Paraguay

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First Citizens
Research & Analytics

COUNTRY

Real GDP growth (%) 2016	3.10%
Next General Election	2018
Exchange Rate	PYG 5577.33
	Price of 1 USD in PYG

CREDIT RATING

S&P Foreign Currency	BB (P)
Fitch Foreign Currency	BB (S)
Moody's Foreign Currency	Ba1 (S)

Major Trade Partners	Brazil 31.7%, Russia 9.1%, Chile 7.1%, Argentina 7%
Major Exports	Soybeans, livestock feed, cotton, meat, edible oils
GDP Composition	Agriculture: 18.9%, industry: 18.5%, services: 62.6%

RECENT ECONOMIC DEVELOPMENTS

ECONOMIC OUTLOOK **STABLE**

Paraguay's economy remains relatively resilient against the backdrop of a regional slowdown. Growth is estimated at 3% in 2015, among the strongest in Latin America. This reflects a milder terms-of-trade shock relative to comparators; stable growth in investment and consumption; and modest fiscal stimulus. However, the economy experienced some loss of momentum over the past year. Growth below potential helps contain inflation pressures, including from past exchange rate depreciation. With Q1 2016 data showing growth of just 1.5% in light of continued weakness in investment and falling public consumption, BMI downwardly revised their growth forecast for 2016 from 4.7% to 3.1%. That said, a gradually improving net exports position will support stronger growth in 2017 and as such forecasted growth stands around 3.5%. In the first two months of 2016, headline inflation was temporarily elevated, mainly due to volatile food prices. Since then, it has moderated below 5% in March and is expected to decline to the mid-point of the central bank's target range (4.5%) over the course of 2016.

Agriculture is significant in the economy of Paraguay, accounting for 19% of GDP and the majority of the population is involved in agriculture (26.5% of employment). Products include cotton, sugarcane, soybeans, corn and wheat. The country is the 2nd largest producer of stevia, 6th largest exporter of corn, 10th largest exporter of wheat and 8th largest exporter of beef. They are also the 4th largest exporter of soybeans and are a major supplier to China of soy-based animal feeds. Beef is the largest non-agricultural export product and Russia is a key customer. The manufacturing and mining sector are also economically important, contributing approximately 11% of GDP and entails the production of cement, clay, iron ore and natural gas.

LABOUR, INFLATION AND THE FINANCIAL SYSTEM **STABLE**

Inflation pressures remain contained despite significant depreciation of the guaraní against the U.S. dollar. Core inflation remained subdued during most of 2015 despite a 25% depreciation against the U.S. dollar (although depreciation of the guaraní in effective terms was more modest). However, core inflation increased towards the end of the year. A limited degree of exchange rate pass-through resulted in higher prices. Services and housing have also contributed to higher core inflation. In the first t half of 2016, inflation remained temporarily elevated (4.7%), mainly due to volatile food prices. IMF expects inflation to decline to the mid-point of the central bank's target range (4.5%) over the course of 2016, as growth below potential helps contain inflation pressures, including from past exchange rate depreciation. Moreover, recent currency appreciation since February, low oil prices, moderating inflation for services and housing, and anchored inflation expectations, further point to more subdued or easing inflationary pressures going forward, also reflected by moderating inflation in March 2016.

In July 2016, the central bank lowered the monetary policy rate by 25bps to 5.50% as inflation projections fall below the target of 4.5% annually (4.7% as at June 2016). A worsening external scenario, especially at the regional level as well as the recent reversal in the prices of volatile products basket and the slowdown contributed to the decision.

EXTERNAL ACCOUNTS **STABLE**

The external position deteriorated modestly in 2015, due to a negative terms-of-trade shock and weakness in major trading partners. The current account balance moved further into negative territory and is expected to remain in deficit at 1.8% of GDP in 2015 as exports receipts (particularly, from Asia) have fallen due to lower commodity prices, as well as from weaker economic activity in trading partners—notably, Brazil and Russia. Recent indicators also point to weaker exports and, consequently, a smaller trade surplus last year. With respect to the financial account, foreign direct investment has grown more modestly, about 10% through Q3 2015, than its average over the last 10 years given generally tighter financial conditions externally. The deterioration of the current account position and reduced capital inflows has reduced international reserve holdings. The Central Bank's reserve position is estimated at around 23% of GDP covers 7 months of imports. Reserves are expected to increase in 2016, relative to 2015, partly as a result of the issuance of a USD600 million government bond.

The country's export receipts are generated primarily by three industries: soy, beef and electricity.
Cereals, soy and meat account for 66% of Paraguayan exports. The country's main imports include machinery, appliances and motors (27%), fuels and lubricants (13%) and cargo vehicles and accessories (8%). Paraguay's main trading partners are Brazil (31.7% of exports and 25.4% of imports) and Russia (9% of exports and 14.8% of imports).

FISCAL PROFILE **STABLE**

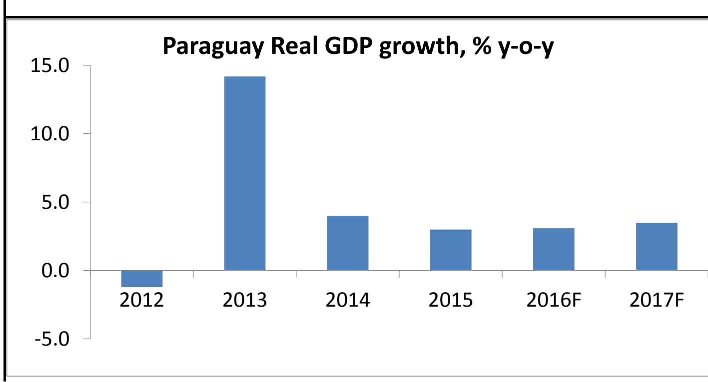
Paraguay's debt burden was estimated at 20% of GDP in 2015 – a steady increase from the 15.4% of GDP reported for 2010. Paraguay's budget deficit will narrow only gradually in the coming years. The country maintains a Fiscal Responsibility Law, enacted in 2014, which establishes a budget deficit ceiling of 1.5% of GDP. However, the law lacks enforcement mechanisms and applies only to budget plans, not their execution, and as such acts only as a guideline. Current forecasts suggest an annual average deficit of 2.8% of GDP between 2016 and 2020 and do not forecast a deficit under 1.5% of GDP until 2022. That said, Paraguay's relatively limited public external debt, 12.2% of GDP in 2015, will allow it to increase its debt load modestly in the coming years without significantly eroding its sovereign credentials. Indebtedness remains below the 'BB' credit rating median of 40% (Fitch). Additionally, the expansion in nominal GDP will mean that debt as a % of GDP will remains stable.

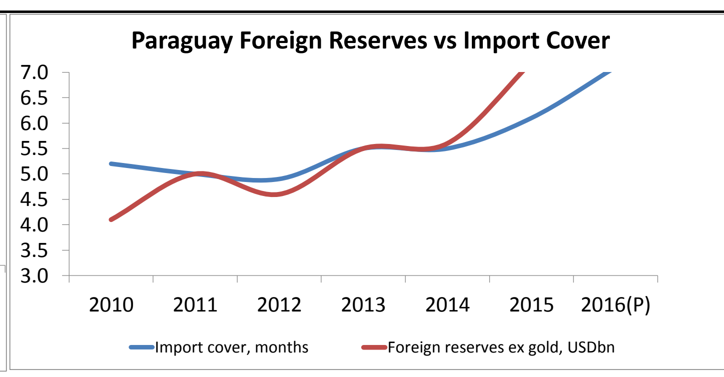
CREDIT RATING

Moody's upgraded Paraguay's credit rating by one notch to Ba1 from Ba2 in March 2015, and changed the outlook to stable from positive. The upgrade was driven by the following factors:
1. Implementation of reforms approved in 2013 to strengthen the fiscal framework and boost infrastructure investment.
2. Efforts to diversify the economy are producing positive results.
3. Improved governance and institutional strength.

Fitch upgraded Paraguay's rating in January 2015 from BB- to BB.

OUTLOOK
There is notable potential in Paraguay. Despite its exposure to agricultural shocks and slippage in fiscal policy, the country has demonstrated a willingness to develop the country and implement the changes that need to be made. Paraguay's main trade partners are Brazil, Russia and Argentina; all of these countries are expected to face challenging economic condition in 2016. The economy is highly dependent on exports to these countries as well as investment into its agricultural and hydropower industries, its main exports. Investments are expected to face headwinds as Argentina becomes a more attractive prospect due to the removal of agricultural export taxes in the Argentine farming sector and cheaper costs due to Argentina's currency devaluation. The effects of the decline of Brazil and Argentine (major trading partners) on Paraguay's economy should be closely monitored.





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