

## PARAGUAY

### 1. General trends

At 15.3%, economic growth in 2010 was the best seen in Paraguay in four decades. It was driven by a good performance in the agricultural sector, thanks to a bumper crop from the 2009-2010 harvest. Other sectors such as livestock, construction and manufacturing also made substantial contributions. Although public spending continued to grow in 2010, the central government achieved a fiscal surplus of 1.4% of GDP owing to higher tax receipts. Strong growth in domestic demand, coupled with rising international food and fuel prices, drove up inflation, which ended the year at 7.2%. The favourable economic climate led to a boom in exports (43.2%) and imports (43.9%) of goods. The current account posted a deficit of 3.3% of GDP, a deterioration with respect to the surplus of 0.3% registered in 2009. The economy is expected to continue to expand in 2011, albeit at a slower pace, with an estimated growth rate of 6%.

### 2. Economic policy

#### (a) Fiscal policy

The central government's overall fiscal balance yielded an end-of-year surplus of 1.4% of GDP in 2010. This was higher than the previous year, when Paraguay posted a surplus equivalent to 0.1% of GDP. The primary surplus was 1.8% of GDP, an improvement on the 0.7% recorded in 2009.

The position of the public finances was largely attributable to higher tax receipts, which grew by 19.0% in 2010, notwithstanding a drop of 8.2% in taxes on net income. Rising domestic demand brought higher VAT receipts (up 27.6%) and increased revenue from taxes on foreign trade (up 50.1%). Non-tax revenue fell by 4.4% in 2010, owing to a drop of 17.3% in the contractual revenue from the Itaipú and Yacyretá binational entities. Cumulative tax receipts from January to May of 2011 were up 19.8% over the same period in 2010 in nominal terms.

Congress once again postponed the introduction of personal income tax in 2010. Paraguay therefore remains the only country in Latin America without a tax of this kind. It also has one of the lowest tax burdens worldwide, despite an increase from 12.9% to 13.5% between 2009 and 2010.

Total central government spending rose by 4.7% and was equivalent to 17.8% of GDP (lower than the 19.6% recorded the previous year). Current spending increased by 7.5% with respect to 2009 and accounted for almost 80% of total encumbered expenditure. Capital expenditure fell by 4.9% reflecting a 25.8% reduction in capital transfers. Physical investment increased from 2.064 billion guaraníes in 2009 to 2.265 billion guaraníes in 2010, up 5.4% in real terms. Physical investment as a percentage of GDP nevertheless dropped from 2.9% in 2009 to 2.7% in 2010. Lower total expenditure in proportion to GDP and in particular lower capital spending stemmed from a less expansionary public spending policy in comparison to 2009, when a countercyclical fiscal policy was implemented to mitigate the impact of the international crisis.

The debt of the non-financial public sector eased down from 16.5% in 2009 to 16.4% in 2010. Of this, 77.0% relates to external debt and the remainder to domestic debt. External public debt has fallen sharply in the past eight years, from 54.8% of GDP in 2002, thanks to strong economic growth and amortization in excess of disbursements over the period.

**(b) Monetary policy**

The rebounding economy and concerns over rising inflation led the Executive Committee for Open Market Operations and Reserves (CEOMA) of the Central Bank of Paraguay to tighten monetary policy, cutting back on the monetary stimulus introduced in 2009. As a result, interest rates on monetary regulation instruments (IRM) began edging up in the second half of 2010. The weighted average interest rate on IRMs increased from 0.3% in May to 5.5% in December 2010, exceeding both the 2.9% rate posted in December 2009 and the 3.9% in November 2010. In May 2011, the weighted average interest rate on IRMs was 9.2%. This higher reference rate is attributable to the fact that domestic growth is continuing apace, in part thanks to steady growth in the credit available within the domestic financial system, which has in turn accompanied the expansion in monetary aggregates.<sup>1</sup>

In December 2010, total bank lending to the private sector was up by 42.5% with respect to the same month in 2009, while in March 2011 year-on-year growth of 30.8% was recorded.

The banks' weighted real lending rate in local currency was 19.9% as an annual average in December 2010, lower than the average of 24.3% for the same month of the previous year. The interest-rate spread was 25.9% in December 2010, wider than the 24.8% of December 2009. By April 2011, average lending and borrowing rates had edged up again, both for local- and foreign-currency loans, but nonetheless remained low in comparison with historical levels.

**(c) Exchange-rate policy**

The nominal exchange rate of the guaraní against the United States dollar was down by 1.7% in December 2010, indicating an appreciation of the guaraní in relation to the same month in 2009. In April 2011, the local currency recorded year-on-year nominal appreciation of 13.9%.

The real effective exchange rate of the guaraní against the United States dollar posted a year-on-year fall of 4.1% in December 2010. In April 2011, the currency showed year-on-year appreciation of 15.3% in real effective terms.

Up to December 2010, the Central Bank of Paraguay had accumulated net annual dollar sales of US\$ 221.8 million, versus cumulative net purchases of US\$ 289.1 million in 2009. In April 2011, cumulative net dollar purchases for the year stood at US\$ 70.9 million. These interventions in the currency market in late 2010 and early 2011 were undertaken to mitigate fluctuations in the dollar exchange rate, according to central bank authorities.

Net international reserves registered a year-on-year rise of 8% in December 2010, standing at US\$ 4.169 billion, or 23% of GDP. In April 2011, net international reserves amounted to US\$ 4.656 billion, 20.8% higher than the reserves registered in March 2010.

Efforts were made to reduce volatility and curb the guaraní's appreciation against the dollar by allowing a build-up in the central bank's international reserves and increasing the foreign currency holdings of commercial banks.<sup>2</sup> Appreciation of the guaraní is attributable, among other factors, to large inflows of foreign currency in the form of international remittances (US\$ 350 million), revenue from the

<sup>1</sup> In May 2011, year-on-year change for M0, M1, M2 and M3 was 16.5%, 6.1%, 11.6% and 13.7%, respectively.

<sup>2</sup> By raising the ceiling on the net foreign currency position of financial entities from 30% to 50% of their total assets.

binational entities of Itaipú and Yacyretá (US\$ 420 million), and exports. To a certain extent, the trade deficit has helped limit the sharp appreciation of the guaraní.

**(d) Other policies**

In 2010, social programmes such as health care, education, cash transfers and pensions for older persons accounted for 50.6% of total expenditure. Social spending is expected to continue to expand in 2011, in particular cash transfers, which were received by 112,000 families in 2010. Growth in physical investment, particularly in infrastructure, resulted in the creation of 51,000 road-building jobs.

### **3. The main variables**

**(a) Economic activity**

The economy grew by 15.3% in 2010, the highest figure recorded in Paraguay since the 12% registered in 1978. In consequence, GDP per capita increased by 13.3%, to US\$ 1,511. This was largely due to a bumper crop in the agricultural sector,<sup>3</sup> which grew by 49.9%, following a sharp decline (-25%) in 2009 when a prolonged drought severely reduced the 2008-2009 harvest. The excellent weather conditions during the 2009-2010 harvest were good for production of soybean, Paraguay's main agricultural product. The 2010 harvest produced a crop of around 7.5 million tons, up 90% on 2009. The livestock, forestry and fishing sector recorded growth of 4.6% (against 2.7% in 2009), in particular thanks to increased cattle production. The manufacturing and mining sector rebounded in 2010, showing growth of 6.5%, compared with -0.8% in 2009. Construction and services also expanded considerably in 2010, posting growth of 14% and 9.3%, respectively (as against growth rates of 2% and 2.2% in 2009).

On the spending side, all the components of aggregate demand rose in 2010. Total consumption, having contracted by 1.8% in 2009, grew by 10.4% in 2010. Private consumption climbed 9.9%, following negative growth (-3.0%) in 2009. Government consumption continued to expand in 2010 and registered a growth rate of 14.7%, compared with 9.4% in 2009. Gross fixed capital formation jumped from -12.5% in 2009 to 21.7% in 2010. Exports of goods and services expanded by 35.3%, as opposed to contracting by 12.8% in 2009, boosted by heightened demand from Paraguay's main trading partners (Argentina, Brazil and Uruguay). Imports of goods and services also recovered strongly in 2010, growing by 29.5% after having dropped by 13.2% in 2009, driven by buoyant domestic demand on the back of higher private consumption.

Bearing in mind the weight of the farming sector in the Paraguayan economy and the fact that 2009 and 2010 were atypical years, the growth rate is expected to return to normal levels in 2011 after the spectacular high recorded in 2010 and a growth rate of 6.0% is forecast for 2011. According to the monthly index of economic activity (IMAEP), a short-term trend indicator published by the central bank, growth has already begun to slacken, since real variation of 5.2% in year-on-year terms was recorded in March 2011, well below the 18.5% reported in March 2010.

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<sup>3</sup> Agriculture is the largest sector in the Paraguayan economy, accounting for a fifth of economic activity.

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

Annual inflation stood at 7.2% in 2010, considerably higher than the 2009 figure of 1.9%. Inflation in 2010 sat just within the target range established by the Central Bank of Paraguay ( $5\% \pm 2.5\%$ ). During the first three quarters of 2010, inflation remained below the centre of the target range but began to climb in the fourth quarter, eventually hitting the ceiling of the range. Higher aggregate demand driven by the auspicious economic climate also created strong inflationary pressures in 2010. Core inflation<sup>4</sup> stood at 8.4% in 2010, significantly higher than in 2009 (0.7%). Core X1<sup>5</sup> inflation was 8.7%, versus 1.3% in 2009. The rise in inflation carried over into 2011, as indicated by the year-on-year rate of 10.2% in May 2011 (versus 4.5% in May 2010). The higher rate of inflation in late 2010 and early 2011 may be attributed, among other factors, to rising food and fuel prices, in particular international prices for agricultural commodities and domestic prices for beef.

In December 2010 the wage and salary index stood 7.5% over the figure for December 2009. The minimum wage increased from 1,408,864 guaraníes in 2009 to 1,507,484 guaraníes in 2010, up 0.5% in real terms.

According to the 2010 Continuous Employment Survey,<sup>6</sup> the open unemployment rate fell during 2010, dropping from 9.2% in the first quarter to 6.1% in the final quarter. The rate for men was 4.9%, while the figure for women was significantly higher at 7.5%.

## **(c) The external sector**

Burgeoning external demand, rising international prices for the main products exported by Paraguay and soaring domestic production thanks to excellent weather conditions all resulted in an increase in registered exports in 2010: of 43.2% in value terms and 30% in volume terms. Exports of soybean seed in particular surged by 102.1% by value (118.9% by volume) and in 2010 accounted for 25% of the growth in total registered exports. Other strong export performers were meat—which climbed 58.9% by value and 17.5% by volume—and cereals, which rose 20.2% in value terms but fell 7.2% in volume terms. Registered exports to Argentina, Brazil and Uruguay, Paraguay's main trading partners with almost 50% of registered exports, increased in value terms by 56.8%, 0.8% and 86.4%, respectively.

The strong performance of the Paraguayan economy in 2010 was reflected in the increase in registered imports of 44.7% in value terms and 22.3% in volume terms. Imports of consumer, intermediate and capital goods rose by 41.6%, 28.5% and 61.1% in value terms and 20.3%, 19.2% and 62.1% in volume terms, respectively. Among capital goods, which posted the biggest increases among total registered imports, the fastest-rising categories of imports were machinery, devices and engines and transport equipment and accessories.<sup>7</sup> Registered imports from Argentina, Brazil and Uruguay together increased by 47.4% in value terms, but the most significant rise was that of imports from China, which jumped by 66.7% in relation to 2009. Indeed, goods purchased from China accounted for a third of total registered imports in 2010.

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<sup>4</sup> Excludes fruit and vegetables, the most volatile products in the basket.

<sup>5</sup> Excludes fruit, vegetables and regulated services.

<sup>6</sup> Covers Asunción and urban areas of the Central Department.

<sup>7</sup> Excludes automobiles, jeeps and pick-up trucks.

The current account balance posted a deficit equivalent to 3.3% of GDP in 2010 (as against a surplus of 0.3% of GDP in 2009). The balance-of-payments surplus shrank from US\$ 915.2 million in 2009 to US\$ 319.2 million in 2010, chiefly reflecting the current account deficit, since the capital and financial account surplus swelled by 20%. The stock of foreign direct investment climbed from US\$ 3.053 billion in 2009 to US\$ 3.323 billion in 2010, primarily taking the form of shares and reinvested profits.

As at April 2011, the value of registered exports had increased by 8.7%, mainly owing to the buoyant export performance of meat, cereals and soybean flour. Registered imports were up by 26.9% year-on-year thanks to surging domestic demand, which continues to climb.