INTERNATIONAL MONETARY FUND

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PARAGUAY

April 2019

2019 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR PARAGUAY

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2019 Article IV consultation with Paraguay, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its February 24, 2019 consideration of the staff report that concluded the Article IV consultation with Paraguay.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on February 24, 2019, following discussions that ended on February 20–March 6, 2019, 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 March 29, 2019.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for Paraguay.

The document listed below will be separately released:

- **Selected Issues**

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May 1, 2019

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IMF Executive Board Concludes Article IV Consultation with Paraguay

On April 24, 2019, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Paraguay.

Growth in 2018 was 3.7 percent, which is near potential and in line with the recent past, despite negative spillovers from the region. Growth was driven by strong private investment and household consumption. Exports were affected by the economic crisis in Argentina and the strong depreciation of Paraguay's neighbors' currencies. The current account deteriorated but remained in surplus.

Average inflation in 2018 was 3.6 percent—near the mid-point of the central bank's target range. Inflation fell during the year, from 4.7 percent in January to 3.2 in December, the result of declining food prices and the appreciation of the guaraní vis-à-vis neighboring countries.

Monetary policy rates were on hold in 2018. However, monetary conditions tightened as the real exchange rate appreciated and *real* interest rates rose. In February and March of 2019, the BCP cut the policy rate twice, from 5¼ to 4¾ percent, citing uncertainty about the external environment and incipient weakening of domestic demand. The fiscal deficit in 2018 amounted to 1.3 percent of GDP, slightly higher than in 2017 but below the ceiling under the Fiscal Responsibility Law.

Growth in 2019 is projected at 3.5 percent. Risks to the outlook are tilted to the downside. External risks include weaker-than-expected growth in Argentina and Brazil, and adverse price movements in the agricultural commodity markets. Domestic risks include weather-related shocks and delays in the execution of public investment.

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

Over the medium-term, the key challenge is to sustain the rapid growth of real incomes during the past 15 years. Over the past decade, Paraguay has been one of the fastest growing economies in South America, averaging above 4.5 percent real growth per year, but the factors that have propelled this growth—including a boom in agricultural commodity prices—are likely to provide less support going forward.

The consultation focused on the policies needed to promote long-term growth, widen the tax base, improve public spending efficiency, and strengthen financial sector supervision.

Executive Board Assessment[2]

Directors commended the Paraguayan authorities for their prudent macroeconomic policies which have contributed to rapid growth and sharp reduction in poverty. Directors considered that policy priorities ahead should focus on consolidating macroeconomic gains, reducing dependence on the agriculture sector by diversifying the economy, and enhancing productivity to attain sustainable and strong growth as well as further reduce poverty.

Directors commended the authorities' prudent fiscal policies which have reduced the public debt. However, they noted that with the deficit close to the ceiling under the Fiscal Responsibility Law it is important to take action to create further fiscal space for priority reforms and investment. Directors recommended increasing revenues, particularly by reducing exemptions and deductions, and improving tax compliance. They also encouraged the authorities to reprioritize expenditure within the existing envelope, away from current spending and toward investment in infrastructure, capital, and social spending, including in health and education.

Directors considered that the current accommodative monetary policy stance is appropriate and consistent with inflation objectives. They noted that exchange rate flexibility should continue to be a key shock absorber and that interventions should be limited to mitigate disorderly market conditions.

Directors welcomed that the banking system is well-capitalized and profitable. They encouraged continued strengthening of supervision of financial cooperatives and adopting supervision standards for the *casas de credito* and *casas comerciales*. Directors commended the progress made towards implementing the 2017 Financial Sector Stability Review recommendations and encouraged steps to further strengthen the institutional framework for interagency coordination. They underscored that further strengthening the AML/CFT framework would support financial stability.

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

Directors encouraged the authorities to reform the pension system to ensure its long-term sustainability, seizing the opportunity that demographic trends are still favorable. They noted that resuming the effort to establish a pension fund supervisor would be an important step in this regard.

Directors noted that economic diversification and productivity growth are needed to maintain rapid growth. They considered that priority should be given to tackling corruption and strengthening the rule of law, enhancing the business climate, as well as improving transport infrastructure and quality of education.

Paraguay: Selected Economic and Social Indicators

I. Social and Demographic Indicators

Population 2017 (millions)	6.9	Gini index (2016)	48.2
Unemployment rate (2017)	5.2	Life expectancy at birth (2016)	73.1
Percentage of population below the poverty line (2017)	26.4	Adult literacy rate (2015)	95.1
Rank in UNDP development index (2018)	110 of 186	GDP per capita (US$, 2017)	5,667

II. Economic Indicators

	2013	2014	2015	2016	2017	Est. 2018	Proj. 2019	Proj. 2020
	(Annual percent change, unless otherwise indicated)							
Income and prices								
Real GDP	8.4	4.9	3.1	4.3	5.0	3.7	3.5	4.0
Nominal GDP	13.2	7.8	4.7	8.6	7.2	8.8	6.8	8.7
Per capita GDP (U.S. dollars, thousands)	5.9	6.0	5.4	5.3	5.7	5.9	5.9	6.3
Consumption (contribution to real GDP growth)	3.1	4.6	3.2	1.9	3.4	3.8	2.8	1.6
Investment (contribution to real GDP growth)	2.2	2.1	-1.8	-0.2	2.7	2.0	1.9	1.8
Net Exports (contribution to real growth)	3.1	-1.9	1.7	2.6	-1.2	-2.1	-1.3	0.6
Consumer prices (end of period)	3.8	4.2	3.1	3.9	4.5	3.2	4.0	4.0
Nominal exchange rate (Guarani per U.S. dollar, eop)	4,524	4,626	5,807	5,767	5,590	5,961	…	…
Monetary sector								
Credit to private sector 1/	20.9	19.1	8.6	4.5	5.6	10.6	8.0	7.0
Monetary policy rate, year-end	6.0	6.8	5.8	5.5	5.3	5.3	…	…
External sector								
Exports (fob, values)	16.7	-3.7	-15.3	7.9	11.9	3.0	-0.4	8.2
Imports (cif, values)	7.8	1.1	-14.6	-5.1	17.7	12.1	3.2	4.1
Terms of trade	5.1	3.8	-5.4	2.3	-0.3	-1.7	0.3	1.9
Real effective exchange rate 2/	5.2	2.4	-2.6	-3.9	-0.5	3.2	…	…
	(In percent of GDP, unless otherwise indicated)							
External current account	**1.6**	**-0.1**	**-0.4**	**3.5**	**3.1**	**0.5**	**-0.8**	**0.4**
Trade balance	3.7	2.0	1.5	5.5	4.1	1.4	0.2	1.4
Exports	35.3	32.5	30.7	33.2	34.4	33.2	32.5	32.8
Of which: Electricity	5.8	5.3	5.6	5.9	5.4	5.1	5.1	4.9
Imports	-31.0	-30.0	-28.5	-27.2	-29.5	-31.0	-31.5	-30.6
Of which: Oil imports	-4.1	-4.2	-3.4	-2.7	-3.0	-3.9	-3.4	-3.3
Capital account and financial account	**0.7**	**4.2**	**-1.7**	**0.0**	**1.0**	**1.7**	**2.3**	**1.1**
Of which: Direct investment	0.6	1.0	0.9	1.0	1.2	0.9	1.0	1.0
Gross international reserves (in millions of U.S. dollars)	**5,871**	**6,891**	**6,200**	**7,144**	**8,146**	**8,004**	**8,404**	**8,809**
In months of next-year imports of goods and services	5.4	6.3	6.5	7.9	7.7	6.8	6.9	6.9
Ratio to short-term external debt	1.9	2.2	1.9	2.3	2.6	2.4	2.5	2.6
Gross domestic investment	**22.3**	**22.5**	**20.8**	**19.7**	**21.2**	**22.1**	**23.3**	**23.9**
Gross domestic saving	**23.9**	**22.4**	**20.4**	**23.3**	**24.3**	**22.6**	**22.5**	**24.3**
Central government revenues	**12.9**	**13.7**	**14.1**	**13.9**	**14.2**	**13.6**	**13.8**	**13.6**
Of which: Tax revenues	8.9	9.7	9.6	9.5	9.9	9.7	9.7	9.9
Central government expenditures	**14.1**	**14.6**	**15.5**	**15.0**	**15.3**	**14.9**	**15.2**	**15.1**
Of which: Compensation of Employees	6.9	6.7	7.0	6.5	6.3	6.4	6.4	6.3
Of which: Net Acquisition of Non Financial Assets	1.8	1.8	2.0	2.2	2.4	2.0	2.3	2.3
Central government net lending/borrowing	**-1.3**	**-0.9**	**-1.3**	**-1.1**	**-1.1**	**-1.3**	**-1.4**	**-1.5**
Central government primary balance	-1.0	-0.6	-0.9	-0.5	-0.5	-0.6	-0.6	-0.7
Public sector debt (excl. central bank bills)	**13.2**	**15.6**	**18.6**	**19.4**	**19.8**	**21.6**	**22.4**	**22.3**
Of which: Foreign currency	9.2	11.2	14.1	15.4	15.8	17.5	18.8	18.4
Of which: Domestic currency	4.1	4.4	4.5	4.1	4.0	4.1	3.5	3.9
Memorandum items:								
GDP (billions of Guaranies) 3/	166,715	179,722	188,231	204,447	219,188	238,480	254,654	276,794

GDP (US$ billions)	38.5	40.0	36.3	36.3	39.4	41.6	…	…

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

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

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

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

INTERNATIONAL MONETARY FUND

PARAGUAY

STAFF REPORT FOR THE 2019 ARTICLE IV CONSULTATION

March 29, 2019

KEY ISSUES

Paraguay has grown rapidly in the past decade and a half, the result of a bounce-back from a crisis in the late 1990s, good macro-policies, and a boom in agricultural commodity prices, which spilled over to the non-tradable sector. Poverty has fallen sharply, from 58 percent in 2002 to 26 percent currently, although it remains one of the highest in Latin America.

GDP grew by around 3¾ percent in 2018, despite spill-overs of the Argentine crisis, which resulted in a sharp appreciation of the guaraní vis-à-vis the peso and the real. GDP growth in 2019 is projected to be around 3½ percent as a drought early in the planting season is affecting the soybean harvest. Inflation is within the central bank target range.

The key question going forward is how to sustain rapid growth of real incomes, as the factors that propelled growth in the last decade are likely to provide less support going forward. Agricultural prices are already off highs and may come under further pressure as China's demand growth slows down. And agricultural land cannot continue to expand rapidly. Future growth will increasingly need to come from the non-energy/non-agricultural export sector, which is growing fast, but still small.

Continued convergence would help reduce poverty further and help generate revenues to finance large spending needs. In the near term, sound macro policies would help avoid the boom-busts that other countries in the region have suffered. Over the longer term, to facilitate diversification and productivity growth, and to boost convergence with advanced countries, business climate and governance indicators need to improve. Policies that focus on improving transport infrastructure, rule of law, and the quality of education would be particularly helpful.

Some of the reforms will require fiscal resources. With expenditure already at low levels, fiscal revenue needs to increase, including through tax reforms that widen the tax base.

The banking sector is well-capitalized and stable, but the *casas de credito* and *casas comerciales* need to be better understood and supervised. The pension system needs reform, both to prevent large pension deficits in the future, and to boost the development of the domestic capital market for long-term instruments.

Approved By
Patricia Alonso-Gamo (WHD) and Vikram Haksar (SPR)

Discussions took place in Asuncion during February 20–March 6, 2019. The staff team comprised of Bas Bakker (head), Tobias Roy, Natasha Che, Alex Ho, and Manuk Ghazanchyan (all WHD), with research assistance from Vibha Nanda and Jaime Monroy, and editorial support from Patricia Delgado. Jorge Corvalan (OED) attended the policy meetings. The team met with Central Bank of Paraguay (BCP) President José Cantero, Minister of Finance Benigno López, Minister of Public Health Julio Mazzoleni, Minister of Industry and Commerce Liz Cramer, and other senior officials, and representatives from the private sector, think tanks, and the donor community.

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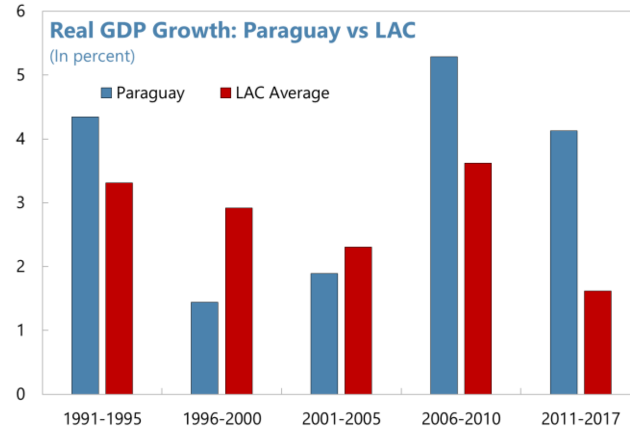
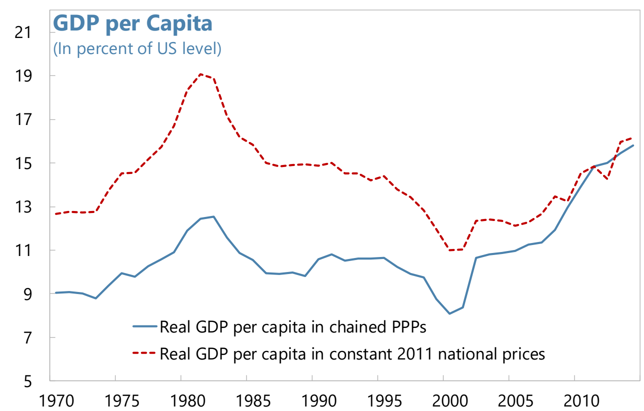
CONTEXT

1. **Paraguay has been one of the fastest growing economies in South America over the past decade.** Real GDP grew by over 4.5 percent annually, well above the 1¾ average for Latin America. This led to a sharp increase of real GDP per capita (although the level remains relatively low) and a big drop in poverty.



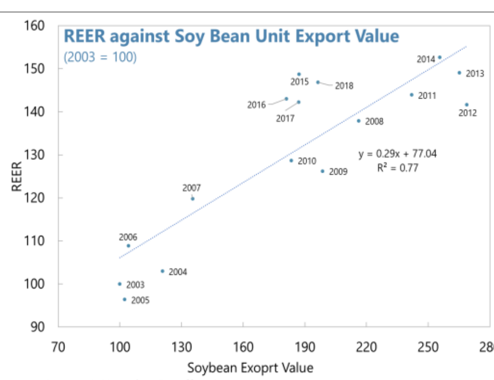
Sources: Penn World Tables, WEO and IMF staff calculations.

2. **Rapid growth was partly due to a bounce-back from the crisis in the late 1990s and good macro-policies.** The crisis had not only led to a fall in real GDP (it took until 2003 before the 1997 level was regained), but also to a very sharp drop of the real exchange rate, which further depressed real incomes in PPP terms. Between 2003 and 2008, in the context of several IMF programs, there was an improvement of macro-economic policies and an opening of the economy. Inflation and exchange rate volatility came down as the central bank shifted to inflation targeting, while prudent fiscal policy reduced government debt from 52 percent in 2002 to around 20 percent currently. Fiscal policy remained conservative during the commodity price boom. As a result, Paraguay did not go through the boom-bust that its neighboring countries experienced.

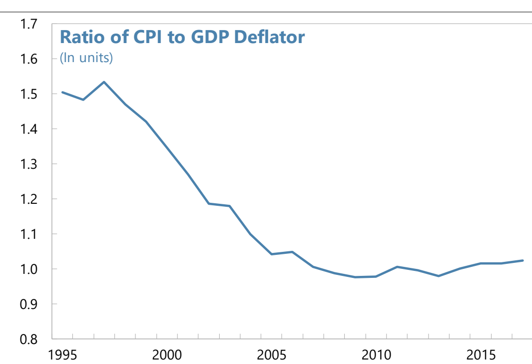


Sources: WEO, BCP and IMF staff calculations.

3. **The global agricultural commodity price boom, which led to a sharp expansion of agricultural exports, also played in important role**. In dollar terms, agricultural exports are now 5 times what they were in 2003. The increase in export prices triggered a sharp expansion of production. Sowing areas for the main crops are two and half times those of 15 years ago.

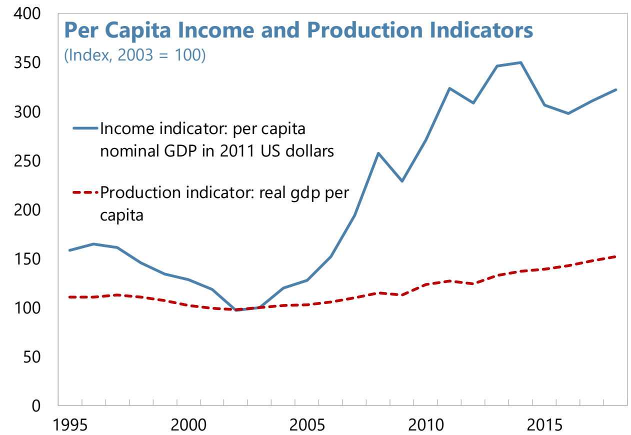


Source: BCP and IMF staff estimates.



Sources: Haver and IMF staff calculations.

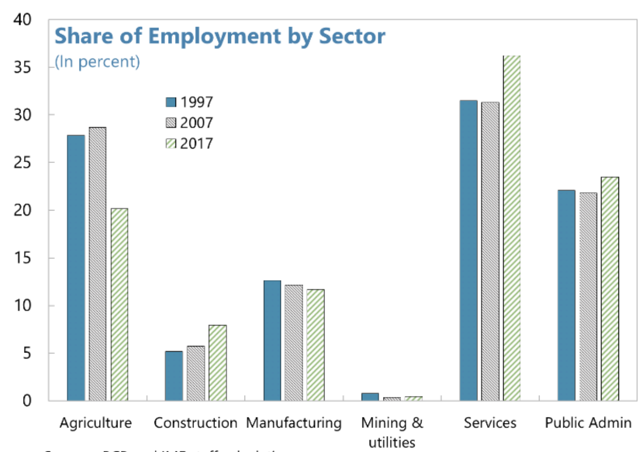
4. The commodity price boom spilled over to the non-tradable sector. The surge in commodity prices led to a sharp appreciation of the real exchange rate—the ratio of the actual exchange rate to the PPP-conversion exchange rate doubled. As a result, real incomes (deflated by the CPI) increased much faster than production (deflated by the GDP deflator). Incomes in constant dollars more than tripled—far outpacing the 50 percent increase in real GDP per capita. The rapid growth in incomes led to a surge in domestic demand and a credit boom (the private sector credit to GDP increased from 13 percent in 2003 to 40 percent in 2017). The share of construction in GDP almost doubled, to 6 percent GDP, while the share of trade and services increased from 41 to 48 percent of GDP.



Sources: WEO and IMF staff calculations.

5. In some respects, the economy looks very different from 15 years ago.

- The structure of the economy has changed. The share of electricity and water in GDP has declined by two thirds, to 8 percent. The share of services is now almost 50 percent. A budding maquila sector is growing rapidly—although the share is still small. The share of labor in agriculture has declined from 28 percent in 2007 to the current 20 percent as agriculture is increasingly mechanized.



Sources: BCP and IMF staff calculations.

- Exports destinations have diversified. This partly reflects the decline in the share of electricity in exports—from 40 to 15 percent. It also reflects the internationalization of the country's agriculture sector. Paraguay now produces for world markets—not just for its neighbors.

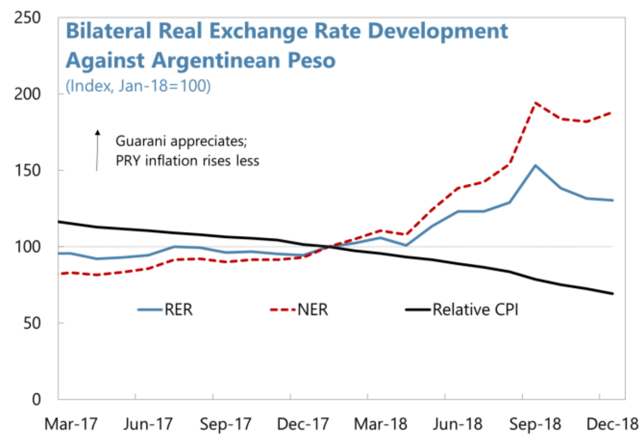
- External vulnerabilities have declined. External debt has declined from 193 percent of GDP in 2003 to 40 percent at end-2017. Excluding the debt of the binationals (which will be served automatically as electricity is produced), debt is only 21 percent of GDP at end-2017. At the same time, reserves have increased.

6. The key question going forward is whether rapid growth of real incomes can be sustained in order to continue improving living standards. Paraguay's economy is still heavily dependent on the agriculture sector. But agricultural prices are already off highs and may come under further pressure as China's demand growth slows down. Moreover, agricultural land cannot continue to expand rapidly. Future growth will increasingly need to come from the non-energy /

non-agricultural export sector, which is growing rapidly, but still small. With unemployment already at low levels, future growth will also need to come from productivity growth. TFP growth has rebounded, but its levels are still below previous peaks.

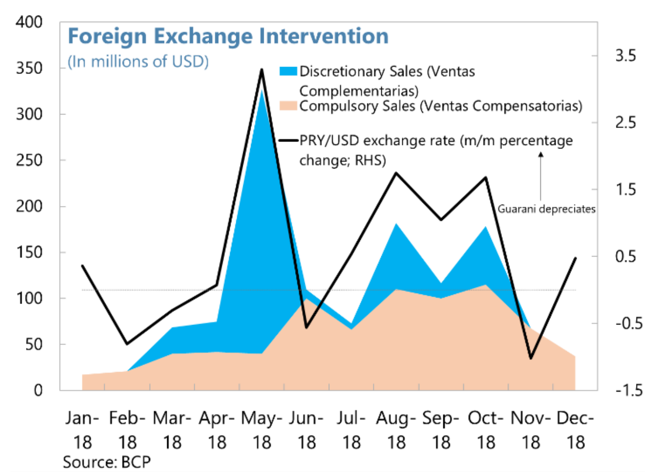
RECENT DEVELOPMENTS

7. In 2018, the crisis in Argentina led to a sharp appreciation of the guaraní vis-à-vis its neighbors and a depreciation vis-à-vis the dollar. The crisis led to an increase in risk aversion vis-à-vis the region, which contributed to a depreciation of the guaraní vis-à-vis the dollar. However, the depreciation was much less than the depreciation in its neighbors; the result was a sharp appreciation of the guaraní vis-à-vis the peso (by 65 percent, y/y) and the real (by 10 percent, y/y).[1] While this was partially offset by the depreciation vis-à-vis the dollar, in real effective terms, the guaraní appreciated by 4 percent (y/y).



Source: IMF International Finance Statistics and staff calculations.

8. The central bank stepped in to provide foreign exchange liquidity to the market. It was concerned that a shift towards dollars by multi-nationals in Paraguay (with headquarters in neighboring countries) in reaction to developments in Argentina could lead to large and unwarranted exchange rate movements in a foreign exchange market that is small and illiquid.[2] Between March and October, the central bank sold US$517 million reserves for intervention purpose (so called *Ventas Complementarias)*; thereafter intervention stopped.[3]



Source: BCP

[1] Measured as the difference in natural log.

[2] Daily purchases and sales average around US$50 million only

[3] The central bank also sells foreign currency received from the Ministry of Finance (the proceeds of bond issuances abroad, and from the binationals) through *Ventas compensatorias.* For the year as a whole, these sales are usually matched by foreign exchange receipts. Overall, net foreign reserves fell from US$8.1 billion in 2017 to US$8 billion in 2018, about 187 percent of the level of reserve considered adequate under the assessing reserve adequacy metric.

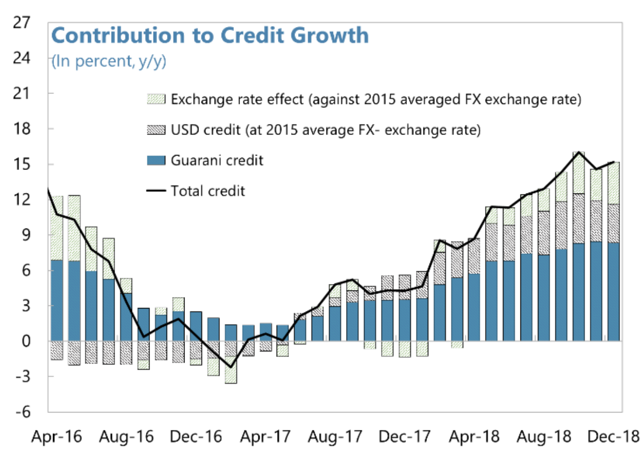
9. The sharp appreciation of the guaraní vis-à-vis Argentina and Brazil affected border trade and tourism. The softening of agricultural export prices in the middle of the year also weighed on export growth. Imports were boosted by strong domestic demand growth and the real appreciation. As a result, there was a sizeable deterioration of the trade balance and the current account.

10. However, the impact on the economy was less than what would be expected by the large share of both countries in Paraguay's exports. About half of exports to both countries consists of hydro-energy exports (which do not depend on domestic demand as they are these countries' cheapest source of energy), while much of the rest consists of agricultural exports that are re-exported to global markets.

11. Growth in 2018, estimated at 3.7 percent, was near potential and in line with the recent past. In terms of demand, growth was driven by strong consumption, and on the supply side, by solid growth in manufacturing and services, as well as good performance of the agriculture sector in the first half of the year. Growth was uneven: a very strong first half was followed by a weaker second half, which not only reflected the slowdown in border trade, but also weather events that affected agriculture, and under-execution of public investment during the government transition.

12. Inflation in 2018 was around 4 percent—the middle of the central bank target. Inflation fell during the year, from 4.7 percent in January to 3.2 in December. Core inflation fell even sharper, from 5.7 to 2.5 percent. The decline in inflation was the result of declining food prices and the appreciation of the guaraní vis-à-vis neighboring countries.

13. Monetary policy rates were on hold in 2018. However, monetary conditions tightened as the real exchange rate appreciated, and real term interest rates increased as inflation fell.[4] In February and March of 2019, the BCP cut the policy rate twice, from 5¼ to 4¾ percent, citing uncertainty about the external environment and incipient weakening of domestic demand.



Source: BCP and IMF staff calculations.

14. Credit growth accelerated to 12 percent—from 6 percent in 2017 (constant exchange rate basis) and less than 1 percent in 2016. Credit growth had almost come to a halt in late 2016, reflecting the impact of the decline of soybean prices in 2015 that had led to a deterioration of banks' loan portfolios. The recovery of

[4] Real policy rates increased from 0.9 percent at end 2017 to 2.1 percent at end 2018.

credit growth was broad-based, although the agriculture related sector remained the largest contributor.[5]

15. Fiscal policy in 2018 was broadly neutral, and the fiscal responsibility law (FRL) was observed.[6] The fiscal deficit amounted to an estimated 1.3 percent of GDP, up from 1.1 percent in 2017. There was a decline in the revenue-to-GDP ratio due to lower nontax revenue and lackluster income tax collection, while an increase in current expenditure was partially offset by reduced capital expenditure.

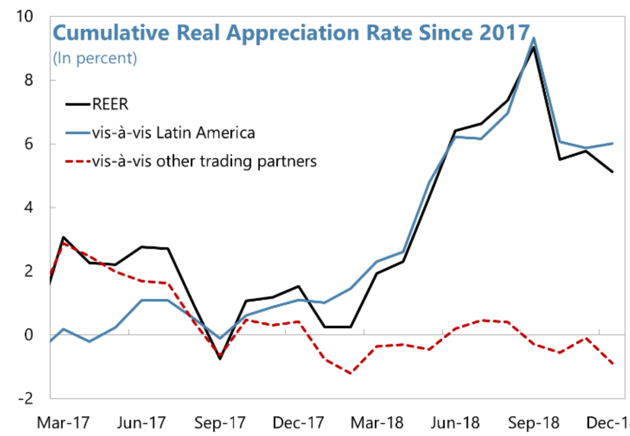
16. Parliamentary elections in April were won by the incumbent Colorado Party. The new government, which took office in August, aims to continue a cautious macro-economic policy, while also focusing on combatting corruption and achieving inclusive growth. Fitch has recently upgraded Paraguay's credit rating from BB to BB+, citing fiscal discipline and resilience to external shocks.

OUTLOOK

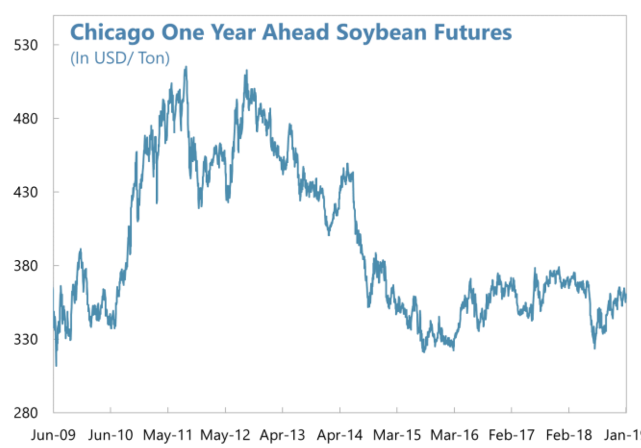
17. Staff projects growth of 3.5 percent in 2019. Growth is being affected by a drought early in the planting season, which will reduce the soybean harvest. This would be partially offset by a pickup of tourism and cross-border trade, which will benefit from the unwinding of the real exchange rate shock that occurred in 2018.

18. Over the medium term, real growth is projected at around 4 percent, close to potential growth, and about 2½ percent in per capita terms.

19. Risks to growth are tilted to the downside. External downside risks include economic instability in Argentina and weak growth in Brazil. Agricultural commodity prices are another risk factor. The strength of domestic demand is also uncertain and will depend on the recovery of public investment, now that the transition to a new government is completed.



Source: IMF International Finance Statistics and staff calculations.



Source: Bloomberg.

[5] See Selected Issues Paper for a review of the credit dynamics between 1990 and 2017.

[6] The Fiscal Responsibility Law (FRL) requires that the fiscal deficit shall not exceed 1.5 percent of GDP and that primary current expenditure should annually rise by no more than four percent in real terms. The 2018 fiscal deficit remained below 1.5 percent partly because GDP was revised up by about 30 percent.

Authorities' Views

20. At the time of the Article IV discussions, the authorities acknowledged that growth would likely be lower than the official forecast of 4.0 percent made in December.[7] They concurred that the lower soybean harvest would affect growth in 2019. However, they also thought that the continued dynamism of the industrial sector, together with a pickup in construction, might offset some of the drag from the primary sector. On the demand side, the authorities were to make a concerted effort to speed up public investment, and this should help pre-empt a further slowdown. The interest rate cut would contribute to the latter as well. Regarding risks to the outlook, they agreed that developments in neighboring countries and agricultural commodities prices were key.

21. The central bank reiterated its commitment to inflation targeting and a floating exchange rate. Central bank intervention served to prevent disorderly market conditions only; it did not aim at targeting an exchange rate level. The pressure on the dollar-guaraní exchange rate in 2018 had been the result of spillovers from Argentina[8]—it did not reflect economic fundamentals. If the central bank had not stepped in to provide foreign exchange liquidity, the result would have been high volatility in a small and illiquid foreign exchange market and a large and unwarranted depreciation. The central bank was not concerned about the impact of exchange rate changes on private sector credit—most of the loans were to the agricultural sector and to exporters, and their dollar revenues would not be affected by a depreciation.

POLICY ISSUES

Paraguay has made impressive progress over the past decade and a half, but challenges remain large. GDP has grown rapidly in the past decade and a half, but seen over a longer period, convergence has been slow. Poverty has fallen sharply, from 47 percent in 2002 to 20 percent currently,[9] but it remains one of the highest ratios in Latin America. Moreover, poverty rates have stagnated in recent years as dollar incomes are no longer rising.

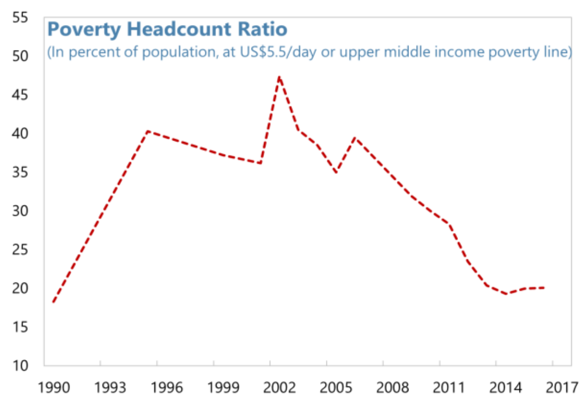
At the same time, spending needs, including for infrastructure, are large. Yet, with GDP per capita growing around 2½ percent only, revenues will grow slowly at current revenue ratios.

Continued convergence, but at a more rapid pace, would help reduce poverty further, and help generate revenues to finance large spending needs. Good policies would help achieve this. In the near term, sound macro policies would help avoid the boom-busts that other countries in the region have

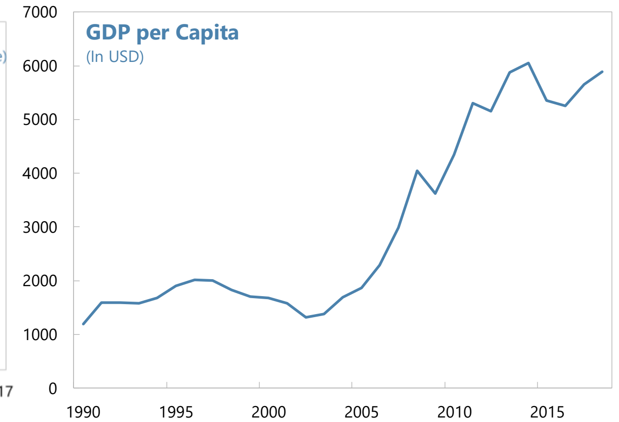
[7] In late March, they published a revised forecast of 3.5 percent, the same as the staff's forecast.

[8] For example, multi-national companies from neighboring countries were told by their headquarters to shift from guaranís to dollars.

[9] Using the World Bank's Upper Middle Income Poverty Line of US$5.50 PPP.



Sources: World Development Indicators

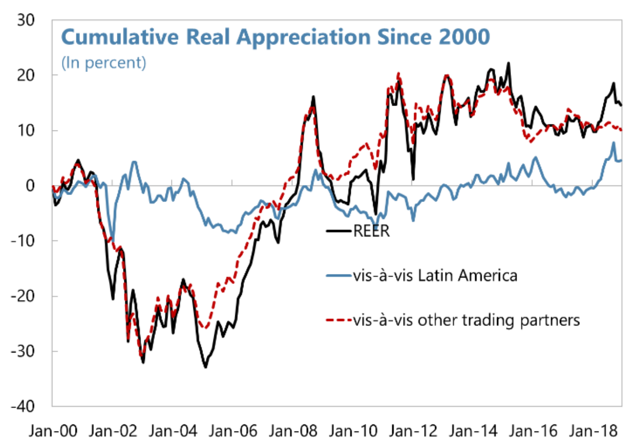


Sources: WEO.

suffered. Over the longer term, structural reforms would boost supply, including by raising TFP, the ey factor for sustained convergence.

A. Monetary and Exchange Rate Policy

22. The current monetary policy stance appears appropriate.[10] Monetary policy is expansionary, which should help mitigate the slowdown and reduce downside risks. Inflation, which fell in the last quarter of 2018, should recover to the middle of the central bank's target range by the end of this year, as last year's real exchange rate appreciation reverses. While unemployment has fallen to low levels, wage growth has remained modest. Overall, current monetary settings appear consistent with meeting the inflation objective. Beyond 2019, or if upside risks materialize, monetary policy may need to be gradually tightened.



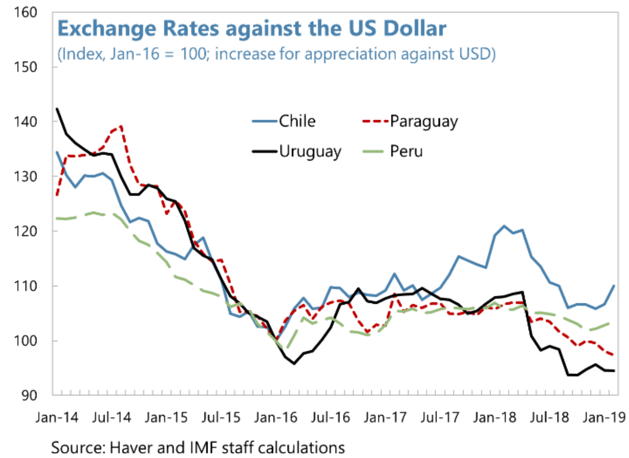
Source: IMF International Finance Statistics and staff estimates.

23. In the event that downside risks in neighboring economies were to materialize and result in pressure on the guaraní-dollar exchange rate, policy action could be called for. The impact of any exchange rate pass through to inflation expectations would need to be kept under close review. Moreover, as in past episodes, some foreign exchange intervention may be needed if disorderly market conditions re-emerge.

[10] In February and March of 2019, the BCP cut the policy rate twice, from 5¼ to 4¾ percent, citing uncertainty about the external environment and incipient weakening of domestic demand.

24. The authorities' implementation of inflation targeting, with some foreign exchange intervention to mitigate disorderly market conditions, has supported exchange rate flexibility. In the past few years the level of the exchange rate has moved freely, broadly in line with other small commodity exporting countries in the region.

25. Paraguay's external position in 2018 was stronger than implied by economic fundamentals and desirable policies according to the External Balance Assessment Lite (EBA-Lite) methodology (see Annex II). From a saving-investment perspective, the current account surplus is the result of low investment levels—not high saving. If economic reforms were to lead to an improvement of the business climate and governance, capital inflows and investment would pick up, and the gap with the current account "norm" would close.



Authorities' Views

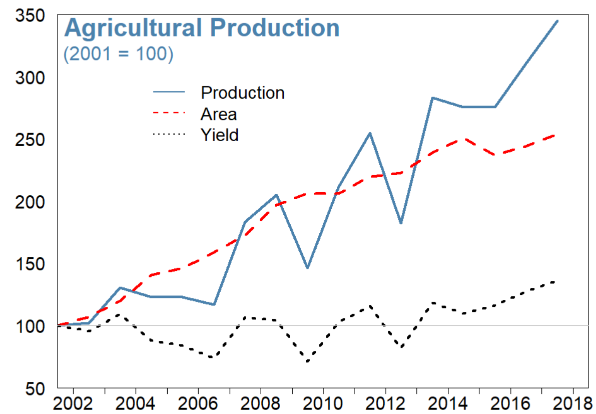
26. The BCP forecasts inflation to return to the middle of the inflation band by end-2019. The recent rate cut was motivated by signs of weakness in domestic demand, a change in the US monetary policy outlook, and continued uncertainty regarding the economic situation in Argentina.

27. In the authorities' view, the guaraní will move back to a valuation in line with fundamentals this year. Last year a temporary shock (the sharp depreciation of the peso) led to a real exchange rate appreciation. This year this appreciation would be reversed—the result of higher inflation in Argentina. Over the medium term, they agreed that structural reforms would lead to increased foreign direct investment into the country, which would result in a moderately negative current account balance.

28. They agreed that the exchange rate was an important risk absorber. They noted that the guaraní tends to move quickly in response to real and permanent shocks. For example, in 2014/15, the guaraní had depreciated by 30 percent vis-à-vis the dollar in few months when agricultural commodity prices fell sharply.

B. Boosting Supply and Keeping Longer-term Growth Strong

29. Paraguay's exports are still heavily dependent on the agriculture sector. Around 70 percent of Paraguay's exports are agricultural commodities and related products, much higher than the average of other middle-income countries that have achieved significant economic convergence (see Selected Issues Paper). The share of agriculture in employment has declined over the past two decades (the result of a sharp increase in agricultural labor productivity), but most of the shift has been towards the non-tradable sector, primarily services. The employment share of the more productive, tradable sector (e.g. manufacturing) shrank.

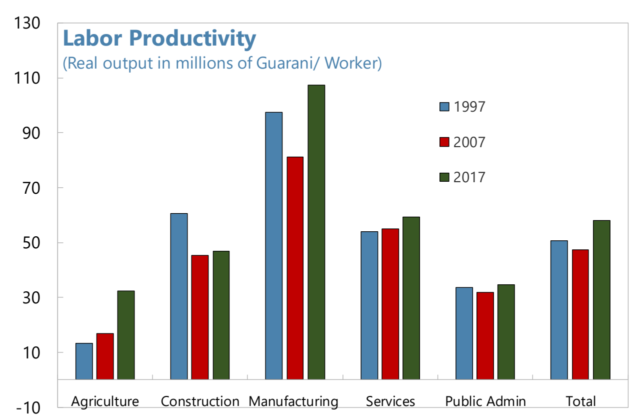


Source: BCP and IMF staff estimates.

30. Continued expansion of agricultural export *volumes* will be difficult. Much of the expansion has been driven by an increase in sowing areas, rather than an increase in yields per hectare. Average yields have not increased much as production has expanded to more marginal land. And yields of major crops are already close to the technological frontier.

31. Agricultural export *values* could come under pressure if commodity prices soften further. Demand growth of China—world's largest soybean importer in the last decade—is already showing signs of slowing. Declining export prices would not directly lead to a decline in real GDP (export volumes may remain unchanged), but they would lead to a decline in incomes, which would reduce domestic demand. The exchange rate would likely depreciate, and with lower incomes (in real dollar terms), demand for both tradables and nontradables would drop.

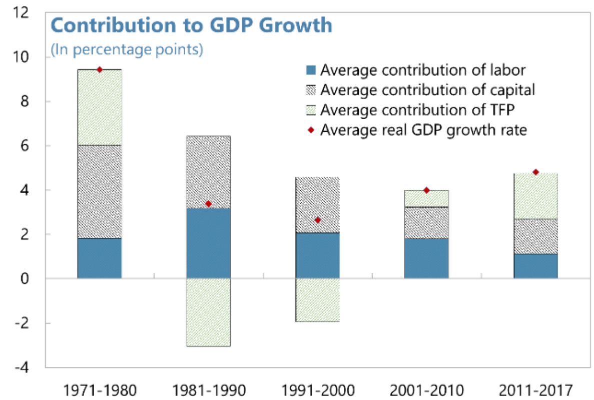
32. The non-energy/non-agriculture export sector is small—at around 7 percent of total exports. The maquila industry has been growing rapidly in recent years, with an average annual export growth of over 20 percent. However, it started from a very low base. It will take consistently rapid expansion at the current rate over the next 15 to 30 years for the emerging export industries to rival the traditional export sector in terms of their significance in the economy.



Sources: National authorities.

33. Investment and FDI levels are low. Compared to other middle-income countries that have achieved faster convergence with advanced economies, the investment level in Paraguay is relatively low. The level of foreign direct investment (FDI), an important driver of industrialization and technology upgrade in many emerging market countries, is minimal.

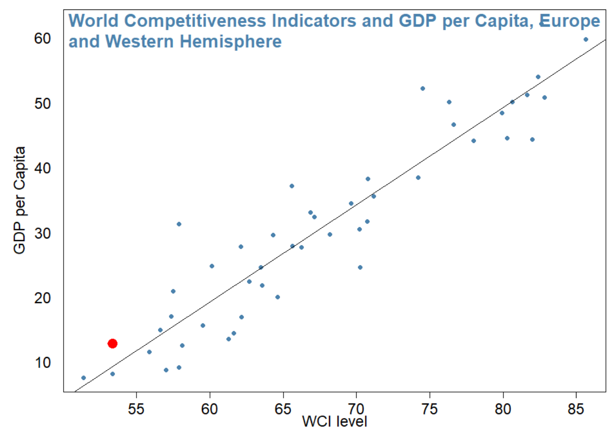
34. The informal sector is large, while the registered level of domestic entrepreneurial activity is low. Informal employment is estimated at about 65 percent of total employment, higher than the average of countries at a similar income level. Meanwhile, the number of new, registered businesses, at 0.145 per thousand adult population, is significant lower than in other middle-income countries.



Sources: Penn World Tables.

35. Labor productivity and TFP growth have rebounded in the last decade, but their *level* is still well below previous peaks. The capital intensiveness of the economy has risen substantially, driven by labor substitution in the agricultural sector, but this has been offset by lower TFP.

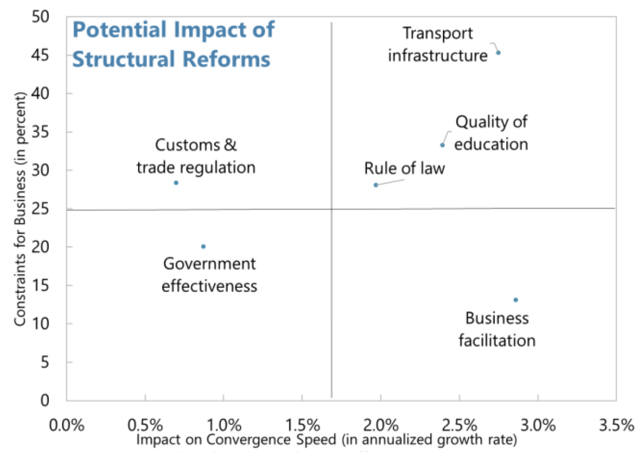
36. A larger non-agriculture tradable sector is needed for sustainable investment and productivity growth. In the absence of a larger non-agriculture tradable sector, investment levels are unlikely to increase, as the capital / output ratio of the existing sectoral structure is already high. In addition, since the labor productivity growth rates and levels in the tradable sector, manufacturing in particular, are higher than in the mostly non-tradable, tertiary sector, further expansion of the former will boost overall labor productivity.



Source: WCI and IMF staff estimates.

37. A better business climate and improved governance would help facilitate diversification and productivity growth. Compared to other countries in the Western Hemisphere and Europe, Paraguay scores relatively weak on business climate and governance indicators (see Figure 9A). Cross-country data shows that there is a strong link between the overall value of these indicators and GDP per capita.

38. Policies should focus on improving transport infrastructure, institutions related to the rule of law, and the quality of education. Staff conducted an empirical analysis ranking the priorities of structural reforms according to their potential impact on the speed of GDP convergence[11], and the level of potential social support a reform may have (proxied by the percent of private sector firms identifying the reform area as a main constraint for business activities). The following reform areas are estimated to have some of the highest impact on growth, as well as being supported by the highest percentages of private sector firms:



Sources: National authorities and IMF staff estimates.

- **Transport infrastructure.** 45 percent of exporting firms identify transportation as a main business constraint. Paraguay scores low in international comparision regarding the quality of roads, road density, airport connectivity and efficiency of air transport services. Staff estimates suggest that improving the quality of transport infrastructure to the average level of the group of high-converging middle-income countries can increase the rate of economic convergence with the United States by 2.7 percentage points annually.

- **Quality of education.** 30 percent of private firms identify uneducated labor force as a main constraint for doing business, which is confirmed by the low scores Paraguay receives in categories such as the quality of vocational training and the skill set of graduates in the Global Competitiveness Report.

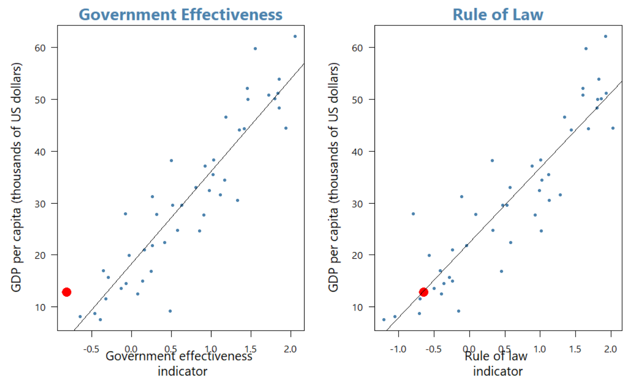
- **Rule of law.** Paraguay lags behind in international comparison in the area of institutional qualities regarding law and order, including judicial system, legal process, anti-curruption and public security. 40 percent (20 percent) of firms identify corruption (courts system) as a major constraint to business. Empirical estimates suggest that improving Paraguay's score in "law and order" to the level of high-converging middle-income country average can improve the rate of convergence by 1.9 percentage points annually.

39. With low electricity costs and neighboring two large consumer markets, Paraguay should be able to attract more FDI if it improves the business climate, governance and infrastructure. Currently, Paraguay consumes only part of the electricity produced by the two bi-

[11] The analysis is done with a cross-country regression, by regressing the annual change in a country's real GDP per capita relative to the US level on lagged relative GDP per capita and the underlining structural indicator for the country. The growth impact of a structural reform on Paraguay is then calculated by multiplying the estimated coefficient of the structural indicator in the growth regression by the gap in the structure indicator between Paraguay and the average level from a group of fast-converging peer countries.

national dams and exports the rest at cheap rates to its neighbors. Higher FDI would help leverage more of Paraguay's cheap energy for domestic production.

Worldwide Governance Indicators and PPP GDP Per Capita, 2017, Europe and Western Hemisphere



Source: Worldwide Governance Indicators and WEO.

40. Paraguay has made progress in improving public governance transparency. The Law of Free Access to Public Information (2014) allows online access to public officials' wages and public procurement data. Paraguay was also accepted as a member of Global Forum on Transparency and Exchange of Information for Tax purposes in 2016. In this regard, it will implement an internationally agreed standard of transparency and exchange of information on tax by 2020 when the first compliance review will take place.

41. However, too many and complicated regulations not only hamper business dynamics, but also provide fertile ground for corruption. Relative to other countries in Europe and Western hemisphere, Paraguay scored relatively poor in business regulation and regulatory quality (Figure 9). Simplifying the regulations (such as removing outdated regulations) could help improve transparency and fight corruption.

Authorities' Views

42. The authorities concurred with staff's assessment of the main bottlenecks to long-term economic growth. They also agreed structural reforms would help to attract more foreign investments and increase the dynamism of domestic private sector.

43. They concurred that the development of the non-agriculture/non-energy tradable sector was key to sustain convergence. They noted that this sector had been growing rapidly, exemplified by the fast growth of the maquila industry.

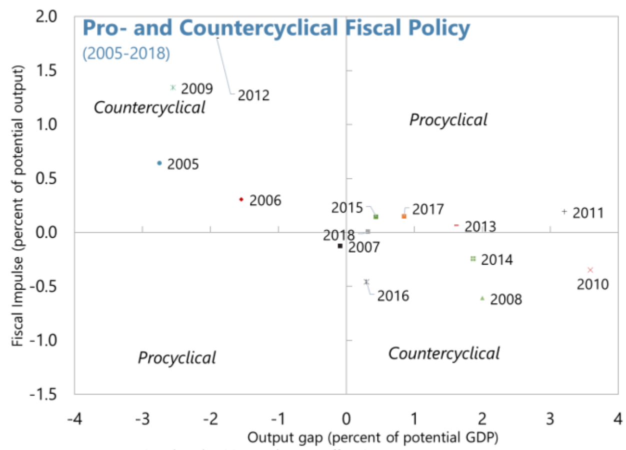
44. In their view, the business climate and governance were not the only factors explaining low investment: Paraguay also needs to make more efforts to promote itself to foreign investors. Fortunately, the country's macro stability and solid growth in recent years had started to catch the attention of foreign investors, and the government had been receiving a growing number of investment-related inquiries.

45. Improving the business environment is a priority for the government. It has initiated reforms to increase the ease of doing business, including legislation to simplify company formation and registration, a new bankruptcy law to streamline the business dissolution process, and legislation to allow companies to use moveable assets as collaterals. The authorities are also making it easier for businesses to obtain licenses and permits, by cutting bureaucratic procedures and increasing digitization in government services. To facilitate higher competition in key industries, they have revived the National Commission for Competition.

46. The authorities see improving human capital as one of their priorities, and they are working to improve health and education. For example, they plan to strengthen primary healthcare by building 400 more family care units across the country in the next five years, which will also help reduce healthcare cost. They have established an education reform committee comprised of members from public sector and civil society, to spearhead the reform agenda. By the end of 2019, the committee will publish a reform roadmap, including measures for focused reform areas such as improving teacher training and performance evaluation.

C. Fiscal Policy

47. Prudent fiscal policies of the past fifteen years have reduced public debt. Public debt is low by international standards and is expected to remain stable over the medium-term (see Annex II). Nevertheless, public debt issued abroad in foreign currency has increased considerably since 2012 (part of a concerted effort to introduce Paraguay to international investors) which has increased vulnerability to shocks. Fiscal policy has also been prudent from a cyclical perspective—in the past decade, fiscal policy has mostly been countercyclical.[12]



Sources: National authorities and IMF staff estimates.

48. The budget for 2019 targets a deficit of 1.4 percent of GDP. This is appropriate from a cyclical perspective (the cyclically adjusted fiscal impulse for 2019 is estimated at zero, the output gap, while negative, is close to zero) and in line with the FRL ceiling of 1.5 percent of GDP. Reaching the FRL target may require keeping spending below budget, as the revenue estimates are likely too optimistic. Paraguay has a history of overly optimistic nontax revenue projections, but has each year managed to adhere to the FRL ceiling by containing expenditure below budgeted levels. Prospects for meeting the targets in 2019 are good again, but it will be important to do so while restoring the level of public investment, which had slipped in 2018.

[12] The fiscal impulse is the increase in the cyclically adjusted deficit. It is countercyclical if fiscal policies retire stimulus at a time when the output gap is positive, and vice versa. Other measures of the fiscal structural balance that consider the commodity cycle as well yield similar results as those shown in the chart.

49. Fiscal space is effectively constrained by the FRL ceiling, which limits the central government deficit to 1.5 percent of GDP. Deficits have crept up over the past few years and appear to be pegged close to the FRL ceiling now, leaving little room for countercyclical fiscal policy if growth were to disappoint.

Summary of Central Government Operations

	2016		2017		2018		2019	
	Adjusted Budget	Fiscal Outturn	Adjusted Budget	Fiscal Outturn	Approved Budget	Fiscal Outturn	Approved Budget	Staff Proj.
	In percent of GDP							
Total revenue	16.0	13.9	15.6	14.2	15.6	13.6	15.3	13.8
of which: Tax revenue	10.1	9.5	9.5	9.9	9.7	9.7	9.9	9.7
Expense	14.8	12.8	14.3	12.8	14.2	12.9	13.9	12.9
of which: Salaries	6.9	6.5	6.7	6.3	6.8	6.4	6.8	6.4
Net acquisition of non-financial assets	3.5	2.2	3.6	2.4	2.6	2.0	2.8	2.3
Net lending/Borrowing	**-2.3**	**-1.1**	**-2.3**	**-1.1**	**-1.2**	**-1.3**	**-1.4**	**-1.4**

50. Revenue and expenditure levels in Paraguay are relatively low. Tax rates are low (the personal and corporate income tax rate and the VAT rate are all 10 percent), and the role of the state is less than that in neighboring countries.

51. At the same time spending needs are large. Some of the priority structural reform areas identified in the previous section, such as transport infrastructure and education, require substantial resources. According to OECD and Global Infrastructure Outlook, total infrastructure investment needs are US$1 billion to 3 billion per year (3 to 8 percent of GDP). The 2017 Article IV report identified infrastructure investment needs of about 20 percent of GDP over the next five years for electricity distribution, roads, sanitation, and other large transportation projects. For education, the World Bank has estimated that over US$1 billion is needed for investment in schools.

52. More fiscal revenue could become available starting in 2023, after the Itaipú loan is fully paid-off. But this will depend on the renegotiation of the Itaipú treaty with the Brazilian government, the outcome of which is uncertain.[13]

53. If raising *actual* tax rates is not a political option, at a minimum *effective* tax rates should be raised. The current tax rates of 10 percent (for both personal income and profits) are already low, but effective tax rates are much lower (the personal income tax yields 0.1 percent of GDP; the corporate income tax 1.9 percent). Low tax rates for VAT and income taxes, combined with

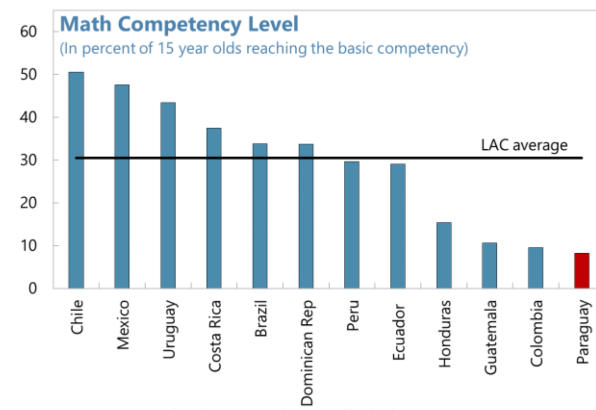
[13] The current tariff for energy paid to the Itaipú binational entity covers operational costs and the annual costs of debt service, which will fall from about US$2 billion to zero, once the debt is paid off. Should the tariff remain unchanged, the total windfall will be equally shared between both governments. Should the tariff be adjusted downward to reflect operational costs only, a disproportionate share of the windfall would go to Brazil, as Paraguay sells 85 percent of its share of Itaipú's electricity to Brazil. Paraguay would benefit only through lower tariffs on the electricity it consumes, and there would be no additional fiscal revenue. Between these two extreme cases, any convex combination between lower tariffs and higher fiscal revenue is also a possible outcome.

generous deductions for household consumption, have fostered formalization, but also resulted in a highly regressive tax system that collects too little.

54. The government has installed an independent commission that will provide a blueprint for tax reform by March 2019. On the table are proposals to curb deductible expenses for the personal income tax, to eliminate exemptions and reduced rates for the VAT, and to unify the corporate income tax with the agricultural income tax.

55. Given the limited fiscal space, alternative financing sources will also be needed, including through public-private partnerships (PPPs). High standards of public and corporate governance and transparency would be essential to attract participation of public investments by the private sector. In the meantime, improving the efficiency of public investment and rebalancing the composition of expenditure from current expenses to investments would help make the most of the available resources. A public-private commission for the review of public expenditure is expected to make reform proposals by end-June 2019.

56. The efficacy of health and education spending needs to be improved. Despite large increases in education spending over the last decade, learning outcomes have not improved.[14] The recent PISA tests shows that only 8 percent of 15-year-old students in Paraguay reach the minimum level in math competency, compared to 31 percent of the LAC average. Similarly, despite increasing public expenditure, health outcomes in the broader population have improved at a slower rate than other countries in the region.



Sources: National authorities and IMF staff calculations.

57. The social safety net needs to be strengthened. Paraguay's social protection system is inefficient due to a multiplicity of small, overlapping and sometimes duplicative programs.[15] With World Bank assistance, the government aims to eliminate the current fragmentation of the social protection programs and build an integrated social protection system.

58. The pension system faces imbalances in the long term and needs to be reformed. Paraguay's population is still young but has started aging, and the pension system's long-term unfunded liabilities have been estimated at 200 percent of GDP (see 2017 Article IV report). While the largest social security fund (IPS) is still in surplus due to recent extension of coverage, the pension fund for public employees (Caja Fiscal) is already running deficits. Gentle parametric adjustments to pension age, benefits, and contributions rates should be made now rather than later.

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

[15] See previous footnote.

59. It would be desirable to increase the share of government debt that is financed domestically. Currently about 80 percent of public sector is external debt denominated in foreign currency. At the same time, pension funds, which are not allowed to invest in government debt, hold a large share of their assets in bank deposits, while banks suffer from excess liquidity. Allowing pension funds to invest in government bonds (see paragraph 65) would reduce both external vulnerabilities and the government's exposure to the banking sector,[16] while effectively channeling domestic savings for the financing of much-needed public investments.

Authorities' Views

60. The authorities agreed that tax revenue needed to be raised to create space for public investment and structural reforms. They cautioned, however, that this would take time, and that their immediate efforts in tax reform would focus on simplifying the system and improving tax compliance, followed by later steps to reduce exemptions and eventually raise tax rates.

61. With regard to pension reform, the authorities agreed that parametric adjustments to the system should be introduced sooner rather than later. They also pointed out that, as a first step, social insurance coverage needed to be improved, as a large share of workers is not formally registered and does not contribute to the system.

D. Financial Sector Policy

62. Financial soundness indicators show the banking sector is well capitalized and profitable. The tier I capital-to-asset ratio (13.4 percent) is well above the regulatory minimum of 8 percent. The return on equity is above the regional average. The banking system performed well in the BCP's recent stress tests under extreme adverse scenarios, such as a drastic deterioration of loan portfolios, a reduction of interest rate spread, guaraní and shocks to main economic sectors. All banks were able to maintain their capital adequacy ratio above the regulatory requirement under the stress scenarios.

63. Parts of the non-bank financial sector need to be better understood and supervised. Since the introduction of the interest rate ceiling on credit card loans by banks, casas de crédito and casas comerciales. have been the main provider of uncollaterized consumer loans and instalment credit to the lower- and middle-income brackets of the population. Their current size is around US$570 million (3 percent of total banking sector assets), but there is no systematic data collection, except for the recent attempt by the Financial Intelligence Unit (SEPRELAD) to register a handful of large borrowers from the sector and acquire the list of entities operating in this segment of the financial system. It is imperative to quickly adopt supervision standards for this sector. The

[16] If banks were to get into trouble, the government would likely need to bail out the pension funds' deposits, which are above the thresholds of deposit insurance.

Paraguay: Financial Soundness Indicators						
	2013	2014	2015	2016	2017	2018
Basic indicators						
Capital adequacy			(in percent)			
Regulatory capital/risk-weighted assets	14.7	15.2	16.1	17.9	18.3	17.5
Tier 1 capital/risk-weighted assets	11.3	11.2	11.7	13.4	13.8	13.4
NPLs net of provisions/equity	0.9	1.2	3.7	3.1	2.5	3.1
Asset quality						
NPLs/total loans	2.1	2.0	2.6	2.9	2.8	2.5
Provisions/NPLs	135.7	135.0	116.5	120.4	126.1	126.7
Profitability						
Return on assets	2.7	2.6	2.5	2.2	2.3	2.3
Return on equity	24.6	24.2	23.4	20.8	20.3	20.0
Interest Margin/ gross income	11.6	10.2	7.4	8.0	9.8	12.2
Admin. expenses/operating margin	29.3	34.1	36.2	38.2	39.5	33.7
Liquidity						
Liquid assets/total assets	25.2	25.0	27.6	24.1	19.1	18.7
Liquid assets/sight deposits	9.8	9.5	10.1	9.3	7.9	7.5
Market risk						
FX position/equity	10.2	8.4	9.1	8.6	9.6	17.3
Recommended indicators			(in percent)			
Capital/assets	7.0	7.0	7.2	7.9	8.2	8.4
Personnel expenses/admin. expenses	14.2	10.4	6.4	6.6	7.8	11.3
FX loans/total loans	45.4	47.8	50.0	48.1	46.7	47.2
FX liabilities/total liabilities	45.7	49.3	54.6	51.6	48.4	48.1

Source: Banco Central del Paraguay and IMF, *Financial Soundness Indicators* .

BCP has started a study to evaluate the scope and feasibility of regulating them, which is a step in the right direction.[17] Supervision of financial cooperatives should also continue to be strengthened.

64. The authorities have made progress in implementing the 2017 FSSR recommendations. Progress has been registered in establishing proper protocols for interagency coordination, establishing a financial stability council, collecting surveillance data on financial sector interconnectedness, and revising the bank resolution law to address weaknesses in supervisory enforcement and procedures for crisis prevention and resolution. In addition, the Superintendency of Banks has recently upgraded its organizational structure and supervisory model, including the risk matrix, to facilitate the transition to risked-based supervision. More work is expected to operationalize the adopted protocols and resolution laws. Revisions to the risk matrix including broader measures of asset quality (NPLs, restructured, renewed and refinanced loans) would also be helpful. A supervisory regime still needs to be implemented for the *casas de credito* and *casas comerciales*.

65. Reducing financial dollarization would be desirable. Borrowing in dollars is risky, even for the agricultural sector, which receives export earnings in dollars. In fact, given that the guaraní-dollar exchange rate tends to depreciate when the main agricultural commodity prices weaken,

[17] The BCP has also imposed restrictions on banks buying asset portfolios from casas de créditos.

borrowing in guaranís would provide a natural hedge against commodity price shocks. Previous research suggests that regulatory measures such as using higher capital requirements on dollar-denominated loans could lower credit dollarization.[18]

66. Regulatory reform is also needed for pension funds. Besides basic legal limitations, which prohibit pension funds to invest in anything else but domestic private sector assets, there is no oversight of a sector that captures long-term savings from a large part of the population. An unintended consequence is that pension funds hold a large share of their assets as domestic bank deposits. Introducing a pension fund supervisor would enhance accountability and allow pension funds to invest in a wider range of assets that would facilitate the development of a domestic capital market. A law project that would have addressed these issues by establishing a pension fund supervisor was not recently approved by parliament—political dialogue should resume the path toward reform.

67. Strengthening the AML/CFT framework and its implementation will support financial stability. The country updated its AML/CFT national risk assessment in 2018, identifying organized crime (drug-trafficking, counterfeiting, human and firearms trafficking) and informality as its main ML risks. Additionally, corruption is identified as a structural and endemic problem impacting government control institutions, acting as both a source and enabler for ML. Some of the priorities established in the national risk assessment include the need to strengthen the legal framework, enhance capacity and cooperation of key agencies, and produce data and statistics on the phenomenon. AML/CFT measures would need to be complemented by strengthening the country's anticorruption efforts. Paraguay's need for action is further pressured by the upcoming evaluation by the regional AML/CFT standard-setting body which will assess the country's framework and its effectiveness in late 2019.

Authorities' Views

68. The authorities stressed that the banking sector is well capitalized and can withstand shocks. They noted they had been making progress in implementing FSSR recommendations, including in risk-based supervision, on further developing macro prudential tools, and on strengthening the institutional and crisis preparedness frameworks.

69. They acknowledged supervisory weaknesses in the non-bank financial sector. They noted that some progress had been made to strengthen the risk-based supervision for cooperatives by improving the coordination with INCOOP (the supervisor of the cooperatives) and collecting surveillance data on the magnitude of interconnectedness with the banking sector.[19] They also agreed with the need to improve the supervision of the casas de crédito and casas comerciales, by quickly adopting supervision standards for this sector. The authorities reiterated their commitment to establish pension fund supervision.

[18] See Box 1 in the 2017 Article IV report.

[19] A follow-up FSSR TA mission on stress testing is helping to strengthen institutional coordination among regulators.

STAFF APPRAISAL

70. The current policy mix is appropriate. Fiscal policy is neutral and monetary policy expansionary, which should help mitigate the slowdown and reduce downside risks. Inflation is projected to return to the midpoint of the target range by year's end. The external position is stronger than the level implied by fundamentals and desirable policies.

71. Paraguay has grown rapidly in the past decade and a half, contributing to a sharp drop in poverty. Prudent macro policies, resulting in low inflation and low government deficits, played an important role. Vulnerabilities have declined, with a significant reduction of both external and public debt.

72. The key question going forward is how to maintain rapid growth of per capita incomes. Paraguay's economy is still heavily dependent on the agriculture sector. But agricultural prices are already off previous highs and may decline further as global demand slows. And agricultural land cannot continue to expand at the same rate as in the past.

73. Future growth will increasingly need to come from the non-agriculture/non-electricity export sector, which is growing rapidly, but is still small. For this, higher private sector investment is needed, including from abroad.

74. A better business climate and improved governance would help facilitate diversification and productivity growth. Low taxes and low energy prices are important attractions of Paraguay for domestic and foreign investors, but these are offset by a weak business climate and governance. Policies that focus on improving transport infrastructure, rule of law and the quality of education would be particularly helpful.

75. Prudent fiscal policies in the past 15 years have reduced the debt-to-GDP ratio. But fiscal space is limited, as the deficit is close to the 1.5 percent ceiling under the Fiscal Responsibility Law. And spending needs are large.

76. To create room for the investment needed for some of the identified reform areas, revenues (which are low by international standards) need to be increased. Current headline tax rates are low, but effective tax rates are even lower. Reducing exemptions and deductions and improving tax compliance will raise effective tax rates, even if headline rates remain unchanged.

77. There should also be some room to reprioritize expenditure within the existing envelope. Spending levels in Paraguay are low compared with other countries, but spending composition is lopsided, with a high share of government expenditure going to wages, while there is a need to increase infrastructure and social spending, including in health and education.

78. Financial soundness indicators show the banking sector is well capitalized and profitable. And risk-based supervision is progressing. Supervision of financial cooperatives should continue to be strengthened. Supervision standards for the *casas de credito* and *casas comerciales* should be adopted quickly.

79. It remains important to establish a pension fund supervisor. Currently, pension funds administer the public's trusted money under a few, overly rigid rules, but without oversight. Supervision would mitigate risks, allow pension funds to invest in a wider range of assets and facilitate the development of a domestic capital market.

80. Restoring the long-term sustainability of the pension system is another challenge that should be tackled now, before the demographic windfall dissipates. This can be achieved through timely and gentle parametric adjustments to pension age, benefits and contribution rates.

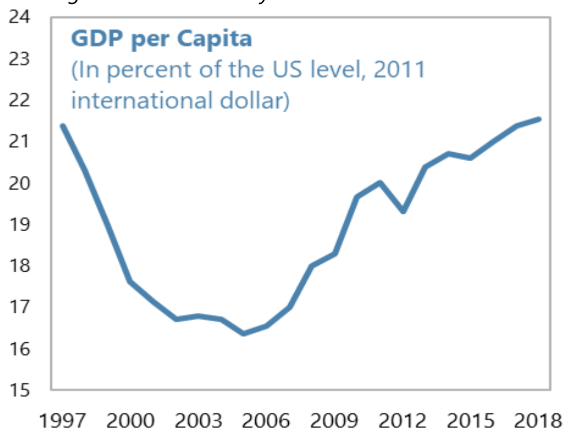
81. Implementing all these structural reforms and continuing with prudent macroeconomic policies would allow Paraguay to continue growing rapidly and improving living standards for all Paraguayans.

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

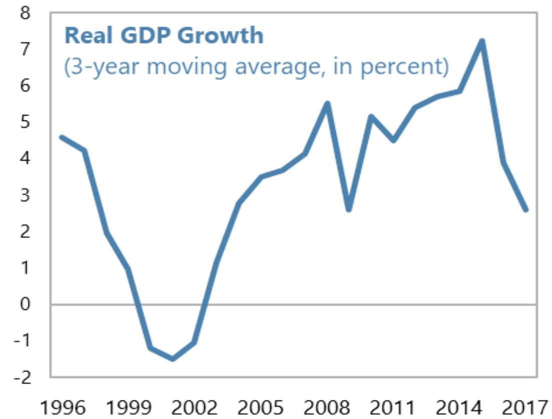
Box 1. Paraguay: Risk Assessment Matrix	
Source/nature of risk (Likelihood / Time horizon)	**Expected impact and recommended response**
External Risks	
Rising protectionism and retreat from multilateralism (**High / ST, MT**): An intensification of global trade conflicts could reduce growth in Paraguay's trading partners and undermine export prices and volumes.	**Medium.** The higher uncertainty in the global environment could hurt investment, increase risk premium, and reduce foreign demand for the traditional exports of Paraguay. Maintaining macroeconomic and financial stability will help contain the perception of investment risks. Continued diversification of exports will also help diffuse the risks.
Significant drop in agricultural commodity prices (**Medium / ST, MT**): Commodity prices could drop significantly if downside global growth risks materialize or supply exceeds expectations.	**High.** As agricultural commodity exports are a significant driver of the economy, a negative price shock will impact GDP growth, financial soundness of the banking sector, and reserve position. In the long run, the most effective risk mitigation measure is to diversify exports. In the short term, the exchange rate should be allowed to depreciate, and monetary policy can become more accommodative.
Sharp tightening of global financial conditions and US dollar appreciation (**High / ST**): A sharper-than-expected increase in US interest rates could lead to an increase in global interest rates.	**Medium.** The exchange rate should be allowed to adjust. The tightening of financial conditions may hurt the economy if other negative shocks to growth also materialize, though the impact may be limited due to the lack of financial linkages between Paraguay and the rest of the world.
Slowdown in growth and higher risks in neighboring countries (**High / ST**): Argentina and Brazil have seen large currency depreciations and could experience slower growth than currently expected.	**Medium.** Shock to neighboring countries may impact growth through the exchange rate and exports. Lower growth in Brazil may reduce FDI inflows, impairing investment and employment. Disorderly market conditions should be mitigated through interventions. Monetary policy can become more accommodative if the shock persists.
Changes in preferential tax treatment for Paraguayan exports (Medium / ST, MT): The new government of Brazil may increase import taxes on goods coming from other Mercosur countries.	**Medium.** The incentive of Brazilian firms to invest in Paraguay may drop, as the final outputs from these FDI flows mainly target the Brazilian market. This would hurt the prospect of export diversification. The government should be proactive in securing customs agreements with main trading partners, while exploring trade agreements with other countries to diversify the sources of investment inflow.
Domestic Risks	
Weather-related shocks (**Medium** to **High / ST**): Agriculture and energy sector may be adversely impacted by weather.	**Medium** to **High.** Shocks to the agriculture sector not only affect GDP growth, export performance and exchange rate, but also the financial sector, due to banks' agricultural lending. Shocks to the energy sector will negatively affect government revenue. The exchange rate could absorb much of the shock, while budget execution should remain compliant with the FRL. Foreign exchange interventions can be used to avoid disorderly market conditions.
Government capacity constraint affecting the execution of public investment projects (**Medium / ST, MT**): The execution of investment projects has been slow in 2018. There is a risk that the pace may still not pick up in 2019.	**Medium**. Under execution of the investment budget may affect the performance of construction and related services, dampening aggregate demand and GDP growth. Lowered public investment also jeopardizes infrastructure development, needed for future growth. The government should strengthen its capacity in budget execution, including through adopting an effective public investment framework.

Figure 1. Paraguay: Economic Transformation 2003–18

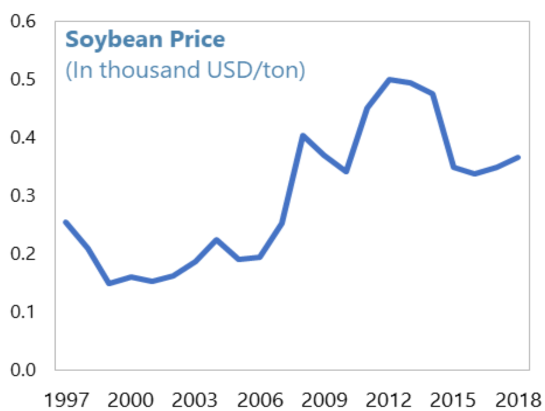
Paraguay has experienced significant economic convergence since the early 2000s…



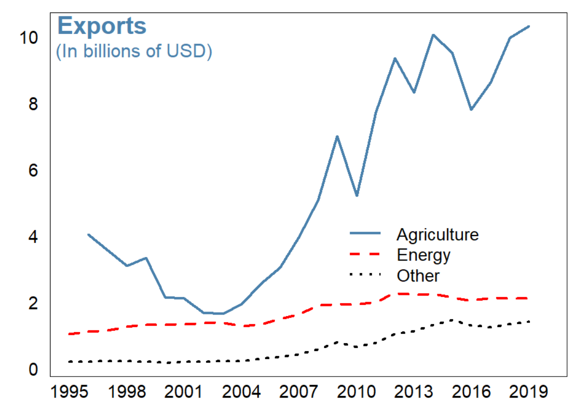
…because of the rapid growth in the last 15 years.



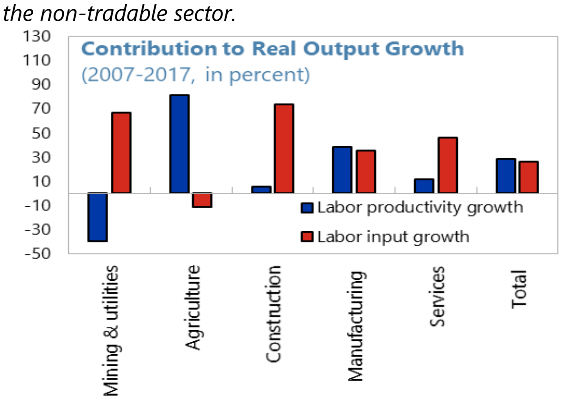
The agricultural commodity price boom during the 2000s is an important factor behind the growth acceleration…



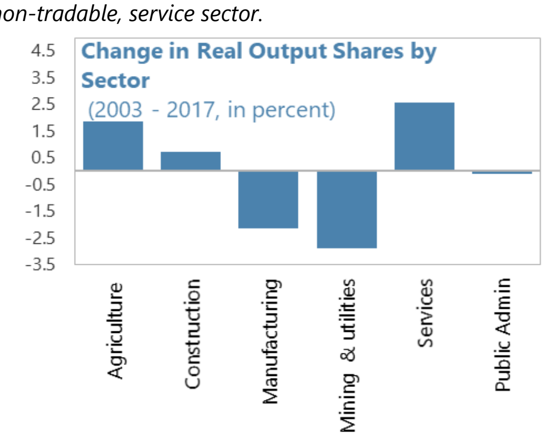
Agricultural exports skyrocketed during the price boom…



…the income effect from which facilitated the growth of the non-tradable sector.



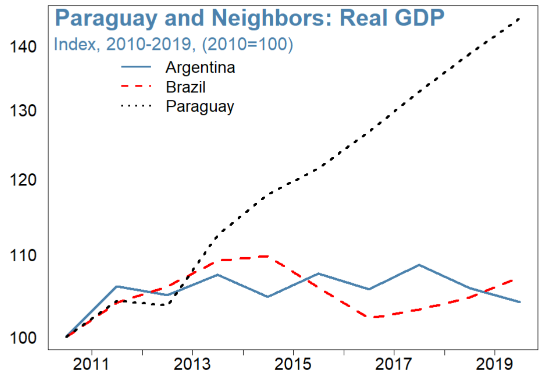
The structure of the economy has shifted towards mostly-non-tradable, service sector.



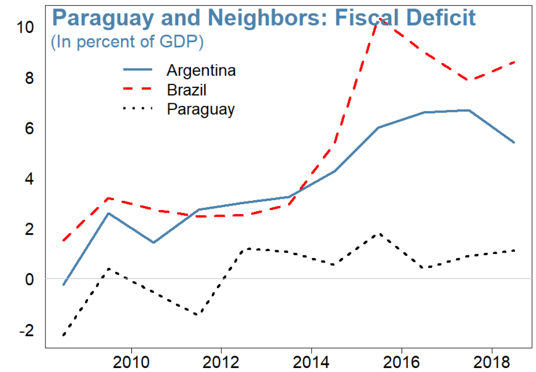
Sources: BCP and IMF staff estimates.

Figure 2. Paraguay: Decoupling from the Region

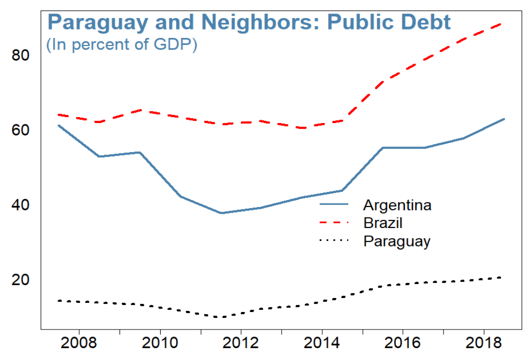
Paraguay has grown much faster than its regional peers....



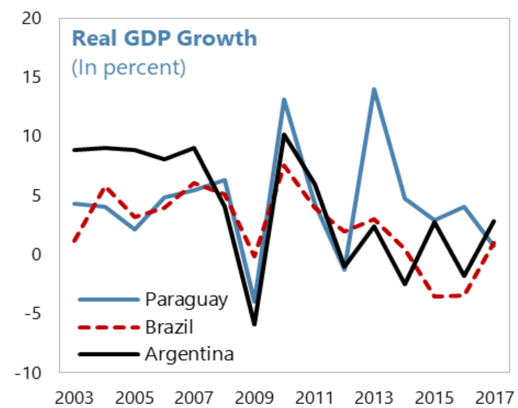
...while fiscal policy has remained conservative during the boom years.



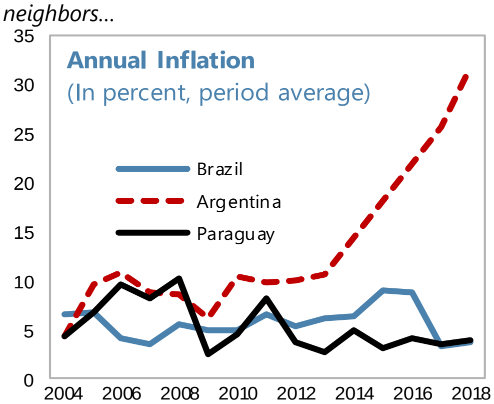
As a result, public debt has remained low...



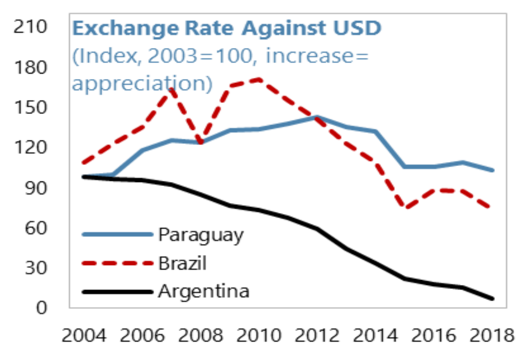
...and the country was much less affected by the recessions in its neighbors.



Inflation has been declining and is less volatile compared to neighbors...



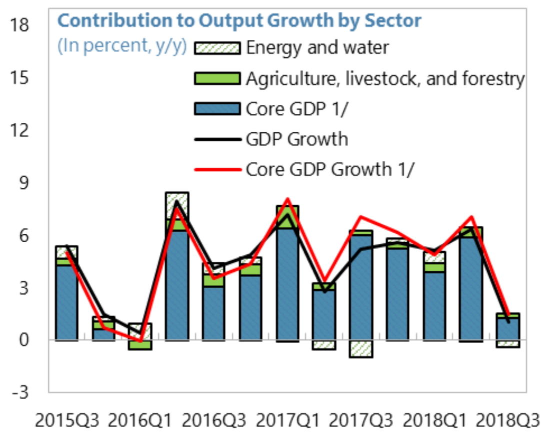
...and the exchange rate has also been more stable.



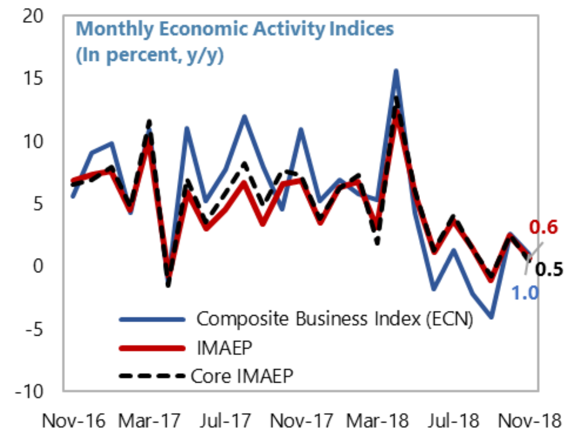
Sources: BCP and IMF staff estimates.

Figure 3. Paraguay: Recent Developments

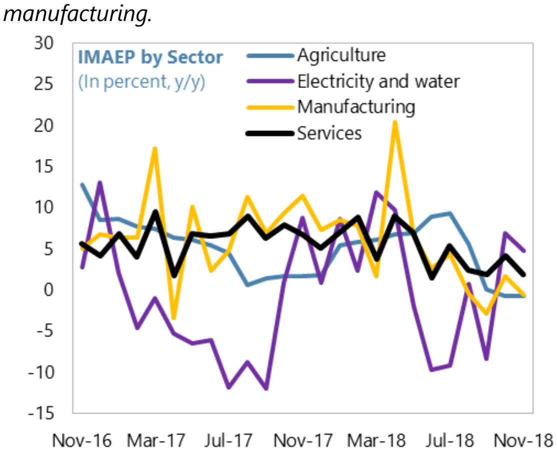
Growth performance started strong in 2018....



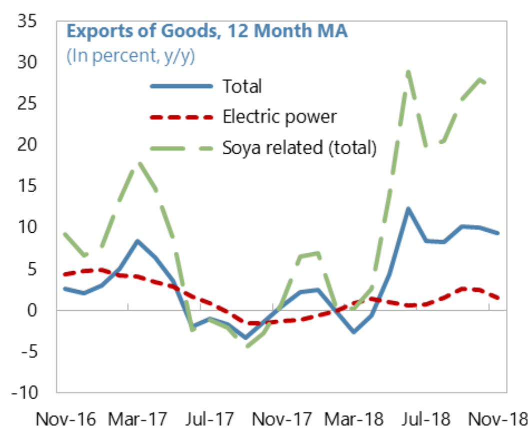
...but slowed in the second half of the year...



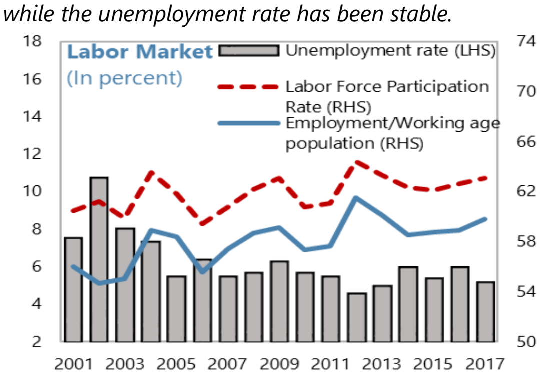
...led by slowdowns in agriculture, commerce and manufacturing.



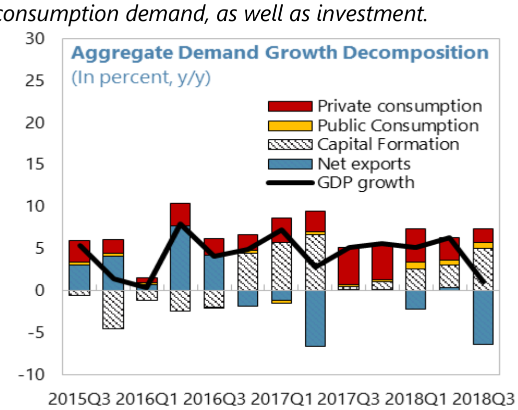
Agricultural exports have performed well.



Employment and labor participation continued to increase, while the unemployment rate has been stable.



On the demand side, growth was driven by strong consumption demand, as well as investment.

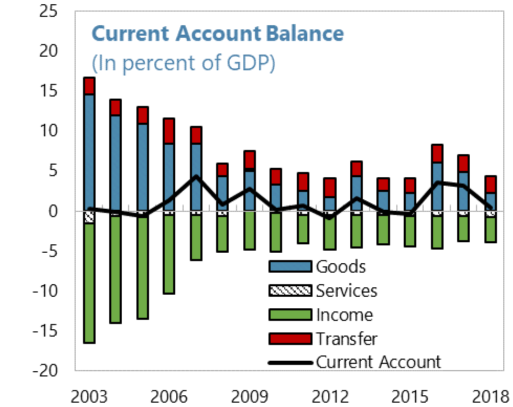


Sources: BCP and IMF staff estimates.

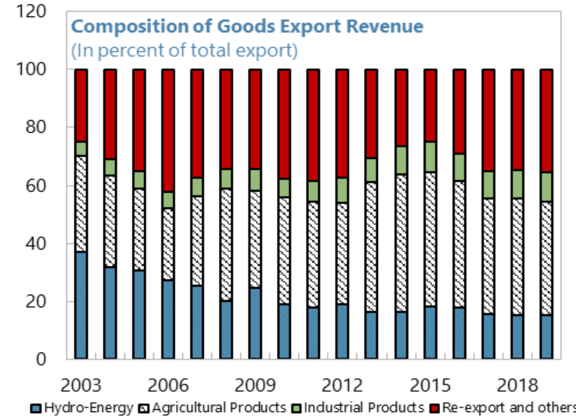
1/ Core GDP excludes agriculture, livestock and forestry as well as energy and water.

Figure 4. Paraguay: External Sector from 2003–18[1]

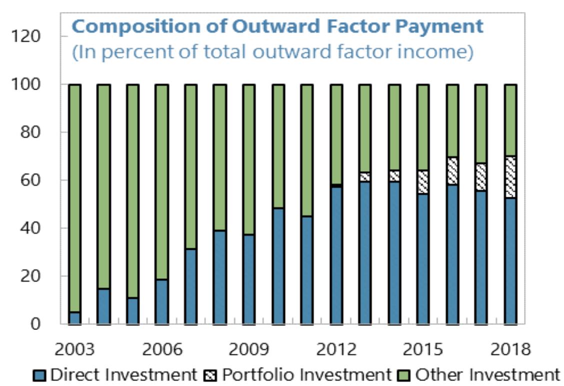
Trade surpluses have offset factor income payments outflows.



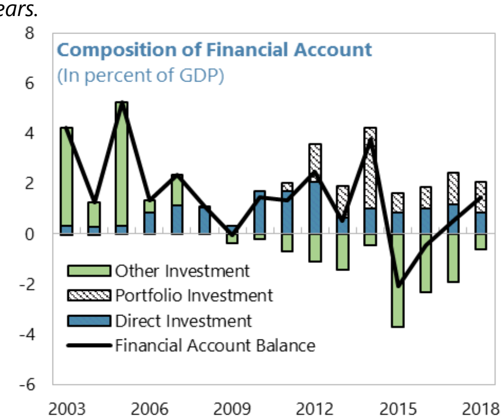
Agricultural products have become the major source of export revenue, overtaking hydro-energy exports.



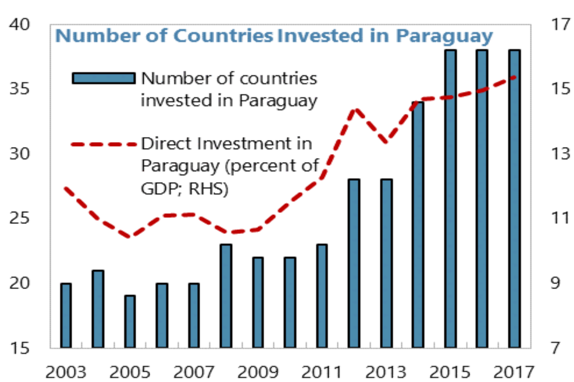
Profit payments have become the major source of outward factor payments.



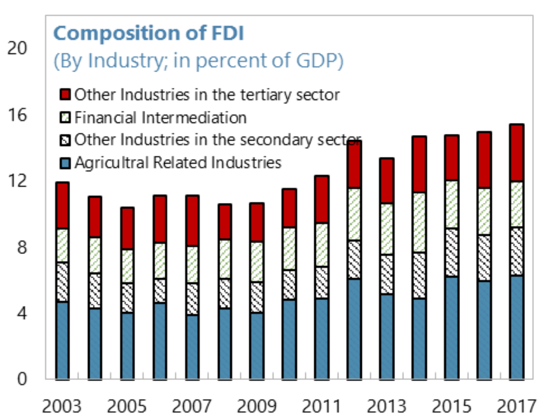
Direct investment has been a stable source of capital. Meanwhile, government's overseas bond issuance has become another source of foreign capital in the last few years.



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



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

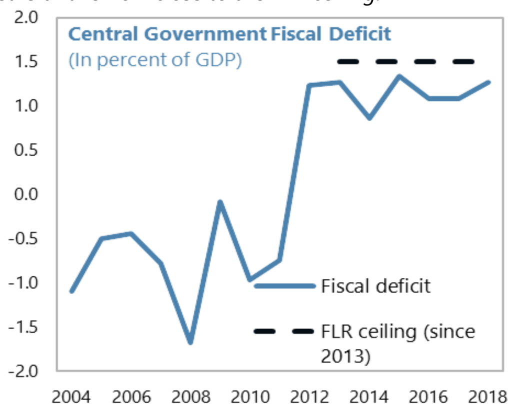


Sources: BCP and IMF staff estimates.

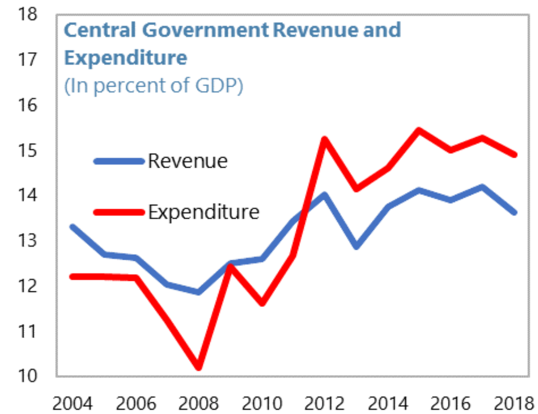
1/Figure for 2018 is based, except for chart on export revenue composition

Figure 5. Paraguay: Fiscal Developments and Trends, 2004–18

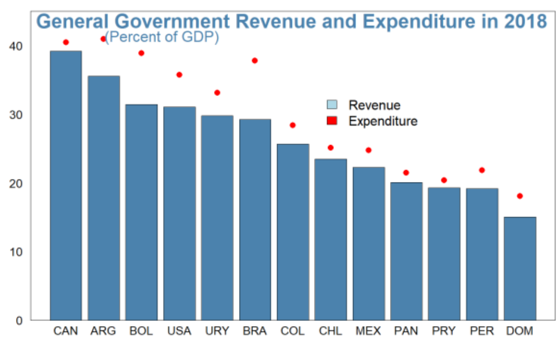
Paraguay's fiscal deficit has increased over the past 15 years and is now close to the FLR ceiling.



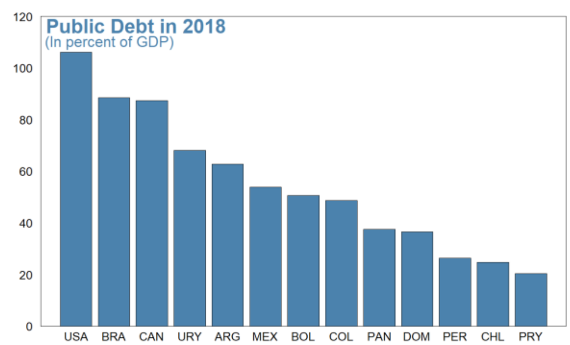
Both revenue and expenditure have increased relative to the economy…



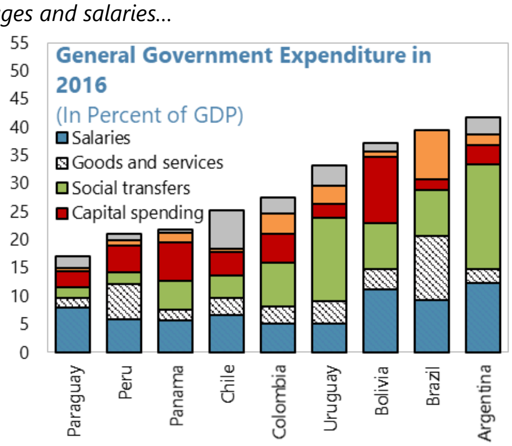
…but are still low compared to other countries in the region…



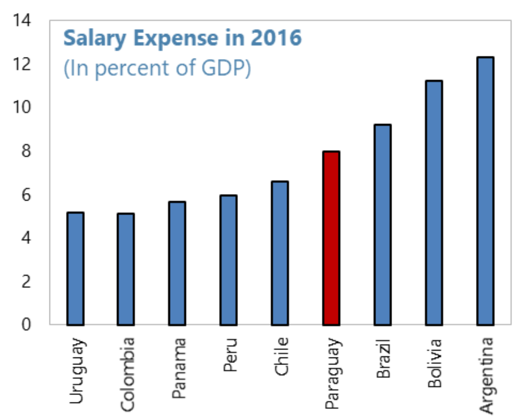
…as is public debt.



Government expenditure is relatively low and tilted toward wages and salaries…



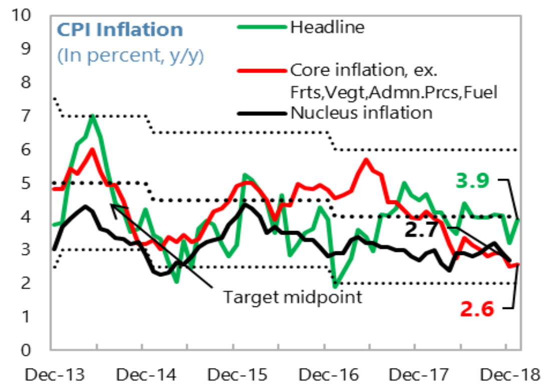
… but as share of the economy government wages and salaries are not out of line with other countries.



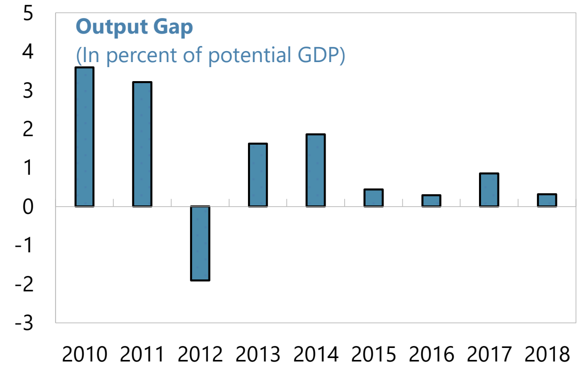
Sources: BCP, Ministry of Finance, WEO and IMF staff estimates.

Figure 6. Paraguay: Monetary Indicators

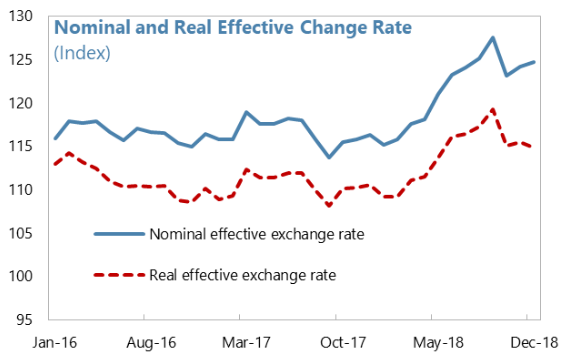
Inflation is close to the middle of BCP's target range....



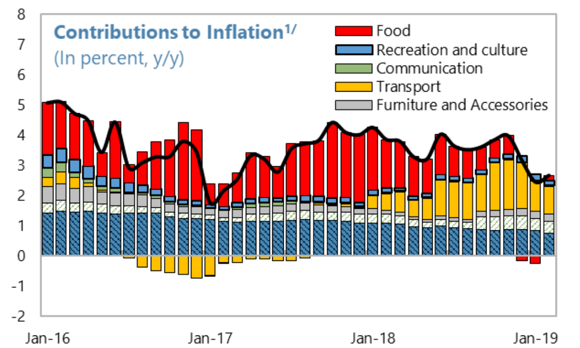
...and the output gap is near zero.



Inflation has been affected by exchange rate appreciation....

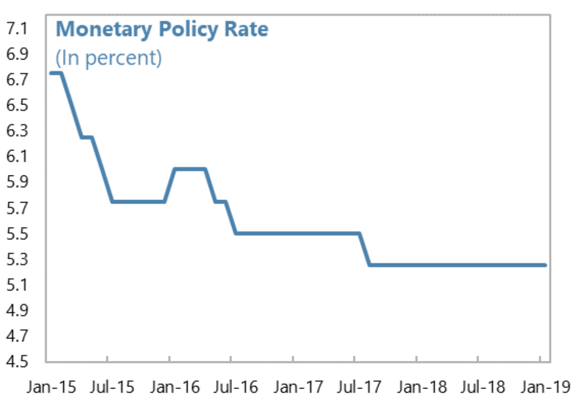


...and the moderation of food prices.

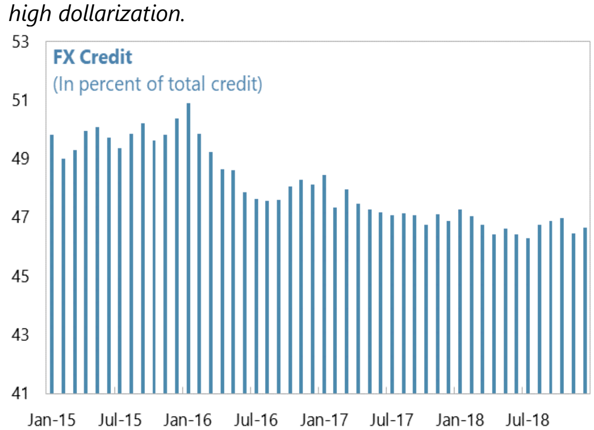


1/ Includes alcoholic beverages, tobacco, apparel, health, education and hospitality.

The BCP has cut the policy rate in February and March of 2019...



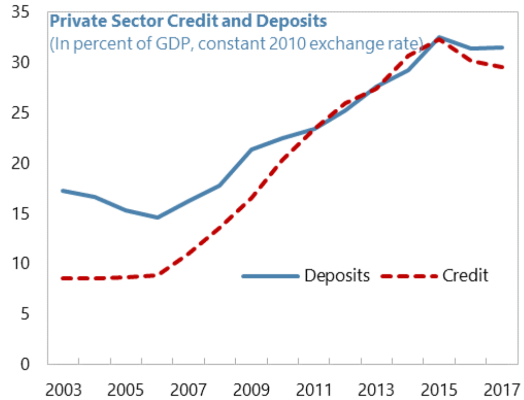
...but the transmission of the policy rate is impeded by high dollarization.



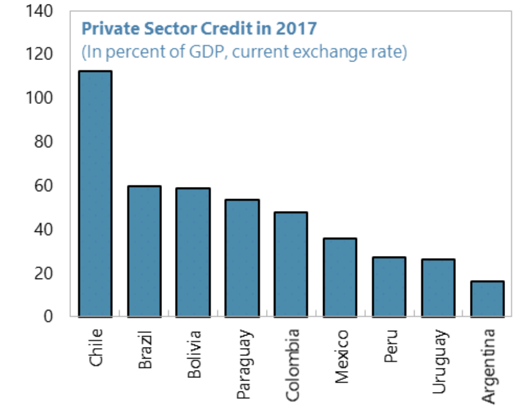
Sources: BCP and IMF staff estimates.

Figure 7. Paraguay: Financial Sector Development

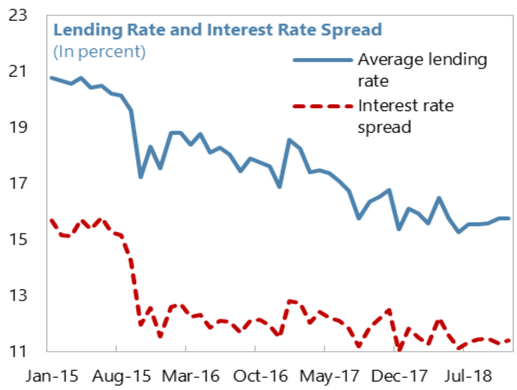
There has been significant financial deepening over the past decade.



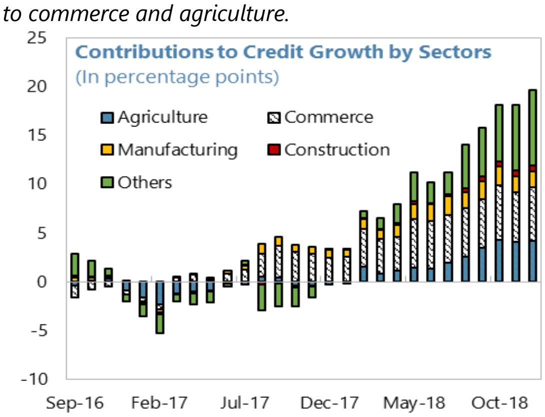
Private sector credit is now higher than the regional average.



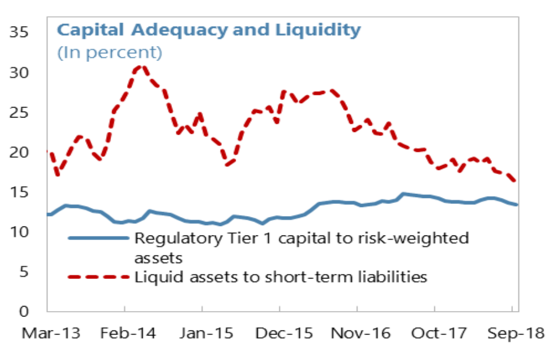
Lending rates and interest rate spreads have come down.



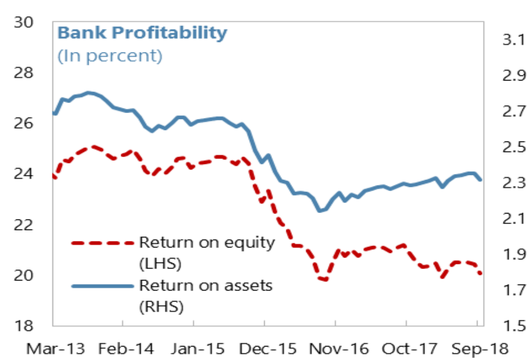
The recent growth in credit is driven by a recovery in credit to commerce and agriculture.



Banks are liquid and well capitalized.



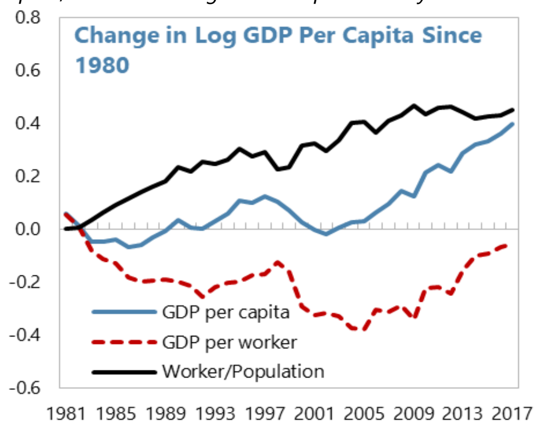
Bank profitability has come down but is still high compared to other countries in the region.



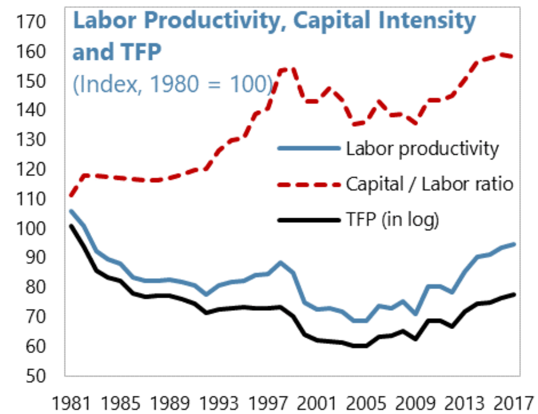
Sources: BCP, WDI and IMF staff estimates.

Figure 8. Paraguay: Challenges for Long-term Growth

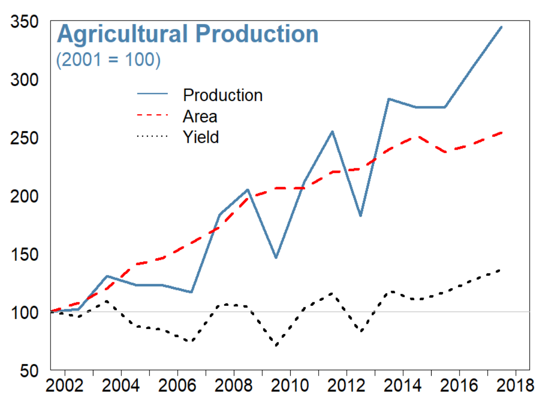
GDP per capita has increased because of higher labor inputs, rather than higher labor productivity….



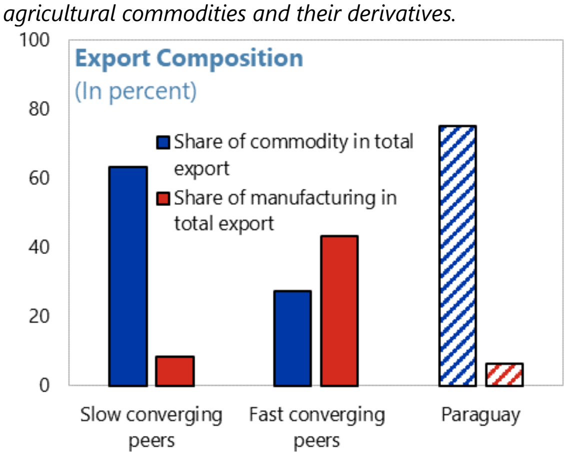
…and labor productivity growth has been the result of capital deepening, rather than TFP growth.



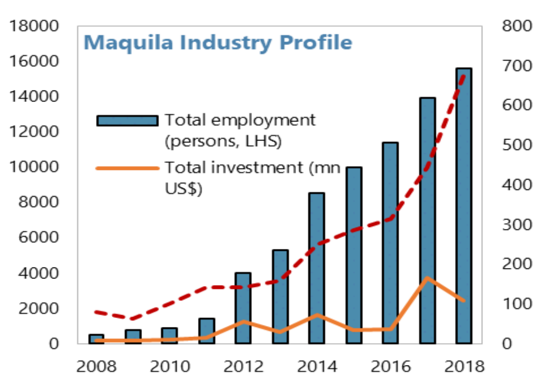
Agriculture growth has been mostly relying on "extensive margin"—through increasing areas of cultivation.



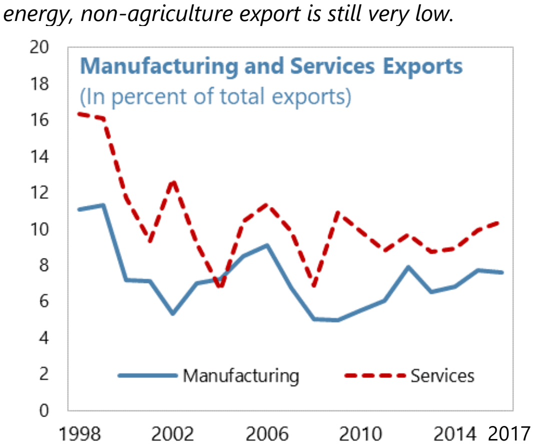
Production and exports are heavily concentrated in agricultural commodities and their derivatives.



The maquila industry has been growing fast…

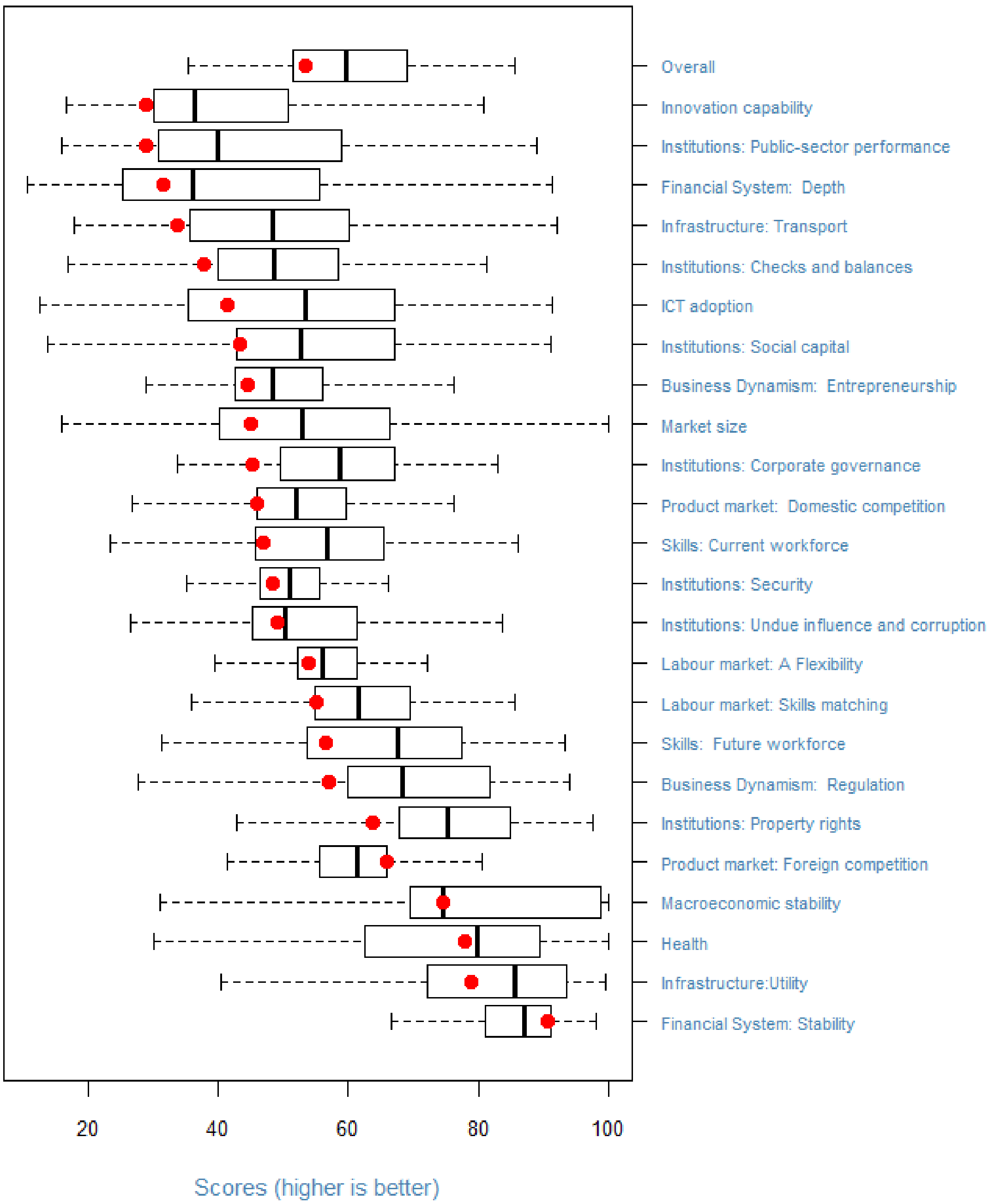


…but it started from a low base, and the share of non-energy, non-agriculture export is still very low.



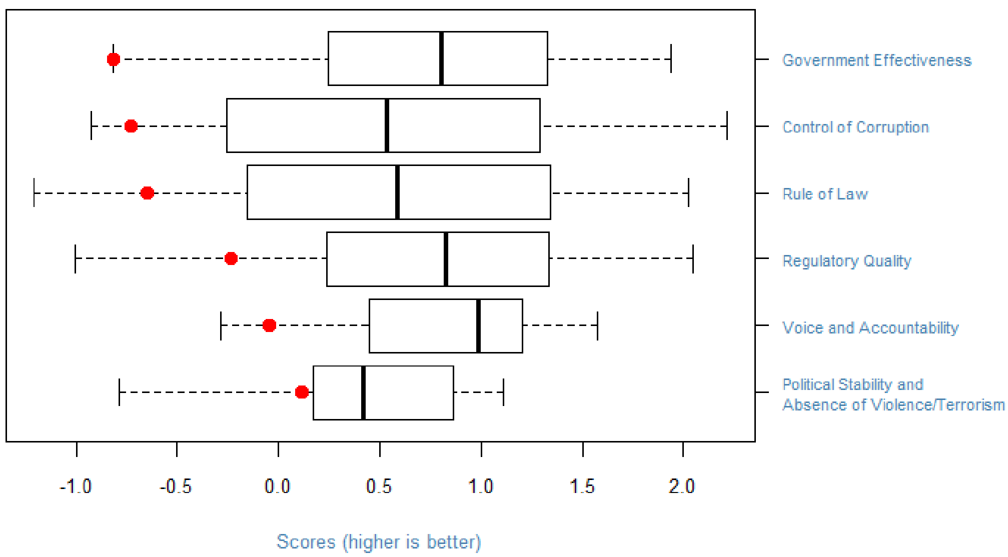
Sources: BCP and IMF staff estimates.

Figure 9a. Paraguay: World Competitiveness Indicators Scores: Paraguay vs Europe and Western Hemisphere



The boxes indicate the 25th percentile, median and 75 percentile. The whiskers indicate the range of the data.

Figure 9b. Paraguay: Worldwide Governance Indicators Values: Paraguay vs Europe and Western Hemisphere



The boxes indicate the 25th percentile, median and 75 percentile. The whiskers indicate the range of the data.

Table 1. Paraguay: Selected Economic and Social Indicators

I. Social and Demographic Indicators

Population 2017 (millions)	6.9	Gini index (2016)	48.2
Unemployment rate (2017)	5.2	Life expectancy at birth (2016)	73.1
Percentage of population below the poverty line (2017)	26.4	Adult literacy rate (2015)	95.1
Rank in UNDP development index (2018)	110 of 186	GDP per capita (US$, 2017)	5,667

II. Economic Indicators

						Est.	Proj.	
	2013	2014	2015	2016	2017	2018	2019	2020
	(Annual percent change, unless otherwise indicated)							
Income and prices								
Real GDP	8.4	4.9	3.1	4.3	5.0	3.7	3.5	4.0
Nominal GDP	13.2	7.8	4.7	8.6	7.2	8.8	6.8	8.7
Per capita GDP (U.S. dollars, thousands)	5.9	6.0	5.4	5.3	5.7	5.9	5.9	6.3
Consumption (contribution to real GDP growth)	3.1	4.6	3.2	1.9	3.4	3.8	2.8	1.6
Investment (contribution to real GDP growth)	2.2	2.1	-1.8	-0.2	2.7	2.0	1.9	1.8
Net Exports (contribution to real growth)	3.1	-1.9	1.7	2.6	-1.2	-2.1	-1.3	0.6
Consumer prices (end of period)	3.8	4.2	3.1	3.9	4.5	3.2	4.0	4.0
Nominal exchange rate (Guarani per U.S. dollar, eop)	4,524	4,626	5,807	5,767	5,590	5,961	...	...
Monetary sector								
Credit to private sector 1/	20.9	19.1	8.6	4.5	5.6	10.6	8.0	7.0
Monetary policy rate, year-end	6.0	6.8	5.8	5.5	5.3	5.3	...	...
External sector								
Exports (fob, values)	16.7	-3.7	-15.3	7.9	11.9	3.0	-0.4	8.2
Imports (cif, values)	7.8	1.1	-14.6	-5.1	17.7	12.1	3.2	4.1
Terms of trade	5.1	3.8	-5.4	2.3	-0.3	-1.7	0.3	1.9
Real effective exchange rate 2/	5.2	2.4	-2.6	-3.9	-0.5	3.2	...	...
	(In percent of GDP, unless otherwise indicated)							
External current account	**1.6**	**-0.1**	**-0.4**	**3.5**	**3.1**	**0.5**	**-0.8**	**0.4**
Trade balance	3.7	2.0	1.5	5.5	4.1	1.4	0.2	1.4
Exports	35.3	32.5	30.7	33.2	34.4	33.2	32.5	32.8
Of which: Electricity	5.8	5.3	5.6	5.9	5.4	5.1	5.1	4.9
Imports	-31.0	-30.0	-28.5	-27.2	-29.5	-31.0	-31.5	-30.6
Of which: Oil imports	-4.1	-4.2	-3.4	-2.7	-3.0	-3.9	-3.4	-3.3
Capital account and financial account	**0.7**	**4.2**	**-1.7**	**0.0**	**1.0**	**1.7**	**2.3**	**1.1**
Of which: Direct investment	0.6	1.0	0.9	1.0	1.2	0.9	1.0	1.0
Gross international reserves (in millions of U.S. dollars)	**5,871**	**6,891**	**6,200**	**7,144**	**8,146**	**8,004**	**8,404**	**8,809**
In months of next-year imports of goods and services	5.4	6.3	6.5	7.9	7.7	6.8	6.9	6.9
Ratio to short-term external debt	1.9	2.2	1.9	2.3	2.6	2.4	2.5	2.6
Gross domestic investment	**22.3**	**22.5**	**20.8**	**19.7**	**21.2**	**22.1**	**23.3**	**23.9**
Gross domestic saving	**23.9**	**22.4**	**20.4**	**23.3**	**24.3**	**22.6**	**22.5**	**24.3**
Central government revenues	**12.9**	**13.7**	**14.1**	**13.9**	**14.2**	**13.6**	**13.8**	**13.6**
Of which: Tax revenues	8.9	9.7	9.6	9.5	9.9	9.7	9.7	9.9
Central government expenditures	**14.1**	**14.6**	**15.5**	**15.0**	**15.3**	**14.9**	**15.2**	**15.1**
Of which: Compensation of Employees	6.9	6.7	7.0	6.5	6.3	6.4	6.4	6.3
Of which: Net Acquisition of Non Financial Assets	1.8	1.8	2.0	2.2	2.4	2.0	2.3	2.3
Central government net lending/borrowing	**-1.3**	**-0.9**	**-1.3**	**-1.1**	**-1.1**	**-1.3**	**-1.4**	**-1.5**
Central government primary balance	-1.0	-0.6	-0.9	-0.5	-0.5	-0.6	-0.6	-0.7
Public sector debt (excl. central bank bills)	**13.2**	**15.6**	**18.6**	**19.4**	**19.8**	**21.6**	**22.4**	**22.3**
Of which: Foreign currency	9.2	11.2	14.1	15.4	15.8	17.5	18.8	18.4
Of which: Domestic currency	4.1	4.4	4.5	4.1	4.0	4.1	3.5	3.9
Memorandum items:								
GDP (billions of Guaranies) 3/	166,715	179,722	188,231	204,447	219,188	238,480	254,654	276,794
GDP (US$ billions)	38.5	40.0	36.3	36.3	39.4	41.6	...	...

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

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

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

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

Table 2. Paraguay: Operations of the Central Government

(In percent of GDP, unless otherwise specified)

						Prel.	Proj.	
	2013	2014	2015	2016	2017	2018	2019	2020
Revenue	**12.9**	**13.7**	**14.1**	**13.9**	**14.2**	**13.6**	**13.8**	**13.6**
Taxes	8.9	9.7	9.6	9.5	9.9	9.7	9.7	9.9
Income taxes	1.9	2.0	2.1	2.2	2.3	2.1	2.1	2.2
Excises	1.2	1.4	1.3	1.3	1.3	1.3	1.3	1.4
Value added tax	4.7	5.2	5.2	5.1	5.1	4.7	4.8	4.7
Import duties	1.0	1.0	0.9	0.8	1.0	1.1	1.1	1.1
Other	0.1	0.1	0.1	0.2	0.2	0.5	0.5	0.5
Social contributions	1.0	1.3	1.1	1.0	1.1	0.9	0.9	0.9
Other revenue	3.0	2.7	3.4	3.4	3.2	3.1	3.2	2.8
Grants	0.6	0.6	0.7	0.7	0.5	0.7	0.4	0.4
Itaipu-Yacyreta hydroelectric plants	1.4	1.2	1.7	1.5	1.3	1.4	1.8	1.4
Other nontax revenue	1.0	1.0	1.0	1.2	1.4	1.0	1.0	1.0
Expenditure	**14.1**	**14.6**	**15.5**	**15.0**	**15.3**	**14.9**	**15.2**	**15.1**
Expense	**12.4**	**12.8**	**13.5**	**12.8**	**12.8**	**12.9**	**12.9**	**12.8**
Compensation of employees	6.9	6.7	7.0	6.5	6.3	6.4	6.4	6.3
Purchases of goods and services	0.9	1.1	1.2	1.2	1.2	1.2	1.2	1.2
Interest	0.2	0.3	0.5	0.6	0.6	0.6	0.8	0.8
Grants	2.2	2.4	2.4	2.2	2.1	2.0	1.8	1.8
Social benefits	1.6	1.6	2.1	2.0	2.1	2.2	2.2	2.2
Other expense	0.5	0.6	0.4	0.4	0.5	0.5	0.5	0.5
Gross operating balance	**0.5**	**1.0**	**0.7**	**1.1**	**1.3**	**0.7**	**0.9**	**0.8**
Net acquisition of nonfinancial assets	1.8	1.8	2.0	2.2	2.4	2.0	2.3	2.3
Net lending/borrowing (overall balance)	**-1.3**	**-0.9**	**-1.3**	**-1.1**	**-1.1**	**-1.3**	**-1.4**	**-1.5**
Net financial transactions	**1.3**	**0.9**	**1.3**	**1.1**	**1.1**	**1.3**	**1.4**	**1.5**
Net acquisition of financial assets	0.2	0.9	0.1	0.5	1.0	1.1	0.0	0.0
Financial investments	0.0	0.5	0.4	0.0	0.0	0.0	0.0	0.0
Net lending	0.0	0.5	0.4	0.0	0.0	0.0	0.0	0.0
Net incurrence of liabilities	1.5	1.5	1.5	1.9	2.4	2.3	1.4	1.6
Domestic	0.2	-0.9	0.7	-0.2	0.6	0.4	-0.2	0.9
Debt securities	0.5	0.3	0.0	-0.2	0.0	0.0	-0.4	0.5
New issues	0.6	0.6	0.3	0.2	0.4	0.3	0.0	1.0
Amortizations	-0.1	-0.3	-0.3	-0.5	-0.4	-0.3	-0.4	-0.5
Net credit from the banking system	-0.5	-1.3	0.5	0.3	0.7	0.4	0.2	0.4
Net credit from the Central bank 1/	-0.5	-1.4	0.6	0.3	0.7	0.4	0.2	0.4
Net credit from the commercial banks	0.0	0.0	0.0	0.1	0.0	0.0	0.0	0.0
Other accounts payable	0.1	0.1	0.1	-0.3	0.0	0.0	0.0	0.0
External	1.3	2.3	0.8	2.1	1.8	1.9	1.6	0.7
Disbursements	1.8	2.8	1.2	2.6	2.2	2.4	2.2	1.2
Amortizations	-0.5	-0.4	-0.4	-0.5	-0.5	-0.5	-0.6	-0.6
Statistical Discrepancy 2/	0.0	0.3	0.0	-0.3	-0.3	0.0	0.0	0.0
Memorandum items:								
Primary balance	-1.0	-0.6	-0.9	-0.5	-0.5	-0.6	-0.6	-0.7
Output gap 3/	1.1	1.4	0.0	-0.1	0.5	0.1	-0.4	-0.4
Central government gross debt	10.2	12.4	14.8	16.0	15.9	17.2	17.8	17.7
Nominal GDP (in billions of Guaranies)	166,715	179,722	188,231	204,447	219,188	238,480	254,654	276,794

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

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

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

3/ In percent of potential GDP.

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

(In percent of GDP)

						Est.	Proj.	
	2013	2014	2015	2016	2017	2018	2019	2020
Revenue	**16.6**	**17.5**	**18.7**	**19.1**	**19.0**	**18.1**	**18.4**	**18.2**
Tax revenue	9.2	9.8	9.9	9.9	10.3	10.0	10.1	10.2
Nontax revenue and grants 2/	6.8	7.4	8.4	8.3	8.3	7.6	7.9	7.6
Public enterprises operating surplus	0.5	0.3	0.3	0.9	0.4	0.5	0.5	0.5
Expenditure	**17.6**	**18.0**	**20.5**	**19.5**	**19.8**	**19.3**	**19.7**	**19.6**
Expense	**15.2**	**15.7**	**17.4**	**16.1**	**16.3**	**16.3**	**16.4**	**16.3**
Compensation of employees	8.8	8.6	9.8	8.6	8.4	8.5	8.5	8.4
Purchases of goods and services	1.5	2.1	2.1	2.2	2.2	2.2	2.2	2.2
Interest payments	0.6	0.6	0.8	0.9	1.0	1.1	1.2	1.3
Transfers 3/	3.8	3.8	4.1	3.5	3.8	3.6	3.6	3.6
Current transfers	3.1	3.2	3.7	3.6	3.7	3.6	3.6	3.6
Capital transfers	0.7	0.6	0.4	-0.1	0.1	0.0	0.0	0.0
Other expense	0.5	0.6	0.6	0.8	0.9	0.9	0.9	0.9
Gross operating balance	**1.3**	**1.7**	**1.3**	**3.0**	**2.6**	**1.8**	**2.0**	**1.9**
Net acquisition of nonfinancial assets	2.4	2.3	3.1	3.4	3.5	3.0	3.3	3.2
Net lending/borrowing (overall balance)	**-1.1**	**-0.6**	**-1.8**	**-0.4**	**-0.8**	**-1.2**	**-1.2**	**-1.3**
Net financial transactions	**1.1**	**0.6**	**1.8**	**0.4**	**0.8**	**1.2**	**1.2**	**1.3**
Net acquisition of financial assets	0.6	0.5	-0.1	1.9	2.2	2.3	1.2	1.2
Net incurrence of liabilities	1.7	1.1	1.7	2.3	3.1	3.5	2.4	2.6
External	1.3	2.4	0.9	2.3	1.8	2.0	1.7	0.7
Disbursements	1.8	2.9	1.4	2.9	2.3	2.5	2.3	1.3
Amortizations	-0.5	-0.5	-0.5	-0.6	-0.5	-0.5	-0.6	-0.6
Domestic	0.3	-1.4	0.8	0.3	1.3	1.5	0.7	1.8
Domestic debt	0.5	0.3	0.0	-0.2	0.0	0.0	-0.4	0.5
Disbursements	0.6	0.6	0.3	0.2	0.4	0.3	0.0	1.0
Amortizations	-0.1	-0.3	-0.3	-0.5	-0.4	-0.3	-0.4	-0.5
Deposits	-0.9	-2.1	0.2	0.1	0.9	1.1	0.9	1.2
Change in net deposits com.bks	-0.4	-0.7	-0.4	-0.2	0.2	0.7	0.7	0.8
Change in net deposits CBP	-0.5	-1.4	0.6	0.3	0.7	0.4	0.2	0.4
Quasi-fiscal deficit financing 4/	0.7	0.3	0.5	0.4	0.4	0.4	0.2	0.2
Other accounts payable	0.1	0.1	0.1	-0.3	0.0	0.0	0.0	0.0
Memorandum items:								
Primary balance	-0.5	0.1	-1.0	0.5	0.1	0.0	0.0	0.0
Public sector debt (excl. central bank bills)	13.2	15.6	18.6	19.4	19.8	21.6	22.4	22.3
Domestic public debt	4.1	4.4	4.5	4.1	4.0	4.1	3.5	3.9
Foreign public debt	9.2	11.2	14.1	15.4	15.8	17.5	18.8	18.4

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

1/ Includes the nonfinancial public sector and the central bank.

2/ Includes social contributions and grants.

3/ Includes social benefits, grants, and capital transfers.

4/ Corresponds to net losses of central bank capital which are not automatically compensated by the government.

Table 4. Paraguay: Summary Accounts of the Central Bank

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

						Est.	Proj.	
	2013	2014	2015	2016	2017	2018	2019	2020
Currency issued	**9,744**	**10,615**	**10,920**	**11,457**	**12,954**	**13,403**	**13,867**	**14,347**
Growth	13.2	8.9	2.9	4.9	13.1	3.5	3.5	3.5
Net international reserves	**27,125**	**31,934**	**27,521**	**31,789**	**36,329**	**35,468**	**37,319**	**39,194**
Net domestic assets	**-17,381**	**-21,319**	**-16,601**	**-20,332**	**-23,375**	**-22,065**	**-23,452**	**-24,847**
Net nonfinancial public sector	-5,837	-8,282	-6,565	-7,127	-8,084	-7,180	-6,672	-5,593
Net credit to the central government	-5,837	-8,282	-6,565	-7,126	-8,084	-7,180	-6,672	-5,592
Net credit to the banking system	-14,926	-16,961	-16,123	-20,641	-24,208	-24,478	-27,475	-31,047
Reserve requirements	-7,605	-9,096	-9,617	-9,558	-10,725	-11,205	-11,617	-12,003
Free reserves	-1,207	-2,036	-2,292	-2,992	-2,188	-2,188	-2,188	-2,188
Monetary control instruments 1/	-7,473	-6,918	-5,349	-9,321	-12,611	-12,401	-14,986	-18,173
Other	1,361	1,090	1,136	1,229	1,316	1,316	1,316	1,316
Other assets and liabilities (net)	3,382	3,924	6,087	7,436	8,917	9,593	10,695	11,794
Capital and reserves	5,387	6,218	2,897	3,709	4,751	5,614	6,179	6,676
Other assets net 2/	-2,005	-2,294	3,191	3,727	4,166	3,979	4,516	5,118
Memorandum Items:								
Total stock of IRMs outstanding 1/	7,614	6,873	5,307	9,247	12,682	12,401	14,986	18,173
Monetary base 3/	13,180	14,616	15,019	16,058	18,391	19,070	19,728	20,390
Monetary base, annual growth	-3	11	3	7	15	4	3	3
Quasi-fiscal balance	1,123	542	993	914	958	862	564	496
In percent of GDP	0.7	0.3	0.5	0.4	0.4	0.4	0.2	0.2
Cost of monetary policy operations	534	592	583	652	882	1,176	1,160	1,374
In percent of GDP	0.3	0.3	0.3	0.3	0.4	0.5	0.5	0.5

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

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

Table 5. Paraguay: Summary Accounts of the Financial System[1/]

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

	2013	2014	2015	2016	2017	Est. 2018	Proj. 2019	Proj. 2020
					I. Central Bank			
Net international reserves	**27,125**	**31,934**	**27,521**	**31,789**	**36,329**	**35,468**	**37,319**	**39,194**
Net domestic assets	**-17,381**	**-21,319**	**-16,601**	**-20,332**	**-23,375**	**-22,065**	**-23,452**	**-24,847**
Credit to public sector, net	-5,837	-8,282	-6,565	-7,127	-8,084	-7,180	-6,672	-5,593
Credit to banking system, net 2/	-7,452	-10,042	-10,774	-11,320	-11,597	-12,077	-12,489	-12,875
Credit	1,361	1,090	1,136	1,229	1,316	1,316	1,316	1,316
Deposits	8,813	11,132	11,910	12,549	12,913	13,393	13,805	14,191
Central bank securites	-7,614	-6,873	-5,307	-9,247	-12,682	-12,401	-14,986	-18,173
Other	3,522	3,879	6,045	7,362	8,989	9,593	10,695	11,794
Currency issued	**9,744**	**10,615**	**10,920**	**11,457**	**12,954**	**13,403**	**13,867**	**14,347**
					II. Monetary Survey			
Net foreign assets	**25,112**	**29,517**	**25,632**	**29,843**	**34,235**	**33,385**	**35,249**	**37,135**
In millions of U.S. dollars	5,424	6,376	5,537	6,447	7,395	7,212	7,614	8,022
Net domestic assets	**39,845**	**44,795**	**51,917**	**53,078**	**55,836**	**60,663**	**62,490**	**64,092**
Credit to the public sector	-9,332	-12,278	-11,204	-13,441	-14,831	-13,920	-13,407	-12,321
Credit to the private sector	57,641	68,660	74,563	77,924	82,309	91,073	98,317	105,242
Other	-8,463	-11,587	-11,442	-11,405	-11,642	-16,490	-22,421	-28,829
Broad liquidity (M4)	**64,957**	**74,313**	**77,548**	**82,921**	**90,071**	**94,048**	**97,738**	**101,227**
Bonds and issued securities	0	0	0	0	0	0	0	0
Other monetary liabilities	3,791	4,826	5,525	4,991	4,927	5,149	5,355	5,548
Central bank securities with private sector	140	0	0	0	71	0	0	0
Broad liquidity (M3)	**61,025**	**69,487**	**72,024**	**77,930**	**85,073**	**88,899**	**92,383**	**95,679**
Foreign currency deposits	20,605	25,358	26,378	26,904	27,606	28,711	29,859	30,934
Money and quasi-money (M2)	**40,420**	**44,129**	**45,645**	**51,026**	**57,466**	**60,188**	**62,524**	**64,745**
Quasi-money	20,340	22,411	22,969	26,464	29,127	30,584	31,807	32,952
Money (M1)	20,080	21,718	22,676	24,562	28,339	29,604	30,717	31,793
					(Annual percent change)			
M0 (Currency issued)	13.2	8.9	2.9	4.9	13.1	3.5	3.5	3.5
Credit to the private sector	20.9	19.1	8.6	4.5	5.6	10.6	8.0	7.0
M1	13.1	8.2	4.4	8.3	15.4	4.5	3.8	3.5
M2	16.9	9.2	3.4	11.8	12.6	4.7	3.9	3.6
M3	19.1	13.9	3.7	8.2	9.2	4.5	3.9	3.6
Of which: Foreign currency deposits	23.5	23.1	4.0	2.0	2.6	4.0	4.0	3.6
Memorandum items:								
Ratio of foreign currency deposits to M3 (percent)	33.8	36.5	36.6	34.5	32.5	32.3	32.3	32.3
Ratio of foreign currency deposits to total private sector deposits (percent)	35.7	38.2	38.2	36.4	34.6	35.5	35.5	35.5

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

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

2/ Excludes LRM held by the banking sector.

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

	2013	2014	2015	2016	2017	Est. 2018	Proj. 2019	2020
Current account	**621**	**-51**	**-145**	**1,275**	**1,215**	**213**	**-336**	**175**
Trade balance	1,443	804	544	1,973	1,608	579	86	636
Exports	13,605	13,105	11,104	11,983	13,405	13,813	13,753	14,883
Hydro-Electricity	2,245	2,144	2,036	2,131	2,105	2,103	2,156	2,204
Agricultural Products	6,073	6,236	5,149	5,248	5,310	5,547	5,180	5,880
Industrial Products and others	1,138	1,257	1,143	1,123	1,265	1,386	1,385	1,447
Unregistered	1,472	1,331	1,223	1,201	1,356	1,526	1,607	1,710
Re-Export	2,677	2,138	1,554	2,282	3,370	3,251	3,425	3,643
Imports	-11,942	-12,079	-10,317	-9,789	-11,524	-12,918	-13,334	-13,881
Of which: Fuel products	-1,571	-1,696	-1,221	-987	-1,183	-1,631	-1,440	-1,494
Services (net)	-219	-222	-244	-221	-273	-317	-334	-366
Transport	-276	-311	-341	-306	-376	-412	-425	-453
Travel	30	33	37	26	38	29	26	21
Other	27	56	60	59	66	66	65	66
Factor income	-1,542	-1,461	-1,361	-1,474	-1,216	-1,243	-1,315	-1,418
Transfers	720	606	672	775	823	877	893	957
Capital and financial account	**263**	**1,673**	**-604**	**0**	**376**	**716**	**990**	**502**
Capital transfers	61	141	154	163	166	170	172	174
Direct investment	245	412	308	371	456	381	415	433
Portfolio investment	500	1,300	280	300	500	517	474	0
Other investment	-543	-180	-1,346	-834	-746	-352	-71	-105
Errors and omissions	**151**	**-484**	**189**	**-318**	**-714**	**-1,115**	**-254**	**-272**
Overall balance	**1,036**	**1,138**	**-560**	**957**	**877**	**-186**	**400**	**405**
Net international reserves (increase -)	-877	-1,020	691	-944	-1,002	186	-400	-405
Change in Gross Reserves	-1,036	-1,131	560	-957	-877	186	-400	-405
Other factors affecting reserve balance	159	111	131	14	-125	0	0	0
Exceptional financing	0	-7	0	0	0	0	0	0
Memorandum items:								
Current account in percent of GDP 1/	1.6	-0.1	-0.4	3.5	3.1	0.5	-0.8	0.4
Gross reserves (in millions of U.S. dollars)	5,871	6,891	6,200	7,144	8,146	8,004	8,404	8,809
In months of imports of GNFS	5.4	6.3	6.5	7.9	7.7	6.8	6.9	6.9
Debt service in percent of exports GNFS	9.7	10.5	12.0	11.9	11.1	10.7	11.5	11.0
Export volume (percent change)	14.6	-4.3	4.6	9.8	8.0	-1.5	0.2	5.6
Import volume (percent change)	12.0	3.9	0.2	-0.4	12.9	4.9	4.0	3.9
Terms of trade (percent change)	5.1	3.8	-5.4	2.3	-0.3	-1.7	0.3	1.9

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

Table 7. Paraguay: Indicators of External Vulnerability
(In percent of GDP, unless otherwise specified)

	2013	2014	2015	2016	2017	Est. 2018
Monetary and financial indicators						
Broad money (M3), percentage change 1/	19.1	13.9	3.7	8.2	9.2	4.5
Credit to the private sector, real (percent change) 1/	16.6	14.3	5.3	0.6	1.1	7.2
Share of nonperforming loans in total loans (percent)	2.0	1.8	2.5	2.8	2.7	2.4
Average domestic bank lending rate, real	13.5	10.6	13.9	12.0	11.2	11.3
Central Bank bill yield, real	3.2	0.9	2.9	2.2	2.4	1.6
Central bank foreign short-term liabilities (millions of U.S. dollars)	0.0	0.0	1.4	1.2	0.0	0.0
External indicators						
Merchandise exports (percentage change)	0.3	-0.4	-16.2	-4.3	1.8	3.8
Merchandise imports (percentage change)	-3.4	-1.2	-13.3	-3.0	1.3	6.8
Merchandise terms of trade (percentage change)	3.8	0.8	-3.3	-1.3	0.5	-2.8
Real effective exchange rate (percentage change)	-3.2	7.4	-8.8	0.2	0.4	3.9
Current account balance (percent of GDP)	1.6	-0.1	-0.4	3.5	3.1	0.5
Capital and financial account (percent of GDP)	0.7	4.2	-1.7	0.0	1.0	1.7
Net foreign direct investment (percent of GDP)	0.6	1.0	0.9	1.0	1.2	0.9
Other net investment (percent of GDP)	-1.4	-0.4	-3.7	-2.3	-1.9	-0.8
External public debt (percent of GDP) 2/	9.2	11.2	14.1	15.4	15.8	17.5
o/w: Central Government External Debt (percent of GDP) 2/	6.4	8.5	11.1	12.8	12.9	14.4
Total external debt (percent of GDP) 2/	42.9	41.8	49.0	44.1	40.1	39.4
Excluding debt of binational companies 2/	14.9	16.7	20.9	20.2	20.6	22.2
External Debt service (in percent of exports GNFS)	9.7	10.5	12.0	11.9	11.1	10.7
International reserves (in millions of U.S. dollars)	5,871	6,891	6,200	7,144	8,146	8,004
In months of imports of GNFS	5.4	6.3	6.5	7.9	7.7	6.8
Ratio to short-term external debt 3/	1.9	2.2	1.9	2.3	2.6	2.4

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

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

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

		Est.	Proj.					
	2017	2018	2019	2020	2021	2022	2023	2024
National accounts and prices								
Real GDP growth (in percent)	5.0	3.7	3.5	4.0	4.0	4.0	4.0	4.0
Output gap 1/	0.5	0.1	-0.4	-0.4	-0.4	-0.4	-0.2	0.1
Gross domestic investment	21.2	22.1	23.3	23.9	24.9	25.7	26.6	27.2
Gross domestic savings	24.3	22.6	22.5	24.3	25.4	26.4	27.3	27.8
Consumer prices (end of period; in percent)	4.5	3.2	4.0	4.0	4.0	4.0	4.0	4.0
Public finances								
Central government primary balance	-0.5	-0.6	-0.6	-0.7	-0.7	-0.7	-0.6	-0.6
Central government net lending/borrowing	-1.1	-1.3	-1.4	-1.5	-1.5	-1.5	-1.4	-1.4
Central government debt	15.9	17.2	17.8	17.7	17.8	17.9	18.1	18.3
Public sector debt	19.8	21.6	22.4	22.3	22.3	22.3	22.3	22.4
External sector								
Terms of trade (annual percent change)	-0.3	-1.7	0.3	1.9	0.9	0.7	0.6	0.3
Current account	3.1	0.5	-0.8	0.4	0.5	0.7	0.7	0.6
Foreign direct investment	1.2	0.9	1.0	1.0	1.0	1.0	1.0	1.0
Gross international reserves (in US$ billion)	8.1	8.0	8.4	8.8	9.2	9.6	10.1	10.6

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

1/ In percent of potential GDP

Annex I. Recommendations of the 2017 Article IV Consultation and Authorities' Actions

Fund Recommendation	Policy Action
Monetary Policy	
Foreign Exchange interventions should continue to be limited to exceptional circumstances such as disorderly market Conditions.	The BCP intervened in the foreign exchange market, mainly between May and October in 2018 (in reactions to the development in Argentina) to prevent the guaraní from having large and unwarranted exchange rate movements in a foreign exchange market that is small and illiquid.
Fiscal Policy	
Pension reform.	A draft law to establish the superintendence of pension was rejected by Congress in 2018. The authorities are revising the draft and will resubmit to Congress later.
Strengthen the budget process to prevent Congress approval of budgets that exceed the ceiling of the FRL.	The government budgets for 2018 and 2019 approved by Congress stayed within the limits of the FRL ceiling.
Expenditure review to identify spending re-prioritization including for social assistance programs.	The World Bank has recently completed a public expenditure review on social sectors. The results are an important input for the public-private commission for the review of public expenditure.
Financial Sector	
Revisions to the BCP organic charter.	The BCP organic charter was approved and promulgated in 2018.
Establishment of a financial stability council with a public decree.	The financial stability committee is created at the BCP.
Improving data collection on the shadow banking sector.	The bank superintendence is setting up data reporting of income statements and balance sheets from the unregulated lenders.
Integrating financial information through a single credit bureau.	Financial information on all segments of the financial sector is not yet fully integrated in the existing credit bureau. Weaknesses still exist in building the appropriate infrastructure to collect and process surveillance data for cooperatives and credit houses and their interconnectedness with banks.

Approving legislation regarding the Sociedades Anonimas and bearer securities in line with international AML/CFT standards.	Congress approved the legislation *Sociedades Constituidas por Acciones* in September 2017, Decree is signed by the President in June 2018 and the BCP issued regulation in September 2018.
Structural Reforms	
Improving transportation and electricity distribution infrastructure.	The government is planning to tender seven transport infrastructure projects of around US$1.5 billion between 2019 and 2021. The national electricity administration, ANDE, is actively investing in transmission lines and other electricity distribution infrastructure, with a financing package of US$500 million for next 5 years.
Reducing the informal sector.	The government is proposing legislation to simplify company formation and registration, with the goal to encourage formalization.

Annex II. External Sector Assessment

The external position of Paraguay has weakened in 2018 but remains stronger than the level implied by fundamentals and desirable policies. External stability risks remain contained given the low level of external debt.

External Balance Sheets

Background

1. **Paraguay's net international investment position (NIIP) has improved in the past decade and a half, the result of an increase in foreign reserves and a decline in external debt**. The reduction in external debt, from nearly 193 percent of GDP in 2003 to 40 percent of GDP in 2018 was the result of the amortization of the debt of the binational hydroelectric company (ITAIPU; about 18 percent of GDP in 2018), which was only partly offset by an increase in external government debt.

2. **Currently, FDI (mainly in the agrobusiness sector) is be the largest source of liabilities of the private sector, at around 15 percent of GDP**.

Assessment

3. **Going forward, external debt is expected to decline steadily as the debt of the binational hydroelectrical company continues to fall**. The external position remains sustainable under a range of adverse shocks.

Current Account

Background

4. **Paraguay's current account has been in surplus over the last 20 years, averaging 1.2 percent of GDP**. The current account surpluses in 2016 and 2017 were particularly strong, the result of record hydro-electricity exports and a surge in agricultural exports. The current account balance deteriorated in 2018 but remained in surplus. The deterioration was the result of to the sharp decline in the trade balance, which reflect both weaker exports (the result of the exchange rate appreciation) and strong import demand. National savings have remained relatively stable as a share of GDP. The current account balance in 2019 is expected to deteriorate due to lower soy bean export, resulting from the drought in the early planting season. Over the medium-term, the current account balance is expected to increase gradually to around 0.6 percent of GDP, reflects the rebound in soy bean production and the decline in interest payment to the binational loan.

Assessment

5. The current account balance of Paraguay is stronger than the multilateral consistent cyclically adjusted current account norm. The estimated current account gap is 3.8 percent of GDP. However, these results need to be interpreted with caution. The current account gap consists of the policy gap (-0.6 percent of GDP), adjustment for natural disasters and conflicts (insignificant), multilateral consistency adjustment (-0.5 percent of GDP), and the residual from the current account regression model (4.9 percent of GDP).[1]

6. The large size of the residual suggests that the regression model does not capture well the factors that determine the current account norm of Paraguay. For example, the repression model does not take into account the fact that Paraguay is landlocked (which may lead to a lower level of foreign direct investment), nor does it take into account the impact of the business climate on foreign investment inflows.

7. Staff's preferred approach to assess the current account position is based on the current account balance that nets out the amortization to binationals. Paraguay has borrowed heavily in the past to build the binational hydro-electric plant (which showed as a large current account deficit in the 1980s). It uses less than the half of Itaipu's electricity production that it is entitled to and exports the remainder to Brazil. Paraguay also needs to service the debt of Itaipu to Brazil. In essence, it pays off the debt through electricity exports. These transactions generate a positive current account item, and an offsetting capital outflow, with no impact on the rest of the economy.[2]

[1] The policy gap is mainly the result of the low level of public health expenditure in 2018 and the gap between Paraguay's productivity growth and the world (measured by relative GDP, in PPP terms, per worker). Given the ceiling on the fiscal deficit as required by the FRL, increasing public health expenditure will require a rebalancing of fiscal resources. Closing the productivity gap requires structural reforms (see earlier sections for details).

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

Summary of the EBA-lite Current Account (CA) Regression Results for 2018[1/]

(percent of GDP)	Total CA	CA excluding amortization to binationals
Current Account Balance (CA)	0.5%	-1.3%
Export of Goods and Services	35.7%	35.7%
Import of Goods and Services	34.3%	34.3%
Cyclical Contributions (from model)	-0.2%	-0.2%
Multilaterally Consistent Cyclically adjusted CA Norm	-3.3%	-3.3%
CA-Gap	3.9%	2.1%
Policy Gap	-0.6%	-0.6%
Natural Disasters and Conflicts	0.0%	0.0%
Multilateral Consistence Adjustment	-0.5%	-0.5%
Residual	5.0%	3.2%
Elasticity of current account to REER 2/	-0.26	-0.26
Implied REER Gap	-15.3%	-8.1%

1/ The current account balance is based on IMF staff projection

2/ The elasticity of current account is calculated as Export of Goods and Service/GDP multiplied by an export elasticity of -0.44 minus Import of Goods and Services/GDP multiplied by import elasticity of 0.29

Real Exchange Rate

Assessment

8. The real exchange rate regression approach yields result consistent with result of the current account regression approach.

Summary of the EBA-lite REER Regression Results for 2018

Actual REER (in log)	4.74
Fitted REER (in log)	4.80
REER Norm (in log)	4.81
REER Gap	-7.0%
Residual	-5.9%
Policy Gap	-0.3%
Natural Disasters and Conflicts	-0.8%

9. There is a strong link between dollar-denominated agricultural commodity export prices and Paraguay's real exchange rate. When commodity prices strengthen, the real exchange rate tends to appreciate, and when they fall, so does the REER.

10. In 2018, the real exchange rate was somewhat stronger than suggested by the historical link between commodity prices and the REER. This reflected in part the appreciation of Paraguay against its neighbors.

Capital and Financial Flows

Background

11. **Foreign direct investment has been the major source of capital inflows in last few years.** In addition, the government has been tapping funding from the international markets with a placement of bonds for US$500 million each year from 2016 to 2018. These international offerings have become another stable source of capital inflows.

Assessment

12. **Paraguay has a fully open capital and financial account, but financial markets are not deep or developed, yet**. Paraguay has enjoyed a stable flow of FDI in the last decade, and despite the economic turmoil in Argentina and Brazil in 2018, FDI is expected to remain positive for 2018, albeit at a lower level than in 2017. Vulnerabilities to the financial flows remain contained as the major source of capital is direct investment and government's external borrowing, which was received well in the last few international public offerings, given the low level of public debt.

Reserves

Background

13. **International reserves registered a net decline of US$146 million to US$8,004 million at end-2018**. Strong accumulation of international reserves continued in Q1-2018 but the trend reversed as the BCP started to intervene in the foreign exchange market to contain the depreciation pressure on the Guaraní. The BCP sold a total of US$1,273 million in the foreign exchange market in 2018. The sales of foreign reserve slowed down towards to the end of the year after peaking in mid-2018, as the depreciation pressure on the Guaraní subsided.

Assessment

14. **Reserves remain ample (about 7 months of imports) and above the Fund metrics for a small open economy (the level of reserves at end-2018 was close to two times the level of reserves considered adequate under the metric)**. The flexible exchange rate continues to be the first line of defense against external shocks. Staff recommends continuing with a rules-based approach for regular dollar sales and to limit discretionary interventions to exceptional situations of disorderly market conditions.

Table 1. Paraguay: External Debt Sustainability Framework 2013–23

(In percent of GDP, unless otherwise specified)

	Actual							Projections						
	2013	2014	2015	2016	2017	10-Year Historical Average	10-Year Standard Deviation	2018	2019	2020	2021	2022	2023	Debt-stabilizing non-interest current account 6/
Baseline: External debt	41.0	40.6	43.8	43.0	39.9			**37.6**	**37.4**	**34.5**	**31.9**	**29.6**	**27.7**	**-1.3**
Change in external debt	-7.2	-0.4	3.2	-0.8	-3.0			-2.4	-0.1	-3.0	-2.6	-2.3	-1.9	
Identified external debt-creating flows (4+8+9)	-8.9	-2.6	4.2	-4.4	-7.5			-2.8	-1.5	-2.7	-2.8	-2.8	-2.8	
Current account deficit, excluding interest payments	-3.3	-1.4	-1.4	-5.3	-4.6			-2.0	-0.8	-2.0	-2.1	-2.1	-2.1	
Deficit in balance of goods and services	-3.7	-2.0	-1.5	-5.4	-4.1			-1.4	-0.2	-1.4	-1.5	-1.5	-1.4	
Exports	37.5	35.0	33.0	35.4	36.4			35.2	34.5	34.8	34.2	33.7	33.2	
Imports	33.8	33.0	31.5	30.0	32.3			33.8	34.3	33.4	32.7	32.2	31.8	
Net non-debt creating capital inflows (negative)	-0.6	-1.0	-0.8	-1.0	-1.2			-0.9	-1.0	-0.9	-1.0	-0.9	-0.9	
Automatic debt dynamics 1/	-5.0	-0.2	6.4	1.9	-1.7			0.1	0.3	0.2	0.2	0.2	0.2	
Contribution from nominal interest rate	1.7	1.5	1.8	1.8	1.5			1.5	1.6	1.6	1.5	1.4	1.3	
Contribution from real GDP growth	-3.5	-1.9	-1.4	-1.9	-2.0			-1.4	-1.3	-1.4	-1.3	-1.2	-1.1	
Contribution from price and exchange rate changes 2/	-3.1	0.2	6.0	2.0	-1.3			...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	1.7	2.2	-1.0	3.6	4.4			0.4	1.3	-0.2	0.2	0.5	0.9	
External debt-to-exports ratio (in percent)	109.4	116.0	132.9	121.4	109.7			106.6	108.4	99.0	93.3	87.8	83.4	
Gross external financing need (in billions of US dollars) 4	1.9	2.5	2.7	1.3	1.3			2.4	3.0	2.5	2.4	2.4	3.2	
in percent of GDP	5.0	6.3	7.4	3.6	3.4			5.6	6.9	5.4	4.9	4.6	5.7	
Scenario with key variables at their historical averages 5/								**37.6**	**32.2**	**27.2**	**22.7**	**18.4**	**14.5**	**-1.8**
Key Macroeconomic Assumptions Underlying Baseline														
Real GDP growth (in percent)	8.4	4.9	3.1	4.3	5.0	4.7	3.5	3.7	3.5	4.0	4.0	4.0	4.0	
GDP deflator in US dollars (change in percent)	6.9	-0.5	-12.9	-4.4	3.1	4.0	12.8	2.8	-1.6	3.0	2.6	2.4	2.1	
Nominal external interest rate (in percent)	4.0	3.9	4.0	4.1	3.8	4.2	0.3	4.0	4.4	4.6	4.7	4.8	4.8	
Growth of exports (US dollar terms, in percent)	16.5	-3.2	-14.5	7.5	11.5	7.5	17.8	3.2	-0.2	8.0	4.8	4.9	4.7	
Growth of imports (US dollar terms, in percent)	8.3	1.4	-13.4	-4.6	16.9	9.0	22.6	11.7	3.3	4.3	4.5	4.7	4.8	
Current account balance, excluding interest payments	3.3	1.4	1.4	5.3	4.6	3.2	1.7	2.0	0.8	2.0	2.1	2.1	2.1	
Net non-debt creating capital inflows	0.6	1.0	0.8	1.0	1.2	1.2	0.5	0.9	1.0	0.9	1.0	0.9	0.9	

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

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

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

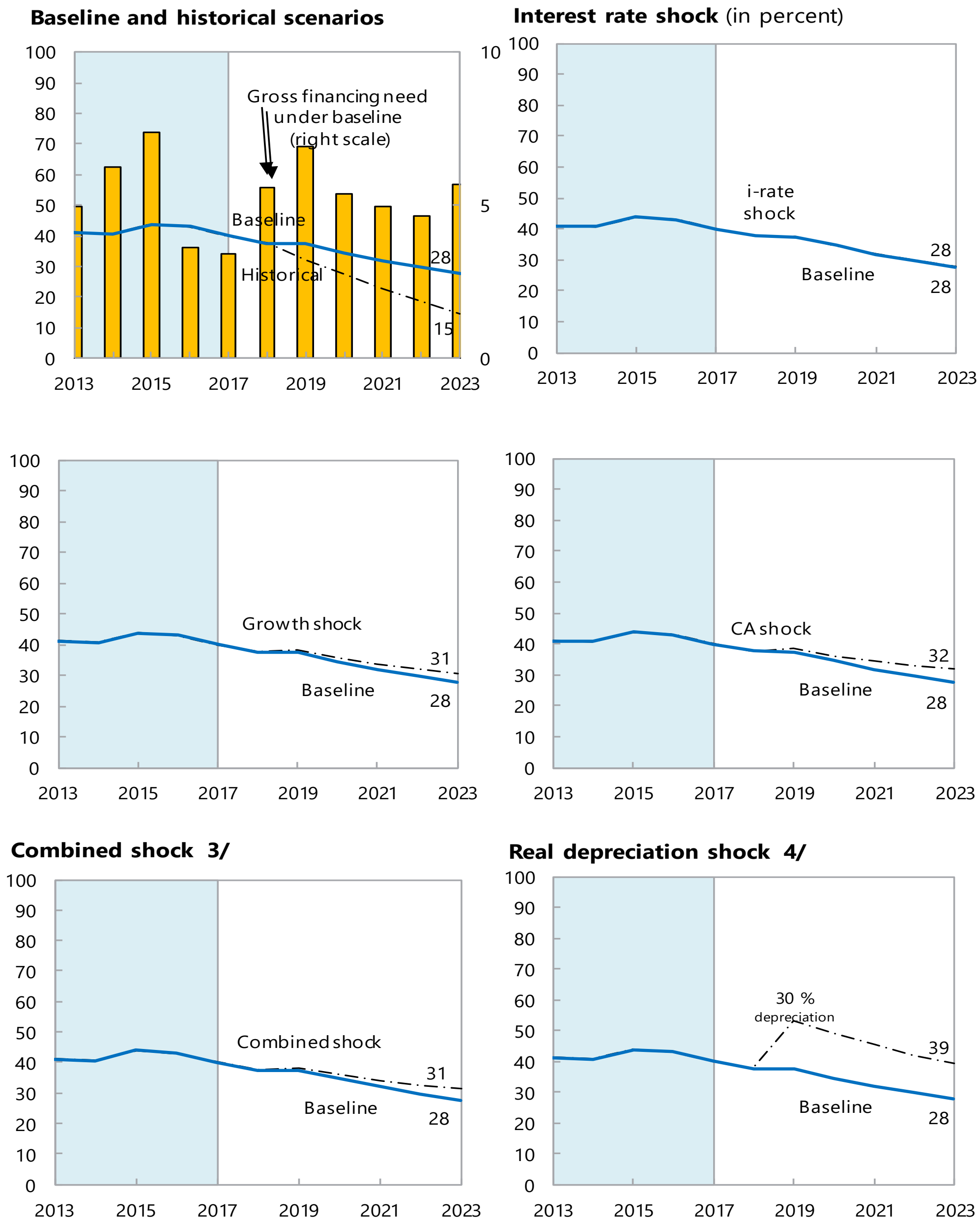
4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

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

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

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

(External debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.
3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
4/ One-time real depreciation of 30 percent occurs in 2019.

Annex III. Public Sector Debt Sustainability Analysis

Paraguay: Public Sector Debt Sustainability Analysis

(In percent of GDP unless otherwise specified)

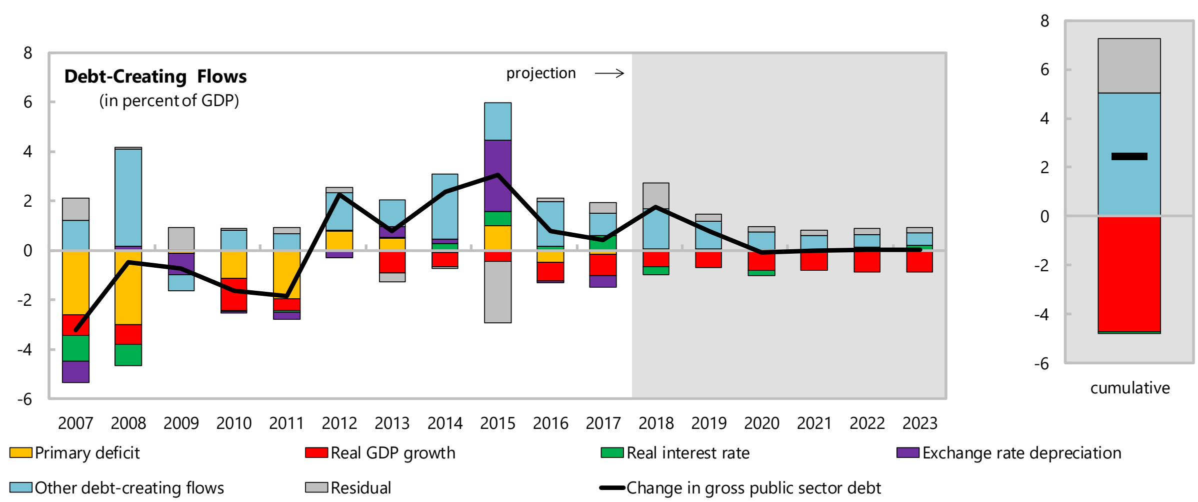
Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2007-2015	2016	2017	2018	2019	2020	2021	2022	2023
Nominal gross public debt	13.9	19.4	19.8	21.6	22.4	22.3	22.3	22.3	22.3
Public gross financing needs	0.9	1.4	1.7	1.5	1.8	1.9	1.8	2.2	3.5
Real GDP growth (in percent)	4.7	4.3	5.0	3.7	3.5	4.0	4.0	4.0	4.0
Inflation (GDP deflator, in percent)	5.8	4.1	2.1	4.9	3.2	4.5	3.9	3.7	3.5
Nominal GDP growth (in percent)	10.8	8.6	7.2	8.8	6.8	8.7	8.0	7.8	7.7
Effective interest rate (in percent) [2/]	5.2	5.2	5.5	3.4	3.6	3.7	4.2	4.5	4.7

As of January 17, 2019		
Sovereign Spreads		
EMBIG (bp)		231
5Y CDS (bp)		...
Ratings	Foreign	Local
Moody's	Ba1	Ba1
S&Ps	BB	BB
Fitch	BB+	BB+

Contribution to Changes in Public Debt

	Actual			Projections							
	2007-2015	2016	2017	2018	2019	2020	2021	2022	2023	cumulative	debt-stabilizing primary balance [8/]
Change in gross public sector debt	0.1	0.8	0.4	1.8	0.8	-0.1	0.0	0.0	0.0	2.5	
Identified debt-creating flows	0.1	0.6	0.0	0.7	0.5	-0.3	-0.2	-0.2	-0.2	0.2	
Primary deficit	-0.7	-0.5	-0.1	0.0	0.0	0.0	0.0	0.0	-0.1	0.0	-0.6
Primary (noninterest) revenue and grants	16.5	19.1	19.0	18.1	18.4	18.2	18.3	18.3	18.5	109.8	
Primary (noninterest) expenditure	15.7	18.6	18.8	18.1	18.4	18.2	18.3	18.3	18.4	109.8	
Automatic debt dynamics [3/]	-0.6	-0.7	-0.8	-1.0	-0.6	-1.0	-0.8	-0.7	-0.6	-4.8	
Interest rate/growth differential [4/]	-0.7	-0.6	-0.3	-1.0	-0.6	-1.0	-0.8	-0.7	-0.6	-4.8	
Of which: real interest rate	-0.1	0.2	0.6	-0.3	0.1	-0.2	0.0	0.1	0.2	-0.1	
Of which: real GDP growth	-0.6	-0.7	-0.9	-0.7	-0.7	-0.8	-0.8	-0.8	-0.8	-4.7	
Exchange rate depreciation [5/]	0.1	-0.1	-0.5	…	…	…	…	…	…	…	
Other identified debt-creating flows	1.4	1.8	0.9	1.6	1.1	0.7	0.6	0.5	0.5	5.0	
NFPS asset accumulation [6/]	1.4	1.8	0.9	1.6	1.1	0.7	0.6	0.5	0.5	5.0	
Residual [7/]	-0.1	0.1	0.5	1.0	0.3	0.2	0.2	0.2	0.2	2.2	



Source: Fund staff estimates and projections.

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

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

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

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

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

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

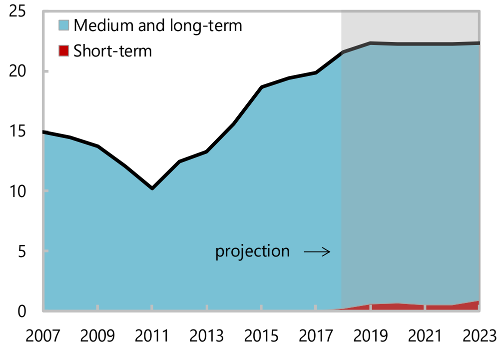
7/ Includes asset changes and interest revenues (if any). For projections, it includes the impacts of exchange rate changes.

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

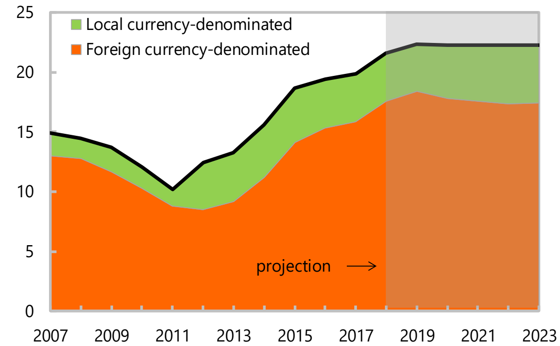
Paraguay: Public DSA - Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

By Maturity
(in percent of GDP)



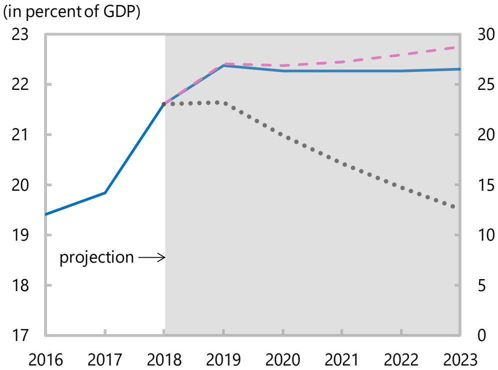
By Currency
(in percent of GDP)



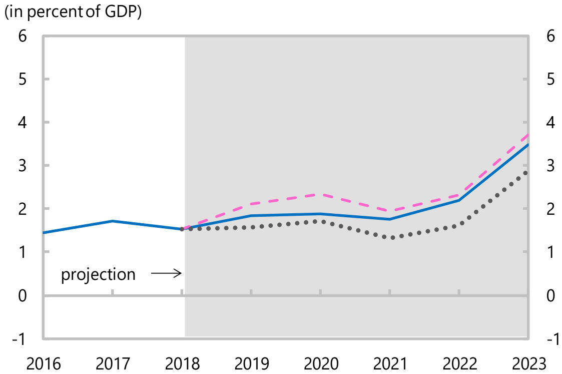
Alternative Scenarios

Baseline Historical Constant Primary Balance

Gross Nominal Public Debt
(in percent of GDP)



Public Gross Financing Needs
(in percent of GDP)



Underlying Assumptions
(in percent)

Baseline Scenario	2018	2019	2020	2021	2022	2023
Real GDP growth	3.7	3.5	4.0	4.0	4.0	4.0
Inflation	4.9	3.2	4.5	3.9	3.7	3.5
Primary Balance	0.0	0.0	0.0	0.0	0.0	0.1
Effective interest rate	3.4	3.6	3.7	4.2	4.5	4.7
Constant Primary Balance Scenario						
Real GDP growth	3.7	3.5	4.0	4.0	4.0	4.0
Inflation	4.9	3.2	4.5	3.9	3.7	3.5
Primary Balance	0.0	0.0	0.0	0.0	0.0	0.0
Effective interest rate	3.4	3.6	3.7	4.3	4.7	4.8

Historical Scenario	2018	2019	2020	2021	2022	2023
Real GDP growth	3.7	4.7	4.7	4.7	4.7	4.7
Inflation	4.9	3.2	4.5	3.9	3.7	3.5
Primary Balance	0.0	0.5	0.5	0.5	0.5	0.5
Effective interest rate	3.4	3.6	3.8	4.4	4.7	4.8

Source: Fund staff estimates and projections.

INTERNATIONAL MONETARY FUND

PARAGUAY

March 29, 2019

STAFF REPORT FOR THE 2019 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By

The Western Hemisphere Department
(In consultation with other departments)

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FUND RELATIONS

(As of March 25, 2018)

Membership Status: Joined: December 28, 1945 Article VIII

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

SDR Department:	**SDR Million**	**% Allocation**
Net cumulative allocation	95.19	100.00
Holdings	95.76	100.59

Outstanding Purchases and Loans: None

Latest Financial Arrangements:

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

Projected Payments to Fund[1]

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

	Forthcoming			
	2019	2020	2021	2022
Principal				
Charges/Interest	0.00	0.00	0.00	0.00
Total	0.00	0.00	0.00	0.00

Exchange Arrangement: The currency of Paraguay is the Paraguayan guaraní. The objective of the BCP under Article 3 of the amendment to Organic Law No. 489/95 (Law No. 6104/2018) is to preserve and safeguard the stability of the currency and promote the efficiency, stability and integrity of the financial system. Article 50 of Law No. 489/95 establishes that foreign currency trading by the BCP aims to smooth seasonal fluctuations in supply and demand and offset erratic capital flows and speculative movements that could disrupt the market or the exchange rate. The de jure exchange rate arrangement is floating as Article 47 of Law No. 489/95 establishes that the exchange rate is

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

determined by market forces. The BCP publishes information on its foreign exchange interventions on its website. The BCP intervenes occasionally in the market to smooth the effects of undue fluctuation. The BCP, as the government's financial agent, receives U.S. dollars from the government flowing from the royalties and compensation paid by the binational hydroelectric entities and exchanges them for guaranies at the request of the government for the purpose of public expenditures. Since June 2018, the exchange rate has followed a depreciating trend within a 2 percent band against the U.S. dollar with one realignment in November 2018. Accordingly, the de facto exchange rate arrangement was reclassified to "crawl like" from "floating", effective June 11, 2018 under the IMF exchange rate arrangement classification system.[2] Paraguay has accepted the obligations of Article VIII, Sections 2(a), 3, and 4 of the Fund's Articles of Agreement. Its exchange system is free of restrictions and multiple currency practices on the making of payments and transfers for current international transactions.

Article IV Consultation: The Executive Board concluded the 2017 Article IV consultation and considered and endorsed the staff appraisal without a meeting in July 2017.

Technical Assistance 2011–19

DPT	Purpose	Date of Delivery
FAD	Public-Private Partnerships	February 2011
STA	National Accounts Statistics	March–April 2011
FAD	Medium-Term Macro-Fiscal Framework and Public Investment Management	March–April 2011
MCM	Monetary Policy, Central Bank Operations, and Accounting	April 2011
FAD	Public Transport Subsidies	June–July 2011
MCM	Financial Soundness Indicators and Financial Oversight	November 2011
FAD	Improve Fiscal Projections and Financial Planning	December 2011
FAD	Modernization of the Customs Administration	December 2011
FAD	Debt and Cash Management	March 2012
FAD	Tax Policy	March 2012
MCM	Monetary Policy, Central Bank Operations, and Accounting	April 2012
FAD	Tax and Custom Administration	December 2012
FAD	Debt and Public Investment Management	May 2013
MCM/LEG	Launch of the AML/CFT	June 2013
MCM	Inflation Targeting and Central Bank Operations	August 2013
FAD	Revenue Administration	September 2013
FAD	Tax Administration	December 2013
STA	ROSC	February 2014

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

FAD	Tax and Customs Administration	Apr, May, Jul, Sep
MCM	Bank Supervision and Regulation	July 2014
MCM	Monetary and FX Policy	July 2014
LEG	Anti Money Laundering Activities	May, Jun, Sep 2014
FAD	Public Financial Management	July 2014
STA	Producer Price Index Statistics	August 2014
STA	Balance of Payments and IIP Statistics	September 2014
MCM	Central Bank Monetary and Foreign Exchange Operations	October 2014
MCM	Insurance Supervision	December 2014
FAD	Budget Preparation and Execution	December 2014
LEG	Anti Money Laundering Activities	February 2015
STA	Government Financial Statistics Mission	March 2015
MCM	Risk-Based Bank Supervision	April 2015
LEG	Anti Money Laundering Activities	April 2015
FAD	Customs Administration	May 2015
MCM	Bank Stress testing	May 2015
FAD	Tax Revenue Administration	July 2015
MCM	Risk-Based Bank Supervision	August 2015
LEG	Anti Money Laundering Activities	September 2015
MCM	Risk-Based Bank Supervision	November 2015
LEG	Anti Money Laundering Activities	December 2015
MCM	Foreign Exchange Operations	February 2016
FAD	Tax Revenue Administration	March 2016
FAD	Fiscal Responsibility Law	March 2016
LEG	Anti Money Laundering Activities	March/April 2016
MCM	Review of Insurance Supervision	May 2016
MCM	Risk-Based Bank Supervision	July 2016
MCM	Central Bank Accounting and Related Systems	October 2016
FAD	Customs Administration	October 2016
FAD	Structural Balance Rule and a Public Debt Objective	November 2016
STA	Government Finance Statistics	December 2016
STA	Enhanced General Data Dissemination	February 2017
STA	National Accounts Statistics	March 2017
MCM	Risk-Based Bank Supervision	April 2017
STA	Balance of Payments Statistics	May 2017
FAD	Tax Revenue Administration	May 2017
MCM	Financial Sector Stability Review - Scoping Mission	May 2017
MCM	Risk-Based Bank Supervision	July 2017
MCM	Financial Sector Stability Review	October 2017
MCM	Adoption of IFRS Accounting Standards	October 2017
MCM	Risk-Based Bank Supervision	December 2017
FAD	Tax Policy	June 2018

MCM	Insurance Regulation and Supervision	July 2018
MCM	Adoption of IFRS	August 2018
STA	National Accounts Statistics	October 2018
MCM	Stress Testing (Banking System)	November 2018
FAD	Customs Administration	December 2018
MCM	Risk-Based Banking Supervision	January 2019
MCM	Contingency Planning for Crisis Preparedness	February 2019
MCM	FSSR: Stress Testing Banking/Credit unions	April 2019

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

RELATIONS WITH OTHER INTERNATIONAL FINANCIAL INSTITUTIONS

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

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

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

STATISTICAL ISSUES

(As of March 2019)

Assessment of Data Adequacy for Surveillance

In general, data provision to the Fund has some shortcomings, but is broadly adequate for surveillance. Paraguay has made significant improvements in the compilation and dissemination of macroeconomic statistics, but some shortcomings persist. In March 2017, the country implemented the IMF's enhanced General Data Dissemination System (e-GDDS) by publishing a National Summary Data Page after being a GDDS participant since September 2001.

National accounts. National account estimates, broadly consistent with the guidelines of the *2008 SNA*, were released in 2018. Authorities had released the rebased national accounts data from 1991 to 2017.

Price statistics. Both the consumer (CPI) and producer price indices (PPI) are reported on a regular and timely basis. The geographic coverage of the CPI is limited to Greater Asunción (the capital and metropolitan area), and expenditure weights are representative of the consumption patterns of urban households. The basket of the PPI (185 items) is representative of current national output; electricity, water, and gas are not covered.

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

Monetary and financial statistics. Paraguay reports monetary data for the central bank and other depository corporations (ODCs) using the standardized report forms (SRFs). An integrated monetary database meeting the data needs of the BCP, STA, and WHD is in operation. Coverage of the ODC survey is complete, including data on credit cooperatives. The Superintendence of Banks reports 11 of the 12 core and 7 of the 13 encouraged financial soundness indicators for deposit takers to STA on a monthly basis. Paraguay reports data on some key series and indicators of the financial access survey (FAS), including the two indicators of the U.N. Sustainable Development Goals.

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

Data Standards and Quality

Paraguay became a participant in the Fund's General Data Dissemination System (now e-GDDS) in September 25, 2001 and published its National Summary Data Page on March 2 2017. Paraguay disseminates 14 of the 15 data categories required in the Table of Common Indicators Required for Surveillance, which puts the country in threshold 1 of the e-GDDS monitoring framework. Paraguay is encouraged to advance through the e-GDDS thresholds by publishing stock market data (if available) and improving the coverage for central and general government operations, the central bank and depository corporations survey, and external debt. Paraguay's data ROSC was published on August 18, 2014.

Paraguay: Table of Common Indicators Required for Surveillance (As of Mar 25, 2019)								
						Memo Items:		
	Date of Latest Observation	Date Received	Frequency of data[8]	Frequency of Reporting[8]	Frequency of Publication[8]	Data Quality – Methodological Soundness[9]	Data Quality Accuracy and Reliability[10]	Year of last metadata update
Exchange Rates	03/25/19	03/25/19	D	D	D			2014
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	Feb-2019	03/12/19	M	M	M			2014
Reserve/Base Money	Feb-2019	03/2/19	M	M	M			2014
Broad Money	Feb-2019	03/22/19	M	M	M			2014
Central Bank Balance Sheet	Feb-2019	03/22/19	M	M	M			2014
Consolidated Balance Sheet of the Banking System	Feb-2019	03/22/19	M	M	M	O, LNO, LO, O	O, O, O, LO, LO	2014
Interest Rates[2]	Jan-2019	02/22/19	M	M	M			2014
Consumer Price Index	Feb-2019	03/01/19	M	M	M	O, LO, O, O	LO, LO, O, O, LO	2014
Revenue, Expenditure, Balance and Composition of Financing[3] – CG	Feb-2019	03/22/19	M	M	M	LNO, LNO, LNO, LO	LO, LO, LO, LO, LO	2017
Revenue, Expenditure, Balance and Composition of Financing – CPS[4]	Dec-2017	06/30/18	A	A	A	LNO, LNO, LNO, LO	LO, LO, LO, LO, LO	not disseminated
Stocks of CG Debt[5]	Jan-2019	03/01/19	M	M	M			2004
International Investment Position[6]	Q3 2018	12/24/18	Q	Q	Q			2014
External Current Account Balance	Q3 2018	12/24/18	Q	Q	Q	LO, LO, LO, LO	LO, O, LO, O, LO	2014
Exports and Imports of Goods and Services[7]	Feb-2019	03/12/19	M	M	M			2014
GDP/GNP	Q3 2018	12/24/18	Q	Q	Q	LO, LNO, LO, LO	LNO, LO, LNO, O, LO	2014
Gross External Debt	Q3 2018	12/24/18	Q	Q	Q			2014

[1] Any reserve assets that are pledged or otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.
[2] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[3] Central government (CG) revenue, expenditure, balance, and composition of financing data are available monthly.
[4] The consolidated public sector consists of the central government, social security funds, state and local governments, public financial institutions, and nonfinancial public enterprises.
[5] Debt guaranteed by the central government. Includes debt by the central administration and decentralized administration (central bank, autonomous entities, nonfinancial public enterprises, social security, and financial public institutions).
[6] Includes external gross financial asset and liability positions vis-à-vis nonresidents.
[7] Monthly frequencies for goods only.
[8] Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A); Irregular (I); Not Available (NA).
[9] Reflects the assessment provided in the data ROSC published in August 2014 and *based* on the findings of the mission that took place during February 12–26, 2014 for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning (respectively) concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O), largely observed (LO), largely not observed (LNO), not observed (NO), or not available (NA).
[10] Same as footnote 9, except referring to international standards concerning (respectively) source data, assessment of source data, statistical techniques, assessment and validation of intermediate data and statistical outputs, and revision studies.

Statement by Mr. Lopetegui and Mr. Corvalan Mendoza on Paraguay
April 24, 2019

On behalf of the Paraguayan authorities, we would like to thank the mission chief Bas Bakker and his team for the constructive dialogue during the 2019 Article IV Consultation discussions. We would also like to thank the supportive team here at headquarters for their close engagement with the country.

For the past 15 years, governments from different political orientations have embraced the idea of laying the foundations to reduce poverty and inequality in a sustainable manner. During this period, with the help and advice of regional and international organizations and development partners, social indicators in Paraguay, as well as key macroeconomic variables, have experienced continuous improvement. The challenge now is to maintain the same course in the years to come.

Risks are mounting for the country within a complex and evolving regional and international scenario. Supportive tail winds from the past like high agricultural commodity prices and easy financial conditions are vanishing. In addition, climate change is perceived as more extreme than in previous decades.

To tackle these challenges, substantial efforts are being made to accelerate an ambitious investment plan in road infrastructure, education, hospitals, and social housing, using available financial options by engaging with the private sector through PPP's.

Regarding education, it is worth mentioning that scholarship programs launched a few years ago are gaining steam. More than 500 students have been trained for their Master's and PhD degrees in the top 300 universities around the world. Scholarships are obtained through a simple and transparent process by which Paraguayan citizens must comply with three basic rules: being under the age of 40, having a letter of acceptance from one of the 300 top universities in the world, and being willing to return to Paraguay for at least double the time spent abroad. The main objective is to have well-trained citizens who could serve the private and public sectors, as well as creating a critical mass of knowledge and expertise for the country.

Real Sector

Economic activity showed significant dynamism in the first months of 2018, with substantial growth in the services, manufacturing, and agricultural sectors. The pace of expansion, however, moderated significantly in the second half of the year, largely because of the more complex regional environment, as well as some domestic factors on the supply side. The depreciation of the currencies of neighboring countries resulted in an appreciation of the bilateral real exchange rate, which led to an important reduction of border trade with Argentina and Brazil, also affecting the performance of businesses linked to tourism. At the same time, other sectors were negatively affected by supply shocks, particularly those related to livestock production, construction, and the generation of electricity. Despite this moderation, real GDP growth is estimated at 3.6 percent in 2018.

A growth rate of 4 percent is foreseen for 2019, mainly because of strong activity in the tertiary sector (commerce and other services) and the secondary sector (manufacturing, construction, and electricity); the primary sector would grow at a slower rate. On the expenditure side, the main contributors to growth are expected to be private consumption and investment. Net external demand would also have a positive contribution, although minimal, with similar rates of growth for both exports and imports. Adverse weather conditions affected the performance of the agricultural sector in 2019, especially the production of soybeans, and the growth projection could be revised downwards at the end of April.

Monetary Sector

Annualized inflation was 2.8 percent in March 2019, falling within the target range of 4 +/-2 percent. This result was explained mainly by price pressures in the transport sector and, to a lesser extent, in the other categories, except for food items and beverages, which registered a decline in prices during the year. Inflation trend measures closed the year at levels consistent with the target range.

Towards the end of last year and the beginning of 2019, headline inflation, as well as the measures of underlying inflation, have shown a downward trajectory. Taking into account both the recent and expected evolution of prices, together with the latest indicators of economic activity and domestic demand, the Central Bank of Paraguay considered it timely to ease the monetary policy stance by reducing the monetary policy rate by 25 bps in both February and March 2019, to 4.75 percent.

The exchange rate has remained in line with the dynamics observed at global and regional levels. During 2018, the Guarani depreciated by around 7 percent vis-à-vis the U.S. dollar, with Central Bank participation in the foreign exchange market being limited to attenuating abrupt exchange rate volatility without altering the trend determined by market fundamentals. Net International Reserves as of today are slightly over USD 8.2 billion (20 percent of GDP), a level that gives a comfortable margin of liquidity to face eventual sudden fluctuations of the exchange rate.

Fiscal Sector

With regards to the public finances, the fiscal deficit is estimated at 1.3 percent of GDP in 2018, below the limit established in the Fiscal Responsibility Law. For 2019, the deficit is also expected to remain below the ceiling established in the fiscal responsibility law (1.5 percent of GDP).

Tax revenue stands at 10 percent of GDP, maintaining the upward trend exhibited in recent years. In mid-2018, in the middle of the political transition to a new administration, the Ministry of Finance established a Technical and Economic Commission for Taxation as well as a Commission to optimize public expenditures. The purpose of these two commissions that interact directly with civil society is to analyze the current tax system and reach an agreement with stakeholders to modernize and simplify the collection of taxes and streamline expenditures. Initial projections show that without increasing the level of tax rates, reducing deductible expenses in the personal income tax, eliminating exemptions, and equalizing VAT rates would allow revenues to increase gradually by 1 percentage point of GDP in the coming years. At the same time, potential savings on the expenditure side would add another percentage point of GDP, according to projections.

The interaction between the government and society in the context of these commissions is not easy but understandings have been reached, and a bill is expected to be sent to Congress during the first half of 2019.

The composition of expenditures is also moving in the right direction, with more fiscal resources being directed to capital and social expenditures while keeping current expenditures in check. It is well understood that additional resources are needed to tackle infrastructure gaps, especially for a landlocked country like Paraguay, as well as to increase investment in human capital.

Financial Sector

The financial system remains stable, with solvency indicators that are in line with the Basel minimum capital requirements. Moreover, liquidity, non-performing loans and profitability indicators continue to stand at adequate levels. Stress testing reveals that the system is resilient to face extreme shocks. At the same time, the process of financial regulation reform continues, with the main challenges involving the development of regulatory frameworks to adapt to the digital environment, as well as to improve market transparency and discipline. Some draft laws that are currently being studied include the creation of a Credit Bureau, Crowdfunding, Transparency of the Total Cost of Credit, Foreign Exchange Brokers, and modifications to the Cooperatives Law and the Charter of the National Institute of Cooperativism (INCOOP), among others.

Final Remarks

Important efforts are being deployed to improve the quality of institutions in Paraguay. In previous years a law was passed by Congress to offer free access to public information, which proved very useful to upgrade the level of transparency of state institutions and reinforce the engagement of civil society with the public sector.

On April 17, Congress approved a financial operation to speed up a digital agenda for the public sector. This action aims to improve the competitiveness of the economy and the quality of public services provided to citizens and corporations.

More recently, three new laws were submitted to Congress to tackle issues that hampered the ease of doing business, namely a new bankruptcy law, a law dealing with company formation simplification, and legislation allowing companies to use moveable assets as collaterals.

In addition, twelve new laws are now being discussed in Congress which are related to the creation of a financial intelligence secretariat to mitigate AML/CFT risks. Other legislations include court sentencing, criminal appeal (all specialized in Money Laundering, drug trafficking, anti-kidnapping, financing terrorism, corruption, and organized crime), along with the creation of punishable acts of transnational bribery.

The agenda is ambitious, but our experience in the past 15 years is that structural reforms bring benefits to all sooner rather than later. The country still has plenty of space to improve its institutions and close the income gap relative to well-performing economies. To enhance the level of productivity and connectivity going forward, society is demanding good governance and stronger institutions.