

## Paraguay

In 2022, Paraguay's economic activity reflected a sharp contraction in agriculture, which was severely affected by the drought since the end of 2021. This was compounded by the effects of the conflict between the Russian Federation and Ukraine, leading to a rapid acceleration of inflation, which reached around 8.5% year-on-year at year-end. This has affected households' disposable income.

Monthly activity figures show a recovery in growth from the second quarter of 2022, driven by improved weather conditions that benefited agricultural activity and generation and exports of electricity. However, estimates by the Economic Commission for Latin America and the Caribbean (ECLAC) suggest the recovery will not be enough to prevent a slight contraction in GDP (-0.3%).

Given the fall in primary exports and the price effect on the value of imports, the balance of payments current account deficit is expected to widen from 0.9% of GDP in 2021 to 5% in 2022. The fiscal consolidation effort made will be reflected the central government deficit narrowing from 3.7% of GDP in 2021 to 3% in 2022.

In 2022, the fiscal policy stance has been aligned with a target of a maximum deficit of 1.5% of GDP in 2024. The accumulated deficit through to October 2022 was 3.8% smaller in real terms year-on-year, as a result of a drive to contain spending.

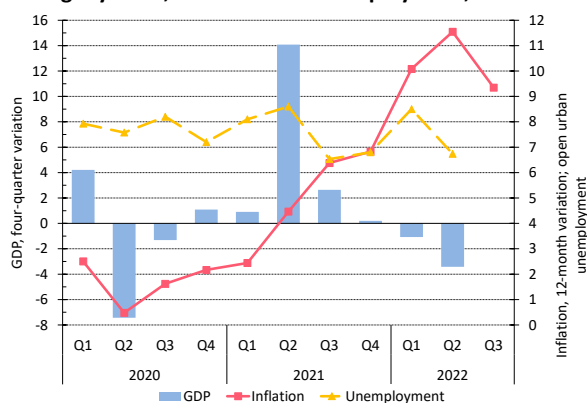
Through to the end of October, central government revenues were relatively stable in real terms. This is the result of robust growth in tax revenues (up 5.6% with respect to the same period of the previous year), boosted by rises in import values, offsetting the 13.1% drop in real terms in non-tax revenues, reflecting lower income from the Itaipu binational hydropower plant.

Through to October, total spending contracted by 1.3% in real terms on the back of lower consumption of goods and services, linked to a decline in expenses related to purchases of vaccines and outsourcing of health services. In contrast, there were rises in employee remuneration, primarily owing to wage changes for public officials, and in interest payments, reflecting the pattern in public debt.

At September, the total balance of public debt stood at US\$ 14.671 billion, equivalent to 36.7% of GDP. This is an increase of over 2 percentage points in the ratio compared to year-end 2021. Despite this greater indebtedness, the level of public debt is still low relative to other countries with similar income. The main threat to the sustainability of the public debt is depreciation of the guaraní, since the Ministry of Finance estimates that 97.5% of the total is external debt.

The proposed budget for 2023 projects a fiscal deficit equivalent to 2.3% of GDP. The anticipated deficit is smaller owing to a forecast rise in revenues tied to the economic recovery and an ongoing effort to limit spending. Given the

**Paraguay: GDP, Inflation and Unemployment, 2020-2022**



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

tightening of international financial conditions, the deficit is expected to be financed mainly through multilateral resources and, to a lesser extent, sovereign bond placements.

In view of the upturn in inflation, the Central Bank of Paraguay continued to raise the benchmark rate in 2022, having begun to do so in August 2021, reaching 8.5% in September 2022. However, as inflation slowed from 11.8% year-on-year in April to 8.3% in November, at its October and November meetings, the Monetary Policy Committee decided to leave the benchmark rate unchanged.

Movements in the benchmark rate were mirrored by the average interbank rate, which rose from 0.55% in mid-2021 to 8.44% in October 2022. Despite higher lending rates, whose weighted average in nominal terms hit 15.11% in September 2022, banking sector lending to the private sector grew by 26.3% in nominal terms, driven by demand for dollar-denominated credit for investment.

Growth in lending and tighter financing conditions have led to a slight deterioration in credit quality. Despite temporary measures to support the primary sector, in September the non-performing loan ratio stood at 3.1%, almost 1 percentage point higher than the 2.2% recorded at the end of 2021. However, the financial system remains well capitalized, with a solvency ratio of 18.2%, and profitable, with a return on equity equivalent to 17.4%. The liquidity ratio for the financial system, which stood at 35.6% in September, is down significantly from the average of 42.2% recorded in 2021, owing to the withdrawal of liquidity mechanisms implemented during the coronavirus disease (COVID-19) pandemic, the spike in inflation and higher interest rates.

In November 2022, the International Monetary Fund (IMF) approved the request for a support programme under the Policy Coordination Instrument (PCI). The programme, which does not include financial support from IMF, is intended to provide continuity to a set of reforms that are built around macroeconomic stability pillars, focusing on fiscal consolidation, public sector modernization and social protection.

The upcoming presidential and congressional elections will be held in April 2023. In addition, the treaty between Brazil and Paraguay regulating operation of the Itaipu hydropower plant will be renegotiated in 2023. The main negotiation points are the possibility of selling energy directly to private Brazilian entities and production surpluses to third countries.

The current account deficit at the end of the first half of 2022 stood at US\$ 1.205 billion, a significant deterioration from the US\$ 348 million deficit recorded in 2021. This was a result of the decline in agricultural exports and the rises in international food and fuel prices, which led to a sharp increase in the value of imports. In addition, there was a US\$ 345.6 million deficit in the services

#### Paraguay: main economic indicators, 2020-2022

	2020	2021	2022 <sup>a</sup>
	<b>Annual growth rate</b>		
Gross domestic product	-0.8	4.1	-0.3
Per capita gross domestic product	-2.0	2.8	-1.5
Consumer prices	2.2	6.8	8.1 <sup>b</sup>
Real average wage <sup>c</sup>	-0.8	1.5	...
Money (M1)	19.0	14.4	-0.3 <sup>d</sup>
Real effective exchange rate <sup>e</sup>	-1.6	0.7	1.9 <sup>b</sup>
Terms of trade	33.5	17.4	-3.7
	<b>Annual average percentage</b>		
Open unemployment rate	7.7	7.5	6.7 <sup>b</sup>
Central government			
Overall balance / GDP	-6.1	-3.7	...
Nominal deposit rate <sup>f</sup>	7.2	6.7	6.5 <sup>d</sup>
Nominal lending rate <sup>g</sup>	10.7	9.8	12.4 <sup>d</sup>
	<b>Millions of dollars</b>		
Exports of goods and services	23 610	28 689	30 388
Imports of goods and services	20 818	27 049	30 801
Current account balance	1 097	-1 412	-2 664
Capital and financial balance <sup>h</sup>	4 546	776	...
Overall balance	5 643	-637	...

**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/ Figures as of September.

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.

balance, driven by a greater outflow of tourists to foreign destinations. The income and current transfers balances remained at levels similar to those in the same period of 2021.

The current account deficit has been financed with a combination of increased foreign direct investment (FDI) inflows (US\$ 343.3 million), multilateral financing, a US\$ 200 million sovereign bond placed earlier in the year, and a US\$ 387 million reduction in the stock of reserve assets. At the end of October, net international reserves stood at US\$ 9.551 billion, equivalent to 23.9% of GDP (25.3% of GDP at the end of 2021) and 7.5 months of imports (9.1 months at the end of 2021).

Although the nominal exchange rate remained relatively stable during the first half of the year, the guaraní depreciated rapidly from the third quarter onward. The nominal exchange rate index with respect to the main trading partners accumulated an average year-on-year depreciation of 3.7% through to September. In contrast, the average annual rate of depreciation in the real exchange rate slowed from over 10% in May to 5.1% in September 2022.

Over the first half of the year, economic activity contracted 2.2% year-on-year, mainly owing to a 34.1% drop in agricultural activity. On the demand side, the lower level of activity is a result of a reversal in the net exports trend. Added to this is the 1.9% contraction in government consumption, owing to fiscal consolidation, and the slowdown in household consumption (down 1.8% compared to 5.8% in the first half of 2021) and gross fixed capital formation (down 2.3% following a 23.4% drop in the first half of 2021).

The inflationary pressure that first emerged in mid-2021 continued throughout 2022. In October 2022, inflation with respect to the end of 2021 was 7.5%, driven by the price trends for food and non-alcoholic beverages, and, to a lesser extent, transportation. Although the inflationary pressure was initially exogenous, the sustained rises have translated into price increases for key services, resulting in core inflation of 6.3% from December 2021 to October 2022. As a result, year-on-year inflation is expected to have closed 2022 at around 8.5%, 2.5 percentage points above the upper threshold of the Central Bank of Paraguay's target range.

In terms of employment, although the unemployment rate was slightly lower in the third quarter of 2022 (6.3%) than in the same quarter of 2021 (6.5%), this was accompanied by a decline of 0.6 percentage points in the participation rate (70.8%), mainly driven by lower participation by men in the labour market. Even though this slightly narrowed the participation gap between men and women, it remains at 22.7 percentage points and is larger for the 15–29 age group.

Although at the end of the first half of 2022 the salaries and wages index showed a nominal increase of 5.2%, driven by wage growth in the electricity, gas and water (7.5%), commerce (7.1%) and financial intermediation (7.4%) sectors, in real terms, wages and salaries contracted by 5.7%. This means that wages contracted 9.4% in real terms between June 2020 and June 2022.

ECLAC expects Paraguay's economy to grow by around 4% in 2023. The recovery will be driven by the performance of agricultural activity. This projection is subject to downside risk, given the delayed effect of the change in monetary policy stance over the course of 2022, the impact of the planned reduction in the public deficit, and the possibility of another drought. Respondents in the Central Bank of Paraguay's economic expectations survey foresee year-on-year inflation returning to the target range of 2%–6%, reaching 5% by the end of 2023. The recovery in primary exports is also expected to contribute to a narrowing of the current account deficit to around 2% of GDP. The deficit will be comfortably financed by FDI flows, which will facilitate accumulation of reserve assets.