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PARAGUAY

November 2022

REQUEST FOR A TWO-YEAR POLICY COORDINATION INSTRUMENT—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR PARAGUAY

In the context of the Request for a Two-year Policy Coordination Instrument, the following documents have been released and are included in this package:

- A **Press Release** including a statement by the Chair of the Executive Board.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on November 21, 2022, following discussions that ended on September 2, 2022, with the officials of Paraguay on economic developments and policies underpinning the IMF arrangement under the PCI. Based on information available at the time of these discussions, the staff report was completed on November 2, 2022.
- A **Statement by the Executive Director** for Paraguay.

The documents listed below have been or will be separately released.

Letter of Intent sent to the IMF by the authorities of Paraguay*
*Also included in Staff Report

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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PRESS RELEASE

PR22/406

IMF Executive Board Approves Paraguay's Policy Coordination Instrument

FOR IMMEDIATE RELEASE

Washington, DC – November 22, 2022: On November 21, 2022, The Executive Board of the International Monetary Fund (IMF) approved a two-year Policy Coordination Instrument (PCI) for Paraguay.[1]

Paraguay continues to recover from the COVID-19 pandemic amidst simultaneous shocks that would lead to flat GDP growth and inflation above the Central Bank's target range this year. The outlook for a recovery in 2023 is favorable, and the authorities are pursuing policies to follow a stronger, more resilient, and inclusive development path. On the back of very positive experiences with Fund-supported programs, the authorities requested approval of a two-year program supported by the Policy Coordination Instrument (PCI) to underpin the implementation of needed structural reforms.

The PCI aims to address the current challenges and foster policy continuity that would encompass two years, the last year of the current and the first year of the next administration. Program reviews take place on a semi-annual fixed schedule. While the PCI involves no use of IMF resources, successful completion of program reviews would help signal Paraguay's commitment to continued strong economic policies and structural reforms.

The authorities' reform efforts will be anchored by three key pillars: (i) ensure macroeconomic stability and resilience by making efforts to rebuild fiscal buffers and ensure fiscal sustainability going forward, while continuing to implement a data-dependent and forward-looking monetary policy; (ii) enhance productivity and foster economic growth by advancing structural reforms to improve the effectiveness of the government, modernize the public sector and improve the business climate, and; (iii) enhance social protection and inclusiveness through augmenting coverage and efficiency of Paraguay's social assistance programs, and implementing reforms to pull informal workers into the formal economy.

Following the Executive Board's discussion, Mr. Kenji Okamura, Deputy Managing Director and Acting Chair, issued the following statement:

"The Paraguayan authorities implemented appropriate fiscal, social, and financial support measures to mitigate the negative impact of the pandemic and to sustain recovery in 2020 and 2021. However, this year the economy is facing simultaneous shocks, including a severe drought in late 2021/early 2022 and a spike in global inflation exacerbated by Russia's war in

[1] The PCI is available to all IMF members that do not need Fund financial resources at the time of approval. It is designed for countries seeking to demonstrate commitment to a reform agenda or to unlock and coordinate financing from other official creditors or private investors. (see https://www.imf.org/en/About/Factsheets/Sheets/2017/07/25/policy-coordination-instrument)

700 19th Street NW
Washington, DC 20431
USA

Ukraine. While the economic outlook remains favorable, several risks arise from global headwinds, more frequent adverse climate shocks, and domestic uncertainties.

“Against this backdrop, the authorities’ economic program under the PCI will be focused on policies to ensure macroeconomic stability, foster economic growth, and enhance social protection. The PCI is underpinned by strong macroeconomic policy plans and will support ongoing initiatives aimed at the implementation of a broad structural reform agenda.

“Rebuilding policy buffers and returning to the fiscal deficit ceiling of 1.5 percent of GDP in 2024 will be critical to ensure macroeconomic stability. Important measures include enhancing domestic revenue mobilization, reforming the public pension fund, and raising the efficiency of the public sector. Monetary policy is aimed at bringing inflation back to the 4 percent target and keeping inflation expectations well-anchored. The authorities are committed to maintaining a strong reserve position and using foreign exchange interventions only to address disorderly market conditions.

“The authorities are focused on fostering the conditions for sustained economic growth, bolstering the efficient use of public resources, and creating more favorable conditions for private investment. Envisaged actions include modernizing public institutions, increasing government effectiveness, strengthening governance and controlling corruption, as well as improving the business climate. Efforts to build resilience to climate change are also needed.

“The emphasis of the authorities’ reform agenda on enhancing social protection and reducing poverty and inequality is welcome. Further measures will be needed to improve the impact of social assistance programs, increase their coverage among the vulnerable population, promote the formalization of the economy, and strengthen financial inclusion.”

PARAGUAY

REQUEST FOR A TWO-YEAR POLICY COORDINATION INSTRUMENT

November 2, 2022

KEY ISSUES

Context: Paraguay continues to recover from the COVID-19 pandemic amidst simultaneous shocks that would lead to flat GDP growth and inflation above the IT range this year. Those conditions are reflected in rising social demands within a politicized environment before the 2023 general elections. The outlook remains favorable, and the authorities are pursuing policies to follow a stronger, more resilient, and inclusive development path. On the back of very positive experiences with Fund-supported programs, the authorities are requesting approval of a two-year program supported by the Policy Coordination Instrument (PCI) to underpin the implementation of needed structural reforms.

Main Policy Commitments

- **Ensure Macroeconomic Stability and Resilience.** Aligned with their goal to converge to the 1.5 percent of GDP fiscal deficit ceiling by 2024, the authorities have committed to reform the "Caja Fiscal" and the pension system, strengthen the supervision of SOEs, and enhance revenue collection. Also, they are engaged in maintaining a strong reserve position and continue publishing detailed information on its foreign exchange operations.
- **Enhance productivity and foster economic growth.** The authorities aim to strengthen public procurement, civil service, and the government structure, improve financial supervision, strengthen governance and control corruption, and improve the business climate.
- **Enhance social protection and inclusiveness.** The authorities have committed to strengthening their social protection and inclusiveness programs while implementing policies to reduce informality.

Risks: Program risks are low considering Paraguay's positive economic outlook and strong external position. Risks to the outlook are tilted to the downside as recurrent adverse weather conditions, more prolonged than expected inflation pressures, de-anchoring of inflation expectations, and local COVID-19 outbreaks could weigh on higher exchange rate (ER) volatility, tighter monetary policy, and lower growth.

Staff support the authorities' request for a two-year program under the PCI.

Approved By
P. Alonso-Gamo (WHD) and E. Cerutti (SPR)

Discussions were held in Asunción between August 25 and September 2, 2022 and continued from Washington D.C.. Staff-level agreement was reached on October 13. The staff team comprised Mauricio Villafuerte (head), Tobias Roy, Mauricio Vargas, Yuanchen Yang, Manuk Ghazanchyan (all WHD), and Jehann Jack (SPR). Jesús Sanchez and Nicolás Landeta (WHD) provided research and administrative assistance. Jorge Corvalan (OED) attended the policy meetings. The team met with Central Bank of Paraguay (BCP) President José Cantero, Minister of Finance Óscar Llamosas, other senior officials from the government, and representatives from the donor community.

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CONTEXT

1. Paraguay continues to recover from the COVID-19 pandemic and is facing simultaneous external shocks, including a severe drought and a spike in global inflation exacerbated by the impact of Russia's war in Ukraine.[1] The government has faced multiple pressures to mitigate the impact of food and fuel price increases on lower-income households and small businesses.[2] Given very limited fiscal space, these pressures have the potential to undermine the authorities' fiscal convergence plans and hard-earned macroeconomic stability. This turmoil takes place at a delicate time, given that Paraguay has entered the pre-electoral cycle toward the general elections in April 2023.

2. Further structural reforms are needed to put Paraguay on a stronger, more resilient, and inclusive development path. Despite the shock to agricultural exports, Paraguay has no immediate balance of payments problem. However, the country still faces substantial development and public investment gaps, which have to be balanced with the need to rebuild policy buffers including by gradually reducing the fiscal deficit. A combination of structural reforms to enhance the public sector's efficiency, improve governance and reduce corruption risks, improve the efficiency of social assistance programs, and remove barriers to private investment would help address all these challenges. A number of structural reform projects are well-defined and ready for implementation. Others, to which the government has committed, are in the design stage.

3. With specific goals to ensure macroeconomic stability, foster economic growth, and enhance social protection through the implementation of structural reforms, the authorities requested a two-year Fund-supported program under the PCI. The general objective of this request is to make the economy more resilient in the face of recurrent external shocks. In particular, the program would support the convergence towards the fiscal deficit ceiling of 1.5 percent of GDP in the medium term, proposed initially under the Fiscal Responsibility Law (FRL). The PCI would serve as a catalyst to advance on many structural reform projects to improve the efficiency of the public sector and the business climate while strengthening Paraguay's social assistance programs.

4. Paraguay had very positive experiences with Fund-supported programs. Two successive SBAs between 2003 and 2008 helped the country resolve major macroeconomic imbalances, including through deep and long-lasting structural reforms, ushering in fifteen years of transformative growth that raised income levels and had a lasting positive impact on poverty reduction. The PCI request aims to address the current challenges and foster policy continuity, eventually serving as a bridge that would encompass both the last year of the current and the first year of the next administration.

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[1] While at first sight the recent global increases of prices for grains should have a positive terms-of-trade impact, Paraguay could not take full advantage of the favorable prices for its agricultural exports because of heavy harvest losses inflicted by the drought that occurred between late 2021 and early 2022.

[2] Paraguay's social fabric is still weakened by the aftermath of the COVID-19 pandemic, with increased poverty rates only partly compensated by social emergency measures.

RECENT DEVELOPMENTS

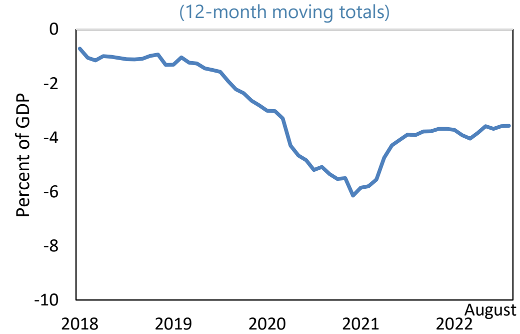
5. The economy's robust growth expected for this year did not materialize due to another adverse weather shock. In 2021, GDP growth jumped to 4.1 percent after two years of negative growth rates. In 2019 and 2020, because of adverse weather conditions and the pandemic, the economy contracted by 0.4 and 0.8, respectively. The robust growth expected for 2022 has been revised down to only 0.2 percent after heatwaves and a severe drought that occurred between late 2021 and early 2022 contracted soy production by about 57 percent in the first months of this year.

6. The confluence of negative shocks has led to a substantial rise in inflation (9.3 percent y-o-y by September 2022). Annual headline inflation started increasing in the second half of 2021 due to global supply chain disruptions and higher energy prices. The continued sharp rise in international fuel, fertilizer, and food prices following the war in Ukraine further exacerbated the increase in domestic prices. The central bank reacted quickly to the price shock, steadily raising its policy interest rate since August 2021 to 8.5 percent currently, a level it considers consistent with the neutral rate. Inflation is likely to close this year at about 9 percent, well above the authorities' inflation target band (2-6 percent).

7. The external current account deficit is expected to reach about 5 percent of GDP in 2022, owing largely to lower agricultural exports and a sharp rise in fuel imports. The guaraní, vis-à-vis the US dollar, stayed almost flat in 2021. At end-2021 gross international reserves in Paraguay covered about 8 months of 2022 projected imports and the reserves-to-ARA metric ratio was 211 percent. This year, reduced agricultural exports and rising import prices generated higher volatility in FX markets triggering FX interventions by the BCP of about US$400 million. As of October, the central bank (BCP) has seen its stock of net international reserves fall by about US$700 million, while domestic banks have also reduced their liquid external assets to help cover payments for imports. The exchange rate vis-à-vis the US dollar has depreciated by about 5 percent since the beginning of 2022. Despite the large current account deficit, Paraguay does not face a present nor prospective balance of payments problem as the seasonal demand for imports of inputs for the next agricultural cycle can be covered by additional sales of international reserves, which the BCP can partly recover in 2023, assuming broadly normal weather conditions.

8. Fiscal developments are aligned with the government's medium-term fiscal convergence plan. The cumulative 12-month fiscal deficit decreased slightly to 3.6 percent of GDP as of August 2022. Corporate income tax revenue still benefits from last year's good growth performance and the aftermath of the 2019 tax reform, but fiscal pressures have increased in the context of high food and fuel prices. For instance, the reduction in excise taxes and the VAT on fuel has been maintained for longer than expected. In

Net Lending/Borrowing, 2018 - 2022
(12-month moving totals)



the political context of upcoming national elections,[3] unions demand salary increases, some economic sectors are pressing for VAT tax holidays, and several initiatives in Congress aim at inflating the wage bill in the 2023 budget. The authorities remain committed to reducing the fiscal deficit to 3 percent of GDP in 2022.

9. **Paraguay's financial sector remains sound**. Solvency indicators comfortably exceed the legal minimum capital requirements and profitability has recovered to pre-pandemic levels thanks in part to continued forbearance measures and recent transitory measures specifically targeting sectors affected by the late 2021/early 2022 drought. Financial risks associated with the debt repayment capacity of households and businesses are expected to remain limited. In response to the increasing demand for digital payment instruments, Paraguay launched the "Instant Payment System (SPI)" module in May 2022, allowing instant transactions 24/7. The project represents a major advancement for the country's payment system by reducing operating costs, increasing the security and transparency of transactions, and thereby fostering financial inclusion.

OUTLOOK AND RISKS

10. **The economic outlook remains favorable.** Growth is expected to recover to 4.5 percent in 2023, supported by a rebound in agricultural production, including soy exports. The external current account balance is projected to improve in 2023 and help the BCP to replenish reserves. A sharp increase in exports will be partly offset by additional imports of machinery and equipment linked to substantial FDI flows.[4] Staff projects reserves to slightly increase to about 7 months of imports over the medium-term, broadly the same level as in the pre-crisis year of 2018. The reserves-to-ARA metric ratio is projected at about 195 percent for end-2022, safely above the suggested comfort zone of 100-150 percent The 2023 fiscal deficit target (-2.3 percent of GDP) is reasonable and achievable as long as Congress agrees with the expenditure envelope proposed in the draft 2023 budget. Assuming that the FRL's deficit ceiling remains the binding constraint on fiscal execution, public debt would peak in 2022 at 39.7 percent of GDP and gradually decline in the following years (Annex III).[5] Inflation pressures are projected to subside—as reflected in the recent fall in inflation expectations over the monetary policy horizon[6]—converging to the authorities' target of 4 percent in the first quarter of 2024. The financial sector is expected to continue to support growth despite

[3] Presidential and Congressional elections will be held in April 2023. The primaries will take place in December 2022. The new administration will take office on August 31, 2023. Pre-electoral political tensions have intensified after the U.S. administration recently blacklisted two important and influential Colorado politicians for being involved in "significant corruption."

[4] In 2023 and 2024, Paraguay will benefit from its largest FDI projects in recent history. Paracel (paper pulp from eucalyptus foresting) and Omega Green (biofuels) have pledged to invest US$4 billion in the next few years. Construction activities are projected to lift off in 2023.

[5] A new draft FRL proposes the addition of a public debt ceiling to the deficit rule. Since its legal definition of public debt excludes some peripheral long-term items unrelated to current fiscal performance (ALADI, Petropar debt to Venezuela), Paraguay's public debt is reported to be about two percentage points of GDP lower than the IMF's measurement.

[6] Down from 4.8 percent to 4.5 percent between May and August this year.

external and domestic shocks. Recent stress tests simulating extreme shocks with low probability of occurrence point to adequate solvency in the banking system.

Key Macroeconomic Indicators as Compared to 2022 Article IV

(In percent of GDP, unless otherwise indicated)

	2022		Proj. 2023		
	Current	Art.IV	Current	Adverse*	Art.IV
Real GDP growth (in percent)	0.2	0.3	4.5	1.5	4.5
Per capita GDP (U.S. dollars, thousands)	5.5	5.6	5.8	5.5	5.9
Consumer prices (end of period; in percent)	8.8	8.0	4.1	5.0	4.2
Terms of trade (annual percent change)	2.5	3.8	-1.9	0.1	-1.7
External current account	-4.9	-2.9	-1.9	-4.5	0.4
Gross international reserves (e.o.p., in US$ billion)	9.2	10.1	9.3	8.6	10.6
Central government fiscal balance	-3.0	-3.2	-2.3	-2.9	-2.3
Public sector debt	39.7	39.5	39.4	43.0	39.0

Sources: Central Bank of Paraguay; Ministry of Finance; and IMF staff estimates and projections.

* The adverse scenario projections assume that the agriculture sector is hit by a weather-related shock in 2023. The shock is similar in magnitude to the 2022 one. Also, this scenario assumes higher depreciation and inflation rates due to less favorable external conditions.

11. Risks to the outlook are tilted to the downside (Annex I). A new drought (e.g., a continuation of the La Niña weather pattern for a third consecutive year, which is rare by historical standards) could derail the positive growth outlook for 2023. In the international context, a growth slowdown in trade partners such as Brazil and Argentina could reduce demand for Paraguayan exports to those countries, while continued global inflation pressures, combined with rising interest rates in advanced economies and sovereign spreads, could increase pressures on the exchange rate and complicate Paraguay's external financing plans. With regard to other local risks, inflation could fail to subside as expected, forcing the BCP to maintain its tight monetary policy stance for longer. A resurgence of the pandemic could result in a deeper and more prolonged downturn, additional erosion of fiscal buffers, and social discontent. In the financial sector, liquidity risks could increase, owing to the gradual withdrawal of financial support measures and sustained increases in the monetary policy rate. Finally, fiscal risks arise from the remainder of the pre-election period, as well as uncertainties related to the April-2023 general election outcome.

12. Staff built an adverse macroeconomic scenario around these risks. Specifically, the scenario assumes that the 2021/2022 drought will repeat in the 2022/2023 campaign with similar effects on the agricultural sector and plausible secondary effects on various sectors of the economy. The simulation shows that 2023 GDP growth would be lower than in the baseline scenario, but still positive at about 1.5 percent; the fiscal impact would be reflected on a higher fiscal deficit and an increase in the stock of debt by more than 3 percent of GDP, while the external current account deficit would be more than double the estimate in the baseline (4.5 percent of GDP in 2023). Even under the adverse scenario, a balance of payments need is not projected.

POLICY DISCUSSIONS

The program to be supported by the new PCI is articulated around three main pillars: (i) ensure macroeconomic stability and resilience by making efforts to rebuild policy buffers; (ii) enhance productivity and foster economic growth by advancing structural reforms to enhance the effectiveness of the government, modernize the public sector, address governance and corruption vulnerabilities, and improve the business climate, and; (iii) enhance social protection and inclusiveness through improvements in Paraguay's social assistance programs.

A. Pillar I. Ensure Macroeconomic Stability and Resilience

13. Paraguay aims at reinforcing its policy space to deal with increasingly recurrent adverse external shocks. Since the recent shocks[7] have reduced fiscal buffers (public debt has risen from 22 percent of GDP in 2018 to close to 40 percent now), the authorities are committed to converge to the 1.5 percent of GDP fiscal deficit ceiling by 2024 to rebuild fiscal buffers and ensure fiscal sustainability going forward. At the same time, domestic revenue needs also to be strengthened to create space for continued infrastructure investment, improved social safety nets, and to properly respond to climate change challenges. Monetary policy has helped to weather well the pandemic and recent external inflation pressures. The authorities are committed to continue to implement a successful inflation targeting framework and to continue to allow the exchange rate to work as an important shock absorber.

Rebuild Fiscal Buffers and Defend the Quality of Public Spending with Sound Financing

14. To protect the credibility of the fiscal framework, the authorities are committed to a plan to return to a fiscal deficit of 1.5 percent of GDP by 2024. This will be predicated on increasing tax revenue, partly on the basis of the 2019 tax reform, and a containment of spending on salaries and goods and services. Despite large investment needs, public investment as share of GDP would temporarily decrease in 2022–24, which is not optimal but has to be seen in the context of relatively high investment spending levels in the last three years as part of the policy responses to the recent external shocks. Consistent with the fiscal consolidation path, the PCI arrangement includes quantitative ceilings on the fiscal deficit and, to protect investment, on primary current expenditure.

15. Timely reporting and appropriate classification of central government expenditures will contribute to improved fiscal management transparency. The authorities are taking steps to regularize some unrecorded expenditure items, primarily for public investment, which accumulated over the past three years and that need to be correctly registered in the Treasury's accounting system.[8] The Treasury is currently unable to quantify the total amount of these unregistered

[7] Drought and flooding in 2019, the COVID-19 pandemic in 2020, and severe drought in late 2021/ early 2022.

[8] Paraguay's expenditure authorization and recording system falls somewhere in between accrual basis and cash basis. Expenditure can be recorded only if included in the current budget under execution, and when covered under

(continued)

expenditure since the suppliers' claims need to be verified, but reportedly the total amount of these claims could be around 0.5 percent of GDP. The authorities intend to accommodate those claims as part of the budget execution in 2023 and the following two years without further adjustment to the fiscal deficit targets. The ministry of finance will introduce additional control and information routines to avoid the build-up of such unregistered claims in the future.

16. The authorities are also committed to limit domestic financing through the carry-over of payment claims to the next budgetary year ("floating debt").[9] While the need to recur to this financing vehicle is acknowledged, their undue proliferation would pass on liquidity problems of the Treasury to the private sector. The program therefore incorporates a quantitative target on the net change of floating debt.

Reform of the "Caja Fiscal"

17. The pension fund for public servants ("Caja Fiscal") has seen a depletion of its funds at increasing speed over the last few years. The deficit of the "Caja Fiscal" reached the equivalent to US$167 million in 2021, and it is expected to increase to US$224 million this year. Current reserves of the "Caja Fiscal" stand at US$430 million and would be exhausted within the next three years, by which time the shortfall would need to be fully covered by the central government.

18. In response to the increasing fiscal risks, the government has proposed to apply transitory measures to protect the solvency of the "Caja Fiscal." The government is preparing a "transition law" that would serve as a stopgap measure to minimize financial losses in the next few years while continuing to work on a more comprehensive pension reform. The transitory measures would be reflected in a draft law to be sent to the Congress by the end of this year **(reform target, June 2023)**. The authorities will continue to work on a comprehensive reform of the pension system.

Strengthen Financial Supervision

19. The government plans to enhance the regulatory framework and supervision of pension funds. Paraguay's pension funds suffer from tight legal restrictions regarding their investment options[10] and lack a comprehensive regulatory framework and a regulator/supervisor to

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the Treasury's cash execution plan. This provision is meant to control expenditure execution, but complicates the recording of investment expenditure that follows pluri-annual programming cycles. The Treasury sometimes learns about these items only when suppliers present their bills and the recording and payment of such claims is usually folded into the next year's budget. This has been a recurrent issue every year, but the amounts grew in the last three years due to additional investments linked to the pandemic and drought mitigation.

[9] Floating debt is a traditional fiscal financing instrument in Paraguay that addresses the seasonality pattern of the Treasury's operations. Expenditures typically surge in December when income tax receipts are low. Part of that expenditure is rolled over into the following year, when it is repaid through short-term financing. Floating debt is not arrears as the payment due date is well-established with the suppliers in advance and the expenditure financed by floating debt is properly registered in the Treasury's accounting system.

[10] Since pension funds are not allowed to invest in government securities and bonds and face restrictions on foreign asset holdings, they hold a large share of their long-term reserves in short-term bank deposits, which is inefficient and deprives the capital market of long-term sources of funding.

foster accountability.[11] To start addressing these shortcomings, the government will propose the creation of a regulatory entity through a draft bill planned to be sent to Congress **(reform target, December 2023)**.

Identify and Minimize Fiscal Risks

20. Fiscal policy decisions will benefit from the forthcoming Fiscal Risk Report analysis. The Ministry of Finance is leading the production of this report. A roadmap has been drawn up to identify and manage the most pressing fiscal risks, including the analysis of macroeconomic and specific risks, such as public companies, PPPs, fiscal funds, and risks related to climate change. The report is expected to be published by the end of this year.

21. The government is strengthening the supervision and management of state-owned enterprises (SOEs). The Directorate General of Public Enterprises of the Ministry of Finance leads the surveillance and monitoring work for the nine public companies. In order to measure the performance of companies relative to results-based management contracts, the control panel system is planned to be restored **(reform target, December 2022)**. This would help identify contingent fiscal risks, enhance governance, and improve public sector efficiency. Also, the ministry of finance continues to work on a revised version of the Corporate Governance Law ("Ley de Gobierno Corporativo"), which would clarify and strengthen the role of the SOEs Supervisory Board and enhance the accountability of SOEs. This bill is expected to be submitted to Congress in the second half of 2023 **(reform target, December 2023)**.

Enhancing Domestic Revenue Mobilization

22. Relatively low tax revenues continue to be a long-standing challenge for public finances in Paraguay. As detailed in the 2022 Article IV report , tax revenue in Paraguay is relatively low, and there is a case for increasing rates and trimming tax expenditures. The current low tax rates and high informality levels offer opportunities to increase tax collection and reduce tax expenditure. The government will undertake an analysis of the costs and benefits of tax expenditure, in particular from special tax regimes and exemptions.

23. Enhanced tax monitoring remains a promising avenue to increase tax collections. Previous Fund technical assistance missions recommended implementing a comprehensive Compliance Risk Management framework for customs and revenue administration. A strengthened framework would allow the tax and customs administrations to have a comprehensive strategy to keep non-compliance at minimum levels. The government is also gradually rolling out a new system for mandatory electronic invoicing by medium and large taxpayers, which will become the norm by October 2024. As an intermediate step, the government plans to have enrolled at least 750 medium and large taxpayers by end-June 2023 **(reform target)**.

[11] In 2018, the government presented a law that would create a pension supervisor under the roof of the BCP, but it was rejected by Congress.

Improving Fiscal Governance

24. The authorities will continue to push for the approval of a revamped version of the Fiscal Responsibility Law. After the temporary suspension of the FRL in 2020, the ministry of finance prepared a draft law that would strengthen the fiscal rule and address several known weaknesses in the current law. The revised law ("FRL 2.0") was submitted to Congress in December 2020 but has since not been taken up for discussion and vote. The new law would maintain the same deficit ceiling but tighten provisions on the growth of current primary expenditures and civil servants' salaries. It would also refine the escape clause triggers, establish transition rules and periods in cases of transgression of the deficit ceiling, and strengthen the role of the Fiscal Council. It would also complement the deficit ceiling with a staggered debt ceiling, the transgression of which would require further fiscal tightening.[12] The government seeks to enact the law after discussion and approval by Congress.

Fiscal Safeguards in Pre-Electoral Times

25. To complement the safeguards of the FRL, the government submitted in April 2022 a fiscal protection bill to Congress[13] that would prohibit all initiatives to increase salaries or reduce taxes outside of the realm of the existing budget during electoral periods. The proposed law would be applied to the three branches of the government, Organisms and Entities of the State (OEE), and corporations with majority public shareholding. The electoral period is defined as the time-span between the fiscal year prior to the year in which the national elections are held and the first quarter of the fiscal year in which they are held. The draft law proposes to suspend legislative treatment and postpone until the end of the respective electoral season the following initiatives: i) bills that imply salary increases or supplementary remuneration increases, ii) proposals on the increase in current or capital expenditures without technical support, iii) projects that affect the tax system. Also, it grants unique attributes to the National Economic Team, chaired by the Minister of Finance, for establishing additional measures to implement the proposed law.

Monetary and Exchange Rate Policies

26. Monetary policy aims at bringing inflation back to 4 percent over the next 18 months. The BCP reacted quickly to the price shock, raising its policy interest rate in several steps by a cumulative 775 basis points to 8.5 percent by late-September this year. Inflation expectations continue to be well anchored, though they remain slightly above the 4 percent inflation target over the 2-year monetary policy horizon. Although further significant adjustments to the monetary policy stance are less likely as there have been some signs of a deceleration in price increases, the BCP stands ready to respond to new information particularly concerning inflation expectations.

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[12] A detailed comparison and discussion of the new draft FRL can be found in Annex I of the 2020 Article IV staff report (SM/21/9).

[13] Law of Government Behavior in Administrative and Fiscal Matters during Electoral Times.

27. A flexible exchange rate is a key element in Paraguay's framework. The authorities believe that the exchange rate is an important shock absorber, the currency value should be aligned with economic fundamentals, and that FX interventions should continue to be used to smooth excessive volatility as documented in the 2022 Article IV staff analysis. The BCP is committed to maintaining a strong reserve position and to continue enhancing transparency in foreign exchange interventions, including by publishing detailed information on its foreign exchange operations.[14] Paraguay's external position is substantially stronger than implied by economic fundamentals and desirable policies (Annex II).

B. Pillar II. Enhance Productivity and Foster Economic Growth

28. Reforms to strengthen the government structure, improve financial supervision, improve governance and control of corruption, ease the business climate, and diversify the energy matrix will be pursued to foster productivity and economic growth.

Rationalize Public Spending

29. A public procurement reform should help to both streamline and improve the quality of government spending. The government has prepared a draft law ("Ley de Suministro y Contrataciones Públicas") to strengthen the planning, transparency, and effectiveness of public procurement. The proposed law would also enhance the procedural role and authority of the National Directorate of Public Procurement (DNCP). The Senate has already approved the law but it is awaiting approval by the Chamber of Deputies, which is expected for December 2022. Upon its approval, specific regulations of the law would need to be formulated and implemented **(reform target, June 2023)**.

Civil Service Reform

30. Paraguay's fragmented civil service needs to be reformed. Following recommendations by the 2020 governance diagnostic assessment mission, the authorities have been working on strengthening the legal framework for the civil service ("Ley de la Función Pública y la Carrera del Servicio Civil"). The draft law proposes a modern and competent civil service structure based on meritocracy, with a single salary scale linked to professional development that promotes more efficient public spending. The new system would open the way for more strategic workforce planning and give public servants more clarity and orientation about their future career paths. The authorities plan to send the bill to the Congress later this year **(reform target, December 2022)**.

Reorganize the Structure of the State

31. The authorities aim to reform the structure of the state to limit institutional overlaps and fragmentation and enhance the effectiveness of policy implementation. The Technical

[14] These operations includes the auction system for the sale of government revenues in U.S. dollars ("ventas compensatorias"), and the more formal FX interventions ("ventas complementarias").

Secretariat for Planning is working on a legislative proposal that aims to clean up and reorder the structure, rules, and responsibilities ruling the organization of all institutions belonging to the public administration, integrate competencies, and avoid conflicts and duplicity of functions. This work is still in progress and is expected to be embodied in a draft bill to be submitted to Congress **(reform target, June 2023)**.

Improve Governance and Reduce Vulnerabilities to Corruption

32. The Fund-led governance diagnostic assessment conducted in early 2020 has been finalized and will be published by end-October 2022 (Prior Action). The report provides a comprehensive evaluation of the public sector and proposes short- and medium-term reforms to address the vulnerabilities identified. The governance diagnostic report includes recommendations on public financial management (PFM), tax and customs policies, financial system supervision, AML/CFT framework, rule of law and anticorruption framework. A number of those recommendations guided the reforms proposed in this PCI. The publication of the report would amplify its relevance and facilitate advancing on its recommendations.

33. The consolidation of the National Anti-Corruption Secretariat (SENAC) requires an enhanced legal framework. Following the 2020 diagnostic, and with the assistance of the US Agency for International Development, the authorities developed and adopted a new and comprehensive anti-corruption plan and submitted to Congress a draft law strengthening the powers, roles, and responsibilities of the authority responsible for combating corruption (SENAC). As the next step, the authorities plan to develop and adopt a national anti-corruption strategy informed by the governance diagnostic results.

34. The results of the 2021 mutual evaluation by GAFILAT (Latin America's FATF) will guide the timetable to continue strengthening the AML/CFT regime. The associated report stated that Paraguay's AML/CFT regime improved significantly since the last evaluation, with a stronger legal and institutional framework in place to fight against money laundering and the financing of terrorism. Paraguay obtained a substantial effectiveness rating on international cooperation, but requires considerable improvements in most of the other areas of the AML/CFT system (moderate effectiveness) including supervision, preventive measures, and financial intelligence. The Fund will support the authorities' efforts in these areas through a multi-year capacity development project. Specific measures in these areas would be identified as reform targets during the PCI's first review.

Improve the Business Climate

35. Measures to improve access to financing and introduce more modern insolvency regulations are important elements of the government's reform agenda. The government wants to foster access to credit by implementing a new legal framework for registration and guaranteeing of movable properties (e.g., machinery, vehicles) to promote their use as collateral for new loans. The authorities plan to submit this bill to Congress **(reform target, December 2022)**.

C. Pillar III. Enhance Social Protection and Inclusiveness

36. The authorities will continue to strengthen social protection and inclusiveness while implementing policies to reduce the size of the vulnerable population. A large share of the vulnerable population has benefited from successful and well-established social programs in Paraguay. However, social assistance programs should be seen as mostly protective measures. Implementing preventive measures such as reducing the share of vulnerable populations (e.g., people under the poverty line and informal workers) remains key.

Formalize the Economy

37. Paraguay's economy has a relatively large informal sector. According to different estimation approaches, informal activities comprise more than half of total employment in Paraguay, a higher rate than in its regional peers. The sizable informal sector, among other things, erodes the structure of public finances constraining the collection of fiscal revenues and creates persistent social challenges as informal workers are usually outside the scope of funded health and pension programs. A large share of the most vulnerable population works in the informal sector.

38. To address informality and foster inclusiveness, the authorities are working on a draft bill to help formalize both dependent workers from micro, small, and medium enterprises and independent workers. The proposed legislation would promote the access to the formal social security system through specific incentives. In the case of independent workers, the tax administration and the social security institute (IPS) are going to prepare plans for their gradual and systematic incorporation into the new regime and the associated regulations. The government plans to send this draft law to Congress next year **(reform target, June 2023).**

Enhance Social Assistance Programs

39. Paraguay's social assistance programs helped mitigate the impact of the COVID-19 pandemic on the vulnerable population. In response to the economic consequences of the pandemic, the country deployed an innovative cash transfer program, "Pytyvõ," which targeted informal sector workers. The program, jointly with other existent social assistance programs such as "Tekoporã"[15] and "Pension Alimentaria para Adultos Mayores",[16] effectively prevented a larger erosion of poverty and inequality indicators (See IMF Country Report No. 22/178).

40. Expanding the coverage of emblematic assistance programs remains crucial for Paraguay. In the short-term, the government plans to continue widening the coverage of two of its most important programs. Tekopora program is projected to expand to 170,000 families in 2022. Similarly, the coverage of the program "Pension Alimentaria para Adultos Mayores" would increase

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[15] Tekoporã provides social assistance to vulnerable populations in the following groups: newborns, infants and school-age (0-18 years old), pregnant women, people with disabilities, and indigenous communities.

[16] This program provides social assistance to older adults who are classified as poor and do not receive a salary or pension from private or public sources.

by twenty-six thousand beneficiaries. Both objectives are expected to be met by end-2022 **(reform target, December 2022).**

41. **The government is working on harmonizing procedures and platforms to enhance the administration and targeting strategies of its social assistance programs.** Currently, many of the government's social programs are administered by different public entities, which leads to duplication of costs and difficulties in keeping an accurate record of all beneficiaries. The Ministry of Finance developed the Pension System (SIPEN), a technological solution for managing pensions in the non-contributory sector (Programa de Seguridad Alimentaria para Adultos Mayores). The SIPEN entails modules for recording, selecting, and setting up benefits for beneficiaries while allowing the Integrated Financial Administration System (SIAF) to control payment procedures. As a first step, the authorities propose formally implementing the SIPEN for the programs managed by the Directorate of Non-Contributory Pensions **(reform target, December 2023).** Subsequently, the SIPEN should be expanded to other social assistance programs.

Increase Financial Inclusion

42. **The reform agenda includes measures to enhance access to financial services, a long-standing challenge in Paraguay.** The authorities have drafted a Financial Inclusion Law establishing mandatory salary payments by electronic transfer rather than cash. It would guarantee workers to open banking accounts free of charge and allow them at least one non-fee cash withdrawal per month. This measure promotes the formalization and financial inclusion of underbanked low-income households. The draft legislation has obtained a favorable opinion from two congressional committees and is awaiting a discussion in the National Congress for its approval. The implementing regulations will be drafted subsequent to its approval.

PROGRAM MODALITIES AND RISKS

43. **The attached Program Statement (PS) details the authorities' policy commitments.** Paraguay meets the criteria for use of the PCI, and the staff's current analysis does not indicate a present, prospective or potential balance of payments need. The program will be monitored by way of quantitative targets (QTs) and reform targets (RTs). QTs will be set on cumulative semi-annual ceilings on the central government fiscal deficit, on current primary expenditure, and on the net change of floating debt (Program Statement, Table 1a). Non-accumulation of external debt payment arrears will be a continuous target. Additional standard continuous targets also apply (Program Statement, Table 1b). An inflation consultation band based on the BCP's inflation projections will also be a QT, with targets to be adjusted in the course of the periodic comprehensive revisions.[17] Given Paraguay's strong reserve position (over 200 percent of the ARA metric) and a commitment to a flexible exchange rate regime (¶7 and 27 and Annex II), a quantitative target on Net International Reserves (NIR) is not warranted. The list of RTs are numbered in Table 2 of the Program Statement.

[17] A memo item on social transfers is also added.

A prior action related to the publication of the Fund-led Governance Diagnostic Assessment report will be met by end-October.

44. **Program implementation will be supported by a comprehensive capacity development strategy (Annex IV)**. The priorities for capacity development are closely aligned with the PCI objectives, including a focus on revenue mobilization, public financial management, and AML/CFT.

45. **Risks to the implementation of the PCI arrangement are assessed to be low.** Paraguay will need to maintain political consensus in favor of fiscal discipline and the implementation of longstanding structural reforms. There is no balance of payments gap for the next 12 months, and there are good prospects that there will be adequate financing for the remaining program period. Nevertheless, global economic uncertainties, adverse climate shocks, and the 2023 elections pose risks to the program's baseline.

STAFF APPRAISAL

46. **The fiscal, monetary and financial sector measures implemented in response to the pandemic and recent external shocks were appropriate to support the economy.** While the economy is exposed to many risks, it is expected to continue its recovery next year. Despite the recent surge in fiscal deficits, public debt projections show a sustainable downward path starting in 2023. Inflation reached double-digit levels, but there are signs that it is decelerating. The Central Bank's timely and determined tightening of the monetary policy stance has been effective in anchoring the medium-term inflation expectations. Paraguay's external position in 2021 was substantially stronger than the level implied by fundamentals and desirable policies. Finally, the banking system remains stable and liquid, offering an opportunity to continue with the authorities' financial inclusion agenda.

47. **The government's agenda, as spelled out in the Program Statement, aims at rebuilding policy buffers while advancing structural and institutional reforms to enhance macroeconomic stability and resilience.** The return to the fiscal deficit ceiling of 1.5 percent is essential to guarantee debt sustainability in the medium term. Paraguay's public finances need to combine revenue-enhancing measures with more effective public spending. Staff concurs that enhancing domestic revenue mobilization, reforming the "Caja Fiscal," and raising the efficiency of the public sector are needed to preserve fiscal sustainability. Additional policies, such as improving public companies' oversight and safeguarding the fiscal account in electoral times, would further contribute to reducing fiscal risks.

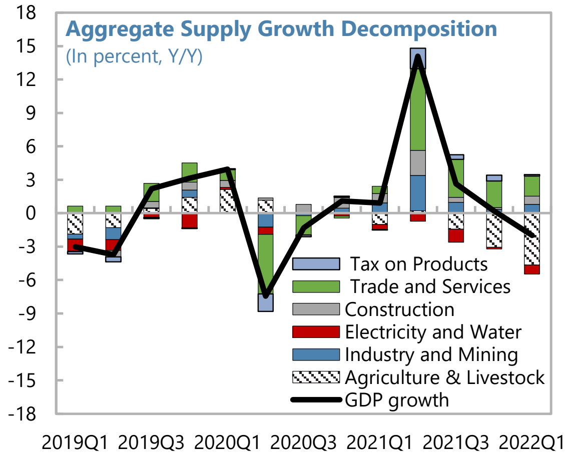
48. **Structural reforms to modernize public institutions, increase government effectiveness, improve governance and control corruption, and improve the business climate will help improve conditions for sustained economic growth.** Paraguay has benefited from previous technical assistance in the areas of public financial management, governance, financial supervision, and the transition to a sustainable and green economy. Staff concurs that the reforms included in this PCI would strengthen the efficient use of public resources and create more favorable conditions for private investment.

49. Social programs have become more prominent in Paraguay, but they need to be strengthened. The COVID19 pandemic revealed significant gaps in Paraguay's social safety net. High informality, inequality, and poverty remain relevant challenges for the policy agenda. The PCI proposes measures that would improve the impact of social assistance programs, increase their coverage among the vulnerable population, foster the formalization of the economy, and strengthen financial inclusion.

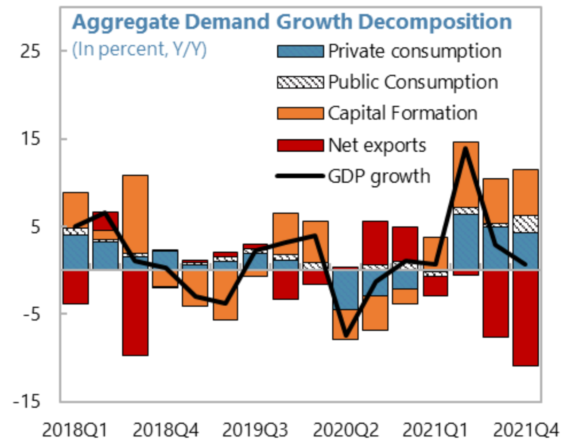
50. The requested two-year Fund-supported PCI would provide an appropriate timeframe for the authorities to implement the identified reform areas and targets. The authorities' reform agenda sets the right priorities. Paraguay meets the criteria for use of the PCI, and the current analysis does not indicate a present, prospective, or potential balance of payments need. Risks to program implementation are low, given Paraguay's strong track record in implementing prudent macroeconomic policies and structural reforms. The program will strengthen the signaling of policy and reform commitments to development partners and the Paraguayan public in general. Staff is not aware of any external arrears to bilateral, multilateral, or commercial creditors. Paraguay benefits from market access as shown by the successful sovereign bond issuances in every year since 2013. External financing by multilateral donors is expected to remain stable, with the IADB, the World Bank, and the Development Bank of Latin America scheduled to disburse various policy loans over the coming year. Staff support the authorities' request for a 2-year PCI-supported program.

Figure 1. Paraguay: Recent Developments

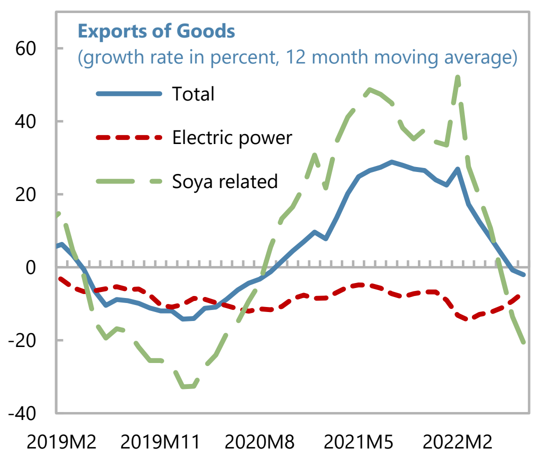
The economy contracted in the beginning of the year as weak agricultural production more than offset positive growth in services and manufacturing.



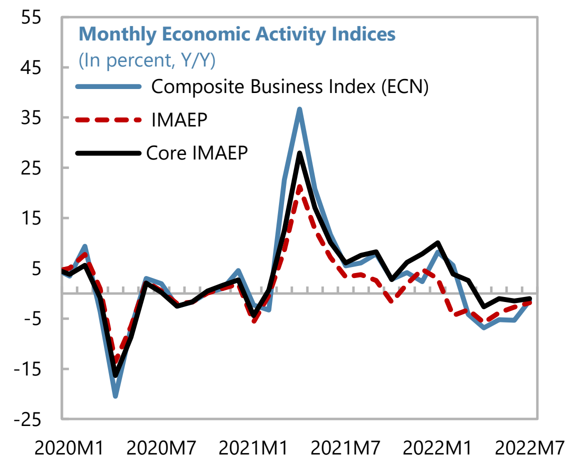
From the demand side, private consumption and investment continue sustaining growth, compensating the large drop of agricultural exports.



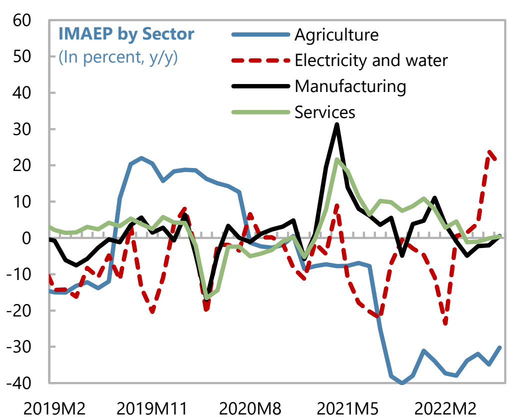
Exports of soy are expected to contract this year. Electricity exports continue to shrink due to sluggish generation and higher domestic consumption.



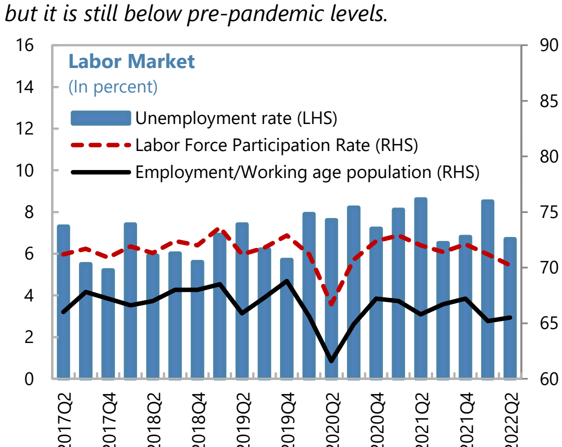
Monthly economic activity estimates up to July are in line with low real growth this year…



…driven mainly by a disappointing soy campaign.



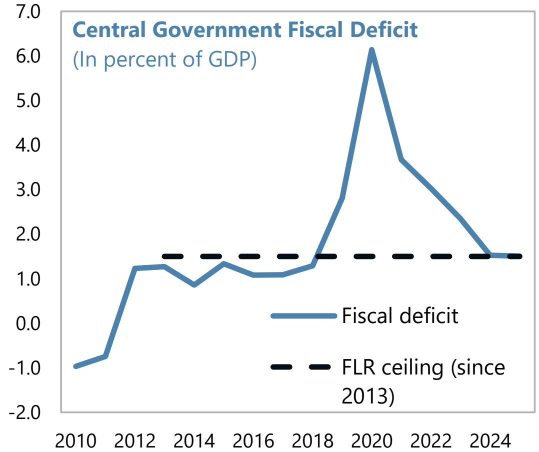
Employment recovered in 2021 and consolidated in 2022, but it is still below pre-pandemic levels.



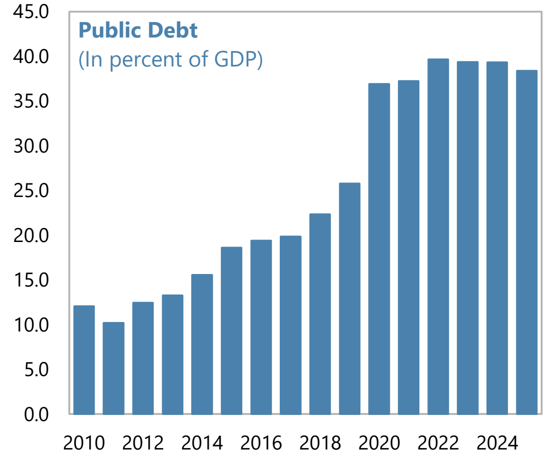
Sources: BCP, Ministry of Finance and IMF staff calculations.

Figure 2. Paraguay: Fiscal Developments

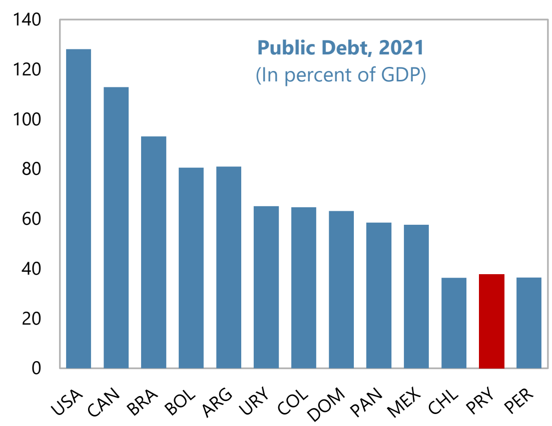
After having breached the FRL ceiling in the past three years, Paraguay plans to converge back by 2024.



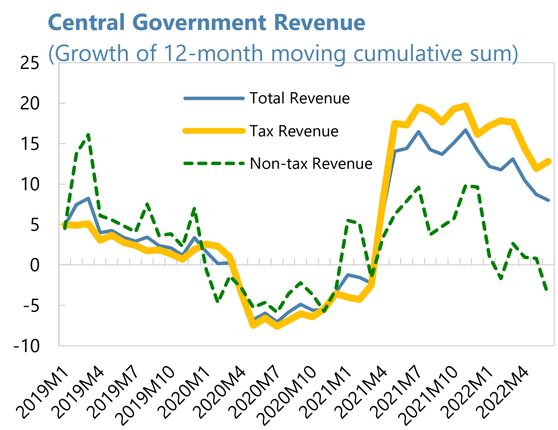
Public debt has increased substantially since the outbreak of the pandemic…



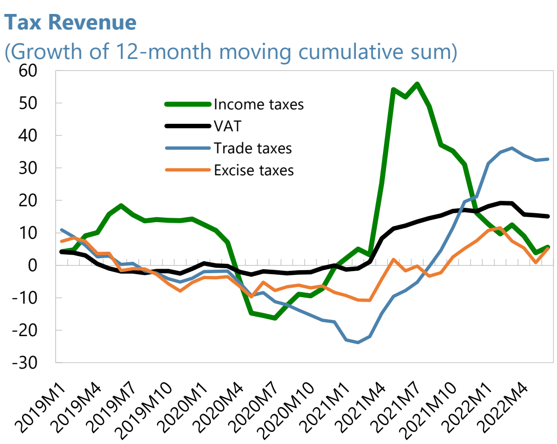
…but is still low compared to other countries in the region.



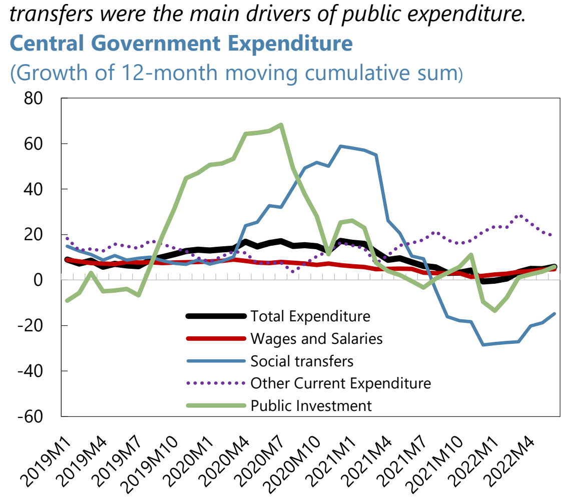
Tax revenue has rebounded after the pandemic and is holding up despite the 2022 economic slump…



…with trade taxes and VAT leading the way.



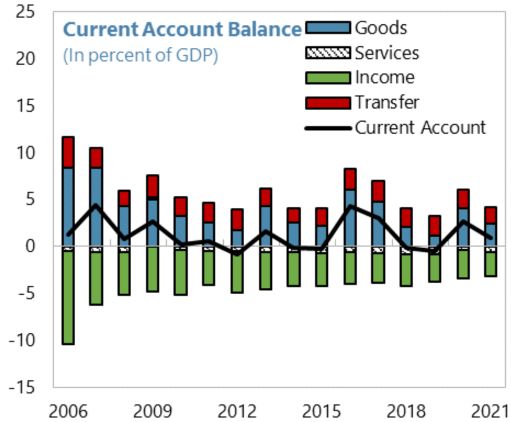
During the pandemic, public investment and social transfers were the main drivers of public expenditure.



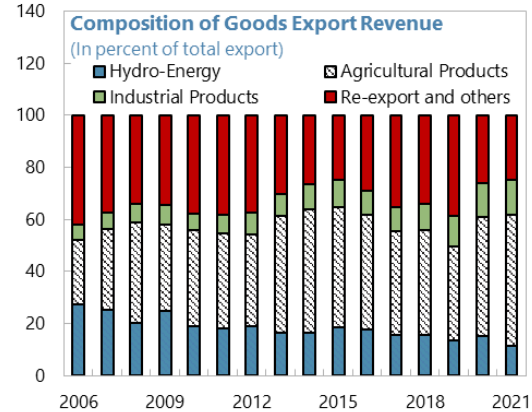
Sources: Ministry of Finance, WEO and IMF staff estimates.

Figure 3. Paraguay: External Sector Developments

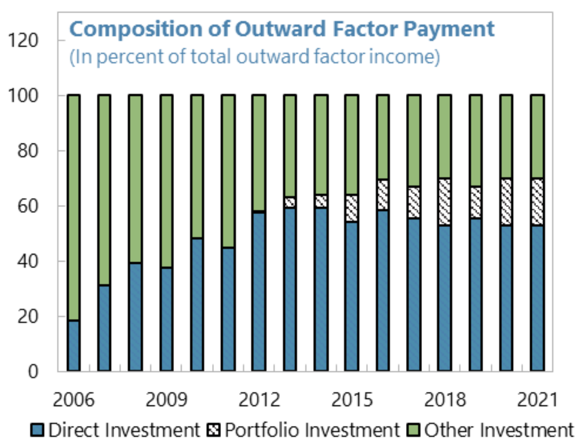
The external current account has deteriorated due to lower exports and higher oil prices.



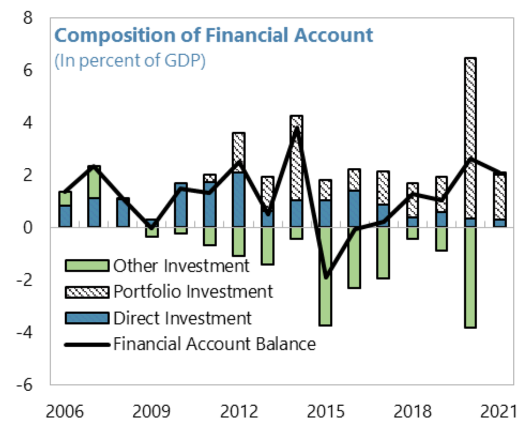
Agricultural products make up a large share of exports.



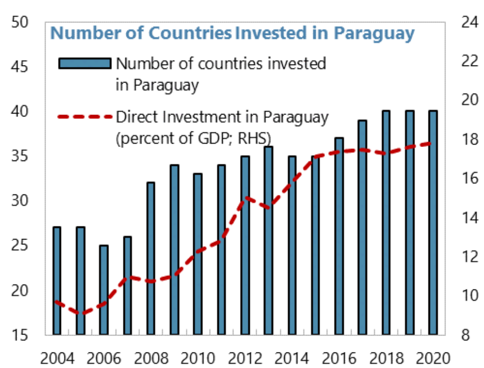
Profit remittances are a major source of outward factor payments. The foreign investor base is expanding along with the increase in direct investment.



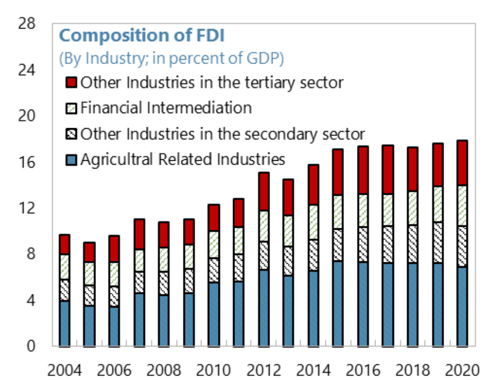
Foreign direct investment and government bond issuances have been stable sources of capital.



Foreign direct investment has been on the rise in Paraguay over the last decade.



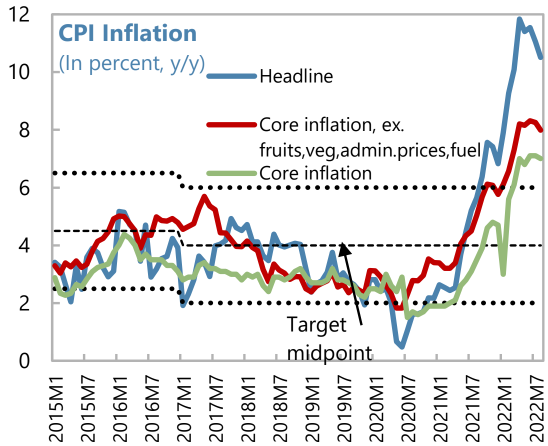
A large portion of foreign capital has invested in agricultural-related industries, manufacturing, and trade.



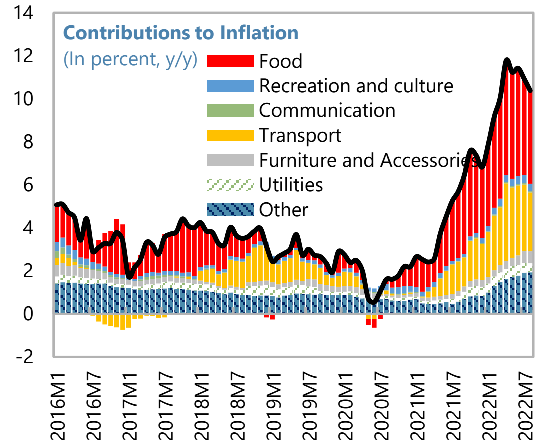
Sources: BCP and IMF staff calculations.

Figure 4. Paraguay: Monetary Indicators

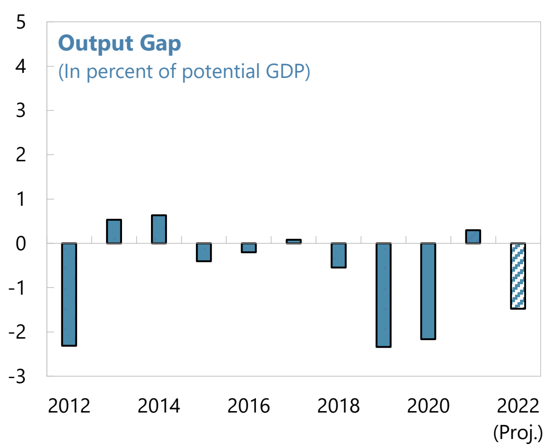
After reaching its lowest point in mid-2020, inflation went up and surpassed the BCP's 6 percent upper-limit target starting in September 2021...



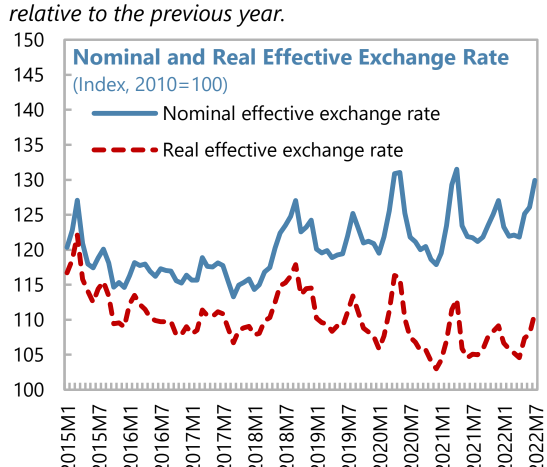
...led by significant higher food and fuel prices.



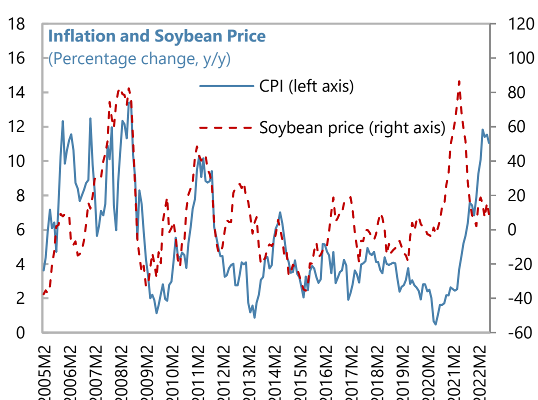
The output gap is expected to turn negative this year...



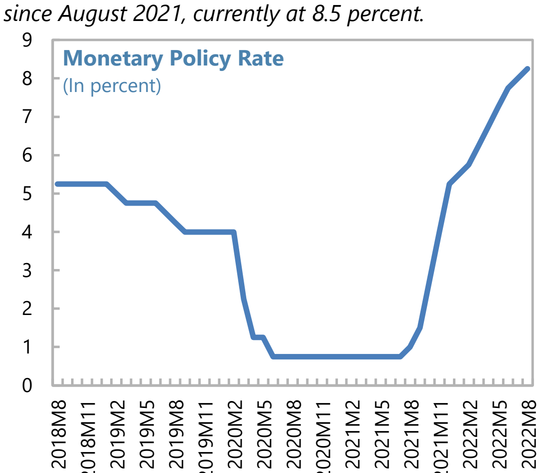
... while the real exchange rate has stayed almost flat relative to the previous year.



Given that inflation has been higher than targeted levels ...



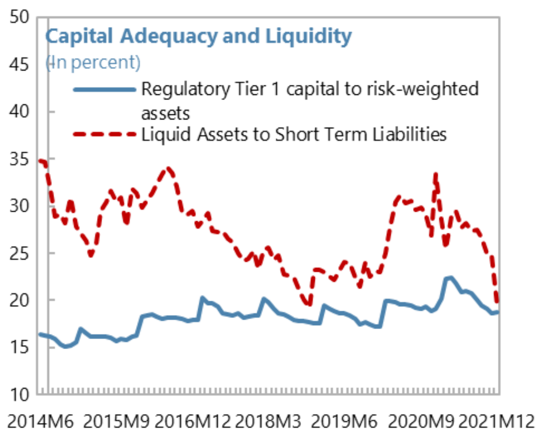
...the central bank has continuosly tightened its policy rate since August 2021, currently at 8.5 percent.



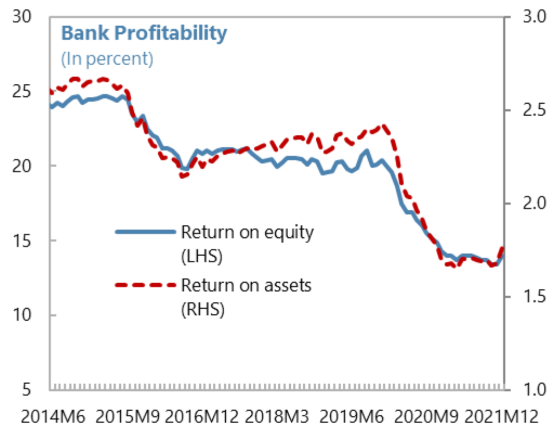
Sources: BCP, Ministry of Finance and IMF staff calculations.

Figure 5. Paraguay: Financial Sector Developments

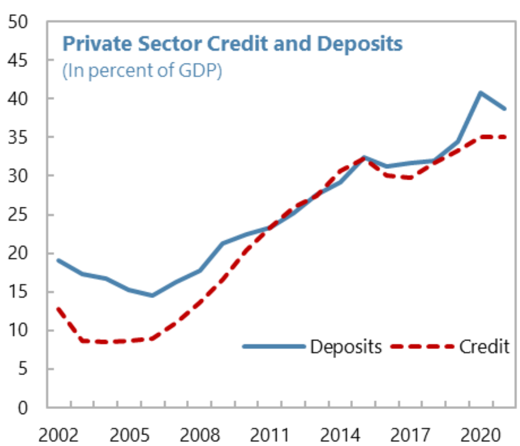
Banks are liquid and well capitalized.



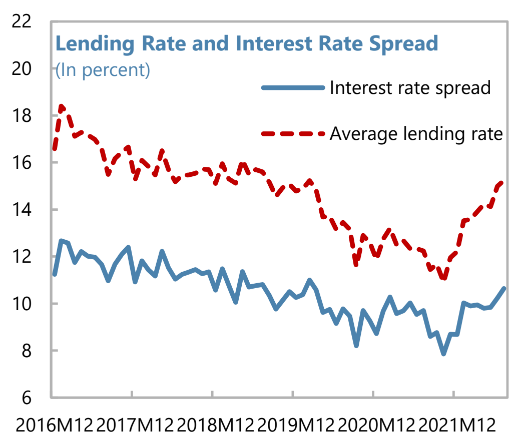
Banks profitability has fallen recently.



Financial deepening has increased in Paraguay.



Lending rates increased since the last quarter of 2021 in response to the normalization of monetary policy.



Sources: BCP and IMF staff calculations.

Table 1. Paraguay: Selected Economic Indicators

I. Social and Demographic Indicators

Population 2021 (millions)	7.4	Gini index (2021)	43.1
Unemployment rate (2021)	7.7	Life expectancy at birth (2020)	74
Percentage of population below the poverty line (2021)	26.9	Adult literacy rate (2020)	95.0
Rank in UNDP development index (2019)	103 of 189	GDP per capita (US$, 2021)	5,207

II. Economic Indicators

				Prel.			Proj.			
	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027
				(Annual percent change, unless otherwise indicated)						
Income and Prices										
Real GDP	3.2	-0.4	-0.8	4.1	0.2	4.5	3.5	3.5	3.5	3.5
Nominal GDP	5.2	2.6	1.4	11.5	7.1	8.4	6.7	9.0	7.8	8.0
Per capita GDP (U.S. dollars, thousands)	5.7	5.3	4.9	5.4	5.5	5.8	6.0	6.3	6.6	6.9
Consumption (contribution to real GDP growth)	3.1	1.7	-1.7	4.3	2.8	-4.2	-0.2	2.5	2.8	2.6
Investment (contribution to real GDP growth)	3.0	-1.5	-1.0	5.3	3.5	6.2	3.6	1.4	1.3	1.4
Net Exports (contribution to real growth)	-2.9	-0.6	1.9	-5.5	-6.1	2.5	0.1	-0.3	-0.6	-0.5
Consumer prices (end of period)	3.2	2.8	2.2	6.8	8.8	4.1	4.0	4.0	4.0	4.0
Nominal exchange rate (Guarani per U.S. dollar, eop)	5,961	6,453	6,917	6,879	...	...	...	...	...	...
Monetary Sector										
Credit to private sector 1/	14.1	9.7	8.1	10.5	9.2	8.7	9.1	9.1	9.1	9.0
Monetary policy rate, year-end	5.3	4.0	0.75	5.25	...	...	...	...	...	...
External Sector										
Exports (fob, values)	2.5	-7.5	-9.5	22.0	-7.6	18.6	4.3	7.0	3.6	4.2
Imports (cif, values)	12.1	-5.2	-18.1	30.4	6.5	8.2	5.5	3.0	3.7	3.5
Terms of trade	-2.1	-2.7	-0.5	-2.7	2.5	-1.9	-2.2	4.3	1.1	1.6
Real effective exchange rate 2/	3.2	-2.9	-1.2	-1.0	...	...	...	...	...	...
				(In percent of GDP, unless otherwise indicated)						
External Current Account	**-0.2**	**-0.5**	**2.7**	**0.9**	**-4.9**	**-1.9**	**-2.3**	**-0.9**	**-0.9**	**-0.7**
Trade balance	1.2	0.3	3.8	1.8	-3.3	-0.4	-0.8	0.5	0.5	0.7
Exports	34.1	33.5	32.4	35.5	31.5	35.1	35.0	35.1	34.4	33.9
Of which: Electricity	5.2	4.5	4.9	4.1	4.0	3.5	3.1	2.7	2.4	2.2
Imports	-32.1	-32.3	-28.3	-33.1	-33.9	-34.5	-34.7	-33.5	-32.9	-32.1
Of which: Oil imports	-4.1	-3.8	-3.0	-3.9	-6.7	-6.8	-5.7	-4.9	-4.5	-4.2
Capital Account and Financial Account	**1.6**	**1.4**	**3.1**	**2.6**	**2.0**	**2.2**	**3.5**	**2.0**	**1.9**	**1.7**
Of which: Direct investment	0.4	0.6	0.3	0.3	1.2	4.0	4.5	1.4	1.0	1.0
Gross International Reserves (in millions of U.S. dollars)	**8,004**	**7,500**	**9,976**	**10,570**	**10,070**	**10,570**	**11,120**	**11,670**	**12,220**	**12,770**
In months of next-year imports of goods and services	7.0	8.3	8.6	8.1	6.8	6.5	6.7	6.8	6.9	7.0
Ratio to short-term external debt	2.2	2.1	2.4	2.4	2.2	2.2	2.5	2.5	2.8	6.8
Gross Domestic Investment	**22.8**	**21.7**	**20.0**	**23.2**	**26.1**	**30.3**	**32.6**	**32.3**	**32.2**	**32.2**
Gross Domestic Saving	**22.6**	**21.2**	**22.7**	**24.2**	**21.1**	**28.4**	**30.3**	**31.4**	**31.3**	**31.5**
Central Government Revenues	**14.1**	**14.2**	**13.5**	**13.9**	**13.9**	**14.2**	**14.5**	**14.4**	**14.3**	**14.3**
Of which: Tax revenues	10.0	10.0	9.5	9.9	10.4	10.4	10.7	10.7	10.7	10.8
Central Government Expenditures	**15.4**	**17.0**	**19.7**	**17.5**	**16.9**	**16.5**	**16.0**	**15.9**	**15.7**	**15.8**
Of which: Compensation of Employees	6.6	6.9	7.3	6.7	6.8	6.8	6.7	6.5	6.3	6.2
Of which: Net Acquisition of Non Financial Assets	2.0	2.9	3.6	2.9	2.6	2.1	2.0	2.2	2.3	2.5
Central Government Net Lending/Borrowing	**-1.3**	**-2.8**	**-6.1**	**-3.7**	**-3.0**	**-2.3**	**-1.5**	**-1.5**	**-1.4**	**-1.4**
Central Government Primary Balance	11.6	12.2	14.2	12.6	12.6	12.1	12.2	11.8	11.6	-7.2
Public Sector Debt (excl. Central Bank Bills)	**22.3**	**25.8**	**36.9**	**37.2**	**39.7**	**39.4**	**39.3**	**38.4**	**37.7**	**36.8**
Of which: Foreign currency	18.1	21.4	31.9	32.6	34.9	34.7	34.6	33.6	32.9	32.1
Of which: Domestic currency	4.2	4.4	5.0	4.7	4.7	4.7	4.7	4.7	4.7	4.7
Memorandum Items:										
GDP (billions of Guaranies) 3/	230,576	236,567	239,915	267,548	286,523	310,499	331,314	361,279	389,481	420,657
GDP (US$ billions)	40.2	37.9	35.4	39.5	...	...	...	...	...	...

Sources: Central Bank of Paraguay; Ministry of Finance; and IMF staff estimates and projections.

1/ Includes local currency credit and foreign currency credit valued at a constant exchange rate.

2/ Average annual change; a positive change indicates an appreciation.

3/ Historical GDPs were revised in 2018, including a 30 percent upward revision in nominal GDP for 2017.

Table 2a. Paraguay: Operations of the Central Government

(In billions of Guaranies)

				Prel.			Proj.			
	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027
Revenue	**32,534**	**33,633**	**32,494**	**37,102**	**39,717**	**43,975**	**48,044**	**51,982**	**55,658**	**60,204**
Taxes	23,137	23,577	22,739	26,409	29,662	32,339	35,369	38,682	41,762	45,608
Income taxes	5,260	6,013	5,970	6,934	8,423	9,022	9,818	11,339	12,413	14,114
Excises	3,194	3,026	2,775	2,985	2,901	3,186	3,297	3,407	3,537	3,697
Value added tax	11,812	11,690	11,686	13,631	15,082	16,563	18,304	19,703	21,255	22,905
Import duties	2,521	2,421	2,000	2,423	2,765	3,038	3,328	3,555	3,827	4,103
Other	350	427	309	437	491	530	622	678	731	790
Social contributions	2,114	2,126	2,443	2,778	2,835	3,130	3,395	3,630	3,859	4,137
Other revenue	7,283	7,929	7,312	7,915	7,220	8,506	9,280	9,670	10,036	10,459
Grants	1,747	1,525	1,443	1,832	1,353	1,671	1,783	1,945	2,097	2,264
Itaipu-Yacyreta	3,232	4,111	2,994	2,410	2,593	2,910	3,308	3,158	3,016	2,877
Other nontax revenue	2,304	2,293	2,875	3,673	3,273	3,925	4,189	4,567	4,924	5,318
Expenditure	**35,511**	**40,284**	**47,223**	**46,929**	**48,450**	**51,259**	**52,976**	**57,490**	**61,213**	**66,281**
Expense	**30,823**	**33,329**	**38,510**	**39,051**	**41,094**	**44,857**	**46,441**	**49,498**	**52,246**	**55,881**
Compensation of employees	15,228	16,432	17,512	17,841	19,552	21,114	22,075	23,369	24,602	26,111
Purchases of goods and services	2,912	3,120	3,461	5,414	4,148	4,442	4,012	4,319	4,649	5,004
Interest	1,549	1,962	2,554	2,962	3,907	4,307	4,576	4,819	4,678	4,982
Grants	4,796	4,723	4,562	4,769	4,626	4,929	5,252	5,513	5,943	6,419
Social benefits	5,253	5,718	9,083	6,496	7,240	8,316	8,873	9,675	10,431	11,266
Other expense	1,085	1,375	1,338	1,568	1,621	1,749	1,653	1,803	1,943	2,099
Gross Operating Balance	**1,711**	**304**	**-6,016**	**-1,949**	**-1,377**	**-882**	**1,603**	**2,484**	**3,412**	**4,323**
Net acquisition of nonfinancial assets	4,688	6,955	8,713	7,877	7,356	6,402	6,534	7,993	8,967	10,400
Net Lending/Borrowing (Overall Balance)	**-2,977**	**-6,651**	**-14,729**	**-9,827**	**-8,733**	**-7,284**	**-4,931**	**-5,508**	**-5,555**	**-6,076**
Net Financial Transactions	**2,977**	**6,651**	**14,729**	**9,827**	**8,733**	**7,284**	**4,931**	**5,508**	**5,555**	**6,076**
Net Acquisition of Financial Assets	**2,525**	**-295**	**6,739**	**1,470**	**0**	**0**	**0**	**0**	**0**	**0**
Financial investments	2,439	-259	5,077	775	0	0	0	0	0	0
Net lending	86	-35	1,662	695	0	0	0	0	0	0
Net Incurrence of Liabilities	**5,779**	**5,114**	**25,213**	**11,504**	**8,733**	**7,284**	**4,931**	**5,508**	**5,555**	**6,076**
Domestic	1,678	-215	4,978	608	751	892	600	1,082	1,035	1,466
Debt securities	5	470	-324	803	251	492	600	1,082	1,035	1,466
New TB issues	732	1,396	1,321	1,628	1,871	2,009	2,185	2,932	2,616	2,678
Amortizations	726	926	1,645	826	1,620	1,516	1,584	1,850	1,581	1,213
Net credit from the banking system	1,750	-1,430	4,317	390	0	0	0	0	0	0
Net credit from the Central bank 1/	-444	1,638	-3,821	-330	0	0	0	0	0	0
Net credit from commercial banks	2,194	-3,067	8,138	720	0	0	0	0	0	0
Other accounts payable/floating debt	-77	745	985	-585	500	400	0	0	0	0
Foreign	4,101	5,328	20,235	10,896	7,982	6,392	4,331	4,426	4,520	4,611
Loans	4,101	5,328	20,235	10,896	7,982	6,392	4,331	4,426	4,520	4,611
Disbursements	5,113	6,429	21,482	12,055	12,965	11,017	8,638	9,789	11,021	12,105
of which: August 2021 SDR allocation	…	…	…	1,858	…	…	…	…	…	…
Amortizations	1,012	1,101	1,247	1,159	4,982	4,625	4,307	5,363	6,501	7,494
Statistical Discrepancy 2/	-276	1,243	-3,744	-208	0	0	0	0	0	0
Memorandum items:										
Primary balance	-1,428	-4,689	-12,175	-6,864	-4,826	-2,977	-355	-689	-877	-1,094
Current primary expenditure	26,830	28,853	34,125	33,599	34,746	37,926	39,149	41,931	44,605	47,699

Sources: Ministry of Finance; Central Bank of Paraguay; and Fund staff estimates and projections.

1/ Includes mainly use of government deposits at the Central Bank.

2/ Captures the discrepancy between above-the-line calculations and financial accounts.

Table 2b. Paraguay: Operations of the Central Government

(In percent of GDP unless specified otherwise)

	2018	2019	2020	Prel. 2021	Proj. 2022	2023	2024	2025	2026	2027
Revenue	**14.1**	**14.2**	**13.5**	**13.9**	**13.9**	**14.2**	**14.5**	**14.4**	**14.3**	**14.3**
Taxes	10.0	10.0	9.5	9.9	10.4	10.4	10.7	10.7	10.7	10.8
Income taxes	2.3	2.5	2.5	2.6	2.9	2.9	3.0	3.1	3.2	3.4
Excises	1.4	1.3	1.2	1.1	1.0	1.0	1.0	0.9	0.9	0.9
Value added tax	5.1	4.9	4.9	5.1	5.3	5.3	5.5	5.5	5.5	5.4
Import duties	1.1	1.0	0.8	0.9	1.0	1.0	1.0	1.0	1.0	1.0
Other	0.2	0.2	0.1	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Social contributions	0.9	0.9	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Other revenue	3.2	3.4	3.0	3.0	2.5	2.7	2.8	2.7	2.6	2.5
Grants	0.8	0.6	0.6	0.7	0.5	0.5	0.5	0.5	0.5	0.5
Itaipu-Yacyreta hydroelectric plants	1.4	1.7	1.2	0.9	0.9	0.9	1.0	0.9	0.8	0.7
Other nontax revenue	1.0	1.0	1.2	1.4	1.1	1.3	1.3	1.3	1.3	1.3
Expenditure	**15.4**	**17.0**	**19.7**	**17.5**	**16.9**	**16.5**	**16.0**	**15.9**	**15.7**	**15.8**
Expense	**13.4**	**14.1**	**16.1**	**14.6**	**14.3**	**14.4**	**14.0**	**13.7**	**13.4**	**13.3**
Compensation of employees	6.6	6.9	7.3	6.7	6.8	6.8	6.7	6.5	6.3	6.2
Purchases of goods and services	1.3	1.3	1.4	2.0	1.4	1.4	1.2	1.2	1.2	1.2
Interest	0.7	0.8	1.1	1.1	1.4	1.4	1.4	1.3	1.2	1.2
Grants	2.1	2.0	1.9	1.8	1.6	1.6	1.6	1.5	1.5	1.5
Social benefits	2.3	2.4	3.8	2.4	2.5	2.7	2.7	2.7	2.7	2.7
Other expense	0.5	0.6	0.6	0.6	0.6	0.6	0.5	0.5	0.5	0.5
Gross Operating Balance	**0.7**	**0.1**	**-2.5**	**-0.7**	**-0.5**	**-0.3**	**0.5**	**0.7**	**0.9**	**1.0**
Net acquisition of nonfinancial assets	2.0	2.9	3.6	2.9	2.6	2.1	2.0	2.2	2.3	2.5
Net Lending/Borrowing (Overall Balance)	**-1.3**	**-2.8**	**-6.1**	**-3.7**	**-3.0**	**-2.3**	**-1.5**	**-1.5**	**-1.4**	**-1.4**
Net Financial Transactions	**1.3**	**2.8**	**6.1**	**3.7**	**3.0**	**2.3**	**1.5**	**1.5**	**1.4**	**1.4**
Net Acquisition of Financial Assets	1.1	-0.1	2.8	0.5	0.0	0.0	0.0	0.0	0.0	0.0
Financial investments	0.0	0.0	0.7	0.3	0.0	0.0	0.0	0.0	0.0	0.0
Net lending	0.0	0.0	0.7	0.3	0.0	0.0	0.0	0.0	0.0	0.0
Net Incurrence of Liabilities	2.5	2.2	10.5	4.3	3.0	2.3	1.5	1.5	1.4	1.4
Domestic	0.7	-0.1	2.1	0.2	0.3	0.3	0.2	0.3	0.3	0.3
Debt securities	0.0	0.2	-0.1	0.3	0.1	0.2	0.2	0.3	0.3	0.3
New issues	0.3	0.6	0.6	0.6	0.7	0.6	0.7	0.8	0.7	0.6
Amortizations	-0.3	-0.4	-0.7	-0.3	-0.6	-0.5	-0.5	-0.5	-0.4	-0.3
Net credit from the banking system	0.8	-0.6	1.8	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Net credit from the Central bank 1/	-0.2	0.7	-1.6	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Net credit from the commercial banks	1.0	-1.3	3.4	0.3	0.0	0.0	0.0	0.0	0.0	0.0
Other accounts payable/floating debt	0.0	0.3	0.4	-0.2	0.2	0.1	0.0	0.0	0.0	0.0
External	1.8	2.3	8.4	4.1	2.8	2.1	1.3	1.2	1.2	1.1
Disbursements	2.2	2.7	9.0	4.5	4.5	3.5	2.6	2.7	2.8	2.9
of which: August 2021 SDR allocation	…	…	…	0.7	…	…	…	…	…	…
Amortizations	-0.4	-0.5	-0.5	-0.4	-1.7	-1.5	-1.3	-1.5	-1.7	-1.8
Statistical Discrepancy 2/	-0.1	0.5	-1.6	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum Items:										
Primary balance	11.6	12.2	14.2	12.6	12.1	12.2	11.8	11.6	11.5	11.3
Primary balance excl. royalties and grants	-2.8	-4.4	-6.9	-4.2	-3.1	-2.4	-1.6	-1.6	-1.5	-1.5
Primary balance excl. royalties and grants 3/	2.0	-18.2	-413.7	-1,188.2	-2,417.3	-1,186.0	-233.2	N.A.	N.A.	N.A.
Output gap 3/	-0.5	-2.3	-2.2	0.3	-1.5	-0.5	-0.2	-0.2	-0.2	-0.2
Cyclically adjusted primary balance 3/	-0.5	-1.6	-4.7	-2.6	-1.5	-0.9	-0.1	-0.2	-0.2	-0.2
Fiscal Impulse (-Δ Cyclically adjusted primary balance)	0.0	1.1	3.1	-2.1	-1.2	-0.6	-0.8	0.1	0.0	0.0
Central government gross debt	17.9	20.8	31.0	31.9	33.5	33.4	33.5	32.9	32.5	32.1
Nominal GDP (in billions of Guaranies)	230,576	236,567	239,915	267,548	286,523	310,499	331,314	361,279	389,481	420,657

Sources: Ministry of Finance; Central Bank of Paraguay; and IMF staff estimates and projections.

1/ Includes mainly use of government deposits at the Central Bank.

2/ Captures the discrepancy between above-the-line calculations and financial accounts.

3/ In percent of potential GDP.

Table 3. Paraguay: Balance of Payments

(In millions of U.S. dollars)

	2018	2019	2020	Prel. 2021	Proj. 2022	2023	2024	2025	2026	2027
Current Account	**-67**	**-178**	**959**	**368**	**-2,031**	**-828**	**-1,066**	**-444**	**-456**	**-374**
Trade balance	479	126	1,333	700	-1,373	-165	-360	264	239	373
Exports	13,730	12,702	11,494	14,025	12,965	15,375	16,042	17,173	17,784	18,539
Hydro-Electricity	2,109	1,722	1,736	1,609	1,657	1,538	1,442	1,347	1,259	1,178
Agricultural Products	5,547	4,582	5,280	7,049	4,625	6,123	6,378	6,573	6,799	7,033
Industrial Products and others	1,386	1,502	1,502	1,893	2,109	2,209	2,273	2,352	2,445	2,547
Unregistered	1,437	1,310	907	713	726	845	1,048	1,118	1,192	1,268
Re-Export	3,251	3,586	2,070	2,762	3,848	4,659	4,901	5,783	6,089	6,513
Imports	-12,917	-12,251	-10,036	-13,087	-13,939	-15,084	-15,916	-16,391	-16,995	-17,584
Of which: Fuel products	-1,631	-1,423	-1,048	-1,531	-2,755	-2,961	-2,635	-2,408	-2,338	-2,324
Services (net)	-334	-325	-125	-239	-399	-455	-486	-517	-551	-582
Transport	-430	-438	-184	-282	-417	-461	-488	-518	-549	-573
Travel	27	40	-16	-45	-74	-82	-90	-96	-102	-109
Other	69	73	75	87	92	89	92	96	100	100
Factor income	-1,348	-1,099	-1,068	-1,028	-1,344	-1,394	-1,473	-1,526	-1,559	-1,661
Transfers	801	795	694	696	687	731	767	818	863	914
Capital and Financial Account	**662**	**539**	**1,103**	**1,045**	**824**	**978**	**1,619**	**995**	**1,008**	**924**
Capital transfers	153	151	172	217	200	166	174	186	196	208
Direct investment	156	225	120	122	500	1,765	2,059	708	512	542
Portfolio investment	530	500	2,161	674	200	0	0	0	0	0
Other investment	-177	-336	-1,350	31	-76	-953	-614	101	299	175
Errors and Omissions	**-777**	**-416**	**-257**	**-819**	**257**	**0**	**0**	**0**	**0**	**0**
Overall Balance	**-183**	**-54**	**1,805**	**593**	**-950**	**150**	**553**	**552**	**551**	**551**
Financing										
Net international reserves (increase -)	4	55	-1,805	-593	950	-150	-550	-550	-550	-550
Change in Gross Reserves	183	55	-1,805	-593	950	-150	-550	-550	-550	-550
Other factors affecting reserve balance	-179	0	0	0	0	0	0	0	0	0
Exceptional financing	0	0	0	0	0	0	0	0	0	0
Memorandum Items:										
Current account in percent of GDP 1/	-0.2	-0.5	2.7	0.9	-4.9	-1.9	-2.3	-0.9	-0.9	-0.7
Gross reserves (in millions of U.S. dollars)	7,844	7,500	9,976	10,145	9,195	9,345	9,895	10,445	10,995	11,545
In months of imports of GNFS	7.0	8.3	8.6	8.1	6.8	6.5	6.7	6.8	6.9	7.0
External public debt in percent of GDP 1/	18.1	21.4	31.9	32.6	34.9	34.7	34.6	33.6	32.9	32.1
Debt service in percent of exports GNFS	10.7	13.7	15.6	16.5	18.8	15.6	15.0	13.0	13.2	11.8
Export volume (percent change)	-2.0	-4.1	-5.2	14.2	-22.3	18.3	5.5	2.6	2.6	2.7
Import volume (percent change)	4.5	-4.5	-15.2	18.8	-3.5	6.5	4.3	3.2	4.0	3.6
Terms of trade (percent change)	-2.1	-2.7	-0.5	-2.7	2.5	-1.9	-2.2	4.3	1.1	1.6

Sources: Central Bank of Paraguay; and IMF staff estimates and projections.

1/ Based on average exchange rate valuation of GDP.

Table 4. Paraguay: Summary of Accounts of the Central Bank

(In billions of Guaranies; end-of-period)

	2018	2019	2020	Prel. 2021	Proj. 2022	2023	2024	2025	2026	2027
Currency Issued	**13,757**	**14,349**	**17,113**	**18,070**	**19,256**	**20,520**	**21,867**	**23,303**	**24,833**	**26,463**
Growth	6.2	4.3	19.3	5.6	6.6	6.6	6.6	6.6	6.6	6.6
Net International Reserves	**46,206**	**48,022**	**63,887**	**66,132**	**61,769**	**63,560**	**68,984**	**74,584**	**80,311**	**86,150**
Net Domestic Assets	**-36,437**	**-34,575**	**-43,767**	**-46,636**	**-42,513**	**-43,040**	**-47,117**	**-51,281**	**-55,478**	**-59,687**
Net nonfinancial public sector	-8,855	-7,160	-10,962	-11,351	-11,351	-11,351	-11,351	-11,351	-11,351	-11,351
Net credit to the central government	-8,854	-7,159	-10,961	-11,350	-11,350	-11,350	-11,350	-11,350	-11,350	-11,350
Net credit to the banking system	-25,411	-25,571	-31,972	-35,706	-35,334	-39,867	-47,045	-54,865	-63,538	-66,917
Reserve requirements	-12,420	-12,513	-9,979	-16,828	-22,391	-26,685	-29,015	-31,825	-34,046	-36,398
Free reserves	-2,394	-2,742	-6,508	-6,138	-6,338	-6,406	-6,537	-6,669	-6,797	-6,920
Monetary control instruments 1/	-11,883	-11,742	-17,779	-14,528	-8,393	-8,565	-13,281	-18,160	-24,484	-25,387
Other	1,286	1,426	2,294	1,788	1,788	1,788	1,788	1,788	1,788	1,788
Other assets and liabilities (net)	-2,171	-1,844	-830	-208	4,172	8,178	11,280	14,935	19,410	18,581
Capital and reserves	-790	-851	-946	-918	4,781	9,182	12,981	17,390	22,643	22,623
Other assets net 2/	-1,381	-994	116	709	-609	-1,003	-1,701	-2,455	-3,233	-4,041
Memorandum Items:										
Total stock of IRMs outstanding 1/	11,960	12,919	18,029	14,761	8,393	8,565	13,281	18,160	24,484	25,387
Monetary base 3/	19,740	20,420	21,843	24,725	26,100	27,561	29,168	30,937	32,818	34,819
Monetary base, annual growth	7.3	3.4	7.0	13.2	5.6	5.6	5.8	6.1	6.1	6.1
Quasi-fiscal balance	568	2,383	3,362	6,548	5,730	4,412	3,820	4,429	5,273	5,821
In percent of GDP	0.2	1.0	1.4	2.4	2.0	1.4	1.2	1.2	1.4	1.4
Cost of monetary policy operations	920	966	743	328	304	221	226	294	368	462
In percent of GDP	0.4	0.4	0.3	0.1	0.1	0.1	0.1	0.1	0.1	0.1

Sources: Central Bank of Paraguay; and IMF staff estimates and projections.

1/ Includes overnight-deposit facility and central bank bills (LRM). A fraction of LRM is held by non-bank institutions.
2/ Includes LRM held by the non-banking sector.
3/ Monetary base comprises currency issued plus legal reserve requirement deposits in guaraní held at the BCP.

Table 5. Paraguay: Summary of Accounts of the Financial System [1/]

(In billions of Guaranies; end-of-period)

	2018	2019	2020	Prel. 2021	Proj. 2022	2023	2024	2025	2026	2027
					I. Central Bank					
Net International Reserves	**46,206**	**48,022**	**63,887**	**66,132**	**61,769**	**63,560**	**68,984**	**74,584**	**80,311**	**86,150**
In millions of U.S. dollars	7,795	7,446	9,200	9,703	8,753	8,903	9,453	10,003	10,553	11,103
Net Domestic Assets	**-36,437**	**-34,575**	**-43,767**	**-46,636**	**-42,513**	**-43,040**	**-47,117**	**-51,281**	**-55,478**	**-59,687**
Credit to public sector, net	-8,855	-7,160	-10,962	-11,351	-11,351	-11,351	-11,351	-11,351	-11,351	-11,351
Credit to banking system, net 2/	-13,528	-13,828	-14,192	-21,178	-26,941	-31,303	-33,764	-36,706	-39,054	-41,530
Credit	1,286	1,426	2,294	1,788	1,788	1,788	1,788	1,788	1,788	1,788
Deposits	14,813	15,254	16,486	22,966	28,729	33,091	35,553	38,494	40,842	43,318
Central bank securites	-11,960	-12,919	-18,029	-14,761	-8,393	-8,565	-13,281	-18,160	-24,484	-25,387
Other	-786,460	-848,410	-950,994	-915,617	4,172	8,178	11,280	14,935	19,410	18,581
Currency Issued	**13,757**	**14,349**	**17,113**	**18,070**	**19,256**	**20,520**	**21,867**	**23,303**	**24,833**	**26,463**
					II. Monetary Survey					
Net Foreign Assets	**41,499**	**43,504**	**68,781**	**66,324**	**59,104**	**60,881**	**66,293**	**71,936**	**77,719**	**83,626**
In millions of U.S. dollars	7,001	6,745	9,905	9,731	8,376	8,528	9,084	9,648	10,212	10,778
Net Domestic Assets	**65,299**	**74,931**	**70,398**	**83,928**	**98,118**	**103,152**	**107,059**	**112,825**	**119,135**	**126,036**
Credit to the public sector	-16,112	-15,250	-19,070	-17,585	-17,567	-17,554	-17,537	-17,517	-17,499	-17,481
Credit to the private sector	101,290	111,097	120,049	132,626	144,811	157,377	171,676	187,272	204,244	222,711
Other	-19,879	-20,916	-30,581	-31,112	-29,126	-36,672	-47,080	-56,931	-67,611	-79,195
Broad Liquidity (M4)	**106,792**	**118,406**	**139,125**	**150,182**	**157,115**	**163,925**	**173,244**	**184,650**	**196,741**	**209,548**
Bonds and issued securities	6	30	54	70	71	71	72	73	74	74
Other monetary liabilities	5,445	6,360	7,811	8,648	9,076	9,453	9,999	10,676	11,394	12,153
Central bank securities with private sector	77	1,177	249	233	0	0	0	0	0	0
Broad Liquidity (M3)	**101,265**	**110,838**	**131,010**	**141,231**	**147,969**	**154,400**	**163,172**	**173,901**	**185,274**	**197,320**
Foreign currency deposits	36,011	40,889	49,332	53,530	56,835	59,510	63,568	68,522	73,784	79,365
Money and Quasi-Money (M2)	**65,254**	**69,949**	**81,678**	**87,701**	**91,134**	**94,890**	**99,605**	**105,379**	**111,489**	**117,955**
Quasi-money	32,394	34,474	39,145	41,635	43,092	44,601	46,608	49,171	51,875	54,728
Money (M1)	32,859	35,476	42,534	46,066	48,042	50,290	52,997	56,208	59,614	63,226
					(Annual percent change)					
M0 (Currency issued)	6.2	4.3	19.3	5.6	6.6	6.6	6.6	6.6	6.6	6.6
Credit to the private sector	14.1	9.7	8.1	10.5	9.2	8.7	9.1	9.1	9.1	9.0
M1	5.4	8.0	19.9	8.3	4.3	4.7	5.4	6.1	6.1	6.1
M2	8.1	7.2	16.8	7.4	3.9	4.1	5.0	5.8	5.8	5.8
M3	8.0	9.5	18.2	7.8	4.8	4.3	5.7	6.6	6.5	6.5
Of which: Foreign currency deposits	7.9	13.5	20.6	8.5	6.2	4.7	6.8	7.8	7.7	7.6
Memorandum Items:										
Ratio of foreign currency deposits to M3 (percent)	35.6	36.9	37.7	37.9	38.4	38.5	39.0	39.4	39.8	40.2
Ratio of foreign currency deposits to total private sector deposits (percent)	37.6	38.6	39.5	39.5	41.5	41.8	42.3	42.9	43.4	43.8

Sources: Central Bank of Paraguay; and IMF staff estimates and projections.

1/ Includes banks, finance companies, and the 20 largest cooperatives.

2/ Excludes LRM held by the banking sector.

Table 6. Paraguay: Gross External Financing Needs and Sources 2021-24

(In millions of U.S. dollars, unless otherwise indicated)

	2021	2022	2023	2024
	Prel.	Projection		
Gross External Financing Needs	**-385**	**-2,809**	**-1,546**	**-1,732**
External current account balance	368	-2,031	-828	-1,066
Debt amortization	-752	-778	-718	-666
Medium and long term debt	-752	-778	-718	-666
Public sector	-752	-778	-718	-666
Private sector				
Short-term debt				
Public sector				
Private sector				
Gross External Financing Sources	**978**	**1,859**	**1,696**	**2,282**
Foreign direct investment (net)	122	500	1,765	2,059
Medium and LT debt disbursements 1/	2,171	2,147	1,655	1,283
Public sector	2,171	2,147	1,655	1,283
Private sector				
Short-term debt disbursement				
Public sector				
Private sector				
Other capital flows (net)	-1,314	-788	-1,724	-1,061
Change in international reserves	-593	950	-150	-550
Use of IMF credit	0	0	0	0
percent of quota				
Memo: Gross international reserves	10,145	9,195	9,345	9,895
In percent of ARA metric	211.1%	194.6%	…	…

1/ The main financing source is the sovereign bond placement.
Other contributions are from CAF, IADB, and WB.

Table 7. Paraguay: Financial Soundness Indicators

	2014	2015	2016	2017	2018	2019	2020	2021	2022M6
Basic Indicators					(in percent)				
Capital adequacy									
Regulatory capital/risk-weighted assets	15.2	16.1	17.9	18.3	17.5	17.2	19.1	18.8	19.6
Tier 1 capital/risk-weighted assets	11.2	11.7	13.4	13.8	13.4	13.5	14.8	15.2	15.3
NPLs net of provisions/equity	1.2	3.7	3.1	2.5	3.1	1.1	0.2	0.9	4.2
Asset quality									
NPLs/total loans	2.0	2.6	2.9	2.8	2.5	2.6	2.4	2.3	3.1
Profitability									
Return on assets	2.6	2.5	2.2	2.3	2.3	2.4	1.7	1.8	2.0
Return on equity	28.0	27.6	23.3	20.3	19.5	20.3	14.3	14.0	15.4
Interest Margin/ gross income	10.2	7.4	8.0	9.8	12.2	8.7	9.5	5.5	7.3
Admin. expenses/operating margin	34.1	36.2	38.2	39.5	33.7	31.5	31.9	30.3	43.3
Liquidity									
Liquid assets/total assets	30.8	31.8	29.5	25.2	23.2	23.0	33.4	19.4	21.6
Liquid assets/sight deposits	11.6	11.7	11.4	10.4	9.4	8.8	14.6	8.5	9.1
Market risk									
FX position/equity	8.4	9.1	8.6	9.6	17.3	15.8	13.9	9.3	9.4
Recommended Indicators					(in percent)				
Capital/assets	7.0	7.2	7.9	8.2	8.4	8.7	8.5	9.4	9.8
Personnel expenses/admin. expenses	10.4	6.4	6.6	7.8	11.3	8.3	9.2	5.7	4.6
FX loans/total loans	47.8	50.0	48.1	46.7	47.2	46.1	42.2	42.1	44.2
FX liabilities/total liabilities	49.3	54.6	51.6	48.4	48.1	47.8	47.4	47.2	48.2

Source: Banco Central del Paraguay and IMF, *Financial Soundness Indicators* .

Annex I. Risk Assessment Matrix

Source/nature of risk (Likelihood / Time horizon)	Expected impact and recommended response
External Risks	
Intensifying spillovers from Russia's war in Ukraine. Further sanctions resulting from the war and related uncertainties exacerbate trade and financial disruptions and commodity price volatility, with Europe, LICs, and commodity-importing EMs among the worst hit. (**High / ST**)	**High.** Disruptions of trade channels already affected a large share of exports of meat to Russia. In addition, the war affected the availability and prices of imported fertilizers (key for soy production). The government should facilitate access to alternative meat and fertilizer markets.
Local Covid-19 outbreaks. Outbreaks in slow-to-vaccinate countries or emergence of more contagious vaccine-resistant variants force new lockdowns or inhibit commerce. This results in extended supply chain disruptions, slower growth, capital outflows, and debt distress in some EMDEs. (**Medium / ST**) **Abrupt growth slowdown in China Covid-19** due to lockdowns, rising geopolitical tensions, a sharper-than-expected slowdown in the property sector (**Medium / ST**)	**Medium.** If the pandemic lingers on globally for extended periods of time and/or China's economy decelerates abruptly, it may dampen external demand, foreign inflows, and border trades. Monetary policy, including exchange rate interventions should balance the impact of lower activity with high-inflation scenarios.
De-anchoring of inflation expectations and stagflation. Higher food and energy prices sharply de-anchor inflation expectations and triggering a wage-price spiral in tight labor markets. Central banks tighten monetary policy more than envisaged leading to weaker global demand, currency depreciations in EMDEs, and sovereign defaults. Together, this could lead to the onset of stagflation. (**Medium / ST**)	**Medium.** Tighter monetary policy in AEs could lead to capital outflows, currency depreciation and higher borrowing costs in Paraguay. Fiscal stability should be assured, and foreign exchange interventions can be calibrated to smooth out the impact of depreciation to domestic prices.
Commodity price shocks. A combination of continuing supply disruptions (e.g., due to conflicts and export restrictions) and negative demand shocks causes recurrent commodity price volatility and social and economic instability.	**High.** Persistent global prices could further increase inflation rates in Paraguay. Higher commodity prices would benefit fiscal revenues but supply disruptions could lead to production stoppages. Monetary policy should be calibrated to face scenarios with lower growth and high prices.
Systemic social unrest. Rising inflation, declining incomes, and worsening inequality amplify social unrest and political instability, causing capital outflows from EMDEs, slowing economic growth, and giving rise to economically damaging populist policies (**High / ST, MT**). **Deepening geo-economic fragmentation and geopolitical tensions.** Cause a reconfiguration of trade, supply disruptions, technological and payments systems fragmentation, rising input costs, financial instability, and lower potential growth. (**High / ST, MT**).	**Medium.** Social unrest in the region may disrupt external demand from trading partners and higher risk premium of financial assets, resulting in tighter financial conditions for Paraguay. Social policies need to continue supporting the most vulnerable population, including informal workers. Governance and anti-corruption reforms need to move forward to strengthen the transparency, equity and effectiveness of public sector operations.
Natural disasters related to climate change. More frequent natural disasters deal severe damage to infrastructure (especially in smaller vulnerable economies) and amplify supply chain disruptions and inflationary pressures, causing water and food shortages and reducing medium-term growth.	**High.** Agriculture and hydro-energy production are the most affected sectors. Exchange rate depreciation would serve as a short-term buffer for climate-related production shocks. In the medium term, reducing export concentration, diversifying the mix of clean power generation, and facilitating adaptation in agriculture would be important.
Domestic Risks	
Weather-related shocks (**Medium** to **High / ST**): Agriculture and energy sector may be adversely impacted by weather.	**Medium** to **High.** Shocks to the agriculture sector affect GDP growth, export performance and exchange rate, and the financial sector, due to banks' agricultural lending. Shocks to the energy sector would lessen government revenue. The exchange rate could absorb some of the shock. Foreign exchange interventions can avoid disorderly market conditions.
Domestic Risks	
Fiscal sustainability (**Medium / ST, MT**): After the large deficit spike in 2020 and 2021 due to the pandemic, amid numerous downside risks to the economy, the proposed path for returning to the FRL stipulated deficit ceiling by 2024 is near the threshold to guarantee fiscal and debt sustainability.	**Medium** to **High**. Fiscal stability is the cornerstone of macroeconomic stability in Paraguay, which significantly impacts investor confidence, financing costs, and growth performance. The government needs to strengthen its ability to raise revenues and control expenditure increases, reform civil services and public procurement processes.

Annex II. External Sector Assessment

Overall Assessment: *The external position of Paraguay in 2021 was substantially stronger than the level implied by fundamentals and desirable policies. The EBA-Lite current account (CA) model points to a 4.4 percent gap, higher than the last assessment's gap and slightly above the threshold for the same classification of the overall assessment. External stability risks remain contained given Paraguay's sizable reserve buffers.*

Potential Policy Responses: *Recommended macro and structural policy actions to continue safeguarding external sustainability include improving governance and reducing vulnerabilities to corruption; improving the business climate; diversifying the energy mix; and formalizing the economy. Together, these policies will enhance Paraguay's attractiveness for foreign direct investment and capital inflows.*

Foreign Assets and Liabilities: Position and Trajectory

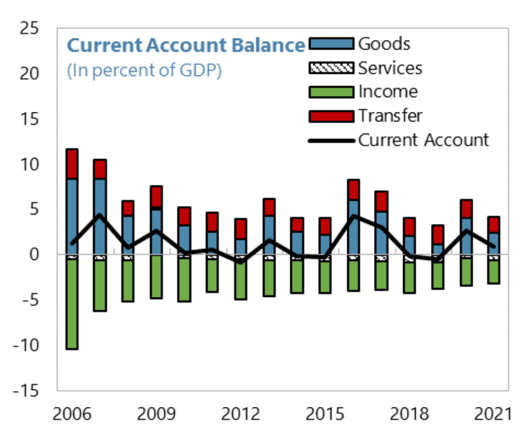
Background. The net international investment position (NIIP) improved moderately to -23 percent of GDP in 2021 from -24 percent of GDP in 2020. The NIIP increased by 8 percent in absolute values, reflecting an increase in gross liabilities. Gross liabilities increased by 3 percent, primarily driven by an increase in debt securities under portfolio investment. On the other hand, gross assets declined marginally (0.1 percent). External public debt rose to 32.6 percent of GDP in 2021 from 31.9 percent of GDP in 2020, affected by additional borrowings to deal with pandemic-related expenditure. Public external debt, as at end-August 2022, was estimated to be $13.4 billion (up from $12.6 billion at end-2021). Public external debt was mainly USD-denominated (86 percent of total) and primarily consisted of sovereign bond liabilities and multilateral debt (48 and 47 percent, respectively).

Assessment. External debt is expected to decline going forward. Before the pandemic, the external debt was expected to decline steadily as the debt of the binational hydroelectrical company continued to fall. With the additional financing needs to respond to new and ongoing shocks (like the drought and rising commodity prices) and the need to resort to cheaper external financing, public external debt has risen, a temporary trend that is expected to reverse. The external position remains sustainable under a range of adverse shocks with the gross international reserves coverage ratio expected to be comfortably within the recommended range of the ARA metric.

2021 (% GDP)	NIIP: -23	Gross Assets: 43	Debt Assets: 17	Gross Liab.: 66	Debt Liab.: 19

Current Account

Background. Paraguay's current account (CA) has been in surplus for most of the past two decades, averaging 1.2 percent of GDP per year for the last five years (2017-2021). The CA surpluses in both 2016 and 2017 were particularly strong, the result of record hydro-electricity exports and a surge in agricultural exports. The CA balance deteriorated in 2019, owing to a large agricultural shock associated with a drought and lower hydro-electricity production owing to lower water levels. With the COVID-19 pandemic onset, the CA balance in 2020 improved, reaching 2.7 percent of GDP from a negative 0.5 percent of GDP in 2019 mostly attributable to a sharp decline in imports, lower oil prices, and a large increase in soybean prices. In 2021, the current account surplus is estimated to have fallen to 0.9 percent of GDP, primarily resulting from the rebound of imports with the partial resumption of activities (with the pandemic



contained) and higher oil prices. As at end-July 2022, registered imports rose by 33 percent y/y explained by the higher prices for consumer, intermediate and capital goods. On the other hand, registered exports fell by 1 percent y/y, largely attributable to the effects of the drought on soybean harvest and hence exports. Over the medium term, the CA balance is expected to remain at just under 1 percent of GDP, reflecting the rebound in soybean production, stabilization of international oil prices, and the phase-out in interest payments linked to the binational loan.

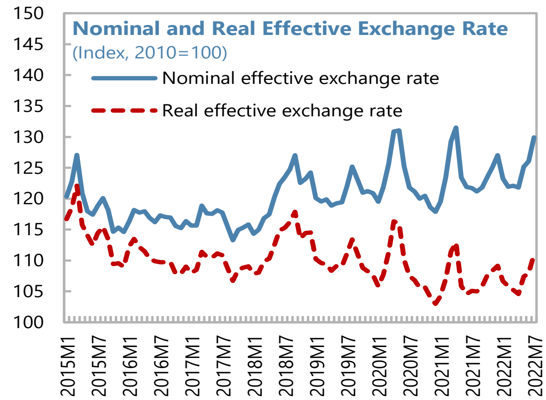
Assessment. The CA model suggests that the external position was substantially stronger than the level implied by fundamentals and desired policies. The estimated CA gap increased to 4.4 percent of GDP in 2021, up from an estimated 2.7 percent of GDP assessed by the 2022 Article IV Consultation, and slightly above the threshold (2-4 percent of GDP) for the same classification of the overall assessment. The current account gap consists of the policy gap (1.8 percent of GDP) and the residual from the CA regression model (2.6 percent of GDP).[1] However, staff's preferred approach is to assess the CA position based on the balance that nets out the amortization to binationals. Paraguay borrowed heavily in the past to build the binational hydro-electric plant (which showed as a large current account deficit in the 1980s). It uses less than the half of its Itaipu's electricity production entitlement and exports the remainder to Brazil. Paraguay also needs to service the debt of Itaipu to Brazil, for which it pays off through electricity exports. These transactions generate a positive CA item, and an offsetting capital outflow, with no impact on the rest of the economy.[2] A qualified adjustment to the model estimates leads to a lower CA gap (2.6 percent of GDP). The REER model finds a CA gap of 1.6 percent of GDP, reflecting a REER undervaluation of 6.5 percent.

Paraguay: Model Estimates for 2021 (in percent of GDP)

	CA model 1/	**CA minus amortization to binationals**	**REER model** 1/
	---------------(in percent of GDP)---------------		
CA-Actual	**0.9**	**-0.9**	
Cyclical contributions (from model) (-)	-0.4	-0.4	
COVID-19 adjustor (-)	0.0	0.0	
Additional temporary/statistical factors (-)	0.0	0.0	
Natural disasters and conflicts (-)	-0.2	-0.2	
Adjusted CA	**1.6**	**-0.3**	
CA Norm (from model) 2/	**-2.8**	**-2.8**	
Adjustments to the norm (-)	0.0	0.0	
Adjusted CA Norm	**-2.8**	**-2.8**	
CA Gap	**4.4**	**2.6**	**1.6**
o/w Relative policy gap	1.8	0.0	
Elasticity	-0.25	-0.25	
REER Gap (in percent)	**-17.6**	**-10.4**	**-6.5**

1/ Based on the EBA-lite 3.0 methodology
2/ Cyclically adjusted, including multilateral consistency adjustments.

Real Exchange Rate



Background. In 2021, the real effective exchange rate (REER) appreciated modestly (1 percent), largely driven by differences in inflation. The REER has appreciated in each of the last 7 years, except for 2018 when it depreciated by 3.2 percent.

Assessment. The REER gap, derived from the EBA-Lite CA model and an estimated elasticity of -0.25, resulted in -17.6 percent. Meanwhile, the qualified adjustment to the model estimates and the EBA-Lite REER model suggests REER gaps of -10.4 percent and -6.5 percent, respectively. However, REER movements hide differing underlying trends across key trading partners as the real exchange rate vis-à-vis Argentina depreciated by 18 percent, while the real exchange rate with respect to Brazil appreciated by 0.9 percent.

Capital and Financial Accounts: Flows and Policy Measures

Background. Sovereign bond issuances and foreign direct investment (FDI) have been major sources of capital inflows in last few years. The government has continued to tap funding from the international markets, placing bonds for about $500 million each year in 2018 and 2019. There was an additional sovereign bond issuance of $1,000 million in the context of the COVID-19 pandemic, bringing the total placement to $1,450 million in 2020. In 2021, the government issued sovereign bonds worth $826 million to finance the 2021 budget and pre-pay a bullet payment falling due in 2023. Given that $330 million was used to pre-pay (through buy back) the bullet payment, the net issuance was $495 million. In addition, Paraguay has enjoyed a stable flow of FDI in the last decade, and despite the economic turmoil mainly in Argentina in 2019, FDI inflows are relatively stable (constituting about 0.3 percent of GDP in 2021). FDI is projected to pick up in the near term to over 1 percent of GDP in 2022 and 4-4.5 percent of GDP in 2023 and 2024, owing to significant private investment in a new pulp mill (Paracel).

Assessment. Paraguay has a fully open capital and financial account, but still shallow financial markets. Vulnerabilities to the financial flows remain contained as the major sources of capital are government's external borrowing, which was received well in the last few international public offerings given the low public debt level, and prospects for FDI.

FX Intervention and Reserves Level

Background. Gross international reserves have increased since 2019, from roughly $8 billion then to about $10 billion at end-2021. Reserves increased by over $2 billion in 2020, largely reflecting the sovereign bond issuances of that year, though there was also an increase in foreign exchange (FX) interventions to contain depreciation pressures of the Guaraní early that year. In 2021, FX interventions declined somewhat, and the Guaraní closed the year with a slight appreciation. According to the last (2021) Annual Report on Exchange Arrangements and Exchange Restrictions, Paraguay's de jure and de facto exchange rate arrangements are classified as floating. As at end-August 2022, reduced agricultural exports and elevated import prices have generated higher volatility in FX markets, triggering FX interventions by the BCP of about US$400 million.

Assessment. Reserves have increased to the coverage of 8.1 months of imports in 2021. The fluctuation in the import coverage of reserves from 8.3 and 8.6 in 2019 and 2020, respectively, to 8.1 in 2021 is primarily related to the sharp fall of expected imports in 2022, owing to lower exports. The reserves level for 2021 is comfortably above the Fund's metrics for a small open economy. The flexible exchange rate continues to be the first line of defense, allowing the economy to absorb external shocks. Staff's recommendation is to limit discretionary interventions to exceptional situations of disorderly market conditions.

[1] The policy gap is mainly the result of the low level of public health expenditure in 2021 and the gap between Paraguay's productivity growth and the world (measured by relative GDP, in PPP terms, per worker). Closing the productivity gap requires structural reforms, see Bakker et al (2020) for details.
[2] As the construction of the binationals finished and Paraguay started to pay off the debt, the CA position started to strengthen. Such strengthening, however, is not a consequence of undervalued real exchange rate).

Table 1. Paraguay: Classification of the Overall Assessments [1/]

CA gap	Description in overall assessment
> 4%	… substantially stronger…
[2%, 4%]	… stronger…
[1%, 2%]	… moderately stronger…
[-1%, 1%]	The external position is broadly in line with the level implied by fundamentals and desirable policies
[-2%, -1%]	… moderately weaker…
[-4%, -2%]	… weaker…
< -4%	… substantially weaker…

1/ The qualitative assessment of the external position is primarily based on the CA gap. Due to different elasticities, the same CA gap could be associated with different REER gaps for different economies.

Annex III. Debt Sustainability Assessment

A. External Debt Sutainability Analysis

1. **External debt in Paraguay has recently increased to about 47 percent of GDP driven by the economic impact of the COVID-19 crisis.** The government issued international bonds for about US$2.8 billion in the last three years, mainly to finance COVID-19 related health expenditures and the pre-payment of international bonds falling due in 2023. Most of the external debt is owed by the public sector (about 35 percent of GDP).

2. **External debt is projected to fall below 40 percent of GDP over the medium term and the external position remains sustainable under a range of adverse shocks.** This mainly reflects large improvements in the non-interest current account going forward. Shocks to growth, non-interest current account balance, a real depreciation shock, and a combined shock have only negligible impacts on the baseline debt sustainability (Figure 1).

3. **Gross external financing needs will remain at comfortable levels going forward.** In the medium term this trend will be supported by lower debt repayment needs, improved non-interest current account balance, and higher real GDP growth.

Table 1. Paraguay: External Debt Sustainability Framework, 2017-2027

(In percent of GDP, unless otherwise indicated)

	Actual					Projections						
	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	Debt-stabilizing non-interest current account 6/
Baseline: External debt	39.9	39.6	41.7	50.8	47.0	**46.4**	**43.4**	**38.9**	**37.6**	**36.7**	**35.7**	**0.2**
Change in external debt	-3.0	-0.4	2.1	9.1	-3.8	-0.6	-3.1	-4.5	-1.2	-0.9	-1.0	
Identified external debt-creating flows (4+8+9)	-7.5	-1.9	2.5	-2.7	-3.1	3.6	-4.1	-3.6	-1.8	-1.4	-1.5	
Current account deficit, excluding interest payments	-4.5	-1.4	-1.2	-4.5	-2.7	3.0	0.0	0.4	-0.3	-0.2	-0.3	
Deficit in balance of goods and services	-4.1	-1.2	-0.3	-3.8	-1.8	3.3	0.4	0.8	-0.5	-0.5	-0.7	
Exports	36.4	36.5	35.9	34.2	37.1	33.1	36.7	36.5	36.6	35.9	35.4	
Imports	32.3	35.3	35.6	30.4	35.4	36.5	37.1	37.3	36.1	35.5	34.7	
Net non-debt creating capital inflows (negative)	-1.3	-0.8	-0.4	-0.3	-0.3	-1.2	-4.0	-4.5	-1.4	-1.0	-1.0	
Automatic debt dynamics 1/	-1.7	0.3	4.0	2.2	-0.1	1.9	-0.1	0.5	-0.1	-0.2	-0.2	
Contribution from nominal interest rate	1.5	1.5	1.6	1.8	1.8	2.0	1.9	1.9	1.2	1.1	1.0	
Contribution from real GDP growth	-1.9	-1.2	0.2	0.4	-1.9	-0.1	-2.0	-1.4	-1.3	-1.2	-1.2	
Contribution from price and exchange rate changes 2/	-1.3	0.0	2.2	0.0	-3.4	-1.8	-0.8	-0.6	-1.2	-0.7	-0.8	
Residual, incl. change in gross foreign assets (2-3) 3/	4.5	1.5	-0.3	11.8	-0.7	-4.2	1.0	-0.9	0.6	0.5	0.5	
External debt-to-exports ratio (in percent)	109.8	108.4	116.0	148.7	126.6	140.1	118.1	106.4	102.7	102.2	100.9	
Gross external financing need (in billions of US dollars) 4	1.4	2.6	3.1	2.0	3.0	5.5	4.2	4.4	3.9	4.1	3.8	
in percent of GDP	3.5	6.6	8.1	5.5	7.7	13.3	9.6	9.6	8.0	7.8	7.0	
Scenario with key variables at their historical averages 5/				47.5	47.5	**42.4**	**41.7**	**38.6**	**37.8**	**36.4**	**35.2**	**-0.1**
Key Macroeconomic Assumptions Underlying Baseline										For debt stabilization		
Nominal GDP (US dollars)	39.4	40.2	37.9	35.4	39.5	41.1	43.7	45.9	49.0	51.7	54.6	
Real GDP growth (in percent)	4.8	3.2	-0.4	-0.8	4.1	0.2	4.5	3.5	3.5	3.5	3.5	
Exchange rate appreciation (US dollar value of local currenc	0.9	-2.0	-8.1	-7.8	0.0	-2.8	-1.8	-1.7	-2.1	-2.1	-2.1	
GDP deflator (change in domestic currency)	2.2	2.0	3.0	2.3	7.1	6.9	3.7	3.1	5.4	4.2	4.4	
GDP deflator in US dollars (change in percent)	3.1	-0.1	-5.4	-5.8	7.1	3.9	1.8	1.4	3.1	1.9	2.1	
Nominal external interest rate (in percent)	3.8	3.9	3.9	4.0	3.9	4.4	4.3	4.6	3.2	3.2	3.2	
Growth of exports (US dollar terms, in percent)	11.4	2.4	-7.2	-11.1	21.0	-7.1	17.9	4.4	7.0	3.6	4.2	
Growth of imports (US dollar terms, in percent)	16.9	11.5	-4.9	-20.1	29.5	7.4	8.2	5.5	3.2	3.8	3.5	
Current account balance, excluding interest payments	4.5	1.4	1.2	4.5	2.7	-3.0	0.0	-0.4	0.3	0.2	0.3	
Net non-debt creating capital inflows	1.3	0.8	0.4	0.3	0.3	1.2	4.0	4.5	1.4	1.0	1.0	

1/ Derived as [r - g - r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as [-r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock. r increases with an appreciating domestic currency (e > 0) and rising inflation (based on GDP deflator).

3/ For projection, line includes the impact of price and exchange rate changes.

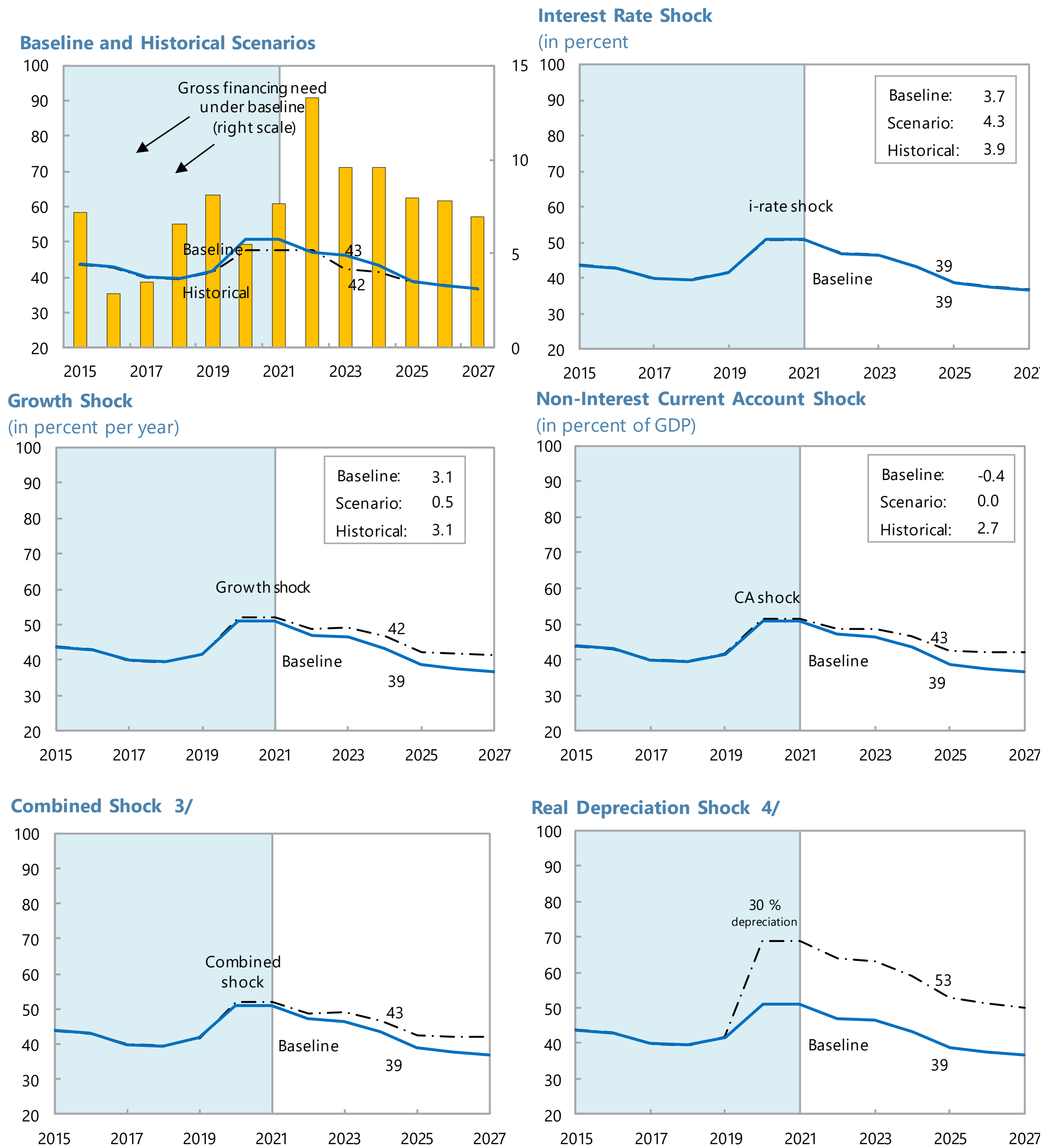
4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Figure 1. Paraguay: External Debt Sustainability: Bound Tests 1/ 2/

(External debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.
3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
4/ One-time real depreciation of 30 percent occurs in 2010.

B. Public Sector Debt Sustainability Analysis

1. Paraguay's public debt increased significantly during the 2019-2022 external shocks due to a vigorous countercyclical fiscal response. Since 2018 (the last pre-crisis year), gross public debt rose from 22.3 percent of GDP to 37.2 percent of GDP (2021). In line with the government's execution of its fiscal consolidation path toward the fiscal deficit ceiling mandated by the fiscal rule (1.5 percent of GDP), growth of public debt has decelerated and is projected to peak at 39.7 percent in 2022. In the medium-term, public debt will gradually decline to just below 37 percent of GDP in the baseline scenario (Figure 2).

2. Paraguay's public debt remains sustainable under most alternative standard shock scenarios. Among these scenarios (Figure 3), the assumption of a constant primary fiscal balance produces the steepest public debt increase, making it rise to 48 percent of GDP by 2027. This scenario is predicated on the continuation of the high fiscal deficits of recent years, which is unlikely. The historical scenario (assuming real growth rates, real interest rates, and primary balances at historical averages over the past ten years) produces a debt trajectory very similar to the baseline scenario (Figure 3). A standard real interest rate shock based on historical maximum interest rates produces similar results (Figure 4).[1]

[1] It is questionable, though, whether the rates used for this scenario are relevant in the current global environment. In any case, medium-term interest rate risks appear low, as no sovereign bond refinancing is due until 2026.

Figure 2. Paraguay: Public Sector Debt Sustainability Analysis - Baseline Scenario

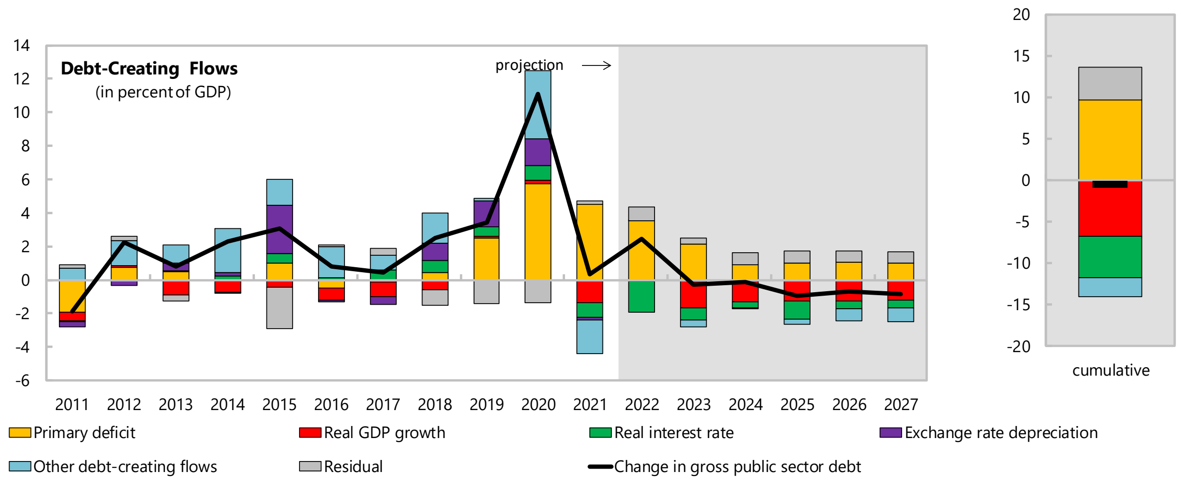
Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2011-2019	2020	2021	2022	2023	2024	2025	2026	2027
Nominal gross public debt	17.5	36.9	37.2	39.7	39.4	39.3	38.3	37.6	36.8
Public gross financing needs	2.0	8.1	8.3	5.9	4.1	2.6	2.9	3.2	3.4
Real GDP growth (in percent)	3.6	-0.8	4.1	0.2	4.5	3.5	3.5	3.5	3.5
Inflation (GDP deflator, in percent)	3.3	2.3	7.1	6.9	3.7	3.1	5.4	4.2	4.4
Nominal GDP growth (in percent)	7.0	1.4	11.5	7.1	8.4	6.7	9.0	7.8	8.0
Effective interest rate (in percent) [2/]	5.3	5.6	4.8	1.6	1.8	2.1	2.5	2.9	3.3

As of September 28, 2022		
Sovereign Spreads		
EMBIG (bp)		325
5Y CDS (bp)		...
Ratings	Foreign	Local
Moody's	Ba1	Ba1
S&Ps	BB	BB
Fitch	BB+	BB+

Contribution to Changes in Public Debt

	Actual			Projections							
	2011-2019	2020	2021	2022	2023	2024	2025	2026	2027	cumulative	debt-stabilizing primary balance [8/]
Change in gross public sector debt	1.5	11.1	0.3	2.4	-0.3	-0.1	-0.9	-0.7	-0.8	-0.4	
Identified debt-creating flows	2.0	12.5	0.1	1.6	-0.7	-0.8	-1.7	-1.4	-1.5	-4.4	
Primary deficit	0.3	5.7	4.5	3.5	2.1	0.9	1.0	1.0	1.0	9.6	-2.5
Primary (noninterest) revenue and grants	18.2	18.7	18.9	19.0	19.8	20.3	20.0	19.8	19.7	118.6	
Primary (noninterest) expenditure	18.4	24.4	23.4	22.5	21.9	21.2	21.1	20.8	20.7	128.2	
Automatic debt dynamics [3/]	0.4	2.7	-2.4	-1.9	-2.4	-1.7	-2.3	-1.7	-1.7	-11.7	
Interest rate/growth differential [4/]	-0.2	1.1	-2.2	-1.9	-2.4	-1.7	-2.3	-1.7	-1.7	-11.7	
Of which: real interest rate	0.3	0.8	-0.9	-1.9	-0.8	-0.4	-1.1	-0.5	-0.4	-5.0	
Of which: real GDP growth	-0.5	0.2	-1.4	-0.1	-1.6	-1.3	-1.3	-1.2	-1.2	-6.7	
Exchange rate depreciation [5/]	0.6	1.6	-0.2	...	...	...	...	...	...	...	
Other identified debt-creating flows	1.3	4.1	-2.0	0.0	-0.4	-0.1	-0.3	-0.7	-0.9	-2.3	
NFPS asset accumulation [6/]	1.3	4.1	-2.0	0.0	-0.4	-0.1	-0.3	-0.7	-0.9	-2.3	
Residual [7/]	-0.5	-1.4	0.2	0.8	0.4	0.7	0.7	0.7	0.7	4.0	



Source: Fund staff estimates and projections.

1/ Public sector is defined as consolidated public sector. It includes the non-financial public sector and the central bank. The stock of public debt excludes central bank bills.

2/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

3/ Derived as [(r - π(1+g) - g + ae(1+r)]/(1+g+π+gπ)) times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

4/ The real interest rate contribution is derived from the numerator in footnote 3 as r - π (1+g) and the real growth contribution as -g.

5/ The exchange rate contribution is derived from the numerator in footnote 3 as ae(1+r).

6/ Includes social security surplus, accumulation of deposits from the sovereign bond issuance in 2014, and financing of the national development bank.

7/ Includes asset changes and interest revenues (if any). For projections, it includes the impacts of exchange rate changes.

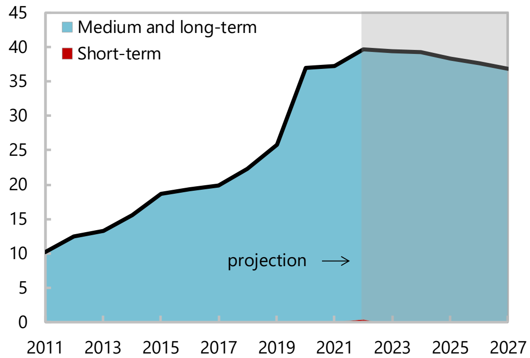
8/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Figure 3. Paraguay: Public Debt Sustainability Analysis - Composition of Public Debt and Alternative Scenarios"

Composition of Public Debt

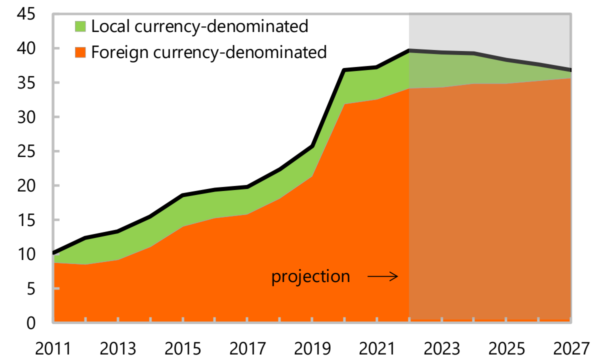
By Maturity

(in percent of GDP)



By Currency

(in percent of GDP)

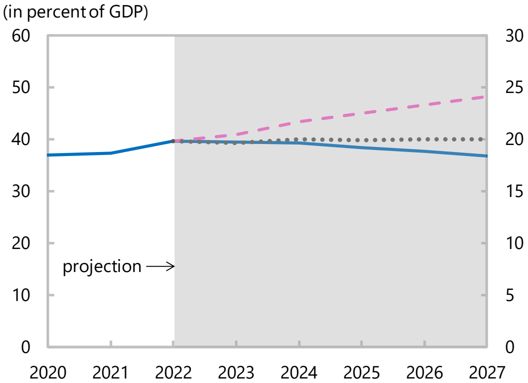


Alternative Scenarios

Baseline Historical Constant Primary Balance

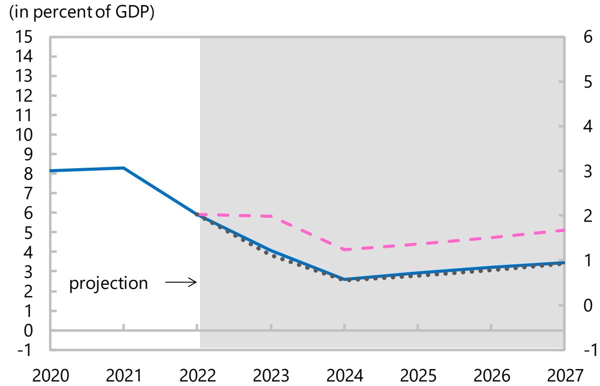
Gross Nominal Public Debt

(in percent of GDP)



Public Gross Financing Needs

(in percent of GDP)



Underlying Assumptions

(in percent)

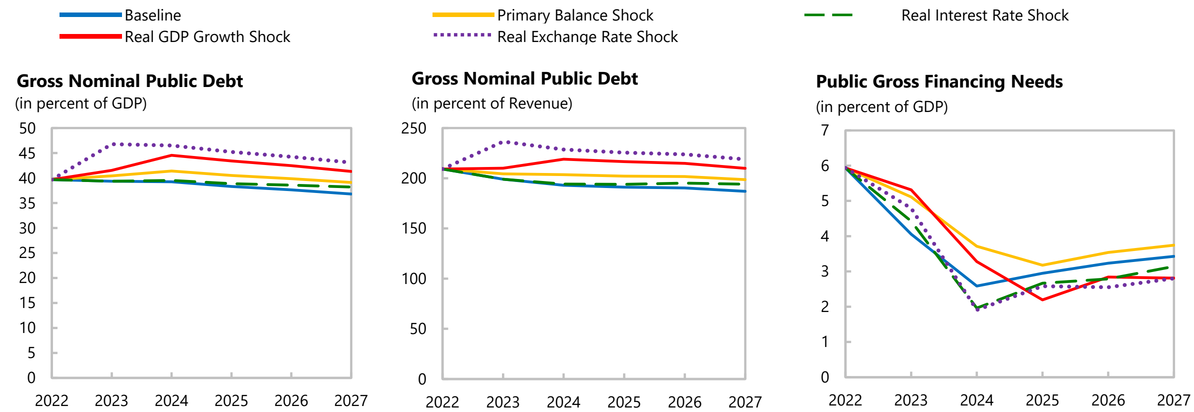
Baseline Scenario	2022	2023	2024	2025	2026	2027
Real GDP growth	0.2	4.5	3.5	3.5	3.5	3.5
Inflation	6.9	3.7	3.1	5.4	4.2	4.4
Primary Balance	-3.5	-2.1	-0.9	-1.0	-1.0	-1.0
Effective interest rate	1.6	1.8	2.1	2.5	2.9	3.3
Constant Primary Balance Scenario						
Real GDP growth	0.2	4.5	3.5	3.5	3.5	3.5
Inflation	6.9	3.7	3.1	5.4	4.2	4.4
Primary Balance	-3.5	-3.5	-3.5	-3.5	-3.5	-3.5
Effective interest rate	1.6	1.8	2.3	2.8	3.3	3.6

Historical Scenario	2022	2023	2024	2025	2026	2027
Real GDP growth	0.2	3.1	3.1	3.1	3.1	3.1
Inflation	6.9	3.7	3.1	5.4	4.2	4.4
Primary Balance	-3.5	-1.5	-1.5	-1.5	-1.5	-1.5
Effective interest rate	1.6	1.8	2.5	3.1	3.7	4.2

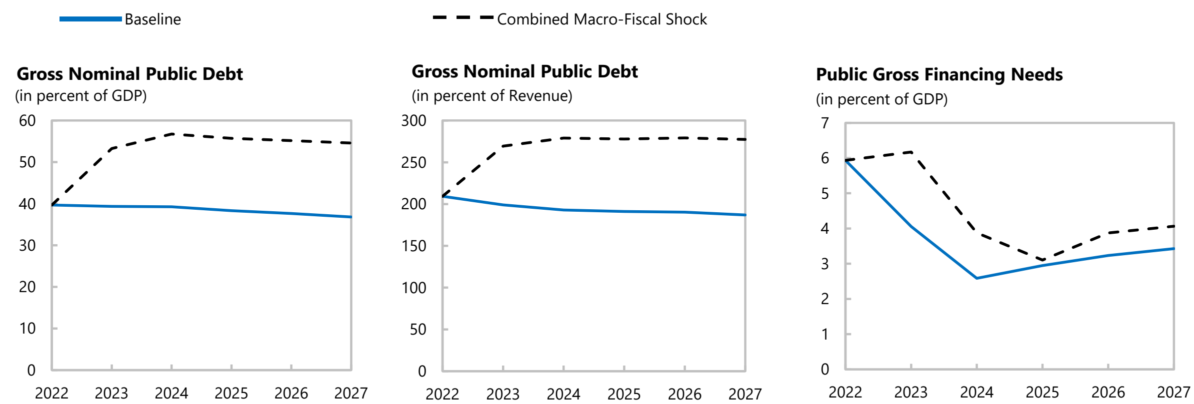
Source: Fund staff estimates and projections.

Figure 4. Paraguay: Public Debt Sustainability Analysis – Stress Test

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions
(in percent)

	2022	2023	2024	2025	2026	2027
Primary Balance Shock						
Real GDP growth	0.2	4.5	3.5	3.5	3.5	3.5
Inflation	6.9	3.7	3.1	5.4	4.2	4.4
Primary balance	-3.5	-3.2	-1.9	-1.0	-1.0	-1.0
Effective interest rate	1.6	1.8	2.3	2.8	3.2	3.5
Real Interest Rate Shock						
Real GDP growth	0.2	4.5	3.5	3.5	3.5	3.5
Inflation	6.9	3.7	3.1	5.4	4.2	4.4
Primary balance	-3.5	-2.1	-0.9	-1.0	-1.0	-1.0
Effective interest rate	1.6	1.8	2.8	3.5	4.1	4.7
Combined Shock						
Real GDP growth	0.2	1.5	0.5	3.5	3.5	3.5
Inflation	6.9	3.0	2.4	5.4	4.2	4.4
Primary balance	-3.5	-3.2	-2.5	-1.0	-1.0	-1.0
Effective interest rate	1.6	2.3	2.9	3.7	4.3	4.8

	2022	2023	2024	2025	2026	2027
Real GDP Growth Shock						
Real GDP growth	0.2	1.5	0.5	3.5	3.5	3.5
Inflation	6.9	3.0	2.4	5.4	4.2	4.4
Primary balance	-3.5	-2.9	-2.5	-1.0	-1.0	
Effective interest rate	1.6	1.8	2.3	2.7	2.9	3.0
Real Exchange Rate Shock						
Real GDP growth	0.2	4.5	3.5	3.5	3.5	3.5
Inflation	6.9	12.2	3.1	5.4	4.2	4.4
Primary balance	-3.5	-2.1	-0.9	-1.0	-1.0	-1.0
Effective interest rate	1.6	2.3	2.2	2.3	2.6	2.8

Source: IMF staff.

Annex IV. Summary of Capacity Development Strategy

Paraguay's institutional capacity (particularly at the Central Bank and the Ministry of Finance) has benefited significantly from CD support by the Fund. The CD agenda going forward will focus on fiscal sustainability, financial integrity, financial sector supervision, and statistical data reporting.

Background

1. Over the past 15 years the Fund provided advice in the areas of tax reform, revenue administration, establishing a fiscal rule, transitioning to inflation targeting, and development of the statistical system. In 2017, Paraguay undertook an FSSR, which informed MCM's CD measures in the areas of banking supervision, stress testing, and insurance regulation and oversight. Paraguay has a strong track record of absorbing CD, and during the past two decades, the Central Bank and the Ministry of Finance (main recipients of Fund TA) have upgraded their institutional and operational capacity.

2. Collaboration with other partners has also been strong, particularly with the World Bank and the IADB (e.g., in the 2020 governance diagnostic assessment mission).

CD Priorities Going Forward

3. Going forward, the CD program prioritizes four areas identified in the Article IV surveillance:

- Re-enforcing fiscal sustainability will require stronger institutions, rules, and procedures. This will require a multi-pronged approach encompassing an improved FRL, increasing domestic revenue collection (both in tax policy and revenue administration), strengthening the public procurement system, improving the management of fiscal risks and liabilities, and civil service and pension reform.

- Continue strengthening Paraguay's overall AML/CFT regime. A comprehensive CD project, financed by the Thematic Trust Fund, was recently established to further strengthen technical aspects and overall effectiveness of Paraguay's legal, regulatory, and supervisory regimes. Additional CD will be needed to further strengthen the anti-corruption framework in line with the recommendations resulting from the 2020 Governance Diagnostic Assessment report.

- Further enhancing financial sector supervision. The ongoing work program to enhance risk-based supervision at the Superintendence of Banks should continue, as well as CD measures to strengthen the supervision of financial cooperatives, insurance companies, and shadow banking activity. Another area identified in the FSSR is the need for strengthening systemic risk monitoring and macroprudential policy formulation. CD support has been provided already for enhancing the bank resolution framework and strengthening the deposit guarantee fund, and continued technical assistance is needed in the area of cybersecurity.

- Strengthening the statistical reporting framework to transition from the e-GDDS towards the Special Data Dissemination Standard (SDDS) and strengthening the compilation of general government data and monetary and financial statistics.

Consultation with the Authorities

4. Staff and the authorities agree on the CD priorities. The workstreams proposed in this note represent areas where strong overlaps between the authorities' priorities and the surveillance priorities have been identified. Staff and the authorities diverge on the urgency of tax policy reform measures—the authorities regard this as difficult in the current environment and prefer to wait until the recent tax modernization law has become fully effective over the medium-medium term.

Political Appetite for Reforms

5. The government is committed to a structural reform agenda that will enhance the efficiency of the state and of public spending. Growing public awareness of the need for governance reforms provides a window of opportunity to implement these reforms, supported by CD delivery.

Challenges and Mitigation Factors

6. CD delivery came to a temporary halt in March 2020, as travel restrictions were imposed and the authorities prioritized the response to the COVID-19 pandemic. However, CD collaboration has resumed mostly through virtual missions.

Paraguay—Policy Coordination Instrument

Attached hereto is a Program Statement dated November 1, 2022 from the Minister of Finance of Paraguay, and the President of the Central Bank of Paraguay, (the "Program Statement") with its attached Technical Memorandum of Understanding ("TMU") requesting from the International Monetary Fund (the "Fund") a Policy Coordination Instrument (the "Instrument"), and setting forth:

(a) the objectives and economic and financial policies (the "Program") that the authorities of Paraguay intend to pursue during the period of the Instrument;

(b) the policies and measures that the authorities of Paraguay intend to pursue during the first year of the Instrument, including a quantified macroeconomic framework for the first 12 months under the Instrument; and

(c) understandings between Paraguay and the Fund regarding reviews that will be made of progress in realizing the objectives of the Program.

To support these objectives and policies, the Fund approves this Instrument for a period of 24 months from the date of approval hereof, in accordance with the following provisions, and subject to the requirements of Decision No. 16230-(17/62), adopted July 14, 2017, on Policy Coordination Instruments ("PCI Decision"):

1. Review Schedule. Paraguay's implementation of the Program will be assessed by the Fund through reviews, which are scheduled to be conducted by June 1, 2023, December 1, 2023, June 1, 2024, and November 1, 2024, subject to paragraphs 7(b) and (c) of the PCI Decision.
2. Establishing Targets. Completion of each review will be subject to Quantitative Targets or Reform Targets, or both, where established, having been set for the shorter of (a) the next two scheduled reviews, or (b) the remaining period of the Instrument.
3. Completing Reviews. A review will be completed only if the Fund is satisfied that the Program is on track to achieve its objectives, based on relevant factors such as Paraguay's observance of the Standard Continuous Targets set forth in Table 1b of the Program Statement, the Quantitative Targets and Reform Targets set forth in Tables 1a and 2 of the Program Statement and further specified in the TMU, consultation under the inflation consultation band as set forth in Table 1a of the Program Statement and further specified in paragraphs 12, 13, and 14 of the TMU, and its policy understandings for the future.
4. Provision of Information. In accordance with the Program Statement, Paraguay will provide the Fund with such information as the Fund requests in connection with Paraguay's progress in implementing the policies and reaching the objectives of the Program.

5. Consultation. In accordance with the Program Statement, during the period of this Instrument, Paraguay will consult with the Fund on the adoption of any measures that may be appropriate at the initiative of Paraguay or whenever the Managing Director of the Fund requests such a consultation. These consultations may include correspondence and visits of officials of the Fund to Paraguay, or representatives of Paraguay to the Fund.

Appendix I. Program Statement

Asunción, November 1, 2022

Ms. Kristalina Georgieva
Managing Director
International Monetary Fund
Washington, D.C. 20431
United States

Dear Ms. Georgieva:

Paraguay coped well with the COVID-19 crisis in 2020-2021. The Emergency Law and the Economic Recovery Plan (Ñapu'a) established, in the second half of 2020, appropriate fiscal, social, and financial support measures, which were essential to mitigate the negative impact of the pandemic and support recovery in 2021, during which the Economic Consolidation and Social Containment Law was also implemented. Thanks to these measures, an abrupt collapse of the economy was averted. In 2020, the Paraguayan economy contracted by 0.8 percent, making it one of the countries with the smallest decline in the region. On the other hand, in 2021 the gross domestic product (GDP) rebounded by 4.1 percent.

Our country is still vulnerable to recurrent climatic shocks and adverse external conditions, however. These factors present a constant challenge for our economy. The severe drought that occurred between late 2021 and early 2022 resulted in significant crop losses of soybeans and other agricultural commodities. In addition, inflationary pressures, largely due to unfavorable external conditions, have been significant this year.

Our government is aware of the uncertainty surrounding the global conditions, which could lead to significant risks for the Paraguayan economy. A further escalation of the conflict between Russia and Ukraine, or new geopolitical frictions, the tightening of financial conditions, and an increased probability of recession in advanced economies are some of the main global risk factors. Downside risks are amplified by adverse developments among some of our major trading partners and potential impacts on the agricultural sector stemming mainly from weather disruptions.

In this challenging landscape, the government of Paraguay will maintain its commitment to sound macroeconomic policies, including the objectives of fiscal solvency, exchange rate flexibility, financial stability, and social protection. To this end, we would like to request the approval of a new macroeconomic and structural reform program, supported by the Policy Coordination Instrument (PCI) of the International Monetary Fund (IMF), for the period November 2022–November 2024. The Program Statement for that period of time describes our objectives and the economic policies that the government intends to implement.

This PCI is designed to ensure macroeconomic stability and resilience, improve productivity, foster economic growth, and strengthen social protection and inclusion. In order to monitor implementation of the program, quantitative targets, standard continuous targets, and reform targets will be used, as well as an inflation consultation clause linked to current projections of the Central Bank of Paraguay (BCP), which are described in the Program Statement and the attached Technical Memorandum of Understanding (TMU). Four reviews, to be conducted every six months, will be scheduled to assess progress in the implementation of the program and to determine what additional measures are needed to achieve its objectives.

We believe that the policies described in this Program Statement are sufficient to achieve the objectives of the PCI-supported program. We will promptly adopt any additional measures that may be necessary for this purpose. We will consult with the IMF prior to adopting these measures or in advance of revising the policies contained in this Program Statement. In addition, we will provide all information requested by the IMF to assess program implementation.

In keeping with our commitment to transparency, we wish to make this letter publicly available, together with the Program Statement and the TMU, as well as the IMF staff report on the PCI request. We therefore authorize its publication on the IMF's website, subject to the approval of the Executive Board.

Sincerely yours,

/s/
Oscar Llamosas Díaz
Minister of Finance of Paraguay

/s/
José Cantero Sienra
President of the Central Bank of Paraguay

Attached document: Technical Memorandum of Understanding

Program Statement for the Period of November 2022-November 2024

1. **Paraguay adequately coped with the COVID-19 crisis in 2020-2021.** The Emergency Law and the Economic Recovery Plan (Ñapu'a) established, in the second half of 2020, appropriate fiscal, social, and financial support measures, which, combined with the monetary and credit measures, were essential to reduce the negative impact of the pandemic and support recovery in 2021, during which the Economic Consolidation and Social Containment Law was also implemented. As a result, an abrupt collapse of the economy was averted. In 2020, the Paraguayan economy contracted by 0.8 percent, making it one of the countries with the smallest decline in the region. On the other hand, in 2021 the gross domestic product (GDP) rebounded by 4.1 percent. The economic outlook for this year has been severely affected by the drought between the end of 2021 and the beginning of this year, however.

2. **Despite the urgent issues, we will continue with important structural reforms.** Further structural and institutional reforms are needed to ensure stronger and more inclusive growth in the medium term, while maintaining fiscal sustainability and financial stability. A comprehensive program of structural and institutional reforms will be needed to boost the Paraguayan economy.

3. **This statement sets out our economic program for the next 24 months.** The program is organized around three pillars: (i) ensuring macroeconomic stability and resilience; (ii) improving productivity and fostering economic growth; and (iii) strengthening social protection and inclusion.

RECENT ECONOMIC DEVELOPMENTS AND OUTLOOK

4. **The severe drought that occurred between late 2021 and early 2022 resulted in significant crop losses of soybeans and other agricultural commodities.** GDP growth projections for 2022 are around 0.2 percent. Since the end of the first quarter, meteorological conditions have improved significantly, which has helped the corn and soybean crops and partially offset the significant losses recorded by producers in the previous months. On the demand side, private consumption and investment growth rates are forecast at 2.6 percent and 3.6 percent, respectively. On the other hand, public consumption is expected to fall by 5.5 percent, in line with the fiscal convergence plan of the Ministry of Finance. Real exports are projected to contract at double-digit growth rates, while real imports would slightly decrease. The current account balance for 2022 is expected to show a deficit of about 5.0 percent of GDP, primarily due to the trade deficit, driven in part by the trends in imports, which have been propelled by higher values of consumer, intermediate, and capital goods.

5. **Inflationary pressures continued to be significant this year.** Inflation projections for 2022 and 2023 are 8.8 percent and 4.1 percent, respectively. The inflation rate is expected to converge to the inflation target during the first quarter of 2024. Overall inflation continued to rise during the second quarter of 2022, due to persistent external pressures on commodity prices. These pressures on external prices have eased recently, however, and together with the moderate buoyancy of local

economic activity – a negative output gap – this would contribute to the containment of domestic inflation pressures in the medium term. In September, inflation stood at 9.3 percent year-on-year and through the ninth month of the year recorded a change of 7.1 percent. Against this backdrop, the Central Bank of Paraguay has begun the process of gradually adjusting the monetary policy rate. At its September meeting, the Monetary Policy Committee increased the monetary policy rate to 8.5 percent per annum, reflecting an increase of 325 basis points from December 2021, amid persistently rising prices.

6. **On the fiscal front, despite the negative impact of the lower growth expected in 2022, the commitment to reduce the deficit by 0.7 percent of GDP remains unchanged.** As of August, the cumulative fiscal deficit was 1.2 percent of GDP, with public investment of 1.6 percent of GDP and operating income of 0.4 percent of GDP. The positive dynamics observed in tax revenues, with a cumulative growth rate of 18.4 percent as of August, and the slowdown in the growth of expenses on certain components such as goods and services, and the reduction in additional expenses due to the pandemic, such as the purchase of vaccines, support the forecasts for reaching the deficit target by the end of 2022.

7. **Some of the main risk factors are a further escalation of the conflict between Russia and Ukraine, the tightening of financial conditions, and the increased likelihood of recession in major advanced economies.** The intensification of the armed conflict is a risk that could put further upward pressure on global inflation due to higher commodity prices, including those for oil, wheat, and corn. Similarly, persistent inflation in the United States and the euro area has led to an acceleration of monetary policy normalization. This results in tighter financing conditions for emerging economies, which could be compounded by higher risk premiums for countries with high levels of debt and a high proportion of foreign currency-denominated debt. In addition, new variants of COVID-19 continue to present a potential risk to the economic outlook. In this environment of high inflation and accelerated withdrawal of monetary and fiscal stimulus, the likelihood of an economic slowdown and even recession in the world's major economies has increased.

8. **Other risks arise from the circumstances of our trading partners and local conditions.** At the local level, the risks to economic activity, especially agriculture, stem mainly from the changing climate and the availability of fertilizers in sufficient quantities. As for the next soybean season, 2022/2023, there is a likelihood of another drought ("la Niña"). As for fertilizers, imports (by volume) in recent months have been below historical averages and, if not remedied, this situation could have a negative impact on soybean yields.

9. **Despite the risks and uncertainty associated with external conditions, however, growth is expected to recover in 2023.** After the severe drought that affected primary sector production during late 2021 and early 2022, a recovery of the economy is expected under normal weather conditions in 2023, with an estimated growth of 4.5 percent. This growth will be driven mainly by the recovery of the primary sector, agro-industries, and trade. On the demand side, a recovery of exports and increased dynamism in consumption and investment are expected.

Strategic Objectives of Our Reform Program

A. Pillar I. Ensuring Macroeconomic Stability and Resilience

10. The first pillar is aimed at reaffirming Paraguay's macroeconomic stability and resilience. We are committed to gradually reduce the fiscal deficit to the original ceiling of 1.5 percent of GDP set in the Fiscal Responsibility Law (LRF). This objective will be achieved through the implementation of several fiscal reforms that will contribute to strengthening fiscal governance, protecting the budget during electoral cycles, reducing fiscal risks, and strengthening the tax revenue base. Monetary and exchange rate policies will continue to be aimed at ensuring low and stable inflation and exchange rate flexibility.

11. On the fiscal front, following the impact of adverse shocks in 2019 (drought) and 2020 (pandemic), which prompted fiscal mitigation measures, the government is committed to a gradual convergence to a deficit of 1.5 percent of GDP. During 2019, the contraction in economic activity, which recorded a 0.4 percent drop, resulted in a reduction in tax revenues and an increase in the fiscal deficit, which reached 2.8 percent of GDP. Then in 2020 the COVID-19 pandemic broke out, requiring exceptional fiscal, monetary, and social containment measures. Our country implemented a significant package of fiscal measures amounting to 5.5 percent of GDP, which was ultimately reflected in an increase in the fiscal deficit to over 6 percent of GDP during 2020. These measures helped reduce the impact on the economy, which ultimately contracted by 0.8 percent.

Fiscal Policies

12. We are proposing the implementation of measures to achieve a fiscal deficit of 1.5 percent of GDP by 2024, as established in the Fiscal Responsibility Law. To achieve this goal, we have sent to the National Congress the National General Budget for fiscal year 2023 with the authorization of a deficit of 2.3 percent of GDP (0.7 percentage point lower than the 2022 target), in line with our goal of a gradual fiscal convergence to a 1.5 percent of GDP deficit by 2024. In this regard, we are committed to maintaining a strategic level of public investment, consistent with our fiscal convergence path, which means returning to investment levels of 2.0 percent of GDP by 2024 (investments equal to US$1 billion per year).

13. Contain growth in primary current expenditure, while maintaining priority spending on health, education, and social programs. As measures to return to sustainable levels of fiscal performance, we propose to maintain a ceiling on primary current expenditure growth of 4 percent in real terms. These measures limit additional current expenditures beyond those established in the legislation in force, which refers to the focus on incremental growth; adjustment in expenditures to those items indexed to the legal minimum wage, including public security services, transfers made to the program for elderly adults, and administrative staff at those salary levels. Regarding the management of expenditures on goods and services, we will ensure better alignment of that spending with institutional operations and improved prioritization in the purchases of medicines and hospital supplies. Under this scenario, current spending is projected to reach 13 percent of GDP by the end of 2024. This stance will result in a decrease in the growth of public debt in terms of GDP over the medium term, thus restoring fiscal buffers. The public debt projections for the central government, considering the 2022-2024 macroeconomic framework presented under the baseline scenario with no adverse shocks, estimate a public debt level of 32.8 percent of GDP at the end of 2024.[1] We are also committed to keeping central government floating debt's net changes at low levels at the close of each fiscal year. The corresponding quantitative targets for the fiscal deficit, primary current expenditure, and floating debt's net changes are described in Table 1a.

Structural Fiscal Policies

14. Paraguay's responsible fiscal management has contributed significantly to the strengthening of its macroeconomic pillars, which has made it possible to deal with the challenging circumstances resulting from the COVID-19 pandemic in a timely manner, and to withstand the impact of other exogenous factors such as the drought and the armed conflict between Russia and Ukraine.

15. Despite the progress made, there are still major challenges to ensuring macroeconomic stability and the country's resilience to strong economic shocks, while putting the country on a sustainable development path and improving social protection and inclusion; therefore, the Executive Branch's proposal for the Transformation of the State, which includes a package of structural reforms, including reform of the Public Sector Retirement and Pension System, is key. These initiatives share the fundamental objective of contributing to the financial and actuarial sustainability of the system, in accordance with the convergence plan currently underway and the guidelines established in Law No. 5098/13 ON FISCAL RESPONSIBILITY.

Reform of the Public Sector Retirement Regime (Caja Fiscal)

16. It is necessary to reform the public sector retirement regime to make it sustainable. The Public Sector Retirement and Pension Regime is not sustainable in the medium term. The cumulative deficit in 2021 was US$167 million and the three sectors whose contributions were insufficient are: The National Teachers Corps under the Civilian Program (-US$93.4 million) and the Armed Forces (-US$74.1 million) and the National Police (-US$63.3 million) under the Non-Civilian Program. For the current year, the deficit is estimated to be approximately US$224 million, of which US$153 million corresponds to the Non-Civilian Contributory Program and US$71 million to the Civilian Contributory Program, mainly due to the deficit of the National Teachers' Sector.

17. The situation reflects a highly fragmented system, with significant inequity in access to benefits. This is even more serious considering that only about 20 percent of the employed population in the country contributes to a retirement system, which means that the remaining 80 percent have no possibility of accessing retirement benefits. Given this scenario, it is inequitable that about 16,000 retirees of the public security services each year absorb more than US$150 million from tax resources, with the likelihood that the National Teachers Corps will require the same

[1] Based on the analysis of the debt evolution endogenous model submitted by the Directorate of Debt Policy (DPE).

treatment, otherwise their benefit levels will not be covered in their entirety. Regarding the actuarial situation of the "Caja Fiscal", the calculation for the period 2019-2056 presents a deficit of 28.5 percent of the 2019 GDP, which in nominal terms is approximately US$11,408 million at present value. As of December 2021, the accumulated surplus deposited with the BCP is approximately US$429 million.[2] The projected cash flow deficit for the Civilian Contributory Program will continue to increase rapidly, reaching a total of close to US$800 million by 2026, which is why it is essential to move forward with reforms to the "Caja Fiscal".

18. A draft law on contingency measures for the Caja Fiscal will be presented, aimed at introducing the most urgent and necessary adjustments to achieve the financial sustainability of the system in the medium term, until the comprehensive reform is carried out. The preliminary draft law[3] has the general objective of establishing contingency measures mainly for those sectors in deficit, aimed at the stability and sustainability of the Fiscal Fund. Under a scenario in which these measures are combined, it is estimated that the financial impact will generate an average annual savings of approximately US$130 million in the first five years of implementation, with the effect of delaying the depletion of accumulated surplus resources by three years. The proposed date for submission to the National Congress is on or before June 2023 **(reform target).** We will continue working on a comprehensive reform of the pension system.

19. Creation of a Retirement and Pension Supervisory Agency. The design of a Retirement and Pension Supervisory Agency will be continued; it will be constituted as a technical body specializing in the supervision and oversight of retirement and pension funds, with emphasis on the technical, actuarial, operational, legal, and financial supervision thereof. The absence of a supervisory and regulatory body is one of the most serious weaknesses of the current system, which is very fragmented and lacks an adequate institutional framework in terms of oversight processes and regulatory and risk diversification mechanisms for investment management, in order to guarantee the resources needed to meet the medium- and long-term objectives of the funds. Solvency and risk management requirements based on technical oversight criteria are not present in the legal system governing pension funds, which represents an obvious risk to the sustainability of the system. The proposed date for submission to the National Congress is on or before December 2023 **(reform target).**

Improve the Mobilization of National Public Revenues

20. We will prepare a comprehensive diagnostic assessment that should improve the mobilization of national public revenues. Tax revenues in Paraguay are relatively low. Fiscal pressures and the need for substantial resources to meet the multiple post-pandemic challenges require a thorough review of opportunities to increase tax revenues and reduce tax expenditures. The assessment will include estimates of revenue losses due to current tax incentives and informal

[2] The reserves deposited with the BCP include the surplus cash flow from the Civilian Contributory Program, as well as income from principal and interest received to date from investments made.

[3] Named as Law "To Establish Contingency Measures for the Public Sector Retirement and Pension System (Caja Fiscal)."

employment, and identify areas where we can reduce tax expenditures, such as the Maquila regime and the Law 60/90.

21. We project significant advances in electronic invoicing. Since April 2022, we have been implementing e-kuatia, the new Integrated National Electronic Invoicing System (SIFEN), in a process that will be completed in October 2024 when 80 percent of invoices nationally will be issued through electronic documents. An important intermediate objective is the incorporation of approximately 800 large and medium taxpayers in the SIFEN by the end of June 2023 **(reform target).**

22. We will continue to develop the compliance risk management framework. We will work on the implementation of a compliance risk management framework by reviewing recommendations from previous technical assistance missions on customs and revenue administration. Our goal is to achieve the best possible result in terms of compliance. The new framework will enable the tax and customs administrations to have strategies and structures in place to keep non-compliance with the tax and customs laws to a minimum. To achieve these goals, the customs code will be updated, and the cooperation and information exchange between the tax and customs administrations will be strengthened.

Improve Fiscal Governance Through a Stricter Fiscal Rule

23. We are working on updating of the Fiscal Responsibility Law. We will continue to work towards the passage of the draft legislation (Fiscal Responsibility Law 2.0) submitted to National Congress in December 2020. The new law, which maintains the same deficit ceiling, proposes to tighten the rules on primary current spending and salary increases for civil servants, improve the triggers for the exception clause, establish rules and transitional periods in the event that the deficit ceiling is exceeded, strengthen the role of the Fiscal Council, and create a sovereign stabilization fund. The new law will also supplement the deficit ceiling with a graduated debt ceiling. Our objective is to conclude the discussion of the content of the law and finalize the draft for approval by the National Congress.

Proposed macro-fiscal rules:

- Public sector debt may not exceed the maximum limit of 40% (forty percent) of the gross domestic product estimated for the respective fiscal year.
- The annual fiscal deficit of the central government, including transfers, shall not exceed: a) 1.5 percent of GDP, if the public debt is less than 36 percent of GDP; b) 1.0 percent of GDP if the public debt is equal to or greater than 36 percent of GDP.
- The annual increase in the primary current expenditure of the central government and the public sector may not exceed the year-on-year inflation rate plus 2% (two percent).

Strengthen Institutional Fiscal Risk Management

24. **We are working to present an annual Fiscal Risk Report.** Following the recommendations of IMF technical assistance missions, with which a roadmap has been developed to identify and manage the most pressing fiscal risks, the Ministry of Finance is working to present in the last quarter of this year Paraguay's first Fiscal Risk Report, which incorporates an analysis of macroeconomic and specific risks (public enterprises, public-private partnerships, "Caja Fiscal") and risks related to climate change (publication October 2022).

Improve the oversight and management of state-owned enterprises (SOEs)

25. **In order to address contingent fiscal risks, improve public sector efficiency, and sharpen the strategic focus, we propose improved oversight and governance of the nine SOEs.** As a first step, by end-December this year, we will re-establish the dashboard system to measure the companies' performance in moving toward results-based management contracts, which will cover the year 2023 **(reform target)**. Further, we will complete the drafting of the Corporate Governance Law, which will clarify and strengthen the role of the SOE Supervisory Board. This draft law will be submitted to the National Congress in the second half of 2023 **(reform target)**.

Fiscal Safeguards in Pre-Election Periods

26. **In any modern state, responsibility for the management of public finances is an issue that should cut across all political groups.** In other words, any public policy, regardless of the ideas and values that inform it, requires for its implementation an environment characterized by sustainability and stability. In April 2022, in support of these principles, we submitted a draft law to the National Congress for its consideration. The purpose of this law is to establish special rules for government behavior in fiscal and administrative matters, in order to promote the maintenance of stability and sustainability of public finances during election periods. The proposed law would prohibit all initiatives that would increase salaries or reduce taxes, outside the scope of the existing budget, during election periods. It also grants special powers to the National Economic Team, chaired by the Minister of Finance, for the establishment of additional measures to implement the proposed law. At this time, we are seeking its approval in the National Congress.

27. **The purpose of the draft law is to maintain the stability and sustainability of public finances during election periods.** The proposed law will apply to the three branches of government, government agencies and institutions, and corporations in which the government holds a majority stake. Election periods will run from the fiscal year prior to the year in which national elections are held through the first quarter of the fiscal year in which the elections are held. The following will be suspended for legislative consideration and postponed until the end of the respective electoral period: i) draft laws that involve salary increases or increases in supplementary remuneration; ii) proposals to increase current or capital expenditures without technical support; iii) draft laws that affect the tax system. Failure to comply with the proposed legislation by the responsible officials will be considered a violation of their duties and functions, and the corresponding sanctions provided for in the legislation will be applied.

Strengthen payment to suppliers' processes and the recording of public investment

28. As a reaction to the external shocks suffered by Paraguay since 2019, and taking into account the country's large infrastructure needs, we substantially increased public investment to an annual average of 3.2 percent of GDP (2019-2021), compared to 2.1 percent during the previous five years. The pandemic and other shocks that our country has suffered in recent years brought unprecedented challenges, so our country was forced to design and implement countercyclical policies, mainly with an expansion of infrastructure investment to historic levels, as well as other economic impact measures to cope with these events. In order to finance this expansionary fiscal policy, additional resources were mobilized mainly through budget reallocations and external financing. In the process of carrying out these major projects based on multi-year plans, there have been occasional delays in the payment process for public works' contracts. Thus, the amount of this extraordinary expense in accrued public investment will be corroborated by the end of the 2022 fiscal year. The government is committed to accommodate the payments associated with these operations as part of the budgetary execution of the public investment of 2022 and even of the following years within the goals of convergence of the fiscal deficit to 1.5 percent of GDP by 2024.

29. We intend to strengthen the process of recording accrued commitments. With regard to outstanding commitments to contractors of the Ministry of Public Works and Communications, we are working on a supplementary legal-financial tool based on debt transfer operations with commercial banks. Likewise, the new regulatory framework that is being developed will allow the Ministry of Finance to control and monitor the commitments generated, thus providing greater predictability and appropriate plans for the settlement of these commitments.

Monetary and Exchange Rate Policies

30. We expect monetary policy tightening to continue if inflationary pressures persist. We have proactively managed the monetary policy rate in response to rising inflation, and we will continue to adjust it until inflation projections and medium-term inflation expectations are in line with the 4 percent inflation target.

31. We will continue with the flexible exchange rate regime, with exceptional interventions in the exchange rate market during periods of excessive short-term volatility of the guaraní. Exchange rate flexibility, within a well-functioning regime of inflation targeting strategies, has proved useful for Paraguay, but our currency is exposed to financial and real shocks. As part of our monetary policy tools, we use exceptional exchange rate interventions to smooth excessive volatility and preserve financial stability. We will continue to maintain and enhance transparency in foreign exchange interventions through the publication of related data in the Banco Central del Paraguay's website.

B. Pillar II: Improving Productivity and Fostering Economic Growth

32. The second pillar is intended to improve productivity and lay the foundations for more diversified and inclusive economic growth through structural reforms. Our program includes reforms that would increase the efficiency of public spending, modernize the civil service, streamline the structure of the government, and improve oversight of pension funds, as well as other measures that would strengthen the legal, regulatory, and supervisory regimes for anti-money laundering and combating the financing of terrorism (AML/CFT), reduce governance and corruption vulnerabilities, and strengthen the business climate.

Streamline Public Spending

33. The public procurement reform we have developed will be implemented shortly. Based on the recommendations of previous technical assistance missions to improve the quality of public spending, we have prepared a draft law that reorganizes procurement procedures through a more consistent and centralized approach. The general objective of the law is to create the National Public Supply System and to regulate the National Public Procurement System as part of the Integrated Public Supply Chain. It establishes a National Public Supply System, consisting of the following stages: planning (what is to be purchased), linkage with the budget (how it is to be paid for), administration of the goods or services (how what was purchased is used in accordance with the plan), and evaluation. In addition, it is intended to change the focus of public procurement from choosing only the cheapest to considering other factors such as quality, citizen satisfaction, product life cycle, and maintenance costs, considerations that constitute the concept of value for money, which implies economy, effectiveness, and efficiency. Finally, a more active role for the National Directorate of Public Procurement (DNCP) in the government procurement process is contemplated, with the creation of a Procurement Unit that will be in charge of making mandatory joint purchases and standardizing goods and services to secure better prices, taking advantage of economies of scale. The Senate has already approved the law, but it is awaiting approval by the Chamber of Deputies. Upon approval, we will draft the associated regulations and adopt them by decree on or before June 30 of 2023 **(reform target)**.

Civil Service Reform

34. We will continue to work on a reform to establish a general legal framework for civil service integrity. The development of government institutions depends largely on the quality of their human resources, and therefore we are proposing the amendment and updating of the Public Service and Professional Civil Service Law.[4] The aim is to have a more modern, competitive civil service, based on meritocracy, with a single salary scale, based on professional development and promoting more efficient public spending. The reform of the Civil Service Law is fundamental and cuts across all government institutions, which will allow for reorganization, professionalism, and

[4] The general objective of the law is to create and establish the general provisions of the Civil Service System, and to regulate the rules and procedures of the Professional Civil Service, based on the principles of the Public Service, with the aim of guaranteeing the right of every person to receive timely and quality public assistance and services.

meritocracy, resulting in greater productivity in the provision of quality public goods and services. We have submitted the bill to the congressional committee, and we are awaiting its debate. As a next step, we will submit the draft law to the National Congress for its consideration before the end of December 2023 **(reform target).** Then, the Ministry of Finance together with the Civil Service Secretariat, within the scope of their respective responsibilities, will work on their regulation and implementation.

Reorganize the Structure of the Government

35. We will continue to work on improving the efficiency of government operations. Paraguay's public institutions can be improved. We are actively working to redesign procedures within the public sector and reduce bureaucracy. A crucial element on our agenda is the reform project that, based on earlier assessments, will redesign and reorganize the structure of the government. Currently, the Technical Secretariat for Planning is working on a legislative proposal to establish the structure, rules, responsibilities, and regulations that will be applicable for the organization of the institutions that make up the government, with the aim of integrating responsibilities and related functions in order to avoid conflicts of authority and duplication within the same public institution or with other government institutions. **(reform target for June, 2023)**.

Improve Governance and Reduce Vulnerability to Corruption

36. In recent years we benefited from a comprehensive governance assessment. The Governance Diagnostic Assessment, led by the IMF and conducted in early 2020, has been finalized and we expect to publish it before the end of October 2022 **(Prior Action)**.

37. We have developed and adopted a new comprehensive anti-corruption plan,[5] in line with the recommendations of the governance assessment. As part of this plan, we have finalized and submitted to Congress a draft law that strengthens the powers, functions, and responsibilities of the authority responsible for combating corruption (the National Anti-Corruption Secretariat, or SENAC).

38. We will continue to strengthen the AML/CFT framework. The results of the 2021 assessment of Paraguay's AML/CFT regime, conducted by the Financial Action Task Force of Latin America (GAFILAT), were discussed and submitted for approval in the last week of July 2022. Paraguay approved the mutual evaluation process. The specific recommendations of the final report, published in September, will guide the next steps in strengthening the AML/CFT regime as a whole.

Strengthening the Business Climate

39. We will continue to work on strengthening the business climate, which is an important indicator of actions to attract new investments and on projects that promote a more sustainable growth. In order to increase productivity and the economy's growth potential, it is essential to

[5] National Integrity, Transparency, and Anti-Corruption Plan for 2021-2025.

provide micro, small and medium-sized enterprises (MSMEs) with additional tools to facilitate the obtention of credit. In this regard, we are working on a draft law on movable asset-based financing, with the aim of facilitating access to credit by MSMEs through greater flexibility and scope in terms of the assets used as collateral (i.e., accounts receivable, crops, etc.). We will submit the draft law to the National Congress before the end of December 2022 **(reform target).**

C. Pillar III: Improving Social Protection and Inclusion

40. Social protection policy is a fundamental pillar for progress toward guaranteeing the fulfillment of economic and social rights. This policy took on greater relevance with the outbreak of the COVID-19 pandemic and in the face of increased uncertainty and inflationary pressures deepened by the armed conflict between Russia and Ukraine, which have exacerbated inequalities and vulnerabilities.

41. Macroeconomic stability contributed to the improvement of socio-economic variables. Macroeconomic stability and economic growth up to 2018 enabled progress in social protection, which had an impact on improvements in indicators of health, education, and living conditions, as well as poverty reduction, which has stagnated as a result of the impact of the COVID-19 crisis.

42. Poverty has declined over the past two decades. Since 2002, total poverty has declined significantly, from 57.7 percent to 28 percent in 2008, followed by a slower decline, reaching a 23.5 percent rate in 2019. As a consequence of the pandemic, however, poverty reduction has stagnated, and the poverty rate rose to 26.9 percent in 2020 and remained at a similar level in 2021.

43. Social spending has doubled, which has contributed to the reduction in poverty and inequality. Central government social spending has been increasing significantly in recent years, from 5.4 percent of GDP in 2003 to 11.9 percent in 2020, due to the measures adopted in response to the COVID-19 crisis. Social spending stayed at high levels in 2021, reaching 10.6 percent of GDP. Social protection programs implemented during the pandemic provided assistance to workers and their families and, according to our estimates, prevented 233,000 and 139,000 people from falling below the overall poverty line in 2020 and 2021, respectively.

44. Paraguay has established the Social Protection System with a life-cycle approach; however, we must continue to work on its further strengthening. Pursuant to Decree No. 4775/2021, the "Vamos" Social Protection System of Paraguay was established and the strategic framework of objectives and actions was approved, as well as the prioritization of strategic actions for the 2019-2023 multi-year planning. The aim is to protect the population from conception to old age. Although we have managed to establish a Social Protection System with a life-cycle approach, this has been a recent development and it involves facing the challenges of coverage and financing.

45. The "Vamos" Social Protection System consists of three basic pillars: i) social integration, linked to universal and selective policies aimed at the population living in poverty; ii) labor and productive integration, related to inclusion and labor regulation policies; and iii) social security, linked to both contributory and non-contributory policies.

46. The non-contributory programs with the highest coverage are Tekoporã and the Food Subsidy Program for Vulnerable Elderly Adults. Among the non-contributory programs with the greatest coverage are Tekoporã (a conditional transfer program), implemented by the Ministry of Social Development (MDS) and the Food Subsidy Program for Vulnerable Elderly Adults, implemented by the Non-Contributory Pension Directorate of the Ministry of Finance. The main objective of the Tekoporã Program is to improve the quality of life of the participating population, facilitating the exercise of the rights to food, health, and education by increasing the use of basic services and strengthening social networks in order to break the intergenerational cycle of poverty. The program is aimed at protecting and supporting vulnerable families living in poverty. It has two clearly differentiated components aimed at achieving its specific objectives: social, family, and community support provided by social service workers and cash transfers.

47. In the short term, Paraguay will continue to increase the coverage of two of its most important programs. Our commitment to strengthening social protection in Paraguay is reflected in our goal of increasing the coverage of the Tekoporã program from almost 166,000 families in 2021 to 170,000 families in 2022. Likewise, the coverage of the Food Subsidy Program for the Elderly will be increased by 26,000 people in 2022. Both targets will be met by December 2022.

48. The draft budget contemplates the continuity of traditional social programs, such as Tekoporã and assistance for the elderly, in order to meet the needs of the most vulnerable segments of the population. For 2023, we presented a Draft National General Budget that provides US$323 million for the Food Subsidy Program for the Elderly and US$57.5 million for the Tekoporã Program. With these allocations we expect to reach 300,000 beneficiaries through the food subsidy program and 175,000 families through conditional cash transfers.

Beneficiary Identification and Social Program Management Systems

49. Paraguay has a number of social programs that are administered by various government institutions. The large number of social program administrators leads to the unnecessary duplication of costs associated with the collection of beneficiary information. This also makes it difficult to correctly register and report beneficiaries with access to more than one social program.

50. Paraguay needs to implement a comprehensive, single beneficiary system that can harmonize the processing and implementation of existing social programs and other future initiatives. The Ministry of Finance developed the Benefits System (SIPEN), an IT and technological solution for managing benefits in the non-contributory sector (Food Subsidy Program for the Vulnerable Elderly Adults). The SIPEN includes processes for the entry of information, selection, generation of benefits, control, and payment to the Integrated Financial Administration System (SIAF) based on best practices in the region. In addition, the SIPEN is integrated with the linked systems that make up the Government Resources Administration System (SIARE). It is expected that implementation of the SIPEN will optimize the systematization efforts being carried out by the Non-Contributory Pensions Directorate, strengthening transparency and efficiency in the processes related to the non-contributory sector.

51. We recently made the decision to formalize the implementation of the SIPEN for the comprehensive management of government programs that make financial transfers to individuals. Decree 6833 of March of this year provides that both non-contributory pensions administered by the Ministry of Finance, as well as other programs involving the transfer of resources to individuals, may be integrated into the SIPEN. Our main objective is to gradually adjust and improve our beneficiary system. Our initial objective is the formal implementation of the SIPEN in the Non-Contributory Pensions Directorate on or before the end of 2023 **(reform target)** and to subsequently expand its implementation to other social assistance programs**.**

Formalize Employment

52. Paraguay is among the countries with the highest levels of informal employment in the region. On average, the rate of informal employment in Latin America and the Caribbean was 51 percent in 2012, a figure very similar to that observed later in the period 2017-2019, reflecting a very complex labor landscape prior to the outbreak of the pandemic (International Labour Organization (ILO), 2021). In the case of Paraguay, according to data from the National Statistics Institute's Permanent Continuous Household Survey (EPHC), 63.7 percent of workers employed in non-agricultural activities (accounting for 1.75 million people) carried out their labor activities informally in 2019,, a much higher percentage than the average observed in the region. In terms of occupational categories, 44 percent of informal workers (accounting for more than 774,000 people) are wage earners in the private sector and 37 percent are independent workers (accounting for more than 651,000 people), most of whom are self-employed, followed by employers or proprietors and public sector contractors. Together, these groups account for 81 percent of informal workers.

53. Social security and health coverages are quite low for wage earners and independent workers. In general, social security coverage for wage earners and independent workers is low: 64 percent of wage earners in the private sector and 99.8 percent of independent workers do not contribute to social security, i.e., they have no prospect of future retirement benefits. As for health insurance coverage, 57 percent of private wage earners and 84.7 percent of independent workers do not have any type of health insurance coverage. This situation puts additional pressure on the coverage offered through the Ministry of Public Health and Social Welfare (MSPBS). In addition, the high level of informal employment makes it necessary to redouble efforts in the design and implementation of public policies to address the growing pressure on social programs, such as the Program for Elderly Adults, which in a period of just 10 years went from 25,000 to more than 256,000 beneficiaries (data from 2011 and January 2022, respectively).

54. In order to address informal employment, we are working on a draft law on the formalization of dependent workers of micro, small, and medium-sized enterprises (MSMEs) and independent workers in general, which would promote access to the formal social security system through the configuration of appropriate incentives for the target population.[6] In the case of

[6] The definition of informal employment taken into account for the drafting of the legislative proposal follows the definition of the National Statistics Institute, which in the case of dependent workers, considers informal workers to

(continued)

dependent workers of MSMEs, the institutions involved will be the Ministry of Industry and Commerce (MIC), the Ministry of Labor, Employment, and Social Security (MTESS), and the Social Security Institute (IPS). In the case of independent workers, the Ministry of Finance, through the Tax Administration, together with the IPS, will prepare a plan for their gradual and systematic incorporation into the new regime, as well as the relevant regulations. The proposed date for submission to the National Congress is June 2023 **(reform target).**

Increase Financial Inclusion

55. Improving access to financial services is a priority for our government. Lack of access to financial services has long been a problem in Paraguay. We have drafted a Financial Inclusion Law that will require employers to pay wages by electronic transfer instead of in cash. It will also require financial intermediaries to provide workers with free payroll direct deposit accounts and to allow them to make at least one free cash withdrawal per month. This measure will improve access and boost the inclusion of underserved low-income households in formal banking services. The proposed law also contemplates tax incentives to ensure compliance with regulations and laws, and to promote transparency in financial transactions. The draft law has obtained a favorable opinion from two congressional committees and is awaiting a start of discussions in the National Congress for its approval. The implementing regulations will be drafted subsequent to its approval.

PROGRAM MONITORING

56. Quantitative targets, continuous targets, and reform targets will be used to monitor progress in policy implementation in the context of this program. Quantitative targets are proposed for the end of December 2022, the end of June 2023, and the end of December 2023, along with a quantitative target to be monitored on an ongoing basis (Tables 1a and 1b of this Program Statement). The government and IMF staff also agreed on the reform targets shown in Table 2 of this Program Statement. The first review is scheduled to be completed by June 1, 2023, the second review by December 1, 2023, the third review by June 1, 2024, and the fourth review by November 1, 2024. Definitions are provided in the attached Technical Memorandum of Understanding.

be those who do not contribute to a retirement and pension system; and in the case of independent workers, those whose company is not entered in the Single Taxpayers' Registry (RUC).

Table 1a. Paraguay: Proposed Quantitative Targets Under the PCI 2022-23 1/

	2022	2023	
	end-Dec.	end-Jun.	end-Dec.
	Prog. QT	Prog. QT	Prog. QT
I. Quantitative Targets (QT)			
1 Ceiling on the central government fiscal deficit (in billions of guaraníes) 2/ 3/	-8,733	-2,322	-7,284
2 Ceiling on current primary expenditure of the central government (in billions of guaraníes) 2/	34,746	17,432	37,926
3 Ceiling on the net incurrence of floating debt by the central government 4/	500	-2,100	500
II. Continuous Targets			
4 Ceiling on accumulation of external debt payment arrears by the central administration (in millions of U.S. dollar)	0.0	0.0	0.0
III. Inflation Consultation Band 5/			
Upper band limit (2 percent above center point)	10.8	8.5	6.1
End of period inflation, center point 6/	*8.8*	*6.5*	*4.1*
Lower band limit (2 percent below center point)	6.8	4.5	2.1
IV. Memorandum Items			
Social assistance benefits 2/	2,906	1,434	3,338

1/ As defined in the Program Statement and the Technical Memorandum of Understanding.
2/ Cumulative since the beginning of a calendar year.
3/ Refers to the negative of net lending/borrowing (overall balance) as per the GFSM 2001 definition.
4/ Cumulative change since the start of each year.
5/ Board consultation is required upon breach of the band limits.
6/ Defined as the change over 12 months of the end-of-period consumer price index, as measured and published by the Central Bank of Paraguay.

Table 1b. Paraguay: Standard Continuous Targets

- Not to impose or intensify restrictions on the making of payments and transfers for current international transactions.
- Not to introduce or modify multiple currency practices.
- Not to conclude bilateral payments agreements which are inconsistent with Article VIII.
- Not to impose or intensify import restrictions for balance of payments reasons.
- Not to accumulate external payments arrears.

Table 2. Paraguay: Proposed Prior Action and Reform Targets for 2022-23

Prior Actions

1 Publish the final report of the Fund-led Governance Diagnostic Assessment on a government website.

	Policy Objective	Possible Reform Targets	Target Date
	Pillar I: Ensure Macroeconomic Stability and Protect the Fiscal Policy Framework		
2	Implement measures to protect the solvency of the Public Sector Pension System ("Caja Fiscal")	Send to Congress the transition law draft that will contain measures to contain the deficit of the "Caja Fiscal".	End-June 2023
3	Enhance domestic revenue mobilization	Incorporate at least 750 large and medium-sized taxpayers in the Integrated National Electronic Invoicing System (SIFEN).	End-June 2023
4	Improve the monitoring and supervision of Public Enterprises	Reestablish the control panel with results-based management contracts for one year (2023).	End-December 2022
5	Strengthen the oversight and strategic management of Public Enterprises	Review and send to Congress the "Corporate Governance Law", which will clarify and strengthen the role of the SOE supervisory board.	End-December 2023
6	Strengthen financial supervision	Send a new version of the pension fund supervision law, which will create a new supervisory agency, to one of the two chambers of Congress.	End-December 2023
	Pillar II: Enhance Productivity and Foster Economic Growth		
7	Civil service reform	Submit to Congress the new "Ley de la Función Pública y Carrera del Servicio Civil" (civil service law).	End-December 2022
8	Rationalize public spending	Complete and enact the administrative regulation for the new procurement law.	End-June 2023
9	Improve the efficiency of government operations	Complete work on the law draft that orders the structure of the state and submit the draft to one of the two chambers of Congress.	End-June 2023
10	Improve the business climate	Submit to Congress a new version of the law on collateral of movable assets ("ley de garantías mobiliarias").	End-December 2022
	Pillar III: Enhance Social Protection and Inclusiveness		
11	Formalize MSME workers and independent workers	Submit to the National Congress a Bill for the formalization of dependent workers of MSMEs and independent workers in general.	End-June 2023
12	Reduce the coverage gap of the social transfer programs.	Increase the number of beneficiaries of the "Tekoporã" and "Food Pension for Elderly Adults" programs by 4,000 families (from 166,000 to 170,000 families) and 26,000 new annual beneficiaries, respectively.	End-December 2022
13	Integrate the information system for beneficiaries of social programs	Implement the guidelines of decree No. 6833 of March 2022 "SIPEN" (Pension Information System), Article 1, subsection a.	End-December 2023

Table 3. Paraguay: Proposed Schedule of Reviews Under the Policy Coordination Instrument 2022-24

Program Review	Review Date	Test Date
Board Discussion of the PCI Request	November 21, 2022	…
First Review	June 1, 2023	December 31, 2022
Second Review	December 1, 2023	June 30, 2023
Third Review	June 1, 2024	December 31, 2023
Fourth Review	November 1, 2024	June 30, 2024

Attachment I. Technical Memorandum of Understanding

1. This Technical Memorandum of Understanding (TMU) defines the quantitative targets, continuous targets, and memorandum items described in the Program Statement to monitor the IMF-supported program, in the context of the Policy Coordination Instrument (PCI), during the period November [21], 2022 – November [20], 2024. It also establishes the terms and schedule for the transmission of information that will allow IMF staff to monitor the program. The reviews of the program will analyze the fulfillment of the quantitative targets on the specified dates and on an ongoing basis. Specifically, the first review will evaluate the targets at the end of December 2022, the second review will evaluate the targets at the end of June 2023, the third review will evaluate the targets at the end of December 2023 and the fourth review the targets at the end of June 2024.

A. Definitions

2. Unless otherwise indicated, in this TMU "Government" refers to the central budgetary government of the Republic of Paraguay. It excludes the central bank, financial and non-financial public companies, and governments at the departmental and municipal levels.

3. Unless otherwise stated, in this TMU "public sector" refers to government, local governments, and all entities owned or majority controlled by the government.

B. Program Goals

Ceiling on the Central Government Fiscal Deficit (Program Definition)

4. **Definition.** For the purposes of the program, the financing capacity/need ratio or the global fiscal balance (also called "net loan / net indebtedness"), is the difference between total income and total expenditure of the government (total obligated expenditure plus net acquisition of non-financial assets). The definition of revenue and expenditure is broadly consistent with that of the Government Finance Statistics Manual 2001 (GFSM). Obligated public spending is defined on the basis of payment orders accepted by the Treasury, as well as those executed with external resources.[1]

5. **Information requirements.** During the program duration, the authorities will report to IMF staff, on a monthly basis, provisional data on the overall fiscal balance (program definition) and its components, with a delay of no more than 30 days after the end of each month. The revenue and expenditure data included in the calculation of the overall fiscal balance will be drawn primarily from the Treasury's preliminary accounting balances. Final data will be shared with the Fund as soon as

[1] Under the Paraguayan Treasury's accounting system, obligated expenditure differs from accrued expenditure in that future payment is assured under the Treasury's cashflow plan. The recording of this expenditure falls somewhere between accrual basis and cash basis.

final Treasury account balances are available, but no later than two months after the provisional data has been reported.

Ceiling on current primary expenditure of the central government (program definition)

6. Definition. For the purposes of the program, the balance of current primary expenditure includes (i) compensation of employees; (ii) expenses for the use of goods and services; (iii) subsidies; (iv) current grants to foreign governments, international organizations and other general government units, (v) social benefits; (vi) and other current expenses. An equivalent definition is the total obligated expense less interest expense, less capital grants and other capital expenses. The quantitative target is set as a ceiling for primary current spending accumulated since the beginning of the year.

7. Information requirements. During the program duration, the authorities will report to IMF staff, on a monthly basis, provisional data on central government current primary expenditure (program definition) and its components, with a delay of no more than 30 days after the end of the month.

Ceiling on the Net Incurrence of Floating Debt by the Central Government (Program Definition)

8. Definition. For the purposes of the program, domestic payment delays are defined as the floating debt, that is, the difference between the expense recorded on an obligated basis and the amounts transferred for its payment by the Treasury (based on the information generated by the integrated accounting system, SICO, and the integrated treasury system, SITE). In the public finance statistics (SITUFIN), the change in the stock of floating debt is recorded as the balance of net changes in floating debt attributable to the current budget year and the change in floating debt attributable to the previous year (repayment). The quantitative target of total floating debt is set as a ceiling for its accumulated net change since the beginning of the year.

9. Information requirements. Monthly data will be provided to the Fund with a lag of no more than 30 days after the end of each month.

Ceiling on Accumulation of External Debt Payment Arrears by the Central Government

10. Definition. External debt service arrears are defined as overdue debt service arising from obligations contracted directly or guaranteed by the central government, except for debt subject to rescheduling or restructuring. The program requires that no new external arrears be accumulated at any time under the arrangement.

11. Information requirements. Reports of external arrears by creditor (if any), with detailed explanations, will be transmitted monthly, within 30 days after the end of the month.

Inflation Consultation Band Linked to Current Projections of the Central Bank of Paraguay

12. Definition. Inflation is defined as the change over 12 months in the consumer price index (CPI) at the end of the period, base index (December 2017=100), published by the Central Bank of Paraguay. If the official press release differs from the index calculation, the index calculation will be used.

13. Information requirements. Reports on inflation and its components must be transmitted monthly, within two weeks after the end of the month.

14. Failure to meet the inflation consultation band limits (specified in the Program Statement, Table 1a) at the end of a semester would trigger discussions with IMF staff about the reasons for the deviation and the proposed policy response, and a consultation with the IMF Board of Directors will be required.

Social assistance benefits

15. Definition. Social assistance benefits follow the GFSM 2001 classification. They will be defined as the *Social Assistance Benefits* subcomponent of the *Social Benefits* account of the central government spending accounts of the Monthly Report on the Financial Situation of the Central Administration (SITUFIN). This target is not part of the formal conditionality under the program but reporting the execution of this item is requested to compare it with its original projection (memorandum item).

16. Information requirements. Social assistance benefits' reports and their components must be transmitted on a monthly basis, within 30 days after the end of each month.

C. Additional Information for Monitoring/Reporting Obligation of the Program

17. The authorities will transmit to the Fund staff, in electronic format, if possible, and within the maximum deadlines indicated, the following:

(a) Three days after implementation: any decree, decision, circular, edict, supplemental appropriation order, ordinance, or law that has economic or financial implications for the current program. This includes, particularly, all actions that modify budget allocations included in the budget law in execution, for example: supplementary allocation orders (advance decrees), cancellation of budget allocations, and orders or decisions that create supplementary budget allocations. This includes also actions leading to the creation of a new agency or a new fund.

b) Within a maximum period of 30 days (except in specific cases explicitly indicated below), preliminary data on:

- Tax receipts and tax and customs settlements by category, accompanied by the corresponding revenue on a monthly basis;

- The monthly number of expenditure committed, certified, or for which payment orders have been issued;

- The four-monthly report by the DGIP, based on the SNIP system (National Public Investment System) on investment projects, with their progress and execution;

- The complete monthly table of the financial situation of the central government based on the accounts of the Treasury (SITUFIN), including the breakdown of tax revenues by type of tax;

- The monthly statistical report of public debt included in the SIGADE system, by creditor category, and breakdown of debt service by amortization and interest payments, providing this information no later than six weeks after the end of the month.

- A quarterly update of the projected public debt service, with a breakdown of debt service by amortization and interest payments, both by creditor category (internal debt: loans, treasury bonds, and others (if any); external debt: multilateral, bilateral, treasury bonds, and others (if any)).

- A monthly report on the price structure of fuel products, including an estimate of subsidies involved, if any.

- (c) Final data will be provided as soon as the final balances of the Treasury accounts are available, but no later than one month after the reporting of provisional data.

18. The Central Bank of Paraguay will transmit to the staff of the Fund:

- The monthly balance sheet of the central bank, with a maximum lag of one month;

- The monthly consolidated balance sheet of banks with a maximum lag of two months;

- The quarterly depository corporations survey (consolidated monetary survey), with a maximum lag of two months;

- The lending and deposit interest rates of commercial banks, on a monthly basis; and

- Indicators of prudential supervision and financial soundness of banking financial institutions, on a quarterly basis, with a maximum delay of two months.

Statement by Mr. Herrera and Mr. Corvalan Mendoza on Paraguay
November 21, 2022

Socio-economic risks are mounting around the world due to a high level of uncertainty. The unintended spillover effects of these risks on small, open economies like Paraguay require well calibrated policy responses to restore depleted economic buffers that were used up during multiple shocks in recent years. In the same vein, a blueprint of what is needed for the economy to recover its potential medium-term growth is warranted.

The COVID-19 pandemic was managed relatively well during the peak of the health crisis in 2020-2021, buttressed by the Emergency Law and the Economic Recovery Plan (Ñapu'a) passed in Congress. Consequently, the government deployed decisive fiscal, monetary, financial, and social measures during the pandemic. The Economic Consolidation and Social Containment Law was also approved in Congress to buttress the economy and protect the most vulnerable. These important and much needed measures dented the Paraguayan economic buffers built in previous years.

More recently, in 2022, the conflict between Russia and Ukraine, geopolitical tensions, monetary policy tightening in major central banks, and a higher probability of recession in advanced economies are adding new risks and difficult trade-off for policy makers; not to mention the impact on the agricultural sector stemming mainly from weather disruptions. The government support deployed to mitigate the hit of inflation on the most vulnerable, due to food and fuel price hikes, had an impact on fiscal balance and public sector debt.

For all these reasons and recognizing the very positive experience with the International Monetary Fund (IMF) -supported programs, the Paraguayan authorities met Management and staff to request a two-year program, supported by the Policy Coordination Instrument (PCI).

The Paraguayan authorities would like to thank Mission Chief Mauricio Villafuerte and his team for their candid technical dialogue during discussions in Asuncion, and more recently in Washington, D.C. during the annual meetings. They also appreciate their close collaboration in these times of uncertainty to bring in this program to the Board for discussion.

A blueprint to recover potential medium-term economic growth.

During the fruitful discussions with Management and staff, the Paraguayan authorities recognized key elements that would be needed when designing the PCI, which are articulated around three main pillars, namely: i) ensuring macroeconomic stability and resilience, ii) improving productivity and fostering economic growth, and iii) improving social protection and inclusion.

How to raise productivity and the quality of public and private investment, and improve governance to tackle corruption, while enhancing transparency, reducing informality, and accelerating pension system reforms were some salient points considered for this program. Supply-side policies to improve human capital, modernize labor regulations, and lift barriers to enhance the business environment were also key themes under consideration.

Governance elements incorporated in the three main pillars.

What is relatively new from previous IMF programs with Paraguay is the incorporation of governance elements in the current PCI. At the request of the Paraguayan authorities, a governance assessment report was completed with the support of the IMF and the Interamerican Development Bank, and its publication was part of the prior action for the proposed PCI program.

A few examples of governance elements are detectable in areas like:

Pillar I. Ensure macroeconomic stability and resilience.

The authorities aim for the approval in Congress of a revamped version of the Fiscal Responsibility Law (FRL) to maintain the deficit ceiling as it is today (1.5 percent of GDP), but to reduce the provisions on current primary expenditure growth and civil servants' salaries. This new version envisages to strengthen the fiscal council participation and complement the deficit ceiling with a staggered debt ceiling.

A draft law to safeguard the fiscal policy in pre-electoral times is also under discussion in Congress, which aims to restrain initiatives to increase salaries or reduce taxes during electoral periods.

A corporate governance law is under revision to strengthen the role of the State-Owned Enterprises supervisory board.

Pillar II. Enhance productivity and foster economic growth.

Paraguay's AML/CFT regime has improved significantly since its last evaluation. The 2021 mutual evaluation report by GAFILAT showed that the country obtained a substantial effectiveness rating on international cooperation, but there is room for improvement in other areas. For the latter, the Paraguayan authorities are thankful for the IMF's swift response to support the plan through a multi-year capacity development project, which would allow the country to strengthen its governance in this sensitive area.

The authorities are well advanced in the implementation of the law on public procurement. As of today, the Senate and the Chamber of Deputies have approved the reform to enhance the planning, transparency, and effectiveness of this fiscal tool.

The civil service reform was a salient element in the governance assessment report. Considering this important input, the government submitted a bill to Congress to seek approval for a modern and competent civil service structure to reinforce the central role of meritocracy to access the public service force.

Pillar III. Enhance social protection and inclusiveness.

The authorities are aware that social programs have room for improvement and how important it is to avoid potential duplication of efforts and costs when implementing them, as well as keeping an accurate record of beneficiaries. Thus, they plan to strengthen the Pension System (SIPEN) to harmonize procedures, and use the technological solution developed by the Ministry of Finance to expand the management of pensions in the non-contributory sector and to other social assistance programs.

Latest developments.

The current GDP growth projection for 2022 stands at 0.2 percent. However, it must be noted that the initial GDP growth forecast for this year was 3.7 percent. The considerable downward adjustment of the projection takes place in the context of a severe drought—registered between the end of 2021 and beginning of 2022—which has significantly affected agriculture, causing important losses in the harvest of soybeans and other farm crops. On the expenditure side, despite this downward revision of economic activity, a rebound in domestic demand (private consumption and investment) continues to be foreseen, although at a lower growth rate than previously expected, while net external demand will have a significant negative incidence. In accumulated terms, GDP contracted 2.2 percent in the first semester of the year, while GDP (excluding agriculture and the hydro electrical bi-national entities) grew by 1.6 percent.

Better results are expected for economic activity in the upcoming months, considering the beginning of the 2022/2023 soybean crop season and the spillover effects that agriculture exerts on other sectors of the economy. Initial calculations aim towards an economic growth rate of above 4 percent in 2023.

Latest figures of Direct Investments (DI) net flows from the rest of the world to Paraguay are showing positive signs of recovery since the COVID-19 pandemic. For example, in 2021 the net flow of DI reached USD192 million, which surpassed by a large margin the figures observed during the pandemic (74 percent increase). In this vein, for 2023 and 2024 the country will receive its largest Foreign Direct Investments (FDI) projects in recent history. A paper pulp from eucalyptus foresting and a biofuels projects have pledged to invest around USD4 billion in the coming years.

As regards the labor market, the results for employment and unemployment indicators have been more favorable in the second quarter of 2022. In this period, employment grew by 47,239 positions as compared to the same period in 2021, representing an increase of 1.4 percent y-o-y. By economic sector, the percentage of the population employed within the tertiary sector (particularly trade, restaurants, and hotels) increased, while an inter-annual reduction was observed in the primary and secondary sectors. By occupational category, there was an improvement in the number of wage-earning workers, although this was offset by the decrease in self-employment. On the other hand, the number of unemployed persons decreased by 69,001 and the unemployment rate dropped from 8.6 percent in the second quarter of 2021 to 6.7 percent in the second quarter of 2022.

Total inflation continued to increase during the first months of 2022, due to the persistence of external pressures on commodity prices. However, the pressures on external prices have moderated recently which, together with the lower dynamism of domestic demand, have contributed to contain inflationary pressures. As for inflation forecasts, a rate of 8.6 percent is foreseen for 2022, decreasing to 4.1 percent for 2023.

On monetary policy, the Central Bank of Paraguay (BCP) has continued with the process of upward adjustments of its reference rate, although at a slower pace within the last few months, given the deceleration of inflation and the potentially lower pressures stemming from the external scenario, mainly those derived from commodity prices. Between March and June 2022, the Monetary Policy Rate (MPR) was revised upward by 200 basis points, while in July to September it increased 75 basis points to stand at 8.50 percent annually.

Total bank loans and other forms of credit have continued to show favorable dynamism, boosted largely by the accelerated growth that loans extended in foreign currency have been experiencing. Loans in U.S. dollars expanded 25.2 percent inter-annually in August 2022, while loans granted in Paraguayan guaranies registered a growth rate of 7.8 percent y-o-y. The financial soundness indicators of the financial system remain at satisfactory levels. In this vein, the solvency ratios continue well above the minimum required levels and the profitability indexes have started to increase in recent months, as compared to the reductions registered since the beginning of 2020.

The payments system has performed normally, in a fluid and efficient manner. In May 2022, the Instant Payments System (SPI) was launched. This system will allow for the availability of 24 hours a day seven days a week (24x7) inter-bank transfer services for all citizens, thereby constituting a qualitative leap of immense relevance for the country's payments system. This new module of the Paraguayan Payment System (SIPAP) is being successfully developed in stages, with the gradual incorporation of financial institutions.