 million with a 3-year maturity mostly denominated in foreign currency (Box 1).

6. **Monetary policy responded flexibly to a stronger-than-anticipated balance of payments position.** Faced with large foreign exchange inflows, the Central Bank opted for a cautious policy mix of greater exchange rate flexibility and some reserve accumulation.

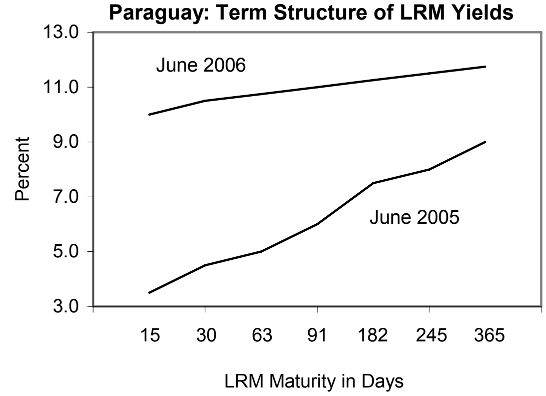


- ***Currency appreciation.*** Against the background of a delayed response to the regional strengthening in exchange rates, the *guaraní* rose gradually against the U.S. dollar by over 10 percent in the first eight months of 2006. This reduced the external pressures but did not eliminate them.

[1] Congress approved legislation in June 2006 delaying the application of the personal income tax to 2007. However, the President vetoed this law in July. Congress has now to vote whether to reject or sustain the presidential veto.

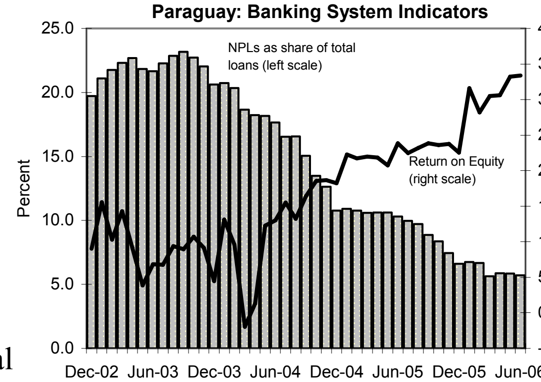
- ***International reserves accumulation***. While the program anticipated no change in reserves during the first half of 2006, the Central Bank accumulated some US$166 million (an increase of about 13 percent), which if not sterilized, would have lead to an expansion of about 35 percent of currency issue during a period when the demand for currency is seasonally low. In response, the Central Bank tightened monetary policy and engaged in active sterilization, as evidenced by the increase in 400 basis points in LRM (Central Bank bills) rates, and an increase in the stock of LRMs by almost 30 percent. Currency issue was allowed to grow at the annual rate of over 15 percent through June 2006 (compared with 10 percent in the program), to accommodate a perceived strengthening in money demand.

Paraguay: Term Structure of LRM Yields



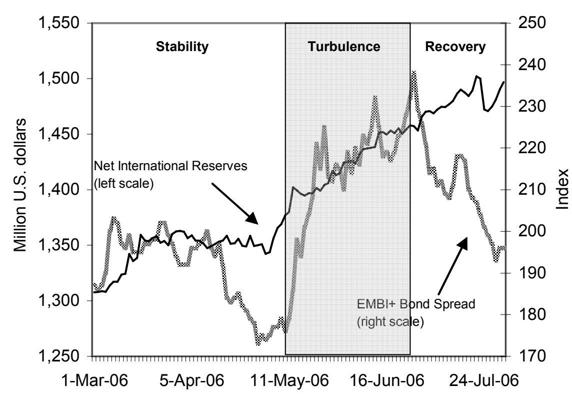
7. **The banking system continues to strengthen.** Supported by the improved macroeconomic performance, the banking system remains well-capitalized, profitable and relatively liquid.[2] Preliminary data shows that financial strengthening of the National Development Bank (BNF) is well under way, with the capital adequacy ratio (CAR) increasing to over 8½ percent at end-June 2006 (compared with 5 percent in the structural benchmark under the program).

Paraguay: Banking System Indicators



8. **The external position remained strong despite the May-June turbulence in emerging markets.** Notwithstanding a higher than-programmed current account deficit in the first half of the year, a surge in private capital inflows generated an overall balance of payments surplus, and led to a record high level of international reserves (US$1.5 billion in August).[3]

Paraguay: Resilience to Capital Market Turbulence



---

[2] Capital adequacy ratios fluctuate around 20 percent, well above the minimum regulatory threshold of 10 percent. Nonperforming loans continue to decline representing 5.8 percent of the portfolio. Profitability remains strong (with ROA and ROE equal to 3.4 and 33.2 percent respectively) as are bank liquidity and foreign exchange positions.

[3] Recent strengthening in customs administration also led to a switch from unrecorded to recorded imports as traders eschewed the risk associated with unregistered trade.

9. **The structural reform agenda is advancing as planned and structural conditionality is being observed**. The authorities issued presidential decree 7712 in June, which delegates to a number of entities the implementation of specific structural measures under the program and provides adequate control and monitoring mechanisms. The benchmark for this review was observed.

- ***Budget controls***. The authorities met the structural benchmark for June 2006 on the design of an action plan to strengthen budget preparation, develop expenditure controls at the commitment level and the streamlining of the treasury account system. The plan benefited from FAD technical assistance, and is in line with its recommendations. The authorities intend to start adopting some elements of the plan later this year. The timing of key measures will be established in the next review.

- ***Diesel subsidies***. To achieve a better targeting of diesel subsidies and thereby protect the poor from recent large increases in international oil prices, the government sent draft legislation to Congress in May 2006 that would introduce a temporary subsidy to public transportation (capped at 0.2 percent of GDP). Once the legislation on subsidies for public transportation is in place, the objective is to eliminate gradually the current generalized diesel subsidies.[4] As a first step in this process, the authorities increased the domestic diesel prices by G 250 per liter (a 6½ percent price increase) in early June.

10. **The political and social environments continue to be tense, and there is still opposition to reform efforts**. President Duarte-Frutos has consolidated his leadership within the Colorado party, most recently in the party's internal elections to select candidates for November's municipal elections. However, Congress remains unenthusiastic, and the advancement of the government's reform agenda is often hampered by the need to fend off legislative initiatives that may not be consistent with the authorities' program. Recently, President Duarte-Frutos has announced plans for a constitutional reform that would include, *inter-alia*, the possibility of a presidential re-election. Poverty indicators appear to be improving slowly. The conditional cash transfer program, which provides between US$15 and US$30 a month to families living in extreme poverty, began operations.

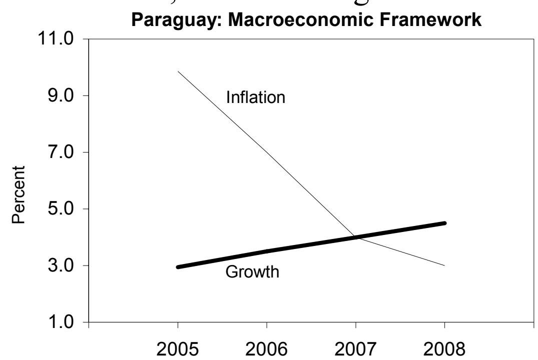
---

[4] The subsidy is targeted to public transportation users and channeled through private transportation enterprises. The transfers will be based on the average diesel consumption of these enterprises, taking into account their routes. The maximum diesel subsidy will be G 400 per liter.

II. Review Issues

A. Macroeconomic Framework

11. **Improvements in macroeconomic conditions are encouraging and the current macroeconomic framework for 2006 and 2007 remains valid.** The authorities and staff agreed that there was no need to modify the framework for 2006, which envisages real GDP growth of 3½ percent and inflation of 7 percent. Notwithstanding the drought, there is some upside risk on real GDP growth given the strength of the economy in the first half of the year and the dynamism of some sectors like meat production, forestry and mobile telephony. There is also an upside risk in observing the inflation target given the strong inflationary pressures of the first quarter. For 2007, original program projections for real GDP growth (4 percent) and inflation (4 percent) also remain unchanged.



B. Fiscal Policy

12. **The fiscal program remains appropriate.** Despite the expansionary 2006 budget approved by Congress, the authorities were able to maintain fiscal discipline during the first half of the year through the application of a financial plan and supported by strong tax revenue performance. The authorities are currently facing re-emerging expenditure pressures, as revealed in recent supplementary budget requests to Congress. They agreed with staff's recommendation for continued prudence in the fiscal stance and resisting pressures to increase current expenditure further. The authorities argued in favor of using the revenue over-performance to achieve a higher-than-programmed level of capital expenditure, while preserving the objective of an overall balance of zero. The staff stressed the need to ensure that higher capital expenditure is allocated to high yielding priority projects, while encouraging the authorities to save part of the revenue over-performance. The authorities noted that some of the revenue over performance would be reduced as a consequence of the appreciation of the *guaraní*.

13. **The strong fiscal performance applied also to the rest of the public sector.** The public enterprises also showed considerable over-performance, resulting from lower capital spending and higher operating surpluses, owing in part to the strength of the *guaraní,* which has lowered the cost of dollar-denominated inputs. PETROPAR is working on a strategy for a gradual elimination of arrears to suppliers by

Paraguay: Fiscal Program 1/
(In percent of GDP)

	2005	2006 Prog.	2006 Rev. Proj.	2007 Budget Proposal	2007 Proj.
Total Revenues	**18.2**	**17.9**	**18.6**	**19.4**	**18.9**
Tax	11.9	11.3	12.1	11.9	12.1
Non-tax	6.4	6.4	6.4	7.5	6.8
Total Expenditures	**17.5**	**17.9**	**18.6**	**20.1**	**18.9**
Current	13.5	13.7	13.9	14.6	14.0
Wages	7.2	7.4	7.6	7.8	7.6
Non-wages	6.3	6.2	6.3	6.8	6.4
Capital	4.0	4.3	4.7	5.6	4.9
Discrepancy	**-0.1**	**0.0**	**-0.1**	**0.0**	**0.0**
Overall Balance	**0.6**	**0.0**	**0.0**	**-0.7**	**0.0**

Sources: Paraguayan authorities; and Fund staff estimates.
1/ Central Government.

September 2007 (US$11 million at end-July 2006). PETROPAR's financial outlook has improved because of lower diesel import prices (as Venezuela becomes the main supplier) and higher domestic prices (following the June diesel price adjustment and possible future adjustments as the government moves to remove the generalized subsidy). The authorities re-affirmed their commitment to strengthening the operations and finances of the public enterprises (see Paragraph 19).

14. **The authorities submitted a budget proposal for 2007 that preserves fiscal discipline.** While the 2007 budget submitted to Congress in late August 2006 shows a deficit of ⅔ percent of GDP, this is mostly explained by conservative tax revenue projections and higher social and capital expenditures.[5] The authorities believe this is a more realistic way of addressing the large ongoing expenditure pressures and a more effective way of minimizing future requests for supplementary budgets. However, the authorities reiterated their commitment to fiscal discipline and stressed that if budget execution is at historical levels, the objective of reaching broad fiscal balance in 2007 can be achieved. The staff believes that fiscal balance can be achieved in 2007, but will recommend that a financial plan be introduced if the budget approved by Congress is inconsistent with program objectives. Fiscal targets for 2007 will be established at the time of the next review.

C. Monetary Policy

15. **Monetary policy will continue to be geared toward achieving the inflation target of 7 percent in 2006.** The authorities were of the view that the appropriate policy mix in upcoming months would depend crucially on whether the recent foreign currency inflows are of a transitory or a more permanent nature. The authorities noted that some of the international reserve accumulation was due to the turbulence in the regional financial markets and that some unwinding was likely in the second half of the year. They considered the recent appreciation of the *guaraní* a healthy correction, but were concerned that further appreciation pressures could undermine competitiveness and conditions for economic growth. The mission noted the considerable strength of exports and private capital inflows—the latter reflecting an important rebound in confidence—and recommended to continue with a flexible exchange rate regime, limiting intervention in the foreign exchange market to smoothing out fluctuations, particularly due to bulky transactions. Staff noted with some concern the pace of currency growth, but acknowledged a possible strengthening in the real demand for money.[6] While agreeing with the authorities that achieving the 7 percent inflation

[5] The budget proposal includes full-execution of projects already under way, mostly financed by international financial institutions, which may be difficult to achieve given implementation capacity. It also includes an increase in royalties from the binational entities, which is being negotiated.

[6] Staff considers that more time is needed to make a firm assessment as to whether an increase in the real demand for money is taking place.

was feasible, the mission encouraged them to consider further interest rates rises should inflationary pressures reemerge.[7]

16. **Monetary policies will aim at a further reduction of inflation for 2007.** The authorities concurred that an inflation objective of 4 percent for 2007 would be both desirable and achievable. Lower inflation and a strengthening of the financial position of the Central Bank, envisaged for 2007, would enhance its credibility and solidify the base for moving toward an inflation-targeting regime in the medium term. The authorities preferred to adhere to the original timetable for discussions and wait until the next review to define the monetary program for 2007, particularly in view of the uncertainties about the extent of the rise in the real demand for money.

Paraguay: Monetary Program 1/
(In percent of previous period currency)

	2005	2006 Prog.	2006 Rev. Proj.	2007 Proj.
Currency	**17.6**	**8.5**	**10.0**	**8.0**
Net international reserves	**32.6**	**4.3**	**15.6**	**8.0**
Net domestic assets	**-15.0**	**4.2**	**-5.6**	**0.0**
Credit to public sector (net)	1.8	6.5	1.0	-6.0
Credit to banks (net)	-26.1	-18.1	-6.4	2.3
Reserve requirements	-5.5	-6.1	-5.9	-3.5
Free reserves	13.2	3.5	-1.7	2.2
BCP bills (LRM)	-33.9	-15.6	0.9	3.7
Other items (net)	9.3	15.8	-0.3	3.7

Sources: Paraguayan authorities; and Fund staff estimates.
1/ Central Bank accounts

D. External Issues

17. **Despite the recent strengthening of the balance of payments, external vulnerabilities remain.** Following the oil-related deterioration in 2005, the current account deficit is projected to remain at about 2 percent of GDP in 2006, which is expected to be offset by private capital inflows (mostly in the form of FDI). The strong export performance is expected to continue for the rest of 2006, especially for meat, where there is a large unsatisfied external demand given Argentina's decision to limit meat exports. Import growth will moderate for the rest of 2006, provided that world oil prices stabilize. Net public borrowing will remain limited. Net international reserves are expected to increase by some US$75 million (more than three times the programmed accumulation).

Paraguay: Balance of Payments
(In percent of GDP)

	2005	2006 Prog.	2006 Rev. Proj.	2007 Proj.
Current Account	**-2.7**	**-2.2**	**-2.5**	**-2.0**
Exports	42.8	39.4	40.2	40.2
Imports	-50.8	-46.6	-48.4	-47.0
Other	5.3	5.1	5.7	4.9
Capital Account	**1.7**	**2.7**	**2.0**	**2.7**
Public sector (net)	-0.8	0.1	0.0	0.2
Private sector (net) 1/	2.5	2.6	2.0	2.5
Overall Balance	**2.1**	**0.6**	**0.8**	**0.7**
Overall Financing	**-2.1**	**-0.6**	**-0.8**	**-0.7**
Net international reserves	-2.0	-0.2	-0.8	-0.4
Exceptional financing	-0.1	-0.3	0.0	-0.3

Sources: Paraguayan authorities; and Fund staff estimates.
1/ Includes errors and omissions

[7] The staff encouraged the authorities to undertake a more proactive reserve and debt management strategy with the objective of developing the domestic bond market.

18. **The authorities continued in their efforts to normalize relations with all external creditors**. They have presented a formal proposal to the government of Belgium for a debt-for-nature swap to clear interest of the Ex-Herstal debt still in dispute (US$7½ million). The cases of the French and Swiss import verification companies continue under review (US$75 million); the authorities indicated that the contracts were signed with their local subsidiaries of these companies. The government has abandoned its long efforts to find a lost South African supplier (US$0.03 million), which has no macroeconomic implications. The authorities continue considering elevating the case of a syndicate of European and American banks to the International Court of Justice in The Hague, following a Swiss court ruling against Paraguay in May 2005 (US$85 million), but no decision has been reached. The authorities continue disputing the validity of this claim. PETROPAR is expected to clear its overdue obligations with suppliers by September 2007, as the authorities pursue the gradual timetable for the elimination of the diesel subsidy.[8]

E. Structural Issues

19. Significant progress has been made in all areas of the reform agenda.

- ***Tax Procedures Code.*** The preparation of a tax procedures code is advancing as planned (a structural performance criterion for end-December 2006); it has benefited from a FAD/LEG technical assistance mission. A draft tax code has been prepared, and is being reviewed by legal experts. Once this process is completed, the draft tax code will be circulated to focus groups within civil society prior to the approval by the economic cabinet.

- ***National Development Bank (BNF).*** The financial situation of the BNF improved significantly due to a continued strengthening in the bank's management, enhanced credit practices and greater emphasis on delinquent loan recovery, which led to higher profits, lower nonperforming loans, and an expansion in the deposit base. Additional efforts are required to consolidate the bank's financial

Paraguay: Structural Conditionality for the Second SBA Review

Measure	Conditionality (Date)	Status
1. Audited CAR of 5% for BNF at end-June 2006	Benchmark (Sep 2006)	**Almost done.** Audited financial statement show a CAR of 8½ %. Needs to be reviewed by the Superintendency.
2. Implement measures on banking strategy & system legislation	Benchmark (Sep 2006)	**In progress.** Amendments to banking law and regulations have been drafted.
3. Plan to improve business climate	Benchmark (Sep 2006)	**In progress**. A draft is expected by August when there will be discussions with private sector.

Sources: Paraguayan authorities.

[8] A claim for US$75 million to the National Bank of Argentina (related to the construction of the Yacyreta dam project) was previously reported as being in dispute because it was not included in the debt reporting system. The authorities have stated that the repayment period of this loan is dependent on the delayed completion of the project and consequently the debt is neither in arrears nor in dispute. The staff agrees with that assessment and encouraged the authorities to include this loan in the debt reporting system.

soundness, and to develop a medium term strategy defining the mission, scope and optimal size of the bank. The audited balance sheet for June 2006 indicates that the CAR was 8½ percent, surpassing the target of 5 percent; the staff will await the assessment of the superintendency of bank before determining if this benchmark was observed (a benchmark for end-September 2006). Preliminary data indicate that the target of a CAR of 10 percent for December (a structural performance criterion for end-March 2007) may have been achieved in July 2006.

- ***Legal and Regulatory Banking Framework.*** The authorities explained that the implementation of the regulatory modifications (not requiring legislative amendments) is well-advanced. In line with FSAP recommendations, the modifications include: (i) provisioning regulations; (ii) sanctions procedures; and (iii) procedures for the calculation of capital requirements. The authorities are currently considering the remaining modifications, including the streamlining of the foreign open position regulations, and the design, structure and publication of the bank rating system (CADEF). Progress with the reform that requires legal changes is more limited. A proposal for amending the Banking Law—which includes FASP recommendations on legal protection of supervisors, acquisition of participation in financial institutions, monitoring of financial groups, sanctioning procedures, "fit and proper" criteria, and relations with foreign supervisors—is still under the authorities' consideration. The authorities intend to send legislation to Congress by September as contemplated in the program (a structural benchmark for end-September 2006), but slippages in the timetable cannot be ruled out given the complexity of the issues and a necessary period of consultation with commercial banks.

- ***Financial Position of the Central Bank.*** The authorities intend to comply with the benchmark on the design of a strategy to strengthen the balance sheet of the Central Bank before the original December 2006 date. Discussions between the Central Bank and the Ministry of Finance are expected to focus on: (i) determining the amount of the financial support needed; (ii) alternative options for structuring the financial support; and (iii) legal and accounting aspects of the operation. The mission facilitated a seminar to discuss key issues in this respect, and reiterated that the Fund stands ready to provide further technical assistance if necessary.

- ***Investment Climate***. The design of a master plan to improve the investment climate (a structural benchmark for end-September 2006) is being prepared by the Unit of Business Climate, in the Ministry of Industry and Trade, with financial and technical support from the IDB and USAID. The plan will represent a road map derived from the work of focus groups (comprised by representatives of the private sector, universities and public sector) that will concentrate on improving the investment climate in four areas: (i) simplifying procedures to facilitate business operations (i.e., one-stop shop for opening and closing enterprises, modernization of properties registration); (ii) incentives for generating new business and investments (i.e., financing and WTO-compatible incentives for exports and investment, and improving mechanisms for VAT refunds); (iii) infrastructure and logistics for exports (i.e., transport and communication networks, training and technology); and (iv) institutional strengthening (i.e., enforcement of contracts, judicial security, protection of investors, and labor regulations).

- ***Restructuring Public Enterprises***. The authorities are advancing as planned in the implementation of result-oriented management contracts with ANDE, COPACO, ESSAP, INC and PETROPAR to improve the managerial and operational efficiency of these companies (a structural benchmark for end-December 2006) (Box 2.). Each individual contract will contain a number of relevant financial and managerial performance indicators, which will be reviewed quarterly by the Supervising Council for the Modernization and Management of Public Enterprises. The Supervising Council will publish the reviews, along with specific recommendations to monitor the performance of each public enterprise.

- ***Cash Transfers***. Progress continues to be made in implementing a targeted cash transfer program (conditioned by contracts with beneficiaries) to 7,000 families living in extreme poverty (a structural benchmark for end-December 2006). The program conditionality includes school attendance, regular visits to health centers by children and expecting mothers, and participation in nutrition and sanitary programs. The Undersecretary of Social Action (SAS) reports that at the end of July, the cash transfers program covers nearly 6,700 families in the poorest districts of three Paraguay Departments. SAS is in the process of introducing a centralized electronic database that will substantially improve the monitoring and evaluation of the program.

F. Program Issues

20. **Conditionality.** The attached letter of intent restates the authorities' commitment to the program and targets. There has not been any change to the program, nor to its performance criteria or benchmarks. Conditionality for 2007 will be established at the time of the next program review.

21. **Safeguards Assessment.** The Central Bank is subject to a full safeguards assessment related to the new arrangement. A FIN mission visited Asunción in March and the assessment is almost concluded. The mission found that while significant progress was made in strengthening the safeguards framework, there are remaining weaknesses in financial and data reporting issues. The staff encouraged the Central Bank to address these weaknesses (including timely publication of the Central Bank's financial statements and refining valuation of international reserves).

III. Program Outlook and Risks

22. **The outlook remains positive given the authorities commitment to sound policies, and the supportive external environment**. The baseline scenario assumes the continuation of measures to consolidate macroeconomic stability; lock in improvements in tax collection and administration; mobilize resources to reduce poverty; put in place lasting structural reforms; and improve the environment for private investment. Economic growth in Argentina and Brazil is projected to remain strong in 2006 and investments in the growing meat industry are expected to yield significant economic benefits. Accordingly, real GDP growth is projected to rise to 5 percent by 2010, macroeconomic and financial stability are expected to be maintained and the public debt-to-GDP ratio to decline to below 30 percent by the end of the decade.

23. **The external and domestic risks identified in the last staff report remain**. These include a sudden reversal of recent capital inflows, reflecting a deterioration of investor's sentiment, the re-emergence of expenditure pressures, and delays in economic reforms owing to delays in the approval of key legislation by Congress. With the aim of attenuating these risks the authorities continue to inspire confidence by pursuing sound economic management and building up international reserves.

IV. Staff Appraisal

24. **The new program is off to a good start with improved macroeconomic performance and a strengthened resolve to undertake structural reform**. The macroeconomic situation had deteriorated markedly at the beginning of 2006, with world oil prices increasing further, inflationary pressures intensifying, the drought persisting, and an expansive and underfinanced budget being approved by Congress. The authorities have now succeeded in turning the situation around, improving market confidence, addressing inflationary pressures and strengthening fiscal performance. All performance criteria and a structural benchmark for end-June were observed, economic growth has picked up, inflation is declining, and fiscal discipline is becoming entrenched. Moreover, the authorities have built consensus within the cabinet of ministers to implement reforms included in the structural agenda. Ownership of the program was evident in the discussions with different ministries and public entities.

25. **Fiscal performance has been better than programmed, notwithstanding strong expenditure pressures.** As in earlier years, the central government has been able to control spending through a financial plan, and is on track to meet the targeted fiscal balance this year, despite a budgeted deficit of 2 percent of GDP. This, together with operational surpluses in the public enterprises (other than the oil company PETROPAR), has contributed to a strong overall fiscal position. A cash surplus in the social security system, reflecting still favorable demographics, has also supported the public finances. The staff commends the authorities for their conduct of fiscal policy in the first half of the year. However, the drain

on PETROPAR from continued diesel subsidies is a concern. Looking ahead, it will be important for the government to continue to adhere to the financial plan, and to be prepared to adopt any corrective measures that may become necessary. The authorities' commitment to fiscal discipline in 2007, including their objective of reaching broad fiscal balance, is welcome. However, in the event the approved budget is inconsistent with program objectives, a financial plan may be necessary to anchor fiscal discipline.

26. **Monetary policy has been effective in addressing inflationary pressures in recent months.** With a stronger than expected balance of payments position, the Central Bank has struck an appropriate balance between accumulating reserves and allowing the *guaraní* to appreciate; similarly, the mix between sterilization and monetization has been adequate to accommodate a potential increase in the real demand for money. The staff commends the Central Bank for the successful reduction in inflationary pressures observed in recent months, and encourages it to remain vigilant and respond promptly to a changing external environment. In this context, staff welcomes the higher exchange rate flexibility, which was key in reducing inflationary pressures.

27. **The authorities need to maintain the momentum on the structural reform agenda**. The staff welcomes the renewed commitment and impetus in implementing structural reform measures, which constitutes an important improvement over the experience under the previous arrangement. While there are measures ahead that will require considerable coordination and determination (especially the strategy to strengthen the financial position of the Central Bank, the reform of the public enterprises, and the design of a tax procedures code), the mechanisms currently in place and the authorities' resolve augurs well for their timely implementation.

28. **Despite the good performance, vulnerabilities and risks remain.** As noted when the Board considered the request for the current arrangement, the risks to the program derive from political and social uncertainties, as well as from possible external shocks. Regarding the former, the authorities are encouraged to strengthen their efforts to improve their communication policy, as this could shield the program from political pressures in the run up to municipal elections in November. At the same time, the regular meetings of the program monitoring group should continue to be used to detect implementation problems and as an early warning system. Regarding the risks associated with external shocks, the authorities' steadfast implementation of the program should strengthen Paraguay's resilience to such shocks.

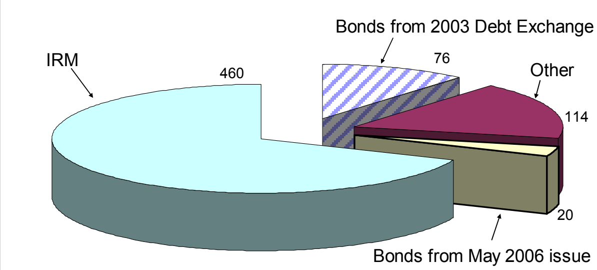
29. **The staff supports completion of the first review under the SBA**. In light of the authorities' strong commitment to the program, and good performance, the staff supports the completion of the first SBA review.

Box 1. Paraguay: Re-opening the Domestic Bond Market

In December 2002, Paraguay's market for public bonds nearly collapsed in the midst of a financial crisis. In addition to running arrears on a large put option on domestic debt, the government faced debt service obligations in the amount of nearly US$70 million (1¼ percent of GDP) in 2003, adding to the financial distress of a government that was still suffering from the impact of the 2002 banking and currency crises. To clear its arrears and avoid adding stress to the already weakened financial system, the government approached bond holders and offered to exchange the existing claims for new bonds with somewhat lower interest coupons and longer maturities. In the event, in 2004 public bonds in the amount of US$132 million (96 percent of the outstanding old bonds) were successfully exchanged for securities with maturities that would extend to 2008.[1]

While the debt exchange succeeded in improving the government's debt service profile, the domestic market for bonds remained severely impaired. The medium-term public bonds resulting from the debt exchange are illiquid, there is no secondary market for debt issued by the treasury, and there have been no new bond placements until recently. The structural problems of the market for domestic public debt are compounded by institutional deficiencies, including the lack of a securities depository and deficient registration and listings systems. Also, the lack of a functioning market for treasury paper puts an additional burden on monetary policy, as sterilization papers (LRM) issued by the central bank account for about 70 percent of securitized domestic public debt.

Composition of Securitized Domestic Public Debt
(in millions of U.S. dollars as of May 2006)



A successful domestic treasury bonds issue in May 2006 indicates a return of confidence and constitutes an important step toward developing the domestic capital market. Facing domestic debt repayments in the amount of more than US$30 million during the first four months of 2006, the government placed public bonds in the amount of US$15 million and G 30 billion (equivalent to about US$5 million) in early May. These bonds, which were acquired mainly by two large commercial banks, carry a maturity of three years at an interest rate of 9 and 15 percent for the dollar- and *guaraní*-denominated titles, respectively. The dollar-denominated bond was heavily oversubscribed, indicating investors' renewed appetite for Paraguayan public debt. However, only about 80 percent of the *guaraní*–denominated bond could be placed, signaling lingering doubts in this market.

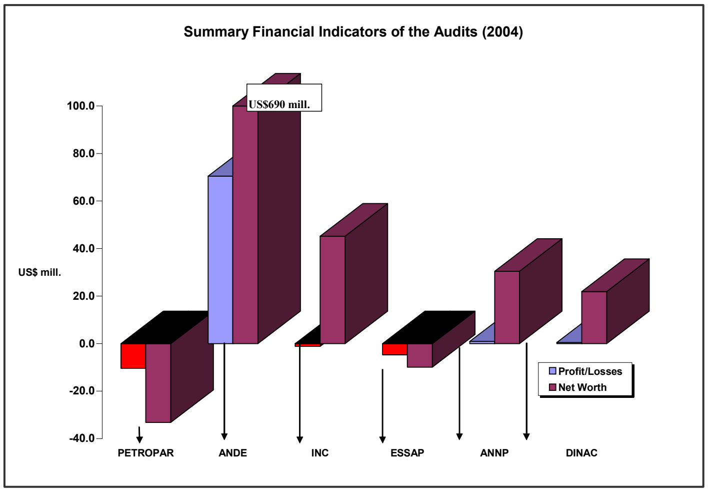
---

[1] The exchange offer was made in December 2003 and the bulk of it completed in July 2004. Past due interest were paid in cash. Bond holders were offered a bundle of 5 bonds with maturities of about 1, 2, 3, 4, and 5 years, at interest rates of 7, 7, 8, 9, and 9½ percent respectively (paid quarterly) and allocated according to the following fixed proportions: 6.5, 15.2, 24.6, 29.0, and 24.7 percent respectively.

Box 2. Paraguay: Restructuring of Public Enterprises

Public enterprises (PE) dominate important areas of Paraguay's economy (electricity, water, transport, telecommunications, fuels, and cement).[1] Low efficiency, quasi-fiscal activities, and underinvestment in public enterprises add costs to other sectors of the economy (and hamper their productivity).

Prior attempts to privatize some PE have proven politically unsuccessful. A draft privatization bill introduced by the government in 2002 was approved by Congress and then nullified through another law following social unrest. An initiative was introduced by a few congressmen in 2005, that attempted to suspend the law that nullified the privatization law but it was rejected. As a consequence, the authorities have designed a comprehensive strategy to improve efficiency, transparency and the quality and coverage of PEs' services.



The main elements of the authorities' strategy to restructure public enterprises are:

- ***First***, comprehensive management audits of PE and other public entities. The President has instructed the publication of full audit results in the website of the line ministries to which individual PE report.
- ***Second***, line ministries must present to the economic cabinet an action plan for each PE aimed at improving its managerial and financial performance relative to the indicators obtained in the audits. To ensure compliance with this step, the authorities issued a Presidential decree (No 6892/December 2005) establishing the need to comply with this instruction.
- ***Third***, based on the comprehensive management audits and the action plans, the authorities will design *Result-Oriented Management Contracts* starting with five PE (ANDE, PETROPAR, COPACO, INC, and ESSAP) by end-December 2006 (a structural benchmark for the SBA) and for DINAC and ANNP in early 2007. The monitoring of the performance indicators will be undertaken jointly by an independent technical committee and the Planning Ministry, and the results will be published.
- ***Fourth***, the government will evaluate private sector participation in the management of some PE on a case by case basis. This would be implemented through different modalities such as granting the management of the selected PE to the private sector in exchange of a "success fee," private-public partnerships (PPP), or outsourcing specific units.

The first phase, of the strategy has been virtually completed, the majority of the comprehensive management audits have been finalized and summary results have been published. The results of the audits confirm a very fragile financial and managerial position for at least three PE: PETROPAR, ESSAP and INC. Although the financial situation of DINAC and ANNP is not as weak, profitability and other managerial indicators are poor. These results stress the authorities' need to move decisively on their strategy to improve the performance of PE.

---

[1] National Electricity Company (ANDE), the Petroleum Company (PETROPAR), the Cement Industry (INC), the Telephone Company (COPACO), the Water and Sewage Company (ESSAP), National Aerospace Authority (DINAC) and the National Port Authority (ANNP).

Table 1. Paraguay: Quantitative Program Targets for 2006

	End-June 2006		End-Sep.2006	End-Dec. 2006
	Target	Actual	Target	Target
Fiscal targets				
1. Overall balance of the central administration (floor, in billions of guaranies)	250	807	325	0
2. Wage bill of the central administration (ceiling, in billions of guaranies) 1/	1,795	1,740	2,695	3,880
3. Overall balance of the public sector (floor, in billions of guaranies) 1/	350	1,153	440	0
Monetary targets				
4. Net international reserves (floor, in millions of U.S. dollars) 2/	1,297	1,463	1,307	1,317
5. Net domestic assets (ceiling, in billions of guaranies) 2/	-5,711	-6,635	-5,751	-5,098
Public debt and arrears targets				
6. Contracting or guaranteeing of nonconcessional external debt by the NFPS (ceiling, in millions of US$) 1/	500	0	500	500
Continuous PCs				
7. Contracted or guaranteed short-term external debt by the NFPS	0	0	0	0
8. Non-accumulation of external debt arrears	0	0	0	0

1/ Cumulative flows from the beginning of the calendar year.

2/ NIR is adjusted upward (downward) for any increase (decrease) in reserve requirement for foreign currency deposits (above pre-specified amounts) and upward by the amount of any program disbursements. Similarly, the NDA target will be adjusted downward (upward) following the adjustment in the NIR.

Table 2. Paraguay: Structural Conditionality Under the Program for 2006/07

Measure	Conditionality [1]	Timing	Status
Public Sector Reform			
A. Preparation of a tax code in consultation with the Fund	PC	end-Dec 2006	**In progress.** FAD/LEG provided TA in May-06. A draft of the tax procedure code was prepared and is being reviewed.
B. Design of an action plan to develop an effective commitment control system for the public sector and rationalize the Treasury account system	SB	end-Jun 2006	**Done**.
Financial Sector Reform			
C. Audited and inspected CAR (fully provisioned) of 5 percer for BNF at end-June 2006	SB	end-Sep 2006	**On track.** Audited data indicates that benchmark was observed. Data needs to be verified by the Superintendency of Banks
D. Audited and inspected CAR (fully provisioned) of 10 perce for BNF at end-December 2006	PC	end-Mar 2007	**On track**. Preliminary data indicates that a 10 percent CAR was reached at end-July.
E. Implement regulatory measures outlined in the banking strategy and put together draft legislation	SB	end-Sep 2006	**In progress**. Amendments to banking law and regulations have been drafted and are being reviewed.
F. Announce a strategy to strengthen the financial position of the Central Bank and a timetable for its implementation	SB	end-Dec 2006	**In progress**. MFD provided TA in March-06 Workings groups have initiated discussions on the strategy.
G. Send a bill to Congress that reflects the legal and budgetary implications of the agreed plan to strengthen the financial position of the Central Bank	SB	mid-Apr 2007	**On track.**
Pro-Growth Reform			
H. Design a plan to improve business climate	SB	end-Sep 2006	**In progress.** The Ministry of Industry and Trade is advancing in the formulation of the plan in consultation with the private sector.
I. Implement result-oriented management contracts for ANDE, COPACO, ESSAP, INC, and PETROPAR	SB	end-Dec 2006	**In progress.** Based on management audits and action plans, performance and financial indicators are being designed.
Social Safety Net			
J. Create a conditional cash transfer mechanism for 7,000 families living under extreme poverty based on contracts with beneficiaries	SB	end-Dec 2006	**In progress**. A pilot program has been initiated, by end-July covered 6690 families living under conditions of extreme poverty.

1/ SB = structural benchmarks; PC = performance criterion

Table 3. Paraguay: Selected Economic and Social Indicators

I. Social and Demographic Indicators

Area (thousand sq. km)	407	**Income distribution**	
		By highest 20 percent of households	61 percent
Population		By lowest 20 percent of households	2 percent
Total (in millions-2004)	5.7		
Rate of increase (percent a year)	1.9	**Health**	
Density (per sq. km.)	14.1	Physicians per 1,000 people	1.1
Unemployment	10.9	Hospital beds per 1,000 people	1.3
		Access to a water source	79 percent
Population characteristics		Access to a sanitation facility	95 percent
Life expectancy at birth (years)	70.6		
Crude birth rate (per thousand)	29.7	**Education (in percent)**	
Crude death rate (per thousand)	5.0	Male literacy rate	94 percent
Infant mortality (per thousand live births)	26.0	Female literacy rate	92 percent
		Primary school enrollment	92 percent
		Secondary school enrollment	47 percent

II. Economic Indicators, 2002-2007

	2002	2003	2004	2005	2006		2007	
					Prog.	Rev. Proj.	Original Proj.	Revised Proj.
				Annual percent change; unless otherwise specified				
National accounts and prices 1/								
GDP at current prices	10.0	22.5	16.4	11.1	13.1	11.0	8.8	9.0
GDP at constant prices	0.0	3.8	4.1	2.9	3.5	3.5	4.0	4.0
Per capita GDP (U.S. dollars, thousands)	0.9	1.0	1.2	1.3	1.4	1.5	1.5	1.6
GDP deflator	10.0	18.0	11.8	7.9	9.2	7.2	4.6	4.8
Consumer prices (end-of-period)	14.6	9.3	2.8	9.9	2.5–7.5	7.0	4.0	4.0
Real effective exchange rate 2/								
Average (depreciation -)	-11.1	-6.7	4.0	-6.9	...	...	...	...
End-of-period (depreciation -)	-11.5	8.0	-7.9	3.8	...	...	...	...
				In millions of U.S. dollars				
External sector								
Exports, f.o.b. (percentage change)	-1.6	16.8	32.1	11.9	7.6	11.5	5.8	6.6
Imports, c.i.f. (percentage change)	-14.6	14.4	29.5	19.9	5.4	13.2	3.9	3.7
Net oil exports and imports	-239	-327	-434	-507	-519	-554	-540	-576
Current account	93	125	55	-204	-180	-225	-170	-185
(in percent of GDP)	1.8	2.3	0.8	-2.7	-2.2	-2.5	-1.9	-2.0
Capital account	53	193	91	128	226	179	203	253
Overall balance	-83	211	269	157	46	73	33	68
Terms of trade (percentage change)	7.4	7.3	2.4	-13.4	4.3	1.4	1.8	1.6
				In percent of GDP				
Savings-investment balance								
Gross domestic investment	18.7	19.9	20.8	21.5	23.8	23.6	24.7	24.5
Private sector	12.2	14.8	16.1	16.5	18.8	18.1	18.9	18.3
Public sector	6.4	5.1	4.7	5.0	5.0	5.5	5.8	6.2
Gross national savings	20.5	22.2	21.6	18.8	21.6	21.1	22.8	22.5
Private sector	17.8	17.6	15.1	13.0	16.7	15.6	17.0	16.4
Public sector	2.7	4.6	6.5	5.8	4.9	5.4	5.7	6.2
Public sector								
Central government primary balance	-1.9	1.0	2.7	1.9	1.0	1.1	1.2	1.1
Central government overall balance	-2.5	-0.3	2.0	0.6	0.0	0.0	0.0	0.0
Consolidated public sector primary balance 3/	-1.4	2.6	3.1	2.8	1.7	2.0	1.7	1.6
Consolidated public sector overall balance 3/	-3.4	0.0	1.8	0.9	0.0	0.0	0.0	0.0
Public sector debt (end-of-year) 4/	57.6	55.0	42.6	37.9	33.1	31.3	30.6	29.4
External	50.3	49.7	38.6	34.4	30.5	28.5	28.4	26.7
Domestic	7.3	5.3	4.0	3.4	2.6	2.8	2.2	2.7
				Annual percent change				
Money and credit								
Monetary base	-1.0	57.7	17.6	4.3	6.0	8.9	4.2	4.9
M2	-2.2	24.9	24.6	16.1	8.5	10.0	6.5	8.0
M5 5/	-18.5	17.7	11.7	7.7	8.2	9.9	6.6	7.7
Credit to the private sector 5/	-20.9	-18.4	13.9	14.1	11.9	12.1	6.6	9.2
Velocity of M2	7.5	8.3	7.7	7.1	7.2	7.0	7.3	7.0
Memorandum items:								
International reserves (in millions of U.S. dollars)	641	983	1,168	1,297	1,317	1,370	1,350	1,411
(In months of imports)	2.8	3.4	3.4	3.3	3.6	3.4	3.5	3.3
GDP (in billions of guaranies)	29,105	35,666	41,522	46,135	52,156	51,194	56,752	55,812
Population (millions)	5.5	5.6	5.7	5.8	5.9	5.9	6.0	6.0

Sources: Paraguayan authorities; and Fund staff estimates.

1/ Revised GDP growth rates and GDP ratios reflects the use of a new national account data recently published by the authorities. However, program GDP ratios were not revised.
2/ INS calculations of real effective exchange rates.
3/ Consolidated public sector, including the quasi-fiscal operations of the BCP.
4/ Based on average exchange rate valuation of GDP.
5/ Foreign currency items are valued at a constant exchange rate.

Table 4. Paraguay: Central Government Operations

	2003	2004	2005	2006				2007	
				Jan-Jun		Jan-Dec		Original	Revised
				Prog.	Rev. Proj.	Prog.	Rev. Proj.	Proj.	Proj.
				In billion of guaraníes					
Total revenues	**6,001**	**7,637**	**8,419**	**4,393**	**4,764**	**9,358**	**9,544**	**10,309**	**10,575**
Tax revenues	3,676	4,929	5,471	2,733	3,121	5,877	6,208	6,615	6,726
Income taxes	624	880	967	311	617	745	1,020	890	1,132
Excises	704	1,000	1,007	583	464	1,174	1,052	1,302	1,152
Nontax revenues 1/	2,318	2,696	2,946	1,660	1,640	3,479	3,332	3,691	3,845
o/w : Public pension contributions	364	440	541	277	252	565	544	615	593
Itaipu-Yacyreta	1,456	1,640	1,651	952	953	1,917	1,834	1,992	1,781
Capital revenues	7	12	2	1	3	2	3	2	3
Current expenditures:	**4,981**	**5,363**	**6,231**	**3,280**	**3,213**	**7,125**	**7,104**	**7,637**	**7,835**
Wages and salaries	2,724	2,984	3,334	1,795	1,740	3,880	3,880	4,105	4,250
Goods and services	408	447	546	265	256	638	645	663	776
Interest payments	489	483	560	275	265	547	507	665	623
Transfers	1,334	1,431	1,771	936	942	2,041	2,050	2,183	2,161
Of which : pensions and benefits	943	940	1,126	601	568	1,265	1,260	1,376	1,340
Other	26	18	19	10	10	19	23	21	25
Capital expenditures and net lending	**1,165**	**1,625**	**1,860**	**863**	**700**	**2,233**	**2,396**	**2,669**	**2,740**
Statistical discrepancy 2/	35	181	-39	0	-44	0	-44	0	0
Overall balance	**-110**	**830**	**289**	**250**	**807**	**0**	**0**	**4**	**0**
Financing	**110**	**-830**	**-289**	**-250**	**-807**	**0**	**0**	**-4**	**0**
External debt (increase +)	588	103	-295	-206	-219	28	-77	5	110
Disbursements	1,151	763	658	362	275	1,192	991	1,144	1,049
Amortizations	563	660	953	568	494	1,164	1,067	1,140	938
Domestic bonds (increase +)	-58	-78	-137	-193	-6	-208	-69	-129	84
Net credit from the banking system 1/	-308	-162	-44	279	-509	190	137	121	-194
Net credit from Central Bank	-343	-114	55	279	-525	190	121	121	-194
Net credit from commercial banks	35	-48	-99	0	16	0	16	0	0
Other	-111	-693	188	-130	-74	-10	8	0	0
				In percent of GDP					
Total revenues	**16.8**	**18.4**	**18.2**	**8.4**	**9.3**	**17.9**	**18.6**	**18.2**	**18.9**
Tax revenues:	10.3	11.9	11.9	5.2	6.1	11.3	12.1	11.7	12.1
Nontax revenues 2/	6.5	6.5	6.4	3.2	3.2	6.7	6.5	6.5	6.9
Capital revenues	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Current expenditures	**14.0**	**12.9**	**13.5**	**6.3**	**6.3**	**13.7**	**13.9**	**13.5**	**14.0**
Wages and salaries	7.6	7.2	7.2	3.4	3.4	7.4	7.6	7.2	7.6
Goods and services	1.1	1.1	1.2	0.5	0.5	1.2	1.3	1.2	1.4
Interest payments	1.4	1.2	1.2	0.5	0.5	1.0	1.0	1.2	1.1
Transfers	3.7	3.4	3.8	1.8	1.8	3.9	4.0	3.8	3.9
Capital expenditures and net lending	**3.3**	**3.9**	**4.0**	**1.7**	**1.4**	**4.3**	**4.7**	**4.7**	**4.9**
Statistical discrepancy 3/	0.1	0.4	-0.1	0.0	-0.1	0.0	-0.1	0.0	0.0
Overall balance	**-0.3**	**2.0**	**0.6**	**0.5**	**1.6**	**0.0**	**0.0**	**0.0**	**0.0**
Financing	**0.3**	**-2.0**	**-0.6**	**-0.5**	**-1.6**	**0.0**	**0.0**	**0.0**	**0.0**
External debt (increase +)	1.6	0.2	-0.6	-0.4	-0.4	0.1	-0.1	0.0	0.2
Disbursements	3.2	1.8	1.4	0.7	0.5	2.3	1.9	2.0	1.9
Amortizations	1.6	1.6	2.1	1.1	1.0	2.2	2.1	2.0	1.7
Domestic bonds (increase +)	-0.2	-0.2	-0.3	-0.4	0.0	-0.4	-0.1	-0.2	0.2
Net credit from the banking system	-0.9	-0.4	-0.1	0.5	-1.0	0.4	0.3	0.2	-0.3
Other	-0.3	-1.7	0.4	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum Item:									
Primary balance	1.0	2.7	1.9	1.0	2.2	1.0	1.1	1.2	1.1
Balance of the Caja Fiscal 4/	-1.6	-1.2	-1.3	-0.6	-0.6	-1.3	-1.4	-1.3	-1.3

Sources: Ministry of Finance; and Fund staff estimates.

1/ Excludes banks' holdings of government bonds.
2/ Includes receipts from the binational hydroelectric plants Itaipu and Yacyreta, and grants.
3/ Measurement error to reconcile above-the-line estimate with measure of the fiscal balance from the financing side.
4/ Includes pension payments to central government employees and Chaco War veterans.

Table 5. Paraguay: Operations of the Consolidated Public Sector 1/

	2003	2004	2005	2006				2007	
				Jan-Jun		Jan-Dec		Original	Revised
				Prog.	Rev. Proj.	Prog.	Rev. Proj.	Proj.	Proj.
				In billion of guaranies					
Revenue	**7,450**	**8,959**	**10,114**	**5,342**	**5,772**	**11,261**	**11,522**	**12,375**	**12,716**
Tax revenue	3,676	4,936	5,483	2,739	3,134	5,890	6,228	6,629	6,748
Nontax revenue and grants	3,617	4,010	4,596	2,585	2,633	5,335	5,272	5,707	5,944
Capital revenue	157	14	35	18	6	36	23	39	24
Current expenditure	**6,247**	**6,959**	**7,908**	**4,281**	**4,023**	**9,275**	**9,180**	**9,820**	**10,008**
Wages and salaries	3,290	3,634	4,087	2,186	2,113	4,730	4,722	5,032	5,177
Goods and services	634	755	994	519	397	1,161	1,123	1,229	1,364
Interest payments	728	678	751	431	397	911	849	981	891
Transfers	1,544	1,699	2,048	1,103	1,101	2,378	2,387	2,549	2,544
Other	51	193	27	42	14	95	98	28	32
Capital expenditure and net lending	**1,819**	**1,956**	**2,306**	**1,049**	**852**	**2,605**	**2,800**	**3,292**	**3,456**
Of which : capital expenditure	1,850	2,189	2,550	1,155	922	2,818	3,005	3,524	3,680
Primary balance	**914**	**1,305**	**1,298**	**781**	**1,723**	**911**	**1,022**	**990**	**892**
Public enterprises' operating surplus	**801**	**583**	**646**	**337**	**429**	**619**	**630**	**746**	**749**
Statistical discrepancy 2/	-203	129	-132	0	-173	0	-173	0	0
Overall balance	**-17**	**756**	**414**	**350**	**1,153**	**0**	**0**	**9**	**0**
Financing	**17**	**-756**	**-414**	**-350**	**-1,153**	**0**	**0**	**-9**	**0**
External financing net	459	-42	-445	-250	-310	-43	-192	-96	2
Disbursements	1,273	808	771	399	290	1,287	1,056	1,286	1,179
Amortizations	814	850	1,216	649	600	1,329	1,248	1,382	1,177
Domestic financing net	-24	72	-202	52	-778	95	190	88	45
Bond financing	-58	-78	-137	-193	-6	-208	-69	-129	84
Net credit from the banking system	-356	-183	-176	100	-799	-73	-19	-39	-152
Quasifiscal deficit financing	390	333	112	145	27	376	278	255	113
Other	-417	-786	232	-152	-65	-53	2	0	-47
				In percent of GDP					
Revenue	**20.9**	**21.6**	**21.9**	**10.2**	**11.3**	**21.6**	**22.5**	**21.8**	**22.8**
Tax revenue	10.3	11.9	11.9	5.3	6.1	11.3	12.2	11.7	12.1
Nontax revenue and grants	10.1	9.7	10.0	5.0	5.1	10.2	10.3	10.1	10.7
Capital revenue	0.4	0.0	0.1	0.0	0.0	0.1	0.0	0.1	0.0
Current expenditure	**17.5**	**16.8**	**17.1**	**8.2**	**7.9**	**17.8**	**17.9**	**17.3**	**17.9**
Wages and salaries	9.2	8.8	8.9	4.2	4.1	9.1	9.2	8.9	9.3
Goods and services	1.8	1.8	2.2	1.0	0.8	2.2	2.2	2.2	2.4
Interest payments	2.0	1.6	1.6	0.8	0.8	1.7	1.7	1.7	1.6
Transfers	4.3	4.1	4.4	2.1	2.2	4.6	4.7	4.5	4.6
Other	0.1	0.5	0.1	0.1	0.0	0.2	0.2	0.0	0.1
Capital expenditure and net lending	**5.1**	**4.7**	**5.0**	**2.0**	**1.7**	**5.0**	**5.5**	**5.8**	**6.2**
Of which : capital expenditure	5.1	4.9	5.0	2.0	1.7	5.0	5.5	5.8	6.2
Public enterprises' operating surplus	**2.2**	**1.4**	**1.4**	**0.6**	**0.8**	**1.2**	**1.2**	**1.3**	**1.3**
Statistical discrepancy 2/	-0.6	0.3	-0.3	0.0	-0.3	0.0	-0.3	0.0	0.0
Overall balance	**0.0**	**1.8**	**0.9**	**0.7**	**2.3**	**0.0**	**0.0**	**0.0**	**0.0**
Financing	**0.0**	**-1.8**	**-0.9**	**-0.7**	**-2.3**	**0.0**	**0.0**	**0.0**	**0.0**
External financing net	1.3	-0.1	-1.0	-0.5	-0.6	-0.1	-0.4	-0.2	0.0
Disbursements	3.6	1.9	1.7	0.0	0.0	0.0	0.0	0.0	0.0
Amortizations	2.3	2.0	2.6	0.0	0.0	0.0	0.0	0.0	0.0
Domestic financing net	-0.1	0.2	-0.4	0.1	-1.5	0.2	0.4	0.2	0.1
Of which : quasifiscal deficit financing	1.1	0.8	0.2	0.3	0.1	0.7	0.5	0.4	0.2
Other	-1.2	-1.9	0.5	-0.3	-0.1	-0.1	0.0	0.0	0.0
Memorandum item:									
Primary balance	2.6	3.1	2.8	1.5	3.4	1.7	2.0	1.7	1.6

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 6. Paraguay: Summary Accounts of the Central Bank,

(In billions of guaranies; end-of-period; valued at constant exchange rate)

	2003	2004	2005	2006				2007	
				Jun		Dec		Original	Revised
				Prog.	Rev. Proj.	Prog.	Rev. Proj.	Proj.	Proj.
Currency issue	**2,207**	**2,488**	**2,925**	**2,435**	**2,552**	**3,174**	**3,217**	**3,380**	**3,475**
Growth	29.9	12.7	17.6	10.0	15.3	8.5	10.0	6.5	8.0
Net international reserves	**6,175**	**7,335**	**8,146**	**8,146**	**9,187**	**8,272**	**8,604**	**8,478**	**8,861**
(In millions of U.S. dollars)	983	1,168	1,297	1,297	1,463	1,317	1,370	1,350	1,411
Net domestic assets	**-3,969**	**-4,848**	**-5,221**	**-5,711**	**-6,635**	**-5,098**	**-5,386**	**-5,098**	**-5,386**
Net nonfinancial public sector	1,163	1,366	1,410	1,689	884	1,600	1,440	1,721	1,246
Net credit to the central government	952	967	1,063	1,342	538	1,253	1,081	1,373	887
Net credit to the rest of NFPS	211	398	347	347	346	347	359	347	359
Net credit to the banking system	-3,362	-4,376	-5,026	-5,980	-5,452	-5,556	-5,213	-5,903	-5,139
Reserve requirements	-2,219	-2,195	-2,331	-2,438	-2,442	-2,510	-2,504	-2,592	-2,618
Free reserves	-543	-1,012	-683	-684	-593	-582	-732	-512	-662
Monetary control bills (LRM)	-602	-1,171	-2,014	-2,864	-2,446	-2,470	-1,987	-2,806	-1,868
Other	2	2	2	6	29	6	9	6	9
Other assets and liabilities (net)	-1,770	-1,838	-1,605	-1,420	-2,067	-1,142	-1,613	-916	-1,493
Capital and reserves	-1,463	-1,722	-1,368	-1,257	-1,339	-1,025	-1,103	-770	-990
Other assets net 1/	-308	-116	-237	-163	-727	-117	-510	-145	-503
Memorandum items:									
Total stock of LRMs outstanding	1,071	1,552	2,293	3,124	2,930	2,686	2,284	3,059	2,148
Quasifiscal balance 2/	-390	-333	-112	-145	-27	-376	-278	-255	-113
in percent of GDP	-1.1	-0.8	-0.2	-0.3	-0.1	-0.7	-0.5	-0.4	-0.2
Costs of monetary policy operations 2/	219	181	179	151	129	353	333	306	258
in percent of GDP	0.6	0.4	0.4	0.3	0.3	0.7	0.6	0.5	0.5
Monetary base	3,406	4,006	4,180	3,736	3,780	4,432	4,553	4,619	4,776
annual growth (in percent)	57.7	17.6	4.3	6.9	8.2	6.0	8.9	4.2	4.9
Narrow monetary base 3/	2,954	3,122	3,667	3,219	3,310	4,018	4,052	4,275	4,345
annual growth (in percent)	44.3	5.7	17.5	10.4	13.5	9.6	10.5	6.4	7.2

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

1/ Includes LRM held by the nonbanking sector.

2/ Cumulative since beginning of year. Follows program definition.

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

Table 7. Paraguay: Summary Accounts of the Banking System

(In billions of guaranies; end-of-period; valued at constant exchange rate)

	2003	2004	2005	2006				2007	
				Jun		Dec		Original	Revised
				Prog.	Rev. Proj.	Prog.	Rev. Proj.	Proj.	Proj.
I. Central Bank									
Net international reserves	**6,175**	**7,335**	**8,146**	**8,146**	**9,187**	**8,272**	**8,604**	**8,478**	**8,861**
(in millions of U.S. dollars)	983	1,168	1,297	1,297	1,463	1,317	1,370	1,350	1,411
Net domestic assets	**-3,969**	**-4,848**	**-5,221**	**-5,711**	**-6,635**	**-5,098**	**-5,386**	**-5,098**	**-5,386**
Credit to public sector, net	1,163	1,366	1,410	1,689	884	1,600	1,440	1,721	1,246
Credit to banking system, net 1/	-2,760	-3,205	-3,012	-3,116	-3,006	-3,086	-3,226	-3,098	-3,270
Central bank securites	-1,071	-1,552	-2,293	-3,124	-2,930	-2,686	-2,284	-3,059	-2,148
Other	-1,301	-1,457	-1,326	-1,161	-1,583	-926	-1,316	-662	-1,214
Currency issue	**2,207**	**2,488**	**2,925**	**2,435**	**2,552**	**3,174**	**3,217**	**3,380**	**3,475**
II. Monetary Survey									
Net foreign assets	**8,405**	**9,478**	**10,028**	**10,277**	**11,681**	**10,353**	**10,951**	**10,716**	**11,403**
(in millions of U.S. dollars)	1,338	1,509	1,597	1,636	1,860	1,649	1,744	1,706	1,816
Net domestic assets	**2,152**	**2,313**	**2,671**	**2,680**	**1,630**	**3,391**	**3,008**	**3,942**	**3,630**
Credit to the public sector	699	531	237	153	-589	27	65	-95	-28
Credit to the private sector	5,081	5,788	6,601	6,748	6,757	7,389	7,402	7,877	8,084
Other	-3,628	-4,006	-4,167	-4,221	-4,539	-4,026	-4,460	-3,840	-4,426
Broad Liquidity (M4)	**10,558**	**11,791**	**12,699**	**12,957**	**13,310**	**13,744**	**13,959**	**14,657**	**15,034**
Bonds and issued securities	31	0	0	0	0	0	0	0	0
Other monetary liabilities	9	125	85	101	61	93	94	99	101
Central bank securities with private secto	469	381	280	312	484	269	297	306	279
Broad liquidity (M3)	**10,047**	**11,285**	**12,334**	**12,543**	**12,765**	**13,383**	**13,568**	**14,253**	**14,653**
Foreign currency deposits	5,253	5,310	5,396	6,041	6,260	5,855	5,936	6,235	6,411
Money and quasi-money (M2)	**4,794**	**5,974**	**6,938**	**6,502**	**6,505**	**7,528**	**7,632**	**8,017**	**8,242**
Quasi-money	1,208	1,482	1,472	1,701	1,481	1,597	1,619	1,701	1,749
Money (M1)	3,587	4,492	5,466	4,801	5,024	5,930	6,012	6,316	6,493
Annual percentage change									
M0 (Currency issued)	29.9	12.7	17.6	10.0	15.3	8.5	10.0	6.5	8.0
Credit to the private sector	-18.4	13.9	14.1	21.6	21.8	11.9	12.1	6.6	9.2
M1	35.8	25.2	21.7	10.9	16.1	8.5	10.0	6.5	8.0
M2	24.9	24.6	16.1	11.1	11.1	8.5	10.0	6.5	8.0
M3	17.7	12.3	9.3	8.3	10.2	8.5	10.0	6.5	8.0
Of which: foreign currency deposits	11.8	1.1	1.6	5.5	9.3	8.5	10.0	6.5	8.0
Memorandum items:									
Ratio of foreign currency deposits to M3 (percent)	52.3	47.1	43.7	48.2	49.0	43.7	43.7	43.7	43.7
Ratio of foreign currency deposits to private sector deposits in banks (percer	63.5	57.1	54.6	57.1	59.0	54.6	54.6	54.6	54.6

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

1/ Reflects debt write-offs of central bank credit to commercial banks during 1997 and 1998.

Table 8. Paraguay: Banking System Indicators

	2001	2002	2003	2004	2005	2006 June
I. Total banking system (II+III+IV+V)						
Share in assets	100.0	100.0	100.0	100.0	100.0	100.0
Capital adequacy ratio (percent) 1/	16.9	17.9	20.9	20.5	20.4	21.4
NPLs/total loans	16.5	19.7	20.6	10.8	6.6	5.7
Provisions/NPLs	37.0	46.6	54.8	54.6	57.7	49.3
Rate of return on assets (ROA)	2.2	1.0	0.4	1.7	2.1	3.4
Rate of return on equity (ROE)	21.2	9.0	4.5	18.3	22.6	33.4
Liquid assets/total assets 2/	23.0	25.1	32.6	30.8	26.6	26.9
Foreign exchange deposits/total deposits	65.3	68.6	61.7	55.0	52.7	51.3
II. Total foreign-owned banks						
Share in assets	45.1	48.4	47.4	35.8	31.3	30.0
Capital adequacy ratio (percent) 1/	16.0	17.6	20.4	26.0	27.2	29.1
NPLs/total loans	15.3	20.1	20.8	11.0	6.4	5.8
Provisions/NPLs	42.6	57.5	64.2	71.2	63.4	57.5
Rate of return on assets (ROA)	3.1	1.6	0.1	1.4	1.4	2.0
Rate of return on equity (ROE)	30.4	15.0	1.2	12.0	11.3	15.4
Liquid assets/total assets 2/	22.2	27.1	29.8	25.4	29.0	24.7
Foreign exchange deposits/total deposits	67.8	71.1	65.6	65.2	65.1	60.3
III. Total majority-owned foreign banks						
Share in assets	38.3	33.2	37.2	45.2	48.0	49.2
Capital adequacy ratio (percent) 1/	16.8	19.9	21.0	17.7	17.8	18.1
NPLs/total loans	10.6	10.4	12.3	3.7	2.3	2.5
Provisions/NPLs	36.8	43.8	52.1	56.9	87.2	78.1
Rate of return on assets (ROA)	1.8	1.4	1.3	2.2	3.0	4.3
Rate of return on equity (ROE)	18.3	13.4	15.5	25.8	35.3	45.6
Liquid assets/total assets 2/	25.0	26.2	35.3	28.8	22.6	24.6
Foreign exchange deposits/total deposits	69.3	70.7	62.3	53.8	51.7	53.9
IV. Total domestic-owned private banks						
Share in assets	7.4	10.4	7.4	8.2	9.4	9.8
Capital adequacy ratio (percent) 1/	14.8	13.6	14.1	13.3	13.4	14.4
NPLs/total loans	6.5	8.8	2.9	2.1	0.8	1.0
Provisions/NPLs	30.8	18.7	46.2	70.3	77.1	60.9
Rate of return on assets (ROA)	1.2	1.1	1.6	2.0	2.2	3.2
Rate of return on equity (ROE)	13.8	14.3	21.1	28.1	30.8	39.0
Liquid assets/total assets 2/	20.1	18.3	38.8	38.1	34.0	37.6
Foreign exchange deposits/total deposits	61.8	62.6	60.7	57.6	54.7	57.0
V. National Development Bank (BNF)						
Share in assets	9.2	8.0	8.0	10.7	11.3	11.1
Capital adequacy ratio (percent) 1/	22.9	18.8	30.0	25.0	26.5	30.0
NPLs/total loans	46.5	56.2	56.2	48.9	40.3	34.5
Provisions/NPLs	31.7	39.6	47.6	43.1	45.1	30.4
Rate of return on assets (ROA)	0.3	-4.7	-2.8	0.5	0.4	3.4
Rate of return on equity (ROE)	2.0	-27.3	-18.7	6.8	5.3	44.6
Liquid assets/total assets 2/	20.4	17.3	30.7	52.0	31.2	33.7
Foreign exchange deposits/total deposits	27.0	42.5	32.7	23.6	20.6	11.7

Source: Superintendency of Banks.

1/ Definition of CAR does not fully comply with international standards. A tightening of CAR definition is scheduled for 2007.

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

Table 9. Paraguay: Balance of Payments

(In millions of U.S. dollars)

	2003	2004	2005	2006				2007	
				Jan-Jun		Jan-Dec		Original	Revised
				Prog.	Rev. Proj	Prog.	Rev. Proj.	Proj.	Proj.
Current account	**125**	**55**	**-204**	**172**	**-178**	**-180**	**-225**	**-170**	**-185**
Trade balance	-280	-306	-596	-40	-390	-599	-729	-562	-650
Exports	2,163	2,857	3,198	1,648	1,799	3,264	3,565	3,454	3,800
Imports	-2,443	-3,163	-3,794	-1,688	-2,189	-3,863	-4,294	-4,015	-4,451
Services (net)	245	280	252	117	93	183	235	184	209
Factor income	-8	-116	-81	3	14	-7	10	-16	16
Transfers	165	194	223	92	105	243	259	223	241
Capital and financial account	**193**	**91**	**128**	**-157**	**224**	**226**	**179**	**203**	**253**
General government	92	14	-59	-29	-33	12	-3	1	19
Disbursements	213	139	107	58	47	188	173	178	178
Amortization	-130	-133	-175	-92	-84	-185	-185	-177	-159
Other	9	9	9	4	4	9	9	0	0
Private Sector 1/	101	77	187	-128	257	214	182	202	235
Direct investment	22	45	59	74	86	125	175	130	182
Foreign currency deposits	335	32	93	-60	57	16	-12	0	0
Other	-256	0	35	-142	114	73	19	72	53
Errors and Omissions	-107	122	233	0	119	0	119	0	0
Overall Balance	**211**	**269**	**157**	**15**	**166**	**46**	**73**	**33**	**68**
Net International Reserves (increase -)	-302	-181	-152	0	-166	-20	-73	-33	-41
Gross Reserves	-301	-179	-152	0	-166	-20	-73	-33	-41
Reserve Liabilities	-1	-1	1	0	0	0	0	0	0
Exceptional Financing	91	-88	-6	-15	0	-26	0	0	-27
Arrears deferral (+)/clearance (-)	91	-88	-6	-15	0	-26	0	0	-27
Reschedulings	0	0	0	0	0	0	0	0	0
Memorandum items:									
Current account in percent of GDP	2.3	0.8	-2.7	4.2	-3.7	-2.2	-2.5	-1.9	-2.0
Gross reserves (millions of U.S. dollars)	983	1,168	1,297	1,297	1,463	1,317	1,370	1,350	1,411
in months of imports of GNFS	3.4	3.4	3.3	3.4	3.4	3.6	3.4	3.5	3.3
External public debt in percent of GDP 2/	49.7	38.6	34.4	30.3	28.4	30.5	28.5	28.4	26.7
Debt service in percent of exports GNFS	11.6	7.5	8.0	8.7	8.6	8.6	8.1	8.8	7.6
Export Volume (percentage change) 3/	13.3	17.8	13.1	…	…	3.1	7.9	6.0	2.0
Import Volume (percentage change) 3/	15.0	17.1	16.4	…	…	5.0	8.9	4.8	4.8
Terms of trade (percentage change)	7.3	2.4	-13.4	…	…	4.3	1.4	1.8	1.6

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

1/ Includes public enterprises and binationals.
2/ Based on average exchange rate valuation of GDP.
3/ Registered trade.

Table 10. Paraguay: Indicators of External Vulnerability

	2001	2002	2003	2004	2005
Monetary and financial indicators					
Broad money (M3), percentage change 1/	0.7	-21.0	17.7	12.3	9.3
Credit to the private sector, real (percentage change) 1/	-8.7	-31.1	-25.5	10.9	3.9
Share of nonperforming loans in total loans (percent) 2/	16.5	19.7	20.6	10.8	6.6
Average domestic lending rate, real 2/	22.5	39.0	19.3	17.4	18.6
Central Bank bill yield, real 2/	12.8	12.9	-1.2	1.0	-0.1
International reserves (millions of US$)	723	641	983	1,168	1,297
Central bank foreign short-term liabilities (millions of US$)	0.2	0.5	0.5	0.3	0.7
External indicators					
Merchandise exports (percentage change)	-18.9	-1.6	16.8	32.1	11.9
Merchandise imports (percentage change)	-12.7	-14.6	14.4	29.5	19.9
Merchandise terms of trade (percentage change)	-1.4	7.4	7.3	2.4	-13.4
Real effective exchange rate (percentage change)	-4.4	-1.2	-6.6	4.0	-6.9
Current account balance (percent of GDP)	-4.1	1.8	2.3	0.8	-2.7
Capital and financial account (percent of GDP)	2.5	1.0	3.5	1.3	1.7
Net foreign direct investment (percent of GDP)	1.2	0.2	0.4	0.6	0.8
Inward portfolio investment (percent of GDP)	0.0	0.0	0.0	0.0	0.0
Other net investment (percent of GDP)	1.1	0.7	2.8	0.4	0.7
External public debt (percent of GDP) 3/	38.3	50.3	49.7	38.6	34.4
Debt service (in percent of exports GNFS)	10.8	9.1	11.6	7.5	8.0
Gross reserves (in US$)	723	641	983	1,168	1,297
In months of imports of GNFS	3.5	2.8	3.4	3.4	3.3
Over short-term external debt 4/	1.2	1.0	1.6	1.8	1.9
Over foreign currency deposits in domestic banks	0.6	0.7	1.0	1.1	1.1

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

1/ Foreign currency components are valued at the accounting exchange rate of Gs. 6,280 per U.S. dollar.
2/ Latest available data, September 2005.
3/ Based on average exchange rate valuation of GDP.
4/ Private and public external debt with a residual maturity of one year or less. Excludes foreign currency deposits in banking system.

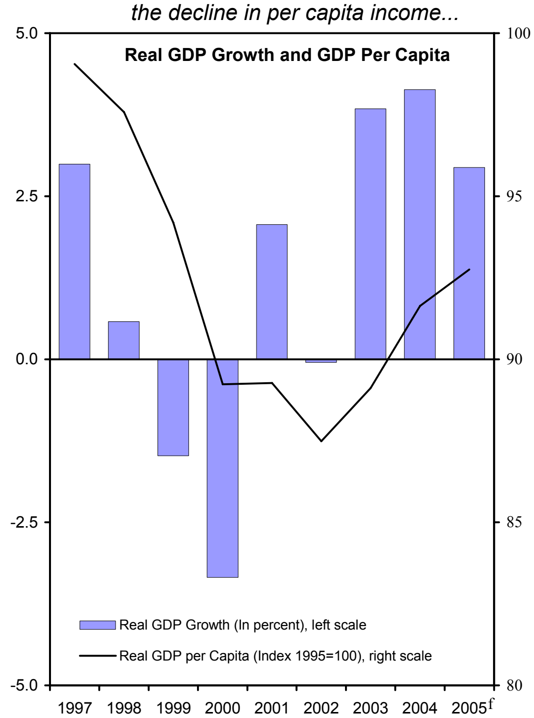
Table 11. Paraguay: Schedule of Reviews and Purchases

Date	Amount of Purchase		Conditions
	Millions of SDRs	Percent of Quota	
May 31, 2006	25.0	25.0	Approval of arrangement
September 29, 2006	6.0	6.0	First review and end-June 2006 performance criteria
December 15, 2006	6.0	6.0	Second review and end-September 2006 performance criteria
March 15, 2007	6.0	6.0	Third review and end-December 2006 performance criteria
June 15, 2007	6.0	6.0	Fourth review and end-March 2007 performance criteria
September 15, 2007	6.0	6.0	End-June 2007 performance criteria
December 15, 2007	2.5	2.5	Fifth review and end-September 2007 performance criteria
March 15, 2008	2.5	2.5	End-December 2007 performance criteria
June 15, 2008	2.5	2.5	Sixth review and end-March 2008 performance criteria
August 28, 2008	2.5	2.5	End-June 2008 performance criteria
Total	**65.0**	**65.0**	

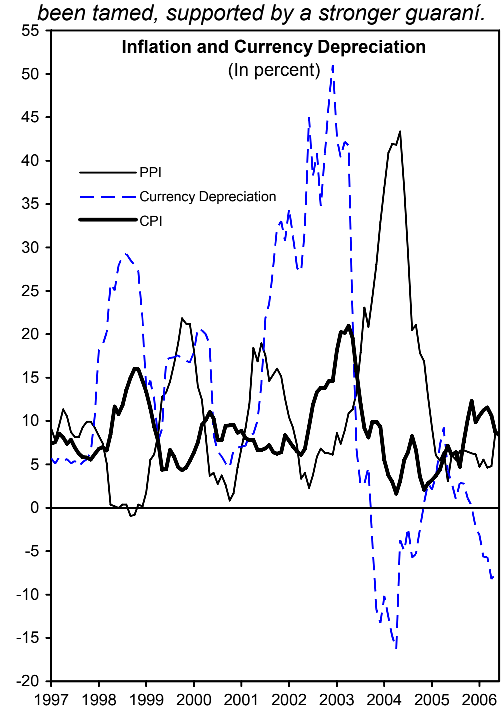
Source: Fund staff estimates.

Figure 1. Paraguay: Selected Economic Indicators

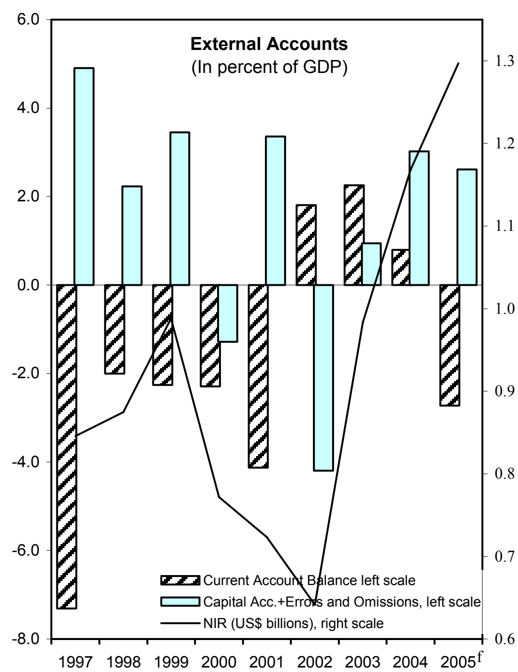
Significant recovery and a reversal of the decline in per capita income...



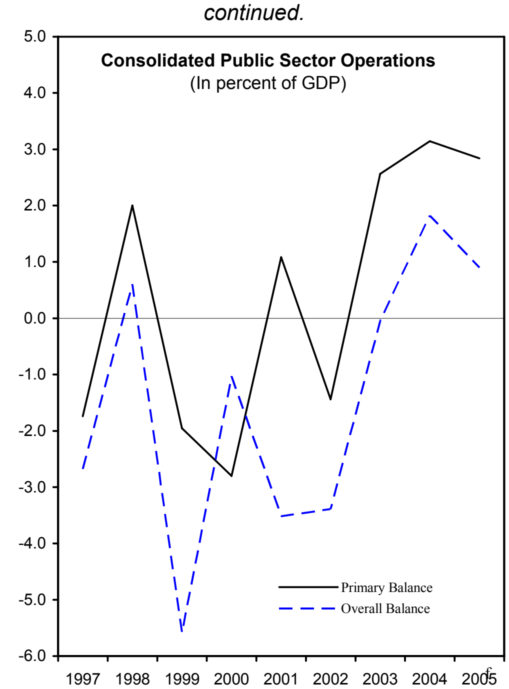
... In recent months, inflationary pressures have been tamed, supported by a stronger guaraní.



... as international reserves continued to rise...



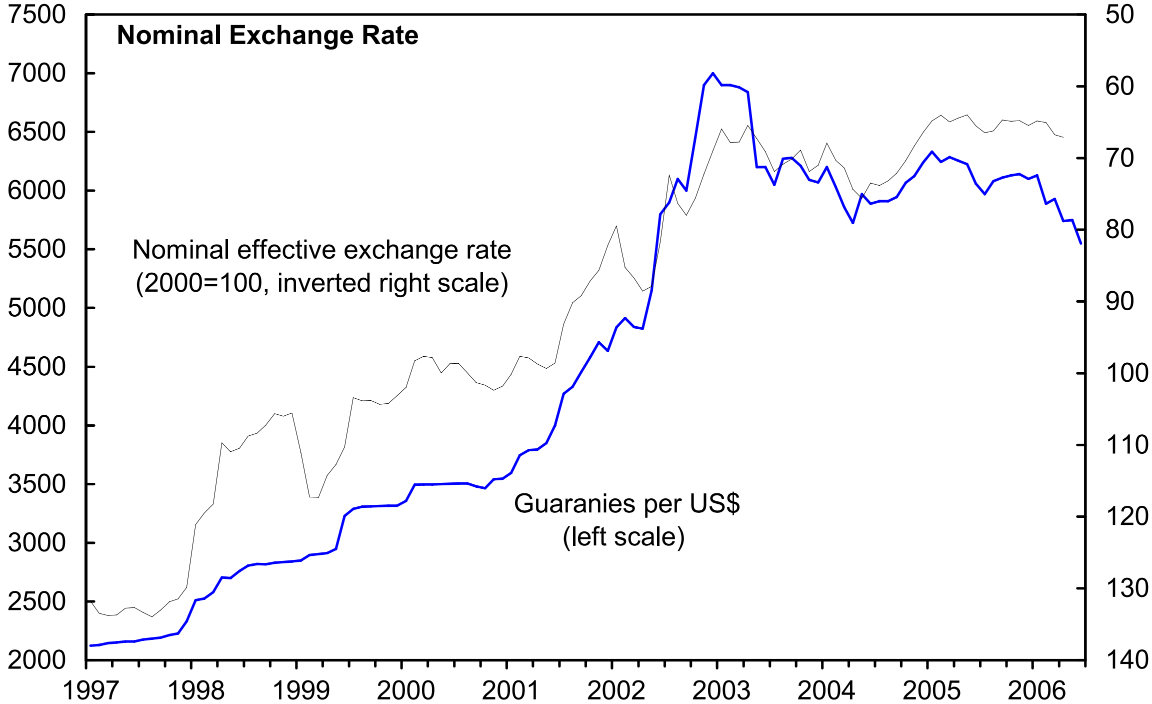
... and fiscal consolidation efforts continued.



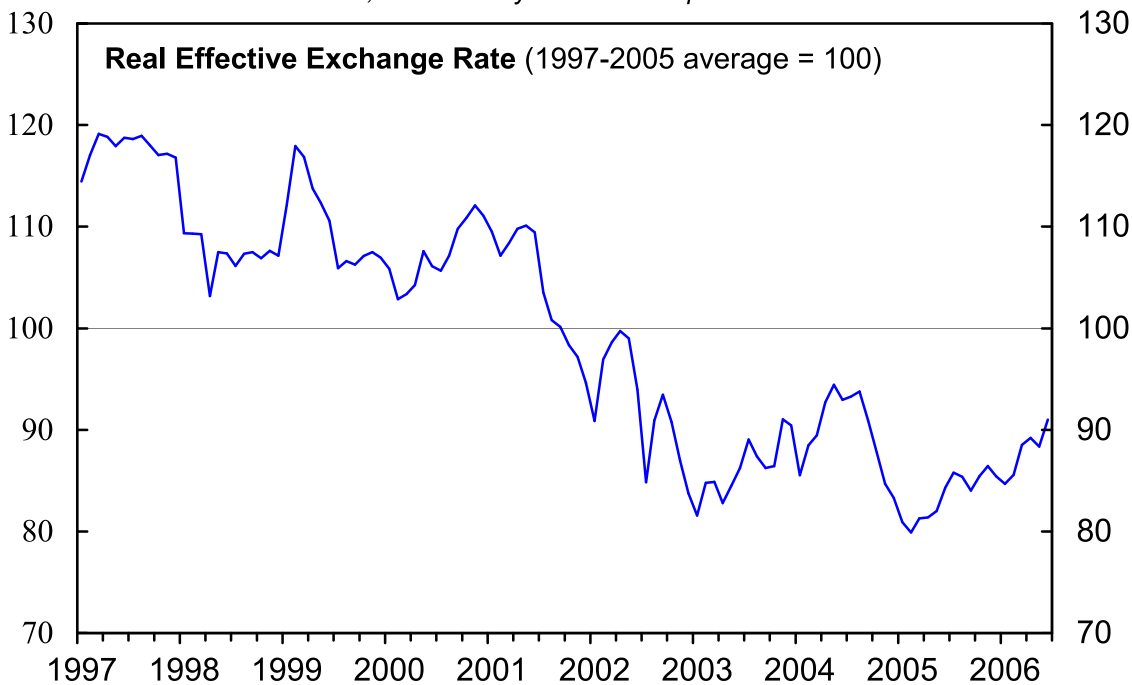
Sources: Central Bank of Paraguay and Ministry of Finance.

Figure 2. Paraguay: Exchange Rate Developments

The exchange rate has appreciated in recent months...

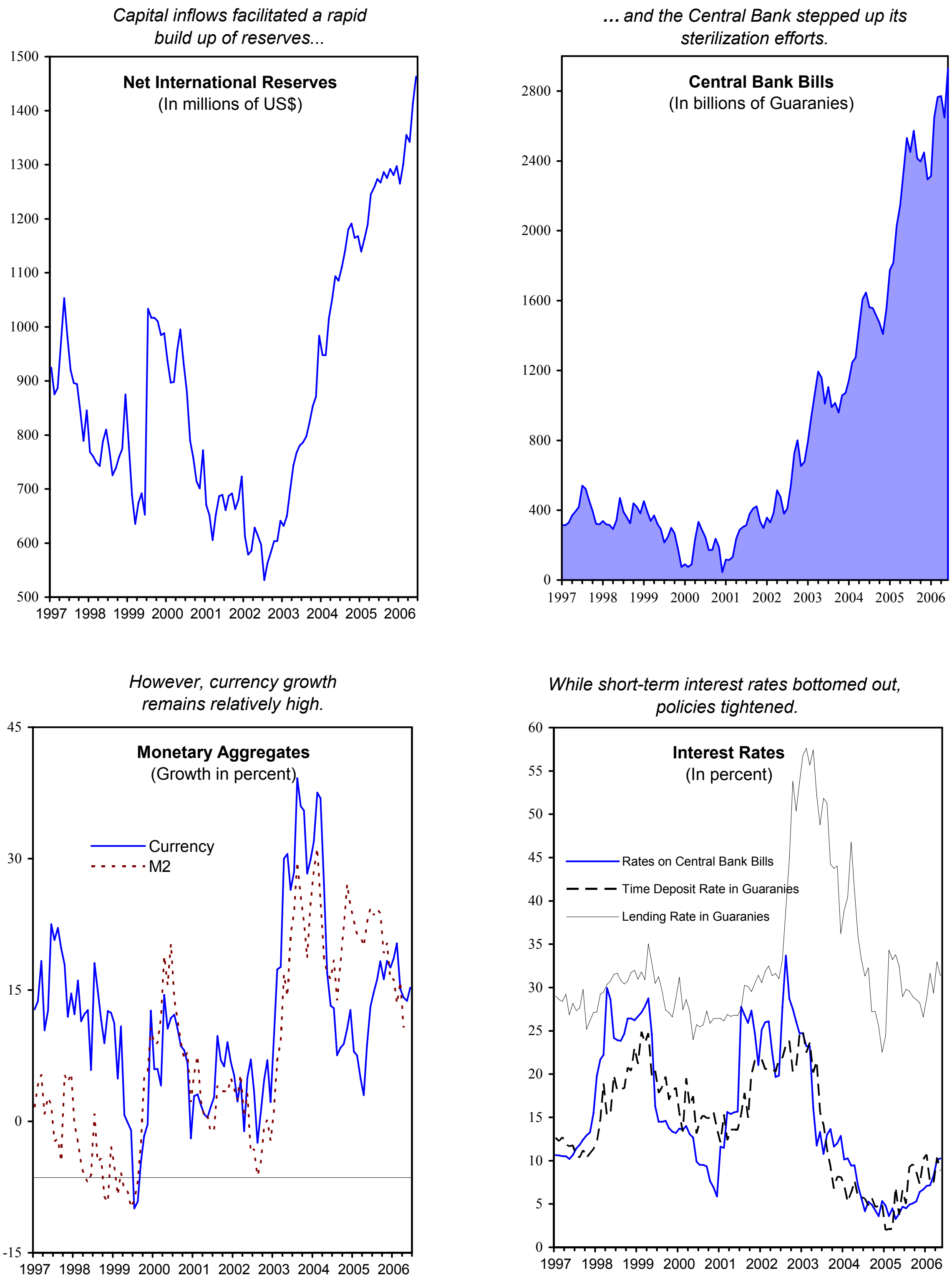


…but so far, the currency remains competitive.



Source: Central Bank of Paraguay and Fund staff estimates.

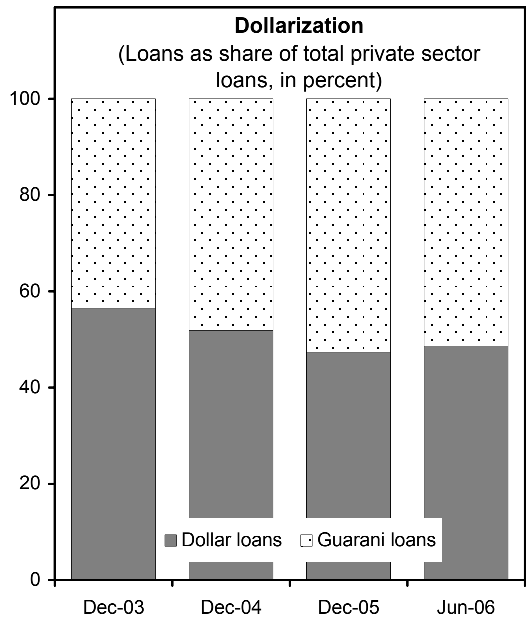
Figure 3. Paraguay: Selected Financial Indicators



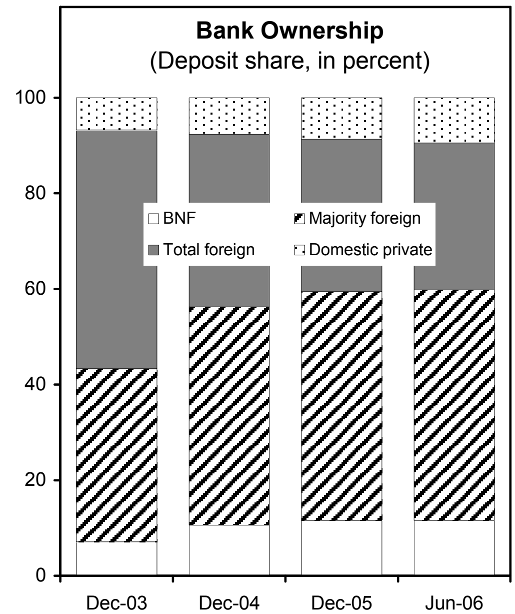
Source: Central Bank of Paraguay.

Figure 4. Paraguay: Selected Banking Indicators

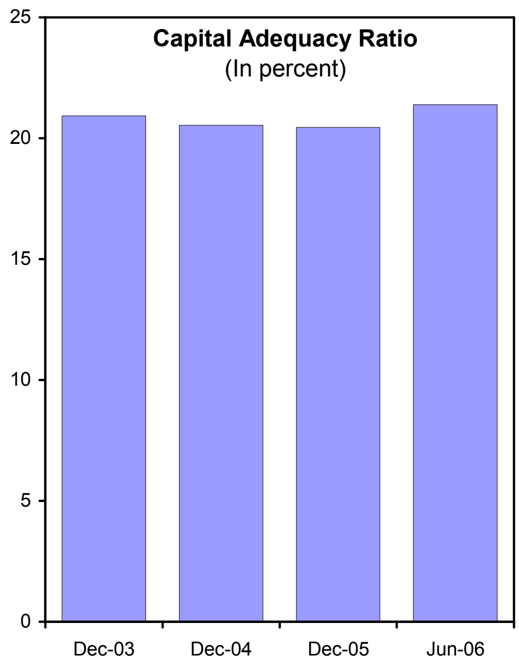
Dollarization remains high but is declining...



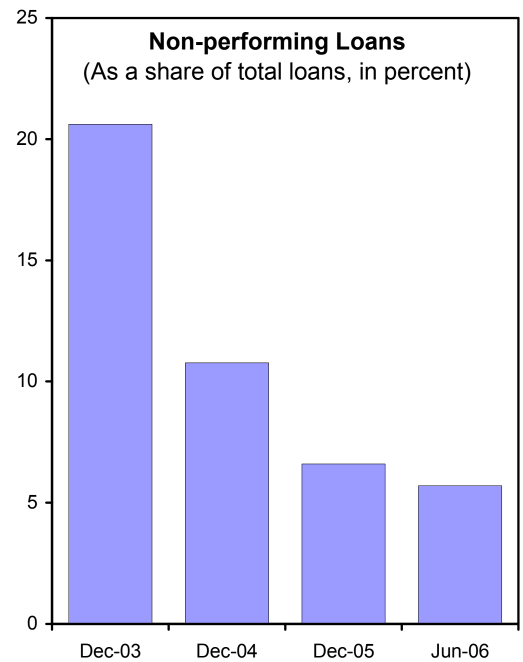
…although some foreign banks have left...



…capital asset ratios remain high...



... as non-performing loans keep falling.



Source: Central Bank of Paraguay.

APPENDIX 1. PARAGUAY—FUND RELATIONS
(As of July 31, 2006)

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

II. General Resources Account:

	In millions of SDRs	In percent of Quota
Quota	99.90	100.00
Fund holdings of currency	78.43	78.51
Reserve position in Fund	21.48	21.50

III. SDR Department:

	In millions of SDRs	Percent of Allocation
Net cumulative allocation	13.70	100.00
Holdings	89.66	654.57

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	65.00	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				
	2006	2007	2008	2009	2010
Principal					
Charges/Interest		0.00	0.00	0.00	0.00
Total		**0.00**	**0.00**	**0.00**	**0.00**

VII. Exchange Rate Arrangement: The currency of Paraguay is the Paraguayan *guaraní*. The exchange rate regime is a managed float. 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 July 31, 2006, the average interbank rate for the U.S. dollar was ₲5,485 =US$1.

VIII. Article IV Consultation: The Executive Board concluded the 2004 Article IV consultation on July 30, 2004; the document is IMF Country Report No. 05/59.

IX. Technical Assistance:

Department	**Purpose**	**Date of Delivery**
MAE	Policy Advisory to the Central Bank	March 1994–2004
FAD	Tax Policy	February 1999
FAD	Tax Administration	March 1999
STA	Monetary Statistics	February 2000
STA	Balance of Payments Statistics	June 2000
STA	Multisector, GDDS accession	February 2001
MAE	Currency Operations	March through September 2002
FAD	Customs Administration	May 2002
MAE	Financial Sector Surveillance	July 2002
FAD	ROSC	August 2002
STA	Multisector, follow-up	September 2002
MAE	Banking Supervision	September through November 2002
MAE	Central Bank Operations	November 2002
TRE	Safeguards Assessment	January 2003
MFD	Banking Supervision	January 2003 through April 2004
MFD	Currency Handling and Reform	February 2002 through April 2004
MFD	Payment System	July 2003
FAD	Customs and Tax Administration	December 2003
MFD	Reorganization of the Central Bank and Monetary Operations	January 2004
FAD	Customs Administration Advisor	July 2004 to May 2005

Department	Purpose	Date of Delivery
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 25–February 8, 2006
MFD	Central Bank Recapitalization	March 7–16, 2006
MFD	Peripatetic Banking Expert	October 2005, February and August 2006.
FAD	Public Financial Management	March 13–24, 2006
FIN	Safeguards Assessment	March 20–28, 2006
STA	Consumer Price Index	April 24–May 5, 2006
FAD and LEG	Tax Procedure Code	May 16–26, 2006

X. Safeguards Assessment: Under the Fund's safeguards assessment policy, Central Bank of Paraguay (CBP) is subject to a full safeguard assessment in respect to the arrangement approved on May 31, 2006. A safeguards assessment mission visited the CBP during March 20–28, 2006 to conduct that assessment. The mission found that while the CBP 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. Luis H. Duran-Downing has been appointed as senior resident representative since May 2005.

APPENDIX 2. PARAGUAY—WORLD BANK RELATIONS[1]
(As of July 31, 2006)

The Country Assistance Strategy (CAS) was approved on December 16, 2003, aiming at restoring confidence in the economy and to support reforms in areas, such as the financial sector, rural development, health, and education.

At the moment the portfolio of the Bank consists of 7 operations, of which three are projects under implementation:

- Fourth Rural Water Supply ($40m, approved in FY98);
- Pilot Community Development ($9m, approved in FY00); and
- Secondary Education Reform ($24m, approved in FY02).

And four projects await Parliament approval:

- Financial Sector Adjustment Loan ($15m, approved in FY05);
- Mother and Child Basic Health Insurance Project ($22m, approved in FY06);
- Modernization of the Ministry of Finance ($7.5m, approved in FY05); and
- the Road Maintenance Project ($74m, approved on August 24, 2006)

The seven World Bank-financed projects presently under implementation have a total value of US$192 million in commitments, of which US$ 146 million remain undisbursed as of July 31, 2006.

In addition to loans, the Bank has mobilized grants for the institutional strengthening of Congress ($0.4m) and the Ministry of Finance ($0.3m); to improve management of indigenous lands ($1.7m); to support social development ($0.9m); and to improve biodiversity and forestry ($0.3m from the Institutional Development Fund, and $0.3m and $0.9m from the Global Environment Fund).

On the analytical, in Y05 the Bank completed a Public Expenditure Review (PER), an Institutional and Governance Review, and sector work on Health Strategy. A study on Land Taxes is underway.

Projects under preparation include a Sustainable Rural Investment project, a Modernization of the Water Sector project, a Private Sector Development project, and a Forestry Project.

---

[1] Prepared by the staff of the World Bank.

FINANCIAL RELATIONS WITH THE WORLD BANK
(In millions of U.S. dollars)

I. IBRD/IDA Operations (as of July 31, 2006)

	Committed (Net of Cancellations)	Disbursed	Undisbursed
Active loans			
Fourth Rural Water Supply	40.0	34.8	5.2
Community development	9.0	4.4	4.6
Education Reform	24.0	6.3	17.7
Modernization of the Ministry of Finance*	7.5	0.0	7.5
Financial Sector Adjustment Loan*	15.0	0.0	15.0
Mother and Child Basic Health Insurance*	22.0	0.0	22.0
Road Maintenance	74.0	0.0	74.0
Total active loans	**191.5**	**45.6**	**146.0**
Total inactive loans		781.9	0.0
Total IBRD/IDA		**827.5**	
Repaid		**585.1**	
Total outstanding		**242.4**	
O/w IBRD (including exchange rate adjustment)		222.5	
O/w IDA		19.9	

II. IFC Operations (as of July 31, 2006)

	Loans	Equity	Total
Commitments	15.0	0.0	15.0
Repayments and cancellations	0.0	0.0	0.0
Held by IFC	5.0	0.0	5.0
Undisbursed	10.0	0.0	10.0

III. IBRD/IDA Loan Transactions (calendar year)[1]

	1997	1998	1999	2000	2001	2002	2003	2004	2005
Disbursements	41.2	37.7	42.1	46.6	26.8	13.5	42.3	16.2	16.7
Repayments	27.5	24.6	24.6	20.2	15.3	16.8	21.0	34.8	26.6
Net lending	13.8	13.1	17.5	26.4	11.5	-3.3	21.3	-18.6	-9.9

[1] As of December 31, 2005

* Not yet effective.

Appendix 3. Paraguay—Inter-American Development Bank Relations [1]

(As of August 11, 2006)

Portfolio

1. As of August 11, 2006, the active loan portfolio amounts to US$497.4 million, with an undisbursed balance of US$242.6 million. In addition, there are 55 active Technical Cooperation operations for US$21.6 million, of which US$11.5 million are undisbursed.

Strategy

- The IDB's Country Strategy with Paraguay is presently being reviewed. The main focus of IDB's actions for 2006–2008 includes support to economic growth, investment in human capital and poverty alleviation.

Pipeline

2. The lending program for 2006-A includes the following operations:

   a. Strengthening of the Judiciary System II, US$6.3 million (approved).

   b. Strengthening of Civil Service, US$4.2 million.

   c. Electric Power Transmission and Distribution Program, US$80 million.

   d. Integration Corridor and Road Rehabilitation Program, Phase I, US$134.1 million.

   e. Institutional Strengthening of the National Institute of Cooperatives (INCOOP), US$4.4 million.

   f. Modernization of the Agriculture Public Sector Management, US$31.5 million.

[1] Prepared by the staff of the IDB.

Appendix 4. Paraguay—Statistical Issues
(As of August 14, 2006)

Paraguay became a GDDS participant in September 2001 with the publication of its metadata on the Fund's Dissemination Standards Bulletin Board (DSBB). A ROSC data mission visited Paraguay in January–February 2006; the authorities' response to the report and the mission's recommendations are being finalized prior to publication.

A. Real Sector

A new national accounts series—broadly consistent with the guidelines of the *1993 SNA*—has been prepared with the assistance of an expert financed by the IDB, and released in 2005. It comprises a more complete coverage of industries, an input-output matrix, and expanded data sources for the compilation of the new benchmark and base year (1994). However, no comprehensive regular data collection program of 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 is becoming obsolete; (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 until1997. The periodicity of annual GDP meets GDDS recommendations, but not timeliness; because the data are disseminated with 11-months lag.

Both the consumer (CPI) and producer price indices (PPI) are reported on a regular and timely basis. 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 CPI has a base weight period of 1992, and the PPI of December 1995. The household budget survey 2005–06, for which information is now being gathered, will be used as the basis for updating the CPI basket and weights and for developing the index methodologically in keeping with the classification and valuation systems established in *1993 SNA*. The PPI basket (150 items) is still not fully representative of current national output; electricity, water, gas, and services are not covered by the PPI.

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 ROSC data mission found that the resources are insufficient for real sector statistics and constrain their further development, particularly the full adoption of the *1993 SNA.*

B. Fiscal Sector

Paraguay's GFS are broadly consistent with the recommendations of *A Manual on Government Finance Statistics 1986* (*GFSM 1986*), but 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). Data on the operations of the local governments are not included in the GFS. The asset position of the social security system is available on a daily basis. Contrary to recommendations in the GFS manuals, (i) statistics on the consolidated central government and general government are not prepared; (ii) statistics on the central administration include data of the Postal Service Directorate, a nonfinancial public corporation; and (iii) statistics on the nonfinancial public sector definition includes 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. Internal debt data are available on request, but need to be more fully integrated with the external debt database. Deficiencies remain in the registration of 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 only budgetary central government through 2004 have been reported for publication in the *2005 edition of the GFS Yearbook*. However, since 1994 no outstanding debt data and no breakdowns for expenditure by function data have been provided for publication in the *GFS Yearbook*. Monthly and quarterly data are not reported for publication in *IFS*. The resumption of reporting quarterly and monthly data for the *IFS* is highly recommended.

C. Money and Banking Sectors

Money and banking statistics are broadly reliable because of the adoption in 1995 of a new accounting plan for commercial banks and finance companies. Following the work on methodologies initiated in the 2000 STA mission, 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 of the CBP, 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 25 percent of deposits and loans of the banking sector. There are plans for a technical assistant mission in fiscal year 2007 aiming at including the credit cooperatives in the other depository corporation's survey.

The superintendency of banks publishes a detailed and informative report on the soundness of the financial system.

D. External Sector

Quarterly and annual data on balance of payments and the international investment position (IIP) are available from 2001 onwards on the central bank website, and reported to STA. Annual IIP data have been compiled and disseminated for the period 1995–2004. The classification of the balance of payments and of the IIP follows the recommendations of the *Balance of Payments Manual*, 5th edition. 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 in the balance of payments and in the IIP. The central bank now produces a highly informative bulletin with balance of payments statistics. Special studies by the central bank have improved the estimation methods for remittances of Paraguayans abroad and unregistered trade transactions, but serious deficiencies remain.

Deficiencies remain in the area of private capital outflows, which are difficult to register due to Paraguay's open capital account. Major recommendations of the 2006 data ROSC mission include the need to: (i) design and conduct sample surveys to capture data for items currently excluded from balance of payments statistics or items not appropriately covered (e.g., some services, direct and portfolio investment abroad, real estate); (ii) review and update the statistical techniques to estimate unrecorded trade; (iii) prepare periodical reports to inform management of the CBP of the quality of survey's data (response, coverage, response errors); and (iv) initiate a process of quarterly reconciliation of flows and stocks of medium- and long-term external public debt with the MOF.

Paraguay—Table of Common Indicators Required for Surveillance

(As of August 14, 2006)

	Date of latest observation	Date received	Frequency of Data[1]	Frequency of Reporting[1]	Frequency of publication[1]
Exchange Rates	8/11/06	8/14/06	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[2]	8/11/06	8/14/06	D	D	D
Reserve/Base Money	8/11/06	8/14/06	D	D	D
Broad Money	6/30/06	7/24/06	M	M	M
Central Bank Balance Sheet	8/11/06	8/14/06	D	D	D
Consolidated Balance Sheet of the Banking System	6/30/06	7/24/06	M	M	M
Interest Rates[3]	6/30/06	8/08/06	M	M	M
Consumer Price Index	Jul. 2006	8/02/05	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[4] – General Government[5]	Jun. 2006	7/24/06	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[4] – Central Government	Jun. 2006	7/24/06	M	M	M
Stocks of Central Government and Central Government-Guaranteed Debt[6]	Jun. 2006	7/24/06	Q	Q	Q
External Current Account Balance	June. 2006 prov.	3/3/06	Q	Q	Q
Exports and Imports of Goods and Services	June 2006 prov.	3/3/06	M	M	M
GDP/GNP	2005	3/15/06	A	A	A
Gross External Debt	Dec. 2005 prov.	3/03/06	Q	Q	Q

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

[2] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.

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

[4] Foreign, domestic bank, and domestic nonbank financing.

[5] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.

[6] Including currency and maturity composition.

APPENDIX 5. PARAGUAY—WORK PROGRAM

Mission	Dates
First SBA Review	
Mission	Jul 19–Aug 1, 2006
Board Meeting	September 29, 2006
Second SBA Review and 2006 Article IV Consultation	
Mission	Nov 29–Dec 12, 2006
Board Meeting	January 29, 2007
Third SBA Review	
Mission	Feb 14–28, 2007
Board Meeting	March 30, 2007
Memorandum items:	
Approval of SBA	May 31, 2006

ATTACHMENT I

Asunción, Paraguay
September 12, 2006

Mr. Rodrigo de Rato
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Mr. de Rato:

1. This letter updates our letter of May 8, 2006, which articulates the policies of our multi-year program supported by a Stand-By Arrangement (SBA) approved by the Fund's Board on May 31, 2006, and at the same time reiterates our commitment to the program.

2. The program went off to a good start. Macroeconomic conditions have improved in the last few months and the program remains on track. All quantitative PCs and the structural benchmark for end-June 2006 were observed.

3. Economic growth remained buoyant and inflationary pressures significantly eased in the second quarter of 2006. Despite a repeated drought and rising international oil prices, our external position continued strengthening; international reserves stood at record highs and the *guaraní* gained ground against major international currencies. Fiscal policy continued to be implemented according to strict adherence to the program. Diesel subsidies were cut in almost one half in June when domestic diesel prices were raised. Short-term rates on monetary instruments (LRMs) almost doubled earlier this year to address inflationary pressures. The structural reform agenda continues to be implemented as scheduled.[1]

4. However, we experienced an unexpected setback when the commitment fee on the SBA due to the Fund—a relatively small sum of no macroeconomic significance—could not be discharged on time owing to unforeseen legal difficulties to making this payment (under the new budgetary procedures for the Central Bank). Mindful of the importance to remain current in our obligations to the Fund, we finally made the payment within our legal framework.

[1] While PETROPAR's financial position has strengthened as a result of domestic price adjustments, higher world prices will make it difficult for PETROPAR to eliminate their overdue obligation to oil suppliers by end-2006 as previously anticipated. We now expect PETROPAR overdue obligations to be cleared by September 2007.

5. Against this background, we would like to: (i) reaffirm our commitment to the policies described in our letter and memorandum of economic and financial policies of May 2006; and (ii) request completion of the first review under the SBA. Our Government will continue its close and fruitful dialogue with the Fund and stands ready to adopt all measures necessary to achieve the objectives of the program. We have authorized the Fund to publish this letter, to facilitate a wider access and review of our policies within Paraguay and among the international community.

Sincerely yours,

_________/s/_________	_______/s/________
Mónica Pérez dos Santos	Ernst Bergen
President	Minister of Finance
Central Bank of Paraguay	

INTERNATIONAL MONETARY FUND

PARAGUAY

First Review Under the Stand-By Arrangement

Prepared by the Western Hemisphere Department
(In consultation with other departments)

Approved by José Fajgenbaum and Matthew Fisher

September 29, 2006

At the time of issuing the staff report for the first review, the staff expected the Safeguards Assessment for Paraguay to be concluded by September 29, the date for completing the review on a lapse of time basis, in accordance with the safeguards policy. A delay in the Central Bank response to the Safeguard Assessment report and its recommendations means that the assessment is not yet completed. However, given the relatively limited scope of the recommendations of the safeguards assessment report, the staff does not believe that this delay warrants holding up the completion of this review. The staff expects an early response by the authorities will allow completion of the assessment soon, and recommends that the next review under the stand-by follow up on the status of implementation of the staff's recommendations.

INTERNATIONAL MONETARY FUND
EXTERNAL RELATIONS DEPARTMENT

Press Release No. 06/208
FOR IMMEDIATE RELEASE
September 29, 2006

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Completes First Review of Paraguay's Stand-By Arrangement

The Executive Board of the International Monetary Fund completed today the first review of Paraguay's economic performance under a 27-month, SDR 65 million (about US$97 million) Stand-By Arrangement, initially approved on May 31, 2006 (see Press Release No. 06/117).

Completion of this review, which was undertaken on a lapse of time basis[1], makes an amount of SDR 31 million (about US$46 million) immediately available. The authorities continue to treat the arrangement as precautionary.

[1] The Executive Board takes decisions under its lapse of time procedure when it is agreed by the Board that a proposal can be considered without convening formal discussions.