

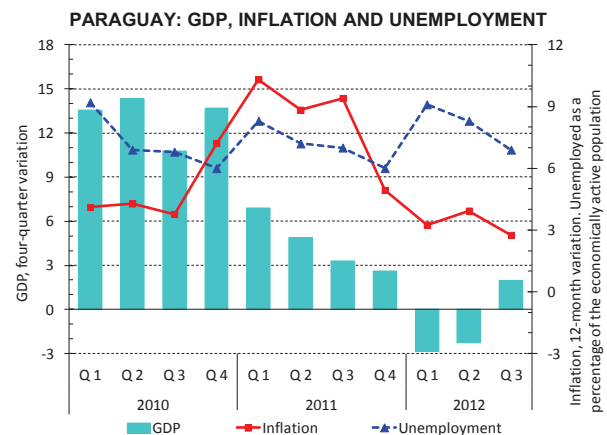
## Paraguay

Paraguay's GDP contracted by 1.8% in 2012 as the key sector of its economy –agriculture– dropped sharply due to the severe drought that hit the country in late 2011 and early 2012. Countercyclical policies implemented by the government and central bank prevented further contraction of the economy in 2012 by boosting economic activity in the non-agricultural sector. Although a marked decline in meat exports was expected following the outbreak of foot-and-mouth disease detected in September 2011, the livestock sector contracted only slightly. The government's countercyclical fiscal policy was reflected in a considerable rise in public spending that took the fiscal deficit to 2.8% of GDP. To October 2012, the year-on-year variation in the consumer price index was 3.4%, lower than the 5.6% posted in 2011. However, this figure is expected to increase slightly by year-end, owing to the upturn in economic activity and a rise in food prices, especially the price of beef on the local market. In the external sector, the current account deficit is expected to rise due to a wider trade deficit. Economic activity is expected to pick up in 2013, particularly in the agricultural and external sectors, with an estimated growth rate of close to 8.5%.

On the legislative front, the personal income tax bill was approved after being shelved for the past four years. The new law entered into force on 1 August 2012. However, it will not increase public revenue by much over the short run because during the first few years it will only apply to a limited number of taxpayers. It will have an indirect impact on value added tax (VAT) revenue since it encourages the formalization of certain transactions. As for financial regulations, measures were adopted to increase the capital held by financial institutions in the face of financial market-related risks. Similarly, changes to reserve requirements on foreign currency deposits and, to a lesser extent, local currency deposits were implemented to minimize the financial system's exposure to deposits and liabilities currency mismatches.

There was a fiscal deficit of 2.8% of GDP in 2012 –the first public account deficit since 2003. Flagging economic activity in the agricultural sector caused by the drought prompted the government to implement an expansionary fiscal policy with a significant increase in current expenditure. Much of the spending was on a

30% wage hike for public employees. Total central government spending therefore rose by 33% compared with 2011. Public revenue collections grew by 11% owing to a considerable rise in non-tax revenues. Tax revenues recorded a more moderate increase during the period, mainly due to a slight fall in taxes on



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

foreign trade. The decline in the agricultural sector did not have a marked impact on public revenue because it accounts for a very small share of the government tax take.

Given the economic contraction and lower inflationary pressures in 2012, the Executive Committee for Open Market Operations and Reserves (CEOMA) of the Central Bank of Paraguay took an expansionary monetary policy stance. The weighted average interest rate on monetary regulation instruments thus declined from 6.6% in January 2012 to 5.5% in August, where it has remained since then.

The nominal exchange rate of the guaraní against the United States dollar posted a year-on-year depreciation of 6.6% to October 2012. With regard to the real effective exchange rate, the guaraní depreciated against the dollar (by 6.8%), the euro (1.0%) and the Argentine peso (3.3%), and appreciated against the Brazilian real (3.1%). The depreciation of the guaraní was due primarily to the widening current account deficit in 2012.

After growing at a moderate 4.3% in 2011, GDP dropped by 1.8% in 2012 due to the decline in the key sector of Paraguay's economy –agriculture, which represented 20% of GDP in 2011. This was the result of the severe drought which affected the country between December 2011 and February 2012. According to Ministry of Agriculture and Livestock estimates, production of soybeans (the country's main export) dropped by 48% and total agricultural output fell by 28%. However, moderate growth in the non-agricultural sector meant that the fall in GDP was relatively small considering the sharp decline in the agricultural sector and the importance of this sector in the economy. On the spending front, the sharp jump in public expenditure, especially current expenditure, shored up domestic demand in 2012 and helped boost non-agricultural sector growth.

According to the findings of the continuous employment survey, unemployment stood at 6.9% (7.1% for men and 6.7% for women) in the third quarter of 2012, close to the rate for the same period in 2011. The central bank's wage and salary index showed a year-on-year variation of 4.9% to June 2012.

To October, year-on-year inflation stood at 3.4%, below the midpoint of the target range set by the central bank (5% plus or minus 2.5 percentage points). The inflation rate declined in 2012 due to the slowing economy and falling livestock sector product prices as a consequence of restrictions on meat exports to certain markets in response to the foot-and-mouth outbreak

#### PARAGUAY: MAIN ECONOMIC INDICATORS

	2010	2011	2012 <sup>a</sup>
<b>Annual growth rates</b>			
Gross domestic product	13.1	4.4	-1.8
Per capita gross domestic product	11.1	2.6	-3.4
Consumer prices	7.2	4.9	3.4 <sup>b</sup>
Real average wage	0.7	2.8	0.3 <sup>c</sup>
Money (M1)	28.7	7.8	8.3 <sup>d</sup>
Real effective exchange rate <sup>e</sup>	-3.0	-10.6	2.4 <sup>f</sup>
Terms of trade	0.0	2.4	2.8
<b>Annual average percentages</b>			
Open urban unemployment rate	7.0	6.5	...
Central government			
overall balance / GDP	1.2	0.7	-2.8
Monetary police rate	2.2	8.0	6.1 <sup>g</sup>
Nominal lending rate <sup>h</sup>	13.2	16.3	15.6 <sup>g</sup>
<b>Millions of dollars</b>			
Exports of goods and services	9 993	12 305	11 127
Imports of goods and services	10 671	12 969	11 971
Current account balance	-654	-270	-469
Capital and financial balance <sup>i</sup>	973	1 054	510
Overall balance	319	784	41

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

<sup>a</sup> Estimates.

<sup>b</sup> Twelve-month variation to October 2012.

<sup>c</sup> Figure for June.

<sup>d</sup> Year-on-year average variation, January to September.

<sup>e</sup> A negative rate indicates an appreciation of the currency in real terms.

<sup>f</sup> Year-on-year average variation, January to October.

<sup>g</sup> January-October average.

<sup>h</sup> Weighted average of the system lending rates.

<sup>i</sup> Includes errors and omissions.

detected in 2011. Year-on-year core inflation, which excludes the most volatile items in the basket (fruits and vegetables), stood at 3.3% to October 2012. Year-on-year X1 core inflation (which excludes not only fruits and vegetables but also regulated services and fuels), was 3.0% to October 2012.

The external sector performed particularly poorly in 2012. Agricultural export value and volume declined owing to the drought, pushing exports down by around 11%. Despite the outbreak of foot-and-mouth disease that was detected in late 2011 and led to the suspension of Paraguay's status as a foot-and-mouth-free country where vaccination is practised, meat exports were up slightly in 2012 as they were redirected to new international markets throughout the year. Imports contracted by 8%, which was less than the decline in exports, due to a sharp drop in imports of capital goods. The current account is expected to post a deficit of 2.1% of GDP at year-end 2012, compared with 1.2% in 2011.

Paraguay's GDP is expected to grow by 8.5% in 2013, fuelled mainly by an upturn in the agricultural sector. Exports (especially soybean exports) are expected to pick up, which should narrow the current account deficit. On the public spending front, despite the countercyclical fiscal policy implemented in 2012, government outlays are not expected to slow

significantly next year. This is due to several factors: (i) the 30% public wage hike implemented in 2012, which is a rigid expenditure and therefore involves a permanent change to the central government's spending structure; (ii) Ministry of Finance plans to

widen capital spending significantly; and (iii) the presidential elections scheduled for March 2013. The government is preparing a sovereign bond issue of about US\$ 550 million for January 2013; it would be Paraguay's first bond issue since 2000.