S&P Global
Ratings

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Research Update:

Paraguay 'BB/B' Ratings Affirmed; Outlook Remains Stable

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Overview

- Paraguay's long-standing macroeconomic stability and fiscal prudence are helping to mitigate the economic and social impact from COVID-19.
- As the pandemic eventually recedes, we would expect Paraguay's economic growth to gradually lower fiscal deficits and stabilize the debt level.
- We affirmed our 'BB/B' long- and short-term sovereign credit ratings on Paraguay.
- The stable outlook reflects our expectation of only limited long-term deterioration in Paraguay's financial and economic profiles, based on the government's commitment to maintaining macroeconomic stability and strengthening its fiscal framework.

Rating Action

On May 19, 2021, S&P Global Ratings affirmed its 'BB/B' long- and short-term sovereign credit ratings on Paraguay. The outlook remains stable. Our transfer and convertibility assessment is unchanged at 'BB+'.

Outlook

The stable outlook indicates our expectation that in the next 12-18 months, with the projected economic recovery underway, Paraguay would gradually reduce fiscal deficits and contain debt buildup. We expect that the government's commitment to fiscal consolidation, including its efforts to strengthen its fiscal framework, will help offset the recent erosion in Paraguay's debt burden and external debt profile.

Downside scenario

We could lower the rating over the next 12-18 months if renewed political instability undermines the government's capacity to normalize its fiscal accounts, resulting in potentially large fiscal deficits. Furthermore, worse-than-expected economic performance or inadequate policy responses that hurt Paraguay's long-term growth trajectory could also lead to a downgrade.

Upside scenario

We could raise our ratings over the next 12-18 months if more effective policymaking and strengthening governance reduce the risk of political instability, thereby bolstering investor confidence. We could also raise the rating if the economy becomes more resilient as a result of continued diversification, lower vulnerability to volatility in commodity prices and adverse weather conditions, and higher per capita income.

Rationale

Our ratings on Paraguay balance its sound macroeconomic fundamentals, still-favorable fiscal framework, and relatively strong growth prospects, with weak political institutions. Despite a temporary hike in government deficits and debt due to the impact of the COVID-19 pandemic, Paraguay's comparatively low narrow net external debt and net general government debt burden are key rating strengths.

On the other hand, Paraguay's political fragility and evolving political institutions affect the long-term predictability of its policymaking. In spite of significant economic growth and social progress over the past two decades, the economy remains vulnerable to volatility in commodity prices and weather conditions, given its concentration in agriculture. Furthermore, monetary policy flexibility is limited because of the shallow domestic markets and high level of dollarization in the financial system.

Institutional and economic profile: Macroeconomic stability and prudent fiscal framework are balanced by weak institutions and political fragility

- We expect Paraguay's economy to rebound to 3.5% growth in 2021 and approach 4% growth thereafter, following two years of economic contraction.
- The government's fiscal consolidation and reactivation plan continues to reflect Paraguay's commitment to macroeconomic stability and overall fiscal prudence.
- Still-developing institutions, relatively weak checks and balances, and political fragility limit long-term predictability and effectiveness of policymaking.

We view Paraguay as making progress on the economic and institutional fronts, with a strong commitment to macroeconomic stability and fiscal prudence. Nonetheless, weak checks and balances between institutions and political fragility constrain overall policy implementation and effectiveness. Moreover, corruption perceptions remain relatively high, and the country ranks poorly in Worldwide Governance Indicators, such as government effectiveness and rule of law.

Despite the recent shift in policy to strengthen the social safety net due to COVID-19, the government presented a "fiscal consolidation and reactivation plan," which underscores its commitment to stabilize fiscal deficits and debt. Among other topics, it includes an infrastructure plan to be implemented over the coming years, as well as enhancements to its Fiscal Responsibility Law, including a debt ceiling cap and spending growth restrictions during fiscal correction periods.

Continued progress on strengthening the country's institutional framework could boost private investment, improve long-term GDP growth prospects, and mitigate the risk from potential political or policy instability. A key institutional challenge will be the potential revision of Annex C of the Itaipú Treaty, which sets rules on electricity tariffs and royalty and compensation payments from the hydroelectrical dam shared with Brazil. As the debt service payments related to the construction of the dam are fully paid down by 2023, there could be positive macroeconomic implications for Paraguay's economic, external, and fiscal outcomes.

Despite relative success at controlling the spread of the pandemic in 2020, Paraguay's health and social situation has deteriorated sharply amid a new wave of COVID-19 since the beginning of 2021, with an increase in cases and deaths. This sparked social protests throughout the country and led to a renewed presidential impeachment attempt in March 2021, which was again quickly buried in Congress. Despite measures implemented in 2020 to contain the virus, delays in vaccinations and high hospitalization rates could result in further mobility restrictions.

Nonetheless, we think the high dependence on the agriculture sector has helped to partially contain the economic fallout of COVID-19, by mitigating the severe impact on the service sector. We expect that GDP will rebound to 3.5% in 2021, following the combined shock of COVID-19 in 2020 and unfavorable weather conditions in 2019.

Private consumption recovery and temporarily higher commodity prices will also contribute to an economic rebound in 2021 and subsequent growth, which we expect to average 4% during 2022-2024. We expect Paraguay to recover to its pre-pandemic GDP level before the end of 2021, which is better than most peers in the region. Per capita GDP would slightly recover to about $5,400 over the next three years, close to its level at the end of the last commodity cycle in 2013. Per capita income was below $2,000 two decades ago.

Despite Paraguay's substantial economic and social progress over the past two decades (increasing wealth and reducing poverty and inequality), the social situation remains fragile, with labor market informality around 70%. Furthermore, the economy remains concentrated in agricultural products, making it vulnerable to adverse weather conditions and volatile commodity prices.

Flexibility and performance profile: Extraordinary relief measures will be gradually withdrawn in the coming years, only marginally deteriorating Paraguay's fundamentals

- We expect fiscal deficits to narrow in the coming years, following the temporary sharp increase in 2020.
- Net general government debt is likely to increase above 30% of GDP in the aftermath of the pandemic and recession.
- The central bank's monetary package of 4% of GDP has helped eased pressures in the financial system during COVID-19, and we expect these measures to be gradually rolled back, while keeping inflation well-anchored around the target of 4%.

We expect fiscal deficits to gradually narrow over the next three years as the government implements its fiscal consolidation and reactivation plan. Fiscal correction would mainly come from the withdrawal of extraordinary measures that were implemented in response to COVID-19 in 2020, and curtailing infrastructure spending following the record high in 2020 (about 3.6% of GDP). To avoid further fiscal slippage, the government announced progressive cuts to public-sector wages and is advancing on reforms to increase spending efficiency. The government implemented a broad fiscal package of 5.5% of GDP in 2020, which included direct money transfers to individuals and a reallocation of spending to the health care system, among other measures.

On the other hand, revenues would increase as the economy picks up and following gains from the tax modernization and simplification law, which was implemented in 2020 but had limited results given the pandemic. Given the combined external shocks in 2019-2020, we do not expect significant tax reforms during the next couple of years.

As a result, we expect the change in net general government debt to average 3.4% of GDP in 2022-2024, narrowing from the average 7.3% in 2020-2021, which included extraordinary and transitory COVID-19-related spending. We are using the flexibility in our sovereign criteria to take into account the temporary impact of the one-off extraordinary shocks in 2020-2021, and focusing on medium-term structural fiscal prospects.

We expect that the government will continue to finance its fiscal consolidation plan through a drawdown in cash reserves and further borrowings, mainly from international bond issuances given the shallow domestic capital markets. As a result, net general government debt is likely to increase to 31% of GDP in 2022-2024, compared with 15% in 2019, but still below international peers with similar levels of development. During the same period, interest payments would remain about 6% of government revenues.

The increasing external debt issuances in foreign currency have raised the exposure to exchange-rate movements, since about 87% of the government's debt stock is denominated in U.S. dollars. The currency exposure is only partially mitigated by hard-currency royalties and compensation payments from hydroelectric dams. Another risk to Paraguay's debt profile is that nonresidents hold a significant share of commercial debt, adding further risk to potential sudden changes in investor confidence and capital outflows.

The combination of higher external debt issuance and adverse movements in the exchange rate is also likely to marginally worsen Paraguay's external profile. We expect narrow net external debt to increase to about 30% of current account receipts (CAR) over the next three years. However, we project gross external liquidity ratios will remain strong and stable, with gross external financing needs estimated at 70% of CAR and usable reserves, given that much of external debt has long maturities and is owed to official creditors. Large inflows of foreign currency related to the central government debt issuances translated into an increase in international reserves to $10.1 billion in May 2021, equivalent to about 27% of GDP, or almost 12 months of imports.

We expect Paraguay to post current account surpluses of about 0.5% of GDP over the next three years, following an extraordinarily high surplus of 2.1% in 2020. The recovery in domestic demand will increase imports, although compensated by higher exports from agricultural products, mainly because of higher prices.

Paraguay's external openness, along with its export concentration in both products and destinations, makes it vulnerable to external shocks. Roughly two-thirds of exports come from soya, beef, grain, and energy, while about 60% of exports are transported to Brazil and Argentina, to be ultimately exported to China. Another important segment of Paraguay's external sector is the "Maquila Regime," which waives import duties for a number of inputs used in the manufacturing of industrial exports, as well as provides other tax benefits.

Paraguay's flexible exchange rate has helped to absorb negative external shocks, containing the risk from export concentration. The central bank occasionally intervenes in the foreign exchange market to avoid excessive volatility, as seen in 2020, and as the government needs resources in local currency for budgetary purposes. However, the central bank does not target the exchange rate.

Since the adoption of the inflation-targeting regime in 2011, Paraguay has kept inflation in line with the central bank target and has been slowly strengthening its supervision of the financial system. We expect inflation to remain anchored close to the target of 4%, suggesting an increasingly credible policy commitment and anchored inflation expectations.

However, we weigh these strengths against what we view as still high dollarization in the economy. The highly dollarized Paraguayan economy reflects an economic structure that is tightly linked to the external sector. While the risks are somewhat counterbalanced by revenues also denominated in U.S. dollars from the export sector, we believe that such high dollarization continues to limit monetary flexibility.

Key Statistics

Table 1

Paraguay--Selected Indicators

	2014	2015	2016	2017	2018	2019	2020	2021f	2022f	2023f	2024f
Economic indicators (%)											
Nominal GDP (bil. LC)	180,174.06	188,477.33	204,647.27	219,122.28	230,576.48	236,566.70	241,527.09	257,479.95	278,490.31	301,215.12	325,794.28
Nominal GDP (bil. $)	40.38	36.21	36.09	39.00	40.23	37.91	35.67	36.74	38.81	40.98	43.15
GDP per capita ($000s)	6.1	5.4	5.3	5.6	5.7	5.3	4.9	5.0	5.2	5.4	5.6
Real GDP growth	5.3	3.0	4.3	4.8	3.2	(0.4)	(0.6)	3.5	4.0	4.0	4.0
Real GDP per capita growth	3.7	1.5	2.8	3.3	1.8	(1.8)	(1.9)	2.1	2.6	2.6	2.6
Real investment growth	12.5	(4.6)	(5.6)	11.1	14.8	(6.7)	(4.5)	6.0	4.0	4.0	4.0
Investment/GDP	25.5	24.4	20.5	22.0	25.6	24.7	20.3	20.7	20.7	20.7	20.7
Savings/GDP	25.4	24.0	24.1	24.9	25.4	24.1	22.3	21.6	21.2	20.8	20.9
Exports/GDP	35.5	34.8	37.2	38.4	36.9	36.2	33.5	36.1	35.7	35.8	35.8
Real exports growth	(4.3)	3.2	9.2	8.5	(0.4)	(3.4)	(10.2)	11.7	2.8	4.3	4.0
Unemployment rate	6.0	5.4	6.0	5.2	5.6	5.7	7.2	6.9	6.6	6.3	6.0
External indicators (%)											
Current account balance/GDP	(0.1)	(0.4)	3.6	2.9	(0.2)	(0.6)	2.1	1.0	0.5	0.1	0.2
Current account balance/CARs	(0.3)	(1.1)	9.5	7.4	(0.4)	(1.4)	5.7	2.5	1.3	0.3	0.6
CARs/GDP	36.3	35.0	38.0	39.2	38.9	38.5	36.4	39.4	39.0	38.9	38.8
Trade balance/GDP	2.5	2.2	6.1	4.8	2.0	1.2	4.1	3.1	2.6	2.1	2.1
Net FDI/GDP	1.0	0.9	1.2	1.5	1.1	1.4	1.6	1.5	1.5	1.6	1.6
Net portfolio equity inflow/GDP	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Table 1

Paraguay--Selected Indicators (cont.)

	2014	2015	2016	2017	2018	2019	2020	2021f	2022f	2023f	2024f
Gross external financing needs/CARs plus usable reserves	80.6	76.4	74.4	71.7	74.3	74.3	66.5	66.2	68.3	73.8	71.6
Narrow net external debt/CARs	(12.9)	(8.2)	(11.4)	(13.6)	(5.9)	(1.0)	6.7	17.3	24.9	30.1	33.8
Narrow net external debt/CAPs	(12.9)	(8.2)	(12.6)	(14.7)	(5.9)	(1.0)	7.1	17.7	25.2	30.1	34.0
Net external liabilities/CARs	74.5	75.9	63.8	54.5	57.8	64.7	70.0	79.8	88.7	94.6	99.3
Net external liabilities/CAPs	74.3	75.0	70.5	58.9	57.6	63.8	74.3	81.8	89.8	94.9	99.9
Short-term external debt by remaining maturity/CARs	7.5	10.5	9.5	6.1	5.7	6.5	6.4	6.9	7.0	12.2	7.0
Usable reserves/CAPs (months)	4.0	5.5	4.6	4.9	5.1	5.3	6.6	7.1	6.7	6.2	5.9
Usable reserves (mil. $)	5,857	4,723	5,759	6,692	6,596	6,690	8,382	8,311	8,236	8,160	8,136
Fiscal indicators (general government; %)											
Balance/GDP	(0.6)	(1.8)	(0.4)	(0.9)	(1.7)	(3.8)	(7.0)	(5.0)	(3.5)	(2.7)	(2.3)
Change in net debt/GDP	1.2	2.6	2.4	2.6	1.8	3.8	8.6	6.0	4.0	3.3	2.9
Primary balance/GDP	(0.3)	(1.3)	0.2	(0.3)	(1.0)	(3.0)	(6.0)	(3.8)	(2.4)	(1.5)	(1.1)
Revenue/GDP	17.4	18.6	19.1	18.6	18.9	19.2	18.7	19.2	19.4	19.4	19.4
Expenditures/GDP	18.0	20.5	19.5	19.5	20.6	23.0	25.7	24.1	22.9	22.1	21.6
Interest/revenues	1.7	2.5	3.0	3.1	3.5	4.3	5.7	5.9	6.0	6.0	6.0
Debt/GDP	13.0	15.0	17.0	19.0	20.2	23.4	33.9	37.4	38.7	39.3	39.4
Debt/revenues	74.7	80.6	89.4	102.2	106.7	121.9	181.5	195.0	200.0	203.1	203.7
Net debt/GDP	4.4	6.8	8.7	10.7	12.0	15.5	23.8	28.3	30.1	31.2	31.8
Liquid assets/GDP	8.6	8.2	8.4	8.3	8.3	7.9	10.0	9.1	8.6	8.1	7.7
Monetary indicators (%)											
CPI growth	5.0	3.1	4.1	3.6	4.0	2.8	1.8	3.0	4.0	4.0	4.0
GDP deflator growth	2.9	1.6	4.1	2.2	2.0	3.0	2.7	3.0	4.0	4.0	4.0
Exchange rate, year-end (LC/$)	4,626.26	5,806.92	5,766.90	5,590.48	5,960.54	6,453.14	6,916.81	7,100.00	7,250.00	7,450.00	7,650.00
Banks' claims on resident non-gov't sector growth	19.8	19.0	3.5	4.9	14.1	9.8	7.7	6.5	8.1	8.1	8.1

Table 1

Paraguay--Selected Indicators (cont.)

	2014	2015	2016	2017	2018	2019	2020	2021f	2022f	2023f	2024f
Banks' claims on resident non-gov't sector/GDP	38.3	43.5	41.5	40.7	44.1	47.2	49.7	49.7	49.7	49.7	49.7
Foreign currency share of claims by banks on residents	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign currency share of residents' bank deposits	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Real effective exchange rate growth	1.9	(2.3)	(3.5)	(0.8)	3.2	(3.0)	(1.2)	N/A	N/A	N/A	N/A

Sources: National Central Bank, National Statistical Institute (Economic Indicators), International Monetary Fund, National Central Bank, National Ministry of Finance (External Indicators), International Monetary Fund, National Central Bank, National Ministry of Finance (Fiscal Indicators), and International Monetary Fund, National Central Bank (Monetary Indicators).
Adjustments: General government revenues adjusted by including incomes from National Central Bank. General government expenditures adjusted by including expenditures from National Central Bank. General government debt adjusted by including debt of National Central Bank. General government liquid financial assets adjusted by including assets of National Central Bank.
Definitions: Savings is defined as investment plus the current account surplus (deficit). Investment is defined as expenditure on capital goods, including plant, equipment, and housing, plus the change in inventories. Banks are other depository corporations other than the central bank, whose liabilities are included in the national definition of broad money. Gross external financing needs are defined as current account payments plus short-term external debt at the end of the prior year plus nonresident deposits at the end of the prior year plus long-term external debt maturing within the year. Narrow net external debt is defined as the stock of foreign and local currency public- and private- sector borrowings from nonresidents minus official reserves minus public-sector liquid claims on nonresidents minus financial-sector loans to, deposits with, or investments in nonresident entities. A negative number indicates net external lending. N/A--Not applicable. LC--Local currency. CARs--Current account receipts. FDI--Foreign direct investment. CAPs--Current account payments. The data and ratios above result from S&P Global Ratings' own calculations, drawing on national as well as international sources, reflecting S&P Global Ratings' independent view on the timeliness, coverage, accuracy, credibility, and usability of available information.

Ratings Score Snapshot

Table 2

Paraguay--Ratings Score Snapshot

Key rating factors	Score	Explanations
Institutional assessment	5	Weak institutional capacity and political fragilities are constraints to Paraguay's economic development. Fiscal rules were introduced, although there is a short track record of compliance. Political divisions embedded in parties and disputes with opposition constrain policymaking. Perceived corruption is still high, alongside risks regarding rule of law and social inequalities.
Economic assessment	5	Based on GDP per capita (US$) and growth trends as per Selected Indicators in table 1.
External assessment	2	Based on narrow net external debt and gross external financing needs/(CAR plus usable reserves) as per Selected Indicators in table 1.
Fiscal assessment: flexibility and performance	3	Based on the change in net general government debt (% of GDP) as per Selected Indicators in table 1.
Fiscal assessment: debt burden	4	Based on net general government debt (% of GDP) and general government interest expenditures (% of general government revenues) as per Selected Indicators in table 1.
		About 80% of gross government debt is denominated in foreign currency.
		Nonresidents are estimated to hold over 60% of government commercial debt.

Table 2

Paraguay--Ratings Score Snapshot (cont.)

Key rating factors	Score	Explanations
Monetary assessment	5	The Guaraní is crawling-peg arrangement, and the central bank intervenes only occasionally in foreign exchange markets.
		Central bank independence is still limited, and there's a short track record of inflation-targeting monetary policy. The central bank has the ability to act as lender of last resort for the financial system.
		Resident deposits/loans in foreign currency has fluctuated around 50% of the total.
Indicative rating	bb-	
Notches of supplemental adjustments and flexibility	1	Institutions are gradually improving, although with a limited track record of being able to mitigate political uncertainty and provide visibility to policymaking. Furthermore, economic, fiscal, and external profiles could improve in the coming years with available resources from hydroelectric dams. These factors have a positive impact on creditworthiness and are not fully captured in the indicative rating.
Final rating		
Foreign currency	BB	
Notches of uplift	0	Default risks do not apply differently to foreign- and local-currency debt.
Local currency	BB	

S&P Global Ratings' analysis of sovereign creditworthiness rests on its assessment and scoring of five key rating factors: (i) institutional assessment; (ii) economic assessment; (iii) external assessment; (iv) the average of fiscal flexibility and performance, and debt burden; and (v) monetary assessment. Each of the factors is assessed on a continuum spanning from 1 (strongest) to 6 (weakest). S&P Global Ratings' "Sovereign Rating Methodology," published on Dec. 18, 2017, details how we derive and combine the scores and then derive the sovereign foreign currency rating. In accordance with S&P Global Ratings' sovereign ratings methodology, a change in score does not in all cases lead to a change in the rating, nor is a change in the rating necessarily predicated on changes in one or more of the scores. In determining the final rating the committee can make use of the flexibility afforded by §15 and §§126-128 of the rating methodology.

Related Criteria

- Criteria | Governments | Sovereigns: Sovereign Rating Methodology, Dec. 18, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011
- General Criteria: Methodology: Criteria For Determining Transfer And Convertibility Assessments, May 18, 2009

Related Research

- Paraguay 'BB/B' Ratings Affirmed; Outlook Remains Stable, May 5, 2020

In accordance with our relevant policies and procedures, the Rating Committee was composed of analysts that are qualified to vote in the committee, with sufficient experience to convey the appropriate level of knowledge and understanding of the methodology applicable (see 'Related Criteria And Research'). At the onset of the committee, the chair confirmed that the information provided to the Rating Committee by the primary analyst had been distributed in a timely manner and was sufficient for Committee members to make an informed decision.

After the primary analyst gave opening remarks and explained the recommendation, the Committee discussed key rating factors and critical issues in accordance with the relevant criteria. Qualitative and quantitative risk factors were considered and discussed, looking at track-record and forecasts.

The committee's assessment of the key rating factors is reflected in the Ratings Score Snapshot above.

The chair ensured every voting member was given the opportunity to articulate his/her opinion. The chair or designee reviewed the draft report to ensure consistency with the Committee decision. The views and the decision of the rating committee are summarized in the above rationale and outlook. The weighting of all rating factors is described in the methodology used in this rating action (see 'Related Criteria And Research').

Ratings List

Ratings Affirmed	
Paraguay	
Sovereign Credit Rating	BB/Stable/B
Transfer & Convertibility Assessment	
Local Currency	BB+
Senior Unsecured	BB

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.