

## Growth volatility

### General Information



GDP	USD25.502bn (World ranking 95, World Bank 2012)
Population	6.69 million (World ranking 102, World Bank 2012)
Form of state	Constitutional Republic
Head of government	Horacio CARTES
Next elections	2018, presidential and legislative



### Strengths

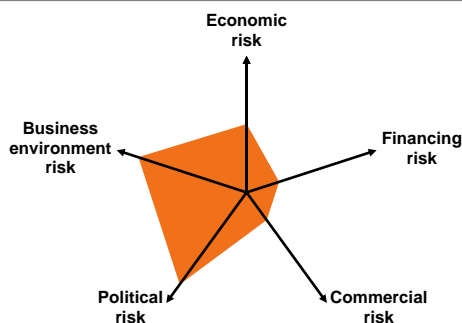
- A contained fiscal budget and public debt
- The current account is generally in surplus
- Relatively large foreign reserves and one of the lowest external debt in Latin America
- The government embraces a business-friendly model

### Weaknesses

- One of the poorest country in Latin America with high inequality and poor infrastructure
- Highly dependent on the agricultural sector and weather conditions
- Low diversification of the economy
- High level of corruption, criminality and poor rule of law
- Wide informal economy
- Landlocked limiting trade?

### Country Rating

C3



Source: Euler Hermes

### Trade Structure

By destination/origin (% of total)

Exports	Rank	Imports
Brazil	38% 1	27% China
Russia	10% 2	23% Brazil
Argentina	8% 3	16% Argentina
Germany	4% 4	13% United States
Netherlands	3% 5	4% Chile

By product (% of total)

Exports	Rank	Imports
Electricity	30% 1	11% Refined Petroleum Products
Other Edible Agricultural Prod	25% 2	10% Telecommunications Equipment
Cereals	14% 3	7% Computer Equipment
Meat	10% 4	7% Miscellaneous Manuf. Articles
Fats	3% 5	6% Fertilizers

Source: Chelem (2012)



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## Economic Overview

### Address business environment and growth volatility are the main challenges

Paraguay is one of the poorest countries in Latin America with approximately 40% of the population living below the national poverty line in 2013, according to the World Bank. This is combined with high inequalities, with a large share of the population working in the informal sector. Paraguay is a landlocked country and deficiencies in basic infrastructure are a large impediment to long-lasting sustained growth.

The investment climate is relatively low. Paraguay is ranked 92 out of 189 economies by the Doing Business survey 2015. Rule of law and corruption (ranked 150 out of 177 economies by Transparency International) are key issues.

The primary sector accounts for approximately 30% of GDP thanks to soy (4th largest exporter in the world) and meat production (8th largest exporter). As a consequence, the country is extremely vulnerable to weather conditions and international commodities prices fluctuations. This led to a highly volatile growth rate over the past years. After a severe drought in 2012, GDP contracted by -1.2%, which was followed by a high rebound in production, bringing GDP to +13.6% in 2013.

Available data for 2014 suggest that the economy has slowed. Real GDP expanded by +3.9% y/y and by +3.0% y/y in Q1 and Q2 2014 respectively, driven by private consumption and investment. Euler Hermes expects growth to reach +3.9% in 2014 and +4.3% in 2015, close to its long term average. However, downside risks are to be monitored. Notably, the country could be affected by a worsening of economic conditions in Brazil and Argentina and by lower international primary commodity prices.

### Inflation is slightly picking up

Since 2011, Paraguay is implementing an inflation-targeting regime, currently set at 5% +/- 2pp. This helped to ease inflation to +3.7% in 2012 and +2.7% in 2013, against an average of +8.3% in 2011. However, a surge in food prices in the summer 2013 drove inflation up again to +7% y/y in May 2014 against 2.2% y/y in June 2013. To tackle these new pressures on prices, the Central bank raised the key interest rate by 50bps in December 2013, in January and in February 2014, bringing it to 6.5%. Inflation has consequently eased and went back within the target range by standing at +3.5% y/y in October. Euler Hermes expects inflationary pressures to remain under control over coming months. The inflation rate should reach on average +5.2% in 2014, and ease to +4.5% in 2015.

### Monetary policy is gaining credibility

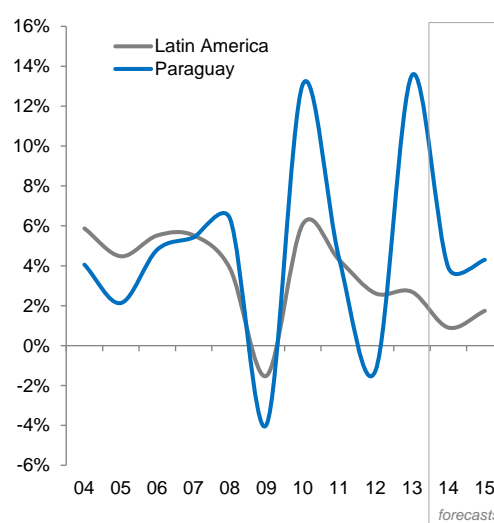
Given the poor economic developments of 2012, the government implemented a supportive fiscal policy, with public expenditure expanding by +24%, while revenues rose by +8.7%. Consequently, the fiscal balance switched into a deficit of -1.2% of GDP, after 8 consecutive years of surplus. The economic rebound of 2013 triggered a tightening of the fiscal policy. However, since the stimulus conducted in 2012 concerned wage increases and rise in current spending, which are difficult to take back in the short term, the major part of fiscal consolidation occurred in public investment. Thus, capital spending contracted by -2.9% in 2013, while current expenditure only slowed down to +8.4%. Alongside, fiscal revenues only expanded by +4% since the agricultural sector, which was the main engine of growth in 2013, has small contribution in tax collection and fiscal revenues, and as tax collection is

### Key economic forecasts

	2012	2013	2014f	2015f
GDP growth (% change)	-1.2	13.6	3.9	4.3
Inflation (% , yearly average)	3.7	2.7	5.2	4.5
Fiscal balance (% of GDP)	-1.2	-0.7	-0.7	-0.2
Public debt (% of GDP)	14.1	14.2	19.3	18.9
Current account (% of GDP)	-0.9	2.1	3.5	2.0
External debt (% of GDP)	25.4	19.5	19.7	23.9

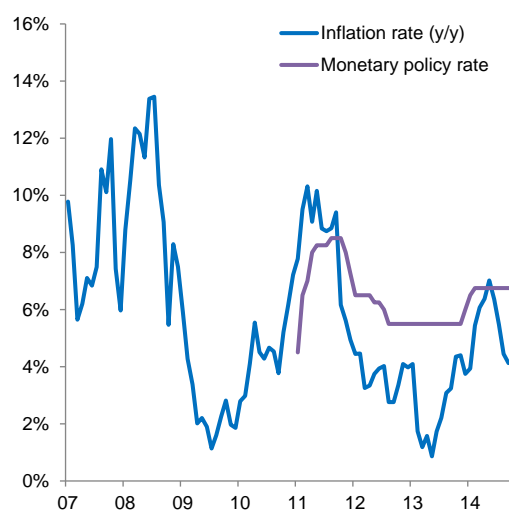
Sources: National sources, IHS, Euler Hermes

### GDP growth (%)



Sources: National sources, IHS, Euler Hermes

### Inflation rate and Monetary policy rate (%)



Sources: National sources, IHS, Euler Hermes

largely inefficient. Indeed, tax collection remains low (estimated at 51% of its potential according to the IMF) and despite recent laws set to increase VAT and other income taxes, the tax agency is not fully prepared to absorb the rapid increase in tax collection.

The fiscal deficit slightly narrowed to -0.7% of GDP in 2013, but should remain at this level in 2014, given the rigidity of expenditures and the difficulties in tax collection. The public debt is expected remain below 20% of GDP, a relative low and manageable level.

### Dollarization of the banking sector increase vulnerability to FX volatility

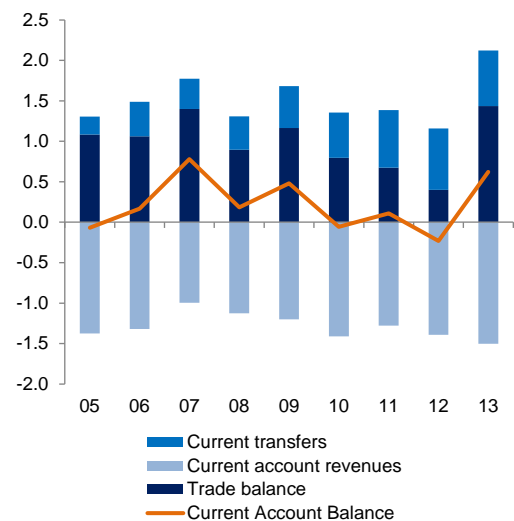
After the financial crisis in the 1990s, half of the banks disappeared and now, the top four banks in the country have more than 60% of total assets. Lending to the private sector grew by +21% in September 2014 and remain concentrated in the agricultural sector. After declining in the 2000s, dollarization ratios started to increase again recently, representing approximately 40% of loans and deposits. Given the importance of the agricultural sector (trading exclusively in dollars) and the country's openness, decreasing the dollarization of the economy might prove challenging. However, the banking system is broadly healthy with NPL ratios relatively low, at around 2.2% of total loans in 2013.

### Comfortable external position although extremely vulnerable to agriculture output

The external balances of Paraguay are extremely dependent on agriculture output and prices. Thus, after the current deficit of -0.9% of GDP recorded in 2012 (following a surplus of 0.4% in 2011), the current account balance switched again into a surplus in 2013 (+2.1% of GDP) thanks to the rebound in agriculture exports. Paraguay exports mainly soy, cotton and meat. Also, thanks to two electrical dams constructed at the border with Brazil and Argentina, Paraguay exports electricity to these two neighbors. Euler Hermes expects the current account surplus to reach 3.5% of GDP in 2014, but to slightly narrow to 2% in 2015 on the back of falling commodity prices.

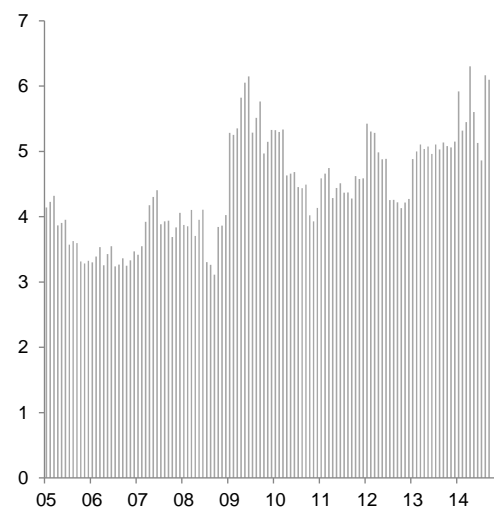
Thanks to export revenues and increased capital inflows (especially FDI attracted by infrastructure projects) over past years, international reserves have shown a steady upward trend since 2012. They reached USD6.8 bn in September 2014, covering approximately 6 months of imports. However it is to be noted that in January 2013, the government issued its first sovereign bonds (USD500 mn), followed by a second USD1 bn in August 2014, to finance infrastructure and energy projects. Due to delays in project implementation, a large part of these sovereign bonds contributed to the increase in foreign reserves.

Current account balance (USD bn)



Sources: National sources, IHS, Euler Hermes

Foreign reserves (USD bn)



Sources: National sources, IHS, Euler Hermes

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