

## Paraguay

### 1. General trends

Following six years of positive growth, Paraguay's GDP fell by 3.8% in 2009, which was equivalent to a 5.5% drop in per capita GDP. Despite having implemented an expansionary fiscal policy to mitigate the negative effects of the international crisis, the government achieved a small public accounts surplus of about 0.1% of GDP. A fiscal stimulus of some 3.9% of GDP provided through public spending compensated in part for the downturn in private consumption. The intense drought that hit the country in 2009 caused a sharp 25% decline in the activity of the agricultural sector, which is the largest sector of the Paraguayan economy. Inflation came down from 7.5% in 2008 to 1.9% in 2009. A similar drop was seen in most of the region's countries and may be attributed to falling international commodity prices associated with the global economic slowdown. The nominal exchange rate against the dollar rose by 14.4% because of the dollar's appreciation and the slack performance of Paraguay's external sector. The current account deficit narrowed to US\$ 196 million (1.4% of GDP). In 2010, the economy is projected to expand on the back of higher external and domestic demand and a more buoyant agricultural sector. ECLAC forecasts GDP growth of around 7%.

### 2. Economic policy

#### (a) Fiscal policy

At the end of 2009 the fiscal accounts showed a small surplus of approximately 45 billion guaraníes, equivalent to 0.1% of GDP, with a primary surplus of 0.7% of GDP. Paraguay was thus one of the few countries in the region to run a surplus, despite having implemented a countercyclical fiscal policy. That policy largely took the form of higher spending (26.4%) aimed at countering the drop in private consumption. In absolute terms, the largest increase was seen in physical investment expenditure,

which rose to 2.06 trillion guaraníes, 66.9% up on the amount for 2008 (when that category of investment fell by 18.3%). Much of the increase in physical investment was driven by spending on public works, which rose by 103% as the result of the expansion of labour-intensive infrastructure programmes (one of the main elements of the government's countercyclical policy). Capital spending increased by a total of 63.7%. Current expenditure, which made up approximately three quarters of total encumbered expenditure, rose by 18.3%, with the largest increases in public sector wages, current transfers and

spending on goods and services. Even with the economy in recession, the government increased total revenues by 8.9%. Within non-tax revenue (up by 14.9%), there was a significant rise in the contractual revenue from the Itaipú and Yacyretá binational entities (21.1%). Tax receipts also rose (6.4%) thanks to higher receipts from taxes on net income and profits (39.4%), which offset the decreases in other components of tax revenue, including value added tax (VAT) and revenue derived from foreign trade. In the first five months of 2010, receipts were up by 21.7% over the year-earlier period. The revenue of the National Customs Department rose by 37.4%, pointing to an upturn in the external sector. During the same period, budget implementation totalled 4.237 billion guaraníes, or 24% of the financial plan for 2010.

With regard to financing, the government issued bonds on the domestic market twice in 2009, raising a total of 682 billion guaraníes (equivalent to approximately US\$ 137 million), and secured US\$ 300 million from multilateral agencies to finance its economic recovery programme. The central government's public debt widened by 11.7% to US\$ 2.403 billion, equivalent to 15.7% of GDP, which is still considered to be low. Domestic debt grew by 54.7% (to 3.2% of GDP) as a result of the bond issues, while external debt rose by 3.9%, to reach US\$ 1.896 billion (11.9% of GDP).

In 2009, for the third time in a row and against the explicit recommendation of the government, congress postponed the introduction of personal income tax, arguing that the introduction of a new tax during a recession was inadvisable. Paraguay therefore continues to be the only country in Latin America without such a tax, which is reflected in the low tax burden (estimated at 14.5% of GDP).

### **(b) Monetary policy**

The Central Bank of Paraguay implemented an expansionary monetary policy with a view to mitigating the negative repercussions of the international financial crisis and providing sufficient liquidity to the domestic financial market. In February 2009, the reserve requirement was lowered to 0% for local currency deposits of over one year and foreign currency deposits of over 541 days, thereby freeing up some 116.416 billion guaraníes and US\$ 16.2 million, respectively. In March, a short-term liquidity facility was provided through repo options on the central bank's monetary regulation instruments (IRM), national treasury bonds and Development Finance Agency bonds. The average balance of IRMs dropped by 45% over the year and the reference yields on these instruments fell from 5.9% in 2008 to 2.1% in 2009 and to 1.9% in May 2010. The first signs of recovery were seen in July 2009 when the financial system once again offered

medium-term IRMs, indicating increased confidence in the local market.

Interest rates fluctuated in line with the rates on IRMs. Average lending rates decreased from 29.5% to 26.2% in local currency and from 13.2% to 9.8% in foreign currency between December 2008 and December 2009. As at April 2010, no significant changes had occurred in that regard. The expansionary trend in bank credit to the private sector continued in 2009, but at a slower rate: 31.8% in 2009 compared with 51.5% in 2008. As in 2008, local-currency lending expanded at a higher rate than foreign-currency lending (34.5% and 27.8%, respectively).

### **(c) Exchange-rate policy**

In 2009, the guaraní depreciated by 14.4% in nominal terms against the dollar. This was due mainly to the appreciation of the dollar following the outbreak of the financial crisis, which drove up demand for lower-risk assets, a decline in export volumes (exacerbated by the falling prices for the main export products) and the decrease in inward remittances. The central bank also accumulated a significant amount of international reserves. This situation changed as of July 2009 and the guaraní started to regain value month by month, but did not make up the losses sustained during the second semester of 2008. In February 2010, however, the currency began to depreciate again and the nominal exchange rate showed a cumulative monthly rise of 2.0% up to May 2010.

The real effective exchange rate climbed by 9.5% in 2009, owing chiefly to the effect of the dollar. In 2009, the central bank scaled back its interventions in the exchange market; as a result its net purchases amounted to US\$ 289.1 million in cumulative terms as at December. Net international reserves expanded by 34.8% to reach a new high of US\$ 3.861 billion, equivalent to 26.2% of GDP. No major changes were made to exchange-rate policy in the first five months of 2010.

### **(d) Other policies**

In the context of the economic recovery plan, the government implemented various sectoral measures, including efforts to boost agricultural development, production, industrial development and employment. A job creation programme based on construction works was implemented in the six poorest departments. Social measures included the expansion of the conditional transfer programme to help families living in extreme poverty. As at December 2009, some 88,000 families were covered by the programme (compared with 13,000 at the beginning of the year). The government intends to expand the scheme's coverage to 120,000 families, equivalent to some 600,000 individuals, in 2010.

### 3. The main variables

#### (a) Economic activity

Following six consecutive years in which annualized growth averaged 4.7%, GDP fell by 3.8% in 2009, equivalent to a 5.5% drop in per capita GDP. This performance largely reflected a 25.0% decline in the agricultural sector, which was hurt by the drought in 2009 and the fall in international prices for agricultural products. Agricultural production plummeted, with the largest drop in soybean (38.9%), the sector's main product. It is estimated that Paraguay's GDP would have risen by 1.5% had the agricultural sector not suffered such a severe contraction. Goods production fell by 10.9% overall in 2009 as a result of the downturn in agriculture, as well as a 4.3% contraction in forestry and a 0.8% drop in industry. Positive growth was recorded in livestock and fishing (4.8% and 1.5%, respectively) and in mining (3%) and construction (1%). Services output was up by 2.3%, with transport and commerce the only sectors to register a contraction (10.5% and 3.4%, respectively), because of their close ties with goods production. Government services were up by 15.2%, followed by business services (12.4%). Crucially, government spending rose by 9.4%, owing to the implementation of countercyclical policies. Lower household income and poorer consumer expectations led to a contraction of 3% in private consumption, which contributed to a drop of 1.8% in total consumption. Gross fixed capital formation slid by 12.5% while inventories shrank by 19.8%. Slacker demand from Paraguay's largest trade partners (MERCOSUR countries whose economies were also slowing heavily) was reflected in a 12.8% drop in exports. With lower private consumption keeping domestic demand sluggish, imports fell by 13.2% compared with 2008.

The behaviour of the monthly index of economic activity (IMAEP), a short-term trend indicator published by the central bank, shows the effects of the international crisis being felt keenly in the first months of 2009. From April onwards, the indicator began to climb month-on-month and has been up on the year-earlier period since

October. In April 2010 the variation in the IMAEP was 10.19%. The economy is projected to pick up significantly in 2010, led by growth in the agricultural sector. With weather conditions better than in 2009, the Ministry of Agriculture and Livestock projects an increase of about 73% in production of soybean, 18.7% in wheat and 16% in maize. The economy is forecast to grow by about 7% in 2010, following a year-on-year rate of 10.9% in the first quarter that was driven principally by a strong upturn in agriculture (28%).

#### (b) Prices, wages and employment

Annual inflation was 1.9% in 2009, which was lower than both the long-term target range and the previous year's rate (7.5%). The drop in inflation was due in large part to the fall in international commodity prices that had begun in late 2008. Although these prices began to pick up from mid-2009 on, the annual averages were still below the highs of 2008. At the national level, prices increased most for agricultural food products, especially vegetables (20.1%) and sugar (37.3%). The fruit and vegetables price index rose by 20.8%, owing chiefly to losses in the agricultural sector. The core inflation rate, which excludes fruit and vegetables, ended the year at 0.7%, compared with 6.9% in 2008. Core inflation X1, which further excludes regulated services, came in at 1.3%, compared with 7.2% in 2008. In the first semester of 2010 prices trended upwards, especially for food and, within that category, for fruit and vegetables. In June, the 12-month variation in both the consumer price index (CPI) and in core inflation was 4.3%

The wages and salaries index rose by 6.5% between June 2008 and June 2009, with the largest increases in the financial intermediation (11.1%) and transport (9.0%) sectors. The smallest rise occurred in the electricity and water sector (2.0%), below the inflation rate for the same period (3.3%), which resulted in a real decrease in wages in that sector. The legal minimum wage increased from 1.3 million guaraníes in 2008 to 1.4 million guaraníes in May 2009, equivalent to an increase of 0.7% in real terms.

Table 1  
PARAGUAY: MAIN ECONOMIC INDICATORS

	2001	2002	2003	2004	2005	2006	2007	2008	2009 <sup>a</sup>
<b>Annual growth rates<sup>b</sup></b>									
<b>Gross domestic product</b>	2.1	-0.0	3.8	4.1	2.9	4.3	6.8	5.8	-3.8
<b>Per capita gross domestic product</b>	-0.0	-2.0	1.8	2.1	0.9	2.4	4.8	3.9	-5.5
<b>Gross domestic product, by sector</b>									
Agriculture, livestock, hunting, forestry and fishing	11.6	4.2	8.0	3.9	-0.1	3.6	14.3	9.2	-16.7
Mining	-8.3	-9.1	15.6	2.7	7.8	-2.2	3.5	5.0	3.0
Manufacturing	-0.7	-1.4	0.7	3.3	2.7	2.5	-1.2	2.0	-1.9
Electricity, gas and water	1.9	1.1	4.6	3.6	2.8	8.5	5.9	3.5	4.2
Construction	-1.4	-8.9	14.4	2.1	4.5	-3.5	7.2	11.0	1.0
Wholesale and retail commerce, restaurants and hotels	0.0	-1.6	5.5	5.1	2.4	5.5	5.1	4.2	-3.6
Transport, storage and communications	2.1	2.0	0.7	9.6	7.2	10.7	10.7	5.2	-1.4
Financial institutions, insurance, real estate and business services	1.2	0.8	-4.9	2.1	4.0	4.0	3.8	7.9	7.7
Community, social and personal services	-5.1	-1.1	0.5	2.7	5.9	4.3	3.0	3.9	11.0
<b>Gross domestic product, by type of expenditure</b>									
Consumption	1.4	-6.7	2.4	4.6	4.7	5.0	6.1	6.2	-1.8
General government	-8.6	-3.2	-2.0	6.0	11.5	4.0	5.3	1.2	9.4
Private	2.6	-7.1	2.9	4.4	3.9	5.1	6.2	6.8	-3.0
Gross capital formation	11.0	-13.7	8.5	11.9	-11.1	4.3	12.5	17.9	-13.0
Exports (goods and services)	-9.6	15.9	4.4	1.8	12.1	14.6	9.6	10.5	-12.8
Imports (goods and services)	-6.1	-6.2	3.6	6.2	9.0	16.5	10.8	15.9	-13.2
<b>Percentages of GDP</b>									
<b>Investment and saving<sup>c</sup></b>									
Gross capital formation	18.7	18.7	19.9	19.2	19.8	19.6	18.0	18.1	15.5
National saving	14.6	20.5	22.3	21.3	20.0	21.0	19.5	15.8	14.1
External saving	4.1	-1.8	-2.3	-2.1	-0.2	-1.4	-1.5	2.3	1.4
<b>Millions of dollars</b>									
<b>Balance of payments</b>									
Current account balance	-266	93	129	143	16	128	184	-385	-196
Goods balance	-614	-280	-276	-244	-462	-621	-533	-1 174	-1 052
Exports, f.o.b.	1 890	1 858	2 170	2 861	3 352	4 401	5 652	7 772	5 784
Imports, f.o.b.	2 504	2 138	2 446	3 105	3 814	5 022	6 185	8 946	6 835
Services trade balance	165	214	245	327	313	414	499	546	702
Income balance	16	43	-4	-134	-58	-92	-155	-162	-345
Net current transfers	167	116	165	194	224	426	373	405	500
Capital and financial balance <sup>d</sup>	220	-213	105	128	144	255	539	763	1 152
Net foreign direct investment	78	12	22	32	47	167	199	171	281
Other capital movements	141	-225	83	96	97	89	340	593	870
Overall balance	-47	-121	234	271	160	383	723	379	956
Variation in reserve assets <sup>e</sup>	45	84	-301	-179	-146	-387	-727	-378	-956
Other financing	2	37	67	-92	-14	4	5	-0	0
<b>Other external-sector indicators</b>									
Real effective exchange rate (index: 2000=100) <sup>f</sup>	102.7	106.3	113.0	106.2	118.4	106.3	95.8	85.1	93.6
Terms of trade for goods (index: 2000=100)	100.2	96.7	101.4	104.3	97.4	95.5	100.1	107.3	105.0
Net resource transfer (millions of dollars)	237	-134	168	-98	72	168	388	601	806
Total gross external debt (millions of dollars)	2 654	2 900	2 951	2 901	2 700	2 739	2 868	3 191	3 497
<b>Average annual rates</b>									
<b>Employment</b>									
Labour force participation rate <sup>g</sup>	59.2	61.2	59.8	63.4	61.8	60.1	60.8	61.7	...
Open unemployment rate <sup>h</sup>	10.8	14.7	11.2	10.0	7.6	8.9	7.2	7.4	...
Visible underemployment rate <sup>i</sup>	8.3	9.5	8.8	8.3	7.5	5.6	5.8	6.6	...
<b>Annual percentages</b>									
<b>Prices</b>									
Variation in consumer prices (December-December)	8.4	14.6	9.3	2.8	9.9	12.5	6.0	7.5	1.9
Variation in nominal exchange rate (annual average)	17.6	39.2	13.3	-7.6	3.3	-8.7	-10.8	-13.5	14.3
Variation in average real wage	1.4	-5.0	-0.8	1.7	1.1	0.6	2.4	-0.7	4.5
Nominal deposit rate <sup>j</sup>	16.0	21.7	15.5	5.7	6.1	9.8	5.9	6.2	3.4
Nominal lending rate <sup>k</sup>	28.3	34.3	30.5	21.2	15.3	16.6	14.6	14.6	15.6
<b>Percentages of GDP</b>									
<b>Central Administration</b>									
Total revenue	18.8	17.5	17.0	18.4	18.3	18.3	17.6	17.3	19.6
Current revenue	18.7	17.3	16.9	18.3	18.1	18.2	17.2	16.9	19.2
Tax revenue	12.0	11.2	11.3	12.9	13.0	13.1	12.6	13.0	14.5

Table I (concluded)

	2001	2002	2003	2004	2005	2006	2007	2008	2009 <sup>a</sup>
Capital revenue	0.0	0.0	0.0	0.0	0.1	0.1	0.0	0.0	0.4
Total expenditure <sup>l</sup>	20.0	20.7	17.4	16.8	17.5	17.8	16.7	14.8	19.6
Current expenditure	16.5	16.3	14.0	12.9	13.5	13.7	12.9	12.2	15.0
Interest	1.4	1.5	1.3	1.1	1.2	1.0	0.8	0.6	0.6
Capital expenditure	3.5	4.4	3.7	4.0	4.1	4.2	3.8	2.7	4.6
Primary balance	0.2	-1.7	0.9	2.7	2.0	1.5	1.8	3.1	0.7
Overall balance	-1.2	-3.2	-0.4	1.6	0.8	0.5	1.0	2.5	0.1
Central-government debt	41.1	59.2	44.4	38.0	31.4	23.8	16.9	14.5	15.7
Domestic	6.4	8.2	5.0	4.1	3.0	2.7	2.5	2.2	3.3
External	34.7	51.0	39.5	33.9	28.4	21.1	14.4	12.3	12.4
<b>Money and credit<sup>m</sup></b>									
Domestic credit <sup>n</sup>	-6.6	-9.4	-10.7	-11.7	-11.0	-10.6	-12.6	-12.5	-17.3
To the public sector	3.3	5.7	3.1	3.3	3.1	1.5	0.1	-1.5	-2.7
To the banking sector	-3.1	-2.7	-4.1	-4.8	-3.9	-3.3	-4.7	-4.9	-8.7
Others	-6.8	-12.4	-9.8	-10.2	-10.2	-8.9	-8.0	-6.0	-6.0
Liquidity (M3)	35.3	31.9	29.1	28.3	27.5	26.8	30.0	31.3	39.8
Currency outside banks and local-currency deposits (M2)	15.4	13.4	14.2	15.2	15.9	16.2	19.2	19.2	25.7
Foreign-currency deposits	19.9	18.4	14.8	13.1	11.7	10.6	10.7	12.1	14.1

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

<sup>a</sup> Preliminary figures.

<sup>b</sup> Based on figures in local currency at constant 1994 prices.

<sup>c</sup> Based on figures in local currency expressed in dollars at current prices.

<sup>d</sup> Includes errors and omissions.

<sup>e</sup> A minus sign (-) denotes an increase in reserves.

<sup>f</sup> Annual average, weighted by the value of goods exports and imports.

<sup>g</sup> Economically active population as a percentage of the working-age population; nationwide total.

<sup>h</sup> Percentage of the economically active population; urban total.

<sup>i</sup> Percentage of the working population; urban total.

<sup>j</sup> Weighted average of effective interest rates on time deposits.

<sup>k</sup> Weighted average of effective interest rates on loans in national currency, excluding overdrafts and credit cards.

<sup>l</sup> Includes net lending.

<sup>m</sup> The monetary figures are end-of-year stocks.

<sup>n</sup> Refers to the credit extended to the banking sector by the Central Bank of Paraguay.

### (c) The external sector

The external sector was badly hit by the international crisis. The contraction in external demand was worsened by the drop in prices of the main export products and the poor weather conditions. Exports shrank by 15.4% in volume terms and 25.6% in value. Imports were down by 15.1% in constant terms, equivalent to a drop of 23.6% in value terms, as a result of slacker domestic demand. The terms of trade were down by 2.2%, after significant gains in previous years. Remittances also declined by an estimated 0.6%. The deficit on the goods trade balance

narrowed, while the services surplus expanded as imports fell more sharply than exports. The current account deficit narrowed from US\$ 385 million dollars to US\$ 196 million, equivalent to 1.2% of GDP. There was an upswing in direct investment, particularly in the form of reinvested earnings, and in other financial investments. Taking that into account, the net transfer of resources into Paraguay rose from US\$ 601 million to US\$ 806 million, equivalent to 4.8% of GDP. External trade is expected to rally in 2010. In the first five months of the year, exports increased by 39.5% in comparison with the year-earlier period, while imports were up 49.3%.

Table 2  
PARAGUAY: MAIN QUARTERLY INDICATORS

	2008				2009 <sup>a</sup>				2010 <sup>a</sup>	
	I	II	III	IV	I	II	III	IV	I	II
Gross domestic product (variation from same quarter of preceding year) <sup>b</sup>	6.9	9.0	2.2	5.3	-5.4	-7.0	-2.4	-0.7	10.9	...
Goods exports, f.o.b. (millions of dollars) <sup>c</sup>	960	1 480	1 274	750	882	826	779	681	1 114	857 <sup>d</sup>
Goods imports, f.o.b. (millions of dollars) <sup>c</sup>	1 761	2 111	2 661	1 973	1 439	1 372	1 676	2 010	1 970	1 458 <sup>d</sup>
International reserves (millions of dollars)	2 638	3 197	2 999	2 864	2 870	3 183	3 552	3 861	3 855	3 885 <sup>d</sup>
Real effective exchange rate (index: 2000=100) <sup>e</sup>	91.7	83.2	80.1	85.4	91.0	93.8	95.1	94.5	90.2	90.8 <sup>d</sup>
Consumer prices (12-month percentage variation)	12.3	13.4	9.1	7.5	3.4	1.9	2.3	1.9	4.1	4.5 <sup>d</sup>
Average nominal exchange rate (guaraníes per dollar)	4 639	4 096	3 974	4 689	5 075	5 043	4 968	4 793	4 685	4 736
Nominal interest rates (annualized percentages)										
Deposit rate <sup>f</sup>	5.6	6.4	5.5	7.2	4.3	2.1	3.6	3.8	2.1	1.2 <sup>g</sup>
Lending rate <sup>h</sup>	13.7	13.6	13.6	17.4	18.5	15.5	14.6	13.8	13.7	13.3 <sup>g</sup>
Domestic credit (variation from same quarter of preceding year)	26.1	-2.5	18.8	34.8	39.0	39.8	66.1	32.8	24.4	19.6 <sup>g</sup>
Non-performing loans as a percentage of total credit	1.3	1.2	1.1	1.1	1.5	1.8	1.8	1.6	1.6	1.7 <sup>d</sup>

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

<sup>a</sup> Preliminary figures.

<sup>b</sup> Based on figures in local currency at constant 1994 prices.

<sup>c</sup> Refers to registered trade only.

<sup>d</sup> Data to May.

<sup>e</sup> Quarterly average, weighted by the value of goods exports and imports.

<sup>f</sup> Weighted average of effective interest rates on time deposits.

<sup>g</sup> Data to April.

<sup>h</sup> Weighted average of effective interest rates on loans, excluding overdrafts and credit cards.