

Paraguay

Estimates show that growth in the Paraguayan economy increased to around 4% in 2006, with livestock and communications once again the most dynamic sectors. Crop-growing activity also trended positively despite being hampered by drought for the third year running. Central government accounts are expected to be in balance, while monetary policy has managed to ease the pace of inflation somewhat, but not enough to keep it around the target of 5%. The nominal exchange rate of the guaraní reflected a sharp appreciation against both the dollar and the real. Up to September, registered import values were up by 73% while registered exports grew by just 13%, which caused the balance of registered trade to deteriorate.

In 2006 the Paraguayan Government signed a new agreement on special drawing rights with the International Monetary Fund (IMF) which entered into force in June and will last until August 2008. Against this backdrop, and following the trend of the last three years, the goal of fiscal policy has been to contain current expenditure and increase tax revenues. To that end, the government froze staff hiring, initially until August, and subsequently until the end of the year. Nonetheless, the 12% increase in the minimum wage decreed in April 2006 will have repercussions on fiscal expenditure. Moreover, the introduction of personal income tax, which was announced for 2006, has been delayed for one year. Central government fiscal accounts are expected to end the year in balance or record a small surplus, similar to the previous year's result.

On the monetary-policy front, the Central Bank of Paraguay maintained the 5% inflation target adopted in early 2005. In November 2006 the consumer price index (CPI) was showing a year-on-year rise of 8.9%, in breach of the ceiling set at 2.5% above the target rate; cumulative inflation to November stood at 9.5%. Exchange-rate appreciation could help to restrain inflation by the end of the year. However, one of the key factors in the trend of the CPI has been the high price of beef, caused by supply shortages on the domestic market in the face of growing external demand.¹ Given this

upward price pressure, the authorities decided to import meat from other countries (such as Argentina and Bolivia) to supply the domestic market.

In the first half of the year, the monetary authority continued with the process of raising interest rates on its debt instruments (Monetary Regulation Instruments, IRM), which had started in mid-2005, with a view to containing inflation. Nonetheless, the monetary aggregates M0 and M1 still rose by more than 15% in nominal terms, thereby generating excess liquidity in the market and adding to inflationary pressures in the medium term. The accumulation of international reserves continues to be the main factor driving the expansion of M0, although this has been partially sterilized by issuing IRMs.

The nominal exchange rate reflected a sharp appreciation in 2006: up to October, the cumulative nominal appreciation of the guaraní was 12.5% against the dollar and 5.7% against the real. This would seem to have been caused by large inflows of foreign exchange stemming mainly from foreign meat sales, family remittances, flows from the binational entities (Itaipú and Yaciretá) and capital movements. Foreign-exchange inflows have also resulted in an accumulation of international reserves amounting to US\$ 1.547 billion in September, representing a 19.3% increase in relation to December 2005.

¹ External demand has been affected by the reduced supply of meat from Argentina, following domestic restrictions on exports of this product, and from Brazil as a result of foot and mouth disease.

As a consequence of exchange-rate and inflation trends, the guaraní appreciated in real terms by 12.3% (cumulatively to October) in relation to the currencies of Paraguay's trading partners, and this served to fuel import growth.

Economic activity is estimated to have grown faster than in 2005. In the services sector, the strongest performers included communications, thanks to an expansion of cellular telephony; commerce, driven by the growth of imports; and transport, influenced by trade buoyancy and the growth of activities related to meat production. The monthly indicator of economic activity in Paraguay (IMAEP), published by the central bank, shows that the business and household services and general government sectors have also trended positively throughout the year.

In the case of goods, crop output recovered following its 5.8% fall in 2005, even though harvests were damaged by drought for the third consecutive year. Soybean production was down by 4.7%, while cotton output declined by 9.1%. Production of cassava, which is ranked second in terms of total agricultural output, remained virtually flat. The crops that will fuel growth in the agriculture sector include maize (32.5%), rice (23.5%), sugar cane (6%), peanuts (5.9%), sunflower (5.4%) and beans (4.5%).

The livestock sector grew vigorously, driven by robust demand particularly from abroad. As a result, meat production is estimated to have led the industrial sector, although dairy products and machinery and equipment also performed well. IMAEP figures suggest that construction activity grew more slowly, however.

Paraguay's registered trade deficit was displaying an increase up to September 2006, with the growth of imports outpacing exports.² Meat exports have grown

Table 1
PARAGUAY: MAIN ECONOMIC INDICATORS

	2004	2005	2006 ^a
Annual growth rates			
Gross domestic product	4.1	2.9	4.0
Consumer prices	2.8	9.9	8.9 ^b
Average real wage	-2.7	1.1	...
Money (M1)	29.6	22.3	16.7 ^c
Real effective exchange rate ^d	-3.7	9.5	-9.4 ^c
Terms of trade	2.8	-6.6	-1.9
Annual average percentages			
Urban unemployment rate	10.0	7.6	...
Central administration overall balance/GDP	1.6	0.8	0.8
Nominal deposit rate	5.7	6.1	9.3 ^e
Nominal lending rate	21.2	15.3	16.3 ^e
Millions of dollars			
Exports of goods and services	3 492	3 927	5 091
Imports of goods and services	3 409	4 098	5 669
Current account	138	-22	-265
Capital and financial account	130	169	545
Overall balance	268	147	280

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

^a Preliminary estimates.

^b Twelve-month variation to November 2006.

^c Year-on-year average variation, January to October.

^d A negative rate indicates an appreciation of the currency in real terms.

^e Average from January to July, annualized.

substantially (83.6%), while exports of soybean and cotton and its by-products have fallen by 20.4% and 27.1%, respectively, reflecting declines in their output. Maquila exports, in contrast, have risen strongly. The fact that imports have been led by machinery and equipment will have positive repercussions on gross fixed capital formation. Nonetheless, a further deterioration in the terms of trade is expected, even though the oil price has fallen on international markets and export prices for Paraguayan meat have risen.

² Nonetheless, foreign-exchange inflows from meat exports suggest that total exports will be substantially higher than the registered figure.