

PARAGUAY

1. General trends

An excellent agricultural season, comparable only to that of 1988, enabled GDP to grow by 2.7% in 2001, more than making up for the previous three years' contractions. As the population grew at a similar rate, however, per capita GDP stalled at the level recorded in the early 1990s. Aggregate demand expanded by 1.3%, slightly outpacing domestic demand, thanks to an export recovery following five straight years of decline. The upswing in domestic demand was attributable to greater buoyancy in private consumption, while public consumption and gross investment –especially by the public sector– both shrank.

THIS PERFORMANCE occurred against a complex subregional backdrop, caused by financial crisis in Argentina and difficulties in obtaining external financing. The government responded to the situation by implementing a fiscal adjustment programme monitored by the International Monetary Fund (IMF), which secured the disbursement of funds from international agencies.

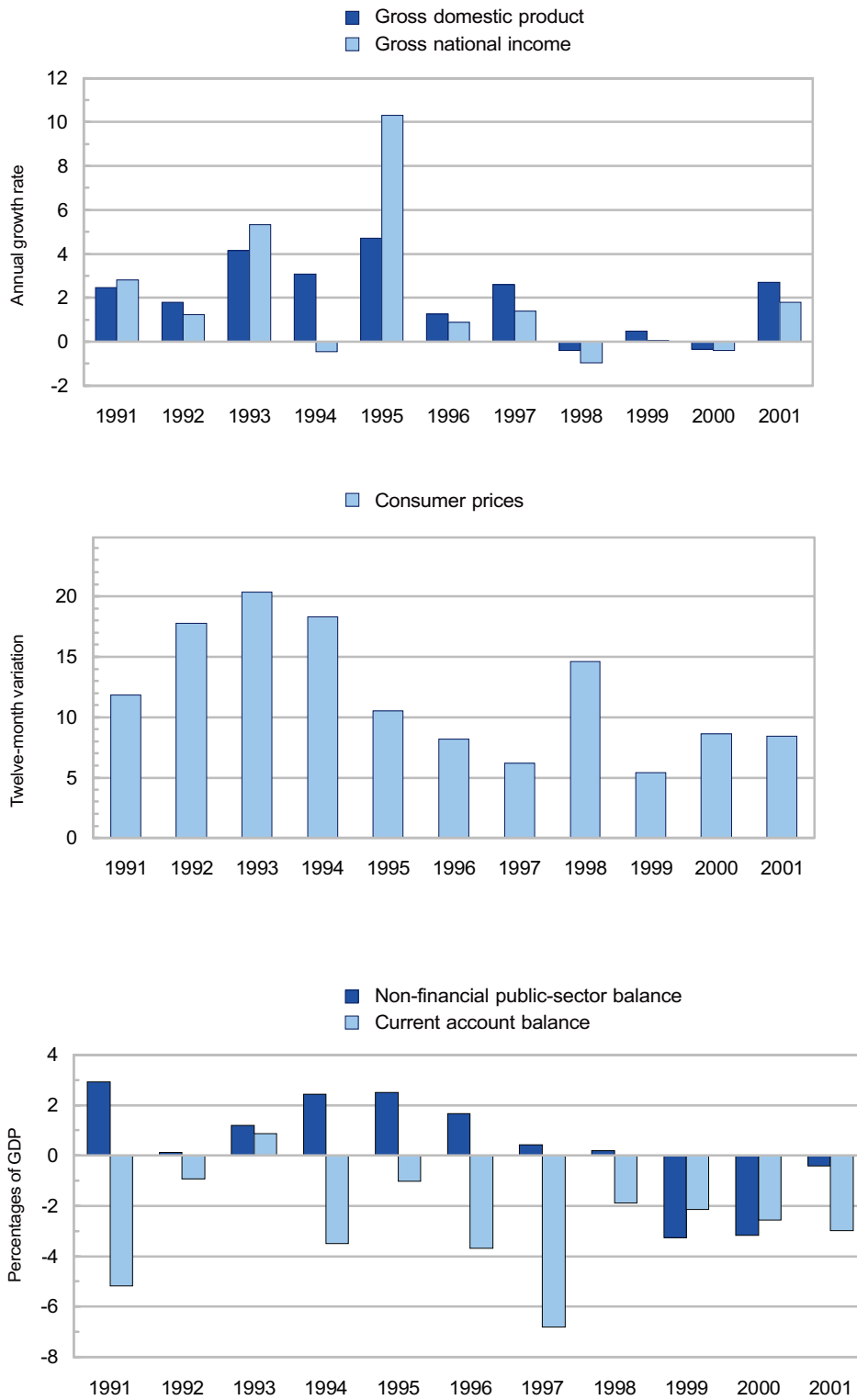
The ambitious goal of narrowing the central government deficit from 4% of GDP in 2000 to 1.1% in 2001 was achieved at the cost of swingeing cuts in capital expenditure. Monetary policy helped to keep inflation down, which, at 8.4%, was slightly lower than the 2000 figure. Exchange-rate policy was made more flexible, particularly after mid-year when the economy was buffeted by a series of currency shocks. The central bank responded by raising rates on its monetary regulation instruments, which had the effect of pushing up interest rates generally, notably so towards the end of the year. On the privatization front, the authorities made some

headway towards defining a set of regulations for the sale of three State-owned enterprises.

Official projections for 2002 see the economy growing more slowly, with GDP expanding by just 1%, partly because of a contraction in agricultural output in the wake of a severe drought. Construction is expected to stage a partial recovery, but manufacturing is likely to remain stalled. The fiscal deficit is forecast to fluctuate around 2% of GDP; tax receipts should be up on the previous year, with current expenditure rising and capital expenditures, in particular, recovering.

The downturn in external trade seen in recent years is likely to continue, since Argentina and Brazil adopted new measures in late 2001 to clamp down on informal transactions. Paraguayan exports will also be hurt by the steep rise in Argentina's real exchange rate. Current transfers are expected to decline, which means that the balance-of-payments deficit on current account will continue to widen.

Figure 1
PARAGUAY: MAIN ECONOMIC INDICATORS



Source: ECLAC, on the basis of official figures.

2. Macroeconomic policy

Macroeconomic policy in 2001 was implemented in the framework of an IMF programme, whose main objective was to bring about a substantial reduction in the central government deficit. The highly expansionary fiscal policy of earlier years reached its zenith in 2000 when the country was able to draw on large volumes of external resources; but in early 2001 this source of funding was expected to dry up so the IMF programme was crucial to secure financing from international agencies. After mid-year, the economic authorities adopted a flexible exchange-rate policy, which halted the leakage of international reserves that had begun in the first quarter. Prudent monetary policy thus enabled the government to keep inflation within the target agreed upon with IMF.

The government approached the Fund again in the second quarter of 2002, this time to seek a stand-by arrangement, which led to a loan of US\$ 50 million and paved the way for further borrowing from official sources. The fiscal budget envisaged an upturn in capital expenditure in 2002, mainly in terms of physical capital.

The central bank is expected to persist with a flexible exchange policy, allowing for sporadic interventions to smooth out episodes of major volatility. This is appropriate to the circumstances, since Paraguay's main Latin American trading partners have adopted a similar policy since early 2002. Monetary policy will continue to be used to restrain price increases.

(a) Fiscal policy

In contrast to the previous two years, fiscal policy was aimed at reducing the central government deficit, within the framework of an IMF programme and external resource constraints. Objectives included scaling back nominal spending and stepping up the level of investment. In fact, the government succeeded in narrowing the deficit from 4.3% of GDP in 2000 to 1.1% in 2001, largely by issuing domestic debt in the form of treasury bonds and drawing down central government deposits.

Other factors that helped reduce the central government deficit included a sharp increase in non-tax income, a decrease in current expenditures and, particularly, a drastic cut in capital spending.

Central government income increased by just under one percentage point of GDP, thanks mainly to large increases in non-tax revenue from binational firms, primarily the Itaipú hydroelectric plant. In contrast, tax

revenues dropped slightly. Receipts from direct taxes, especially on personal and corporate income and profits, continued their downward trend, and indirect taxes were unable to compensate. The indirect taxes that posted strongest revenue growth were selective levies on fuels and petroleum products; the selective diesel consumption tax rate had been raised by 14.1% in January 2001. Conversely, revenues arising from external trade shrank and VAT receipts remained broadly flat.

Central government expenditure shrank by over two percentage points of GDP, despite growing by 5% in nominal terms. The fastest growing items included interest payments on external debt, while other headings either decreased or edged up in nominal terms. Within current spending, real wages dropped by around 5%, unlike the previous three-year period when they had risen by 5% annually.

Capital expenditure was the category that contracted most sharply—specifically investment, as capital transfers remained stable. Capital investment was scaled back by 1.5 percentage points to 2.9% of GDP in 2001, which was well below the figure for 1995. A functional breakdown of the data shows that the Ministries of Education and Culture, and Public Health and Social Welfare were least affected by the budget cuts, while the Ministries of Agriculture, and Public Works and Communications bore the brunt.

The non-financial public sector, including central government and public-sector firms, posted a deficit of 0.4% of GDP in 2001, with improved operating results from most State enterprises partly offsetting the government shortfall.

(b) Monetary and foreign-exchange policy

Monetary policy in 2001 was geared towards controlling inflation and, from mid-year onwards, implementing a flexible exchange-rate policy. The central bank intervened early in the year to avert a steep devaluation of the guaraní, running down reserves to the tune of US\$ 100 million by late March. In view of the complex regional situation, the new central bank authorities adopted a more flexible exchange-rate policy from mid-year onwards, intervening only to avert sharp fluctuations. The real effective exchange rate had risen by 14% by the end of 2001, with the nominal rate up by 20%. International reserves recovered in the second semester thanks to the new exchange-rate policy, to stand at US\$ 725 million at year's end.

Table 1
PARAGUAY: MAIN ECONOMIC INDICATORS

	1993	1994	1995	1996	1997	1998	1999	2000	2001 ^a
Annual growth rates^b									
Growth and investment									
Gross domestic product	4.1	3.1	4.7	1.3	2.6	-0.4	0.5	-0.4	2.7
Per capita gross domestic product	1.4	0.4	2.0	-1.4	-0.1	-3.0	-2.1	-2.8	0.2
Gross domestic product, by sector									
Goods	4.0	0.6	5.9	0.4	3.1	0.6	2.1	-2.0	3.5
Agriculture	5.6	-0.6	8.1	1.3	5.3	0.2	3.2	-4.4	10.5
Mining	-1.2	5.0	2.9	1.5	2.0	2.5	2.2	2.5	-15.2
Manufacturing	2.0	1.5	3.0	-2.2	-0.2	1.0	0.0	1.0	1.3
Construction	2.7	3.6	4.0	3.0	1.0	1.0	2.5	2.0	-22.7
Basic services	8.1	11.7	9.1	4.4	3.7	2.2	9.1	9.2	4.2
Electricity, gas and water	14.1	20.6	14.7	6.1	3.6	1.6	14.7	7.8	0.7
Transport, storage and communications	3.4	3.9	3.5	2.5	3.8	3.0	2.6	10.9	8.6
Other services	3.6	4.1	2.4	1.4	1.8	-2.4	-4.0	-1.4	1.4
Commerce, restaurants and hotels									
Financial establishments, insurance, real estate and business services	3.8	4.3	1.6	-1.0	0.2	-4.2	-9.2	-4.9	2.4
Consumption	5.3	8.5	8.1	2.4	3.1	-0.7	-3.6	0.8	7.0
General government	5.3	3.9	12.1	10.0	2.0	0.7	3.7	14.1	-12.5
Private	5.3	9.1	7.6	1.6	3.2	-0.8	-4.5	-1.0	10.1
Gross domestic investment	2.3	4.5	7.1	-0.1	-2.0	-4.7	-3.8	-0.7	-26.6
Exports of goods and services	39.6	14.5	8.7	-11.6	-5.9	-7.2	-27.0	-15.1	3.0
Imports of goods and services	31.6	23.4	14.4	-6.1	-4.0	-7.0	-27.1	-6.7	-3.0
Percentages of GDP^c									
Gross national income	101.6	98.1	103.7	103.4	102.4	102.1	102.2	102.4	101.8
Gross domestic investment	23.1	23.4	23.9	23.7	22.7	21.8	21.1	21.1	17.0
National saving	15.2	7.4	9.9	8.7	7.2	7.1	11.0	10.5	6.1
External saving	7.9	16.0	14.0	15.0	15.5	14.8	10.1	10.6	10.9
Percentages									
Employment and wages									
Labour force participation rate ^d	...	59.1	64.8	63.0	61.9	60.6	58.8	62.8	59.6
Rate of unemployment ^e	5.1	4.4	5.3	8.2	7.1	6.6	9.4	10.0	10.8
Real average wage (index: 1995=100)	91.7	93.0	100.0	103.1	102.6	100.7	98.6	99.9	101.3
Growth rates									
Prices (December-December)									
Consumer prices	20.4	18.3	10.5	8.2	6.2	14.6	5.4	8.6	8.4
Producer prices	...	...	...	8.3	1.8	18.1	6.8	10.4	8.6
External sector									
Terms of trade (index: 1995=100) ^c	87.2	105.1	100.0	100.0	99.9	92.4	87.7	84.2	84.2
Nominal exchange rate (guaranies per dollar)	1,744	1,905	1,963	2,057	2,178	2,726	3,119	3,486	4,106
Real effective exchange rate for imports (index: 1995=100)	107.7	101.3	100.0	96.4	95.0	105.7	103.6	107.6	112.7
Millions of dollars									
Balance of payments									
Current account	59	-274	-92	-353	-650	-160	-165	-192	-220
Trade balance (goods and services)	-74	-411	-397	-645	-864	-343	-358	-408	-371
Exports	3,298	3,786	4,802	4,397	3,983	4,174	2,888	2,926	2,907
Imports	3,372	4,197	5,200	5,042	4,847	4,517	3,246	3,335	3,278
Capital and financial accounts ^f	-4	576	137	306	435	177	-148	-145	164
Overall balance	55	302	45	-47	-216	17	-313	-336	-56
Variation in reserve assets (- indicates an increase)	-87	-346	-60	39	206	-23	-104	207	58

Table 1 (concluded)

	1993	1994	1995	1996	1997	1998	1999	2000	2001 ^a
Percentages									
External debt									
Gross debt (as a percentage of GDP)	18.2	16.2	19.4	18.8	20.2	25.1	34.8	35.9	35.0
Net interest (as a percentage of exports) ^g	-0.1	-0.1	-0.2	-0.4	-0.4	-0.7	0.3	0.1	1.0
Percentages of GDP									
Central government									
Current income	12.3	14.5	15.3	14.8	15.6	16.0	16.8	15.8	16.8
Current expenditure	11.1	11.4	11.7	12.4	12.7	13.7	14.7	15.5	14.8
Saving	1.1	3.1	3.7	2.5	2.8	2.4	2.1	0.8	2.0
Capital expenditure (net)	1.8	2.1	4.0	3.3	4.1	3.3	5.7	4.6	3.1
Financial balance	-0.7	1.0	-0.3	-0.8	-1.3	-1.0	-3.6	-4.3	-1.1
Financial balance of non-financial public sector	1.2	2.4	2.5	1.7	0.4	0.2	-3.3	-3.2	-0.4
Growth rates									
Money and credit									
Net international reserves	28.3	41.3	-0.4	12.6	-19.8	40.0	42.9	-1.6	22.6
Net domestic credit	19.6	8.2	58.1	37.5	50.5	-8.5	-4.1	11.7	15.2
To public sector	-2.2	-82.9	...	...	...	-82.0	...	...	...
To private sector	35.7	36.7	18.3	22.8	12.3	-8	10.6	3.2	13.2
Money (M1)	17.7	32.4	21.1	2.0	13.9	7.4	9.5	17.8	9.0
Local currency savings and time deposits	4.1	59.3	22.2	39.4	1.1	-13.6	5.7	-32.8	-17.1
M2	9.7	38.4	28.3	15.4	7.2	-2.8	10.9	3.2	6.4
Dollar deposits	53.0	15.3	3.0	39.5	25.8	26.1	25.8	4.8	31.3
Annual rates									
Real interest rate (annualized, %) ^h									
Deposit rate	3.3	2.1	6.9	6.7	5.6	4.6	7.6	3.7	8.1
Lending rate	10.7	12.3	18.2	20.1	19.4	17.1	21.9	16.4	19.1
Equivalent interest rate in foreign currency ⁱ	22.1	23.0	20.2	17.0	14.0	16.3	19.6	15.7	14.9

Source: ECLAC, on the basis of official figures.

^a Preliminary figures. ^b Based on constant 1982 guaraníes. ^c Based on constant 1995 dollars. ^d Percentage of the working-age population in Asunción. From 1994 on, refers to the national total for urban areas. ^e Percentages of the economically active population. Up to 1993, this figure refers to the Asunción metropolitan area. From 1994 on, it refers to the national total for urban areas. ^f Includes errors and omissions. ^g Refers to net interest as shown in the balance of payments, divided by exports of goods and services. ^h Annual averages. ⁱ Interest rate on deposits, deflated by the variation in the exchange rate.

Open-market operations, through sales of monetary regulation notes, were insignificant in the first quarter. In the Paraguayan economy, the rates on these notes serve as a benchmark, since few loans are made at the discount rate. In the second quarter, however, when the currency came under strong pressure stemming from the fragile situation in the subregion, the central bank stepped up its sales of these instruments in order to bolster its low level of international reserves. In the third quarter, note issues and the corresponding rates were both increased considerably, in order to raise interest rates generally and avert a sharp depreciation of the guaraní.

Under this policy, during the fourth quarter, average real interest rates on loans and deposits rose to 36% and

13% per year, respectively. The growth of monetary aggregates registered in December was less than the rate recorded a year earlier, with M1 expanding by just 9% and M2 by 6.4%. In view of the depreciation of the guaraní, savers increasingly preferred foreign-currency deposits, which resulted in M3 expanding by 19%.

The private banking sector posted slightly better solvency indicators than a year earlier, with the arrears index (non-performing loans as a percentage of the total portfolio) standing at 11.4% by the end of 2001. The largest State bank, Banco Nacional de Fomento, was beset by serious management problems and recorded arrears of 32%. This partly accounted for the high rates of interest in the banking system.

Table 2
PARAGUAY: MAIN QUARTERLY INDICATORS

	1999				2000				2001 ^a				2002 ^a
	I	II	III	IV	I	II	III	IV	I	II	III	IV	I
Consumer prices (12-month variation, %)	9.4	4.5	4.8	5.4	9.6	10.2	9.3	8.6	7.8	6.7	6.5	8.4	5.5
Registered exports (millions of dollars)	159	287	165	130	184	294	210	183	212	295	282	202	175
Registered imports (millions of dollars)	394	425	423	483	436	499	504	611	503	509	490	487	363
International reserves (millions of dollars)	626	643	1,006	978	888	922	748	761	597	680	682	713	575
Real effective exchange rate ^b (index: 1995=100)	97.8	100.8	108.1	107.8	109.7	108.2	107.6	104.8	105.7	106.4	116.1	122.5	103.5
Real interest rates (annualized, %)													
Deposit rate	6.7	12.1	4.8	6.9	4.3	1.4	3.5	5.6	7.1	5.9	9.7	10.7	5.8
Lending rate	17.8	25.8	22.3	21.6	19.6	13.8	16.5	15.6	16.9	18.4	21.0	21.9	14.6
Equivalent interest rate in foreign currency	22.3	22.2	17.2	16.6	16.2	15.8	15.1	15.6	15.0	13.2	16.4	18.2	3.2

Source: ECLAC, on the basis of official figures.

^a Preliminary figures. ^b Refers to exchange rate for imports.

(c) Structural reform

Some headway was made in the privatization of State-owned enterprises in 2001. Following government intervention in the National Telecommunications Authority (ANTELCO), this enterprise became a majority-State-owned corporation, under the name of Compañía Paraguaya de Comunicaciones. The water company (CORPOSANA) also became a corporation, known as Empresa de

Servicios Sanitarios de Paraguay. Expressions of interest were invited for total or partial concession of the Carlos Antonio López railway, which used to cover the Asunción-Encarnación route and now provides services between General Artigas and Encarnación. Various surveys have been conducted, but they have given conflicting predictions as to the profitability of fully resuscitating the line. Greater consensus exists on the viability of the Encarnación segment, from which the bulk of soybean exports are shipped.

3. The main variables

(a) Economic activity

The output of the Paraguayan economy expanded by 2.7% in 2001, breaking a three-year period of stagnation. This was mainly thanks to an upturn in the production of agricultural goods (10.5%), reversing the previous year's slump.

As agriculture accounts for a large proportion of Paraguayan GDP, economic trends are closely linked to events in that sector; and these, in turn, are heavily dependent on weather conditions. The excellent 2001 harvest was comparable only to those of 1988 and 1995.

The upswing in agricultural output (18.5%) came on the heels of the previous year's 8.5% contraction caused by adverse meteorological conditions. The weather was better in 2001, however, and nearly all crops registered substantially larger harvests—with increased areas under cultivation in most cases. Output of soybeans, Paraguay's leading export, grew by 18%, posting an all-time record and more than making up for the previous year's slump. Paraguay is Latin America's third largest producer of this crop, after Argentina and Brazil. In cotton, a national revival programme boosted

production, which grew at a similar pace. Cassava output also expanded sharply to post volumes similar to those of the record harvest of 1998-1999. Wheat was the only crop to buck the trend, continuing on its downward path of recent years. Certification of Paraguay's foot-and-mouth-disease status as an "FMD-free country with vaccination" was renewed, and this was expected to herald an upturn in livestock earnings in 2002.

In contrast to this, the output of non-agricultural goods declined by 6%. Manufacturing production expanded only slightly, as exchange-rate fluctuations led to a massive influx of Brazilian goods; and construction contracted sharply (-23%), registering activity levels similar to those of the early 1990s. Performance in this sector was constrained by difficulties in obtaining funding for government public works and by delays in obtaining approval for concessions.

The basic services sector expanded by 4.2%, which was half the rate recorded in 2000; the transport segment continued to grow, thanks to further investments in telecommunications, mainly in mobile telephony. Services turned in a modest 1% expansion, with recovery in trade and finance being offset by a dip in the general government subsector.

Aggregate demand staged a tentative recovery (1.3%) for the first time since 1995, on the back of stronger external demand (3%). Domestic demand edged up by 1%, thanks largely to an upturn in consumption, while gross investment retreated for the sixth year running. Private consumption, which accounts for three quarters of domestic demand, increased; but public-sector consumption dipped again following the previous year's improvement, as the effects of government spending cuts kicked in. Public investment fell steeply, while private investment shrank for the fifth year running, albeit less sharply.

(b) Prices, wages and employment

Inflation, at 8.4% in terms of the consumer price index (CPI), came in just below the previous year's 8.6% figure, thereby making it possible to meet the target set in the IMF programme in April 2001. Price hikes in the food and clothing sectors were smaller than in 2000, partly because of increased competition from Brazilian goods, despite depreciation of the guaraní, which tended to moderate price increases among domestic products. Inflation in transport prices slowed significantly in 2001, easing to 9.5% compared to 24.6% in 2000, thanks to smaller hikes in public transport fares. Conversely, costs rose faster in the housing and health sectors, and in miscellaneous expenses.

In keeping with the nominal devaluation of the

guaraní (17.8% in 2001), price increases in the imported goods segment of the CPI averaged 14.8%, up from the previous year's 6.9%. The cost of locally-produced goods rose by 6.9%, compared to 9% in 2000.

The real average wage grew for the second year running, this time by 1.4%, thereby restoring the purchasing power lost in earlier years. Real wages in manufacturing and commerce rose by around 5%, while pay in the construction sector remained at the same real levels as in 2000. Service-sector workers, including those in the electricity, gas and water sector, saw their wages shrink by 5%-6%, in a continuation of the trend that has been ongoing since 1998. On a slightly more positive note, the minimum wage rose at a real annual rate of about 4% in the 2000-2001 biennium, helped undoubtedly by the fact that the inflation target was met.

Nationwide open unemployment edged up to 7.6% in 2001 from 7.3% a year earlier –which itself was nearly a percentage point higher than the 1999 figure. Sagging economic activity in urban areas pushed unemployment up from 10% to 10.8%, despite a drop in the labour force participation rate –particularly among women. Construction was one of the sectors to record the sharpest drop in employment levels.

(c) The external sector

The current account deficit widened from US\$ 190 million in 2000 to US\$ 220 million in 2001, equivalent to 3.5% of GDP. Trade in goods and services did not depart significantly from the gradual downward trend that has prevailed since 1996; exports edged up very slightly and imports dipped minimally, which narrowed the trade deficit to US\$ 370 million. In contrast, the factor income account slipped from surplus into deficit, which, combined with current transfers of US\$ 170 million, generated a small increase in the current account deficit.

The current account was financed by a net capital inflow of about US\$ 160 million and by drawing down international reserves by approximately US\$ 60 million. The financial account absorbed US\$ 150 million in FDI and US\$ 130 million in medium- and long-term loans, but these inflows were offset by short-term capital outflows of about US\$ 120 million. In the first semester of 2001, FDI flows consisted of equity investment (48%) and reinvested profits (37%), with the balance made up by loans from parent companies or shareholders.

Registered exports, which accounted for 42% of the total, expanded by 14%. Exports of soybeans, the leading product, grew by 25%, while sales of the main

livestock items continued to expand to match the record levels of the previous decade. Cotton exports remained flat, however.

Imports were virtually unchanged at US\$ 2.9 billion, although registered imports (70% of the total) declined slightly. The decline was steeper among consumer and capital goods, where machinery imports slipped for the third year running, this time by 12%. Imports of intermediate goods were up by nearly 5% overall, but registered imports in this category fell back by 3%, thanks to lower oil prices in 2001.

Paraguay posted a deficit of nearly US\$ 600 million in trade with its MERCOSUR partners in 2001 –over 8% higher than the previous year’s negative balance.

The trade gap with Argentina amounted to US\$ 418 million, mainly reflecting a slump in exports (-34%). With Brazil, the deficit virtually doubled to US\$ 336 million, with exports plunging by 17% while imports from that country expanded by 13%. Paraguay’s trade with Uruguay ended the year in surplus by over US\$ 100 million.

Although 2001 was a difficult year for raising external financing, the country’s external debt, owed mainly to governments and multilateral creditors, dropped to US\$ 2.6 billion. External debt represented 90% of total exports, which, despite having increased threefold since 1995, is still one of the lowest ratios in the region.