Paraguay

According to the Economic Commission for Latin America and the Caribbean (ECLAC), the Paraguayan economy is likely to end 2020 with a contraction of 1.6% and year-on-year inflation between 1.5% and 2%. The robust fiscal-policy measures adopted to mitigate the economic effects of the health crisis will widen the central government fiscal deficit, which is expected to reach 6.5% of gross domestic product (GDP). In contrast, the current account deficit is set to narrow on the back of a recovery in commodity exports and the effect of subdued domestic demand on imports.

At the end of the third quarter, the central government's fiscal deficit represented 3.5% of GDP, as a result of an operating deficit of 1.7% of GDP and net acquisition of assets equivalent to 1.9% of GDP. The operating deficit reflects an 8.7% contraction in total income and an 11.9% increase in total expenditure, both in real terms.

The drop in income reflects the effect of the slacker economic activity on tax revenue, together with tax relief measures (including a cut in value added tax (VAT) on certain products and services) and the possibility of postponing the payment of some taxes. Nonetheless, VAT revenue intake has grown strongly since the start of the third quarter.

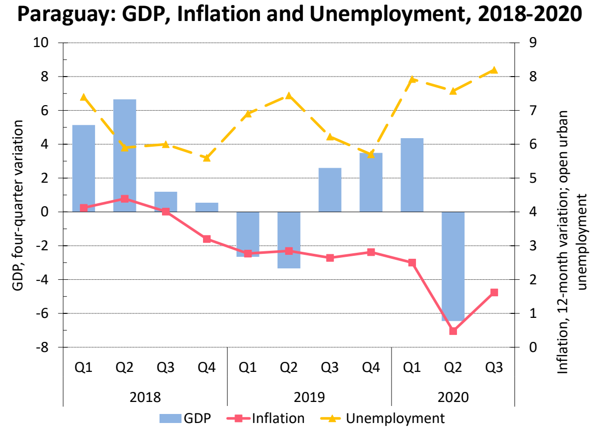
The increase in expenditure is driven by the implementation of emergency and recovery measures in response to the economic crisis, which resulted in a 4.7% real increase in expenditure on personal services —explained by a wage hike for civil servants and the hiring of health workers— and a 59.7% real increase in social benefits. These corresponded to programs to support vulnerable populations and subsidies for public services.

The fiscal deficit has been financed by issuing sovereign bonds (US$450 million in January and US$1 billion in April), together with multilateral financing, including loans from the World Bank (US$ 300 million) and the International Monetary Fund (IMF) (US$ 274 million). As a result, the public debt at the end of the third quarter represented 31.3% of GDP, 8.6 percentage points higher than in late 2019.

In the medium term, the economic recovery plan envisages measures aimed at gradually reducing the fiscal deficit until it converges in 2024 on the 1.5% of GDP target specified in the Fiscal Responsibility Law. The measures include the gradual implementation of the tax reform approved at the end of 2019 and the containment of current expenditure.

Since March, the Central Bank of Paraguay has adopted a strongly expansionary stance, lowering its monetary policy rate by 325 basis points between March and June to 0.75% and cutting the rate charged on its temporary liquidity facility by 200 basis points to 2.5%. In addition, legal reserve requirements were reduced to increase liquidity in the financial system, thus

Paraguay: GDP, Inflation and Unemployment, 2018-2020



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

freeing up nearly US$ 960 million for lending; and a special credit facility was created that will channel up to US$ 760 million to small and medium-sized enterprises. This has been supplemented by authorization to renegotiate existing credits and to make new lending more flexible.

Both lending and deposit interest rates have trended down since the second quarter of the year; and, by September, the M2 monetary aggregate had expanded by 8.3% in nominal terms since the end of 2019. This had a positive impact on lending to the private sector which, despite the complicated economic situation, grew by 1.2% in nominal terms in the same period. Most of this credit expansion was in national currency (+3.7%), since foreign-currency lending (44.2% of the total) contracted by 1.8% during the period.

Up to September, the guaraní had appreciated in annual average terms by 30.1% against the Argentine peso and by 12.1% with respect to the Brazilian real, the currencies of Paraguay's main trading partners. In contrast, it had depreciated by 8.5% against the dollar and by 7.8% relative to the euro. The real exchange rate displayed a slight depreciation of 0.4%.

Paraguay: main economic indicators, 2018-2020

	2018	2019	2020 [a]
	Annual growth rate		
Gross domestic product	3.4	0.0	-1.6
Per capita gross domestic product	2.0	-1.3	-2.8
Consumer prices	3.2	2.8	1.6 [b]
Real average wage [c]	1.8	1.5	0.7 [b]
Money (M1)	10.1	4.3	17.0 [b]
Real effective exchange rate [d]	-5.4	2.0	-1.6 [b]
Terms of trade	-2.2	-3.5	5.5
	Annual average percentage		
Open unemployment rate [e]	6.2	6.6	7.9 [b]
Central government			
Overall balance / GDP	-1.3	-2.8	...
Nominal deposit rate [f]	6.6	7.3	7.3 [g]
Nominal lending rate [h]	12.9	12.7	11.4 [g]
	Millions of dollars		
Exports of goods and services	14 677	13 625	5 719 [i]
Imports of goods and services	14 197	13 499	5 212 [i]
Current account balance	-70	-385	122 [i]
Capital and financial balance [j]	-113	331	1 409 [i]
Overall balance	-183	-55	1 531 [i]

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
a/ Estimates.
b/ Figures as of October.
c/ Wage and salary index.
d/ A negative rate indicates an appreciation of the currency in real terms. Refers to the global real effective exchange rate.
e/ New measurements have been used since 2017; the data are not comparable with the previous series.
f/ Weighted average of effective fix term deposit rates.
g/ Figures as of August.
h/ Commercial lending rate, local currency.
i/ Cumulative figures to the second quarter of 2020.
j/ Includes errors and omissions.

In the first half of 2020, the current account of the balance of payments strengthened with respect to the end-2019 situation, accumulating a surplus of US$ 236.2 million (0.7% of GDP). This stemmed from an improvement in the trade balance, where a 16.3% fall in imports outweighed the 15.4% drop in exports. The trade surplus offset both a larger deficit on the income account and a reduction in remittances from abroad.

Despite acquisition of financial assets totalling more than US$ 1.4 billion in the first quarter of 2020, a US$ 357.7 million inflow of foreign direct investment and the sovereign bond placement explain the financial account surplus of US$ 875.9 million. The overall balance of payments surplus allowed for an increase in net international reserves by US$ 1.350 billion as of end-October 2020, to a level of US$ 9.024 billion (25.6% of GDP).

Economic activity contracted by 0.9% in the first half of 2020, owing to the impact of the health measures adopted to reduce the spread of the coronavirus disease (COVID-19). The 4.4% reduction in the services sector, which was the hardest hit by the mobility restrictions, was mitigated by a recovery in agriculture (+18.8%) and, to a lesser extent, by the buoyancy of construction (+9.4%) driven by public investment. On the demand side, a 3% reduction in household consumption was partially offset by a 3.3% expansion in government consumption and a 2.4% increase in investment. The impact of net exports on growth was slightly positive.

The monthly figures point to a rebound in economic activity since May, when the mobility restrictions began to be lifted. Based on the seasonally adjusted series, GDP grew by 8.7% in the third quarter, following the previous quarter’s 9.4% contraction. However, the sales turnover indicator suggests a uneven recovery across sectors, with clothing in large stores, vehicles and fuel all down, but significant growth in construction materials and cell phone services.

Given the contraction in domestic demand and the relative stability of the exchange rate, average annual inflation eased from 2.8% at the end of 2019 to 1.8% in October 2020, which is below the lower bound of the target range of 4.0% +/-2 percentage points. The sharpest deceleration in prices occurred in the transport sector and in water, electricity, gas and other categories, which includes fuels. As a result, average core inflation remained around 2.6% in October.

After falling to 66.7% in the second quarter of 2020, the labour market participation rate rose to 70.7% at the end of September —but still below the 71.8% recorded in the second quarter of 2019. However, the rise in the participation rate was accompanied by an increase in both unemployment (8.2%) and underemployment (9.2%). The deterioration in labour market conditions during this period has been particularly acute for women, whose participation rate fell to 57.5% in the third quarter of 2020 —almost 2 percentage points lower than in the third quarter of 2019. The aggregate rate of unemployment and unemployment among women rose from 17.4% to 24.6% in the same period.

The index of wages and salaries was up by 2.3% year-on-year in nominal terms at the end of the first half of 2020, compared to the year-earlier rise of 4.2%. This was mainly due to the trend of wages and salaries in the manufacturing sector. However, lower inflation meant that, in real terms, growth in the wage and salary index accelerated from 0.4% to 1.8% in the same period.

Based on the recent buoyancy, ECLAC forecasts that Paraguay’s economy will grow by 3.5% in 2021. This will likely cause a slight uptick in inflation, although the rate will remain within the target range. In the external sector, the current account surplus is expected to widen as external demand stages a relative recovery. Lastly, on the public finance front, the central government’s fiscal deficit is set to narrow. The projection for 2021 assumes continued momentum in primary activities and the maintenance of measures to support the economy.