

Paraguay

After closing out 2020 with an economic contraction of just 0.6%, the Paraguayan economy is set to grow by 4.6% in 2021, with the pace of growth slowing towards the end of the year, according to the projections of the Economic Commission for Latin America and the Caribbean (ECLAC). The recovery of domestic demand, coupled with international food and fuel price trends, has driven up the inflation rate, which, at an expected rate of around 7% at year's end, will be above the upper limit of the target band. The gradual withdrawal of fiscal stimuli equivalent to nearly 4 percentage points of GDP in 2020 has reduced the central government deficit from 6.1% of GDP in 2020 to 3.6% of GDP in 2021. As a result of domestic demand's influence on imports, a slight decrease in the surplus on current account is expected, which should stand at around 1% at year's end.

The reduction in the central government's deficit is accounted for by the impact of the recovery in economic activity on tax receipts, as well as the gradual reduction of fiscal incentives for spending and investment. The primary deficit at the close of 2021 stood at 2.5% of GDP.

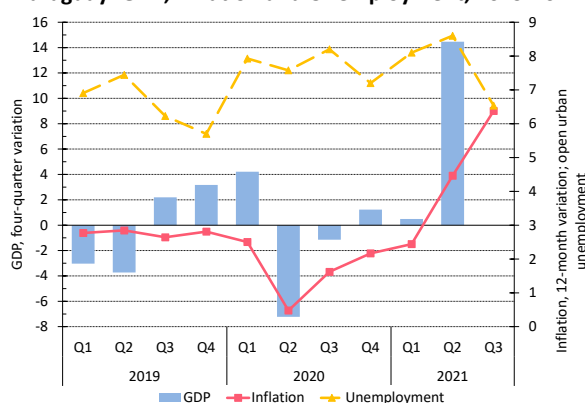
During 2021, total income climbed by 8.7% in real terms to the equivalent of 13.5% of GDP. The increase was primarily a reflection of the trend in tax revenues, which rose by 10.5% in real terms to 9.6% of GDP as compared to 9.5% of GDP in 2020. The real 3.3% decline in expenditure was chiefly due to the high level of the 2020 comparator, which was in turn attributable to the large number of social emergency programmes that were in place in 2020. The net acquisition of non-financial assets was down by 0.7 points of GDP to 2.9% of GDP.

During 2021, the fiscal deficit was mainly financed through debt placements on the national market, but early in the year Paraguay also floated a US\$ 600 million sovereign bond issue with an 11-year maturity at 2.74% interest, a spread of just 165 base points greater than comparable United States Treasury bonds. At the close of 2021, the public debt balance came to US\$ 13.631 billion (33.8% of GDP); external debt amounted to 87% of the total.

Based on official estimates, the central government deficit is projected to remain above the threshold of 1.5% of GDP stipulated in the Fiscal Responsibility Act at least until 2024. Over the medium term, the only way to reduce the deficit will be by gradually cutting public expenditure, since the only measures envisaged for increasing government revenues are improvements in tax administration. This represents a risk for public investment.

In the medium term, inflation expectations have held fairly steady at around the 4% target. Nonetheless, the fact that there is less slack in the economy and the upswing in inflation seen beginning in May convinced the Central Bank of Paraguay to move away from its accommodative

Paraguay: GDP, Inflation and Unemployment, 2019-2021



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

monetary policy stance and raise its reference rate by 500 base points between August and December 2021. This put the rate up to 5.25%, which was well above the 4.5% rate cited in the survey of economic expectations conducted in December.

Given the lags typical of the monetary policy transmission mechanism, despite recent adjustments in the monetary policy rate, the weighted average lending rate up to November 2021 was 12.2%, compared to 13.6% for the corresponding period in 2020. A similar situation was to be observed in the case of nominal deposit rates, which averaged 2.9% up to November 2021 versus the average of 3.8% for the same period the year before.

After having expanded by 19.6% in 2020, the broad monetary aggregate (M2) grew by just 6.8% in 2021. Thanks to government stimulus measures, the slowdown in deposits did not translate into a reduction in lending to the private sector, however, as the nominal growth rate for private-sector lending climbed from 8.0% in the period up to November 2020 to 9.6% for the same period of 2021.

Throughout 2021, the nominal exchange rate for the guaraní continued to appreciate against the Argentine peso and the Brazilian real and to depreciate against the United States dollar. At the close of the year, the trade-weighted nominal exchange rate against the currencies of the country's main trading partners (Argentina and Brazil) had depreciated by an annual average of 1.1% (versus 11.1% in 2020). Owing to the difference in their inflation rates, the real exchange rate depreciated by 9.8% during the same period (0.9% in 2020).

At the end of the third quarter of 2021, the surplus on current account stood at US\$ 975.7 million, thus outdistancing the surplus in 2020 as a whole, which had been the equivalent of 2.5% of GDP. The improvement is accounted for by the outturn on the merchandise trade balance, which more than offset the slight increases in the deficits on the services balance and the income account. The surplus on the trade balance for goods was made possible by the upswing in the value of exports, which was driven by higher commodity prices, especially for soybean. Exports grew faster than imports, with strong growth in intermediate and capital goods imports. In the remainder of the year, the external sector is expected to be less buoyant owing to the negative impact of the drought on energy exports and the effect of the projected softening of domestic demand on imports.

The result on the financial account balance up to the end of the third quarter (US\$ -159 million) was mainly a reflection of the deficit on the "other assets" account (US\$ -773.6 million), which was partially counterbalanced by a net inflow of US\$ 118.3 million in foreign direct investment and US\$ 496.4 million in portfolio investment. Portfolio investment liabilities were sharply down, at US\$ 496 million at the end of the third quarter of 2021 from US\$ 1.8 billion in the year-earlier period as a consequence of the country's reduced need for crisis-related financing.

Paraguay: main economic indicators, 2019-2021

	2019	2020	2021 ^a
	Annual growth rate		
Gross domestic product	-0.4	-0.6	4.6
Per capita gross domestic product	-1.7	-1.9	3.3
Consumer prices	2.8	2.2	6.4 ^b
Real average wage ^c	1.5	-0.8	-3.2 ^b
Money (M1)	4.3	19.0	17.7 ^d
Real effective exchange rate ^e	2.0	-0.9	1.8 ^b
Terms of trade	-3.5	5.5	11.6
	Annual average percentage		
Open unemployment rate	6.6	7.7	7.7 ^b
Central government			
Overall balance / GDP	-2.8	-6.2	...
Nominal deposit rate ^f	7.3	7.2	6.6 ^d
Nominal lending rate ^g	12.7	10.7	9.8 ^d
	Millions of dollars		
Exports of goods and services	13 625	12 122	15 823
Imports of goods and services	13 499	10 854	15 084
Current account balance	-212	887	209
Capital and financial balance ^h	157	918	...
Overall balance	-55	1 805	...

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

a/ Estimates.

b/ Figures as of Septiembre.

c/ Wage and salary index.

d/ Figures as of August.

e/ A negative rate indicates an appreciation of the currency in real terms. Refers to the global real effective exchange rate.

f/ Weighted average of effective fix term deposit rates.

g/ Commercial lending rate, local currency.

h/ Includes errors and omissions.

At the end of the third quarter of 2021, the Paraguayan economy was displaying a year-on-year growth rate of 5.8% (at that point in 2020, it had contracted by 1.5%). The services (7.6%) and manufacturing (8.6%) sectors exhibited particularly strong growth as economic activity began to rebound, as did construction (16.9%), thanks to the momentum generated by the country's economic reactivation plan. In the primary sector, the 8.8% slump in agricultural activity was attributable to the drought that has gripped the country.

The dynamism of expenditure in the first three quarters of the year was driven by household consumption (5.6%) and gross fixed capital formation (22.2%). Given the robustness of domestic demand, net imports have subtracted 3.6 percentage points from GDP growth.

As can be gleaned from the trend in the monthly indicators of economic activity, although the Paraguayan economy continued to expand, the year-on-year growth rate of 4.4% registered during the third quarter was a steep drop from the 13% year-on-year rate posted for the second quarter of the year. This was principally a reflection of the impact of the drought on electrical power generation (the energy and water supply subsector accounted for 7.1% of the country's GDP in 2020) and the high basis of comparison.

As demand heated up and international food and energy prices rose, in June the year-on-year inflation rate breached the ceiling of the target band (two percentage points above and below the target rate of 4%). By the close of 2021, the 12-month inflation rate had reached 6.8%, with some of the main drivers being food and non-alcoholic beverage prices (12.3%) and transport (11.4%). The underlying inflation rate (which excludes the prices of fruits and vegetables, fuel prices and service charges) continued to climb, closing out the year at 5.8%.

The labour market participation rate, which had begun to rebound in the third quarter of 2020 reached 72.9% in the first quarter of 2021, similar to pre-pandemic levels, although by the end of the third quarter of 2021, it had edged down to 71.4% (as the overall result of a male participation rate of 84% and a female participation rate of 59.1%). In the first half of 2021, this higher labour market participation rate was coupled with a higher unemployment rate: at 8.6% at the end of the second quarter of 2021, the jobless rate was a percentage point above where it had been during the same period of 2020. Unemployment was particularly high among women, for whom the jobless rate rose from 8.8% to 11.2% during that period.

The nominal minimum wage was up by a scant 2.2% over its 2020 average, which translated into a 2.5% loss of purchasing power for workers earning this wage in 2021. Similarly, the wage and salary index climbed by a nominal rate of 2.7% during the first half of 2021, with most of that growth being driven by wages and salaries in the transport (5.4%), construction (4.4%) and financial intermediation (4.1%) industries, for a 1.6% reduction in real terms.

ECLAC projects 3.8% growth for the Paraguayan economy in 2022 as a result of the performance of services and, to a lesser extent, manufacturing. A weakening of domestic demand is likely to dampen inflation, but inflation is still expected to remain above the upper limit of the central bank's target range. The government is expected to continue with its fiscal consolidation effort in 2022, while the surplus on current account will be buoyed by the upward trend in international food prices. The main risk factors that could undercut these projections for 2022 are a deepening of the drought and a resurgence of the coronavirus disease (COVID-19).