INTERNATIONAL MONETARY FUND

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PARAGUAY

February 2015

2014 ARTICLE IV CONSULTATION—STAFF REPORT; AND PRESS RELEASE

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2014 Article IV consultation with Paraguay, the following documents have been released and are included in this package:

- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on a lapse of time basis, following discussions that ended on December 12, 2014, with the officials of Paraguay on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on January 29, 2015.
- An **Informational Annex** prepared by the IMF.
- A **Press Release** on the conclusion of the 2014 Article IV consultation with Paraguay.

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

Selected Issues Paper

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

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INTERNATIONAL MONETARY FUND

PARAGUAY

STAFF REPORT FOR THE 2014 ARTICLE IV CONSULTATION

January 29, 2015

KEY ISSUES

Context: Paraguay remains one of the most dynamic economies in Latin America, with growth projected around 4 percent in 2014–15. Macroeconomic fundamentals are sound, and the government is pursuing an ambitious reform program to address infrastructure bottlenecks and other long-standing structural weaknesses. However, implementation capacity is limited, and the envisaged improvement in public services will need to be integrated into a prudent medium-term fiscal plan.

Focus: The consultation focused on policies to consolidate macroeconomic stability, contain financial sector risks, and support inclusive growth.

Key policy issues:

- The recently adopted Fiscal Responsibility Law (FRL) prescribes limits on government spending and the deficit to safeguard Paraguay's healthy public finances. It is unfortunate that the approved 2015 budget exceeds these limits. Strict control over current expenditure and a resolute fight against tax evasion would allow the authorities to achieve compliance with the fiscal rules ex post and establish the FRL as a reliable anchor. Over time, it will be important to generate sufficient additional revenue to accommodate spending priorities and preserve some buffer for adverse shocks. A stronger budget process is critically needed to underpin fiscal discipline.
- Paraguay has made strides in implementing a credible inflation targeting regime. To further improve its effectiveness, the central bank is rightly focused on refining its liquidity management and FX intervention modalities.
- Credit growth has slowed from recent peaks, but remains fairly rapid. Although banks continue to report solid buffers, the authorities should continue to closely monitor risks and consider targeted macroprudential tightening, especially in the areas of consumer credit and foreign-currency lending. These efforts should be underpinned by adoption of the revised central bank and banking laws, along with long-due reforms of the regulatory framework in the cooperative sector.
- Sustained improvements in public services, government efficiency, and the business environment are needed to attract investment, boost productivity, and support medium-term growth and poverty reduction, even more so in a less favorable external environment.

Approved By
Jorge Roldos and Masato Miyazaki

Discussions took place in Asunción during December 1–12. The staff team comprised A. Meier (head), A. Guerson, C. Perez, and X. Xu (all WHD), M. Vargas (RES), and A. Santos (Resident Representative), with research assistance from E. Tawfik and editorial support from J. Meza-Cuadra. Mr. Corvalan (OED) also participated in the meetings. The team met with BCP President Carlos Fernández, Minister of Finance Germán Rojas, Minister of Labor, Employment, and Social Security Guillermo Sosa, Minister of Public Works and Communications Ramón Jiménez, other senior officials, and representatives from Congress, the private sector, think tanks, and the donor community. Minister of Finance Germán Rojas stepped down from his post shortly after the Article IV discussions, and was replaced in early January 2015 by Santiago Peña, previously member of the Board of the BCP.

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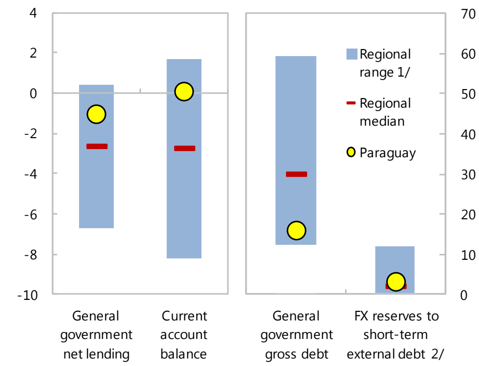
BACKDROP

1. Paraguay's economy combines sound macroeconomic fundamentals with persistent developmental challenges. Government debt stands at a moderate 18 percent of GDP, inflation is well contained, and international reserves are ample. Output growth picked up significantly over the past decade, amid a boom in agricultural commodity prices that boosted the country's soy, grains, and beef industries. Nonetheless, Paraguay's per capita income continues to lag well behind regional comparators, reflecting deficient infrastructure, poor educational outcomes, and a business environment marked by weak law enforcement and high informality (Figure 1). Inequality and poverty rates have come down markedly in recent years, but remain elevated.

Comparative Macroeconomic Indicators, 2014
(In percent of GDP, unless otherwise stated)



Sources: IMF, *World Economic Outlook*; and Fund staff calculations.
1/ Includes Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Peru, and Uruguay.
2/ Short-term debt is on a remaing maturity basis.

2. The government is pursuing an ambitious reform agenda to address some of these challenges. Upon assuming office in August 2013, the administration of President Cartes launched a series of initiatives, including a Fiscal Responsibility Law (FRL) and a strategy for increasing infrastructure investment. The authorities remain committed to creating a more diversified, investor-friendly, and inclusive economy, though weak institutional capacity has constrained implementation in certain areas. The government has also been facing resistance to some of its plans from Congress, including during the 2015 budget round. Country-wide municipal elections are scheduled for November.

Paraguay: Rank in Doing Business and Corruption Perceptions Surveys

Starting a Business	126
Dealing with Construction Permits	43
Getting Electricity	51
Registering Property	60
Getting Credit	71
Protecting Minority Investors	166
Paying Taxes	111
Trading Across Borders	150
Enforcing Contracts	90
Resolving Insolvency	106
Perceived Level of Corruption	150

Note: All indicators are taken from World Bank, Doing Business 2015, which covers 189 economies in total. Perceived level of corruption taken from Transparency International 2014, which covers 174 economies.

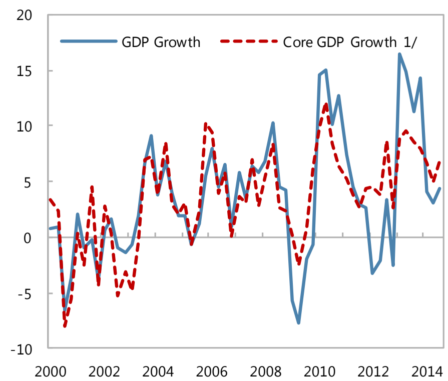
RECENT ECONOMIC DEVELOPMENTS

3. Activity has decelerated markedly from the record pace of 2013, but remains buoyant. In 2013, Paraguay grew a record 14.2 percent, as the agricultural sector rebounded from the previous year's drought (Figure 2, Table 1). The economy entered a soft spot in early 2014 but has since regained momentum, with GDP expanding 3.9 percent (yoy) over the first three quarters of the year. A weather-related drop in electricity production[1] was the main drag on growth, while

[1] The production of two large hydroelectric plants, one operated jointly with Brazil (Itaipu), one with Argentina (Yacyreta), accounts for 10 percent of Paraguay's GDP, 17 percent of exports, and 12 percent of fiscal revenue.

agricultural output edged up and the remainder of the economy expanded at a robust 6.4 percent (yoy). Construction, manufacturing (notably the fast-growing maquila industry), and services led the expansion, although retail and re-export activities suffered from the abundance of cheap contraband imports from Argentina and weak growth in Brazil. High-frequency indicators for the fourth quarter suggest continued dynamism, putting full-year growth on course to slightly exceed 4 percent. Inflation spiked in early 2014 on account of higher food and regulated prices, but subsequently declined to end the year at 4.2 percent, well within the +/- 2 percent corridor around the authorities' 5 percent target. Credit growth has slowed from earlier peaks but remains in double digits.

Growth of Real GDP, 2000–14
(In percent, y/y)

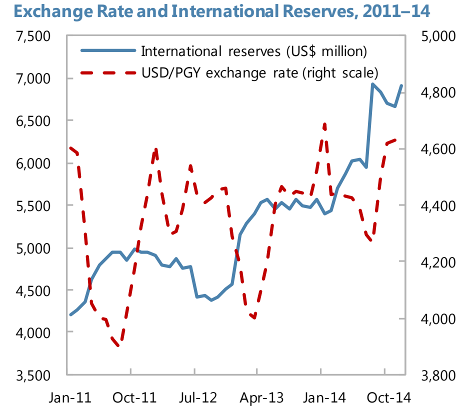


Sources: Haver Analytics; and IMF staff calculations.
1/ Excludes agriculture, livestock and forestry, energy and water.

4. Macroeconomic policies have been tightened somewhat since late 2013. Following the large 2012 stimulus under the previous government, the new administration started reining in expenditure growth (Figure 3), containing the central government deficit at 2 percent of GDP in 2013. For 2014, tax revenue is estimated to have increased by a brisk 19 percent (yoy), linked to better enforcement and new taxes. Due to a sharply accelerated execution of spending in the latter part of the year[2] and lower revenue from electricity royalties, the headline deficit eventually edged up relative to 2013. Still, staff estimates a mildly contractionary fiscal impulse for the full year of around ½ percent of GDP (Table 2a). Monetary policy has been on hold since the central bank (BCP) raised the official policy rate by 125 basis points, to 6.75 percent, between December 2013 and February 2014 (Figure 4). The guaraní strengthened in the first half of 2014, but later pared all of its gains against the U.S. dollar, although it still appreciated almost 12 percent in real effective terms.

5. The exchange rate appears broadly in line with fundamentals (Annex II). Standard methodologies provide mixed results on exchange rate valuation. EBA-lite points to significant *undervaluation*, although the model fit is poor and only a fraction of the estimated gap can be explained by policies. By contrast, one CGER-type estimate implies significant *overvaluation*. While ostensibly plausible in light of a real appreciation of 60 percent since 2005, this diagnosis is hard to square with the significant build-up of international reserves and generally positive current account balances over the period, which featured rapid gains in productivity and output. Indeed, the other two CGER-type approaches show the guaraní to be close to equilibrium. Market share data, in

Exchange Rate and International Reserves, 2011–14



Source: IMF, *International Financial Statistics.*

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[2] As Paraguay's fiscal accounts are compiled on a cash basis, some of the capital spending recorded in late 2014, notably new lending to state-owned enterprises, is likely to be executed in 2015 only.

turn, suggest robust competitiveness. Overall, it is difficult to argue that Paraguay's current account signals a significant misalignment of the exchange rate—the small surplus estimated for 2014 is projected to give way to moderate deficits over the period ahead, reflecting weaker terms of trade and consistent with an economy in catch-up mode (Figure 5).

Paraguay: Exchange Rate Assessment, Model Results

	Current account norm 2/	Current account balance 2/	Gap 2/	REER 3/
EBA-lite methodology 1/	-4.4	0.1	4.4	-14.8
	Current account balance 2/			
	Norm	Underlying		REER 3/
CGER-like methodologies 4/				
Macroeconomic balance	-3.6	-1.2		-2.7
External sustainability	-2.4	-1.2		-2.5
Equilibrium Real Exchange Rate 5/				33.8

1/ Assessment based on estimated outcomes for 2014.

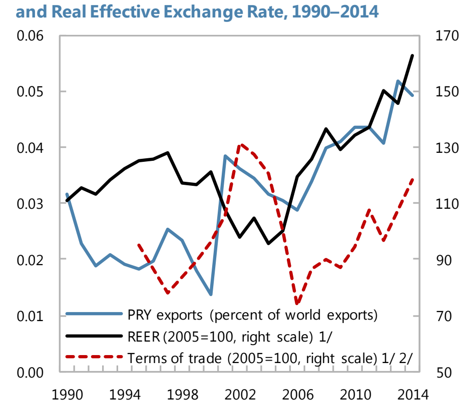
2/ Percent of GDP.

3/ Positive number indicates overvaluation.

4/ Estimated REER gap includes adjustment for multilateral consistency.

5/ Based on REER as of November 2014.

Paraguay's Share of World Exports vs. Terms of Trade and Real Effective Exchange Rate, 1990–2014



Sources: IMF, *International Financial Statistics;* and IMF staff calculations.

1/ 2014 observation corresponds to November.

2/ Excludes unregistered trade.

6. **Meanwhile, reserve coverage is fully adequate**. International reserves have risen further—mostly reflecting a US$1 billion government bond issuance intended to finance future infrastructure spending—and now somewhat exceed the IMF's standard adequacy metric for floating exchange rate regimes.[3] However, reserve coverage does not appear excessive in light of Paraguay's high openness to trade, especially considering the vulnerability of its still-narrow export base to disease, weather, and price shocks. High dollarization provides another rationale for relatively large buffers.[4] That said, the cost of holding the current level of reserves (estimated at 1.1 percent of GDP p.a.) argues against significant further accumulation—a view that was shared by the authorities.

OUTLOOK AND RISKS

7. **Growth is projected to remain near 4 percent in 2015, amid broadly balanced risks**. Weak trading partner growth and lower export prices cloud the outlook, and agricultural production is projected to rise only marginally above the high level of 2014. Meanwhile, positive impulses should come from the expected rebound in electricity generation, the lower oil price, and the launch of new infrastructure projects. Yet, uncertainty around the outlook is considerable (Risk Assessment Matrix), as worsening terms of trade could affect domestic spending more than anticipated, while

[3] Paraguay's exchange rate regime was formally reclassified to floating in mid-2013. Under the previous classification ("other managed arrangement"), the current level of reserves was closely aligned with the relevant adequacy metric.

[4] Required FX reserves of banks accounted for one-sixth of the BCP's total international reserves at end-2014.

further ruble depreciation might hurt exports to Russia.[5] Exposures to global financial volatility are limited by the lack of domestic capital markets, though shocks could conceivably be transmitted through foreign banks operating in Paraguay (Box 1). On the upside, a recent hydrocarbon discovery might foreshadow the beginning of oil production in Paraguay;[6] and looser-than-expected fiscal policy could lift 2015 growth above staff's projection of 4 percent. Inflation is expected to hover around the revised 4.5 percent target in 2015, as recent guaraní depreciation and a small positive output gap balance the impact of lower commodity prices.[7]

8. **Looking further ahead, Paraguay's growth prospects hinge on the successful implementation of ongoing reforms**. Like all of South America, Paraguay is confronting the end of an extended period of extraordinarily benign external conditions. The more challenging external environment underscores the importance of strengthening the domestic underpinnings of growth, notably by addressing infrastructure bottlenecks and improving the business environment to attract private investment. Under a scenario of measured, but steady implementation of the government's reform agenda, medium-term growth around 4 percent is realistic.[8] However, failure to achieve the sustained expansion of public and private investment projected by staff could reduce potential growth by a full percentage point.

Medium-Term Outlook

(In percent of GDP, unless otherwise indicated)

		Est.	Projections					
	2013	2014	2015	2016	2017	2018	2019	2020
National accounts and prices								
Real GDP growth (in percent)	14.2	4.3	4.0	4.0	4.0	4.0	4.0	4.0
Gross domestic investment	15.4	15.3	16.1	16.3	16.3	16.4	16.6	16.7
Gross domestic savings	17.6	15.3	14.9	14.8	15.1	15.2	15.4	15.6
Consumer prices (end of period; in percent)	3.7	4.2	4.5	4.5	4.5	4.5	4.5	4.5
Public finances								
Central government primary balance	-1.6	-1.9	-1.4	-1.1	-0.9	-0.8	-0.7	-0.6
Central government overall balance	-2.0	-2.3	-2.1	-1.9	-1.9	-1.9	-1.9	-1.9
Central government debt	13.6	18.4	19.4	19.9	20.3	20.8	21.2	21.5
Public sector debt	16.8	21.5	22.7	23.4	24.0	24.5	24.9	25.3
External sector								
Terms of trade (annual percent change)	11.4	9.8	-3.2	-1.7	-0.7	-0.3	0.1	0.3
Current account	2.2	0.1	-1.2	-1.5	-1.2	-1.2	-1.2	-1.1
Foreign direct investment	1.3	1.2	1.3	1.5	1.7	1.8	1.9	1.9
Gross international reserves (in US$ billion)	5.9	6.9	6.9	6.9	6.9	7.0	7.0	7.0

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

[5] In 2013, total exports to Russia reached nearly US$950 million, the bulk of which accounted for by meat.

[6] Given large technical and commercial uncertainties surrounding the discovery, potential hydrocarbon production is not included in staff's projections.

[7] The BCP announced in mid-December 2014 that it had lowered its midpoint target to 4.5 percent for 2015/16.

[8] This scenario would entail a gradual rise in public and private investment, though capacity constraints would impose delays relative to the authorities' ambitious plans for infrastructure spending; and modest additional steps to improve the business environment.

Paraguay: Risk Assessment Matrix [1/]

Source of Risks	Direction	Relative Likelihood	Impact	Policy Response[2/]
Further growth slowdown among trading partners, resulting in lower exports.	↓	Medium	Medium	Use exchange rate as a shock absorber; reserves could be used to avoid excessive volatility; accelerate measures to improve business climate and productivity; easing of monetary policy consistent with the IT framework; let automatic fiscal stabilizers operate.
Further persistent decline in agricultural commodity prices.	↓	Medium	High	Use exchange rate as a shock absorber; reserves could be used to avoid excessive volatility; accelerate measures to improve business climate and productivity; easing of monetary policy consistent with the IT framework; let automatic fiscal stabilizers operate.
Significant disruptions associated with increased geopolitical tensions surrounding Russia/Ukraine; in global financial, trade, and commodity markets.	↓	Medium	Low	Use exchange rate as a shock absorber if ruble weakness were to negatively affect meat exports to Russia; extend efforts to diversify export destinations.
Weather-related shocks curb agricultural and electricity output and exports.	↓	Low	High	Use exchange rate as a shock absorber; reserves could be used to avoid excessive volatility; easing of monetary policy consistent with the IT framework; let automatic fiscal stabilizers operate.
Administrative capacity constrains execution of public investment and limits progress on structural reform.	↓	Medium	High	Accelerate efforts to address institutional weaknesses and strengthen capacity building in public investment implementation to avoid persistent shortfalls in growth.
Weak management of private sector participation in infrastructure creates fiscal contingencies.	↓	Medium	Medium	Strengthen public investment monitoring and selectivity. Ensure full transparency in assessing the potential impact of projects on the public finances. Privilege quality over speed of execution.
Near-term start of hydrocarbon production, following a recent oil discovery in the Chaco	↑	Low/ Medium	Medium	Save initial windfall, consistent with FRL-mandated cap on current spending and institutional constraints on public investment implementation; build administrative capacity to oversee hydrocarbon industry operators and manage related fiscal revenue; use TA to further develop Paraguay's macroeconomic framework, to ensure prudent management of natural resource wealth.

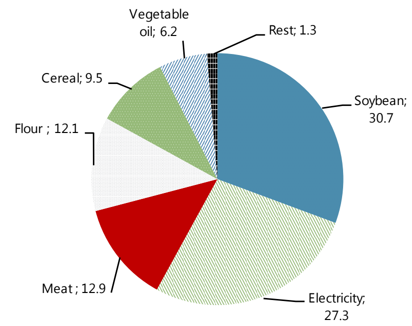
1/ The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood of risks listed is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability of 30 percent or more). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly.

2/ Policy response recommended by staff. Fiscal response circumscribed by Paraguay's Fiscal Responsibility Law.

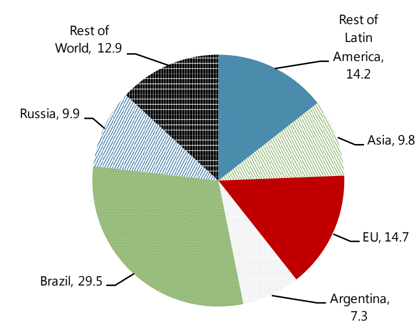
Box 1. Global and Regional Spillovers to Paraguay[1]

Paraguay is exposed to external shocks, chiefly through trade channels. Trade openness is among the highest in the region, with total registered exports and imports at 80 percent of GDP. Trade is also heavily concentrated, making Paraguay vulnerable to shocks from major trading partners and commodity markets. Meanwhile, portfolio inflows into local financial markets are negligible, reflecting the dearth of investable assets. However, foreign-owned banks (notably from Brazil and Spain) account for more than 40 percent of total bank loans and deposits, and there is some cross-border lending, mostly to local banks and companies. High levels of financial dollarization provide another potential channel for transmitting external shocks, though Paraguay's financial system has sizeable buffers to cope with such shocks.

Exports by Main Products, 2013
(In percent of total)



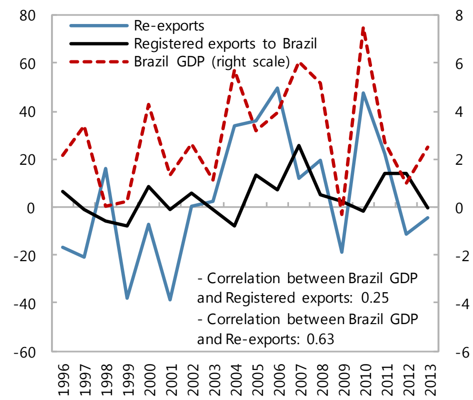
Exports by Key Trading Partners, 2013
(In percent of total)



Sources: Haver; and IMF staff calculations.
Note: Date refer to registered exports only.

Developments in Brazil are of particular importance. As Paraguay's largest trading partner, Brazil accounts for 30 percent of registered exports and the bulk of re-exports. Recently, Brazil's weak growth and currency depreciation has dampened demand for re-exports, contributing to slower activity in Ciudad del Este, Paraguay's main hub for cross-border trading. However, there have also been positive spillovers, notably through rising FDI inflows into Paraguay's maquila industry, which attracts Brazilian companies with its relatively low cost base and favorable tax and regulatory regime. Overall, staff estimates suggest that a one percent decline in Brazilian output reduces Paraguay's output by 0.5 percent; a 10 percent real depreciation of the bilateral exchange rate is estimated to have a similar effect.

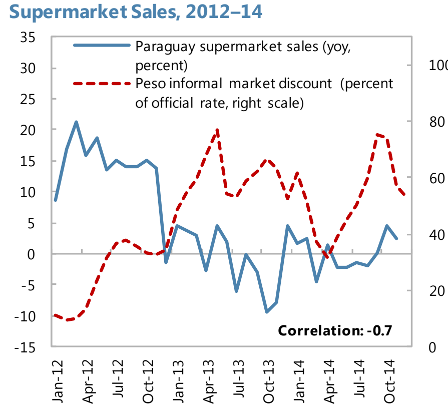
Exports to Brazil and Brazil GDP Growth
(In percent, yoy)



Sources: Haver; and IMF staff estimates.

Recent spillovers from Argentina have mainly been transmitted through surging contraband imports. Argentina's export taxes and FX market controls have created strong incentives for contraband trade. Since mid-2012, contraband exports to Paraguay appear to have proliferated, alongside the widening gap between the official and informal market exchange rates of the peso. For the most part, the contraband (especially foodstuffs and household goods) displaces legal imports, as domestic production in Paraguay is limited. However, businesses involved in the formal distribution and retail chain have been negatively affected, while consumers have benefited from lower prices. Separately, there is anecdotal evidence for Argentine capital flows into Paraguay's property market.

Argentine Peso Exchange Rate Gap vs. Paraguay Supermarket Sales, 2012–14

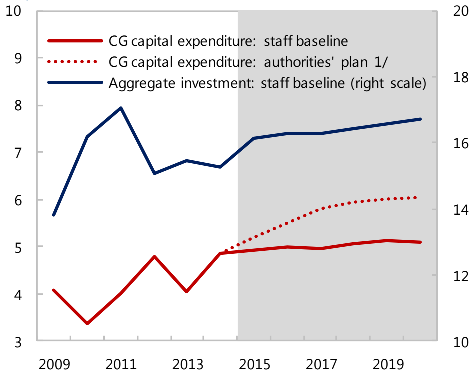


Sources: National authorities; and IMF staff estimates.

Changes in commodity prices have potentially large effects on Paraguay's economy. The recent decline in the price of soybeans, Paraguay's major export, is likely to reduce profits rather than production, given still-solid margins. However, sustained further price declines in agricultural commodity prices could hurt business confidence and restrain investment and output. The lower oil price, in contrast, conveys significant benefits, as Paraguay imports its entire fuel needs. These benefits are manifest in greater consumer purchasing power and reduced losses at Petropar, the state-owned fuel importer. Overall, a 10 percent drop in Paraguay's net commodity price index is estimated to reduce GDP growth by 0.6 percent within one year.

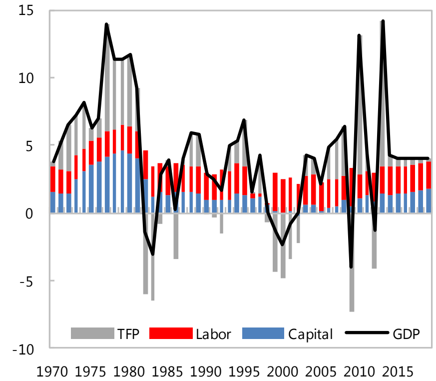
1/ Prepared by Xin Xu. For a more detailed analysis, see Selected Issues Papers.

Central Government Capital Expenditure and Aggregate Investment
(In percent of GDP)



Sources: Ministry of Finance; and IMF staff estimates and projections.
1/ Staff estimates based on project-level information from authorities.

Factor Decomposition of GDP Growth , 1970–2019
(In percentage points)



Sources: IMF, *World Economic Outlook*; and IMF staff estimates and projections.

9. The authorities broadly agreed with staff's assessment, but projected slightly faster growth. For both 2015 and the medium term, the authorities reaffirmed their previous projection of 4.5 percent growth. They emphasized that the industrialization of the agricultural sector is still in the early stages and holds significant potential for future expansion. Moreover, the build-out of public infrastructure would proceed at a somewhat faster pace than projected by staff, catalyzing fresh private investment and helping to keep growth close to the high rates observed over the past decade. Although the authorities recognized the challenging external environment as a risk, they argued that Paraguay was very well prepared to weather adverse external shocks, thanks to strong macroeconomic fundamentals and the resulting room for maneuver in policies.

POLICY DISCUSSIONS

10. Discussions focused on policies to advance the structural reform agenda while consolidating sound macroeconomic fundamentals and containing financial sector risks. Staff endorsed the authorities' plans to address Paraguay's critical infrastructure needs and improve public services, especially in transportation, electricity, and water and sanitation.[1] Progress in these areas can and should be achieved without jeopardizing the strong macroeconomic position that Paraguay has attained. In that light, the mission discussed steps to further improve the macroeconomic policy framework and buttress its credibility, notably by establishing the FRL as a reliable fiscal anchor. To contain the risks from continued high credit growth, staff suggested close monitoring of riskier lending segments and targeted macroprudential measures, along with a further strengthening of the regulatory and supervisory framework.

[1] The IADB's country strategy for Paraguay (http://idbdocs.iadb.org/wsdocs/getdocument.aspx?docnum=38846631) discusses the country's striking infrastructure gaps and lays out priorities for action.

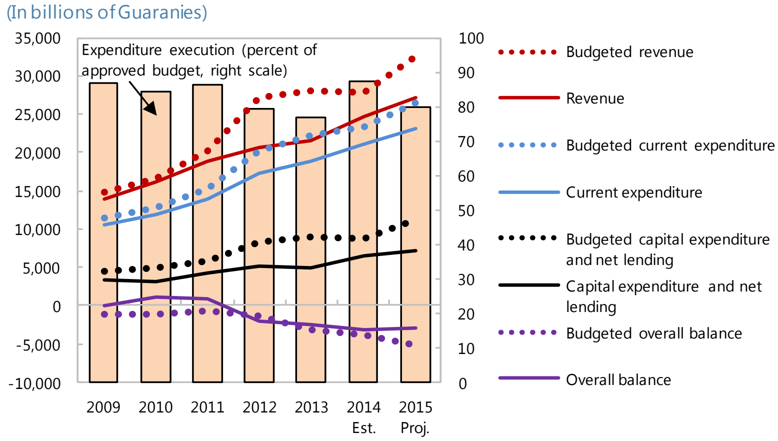
A. Fiscal Policy: Anchoring Solid Public Finances

11. The mission made the case for complying with the FRL. The law has become effective with the 2015 budget, prescribing new rules for government spending and the deficit. While not perfect[2], these rules are commendably simple and suited to protect fiscal sustainability. Thus, the mission stressed the importance of respecting the FRL, including the 1.5 percent of GDP deficit targeted in the government's budget submission. For 2015, this target implies a moderate fiscal tightening—a stance that also appears justifiable from a cyclical perspective, especially given the surge in government spending in late 2014.

Fiscal Responsibility Law: Numerical Constraints	
Deficit ceiling	1. The deficit of the central government must not exceed **1.5 percent of GDP**. 2. Congress can approve a deficit of up to **3 percent of GDP** in cases of national emergency; international crisis affecting the domestic economy; or negative growth. 3. The budgeted average deficit over three consecutive budget periods must not exceed **1 percent of GDP**. This rule only applies to the *ex ante* medium-term budget plan, not to its execution.
Expenditure ceiling	The growth rate of public sector current primary expenditure must not exceed **4 percent** plus inflation.

12. In the event, Congress passed a 2015 budget with higher spending and deficit numbers. The budget ultimately approved by the legislature authorizes central government spending almost 36 percent above the estimated 2014 outturn. As in previous years, these extravagant spending authorizations are partly matched by inflated revenue projections. Nonetheless, the implied deficit (3.4 percent of GDP) significantly exceeds the FRL ceiling, although the budget law also creates a legal exception whereby any capital spending financed by external bond issuance will be excluded from the deficit calculation.

Central Government Budget Execution
(In billions of Guaranies)



Sources: Paraguayan authorities; and IMF staff estimates and projections.

[2] In particular, the FRL lacks a back-up rule for public debt and fails to specify correction mechanisms. Being defined in unadjusted, headline terms, the deficit ceiling might also reinforce procyclicality, unless fiscal policy observes a margin of safety during normal times that obviates the need for discretionary tightening in a downturn. This drawback needs to be weighed, however, against the greater simplicity and transparency of the current rule vis-à-vis hypothetical alternatives defined in cyclically adjusted terms.

13. The government committed to seek compliance with the original FRL targets but left the door open to a moderately looser fiscal stance. Consistent with staff advice, the Finance Ministry underscored its aim to restrain current expenditure execution and extend efforts to improve tax enforcement. In principle, these efforts could make the original FRL targets achievable *ex post*. However, the budget amendments made in Congress have further increased the burden of rigid current expenditure, notably on wages. Higher public investment, in turn, is a stated priority, and political pressure for swift progress may mount in the run up to the municipal elections. All things considered, the authorities indicated that, while achieving an "unadjusted" deficit of 1.5 percent of GDP was preferable, they were prepared to accept a moderate overrun as long as it was fully accounted for by bond-financed investment. Staff projects a deficit around 2 percent of GDP, slightly below the estimated outturn for 2014.[3] This projection incorporates the full-year effect of recent tax increases[4] and assumes an execution rate of 64 percent on the authorities' investment budget, in line with historical trends.

14. The mission expressed concern about the likely damage to the credibility of the FRL and stressed the importance of strengthening budget practices. With public debt starting from a moderate level, a deficit slightly above 1.5 percent of GDP would not raise any immediate concerns for fiscal sustainability. Still, the mission noted that the circumvention of the fiscal rules, in the very first year of their application, was unfortunate. The exemption of bond-financed capital spending from the authorities' deficit calculation could bias spending initiatives against financing sources that impose tighter restrictions (such as loans from IADB and World Bank). More fundamentally, the unresolved weakness of the budget process leaves in place a system where fiscal discipline hinges on the close intra-year control of expenditure by the Finance Ministry. Although this strategy has been effective in the past, it fails to provide the desired strong anchor for medium-term policy. The government shared staff's concern but, short of constitutional changes, saw little scope for hard-wiring a better budget process, given the prerogative of Congress to write budget laws. Within its own purview, the Finance Ministry signaled its intention to expeditiously transition toward the 2001 GFSM format for its fiscal accounts, using IMF technical assistance (TA).

15. Regarding the medium-term path of policy, staff emphasized the need to maintain prudent debt dynamics, including by ensuring a buffer against adverse shocks. Achieving a sustained improvement in public services will require additional fiscal resources over the medium term. Above and beyond the need to match spending goals with revenue, there is a case for incorporating some safety margin in multi-year fiscal plans. Without such a margin, economic

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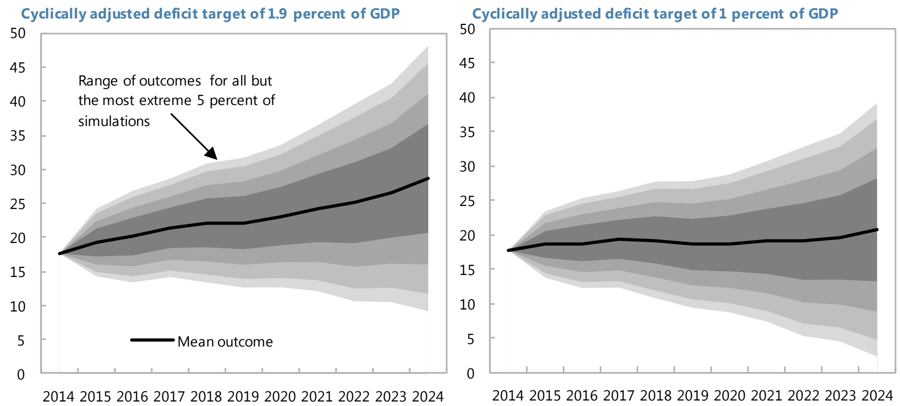
[3] All deficit numbers cited here refer to the authorities' fiscal template for the central government, which follows the 1986 Government Finance Statistics Manual (GFSM). A mechanical translation into the 2001 GFSM template points to a somewhat lower deficit, as financial investments and net lending (to state-owned enterprises) are recorded below the line (Tables 2a and 2b). However, a full-fledged move to the 2001 GFSM would imply significant further changes to the fiscal accounts whose net effect on the measured deficit is difficult to foresee. The reclassification of financial investments and net lending also does not affect the fact that such transactions increase gross government debt.

[4] These include the tax on personal rents and on rents from the export of grains, as well as the increase in the VAT rate on net interest earned.

downturns could impose a painful trade-off between letting deficits widen beyond prudent limits, and engineering a procyclical fiscal tightening. The FRL recognizes this point by prescribing that the average projected deficit over a three-year horizon should remain 0.5 percent of GDP below the hard deficit ceiling. Staff research suggests that a safety margin of this magnitude—or even a bit wider—is indeed necessary to let automatic stabilizers operate freely during most downturns and avert an upward trajectory in debt (see Selected Issues Papers). Targeting a central government deficit on the order of 0.5–1 percent of GDP would also help to offset financial weaknesses in the wider public sector (see Annexes III and IV).[5] The authorities acknowledged the argument in principle but saw little scope for keeping medium-term deficits below 1.5 percent of GDP.

Probabilistic Simulations for Central Government Debt Under Different Deficit Scenarios 1/
(In percent of GDP)



Source: IMF staff estimates and projections.
1/ Each set of results is based on 1,000 simulations of a macroeconomic model for Paraguay featuring random shocks as observed in historical data; see Selected Issues Papers.

16. There was agreement that improved tax collection remains a top priority. Recent increases in revenue partly reflect successful steps to improve taxpayer compliance. Within the tax administration, the creation of a large taxpayer office has underpinned this success, as has the highly publicized detection of an extensive VAT fraud. Nonetheless, tax evasion remains widespread, amid entrenched enforcement gaps. The authorities agreed that further efforts to improve compliance were critical, especially in the customs administration. In staff's view, such efforts would likely have to be combined, over time, with some widening of the tax base or a rise in rates. Thus, the mission suggested exploring higher taxation of the agricultural sector, whose contribution to revenue remains modest. Overdue tariff increases for water and electricity would also generate resources for upgrading public services, though any adverse impact on poor households would have to be mitigated through targeted support. The authorities agreed in principle but for the time being favored improvements in collecting existing taxes, especially since low nominal tax rates were a strategic factor in sustaining Paraguay's attractiveness to investors.[6]

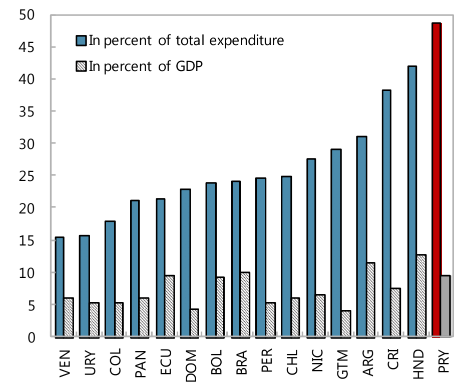
17. On the expenditure side, civil service reform is critical to trim Paraguay's high government wage bill and boost efficiency. The authorities acknowledged significant structural

[5] These include financial imbalances in state-owned enterprises as well as the quasi-fiscal deficit at the central bank. The cash surplus currently generated by the public pension fund system seemingly provides an offset, but in reality does not represent net worth as it falls short of covering the system's future liabilities.

[6] Staff projections incorporate all previously announced measures to raise revenue, but assume no further discretionary effort. Consequently, the implementation of staff recommendations represents upside potential.

weaknesses in public sector employment, where non-competitive hiring practices and opaque pay scales have created a legacy of high wage bills and low efficiency. Efforts to redress this situation have started, with a cap on wage growth enshrined in the FRL[7], the introduction of a new pay scale effective in 2015, and the roll-out of hiring competitions in a growing number of public institutions. There was agreement that these efforts had to be taken further, with the goal of firmly establishing meritocratic criteria in hiring, pay, and promotion. While this process should generate savings in some areas, by addressing cases of overstaffing and excessive remuneration, it would also be necessary to raise the remuneration for some positions, notably to attract highly skilled technical staff.

General Government: Compensation of Employees, 2013



Source: IMF, *World Economic Outlook*.

18. The mission also discussed fiscal risks related to ailing public companies, private sector participation in infrastructure, and the public pension system:

- **Paraguay's state-owned enterprises** (SOEs) generate a small operating surplus but are typically unable to cover their investment needs from regular revenue, reflecting low efficiency and, in some cases, regulated tariffs below cost-recovery levels (Annex III). The result has been a gradual erosion of their physical capital stock, worsening operational performance. The mission recommended a thorough review of each entity, along with a tailored strategy to address financial imbalances. In some cases, notably where SOEs perform functions readily substitutable by private operators, divestment should be considered. The authorities ruled out such far-reaching steps but underscored their commitment to improve the operations of weak SOEs.

- **Infrastructure finance**. The authorities have advanced their plans to use Public-Private Partnerships (PPPs) and expect to launch the first two road expansion projects (US$400 million) in 2015.[8] Although the PPP Law provides a suitable framework, staff reiterated the importance of ensuring transparent contracts and prudent assessments of contingent risks as part of the budget process. In the same vein, the mission cautioned against the risks associated with "deferred financing" schemes for public investment under Law 5074/2013, which could obscure the true state of the public finances. More broadly, sufficient institutional capacity for managing large projects will be crucial to

[7] In addition to prescribing an overall limit on the growth of primary current expenditure (4 percent p.a. in real terms), the FRL allows public salary increases only up to the legislated increase in the minimum wage, and subject to the financial capacity of the state. The minimum wage, in turn, can only be adjusted when cumulative inflation since the previous adjustment has reached 10 percent.

[8] Moreover, several government-initiated PPP projects were at the stage of pre-feasibility studies, including the upgrade of the Asuncion airport, expansion of two further roads, and the dredging of the Paraguay River, which together account for a prospective project volume of nearly US$1 billion. Staff projections incorporate these projects, albeit on somewhat less ambitious time schedules than envisaged by the authorities.

secure adequate economic returns. The authorities noted that they were successfully developing such capacity, with assistance from international consultants. They also agreed with the need to carefully manage fiscal risks but wanted to retain a range of financing modalities.

- **Paraguay's social security system** comprises 8 defined-benefit pension funds serving different professional groups. Although the aggregate system still generates an annual cash surplus on the order of 1 percent of GDP, some of the weaker funds already require budget support to cover their obligations. Moreover, the system lacks oversight and exhibits significant actuarial imbalances that would give rise to large deficits over the medium to long term. The mission welcomed the authorities' resolve to tackle these issues and, as a first step, encouraged swift progress toward creating a pension fund regulator, as foreseen in draft legislation.

B. Monetary and Exchange Rate Policy: Extending Recent Achievements

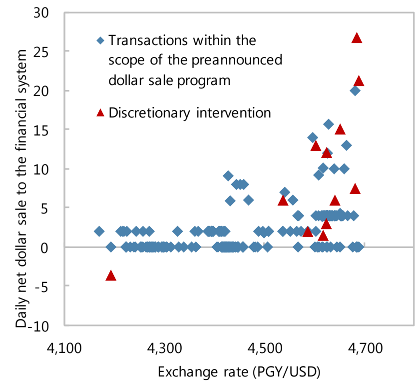
19. Staff and the BCP agreed that monetary policy was well calibrated. Inflation eased back into the lower part of the target range in mid-2014, while survey expectations were anchored at the 5 percent midpoint, suggesting a credible policy commitment. From a cyclical perspective, the setting of a low, positive real policy rate, along with a somewhat restrictive fiscal impulse, seemed appropriate. Thus, the mission endorsed the BCP's stance and recommended that monetary policy remain focused on keeping inflation close to the target. In this regard, the BCP announced in mid-December that it was lowering its midpoint target to 4.5 percent—closer to the 4.2 percent average of actual inflation since end-2010. In staff's view, this slightly lower target should be achievable without a distinct policy effort. Consistent with this notion, BCP survey results from January suggested that inflation expectations had already settled at the new target.

20. The mission recommended several actions to further enhance the effectiveness of Paraguay's inflation targeting regime. The BCP has made strides since 2011 in establishing an inflation targeting framework backed by very transparent communication. Against that background, the mission focused on discussing steps to further improve the implementation of policies and strengthen the monetary transmission mechanism:

- **Promote a well-functioning interbank market**, which would facilitate the distribution of liquidity. To this end, the mission recommended increasing the frequency of central bank paper auctions, improving liquidity forecasting, and introducing an averaging scheme for reserve requirements. Once an active money market is in place, the BCP would also be able to establish its official policy rate as the true anchor and move away from the current floor system, where the market rate is determined by the overnight deposit facility in which banks place their excess liquidity.

- **Further refine the conduct of BCP transactions in the foreign exchange (FX) market**. The BCP provides timely data on both its pre-announced sales of government dollar receipts and discretionary interventions. The latter became relatively infrequent in 2014 and were focused on mitigating bouts of guaraní depreciation. However, there is scope for further regularizing the pre-announced dollar sales, which were repeatedly adjusted in size (and temporarily suspended) over the past year. A more rules-based approach would clearly delink these transactions from occasional discretionary intervention aimed at curbing short-term volatility.

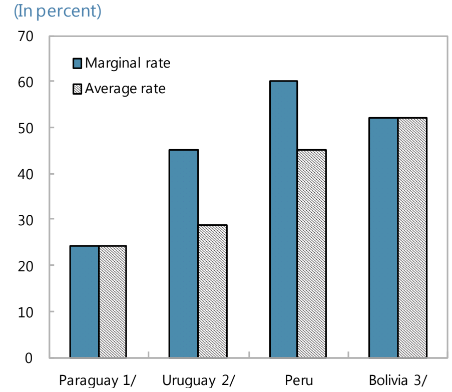
Daily Foreign Exchange Market Transactions by the BCP vs. Bilateral Exchange Rate, 2014
(In millions of U.S. dollars)



Source: Central Bank of Paraguay.

- **Facilitate gradual de-dollarization**. Bank deposits and loans in foreign currency account for nearly half the total and have outpaced domestic-currency aggregates over the past year, in the context of strong export earnings in the agricultural sector. To enhance the transmission of monetary policy and reduce financial risks, the mission encouraged the authorities to consider stronger prudential incentives for de-dollarization, such as a rise in FX reserve requirements (which remain well below comparable rates in other partially dollarized economies).

Reserve Requirements on FX Deposits, Jan. 2015
(In percent)



Sources: National authorities; and IMF staff estimates.
1/ Corresponds to FX deposits with a maturity up to 360 days.
2/ Refers to FX deposits of residents with up to 180 days maturity and FX deposits of nonresidents.
3/ Rate is scheduled to increase to 66.5 percent by 2016.

- **Recapitalize the central bank** to forestall any perception that the BCP's inflation targeting mandate might be compromised by concerns about its financial position.[9]

21. The BCP noted that it was planning to take several concrete steps in line with these recommendations. Specifically, the central bank intended to implement a series of measures advised in a recent TA report, including the adoption of an averaging regime for reserve requirements and a rule-based mechanism for its regular FX sales. In this context, the BCP emphasized that excess liquidity in the banking system, as measured by the use of the overnight deposit facility, had already declined to more reasonable levels. The BCP was not convinced that dollarization posed a significant challenge to the effectiveness of monetary policy in keeping inflation on target. Lastly, the authorities agreed with the case for fully recapitalizing the BCP, but did not plan further steps as a near-term priority.

[9] The BCP had negative equity of US$1.3 billion (4½ percent of GDP) at end-2013 and suffers an annual loss of about ½ percent of GDP at current interest rates, reflecting the costly sterilization of its FX reserves. The government initiated the recapitalization process in 2012 by injecting perpetual bonds. However, these bonds currently carry a very low (albeit negotiable) interest rate, significantly limiting their net present value.

C. Financial Sector Policy: Vigilance and Institutional Strengthening

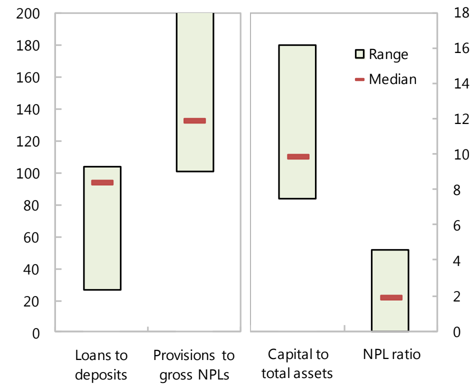
22. Banks continue to report strong capitalization, profits, and liquidity. The financial strength of Paraguay's banking system compares favorably to its regional peers (Figure 6). Relatively limited leverage, high returns on assets, and a large deposit funding base characterize essentially the entire cross-section of banks.

23. However, the continued rapid expansion of credit raises concerns. Credit outstanding is in line with other countries at a similar income level. Nonetheless, the mission argued that continued high credit growth may increase banks' exposure to riskier borrowers. Credit gap analysis suggests only moderate overall excesses, though the underlying growth in FX-denominated credit is understated by the appreciation of the guaraní over the past decade. Meanwhile, nonperforming loans have remained stable at 2 percent, but the mission cautioned that additional credit quality problems might be masked by regular sales of NPL portfolios to finance companies, as well as the significant stock of renegotiated loans on bank balance sheets.[10]

24. The mission recommended vigilance especially in the areas of household credit and FX lending. The largest exposures of Paraguay's banks, and a significant share of their U.S. dollar loans and deposits, relate to the agricultural sector. Thanks to its financial buffers, this sector has withstood recent weather-related shocks very well, though it remains vulnerable to more extended periods of weak output or further sharp price declines. Staff's more immediate concerns, however, focused on other areas:

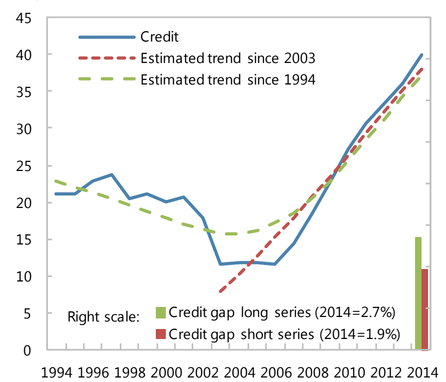
- **Household debt**. Although systematic data on household leverage are not available, the sector has seen a significant rise in indebtedness over the past few years, led by credit card debt and commercial installment

Key Indicators for the Universe of Paraguayan Banks, 2014
(In percent)



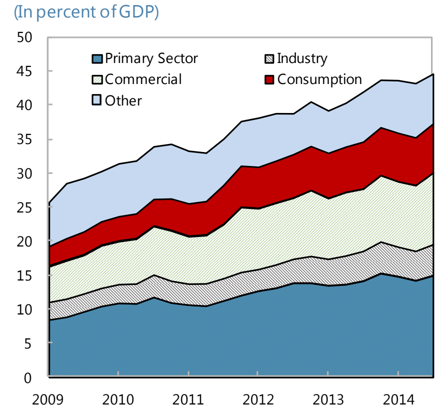
Source: Central Bank of Paraguay.
Note: Data refer to end-December 2014 and cover all 16 banks present in Paraguay.

Credit Gap Estimates, 1994–2014
(In percent of GDP)



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

Credit Outstanding by Borrower Sector, 2009–14
(In percent of GDP)



Source: Central Bank of Paraguay.

[10] A long-standing feature of the banking system, the high stock of such loans was also discussed in the 2011 FSAP Update. Key recommendations included (i) improving the provisioning treatment of refinanced and restructured loans; and (ii) ensuring that the renewed loans category not be used to conceal revolving or long-term loan facilities. More generally, greater transparency on the nature of renegotiated loans is critical for a proper risk assessment.

loans.[11] The use of multiple (and expensive) credit products has reportedly led to elevated payroll deductions for many wage earners, raising concerns from a consumer protection perspective. Growing financial pressures in the household sector could also come back to hurt lenders at some point. As a preemptive measure, the mission therefore suggested that lenders be formally required to demonstrate compliance with prudent limits on their customers' debt servicing capacity.

- **Lending in foreign currency** has been another area of strong recent growth. Although the relevant borrowers typically appear to have some FX revenue, the regulator only had access to qualitative information provided by banks, precluding an accurate assessment of FX mismatches. Outside of the export-oriented primary sector, it also appeared that some borrowers recorded FX revenue from activities ultimately driven by domestic demand, such as corporate real estate. The mission recommended stepping up the data collection on related balance sheet risks and considering suitable macroprudential tightening measures, notably higher capital risk weights or provisioning rates for FX loans. By supporting de-dollarization and reinforcing buffers, such measures would help to contain any fallout from rising U.S. interest rates or a stronger dollar over the period ahead.

- **Corporate real estate**. Close monitoring seemed warranted, as rapid recent construction and fast-rising prices may have squeezed the profitability of new projects. Direct risks to financial stability were attenuated, however, by reports that funding was typically tilted toward equity provided by foreign investors, rather than domestic credit.

25. The mission also discussed ways to refine the regulator's stress-testing framework. The BCP's latest Financial Stability Report presents stress tests analyzing, inter alia, an across-the-board rise in NPLs by 10 percent and sector-specific NPL increases of 30 percent. Even under combined stress scenarios, the regulator judged risks of financial instability to be minimal. The mission welcomed the inclusion of these results in the FSR but suggested that the tests be developed further to consider more severe shocks and anchor simulations in more detailed macro-financial scenarios.

26. The authorities agreed with the need for close monitoring of credit markets but expressed confidence that risks to financial stability were well contained. They argued that consumer credit had already slowed from the very rapid growth of recent years and was unlikely to pose risks to banking sector health, given strong margins and generally sound underwriting practices. They also pointed out that the Credit Bureau Law currently under preparation would facilitate banks' efforts to achieve a more comprehensive assessment of potential customers, reducing credit risk. On NPL portfolio sales and FX lending, they were open to staff recommendations for improved monitoring, but reiterated that the banking system was

[11] Interest rates in the high double digits are common for these lending products. Banks' consumer loan portfolio alone has quadrupled since 2009 and exceeded 7 percent of GDP at end-2014. Cooperatives' portfolio of personal and consumer loans stood at an estimated 5 percent of GDP, and finance companies accounted for an additional 1 percent of GDP. Data on the stock of commercial installment credit are unavailable.

fundamentally sound and resilient, including to spillovers from U.S. monetary policy. Accordingly, they saw no immediate need for mandating stricter lending standards. They noted, however, that the rules for the classification of renegotiated loans had been tightened and were progressively being enforced. A complete review of banks' compliance was envisaged by early 2015. The BCP also expressed interest in receiving TA on stress-testing.

Classification of Renegotiated Loans: Updated Regulatory Requirements (April 2014)

Category	**Definition/Requirement**	**Stock at end-November 2014** (Percent of total banking system loans)
Renewed loans	Loans whose tenor is extended, either while the debtor is still current on all obligations, or when the loan is past due by up to 60 days. C*urrent loans* are considered renewed if their tenor is extended without a significant amortization (i.e., less than 60 percent of principal for bullet loans; and less than 75 percent of total installments for installment loans). For loans past due by up to 60 days, two modalities exist: extending the due date without any debtor payment, but continuing to count past-due days based on the original loan schedule; or paying accrued interest and other charges (with the debtor's own resources), and thus interrupting the original past-due period.	10.2
Refinanced loans	Loans that are past due by more than 60 days where the debtor pays, out of her own resources, all past due interest and other charges, as well as a portion of the past due principal. Only when at least 10 percent of the principal and all past due interest and charges are paid, the loan can be moved to a better risk category.	0.6
Restructured loans	Loans whose terms are partially or totally modified (e.g., longer tenor, lower interest rate, lower installments) to provide relief before the debtor falls behind on payments.	1.1

Source: Central Bank of Paraguay, Superintendence of Banks.

27. There was agreement that proactive prudential oversight would be greatly facilitated by the approval of the new banking and central bank laws. The BCP's regulatory powers are tightly circumscribed by an outdated legal framework. The new draft laws aim to expand the regulator's authority and create a transparent basis for risk-based oversight. Thus, the mission welcomed the government's intention to submit the laws to Congress in March 2015. To allow an effective use of these powers, the mission also recommended reinforcing the resources of the superintendence.

28. The mission reiterated the case for long-due reforms in the cooperative sector, which accounts for one-fifth of total financial sector assets and serves many small savers, but is subject to a prudential regime with serious shortcomings flagged during the FSAP. Elevated NPL ratios (7.9 percent among the largest institutions at end-September 2014) and the opacity of cooperatives' accounts underscore the contingent risks that the sector poses to Paraguay's public finances. The regulator (INCOOP) noted its intention to set up a liquidity support scheme and deposit insurance fund headed by a board with greater independence. Staff welcomed the objective of creating a financial safety net but reaffirmed the view that such steps should be preceded by a substantial upgrading of the current regulatory and supervisory framework. The mission also welcomed INCOOP's intention to work toward creating a system-wide creditor database with the BCP.

D. Structural Reforms for Economic Development and Inclusive Growth

29. The mission discussed specific structural reforms that would support the government's drive to boost medium-term potential growth and alleviate poverty. There was agreement that improvements in public infrastructure were a critical priority. Supplementary efforts to promote higher investment, job creation, and better livelihoods could focus on the following areas:

- **Poverty relief and education**. The mission welcomed the government's plan to expand the Tekopora conditional cash transfer program to 130,000 households (from currently 100,000). Notwithstanding Tekopora, the government's strategy for alleviating poverty remains centered on fostering higher market incomes, for which improved educational attainment will be crucial. The authorities noted that they are pursuing several measures in this area, from wider availability of preschool places to scholarships for study abroad. To measure the success of these efforts, Paraguay has joined the OECD's PISA program for the 2015 round.

- **Improving the business environment**, notably by strengthening the rule of law and reducing corruption. In this context, the mission welcomed the recently adopted freedom-of-information law, which can provide a powerful tool to raise government transparency,[12] and the authorities' commitment to implement an action plan on anti-money laundering and combating the financing of terrorism. Separately, they noted their intention to gradually ease onerous licensing and registration requirements, which are viewed as a significant contributor to economic informality (see Selected Issues Papers).

- **Financial inclusion**. The government's strategy emphasizes financial education and wider access to basic financial services for households and SMEs. The mission supported the thrust of this initiative and welcomed the authorities' position that financial inclusion should not be misconstrued as an easing of credit requirements, which could in fact prove counterproductive (see Selected Issues Papers).

30. In light of a recent oil discovery, staff offered support in developing a suitable framework for managing Paraguay's natural resource wealth. A private UK company recently reported the discovery of a hydrocarbon resource in the Chaco. Under favorable conditions, the company saw scope for starting production as early as 2015, though significant uncertainty remained over the technical and commercial challenges involved. The authorities were in the early stages of preparing for such an outcome and had sought World Bank advice. The mission stressed the IMF's readiness to provide supplementary TA as needed. A prudent policy framework would need to delink government spending from the volatility of hydrocarbon revenue and channel a large share of the revenue to savings and high-quality domestic investment.[13]

[12] The law creates an unprecedented requirement to disclose the remuneration of all public sector employees.

[13] See IMF (2012), "Macroeconomic Policy Frameworks for Resource-Rich Developing Countries."

STAFF APPRAISAL

31. The government has started to tackle some of the long-standing structural weaknesses holding back development. Tax collection has improved significantly, creating space for higher public investment; preparations are underway to launch several large infrastructure projects; and the recently adopted "freedom-of-information" law will foster government transparency. These efforts are commendable, and should be extended to achieve lasting improvements in public services, institutional quality, and the rule of law. Such improvements, in turn, are critical to attract investment, boost productivity, and underpin medium-term growth and poverty reduction.

32. Paraguay's macroeconomic fundamentals remain sound, though the 2015 budget has dimmed hopes that the FRL would provide a firm institutional anchor for fiscal prudence. Paraguay boasts moderate public debt, low inflation, and strong external balances. To consolidate macroeconomic stability, the authorities have adopted new policy frameworks in recent years, notably an inflation targeting regime and the FRL. These frameworks provide appropriate anchors for policy. It is thus unfortunate that the approved 2015 budget envisages spending and a deficit above the mandated limits. With due restraint in the execution of the budget and continued efforts to improve tax enforcement, it remains possible to achieve the original FRL targets and thereby bolster the credibility of the fiscal rules. Over time, a stronger budget process will be essential to support fiscal discipline.

33. More broadly, it will be crucial to integrate the planned improvement of public services into a prudent fiscal plan for the medium term. The authorities' reform strategy holds great promise, but should not come at the expense of weakening Paraguay's solid macroeconomic position. This puts a premium on generating sufficient revenue to accommodate spending plans and preserve favorable debt dynamics. To ensure public support, it is important that additional revenue effectively translates into better public services. Civil service reform would assist this endeavor, by rationalizing public employment and raising efficiency. A prudent medium-term fiscal plan should also incorporate some buffer against adverse shocks, given the high volatility of Paraguay's economic environment.

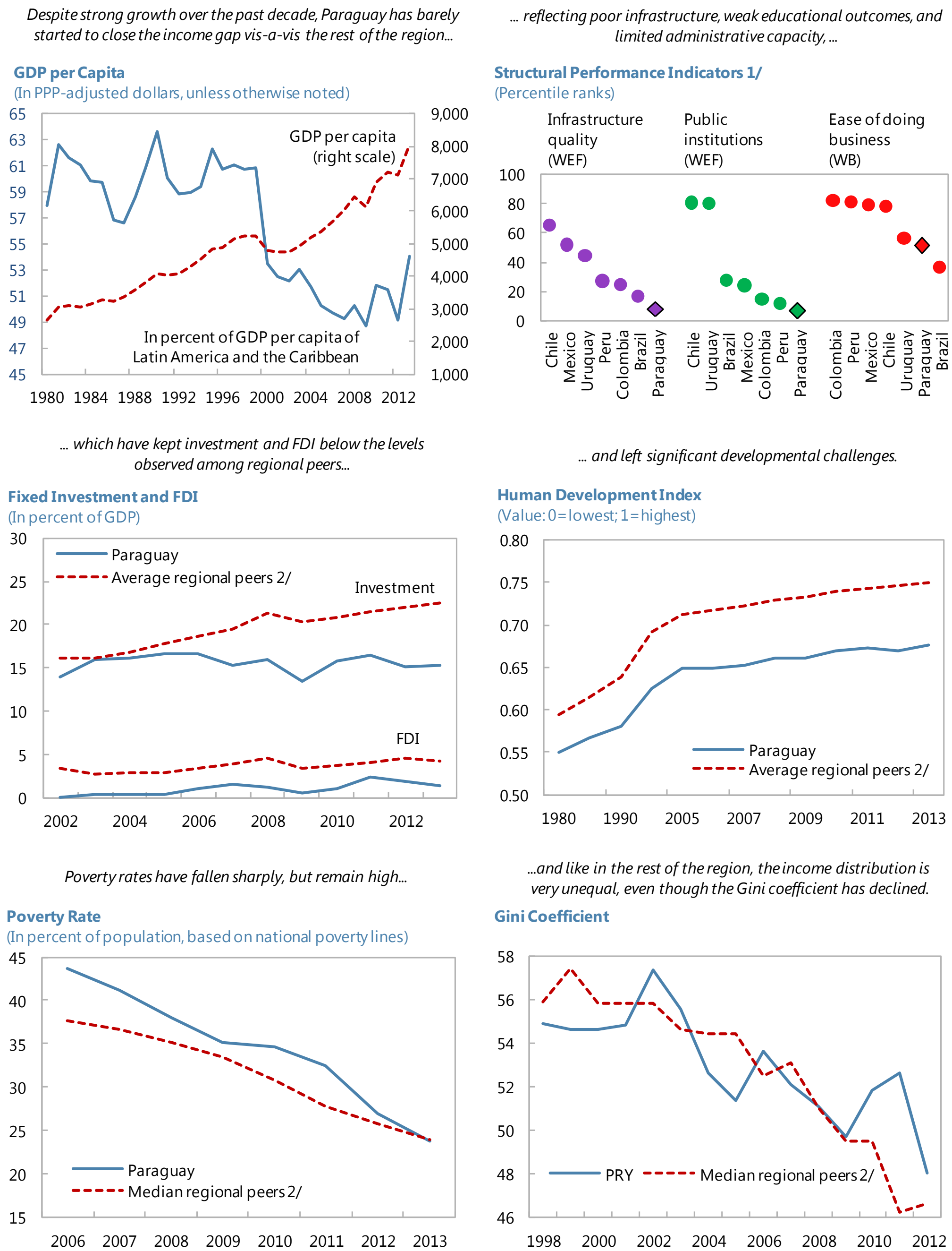
34. In the same vein, it will be important to contain fiscal risks related to infrastructure projects, SOEs, and public pension funds. Private sector participation in infrastructure is welcome but must be managed carefully to contain risks to the public finances. Particular caution is warranted with respect to deferred financing schemes that could create government liabilities without the scrutiny of the regular budget process. Fiscal risks could also arise from the missing oversight of Paraguay's pension funds and their actuarial imbalances. It is encouraging that the authorities plan to address these risks proactively, starting with the planned creation of a regulator. Similar resolve is required to address the financial and operational challenges in the SOE sector.

35. Monetary policy is currently well calibrated, and efforts should focus on further enhancing the effectiveness of the inflation targeting regime. To strengthen the transmission of monetary policy, it will be instrumental to develop a more active money market and encourage gradual de-dollarization. Meanwhile, the central bank's plan to make its sales of government foreign-currency receipts more predictable will help to distinguish these transactions clearly from occasional discretionary intervention within the flexible exchange rate regime.

36. In light of continued strong credit growth, the authorities should closely monitor potential risks and consider targeted macroprudential tightening. Paraguay's banking system remains sound, but the long-running credit expansion calls for vigilance. To contain the risks from rising consumer indebtedness, lenders should be formally required to observe prudent limits on households' debt servicing capacity. Other areas for stepped-up oversight include foreign-currency lending; and the proper recognition of credit risk in renegotiated loans. In this context, the proposed revision of the central bank and banking laws is essential to put risk-based regulation and supervision on a robust legal basis. Another priority is to strengthen the governance, resources, and enforcement powers of INCOOP.

37. It is recommended that the next Article IV consultation be held on the standard 12-month cycle.

Figure 1. Paraguay: Long-Term Growth and Social Outcomes



Sources: IMF, *World Economic* Outlook; World Economic Forum, *Global Competitiveness Report (2014–15)*; World Bank, *Doing Business (2015);* World Bank, *World Development Indicators;* UNDP Human Development Report; and Fund staff calculations.

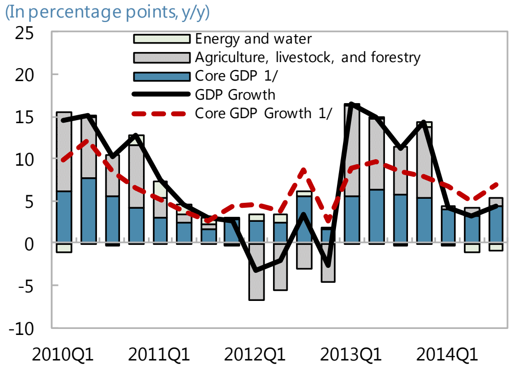
1/ The scale reflects the percentile distribution across all countries in the respective survey; higher scores reflect higher performance; WB: World Bank; WEF: World Economic Forum.

2/ Includes Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Peru, and Uruguay. Poverty rate data exclude Argentina.

Figure 2. Paraguay: Real Sector Developments, 2010–14

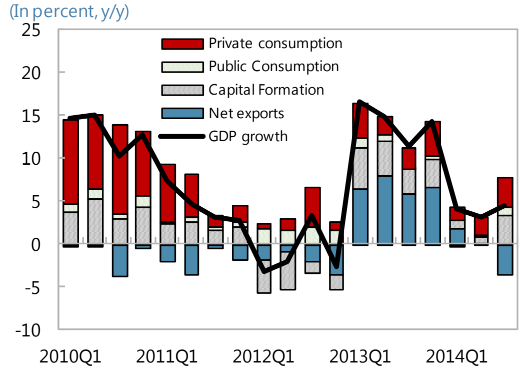
Overall growth has slowed markely from last year's record pace, but underlying activity remains buoyant…

Contribution to Output Growth by Sector
(In percentage points, y/y)



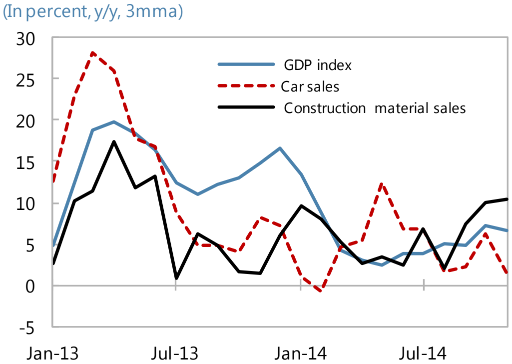
… supported by domestic demand, even as net trade has weakened.

Aggregate Demand Growth Decomposition
(In percent, y/y)



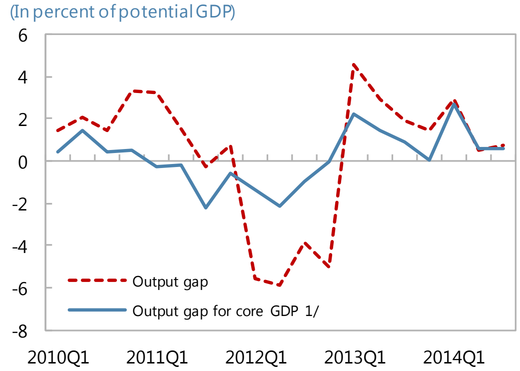
Higher-frequency data show continued robust activity in the final months of 2014.

Monthly Economic Activity Indices
(In percent, y/y, 3mma)



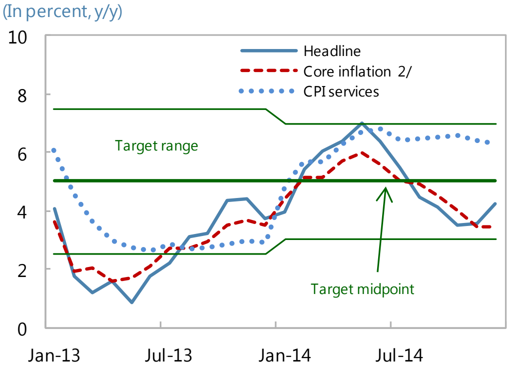
After the recent moderation of GDP growth, the economy is operating near potential.

Output Gap
(In percent of potential GDP)



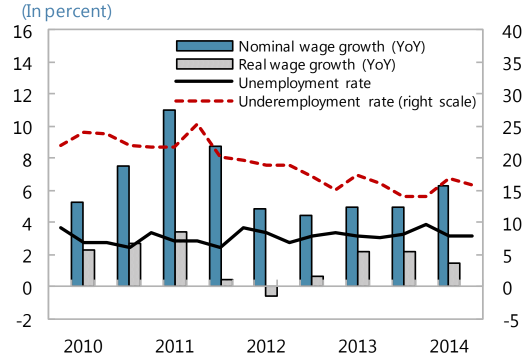
Inflation eased from a brief spike in early 2014, and ended the year somewhat below the 5 percent midpoint target…

CPI Inflation
(In percent, y/y)



… amid robust labor markets and continued real wage growth.

Unemployment and Wages
(In percent)

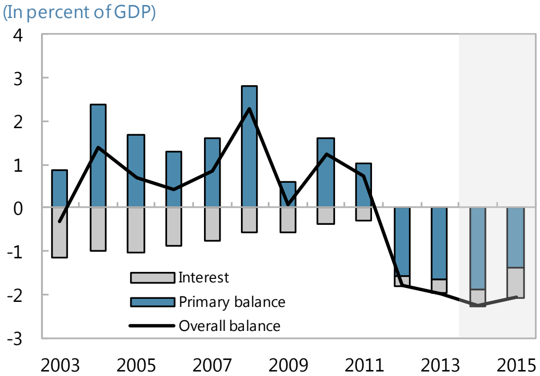


Source: IMF staff calculations based on authorities' data.
1/ Core GDP excludes agriculture, livestock and forestry, energy and water.
2/ Excludes fruits, vegetables, taxed services, and fuels.

Figure 3. Paraguay: Fiscal Sector Developments

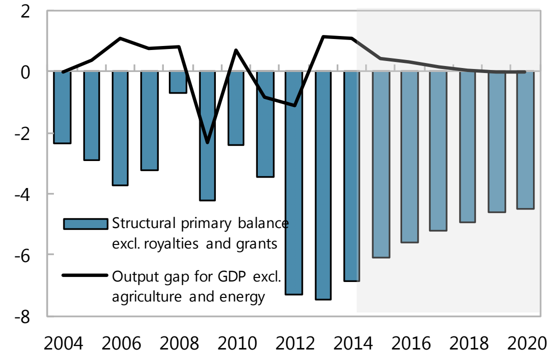
The central government switched into deficit in 2012, after an extended period of fiscal surpluses...

Central Government Overall Balance
(In percent of GDP)



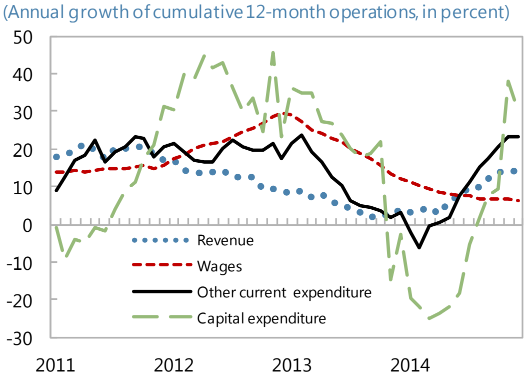
... but the fiscal stance has started to be tightened and under staff's projection will remain slightly restrictive over the period ahead.

Fiscal Policy over the Business Cycle
(In percent of non-agricultural non-energy potential GDP)



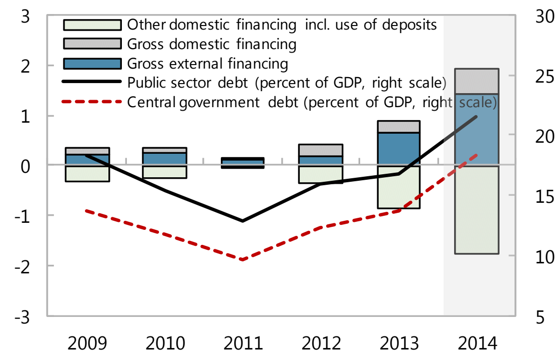
However, accelerated spending execution in late 2014 has caused the headline deficit to edge up, despite strong tax revenue growth...

Central Government Operations
(Annual growth of cumulative 12-month operations, in percent)



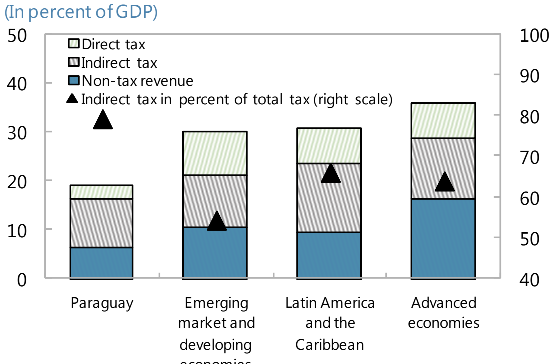
...while a large U.S. dollar bond issuance, intended to finance future capital spending, has increased gross debt.

Public Sector Financing and Debt
(In billions of U.S. dollars)



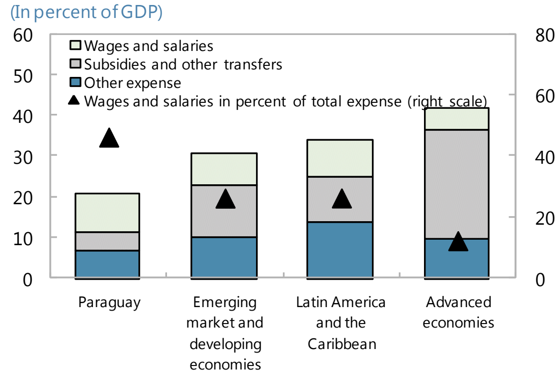
Paraguay's tax revenue remains modest by international standards, and tilted toward indirect taxes...

Public Sector Revenue Structure, 2012
(In percent of GDP)



... while wages account for an outsized share of expenditure.

Public Sector Expenditure Structure, 2012
(In percent of GDP)

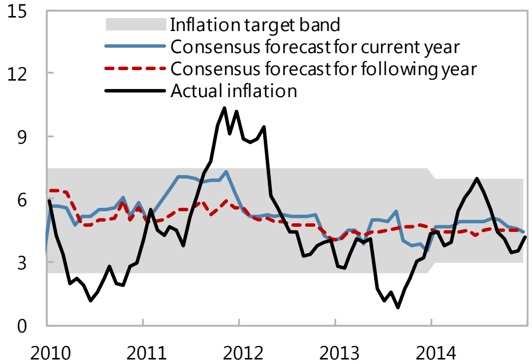


Sources: Paraguayan authorities; IMF, *World Economic Outlook;* World Bank, *World Development Indicators;* and IMF staff estimates and projections.

Figure 4. Paraguay: Monetary Developments, 2010–15

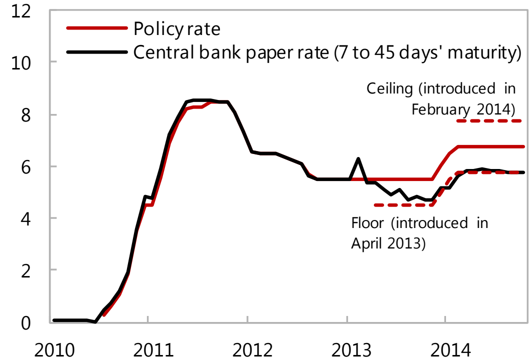
Despite significant volatility in inflation outturns, expectations stayed anchored around the 5 percent target during 2014.

Inflation Expectations
(In percent, y/y)



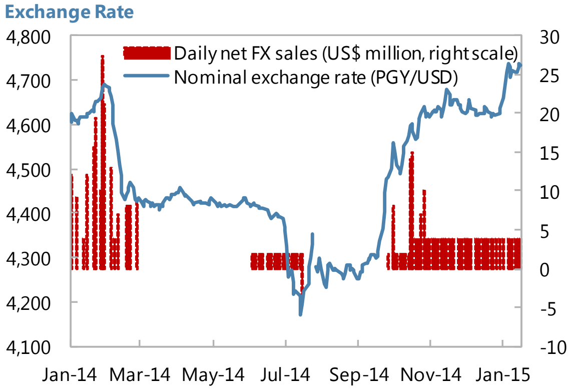
The BCP has kept the policy rate at 6.75 percent since February 2014, with actual money market rates persisting at the floor of the band...

Central Bank Interest Rates
(In percent)



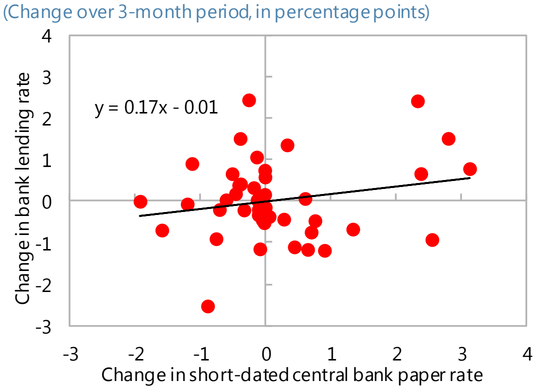
... while FX market transactions have been adjusted in response to exchange rate developments.

Intervention in the Foreign Exchange Market and Nominal Exchange Rate



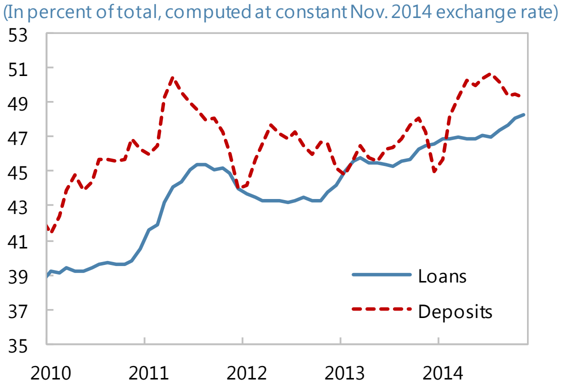
The transmission of policy rates into commerical bank rates remains well below one-for-one, amid high lending spreads.

Interest Rate Pass-Through, 2011Q1–2014Q4
(Change over 3-month period, in percentage points)



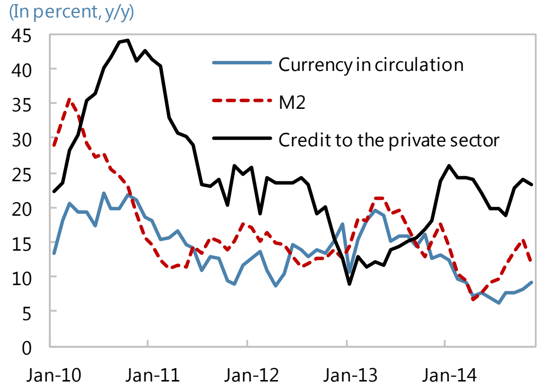
High dollarization is another factor hampering the monetary transmission mechanism.

Dollarization of Loans and Deposits
(In percent of total, computed at constant Nov. 2014 exchange rate)



Meanwhile, credit has continued to grow at a fairly rapid pace.

Monetary Aggregates
(In percent, y/y)

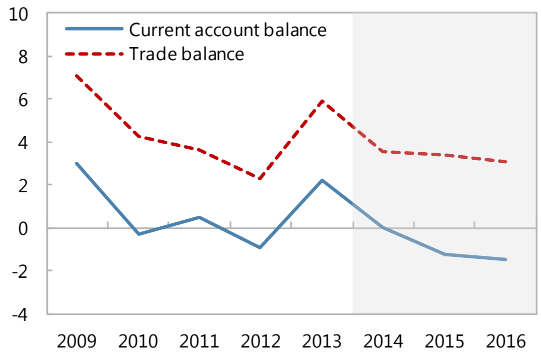


Sources: Central Bank of Paraguay; Consensus Forecasts; Haver Analytics; and IMF staff calculations.

Figure 5. Paraguay: Balance of Payments Developments, 2009–16

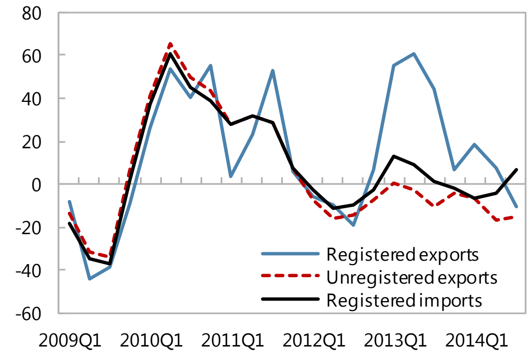
The current account is projected to move from a small surplus in 2014 into a moderate deficit in 2015...

Current Account and Trade Balance
(In percent of GDP)



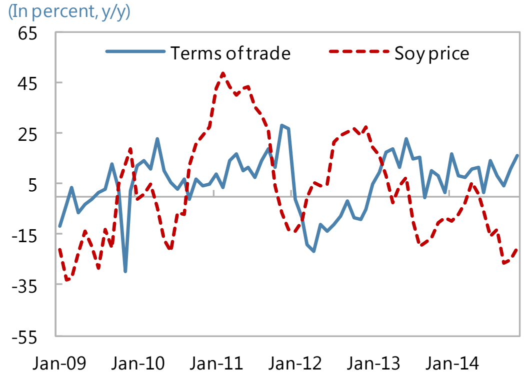
... driven by lower growth in commodity exports and re-exports, amid weak trading partner activity...

Growth in Registered and Unregistered Trade
(In percent, y/y)



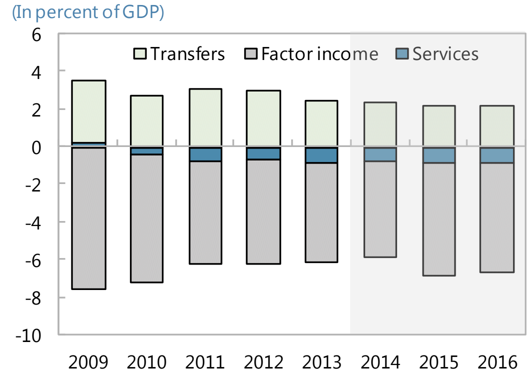
... and lower prices for soy, Paraguay's main export product, although cheaper oil will limit the worsening of the terms of trade.

Terms of Trade and Soy Prices
(In percent, y/y)



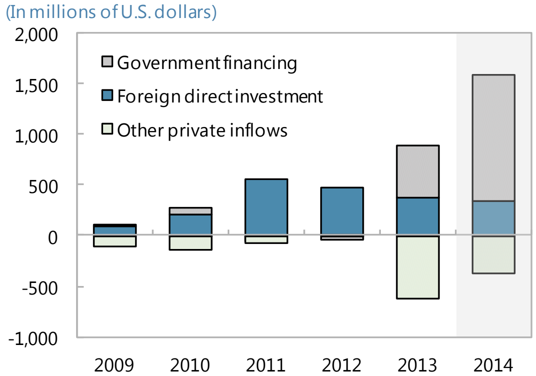
The service and transfer balances should broadly remain stable, while outbound factor payments are projected to grow.

Current Account Components
(In percent of GDP)



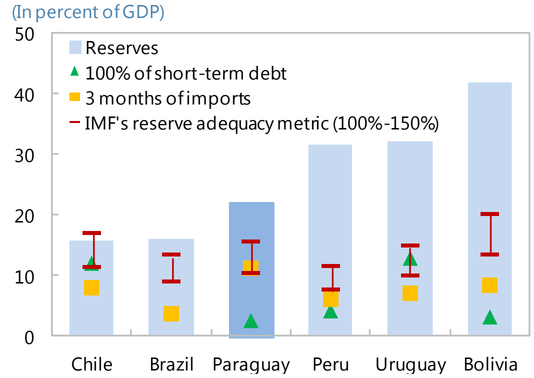
With significant recent financial inflows, linked to the issuance of a US$1 billion government bond, reserves have grown further...

Net Capital Inflows
(In millions of U.S. dollars)



... and now somewhat exceed the typical adequacy range, though less so than in other partially dollarized economies in the region.

Adequacy of International Reserves, 2014
(In percent of GDP)

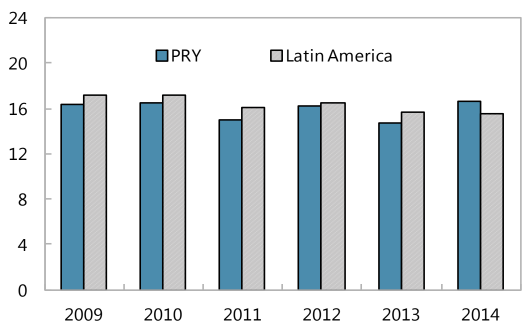


Sources: Central Bank of Paraguay; and IMF staff calculations.

Figure 6. Paraguay: Banking System Indicators 1/

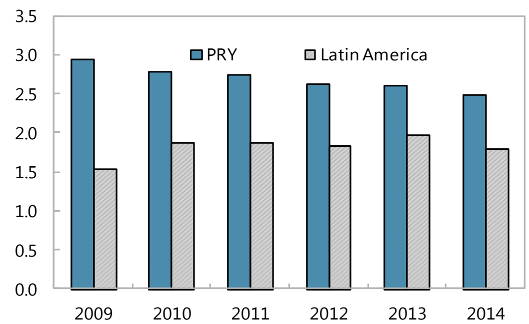
Capital adequacy among Paraguay's banks remains solid and in line with regional levels...

Regulatory Capital to Risk-Weighted Assets
(In percent)



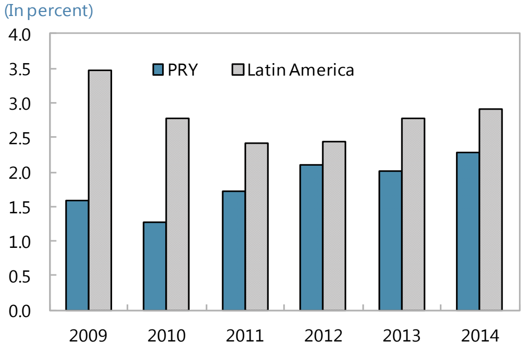
... supported by very stong profitability, with average RoAs around 2.5 percent and RoEs close to 25 percent.

Return on Assets
(In percent)



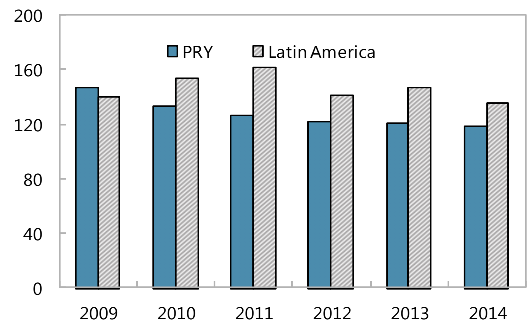
NPL ratios have edged up in recent years, but remain fairly moderate...

Nonperforming Loans to Total Loans
(In percent)



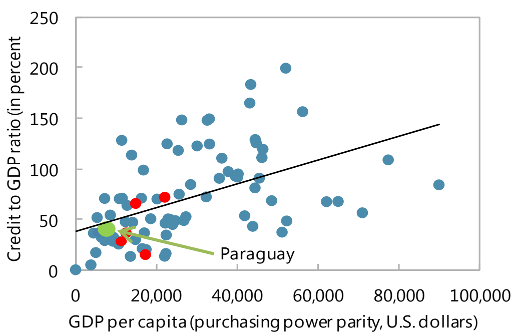
... and fully covered by provisions, although the extent of excess coverage has come down in recent years.

Provisions to Nonperforming Loans
(In percent)



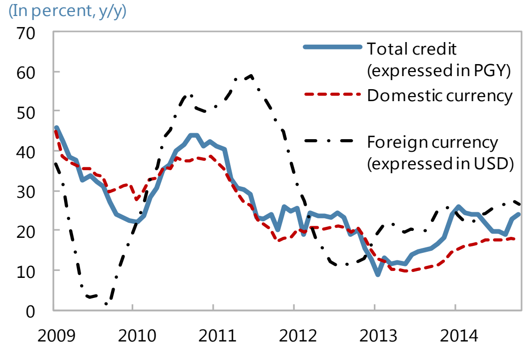
Paraguay's credit-to-GDP ratio does not appear unusual for its level of economic development...

Credit vs. GDP per capita, 2012–13 2/



... but it is important to contain the risks from continued strong credit growth, especially in foreign currency.

Private Sector Credit
(In percent, y/y)



Sources: Paraguayan authorities; IMF Financial Indicators; IMF, *International Financial Statistics*; IMF, *World Economic Outlook*; IMF, *MCM Financial Soundness Tool*; Haver Analytics; Bank of International Settlements; and Fund staff calculations.

1/ End of period data. Data for 2014 correspond to latest available observation. Regional aggregates represent median values of Argentina, Brazil, Chile, Colombia, Costa Rica, Ecuador, Mexico, and Peru. Regulatory data are not consistently defined across countries.

2/ Cyprus (credit to GDP = 306 percent) and Qatar (GDP per capita, PPP US$ = 147,943) are omitted as outliers.

Table 1. Paraguay: Selected Economic and Social Indicators

I. Social and Demographic Indicators

Population 2013 (millions)	6.8	Gini index (2013)	48.0
Unemployment rate (2013)	5.0	Life expectancy at birth (2010)	72.3
Percentage of population below the poverty line (2013)	23.8	Adult illiteracy rate (2013)	5.3
Rank in UNDP development index (2013)	111 of 186	GDP per capita (US$, 2013)	4,193

II. Economic Indicators

	2009	2010	2011	2012	2013	Est. 2014	Proj. 2015
(Annual percent change, unless otherwise indicated)							
Income and prices							
Real GDP	-4.0	13.1	4.3	-1.2	14.2	4.3	4.0
Nominal GDP	-2.0	20.0	10.8	3.4	14.7	8.8	7.1
Consumer prices (end of period)	1.9	7.2	4.9	4.0	3.7	4.2	4.5
Nominal exchange rate (Guarani per U.S. dollar, eop)	4,600	4,558	4,478	4,224	4,585	4,629	…
Monetary sector							
Currency issue	11.3	18.5	11.6	17.5	13.2	8.9	8.7
Bank credit to private sector	22.4	42.5	24.8	12.6	23.9	21.1	18.3
Liabilities to private sector	25.0	19.9	19.3	14.0	20.0	19.4	11.8
External sector							
Exports (fob, values)	-20.3	35.1	20.7	-7.8	16.8	-3.4	-1.4
Imports (cif, values)	-23.6	44.7	22.9	-6.0	7.8	1.1	-1.3
Terms of trade	-3.0	8.2	14.3	-10.2	11.4	9.8	-3.2
Real effective exchange rate 1/	-5.1	3.8	2.2	9.3	-3.0	11.6	…
(In percent of GDP, unless otherwise indicated)							
Current account	**3.0**	**-0.3**	**0.5**	**-0.9**	**2.2**	**0.1**	**-1.2**
Trade balance	7.1	4.3	3.7	2.3	5.9	3.6	3.4
Exports	48.6	50.6	54.1	46.7	48.0	44.3	42.1
Electricity	11.9	9.5	9.7	9.2	8.1	7.4	7.6
Other registered	19.9	21.9	23.6	20.3	25.4	25.2	21.6
Unregistered	16.8	19.2	20.9	17.3	14.5	11.7	12.8
Imports	-41.6	-46.4	-50.5	-44.4	-42.1	-40.7	-38.7
Of which: Oil imports	-5.7	-5.2	-6.5	-6.6	-6.1	-5.7	-3.3
Capital account and financial account	**0.4**	**0.9**	**2.0**	**2.1**	**1.2**	**3.4**	**1.2**
General government	0.1	0.3	-0.3	-0.1	1.8	4.2	0.7
Private sector	0.2	0.6	2.3	2.2	-0.6	-0.8	0.6
Of which: Direct investment	0.6	1.0	2.4	1.9	1.3	1.2	1.3
Errors and omissions	2.3	0.9	0.9	-1.2	0.3	0.1	0.0
Gross international reserves (in millions of U.S. dollars)	**3,861**	**4,168**	**4,984**	**4,994**	**5,871**	**6,914**	**6,922**
In months of next-year imports of goods and services	4.5	3.9	5.0	4.6	5.3	6.3	6.0
Ratio to short-term external debt	2.0	2.3	2.7	2.8	3.2	3.7	3.7
Gross domestic investment	**13.8**	**16.2**	**17.1**	**15.1**	**15.4**	**15.3**	**16.1**
Gross national saving	**16.8**	**15.9**	**17.5**	**14.2**	**17.6**	**15.3**	**14.9**
External saving (+) or dissaving (-)	**3.0**	**-0.3**	**0.5**	**-0.9**	**2.2**	**0.1**	**-1.2**
Central government revenues 2/	**17.5**	**17.1**	**18.0**	**19.0**	**17.2**	**18.2**	**18.7**
Of which: Tax revenues	11.6	12.0	12.6	12.7	11.8	12.9	13.3
Central government expenditures 2/	**17.5**	**15.9**	**17.3**	**20.8**	**19.2**	**20.5**	**20.8**
Of which: Wages and salaries	7.7	7.3	7.6	9.6	9.4	9.1	9.3
Of which: Transfers	3.7	3.4	3.7	4.4	4.2	4.6	4.3
Of which: Capital expenditure	4.1	3.4	4.0	4.8	4.1	4.9	4.9
Central government primary balance 2/	**0.6**	**1.6**	**1.0**	**-1.6**	**-1.6**	**-1.9**	**-1.4**
Central government overall balance 2/	**0.1**	**1.2**	**0.7**	**-1.8**	**-2.0**	**-2.3**	**-2.1**
Public sector debt (excl. central bank bills)	**18.2**	**15.4**	**12.8**	**16.0**	**16.8**	**21.5**	**22.7**
Of which: Foreign currency	15.4	13.2	11.1	10.9	11.4	15.0	15.5
Of which: Domestic currency	2.9	2.2	1.7	5.1	5.4	6.4	7.2
Memorandum items:							
GDP (billions of Guaranies)	79,117	94,934	105,203	108,832	124,853	135,780	145,393
GDP (US$ billions)	15.9	20.7	23.3	24.9	28.3	29.6	…

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

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

2/ According to the GFSM 1986 presentation.

Table 2a. Paraguay: Central Government Operations (GFSM 1986, Authorities' Presentation)

(In percent of GDP; unless otherwise indicated)

					Est.	Projections					
	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Total revenues	**17.1**	**18.0**	**19.0**	**17.2**	**18.2**	**18.7**	**19.0**	**19.0**	**19.1**	**19.1**	**19.2**
Tax revenues	12.0	12.6	12.7	11.8	12.9	13.3	13.4	13.6	13.7	13.8	13.8
Income taxes	2.2	2.5	2.7	2.5	2.7	3.1	3.2	3.3	3.3	3.4	3.4
Excises	1.9	1.9	1.9	1.6	1.9	1.8	1.8	1.8	1.8	1.9	1.9
Value added tax	6.2	6.5	6.5	6.3	6.9	7.0	7.0	7.0	7.1	7.1	7.1
Import duties	1.6	1.6	1.5	1.3	1.3	1.3	1.3	1.3	1.3	1.3	1.3
Other	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Nontax revenues 1/	5.1	5.5	6.2	5.3	5.3	5.4	5.5	5.5	5.4	5.3	5.3
Of which: Public pension contributions	1.2	1.3	1.6	1.3	1.7	1.7	1.7	1.7	1.7	1.7	1.7
Itaipu-Yacyreta hydroelectric plants	2.1	2.2	2.8	2.5	2.0	2.1	2.0	2.0	1.9	1.9	1.9
Capital revenues	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Current expenditures	**12.5**	**13.3**	**16.0**	**15.1**	**15.6**	**15.8**	**15.9**	**16.0**	**16.0**	**15.9**	**15.9**
Wages and salaries	7.3	7.6	9.6	9.4	9.1	9.3	9.3	9.3	9.2	9.1	9.0
Goods and services	1.4	1.6	1.6	1.2	1.5	1.5	1.5	1.5	1.5	1.5	1.5
Interest payments	0.4	0.3	0.2	0.3	0.4	0.7	0.8	1.0	1.1	1.2	1.3
Transfers	3.4	3.7	4.4	4.2	4.6	4.3	4.2	4.1	4.1	4.1	4.0
Of which : Public pensions and benefits	1.6	1.6	1.9	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Other	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Capital expenditures and net lending	**3.4**	**4.0**	**4.8**	**4.1**	**4.9**	**4.9**	**5.0**	**5.0**	**5.1**	**5.1**	**5.1**
Capital formation	2.4	2.3	2.6	2.3	2.4	3.1	3.2	3.2	3.3	3.3	3.3
Capital transfers	0.9	1.4	2.0	1.4	1.3	1.0	1.0	1.0	1.0	1.0	1.0
Financial investments	0.1	0.3	0.2	0.2	0.5	0.5	0.5	0.5	0.5	0.5	0.5
Net lending 2/	0.0	0.0	0.0	0.1	0.7	0.3	0.3	0.3	0.3	0.3	0.3
Overall balance	**1.2**	**0.7**	**-1.8**	**-2.0**	**-2.3**	**-2.1**	**-1.9**	**-1.9**	**-1.9**	**-1.9**	**-1.9**
Financing	**-1.2**	**-0.7**	**1.8**	**2.0**	**2.3**	**2.1**	**1.9**	**1.9**	**1.9**	**1.9**	**1.9**
External debt (increase +)	0.3	-0.2	-0.1	1.7	4.2	0.6	0.6	0.6	0.6	0.4	0.4
Disbursements	1.3	0.6	0.8	2.4	4.8	1.3	1.2	1.1	1.1	1.1	1.0
Amortizations	-1.0	-0.8	-0.9	-0.6	-0.6	-0.6	-0.6	-0.5	-0.6	-0.6	-0.6
Domestic bonds (increase +)	0.0	-0.4	0.7	0.7	1.3	1.0	0.9	1.0	1.0	1.0	1.0
Net credit from the banking system	-1.7	-0.3	0.9	-1.9	-3.2	0.4	0.4	0.4	0.4	0.4	0.4
Net credit from Central Bank 3/	-1.7	-0.3	0.8	-2.0	-3.2	0.4	0.4	0.4	0.4	0.4	0.4
Net credit from commercial banks	0.0	0.0	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other 4/	0.2	0.2	0.3	1.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:											
Current primary expenditure (% GDP)	12.1	13.0	15.7	14.8	15.2	15.1	15.1	15.0	14.8	14.7	14.6
Primary balance	1.6	1.0	-1.6	-1.6	-1.9	-1.4	-1.1	-0.9	-0.8	-0.7	-0.6
Current primary expenditure real growth (in percent)	8.3	9.8	20.7	4.8	6.8	2.8	3.0	2.9	2.3	2.3	3.1
Central government gross debt	11.7	9.7	12.3	13.6	18.4	19.4	19.9	20.3	20.8	21.2	21.5
Central government net debt 5/	5.4	3.7	7.4	8.6	10.5	12.4	13.9	15.2	16.5	17.6	18.6
Public sector debt (net of central bank bills)	15.4	12.8	16.0	16.8	21.5	22.7	23.4	24.0	24.5	24.9	25.3
Primary balance excl. royalties and grants	-1.5	-2.5	-5.5	-5.0	-4.7	-4.2	-3.9	-3.7	-3.5	-3.3	-3.3
Primary balance excl. royalties and grants 6/	-2.3	-3.6	-7.6	-7.3	-6.7	-6.0	-5.5	-5.2	-4.9	-4.6	-4.5
Output gap for GDP excl. agriculture and energy	0.7	-0.8	-1.1	1.1	1.1	0.4	0.3	0.2	0.1	0.0	0.0
Structural primary balance excl. royalties and grants 6/	-2.4	-3.5	-7.4	-7.5	-6.9	-6.1	-5.6	-5.3	-5.0	-4.6	-4.5
Fiscal impulse	-1.8	1.0	3.9	0.2	-0.6	-0.8	-0.5	-0.4	-0.3	-0.3	-0.1

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

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

2/ Includes central government lending to state-owned enterprises.

3/ Includes deposit drawdown.

4/ Includes floating debt and statistical discrepancy between above and below the line calculations.

5/ Net of central government deposits at the central bank.

6/ In percent of potential non-agricultural non-energy GDP.

Table 2b. Paraguay: Central Government Operations (GFSM 2001, Staff Presentation) 1/

(In percent of GDP)

					Est.	Projections					
	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Revenue 2/	**17.1**	**18.0**	**19.0**	**17.2**	**18.2**	**18.7**	**18.9**	**19.0**	**19.1**	**19.1**	**19.2**
Taxes	12.0	12.6	12.7	11.8	12.9	13.3	13.4	13.6	13.7	13.8	13.8
Income taxes	2.2	2.5	2.7	2.5	2.7	3.1	3.2	3.3	3.3	3.4	3.4
Excises	1.9	1.9	1.9	1.6	1.9	1.8	1.8	1.8	1.8	1.9	1.9
Value added tax	6.2	6.5	6.5	6.3	6.9	7.0	7.0	7.0	7.1	7.1	7.1
Import duties	1.6	1.6	1.5	1.3	1.3	1.3	1.3	1.3	1.3	1.3	1.3
Other	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Social contributions	1.2	1.3	1.6	1.3	1.7	1.7	1.7	1.7	1.7	1.7	1.7
Other revenue	3.9	4.2	4.7	4.0	3.6	3.7	3.8	3.7	3.7	3.6	3.7
Itaipu-Yacyreta hydroelectric plants	2.1	2.2	2.8	2.5	2.0	2.1	2.0	2.0	1.9	1.9	1.9
Other nontax revenue	1.8	2.0	1.9	1.5	1.6	1.6	1.8	1.8	1.8	1.8	1.8
Expenditure	**15.8**	**17.0**	**20.6**	**18.9**	**19.3**	**20.0**	**20.1**	**20.2**	**20.2**	**20.2**	**20.2**
Expense	**13.4**	**14.7**	**18.0**	**16.5**	**16.9**	**16.8**	**16.9**	**17.0**	**17.0**	**16.9**	**16.9**
Compensation of employees	7.3	7.6	9.6	9.4	9.1	9.3	9.3	9.3	9.2	9.1	9.0
Purchases of goods and services	1.4	1.6	1.6	1.2	1.5	1.5	1.5	1.5	1.5	1.5	1.5
Interest	0.4	0.3	0.2	0.3	0.4	0.7	0.8	1.0	1.1	1.2	1.3
Grants 3/	0.9	1.4	2.0	1.4	1.3	1.0	1.0	1.0	1.0	1.0	1.0
Social benefits 4/	1.6	1.6	1.9	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Other expense	1.9	2.2	2.6	2.3	2.6	2.3	2.3	2.2	2.1	2.1	2.1
Transfers 5/	1.8	2.1	2.5	2.2	2.6	2.2	2.2	2.1	2.1	2.0	2.0
Other	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net acquisition of nonfinancial assets	**2.4**	**2.3**	**2.6**	**2.3**	**2.4**	**3.1**	**3.2**	**3.2**	**3.3**	**3.3**	**3.3**
Gross operating balance	**3.7**	**3.3**	**1.0**	**0.6**	**1.3**	**1.9**	**2.0**	**2.0**	**2.1**	**2.2**	**2.3**
Net lending/borrowing (overall balance)	**1.3**	**1.0**	**-1.7**	**-1.7**	**-1.1**	**-1.3**	**-1.2**	**-1.2**	**-1.2**	**-1.1**	**-1.1**
Net financial transactions	**-1.3**	**-1.0**	**1.7**	**1.7**	**1.1**	**1.3**	**1.2**	**1.2**	**1.2**	**1.1**	**1.1**
Net acquisition of financial assets 6/	0.1	0.3	0.1	0.3	1.2	0.8	0.8	0.8	0.8	0.8	0.8
Net incurrence of liabilities	-1.4	-0.7	1.8	0.7	2.3	2.1	1.9	1.9	1.9	1.9	1.9
Domestic	-1.6	-0.4	1.8	-1.0	-1.9	1.4	1.3	1.4	1.4	1.5	1.5
Debt securities	0.0	-0.4	0.7	0.7	1.3	1.0	0.9	1.0	1.0	1.0	1.0
New TB issues	0.5	0.0	1.0	0.9	1.7	1.8	1.9	2.2	2.3	2.7	2.8
Amortizations	-0.5	-0.5	-0.3	-0.1	-0.4	-0.7	-1.0	-1.2	-1.4	-1.6	-1.8
Net credit from the banking system	-1.7	-0.3	0.9	-1.9	-3.2	0.4	0.4	0.4	0.4	0.4	0.4
Net credit from the Central bank 7/	-1.7	-0.3	0.8	-2.0	-3.2	0.4	0.4	0.4	0.4	0.4	0.4
Net credit from the commercial banks	0.0	0.0	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other accounts payable	0.1	0.3	0.2	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign	0.3	-0.2	-0.1	1.7	4.2	0.6	0.6	0.6	0.6	0.4	0.4
Disbursements	1.3	0.6	0.8	2.4	4.8	1.3	1.2	1.1	1.1	1.1	1.0
Amortizations	-1.0	-0.8	-0.9	-0.6	-0.6	-0.6	-0.6	-0.5	-0.6	-0.6	-0.6
Statistical Discrepancy 8/	0.1	-0.1	0.0	1.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:											
Primary balance	1.7	1.3	-1.4	-1.4	-0.7	-0.6	-0.3	-0.2	0.0	0.1	0.2
Nominal GDP (in billions of Guaranies)	94,934	105,203	108,832	124,853	135,780	145,393	157,285	170,126	183,852	198,568	214,501

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

1/ The GFSM 2001 presentation is an approximation based on the reallocation of certain revenue and expenditure categories within the GFSM 1986 template (reported on a cash basis).

2/ The GFSM 2001 definition of revenues excludes capital revenues, which are included in net acquisition of nonfinancial assets.

3/ Grants cover capital transfers and other grants, which are mostly paid to municipalities.

4/ Pensions and benefits are included in social benefits.

5/ Excludes pensions and benefits, which are recorded under social benefits.

6/ Includes lending to the rest of the public sector and financial investments. A positive sign indicates acummulation of assets.

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

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

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

(In percent of GDP)

	2010	2011	2012	2013	Est. 2014	Projections 2015	2016	2017	2018	2019	2020
Revenue	**20.8**	**23.3**	**23.6**	**22.1**	**23.7**	**24.3**	**24.5**	**24.6**	**24.5**	**24.5**	**24.5**
Tax revenue	12.1	12.6	12.8	12.3	13.4	13.8	13.9	14.0	14.1	14.3	14.3
Nontax revenue and grants 2/	8.5	9.3	10.4	9.1	9.7	9.9	10.0	9.9	9.8	9.7	9.7
Public enterprises operating surplus	0.2	1.4	0.5	0.7	0.7	0.7	0.6	0.6	0.6	0.6	0.6
Expenditure	**20.1**	**21.4**	**25.3**	**23.6**	**24.3**	**25.5**	**25.6**	**25.7**	**25.8**	**25.7**	**25.7**
Expense	**16.5**	**18.3**	**21.6**	**20.4**	**21.0**	**20.9**	**20.9**	**21.1**	**21.0**	**20.9**	**20.9**
Wages and salaries	9.1	9.5	12.1	11.9	11.7	11.9	11.9	11.9	11.7	11.6	11.6
Goods and services	2.2	2.7	2.7	2.0	2.3	2.3	2.3	2.3	2.3	2.4	2.4
Interest payments	0.8	0.7	0.6	0.8	0.8	1.0	1.2	1.4	1.5	1.6	1.7
Transfers 3/	4.2	5.2	6.0	5.5	6.1	5.5	5.5	5.4	5.3	5.3	5.2
Current transfers	3.7	4.0	4.5	4.4	5.2	4.9	4.8	4.7	4.7	4.6	4.6
Capital transfers	0.5	1.3	1.5	1.1	0.9	0.6	0.6	0.6	0.6	0.6	0.6
Other expense	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Gross operating balance	**4.3**	**5.0**	**2.0**	**1.8**	**2.7**	**3.4**	**3.6**	**3.5**	**3.5**	**3.6**	**3.6**
Net acquisition of nonfinancial assets 4/	3.7	3.1	3.7	3.2	3.3	4.6	4.7	4.7	4.7	4.8	4.8
Net lending/borrowing (overall balance)	**0.7**	**1.9**	**-1.7**	**-1.5**	**-0.5**	**-1.2**	**-1.1**	**-1.2**	**-1.2**	**-1.2**	**-1.2**
Net financial transactions	**-0.7**	**-1.9**	**1.7**	**1.5**	**0.5**	**1.2**	**1.1**	**1.2**	**1.2**	**1.2**	**1.2**
Net acquisition of financial assets	0.3	0.5	0.6	0.9	0.8	0.8	0.8	0.8	0.8	0.8	0.7
Net incurrence of liabilities	-0.4	-1.4	2.3	2.3	1.3	1.9	1.9	1.9	2.0	2.0	2.0
External	0.3	-0.3	-0.1	1.7	4.1	0.8	0.7	0.7	0.7	0.5	0.5
Disbursements	1.4	0.6	0.8	2.4	4.8	1.4	1.3	1.2	1.3	1.2	1.2
Amortizations	-1.2	-0.9	-0.9	-0.7	-0.7	-0.7	-0.6	-0.6	-0.6	-0.7	-0.7
Domestic	-0.7	-1.4	2.2	0.5	-2.8	1.2	1.1	1.2	1.3	1.5	1.5
Domestic debt	0.0	-0.4	0.7	0.7	1.3	1.0	0.9	1.0	1.0	1.0	1.0
Disbursements	0.5	0.0	1.0	0.9	1.7	1.8	1.9	2.2	2.3	2.7	2.8
Amortizations	-0.5	-0.5	-0.3	-0.1	-0.4	-0.7	-1.0	-1.2	-1.4	-1.6	-1.8
Deposits	-1.1	-1.6	1.3	-1.2	-4.5	-0.3	-0.2	-0.2	-0.1	0.0	0.0
Quasifiscal deficit financing 5/	0.3	0.6	0.2	0.9	0.4	0.4	0.4	0.5	0.5	0.5	0.5
Net change in domestic arrears	0.1	0.3	0.2	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:											
Primary balance	1.5	2.6	-1.1	-0.7	0.3	-0.1	0.1	0.2	0.3	0.4	0.5
Public sector debt (excl. central bank bills)	15.4	12.8	16.0	16.8	21.5	22.7	23.4	24.0	24.5	24.9	25.3
Domestic public debt	2.2	1.7	5.1	5.4	6.4	7.2	7.7	8.2	8.6	9.2	9.6
Foreign public debt	13.2	11.1	10.9	11.4	15.0	15.5	15.7	15.8	15.9	15.8	15.7

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

1/ Includes the nonfinancial public sector and the central bank.
The GFSM 2001 presentation is an approximation based on the reallocation of certain revenue and expenditure categories within the GFSM 1986 template (reported on a cash basis).
2/ Includes social contributions and grants.
3/ Includes social benefits, grants, and capital transfers.
4/ Includes capital formation.
5/ Corresponds to net losses of central bank capital which are not automatically compensated by the government.

Table 4. Paraguay: Summary Accounts of the Central Bank

(In billions of Guaranies; eop; valued at constant exchange rate)

	2010	2011	2012	2013	Est. 2014
Currency issue	**6,564**	**7,324**	**8,606**	**9,744**	**10,615**
Growth	18.5	11.6	17.5	13.2	8.9
Net international reserves	**19,284**	**23,015**	**23,070**	**27,129**	**32,012**
In millions of U.S. dollars	4,165	4,971	4,983	5,859	6,914
Net domestic assets	**-12,721**	**-15,690**	**-14,464**	**-17,385**	**-21,397**
Net nonfinancial public sector	-3,086	-3,263	-1,354	-5,838	-8,251
Net credit to the central government	-3,562	-3,756	-1,342	-5,837	-8,251
Net credit to the rest of NFPS	476	493	-12	-1	-1
Net credit to the banking system	-8,344	-11,382	-11,793	-14,926	-15,804
Reserve requirements	-4,721	-6,115	-6,539	-7,606	-8,986
Free reserves	-2,101	-2,577	-2,685	-1,207	-1,035
Monetary control instruments 1/	-2,881	-4,111	-3,665	-7,473	-6,918
Other	1,360	1,421	1,097	1,361	1,135
Other assets and liabilities (net)	-1,291	-1,045	-1,317	3,379	2,658
Capital and reserves	735	1,298	1,557	5,387	6,218
Other assets net 2/	-2,026	-2,343	-2,874	-2,008	-3,561
Memorandum Items:					
Total stock of IRMs outstanding 1/	3,137	4,155	3,601	7,614	6,873
Quasifiscal balance	322	661	261	1,123	529
In percent of GDP	0.3	0.6	0.2	0.9	0.4
Cost of monetary policy operations	142	433	400	534	586
In percent of GDP	0.2	0.4	0.4	0.4	0.4

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

1/ Includes overnight-deposit facility and central bank bills (LRM). A fraction of LRM is held by non-bank institutions.

2/ Includes LRM held by the non-banking sector.

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

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

	2010	2011	2012	2013	Est. 2014
I. Central Bank					
Net international reserves	**19,284**	**23,015**	**23,070**	**27,129**	**32,012**
In millions of U.S. dollars	4,165	4,971	4,983	5,859	6,914
Net domestic assets	**-12,721**	**-15,690**	**-14,464**	**-17,385**	**-21,397**
Credit to public sector, net	-3,086	-3,263	-1,354	-5,838	-8,251
Credit to banking system, net 2/	-5,462	-7,271	-8,128	-7,453	-8,886
Credit	1,360	1,421	1,097	1,361	1,135
Deposits	6,822	8,692	9,224	8,813	10,021
Central bank securites	-3,137	-4,155	-3,601	-7,614	-6,873
Other	-1,036	-1,001	-1,382	3,519	2,613
Currency issue	**6,564**	**7,324**	**8,606**	**9,744**	**10,615**
II. Monetary Survey					
Net foreign assets	**20,050**	**22,578**	**22,537**	**25,151**	**29,091**
In millions of U.S. dollars	4,331	4,876	4,868	5,432	6,283
Net domestic assets	**20,544**	**25,155**	**31,695**	**39,318**	**45,572**
Credit to the public sector	-4,704	-6,560	-4,856	-9,328	-12,247
Credit to the private sector	32,923	41,339	47,880	57,301	68,744
Other	-7,675	-9,623	-11,329	-8,655	-10,925
Broad liquidity (M3)	**38,695**	**45,207**	**51,467**	**60,709**	**69,846**
Foreign currency deposits	12,269	14,340	16,896	20,289	25,358
Money and quasi-money (M2)	**26,426**	**30,867**	**34,571**	**40,420**	**44,488**
Quasi-money	11,638	14,729	16,813	20,340	21,583
Money (M1)	14,788	16,138	17,758	20,080	22,906
(Annual percent change)					
M0 (Currency issued)	18.5	11.6	17.5	13.2	8.9
Credit to the private sector	37.9	25.6	15.8	19.7	20.0
M1	14.1	9.1	10.0	13.1	14.1
M2	16.2	16.8	12.0	16.9	10.1
M3	20.0	16.8	13.8	18.0	15.1
Of which: Foreign currency deposits	28.9	16.9	17.8	20.1	25.0
Memorandum items:					
Ratio of foreign currency deposits to M3 (percent)	31.7	31.7	32.8	33.4	36.3
Ratio of foreign currency deposits to total private sector deposits (percent)	34.9	34.2	35.3	35.4	38.0

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

1/ Includes banks, finance companies, and the 20 largest cooperatives.
2/ Excludes LRM held by the banking sector.

Table 6. Paraguay: Balance of Payments

(In millions of U.S. dollars)

					Est.	Projections					
	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Current account	**-57**	**110**	**-231**	**622**	**15**	**-376**	**-466**	**-411**	**-429**	**-442**	**-437**
Trade balance	882	855	572	1,663	1,064	1,036	981	1,000	1,036	1,106	1,201
Exports	10,469	12,634	11,649	13,600	13,137	12,949	13,568	14,242	14,980	15,739	16,530
Electricity	1,967	2,257	2,286	2,290	2,180	2,337	2,388	2,441	2,494	2,549	2,605
Other registered	4,534	5,509	5,052	7,196	7,477	6,662	7,011	7,409	7,856	8,326	8,825
Of which: Beef	920	754	827	1,059	1,370	1,391	1,389	1,488	1,593	1,706	1,827
Of which: Soy	1,591	2,295	1,624	2,790	2,305	1,901	1,978	2,055	2,158	2,266	2,379
Unregistered	3,969	4,867	4,311	4,114	3,481	3,950	4,169	4,393	4,629	4,863	5,100
Imports	-9,587	-11,779	-11,077	-11,937	-12,073	-11,913	-12,588	-13,242	-13,944	-14,633	-15,330
Registered	-9,400	-11,549	-10,756	-11,302	-11,299	-11,174	-11,824	-12,454	-13,114	-13,761	-14,416
Of which: Fuel products	-1,073	-1,507	-1,647	-1,735	-1,696	-1,023	-1,197	-1,324	-1,437	-1,518	-1,590
Unregistered	-187	-230	-321	-635	-774	-739	-763	-788	-830	-872	-913
Services (net)	-84	-181	-170	-227	-222	-258	-271	-291	-310	-331	-337
Transport	-250	-309	-296	-284	-299	-360	-372	-400	-429	-459	-479
Travel	72	67	58	30	28	35	35	35	36	38	44
Other	93	62	68	27	50	67	66	74	82	90	99
Factor income	-1,412	-1,278	-1,391	-1,501	-1,522	-1,841	-1,885	-1,859	-1,923	-2,017	-2,114
Transfers	557	714	759	688	696	687	709	739	769	799	813
Capital and financial account	**193**	**467**	**514**	**341**	**994**	**383**	**476**	**425**	**444**	**457**	**451**
Capital transfers	40	40	51	61	141	119	124	129	135	141	147
Direct investment	216	557	480	382	352	408	490	588	646	679	713
Portfolio investment	0	100	500	500	1,300	0	0	0	0	0	0
Of which: government	0	0	0	500	1,000	0	0	0	0	0	0
Other investment	-62	-230	-516	-602	-799	-143	-137	-292	-337	-363	-409
Of which: government	69	-59	-30	13	242	201	201	201	202	153	154
Errors and omissions	**182**	**206**	**-308**	**72**	**34**	**0**	**0**	**0**	**0**	**0**	**0**
Overall balance	**319**	**783**	**-25**	**1,036**	**1,043**	**8**	**10**	**14**	**15**	**15**	**15**
Net international reserves (increase -)	-319	-783	25	-1,036	-1,043	-8	-10	-14	-15	-15	-15
Gross reserves	-319	-784	25	-1,036	-1,043	-8	-10	-14	-15	-15	-15
Reserve liabilities	1	1	0	0	0	0	0	0	0	0	0
Exceptional financing	0	0	0	0	0	0	0	0	0	0	0
Memorandum items:											
Current account in percent of GDP	-0.3	0.5	-0.9	2.2	0.1	-1.2	-1.5	-1.2	-1.2	-1.2	-1.1
Gross reserves (in millions of U.S. dollars)	4,168	4,984	4,994	5,871	6,914	6,922	6,932	6,946	6,961	6,976	6,990
In months of imports of GNFS	3.9	5.0	4.6	5.3	6.3	6.0	5.7	5.4	5.4	5.4	5.4
External public debt in percent of GDP 1/	13.2	11.1	10.9	11.4	15.0	15.5	15.7	15.8	15.9	15.8	15.7
Debt service in percent of exports GNFS	12.7	10.4	11.2	9.0	9.7	10.0	10.0	9.9	10.1	10.1	9.9
Export volume (percent change) 2/	19.8	0.6	-8.9	29.6	0.0	5.6	4.4	4.3	4.3	4.3	4.4
Import volume (percent change) 2/	32.8	27.9	-11.0	10.9	9.0	4.1	4.1	4.1	4.2	4.2	4.3
Terms of trade (percent change) 2/	8.2	14.3	-10.2	11.4	9.8	-3.2	-1.7	-0.7	-0.3	0.1	0.3

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

1/ Based on average exchange rate valuation of GDP.

2/ Excludes unregistered trade and imports destined for re-export.

Table 7. Paraguay: Indicators of External Vulnerability

(In percent of GDP, unless otherwise indicated)

	2009	2010	2011	2012	2013	Est. 2014
Monetary and financial indicators						
Broad money (M3), percentage change 1/	22.7	20.0	16.8	13.8	18.0	15.1
Credit to the private sector, real (percent change) 1/	19.3	28.7	19.7	11.4	15.4	15.1
Share of nonperforming loans in total loans (percent) 2/	1.6	1.3	1.7	2.1	2.0	2.1
Average domestic bank lending rate, real	23.0	21.5	6.0	11.0	11.6	7.8
Central Bank bill yield, real	0.3	0.8	-0.8	1.8	3.1	1.0
Central bank foreign short-term liabilities (millions of U.S. dollars)	1.2	0.0	0.0	0.0	0.0	0.0
External indicators						
Merchandise exports (percentage change)	-20.3	35.1	20.7	-7.8	16.8	-3.4
Merchandise imports (percentage change)	-23.6	44.7	22.9	-6.0	7.8	1.1
Merchandise terms of trade (percentage change)	-3.3	8.3	14.3	-10.2	11.4	9.8
Real effective exchange rate (percentage change)	-5.1	3.8	2.2	9.3	-3.0	11.6
Current account balance (percent of GDP)	3.0	-0.3	0.5	-0.9	2.2	0.1
Capital and financial account (percent of GDP)	0.4	0.9	2.0	2.1	1.2	3.4
Net foreign direct investment (percent of GDP)	0.6	1.0	2.4	1.9	1.3	1.2
Other net investment (percent of GDP)	-0.5	-0.3	-1.0	-2.1	-2.1	-2.7
External public debt (percent of GDP) 2/	15.4	13.2	11.1	10.9	11.4	15.0
Total external debt (percent of GDP)	97.4	76.4	66.8	64.4	56.4	59.3
Excluding debt of binational companies	22.4	19.9	18.4	20.9	19.9	25.0
Debt service (in percent of exports GNFS)	12.9	12.7	10.4	11.2	9.0	9.7
International reserves (in millions of U.S. dollars)	3,861	4,168	4,984	4,994	5,871	6,914
In months of imports of GNFS	4.5	3.9	5.0	4.6	5.3	6.3
Ratio to short-term external debt 3/	2.0	2.3	2.7	2.8	3.2	3.7
Ratio to foreign currency deposits in domestic banks	1.7	1.5	1.5	1.3	1.3	1.3

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

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

Annex I. Implementation of Past Fund Policy Advice

The authorities have taken on board several of the policy recommendations from the 2013 Article IV consultation, though in some areas the implementation of specific measures is still at an early stage.

- Directors commended the adoption of the FRL and endorsed it as a suitable anchor for fiscal sustainability. They also called on the authorities to improve the quality of government spending, strengthen tax and customs administration, and enhance the capacity to deal with potential risks from public-private partnerships. Civil service and pension reforms were stressed as additional priorities. *The 2015 budget process did not respect all the fiscal rules laid down in the FRL, though the authorities have expressed their commitment to seek compliance during the implementation of the budget. Progress has been made in upgrading the capacity of the tax administration, and revenue collection has improved significantly, though further efforts to rein in tax evasion are needed. The government's capacity to implement infrastructure projects has grown, and work is underway to strengthen it further, with assistance from international consultants. A comprehensive reform of the civil service and the pension system remain important priorities.*

- On monetary and exchange rate policy, Directors highlighted the need to develop an active interbank money market, maintain exchange rate flexibility, and step up efforts to reduce dollarization. They also called for steps to address the remaining deficiencies in Paraguay's anti-money laundering regime. *The central bank has limited discretionary FX market intervention and allowed significant exchange rate movements over the course of the past year, with a trough-to-peak span of almost 13 percent in the bilateral U.S. dollar/guaraní rate during 2014. Based on recent TA advice, the central bank is also planning to improve further the functioning of the money market, including by adopting an averaging scheme for reserve requirements.*

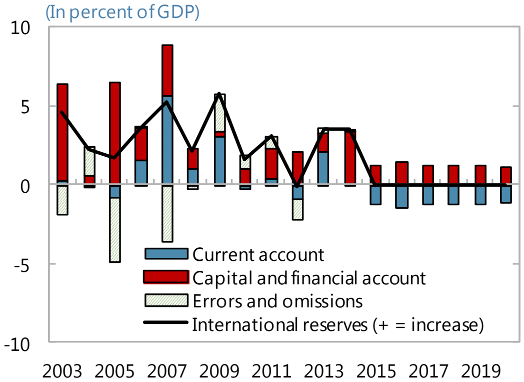
- On financial sector policy, Directors recommended strengthening risk-based supervision, including through the adoption of new financial sector legislation. *Draft versions of the new central bank and banking laws, which are critical to strengthening risk-based financial sector oversight, have been completed and are due to be submitted to Congress in early 2015.*

The authorities have also maintained their commitment to transparency in the discussions with staff, by consenting to the publication of the mission's concluding statement and arranging a press conference that typically generates comprehensive media coverage of the mission's main findings and policy recommendations.

Annex II. External Stability Assessment[1]

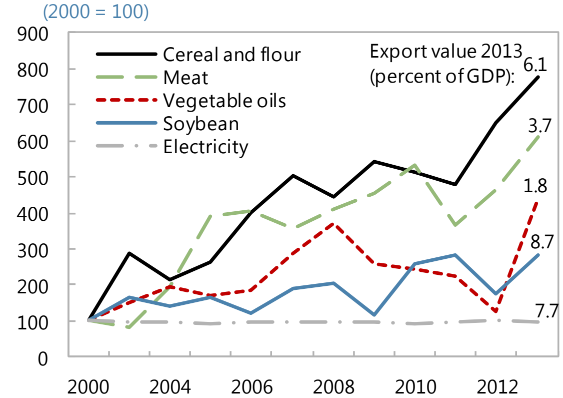
1. Paraguay's current account is estimated to post a small surplus in 2014, before switching into a moderate deficit from 2015 onward. Lower world market prices for agricultural products are set to weigh on export proceeds over the period ahead, although this effect will be partly offset by continued volume growth, greater industrialization of agricultural exports, and more favorable price trends for meat, another key export. The significantly lower cost of fuel imports will also help to curtail the deterioration of the trade balance, even as other imports continue to grow, in the context of rising public and private investment. The financial account, in turn, is projected to stay in surplus, reflecting financing for the government and direct investment. Consequently, Paraguay's international reserves are expected to stabilize around their end-2014 level, which reflected the impact of a US$1 billion government bond issuance with a 30-year maturity.

Balance of Payments, 2003–20
(In percent of GDP)



Sources: Haver Analytics; and IMF staff projections.

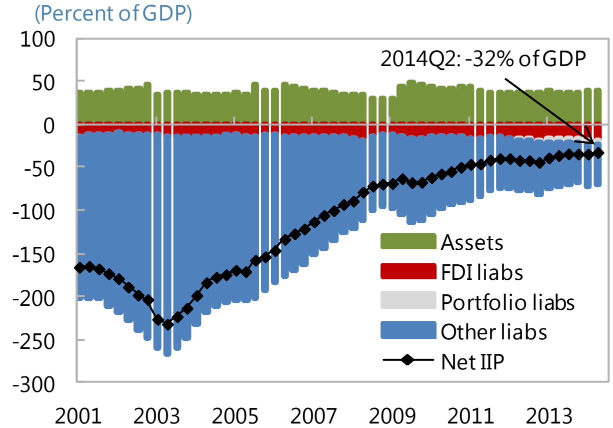
Principal Exports: Volume Indices, 2000–13
(2000 = 100)



Source: Haver Analytics.

2. The international investment position has continued to improve, and the remaining net liability is fully accounted for by the debt of the two binational hydroelectric power companies. Paraguay's net international liabilities reached 32 percent of GDP at end-June 2014, continuing a secular decline from levels of some 200 percent of GDP ten years ago. Moreover, the remaining net liability is fully attributable to the debt of the Itaipu and Yacyreta power companies, whose debt service is covered by electricity deliveries.

International Investment Position, 2001–14
(Percent of GDP)



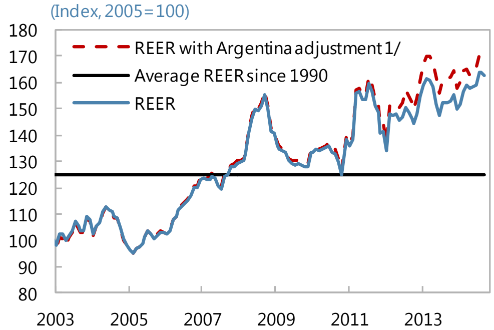
Source: Haver Analytics.

3. Paraguay's real exchange rate has appreciated by about 60 percent since 2005, or even slightly more if the bilateral real exchange rate vis-à-vis Argentina is computed using the

[1] Prepared by Andre Meier and Mauricio Vargas.

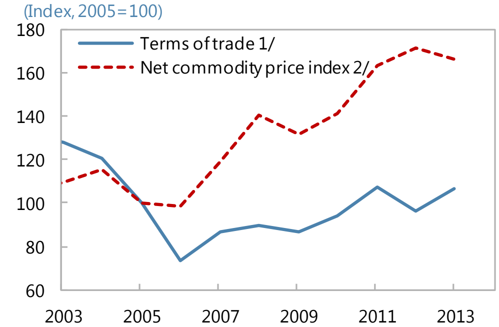
informal market exchange rate of the peso and private sector estimates of Argentine CPI inflation, instead of official data. The guaraní's appreciation has occurred against a backdrop of generally favorable terms of trade developments, especially from commodity prices, strong productivity and output growth, and improved macroeconomic fundamentals. More than three-quarters of the cumulative change are accounted for by nominal appreciation, despite significant reserve accumulation over the same period. Over the course of 2014, the REER rose by almost 12 percent, reflecting the relative strength of the guaraní vis-à-vis other Latin American currencies, even as the bilateral guaraní-U.S. dollar exchange rate remained basically unchanged on balance.

Paraguay: Real Effective Exchange Rate, 2003–14
(Index, 2005=100)



Sources: IMF databases; and IMF staff estimates.
1/ Uses informal ('blue') market exchange rate for the peso and private sector estimates of Argentine CPI inflation.

Terms of Trade and Net Commodity Price Index, 2003–13
(Index, 2005=100)



Source: Central Bank of Paraguay.
1/ Refers to registered exports and imports only.
2/ Computed using net exports of each commodity as weights. See IMF Working Paper 2014/154.

4. Despite the strong appreciation over the past decade, there are no obvious signs of competitiveness problems.

- **Model-based estimates** paint a mixed picture of exchange rate valuation. The EBA-lite model points to significant *undervaluation* of the guaraní, as Paraguay's estimated 2014 current account balance (0.1 percent of GDP) was significantly stronger than the estimated norm (-4.4 percent of GDP). However, the empirical fit of the EBA-lite specification is poor for the time series under consideration, and only a small fraction of the estimated gap can be attributed to policies. The CGER-like methodologies for assessing the current account, in turn, suggest that the guaraní is in line with fundamentals. Lastly, the equilibrium real exchange rate approach yields a finding of substantial *overvaluation*, essentially reflecting the strong run-up in the REER over the past decade. Thus, the model results generate a

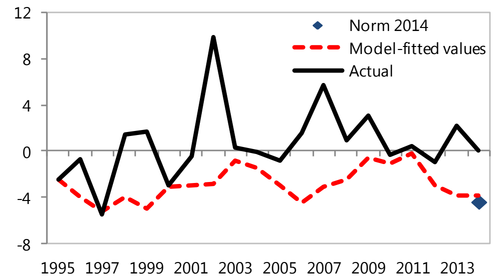
Paraguay: Exchange Rate Assessment, Model Results

	Current account norm 2/	Current account balance 2/	Gap 2/	REER 3/
EBA-lite methodology 1/	-4.4	0.1	4.4	-14.8
	Current account balance 2/			
	Norm	Underlying		REER 3/
CGER-like methodologies 4/				
Macroeconomic balance	-3.6	-1.2		-2.7
External sustainability	-2.4	-1.2		-2.5
Equilibrium Real Exchange Rate 5/				33.8

1/ Assessment based on estimated outcomes for 2014.
2/ Percent of GDP.
3/ Positive number indicates overvaluation.
4/ Estimated REER gap includes adjustment for multilateral consistency.
5/ Based on REER as of November 2014.

relatively wide range of diagnoses, though the most extreme findings cancel each other out and relate to models suffering from poor empirical fit (EBA-lite) or implausibility in light of basic economic data (the ERER finding of persistent overvaluation is hard to square with the fact that the current account has been balanced or in surplus essentially over the whole recent period, while reserves have grown markedly). On balance, and putting somewhat greater weight on the remaining two methodolgies, it is hard to reject the hypothesis of no significant exchange rate misalignment in either direction.

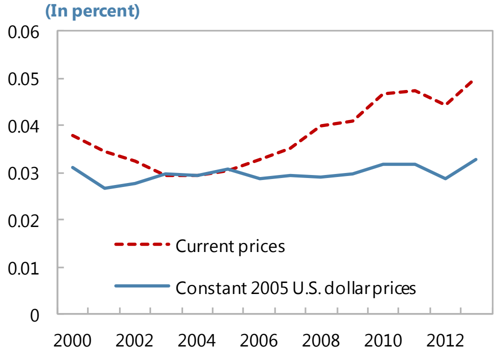
External Current Account Balance: EBA-Lite Results, 1995-2014



Source: IMF staff calculations

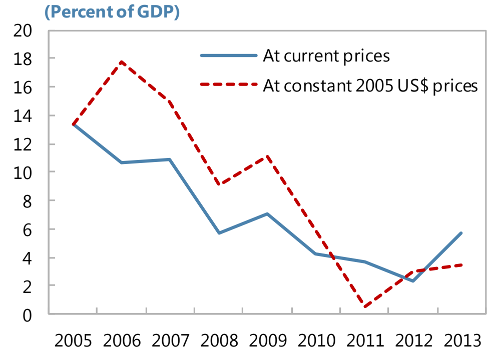
- **World market share**. Paraguay's share of global exports has risen over the past decade, from about 0.03 percent to 0.05 percent. This marked upward trend has been driven by favorable price dynamics, as Paraguay's agricultural commodity exports saw a significant

Paraguay's Share of World Exports, 2000–13
(In percent)



Sources: IMF, World Economic Outlook; and IMF staff calculations.

Trade Balance, 2005–13 1/
(Percent of GDP)



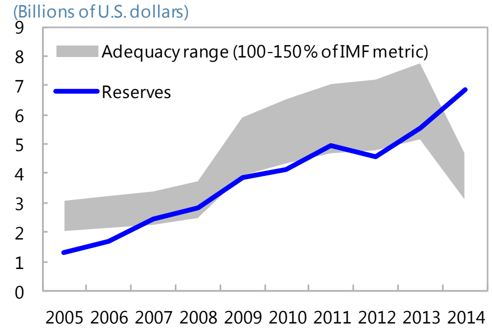
Sources: IMF, World Economic Outlook; and IMF staff calculations.
1/ Uses actual price indices for registered trade; imputes prices of unregistered trade using registered import prices.

cumulative rise in prices over the period. Still, Paraguay has maintained and slightly increased its share of global export markets even at constant 2005 U.S. dollar prices. A closer analysis of the trade balance confirms that the 2013 trade surplus would not be much smaller if registered exports and imports were valued at constant 2005 U.S. dollar prices, as the effect of lower average export prices would be offset by the lower cost of imports.

- **Other indicators of competitiveness** also suggest that Paraguay's four main export sectors (hydroelectric power, soy, cereals, and beef) have remained competitive. While the country's weak infrastructure complicates the transport of exported goods, efficient, large-scale production has allowed Paraguay to become the fourth-largest exporter of soy and six-largest exporter of beef in the world. Meanwhile, domestic and foreign investment in these sectors has promoted a progressive industrialization that allows Paraguay to reap a higher value-added from some of its export commodities. Even beyond its traditional economic base, Paraguay has recently seen a successful development of the *maquila* industry, which processes manufactured goods for exports mostly to Brazil. The *maquila* sector benefits from cost, tax, and regulatory advantages vis-à-vis Paraguay's large neighbor and is growing at high double-digit rates. Under staff's baseline projections, which include tight government control over the wage bill (in line with the FRL) and improvements in infrastructure and the business environment, competitiveness is likely to remain robust. That said, some business areas, notably the trading and re-export sectors, have recently been affected by weak demand and depreciating local currencies in Brazil and Argentina.

- **Intervention behavior**. Paraguay's central bank, as the agent for the government, receives a steady inflow of dollar proceeds from the royalties paid by the binational power companies. The BCP maintains a program of dollar sale auctions to offset the resulting accumulation of reserves. In addition to this program, the BCP has continued to engage in occasional discretionary intervention, typically with additional dollar sales on days when the domestic currency trades on a particularly weak note. Even so, the guaraní has fluctuated significantly (13 percent peak-to-trough) over the past year, consistent with the authorities' commitment to a flexible exchange rate. International reserves are high and, following the recent reclassification of the exchange rate regime as "floating", somewhat exceed the standard adequacy metric. Reserves do not appear excessive, however, in relation to Paraguay's high economic openness, at six months of imports, especially when considering the significant volatility of the country's export industries and their exposure to disease, weather, and price shocks. Another important rationale for holding sizeable international reserves is the dollarization of the domestic financial system—around half of loans and deposits are denominated in U.S. dollar—which calls for high precautionary balances to reduce the risk of a destabilizing run on the banking system's foreign-currency debt. As of end-November, international reserves covered about 130 percent of banks' foreign-currency deposits, and banks FX reserve requirements accounted for one-sixth of the BCP's total FX reserves.

International Reserves vs. Adequacy Range
(Billions of U.S. dollars)



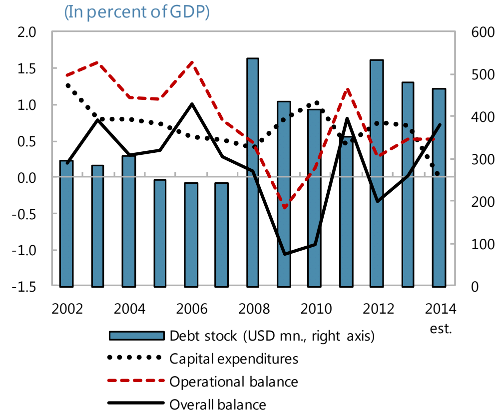
Sources: IMF staff estimates and calculations.
Note: Lower adequacy range for 2014 reflects reclassification of Paraguay's exchange rate regime to "floating".

5. Taking all these considerations into account, there is no compelling evidence to suggest that the guaraní is either over- or undervalued. Although a moderate deviation in either direction cannot be ruled out, staff's best judgment is that the exchange rate is broadly in line with fundamentals at present.

Annex III. Challenges in the State-Owned Enterprise (SOE) Sector[1]

Paraguay's SOE sector includes 9 entities performing a wide range of activities, from public utilities to transport infrastructure (airport, ports, and railroad) and commercial activities, including fuel import and distribution, telecommunications, and the production of alcoholic beverages and cement.[2]

Operations of State-Owned Enterprises
(In percent of GDP)



Sources: Paraguayan authorities and staff estimates.

Many SOEs are facing financial sustainability problems, linked with underinvestment and operational inefficiencies. The sector has posted a modest operational surplus in recent years. However, in most companies investment has been very low, in some cases to the point of eroding the physical capital base. The sector's financial problems have several causes:

1. Government-controlled prices. One example is ANDE, whose electricity tariffs have remained unchanged for the past 11 years. Similarly, the price of water and sanitation services is below regional averages and has not been adjusted for several years. The state-owned oil company Petropar has also suffered losses due to implicit subsidies for domestic users of diesel and producers of biofuel.

2. Weak payment collection. For instance, some 8 percent of electricity consumption represents illegal connections to the grid. Other ANDE customers have accumulated unpaid bills—this includes the central government, which owed some US$100 million at end-2014.

3. Operational inefficiencies. One quarter of electricity is lost during transmission and distribution. The water and sanitation network requires recurrent high-cost repair work as a result of poor maintenance. Overstaffing, poor management practices, and corruption heighten the financial burden in many companies. The operational underperformance of SOEs is clearly apparent in sectors open to private competition, such as cement and telecommunications.

4. Transfer of SOE cash flow to the central government. Mandated contributions to the budget have reduced the availability of funds for the companies' reinvestment needs.

The authorities plan to restore financial sustainability in the sector, while expanding the quality and quantity of services. Their strategy includes specific efficiency and financial objectives for each company; the settlement of state debt by way of a payment program; and restrictions on expanding employment. The government has also been tightening controls on the use of transferred resources for investment. Investment plans in the sector are ambitious, especially in the public utilities. However, the government has pledged to avoid privatization.

[1] Prepared by Alejandro Guerson.

[2] Two of these entities, i.e., Capasa (alcohol) and Fepasa (railroad), are excluded from the consolidated public sector.

Annex IV. Public Debt Sustainability Analysis[1]

Table A. Paraguay: Public Sector DSA - Baseline Scenario

(in percent of GDP unless otherwise indicated)

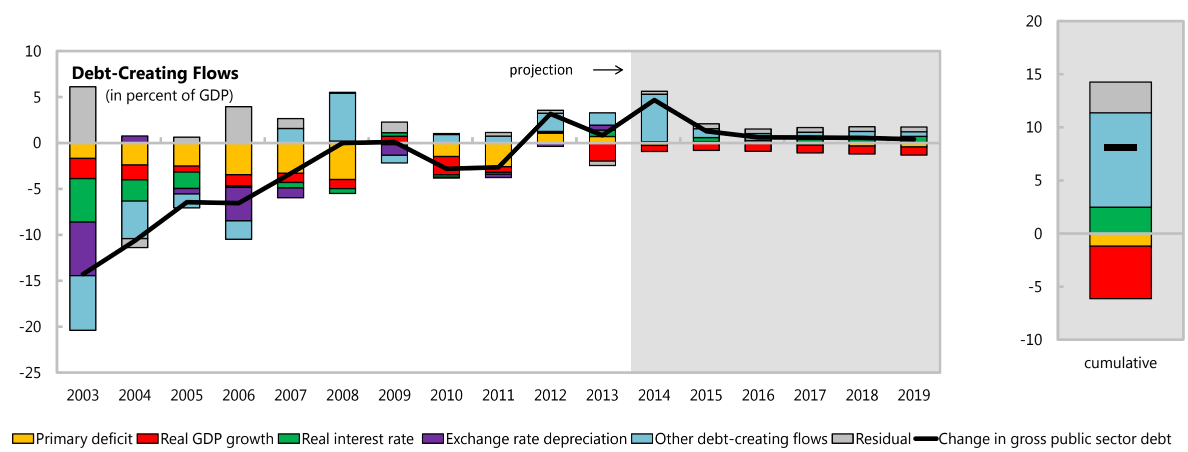
Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2003-2011	2012	2013	2014	2015	2016	2017	2018	2019
Nominal gross public debt	23.5	16.0	16.8	21.5	22.7	23.4	23.9	24.5	24.9
Public gross financing needs	0.7	2.9	2.3	1.6	2.2	2.0	1.8	1.7	2.4
Real GDP growth (in percent)	4.5	-1.2	14.2	4.3	4.0	4.0	4.0	4.0	4.0
Inflation (GDP deflator, in percent)	7.9	4.7	0.4	4.3	2.9	4.1	4.0	3.9	3.9
Nominal GDP growth (in percent)	12.8	3.4	14.7	8.8	7.1	8.2	8.2	8.1	8.0
Effective interest rate (in percent) [2/]	5.0	4.9	5.5	5.3	5.2	5.5	6.0	6.5	7.2

As of January 26, 2015		
Sovereign Spreads		
EMBIG (bp)		305
5Y CDS (bp)		...
Ratings	Foreign	Local
Moody's	Ba2	Ba2
S&Ps	BB	BB
Fitch	BB-	BB-

Contribution to Changes in Public Debt

	Actual			Projections							
	2003-2011	2012	2013	2014	2015	2016	2017	2018	2019	cumulative	debt-stabilizing primary balance [8/]
Change in gross public sector debt	-5.2	3.2	0.8	4.7	1.3	0.6	0.6	0.6	0.4	8.1	
Identified debt-creating flows	-6.6	2.8	1.3	4.4	0.7	0.1	0.1	0.0	-0.1	5.2	
Primary deficit	-2.4	1.1	0.7	-0.3	0.1	-0.1	-0.2	-0.3	-0.4	-1.2	-0.2
Primary (noninterest) revenue and grants	20.5	23.6	22.1	23.7	24.3	24.5	24.6	24.5	24.5	146.2	
Primary (noninterest) expenditure	18.1	24.7	22.8	23.5	24.5	24.4	24.3	24.2	24.1	145.0	
Automatic debt dynamics [3/]	-3.5	-0.2	-0.7	-0.5	-0.4	-0.6	-0.5	-0.3	-0.2	-2.5	
Interest rate/growth differential [4/]	-2.2	0.2	-1.3	-0.5	-0.4	-0.6	-0.5	-0.3	-0.2	-2.5	
Of which: real interest rate	-1.1	0.0	0.7	0.1	0.4	0.3	0.4	0.5	0.7	2.5	
Of which: real GDP growth	-1.1	0.2	-2.0	-0.7	-0.8	-0.8	-0.9	-0.9	-0.9	-4.9	
Exchange rate depreciation [5/]	-1.3	-0.4	0.5	...	...	...	...	...	...	...	
Other identified debt-creating flows	-0.7	2.0	1.3	5.2	1.0	0.7	0.8	0.7	0.5	8.9	
NFPS asset accumulation [6/]	-0.7	2.0	1.3	5.2	1.0	0.7	0.8	0.7	0.5	8.9	
Residual [7/]	1.4	0.3	-0.5	0.3	0.5	0.5	0.5	0.5	0.5	2.9	



Source: Fund staff estimates and projections.

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

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

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

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

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

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

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

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

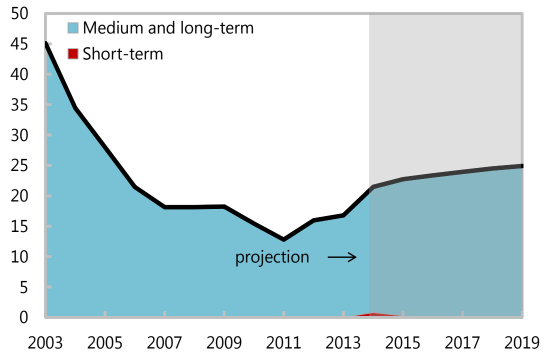
[1] Prepared by Alejandro Guerson and Xin Xu.

Table B. Paraguay: Public DSA - Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

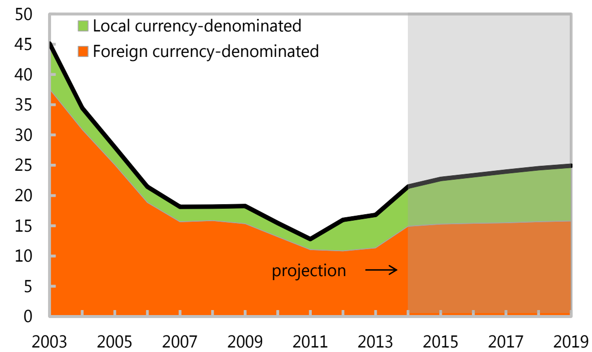
By Maturity

(in percent of GDP)



By Currency

(in percent of GDP)

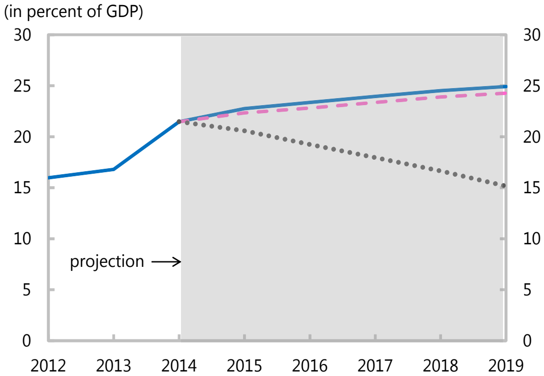


Alternative Scenarios

Baseline   Historical   Constant Primary Balance

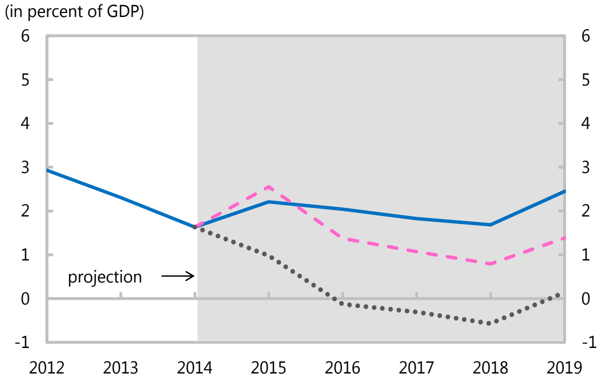
Gross Nominal Public Debt

(in percent of GDP)



Public Gross Financing Needs

(in percent of GDP)



Underlying Assumptions

(in percent)

Baseline Scenario	2014	2015	2016	2017	2018	2019
Real GDP growth	4.3	4.0	4.0	4.0	4.0	4.0
Inflation	4.3	2.9	4.1	4.0	3.9	3.9
Primary Balance	0.3	-0.1	0.1	0.2	0.3	0.4
Effective interest rate	5.3	5.2	5.5	6.0	6.5	7.2
Constant Primary Balance Scenario						
Real GDP growth	4.3	4.0	4.0	4.0	4.0	4.0
Inflation	4.3	2.9	4.1	4.0	3.9	3.9
Primary Balance	0.3	0.3	0.3	0.3	0.3	0.3
Effective interest rate	5.3	5.2	5.7	6.0	6.2	6.5

Historical Scenario	2014	2015	2016	2017	2018	2019
Real GDP growth	4.3	4.9	4.9	4.9	4.9	4.9
Inflation	4.3	2.9	4.1	4.0	3.9	3.9
Primary Balance	0.3	1.8	1.8	1.8	1.8	1.8
Effective interest rate	5.3	5.2	5.4	5.4	5.5	5.5

Source: Fund staff estimates and projections.

Annex V. External Debt Sustainability Analysis[1]

Table 1. Paraguay: External Debt Sustainability Framework, 2009-2019
(In percent of GDP, unless otherwise indicated)

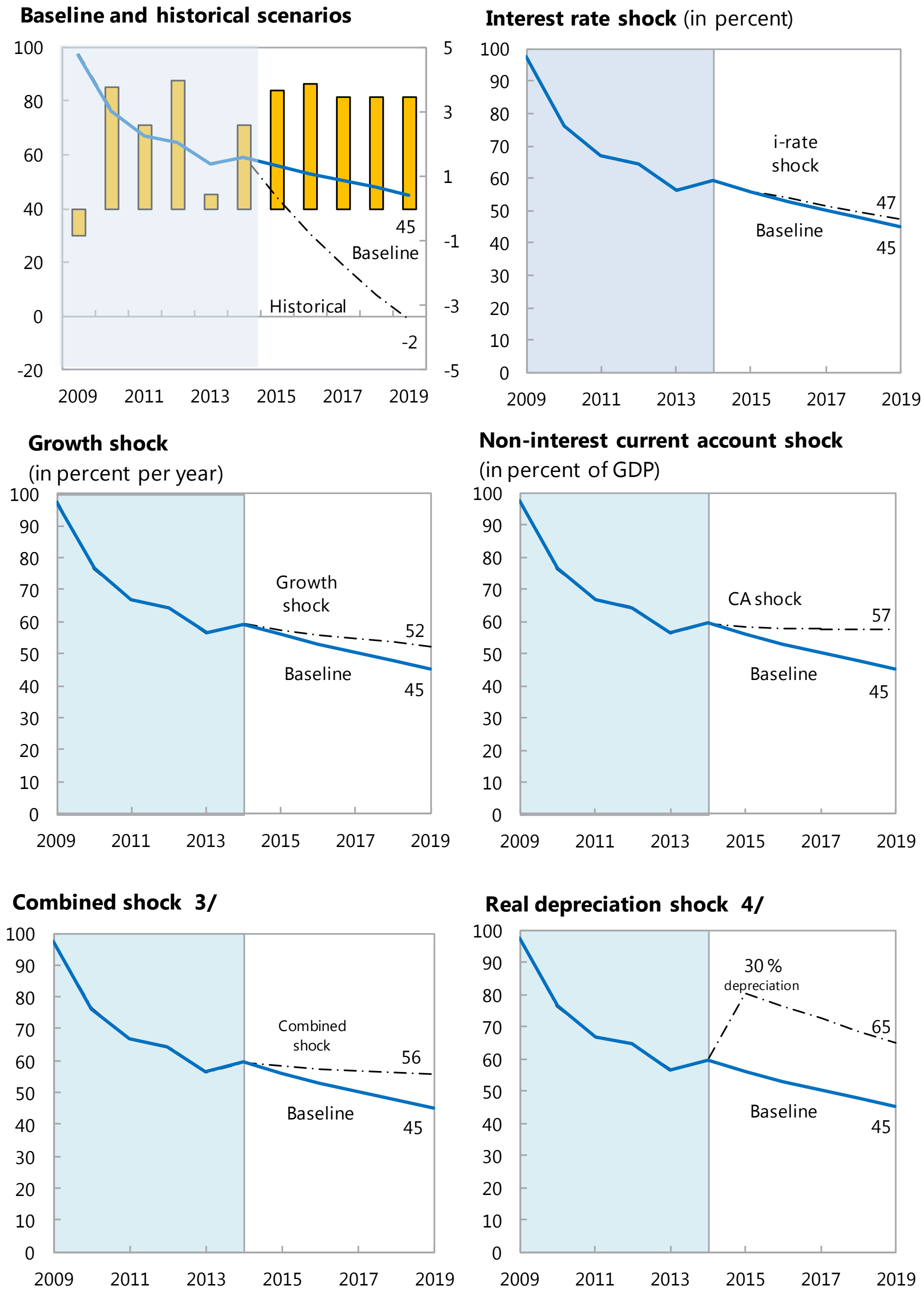
	Actual							Projections					
	2009	2010	2011	2012	2013			2014	2015	2016	2017	2018	2019
Baseline: External debt	97.4	76.4	66.8	64.4	56.4			**59.3**	**55.8**	**53.0**	**50.3**	**47.7**	**45.0**
Change in external debt	10.6	-21.0	-9.6	-2.4	-8.0			2.9	-3.5	-2.8	-2.7	-2.6	-2.7
Identified external debt-creating flows (4+8+9)	11.5	-23.1	-10.0	-4.3	-10.5			-3.0	-1.7	-1.4	-1.6	-1.6	-1.5
Current account deficit, excluding interest payments	-7.6	-3.1	-3.4	-1.6	-4.2			-2.0	-0.8	-0.7	-1.0	-1.2	-1.2
Deficit in balance of goods and services	-7.3	-3.9	-2.9	-1.6	-5.1			-2.7	-2.5	-2.2	-2.1	-2.0	-2.1
Exports	52.3	53.8	57.2	49.7	51.0			47.3	45.0	45.2	45.4	45.7	46.1
Imports	45.0	50.0	54.3	48.1	45.9			44.6	42.5	43.0	43.3	43.7	44.0
Net non-debt creating capital inflows (negative)	0.5	-1.1	-0.8	-1.0	-0.6			-0.6	-0.6	-0.7	-0.8	-0.9	-0.9
Automatic debt dynamics 1/	18.5	-19.0	-5.9	-1.7	-5.7			-0.4	-0.3	0.0	0.3	0.5	0.6
Contribution from nominal interest rate	4.5	3.4	2.9	2.5	2.0			1.9	2.1	2.1	2.3	2.4	2.4
Contribution from real GDP growth	4.0	-9.8	-2.9	0.8	-8.1			-2.3	-2.3	-2.1	-2.0	-1.9	-1.8
Contribution from price and exchange rate changes 2/	10.0	-12.5	-5.8	-5.0	0.3			...	...	...	...	...	...
Residual, incl. change in gross foreign assets (2-3) 3/	-0.8	2.2	0.5	1.9	2.6			5.9	-1.8	-1.5	-1.1	-1.0	-1.2
External debt-to-exports ratio (in percent)	186.2	141.9	116.8	129.5	110.7			125.5	124.0	117.2	110.7	104.3	97.8
Gross external financing need (in billions of US dollars) 4/	-0.1	0.8	0.6	1.0	0.1			0.8	1.1	1.2	1.2	1.2	1.3
in percent of GDP	-0.9	3.8	2.6	4.0	0.4			2.6	3.7	3.8	3.5	3.5	3.4
Scenario with key variables at their historical averages 5/								**59.3**	**43.7**	**30.3**	**18.6**	**8.0**	**-1.6**
Key Macroeconomic Assumptions Underlying Baseline						10-Year Historical Average	10-Year Standard Deviation						
Real GDP growth (in percent)	-4.0	13.1	4.3	-1.2	14.2	4.9	5.6	4.3	4.0	4.0	4.0	4.0	4.0
GDP deflator in US dollars (change in percent)	-10.3	14.7	8.2	8.2	-0.5	10.9	10.9	0.3	-0.2	0.5	0.5	0.4	0.4
Nominal external interest rate (in percent)	4.5	4.5	4.3	4.1	3.5	5.4	1.7	3.6	3.6	4.0	4.5	5.0	5.3
Growth of exports (US dollar terms, in percent)	-18.1	33.6	20.0	-7.1	16.4	15.9	16.2	-2.9	-1.1	4.8	5.0	5.2	5.1
Growth of imports (US dollar terms, in percent)	-22.7	44.2	22.7	-5.3	8.4	19.1	20.8	1.6	-1.0	5.7	5.3	5.4	5.0
Current account balance, excluding interest payments	7.6	3.1	3.4	1.6	4.2	7.7	4.9	2.0	0.8	0.7	1.0	1.2	1.2
Net non-debt creating capital inflows	-0.5	1.1	0.8	1.0	0.6	0.6	0.6	0.6	0.6	0.7	0.8	0.9	0.9

1/ Derived as [r - g - r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.
2/ The contribution from price and exchange rate changes is defined as [-r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock. r increases with an appreciating domestic currency (e > 0) and rising inflation (based on GDP deflator).
3/ For projection, line includes the impact of price and exchange rate changes.
4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period. Interest payments exclude binational companies.
5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.
6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

[1] Prepared by Camila Perez and Mauricio Vargas.

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

(External debt in percent of GDP)



Sources: International Monetary Fund, country desk data and staff estimates.

1/ Shaded areas represent actual or estimated data through 2014. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.

2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.

3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.

4/ One-time real depreciation of 30 percent occurs in 2015.

INTERNATIONAL MONETARY FUND

PARAGUAY

STAFF REPORT FOR THE 2014 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

January 28, 2015

Prepared By | The Western Hemisphere Department (In consultation with other departments)

CONTENTS

FUND RELATIONS

(As of December 31, 2014)

Article VIII

Membership Status: Joined: December 28, 1945

General Resources Account:	**SDR Million**	**% Quota**
Quota	99.90	100.00
Fund holdings of currency	78.43	78.51
Reserve Tranche Position	21.48	21.50

SDR Department:	**SDR Million**	**% Allocation**
Net cumulative allocation	95.19	100.00
Holdings	110.67	116.25

Outstanding Purchases and Loans: None

Latest Financial Arrangements:

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

Projected Payments to Fund[1/]
(SDR Million; based on existing use of resources and present holdings of SDRs):

	Forthcoming			
	2015	2016	2017	2018
Principal				
Charges/Interest	0.00	0.00	0.00	0.00
Total	0.00	0.00	0.00	0.00

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

Exchange Arrangement: The currency of Paraguay is the Paraguayan guaraní. The exchange arrangement of the guaraní is floating, and the exchange rate is determined by supply and demand. The objective of the Central Bank of Paraguay (BCP) under Article 3 of Organic Law No. 489/95 is to preserve and safeguard the stability of the currency and promote the efficiency and stability of the financial system. Article 50 establishes that foreign currency trading by the BCP aims to smooth seasonal fluctuations in supply and demand and offset erratic capital flows and speculative movements that could disrupt the market or the exchange rate. Article 47 establishes that the exchange rate is determined by market forces. The BCP publishes information on its foreign exchange interventions on its website. The BCP intervenes occasionally in the market to smooth the effects of undue fluctuation. The BCP, as the government's financial agent, receives U.S. dollars from the government flowing from the royalties and compensation paid by the binational hydroelectric entities and exchanges them for guaranís at the request of the government for the purpose of public expenditures. The BCP implemented, effective July 1, 2013, a program of preannounced sales of the U.S. dollars it purchases from the government. The new program is more transparent, better communicated, and more consistent with an inflation-targeting regime. This program indicates in advance the nature, frequency, and size of the BCP's foreign exchange transactions to avoid influencing market expectations of the exchange rate. Accordingly, the de facto exchange rate arrangement was reclassified to floating from other managed arrangement, effective July 1, 2013. Paraguay has accepted the obligations of Article VIII, Sections 2(a), 3, and 4 of the Fund's Articles of Agreement. Its exchange system is free of restrictions on the making of payments and transfers for current international transactions.

Article IV Consultation: The Executive Board concluded the 2013 Article IV consultation in February 2014.

Technical Assistance 2010–14:

DPT	Purpose	Date of Delivery
FAD	Debt Management	February 2010
MCM	First Issuance Sovereign Bond	March 2010
STA	Monetary and Financial Statistics	April 2010
MCM	Banking Supervision	April 2010
STA	National Accounts	August 2010
MCM and WB	FSAP/FSSA	November 2010
FAD	Tax and Customs Administration	December 2010
FAD	Public-Private Partnerships	February 2011
STA	National Accounts Statistics	March–April 2011
FAD	Medium-Term Macro-Fiscal Framework and Public Investment Management	March–April 2011
MCM	Monetary Policy, Central Bank Operations, and Accounting	April 2011
FAD	Public Transport Subsidies	June-July 2011
MCM	Financial Soundness Indicators and Financial Oversight	November 2011
FAD	Improve Fiscal Projections and Financial Planning	December 2011
FAD	Modernization of the Customs Administration	December 2011
FAD	Debt and Cash Management	March 2012
FAD	Tax Policy	March 2012
MCM	Monetary Policy, Central Bank Operations, and Accounting	April 2012
FAD	Tax and Custom Administration	December 2012
FAD	Debt and Public Investment Management	May 2013

MCM/LEG	Launch of the AML/CFT	June 2013
MCM	Inflation Targeting and Central Bank Operations	August 2013
FAD	Revenue Administration	September 2013
FAD	Tax Administration	December 2013
STA	ROSC	February 2014
FAD	Tax and Customs Administration	Apr, May, Jul, Sep
MCM	Bank Supervision and Regulation	July 2014
MCM	Monetary and FX Policy	July 2014
LEG	Anti Money Laundering Activities	May, Jun, Sep 2014
FAD	Public Financial Management	July 2014
STA	Producer Price Index Statistics	August 2014
STA	Balance of Payments and IIP Statistics	September 2014
MCM	Central Bank Monetary and Foreign Exchange Operations	October 2014
MCM	Insurance Supervision	December 2014

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

Resident Representative: Mr. Alejandro Santos has been the regional resident representative since December 2014. He is based in Lima, Peru.

RELATIONS WITH THE WORLD BANK UNDER JMAP

Meeting of teams. The IMF and World Bank Paraguay teams met in November 2014 to exchange views on economic developments in Paraguay, and discuss ongoing work and work plans for the year ahead. The IMF mission also met with the World Bank's representative in Asuncion. This section summarizes key themes of the discussions.

The Board of the World Bank discussed the new Country Partnership Strategy (CPS) for Paraguay in December 2014. The CPS covers Fiscal Years 2015–18, is closely aligned with the authorities' first National Development Plan (NDP, 2014–30) and aims to contribute to the NDP's overall poverty and equity targets. To this end, the CPS specifies three results areas: (i) strengthening resilience to risks and volatility; (ii) boosting pro-poor delivery of public goods and services; and (iii) fostering market integration. The overall World Bank Group financial support is expected to be in the range of US$900 million to US$1,100 million during the CPS period.

The overriding challenge for Paraguay is to address long-standing structural weaknesses while consolidating sound macroeconomic fundamentals. Paraguay enjoyed strong growth over the period 2003–13 and achieved significant progress in poverty reduction. Nonetheless, income per capita continues to lag well behind regional peers, reflecting persistent developmental obstacles, including limited public sector capacity, poor service delivery, and deep-rooted governance problems. The challenge ahead is to overcome these obstacles and advance the structural transformation of Paraguay's economy, without jeopardizing the sound macroeconomic position attained over the past decade. In this context, it will also be important to improve the economy's resilience to risks in order to preserve and build on the gains in poverty reduction and shared prosperity of the last few years.

In this context, the following reform areas have been identified as critical:

- *Fiscal framework*. The FRL provides a suitable anchor for fiscal sustainability. Improvements in the budget process are critical to underpin the new fiscal framework provided by the FRL. Potential fiscal risks, including from the public pension fund system and from private sector participation in infrastructure investment, need to be addressed proactively.

- *Tax policy and revenue administration*. Continued improvement in tax enforcement is necessary to increase low revenues while enhancing the progressivity of the tax system. This includes further improving tax and customs administration, reducing exemptions, and exploring the possibility of raising the tax contribution of the primary sector.

- *Public services*. Improvements in public infrastructure (including transport, electricity, and water and sanitation) are crucial to support economic development and improve livelihoods. Boosting the pro-poor delivery of public goods and services, including in education and health, will contribute to poverty reduction and shared prosperity. Advances in these areas will need to be underpinned by improved government efficiency.

- *Financial system.* The proposed reform of the banking and central bank laws is needed to provide a robust legal basis for risk-based regulation and supervision. There is also a need to significantly strengthen the prudential oversight of the cooperative sector and, on that basis, establish a safety net for the sector.

The division of labor between the teams would be along the following lines:

- *Tax policy and revenue administration.* The Fund will continue providing technical assistance (TA) to support the authorities' efforts to improve the tax system and increase revenue collection. The Bank will continue to provide TA to support the authorities' efforts to strengthen the tax administration (core business areas including the legal function) by modernizing the tax administration and increasing its effectiveness. In addition, the Bank will continue to analyze the distributional impacts of fiscal policies to support the authorities' efforts to improve the progressivity of the tax and transfer system.

- *Financial system.* The Fund will continue to provide TA on the implementation of risk-based bank supervision and stands ready to support the authorities' efforts to develop further their stress-testing toolkit.

- *Money laundering.* The Fund will continue to provide TA on the calibration of a risk assessment tool for banks and other financial institutions to prevent money laundering and terrorism financing (ML/TF).

- *Medium-term debt management*. The Bank, with the Fund's support, will continue providing technical assistance to develop a medium-term debt strategy so as to reduce domestic debt servicing costs and promote the development of a domestic government debt market.

- *State-owned enterprises.* The Bank will continue providing TA to support the government's efforts to improve corporate governance, eliminate payment arrears, and strengthen technical oversight of SOEs.

- *Poverty*. The Bank will provide TA on improving the measurement of poverty and income inequality, with emphasis on understanding why Paraguay's inequality is so high. Gender issues will also be considered. It will also provide TA on improving the monitoring and evaluation system of the National Development Plan and on the targeting of social programs, as well as study the impacts of food price fluctuations on poverty and potential policies to manage negative effects.

- *Education and social programs.* The Bank will provide technical assistance on education programs, social assistance, and rural and agricultural development.

- *Pensions.* The Bank will continue providing advisory services to improve the pension system, including with best practices.

- *Public expenditure and revenues.* The Bank will continue to provide TA on public expenditure and budget processes, including fiscal rules, fiscal policy in volatile environments, efficiency of public expenditure, tax revenues, fiscal policy and equity, and commodity prices and fiscal policy.

- The Bank and IFC will also jointly provide advice to the government on two potential areas for PPPs.

- *Mitigation of agricultural volatility.* The Bank will provide advisory services to manage risks stemming from volatility at the macroeconomic, sector, and microeconomic levels.

- *Paraguay Job Diagnostic:* The Bank will undertake a comprehensive multi-sector job diagnostic analysis to identify challenges for expanding job opportunities in Paraguay.

Work programs. The table below lists the teams' work programs for the year ahead.

Work Programs of the World Bank and IMF Teams

Title	Products	Provisional Timing of Missions	Expected Delivery Date
Bank Work Program			
	TA on strengthening tax administration and SOE corporate governance	December 2014	June 2015
	TA on PPPs	February 2015	April 2015
	TA on agriculture risk management	Spring 2015	Fall 2015
	TA on extractives	December 2014	June 2015
	Programmatic TA on equity and poverty/gender	March 2015	June 2016
	TA on financial sector stability	January 2015	June 2016
	TA on social protection	March 2015	June 2016
	TA on education	March 2015	June 2016
	TA on implementation of the National Strategy for Financial Inclusion and the Consumer Protection and Financial Literacy Diagnostic	March 2015	December 2015
	Paraguay Job Diagnostic	February 2015	June 2015

Fund Work Program			
	Article IV Consultation	December 2014	February 2015
	TA to calibrate a risk assessment tool for AML/CFT supervision	February 2015	June 2015
	TA on implementing risk-based bank supervision	Spring 2015	June 2015
	TA on implementing insurance market supervision	February 2015	June 2015
	TA on revenue administration	Spring 2015	June 2015

RELATIONS WITH THE INTER-AMERICAN DEVELOPMENT BANK

The IMF and IADB Paraguay teams met in November 2014 to exchange views on economic developments in Paraguay, and discuss ongoing work and work plans for the year ahead. The IMF mission also met with IADB staff based in Asuncion.

The IADB's Board of Executive Directors approved in 2014 the Country Strategy with Paraguay (2014–2018). Sovereign-guaranteed lending under the program is expected to reach approximately US$1 billion.

Under the Strategy, the national authorities and the Bank identified the following priority sectors in which the IDB Group would focus both its financial and non-financial products and services: (i) transportation and connectivity; (ii) water and sanitation; (iii) energy; (iv) productive development; (v) financial sector; and (vi) public management. Furthermore, the Bank will support the social sector through two channels: (i) with specific interventions in each of the priority sectors, in support of the objective of reducing extreme poverty; and (ii) through a crosscutting element in the form of interventions to support the investment of FONACIDE resources, primarily targeting education and health.

As of November 30, 2014, the Bank's portfolio in Paraguay included loans for the financing of 24 projects. The lending portfolio amounts to US$857 million, of which US$477 million are pending disbursement. Disbursements in 2014 are expected to total US$81 million. The current portfolio includes lending to support the Government in the following sectors: transportation (51 percent), energy (14 percent), social sector (11 percent), financial sector (7 percent), and agriculture (5 percent). The portfolio additionally includes 12 loans to the private sector for US$200million mostly in agriculture and the financial sector.

Financial Relations with the Inter-American Development Bank[1]

(In millions of U.S. dollars)

	Loan Transactions								
	2006	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**
Disbursement	67.2	67.8	85.6	91.3	240.3	91.4	102.8	142.4	81.4
Amortization	66.7	88.1	94.3	91.3	96.2	94.5	91	83.9	97.7
Net Loan Flows	**0.5**	**-20.3**	**-8.7**	**0**	**144.1**	**-3.1**	**11.8**	**58.5**	**-16.3**

Source: Inter-American Development Bank.

1/ Only loans with sovereign guarantee are considered.

STATISTICAL ISSUES

(As of December 2014)

Assessment of Data Adequacy for Surveillance

General: Data provision to the Fund has some shortcomings, but is broadly adequate for surveillance. Paraguay has made significant improvements in the compilation and dissemination of macroeconomic statistics, but some shortcomings persist. In February 2014, a Data ROSC mission conducted an assessment of data quality based on the new 2012 DQAF for six datasets (national accounts, CPI, PPI, GFS, monetary, and balance of payments and IIP statistics). The mission also assessed Paraguay's macroeconomic statistics against the GDDS and, at the request of the authorities, against the SDDS; the authorities' response to the report and the mission's recommendations were published on the Fund's website on August 18, 2014. The country is a GDDS participant.

National Accounts. National accounts estimates, broadly consistent with the guidelines of the 1993 SNA, were released in 2005. A program for changing the outdated base year (1994=100) and implementing relevant 2008 SNA recommendations is under development. The production boundary is broadly in line with the 1993 SNA and recently included the two binational hydroelectric enterprises following the 2008 SNA. Nonetheless, there are no independent estimates of the nonobserved economy after 1997, and mineral exploration and own-account production are mostly excluded. Source data for nonfinancial services, household consumption, and changes in inventories are insufficient. Currently, the major deviations from concepts and definitions established in the 1993 SNA involve: investment in in-house development of software; investment in mineral exploration; investment in military expenses in fixed assets; the estimation of output broken down by market, nonmarket, and own final use components; the inclusion of work-in-progress in forestry and livestock production; and the partial inclusion of the nonobserved economy in the national accounts. Annual GDP meets GDDS recommendations, and QNA meets DSSD timeliness requirements (90 days). Several STA missions on the compilation of quarterly national accounts (QNA) were fielded in August 2007, August 2008, November 2009, and March–April 2011. QNA series were published in December 2010. The STA mission of March–April 2011 assisted the authorities in outlining a work program for updating the national accounts' base year.

Labor market. Since the introduction of a regular household survey in 1998, the coverage and quality of employment and unemployment statistics have improved significantly. Since 2010, data are released on a quarterly basis, although the latter covers the Asuncion area only. The last available observation for the quarterly series is the third quarter of 2014, whereas the annual data for 2013 were released in June 2014.

Price statistics. Both the consumer (CPI) and producer price indices (PPI) are reported on a regular and timely basis. Since January 2008, the Central Bank of Paraguay (BCP) has been using a new CPI index based on the 2005–06 household budget survey. The geographic coverage of the CPI is limited to Greater Asunción (the capital and metropolitan area), and expenditure weights are representative of the consumption patterns of urban households. The PPI has a base weight period of June 2010 and its basket (185 items) is representative of current national output; electricity, water, and gas are not covered.

The data ROSC mission found that the resources are insufficient for real sector statistics and constrain further development, particularly the full adoption of the 1993 SNA. The authorities have been trying to address these resource shortcomings in the context of the recent compilation of a new CPI and the production of QNA series. A new ROSC mission took place in February 2014.

Government finance statistics. The Government finance statistics (GFS) used for internal purposes and for reporting to WHD is broadly consistent with the recommendations of the Manual on Government Finance Statistics 1986 (GFSM 1986). There was a GFS TA mission to the country in July 2014 that assisted the authorities in the process of adopting the GFSM 2014 methodology. Monthly data are available for the central administration (budgetary central government). The asset position of the social security system is available on a daily basis. Statistics on the central administration include data of the Postal Service Directorate (a nonfinancial public corporation) and the statistics of the nonfinancial public sector include data of financial public corporations—four employer social insurance schemes. These social insurance schemes are treated as financial corporations in the monetary and financial accounts. Data on medium- and long-term external debt are reliable and available on a monthly basis. Domestic debt data are available on request, but need to be fully integrated with the external debt database. Deficiencies remain in recording short-term supplier and commercial credit of the public sector. Moreover, there is a discrepancy in the fiscal data reported by the monetary and fiscal authorities. Measures are being taken to make reporting more transparent

The latest available data for general government and its subsectors in the 2013 GFS Yearbook are for 2012. However, since 1994 no outstanding debt data and no breakdowns for expenditure by function have been provided for publication in the GFS Yearbook. Monthly and quarterly data are not reported for publication in IFS.

Balance of payments. The classification of the balance of payments and the international investment position (IIP) follows the recommendations of the fifth edition of the Balance of Payments Manual (BPM5). Quarterly data on balance of payments and the IIP are available from 2001 onwards, and are reported only once a year to STA for publication in the IFS. Improvements have been made in the quality of the external sector statistics, especially in the coverage of foreign direct investment and in the recording of external debt transactions but some deficiencies remain.

An STA mission on External Sector Statistics assisted the BCP in September 2014 in implementing recommendations of the ROSC mission. In particular, the mission focused on: (1) assisting the Central Bank of Paraguay in the migration to the methodology of the sixth edition of the Balance of Payments and International Investment Position Manual (BPM6); (2) reviewing and updating the adjustments in the estimation of data on foreign trade; (3) assisting in improving the coverage of direct investment data; and (4) reviewing and preparing a data template for reporting data on international reserves and foreign currency liquidity.

Monetary and financial statistics. Paraguay reports monetary data for the central bank and other depository corporations (ODCs) using the standardized report forms (SRFs). An integrated monetary database meeting the data needs of the BCP, STA, and WHD is in operation Coverage of the ODC survey is complete, including data on credit cooperatives, which account for around 20 percent of deposits and loans of the system. The Superintendence of Banks reports 11 of the 12 core and 7 of the 13 encouraged financial soundness indicators for deposit takers to STA on a monthly basis.

Press Release No. 15/63
FOR IMMEDIATE RELEASE
February 20, 2015

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2014 Article IV Consultation with Paraguay

On February 12, 2015, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Paraguay, and considered and endorsed the staff appraisal without a meeting.[2]

Economic activity in Paraguay has slowed from the record-high growth in 2013, but remains buoyant. Construction, manufacturing, and services led the expansion in 2014, whereas electricity production declined, and re-exports suffered from weak growth in Brazil. Full-year growth is estimated to have slightly exceeded 4 percent. Inflation spiked in early 2014 on account of higher food and regulated prices, but subsequently eased, ending the year at 4.2 percent, slightly below the authorities' midpoint target. Credit growth has moderated from earlier peak rates but still hovers around 20 percent, while banks continue to report strong capitalization and profitability.

Macroeconomic policies have been tightened somewhat since late 2013. Tax revenue grew at a brisk pace in 2014, linked to better enforcement and new taxes. Due to lower revenue from electricity royalties and faster execution of spending in the latter part of the year, the headline deficit increased slightly relative to 2013. Still, estimates point to a modest contractionary impulse. Monetary policy has been on hold since the central bank (BCP) raised the official policy rate by 125 basis points, to 6.75 percent, between December 2013 and February 2014.

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

[2] The Executive Board takes decisions under its lapse-of-time procedure when the Board agrees that a proposal can be considered without convening formal discussions.

Real GDP is projected to remain close to 4 percent in 2015. Weak trading partner growth and lower export prices cloud the outlook, and agricultural production is projected to rise only marginally above the high level of 2014. However, positive impulses should come from the projected rebound in electricity generation, the lower oil price, and the launch of new infrastructure projects. The external current account is projected to switch from a small surplus in 2014 to a moderate deficit in 2015, reflecting weaker terms of trade.

Risks around the outlook are broadly balanced. On the one hand, worsening terms of trade could affect domestic spending more than anticipated, while further ruble depreciation might hurt exports to Russia. On the other hand, looser-than-expected macroeconomic policies and efforts to exploit a recently discovered hydrocarbon resource could create upside surprises. Inflation is expected to hover around the 4.5 percent target in 2015, as recent guaraní depreciation and a small positive output gap offset the impact of lower commodity prices.

Executive Board Assessment

In concluding the 2014 Article IV consultation with Paraguay, Executive Directors endorsed the staff's appraisal as follows:

The government has started to tackle some of the long-standing structural weaknesses holding back development. Tax collection has improved significantly, creating space for higher public investment; preparations are underway to launch several large infrastructure projects; and the recently adopted "freedom-of-information" law will foster government transparency. These efforts are commendable, and should be extended to achieve lasting improvements in public services, institutional quality, and the rule of law. Such improvements, in turn, are critical to attract investment, boost productivity, and underpin medium-term growth and poverty reduction.

Paraguay's macroeconomic fundamentals remain sound, though the 2015 budget has dimmed hopes that the Fiscal Responsibility Law (FRL) would provide a firm institutional anchor for fiscal prudence. Paraguay boasts moderate public debt, low inflation, and strong external balances. To consolidate macroeconomic stability, the authorities have adopted new policy frameworks in recent years, notably an inflation targeting regime and the FRL. These frameworks provide appropriate anchors for policy. It is thus unfortunate that the approved 2015 budget envisages spending and a deficit above the mandated limits. With due restraint in the execution of the budget and continued efforts to improve tax enforcement, it remains possible to achieve the original FRL targets and thereby bolster the credibility of the fiscal rules. Over time, a stronger budget process will be essential to support fiscal discipline.

More broadly, it will be crucial to integrate the planned improvement of public services into a prudent fiscal plan for the medium term. The authorities' reform strategy holds great promise, but should not come at the expense of weakening Paraguay's solid macroeconomic position. This puts a premium on generating sufficient revenue to accommodate spending plans and preserve favorable debt dynamics. To ensure public support, it is important that additional revenue effectively translates into better public services. Civil service reform would assist this endeavor, by rationalizing public employment and raising efficiency. A prudent medium-term fiscal plan should also incorporate some buffer against adverse shocks, given the high volatility of Paraguay's economic environment.

In the same vein, it will be important to contain fiscal risks related to infrastructure projects, State Owned Entreprises (SOEs), and public pension funds. Private sector participation in infrastructure is welcome but must be managed carefully to contain risks to the public finances. Particular caution is warranted with respect to deferred financing schemes that could create government liabilities without the scrutiny of the regular budget process. Fiscal risks could also arise from the missing oversight of Paraguay's pension funds and their actuarial imbalances. It is encouraging that the authorities plan to address these risks proactively, starting with the planned creation of a regulator. Similar resolve is required to address the financial and operational challenges in the SOE sector.

Monetary policy is currently well calibrated, and efforts should focus on further enhancing the effectiveness of the inflation targeting regime. To strengthen the transmission of monetary policy, it will be instrumental to develop a more active money market and encourage gradual de-dollarization. Meanwhile, the central bank's plan to make its sales of government foreign-currency receipts more predictable will help to distinguish these transactions clearly from occasional discretionary intervention within the flexible exchange rate regime.

In light of continued strong credit growth, the authorities should closely monitor potential risks and consider targeted macroprudential tightening. Paraguay's banking system remains sound, but the long-running credit expansion calls for vigilance. To contain the risks from rising consumer indebtedness, lenders should be formally required to observe prudent limits on households' debt servicing capacity. Other areas for stepped-up oversight include foreign-currency lending; and the proper recognition of credit risk in renegotiated loans. In this context, the proposed revision of the central bank and banking laws is essential to put risk-based regulation and supervision on a robust legal basis. Another priority is to strengthen the governance, resources, and enforcement powers of Instituto Nacional de Cooperativismo (INCOOP).

Paraguay: Selected Economic and Social Indicators

I. Social and Demographic Indicators

Population 2013 (millions)	6.8	Gini index (2013)	48.0
Unemployment rate (2013)	5.0	Life expectancy at birth (2010)	72.3
Percentage of population below the poverty line (2013)	23.8	Adult illiteracy rate (2013)	5.3
Rank in UNDP development index (2013)	111 of 186	GDP per capita (US$, 2013)	4,193

II. Economic Indicators

	2009	2010	2011	2012	2013	Est. 2014	Proj. 2015
	(Annual percent change, unless otherwise indicated)						
Income and prices							
Real GDP	-4.0	13.1	4.3	-1.2	14.2	4.3	4.0
Nominal GDP	-2.0	20.0	10.8	3.4	14.7	8.8	7.1
Consumer prices (end of period)	1.9	7.2	4.9	4.0	3.7	4.2	4.5
Nominal exchange rate (Guarani per U.S. dollar, eop)	4,600	4,558	4,478	4,224	4,585	4,629	...
Monetary sector							
Currency issue	11.3	18.5	11.6	17.5	13.2	8.9	8.7
Bank credit to private sector	22.4	42.5	24.8	12.6	23.9	21.1	18.3
Liabilities to private sector	25.0	19.9	19.3	14.0	20.0	19.4	11.8
External sector							
Exports (fob, values)	-20.3	35.1	20.7	-7.8	16.8	-3.4	-1.4
Imports (cif, values)	-23.6	44.7	22.9	-6.0	7.8	1.1	-1.3
Terms of trade	-3.0	8.2	14.3	-10.2	11.4	9.8	-3.2
Real effective exchange rate 1/	-5.1	3.8	2.2	9.3	-3.0	11.6	...
	(In percent of GDP, unless otherwise indicated)						
Current account	**3.0**	**-0.3**	**0.5**	**-0.9**	**2.2**	**0.1**	**-1.2**
Trade balance	7.1	4.3	3.7	2.3	5.9	3.6	3.4
Exports	48.6	50.6	54.1	46.7	48.0	44.3	42.1
Electricity	11.9	9.5	9.7	9.2	8.1	7.4	7.6
Other registered	19.9	21.9	23.6	20.3	25.4	25.2	21.6
Unregistered	16.8	19.2	20.9	17.3	14.5	11.7	12.8
Imports	-41.6	-46.4	-50.5	-44.4	-42.1	-40.7	-38.7
Of which: Oil imports	-5.7	-5.2	-6.5	-6.6	-6.1	-5.7	-3.3
Capital account and financial account	**0.4**	**0.9**	**2.0**	**2.1**	**1.2**	**3.4**	**1.2**
General government	0.1	0.3	-0.3	-0.1	1.8	4.2	0.7
Private sector	0.2	0.6	2.3	2.2	-0.6	-0.8	0.6
Of which: Direct investment	0.6	1.0	2.4	1.9	1.3	1.2	1.3
Errors and omissions	2.3	0.9	0.9	-1.2	0.3	0.1	0.0
Gross international reserves (in millions of U.S. dollars)	**3,861**	**4,168**	**4,984**	**4,994**	**5,871**	**6,914**	**6,922**
In months of next-year imports of goods and services	4.5	3.9	5.0	4.6	5.3	6.3	6.0
Ratio to short-term external debt	2.0	2.3	2.7	2.8	3.2	3.7	3.7
Gross domestic investment	**13.8**	**16.2**	**17.1**	**15.1**	**15.4**	**15.3**	**16.1**
Gross national saving	**16.8**	**15.9**	**17.5**	**14.2**	**17.6**	**15.3**	**14.9**
External saving (+) or dissaving (-)	**3.0**	**-0.3**	**0.5**	**-0.9**	**2.2**	**0.1**	**-1.2**
Central government revenues 2/	**17.5**	**17.1**	**18.0**	**19.0**	**17.2**	**18.2**	**18.7**
Of which: Tax revenues	11.6	12.0	12.6	12.7	11.8	12.9	13.3
Central government expenditures 2/	**17.5**	**15.9**	**17.3**	**20.8**	**19.2**	**20.5**	**20.8**
Of which: Wages and salaries	7.7	7.3	7.6	9.6	9.4	9.1	9.3
Of which: Transfers	3.7	3.4	3.7	4.4	4.2	4.6	4.3
Of which: Capital expenditure	4.1	3.4	4.0	4.8	4.1	4.9	4.9
Central government primary balance 2/	**0.6**	**1.6**	**1.0**	**-1.6**	**-1.6**	**-1.9**	**-1.4**
Central government overall balance 2/	**0.1**	**1.2**	**0.7**	**-1.8**	**-2.0**	**-2.3**	**-2.1**
Public sector debt (excl. central bank bills)	**18.2**	**15.4**	**12.8**	**16.0**	**16.8**	**21.5**	**22.7**
Of which: Foreign currency	15.4	13.2	11.1	10.9	11.4	15.0	15.5
Of which: Domestic currency	2.9	2.2	1.7	5.1	5.4	6.4	7.2
Memorandum items:							
GDP (billions of Guaranies)	79,117	94,934	105,203	108,832	124,853	135,780	145,393
GDP (US$ billions)	15.9	20.7	23.3	24.9	28.3	29.6	...

Sources: Central Bank of Paraguay; Ministry of Finance; and IMF staff estimates and projections.
1/ Average annual change; a positive change indicates an appreciation.
2/ According to the GFSM 1986 presentation.