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Paraguay: Fourth Review Under the Stand-By Arrangement and Request for Waiver of Performance Criteria—Staff Report; Press Release on the Executive Board Discussion; and Statement by the Executive Director for Paraguay

In the context of the fourth review under the Stand-By Arrangement and request for waiver of performance criteria, the following documents have been released and are included in this package:

- the staff paper for the Fourth Review Under the Stand-By Arrangement and Request for Waiver of Performance Criteria, prepared by a staff team of the IMF, following discussions that ended on February 11, 2005, 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 16, 2005. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- a Press Release summarizing the views of the Executive Board as expressed during its March 28, 2005 discussion of the staff report that completed the request and review.

- a statement by the Executive Director for Paraguay.

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

Letter of Intent sent to the IMF by the authorities of Paraguay*

*May also be included in Staff Report

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

To assist the IMF in evaluating the publication policy, reader comments are invited and may be sent by e-mail to publicationpolicy@imf.org.

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INTERNATIONAL MONETARY FUND

PARAGUAY

Fourth Review Under the Stand-By Arrangement and Request for Waiver of Performance Criteria

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

Approved by Caroline Atkinson and Matthew Fisher

March 16, 2005

- **Arrangement.** The Executive Board approved a 15-month precautionary Stand-By Arrangement (SBA) for SDR 50 million (50 percent of quota) on December 15, 2003. This was the first Fund arrangement with Paraguay since 1968. No purchases have been made since the SBA approval. The program aims at restoring macroeconomic stability (following a financial crisis in 2002–03) and adopting structural reforms to create conditions for sustained growth and poverty reduction. The SBA was extended for six months (through end-September 2005) on December 20, 2004 (at the time of the third review). Access remained unchanged after the SBA extension and the outstanding amounts committed were rephased.

- **Performance**. The program is broadly on track. Most performance criteria for end-December 2004 were observed (except for the arrears targets), some with large margins. Real GDP growth accelerated to almost 3 percent in 2004 despite a drought, the highest growth rate in a decade. Inflation fell to below 3 percent in 2004, the lowest rate in three decades. The exchange rate stabilized and reserves reached record high levels in 2004. The overall fiscal position of the central government was in surplus in 2004, for the first time in a decade.

- **Policies**. The main macroeconomic challenge for 2005 will be to maintain fiscal discipline against the background of a congressionally approved budget with a large deficit. To that end, the authorities have designed a financial plan to align current expenditures with those in the program and have strengthened their coordinating investment unit to better control capital expenditures. The Central Bank is adhering to the program targets and has adopted recommendations made by MFD technical assistance missions to strengthen monetary management. The structural reform agenda is now advancing as planned after the delays of the second half of 2004. The main structural challenge for 2005 will be the restructuring of the national development bank (BNF); a commission has been appointed to design this restructuring and MFD is providing technical assistance.

- **Discussions.** These took place in Asunción during February 1–11. The mission met with Vice-President Castiglioni, Finance Minister Borda, Central Bank President González, other senior officials, representatives of Congress and civil society. The staff team consisted of A. Santos (Head), F. Frantischek, R. Sab (both WHD), P. Breuer (PDR), R. Morales (MFD), and Z. Partow (World Bank). The mission was assisted by L. Durán-Downing, resident representative in Asunción. Mr. Ayala (OED) participated in the discussions. The mission liaised with an MFD technical assistance mission (on public banking reform) led by Mr. Seelig as well as the World Bank and IDB offices in Asunción.

List of Acronyms

ANDE	National Electricity Company
ANNP	National Port Authority
BCP	Central Bank of Paraguay
BNF	National Development Bank
CONATEL	National Telecommunications Commission
COPACO	Telephone Company
DINAC	National Aerospace Authority
ESSAP	Water and Sewage Company
FAD	Fiscal Affairs Department
FSAP	Financial Sector Assessment Program
GDP	Gross Domestic Product
GFS	Government Finance Statistics
GNFS	Good and Non-factor Services
IAS	International Accounting Standards
IDB	Inter-American Development Bank
IFS	International Financial Statistics
INC	National Cement Company
INCOOP	National Cooperative Institute
IPS	Social Security System
IT	Indicative Target
JBIC	Japan Bank for International Cooperation
LEG	Legal Department
LOI	Letter of Intent
LRM	Central Bank bills
MEFP	Memorandum of Economic and Financial Policies
MFD	Monetary and Financial Systems Department
NPL	Nonperforming loans
PC	Performance Criteria
PDR	Policy Development and Review Department
PETROPAR	Petroleum Company
SBA	Stand-By Arrangement
SMEFP	Supplement MEFP
SDR	Special Drawing Rights
TMU	Technical Memorandum of Understanding
VAT	Value Added Tax
WB	World Bank
WHD	Western Hemisphere Department

Contents Page

Appendices

Attachment

Executive Summary

Program Performance

- **Performance under the program continues to be strong**. The program remains broadly on track. With the exception of the arrears targets, all quantitative performance criteria for end-December 2004 were observed, and all structural conditionality under the fourth review was also observed.

- **Against the background of a benign external environment, the program generated some of the best macroeconomic outcomes in a decade**. The economy grew at almost 3 percent in 2004. Inflation was reduced to below 3 percent in 2004. The Central Administration accounts were in surplus in 2004. The Central Bank's international reserves stood at record levels in 2004.

- **The structural agenda is being implemented**. After some delays in the second half of 2004, the authorities have improved the implementation of structural measures.

Policy Issues

- **The main challenge is to consolidate the macroeconomic gains achieved thus far and deepen structural reform.** A stable macroeconomic environment will be key for creating the conditions for sustainable growth and poverty reduction.

- **Fiscal discipline should be maintained**. It will be challenging to preserve fiscal discipline in 2005 because the congressionally approved budget authorized a much higher level of spending than envisaged in the program. The authorities believe that current expenditures can be contained with their financial plan and that capital spending can be controlled by strengthening the role of their coordinating public investment unit.

- **The authorities should aim at an inflation rate at the lower end of the inflation range**. The authorities reiterated their commitment to keep inflation in 2005 at 6 percent within a range of plus or minus 2 percentage points. The staff recommended to strengthen monetary management and target an inflation below the mid-point given the lower inflation for 2004. However, a recent uptick in inflation may complicate that objective.

- **It is important to move decisively in implementing the public banking reform**. While all areas of structural reform are important, public banking reform has proved to be difficult and its implementation will signal the resolve of the authorities to carry on with the reform agenda. Restructuring the national development bank (BNF) will be challenging given the high level of non-performing assets and its limited capital.

- **Staff supports completion of the program review and waiver requests**. This assessment is based on the strong performance, success in achieving stability, better implementation of structural reform and strong commitment to the program.

I. PROGRAM PERFORMANCE

1. **Performance under the program continues to be strong with earlier delays on the structural reform agenda now being addressed**. All performance criteria for end-December 2004 were observed with the exception of the arrears targets (for which the authorities are requesting waivers). Some of the main macroeconomic targets were met with significant margins. All structural performance criteria and benchmarks for this review were also observed. Program implementation is being strengthened.[1] While macroeconomic performance remains satisfactory, the structural reform agenda continues to face political challenges, and underlying social tensions persist.

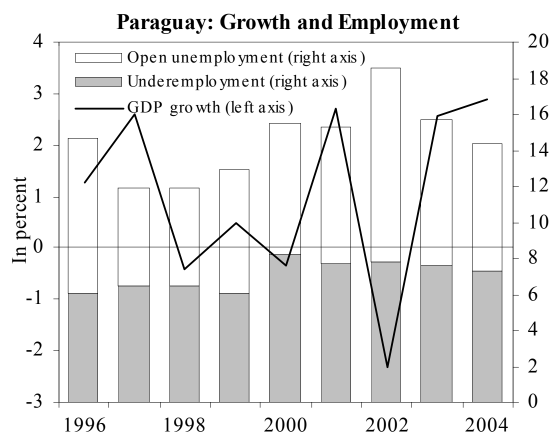
Paraguay: Performance Under the Program
(In trillions of guaranies, unless indicated)

	end-December 2004	
Main Targets	Prog	Actual
Fiscal Targets		
Fiscal balance 1/	0.06	0.79
Wage bill 1/	3.01	2.98
Consolidated fiscal balance 2/	0.13	1.00
Monetary Targets		
Net international reserves 3/	1.06	1.14
Net domestic assets	-3.96	-4.85

Sources: Paraguayan authorities and Fund staff.
1/ Central administration.
2/ Nonfinancial public sector and Central Bank.
3/ In billions of U.S. dollars.

2. **Macroeconomic outcomes in 2004 were significantly better than anticipated in the program.**

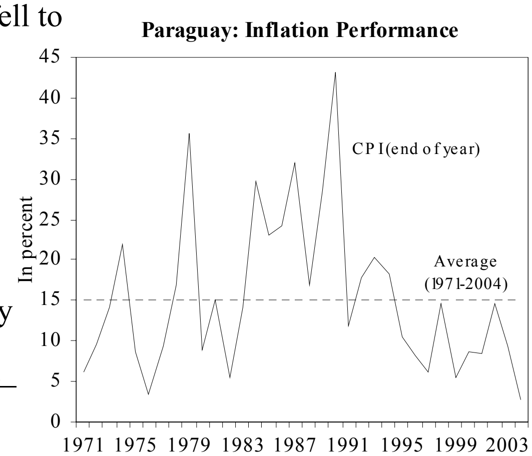
- ***The economic recovery strengthened in the second half of the year and the economy grew in 2004 at the highest rate in a decade.*** Real GDP grew almost 3 percent despite a drought, somewhat above the 2½ percent program objective.[2] There is evidence of a strengthening in economic activity during the second half of the year driven—on the supply side—by improved performance in the agricultural and livestock sectors, and—on the demand side—by higher investment and exports.



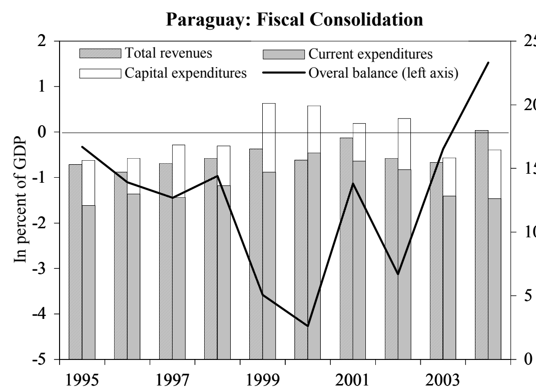
[1] The authorities formed the "program monitoring group" to ensure the timely implementation of program measures. The group meets weekly and consists of officials from the Ministry of Finance, the Central Bank of Paraguay, the Fund 's Resident Representative and the IMF team in Washington (via telephone).

[2] The authorities will release shortly a revised series for GDP with 1994 as the base year, updating the previous series based in 1982. Real GDP growth in 2004 under the new base year is estimated at 4 percent.

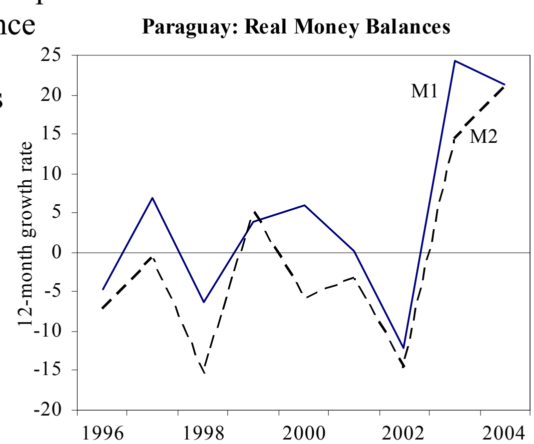
- ***Inflation fell in 2004 to the lowest level in over three decades.*** Despite negative supply shocks, the 12-month inflation rate fell to 2.8 percent in December 2004, well below the program objective of 8 percent. Stabilization of the exchange rate played an important role in reducing inflation. However, there was an uptick in inflation during December (1½ percent increase) reflecting high liquidity conditions associated with an accommodative monetary policy and the payment of yearly bonuses. Inflationary pressures moderated in January–February 2005 (with an underlying average monthly inflation rate dropping to about ½ percent).



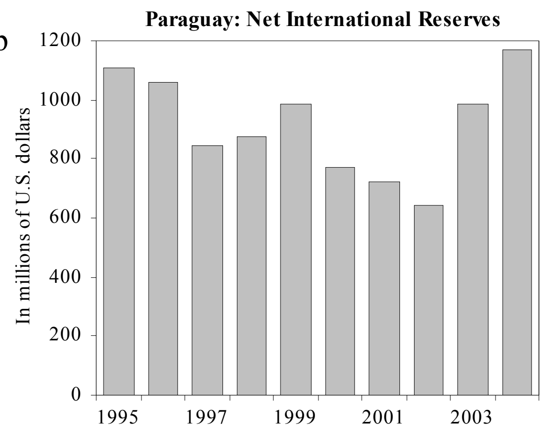
- ***The public finances were in surplus in 2004 for the first time in a decade.*** The central administration recorded a surplus of about 2 percent of GDP, significantly tighter than the program objective of broad balance. The positive fiscal performance was mostly due to a continuation of buoyant revenues. Tax receipts increased by about 35 percent in the year, reflecting significant improvements in tax administration. Expenditures were kept in check, although an effort was made to increase public investment in the second half of the year.



- ***High capital inflows complicated monetary management in 2004.*** Improved market confidence and a portfolio shift into *guaraní* denominated assets produced a rapid increase in net international reserves (NIR). This facilitated the observance of the NIR targets, but created a significant liquidity problem (the reserves build up was equivalent to about one-half of the stock of base money). A combination of strong money demand (the highest real money balances growth in a decade) and banks' liquidity preferences helped to absorb the excess liquidity. But the Central Bank still needed to undertake significant sterilization efforts, and placement of Central Bank paper (LRM) increased by over 25 percent.



- ***A strong balance of payments in 2004 facilitated the stabilization of the exchange rate and led to record high reserves.*** Surpluses in the current and capital account led to a rapid accumulation of reserves despite significant payments of arrears. Strong external demand, high soy prices, and the opening of new markets for beef pushed up exports by almost one-third. However, recorded imports grew at about the same rate, reflecting the economic recovery, high oil prices and improvements in customs procedures.[3] Private capital inflows accelerated in the first half of the year and stabilized in the second. The guaraní depreciated slightly—by 2¾ percent—against the U.S. dollar but appreciated—by 5¼ percent—in real effective terms.



3. **Implementation of the structural reform agenda improved in early 2005, with all structural measures for the fourth review observed.**

- ***The end-December 2004 structural performance criterion on audits for two public agencies was observed***. The audits for CONATEL and IPS were finalized in November 2004.

- ***The early-January 2005 structural performance criterion on adjustment of fuel prices and tariffs if necessary to reflect costs was observed***. Domestic fuel prices were adjusted by 26 percent (in three steps) during 2004, with the last adjustment in October 2004 and an additional adjustment in early January 2005 (7 percent).[4] There was no need to adjust tariffs on public utilities as their costs

Paraguay: Structural Conditionality for the Fourth SBA Reviews

	Measure	Conditionality (Date)	Status
1.	Independent audits for CONATEL and IPS	PC (Dec 2004)	Done
2.	Adjustment in fuel and utility prices to reflect costs	PC (Jan 2005)	Done
3.	Introduce prudential regulations on cooperatives	Benchmark (Mar 2005)	Done
4.	Approval of the public banking law (2nd-tier) by one chamber	PC (Mar 2005)	Done

Sources: Paraguayan authorities; and Fund staff estimates.

[3] Improved recording of imports is estimated to explain as much as one quarter of the increase.

[4] The oil company (PETROPAR) faced temporary cash problems in December–January, which is being resolved in the first quarter of 2005 following the diesel price increase and other measures.

were contained by a stable exchange rate, a wage freeze, and lower than programmed inflation. Public utilities as a whole reported surpluses in 2004.[5]

- ***The mid-March 2005 structural performance criterion on the approval of the second-tier public banking law by at least one chamber was met***. The Senate approved the law in early March. Full congressional approval of the law is a benchmark for May 2005. The authorities are receiving MFD technical assistance on the restructuring of public banks.

- ***The end-March 2005 structural benchmark on the introduction of prudential regulations on cooperatives was met***. The cooperative institute (INCOOP) introduced in late-December 2004 regulations designed in consultation with the World Council of Credit Unions (WOCCU) and with input from the Fund and the World Bank. The regulations need to be strengthened and INCOOP has agreed to continue working closely with the IFIs and WOCCU.

4. **The social and political situation has improved but continues to be tense**. Reported incidents of social unrest, with rural workers taking over land and some street demonstrations in several cities, have diminished in early 2005. The authorities are addressing some of the concerns of the rural poor by buying land and distributing it among rural workers. Nevertheless, considerable divisions remain in society.

II. POLICY ISSUES

5. **The main policy goals for 2005 are to consolidate macroeconomic gains and to deepen structural reform**. The authorities agreed that the key challenges for this year were to maintain fiscal discipline and implement the public banking reform in line with the program. The authorities felt that, despite expenditure pressures, the fiscal situation was under control. However, they acknowledged that the public banking reform, and other reform areas that require congressional approval, are subject to political uncertainties. The staff and the authorities agreed that the program remains appropriate and does not need revisions or modifications at this stage.

[5] Under the program, fuel and utilities prices were to be adjusted semi-annually (July 1, 2004 and January 1, 2005) to compensate for higher costs. No adjustment on utility prices was needed for the second review either (July 2004), as the cost for electricity and water were contained by the low inflation and stable exchange rate.

A. Macroeconomic Issues

6. **The authorities were encouraged by the recent strengthening of economic activity and the low inflation of 2004 but considered it premature to change the macroeconomic framework.** The authorities noted that the recent positive developments on the growth front enhanced the credibility of the macroeconomic framework and increased the chances of the program's success. They acknowledged the possibility of higher than programmed growth for 2005, but felt it was too soon to change the program assumptions, especially as there could be another drought. They were also of the view that inflation may be below the midpoint of the programmed inflation range (6 percent plus/minus 2 percentage points). The mission agreed with the authorities' assessment.

Paraguay: Macroeconomic Framework, 2002–05

			SBA		Extension
			Prog. 1/	Est.	Proj.
	2002	2003	2004		2005
(Annual percent change)					
Real GDP	-2.3	2.6	2.4	2.9	3.2
Inflation (e.o.p.)	14.6	9.3	8.0	2.8	6.0 (± 2.0)
Real exchange rate 2/	-1.2	-6.6	...	1.4	2.0
(In percent of GDP)					
External current account	1.7	2.2	0.4	0.7	-0.4
Overall fiscal balance 3/	-2.3	-0.3	0.1	1.9	-0.3
Public sector debt	49.6	48.2	45.6	39.8	39.7

Sources: Paraguayan authorities; and Fund staff estimates.
1/ Original program (Country Report No. 04/66).
2/ Minus indicates a real depreciation.
3/ Central government.

B. Fiscal Policy

7. **The authorities remain firmly committed to maintain fiscal discipline despite the expansionary 2005 budget approved by Congress.** The 2005 budget contains an implicit deficit for the central administration of 2¼ percent of GDP, significantly higher than the ½ percent of GDP envisaged under the program. However, the authorities indicated that they will meet the fiscal targets under the program through prudent budget execution. The deviation of about 2 percent of GDP will be addressed by: (i) stronger-than-programmed fiscal revenues expected for 2005 (¼ percent of GDP); (ii) strict application of a financial plan with monthly allocations, which effectively cut current expenditures of the approved 2005 budget (¾ percent of GDP); and (iii) broadening the scope and monitoring role of the coordinating unit for public investment (UCIP) at the Ministry of Finance to limit capital expenditure to levels consistent with the program and available financing (1 percent of GDP).[6] Finally, the authorities indicated that they have at their

Paraguay: 2005 Public Finances
(In percent of GDP)

	2004		2005	
	Prog. 1/	Est.	Prog. 2/	Proj.
Revenues	**16.7**	**18.0**	**18.3**	**18.6**
Expenditures	**16.5**	**16.5**	**18.8**	**18.9**
Current	13.1	12.6	13.7	13.8
Non-interest	11.7	11.5	12.4	12.6
Interest	1.4	1.1	1.3	1.2
Capital	3.4	3.8	5.1	5.0
Statistical Discrepancy	**--**	**0.3**	**--**	**--**
Overall Balance	**0.1**	**1.9**	**-0.5**	**-0.3**
Memorandum item:				
Primary Savings	5.0	6.5	5.9	6.0
Primary Balance	1.5	3.0	0.7	1.0
Real GDP growth (%)	2.4	2.9	3.2	3.2

Sources: Paraguayan authorities; and Fund staff estimates.
1/ Original SBA program (Country Report No. 04/66).
2/ Extended SBA program (see www.imf.org).

[6] A Ministerial resolution is being issued to strengthen the role and scope of UCIP to effectively control and monitor public investment. Aligning public investment to program levels is not likely to be a big challenge for UCIP given the financing constraints. A bigger challenge for UCIP will be to implement as programmed already agreed projects and avoid underperformance of public investment.

disposal—as a safeguard—a strict cash management plan, which was successfully implemented in the first months of the 2004 program. The staff warned against the use of cash rationing systems as it could lead to arrears (Box 1)

8. **As contemplated in the program extension, the fiscal program for 2005 aims at broad budget balance, while allowing a significant increase in public investment**. The 2005 fiscal program now implies a marginally larger fiscal stimulus for 2005 than originally envisaged (because of the larger-than-expected overperformance for 2004). However, a likely tax overperformance will trigger a partial tightening of the fiscal balance (due to the working of the program adjustor on taxes). The staff believes that the fiscal program remains broadly appropriate given the large output gap and the large—open and disguised—unemployment rate (close to 15 percent).

9. **The prospects for continued tax buoyancy in 2005 remain strong.** Although the growth in tax collections moderated toward the end of 2004, data for January and February 2005 show growth rates above 20 percent, considerably higher than contemplated in the program. The authorities believe that the introduction of the new Customs Code in early 2005 and the gradual broadening of the tax base contemplated in the Fiscal Adjustment Law (FAL) will sustain these tax efficiency gains.[7] The staff estimates now that tax collections for 2005 could be over ½ percent of GDP higher than programmed.[8]

10. **The government may need to provide budgetary support to a financial ailing pension fund in the second half of the year.** A pension fund for bank employees (private and public) is currently facing liquidity problems, which reflect more serious long-term financial problems. The government is developing a plan to resolve the pension fund problem, which may involve budgetary support (for as much as 0.2 percent of GDP on an annual basis), in addition to an increase in contributions and cuts in the pension fund benefits. The authorities believe that measures will be taken in the second half of the year and the necessary budgetary support could be accommodated within the program limits.

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[7] On tax policy, the authorities clarified that the FAL did not introduced a financial transaction tax since this tax was already in place. However, the law redefined the tax base (to be applied to some financial transfers instead of commissions only) and reduced the tax rate (from 1 percent to 0.15 percent for domestic transfers and from 1.5 percent to 0.20 percent for external transfers), applicable as of January 2005. The corporate income tax will be reduced from 30 to 20 percent effective as of January 2005 in accordance with the FAL but its cash impact will be felt only in 2006 (since the tax is paid with a one-year delay). Other changes in tax policy include the elimination of the temporary export tax in February 2005 following its own sunset provision, and the increase in the minimum tax-exempt level of electricity use for low-income groups as of January 2005. All these measures have limited macroeconomic impact and have already been incorporated in program projections.

[8] The program contemplates an adjustor on tax revenues that saves 30 percent of the tax collection over-performance. With the now projected strengthening in tax revenues, this would lead to a reduction in the fiscal deficit target of the central administration from 0.5 to 0.3 percent of GDP in 2005.

11. **The overall performance of the public enterprises remains strong, but the situation of the petroleum company (PETROPAR) needs to be monitored closely.** Overall, the public enterprises ran an operating surplus of about 1½ percent of GDP in 2004. While the petroleum company (PETROPAR) had a broadly balanced position, it faced financial difficulties in December 2004–January 2005. Diesel shortages in the regional market, higher prices and increasing inventories, led to temporary cash problems and the accumulation of arrears to suppliers through end-January 2005 (about US$15 million by end-December 2004). To address these difficulties, the authorities raised domestic diesel prices again in early January 2005 (by 7 percent), and are seeking suppliers' refinancing of their arrears obligations.[9]

12. **The authorities will carry out a census of unrecorded and contingent public liabilities**. During the 2005 budget discussion, Congress approved the payment for a land expropriation carried out in 1995, which is currently in dispute in a judicial court (about ½ percent of GDP). Against this background, the staff encouraged the authorities to have a better understanding of possible contingent liabilities in order to assess their fiscal implications. To that end, the authorities are planning to have an inventory of all contingent liabilities by May 2005. The staff clarified that any payment of the disputed claim will be recorded below the line with no impact on the program fiscal targets (payments should be made with a bond to avoid an impact on the monetary program).

C. Monetary Policy

13. **The authorities reiterated their inflation objective for 2005 despite an uptick in inflation in the last few months.** They were of the view that their inflation target of 6 percent for 2005 (within a range of 2 percentage points higher or lower) remained feasible. The staff encouraged the authorities to aim at an inflation rate below the mid-point of the range for 2005 to consolidate the lower-than-expected inflation of 2004. The mission discussed with authorities the reasons for the uptick in inflation in the last few months and the appropriateness of modifying policies. Inflation in Paraguay is volatile and subject to regional supply shocks, making it difficult to assess underlying pressures. It appears that some inflationary pressures emerged in December (1½ percent) and eased significantly in January–February (monthly average of about ½ percent)

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

	2004		2005	
	Prog. 1/	Actual	Prog. 2/	Proj.
Currency	**16.5**	**12.7**	**13.2**	**10.0**
Net international reserves	**10.4**	**52.6**	**13.2**	**13.2**
Net domestic assets	**6.1**	**-39.9**	**0.0**	**-3.2**
Credit to public sector (net)	-6.3	1.8	4.2	2.4
Credit to banks (net)	-1.7	-42.0	-14.8	-13.7
Free reserves	13.4	-21.3	6.8	2.6
BCP bills (LRM)	-6.3	-21.8	-13.1	-19.0
Other bank credit	-8.8	1.1	-8.5	-2.1
Other items net	14.1	0.3	10.6	12.9
Memorandum item:				
Base money growth (%)	3.2	17.6	9.4	9.3
Money supply growth (%)	17.8	24.7	12.0	10.0

Sources: Paraguayan authorities; and Fund staff estimates.
1/ Original program (Country Report No. 04/66).
2/ Implicit flows from the stock for 2004 in extended SBA program (see www.imf.org) and actuals for 2003.

[9] The authorities are looking for a more permanent solution to the PETROPAR's financial problems, including establishing a new regulatory framework for the fuel sector and a new role for PETROPAR.

despite the fuel price adjustment in January. The authorities and the staff agreed that some tightening was necessary in the short run in order to achieve the inflation objectives. The authorities increased the rates on monetary policy instruments (LRM) by 1 point in February (to 7 percent) and will continue monitoring the situation closely.

14. **The authorities renewed their commitment to the monetary framework and the targets under the program.** The authorities are currently following a standard monetary program, targeting (directly) currency issue and (indirectly) inflation. The program envisages an accumulation of net international reserves of US$40 million in 2005 and a tight credit policy. The authorities agreed to use exchange and interest rates flexibly in the coming year to meet the inflation objective, and noted the close relationship between exchange rate movements and inflation. The staff stressed the need to introduce further interest rate flexibility and to follow interest rates developments in neighboring countries and the U.S. to avoid sudden reversals in capital movements.

15. **There was evidence of a temporary monetary overhang in January 2005 that appears to have been resolved in February 2005**. Incipient pressures in the foreign exchange market were felt at the end of December 2004 and in January 2005. The authorities reacted with a combination of exchange rate flexibility and foreign exchange intervention. The guaraní depreciated by almost 4 percent in those months and the Central Bank lost about US$30 million in reserves. The staff estimated that while an important part of the pressures was related to a seasonal weakening in the balance of payments (i.e., high demand for imports during Christmas and high travel during the austral summer vacation), there was also a temporary monetary overhang. The excess money supply was small and followed from an accommodative policy and the payment of yearly bonuses, spilling over to the foreign exchange market and creating some inflationary pressures. The authorities were confident that the tightening in policies in February should resolve the liquidity problem. The staff stressed that the authorities would need to remain vigilant in ensuring that this episode is not repeated in the future.[10]

16. **The authorities started implementing MFD recommendations to improve monetary policy and operations.** The liquidity management problems of December–January highlight the limitations of the current control systems and the need to modernize the monetary policy instruments. With that in mind, the authorities have agreed to adopt shortly the following list of measures recommended by technical assistance missions from MFD: (i) formalize with a Board directive the frequency, attendance, and matters to be treated at Executive Committee for Monetary Operations (CEOMA) meetings, and implement a procedure for the recording and internal drafting of the minutes of the meetings; (ii) construct a standard set of figures and tables, focusing on monetary, price, exchange rate, and external developments; (iii) issue shorter-term instruments (including one month); (iv) start using the

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[10] The amendments to the national development bank (BNF) law—which raised lending limits—in October 2004 did not generate credit pressures because the decree that regulates the law has not been finalized. The authorities believed that BNF does not pose a risk for its credit policy in 2005.

one-month rate as the key policy rate; (v) concentrate the auctions of longer-term instruments and allow their rates to become market-determined; and (vi) revise repo (RIR) rules.

D. External Issues

17. **Despite a moderate deterioration in the current account in 2005, the balance of payments is expected to remain relatively strong**. A worsening in the terms of trade is expected to push the current account slightly into deficit in 2005. Soy and cotton prices will likely fall from their 2004 highs while import prices are expected to continue to rise. The soybean harvest may be exposed to a drought again. The capital account is projected to remain in surplus due to public sector borrowing for investment projects and higher direct foreign investment. Net international reserves are expected to increase by US$40 million as anticipated in the program.

Paraguay: Balance of Payments
(In percent of GDP)

	2004		2005	
	Prog. 1/	Est.	Prog. 2/	Proj.
Current Account	**0.4**	**0.7**	**-0.4**	**-0.3**
Exports	30.2	40.3	37.6	41.4
Imports	-34.4	-45.6	-43.7	-47.7
Other	4.5	6.0	5.8	6.0
Capital Account	**1.6**	**2.6**	**0.9**	**1.1**
Public sector (net)	1.1	0.4	0.4	0.5
Private sector (net) 3/	0.5	2.2	0.4	0.6
Overall Balance	**2.0**	**3.3**	**0.5**	**0.7**
Overall Financing	**-2.0**	**-3.3**	**-0.5**	**-0.7**
Net international reserves	-0.5	-2.5	-0.5	-0.7
Exceptional financing	-1.5	-0.7	0.0	0.0

Sources: Paraguayan authorities; and Fund staff estimates.
1/ Original program (Country Report No. 04/66).
2/ Extended SBA program (see www.imf.org).
3/ Includes errors and omissions.

18. **Efforts continue to be made in eliminating arrears, although there was an unexpected accumulation towards the end of 2004**. Rising diesel prices in the regional market and higher inventories resulted in a build up of arrears at PETROPAR of about US$15 million in end- December (and about US$25 million by end-February), which the authorities are trying to eliminate by refinancing them with their suppliers. The authorities continue making good faith efforts toward resolving disputed arrears. Measures are being taken to prevent new arrears episodes in the future. An internal instruction has been given by the Ministry of Finance to pay all obligations on their due date (rather than using part of the 30-day grace period like in the past). The authorities feel that with a large fiscal overperformance and record high reserves, there is no reason to have arrears episodes in the future.

E. Structural Issues

19. **The authorities are working towards the timely implementation of the structural reform agenda**. The authorities realize that it is important to strengthen their credibility by adhering to the schedule of reforms agreed during the extension to the SBA. Efforts are being made to implement measures before its due date. The experience of the first quarter of the year has been positive with all structural performance criteria and benchmarks being observed.

20. **Financial sector issues**. Significant progress has been made in advancing the financial reform agenda.

- ***General banking reform***. The commitment under the program was to introduce this legislation to Congress in March 2005 and to have the law approved by June 2005 (performance criterion). The authorities submitted the law to Congress (ahead of schedule) in December 2004 and expect it to be approved before June.

- ***Public banking reform***. The authorities divided this reform in two stages, the first-tier public bank reform and the second-tier public bank reform.

  - *The first tier-public bank reform*. The commitments under the program involve the restructuring of BNF and the approval of a first-tier public banking law. A commission to prepare a medium-term business plan and restructure BNF was created in January 2005, ahead of the timetable in the program. The recommendations of the commission are to be adopted by June 2005 together with the submission to Congress of a first-tier public banking law. The authorities submitted the first-tier public banking law to Congress in February 2005 (ahead of schedule) (performance criterion). The authorities received technical assistance from MFD on the restructuring of BNF.

Paraguay: Structural Conditionality for the Fifth and Sixth SBA Reviews

Measure	Conditionality (Date)	Status
Fifth Review		
1. Independent audit for ANNP, DINAC, INC, PETROPAR	PC (Apr 2005)	In progress
2. Finalize plan for comprehensive civil service reform	Benchmark (Apr 2005)	In progress
3. Approval of public banking law (2nd-tier)	Benchmark (May 2005)	Law approved by the Senate in Mar 2005
4. Approval of comprehensive banking law	PC (Jun 2005)	Law submitted to Congress in Dec 2004
Sixth Review		
5. Submission of public banking law (1st-tier). Adopt the commission's recommendations	PC (Jul 2005)	Partly Done Law submitted to Congress in Feb 2005
6. Plans for private capital participation ESSAP, COPACO, PETROPAR	Benchmark (Aug 2005)	In progress

Sources: Paraguayan authorities; and Fund staff estimates.

  - *The second-tier public bank reform*. The authorities had intended to get this law approved by at least one chamber in December 2004, but the date of its approval was modified to mid-March 2005 (performance criterion). The Senate approved the law in early March 2005. The law is expected to have full Congressional approval by May 2005 (structural benchmark).

- ***Central banking issues***. The staff encouraged the authorities to expedite the legislation required to allow for the provision of non-negotiable bonds to gradually capitalize the Central Bank (about ½ percent of GDP). Progress continues in the reconciliation of debts between the Central Bank and the Ministry of Finance in accordance with their Memorandum of Understanding.

- ***Deposit guarantee fund***. The fund remains operational. The government was encouraged to continue with its gradual contributions to the fund. Commercial banks continue to complain about the rapid speed of capitalization of the fund and the high level of their contributions, which increases the cost of intermediation.

21. **Public sector issues**. Progress has also been made in this area.

- ***Independent audits for ANNP, DINAC, INC, PETROPAR***. These are to be completed by April 2005 (performance criterion). The process is quite advanced, tenders made and contracts awarded to accounting firms.

- ***Finalize plan for comprehensive civil service reform***. The program commitment is to finalize this plan by April 2005 (structural benchmark). The authorities developed a civil service reform that covers all state workers within a new legal framework. The draft law formally establishes the civil service career and provides a clear definition of aptitudes and functions for the different positions. The authorities expect to submit the draft law to Congress in April.

- ***Plans for private capital participation in ESSAP, COPACO, PETROPAR***. These plans are expected to be implemented by August 2005 (structural benchmark). Work is at an early stage.

22. **Debt restructuring issues**. The authorities continue making progress on the debt exchange of domestic public bonds initiated last year. About 75 percent of the eligible debt had been normalized by the time of the first exchange in August 2004. Some additional 20 percent of eligible debt has subsequently been tendered and is in the process of being normalized. The holders of the remaining 5 percent have not yet tendered their claims. The authorities are designing strategies to entice bond holders that have not participated yet, while at the same time respecting inter-creditor equity. In the meantime, no payments are being made to non-participating creditors.

Paraguay: Status of Bond Exchange
(as of end-January 2005)

	Millions of US$	Percent of Total
Eligible debt	**138.1**	**100.0**
1. Debts used to pay taxes	15.7	11.4
2. Debts already tendered	115.2	83.4
Bonds already exchanged	98.0	71.0
Bonds about to be issued	17.2	12.5
3. Debts not tendered yet	7.2	5.2

Sources: Paraguayan authorities.

23. **Investment climate**. The authorities attach particular importance to the improvement of the investment climate as a precondition for sustainable growth. This was a key issue in a growth seminar organized by the authorities with the assistance of the World Bank in November 2004. The authorities are studying ways to improve the investment climate, including by adopting private partnerships with public corporations. The authorities have adopted a pilot program with assistance of the World Bank to strengthen governance at different Ministries (*Ministerio de Excelencia*). They have agreed to conduct a comprehensive study on how to improve the business climate with possible World Bank assistance (Box 2).

24. **Social sector issues**. The authorities are committed to resolve social problems and are working toward strengthening the social safety net (*red de protección social*). The 2005 budget allocates some ½ percent of GDP to the purchase of land to redistribute among rural workers as a way to appease social tensions. Similarly, the authorities are working with the

UNDP in consolidating over 40 social programs and refocusing them to deal with those in extreme or moderate poverty, which the authorities estimate include about 40 percent of the population. One program being developed includes cash payments to targeted families living under conditions of extreme poverty.

F. Program Issues

25. **Waivers.** The authorities are requesting a waiver for the non-observance of the end-December 2004 performance criterion on the stock of arrears, which was due to a delayed payment to PETROPAR's suppliers. PETROPAR will seek to refinance these outstanding obligations with their suppliers by end-May and the authorities will submit legislation to Congress to liberalize diesel prices by end-April. The authorities also request a waiver for the non-observance of the continuous performance criterion on the non-accumulation of arrears due to a delayed payment to the IDB in November 2004 for US$4 million (see below) and some small amounts due to USAID in February 2005 (US$0.2 million).

26. **Information.** There was inadequate information provided to the Board at the time of the last review when a waiver request was granted on the continuous performance criterion on the non-accumulation of arrears. At the time, the staff informed the Board that the breach on the performance criterion was due to a delay in payments to France in September 2004. However, there were two short delays in payments to the IDB in November 2004, for which a waiver is now requested.[11]

27. **Adjustor**. The authorities are requesting an amendment to the adjustor to the net international reserves (NIR) and net domestic assets (NDA) performance criteria. Under the program, all non-project lending provided by the IFIs would trigger an adjustor to tighten the PCs on NIR and NDA. The authorities request that the adjustor be triggered only after US$25 million has been disbursed to allow for some funds to be intermediated by the second-tier bank, since now it appears likely that the second-tier bank may be operating before the program expires (a possibility that was not anticipated when the program was designed).

28. **Conditionality.** The attached letter of intent reiterates the authorities commitment to the program and targets. There has not been any change to the program or its performance criteria. There are no prior actions requested to complete this review.

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[11] The IDB transaction involved delayed payments for the equivalent of US$4 million on two IDB loans over the Thanksgiving weekend in November, which were in arrears for four days (including a weekend).

III. Medium-Term Scenario, Risks, and Capacity to Repay the Fund

29. **The medium-term outlook confirms the sustainability of the program and highlights the need to continue with the structural reform agenda**. The staff carried out two scenarios. The baseline scenario assumes prudent macroeconomic policies and continuation of the reform program over the medium-term, increasing the growth potential of the economy to 4 percent per annum. Under an alternative (low growth) scenario, also with continued prudent macroeconomic policies, but with no additional structural reforms beyond this program, growth is projected to remain at the historical average of around 2 percent. This scenario would result in stagnation in per capita income. These scenarios stress the need to embrace structural reform over the medium-term. The staff believes that under a scenario of prudent macro policies and deepened structural reform it is possible to double the growth potential of the economy to reach 4 percent a year. Under the baseline scenario, fiscal consolidation continues and the public accounts remain in balance, reducing the debt-to-GDP ratio to around 30 percent by 2010.

30. **There is a strong capacity to repay the Fund.** Even under a scenario where the arrangement is no longer precautionary, Paraguay has a strong enough external position to fully service obligations to the Fund on a timely basis. A potential risk is the accumulation of arrears to multilaterals in the recent past. However, staff believes this risk is small given the improvements under the program to Paraguay's fiscal and external positions, and consequently its payment capacity. In addition, the overall public debt service ratios are low and debt service to the Fund would be a small part of the total. Paraguay currently has no Fund credit outstanding.

31. **However, risks to the program remain as described in previous reviews**. Political support for further reform may erode and could undermine approval of key structural reform legislation. Social tensions could trigger a more expansionary policy stance, which could compromise macroeconomic stability. There are a number of vulnerabilities: higher interest rates and/or slower growth in the world /regional economy could affect economic activity in Paraguay. Further increases in oil prices would put pressure on the balance of payments. The high level of dollarization carries liquidity and solvency risks for the banking system, and BNF's weaknesses makes the banking system vulnerable.

IV. Staff Appraisal

32. **Overall performance under the program continues to be strong**. With the exception of the arrears PCs, the authorities have met all other quantitative performance criteria. The authorities have managed to address previous weaknesses in implementing the structural reform agenda and there are indications that in some areas, implementation is ahead of schedule. This is a welcome development, which it will be important to sustain.

33. **The staff welcomes the better implementation of the structural reform agenda in the first quarter of 2005.** The delays in implementing the structural reform agenda observed

in the second half of 2004 appear to have receded, although political risks persist and could jeopardize policy efforts in the future.

34. **The program has been successful in achieving the main objectives of regaining macro stability and beginning to create the conditions for growth.** Macroeconomic achievements in 2004 are among the best in decades. The difficult policies adopted during the program are beginning to yield tangible benefits. Economic growth is gaining momentum, inflation has moderated, international reserves are at a record high, the budget is in order, confidence in the banking system has been restored, and the currency stabilized. While this is a comfortable situation to be in, the authorities are encouraged to continue in their efforts to modernize the economy and address the long-term low productivity, which is at the core of the unimpressive economic performance of the last two decades and the high poverty rates.

35. **In the short-run, the key challenges and main vulnerabilities to the program will be to maintain fiscal discipline and to demonstrate commitment to reform by advancing with the difficult restructuring of BNF.** While the staff is confident that the authorities can implement the fiscal program, there are clear risks. The authorities will need to contain expenditure pressures coming from unfunded mandates and expenditure intentions approved in the budget. It will be a challenge in this environment to prevail and implement a prudent fiscal policy. Fiscal prudence is especially important given the contingencies arising from the ongoing census of unrecorded liabilities, the banking system, pension funds, and civil service reform. Similarly, in order to keep the momentum with the structural reform agenda, it is imperative that the authorities show their determination by restructuring the state development bank (BNF).

36. **Fiscal policy has been the pillar of the stabilization and should be protected against political pressures by "institutionalizing" some of the gains**. The public finances have been placed on a sustainable path. The fiscal outlook is now significantly better than at the time the program was approved, especially after the congressional passage of the fiscal adjustment law (FAL). At the core of these efforts are the improvements in tax administration in the internal revenue service and customs. These gains should be maintained through strengthening of these institutions to ensure that these gains are permanent.

37. **The authorities need to monitor fiscal policy to avoid a pro-cyclical policy stance**. The unexpected strengthening of the economy and the better-than-anticipated fiscal position at the end of 2004, imply that the fiscal program for 2005 will allow now for a marginally greater fiscal stimulus than originally intended. This places the authorities in a difficult situation as prudence may dictate a more conservative stance than that imbedded in the program whereas Congress has approved a much looser fiscal stance. The staff believes that the high unemployment and large output gap in the economy still justifies the agreed fiscal program and its implicit policy stance but the authorities need to exercise caution in implementing the 2005 budget to avoid any potential overheating.

38. **Monetary policy has been supportive of the stabilization efforts but needs to be strengthened**. The episode of the uptick in inflation in December and the indications of a monetary overhang in January highlight the need to strengthen monetary management at the Central Bank. The staff welcomes the authorities' decision to embrace the recommendations of MFD that can be implemented in the short-run. However, the staff notes that further reforms at the Central Bank will be necessary to strengthen monetary management and build on the success of 2004 in reducing inflation to the lowest level in over 30 years.

39. **Since the main vulnerability to the program comes from political and social uncertainties, it will be important to build consensus in favor of reform by properly communicating the authorities' policy intentions.** The continued success of the program will depend not only on the authorities' determination to implement the reform contained in the program but also on the ability to persuade important segments of the population and key politicians about the merits of the policies being adopted. In this regard, an effective communication policy is needed to explain better the rationale for their policies and their policy intentions.

40. **The staff supports completion of the fourth review under the SBA and the waiver requests**. In light of the authorities' strong commitment to the program and good performance, the staff supports the completion of the review, and the waiver requests on: (i) the non-observance of the end-December 2004 performance criterion on the stock of arrears and (ii) the non-observance of the continuous performance criteria on the non-accumulation of arrears.

Box 1. Paraguay: The 2005 Budget

In early December 2004, Congress approved the 2005 budget containing considerably higher spending than the program and an implicit deficit for the central administration of about 2¼ percent of GDP. Although the 2005 budget approved by Congress shows a deficit of 1 percent of GDP, it includes unrealistic non-tax revenue projections (1¼ percent of GDP higher than the budget proposal) without specifying explicit revenue measures. Once the budget is adjusted for unrealistic revenues, the effective deficit is 2¼ percent of GDP, well above the deficit target of ½ percent of GDP in the program. The budget also includes unidentified external financing and unrealistic domestic bond placements. Regarding spending, the approved budget contemplates higher spending than the program for about 1¾ percent of GDP relatively evenly divided between higher current and capital expenditures.

However, the approved budget is an expenditure limit that can be modified *de-facto* by the executive branch through several legal mechanisms. First, an administrative budget law (*Ley de Administracion Financiera del Estado No. 1535/99*) gives the authority to the government to curtail budget appropriations according to a "financial plan" proposed by the Ministry of Finance and approved by the executive branch (Article 21 and 22), taking into account seasonal factors and realistic revenue, expenditure and financing sources. Second, the Ministry of Finance can save some resources by delaying some budget appropriations through the executive decree that regulates the budget implementation. Third, as a last resource, the Ministry of Finance can use a strict monthly cash flow to ration cash resources available, a mechanism used successfully during the first months of the 2004 fiscal program.

Paraguay: 2005 Budget
(In percent of GDP)

	2004	2005				Δ
			1/ Approved	Effective		Adjustment
	Actual	Prog.	Budget	Budget	Proj.	Plan
	(1)	(2)	(3)	(4)	(5)	(6)=(5-4)
Total revenue	**18.0**	**18.3**	**19.5**	**18.3**	**18.6**	**0.3**
Total expenditure	**16.5**	**18.8**	**20.5**	**20.5**	**18.8**	**-1.7**
Current	12.6	13.7	14.6	14.6	13.8	-0.8
Wages	7.0	7.5	7.5	7.5	7.3	-0.2
Non-wages	5.6	6.2	7.1	7.1	6.5	-0.6
Capital	3.8	5.1	6.0	6.0	5.0	-1.0
Statistical Discrepancy	**0.3**	--	--	--	--	--
Overall balance	**1.9**	**-0.5**	**-1.0**	**-2.3**	**-0.3**	**2.0**

Source: Fund staff estimates based on aggregate information for the 2005 budget.
1/ see www.imf.org

To achieve the 2005 fiscal program targets, the government will benefit from higher-than-programmed revenues and strict control of expenditure commitments using a twofold approach. Revenues are stronger than anticipated and will help in maintaining budgetary discipline in 2005. The authorities plan to reduce budget commitments for the most rigid current expenditures (about ¾ percent of GDP relative to the 2005 budget) through the application of a strict monthly financial plan (and by savings in some current expenditure items achieved through the budget regulating decree). To control capital expenditure to levels consistent with identified financing and allocate available resources more efficiently, the authorities will broaden the monitoring power of the coordinating unit for public investment (UCIP) (saving about 1 percent of GDP). The authorities believe that these measures will restrict expenditures, making them consistent with a realistic projection of revenues and the real execution capacity of the public entities.

Box 2. Paraguay: Business Environment

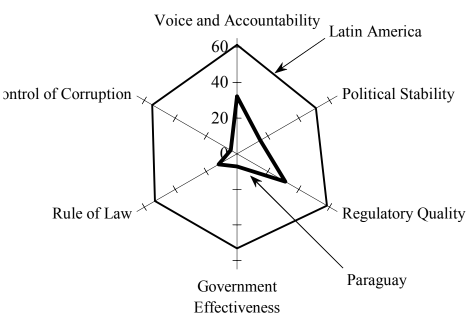
The unfavorable business environment discourages investment in Paraguay. According to a World Bank business environment report, it is more challenging to open a business in Paraguay than in any other country in the region. Entrepreneurs in Paraguay need to complete 17 steps to launch a business taking 74 days on average, at a cost equal to about 158 percent of gross national income (GNI) per capita; while in the region, entrepreneurs need to take 11 steps over 70 days at a lower cost of 60 percent of GNI per capita (less than one half of the cost in Paraguay). The rigidity of employment the index—an average of three indices (difficulty of hiring, rigidity of hours, and difficulty of firing)—is 59 for Paraguay, considerably higher than the regional average of 44. Similarly, it is lengthy and costly to close a business in Paraguay.

Paraguay: Business Environment

Indicator	Paraguay	Latin America
Starting a business (procedures)	17.0	11.0
Cost (percent income per capita)	157.6	60.4
Difficulty of hiring index	56.0	44.4
Rigidity of hours index	60.0	53.3
Difficulty of firing index	60.0	34.3
Rigidity of employment index	59.0	44.0
Firing costs (weeks of wages)	99.0	70.8
Cost to create collateral (percent of income per capita)	26.0	19.4

Source: World Bank.

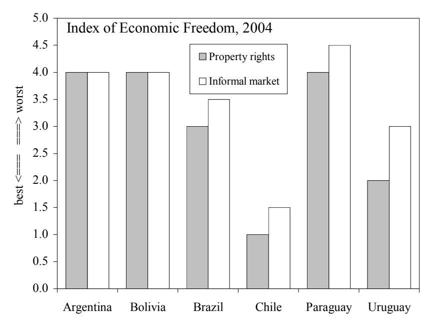
Paraguay: Governance Indicators



Source: D. Kaufmann, A. Kraay, and M. Mastruzzi 2003: Governance Matters III: Governance Indicators for 1996-2002.

Moreover, weak governance hinders investment. While Paraguay has made some progress in governance issues, more needs to be done to address the remaining weaknesses. Paraguay fairs poorly in selected governance indicators—voice and accountability, political stability, regulatory quality, government effectiveness, rule of law, and control of corruption—relative to other Latin America countries. Paraguay ranks as the most corrupt country in Latin America and the third most corrupt out of 133 countries, according to the 2003 Transparency International *Corruption Perception Index*. Government effectiveness is the second worst indicator.

Paraguay has long-standing problems with its large informal market—another deterrent to growth. Companies in the formal sector compete with the informal sector, which evade taxes. Paraguay ranks as the country with the largest informal economy in the region, according to Heritage Foundation.



Source: Heritage Fundation.

The authorities should move forward with the reform agenda, increasing tax and customs efficiency, tackling governance issues, and improving the business climate. The authorities should pursue tax and customs reforms to tax the informal economy and foster a "formalization" of activities. In addition, they should reform the judicial system and property rights to improve the investment climate.

Table 1. Paraguay: Quantitative Performance Criteria

	SBA								Extension	
	2003		2004						2005	
	End-Dec.		End-Mar.		End-Aug.		End-Dec.		Target	
	Adj. Target	Actual	Adj. Target	Actual	Adj. Target	Actual	Adj. Target	Actual	Mar. 31	Jun. 30
Fiscal targets										
1. Overall balance of the central administration (floor, in billions of guaranies) 1/ 2/	-125	-100	240	523	430	982	55	792	105	111
2. Wage bill of the central administration (ceiling, in billions of guaranies)	2,750	2,724	650	668	1,791	1,812	3,010	2,984	754	1,525
3. Overall balance of the public sector (floor, in billions of guaranies) 1/ 2/	-321	33	250	678	500	1,529	130	999	174	310
Monetary targets										
4. Net international reserves (floor, in millions of U.S. dollars) 3/	812	983	773	1,016	1,057	1,141	1,059	1,168	1,120	1,180
5. Net domestic assets (ceiling, in billions of guaranies) 3/	-2,852	-3,969	-2,839	-4,264	-4,444	-5,231	-3,958	-4,848	-4,614	-5,197
Public debt and arrears targets										
6. Contracting or guaranteeing of nonconcessional external debt by the NFPS (ceiling, in millions of US$)	50	0	50	0	200	0	200	0	200	200
7. External payments arrears of NFPS (ceiling, in millions of US$) 4/	102	91	75	75	5	3	0	16	...	...
8. *Of which:* bilateral arrears 4/	51	43	38	12	0	0	0	0	...	...
9. Central government floating debt (ceiling, in billions of guaranies) 4/	360	400	350	228	297	235	320	134	...	...
Continous PCs										
10. Contracted or guaranteed short-term external debt by the NFPS	0	0	0	0	0	0	0	0	0	0
11. Non-accumulation of external debt arrears 5/	0	B	0	B	0	B	0	B	0	0

1/ As specified in the TMU (see www.imf.org), this target is adjusted upward by 30 percent in case of over performance in tax revenues for 2005.
2/ Cumulative flows from the beginning of the corresponding calendar year.
3/ NIR is adjusted upward (downward) for any increase (decrease) in reserve requirement deposits and upward by the amount of any program disbursements. Similarly, the NDA target will be adjusted downward (upward) following the adjustment in the NIR.
4/ These performance criteria will not apply in 2005.
5/ B = breached.

Table 2. Paraguay: Structural Conditionality Under the Program

	Measure	Conditionality 1/	Timing	Status and Comments
Public Sector Reform				
A.	Independent audits for CONATEL and IPS	PC	Dec. 31, 2004	
B.	Adjustment in fuel and utility prices to reflect costs	PC	January 1, 2005	Done. Fuel prices adjusted three times during 2004 and once in 2005.
C.	Independent audits for ANNP, DINAC, INC, PETROPAR	PC	April 30, 2005	In progress
D.	Finalize plan for comprehensive civil service reform	SB	April 30, 2005	Census of civil servants completed and a new draft law for civil service presented to the economic cabinet.
E.	Plan for private capital participation ESSAP, COPACO, PETROPAR	SB	August 31, 2005	To be designed
Financial Sector Reform				
F.	Approval of public banking law (second tier) by one chamber	PC	March 15, 2004	Done. Approved by Senate on March 8, 2005.
G.	Introduce prudential regulations to cooperatives	SB	March 31, 2005	Done. Introduced in late December 2004
H.	Approval of public banking law (second tier)	SB	May 31, 2005	In progress, law already approved by the Senate.
I.	Approval of new comprehensive banking legislation	PC	June 30, 2005	Law submitted to Congress in December 2004
J.	Submission of public banking law (first tier) and adopt commission's recommendations.	PC	July 30, 2005	Partly done. Law submitted to Congress on February 16, 2005.

Sources: Paraguayan authorities; and Fund staff estimates.

1/ SB = structural benchmarks; PC = performance criteria

Table 3. Paraguay: Selected Economic and Social Indicators

I. Social and Demographic Indicators

Area (thousand sq. km)	407
Population	
Total (in millions)	5.7
Rate of increase (percent a year)	2.4
Density (per sq. km.)	14.1
Unemployment	15.7
Population characteristics	
Life expectancy at birth (years)	70.6
Crude birth rate (per thousand)	29.7
Crude death rate (per thousand)	5.0
Infant mortality (per thousand live births)	26.0

Income distribution	
By highest 20 percent of households	61 percent
By lowest 20 percent of households	2 percent
Health	
Physicians per 1,000 people	1.1
Hosp. beds per 1,000 people	1.3
Access to a water source	79 percent
Access to a sanitation facility	95 percent
Education (in percent)	
Male literacy rate	94 percent
Female literacy rate	92 percent
Primary school enrollment	92 percent
Secondary school enrollment	47 percent

II. Economic Indicators, 2002-2005

	2002	2003	2004		2005	
			Prog. 1/	Est.	Prog. 1/	Est.
(Annual percent change; unless otherwise specified)						
National accounts and prices						
GDP at current prices	13.7	21.4	9.3	9.4	7.5	6.9
GDP at constant prices	-2.3	2.6	2.4	2.9	3.2	3.2
Per capita GDP (U.S. dollars, thousands)	1.0	1.0	1.0	1.2	1.2	1.2
Consumption	-5.1	3.5	2.4	3.6	2.0	2.7
Investment	-11.0	7.0	7.6	1.4	13.1	7.4
Net exports (contribution to growth)	4.4	-1.8	-0.8	-0.7	-0.7	-0.5
Exports of goods and nonfactor services	14.3	13.2	0.2	4.9	5.7	6.7
Imports of goods and nonfactor services	-6.3	15.4	3.0	5.5	6.0	6.2
Consumer prices (average)	10.5	14.2	7.5	4.3	6.0	4.8
Consumer prices (end-of-period)	14.6	9.3	8.0	2.8	6.0	6.0
Real effective exchange rate						
Average (depreciation -)	-1.2	-6.6	...	5.3	...	...
End-of-period (depreciation -)	-2.6	9.5	...	-7.5	...	...
(In millions of U.S. dollars)						
External sector						
Exports, f.o.b. (percentage change)	-1.6	19.4	4.1	29.7	3.0	4.1
Imports, c.i.f. (percentage change)	-14.6	16.3	3.1	30.7	6.2	6.2
Net oil exports and imports	243	331	...	410	510	510
Current account	97	132	91	48	-27	-25
(in percent of GDP)	1.7	2.2	1.3	0.7	-0.4	-0.3
Capital account	65	194	40	22	66	114
Overall balance	-83	181	189	233	39	51
Terms of trade (percentage change)	6.9	7.0	8.8	8.4	-5.4	-13.3
(In percent of GDP)						
Savings-investment balance						
Gross domestic investment	19.1	19.8	18.7	21.0	21.3	21.5
Private sector	13.2	15.1	13.1	16.5	14.1	15.0
Public sector	5.9	4.7	5.6	4.5	7.2	6.5
Gross national savings	20.8	22.0	20.0	21.7	21.0	21.2
Private sector	18.4	17.8	14.7	15.3	13.9	14.4
Public sector	2.4	4.2	5.3	6.4	7.0	6.8
Public sector						
Central government primary balance	-1.7	0.9	1.6	2.7	0.7	1.0
Central government overall balance	-2.3	-0.2	0.2	1.9	-0.5	-0.3
Consolidated public sector primary balance 2/	-1.3	2.4	2.2	3.6	1.4	1.7
Consolidated public sector overall balance 2/	-3.1	-0.1	0.3	2.4	0.0	0.2
Public sector debt (end-of-year)	49.6	48.3	45.6	39.8	38.1	39.7
External	42.9	43.5	42.6	36.0	36.0	36.3
Domestic	6.7	4.9	3.0	3.8	2.0	3.5
(Annual percent change)						
Money and credit						
Monetary base	-1.0	57.7	21.6	17.6	8.2	9.3
M2	-2.2	24.9	13.8	24.2	10.7	9.6
M5 3/	-18.5	17.7	18.5	11.5	8.3	5.8
Credit to the private sector 3/	-21.0	-18.6	5.5	14.0	10.2	8.5
Velocity of M2	8.2	9.0	7.4	7.9	7.8	7.3
Memorandum items:						
International reserves (in millions of U.S. dollars)	641	983	1,080	1,168	1,220	1,220
(In months of imports)	2.7	3.3	4.5	3.7	4.0	3.8
GDP (in billions of guaranies)	31,977	38,806	40,779	42,469	44,516	45,395
Population (millions)	5.7	5.9	6.1	6.1	6.2	6.2

Sources: Paraguayan authorities; and Fund staff estimates.

1/ Revised program (Country Report No. 05/59).
2/ Consolidated public sector, including the quasi-fiscal operations of the BCP.
3/ Foreign currency items are valued at a constant exchange rate.

Table 4. Paraguay: Central Government Operations

				2004		2005			
						Jan-Mar		Year	
	2001	2002	2003	Prog. 1/	Actual	Prog.	Rev. Proj.	Prog.	Rev. Proj.
(In billion of guaranies)									
Total revenues	**4,892**	**5,048**	**6,001**	**6,809**	**7,637**	**1,761**	**1,728**	**8,137**	**8,448**
Tax revenues	2,851	2,923	3,676	4,395	4,929	1,174	1,185	5,093	5,484
Nontax revenues 2/	1,983	2,118	2,318	2,412	2,696	585	544	3,035	2,954
Capital revenues	57	7	7	3	12	2	0	9	9
Current expenditures*:*	**4,378**	**4,766**	**4,981**	**5,335**	**5,363**	**1,318**	**1,333**	**6,089**	**6,280**
Wages and salaries	2,400	2,582	2,724	2,882	2,984	754	733	3,328	3,327
Goods and services	295	373	408	505	447	83	71	526	588
Interest payments	378	456	489	562	483	113	152	561	561
Transfers	1,270	1,326	1,334	1,304	1,431	361	377	1,647	1,777
Other	35	29	26	83	18	7	1	26	26
Capital expenditures and net lending	**831**	**1,281**	**1,165**	**1,395**	**1,625**	**338**	**285**	**2,287**	**2,287**
Statistical discrepancy 3/	-910	271	29	0	143	0	0	0	0
Overall balance	**-1,228**	**-728**	**-116**	**79**	**792**	**105**	**110**	**-240**	**-119**
Financing	**1,228**	**728**	**116**	**-79**	**-792**	**-105**	**-110**	**240**	**119**
External debt (increase +)	-29	118	590	306	103	10	18	301	235
Disbursements	357	738	1,156	1,527	763	164	177	1,142	1,161
Amortizations	387	619	566	1,296	660	154	159	841	927
Domestic bonds (increase +)	528	-26	-58	-60	-78	-167	-123	-167	-168
Net credit from the banking system	207	-27	-308	-163	-124	52	40	105	51
Exceptional financing (incl. change in arrears)	522	663	-108	-161	-693	0	-45	0	0
(In percent of GDP)									
Total revenues	**17.4**	**15.8**	**15.5**	**16.7**	**18.0**	**15.8**	**15.2**	**18.3**	**18.6**
Tax revenues*:*	10.1	9.1	9.5	10.8	11.6	10.5	9.9	11.4	12.1
Nontax revenues 2/	7.1	6.6	6.0	5.9	6.3	5.3	5.3	6.8	6.5
Capital revenues	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Current expenditures, *of which:*	**15.6**	**14.9**	**12.8**	**13.1**	**12.6**	**11.8**	**11.7**	**13.7**	**13.8**
Wages and salaries	8.5	8.1	7.0	7.1	7.0	6.8	6.5	7.5	7.3
Goods and services	1.1	1.2	1.1	1.2	1.1	0.7	0.6	1.2	1.3
Interest payments	1.3	1.4	1.3	1.4	1.1	1.0	1.3	1.3	1.2
Transfers	4.5	4.1	3.4	3.2	3.4	3.2	3.3	3.7	3.9
Other	0.1	0.1	0.1	0.2	0.0	0.1	0.0	0.1	0.1
Capital expenditures and net lending	**3.0**	**4.0**	**3.0**	**3.4**	**3.8**	**3.0**	**2.5**	**5.1**	**5.0**
Statistical discrepancy 3/	-3.2	0.8	0.1	0.0	0.3	0.0	0.0	0.0	0.0
Overall balance	**-4.4**	**-2.3**	**-0.3**	**0.2**	**1.9**	**0.9**	**0.9**	**-0.5**	**-0.3**
Financing	**4.4**	**2.3**	**0.3**	**-0.2**	**-1.9**	**-0.9**	**-0.9**	**0.5**	**0.3**
External debt (increase +)	-0.1	0.4	1.5	0.7	0.2	0.1	0.2	0.7	0.5
Disbursements	1.3	2.3	3.0	3.7	1.8	1.5	1.6	2.6	2.6
Amortizations	1.4	1.9	1.5	3.2	1.6	1.4	1.4	1.9	2.0
Domestic bonds (increase +)	1.9	-0.1	-0.2	-0.1	-0.2	-1.5	-1.1	-0.4	-0.4
Net credit from the banking system	0.7	-0.1	-0.8	-0.4	-0.3	0.5	0.4	0.2	0.1
Exceptional financing (incl. change in arrears)	1.9	2.1	-0.3	-0.4	-1.6	0.0	-0.4	0.0	0.0
Memorandum Item:									
Primary balance	0.2	-1.7	0.9	1.6	2.7	2.0	2.3	0.7	1.0
Balance of the Caja Fiscal 4/	-2.0	-1.9	-1.5	-1.3	-1.2	-1.5	-1.5	-1.5	-1.5

Sources: Ministry of Finance; and Fund staff estimates.

1/ Revised Program (Country Report No. 05/59).
2/ Includes receipts from the binational hydroelectric plants Itaipu and Yacyreta, and grants.
3/ Measurement error to reconcile above-the-line estimate with measure of the fiscal balance from the financing side.
4/ Includes pension payments to central government employees and Chaco War veterans.

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

						2005			
				2004		Jan-Mar		Year	
	2001	2002	2003	Prog. 2/	Proj.	Prog.	Rev. Proj.	Prog.	Rev. Proj.
			(In billions of guaranies)						
Revenue	**5,984**	**6,160**	**7,450**	**8,306**	**8,950**	**2,141**	**2,065**	**9,665**	**9,811**
Tax revenue	2,855	2,926.9	3,676	4,384	4,936	1,175	1,186	5,098	5,492
Nontax revenue and grants	2,936	3,117	3,617	3,705	3,999	952	878	4,505	4,309
Capital revenue	193	116	156	217	15	15	0	62	10
Current expenditure	**5,464**	**5,763**	**6,246**	**6,626**	**6,806**	**1,665**	**1,701**	**7,532**	**7,811**
Wages and salaries	2,928	3,095	3,290	3,508	3,630	901	892	3,957	4,007
Goods and services	503	572	634	752	723	153	140	816	877
Interest payments	485	603	728	776	687	136	175	660	660
Transfers	1,340	1,455	1,544	1,492	1,713	438	462	1,952	2,115
Other	209	39	51	98	52	37	32	146	152
Capital expenditure and net lending	**1,430**	**1,875**	**1,818**	**2,231**	**1,895**	**591**	**471**	**3,217**	**2,931**
Public enterprises' operating surplus	**712**	**458**	**801**	**680**	**596**	**289**	**324**	**1,063**	**1,038**
Statistical discrepancy 3/	-733	35	-207	0	154	0		0	0
Overall balance	**-931**	**-986**	**-21**	**130**	**999**	**174**	**217**	**-21**	**108**
Financing	**931**	**986**	**21**	**-130**	**-778**	**-174**	**-217**	**21**	**-108**
External financing net	20	19	460	439	-42	-28	-14	293	295
Domestic financing net	389	-157	-24	224	-170	-147	-152	-273	-308
Of which: quasifiscal deficit financing	348	394	390	220	194	62	62	260	260
Net change in arrears	522	1,124	-415	-793	-787	0	0	0	0
			(In percent of GDP)						
Revenue	**21.3**	**19.3**	**19.2**	**20.0**	**21.1**	**19.2**	**18.2**	**21.7**	**21.6**
Tax revenue	10.2	9.2	9.5	10.5	11.6	10.6	10.5	11.5	12.1
Nontax revenue and grants	10.4	9.7	9.3	8.9	9.4	8.5	7.7	10.1	9.5
Capital revenue	0.7	0.4	0.4	0.5	0.0	0.1	0.0	0.1	0.0
Current expenditure	**19.4**	**18.0**	**16.1**	**15.9**	**16.0**	**15.0**	**15.0**	**16.9**	**17.2**
Wages and salaries	10.4	9.7	8.5	8.4	8.5	8.1	7.9	8.9	8.8
Goods and services	1.8	1.8	1.6	1.8	1.7	1.4	1.2	1.8	1.9
Interest payments	1.7	1.9	1.9	1.9	1.6	1.2	1.5	1.5	1.5
Transfers	4.8	4.5	4.0	3.6	4.0	3.9	4.1	4.4	4.7
Other	0.7	0.1	0.1	0.2	0.1	0.3	0.3	0.3	0.3
Capital expenditure and net lending	**5.1**	**5.9**	**4.7**	**5.4**	**4.5**	**5.3**	**4.1**	**7.2**	**6.5**
Public enterprises' operating surplus	**2.5**	**1.4**	**2.1**	**1.6**	**1.4**	**2.6**	**2.9**	**2.4**	**2.3**
Statistical discrepancy 3/	-2.6	0.1	-0.5	0.0	0.4	0.0	0.0	0.0	0.0
Overall balance	**-3.3**	**-3.1**	**-0.1**	**0.3**	**2.4**	**1.6**	**1.9**	**0.0**	**0.2**
Financing	**3.3**	**3.1**	**0.1**	**-0.3**	**-2.4**	**-1.6**	**-1.9**	**0.0**	**-0.2**
External financing net	0.1	0.1	1.2	1.1	-0.1	-0.2	-0.1	0.7	0.7
Domestic financing net	3.2	1.6	-0.8	0.5	0.1	-1.3	-1.3	-0.6	-0.7
Of which: quasifiscal deficit financing	1.2	1.2	1.0	0.5	0.5	0.6	0.5	0.6	0.6
Net change in arrears	0.0	1.4	-0.3	-1.9	-1.9	0.0	-0.4	0.0	-0.2
Memorandum item:									
Primary balance	1.0	-1.3	2.4	2.2	3.6	2.8	3.4	1.4	1.7

Sources: Ministry of Finance; and Fund staff estimates.

1/ Public sector comprises the nonfinancial public sector and the central bank.
2/ Revised program (Country Report No. 05/59).
3/ Measurement error to reconcile above-the-line estimate with measure of the fiscal balance from the financing side.

Table 6. Paraguay: Public Sector Arrears 1/
(In millions of U.S. dollars)

	December 2003		March 2004		August 2004		December 2004	
	Target	Actual	Target	Actual 2/	Target	Actual	Target	Actual
Total public sector arrears	**162**	**157**	**135**	**114**	**60**	**42**	**51**	**37**
(In percent of GDP)	**2.8**	**2.7**	**2.0**	**1.7**	**0.9**	**0.6**	**0.7**	**0.5**
Central government	**105**	**123**	**93**	**45**	**50**	**40**	**51**	**21**
Domestic	59	66	60	39	50	40	**51**	**21**
(In billions of guaranies)	(360)	(400)	(350)	(228)	(297)	(235)	(320)	(134)
External	46	58	34	6	0	0	0	0
Of which: multilateral	0	0	0	0	0	0		
Rest of public sector	**57**	**34**	**42**	**69**	**10**	**2**	**0**	**16**
Domestic	0	0	0	0	0	0	0	0
External	57	34	42	69	10	3	0	16
Of which: PETROPAR arrears to foreign supplier	44	22	32	55	10	3	0	16
ESSAP arrears	9	4	0	0	0	0	0	0
Memorandum items:								
External public arrears	102	91	75	75	10	3	0	16

Sources: Ministry of Finance; and Fund staff estimates.

1/ Stock at end of period, Adjusted for program definitions. The program considers as arrears: (i) all payments past due over 30 days; (ii) nondisputed arrears; (iii) domestic arrears which exclude "normal" floating debt (equal to G250 billion, or US$40 million).
2/ For the purposes of the target on domestic floating debt in March, interest on new bonds not yet processed and verified are not part of domestic debt as of March 31, 2004.

Table 7. Paraguay: Summary Accounts of the Central Bank

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

				2004		2005			
						March		Year	
	2001	2002	2003	Prog. 1/	Actual	Prog.	Rev. Proj.	Prog.	Rev. Proj.
Currency issue	**1,662**	**1,699**	**2,207**	**2,692**	**2,488**	**2,422**	**2,422**	**2,816**	**2,736**
Growth	6.8	2.2	29.9	22.0	12.7	14.5	14.5	10.0	10.0
Net international reserves	**4,541**	**4,027**	**6,175**	**6,782**	**7,335**	**7,036**	**7,036**	**7,660**	**7,660**
(In millions of U.S. dollars)	723	641	983	1,080	1,168	1,120	1,120	1,220	1,220
Net dometic assets	**-2,879**	**-2,329**	**-3,969**	**-4,090**	**-4,848**	**-4,614**	**-4,614**	**-4,844**	**-4,924**
Net nonfinancial public sector	1,176	1,507	1,163	1,137	1,204	1,004	1,252	1,058	1,264
Net credit to the central government	978	1,291	952	883	947	866	990	919	1,002
Net credit to the rest of NFPS	198	216	211	254	257	139	262	139	262
Net credit to the banking system	-2,591	-2,491	-3,831	-4,441	-4,757	-4,389	-4,682	-4,873	-5,215
Reserve requirements	-2,159	-1,600	-2,219	-2,356	-2,195	-2,315	-2,187	-2,413	-2,270
Free reserves	-140.8	-217	-543	-949	-1,012	-781	-981	-842	-948
Monetary control bills (LRM)	-297	-677	-1,071	-1,165	-1,552	-1,302	-1,537	-1,627	-2,021
Other	7	4	2	29	2	9	23	9	23
Other assets and liabilities (net)	-1,464	-1,345	-1,301	-786	-1,295	-1,228	-1,183	-1,029	-973
Capital and reserves	-1,584	-2,941	-1,463	-1,158	-1,674	-1,188	-1,625	-988	-1,414
Other assets net	120	1,596	162	372	379	-40	441	-41	441
Memorandum item:									
Monetary base growth	5.8	-1.0	57.7	21.6	17.6	8.8	14.0	8.2	9.3

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

Table 8. Paraguay: Summary Accounts of the Banking System

(End of period; valued at constant exchange rate)

	2001	2002	2003	2004 Prog.	2004 Actual	2005 March Prog.	2005 March Rev. Proj.	2005 Year Prog.	2005 Year Rev. Proj.
(In billions of guaranies)									
I. Central Bank									
Net international reserves	**4,541**	**4,027**	**6,175**	**6,782**	**7,335**	**7,036**	**7,036**	**7,660**	**7,660**
(in millions of U.S. dollars)	723	641	983	1,080	1,168	1,120	1,120	1,220	1,220
Net domestic assets	**-2,879**	**-2,329**	**-3,969**	**-4,090**	**-4,848**	**-4,614**	**-4,614**	**-4,844**	**-4,924**
Credit to public sector, net	1,176	1,507	1,163	1,137	1,204	1,004	1,252	1,058	1,264
Credit to banking system, net 1/	-2,293	-1,814	-2,760	-3,276	-3,205	-3,087	-3,145	-3,247	-3,194
Central bank securities	-297	-677	-1,071	-1,165	-1,552	-1,302	-1,537	-1,627	-2,021
Other	-1,464	-1,345	-1,301	-786	-1,295	-1,228	-1,183	-1,029	-973
Currency issue	**1,662**	**1,699**	**2,207**	**2,692**	**2,488**	**2,422**	**2,422**	**2,816**	**2,736**
II. Monetary Survey									
Net foreign assets	**6,907**	**5,497**	**8,405**	**9,393**	**9,478**	**9,340**	**9,179**	**9,965**	**9,803**
(in millions of U.S. dollars)	1,100	875	1,338	1,496	1,509	1,487	1,462	1,587	1,561
Net domestic assets	**4,093**	**3,473**	**2,152**	**3,122**	**2,292**	**2,436**	**2,729**	**2,496**	**2,652**
Credit to the public sector	358	932	699	-136	369	64	324	-261	-42
Credit to the private sector	7,872	6,230	5,081	5,658	5,788	6,138	6,020	6,464	6,280
Other	-4,137	-3,689	-3,628	-2,399	-3,866	-3,766	-3,614	-3,707	-3,585
Broad Liquidity (M4)	**11,000**	**8,970**	**10,558**	**12,515**	**11,770**	**11,777**	**11,908**	**12,460**	**12,456**
Bonds and issued securities	50	135	31	0	0	0	0	0	0
Other monetary liabilities	16	15	9	7	125	3	125	3	126
Central bank securities with private sector	121	281	469	1,153	381	711	546	713	496
Broad liquidity (M3)	**10,813**	**8,539**	**10,047**	**11,355**	**11,263**	**11,063**	**11,236**	**11,745**	**11,834**
Foreign currency deposits	6,886	4,699	5,253	5,898	5,310	5,726	5,310	5,726	5,310
Money and quasi-money (M2)	**3,926**	**3,839**	**4,794**	**5,456**	**5,953**	**5,336**	**5,926**	**6,018**	**6,523**
Time and savings deposits	1,306	1,198	1,208	1,315	1,482	1,282	1,512	1,378	1,606
Money (M1)	2,621	2,641	3,587	4,141	4,471	4,054	4,414	4,641	4,918
(Annual percentage change)									
M0 (Currency issued)	6.8	2.2	29.9	22.0	12.7	14.5	14.5	10.0	10.0
Credit to the private sector	-1.0	-20.9	-18.4	11.3	13.9	15.4	13.2	10.2	8.5
M1	8.5	0.8	35.8	15.4	24.7	17.0	27.4	11.0	10.0
M2	4.9	-2.2	24.9	13.8	24.2	12.5	24.9	10.7	9.6
M3	0.7	-21.0	17.7	13.0	12.1	5.3	6.9	5.2	5.1
Of which: foreign currency deposits	-1.5	-31.8	11.8	12.3	1.1	-0.7	-7.9	0.0	0.0
Memorandum items:									
Ratio of foreign currency deposits to M3 (percent)	63.7	55.0	52.3	51.9	47.1	51.8	47.3	48.8	44.9
Ratio of foreign currency deposits to private sector deposits in banks (percent)	72.5	64.9	63.5	65.1	57.1	63.1	56.7	61.4	55.2

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

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

Table 9. Paraguay: Banking System Indicators

	2000	2001	2002	2003	2004
I. Total banking system (II+III+IV+V)					
Share in assets	100.0	100.0	100.0	100.0	100.0
Capital adequacy ratio (percent)	17.6	16.9	17.9	20.9	20.5
NPLs/total loans	16.6	16.5	19.7	20.6	10.8
Provisions/NPLs	38.8	37.0	46.6	54.8	54.6
Rate of return on assets (ROA)	1.4	2.2	1.0	0.4	1.7
Rate of return on equity (ROE)	12.4	21.2	9.0	4.5	18.3
Liquid assets/total assets 1/	21.7	23.0	25.1	32.6	30.8
Foreign exchange deposits/total deposits	59.7	65.3	68.6	61.7	55.0
II. Total foreign-owned banks					
Share in assets	47.0	45.1	48.4	47.4	35.8
Capital adequacy ratio (percent)	17.1	16.0	17.6	20.4	26.0
NPLs/total loans	14.1	15.3	20.1	20.8	11.0
Provisions/NPLs	40.2	42.6	57.5	64.2	71.2
Rate of return on assets (ROA)	2.3	3.1	1.6	0.1	1.4
Rate of return on equity (ROE)	20.2	30.4	15.0	1.2	12.0
Liquid assets/total assets 1/	21.6	22.2	27.1	29.8	25.4
Foreign exchange deposits/total deposits	63.2	67.8	71.1	65.6	65.2
III. Total majority-owned foreign banks					
Share in assets	34.9	38.3	33.2	37.2	45.2
Capital adequacy ratio (percent)	17.7	16.8	19.9	21.0	17.7
NPLs/total loans	10.6	10.6	10.4	12.3	3.7
Provisions/NPLs	39.7	36.8	43.8	52.1	56.9
Rate of return on assets (ROA)	1.0	1.8	1.4	1.3	2.2
Rate of return on equity (ROE)	8.6	18.3	13.4	15.5	25.8
Liquid assets/total assets 1/	24.2	25.0	26.2	35.3	28.8
Foreign exchange deposits/total deposits	64.3	69.3	70.7	62.3	53.8
IV. Total domestic-owned private banks					
Share in assets	6.8	7.4	10.4	7.4	8.2
Capital adequacy ratio (percent)	15.2	14.8	13.6	14.1	13.3
NPLs/total loans	7.0	6.5	8.8	2.9	2.1
Provisions/NPLs	25.0	30.8	18.7	46.2	70.3
Rate of return on assets (ROA)	1.0	1.2	1.1	1.6	2.0
Rate of return on equity (ROE)	8.9	13.8	14.3	21.1	28.1
Liquid assets/total assets 1/	17.3	20.1	18.3	38.8	38.1
Foreign exchange deposits/total deposits	49.4	61.8	62.6	60.7	57.6
V. National Development Bank (BNF)					
Share in assets	11.4	9.2	8.0	8.0	10.7
Capital adequacy ratio (percent)	21.2	22.9	18.8	30.0	25.0
NPLs/total loans	44.6	46.5	56.2	56.2	48.9
Provisions/NPLs	38.1	31.7	39.6	47.6	43.1
Rate of return on assets (ROA)	-0.5	0.3	-4.7	-2.8	0.5
Rate of return on equity (ROE)	-4.2	2.0	-27.3	-18.7	6.8
Liquid assets/total assets 1/	16.7	20.4	17.3	30.7	52.0
Foreign exchange deposits/total deposits	19.3	27.0	42.5	32.7	23.6

Source: Superintendency of Banks.

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

Table 10. Paraguay: Balance of Payments, 2003-2005

(In millions of U.S. dollars)

						2005			
				2004		Jan-Mar		Year	
	2001	2002	2003	Prog. 1/	Proj.	Prog. 2/	Proj.	Prog. 2/	Proj.
Current account	**-266**	**94**	**132**	**91**	**48**	**-50**	**52**	**-27**	**-25**
Trade balance	-618	-283	-271	-299	-376	-133	-36	-460	-459
Exports	1883	1852	2211	2096	2869	674	682	2820	2986
Imports	-2500	-2134	-2483	-2395	-3245	-808	-718	-3280	-3445
Services (net)	165	214	236	209	230	55	59	214	211
Factor income	16	44	-1	6	0	-26	-25	6	8
Transfers	167	116	165	176	194	54	54	215	215
Capital and financial account	**163**	**64**	**224**	**40**	**22**	**-11**	**-59**	**66**	**129**
Public sector 3/	150	-4	92	39	28	-3	-3	33	33
Disbursements	144	146	213	148	157	27	27	185	185
Amortization	-102	-123	-130	-118	-138	-32	-32	-161	-161
Other	108	-27	9	9	9	2	2	9	9
Private Sector 4/	13	67	132	1	-6	-7	-56	33	96
Direct investment	78	12	31	35	42	8	8	83	83
Foreign currency deposits	-61	-153	343	34	54	-16	-64	-101	-53
Other	-4	209	-242	-68	-102	0	0	51	66
Errors and Omissions	58	-240	-145	58	163	0	-38	0	-38
Overall Balance	**-45**	**-83**	**211**	**189**	**233**	**-61**	**-45**	**39**	**66**
Net International Reserves (increase -)	45	83	-302	-99	-181	61	49	-39	-51
Gross Reserves	45	84	-301	-98	-179	60	48	-40	-52
Reserve Liabilities	0	-1	-1	-1	-1	1	1	1	1
Exceptional Financing	...	...	91	-91	-52	0	-4	0	-15
Arrears deferral (+)/clearance (-)	...	...	91	-91	-55	0	0	0	-15
Memorandum items:									
Current account in percent of GDP	-3.9	1.7	2.2	1.3	0.7	-2.7	2.9	-0.4	-0.3
Gross reserves (in millions of U.S. dollar	723	641	982	1080	1168	1,120	1120	1,220	1220
in months of imports of GNFS	3.5	2.7	3.3	4.5	3.7	3.6	3.4	3.9	3.7
External public debt in percent of GDP	33.5	42.9	43.3	39.6	36.3	37.0	35.7	37.4	36.1
Debt service in percent of exports GNFS	10.8	9.1	11.1	15.4	9.9	8.8	8.6	8.5	8.1
Export Volume (percentage change) 5/	19.2	-7.0	14.5	4.9	14.0	-22.6	14.7	5.7	12.8
Import Volume (percentage change) 5/	1.4	-21.7	15.9	4.6	17.1	4.2	1.9	3.3	3.3
Terms of trade (percentage change)	-0.1	6.5	7.0	8.8	8.4	-5.4	-13.3	-5.4	-13.3

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

1/ Revised program (Country Report No. 05/59).

2/ Revised program (see www.imf.org).

3/ Includes the central administration and descentralized public entities.

4/ Includes public enterprises and binationals.

5/ Registered trade.

Table 11. Paraguay: Indicators of External Vulnerability

	2000	2001	2002	2003	2004
Monetary and financial indicators					
Broad money (M3), percentage change 1/	-0.5	0.7	-21.0	17.7	12.1
Credit to the private sector, real (percentage change) 1/	-9.0	-8.7	-31.1	-25.5	10.9
Share of nonperforming loans in total loans (percent) 2/	16.6	16.5	19.7	20.6	10.8
Average domestic lending rate, real 3/	16.0	22.5	39.0	19.3	17.4
Central bank bill yield, real 2/	-2.8	12.8	12.9	-1.2	1.0
Central bank foreign short-term liabilities (millions of US$) 3/	0.5	0.2	0.5	0.5	0.3
External indicators 3/					
Merchandise exports (percentage change)	0.7	-18.9	-1.6	21.8	21.4
Merchandise imports (percentage change)	4.1	-12.7	-14.6	18.0	22.7
Merchandise terms of trade (percentage change)	-4.6	-0.3	6.9	8.6	4.4
Real effective exchange rate (average; percentage change)	-3.1	-1.5	-3.9	-6.6	5.3
Current account balance (percent of GDP)	-2.1	-3.9	1.7	2.4	0.9
Capital and financial account (percent of GDP)	2.0	2.2	1.1	3.7	2.4
Net foreign direct investment (percent of GDP)	1.3	1.2	0.2	0.5	0.9
Inward portfolio investment (percent of GDP)	0.0	0.0	0.0	0.0	0.0
Other net investment (percent of GDP)	0.7	0.8	0.8	3.0	1.2
External public debt (percent of GDP)	30.6	33.5	42.9	43.3	38.0
Debt service (in percent of exports GNFS)	10.4	10.8	9.1	11.0	10.4
Gross reserves (in US$)	772	723	641	983	1,180
In months of imports of GNFS	3.2	3.5	2.7	3.4	3.9
Over short-term external debt 4/	1.1	1.1	0.9	1.3	1.7
Over foreign currency deposits in domestic banks	0.6	0.6	0.7	1.0	1.1

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

1/ Foreign currency components are valued at the accounting exchange rate of Gs. 6,280 per U.S. dollar.
2/ Latest available data, September 2004.
3/ Projection for 2004.
4/ Private and public external debt with a residual maturity of one year or less. Excludes foreign currency deposits in banking system.

Table 12. Paraguay: Proposed Schedule of Reviews and Purchases

	Amount of Purchase		
Date	Millions of SDRs	Percent of Quota	Conditions
Purchases available	**41.0**	**41.0**	
December 15, 2003	30.0	30.0	Approval of arrangement
March 16, 2004	4.0	4.0	First review and end-December 2003 performance criteria
July 30, 2004	4.0	4.0	Second review and end-March 2004 performance criteria
December 20, 2004	3.0	3.0	Third review and end-August 2004 performance criteria
Purchases to become available	**9.0**	**9.0**	
March 30, 2005	3.0	3.0	Fourth review and end-December 2004 performance criteria
June 24, 2005	3.0	3.0	Fifth review and end-March 2005 performance criteria
September 15, 2005	3.0	3.0	Sixth review and end-June 2005 performance criteria
Total	**50.0**	**50.0**	

Source: Fund staff estimates.

Table 13. Paraguay: Indicators of Capacity to Repay the Fund 1/

		Projections					
	2004	2005	2006	2007	2008	2009	2010
Fund repurchases and charges							
In millions of SDRs	0.0	1.2	1.6	1.6	19.1	25.8	7.5
In millions of U.S. dollars	0.0	1.8	2.4	2.4	29.5	39.8	11.6
In percent of exports of goods and NFS	0.0	0.1	0.1	0.1	0.8	1.1	0.3
In percent of quota	0.0	1.2	1.6	1.6	19.1	25.8	7.5
In percent of gross official reserves	0.0	0.1	0.2	0.2	2.1	2.8	0.8
Fund credit outstanding							
In millions of SDRs	0.0	50.0	50.0	50.0	32.4	7.4	0.0
In millions of U.S. dollars	0.0	77.0	77.1	77.1	49.9	11.4	0.0
In percent of exports of goods and NFS	0.0	2.3	2.2	2.2	1.4	0.3	0.0
In percent of quota	0.0	50.1	50.1	50.1	32.4	7.4	0.0
In percent of gross official reserves	0.0	4.1	3.9	3.8	2.4	0.5	0.0
Memorandum items:							
Exports of goods and NFS (mlns. of U.S. dollars), baseline	3,316	3,407	3,449	3,540	3,634	3,732	3,836
Debt service (millions of U.S. dollars)	345	291	314	338	347	348	360
Quota (millions of SDRs)	100	100	100	100	100	100	100
Quota (millions of U.S. dollars)	148	154	154	154	154	154	154
Gross official reserves (millions of U.S. dollars)	1,180	1,220	1,268	1,319	1,372	1,437	1,497
U.S. dollars per SDR (e.o.p.) 2/	1.48	1.54	1.54	1.54	1.54	1.54	1.54

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

1/ Assumes all purchases made as scheduled under current program starting from March 15, 2005, and repurchases made on the obligations schedule.

2/ WEO projections.

Table 14. Paraguay: Medium-Term Scenario

(In percent of GDP, unless otherwise specified)

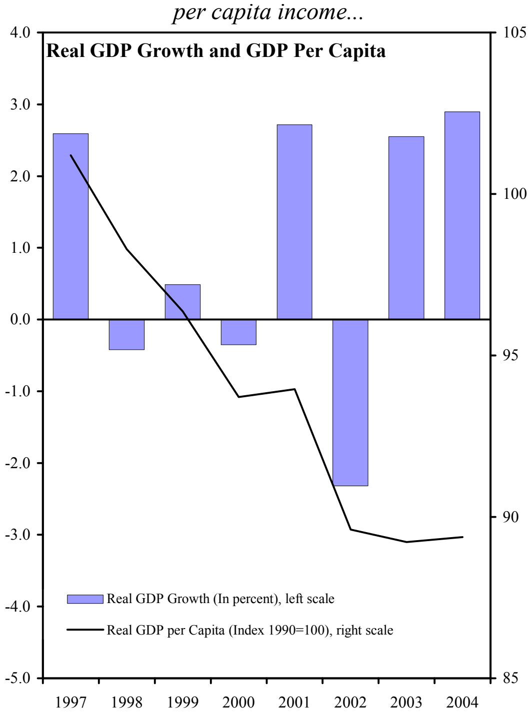
	Est.	Projections					
	2004	2005	2006	2007	2008	2009	2010
I. Program scenario							
Real sector							
Real GDP growth (annual percentage change)	2.9	3.2	3.5	4.0	4.0	4.0	4.0
Consumer prices (annual percentage change)	2.8	6.0	4.0	3.0	3.0	3.0	3.0
GDP per capita (US dollars)	1,175	1,160	1,213	1,267	1,327	1,391	1,461
Public finances 1/							
Revenues	21.1	21.6	22.0	22.0	21.9	21.7	21.5
Current primary expenditures	14.4	15.8	15.6	15.6	15.6	15.6	15.6
Interest payments	1.6	1.5	1.7	1.7	1.6	1.5	1.5
Capital expenditures	4.5	6.5	6.5	6.5	6.6	6.6	6.5
Public enterprise operating surplus	1.4	2.3	2.4	2.3	2.3	2.2	2.2
Primary balance	3.6	1.7	2.3	2.2	2.0	1.8	1.6
Overall balance	2.4	0.2	0.5	0.5	0.4	0.3	0.1
Public sector debt (in millions of U.S. dollars)	2,835	2,867	2,835	2,825	2,870	2,955	2,980
(In percent of GDP)	39.8	39.7	36.8	34.4	32.6	31.4	29.5
Balance of payments (in millions of U.S. dollars)							
Exports	2,869	2,986	3,049	3,196	3,352	3,492	3,637
Imports	-3,245	-3,445	-3,536	-3,692	-3,877	-4,047	-4,251
Current account	48	-25	-35	-40	-62	-78	-122
(In percent of GDP)	0.7	-0.3	-0.5	-0.5	-0.7	-0.8	-1.2
Capital and financial account	22	129	87	109	151	205	245
Net international reserves	1,168	1,220	1,272	1,340	1,430	1,556	1,679
(In months of imports)	3.7	3.7	3.7	3.7	3.8	4.0	4.2
II. No Reform Scenario							
Real sector							
Real GDP growth (annual percentage change)	2.9	3.2	2.0	2.0	2.0	2.0	2.0
Consumer prices (annual percentage change)	2.8	6.0	4.0	4.0	4.0	4.0	4.0
GDP per capita (US dollars)	1,175	1,160	1,195	1,224	1,258	1,293	1,332
Public finances 1/							
Revenues	21.1	21.6	22.0	21.9	21.8	21.6	21.3
Current primary expenditures	14.4	15.8	15.9	16.3	16.6	17.0	17.4
Interest payments	1.6	1.5	2.0	2.0	2.0	2.1	2.1
Capital expenditures	4.5	6.5	6.5	6.5	6.5	6.5	6.5
Public enterprise operating surplus	1.4	2.3	2.1	1.9	1.7	1.5	1.2
Primary balance	3.6	1.7	1.7	1.0	0.4	-0.4	-1.3
Overall balance	2.4	0.2	-0.3	-1.0	-1.7	-2.5	-3.3
Public sector debt (in millions of U.S. dollars)	2,835	2,867	2,878	2,970	3,129	3,361	3,368
(In percent of GDP)	39.8	39.7	37.9	37.4	37.5	38.4	36.6
Balance of payments (in millions of U.S. dollars)							
Exports	2,869	2,986	3,049	3,196	3,352	3,492	3,637
Imports	-3,245	-3,445	-3,493	-3,589	-3,709	-3,808	-3,934
Current account	48	-25	12	74	125	188	231
(In percent of GDP)	0.7	-0.3	0.2	0.9	1.5	2.2	2.5
Capital and financial account	22	129	-9	-18	-21	-55	-169
Net international reserves	1,168	1,220	1,223	1,279	1,382	1,516	1,579
(In months of imports)	3.7	3.8	3.7	3.7	3.9	4.2	4.3

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

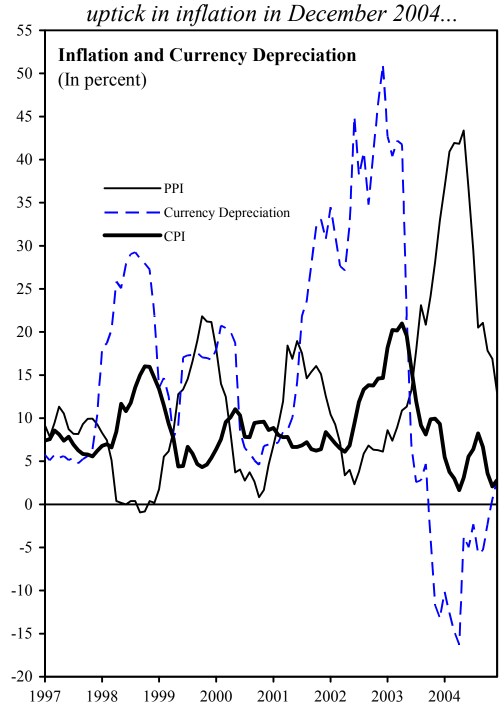
1/ Defined as the nonfinancial public sector and the BCP.

Figure 1. Paraguay: Selected Economic Indicators

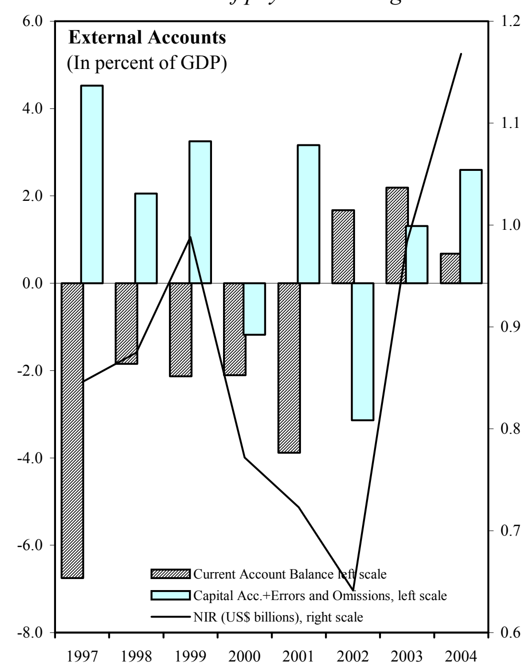
Strong recovery but declining per capita income...



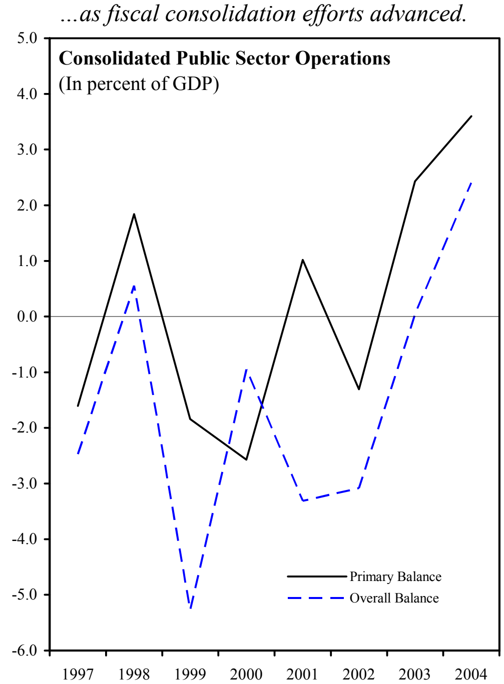
...inflation is under control despite and uptick in inflation in December 2004...



...the balance of payments strengthened



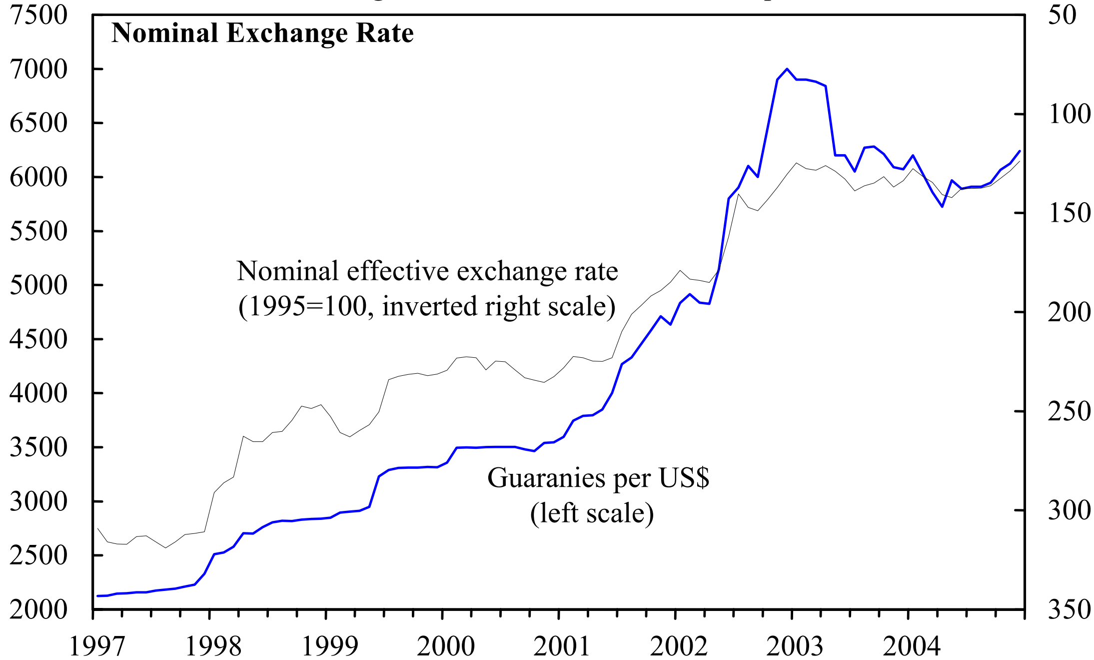
...as fiscal consolidation efforts advanced.



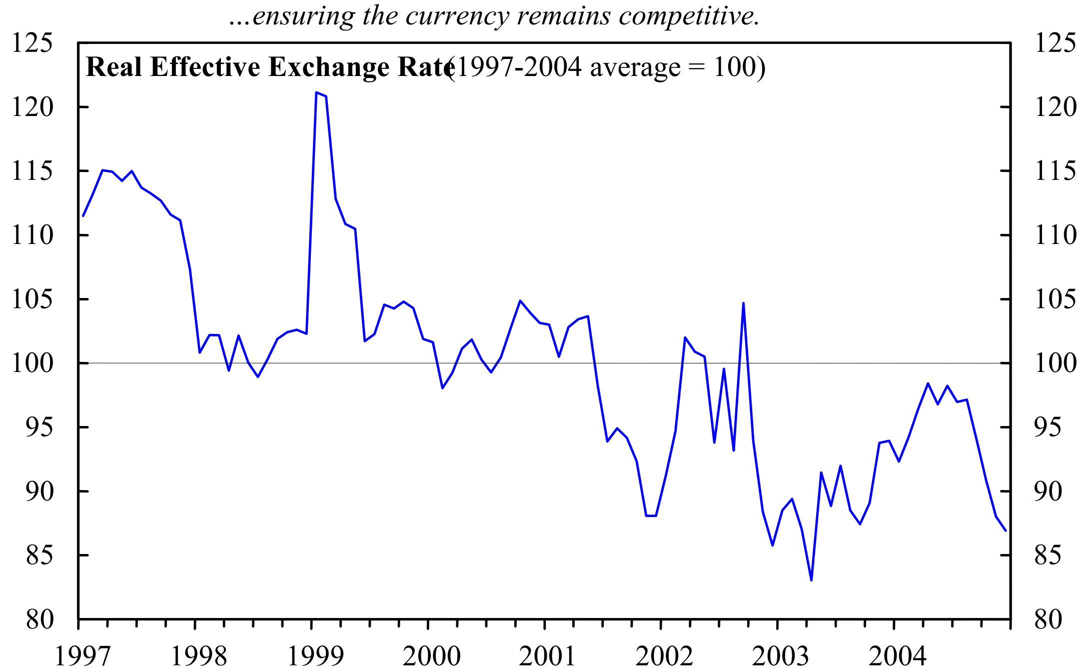
Source: Central Bank of Paraguay and Ministry of Finance.

Figure 2. Paraguay: Exchange Rate Developments

The exchange rate is more stable than in the past...



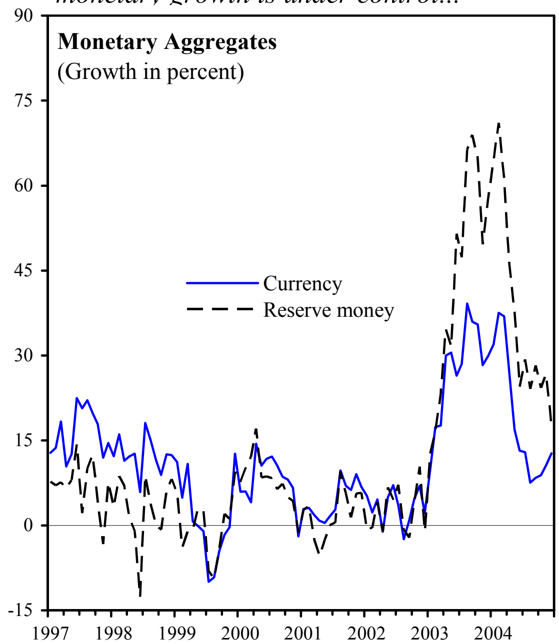
...ensuring the currency remains competitive.



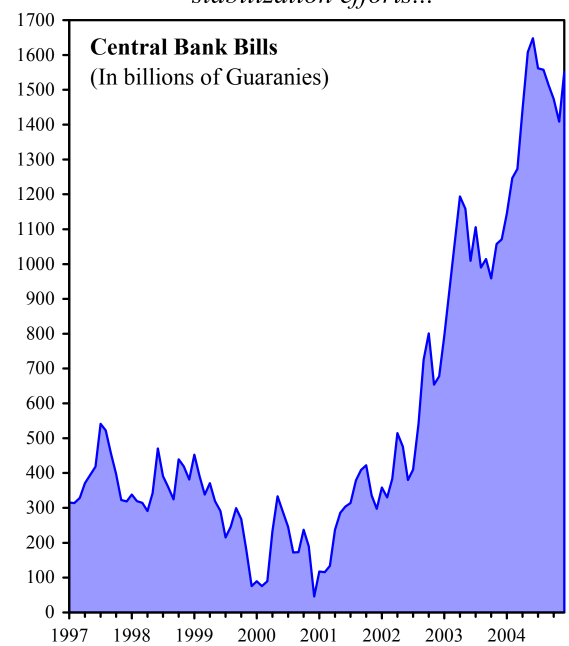
Source: Central Bank of Paraguay and Fund staff estimates.

Figure 3. Paraguay: Selected Financial Indicators

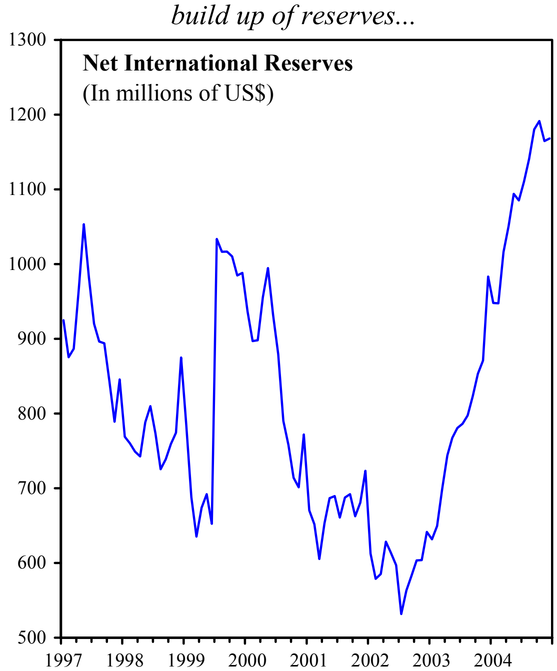
Despite an overhang in December 2004, monetary growth is under control...



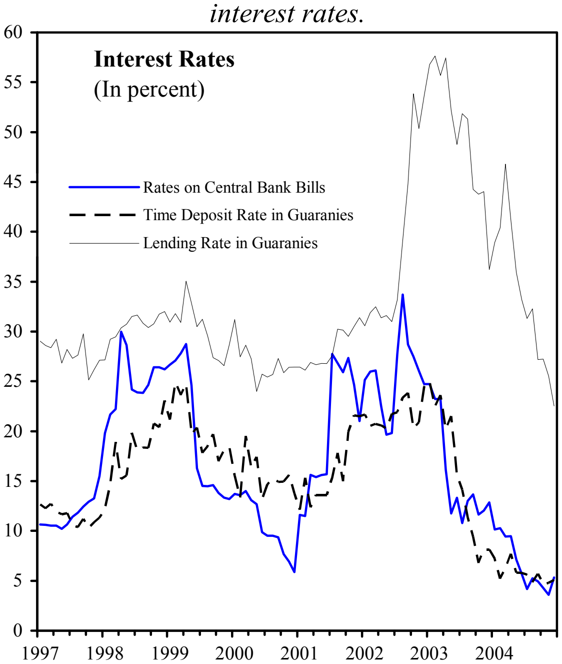
...The Central Bank continues with its stabilization efforts...



...capital inflows facilitated a rapid build up of reserves...

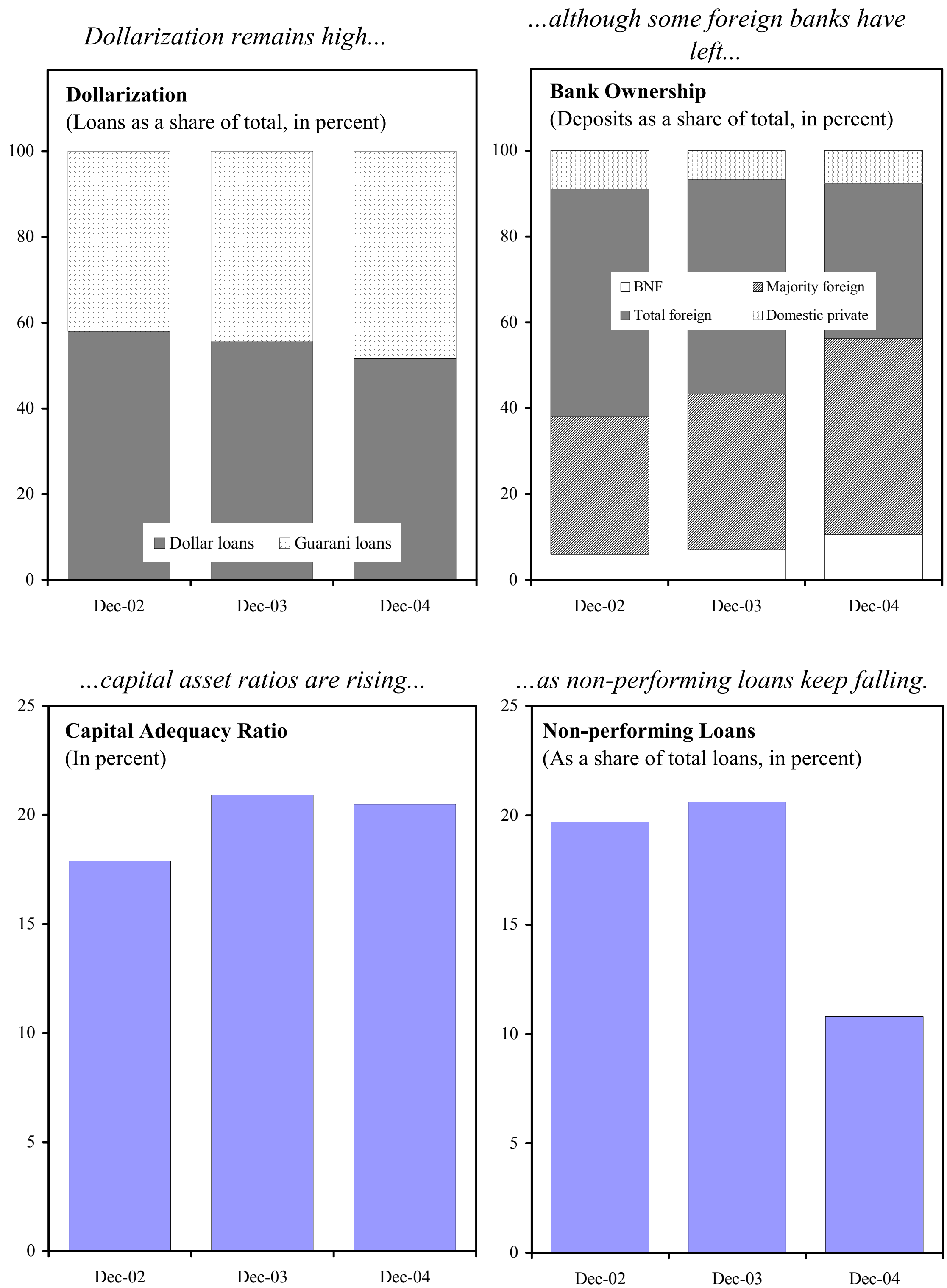


...and put downward pressure on interest rates.



Source: Central Bank of Paraguay.

Figure 4. Paraguay: Selected Banking Indicators



Source: Central Bank of Paraguay.

FUND RELATIONS
(As of February 28, 2005)

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

II. **General Resources Account**:

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

III. **SDR Department**:

	In millions of SDRs	**Percent of Allocation**
Net cumulative allocation	13.70	100.00
Holdings	86.04	628.18

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

V. **Exchange Rate Arrangement:** The currency of Paraguay is the Paraguayan *guaraní*. The exchange rate regime is a managed float. The exchange rate is determined in the interbank foreign exchange market, but the central bank intervenes in the foreign exchange and monetary markets to smooth out exchange rate fluctuations in real effective terms. The U.S. dollar is the principal intervention currency. On February 28, 2005, the average interbank rate for the U.S. dollar was ₲6,260=US$1.

VI. **Article IV Consultation:** The 2002 Article IV consultation was concluded by the Executive Board on March 10, 2003; the documents are IMF Country Reports No. 03/94 and 03/95. The 2004 Article IV consultation was concluded by the Executive Board on July 30, 2004; the document is Country Report No. 05/59.

VII. **Technical Assistance:**

Department	**Purpose**	**Date of Delivery**
MAE	Policy Advisory to the Central Bank	March 1994–Present
FAD	Tax Policy	February 1999
FAD	Tax Administration	March 1999
STA	Monetary Statistics	February 2000
STA	Balance of Payments Statistics	June 2000
STA	Multisector, GDDS accession	February 2001

Department	Purpose	Date of Delivery
MAE	Currency Operations	March through September 2002
MAE	Financial Sector Surveillance	July 2002
FAD	ROSC	August 2002
STA	Multisector, follow-up	September 2002
MAE	Banking Supervision	September through November 2002
MAE	Central Bank Operations	November 2002
TRE	Safeguard Assessment	January 2003
MFD	Banking Supervision	January 2003 through April 2004
MFD	Currency Handling and Reform	February 2002 through April 2004
MFD	Payment System	July 2003
FAD	Customs and Tax Administration	December 2003
MFD	Reorganization of the Central Bank and Monetary Operations	January 2004
MFD	Monetary Operations and Monetary Policy Formulation	October 2004
MFD	Public Banking Restructuring	February 2005

VIII. **Safeguard Assessment:** Under the Fund's safeguards assessment policy, Central Bank of Paraguay (CBP) is subject to an assessment with respect to the expected arrangement. A safeguards assessment of the CBP was completed on January 31, 2003. The assessment concluded that substantial risks may exist in legal structure and independence of the central bank, and in its control environment. Staff findings, proposed recommendations under program conditionality, and other recommendations are reported in IMF Country Report No. 03/94. The CBP has implemented all significant recommendations made in the report. Staff will continue to monitor the implementation of the remaining recommendations.

X. **Resident Representative:** Mr. Luis H. Duran-Downing has been appointed as Representative since February 2004.

WORLD BANK RELATIONS[1]

(As of February 28, 2005)

A new Paraguay Country Assistance Strategy (CAS) was approved on December 16, 2003, covering the period from mid-FY04 to FY07. The Bank's strategy as outlined in the new CAS aims at restoring confidence in the economy and lays the basis for sustainable growth and poverty reduction. To this end, the CAS supports (i) the fiscal and financial reforms the Administration has to send to congress; (ii) improved governance and transparency in public administration; (iii) sustained growth, particularly in the rural areas where poverty is concentrated and deepest; and (iv) social inclusion, to improve the coverage and efficiency of basic social services to help Paraguay meet the millennium development goals. The proposed base case-lending program for the CAS periods is for US$325 million, of which US$80 million, or about 25 percent, are envisaged for adjustment operations. One of them, the Economic Recovery Loan in the amount of US$30 million was approved on December 16, 2003 together with the CAS, and has been fully disbursed.

A comprehensive Policy Notes document was completed in May 2003 and discussed with the new Administration in June 2003. In FY04, the Bank also prepared a Social Protection Study and a Country Financial Accountability Assessment (CFAA). In FY05, the Bank has completed an Institutional and Governance Review. In addition, sector work on a Health Strategy and a Public Expenditure Review (PER) is underway and will be delivered in FY05.

Four World Bank-financed projects are presently under implementation, for a total value of US$123 million in commitments, of which US$56.5 million are undisbursed as of February 28, 2005. These projects include Fourth Rural Water Supply, Natural Resource Management, Pilot Community Development, and the Secondary Education Reform, which became effective in July 2004. An active program of grants is also being currently implemented.

A first Programmatic Financial Sector Adjustment Loan and Technical Assistance Loan are at an advanced stage of preparation. A technical assistance loan to assist in the restructuring of the Ministry of Finance and help it become a ministry of excellence, and a Maternal Health II project are also under preparation for FY05 delivery. A Social Security Reform Technical Assistance Loan, a Sustainable Rural Investment Project, which will be a follow-up to the ongoing Natural Resource Management Project, and a Road Maintenance Project are also being prepared for delivery in FY06. The FY06 program further includes a second Programmatic Financial Sector Adjustment Loan.

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

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

I. IBRD/IDA Operations

	Committed (Net of Cancellations)	Disbursed	Undisbursed
Active loans			
Natural Resource Management	50.0	40.5	9.5
Fourth Rural Water Supply	40.0	23.3	16.7
Community development	9.0	1.7	7.3
Education Reform	24.0	1.0	23.0
Total active loans	123.0	66.5	56.5
Total inactive loans	729.8	729.8	0.0
Total IBRD/IDA	**852.8**	**796.3**	**56.5**
Repaid (incl. Repay to 3rd parties)		**545.8**	
Total outstanding		**247.0**	
O/w IBRD		224.8	
O/w IDA		22.2	

II. IFC Operations

	Loans	Equity	Total
Commitments	0.0	0.0	0.0
Repayments and cancellations	0.0	0.0	0.0
Now held by IFC	0.0	0.0	0.0
Undisbursed	0.0	0.0	0 0

III. IBRD/IDA Loan Transactions (calendar year)

	1997	1998	1999	2000	2001	2002	2003	2004	2005
Disbursements	41.2	37.7	42.1	46.6	26.8	13.5	42.3	16.2	-0.2
Repayments	27.5	24.6	24.6	20.2	15.3	16.8	21.0	34.8	2.2
Net lending	13.8	13.1	17.5	26.4	11.5	-3.3	21.3	-18.6	-2.4

INTER-AMERICAN DEVELOPMENT BANK RELATIONS [1]

(As of February 28, 2005)

Portfolio

1. The operations of IDB, Paraguay's main creditor, have been affected in the past by fiscal constraints and political instability with regard to decisions concerning new loans. As a direct consequence, Paraguay entered in default in 2002 and again in 2003, loans had to be postponed, loan disbursements were slow, and even though the net loan flow was neutral in 2004, the net cash flow to the country was negative for the fourth consecutive year.

2. As of February 28, 2005 the active loan portfolio amounts to US$600 million, of which 46.5 percent have been disbursed. In addition, there are 45 active Technical Cooperation operations for US$19.8 million, of which 48 percent have been disbursed.

New Strategy

3. In July, 2004 the IDB approved its new strategy for 2004-2008 with Paraguay, which calls for the Bank's work to be concentrated in the following areas:

- **Strengthening governance** by restoring the credibility of State institutions. The aim of this component will be at enabling the State to coordinate the economic development process by heightening the efficiency and transparency of public administration, promoting greater citizen participation, and consolidating democratic institutions;

- **Laying the foundations for sustainable growth** through the consolidation of the market economy and greater regional and global integration by creating conditions conducive to increased private-sector participation, greater competitiveness, and deeper integration; and

- **Reducing poverty and improving the quality of life of low-income sectors of the population** through the development of human capital and the provision of greater access to quality basic services.

Pipeline

4. Given the large active portfolio and the fiscal constraints IDB approved no new loans to Paraguay in 2004, concentrating its actions mostly in grants for institutional strengthening (13 operations for US$2.5 million)

[1] Prepared by the staff of the IDB.

5. The lending program for 2005 includes the following operations:

a. Strengthening of the Judiciary System II, for US$10.8 million
b. Depositary, Compensation and Liquidation System, for US$2.0 million
c. Professionalism of the Civil Service, for US$5.0 million
d. Asunción Coastal Development Program, for US$55 million
e. Science and Technology Program, for US$6.5 million

STATISTICAL ISSUES
(As of February 28, 2005)

A. Real Sector

A new national accounts series has been prepared recently with the assistance of an expert financed by the IDB. It comprises a fuller coverage of industries, an input-output matrix, and expanded data sources for the compilation of the new benchmark and base year (1994). Quarterly information recently became available for 1997–2001.

Both the consumer and producer price indices are reported on a regular and timely basis. The CPI has a base period of 1992, and the PPI of December 1995. A change in the base period and basket of the CPI is scheduled to take place after the results of a new household income and expenditure survey covering the period 2001–02 become available. The coverage and quality of employment and unemployment statistics have improved their coverage and quality significantly since a regular household survey was introduced in 1998. However, frequencies remain at the annual level, and the publication lag is close to one year. Wage indices are updated twice a year.

Paraguay became a GDDS participant in 2001 with the publication of its metadata on the Fund's Dissemination Standards Bulletin Board (DSBB).

B. Public Finances

Reliable monthly data are available on a timely basis for the central government, where much improvement has been made over the past years. The asset position of the social security system is available on a daily basis. However, shortcomings in the classification and recording remain and the Paraguayan GFS is not fully consistent with the methodology of the IMF *Government Finance Statistics Manual 1986 (GFSM 1986).* For instance, nontax revenues include social security contributions. Additionally, public enterprises and the social security system have been following somewhat different classifications of revenues and expenditures than the central government. A law (*Ley* 1535) that was passed in 2000 should allow closer integration, as it sets uniform standards and creates a database for the entire public sector. Data on medium- and long-term external debt are reliable and available on a monthly basis. Internal debt data are available on request, but need to be more fully integrated with the external debt database. Deficiencies remain in the registration of short-term supplier and commercial credit of the public sector. Moreover, there is a discrepancy in the fiscal data reported by the monetary and fiscal authorities. On November 2003, the Ministry of Finance issued a decree requiring all decentralized entities and public enterprises to provide updated monthly financial data to the Ministry of Finance, as well as the balance sheet. Other measures are being taken to make reporting more transparent. Under the SBA, all public enterprises and the IPS are required to undergo a complete financial audit by an internationally-recognized auditor.

Annual data covering only budgetary central government through 2003 have been reported for publication in the *2004 GFS Yearbook*. However, since 1994 no outstanding debt data and no breakdowns for expenditure by function data have been provided for publication in the *GFSY*. Monthly and quarterly data are not reported for publication in *IFS*. The resumption of reporting quarterly and monthly data for the *IFS* is highly recommended. Data on local governments and public enterprises are deficient and not reported regularly.

C. Money and Banking

Money and banking statistics are broadly reliable as a result of the adoption in 1995 of a new accounting plan for commercial banks and finance companies. Following the work on methodologies initiated in the 2000 STA mission, Paraguay completed the establishment of a unified compilation and reporting system for the whole range of monetary data. This new system intends to harmonize monetary data for use of the CBP, for reporting to STA for publication in *IFS*, and for operational and monitoring purposes. A revision of the classification criteria has led also to a marked reduction in the discrepancies of interbank positions. A recent STA money and banking statistics mission recommended that (i) institutional coverage of the depository corporations survey be expanded to include financial investment funds and financial cooperatives; (ii) the compilation unit be given on-line access to the database maintained by the superintendency of banks; and (iii) methodological notes be disseminated, including an explanation of improvements and reasons for breaks in the series.

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

D. External Sector

Quarterly and annual data on balance of payments and the international investment position (IIP) statistics are available from 2001 onwards on the central bank website, and reported to STA. Annual IIP data have been compiled and disseminated for the period 1995–2003. The classification of the balance of payments and of the IIP follows the recommendations of the Balance of Payments Manual (5th edition). Technical assistance by STA has led to improvements in the quality of the data on capital flows, especially in the coverage on foreign direct investment, and in the recording of external debt transactions in the balance of payments and in the IIP. The central bank now produces a highly informative bulletin on balance of payments statistics. Special studies by the central bank have improved the estimation methods for remittances of Paraguayans abroad and unregistered trade transactions but serious deficiencies remain.

Deficiencies remain in the area of private capital outflows, which are difficult to register due to Paraguay's liberal capital account. Major recommendations of the multisector statistics mission include the need to: (i) introduce quarterly surveys for recording services, transfers, and financial transactions of the nonfinancial private sector; (ii) apply quality control procedures for surveys; (iii) revise and improve the statistical techniques to take into account unrecorded merchandise trade and smuggling; (iv) improve the compilation procedures of several services and financial transactions; and (v) institute a system of coordination with other official agencies, and within the CBP, to promote intersectoral data consistency. Sizable negative errors and omissions over the last few years can be attributed mostly to unregistered trade and outflows of portfolio capital.

PARAGUAY—TABLE OF COMMON INDICATORS REQUIRED FOR SURVEILLANCE
(As of March 3, 2005)

	Date of latest observation	Date received	Frequency of Data[1]	Frequency of Reporting[1]	Frequency of publication[1]
Exchange Rates	3/02/05	3/03/05	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[2]	3/02/05	3/03/05	D	D	D
Reserve/Base Money	3/02/05	3/03/05	D	D	D
Broad Money	1/31/05	2/20/05	M	M	M
Central Bank Balance Sheet	2/22/05	2/23/05	D	D	D
Consolidated Balance Sheet of the Banking System	12/31/04	1/24/05	M	M	M
Interest Rates[3]	1/31/05	2/20/05	M	M	M
Consumer Price Index	Feb. 2005	2/28/05	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[4] – General Government[5]	Dec. 2005	02/1/05	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[4] – Central Government	Jan. 2005	2/28/05	M	M	M
Stocks of Central Government and Central Government-Guaranteed Debt[6]	Dec. 2005	2/01/05	Q	Q	Q
External Current Account Balance	Q4/2004	2/01/05	Q	Q	Q
Exports and Imports of Goods and Services	Dec 2005	2/01/05	M	M	M
GDP/GNP	2004	2/01/05	A	A	A
Gross External Debt	Sep. 2005	12/20/05	Q	Q	Q

[1] Daily (D); Weekly (W); Monthly (M); Quarterly (Q); Annually (A); Irregular (I); Not Available (NA).
[2] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[3] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[4] Foreign, domestic bank, and domestic nonbank financing.
[5] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[6] Including currency and maturity composition.

WORK PROGRAM

Mission	Dates
Fourth SBA Review	
Board Meeting	March 28, 2005
FSAB	
First Mission	April 19–29, 2005
Second Mission	Mid-July, 2005
Board Meeting	Mid-October, 2005
Fifth SBA Review	
Mission	April 27–May 10, 2005
Board Meeting	June 24, 2005
Sixth SBA Review	
Mission	July 18–29, 2005
Board Meeting	September 16, 2005
Article IV Consultation	
Mission	February 6–17, 2006
Board Meeting	March 31, 2006

Asunción, Paraguay
March 15, 2005

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

Dear Mr. de Rato:

1. This letter updates our earlier communications with you during December 2004 when we requested a six-month extension of the Stand-By Arrangement (SBA), described our economic program for 2005, and reiterated our commitment to implement the agreed structural reform agenda.

2. The extended economic program had a good start. With the exception of some arrears that are being cleared (and for which we request a waiver), all other quantitative and structural performance criteria for end-2004 under the SBA-supported program were observed. There are also indications of a strengthening in economic activity towards the end of 2004. Our tax collections remained stronger than anticipated and our expenditures were kept in check despite end-year spending pressures, allowing us to achieve a small fiscal surplus for the central administration for the first time in a decade and a larger surplus for the consolidated public sector. Market sentiment has strengthened, liquidity in the financial system remains ample, and credit to the private sector has picked up. Exports continue on the rise while imports remain strong. Inflation for 2004 was one of the lowest in the region despite some upward pressures in December.

3. A number of measures and decisions have been taken in the last several weeks to strengthen our ability to implement the program and achieve its objectives.

- The Executive Branch approved a financial plan for 2005 in February (to control current expenditures), which together with a significant strengthening of the central unit for public investment at the Ministry of Finance (to control capital expenditures) will align the 2005 budget with the fiscal position committed under the program.[1]

- The Senate approved the second-tier public banking law in early-March, which constituted a structural performance criterion under the program.

[1] The role of the central unit for public investment has been expanded to monitor the quality of the public investment program as well as its appropriate implementation to ensure it does not exceed program limits.

- A commission was created in early January 2005—and its members were appointed—to oversee the restructuring of the National Development Bank (BNF) with assistance from the international financial institutions.

- The Central Bank of Paraguay increased the interest rate on its monetary control instruments by about 1 percentage points during February to facilitate observance of the monetary targets.

- The Board of the Central Bank of Paraguay started to implement the short-term recommendation made by a recent technical assistance mission from the IMF's Monetary and Financial Department in early February to improve the functioning of monetary operations as well as the performance of financial and exchange markets.[2]

- We have agreed to have a financial sector assessment program (FSAP) and a comprehensive assessment of our financial sector. An FSAP mission is scheduled for April 2005.

- We intend to conduct a study on how to improve the investment climate in the country by end-July 2005, to increase productive investment and the prospects for sustainable growth and poverty reduction. We will benefit from the World Bank experience on the subject in conducting our study.

- Work in other areas of the reform agenda continues as scheduled.

4. At a more general level, an important consensus has been reached with the business community and civil society on 6-year plan of strategic priorities at a Forum convened especially to that effect. The Plan, PARAGUAY 2011, contemplates four areas of work, namely a) business climate, b) growth and exports, c) land and agricultural development, and d) poverty reduction, and identifies the main problems, recommends courses of action and objectives to be attained and a follow up mechanism to ensure a timely performance evaluation of the agreements reached at the Forum.

5. We strongly reiterate our commitment to the policies described in our letter and memorandum of economic and financial policies of December 2004 and request: (i) waivers on the nonobservance of the stock of arrears for end-December 2004 and the continuous

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[2] The list of measures adopted include: (i) formalize with a Board directive the frequency, attendance, and matters to be treated of Executive Committee for Monetary Operations (CEOMA) meetings; and implement a procedure for the recording and internal drafting of the minutes of the meetings; (ii) construct a standard set of figures and tables, focusing on monetary, price, exchange rate, and external developments; (iii) issue shorter-term instruments (including one month); (iv) start using the one-month rate as the key policy rate; (v) concentrate the auctions of longer-term instruments and allow their rates to become market-determined; and (vi) revise repo (RIR) rules.

non-accumulation of arrears performance criteria;[3] and (ii) an amendment to the program adjustor on net international reserves and net domestic assets performance criteria related to IFI program lending, which is proposed to be triggered only after US$25 million has been disbursed and transferred to the second-tier public bank, to allow its effective operation once it is created. We also request completion of the fourth review under the SBA. The Government will continue the usual close and fruitful dialogue with the Fund and stands ready to adopt the necessary measures to achieve the objectives of the program.

Sincerely yours,

/s/
Ángel Gabriel González Cáceres
President
Central Bank of Paraguay

/s/
Dionisio Borda
Minister of Finance

[3] The non-observance of the end-December 2004 arrears stock was due to PETROPAR's overdue obligations to its suppliers. This in turn was due to higher regional fuel prices as well as an accumulation of inventories. We expect that the liquidity position of PETROPAR will improve once those stocks are sold. In the meantime, PETROPAR is making best efforts to eliminate its arrears by end-May. In order to provide a long-term solution to this problem, the government will send a hydrocarbons law to Congress by end-April which proposes to liberalize diesel prices. The non-observance of the continuous non-accumulation of arrears performance criteria was due to small delays in payment or amounts in dispute.

Press Release No. 05/70
FOR IMMEDIATE RELEASE
March 29, 2005

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Completes Fourth Review Under Stand-By Arrangement for Paraguay

The Executive Board of the International Monetary Fund (IMF) completed the fourth review under an SDR 50 million (about US$ 75.6 million) Stand-By Arrangement for Paraguay, originally approved on December 15, 2003 for 15 months (see Press Release No. 03/218), and extended through September 30, 2005 on December 20, 2004 (see Press Release No. 04/271)

In completing the review, the Executive Board also granted waivers for the nonobservance of one quantitative performance criterion and one continuous performance criterion.
The completion of this review makes a further amount equivalent to SDR 3 million (about US$4.5 million) immediately available to Paraguay. However, Paraguay has not made any drawings under the arrangement so far, and the authorities have indicated that they will continue to treat it as precautionary.

The Executive Board has also determined that, on the basis of the corrective measures already undertaken, no further remedial action is required with respect to Paraguay's delayed report on arrears and its obligation to provide information under Article VIII, Section 5 of the Fund's Articles of Agreement.

Following the Executive Board's discussion of Paraguay's economic performance, Mr. Takatoshi Kato, Deputy Managing Director and Acting Chair, said:

"Paraguay's overall performance under the program continues to be strong. Prudent macroeconomic policies have been maintained and structural reform has been reinvigorated after the extension of the Stand-By Arrangement.

"Paraguay's macroeconomic situation has been better than envisaged under the program. Real GDP growth accelerated to almost 3 percent in 2004 despite a drought, the highest growth rate in a decade, while inflation fell below 3 percent, the lowest inflation rate in three decades.
The overall fiscal position of the central government has been brought back into surplus, confidence in the banking system has returned, and the foreign exchange market has broadly stabilized. However, unemployment and poverty levels remain high, underscoring the importance of pressing ahead with the reform agenda.

“The main challenges for 2005 will be to maintain fiscal discipline and move forward the structural reform agenda. On fiscal policy, it will be key that the authorities implement the budget in line with the program, notwithstanding the higher spending implicit in the congressionally approved budget, while using higher projected revenues for a significant increase in capital expenditure in needed infrastructure.

“The fiscal outlook has improved, partly reflecting the congressional passage of the fiscal adjustment law (FAL). At the core of these efforts are the significant improvements in tax administration in the internal revenue service and customs. These gains should be consolidated through institutional strengthening.

“Monetary policy has succeeded in containing inflation while allowing for rapid reserve accumulation. However, further strengthening is required to consolidate inflation performance. The authorities’ decision to start implementing the recommendations of the IMF’s Monetary and Financial Systems Department is welcome. However, further reforms at the Central Bank will be necessary to strengthen monetary management and build on the success of 2004.

“The structural reform agenda remains ambitious but feasible. Performance has improved after some delays at the end of 2004. The authorities remain committed to the reform agenda and considerable progress has been made in the first quarter of 2005. A particularly important step has been the approval of the second-tier public banking law by the Senate. Looking ahead, the authorities would need to reinforce their commitment to reform by further advancing with the difficult task of restructuring the National Development Bank (BNF). It will also be important to strengthen governance and the climate for private investment to allow the economy to reach its full growth potential.

“With respect to Paraguay's obligation to provide information under Article VIII, Section 5 of the Fund’s Articles of Agreement in connection with the delayed reports on arrears, Directors determined that, on the basis of the corrective measures already undertaken, no further remedial action is required,” Mr. Kato said.

Statement by Javier Silva-Ruete, Alternate Executive Director for Paraguay and Dimas Ayala, Advisor to Executive Director
March 28, 2005

1. Our authorities wish to express their gratitude to management and the staff for their continuous support and valuable advice in the design and implementation of the current SBA, which has contributed significantly to improving the administration of the Paraguayan economy.

2. Even though democratic rule was restored in early 1989, Paraguay's significant institutional weaknesses seriously undermined economic management. For many years the economy was characterized by slow growth —only 0.8 percent per year on average in 1995-2002— mainly due to structural impediments to growth, banking sector weaknesses, governance problems, and inefficient public enterprises. Furthermore, attempts to implement and sustain a comprehensive stabilization and reform plan failed mainly because of considerable difficulties in mustering the necessary political and social consensus.

3. Against this background, the government that took office in August 2003 set out to develop a plan to stabilize macroeconomic conditions, particularly oriented to strengthen fiscal sustainability and eliminate important arrears in public debt, enhance transparency and governance, and address long-standing structural weaknesses, in order to bring the economy towards a long-term path of stability, sustained growth, and poverty reduction. Our authorities have made significant efforts to ensure broad support for the envisaged reforms.

4. It is noteworthy, as pointed out by staff, that the Paraguayan authorities have made remarkable progress in implementing their comprehensive and ambitious program, supported by a Fund arrangement, and that macroeconomic results have been impressive during the past year —in fact, the best in decades. Despite last year's drought that severely affected soy production, the main export crop, GDP grew almost 3 percent in 2004 —4 percent using the new methodology for calculating the GDP, which sets 1994 as the base year. In addition, the inflation rate declined to 2.8 percent, the lowest in 30 years (and significantly below the program target of 8 percent); a fiscal surplus was achieved for the first time in a decade; central government arrears were nearly eliminated from around USD 130 million at the beginning of the present administration; the level of international reserves increased well above the original program target; the net domestic credit of the central bank was maintained within the range agreed with the Fund; the foreign exchange market is stable; and confidence in the banking system has been restored.

5. The observance of almost all end-December quantitative performance criteria and all structural conditions for the current review reflects the authorities' unrelenting commitment to the program. They request waivers for the non-observance of certain performance criteria, in view of the corrective actions introduced. In this respect, we would like to make the following remarks:

- The authorities regret that the limit on the stock of arrears for end-December 2004 was not observed. This was due to the accumulation of inventories by the state-owned petroleum company (PETROPAR) at a time when historically high fuel prices accelerated the accumulation of arrears with suppliers. However, the authorities increased diesel prices last January, which will contribute significantly to a gradual clearing of the arrears. At the same time, they are considering some options to ensure a long-term solution to PETROPAR's financial difficulties. A cooperation agreement with Venezuela to purchase fuel under preferential conditions will moderate the impact of high oil prices. Notably, a draft hydrocarbons law —to be submitted to Congress in April— will propose the liberalization of diesel prices.

- The financial obligation which was considered not paid on time to the Inter-American Development Bank (IDB) in November 2004 was actually a debt the water company (ESSAP) had and which was guaranteed by the government. Time-consuming legal and operative procedures needed to be completed before the payment could be ordered by the Ministry of Finance. Even though it was within the grace period that the Ministry of Finance ordered the payment transaction through the Central Bank of Paraguay, the observance of the Thanksgiving holiday in the U.S. and some operative problems caused a four-day delay until the credit to the IDB was made effective. Given that last year's arrears were originated in public enterprises, the Ministry of Finance is closely monitoring them to ensure timely payments, and to avoid future slippages it has instructed that all obligations are to be paid on their due date rather than using grace periods.

6. At this stage, we would like to recall that Paraguay's short experience in managing a Fund-supported program (the current arrangement is the first in 40 years), the challenge of meeting a heavy structural agenda in a short period, and complex congressional negotiations for the approval of reforms have been the main causes of the delays and slippages in the observance of some performance criteria since the program was launched. However, we would like to stress that, in spite of these limitations, much has been done, and economic results have been remarkable. Over the last 15 months, the authorities have successfully pressed for passage of important legislation regarding the fiscal, banking, cooperative, pensions and customs sectors; taken determined steps to reduce the country's debt and arrears, made significant efforts to normalize relations with all creditors; introduced procedures to improve transparency and governance (such as enforcement of the public procurement law in all public agencies, as well as independent and external audits in public enterprises and the central bank); and adjusted fuel and utilities prices regularly to restore the financial health of public enterprises. These reflect the authorities' strong ownership, as well as their ability to gather consensus on the need for several key policies. Moreover, they would like to reiterate their firm commitment to complete the envisaged structural reform agenda in a timely manner, and to implement the necessary measures to lock in the gains achieved so far. At the same time, they intend to implement mechanisms to avoid slippages in the future. In this regard, a joint Ministry of Finance/Central Bank monitoring group has been formed recently to coordinate program implementation with Fund staff through weekly telephone conferences.

7. Even though Congress approved an expansionary 2005 budget —which increased the level of spending, and could eventually endanger the fiscal target envisaged under the program— our authorities remain determined to maintaining fiscal prudence and discipline. In this respect, they are considering a number of budget control mechanisms. Among these, the Fiscal Financial Plan is a strong legal and administrative instrument geared to limit spending units' operations to available resources. The Ministry of Finance has already used this tool successfully last year. Additionally, the authorities will enhance the monitoring role of the Public Investment Coordination Unit (UCIP) at the Ministry of Finance to ensure an efficient use of resources, and to ensure that capital expenditures remain consistent with the fiscal program and with available financing. It is important to keep in mind that, once macroeconomic stability is achieved, the main challenge will be to attain high and sustained growth. In this regard, the role of the UCIP is crucial to increase public investment to support higher GDP growth, while at the same time maintaining a prudent stance.

8. The authorities' continuous efforts to strengthen tax and customs administration through wide-ranging measures, and actions geared to reduce tax evasion and combat corruption, have been key in increasing fiscal revenues beyond program projections, by around 35 percent in 2004. Moreover, administrative improvements; a gradual implementation of the streamlined Fiscal Adjustment Law, which broadens the tax base and intends to further formalize the economy; and the introduction of a new Customs Code early this year, have further increased tax collections during the first two months of 2005. The authorities are confident that the introduction of these important reforms, as well as the launching of the public pension system reform early last year, will contribute to placing the country on a path of long-term fiscal sustainability, while creating space for increasing investment and social outlays. Actions in that direction are also consistent with the authorities' intention to put the debt-to-GDP ratio on a declining trend. The debt burden decreased to 39.8 percent at end-December 2004, from almost 50 percent in 2002, and is expected to fall below 30 percent in 2010.

9. The authorities' prudent monetary policy is reflected in the stabilization of the guarani, a sharper than anticipated reduction in inflation pressures, a limited growth of the Central Bank's net domestic credit, and a higher than expected accumulation of international reserves in 2004. The slight pickup in inflation over the last months, as well as moderated pressures in the foreign exchange market, were associated with oil market developments, payment of end-year bonuses, a seasonal spike in food prices, the sharp real appreciation of the Brazilian real against the domestic currency, and a temporary increase in foreign exchange demand. However, the Central Bank was proactive in implementing monetary and exchange rate adjustments. The monetary authorities raised the interest rate on monetary policy instruments in February to control liquidity, and had limited intervention in the foreign exchange market to moderate the seasonal depreciation of the guarani due to the excess foreign currency demand that characterized the first two months of the year. Consistent with the staff's advice, the Central Bank is monitoring interest rate developments in neighboring countries and the U.S.. Additionally, priority is given to using exchange and interest rates flexibly to meet this year's inflation objective. Likewise, the authorities give due priority to the prompt implementation of MFD's recommendations for the modernization of monetary and foreign exchange policies.

10. The authorities continue to strengthen the financial system, including financial cooperatives, by introducing enhanced supervision and regulation. After the 2002 financial crisis, banks are currently in a much better stance, as evidenced by their improved financial indicators, in particular their capital ratios, the share of non-performing loans, and the overall profitability. Thus, credit is finally recovering, especially in domestic currency, which was sharply interrupted in 2002. In this regard, the forthcoming FSAP mission in April will significantly contribute to identifying existing vulnerabilities. Our authorities look forward to the exercise, and intend to follow the staff's recommendations to enhance banking legislation.

11. Regarding public banks, in early March 2005 the second-tier public bank reform was approved by the Senate, and is expected to be fully approved by Congress around May. Implementation of this law will be instrumental in improving management of credit lines and development financing through intermediation of external resources. In addition, the authorities are confident that Congress will soon approve the first-tier public bank reform draft-law —including the reform of the deteriorated Public National Development Bank (BNF). Meanwhile, much progress has been attained regarding the management and financial conditions of the BNF since new managers were appointed in mid-2003. In addition, the commission created by the authorities in January 2005 aims at developing a medium-term business and restructuring plan for the BNF to enhance its efficiency and reduce its costly impact on fiscal finances. The recent MFD mission provided a helpful diagnose of the BNF's financial situation and recommendations on how to restructure it, which are currently under consideration by the commission.

12. The authorities' main objective is to advance steadily with the structural reform agenda, using the opportunity provided by the extension of the Fund-supported program. Plans to improve the efficiency and governance of the public sector are also a centerpiece of the program. Independent regular audits, improvements in transparency, and anti-corruption measures are progressing, while the comprehensive plan for the reform of the civil service — a structural benchmark for the next review— is almost complete. Plans to engage private investors in some public enterprises as a way to increase investment and improve efficiency are also being evaluated by the authorities.

13. The government recognizes that, along with the structural reforms needed to strengthen the institutional framework, a major challenge is to enhance productivity and diversify the economy, considering that Paraguayan exports remain highly concentrated in primary agricultural goods. In this vein, a significant improvement in the investment climate is essential to attract domestic and foreign resources and to lay the foundation for higher and sustainable growth. A broad consensus on an ambitious economic strategy was achieved with the business community and the civil society in the context of a broad-based seminar at the end of last year. On that occasion, actions to address the main hindrances to growth, enhance competitiveness, diversify the economy, reduce inequalities, and improve the business environment were discussed and included in a six-year plan.

14. Our authorities are confident that their policy framework will succeed in attaining the economic objectives envisaged under the program. They are aware of the importance of reforms to change the structure of the economy and ensure long-term growth, while reducing

the high unemployment and poverty rates. They acknowledge that the flexibility shown by the Fund since the beginning of the program has given the government enough time to build the consensus needed to ensure approval of key legislation and reforms. Finally, our authorities believe that continuing Fund support is crucial to leverage their efforts to move ahead with the reform process and reinforce policy credibility.