

Paraguay: Sixth and Final Review Under the Stand-By Arrangement—Staff Report; Staff Statement; Press Release on the Executive Board Discussion; and Statement by the Executive Director for Paraguay

In the context of the sixth and final review under the Stand-By Arrangement, the following documents have been released and are included in this package:

- The staff report for the Sixth and Final Review Under the Stand-By Arrangement, prepared by a staff team of the IMF, following discussions that ended on June 4, 2008, with the officials of Paraguay on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on July 21, 2008. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- A staff statement of July 30, 2008 updating information on recent developments.
- A Press Release summarizing the views of the Executive Board as expressed during its July 30, 2008 discussion of the staff report that completed the review.
- A statement by the Executive Director for Paraguay.

The document listed below has been or will be separately released.

Letter of Intent sent to the IMF by the authorities of Paraguay*

*Also included in Staff Report

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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INTERNATIONAL MONETARY FUND

PARAGUAY

Sixth and Final Review Under the Stand-By Arrangement

Prepared by the Western Hemisphere Department

(In consultation with other departments)

Approved by José Fajgenbaum and Anthony R. Boote

July 21, 2008

EXECUTIVE SUMMARY

- **Achievements.** Following successful policy implementation that has been supported by two successive stand-by arrangements (SBAs), macroeconomic fundamentals are among the best in over a quarter of a century, although inflation remains a problem. The economy has grown about 25 percent in the last 5 years; public debt has been more than halved as a percent of GDP, to less than 30 percent; the external position has strengthened significantly; and international reserves have more than tripled to record highs in the same period.
- **Developments.** The economy grew 6¾ percent in 2007 and is expected to continue expanding at least 5 percent in 2008 driven by strong agricultural exports. However, inflation has been on the rise over the last several months reaching 13½ percent (y-o-y) in June 2008, driven by food and fuel supply shocks. Fiscal discipline has been preserved despite expenditure pressures in the pre-electoral period (elections took place in April 2008). Monetary policy has been tightened in response to price pressures, while the currency appreciated. Reserves rose to about US\$3¼ billion at end-June 2008.
- **Review.** The program remains broadly on track. All performance criteria for end-March 2008 were met, and those for end-June 2008 are expected to have been observed. With one exception, all structural benchmarks for 2008 are expected to be implemented, albeit with delays.
- **Discussions.** These took place in Asunción from May 21 to June 4, 2008. The mission met with Vice-President-elect Franco, Central Bank President Rojas, Finance Minister-designate Borda, Interim Finance Minister Gómez, Education Minister Jimenez, Deputy Finance Minister Alarcón, senior government officials, and representatives of the banking community and the private sector. The staff team consisted of A. Santos (head), M. Mlachila, B. Monfort (all WHD), and B. Barkbu (PDR). The mission was assisted by T. Roy, the Fund's resident representative in Asunción, and it liaised with World Bank and IDB staff. Mr. J. Maciel (OED) participated in the meetings.
- **Arrangement.** A 27-month SBA for SDR 65 million (or 65 percent of quota) was approved on May 31, 2006 (expiring in August 2008). A reduction in access to SDR 30 million was approved during the fourth review in October, 2007. The fifth review was completed in March 2008. The SBA is treated as precautionary.
- **Appraisal.** Staff supports completion of the sixth review given the strong performance.

LIST OF ACRONYMS

ANDE	National Electricity Company
ANR	National Republican Association (Colorado Party)
BCP	Central Bank of Paraguay
BNF	National Development Bank
CAR	Capital Adequacy Ratio
CCT	Conditional Cash Transfer
COPACO	Public Telephone Company
ESSAP	Public Water and Sewage Company
FAD	Fiscal Affairs Department
GDP	Gross Domestic Product
GNFS	Good and Nonfactor Services
IDB	Inter-American Development Bank
INC	National Cement Company
INCOOP	National Institute of Cooperatives
IPS	Social Security System
LOI	Letter of Intent
LRM	Central Bank Bills
MOF	Ministry of Finance
NDA	Net Domestic Assets
NFPS	Non-Financial Public Sector
NIR	Net International Reserves
NPL	Nonperforming Loans
OED	Office of the Executive Director
PC	Performance Criteria
PDR	Policy Development and Review Department
PETROPAR	Public Petroleum Company
PLRA	Authentic Radical Liberal Party
REER	Real Effective Exchange Rate
SAS	Undersecretary of Social Action
SB	Structural Benchmark
SBA	Stand-By Arrangement
SDR	Special Drawing Rights
SET	Tax Collection Agency
SOE	State-Owned Enterprises
UNACE	Ethic Citizens National Union Party
VAT	Value Added Tax
WB	World Bank
WHD	Western Hemisphere Department

Contents	Page
Executive Summary	1
I. Background	5
A. Developments	5
B. Performance	13
II. Outlook	17
III. Discussions	17
A. Macroeconomic Management	18
B. Institutional Strengthening	19
C. Poverty Alleviation	21
IV. Staff Appraisal	23

Text Boxes

1. Assessment of Performance Under the SBA	9
2. Foreign Exchange Inflows	14
3. The Conditional Cash Transfer Program	22

Tables

1. Quantitative Performance Criteria	27
2. Structural Conditionality Under the Program	28
3. Selected Economic and Social Indicators	29
4. Central Government Operations	30
5. Consolidated Public Sector Operations	31
6. Summary Accounts of the Central Bank	32
7. Summary Accounts of the Banking System	33
8. Banking System Indicators	34
9. Balance of Payments	35
10. Indicators of External Vulnerability	36
11. Schedule of Reviews and Purchases	37
12. Medium-Term Scenario	38

Figures

1. Real Sector Developments	7
2. Fiscal Developments	8
3. Monetary Developments	11
4. Financial System Developments	12
5. Balance of Payments Developments	15
6. Program Performance	16

Appendix

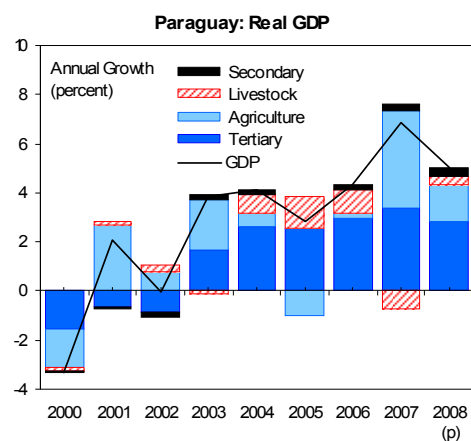
I. Letter of Intent	39
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I. BACKGROUND

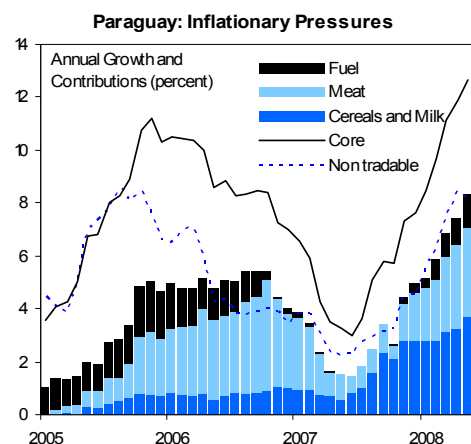
1. **Accomplishments.** Over the last five years real GDP rose by about 25 percent (more than in the previous 12 years), thanks to the pursuit of sound macroeconomic policies and a favorable external environment. Public finances remained in surplus throughout the period; consolidated public debt as a percent of GDP was reduced by more than half to less than 30 percent; the financial system strengthened considerably and no longer poses systemic risks; core inflation was reduced by about three-quarters to less than 5 percent (although it has risen in 2008 mainly due to supply shocks); international reserves more than tripled, to about US\$3¼ billion; following a downside overshooting, the *guarani* strengthened against major currencies (in line with fundamentals); per capita income more than doubled to over US\$2,500; and the poverty rate was reduced by ¼ to about 35 percent (Box 1).

A. Developments

2. **Output.** Real GDP growth in 2007 is estimated at 6¾ percent, driven by a major expansion of the agriculture sector (almost 25 percent). Non-agricultural GDP increased 3½ percent, reflecting a good performance of the service sector, offset in part by the lack of dynamism of the secondary sector, and the temporary contraction of the livestock sector. The unemployment rate fell to about 5½ percent in 2007, the lowest of the past decade, although underemployment remains high at over 25 percent. Real GDP is expected to grow by at least 5 percent in 2008, owing to a continued vigorous expansion of agriculture.



3. **Inflation.** Core inflation has risen since mid-2007, reaching 13 percent (y-o-y) in June 2008 (about ½ point lower than headline inflation).¹ About ⅔ of core inflation is due to food price shocks, either worldwide (cereals and milk) or country-specific (beef), as well as higher fuel prices. Non-tradable prices accelerated to 9 percent (y-o-y) in June 2008, indicating the emergence of spillover effects from supply shocks and expected wage pressures to the rest of the economy.

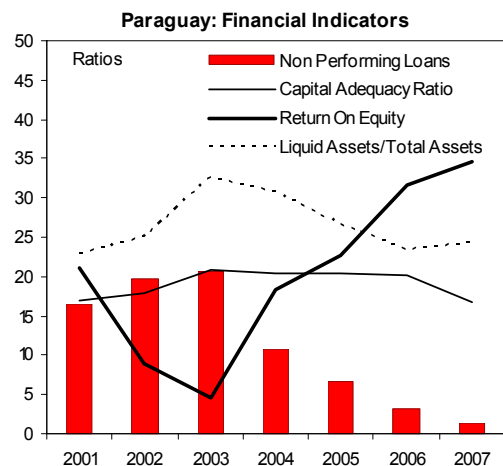
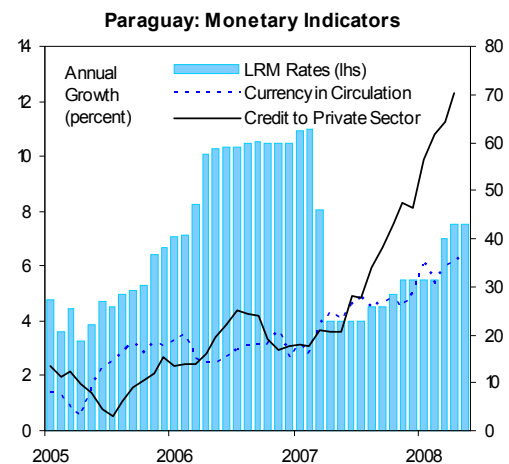
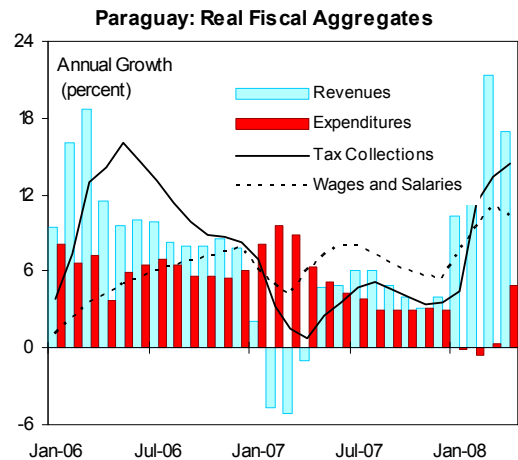


¹ Core inflation in Paraguay excludes fruits and vegetables but includes other food items as well as fuels (which have also been subject to supply shocks). In the absence of the food and fuels shocks, staff estimates that inflation would be 7½ percent, or at the top of the authorities' inflation range of 2½ to 7½ percent for 2008.

4. **Budget.** Despite considerable expenditure pressures in the run-up to the April 2008 general elections, fiscal policy remained under control and continued to be adequately countercyclical.² Tax collections, particularly VAT and import duties, have been buoyant, increasing by over 20 percent through April. At the same time, expenditures were kept in line with the Finance Ministry's financial plan. As a result, the overall fiscal surplus through May 2008 was significantly larger than expected, and reached nearly 1½ percent of GDP.

5. **Monetary stance.** In response to inflationary pressures, the authorities resumed the tightening stance initiated in the second half of 2007, raising interest rates on sterilization bills (LRM) by 150 basis points in March 2008 (the 182-day LRM rate is about 7 percent).³ Notwithstanding these efforts, real interest rates have become negative over the last several months. Strong foreign exchange inflows have led to a sharp increase in international reserves, to about US\$3½ billion by end-June 2008. Despite large placements of LRM to contain the resulting monetary expansion, currency in circulation increased by over 35 percent (y-o-y) in June 2008. In an effort to control liquidity, reserve requirements were raised from 15 to 17 percent in June 2008.

6. **Financial system.** The banking system remains sound and has not been affected by the global financial turmoil. The average capital adequacy ratio exceeds the 10 percent regulatory



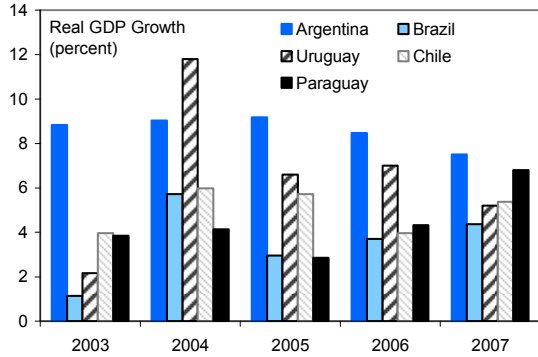
² Staff estimates that the Central Administration's primary surplus for 2008 would be about 1 percent of GDP higher than the structural primary surplus.

³ To improve liquidity management, the Central Bank switched open market operations procedures from fixing LRM rates to conducting weekly auctions of LRMs in June 2008.

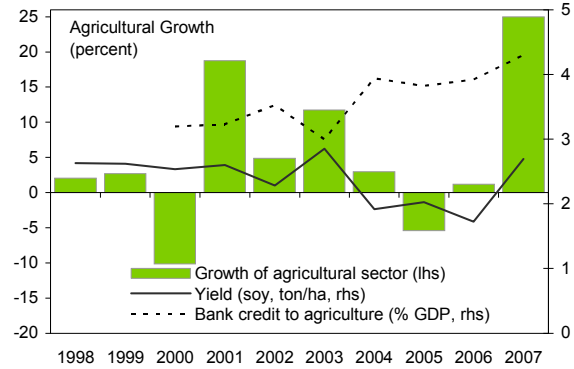
Figure 1. Paraguay: Real Sector Developments

Contrary to the regional pattern, growth accelerated strongly in 2007, supported mainly by a record agricultural production. The increase of core inflation since mid-2007 reflects mostly food supply shocks, something also experienced by other countries in the region.

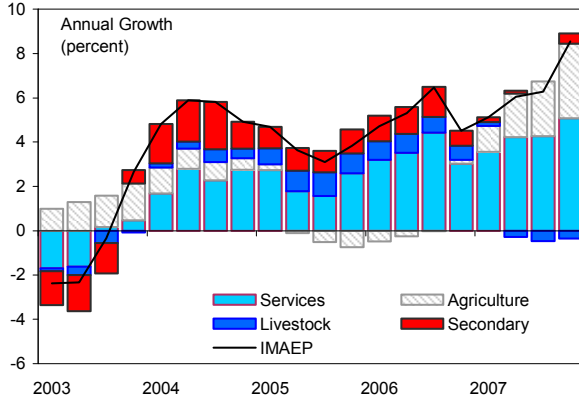
Real GDP growth has been among the highest in the region, thanks to a strong agricultural recovery...



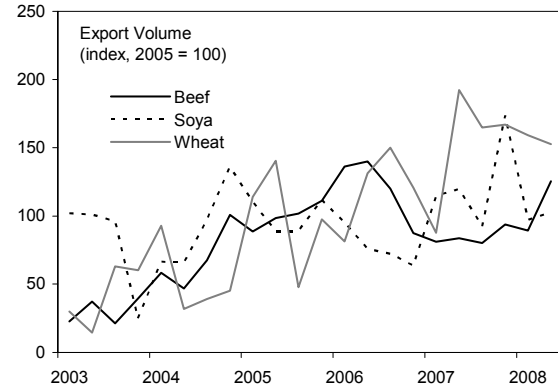
...led by improved productivity after three years of drought as well as to higher investment.



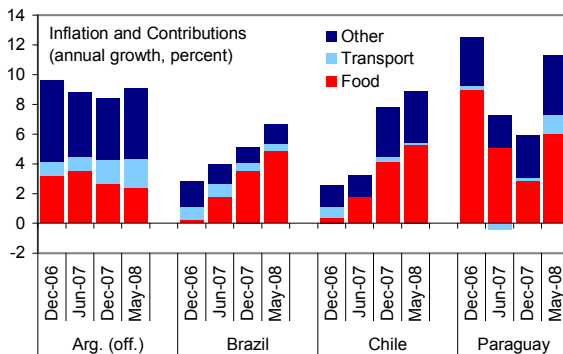
The service sector has also grown rapidly, driven by trade, communication, and transport.



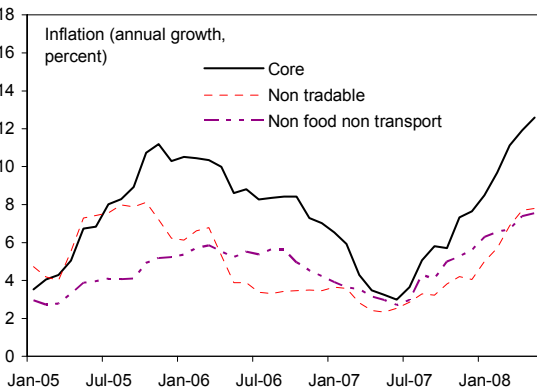
The growth of the primary sector, while moderating, should remain high this year.



Energy and food supply shocks have driven upward headline inflation as elsewhere in the region...



...while their spillover effects and monetary conditions have led to the increase of core inflation.

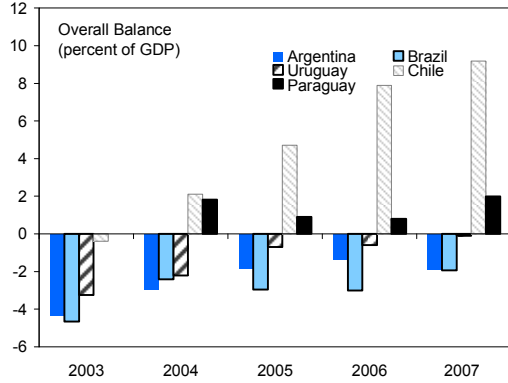


Source: Paraguayan Authorities and Fund staff estimates.

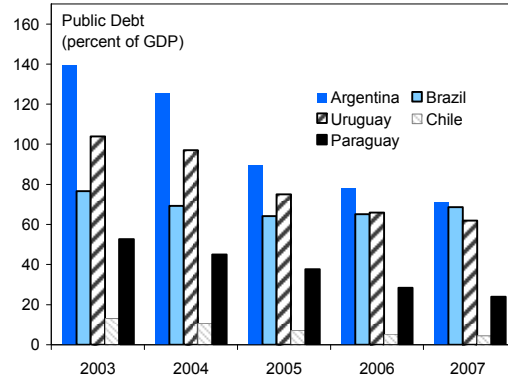
Figure 2. Paraguay: Fiscal Developments

Significant progress has been made in reducing fiscal imbalances in line with general regional trends, although Paraguay has performed better than its MERCOSUR partners. The challenge is to preserve fiscal sustainability and create the fiscal space to meet essential social and infrastructure spending needs.

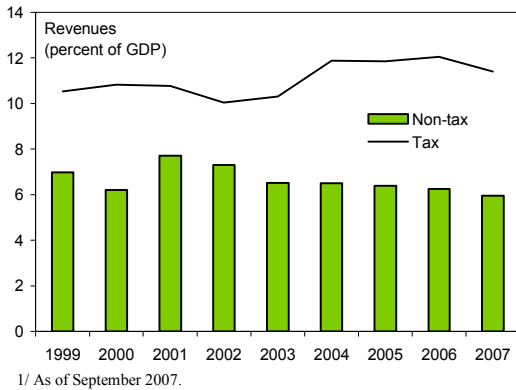
Paraguay has one of the strongest fiscal positions in the region...



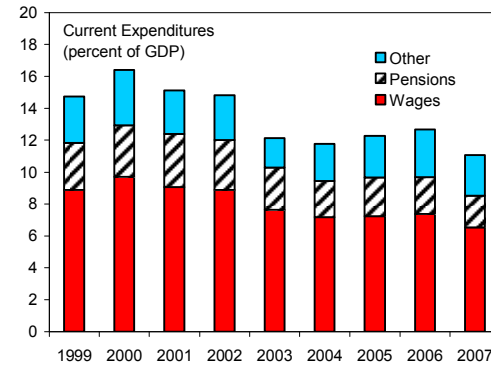
... and one of the lowest levels of public debt in the region.



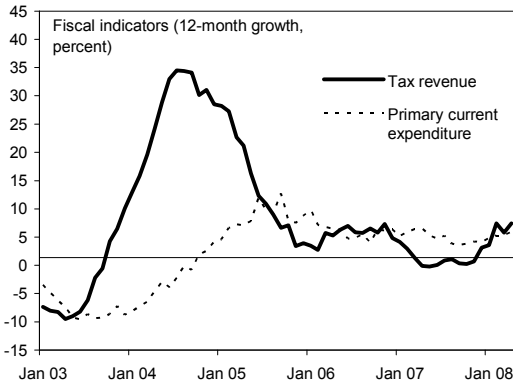
This has been achieved through improved tax collection...



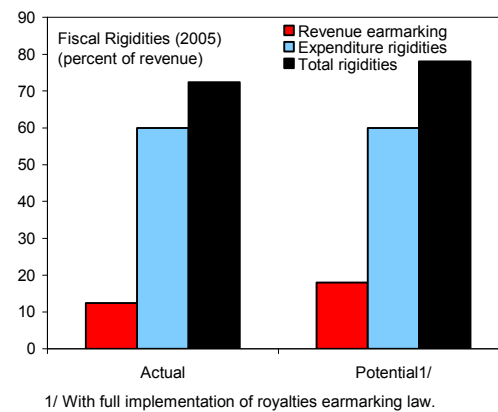
...and by efforts to contain current spending below appropriated amounts.



But with real tax revenue growth leveling off and renewed current spending pressures ...



...the challenge is to step up revenue mobilization and reduce budget rigidities.



Sources: Paraguayan Authorities and Fund staff estimates.

Box 1. Paraguay: Assessment of Performance under the SBA

Overview. Performance under the current SBA (2006-08) has been strong. Virtually all the macroeconomic objectives were met, and most structural reforms under the program have been achieved, although there were some delays, especially in the financial sector. The program was based on a strong macroeconomic framework supported by four pillars of structural reforms in the following areas: (i) public sector; (ii) financial sector; (iii) enhancing growth; and (iv) reducing poverty.¹

The main macroeconomic objectives were to lay the foundation for a gradual but sustainable increase of economic growth to 4-5 percent, lower inflation to industrial country levels, reduce public debt levels to about 30 percent of GDP, and build an adequate external reserve cover. With the exception of the inflation objective, the macroeconomic targets were exceeded, some by large margins.

	2006		2007		2008	
	Prog.	Actual	Prog.	Actual	Prog.	Proj.
Real GDP growth (%)	3.5	4.3	4.0	6.8	4.5	5.0
Inflation (y-o-y, %)	2.5-7.5	12.5	4.0	6.0	3.0	7.5
Overall fiscal balance (% of GDP)	0.0	0.1	0.0	0.9	0.0	0.5
Public debt (% of GDP) 1/	33.7	27.7	31.7	22.4	30.5	17.1
Reserves (NIR) (mn of US\$) 2/	20	406	33	759	32	700

1/ Non financial public sector (excluding central bank).
2/ Accumulation.

Public sector reforms. Achievements under the program have been commendable, especially in the revenue mobilization area. Significant improvements were achieved in modernizing the tax and customs administrations, especially regarding new information systems and collection through banks. With the implementation of a commitment control system and development of capital sector investment system, budgetary deficiencies have been reduced. Nonetheless, there has been little progress in reducing budget rigidities given the continued congressional approval of unfunded expenditures. Furthermore, a comprehensive pension reform, including through the consolidation of various pension funds, is needed.

Financial sector reforms. There have been major improvements in the health and the regulatory framework of the financial sector, although reform implementation was uneven and there were delays. The most notable achievement has been the significant improvement of BNF, from an essentially insolvent institution to one with a capital adequacy ratio of over 20 percent, as well as reducing the NPL rate from about 40 at end-2005 to about 8 percent at end-2007. At the same time, prudential regulations have been enhanced, including through the adoption of a modified Resolution 8/03 (to be implemented from October 2008). Although the process has been delayed and protracted, the authorities are now implementing measures to enhance BCP's financial position.

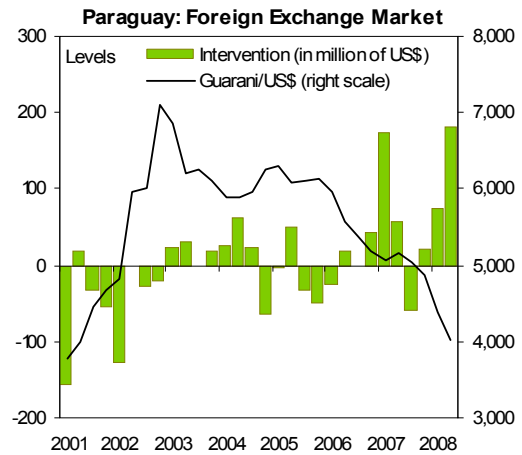
Pro-growth agenda. While considerable progress has been achieved in improving the business climate, a lasting improvement of SOE performance has proven elusive. Performance under results-oriented contracts has been uneven, with three of the five SOEs not meeting their key targets. Nonetheless, more transparency on SOE performance has been brought to bear with the publication of their quarterly performance reports (<http://www.csee.gov.py/>). The investment climate has been improved particularly with regard to the facilitation of opening new firms, and the creation of a business development gateway by the government and the private sector (<http://www.rediex.gov.py>).

Social safety net. The creation of a social safety net to protect the most vulnerable has been a key success under the program. The program set out to create a conditional cash transfer (CCT) program (Tekoporã) for poor families (see Box 3).

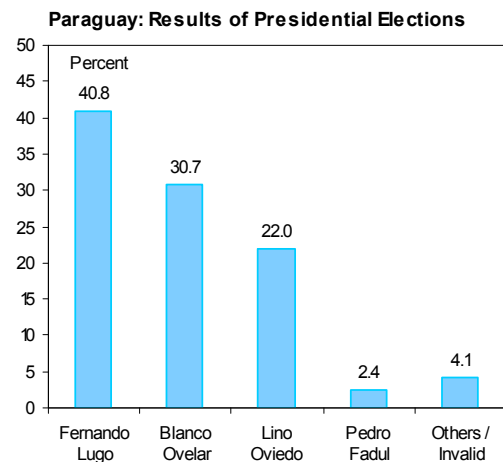
¹ The program builds on achievements of a previous SBA (2003-05) including: (i) significant fiscal consolidation facilitated by a fiscal adjustment law and a customs code; (ii) a revamp of the banking resolution framework; (iii) a reform of the public pension system to reduce deficits; and (v) the introduction of a second-tier banking law.

minimum. Credit growth of over 70 percent (y-o-y) in May 2008 remains a concern but it has not affected the quality of the portfolio thus far. Nonperforming loans continue to decline (reaching about 1 percent on average) and remain adequately provisioned. Liquidity risks are low, with LRMs representing about 95 percent of banks' investment portfolio, and funding from parent banks and banks abroad accounting for less than 2 percent of liabilities in May 2008.

7. **External sector.** The external position strengthened further in the first half of 2008, mostly due to high exports earnings associated with high international food prices, in particular of soybeans (the main crop). Faced with large inflows, the authorities intervened and purchased a considerable amount of foreign exchange in the first half of 2008, surpassing the international reserve target for end-December 2008 by about US\$600 million, while the *guaraní* was allowed to appreciate by almost 20 percent against the U.S. dollar in the same period (Box 2).



8. **Political situation.** After 61 years in power, the Colorado Party lost the presidential elections in April 2008.⁴ The newly-elected President Fernando Lugo, a former bishop, will assume office on August 15, 2008. The transition to the new government has been smooth, although Congress will be fragmented. Governance in such an environment could prove difficult, and the new government will have to reach political consensus with opposition parties to pursue its legislative agenda. President Lugo has already designated Mr. Dionisio Borda as Minister of Finance, sending a clear signal to the private sector that his government will be committed to macroeconomic stability.⁵



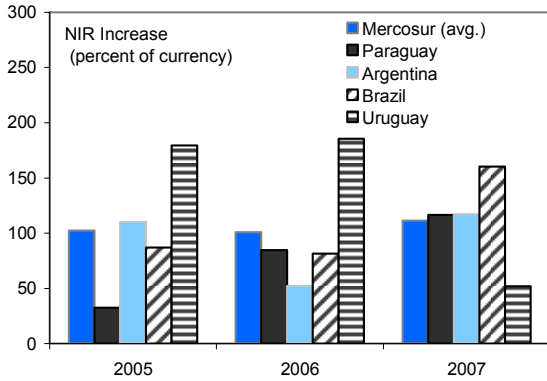
⁴ International observers characterized the elections as free, fair and highly participatory; the results were not disputed. Mr. Fernando Lugo gained 41 percent of the votes (with a coalition that included the Liberal Party, PLRA), against 31 percent by former Education Minister Ms. Blanca Ovelar's (from the Colorado Party, ANR). Former general Mr. Lino Oviedo (from the Ethic Citizens Party, UNACE) came in third with 22 percent of the votes.

⁵ Mr. Borda already served as Finance Minister from 2003-05 under President Duarte Frutos. He negotiated the first SBA in 2003 and initiated a round of important structural reforms.

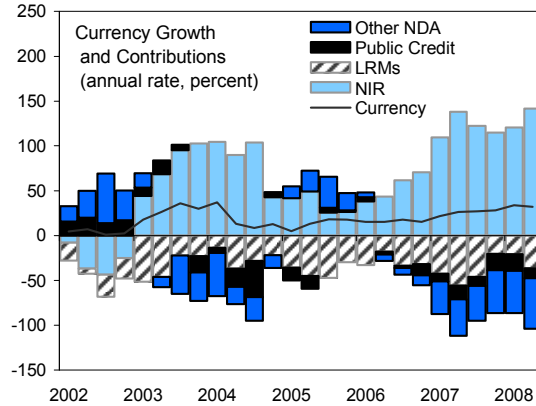
Figure 3. Paraguay: Monetary Developments

In response to large foreign exchange inflows, the central bank has increased foreign exchange purchases and let the exchange rate appreciate. Partial sterilization has led to high growth of monetary aggregates, contributing to inflationary pressures.

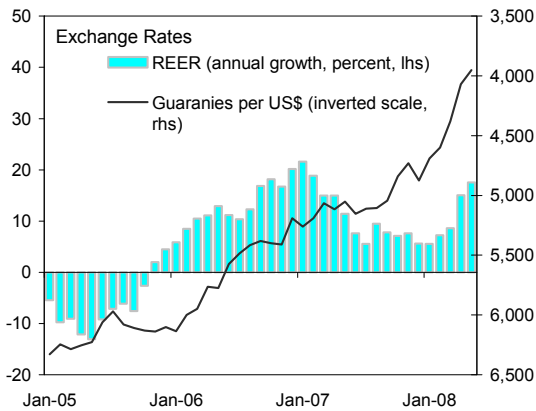
Paraguay has experienced large increases in international reserves, similar to other countries in the region...



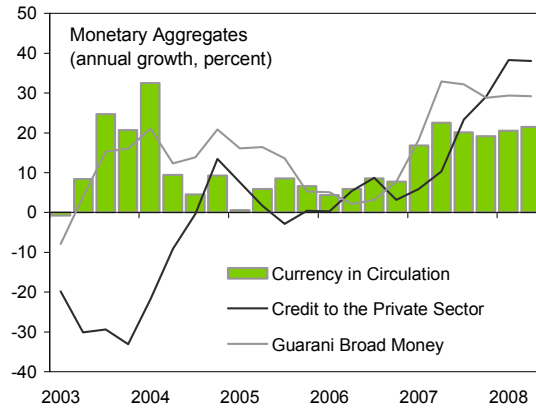
...which has fueled currency growth, despite the active sterilization policy...



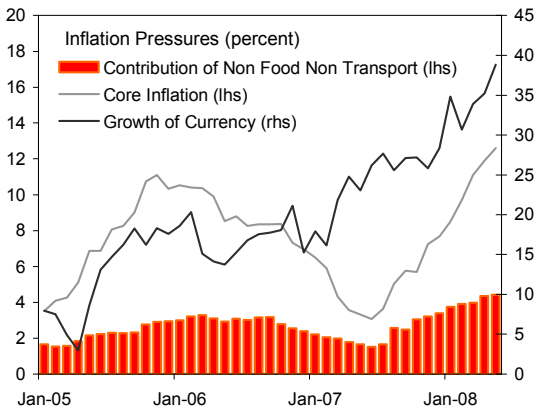
...while the authorities have allowed a sizable exchange rate appreciation.



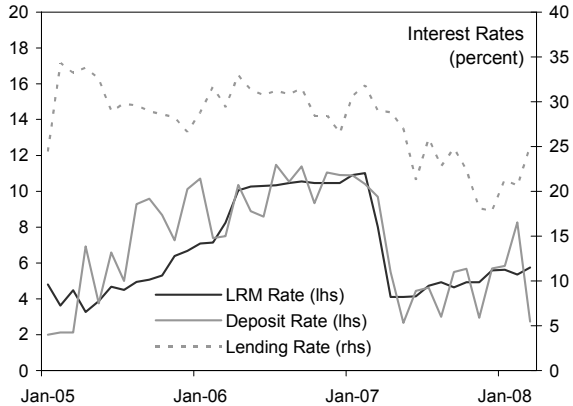
Growth in real monetary aggregates has stabilized at a high level...



... adding to inflation pressures already affected by supply shocks...



...and inducing the authorities to gradually increase interest rates recently.

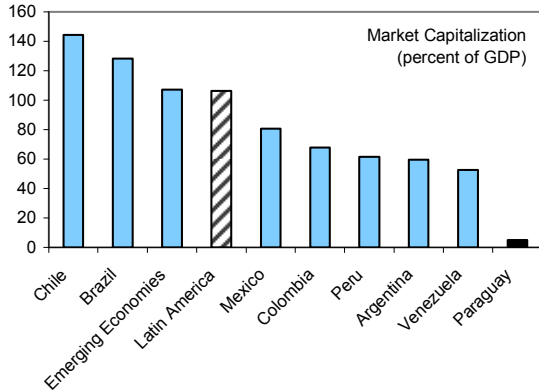


Sources: Paraguayan authorities and Fund staff estimates.

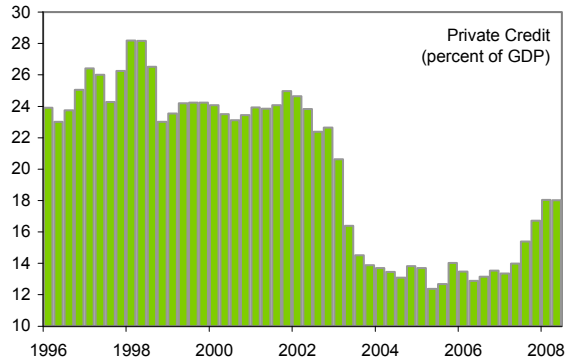
Figure 4. Paraguay: Financial System Developments

While financial markets are the least developed in the region, they continued expanding and strengthening as macroeconomic conditions continued to improve.

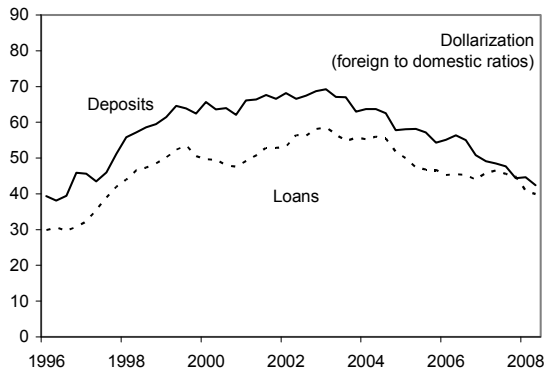
Market capitalization is low in Paraguay but capital markets are ripe for development.



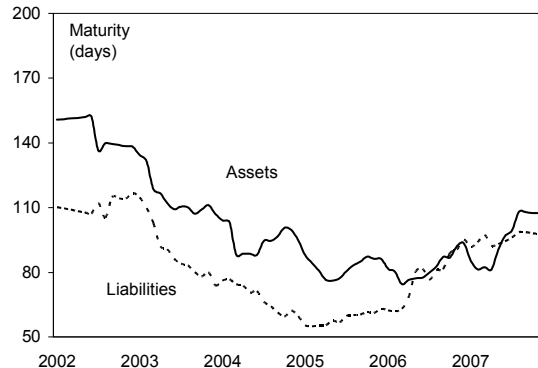
Credit to the private sector is beginning to recover, increasing financial deepening...



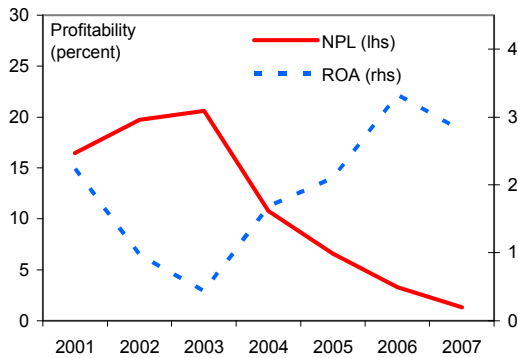
... at the same time, dollarization continues to decline...



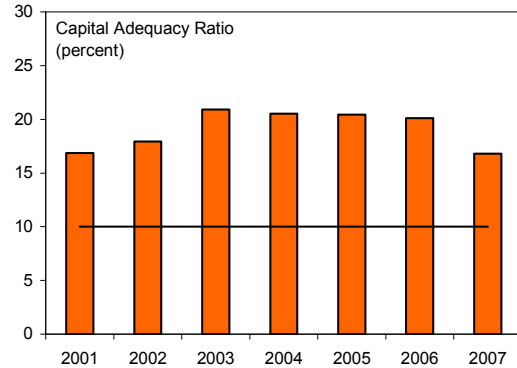
... and the maturity of assets and liabilities has lengthened...



Loans continue to perform well, contributing to declining financial delinquency and increased profitability....



... as a result, the system remains well-capitalized, with CARs well above the 10 percent regulatory minimum.



Sources: Paraguayan Authorities and Fund staff estimates.

9. **Social conditions.** Despite high economic growth and advances in employment, the social situation has deteriorated due to continued and sustained increases in food prices, particularly for the urban poor. There are increasing difficulties in the eastern provinces, where the use of land in highly-mechanized soybean production has fueled conflict with poor small-scale farmers and landless peasants. The new government is expected to implement social emergency measures, but their fiscal impact is as yet unknown.

B. Performance

10. **Quantitative.** Performance under the program has generally been strong. All quantitative performance criteria through end-March 2008 have been observed, most with large margins. All end-June 2008 performance criteria are expected to have been met too (Table 1).⁶

11. **Structural.** Progress continued to be made in implementing structural reforms, but there have been delays in implementing the structural agenda. However, most structural benchmarks (SB) for 2008 are expected to be implemented before the end of the arrangement (Table 2).⁷

- **Cash transfer program.** This program covered over 19,500 families by end-May, or above the 19,000 families target (SB for end-May 2008).
- **Treasury accounts.** In an important move towards reaching a single Treasury account, the authorities consolidated all accounts that are not established by law into one account at the BCP in early-July 2008 (SB for end-June 2008).
- **Central Bank's balance sheet.** As part of the strategy to strengthen the financial position of the Central Bank (BCP), the authorities are expected to send to the attorney general the disputed claims between the BCP and the MOF (SB for end-May 2008).

Paraguay: Performance for March 2008			
	Prog.	Actual	
(In percent of GDP)			
Fiscal Targets			
Fiscal balance 1/	0.1	1.2	✓
Wage bill 1/	1.8	1.7	✓
Consolidated balance	0.3	2.1	✓
(In percent of currency)			
Monetary Targets			
Net international reserves	83.4	120.4	✓
Net domestic assets	-59.2	-86.4	✓

Sources: Paraguayan authorities and Fund staff.
1/ Central administration.

Paraguay: SBA Performance			
(May 2006 - Mar 2008)			
	Number of Targets		Performance (%)
	Prog	Observed	
	(1)	(2)	(3)=(2)/(1)
All Targets	67	64	96
Quantitative PCs	42	42	100
Continuous PCs	2	2	100
Structural PCs	2	2	100
Qualitative SBs	21	1/ 18	86

Sources: Paraguayan authorities and Fund staff.
PC = Performance Criteria; SB = Structural Benchmark.
1/ Of which 18 SB fully observed and 3 SB partly observed.
There have been delays in implementation, which have led to delays in completing previous reviews. One SB had to be reset and modified into three new benchmarks.

⁶ All performance criteria have been observed since the approval of the SBA in May 2006.

⁷ The economic cabinet is expected to approve a draft payment system law shortly (originally a benchmark for September 2007).

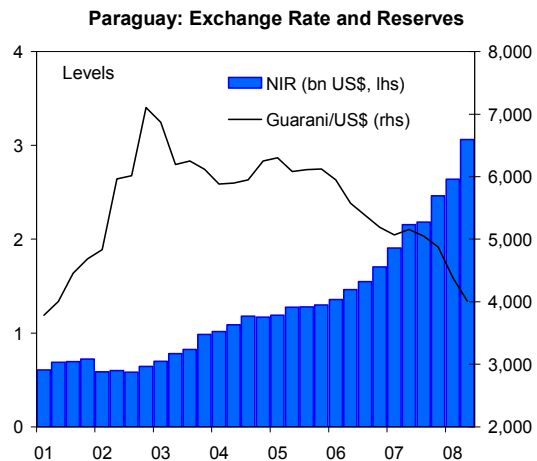
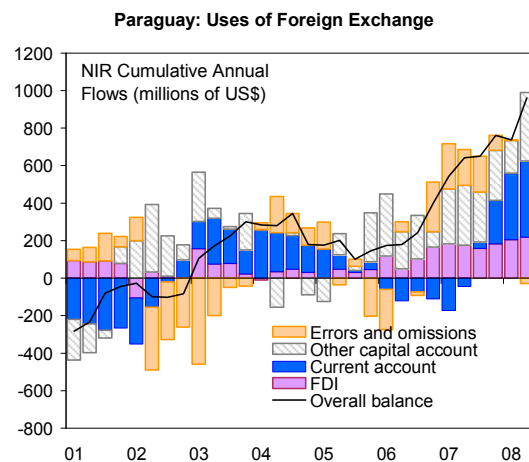
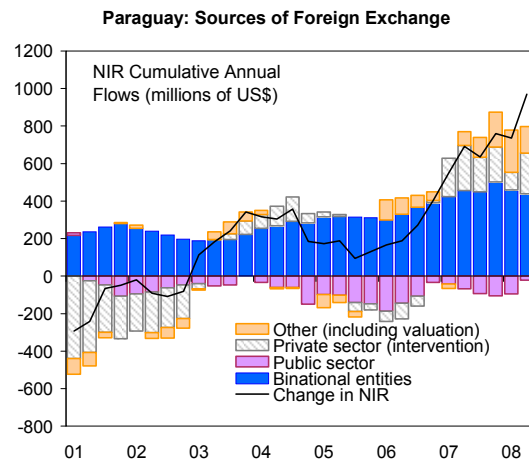
Box 2. Paraguay: Foreign Exchange Inflows

Paraguay has received substantial foreign exchange inflows recently. This is related to a combination of medium-term trends and favorable cyclical factors:

- Trade Balance.** The record agriculture production in 2007 and the price increases of primary products led to a rise in exports of about 25 percent. Although this impact was partly offset by an expansion of imports, the trade balance improved by over 1 percent of GDP. With continued strengthening of commodity prices in early 2008, this strong external position is expected to be sustained.
- Binational Entities.** These inflows—amounting to 5¾ percent of GDP in 2007—are twice as large as in 2003. Increased inflows reflect the completion of the Yacyretá dam, the increase of royalties from the Itaipú dam, and the increase of social expenditures by both entities.
- Capital Inflow.** Foreign direct investments have jumped from ½ percent of GDP in 2003-05 to over 1½ percent in 2006-07. This reflects in part investment from multinational companies in the soybean and telecommunications sectors.

These foreign exchange inflows have led to upward pressures on the exchange rate. The *guaraní* has appreciated by about 20 percent with respect to the U.S. dollar between January 2007 and June 2008. In nominal effective terms, the exchange rate has appreciated by about 10 percent over the same period.

The central bank has intervened in the foreign exchange market to smooth temporary or seasonal volatility. The central bank has stepped up interventions to reduce volatility and prevent the disruptive impact of seasonal transactions on the foreign exchange market. As of end-2007, the level of reserve was adequate by standard rules-of-thumb of reserve coverage and represented almost 4 months of imports of goods and services or over 3½ times short-term external debt (excluding foreign currency deposits).¹

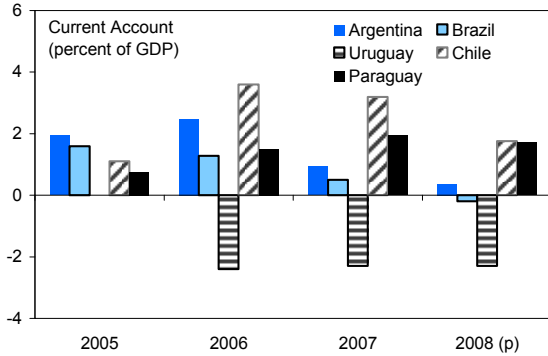


¹ The Greenspan-Guidotti rule suggests a reserve coverage of 100 percent of short-term debt. An alternative benchmark, based on the Jeanne-Ranci re (2007) model, suggests that, at over 20 percent of GDP, reserves are somewhat higher than the optimal level of 16 percent, determined using parameters tailored with country-specific data.

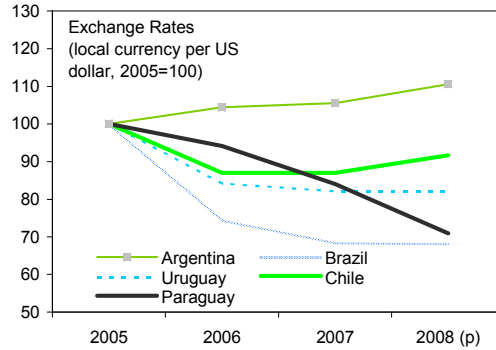
Figure 5. Paraguay: Balance of Payments Developments

The external position is expected to remain strong in 2008, largely on account of surging soybean prices, and despite a moderat slowdown in regional trade partners.

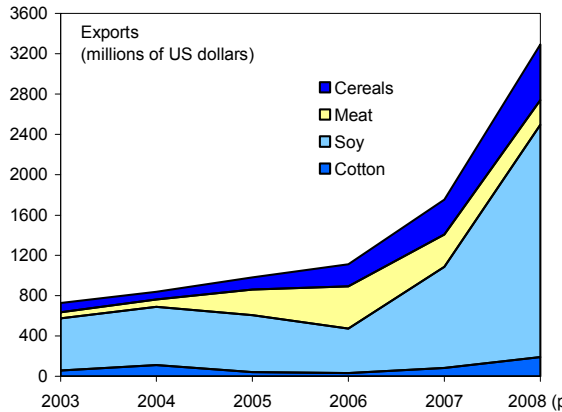
Paraguay's external current account is expected to remain strong and relatively high compared to the regional average in 2008...



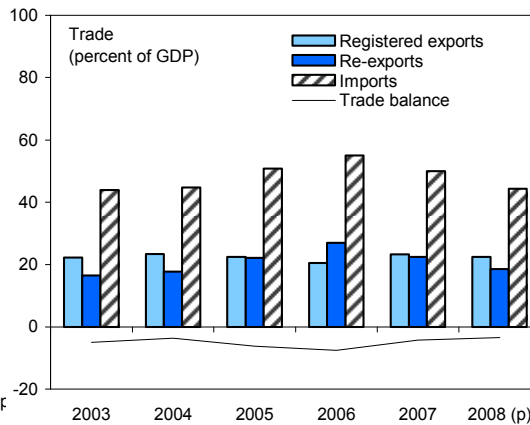
... while the appreciation against the US dollar has been strong in 2007 and so far in 2008 compared to most countries in the region.



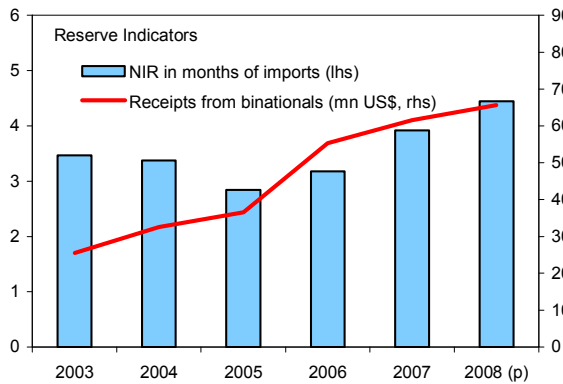
Surging soy exports prices have improved the external position...



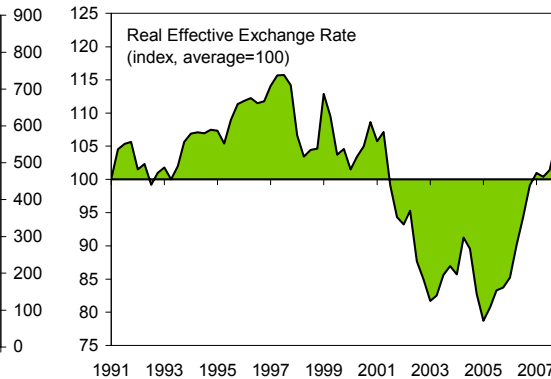
... together with a stabilization of the growth rate of registered imports.



...and continued large flows from the hydroelectric binational entittes, leading to increased NIR...



... and to an appreciation of the real effective exchange rate.



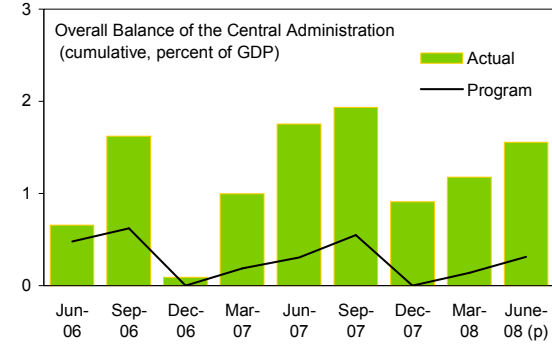
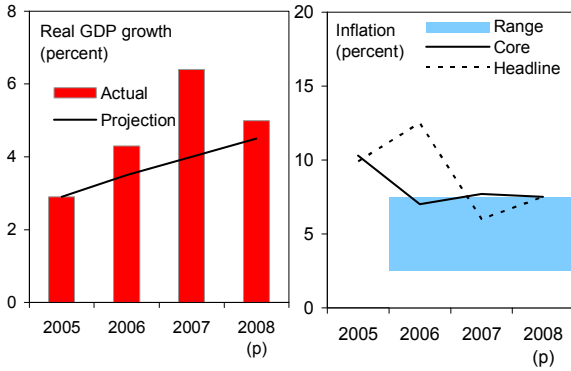
Sources: Paraguayan Authorities and Fund staff estimates.

Figure 6. Paraguay: Program Performance

The program has remained on track throughout the period. Fiscal discipline has resulted in surpluses of the central and overall public sector. The external position has strengthened, but its impact on currency has only been partly sterilized.

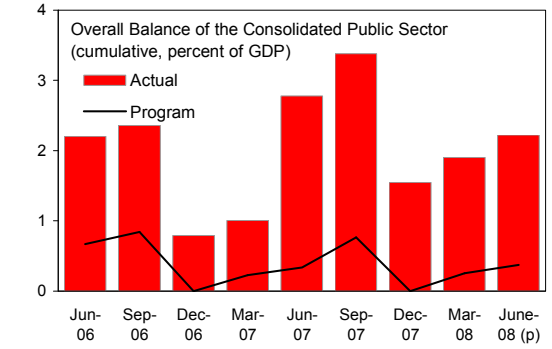
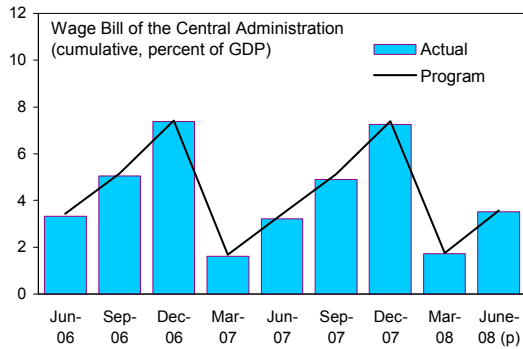
Real GDP growth has exceeded program projections but inflation has remained outside of the target range.

A strict fiscal policy has been maintained over the past several years...



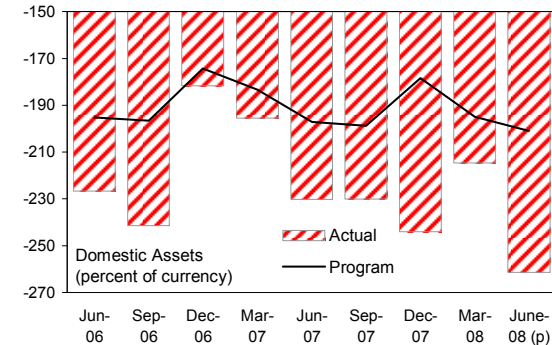
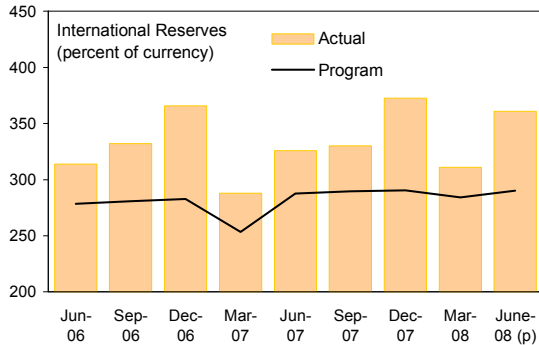
Wages have been carefully managed too....

...and fiscal discipline has been preserved.



Strong inflows of foreign exchange have contributed to overperformance of the NIR target...

...while the sterilization policy has limited its impact on currency growth.



Sources: Paraguayan authorities and Fund staff estimates.

- **State-owned enterprises.** The benchmark related to the signing of revised result-oriented management contracts and corresponding development of strategic business plans for five large state-owned enterprises (SOE) was only partly met (SB for end-May 2008).⁸ Contracts signed at end-2006 are still in effect (until August 2008), but new ones were not signed as managers are political appointees and realized they might be removed (see ¶ 23). While most SOEs prepared timely draft business plans, staff viewed them as generally weak as the objectives were not ambitious and the targets were unclear.

II. OUTLOOK

12. **Prospects.** As a primary commodity exporter, Paraguay should continue to benefit from the strong global increase in commodity prices, while investments realized over the past few years in the livestock and agricultural sectors should sustain the ongoing expansion and increase productivity. By contrast, the appreciation of the *guaraní*, could penalize nontraditional exports. While the supply shock related to higher international oil prices is a drag on the economy, the medium-term outlook for Paraguay remains positive.

13. **Risks.** Paraguay continues to be vulnerable to an eventual deceleration of the world economy and setbacks in international prices and demand for the country's commodity exports. The downside risks for growth in Paraguay are increasing, although not for this year given that the agricultural season has been quite good. If the global financial turbulence spreads, it could contaminate the headquarters of foreign-owned banks in Paraguay, leading to a possible credit crunch. There is also the political risk that the new government might fail to assemble a durable working coalition in Congress, which might undermine the fiscal balance and the structural reform agenda that needs to be implemented to sustain high economic growth.

III. DISCUSSIONS

14. **Focus.** Discussions with the current authorities focused on ensuring that the new Government takes over an economy in sound shape in August 2008. The authorities reiterated their commitment to the program, and their intention to go out with the reputation of being good economic managers. Staff stressed the need to continue implementing counter-cyclical policies by sustaining a tightening stance as the economy was growing above potential while remaining flexible and ready to relax policies if there was a clear indication of a sudden softening in economic activity.

⁸ However, the authorities published in May 2008 (for the first time) the quarterly assessments of all SOE from 2007 through the first quarter of 2008.

15. **Engagement.** The incoming authorities expressed their desire to maintain a close dialogue and engagement with the Fund (including through intensified technical assistance). Although they had not taken a formal decision, they seemed unlikely to request a successor Fund arrangement immediately after taking office in August 2008. The incoming authorities also expressed their intention to cement macroeconomic stability and deepen structural reforms over the next several years.

A. Macroeconomic Management

16. **Fiscal policy.** There was agreement to continue with tight policies as an effort to contain inflationary pressures. In particular, it was agreed to save the over-performance of the first half of the year with the objective of reaching an overall surplus of at least ½ percent of GDP in 2008, compared with the program objective of overall balance. This is expected to be achieved through a combination of good revenue performance and tight expenditure controls established in the Finance Ministry's financial plan. Staff urged the protection of needed capital expenditures, the execution rate of which has generally been low. However, there is a risk that the new government will be under pressure to rapidly increase social spending, especially in light of increasing food and fuel prices that are hitting the poor. Already, Congress passed a new law that would have increased consumer subsidies for electricity by about ½ percent of GDP (overriding a President veto).⁹ Staff urged the new economic team to resist pressures to increase expenditures sharply as this would exacerbate inflationary pressures, and in turn undermine the policy of protecting the real incomes of the poor.

	2006	2007	Prog. 2008	Proj.
Total Revenues	18.3	18.0	18.5	18.4
o/w Tax	12.0	11.7	11.8	12.3
Total Expenditures	17.9	17.0	18.5	17.9
o/w Wages	7.4	7.2	8.1	7.9
o/w Capital	4.2	3.8	4.3	4.2
Discrepancy	-0.4	-0.1	--	0.1
Overall Balance	0.1	0.9	0.0	0.5

Sources: Paraguayan authorities; and staff estimates
1/ Central Government.

17. **Monetary policy.** In view of the inflationary pressures, staff stressed the need to tighten monetary policy further, even if this may lead to some further appreciation of the *guarani*. Staff expressed concern about the strong growth of monetary aggregates, the negative real interest rates, and the likely negative impact of high credit growth on credit quality once the current

	2006	2007	Prog. 2008	Proj.
Currency Issue	15.3	28.3	11.8	17.0
Reserves (NIR)	87.1	114.8	11.8	82.6
Credit (NDA)	-71.8	-86.5	0.0	-65.6
Credit to public sector	-13.5	-18.3	-4.6	-5.7
Credit to banks	-27.4	-58.7	5.7	-31.6
Other items	-30.9	-9.6	-1.2	-28.2

Sources: Paraguayan authorities; and Fund staff estimates.
1/ Central Bank Accounts.

⁹ The fiscal impact for 2008 is likely to be minimal as the law will only become effective later in the year once the implementing decree has been put in place. Two other laws (also originating within Congress) are under consideration with potentially large fiscal impacts: (i) introduce an old-age pension for people without coverage; and (ii) create a pension fund for housewives.

favorable conditions subside. The authorities argued that the high growth of monetary aggregates reflects in part higher money demand due to increased confidence in the economy, and that despite rapid growth, credit to the private sector is only 18 percent of GDP, well below the level prior to the 2002 crisis.¹⁰ Nevertheless, the monetary authorities agreed in principle on the need of further tightening, while noting that the LRM rate adjustment in late March 2008 has not had its full effect. They also claimed that any additional tightening may attract capital inflows (especially in a low interest rate environment globally) and would further complicate monetary management.

18. **External policy.** The favorable balance of payments prospects in 2008 translated into sustained appreciation pressures. The current account surplus is expected to narrow moderately from 2 percent of GDP in 2007 to 1¾ percent in 2008 as exports remain high and imports continue to grow at a steady pace consistent with high economic activity and high oil prices. In response to continued foreign exchange inflows and upward pressure on the *guarani*, the authorities and staff agreed on the need to maintain a flexible exchange rate regime and restrict interventions to limit the risks to the inflation outlook and the cost of sterilization. Progress continues toward resolving remaining claims in dispute with foreign creditors/suppliers.¹¹

	2006	Est. 2007	Prog. 2008	Proj.
Current Account	1.5	1.9	1.0	1.7
o/w Exports	47.5	45.7	53.6	40.9
o/w Imports	-55.0	-50.0	-58.8	-44.3
Capital Account	2.8	4.4	-0.2	2.6
Public sector (net) 1/	-0.2	0.1	0.3	0.4
Private sector (net) 2/	3.1	4.3	-0.5	2.2
Overall Balance	4.3	6.4	0.8	4.4

Sources: Paraguayan authorities; and Fund staff estimates.
1/ General government only.
2/ Includes errors and omissions

B. Institutional Strengthening

19. **Tax administration.** Staff underscored the need to preserve and enhance the considerable gains in tax and customs administration of recent years, and recommended additional efforts to strengthen the operations of the large taxpayer unit and the use of a risk-based auditing approach. Following recent FAD technical assistance, the tax collection agency (SET) has developed a medium-term strategic management plan. Staff urged the incoming authorities to approve the plan in order to ensure administrative continuity for tax administration. Progress continued on strengthening ex-post audits and the consolidation of the bank collection system. Customs enforcement has also been significantly improved with the purchase of state-of-the art electronic equipment for scanning vehicles and containers to detect contraband and illegal products.

¹⁰ Part of credit expansion appears to be temporary as the continued appreciation of the *guarani* has created incentives among primary exporters to hedge foreign exchange risk by borrowing short-term in foreign currency to insure themselves against foreign exchange losses ahead of the repatriation of export proceeds.

¹¹ Claims in dispute amount to about 1 percent of GDP, and include (i) Belgium's Ex-Herstal (US\$7 million); (ii) import verification companies (US\$75 million); and (iii) a Swiss court ruling in favor of several European and American banks (US\$85 million).

20. **Expenditure control.** A key structural objective under the program has been the strengthening of the public expenditure control system. So far, the newly implemented expenditure commitment control system is working well, although additional fine-tuning is needed.¹² The authorities have consolidated all accounts that are currently not established by law into a Single Treasury Account. The mission also urged the initiation of the process to incorporate the rest of the accounts. Going forward, deeper reforms will be needed in the medium term to address weaknesses in the budgetary process, notably the ability of Congress to completely revise the budget presented by the executive branch.

21. **Central Bank.** Progress continues to be made toward strengthening the financial position of the BCP.¹³ Following the authorities' strategy of August 2007, the Ministry of Finance is in the process of transferring bonds to the Central Bank for the equivalent of $\frac{1}{4}$ of one percent of GDP to regularize the BCP's claims that are not in dispute. The authorities sent in May 2008 amendments to a BCP bill in Congress, increasing the ceiling of potential budgetary transfers to the Central Bank to cover its losses from 0.2 to 0.5 percent of GDP annually. The bill has been unanimously approved by the Senate's Finance Committee, which makes it likely that both houses of Congress will approve the law in the near future. In addition, the Ministry of Finance is in the process of forwarding the list of the BCP's claims that are still in dispute to the Attorney General for his clearance and approval. To further enhance the BCP's *de facto* independence, future draft legislation should aim at revising the appointment procedure of the Central Bank's governing body.¹⁴

22. **Prudential regulations.** The authorities have shown a strong commitment to implement their strategy (designed in June 2007) to enhance the regulatory and supervisory framework for the financial system in line with Basel I criteria. Banks will start reporting information to the Superintendency of Banks based on a strengthened framework from June 2008 onwards. Regulation on increased protection of supervisors is to take effect from September 2008. The final steps are also being taken to have new standards for financial risks management practices by January 2009.

¹² This could include the adoption of a more adequate definition of the commitment and accrued stages of the budget execution process. In particular, there is a need for differentiated definitions according to the economic category of expenditure. The authorities should also establish the moment for recording the commitment and accrued stage for each type of expenditure.

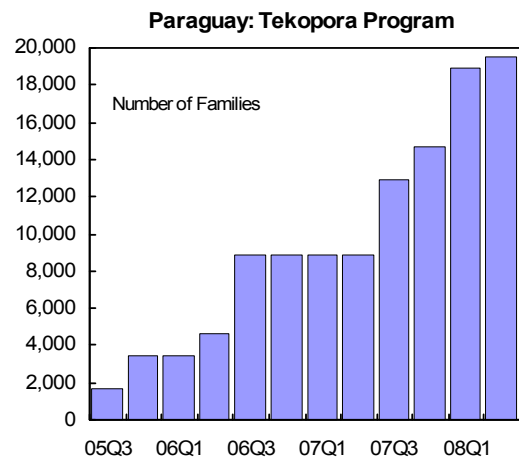
¹³ For a description of the authorities' strategy to strengthen the financial position of the Central Bank see Box 2 of the Staff Report for the Fourth SBA Review (Country Report No. 07/54).

¹⁴ Under Paraguayan law, both the BCP governor and the four members of the Board of Directors are proposed by the President and approved by the Senate. But whereas directors are appointed for a five year term (one appointment every year), the governor's term ends automatically with the term of the President. The mission emphasized the merits of decoupling the term of the BCP governor from the political cycle.

23. **State-owned enterprises.** Staff expressed strong concern about the poor management and widely reported deficient provision of services of public enterprises (despite generating overall surpluses as a group), which was the weakest area under the program.¹⁵ While welcoming the increased transparency brought about by the publication of quarterly assessments, staff noted that enforcement of recommendations and accountability continued to fall short of expectations. Staff regretted that the benchmark on the signing of new result-oriented contracts (setting revised performance targets), and the corresponding development of strategic business plans for all the SOEs that are being monitored was not fully observed. This was associated with the uncertainties of the political transition period given that the management of most SOEs is not expected to remain in office. Staff urged the incoming authorities to address vigorously short-comings in this area, as they hamper growth potential. Apart from signing new contracts to increase efficiency, measures could include the early establishment of new boards, and increased private sector participation.¹⁶

C. Poverty Alleviation

24. **Social policy.** The mission commended the authorities on the continued successful implementation of the conditional-cash transfer program (Tekoporã) for low-income households (Box 3). The end-May 2008 benchmark was met, and more than 19,500 families received assistance. The mission noted that extreme poverty has risen recently mainly due to high food and fuel inflation, notwithstanding the decline in overall poverty levels, and urged the wider expansion of Tekoporã to urban areas. The authorities concurred that urban poverty is a problem that needs to be addressed, and they are considering increasing the coverage to about 100,000 families in 2008 (doubling the original target). However, rapidly increasing the number is likely to face logistical difficulties, including the development of adequate identification and monitoring infrastructure and human resources, although the financial costs should remain modest (about $\frac{1}{3}$ percent of GDP). The new government intends to implement new social measures including land reform.



¹⁵ The rapid increase in international oil prices recently has put an extra strain on PETROPAR's finances given their policy of quarterly diesel price adjustments to prevent subsidies. The next price adjustment is expected for August 2008.

¹⁶ The new authorities are unlikely to include outright privatization in their reform program. Two attempts to introduce legislation on the subject have been rejected by Congress in the past (2002 and 2006).

Box 3. Paraguay: The Conditional Cash Transfer Program

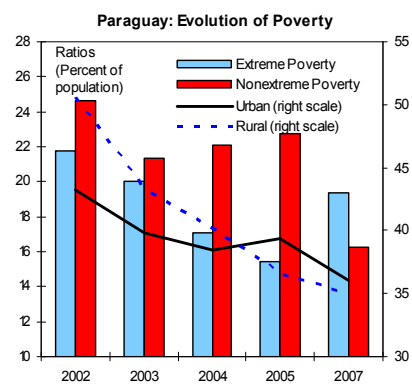
The creation of a social safety net was one of the four pillars of the stand-by arrangement. It was realized early on that despite increasing growth, some of the people at the bottom of the social ladder would need assistance in order to progressively escape from the vicious circle of poverty. With the assistance of the IDB, a conditional cash transfer (CCT) program (Tekoporã) was set up in 2005, originally on a pilot basis. CCTs have proven quite effective in reducing extreme poverty in several Latin American countries, including Brazil and Mexico.¹

The Tekoporã program is aimed at mitigating adverse social conditions of people living in extreme poverty in Paraguay in order to reduce its inter-generational transmission. The idea is to encourage the formation of human capital in poor households by reducing financial constraints. This is done through financial assistance in exchange for meeting certain conditions by families under the program, including school attendance, vaccination, and basic sanitation. The program covers extremely poor families with children under the age of 15 or with pregnant women in poor, rural provinces (“*departamentos*”). Selection of families is based on a multi-dimensional quality of life index, drawing on the 2001 Household Survey.

Each family receives a modest amount of financial assistance to cover monthly food and education expenses. The assistance amounts up to Gs. 180,000 (about US\$45), with a minimum of Gs. 60,000 (about US\$15). The total fiscal cost in 2007 was less than 0.1 percent of GDP. Although the amount of monthly assistance is fairly low, the idea is to set it at a level that reduces work disincentives among adults, and to encourage human capital accumulation among the young, while meeting some basic needs.

The program has been quite successful on several levels.² Originally set to cover 7,000 families in 2006, the number has increased to over 19,500 by end-May 2008, and there are plans to increase the coverage to 100,000 families (almost half of the people in extreme poverty). The program has had a positive impact on school attendance, especially among groups likely to drop out. More fundamentally, it has had a sizeable impact on consumption and in reducing extreme poverty, even after taking into account the transfers themselves. In other words, beneficiaries have been able to autonomously generate income rather than relying solely on the transfers to exit extreme poverty. The main shortcoming has been failure to increase vaccination rates significantly (despite increased health center attendance), and in its inability to raise male labor supply.

Going forward, the main challenge is to scale up the program to cover a lot more poor people, including in urban areas. A recent survey has shown that while the overall level of poverty fell from 38½ percent in 2005 to 35½ percent in 2007, the level of extreme poverty rose during the same period from 15½ to 19½ percent, in part due to a sharp increase in food and fuel prices. Scaling up the program will require developing adequate infrastructure and human resources for service delivery and effective monitoring. Moreover, the extension of the program to urban areas will involve the development of different identification and monitoring systems. Finally, to enhance monitoring and accountability, it would be important to introduce a debit card for beneficiaries, especially in urban areas, rather than the current cash distribution system.



¹ See, *The Economist*, “When Bribery Pays”, http://www.economist.com/finance/displaystory.cfm?story_id=10854937 March 13, 2008.

² For a complete assessment, see, Soares and Britto, 2007, “Confronting Capacity Constraints on Conditional Cash Transfers in Latin America: The Cases of El Salvador and Paraguay”, and Soares *et al.*, 2007, “*Los Logros y Carencias de las Transferencias de Efectivo Condicionadas : Evaluación del Impacto del Programa Tekoporã del Paraguay*”, UNDP International Poverty Centre, Brasília, Brazil.

IV. STAFF APPRAISAL

25. **Overall.** Macroeconomic outcomes have been significantly better than anticipated and policy implementation remained strong throughout the program period. There is a broad consensus that the program was very successful in cementing macroeconomic stability, reinvigorating growth, deepening structural reforms and alleviating poverty. All performance criteria and some structural measures for 2008 are expected to have been fully observed. The authorities are to be commended for their achievements and the strong performance. The incoming administration is encouraged to safeguard the reforms implemented and deepen those that are in train.

26. **Fiscal.** The consistent maintenance of sound fiscal policies throughout the program despite trying political circumstances is worth noting. In fact, Paraguay has recorded fiscal surpluses since 2004, thereby setting public debt levels on a firmly downward trend. Since 2007 the authorities have appropriately adopted a counter-cyclical stance in view of the strength of the economy. This performance reflects the implementation of financial plans that had to offset the impact of expansionary budgets approved by Congress, including large salary increases. As a result, there has been an increase in budget rigidities, and a weakening of credibility *vis-à-vis* economic agents regarding the government's fiscal stance. Staff urges the authorities to save revenue overperformance to strengthen its counter-cyclical stance and consider a reform of the public financial management framework that would limit Congress' ability to completely revise the overall annual budget.

27. **Monetary.** Staff noted that improved fundamentals, in particular high economic growth and increased confidence in the *guaraní*, have contributed to increased real money demand and financial deepening. However, the current expansion of monetary aggregates exceeds what would be warranted by fundamentals, and the staff urged the authorities to tighten their policy stance. In addition, the uptick of core inflation has spread beyond the initial supply shocks, and raises the risks of a wage-price spiral. In this context, staff welcomes the monetary tightening of March and June 2008 and encourages the authorities to remain vigilant to prevent a monetary overhang, but notes that the Central Bank's strong concern for its net income position might have deterred a more determined monetary action, reinforcing the case for a rapid recapitalization of the Central Bank.

28. **Exchange rate.** The authorities have appropriately maintained a flexible exchange rate policy. As the external position has remained strong, the *guaraní* has appreciated by about 20 percent in the first half of 2008 and international reserves substantially exceeded program targets, thereby reducing Paraguay's vulnerability to shocks. The external outlook for 2008 continues to be favorable, and staff welcomes the authorities' commitment to a policy of limited intervention.

29. **Reform.** The authorities continued to make progress in all areas of the reform agenda. While the structural agenda had some setbacks in late 2006 and early 2007, the impetus for financial sector reform was regained in the second half of 2007 and the authorities began to adopt key measures, especially on designing a strategy to strengthen the Central Bank's balance sheet. On SOE reform, the authorities took the first steps towards a more determined restructuring in terms of disclosing information and rising awareness about the operations of these companies. Nonetheless, staff regrets that reforms in this area fell short of expectations, and urges further and deeper reforms to unleash the potential growth of the economy.

30. **Vulnerabilities.** On the external front, the environment for Paraguay's export sector may suffer if external demand falls, especially as the tightening of credit conditions in mature economies may adversely affect Paraguay's main trading partners. On the domestic front, there is a risk of an overheating economy that might stoke further inflationary pressures, exacerbating second-round effects from recent fuel and food price increases. On the political front, there is a risk that the new government might fail to establish a working majority coalition in Congress. This could lead to backtracking from recent reforms and increased spending requests, which would undermine macroeconomic stability.

31. **Review.** The staff supports completion of the sixth and last SBA review in light of the good performance and program ownership.

Table 1. Paraguay: Quantitative Performance Criteria

	2007						2008					
	End-Jun		End-Sep		End-Dec		End-Mar		End-Jun		End-Jun	
	Prog.	Actual	Prog.	Actual	Prog.	Actual	Prog.	Actual	Prog.	Actual	Prog.	Actual
Fiscal targets												
1. Overall balance of the central administration (floor, in billions of guaranies) 1/	184	1,054 ✓	330	1,162 ✓	0	546 ✓	95	802 ✓	213			
2. Wage bill of the central administration (ceiling, in billions of guaranies) 1/	2,055	1,940 ✓	3,086	2,949 ✓	4,443	4,360 ✓	1,195	1,170 ✓	2,429			
3. Overall balance of the public sector (floor, in billions of guaranies) 1/	202	1,675 ✓	459	2,033 ✓	0	930 ✓	172	1,292 ✓	253			
Monetary targets												
4. Net international reserves (floor, in millions of U.S. dollars) 2/	1,900	2,153 ✓	1,915	2,182 ✓	1,920	2,462 ✓	2,412	2,638 ✓	2,462			
5. Net domestic assets (ceiling, in billions of guaranies) 2/	-6,645	-7,762 ✓	-6,700	-7,756 ✓	-6,016	-8,229 ✓	-8,436	-9,285 ✓	-8,692			
Public debt and arrears targets												
6. Contracting or guaranteeing of nonconcessional external debt by the NFPS (ceiling, in millions of US\$) 1/	500	0 ✓	500	10 ✓	500	254 ✓	500	70 ✓	500			
Continuous PCs												
7. Contracted or guaranteed short-term external debt by the NFPS	0	0 ✓	0	0 ✓	0	0 ✓	0	0 ✓	0			
8. Non-accumulation of external debt arrears	0	0 ✓	0	0 ✓	0	0 ✓	0	0 ✓	0			

Sources: Paraguayan authorities; and Fund staff estimates.

1/ Cumulative flows from the beginning of the calendar year.

2/ Stocks. NIR is adjusted upward (downward) for any increase (decrease) in reserve requirement for foreign currency deposits (above pre-specified amounts) and upward by the amount of any program disbursements. Similarly, the NDA target will be adjusted downward (upward) following the adjustment in the NIR.

Table 2. Paraguay: Structural Conditionality Under the Program

Measure	Conditionality 1/	Timing	Status
Public Sector Reform			
A. Design of an action plan to develop an effective commitment control system for the public sector and rationalize the Treasury account system	SB	end-Jun 2006	● Done.
B. Preparation of a tax code	PC	end-Dec 2006	● Done.
C. Draft implementing regulations for the tax procedures code	SB	end-Sep 2007	● Done.
D. Develop an action plan for a comprehensive pension reform	SB	end-Sep 2007	● Done.
E. Design a public sector investment system	SB	end-Dec 2007	● Done.
F. Establish a commitment control system	SB	end-Dec 2007	● Done.
G. Consolidate all Treasury accounts not established by law into a Single Treasury Account	SB	end-Jun 2008	● Done.
Financial Sector Reform			
H. Audited and inspected CAR (fully provisioned) of 5 percent for BNF at end-June 2006	SB	end-Sep 2006	● Done.
I. Design an action plan to strengthen financial sector reform and increase compliance with Basel Core Principles to at least 80 percent (in line with regional best practices)	SB	end-Jun 2007	● Done.
J. Announce a strategy to strengthen the financial position of the Central Bank and a timetable for its implementation	SB	end-Jun 2007	● Done.
K. Audited and inspected CAR (fully provisioned) of 10 percent for BNF at end-December 2006	PC	end-Mar 2007	● Done.
L. Develop a medium-term business plan for BNF that includes a strategy to reduce costs, increase asset recovery, and improve credit and risk management	SB	end-Jun 2007	● Done.
M. Send a bill to Congress that reflects the legal and budgetary implications of the agreed plan to strengthen the financial position of the Central Bank	SB	end-Sep 2007	● Done.
N. Develop legal and regulatory framework to revamp the payment system and preparing a draft payment system law	SB	end-Sep 2007	⚠ In progress. Expected to be completed before the end of the arrangement.
O. Development of an effective supervisory and regulatory framework for the cooperative sector	SB	end-Sep 2007	● Done.
P. Reinstate a modified Resolution 8/03 to become effective on January 1, 2008	SB	end-Sep 2007	◐ Partly done. Resolution was approved on time, but will become effective after October 1, 2008.
Q. Design a strategy for the development of capital markets	SB	end-Dec 2007	● Done.
R. Implement prudential regulations in line with BCP operational plan	SB	end-Dec 2007	● Done.
S. Send to Attorney General for his review and clearance the claims in dispute between BCP and the Min. of Finance	SB	end-May 2008	⚠ In progress. Expected to be completed before the end of the arrangement.
Pro-Growth Reform			
T. Design a plan to improve business climate	SB	end-Sep 2006	● Done.
U. Implement result-oriented management contract for ANDE, COPACO, ESSAP, INC, and PETROPAR	SB	end-Dec 2006	● Done.
V. Implement the plan to improve the investment climate designed in September 2006	SB	end-Sep 2007	● Done.
W. Observance of targets under the result-oriented management contracts for ANDE, COPACO, ESSAP, INC, and PETROPAR	SB	end-Dec 2007	◐ Partly done. Contracts signed but problems with 2 of the 5 state-owned enterprises.
X. Sign result-oriented management contracts for 2008 with contracts for ANDE, COPACO, ESSAP, INC, and PETROPAR	SB	end-May 2008	◐ Partly done. Contracts not signed, but some business plans completed.
Social Safety Net			
Y. Create a conditional cash transfer mechanism for 7,000 families living under extreme poverty based on contracts with beneficiaries	SB	end-Dec 2006	● Done.
Z. Increase the coverage of the conditional cash transfer program to 15,000 families and establish mechanisms for the evaluation of results	SB	end-Dec 2007	● Done.
AA. Increase the coverage of the conditional cash transfer program to 19,000 families	SB	end-May 2008	● Done.

Source: Paraguayan authorities.

1/ SB = structural benchmarks; PC = performance criteria.

Table 3. Paraguay: Selected Economic and Social Indicators

I. Social and Demographic Indicators							
Area (thousand sq. km)	407	Income distribution (2002)					
Population (2005)		By highest 20 percent of households (percent)					61
Total (in millions)	5.9	By lowest 20 percent of households (percent)					2
Rate of increase (percent a year)	1.9	Health (2004)					
Density (per sq. km.)	14.5	Physicians per 1,000 people					1.1
Unemployment (2007)	5.6	Hospital beds per 1,000 people					1.3
Population characteristics (2004)		Access to a water source (percent)					80
Life expectancy at birth (years - 2005)	71.4	Access to a sanitation facility (percent)					86
Crude birth rate (per thousand)	29.7	Education (2004; in percent)					
Crude death rate (per thousand)	5.0	Male literacy rate (percent)					94
Infant mortality (per thousand live births)	21.0	Female literacy rate (percent)					92
		Primary school enrollment (net, percent)					94
		Secondary school enrollment (gross, percent)					63
II. Economic Indicators, 2004-2008							
	2004	2005	2006	2007	2008		
					Prog.	Proj.	
Annual percent change; unless otherwise specified							
National accounts and prices							
GDP at current prices	16.4	11.2	13.2	15.1	11.2	13.1	
GDP at constant prices	4.1	2.9	4.3	6.8	4.0-5.5	5.0	
Per capita GDP (U.S. dollars, thousands)	1.2	1.3	1.6	2.0	2.2	2.6	
GDP deflator	11.8	8.1	8.5	7.7	6.9	7.7	
Consumer prices (end-of-period)	2.8	9.8	12.5	6.0	2.5-7.5	7.5	
Real effective exchange rate 1/							
Average (depreciation -)	3.7	-6.5	13.0	10.8	...	...
End-of-period (depreciation -)	-8.5	4.5	20.2	5.6	...	...
In millions of U.S. dollars							
External sector							
Exports, f.o.b. (percentage change)	32.0	17.4	31.4	24.0	11.1	20.0	
Imports, c.i.f. (percentage change)	27.0	22.9	33.8	17.1	11.4	18.9	
Net oil exports and imports	-434	-507	-701	-723	-740	-987	
Current account	143	56	139	232	133	277	
(in percent of GDP)	2.1	0.8	1.5	1.9	1.0	1.7	
Capital account	41	305	260	450	-33	423	
Overall balance	277	147	402	762	100	700	
Terms of trade (percentage change)	-1.3	-9.4	-2.2	5.8	0.3	0.8	
In percent of GDP							
Savings-investment balance							
Gross domestic investment	19.2	19.8	19.6	18.4	20.2	18.7	
Private sector	14.5	14.8	14.7	13.7	14.7	13.6	
Public sector	4.7	5.0	4.9	4.7	5.5	5.1	
Gross national savings	21.4	20.5	21.0	20.4	21.2	20.4	
Private sector	14.9	14.7	15.4	13.7	15.8	14.7	
Public sector	6.5	5.8	5.7	6.6	5.4	5.7	
Public sector							
Central government primary balance	2.7	1.9	1.5	1.8	0.8	1.1	
Central government overall balance	2.0	0.6	0.1	0.9	0.0	0.5	
Consolidated public sector primary balance 2/	3.2	2.8	3.7	3.5	1.5	2.1	
Consolidated public sector overall balance 2/	1.8	0.9	0.8	2.0	0.0	0.7	
Public sector debt (end-of-year) 3/	45.1	37.7	27.7	22.4	20.5	17.1	
External	40.9	34.3	25.3	20.4	18.9	15.7	
Domestic	4.2	3.4	2.4	2.0	1.7	1.5	
Consolidated public sector debt 4/	48.8	42.7	34.1	28.9	26.2	25.6	
Annual percent change							
Money and credit							
Monetary base	17.6	4.3	13.0	35.3	10.4	17.8	
M2	24.6	16.1	15.3	38.6	12.0	20.1	
M5 5/	11.7	7.7	7.9	8.2	12.0	24.1	
Credit to the private sector 5/	13.9	14.1	17.6	46.3	12.5	23.4	
Velocity of M2	7.7	7.2	7.0	6.3	5.6	5.6	
Memorandum items:							
International reserves (in millions of U.S. dollars)	1,168	1,297	1,703	2,462	2,562	3,162	
(In months of imports)	3.4	2.8	3.2	3.9	3.3	4.4	
GDP (in billions of guaranías)	41,522	46,169	52,270	60,163	66,130	68,026	
Population (millions)	5.7	5.8	5.9	6.0	6.2	6.2	

Sources: Paraguayan authorities; and Fund staff estimates.

1/ INS calculations of real effective exchange rates.

2/ Consolidated public sector, including the quasi-fiscal operations of the BCP.

3/ Nonfinancial Public Sector. Based on end-of-period exchange rate conversion of U.S. dollar-denominated debt.

4/ Includes Central Bank Bills (LRMs).

5/ Foreign currency items are valued at a constant exchange rate.

Table 4. Paraguay: Central Government Operations

	2004	2005	2006	2007	2008					
					Jan-Mar		Jan-Jun		Jan-Dec	
					Prog.	Actual	Prog.	Proj.	Prog.	Proj.
In billion of guaraníes										
Total revenues	7,637	8,419	9,588	10,837	2,620	3,030	5,570	6,069	12,246	12,539
Tax revenues	4,929	5,471	6,295	7,019	1,677	1,871	3,557	4,001	7,834	8,394
Corporate taxes	880	967	1,009	1,229	279	166	622	655	1,290	1,400
Excises	1,000	1,007	1,049	1,310	292	410	649	819	1,483	1,720
Value added tax	1,939	2,372	2,786	3,318	839	1,024	1,724	1,941	3,775	3,899
Import Duties	904	843	938	853	218	243	440	493	975	1,030
Other	205	282	513	309	49	29	121	92	312	345
Nontax revenues 1/	2,696	2,946	3,262	3,794	924	1,156	1,976	2,048	4,337	4,070
o/w: Public pension contributions	440	541	560	752	202	214	392	382	795	795
Itaipu-Yacyreta	1,640	1,651	1,883	2,042	452	455	931	903	2,015	1,819
Capital revenues	12	2	31	25	19	2	37	21	75	75
Current expenditures:	5,363	6,231	7,138	7,964	2,091	1,990	4,222	4,170	9,384	9,407
Wages and salaries	2,984	3,334	3,857	4,360	1,195	1,170	2,429	2,395	5,372	5,372
Goods and services	447	546	674	704	184	105	374	320	827	875
Interest payments	483	560	519	515	159	149	275	260	562	498
Transfers	1,431	1,771	2,067	2,366	547	563	1,133	1,187	2,602	2,640
Of which: pensions and benefits	940	1,126	1,207	1,264	322	314	649	641	1,434	1,434
Other	18	19	22	19	5	3	11	8	21	21
Capital expenditures and net lending	1,625	1,860	2,185	2,280	434	255	1,135	912	2,861	2,860
o/w: Capital expenditure	1,383	1,440	1,571	1,514	277	103	874	563	2,179	2,058
Of which:										
Net lending	-29	-24	99	132	-6	-11	-12	-12	-23	-23
Capital transfers and other	271	445	515	634	163	162	273	361	706	825
Statistical discrepancy 2/	181	-39	-216	0	0	17	0	69	0	69
Overall balance	830	289	48	546	95	802	213	1,057	0	341
Financing	-830	-288	-51	-547	-95	-802	-213	-1,057	0	-341
External debt (increase +)	103	-295	-123	-207	-136	-175	-9	-115	192	258
Disbursements	763	658	832	724	139	95	437	306	1,090	1,054
Amortizations	660	954	955	932	274	270	445	421	898	796
Domestic bonds (increase +)	-78	-137	147	186	0	6	0	-22	0	-22
New TB issues	0	0	318	382	143	119	143	119	155	130
Amortizations	78	137	171	196	143	114	143	141	155	152
Net credit from the banking system 3/	-162	-44	-375	-832	41	-73	-204	-457	-192	-249
Net credit from Central Bank	-114	55	-468	-837	41	-29	-204	-390	-192	-181
Net credit from commercial banks	-48	-99	93	4	0	-44	0	-67	0	-67
Other	-693	188	300	307	0	-560	0	-463	0	-328
In percent of GDP										
Total revenues	18.4	18.2	18.3	18.0	4.0	4.5	8.4	8.9	18.5	18.4
Tax revenues:	11.9	11.8	12.0	11.7	2.5	2.8	5.4	5.9	11.8	12.3
Corporate taxes	2.1	2.1	1.9	2.0	0.4	0.2	0.9	1.0	2.0	2.1
Excises	2.4	2.2	2.0	2.2	0.4	0.6	1.0	1.2	2.2	2.5
Value added tax	4.7	5.1	5.3	5.5	1.3	1.5	2.6	2.9	5.7	5.7
Import duties	2.2	1.8	1.8	1.4	0.3	0.4	0.7	0.7	1.5	1.5
Other	0.5	0.6	1.0	0.5	0.1	0.0	0.2	0.1	0.5	0.5
Nontax revenues 1/	6.5	6.4	6.2	6.3	1.4	1.7	3.0	3.0	6.6	6.0
o/w: public pension contributions	1.1	1.2	1.1	1.3	0.3	0.3	0.6	0.6	1.2	1.2
Itaipu-Yacyreta	3.9	3.6	3.6	3.4	0.7	0.7	1.4	1.3	3.0	2.7
Capital revenues	0.0	0.0	0.1	0.0	0.0	0.0	0.1	0.0	0.1	0.1
Current expenditures	12.9	13.5	13.7	13.2	3.2	2.9	6.4	6.1	14.2	13.8
Wages and salaries	7.2	7.2	7.4	7.2	1.8	1.7	3.7	3.5	8.1	7.9
Goods and services	1.1	1.2	1.3	1.2	0.3	0.2	0.6	0.5	1.2	1.3
Interest payments	1.2	1.2	1.0	0.9	0.2	0.2	0.4	0.4	0.8	0.7
Transfers	3.4	3.8	4.0	3.9	0.8	0.8	1.7	1.7	3.9	3.9
Capital expenditures and net lending	3.9	4.0	4.2	3.8	0.7	0.4	1.7	1.3	4.3	4.2
Statistical discrepancy 2/	0.4	-0.1	-0.4	-0.1	0.0	0.0	0.0	0.1	0.0	0.1
Overall balance	2.0	0.6	0.1	0.9	0.1	1.2	0.3	1.6	0.0	0.5
Financing	-2.0	-0.6	-0.1	-0.9	-0.1	-1.2	-0.3	-1.6	0.0	-0.5
External debt (increase +)	0.2	-0.6	-0.2	-0.3	-0.2	-0.3	0.0	-0.2	0.3	0.4
Disbursements	1.8	1.4	1.6	1.2	-0.2	-0.3	0.0	-0.2	1.6	1.5
Amortizations	1.6	2.1	1.8	1.5	0.2	0.1	0.7	0.5	1.4	1.2
Domestic bonds (increase +)	-0.2	-0.3	0.3	0.3	0.0	0.0	0.0	0.0	0.0	0.0
Net credit from the banking system 3/	-0.4	-0.1	-0.7	-1.4	0.1	-0.1	-0.3	-0.7	-0.3	-0.4
Other	-1.7	0.4	0.6	0.5	0.0	-0.8	0.0	-0.7	0.0	-0.5
Memorandum Item:										
Primary balance	2.7	1.9	1.5	1.8	0.4	1.4	0.7	1.8	0.8	1.1
Balance of the Caja Fiscal 4/	-1.2	-1.3	-1.2	-0.9	-0.2	-0.1	-0.4	-0.4	-1.0	-0.9

Sources: Ministry of Finance; and Fund staff estimates.

1/ Includes receipts from the binational hydroelectric plants Itaipu and Yacyreta, and grants.

2/ Measurement error to reconcile above-the-line estimate with measure of the fiscal balance from the financing side.

3/ Excludes banks' holdings of government bonds.

4/ Includes pension payments to central government employees and Chaco War veterans.

Table 5. Paraguay: Consolidated Public Sector Operations 1/

	2004	2005	2006	2007	2008					
					Jan-Mar		Jan-Jun		Jan Dec	
					Prog.	Actual	Prog.	Proj.	Prog.	Proj.
In billion of guaranies										
Revenue	8,959	10,114	11,821	13,507	3,306	3,708	6,975	7,423	15,209	15,280
Tax revenue	4,936	5,483	6,320	7,044	1,682	1,879	3,568	4,013	7,868	8,422
Nontax revenue and grants	4,010	4,596	5,469	6,431	1,605	1,816	3,360	3,372	7,261	6,778
Capital revenue	14	35	32	32	20	13	48	38	80	80
Current expenditure	6,959	7,908	9,177	10,190	2,571	2,534	5,260	5,292	11,841	12,013
Wages and salaries	3,634	4,087	4,711	5,357	1,441	1,446	2,910	2,923	6,434	6,515
Goods and services	755	994	1,200	1,194	258	173	584	523	1,376	1,420
Interest payments	678	751	858	910	260	240	479	460	971	941
Transfers	1,699	2,048	2,373	2,691	602	659	1,269	1,360	3,012	3,087
Other	193	27	35	38	11	16	21	26	48	51
Capital expenditure and net lending	1,956	2,306	2,580	2,832	580	274	1,442	1,052	3,630	3,485
<i>Of which: capital expenditure</i>	2,189	2,550	2,844	3,085	619	346	1,536	1,182	3,921	3,771
Primary balance	1,315	1,298	1,960	2,106	431	1,532	729	1,971	971	1,442
Public enterprises' operating surplus	593	646	1,039	712	18	392	-20	432	262	956
Statistical discrepancy 2/	119	-132	-689	0	0	0	0	0	0	0
Overall balance	756	414	413	1,196	172	1,292	253	1,511	0	850
Financing	-756	-415	-413	-1,196	-172	-1,292	-253	-1,511	0	-850
External financing net	-42	-445	-258	-384	-134	-195	-40	-171	157	121
Disbursements	808	771	939	724	-134	-195	-40	-171	1,240	121
Amortizations	850	1,216	1,197	1,109	272	290	477	477	1,083	932
Domestic financing net	72	-201	-476	-812	-39	-537	-1,193	-877	-157	-643
Bond financing	-78	-137	147	186	0	6	-44	-22	0	-22
Net credit from the banking system	-183	-176	-728	-1,042	-63	-560	-1,182	-923	-333	-945
Net credit from commercial banks	-257	-146	-250	-210	-273	-531	-624	-533	-142	-764
Net credit from Central Bank	74	-30	-478	-832	211	-29	-558	-390	-192	-181
Quasifiscal deficit financing	333	112	105	44	24	17	49	67	176	323
Other	-786	232	320	0	0	-560	0	-463	0	-328
In percent of GDP										
Revenue	21.6	21.9	22.6	22.5	5.6	6.2	11.7	12.3	23.0	22.5
Tax revenue	11.9	11.9	12.1	11.7	2.8	3.1	6.0	6.7	11.9	12.4
Nontax revenue and grants	9.7	10.0	10.5	10.7	2.7	3.0	5.7	5.6	11.0	10.0
Capital revenue	0.0	0.1	0.1	0.1	0.0	0.0	0.1	0.1	0.1	0.1
Current expenditure	16.8	17.1	17.6	16.9	4.3	4.2	8.8	8.8	17.9	17.6
Wages and salaries	8.8	8.9	9.0	8.9	2.4	2.4	4.9	4.9	9.7	9.6
Goods and services	1.8	2.2	2.3	2.0	0.4	0.3	1.0	0.9	2.1	2.1
Interest payments	1.6	1.6	1.6	1.5	0.4	0.4	0.8	0.8	1.5	1.4
Transfers	4.1	4.4	4.5	4.5	1.0	1.1	2.1	2.3	4.6	4.5
Other	0.5	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.1	0.1
Capital expenditure and net lending	4.7	5.0	4.9	4.7	1.0	0.5	2.4	1.7	5.5	5.1
<i>Of which: capital expenditure</i>	4.9	5.0	4.9	4.7	1.0	0.5	2.4	1.7	5.5	5.1
Public enterprises' operating surplus	1.4	1.4	2.0	1.2	0.0	0.7	0.0	0.7	0.4	1.0
Statistical discrepancy 2/	0.3	-0.3	-1.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	1.8	0.9	0.8	2.0	0.3	2.1	0.4	2.5	0.0	0.7
Financing	-1.8	-0.9	-0.8	-2.0	-0.3	-2.1	-0.4	-2.5	0.0	-0.7
External financing net	-0.1	-1.0	-0.5	-0.6	-0.2	-0.3	-0.1	-0.3	0.2	0.4
Disbursements	1.9	1.7	1.8	1.2	0.2	0.2	0.7	0.5	1.9	1.8
Amortizations	2.0	2.6	2.3	1.8	0.0	0.0	0.0	0.0	1.6	1.4
Domestic financing net	0.2	-0.4	-0.9	-1.4	-0.1	-0.9	-0.4	-1.5	-0.2	-1.1
<i>Of which: quasifiscal deficit financing</i>	0.8	0.2	0.2	0.1	0.0	0.0	0.1	0.1	0.3	0.5
Other	-1.9	0.5	0.6	0.0	0.0	-0.9	0.0	-0.8	0.0	-0.5
Memorandum item:										
Primary balance	3.2	2.8	3.7	3.5	0.7	2.5	1.2	3.3	1.5	2.1

Sources: Ministry of Finance and Fund staff estimates.

1/ Public sector comprises only the nonfinancial public sector and the Central Bank.

2/ Measurement error to reconcile above the line estimate with estimates of the fiscal balance from the financing side.

Table 6. Paraguay: Summary Accounts of the Central Bank, 2004-08
(In billions of guaranies; end-of-period; valued at constant exchange rate)

	2004	2005	2006 1/	2006 2/	2007 2/	2008 2/					
						March		June		Dec.	
						Prog.	Actual	Prog.	Proj.	Prog.	Proj.
Currency issue	2,488	2,925	3,371	3,371	4,326	3,866	4,168	3,865	4,312	4,836	5,063
Growth	12.7	17.6	15.3	15.3	28.3	24.2	33.9	20.1	33.9	11.8	17.0
Net international reserves	7,335	8,146	10,693	8,684	12,555	12,302	13,453	12,557	15,619	13,067	16,129
(In millions of U.S. dollars)	1,168	1,297	1,703	1,703	2,462	2,412	2,638	2,462	3,063	2,562	3,162
Net domestic assets	-4,848	-5,221	-7,322	-5,312	-8,229	-8,436	-9,285	-8,692	-11,307	-8,231	-11,065
Net nonfinancial public sector	1,366	1,410	1,015	728	111	130	153	-94	-208	-86	-137
Net credit to the central government	967	1,063	703	425	-241	-200	-244	-446	-582	-433	-422
Net credit to the rest of NFPS	398	347	311	303	352	330	396	352	373	347	285
Net credit to the banking system	-4,376	-5,026	-5,828	-5,484	-7,461	-7,362	-8,226	-7,450	-9,413	-7,216	-8,829
Reserve requirements	-2,195	-2,331	-2,535	-2,209	-3,089	-2,764	-3,287	-3,024	-3,577	-3,239	-3,424
Free reserves	-1,012	-683	-651	-633	-1,022	-1,007	-1,148	-992	-1,092	-962	-1,092
Monetary control bills (LRM) 3/	-1,171	-2,014	-2,644	-2,644	-3,352	-3,592	-3,824	-3,436	-4,747	-3,017	-4,316
Other	2	2	2	2	2	2	34	2	3	2	3
Other assets and liabilities (net)	-1,838	-1,605	-2,508	-556	-879	-1,204	-1,211	-1,148	-1,685	-929	-2,099
Capital and reserves	-1,722	-1,368	-141	-116	161	185	1,070	208	1,833	334	2,087
Other assets net 4/	-116	-237	-2,367	-440	-1,040	-1,389	-2,282	-1,357	-3,518	-1,263	-4,186
Memorandum items:											
Total stock of LRMs outstanding 3/	1,552	2,293	3,224	3,224	3,907	4,490	4,491	4,295	5,640	3,771	5,754
Quasifiscal balance 5/	-333	-112	-105	-105	-44	-24	-17	-49	-67	-174	-322
in percent of GDP	-0.8	-0.2	-0.2	-0.2	-0.1	0.0	0.0	-0.1	-0.1	-0.3	-0.5
Costs of monetary policy operations 4/	181	179	331	331	386	99	90	201	198	399	434
in percent of GDP	0.4	0.4	0.6	0.6	0.6	0.1	0.1	0.3	0.3	0.6	0.6
Monetary base	4,006	4,180	4,724	4,724	6,390	5,918	6,510	6,045	6,770	7,052	7,528
annual growth (in percent)	17.6	4.3	13.0	13.0	35.3	15.0	26.0	17.0	31.4	10.0	17.8
Narrow monetary base 6/	3,122	3,667	4,169	4,169	5,507	5,050	5,517	5,192	5,786	6,229	6,545
annual growth (in percent)	5.7	17.5	13.7	13.7	32.1	27.4	37.5	22.2	36.0	11.0	18.8

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

1/ Foreign-currency denominated items valued at 6,280 *guaranies* per U.S. dollar. This exchange rate also applies for all dates preceding December 2006.

2/ Foreign-currency denominated items valued at 5,100 *guaranies* per U.S. dollar. This exchange rate also applies for all dates following December 2006.

3/ A fraction of LRM, about 15 percent at end-2007, is held by non-bank institutions.

4/ Includes LRM held by the nonbanking sector.

5/ Cumulative since beginning of year. Follows program definition.

6/ Narrow monetary base comprises currency issued plus legal reserve requirement deposits in guaraní held at the BCP.

Table 7. Paraguay: Summary Accounts of the Banking System
(In billions of guaranies; end-of-period; valued at constant exchange rate)

	2004 1/	2005 1/	2006 1/	2006 2/	2007 2/	2008 2/					
						March		June		Dec.	
						Prog.	Actual	Prog.	Proj.	Prog.	Proj.
I. Central Bank											
Net international reserves	7,335	8,146	10,693	8,684	12,555	12,302	13,453	12,557	15,619	13,067	16,129
(in millions of U.S. dollars)	1,168	1,297	1,703	1,703	2,462	2,412	2,638	2,462	3,063	2,562	3,162
Net domestic assets	-4,848	-5,221	-7,322	-5,312	-8,229	-8,436	-9,285	-8,692	-11,307	-8,231	-11,065
Credit to public sector, net	1,366	1,410	1,015	728	111	98	153	-219	-208	88	-137
Credit to banking system, net 3/	-3,205	-3,012	-3,185	-2,840	-4,109	-3,868	-4,402	-4,061	-4,667	-3,886	-4,513
Central bank securities	-1,552	-2,293	-3,224	-3,224	-3,907	-4,370	-4,491	-4,138	-5,640	-4,276	-5,754
Other	-1,457	-1,326	-1,928	24	-324	-296	-545	-273	-791	-157	-661
Currency issue	2,488	2,925	3,371	3,371	4,326	3,866	4,168	3,865	4,312	4,836	5,063
II. Monetary Survey											
Net foreign assets	9,478	10,028	12,491	10,140	13,505	13,840	15,465	14,193	17,464	14,789	17,088
(in millions of U.S. dollars)	1,509	1,597	1,989	1,988	2,648	2,714	3,032	2,783	3,424	2,900	3,351
Net domestic assets	2,313	2,671	2,398	3,564	4,341	3,347	4,866	3,726	4,069	4,080	5,082
Credit to the public sector	531	237	-188	-411	-1,665	-1,550	-1,861	-2,170	-2,445	-1,313	-2,762
Credit to the private sector	5,788	6,601	7,760	7,051	10,316	9,502	11,990	10,604	12,259	9,751	12,746
Other	-4,006	-4,167	-5,174	-3,077	-4,310	-4,605	-5,263	-4,708	-5,745	-4,357	-4,902
Broad Liquidity (M4)	11,791	12,699	14,890	13,704	17,846	17,187	20,331	17,919	21,533	18,869	22,170
Bonds and issued securities	0	0	0	0	0	0	26	0	26	0	26
Other monetary liabilities	125	85	32	26	83	21	55	14	18	29	99
Central bank securities with private sector	381	280	580	580	555	629	667	595	894	615	1,439
Broad liquidity (M3)	11,285	12,334	14,278	13,098	17,208	16,538	19,583	17,309	20,595	18,225	20,606
Foreign currency deposits	5,310	5,396	6,280	5,100	6,120	5,632	7,768	6,105	7,961	5,765	7,286
Money and quasi-money (M2)	5,974	6,938	7,998	7,998	11,088	10,906	11,815	11,205	12,634	12,460	13,321
Quasi-money	1,482	1,472	1,668	1,668	2,339	2,535	2,988	2,562	2,887	2,680	2,831
Money (M1)	4,492	5,466	6,330	6,330	8,749	8,371	8,828	8,643	9,747	9,780	10,490
(Annual percentage change)											
M0 (Currency issued)	12.7	17.6	15.3	15.3	28.3	24.2	33.9	20.1	33.9	11.8	17.0
Credit to the private sector	13.9	14.1	17.6	17.6	46.3	30.2	64.3	35.0	56.0	17.6	23.6
M1	25.2	21.7	15.8	15.8	38.2	31.8	39.0	25.3	41.3	12.1	19.9
M2	24.6	16.1	15.3	15.3	38.6	32.7	43.8	25.8	41.9	12.0	20.1
M3	12.3	9.3	15.8	15.8	31.4	21.6	44.0	18.2	40.7	11.3	19.8
Of which: foreign currency deposits	1.1	1.6	16.4	16.4	20.0	4.7	44.4	6.4	38.7	9.8	19.0
Memorandum items:											
Ratio of foreign currency deposits to M3 (percent)	47.1	43.7	44.0	38.9	35.6	34.1	39.7	35.3	38.7	31.6	35.4
Ratio of foreign currency deposits to private sector deposits in banks (percent)	57.1	54.6	55.4	50.3	45.3	42.8	48.2	43.7	47.3	41.6	44.8

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

1/ Foreign-currency denominated items valued at 6,280 guaranies per U.S. dollar. This exchange rate also applies for all dates preceding December 2006.

2/ Foreign-currency denominated items valued at 5,100 guaranies per U.S. dollar. This exchange rate also applies for all dates following December 2006.

3/ Exclude LRM held by the banking sector.

Table 8. Paraguay: Banking System Indicators

	2003	2004	2005	2006	2007
I. Total banking system (II+III+IV+V)					
Share in assets	100.0	100.0	100.0	100.0	100.0
Capital adequacy ratio (percent) 1/	20.9	20.5	20.4	20.1	16.8
NPLs/total loans	20.6	10.8	6.6	3.3	1.3
Provisions/NPLs	54.8	54.6	57.7	59.1	78.2
Rate of return on assets (ROA)	0.4	1.7	2.1	3.0	2.8
Rate of return on equity (ROE)	4.5	18.3	22.6	31.7	34.7
Liquid assets/total assets 2/	32.6	30.8	26.6	23.3	24.3
Foreign exchange deposits/total deposits	61.7	55.0	52.7	49.1	44.3
II. Total foreign-owned banks					
Share in assets	47.4	35.8	31.3	29.1	28.4
Capital adequacy ratio (percent) 1/	20.4	26.0	27.2	25.5	20.6
NPLs/total loans	20.8	11.0	6.4	3.6	1.5
Provisions/NPLs	64.2	71.2	63.4	68.6	53.6
Rate of return on assets (ROA)	0.1	1.4	1.4	2.2	1.2
Rate of return on equity (ROE)	1.2	12.0	11.3	18.6	13.1
Liquid assets/total assets 2/	29.8	25.4	29.0	24.5	25.5
Foreign exchange deposits/total deposits	65.6	65.2	65.1	61.2	55.4
III. Total majority-owned foreign banks					
Share in assets	37.2	45.2	48.0	51.4	51.7
Capital adequacy ratio (percent) 1/	21.0	17.7	17.8	17.4	15.1
NPLs/total loans	12.3	3.7	2.3	1.8	0.9
Provisions/NPLs	52.1	56.9	87.2	83.0	91.5
Rate of return on assets (ROA)	1.3	2.2	3.0	3.9	4.1
Rate of return on equity (ROE)	15.5	25.8	35.3	45.8	53.5
Liquid assets/total assets 2/	35.3	28.8	22.6	18.5	21.1
Foreign exchange deposits/total deposits	62.3	53.8	51.7	48.8	42.8
IV. Total domestic-owned private banks					
Share in assets	7.4	8.2	9.4	9.9	11.3
Capital adequacy ratio (percent) 1/	14.1	13.3	13.4	15.6	12.2
NPLs/total loans	2.9	2.1	0.8	1.4	0.8
Provisions/NPLs	46.2	70.3	77.1	78.6	95.0
Rate of return on assets (ROA)	1.6	2.0	2.2	2.9	2.7
Rate of return on equity (ROE)	21.1	28.1	30.8	35.9	38.3
Liquid assets/total assets 2/	38.8	38.1	34.0	34.6	28.2
Foreign exchange deposits/total deposits	60.7	57.6	54.7	51.5	51.6
V. National Development Bank (BNF)					
Share in assets	8.0	10.7	11.3	9.5	8.5
Capital adequacy ratio (percent) 1/	30.0	25.0	26.5	32.2	35.5
NPLs/total loans	56.2	48.9	40.3	19.4	7.8
Provisions/NPLs	47.6	43.1	45.1	31.6	76.9
Rate of return on assets (ROA)	-2.8	0.5	0.4	0.5	0.4
Rate of return on equity (ROE)	-18.7	6.8	5.3	5.7	5.3
Liquid assets/total assets 2/	30.7	52.0	31.2	33.8	34.5
Foreign exchange deposits/total deposits	32.7	23.6	20.6	13.1	8.8

Source: Superintendency of Banks.

1/ Definition of CAR does not fully comply with international standards.

2/ Liquid assets are calculated as the sum of cash, reserves, accounts in banks and lending in interbank market.

Table 9. Paraguay: Balance of Payments

(In millions of U.S. dollars)

	2004	2005	2006	2007	2008					
					Jan-Mar		Jan-Jun		Jan-Dec	
					Prog.	Est.	Prog.	Proj.	Prog.	Proj.
Current account	143	56	139	232	-51	84	40	273	133	277
Trade balance	-248	-459	-693	-508	-254	-93	-338	-100	-702	-541
Exports	2,854	3,352	4,405	5,464	1,592	1,433	3,352	3,054	7,130	6,557
Registered	1,627	1,688	1,903	2,785	780	781	1,700	1,671	3,574	3,592
Unregistered	1,228	1,664	2,502	2,679	812	652	1,653	1,382	3,556	2,965
Imports	-3,102	-3,811	-5,099	-5,972	-1,846	-1,526	-3,690	-3,153	-7,832	-7,098
Registered	-2,658	-3,251	-4,614	-5,663	-1,688	-1,446	-3,349	-2,978	-7,154	-6,750
o/w fuel products	-434	-507	-701	-723	-175	-239	-368	-504	-740	-987
Unregistered	-444	-560	-484	-309	-158	-81	-341	-175	-678	-348
Services (net)	327	349	425	391	97	99	183	188	413	423
Transport	-77	-95	-112	-133	-28	-24	-68	-59	-108	-96
Travel	-1	-1	-1	-7	-8	-8	-13	-12	-16	-11
Other	405	445	538	530	132	130	263	260	537	530
Factor income	-134	-58	-19	-25	-17	-7	-32	-13	-61	-28
Transfers	194	224	426	373	124	86	227	197	482	423
Capital and financial account	41	305	260	450	1	91	-40	328	-33	423
General government	-26	-107	-21	12	-28	-38	-2	-23	38	68
Disbursements	139	107	184	217	28	21	89	72	221	254
Amortization	-133	-175	-169	-184	-56	-58	-91	-95	-183	-186
Other	-32	-39	-36	-21	0	0	0	0	0	0
Private Sector 1/	67	412	282	438	29	129	-38	350	-71	355
Direct investment	32	47	166	182	45	40	89	141	179	211
Foreign currency deposits	30	423	165	143	0	0	0	0	0	0
Other	6	-58	-49	113	-16	89	-127	209	-250	144
Errors and Omissions	93	-214	3	80	0	0	0	0	0	0
Overall Balance	277	147	402	762	-50	176	0	600	100	700
Net International Reserves (increase -)	-186	-129	-405	-759	50	-176	0	-600	-100	-700
Gross Reserves	-185	-130	-405	-759	50	-176	0	-600	-100	-700
Reserve Liabilities	-1	1	0	0	0	0	0	0	0	0
Exceptional Financing	-92	-19	3	-2	0	0	0	0	0	0
Arrears deferral (+)/clearance (-)	-92	-19	3	-2	0	0	0	0	0	0
Reschedulings 2/	0	0	0	0	0	0	0	0	0	0
Memorandum items:										
Current account in percent of GDP	2.1	0.8	1.5	1.9	-1.5	2.1	1.2	4.5	1.0	1.7
Gross reserves (in millions of U.S. dollars)	1,168	1,298	1,703	2,462	2,412	2,638	2,462	3,063	2,562	3,162
in months of imports of GNFS	3.4	2.8	3.2	3.9	3.1	3.7	3.2	4.3	3.3	4.4
External public debt in percent of GDP 3/	41.3	34.6	25.4	20.4	18.8	15.2	19.0	15.3	19.3	15.9
Debt service in percent of exports GNFS	7.3	8.6	6.4	5.4	5.5	6.3	4.6	5.4	5.0	4.8
Export Volume (percentage change) 4/	17.7	11.1	8.9	17.2	8.0	34.5	5.4	19.0	6.5	9.6
Import Volume (percentage change) 4/	17.1	13.4	32.6	14.0	2.6	6.9	5.7	6.1	6.8	8.2
Terms of trade (percentage change)	-1.3	-9.4	-2.2	5.8	..	..	..	..	0.3	0.8

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

1/ Includes public enterprises and binationals.

2/ Excludes disputed claims (Office Nacional du Ducroire, PDI, \$8 million, BIVAC and SGS, \$77 million, Swiss bank syndicate, \$85million) and unidentified creditors (D.B. Pty, \$0.03 million)

3/ Based on average exchange rate valuation of GDP.

4/ Registered trade.

Table 10. Paraguay: Indicators of External Vulnerability

	2003	2004	2005	2006	2007
Monetary and financial indicators					
Broad money (M3), percentage change 1/	17.7	12.3	9.3	6.2	31.4
Credit to the private sector, real (percentage change) 1/	-25.5	10.9	3.9	-4.9	38.3
Share of nonperforming loans in total loans (percent) 2/	20.6	10.8	6.6	3.3	1.3
Average domestic lending rate, real	19.3	17.4	18.5	15.4	19.2
Central Bank bill yield, real	-1.2	1.0	-0.1	0.8	1.3
International reserves (millions of US\$)	983	1,168	1,297	1,703	2,462
Central bank foreign short-term liabilities (millions of US\$)	0.5	0.3	0.7	0.0	0.3
External indicators					
Merchandise exports (percentage change)	16.8	32.0	17.4	31.4	24.0
Merchandise imports (percentage change)	14.4	27.0	22.9	33.8	17.1
Merchandise terms of trade (percentage change)	0.1	-1.3	-9.4	-2.2	5.8
Real effective exchange rate (percentage change)	-6.6	3.7	-6.5	13.0	10.8
Current account balance (percent of GDP)	2.3	2.1	0.8	1.5	1.9
Capital and financial account (percent of GDP)	3.2	0.6	4.1	2.8	3.8
Net foreign direct investment (percent of GDP)	0.4	0.5	0.6	1.8	1.5
Inward portfolio investment (percent of GDP)	0.0	0.0	0.0	0.0	0.0
Other net investment (percent of GDP)	2.6	-0.1	3.2	0.7	2.0
External public debt (percent of GDP) 2/	48.1	41.3	34.6	25.4	20.4
Debt service (in percent of exports GNFS)	11.5	7.3	8.6	6.4	5.4
Gross reserves (in US\$ million)	984	1,168	1,298	1,703	2,462
In months of imports of GNFS	3.5	3.4	2.8	3.2	3.9
Over short-term external debt 3/	1.7	1.7	1.9	2.6	3.7
Over foreign currency deposits in domestic banks	1.0	1.2	1.3	1.5	1.5

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

1/ Foreign currency components are valued at the accounting exchange rate.

2/ Based on end-of-period exchange rate conversion of U.S. dollar-denominated debt.

3/ Private and public external debt with a residual maturity of one year or less. Excludes foreign currency deposits in banking system.

Table 11. Paraguay: Schedule of Reviews and Purchases

Date	Amount of Purchase		Conditions
	June 2007 Phasing	New Access and Phasing	
	Percent of Quota 1/		
May 31, 2006	25.0	25	Approval of arrangement
September 29, 2006	6.0	...	First review and end-June 2006 performance criteria
June 29, 2007	12.0	...	Second and third reviews and end-September and end-December 2006 performance criteria
October 15, 2007	6.0	1.0	Fourth review and end-June 2007 and end-September 2007 performance criteria 2/
March 28, 2008	6.0	1.0	Fifth review and end-December 2007 performance criteria 3/
March 28, 2008	5.0	1.0	End-December 2007 performance criteria 3/
July 30, 2008	2.5	1.0	Sixth review and end-March 2008 performance criteria 4/
July 30, 2008	2.5	1.0	End-June 2008 performance criteria
Total	65.0	30.0	

Source: Fund staff estimates.

1/ Since Paraguay's quota is SDR 99.9 million, the percent of quota is almost equivalent to the amount of the purchase in SDR. For instance, the first credit tranche is 25 percent of quota or about SDR 25 million.

2/ The fourth review was originally scheduled to be completed by mid-September 2007, based on end-June 2007 performance criteria.

The review was completed with a delay on October 15, 2007, and was controlled by end-September 2007 performance criteria.

3/ The fifth review was originally scheduled to be completed by mid-December 2007 based on end-September 2007 performance criteria.

The review was subsequently completed with a delay on March 28, 2008, and was controlled by end-December 2007 performance criteria.

4/ The sixth review was originally scheduled to be completed by mid-June 2008, based on March 2008 performance criteria.

The review was subsequently completed with a delay on July 30, 2008, and was controlled by end-June 2008 performance criteria.

Table 12. Paraguay: Medium-Term Scenario

	2004	2005	2006	2007	2008	2009	2010	2011	2012
	Projections								
Real sector									
Real GDP growth (annual percentage change)	4.1	2.9	4.3	6.8	5.0	5.0	5.0	5.0	5.0
Consumer prices (annual percentage change)	2.8	9.8	12.5	6.0	7.5	3.0	3.0	3.0	3.0
GDP per capita (US dollars)	1,216	1,292	1,568	1,982	2,602	2,809	2,947	3,099	3,259
	(In percent of GDP)								
Gross domestic investment	19.2	19.8	19.6	18.4	18.7	19.6	19.9	20.3	20.5
Private sector	14.5	14.8	14.7	13.7	13.6	13.7	13.9	14.0	14.2
Public sector	4.7	5.0	4.9	4.7	5.1	5.8	6.0	6.2	6.3
Gross national savings	21.4	20.5	21.0	20.4	20.4	20.6	20.7	20.9	20.9
Private sector	14.9	14.7	15.4	13.7	14.7	14.8	14.8	14.7	14.6
Public sector	6.5	5.8	5.7	6.6	5.7	5.7	5.9	6.2	6.2
Public finances 1/									
Revenues	21.6	21.9	22.6	22.5	22.5	22.6	22.9	23.0	23.1
Current primary expenditures	15.1	15.5	15.9	15.4	16.2	15.9	15.6	15.5	15.4
Interest payments	1.6	1.6	1.6	1.5	1.4	1.5	1.6	1.5	1.5
Capital expenditures	4.7	5.0	4.9	4.7	5.1	5.8	6.0	6.2	6.3
Public enterprise operating surplus	1.4	1.4	2.0	1.2	1.0	0.7	0.3	0.3	0.2
Primary balance	3.2	2.8	3.7	3.5	2.1	1.5	1.6	1.5	1.5
Overall balance	1.8	0.9	0.8	2.0	0.7	0.0	0.0	0.0	0.0
Public sector debt 2/ 3/	45.1	37.7	27.7	22.4	17.1	16.3	15.7	15.2	14.7
Consolidated public sector debt 3/	49.2	43.0	34.2	29.0	25.7	25.5	24.9	24.0	23.1
	(In millions of U.S. dollars)								
Public sector debt 2/	3,027	2,876	2,807	2,773	2,815	2,877	2,969	3,071	3,187
Balance of payments									
Exports	2,854	3,352	4,405	5,464	6,557	7,407	8,397	9,518	10,795
Imports	3,102	3,811	5,099	5,972	7,098	7,963	9,022	10,232	11,617
Current account	143	56	139	232	277	178	150	119	79
(In percent of GDP)	2.1	0.8	1.5	1.9	1.7	1.0	0.8	0.6	0.4
Capital and financial account	41	305	260	450	423	185	213	245	285
Gross international reserves	1,168	1,298	1,703	2,462	3,162	3,526	3,890	4,254	4,618
(In months of imports)	3.4	2.8	3.2	3.9	4.4	4.3	4.7	4.6	4.4

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

1/ Defined as the nonfinancial public sector and the BCP.

2/ Nonfinancial public sector debt; excludes Central Bank bills.

3/ Based on end-of-period exchange rate conversion of U.S. dollar-denominated debt.

APPENDIX I. PARAGUAY—LETTER OF INTENT

Asunción, Paraguay
July 14, 2008

Mr. Dominique Strauss-Kahn
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Mr. Strauss-Kahn:

1. **Achievements.** Macroeconomic conditions have improved markedly since the adoption of the Stand-By Arrangement (SBA) in May 2006. Macroeconomic performance has exceeded most of the objectives under the SBA; economic growth reached an estimated 6¾ percent in 2007, public debt levels have been reduced to around 20 percent of GDP, and international reserves have reached record levels. However, while core inflation was reduced to 6 percent at end-2007, it reached a cumulative 4 percent over the first five months of 2008, mostly driven by international supply shocks on food and fuel items. A key challenge for the new administration that takes over on August 15 will be to consolidate these gains.
2. **Program implementation.** Performance under our economic program for 2008, supported by the SBA, has been quite strong.
 - **Quantitative performance criteria.** All performance criteria through end-March 2008 have been observed with large margins. In particular, international reserves have surpassed US\$3 billion and the public finances have recorded a surplus of about 1½ percent of GDP, both substantially above program objectives. We also believe that the end-June 2008 performance criteria have been met.
 - **Structural benchmarks.** All structural benchmarks through end-June 2008 have been met, except for the benchmark on the signing of revised result-oriented management contracts and development of business plans for five large state-owned enterprises, which was only partly satisfied due to time constraints and the imminent change of the government and the management of these companies.
3. **Sixth program review.** Against this background of good economic performance, the Government of Paraguay hereby requests the completion of the sixth and last review under the SBA-supported program.
4. **Expiration of the program.** We remain committed to the broad macroeconomic and reform agenda set out in previous Letters of Intent as the program comes to an end in August 2008. We encourage the new administration to maintain the productive and fruitful dialogue we have had with the Fund.

5. **Publication.** As part of our communication policy, we intend to publish this Letter in the websites of the Ministry of Finance and Central Bank to maintain our citizens informed about our policy intentions. We also authorize the Fund to publish this Letter.

Sincerely yours,

_____/s/_____
Germán Rojas
President
Central Bank of Paraguay

_____/s/_____
Miguel Gómez
Minister of Finance

INTERNATIONAL MONETARY FUND

PARAGUAY

Sixth and Final Review Under the Stand-By Arrangement—Informational Annex

Prepared by the Western Hemisphere Department
(In collaboration with other departments)

Approved by Jose Fajgenbaum and Matthew Fisher

July 21, 2008

	Contents	Page
1.	Fund Relations	2
2.	World Bank Relations.....	5
3.	Inter-American Development Bank Relations.....	7
4.	Statistical Issues	8

ANNEX 1. PARAGUAY—FUND RELATIONS
(As of May 31, 2008)

I. Membership Status: Joined December 28, 1945; Article VIII

II. General Resources Account:	In millions of SDRs	In percent of Quota
Quota	99.90	100.00
Fund holdings of currency	78.43	78.51
Reserve position in Fund	21.48	21.50

III. SDR Department:	In millions of SDRs	Percent of Allocation
Net cumulative allocation	13.70	100.00
Holdings	28.27	206.39

IV. Outstanding Purchases and Loans: None

V. Latest Financial Arrangements:

Type	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
Stand-By	May 31, 2006	Aug 31, 2008	30.00	0.00
Stand-By	Dec 15, 2003	Nov 30, 2005	50.00	0.00

VI. Projected Payments to Fund

(SDR Million; based on existing use of resources and present holdings of SDRs):

	Forthcoming			
	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>
Principal				
Charges/Interest	0.00	0.00	0.00	0.00
Total	0.00	0.00	0.00	0.00

VII. Exchange Rate Arrangement: The currency of Paraguay is the Paraguayan *guaraní*. The exchange rate regime is a managed float. The exchange rate is determined in the interbank foreign exchange market, but the central bank intervenes in the foreign exchange and monetary markets to smooth out exchange rate fluctuations in real effective terms. The U.S. dollar is the principal intervention currency. On May 30, 2008, the average interbank rate for the U.S. dollar was ₡4,070 =US\$1. Paraguay has accepted the obligations of Article VIII, Sections 2(a), 3 and 4 of the Fund's Articles of Agreement. Staff is considering whether the application of the income tax regime may give rise to exchange restrictions subject to Fund jurisdiction.

VIII. Article IV Consultation: The Executive Board concluded the 2007 Article IV consultation on June 29, 2007.

IX. Technical Assistance:

Department	Purpose	Date of Delivery
MFD	Reorganization of the Central Bank and Monetary Operations	January 2004
FAD	Customs Administration Advisor	July 2004–May 2005
MFD	Monetary Operations and Monetary Policy Formulation	October 2004
MFD	Public Banking Restructuring	February 2005
FAD	Customs and Tax Administration	February 2005
MFD and WB	FSAP Mission	April 2005 and July 2005
FAD	Update of ROSC	September 2005
STA	ROSC	January–February 2006
MFD	Central Bank Recapitalization	March 2006
MFD	Peripatetic Banking Expert	October 2005, February and August 2006
FAD	Public Financial Management	March 2006
FIN	Safeguards Assessment	March 2006
STA	Consumer Price Index	April –May 2006
FAD and LEG	Tax Procedure Code	May 2006
LEG	Money Laundering	July 2006
STA	Monetary and Financial Statistics	August–September 2006
MCM	Payments System	October 2006
STA	Balance of Payments	November 2006
FAD	Revenue Administration	December 2006
FAD	Peripatetic Customs Advisor / Customs Administration	May, August, and December 2007
FAD	Tax Code Regulations	June 2007
MCM	Development of Local Capital Markets	June 2007
MCM	Banking Regulation and Supervision	June, August, and November 2007
STA	Quarterly National Accounts	August 2007
STA	Consumer Price Index	August 2007
STA	Monetary and Financial Statistics	November 2007

Department	Purpose	Date of Delivery
MCM	Bank regulation and supervision	February - March 2008, June 2008
FAD	Tax Administration Strategic Planning	April 2008

X. Safeguards Assessment: Under the Fund's safeguards assessment policy, Central Bank of Paraguay (CBP) is subject to a full safeguard assessment in respect to the arrangement approved on May 31, 2006. A safeguards assessment of the CBP was completed in October 2006. The report states that while the CBP has made some progress in strengthening the safeguards framework since the 2003 safeguards assessment, vulnerabilities remain in certain areas such as financial reporting and program data reporting to the Fund.

XI. Resident Representative: Mr. Tobias Roy has been appointed as resident representative since December 2007.

ANNEX 2. PARAGUAY—WORLD BANK RELATIONS¹

(As of June 19, 2008)

The Country Assistance Strategy (CAS) was approved in December 2003. It aimed at restoring confidence in the economy and at supporting reforms in key areas of the economy, such as financial sector, rural development, health, and education. At the moment the Bank's portfolio consists of four operations, of which three are projects under implementation:

- Pilot Community Development (US\$9 million, approved in FY02).
- Secondary Education Reform (US\$24 million, approved in FY04).
- Road Maintenance Project (US\$74 million, approved in FY07).

One project is awaiting Parliament approval:

- Sustainable Agricultural Development (US\$37.5 million, approved in January 2008).

The four World Bank-financed projects presently under implementation or awaiting ratification by Parliament have a total value of US\$144.5 million in commitments, of which US\$116.4 million remain undisbursed as of May 31, 2008.

In addition to loans, the Bank has mobilized grants for the institutional strengthening of Congress (US\$0.4 million) and the Ministry of Finance (US\$0.3 million); for improving the management of indigenous lands (US\$1.7 million); to support social development in two municipalities (US\$0.9 million); to promote development in indigenous communities (US\$1.6 million), and to improve biodiversity and forestry (US\$0.3 million from the Institutional Development Fund, and US\$0.3 million and US\$0.9 million from the Global Environment Fund). Paraguay has also elected to become a governance and anti-corruption (GAC) pilot country. A high level seminar on governance, to be convened by the authorities and organized with the support of the Bank is likely to take place soon after the new Government takes office in mid-August.

On the analytical front, in FY07 the Bank completed a Land Tax Study and an Integrated Fiduciary Framework (jointly with the Interamerican Development Bank and the European Union). A Secondary Education Attainment Assessment was completed in FY08. The Policy Notes for the New Administration were also completed in FY08 and will be presented to the incoming administration at the end of June 2008.

While the CAS has now formally expired, the Bank is proceeding with the preparation of two additional projects already included in this CAS (Additional Financing for the Pilot Community Development Project, and a Water Reform Project). A new CAS will be prepared with the forthcoming administration and presented to the Board in late FY09.

¹ Prepared by the staff of the World Bank..

Financial Relations With The World Bank

(In millions of U.S. dollars)

I. IBRD/IDA Active Operations (as of May 31, 2008)

	Committed (Net of Cancellations)	Disbursed	Undisbursed
Active loans			
Community development	9.0	8.7	0.3
Education Reform	24.0	19.4	4.6
Road Maintenance	74.0	0.0	74.0
Sustainable Agricultural Development	37.5	0.0	37.5
Total active loans	144.5	28.1	116.4
Total IBRD/IDA²		1,083.8	
Repaid		626.0	
Total outstanding		228.9	
O/w IBRD (including exchange rate adjustment)		211.2	
O/w IDA		17.7	

II. IFC Operations (as of May 31 2008)

	Loans	Equity	Total
Commitments	0.0	0.0	0.0
Held by IFC	0.0	0.0	0.0
Undisbursed	0.0	0.0	0.0

III. IBRD/IDA Loan Transactions (calendar year)

	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Disbursements	37.7	42.1	46.6	26.8	13.5	42.3	16.2	16.7	31.9	13.0
Repayments	24.6	24.6	20.2	15.3	16.8	21.0	34.8	26.6	27.5	28.9
Net Lending	13.1	17.5	26.4	11.5	-3.3	21.3	-18.6	-9.9	4.4	-15.9

² As of January 31, 2008

ANNEX 3. PARAGUAY—INTER-AMERICAN DEVELOPMENT BANK RELATIONS¹
(As of May 30, 2008)

Portfolio

As of May 30, 2008, the active loan portfolio amounts to US\$716.2 million, with an undisbursed balance of US\$479 million. In addition, there are 68 active Technical Cooperation operations (regular TCs, MIF, and Small Projects) for US\$23.8 million, of which US\$15.1 million are undisbursed. Loan approvals in 2008 have reached US\$58 million.

Strategy

A review of IDB's Country Strategy with Paraguay was approved in November, 2006. The main focus of IDB's actions for 2008 will be the support of economic growth and modernization of the state. During 2008 a new IDB strategy for 2009-2013 will be prepared in accordance with the new government's priorities. It is expected that the main emphasis will be placed on social programs for poverty alleviation.

Pipeline

The lending program for 2008 includes the following operations:

- a. Conditional Line of Credit for AFD, \$50 million (approved).
- b. Environmental System Support II Phase, US\$8 million (approved).
- c. Strengthening of the Customs Administration II Phase, US\$9.0 million .
- d. Strengthening of the Fiscal Administration II Phase, US\$9.5 million.
- e. Integrated Municipal Fiscal Management and Development, US\$120 million.
- f. Trade Facilitation Banco Sudameris, US\$5 million.

Expected total 2008: US\$201.5 million.

¹ Prepared by the staff of the IDB.

ANNEX 4. PARAGUAY—STATISTICAL ISSUES

Data provision to the Fund has some shortcomings, but is broadly adequate for surveillance. Following a data ROSC mission in January–February 2006, the authorities' response to the report and the mission's recommendations were published on the Fund's website on June 30, 2006. The country is a GDDS participant.

A. Real Sector

National accounts estimates, broadly consistent with the guidelines of the *1993 SNA*, were released in 2005. However, no comprehensive regular program for data collection through economic censuses and surveys exists (an industrial survey was conducted in 2002) and source data for nonfinancial services, household consumption, and changes in inventories are insufficient. Major areas of concern include: (i) the 1994 reference year needs to be updated; (ii) excessive use is made of fixed coefficients for value added and household consumption; (iii) changes in inventories are obtained residually; (iv) informal activities are not monitored; and (v) supply and use tables have been compiled only until 1997. While the periodicity of annual GDP meets GDDS recommendations, timeliness does not because data are disseminated with a lag of 11 months. An STA mission on the compilation of quarterly national accounts (QNA) was fielded in August 2007. The mission agreed with the authorities on a work plan for the production of provisional QNA series by end-2008. Production of definite QNA series would need to await a revision of the national accounts base year and the compilation of supporting basic data, which are tentatively scheduled for completion by 2009/10. A follow-up QNA mission is currently scheduled for early-August 2008.

Both the consumer (CPI) and producer price indices (PPI) are reported on a regular and timely basis. From January 2008, the Central Bank of Paraguay (BCP) is using a new CPI index based on the 2005–06 household budget survey. The geographic coverage of the CPI is limited to Asunción (the capital) and expenditure weights are representative of the consumption patterns of urban households. The PPI has a base weight period of December 1995 and its basket (150 items) is not fully representative of current national output; electricity, water, gas, and services are not covered.

Since the introduction of a regular household survey in 1998, the coverage and quality of employment and unemployment statistics have improved significantly. However, frequencies remain at the annual level, and the publication lag is close to one year. Wage indices are updated twice a year.

The data ROSC mission found that the resources are insufficient for real sector statistics and constrain further development, particularly the full adoption of the *1993 SNA*. The authorities have been trying to address these resource shortcomings in the context of the recent compilation of a new CPI and the production of provisional QNA series.

B. Fiscal Sector

The Government finance statistics (GFS) used for internal purposes and for reporting to WHD are broadly consistent with the recommendations of the *Manual on Government Finance Statistics 1986 (GFSM 1986)*. The authorities have not yet prepared a plan to migrate to the *Government Finance Statistics Manual 2001 (GFSM 2001)*. Monthly data are available for the central administration (budgetary central government). The asset position of the social security system is available on a daily basis. Statistics on the central administration include data of the Postal Service Directorate (a nonfinancial public corporation) and the statistics of the nonfinancial public sector include data of financial public corporations—four employer social insurance schemes. These social insurance schemes are treated as financial corporations in the monetary and financial accounts. Data on medium- and long-term external debt are reliable and available on a monthly basis. Domestic debt data are available on request, but need to be fully integrated with the external debt database. Deficiencies remain in recording short-term supplier and commercial credit of the public sector. Moreover, there is a discrepancy in the fiscal data reported by the monetary and fiscal authorities. Measures are being taken to make reporting more transparent.

Annual data covering general government for 2006 have been reported for publication in the *2007 edition of the GFS Yearbook*. However, since 1994 no outstanding debt data and no breakdowns for expenditure by function have been provided for publication in the *GFS Yearbook*. Monthly and quarterly data are not reported for publication in *IFS*.

C. Money and Banking Sectors

Paraguay completed the establishment of a unified compilation and reporting system for the whole range of monetary data. This new system intends to harmonize monetary data for use within the BCP, for reporting to STA for publication in *IFS*, and for operational and monitoring purposes. A revision of the classification criteria has led also to a marked reduction in the discrepancies of interbank positions. However, the lack of coverage of the credit cooperatives remains a matter of concern since they account for around 25 percent of deposits and loans of the banking sector. The BCP, with assistance from STA, plans to include monthly data of the 20 largest credit cooperatives in the monetary survey during 2009. The superintendence of banks publishes a detailed and informative report on the soundness of the financial system.

D. External Sector

The classification of the balance of payments and the international investment position (IIP) follows the recommendations of the *Balance of Payments Manual*, 5th edition. Quarterly and annual data on balance of payments and the IIP are available from 2001 onwards on the central bank website, and are reported only once a year to STA for publication in the *IFS*. Improvements have been made in the quality of the data on capital flows, especially in the coverage of foreign direct investment, and in the recording of external debt transactions. Special studies by the central bank have improved the estimation methods for remittances of Paraguayans abroad and unregistered trade transactions, but serious deficiencies remain.

Also, there are deficiencies in the area of private capital outflows, which are difficult to register due to Paraguay's open capital account. An STA mission on Balance of Payments Statistics assisted the BCP in November 2006 in implementing recommendations of the ROSC mission. In particular, the mission focused on: (1) assessing the surveys used to capture data on services, direct investment, nonfinancial private sector portfolio investment, and other investment; (2) reviewing and updating the statistical techniques used to calculate unrecorded trade; (3) reassessing the treatment of the binational hydroelectric energy enterprises in the external sector accounts; and (4) reviewing and preparing a preliminary template for reporting data on international reserves and foreign currency liquidity.

Paraguay: Table of Common Indicators Required for Surveillance
(As of February 29, 2008)

	Date of latest observation	Date received	Frequency of Data ¹	Frequency of Reporting ¹	Frequency of publication	Memo Items:	
						Data Quality Methodological soundness ^{7/}	Data Quality Accuracy and reliability ^{8/}
Exchange Rates	May 2008	6/18/08	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities ²	Apr. 2008	5/28/08	D	M	D		
Reserve/Base Money	May 2008	6/10/08	D	M	D	O, LNO, LO, O	O, O, O, LO, LO
Broad Money	Apr. 2008	6/10/08	M	M	M		
Central Bank Balance Sheet	Apr. 2008	6/10/08	D	M	D		
Consolidated Balance Sheet of the Banking System	Apr. 2008	6/10/08	M	M	M		
Interest Rates ³	Apr. 2008	6/10/08	M	M	M		
Consumer Price Index	May 2008	6/18/08	M	M	M	O, LO, O, O	O, LO, LNO, O, LO
Revenue, Expenditure, Balance and Composition of Financing ⁴ —General Government ⁵	Jun. 2006	08/03/07	M	M	M	LO, LO, LO, LO	LO, LNO, O, LO, LO
Stocks of Central Government and Central Government-Guaranteed Debt ⁶	Q1 2007	07/19/07	Q	Q	Q		
External Current Account Balance	Q1 2007	07/19/07	Q	Q	Q	O, LO, LO, LO	LO, O, LO, LO, LO
Exports and Imports of Goods and Services	Q4 2006	09/06/07	M	M	M		
GDP/GNP	2007	04/07/08	A	A	A	O, LO, LO, LO	LO, O, LNO, O, LO

¹ Daily (D); Weekly (W); Monthly (M); Quarterly (Q); Annually (A); Irregular (I); Not Available (NA).

² Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.

³ Both market-based and officially-determined, including discounts rates, money market rates, rates on treasury bills, notes and bonds.

⁴ Foreign, domestic bank, and domestic nonbank financing.

⁵ The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.

⁶ Including currency and maturity composition

⁷ Reflects the assessment provided in the data ROSC published on June 30, 2006 and based on the findings of the mission that took place during January 25–February 8, 2006. For the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning (respectively) concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O), largely observed (LO), largely not observed (LNO), or not observed (NO).

⁸ Same as footnote 7, except referring to international standards concerning (respectively) source data, assessment of source data, statistical techniques, assessment and validation of intermediate data and statistical outputs, and revision studies.

**Statement by the IMF Staff Representative
July 30, 2008**

This statement provides additional information on developments since the issuance of the staff report for the sixth and final review under the Stand-By Arrangement for Paraguay. This information does not change the thrust of the staff appraisal.

I. RECENT DEVELOPMENTS

1. **The economy continues to enjoy strong and broad-based growth, with significant upside risks to the program's growth projection for 2008.** Recently released

quarterly GDP data indicate that the economy grew at an annual rate of 7½ percent in the first quarter of 2008. In contrast with the concentrated growth pattern of 2007, the economic expansion in early 2008 was broad-based with agricultural production in the double-digit growth rates, livestock and industry recovering from last year's weak performance, while the service sector continuing to be supportive. The completion of infrastructure projects has also contributed to a high growth of the construction sector.

Paraguay: Real GDP Growth (Year on Year, Percent)			
	2007	2008	
		Act. Q1	Prog. Year
Real GDP	6.8	7.6	5.0
Agriculture	24.1	13.6	8.0
Livestock	-4.7	10.1	3.5
Industry	1.0	7.4	3.2
Services	5.5	4.7	4.7

Sources: BCP and Fund staff estimates.

2. **Fiscal policy reinforced its counter-cyclical stance.** The fiscal position further strengthened during the second quarter of 2008. Despite the sharp appreciation of the *guaraní*, which reduced customs revenues and royalties (in local currency terms), overall revenue performance was very strong, with a growth of about 20 percent (yoy). At the same time, expenditures were well-contained, growing by 15 percent. As a result, the overall surplus increased further, to about 2¼ percent of GDP in the first half of 2008.

3. **Monetary expansion has slowed modestly.** Since switching open market operations procedures from fixing LRM rates to conducting weekly auctions of LRMs in mid-June 2008, the Central Bank has continued to mop up liquidity to reduce the growth of monetary aggregates. The annual growth of currency in circulation has declined moderately to 33 percent in late-July 2008, after having peaked at almost 40 percent at end-May 2008. This positive development is also partly due to the 2 percentage point increase in reserves requirements in mid-June 2008.

II. PERFORMANCE CRITERIA AND STRUCTURAL BENCHMARKS

4. **All performance criteria for end-June 2008 were met, most with large margins.** Table 1 (attached) includes all the quantitative performance criteria.

5. **The benchmarks expected to be completed before the end of the arrangement were implemented.**

As noted in the staff report, the authorities were expected to meet four out of the five benchmarks due for this review (a fifth benchmark, related to the state-owned enterprises was only partly met). Two of the five measures had already been completed by the time the report was published (conditional cash transfers and consolidation of Treasury accounts) and the remaining two benchmarks have now been implemented:

Paraguay: Targets for Sixth SBA Review			
	Prog.	Actual	
(In percent of GDP)			
Fiscal Targets			
Fiscal balance 1/	0.3	2.2	✓
Wage bill 1/	3.6	3.5	✓
Consolidated balance	0.4	3.3	✓
(In percent of currency)			
Monetary Targets			
Net international reserves	49.0	165.3	✓
Net domestic assets	-28.9	-129.1	✓

Sources: Paraguayan authorities and Fund staff.
1/ Central administration.

- **Central Bank's balance sheet.** As part of the strategy to strengthen the financial position of the Central Bank (BCP), the authorities sent today to the attorney general the disputed claims between the BCP and the Ministry of Finance.

Paraguay: Structural Benchmarks for Sixth SBA Review			
Measure	Due Date		Status
1. Economic Cabinet approval of the draft payments system law	Sep 2007	●	Done. Economic Cabinet approved the draft law in late-July 2008.
2. Increase coverage of the conditional cash transfer program to 19,000 families	May 2008	●	Done. There were 19,500 families covered by end-May 2008.
3. Sign result-oriented management contracts for 2008 with SOE and design business plans	May 2008	◐	Partly done. Contracts not signed, but some business plans completed.
4. Send to Attorney General for his review and clearance the claims in dispute between BCP and MinFin	May 2008	●	Done. Claims sent to Attorney General in late-July 2008.
5. Consolidate all Treasury accounts not established by law into one account	Jun 2008	●	Done. Account consolidation took place in early-July 2008.

Sources: Paraguayan authorities.

- **Payment system.** A revamped legal and regulatory framework for the payment system has been prepared and a draft payment system law has been approved by the Economic Cabinet.

Table 1. Paraguay: Quantitative Performance Criteria

	2007						2008					
	End-Jun		End-Sep		End-Dec		End-Mar		End-Jun		End-Jun	
	Prog.	Actual	Prog.	Actual	Prog.	Actual	Prog.	Actual	Prog.	Actual	Prog.	Actual
Fiscal targets												
1. Overall balance of the central administration (floor, in billions of guaranies) 1/	184	1,054 ✓	330	1,162 ✓	0	546 ✓	95	802 ✓	213	1,497 ✓		
2. Wage bill of the central administration (ceiling, in billions of guaranies) 1/	2,055	1,940 ✓	3,086	2,949 ✓	4,443	4,360 ✓	1,195	1,167 ✓	2,429	2,364 ✓		
3. Overall balance of the public sector (floor, in billions of guaranies) 1/	202	1,669 ✓	459	1,930 ✓	0	930 ✓	172	1,292 ✓	253	2,045 ✓		
Monetary targets												
4. Net international reserves (floor, in millions of U.S. dollars) 2/	1,900	2,153 ✓	1,915	2,182 ✓	1,920	2,462 ✓	2,412	2,638 ✓	2,462	3,197 ✓		
5. Net domestic assets (ceiling, in billions of guaranies) 2/	-6,645	-7,762 ✓	-6,700	-7,756 ✓	-6,016	-8,229 ✓	-8,436	-9,285 ✓	-8,692	-11,917 ✓		
Public debt and arrears targets												
6. Contracting or guaranteeing of nonconcessional external debt by the NFPS (ceiling, in millions of US\$) 1/	500	0 ✓	500	10 ✓	500	254 ✓	500	70 ✓	500	227 ✓		
Continuous PCs												
7. Contracted or guaranteed short-term external debt by the NFPS	0	0 ✓	0	0 ✓	0	0 ✓	0	0 ✓	0	0 ✓		
8. Non-accumulation of external debt arrears	0	0 ✓	0	0 ✓	0	0 ✓	0	0 ✓	0	0 ✓		

Sources: Paraguayan authorities; and Fund staff estimates.

1/ Cumulative flows from the beginning of the calendar year.

2/ Stocks. NIR is adjusted upward (downward) for any increase (decrease) in reserve requirement for foreign currency deposits (above pre-specified amounts) and upward by the amount of any program disbursements. Similarly, the NDA target will be adjusted downward (upward) following the adjustment in the NIR.



Press Release No. 08/187
FOR IMMEDIATE RELEASE
July 31, 2008

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Completes Sixth and Final Review under Paraguay's Stand-By Arrangement

The Executive Board of the International Monetary Fund (IMF) today completed the sixth and final review of Paraguay's economic performance under a 27-month Stand-By Arrangement for an amount equivalent to SDR 30 million (about US\$49 million). Although completion of the review will make up to SDR 30 million (about US\$49 million) available to the country, the Paraguayan authorities intend to continue treating the arrangement as precautionary.

The original amount of the arrangement of SDR 65 million (about US\$107 million) was reduced—at the authorities' request—to SDR 30 million (about US\$49 million) at the time of the fourth review (see [Press Release No. 07/231](#)). The Stand-By Arrangement was approved May 31, 2006 (see [Press Release No. 06/117](#)), and expires on August 31, 2008.

Following the Board's discussion of Paraguay's economic performance, Mr. Murilo Portugal, Deputy Managing Director and Acting Chair, said:

“Paraguay has had a commendable track record of successful policy implementation under two successive stand-by arrangements. The country's macroeconomic fundamentals are currently among the best in over a quarter of a century, notwithstanding the recent increase in inflation. Notable achievements over the past five years have been a more than doubling of per capita GDP; the halving of public debt; the tripling of external reserves; the considerable strengthening of the financial sector and elimination of systemic risks.

“Overall macroeconomic performance continues to be good. After record real GDP growth in 2007, growth is expected to continue to be robust, driven by agricultural exports. In an effort to address inflationary pressures from food and energy price increases, the central bank increased interest rates earlier this year and raised reserve requirements more recently. Fiscal discipline has been preserved, and international reserves have grown significantly.

“The Fund welcomes the authorities’ commitment to maintaining sound macroeconomic policies. They are to be commended for consistently maintaining fiscal discipline. The current countercyclical fiscal stance is appropriate given that the economy is growing above potential and that inflationary pressures are rising. The recent increase in reserve requirements is a welcome step, and a further tightening of monetary policy may be needed since monetary aggregates are growing rapidly, and interest rates have become negative in real terms.

“The central bank’s financial position will need to be sustainably strengthened, and reforms of state-owned enterprises will improve efficiency and service delivery. The Fund looks forward to continued close cooperation with the Paraguayan authorities in the period ahead,” Mr. Portugal stated.

**Statement by Javier Silva-Ruete, Executive Director for Paraguay
and Jose Maciel, Senior Advisor to Executive Director
July 30, 2008**

On behalf of the Paraguayan authorities, we thank the staff for a thoughtful report and for the open and useful policy discussions held with the Paraguayan authorities on the occasion of the sixth and final review of the Stand-By Arrangement (SBA).

General Remarks

1. The Paraguayan economy has been steadily improved during the last five years, concurrent with the two SBAs signed with the IMF and a positive external environment. All performance criteria were met, some by large margins, and most of the structural conditionalities are expected to be fully completed by the end of July 2008. The staff rightly points out that the macroeconomic outcomes were significantly better than anticipated, while there is a wide consensus among the staff and the authorities that the two successive SBAs were successful in buttressing economic stability, boosting growth, deepening structural reforms and reducing poverty.

2. The Paraguayan authorities are committed to meeting the program's targets that are still in progress, and the newly elected authorities have already signaled their support to consolidate macroeconomic stability and to pursue further structural reforms. Although they do not wish to request a successor SBA at the completion of the current one, they have expressed their intention to maintain a fluid dialogue and strong relationship with the Fund.

Recent Developments – Outlook

3. In 2007, Paraguay's real GDP grew 6.8 percent as the result of strong recovery of the agricultural sector, mainly driven by improved productivity and expansion of soybean crops. This outcome was extraordinary not only because it has duplicated the historical average growth of the country, but it was also higher than most neighboring countries. The outlook for the present year remains positive mainly due to a continued expansion of agriculture and an expected recovery of the livestock sector.

4. According to the Central Bank of Paraguay (BCP)¹, annualized GDP growth reached 7.6 percent at the end of the first quarter of 2008. The best performer was the construction sector which registered a 24.6 percent growth compared with the first quarter of last year, mostly thanks to the works in the Yacyreta Hydroelectrical Dam—the completion of which is projected by end-2008. In the same period, exports registered an annual growth of 13.6 percent, while imports grew 16.5 percent on an annual basis. Under the present developments, the authorities expect real GDP will grow more than the projected 5 percent in 2008.

¹ Updated Report on GDP – Quarterly and Annual Information, First Quarter 2008.

5. The main concern of the Paraguayan authorities is the recent surge in inflation, which has exceeded the target range of the SBA (core inflation between 2½-7½ percent). Although erratic and volatile, last year's inflation fell to 6 percent from 12.5 percent at the end of 2006. During the first six months of this year, headline inflation had reached 5.4 percent and it rose to 13.4 percent year-on-year at end-June. As is the global trend, external shocks stemming from high food and fuel prices have had a negative impact on the consumer price index (CPI). The food component weights about 35 percent in the CPI basket and food prices had increased by 26 percent year-on-year at the end of June, thus speeding up inflation.

6. Moreover, considering the percentage changes in the different components of domestic demand, the authorities do not believe the economy is overheating. Domestic and public consumption growth are lower than GDP growth and the increase in domestic demand is explained by the high growth in export-oriented investments, mainly in the agricultural and livestock sectors. However, the authorities are committed to maintain price stability and to switch to a tougher stance in order to bring inflation to a more comfortable level by the end of the year.

7. The *guarani* has gone through a long period of appreciation, which started in 2003. In the first six months of 2008, the *guarani* has appreciated by almost 20 percent against the U.S. dollar, and when compared with the end-2002 exchange rate, the dollar value has decreased almost by half in *guarani* terms. This trend reflects the worldwide weakness of the dollar, as well as strong capital inflows. Although non-traditional exports are negatively affected by the appreciation of the Paraguayan currency, exports from the agricultural and livestock sectors would not necessarily be hampered thanks to large investments made to enhance productivity. In this regard, the BCP is willing to intervene in the foreign exchange market to alleviate the destabilizing effects of sharp appreciation. The authorities will not seek to change the long-term trend of the currency but, in the short term, they believe that is possible to affect the speed of the adjustment. The authorities are pleased with the staff's appraisal that the exchange rate is in line with fundamentals.

8. Continuing the trend of recent years, strong foreign currency inflows have led to continued reserves purchases by the BCP to avoid a sudden appreciation of the exchange rate. Since the beginning of the year, international reserves have increased by almost 30 percent to record levels equivalent to 4 months of imports or 1.6 times the volume of foreign currency deposits in the banking system. The strong reserve position will shield the economy from external shocks and a further deterioration of the global economy.

9. Regarding the international claims in dispute, the authorities are closely monitoring the developments and they are engaged in resolving the pending issues with the involved parties.

Fiscal Developments

10. Sound fiscal policies were constantly employed throughout the program. This year, improved tax collections and government expenditures constrained by the financial plan approved by the Ministry of Finance (MH), resulted in an overall fiscal surplus of 1½ percent of GDP at the end of May 2008. This outcome was possible despite the 2008 budget position

(deficit) approved by Congress. The authorities have agreed with the staff to maintain and even tighten the fiscal stance to contain inflationary pressures. The aim is to improve the program goal's overall balance by saving the proceeds of the first semester to achieve an overall surplus of ½ percent of GDP by end-2008. The authorities concur with the staff on the importance of applying tight expenditure controls without holding back capital infrastructure, although they recognize this would be a difficult task given the rigidities of the budget and the social pressures that the new government is already sensing.

11. In general, tax revenues have improved during the execution of the SBAs, especially thanks to the reforms introduced in tax administration and customs enforcement. Regarding expenses, the implementation of the expenditure commitment control system and the establishment of a Single Treasury Account to consolidate all accounts not established by law were positive steps commended by the staff. The public debt (excluding BCP notes) has decreased to around 22 percent of GDP and it is projected to decline further to 17 percent of GDP by end-2008. Although these achievements were difficult to attain, the authorities recognize the need for further reforms—especially in the budgetary process—and they are willing to address this issue with the incoming authorities.

Monetary Developments

12. Considering the acceleration of inflation since the beginning of 2008, the BCP has started to tighten its monetary policy by increasing the interest rate of its notes by 150 basis points in March 2008 and later by increasing banking reserve requirements. To optimize monetary interventions, the BCP has changed the modality to conduct open market operations by switching to weekly competitive auctions of its notes from fixed interest rate notes. The outcome was positive since the amount sterilized has increased and the interest rate has slightly decreased. With these measures, the authorities remain confident that the annual monetary growth—currently at 34 percent—will be slowly and gradually reduced to a reasonable level compatible to a single digit inflation in the short term.

13. However, the monetary authorities have agreed that in the event of a worsening scenario, they are ready to switch to a tougher stance, although they have concerns that additional interest rate increases combined with the strong appreciation of the *guarani* could lead to large inflows of carry trade monies, complicating the monetary management. Therefore, future tightening is going to be carefully evaluated before taking action.

Financial Developments

14. The financial system continues to perform well, despite the global financial turmoil. The staff points out that foreign banks' funding from parent banks and other international banks account for less than 2 percent of liabilities, which indicates a low exposure to liquidity risks coming from a deterioration of the banking credit abroad. In addition, banks are well capitalized, profitable, and adequately provisioned. The rapid credit expansion has not affected the quality of the portfolio, since nonperforming loans are steadily declining. Although credit growth is high compared to other sectors' growth, the percentage of private credit to GDP (18 percent) it is still low when contrasted to the level of past years, as well as in relation to other economies in the region. Moreover, the credit growth reflects the better

positioning of the country's economy after years of stagnation. Figure 4 of the staff report clearly exposes the banking credit crunch after successive banking failures and the gradual recovery after the crisis.

15. One of the most successful stories was the recovery of the National Development Bank (BNF), a public financial entity. The reforms implemented by the authorities have been rewarding and by end-2007 the bank presented a capital adequacy ratio that doubles the minimum required and a reduced NPL rate of only 7.8 percent. These indicators are impressive, after the bank had been assessed as an insolvent institution with a record ratio of 48 percent of NPL to total outstanding loans. However, the reforms must continue to improve and align the BNF's indicators in relation to those of private banks.

16. The Paraguayan authorities are grateful for the continued support from Fund missions and technical assistance, which enabled a successful restructuring of the financial system. In this regard, they expect to continue the fruitful dialogue to continue improving the prudential environment and address the shortcoming in the regulatory and supervisory framework through future technical assistance missions.

Structural Reforms Developments

17. Most of the structural conditionalities were met and those which are in progress are expected to be completed in the coming days. One of the most important reforms refers to the implementation of a renewed payment system along with the approval of the draft of the payment system law. This draft was originally projected to be approved by the Economic Cabinet by end-September 2007, but it was delayed until recently. The BCP's authorities stated that the draft was remitted to the Economic Cabinet a week ago after a thorough review by involved parties and receiving technical advice from the World Bank. The Vice Minister of Economy has already issued a press release informing that the final draft was approved and it will be sent to Congress in the coming days.

18. Regarding the capitalization of the BCP, it's been agreed by the monetary and fiscal authorities to strengthen the financial position of the bank. By end-2007, two Presidential decrees had approved the reconciliation of claims between the MH and the BCP and the issuance of bonds to clear this debt. Two months ago, a new decree was enacted to authorize the payment using the 2008 budget. The MH is now in the process of transferring the bonds to the BCP. Moreover, the MH is also in the process of sending the remaining claims that are still in dispute to the Attorney General for his compliance, prior to forwarding a draft legislation to Congress for its approval.

19. The benchmark regarding the signing of result-oriented contracts and the adherence to performance standard by five State Owned Enterprises (SOEs), were not fully met. All entities presented their business plans but these were weak and incomplete. We concur with the staff's assessment that the underperformance in this area was a consequence of the uncertainties associated with the post-election political transition period, taking into account that the managers of these SOEs will not remain in office (the inauguration ceremony of the recently elected authorities will be held on August 15). However, under prior contracts some important structural and operatives changes had taken place in some of these SOEs.

Moreover, the publication of the SOEs' audits and their quarterly assessments by the Supervisory Council of Public Enterprises is a welcome development, which has already brought transparency and is expected to convey accountability to these public entities.

20. Finally, the implementation of the conditional-cash transfer program known as Tekoporã continues to be a successful experience. By end-May 2008, more than 19,000 low-income families had received transfers from the program. Although the program was not designed to deal with the current food crisis, it has helped the poor sectors of the population alleviate the distress caused by the food price increases. The authorities are planning to expand the coverage of the social safety net program to 100,000 households by the end of the year. Although this target may imply logistical problems, the authorities are willing to take the risk in order to cope with the food crisis. The staff's presentation included in Box 3 of their report, reflects a fair assessment of the program.

Closing Remarks

21. The structural reforms that have been implemented are strong signals of the Paraguayan authorities' commitment to achieve the necessary changes to improve the business climate, attain a high level of investment, and continued growth. The recent positive economic outcomes have placed the country in good position to weather possible external shocks and to continue its path of macroeconomic stability and growth, which will reduce poverty and inequalities.

22. The authorities believe that the implementation of the program has been successful in the completion of its targets, for which they want to thank the staff and Management for their support. In this regard, we would like to mention that the authorities consent to the publication of the staff report. Going forward, the newly-elected authorities have mentioned their willingness to continue the fruitful dialogue with the Fund and they are looking ahead to strengthening the engagement, especially through technical assistance support.