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Ratings

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Research Update:

Paraguay Long-Term Ratings Raised To 'BB+' On Greater Economic Resiliency; Outlook Stable

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Overview

- Paraguay's macroeconomic stability and excess supply of renewable energy are attracting investments, which would sustain growth and a gradual economic diversification.
- We expect pragmatic fiscal policy to result in a gradual government fiscal consolidation and stable debt levels.
- As a result, we raised our long-term sovereign credit ratings on Paraguay to 'BB+' from 'BB' and affirmed our 'B' short-term sovereign credit ratings. We also revised upward our transfer and convertibility (T&C) assessment to 'BBB-' from 'BB+'. We plan to assign a 'BB+' issue rating to the sovereign's proposed market debt.
- The stable outlook reflects our expectation that Paraguay's consistent economic growth could mitigate expenditure pressure and support debt stabilization.

Rating Action

On Feb. 1, 2024, S&P Global Ratings raised the long-term foreign and local currency ratings on Paraguay to 'BB+' from 'BB'. The outlook is stable. In addition, we affirmed our 'B' short-term foreign and local currency ratings. We revised upward the T&C assessment to 'BBB-' from 'BB+'.

Outlook

The stable outlook reflects our view that continued strengthening of the Paraguayan economy, supported by private-sector investments, could mitigate potential climate risks and contribute to the government's capacity to absorb recent increases in debt.

Downside scenario

We could lower the ratings in the next 12-18 months if slower-than-expected growth, due to higher frequency of external and weather shocks, reduces the growth potential and weakens the government's commitment to fiscal consolidation. This could weaken the economy and increase the debt burden.

Upside scenario

We could raise the ratings in the next 24 months if effective political and economic management leads to a sustainable fiscal consolidation amid continued strengthening of Paraguay's political and economic institutions, reducing the government's vulnerabilities to the level of those of investment-grade sovereigns.

Rationale

The upgrade reflects Paraguay's track record of evolving but prudent macroeconomic policies, moderate fiscal deficits and general government (GG) debt, as well as a strong external position. All these characteristics have bolstered the Paraguayan economy's resiliency against external shocks, and caused GDP per capita to rise consistently.

The ratings continue to be constrained by evolving institutions and weaker than peers' monetary transmission mechanism. Effective political and economic management that continues to strengthen Paraguay's checks and balances, pass reforms to sustain medium-term growth, and deepen the domestic capital market could reduce the country's vulnerabilities to the level of those of investment-grade sovereigns.

Institutional and economic profile: Sustained growth of income despite vulnerability to weather-related risks

- Paraguay's economic activity has been resilient against external and weather shocks, translating into consistent real per capita GDP growth;
- Investment projects should sustain economic growth at about 3% during 2024-2027; and
- The new administration will maintain the focus on prudent fiscal policies, while continuing efforts to promote private-sector investments and economic diversification.

We expect the new administration to continue to build on Paraguay's track record of prudent macroeconomic policies, focusing on reaching a structural deficit target over the medium term, as part of the Fiscal Responsibility Law (FRL), as well as widening the economic diversification. The government's agenda is guided by the commitment to the IMF's policy coordination instrument (PCI), which includes reforms to improve public-sector efficiency and implement climate resiliency policies. The recent approval of a pension fund oversight law illustrates some progress; while other reforms included in the PCI to modify the civil servants' careers and the pension system parameters, could encounter political resistance, despite the Partido Colorado's legislative majority.

Moreover, high levels of perceived corruption and public-sector inefficiencies constitute long-standing constraints to policy design. Low human capital productivity, a large informal economy, and infrastructure gaps are longstanding barriers, and the progress in removing them will likely be limited given the political consensus about curtailing the public sector's expansion.

Regardless, a track record of macroeconomic stability, low taxation, and excess supply of renewable energy should continue to attract investments. These factors are also helping to sustain the economic diversification trend. The country's largest investment project in the pipeline is a cellulose plant, which is expected to start production by 2027.

Sustained growth will raise GDP per capita to $6,140 in 2024 and $7,100 by 2027. That said, the most recent census showed a drop in population, which is likely to result in GDP per capita closer to $7,400 this year. While declining fertility and a lower-than-expected population, due to emigration, will act as a drag on long-term growth and fiscal performance, it's also evident that the Paraguayan economy was moderately stronger than previously assessed.

Flexibility and performance profile: GG deficit has increased and fiscal correction will be gradual, but the debt burden will stabilize

- The Paraguayan government aims to reduce its fiscal deficit following larger expenditure due to the pandemic support and political transition.
- We expect net GG debt to remain stable at about 30% of GDP, but the interest burden to increase amid higher global interest rates.
- The current account is swinging back toward surplus, thanks to strong soy exports. The external profile remains a key rating strength.

A gradual fiscal consolidation strategy would reduce GG deficit to 2.6% of GDP in 2024. Deficit increased to 4.1% in 2023 because of one-off expenses to settle suppliers' debt accumulated in 2021-2022. Even before recognizing off-balance spending, fiscal numbers were already pointing to deficit above the 2023 target due to budgetary constraints. GG revenue will remain below that of Latin American peers, at 13% of GDP, and tax revenue at 10% of GDP. Higher revenue is unlikely due to a broad consensus about a low taxation economic model.

As a result, and given moderate debt levels and decent growth prospects, the authorities have extended the timeframe to meet the 1.5% fiscal deficit target to 2026 from 2024, which is consistent with the FRL. The bulk of fiscal consolidation will stem from cuts to infrastructure spending—currently at 2.5% of GDP—and improvements in revenue administration.

Our base-case scenario assumes any additional revenue from the ongoing Itaipu dam negotiation would likely be marginal as Brazil, the counterparty to the treaty, continues to resist higher electricity tariffs. We expect net GG debt to stabilize at 30% of GDP in the forecasted period, after surging from 11% as of 2019. Higher debt and interest rates are pushing GG debt interest close to 10% of revenue from less than 5% in 2019, and above that of sovereigns with a similar debt burden.

Debt projections are subject to volatility resulting from sharp movements in the exchange rate, as about 90% of the government's debt is denominated in foreign currency. The authorities expect to reduce the currency exposure, but this process is likely to be very gradual due to a shallow domestic debt market. The large exposure to non-resident holdings of GG debt is somewhat offset by the long-term amortization profile of the external debt, partially because of the large share of debt contracted from multilateral lending institutions. The average maturity of the government's external debt is about 11 years, and there are no bond amortizations until 2026.

Paraguay's external position is a rating strength. The smooth external maturity debt profile, coupled with our expectation of balanced current account results, should keep gross external financing needs estimated at 79% of current account receipts (CAR) and usable reserves. We expect narrow net external debt to drop to 27% of CAR by 2027.

CAR have recovered strongly following a surge in agricultural exports in 2023. Current account deficit ballooned to 7% of GDP because of the drought in 2022 and swung to a slight surplus in 2023. Exports value increased 25%, boosted by over 100% soy export jump. We expect supportive climate conditions to increase agricultural production in 2024 and offset the fall in commodity prices. The forecast for current account in 2025-2027 remains vulnerable to future weather events.

Paraguay's flexible exchange is an important external shock absorber. The central bank occasionally intervenes in the foreign exchange market to dampen volatility without targeting the exchange rate. Since the adoption of the inflation-targeting regime in 2011, Paraguay has kept inflation largely in line with the central bank's target, and has slowly strengthened its supervision of the financial system.

Restrictive monetary policy stance and lower pressure from food and energy prices contributed to a fast correction in inflation. It has remained close to 4% (the central bank's target) since July 2023, down sharply from the 11.8% peak in April 2022. Consequently, the central bank has cut interest rates by a total of 200 basis points since August 2022 to 6.5%. Our monetary score assessment balances the central bank's proactive response and growing track record of price stability, with a less developed resident financial system and debt markets and high levels of dollarization in the financial system. The reduction of the latter, higher dependence on domestic currency debt to finance fiscal deficits, and a substantial deepening of capital markets would contribute to a more powerful and predictable monetary transmission.

Key Statistics

Table 1

Selected Indicators

	2017	2018	2019	2020	2021	2022	2023	2024bc	2025bc	2026bc	2027bc
Nominal GDP (bil. LC)	219,122.28	230,576.48	236,681.50	239,914.73	270,633.90	292,946.79	315,283.98	337,740.08	361,787.18	384,934.32	409,562.42
Nominal GDP (bil. $)	39.00	40.23	37.93	35.43	39.95	41.95	43.26	46.19	48.75	51.13	53.88
GDP per capita (000s $)	5.6	5.7	5.3	4.9	5.4	5.6	5.8	6.1	6.4	6.7	7.1
Real GDP growth	4.8	3.2	(0.4)	(0.8)	4.0	0.2	5.0	3.5	3.0	2.8	2.8
Real GDP per capita growth	3.3	1.8	(1.8)	(2.2)	2.6	(1.2)	4.5	3.0	2.5	2.3	2.3
Real investment growth	5.9	6.9	(6.1)	5.3	18.2	(1.8)	(3.0)	3.0	6.5	4.0	0.5
Investment/GDP	20.6	22.8	21.7	20.0	24.0	27.7	25.9	25.7	26.3	26.4	26.7
Savings/GDP	23.9	22.6	21.1	21.9	23.1	20.6	26.5	26.3	26.2	25.9	26.5
Exports/GDP	38.2	36.9	36.1	33.3	35.5	34.4	41.2	40.8	40.0	39.3	39.3
Real exports growth	8.5	(0.4)	(3.4)	(9.0)	2.1	(1.1)	30.9	3.0	1.0	1.0	2.7
Unemployment rate	5.2	5.6	5.7	7.2	6.8	6.7	6.4	6.1	5.7	5.7	5.7
External indicators (%)											
Current account balance/GDP	3.3	(0.2)	(0.6)	1.9	(0.9)	(7.1)	0.6	0.6	(0.1)	(0.4)	(0.2)

Table 1

Selected Indicators (cont.)

	2017	2018	2019	2020	2021	2022	2023	2024bc	2025bc	2026bc	2027bc
Current account balance/CARs	8.1	(0.5)	(1.4)	5.1	(2.2)	(19.0)	1.4	1.3	(0.1)	(1.0)	(0.4)
CARs/GDP	41.3	40.5	40.2	36.9	38.9	37.6	44.9	44.4	43.6	42.9	42.8
Trade balance/GDP	4.3	1.4	0.5	3.5	1.6	(4.6)	2.6	2.6	1.8	1.4	1.4
Net FDI/GDP	0.2	0.5	1.4	0.4	0.2	1.7	0.9	1.0	1.2	1.2	0.9
Net portfolio equity inflow/GDP	1.2	1.3	1.1	6.1	0.5	0.5	0.0	0.0	0.0	0.0	0.0
Gross external financing needs/CARs plus usable reserves	76.0	79.8	81.2	75.5	74.5	86.5	78.9	78.5	78.2	79.9	79.9
Narrow net external debt/CARs	(2.2)	5.3	11.9	19.5	26.5	41.8	33.7	30.3	29.3	28.8	27.4
Narrow net external debt/CAPs	(2.4)	5.2	11.7	20.6	25.9	35.1	34.2	30.7	29.2	28.6	27.3
Net external liabilities/CARs	68.7	71.0	76.8	87.4	78.4	94.1	78.7	73.1	70.8	69.6	66.6
Net external liabilities/CAPs	74.8	70.7	75.7	92.1	76.7	79.1	79.9	74.1	70.7	68.9	66.3
Short-term external debt by remaining maturity/CARs	12.4	13.3	16.4	19.0	13.7	13.5	14.8	12.4	10.7	12.0	11.3
Usable reserves/CAPs (months)	4.9	5.1	5.3	6.4	6.5	5.4	5.3	5.1	5.0	4.9	4.8
Usable reserves (mil. $)	6,958	6,868	6,649	8,668	8,364	8,469	8,528	8,878	9,071	9,189	9,297
Fiscal indicators (general government; %)											
Balance/GDP	(0.4)	(1.0)	(2.4)	(5.7)	(3.4)	(2.6)	(3.9)	(2.6)	(2.2)	(1.7)	(1.7)
Change in net debt/GDP	0.9	2.4	3.6	8.1	3.3	7.2	3.6	2.8	2.7	1.9	1.9
Primary balance/GDP	0.1	(0.3)	(1.6)	(4.7)	(2.3)	(1.4)	(2.2)	(0.9)	(0.5)	0.1	0.1
Revenue/GDP	17.6	17.5	17.7	17.1	17.1	17.5	17.7	17.7	18.0	18.0	18.3
Expenditures/GDP	18.1	18.5	20.1	22.8	20.4	20.2	21.6	20.3	20.2	19.7	20.0
Interest/revenues	3.3	3.8	4.7	6.2	6.4	7.0	9.4	9.7	9.7	9.8	9.6
Debt/GDP	14.1	16.2	19.2	29.3	29.4	34.4	35.6	36.0	36.3	36.0	35.8
Debt/revenues	80.1	92.4	108.4	171.5	172.4	196.2	201.1	203.4	201.8	200.3	195.6
Net debt/GDP	5.8	7.9	11.3	19.2	20.4	26.0	27.8	28.8	29.6	29.7	29.8
Liquid assets/GDP	8.3	8.3	7.9	10.1	9.0	8.3	7.7	7.2	6.8	6.3	6.0

Table 1

Selected Indicators (cont.)

	2017	2018	2019	2020	2021	2022	2023	2024bc	2025bc	2026bc	2027bc
Monetary indicators (%)											
CPI growth	4.5	3.2	1.5	1.7	4.8	9.8	4.7	4.0	4.0	3.5	3.5
GDP deflator growth	2.2	2.0	3.1	2.2	8.4	8.1	2.5	3.5	4.0	3.5	3.5
Exchange rate, year-end (LC/$)	5,590.5	5,960.5	6,453.1	6,916.8	6,879.1	7,331.3	7,273.6	7,350.0	7,492.7	7,564.1	7,639.7
Banks' claims on resident non-gov't sector growth	4.5	14.8	9.7	10.0	13.1	8.8	7.7	7.2	7.2	6.5	6.5
Banks' claims on resident non-gov't sector/GDP	35.1	38.3	40.9	44.4	44.5	44.7	44.8	44.8	44.9	44.9	45.0
Foreign currency share of claims by banks on residents	44.8	45.1	44.1	40.2	39.2	44.0	45.0	45.0	45.0	45.0	45.0
Foreign currency share of residents' bank deposits	47.7	47.6	48.8	49.3	49.8	50.1	50.1	50.1	50.1	50.1	50.1
Real effective exchange rate growth	(0.8)	3.4	(3.0)	(1.3)	(1.0)	2.0	(5.9)	0.0	0.0	0.0	1.0

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. bc--Base case. 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

Ratings Score Snapshot

Key rating factors	Score	Explanations
Institutional assessment	4	Long-standing commitment to macroeconomic stability and fiscal prudency, which have been key at promoting balanced growth. We perceive higher level of policy predictability. Checks and balances have been gradually improving. Political tensions are less likely than before to constrain overall policy implementation and effectiveness.
Economic assessment	4	Based on GDP per capita ($) as per Selected Indicators in Table 1.
External assessment	2	Based on narrow net external debt and gross external financing needs/(CAR +useable 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

Table 2

Ratings Score Snapshot (cont.)

Key rating factors	Score	Explanations
Fiscal assessment: debt burden	3	Based on net general government debt (% of GDP) and general government interest expenditures (% of general government revenues) as per Selected Indicators in Table 1
		Over 50% of gross government debt is denominated in foreign currency.
		Nonresidents are estimated to hold over 60% of government commercial debt.
Monetary assessment	5	The Guaraní exchange rate regime is floating and the central bank intervenes only occasionally in foreign exchange markets.
		The central bank has operational independence and uses market-based instruments monetary instruments. CPI as per Selected Indicators in Table 1. The central bank has the ability to act as lender of last resort for the financial system. Depository corporation claims on residents in local currency and nonsovereign local currency bond market capitalization combined amount to less than 50% of GDP.
		Resident deposits in foreign currency has fluctuated around 50% of the total.
Indicative rating	bb+	
Notches of supplemental adjustments and flexibility	0	
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: institutional assessment; economic assessment; external assessment; the average of fiscal flexibility and performance, and debt burden; and 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

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- 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

- Banking Industry Country Risk Assessment: Paraguay, Nov. 30, 2023
- Paraguay, March 29, 2023

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

Upgraded

	To	From
Paraguay		
Transfer & Convertibility Assessment		
Local Currency	BBB-	BB+
Paraguay		
Senior Unsecured	BB+	BB

Upgraded; Ratings Affirmed

	To	From
Paraguay		
Sovereign Credit Rating	BB+/Stable/B	BB/Stable/B

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.spglobal.com/ratings for further information. Complete ratings information is available to RatingsDirect subscribers at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.spglobal.com/ratings.