

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

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

- The staff report for the First Review Under the Stand-By Arrangement, prepared by a staff team of the IMF, following discussions that ended on December 12, 2007, 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 March 18, 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 Press Release summarizing the views of the Executive Board as expressed during its March 28, 2008 discussion of the staff report that completed the review.
- A statement by the Executive Director for Paraguay.

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

Letter of Intent sent to the IMF by the authorities of Paraguay*
Memorandum of Economic and Financial Policies by the authorities of Paraguay*
Technical Memorandum of Understanding*

*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

Fifth Review Under the Stand-By Arrangement

Prepared by the Western Hemisphere Department

(In consultation with other departments)

Approved by José Fajgenbaum and Matthew Fisher

March 18, 2008

EXECUTIVE SUMMARY

- **Arrangement.** A 27-month Stand-By Arrangement (SBA) for SDR 65 million (or 65 percent of quota) was approved by the Executive Board on May 31, 2006 (expiring in August 2008). A reduction in access to SDR 30 million was approved during the fourth review, which was completed on October 15, 2007. The authorities continue treating the arrangement as precautionary.
- **2007 Developments.** The economy is estimated to have grown almost 6½ percent, driven by dynamic exports. After a period of falling prices, inflation rebounded in the second half of the year, mostly due to food supply shocks, and headline inflation ended at 6 percent. Fiscal discipline has been preserved despite intense expenditure pressures. Monetary policy switched to a tightening phase in response to price pressures, and the currency was allowed to appreciate. Reserves rose to US\$2½ billion at year-end.
- **Review.** The program remains on track. All performance criteria for end-September and end-December 2007 were observed. With three exceptions, all structural measure for end-September and end-December 2007 were observed.
- **2008 Program.** The macroeconomic objectives for 2008 are to achieve a real GDP growth of 4 to 5½ percent and an inflation rate of 5 percent (within the range of ± 2½ percentage points). Despite approval of an expansionary 2008 budget, the authorities have designed a financial plan that aims at overall fiscal balance. Monetary policy will anchor expectations by limiting currency growth and pursuing a policy of no Central Bank credit expansion, while accumulating at least US\$100 million in international reserves. The reform agenda is parsimonious, but includes measures in all the reform pillars.
- **Discussions.** These took place from November 28 to December 12, 2007. The mission met with Central Bank President Rojas, Finance Minister Barreto, Industry Minister Ibarra, Education Minister Jimenez, Deputy Finance Minister Alarcon, senior government officials, representatives of the banking community, and the private sector. The staff team consisted of A. Santos (head), M. Mlachila, B. Monfort (all WHD), B. Barkbu (PDR), A. Lemgruber (FAD) and J. Gasha (MCM). 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.
- **Appraisal.** Staff supports completion of the fifth review given the strong performance.

LIST OF ACRONYMS

ANDE	National Electricity Company
BCP	Central Bank of Paraguay
BCPEBS	Basel Core Principles of Effective Banking Supervision
BNF	National Development Bank
CADEF	Ranking of Financial Institutions
CAR	Capital Adequacy Ratio
CCT	Conditional Cash Transfer
COPACO	Public Telephone Company
DSA	Debt Sustainability Analysis
ESSAP	Public Water and Sewage Company
FAD	Fiscal Affairs Department
FSAP	Financial Sector Assessment Program
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
LEG	Legal Department
LOI	Letter of Intent
LRM	Central Bank Bills
MCM	Monetary and Capital Markets Department
MEFP	Memorandum of Economic and Financial Policies
NDA	Net Domestic Assets
NFPS	Non-Financial Public Sector
NIR	Net International Reserves
NPL	Nonperforming Loans
PC	Performance Criteria
PDR	Policy Development and Review Department
PFM	Public Financial Management
PETROPAR	Public Petroleum Company
ROSC	Report on the Observance of Standards and Codes
SAS	Undersecretary of Social Action
SB	Structural Benchmark
SBA	Stand-By Arrangement
SDR	Special Drawing Rights
TMU	Technical Memorandum of Understanding
VAT	Value Added Tax
WB	World Bank
WHD	Western Hemisphere Department

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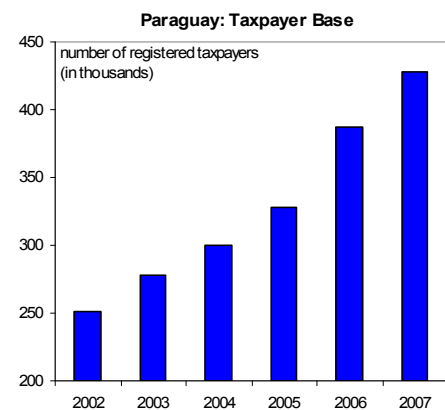
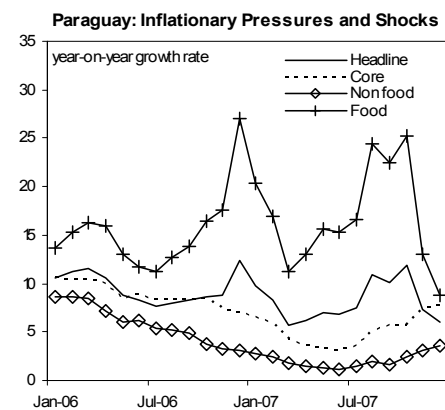
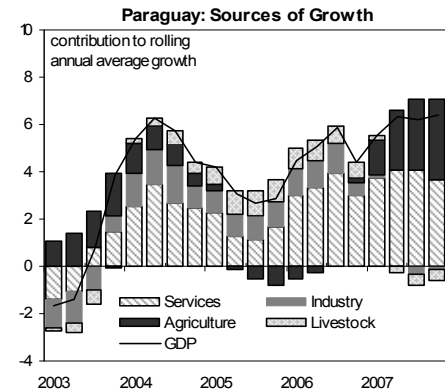
I. DEVELOPMENTS IN 2007/08

1. **Context.** Macroeconomic conditions are the best in many years. The economy has grown almost 25 percent in the last 5 years. This kind of sustained economic expansion has not been observed in Paraguay since the late 1970s (when the *Itaipú* hydroelectric dam was in the last stages of construction). The financial system is the strongest in recent history. The public finances were in surplus in 2007 for the fourth consecutive year. The consolidated public debt fell below 30 percent of GDP (from 70 percent in 2002). The external position remained strong and international reserves reached record highs.

2. **Output.** Real GDP growth was almost 6½ percent in 2007 (well above the 4 percent program objective), supported by strong exports. On the supply side, agriculture was the most dynamic sector (25 percent growth), reflecting larger cultivated areas, better yields, and a record soybean crop.

3. **Inflation.** Following a period of falling prices, there was an uptick in inflation in the second half of 2007 reflecting food supply shocks. While headline inflation was contained at 6 percent in 2007 (down from 12½ percent in 2006), core inflation ended up at 7¾ percent in 2007 (slightly over the 7½ percent upper bound of the targeted inflation range).¹ Non-food inflation remained subdued at 3½ percent in 2007 (Box 1). However, pressures continued in the first two months of 2008 mostly on account of higher food and energy prices, and headline inflation increased to 10½ percent.

4. **Fiscal.** The authorities conducted an adequate countercyclical policy by strengthening its fiscal stance in 2007.² While domestic tax collections remained buoyant (reflecting the strength of the economy and the growing number of registered taxpayers), import duties fell due to the effect of the appreciation of the currency.

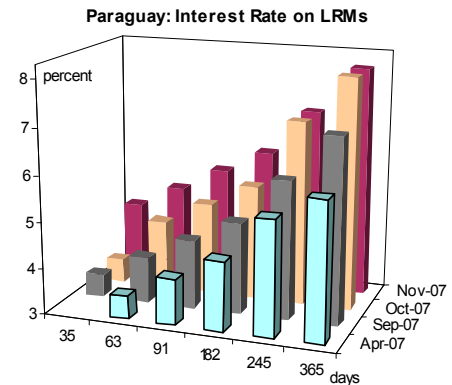


¹ Core inflation in Paraguay excludes fruits and vegetables prices (which declined in 2007) but includes other food prices (which increased significantly).

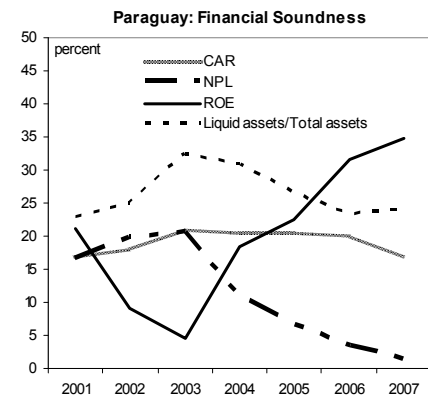
² Staff estimates that the Central Administration's primary surplus for 2007 was over ½ percent of GDP higher than the structural primary surplus.

At the same time, expenditures were well-contained. The Central Administration recorded a surplus of about 1 percent of GDP in 2007, and the consolidated public sector surplus increased to over 1½ percent of GDP in 2007.

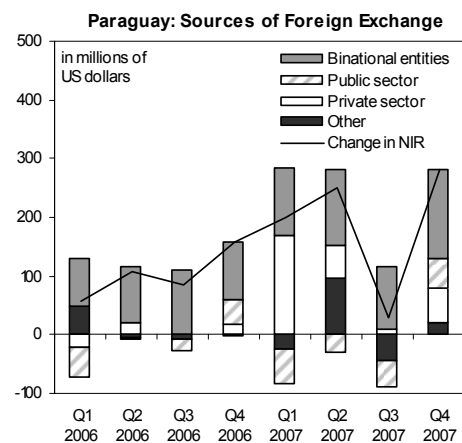
5. **Monetary.** The Central Bank (BCP) tightened its policy stance in the second half of the year to curb inflationary pressures and expectations, as it raised interest rates on BCP bills (LRMs) some 150 basis points on 3 occasions between September and December 2007. Improvements in the external position led to an increase in international reserves by US\$¾ billion (more than the entire stock of currency), and an appreciation of the *guaraní* against the U.S. dollar (10 percent). This posed a significant burden on monetary policy as large placements of LRMs were undertaken to contain the monetary expansion.



6. **Financial.** Banking system soundness indicators strengthened further in 2007. Banks remained well-capitalized (with capital adequacy ratios of over 15 percent), while non-performing loans continued to decline (to 1¼ percent). Profitability and liquidity ratios also remained strong in 2007 while dollarization declined. Credit to the private sector grew 42 percent, and banks started to offer long-term financing, such as mortgage loans of up to 30 years.



7. **External.** The balance of payments continued strengthening in 2007. High export volume growth, coupled with a slowdown in import growth led to a turn around in the current account from a small deficit in 2006 to a surplus of about 1½ percent of GDP in 2007. The capital account was also in surplus as domestic banks repatriated deposits, and foreign corporations pre-financed crops and increased foreign direct investment. As a result, net international reserves increased significantly.

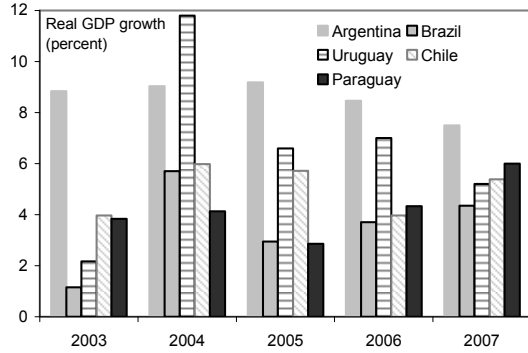


8. **Politics.** General elections are scheduled for April 20, 2008, and a change of administration will take place in mid-August 2008. Opinion polls suggest that the elections will be highly contested. While there are seven registered Presidential candidates, the main ones are: (i) Pedro Fadul (Motherland Party); (ii) former bishop Fernando Lugo (with the support of the Liberal Party); (iii) former Minister of Education Blanca Ovelar (from the governing Colorado Party); and (iv) former army chief Lino Oviedo (Ethical Citizens Party).

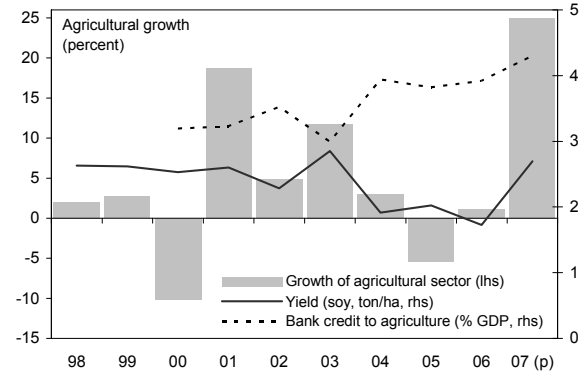
Figure 1. Paraguay: Real Sector Developments

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

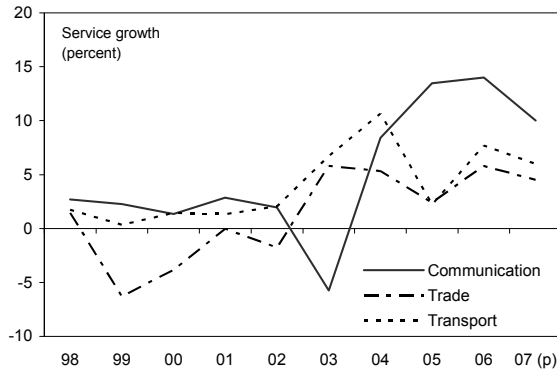
Real GDP growth is among the highest in the region, thanks to a strong agricultural recovery...



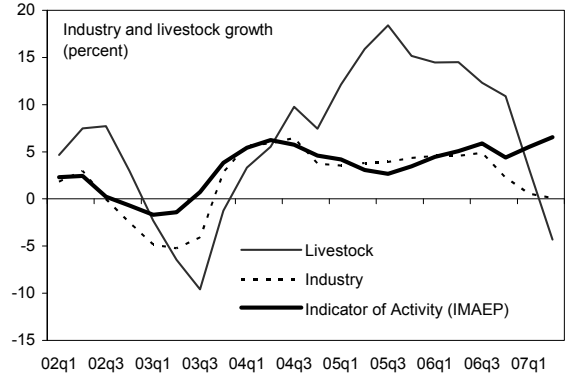
...led by improved productivity after three years of drought as well as to higher investment.



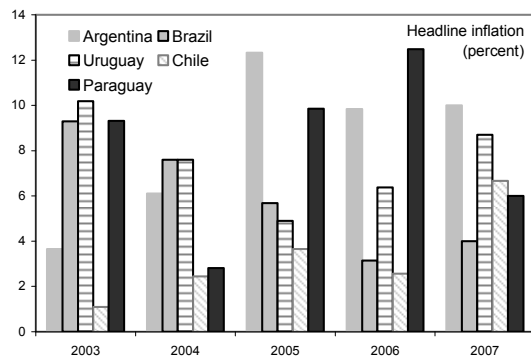
The service sector is also growing strongly, driven by trade, communication, and transport.



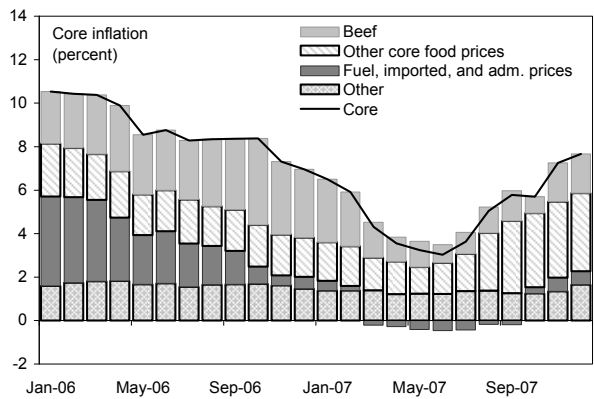
By contrast, the beef sector, formerly an engine of growth, and industry are less dynamic.



In contrast to the region, headline inflation has declined, despite supply shocks...



...but the regional increase in food prices since mid-2007 is reflected in the uptick in core inflation.

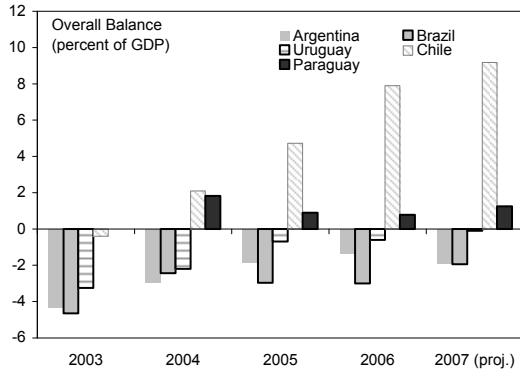


Sources: Paraguayan authorities and Fund staff estimates.

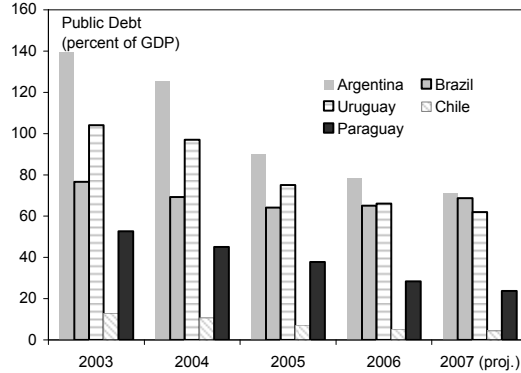
Figure 2. Paraguay: Fiscal Developments

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.

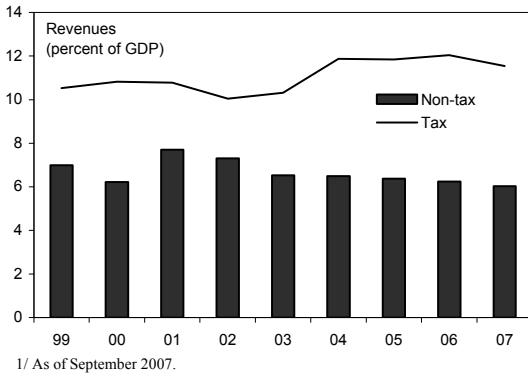
Paraguay has one of the strongest fiscal positions in the region...



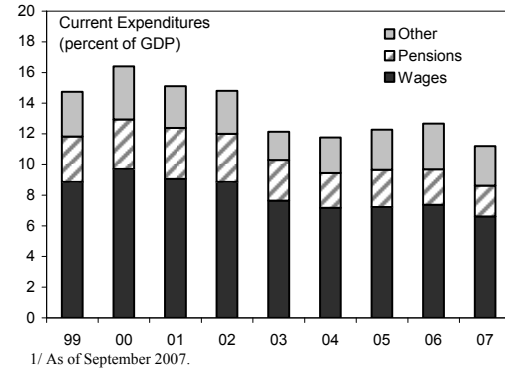
... and one of the lowest levels of public debt in the region.



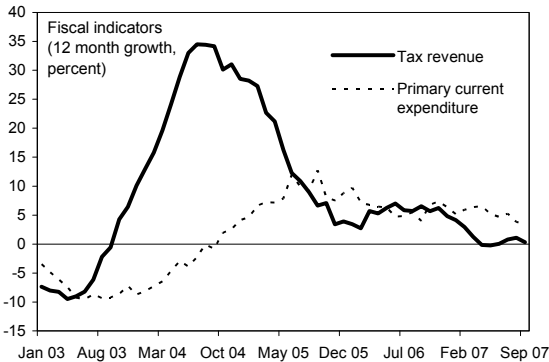
This has been achieved through improved tax collection...



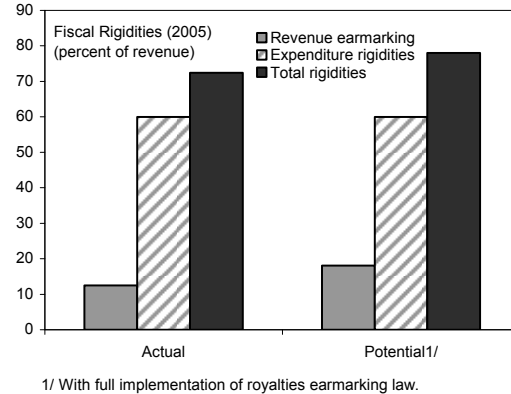
...and by efforts to contain current spending below appropriated amounts.



But with 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.

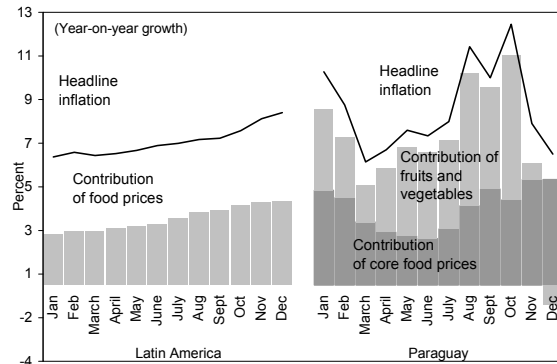
Box 1. Paraguay: Inflationary Pressures

The rebound in inflation since mid-2007 is mostly due to a jump in food prices. Staff estimates that 70 percent of the increase in the core price level during 2007 is due to higher food prices. While this is a global and a regional phenomenon, its effect is exacerbated because the consumer price index is based on the 1992 household budget survey, which assigns a large share to food items. At almost 40 percent, the weight of food in the CPI basket is the highest in the region, which reflects the relatively lower income of Paraguay, and is amplified by the outdated character of the index. From January 2008, the BCP is using a new CPI index based on the 2005 expenditure survey, where the share of food would be reduced by over 5 percentage points. Staff estimates that if the weight of the 2005 expenditure survey were used to measure inflation, 12-month core and headline inflation would have been about one percentage point lower in December 2007.

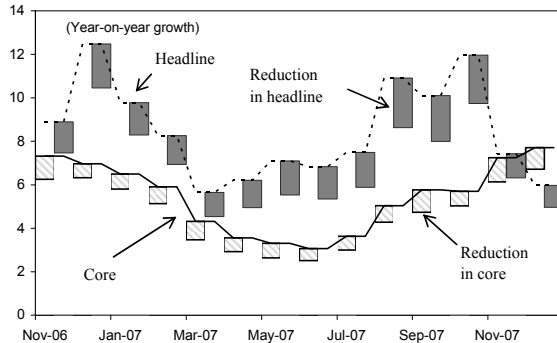
The price volatility of fruits and vegetables explains the divergence between headline and core inflation indicators observed in 2007. The core inflation index excludes fruits and vegetables, which represent only 6¼ percent of the basket for headline inflation, as they are by far the most volatile items. In addition, so called sanitary controls on imports in late 2006 (partly to protect income of domestic producers), contributed to a spike of prices in December 2006. These prices subsequently declined in the first quarter of 2007, before stabilizing. Renewed import restrictions between August and October 2007, compounded by adverse weather and higher exports to Argentina, pushed prices up significantly during this period. The lifting of these restrictions in November led to a sharp drop in these prices.

Following a decline that started in 2006, core inflation rose in the second part of 2007. The decline of core inflation reflected a combination of positive factors, such as the fall in international oil prices in early 2007, the positive impact of appreciation on imported inflation, and the moderation of administrated prices. The increase of agricultural commodity prices since the middle of 2007 has led to higher core food prices, and an increase in core inflation to 7.7 percent year-on-year in December 2007, although non food inflation remains quite low at 3.6 percent.

Paraguay: Headline inflation and food contribution in 2007



Paraguay: Possible Impact of New Weights



Paraguay: Inflation in Dec. 2007

	Weight in CPI index	Std. dev. 1/	Growth rate	
			Y-o-Y	Contrib.
Headline	100.0	0.9	6.0	6.0
Food	39.0	1.9	8.9	3.9
Beef	10.7	2.3	14.8	1.9
Fruits and vegetables	6.2	8.7	-8.5	-0.9
Other	22.1	1.2	14.2	2.9
Non food	61.0	0.6	3.6	2.0
Other indicators				
Core	93.8	0.7	7.7	6.8
Trimmed inflation	95.0	0.5	5.5	...
Administrated prices	7.7	2.0	2.1	0.2
Fuel	3.6	3.0	5.4	0.3
Tradable	66.7	1.3	6.8	4.6
Non tradable	33.3	0.7	4.1	1.3

Source: Staff estimates.

1/ Standard deviation of monthly growth.

9. **Social.** Tensions eased after Congress granted a 20 percent salary increase to teachers following protests in late 2007. While the salary increase was not consistent with the fiscal program, the authorities managed to observe the fiscal targets by phasing in gradually the salary increase. However, the social situation remains precarious for the poor as food prices have increased significantly and the poverty rate remains high (about 35 percent).

II. PERFORMANCE UNDER THE 2007 PROGRAM

10. **Review.** Economic performance under the program continues to be very good. While there were some delays in implementing specific structural measures, the program remains on track and the authorities continue to adhere strictly to the macroeconomic program. All performance criteria (PCs) for end-September and end-December 2007 were observed with wide margins.³

11. **Structural reforms in 2007.** Most structural benchmarks for end-September and end-December 2007 were fully observed. However, implementation of three benchmarks fell short of expectations.

- **September benchmarks.**⁴ With two exceptions, benchmarks were fully implemented: (i) a modified *Resolución 8/03* (which strengthens loan classification and provisioning requirements) was approved by the BCP Board and will be implemented after October 2008, as agreed with all parties involved instead of January 2008 as envisaged in the program (it is estimated that the bulk of the banking system already complies *de facto* with this stricter resolution); and (ii) a draft payment system law is under internal review, and the authorities estimate that it will be approved by the Economic Cabinet by mid-April 2008.

	Prog.	Actual	
(In percent of GDP)			
Fiscal Targets			
Fiscal balance 1/	0.0	0.9	✓
Wage bill 1/	7.7	7.3	✓
Consolidated balance	0.0	1.6	✓
(In percent of currency)			
Monetary Targets			
Net international reserves	32.9	114.9	✓
Net domestic assets	-20.9	-86.6	✓

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

	Number of Targets		Performance (%) (3)=(2)/(1)
	Prog (1)	Observed (2)	
All Targets	61	58	95
Quantitative PCs	36	36	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 implementing some measures, which have led to delays in completing previous reviews. One SB had to be reset and modified into three new benchmarks.

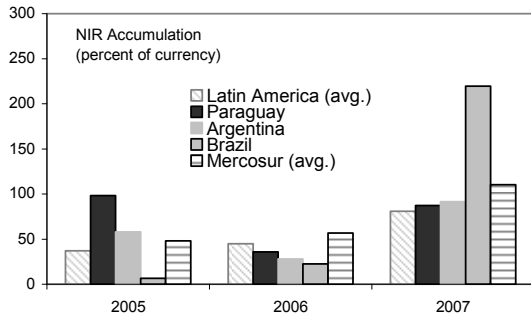
³ To this date, all performance criteria (PC) have been observed since the approval of the SBA in May 2006.

⁴ The authorities submitted draft legislation to Congress to provide annual budgetary support of up to 0.2 percent of GDP to the BCP to cover its losses, and the BCP and the Ministry of Finance reconciled their undisputed claims. To settle these claims, the Ministry of Finance will issue public bonds to the BCP amounting to ¼ percent of GDP.

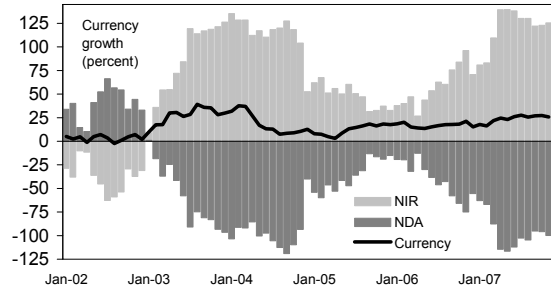
Figure 3. Paraguay: Monetary Developments

The BCP stepped down the pace of foreign exchange purchases, and the guaraní started appreciating again. Growth in money demand has outpaced nominal GDP, despite recent interest rate hikes.

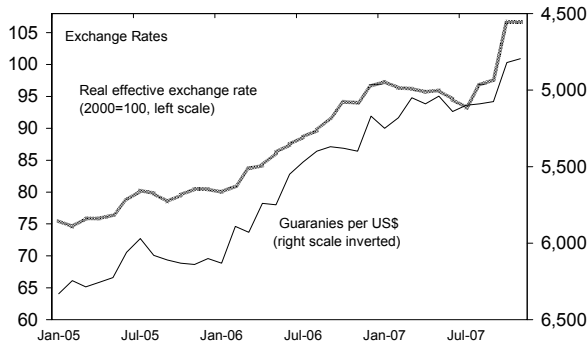
Paraguay has experienced large increases in international reserves, similar to other countries in the region...



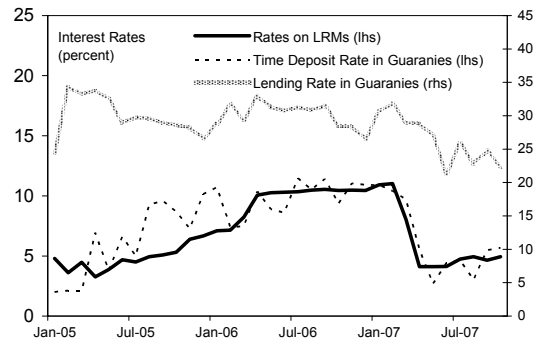
... but an active sterilization policy has contained currency growth...



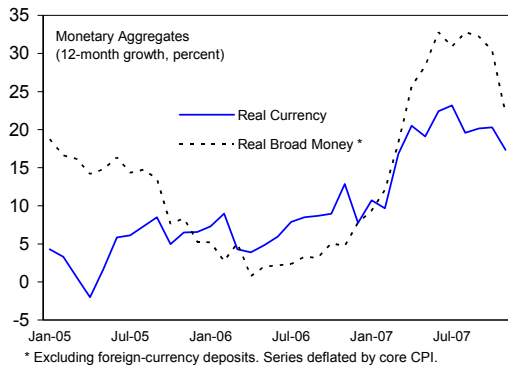
...as foreign exchange purchases were reduced.



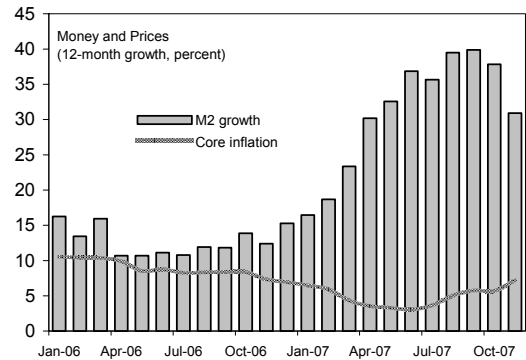
Despite recent interest rate rises...



...growth in real monetary aggregates continues to be high...



... while inflation remains under control despite food supply shocks.

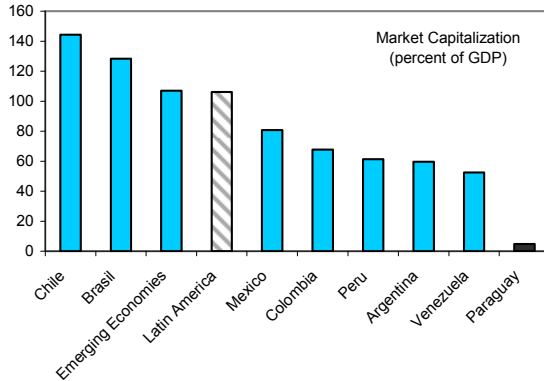


Sources: Paraguayan Authorities and Fund staff estimates.

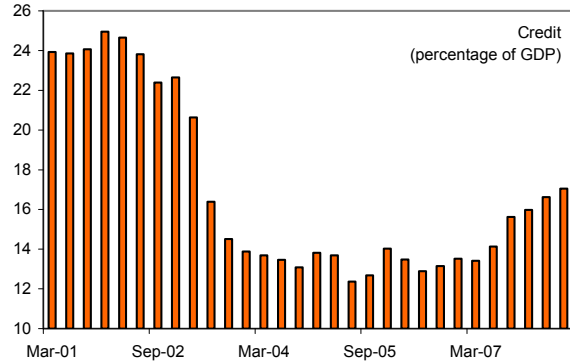
Figure 4. Paraguay: Financial System Developments

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

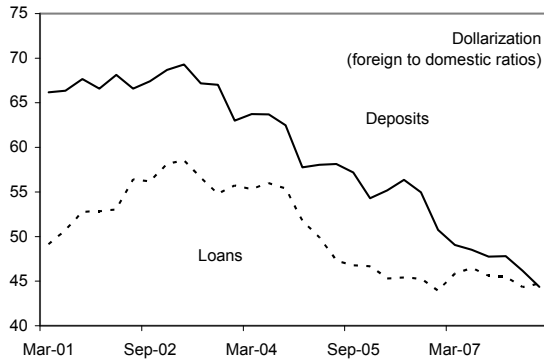
Market capitalization is low in Paraguay but capital markets are ripe for development.



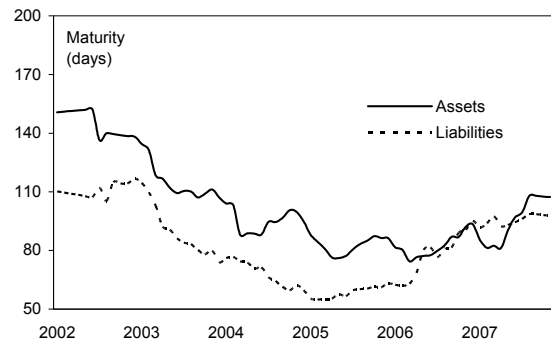
Credit to the private sector is beginning to recover, increasing financial deepening...



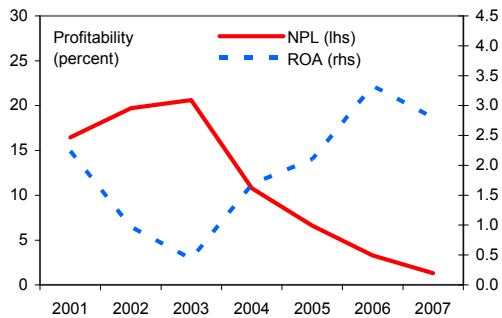
... at the same time, dollarization continues to decline...



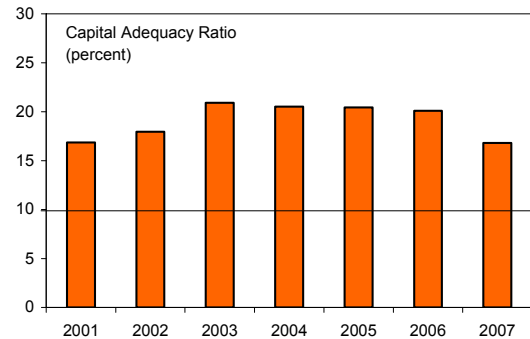
... and the maturity of assets and liabilities has lengthened...



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.

- December benchmarks.**⁵ They were implemented, with one falling short of expectations. The internal evaluations of the management contracts with the five largest state owned enterprises (SOE) revealed some shortcomings: ANDE and COPACO's performance was acceptable, PETROPAR's was uneven, while ESSAP and INC's was weak (Box 2). The authorities intend to strengthen SOE performance in 2008 through the design of well-articulated business plans in the context of new performance contracts.⁶

III. OUTLOOK

12. **Perspective.** The external environment for Paraguay continues to be good, with favorable terms of trade, strong regional growth, and significant foreign investment. So far, the region around Paraguay has coped well with the effects of the financial turbulence in the U.S., but a more pronounced deceleration of the world economy would hamper economic growth. Staff estimates that

a 1 percent fall in external demand would reduce GDP growth by $\frac{3}{4}$ percent. While the authorities are determined to continue implementing sound policies, they noted that pre-election politics could pose a risk to macroeconomic management and the structural reform agenda.

Paraguay: Structural Benchmarks for 2007	
Measure	Status
September 2007	
1. Draft implementing regulations for the tax procedures code	● Done
2. Develop an action plan for a comprehensive pension reform	● Done
3. Reinstate a modified Resolution 8/03 becoming effective on Jan 1, 2008	◐ Partly done. Resolution approved but enters into effect October 2008
4. Send bill to Congress with implications of plan to financially strengthen BCP	● Done
5. Develop a supervisory and regulatory framework for cooperatives	● Done
6. Economic cabinet approval of the legal framework to revamp the payment system	◐ Partly done. Legislation was drafted but is still being reviewed
7. Implement plan to improve the investment climate	● Done
December 2007	
8. Design a public sector investment system	● Done
9. Establish an expenditure commitment control system	● Done
10. Design a strategy for the development of capital markets	● Done
11. Implement prudential regulations in line with operational plan	● Done
12. Observance of result-oriented management contracts with SOE	◐ Partly done. Two of the five SOE did not meet performance standards
13. Increase coverage of conditional cash transfer program to 15,000 families	● Done. Coverage raised to over 17,000 families

Sources: Paraguayan authorities.

IV. POLICY DISCUSSIONS AND THE 2008 PROGRAM

13. **Focus.** The authorities reiterated their commitment to the program, and stressed the need to maintain fiscal discipline in 2008 and pursue the envisaged structural reforms. The authorities underscored significant improvements in macroeconomic conditions in 2007, and emphasized that these improvements were due, in good part, to their solid policies implemented in the context of the Fund-supported program in addition to the favorable

⁵ As part of its operational plan, the BCP issued key regulations on opening financial institutions, prepared regulations for credit risk management; and strengthened the superintendency of banks' risk unit by increasing staff and providing adequate training.

⁶ The authorities already took corrective measures on ESSAP in December 2007 by submitting to Congress a draft law with a view to restructure its debt, clarify its ownership structure, and strengthen its financial oversight.

Box 2. Paraguay: Reforming State Owned Enterprises (SOE)^{1/}

Inefficiencies of the SOE sector constitute an impediment to long-term growth in a country in need of improving its infrastructure. SOEs constitute a large segment of the economy and include several natural monopolies that need to improve their performance to create the basis for sustained growth. An attempt to privatize public enterprises was rejected by Congress in 2004. Since then the authorities have changed the strategy to improve the functioning of the SOE as part of the public sector reform. Against that background, the authorities conducted financial and managerial audits of the main SOEs in 2005 to prepare a strategy to improve their performance. The audits revealed serious operational and financial problems in most SOEs.

In order to address SOE problems, the government adopted a comprehensive management performance system in 2006. The system, overseen by the High Council for Supervision of State-owned Enterprises, consists of three main steps: (i) establishing objective result-oriented contracts signed by the government and the SOEs, in which a series of quantitative and qualitative performance indicators and respective targets are agreed upon (based on the balanced scorecard methodology); (ii) implementing an automated monitoring system which captures and processes the operational information, and calculates the actual performance against the agreed targets; and (iii) submitting quarterly performance results to the High Council, which analyzes the results, produces a report, and makes recommendations on corrective measures when needed.

The system has proved to be an important tool in raising awareness regarding the sector's performance, which is uneven across companies, and in better identifying major problematic areas. Overall results for the five monitored companies during the first three quarters of 2007 were volatile and varied between 35 and 80 percent of the agreed targets. The results, which are broken down by business categories (commercial, financial, economic, technical, and services), provide relevant information for decision-making towards institutional strengthening and operational improvement in the most critical areas.

SOE problems are structural and complex to solve, and demand profound structural adjustments and political will. The overall weak results imply that, in some cases, performance can not be improved without major structural changes such as: competitive conditions; transparent institutional relationship with the government (isolating roles as client, stakeholder, and tax collector); operational and technological upgrade; professional workforce; and technically-led decision-making. Going forward, greater involvement of the World Bank and IDB will be required.

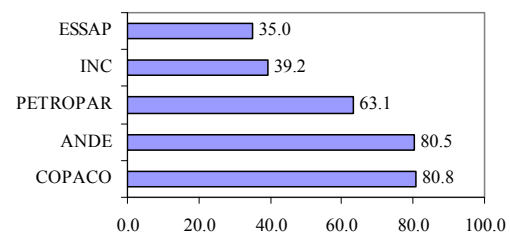
There is a need for further strengthening the monitoring mechanism under a clearer strategic management framework. As part of the contracts, the SOE will develop business plans in 2008 to strengthen their performance. Staff recommended that the performance contracts for 2008 include: (i) systematic publication of results and Council decisions; (ii) design of coherent and realistic targets for the next fiscal years; (iii) adoption of comprehensive strategic plans; (iv) establishment of a proper incentive and sanctioning system; and (v) transparent oversight done by a board of directors.

Performance Indicator Matrix

(Overall performance is calculated as a balanced measure of actual performance in different areas)

Quantitative	Measurable Indicator
Commercial	Delinquent payment index Collection recovery margin
Financial	Liquidity index ratio Debt-equity ratio
Economic	Profitability margin
Technical	Energy loss; water leakage; etc. Personnel Index
Services	Number of disconnections Coverage level Client assistance responsiveness
Qualitative	Submit the 2008 strategic plan

Paraguay: SOE's Management Performance
percent of overall achievement of agreed target
(average of 1st, 2nd and 3rd quarters - 2007)



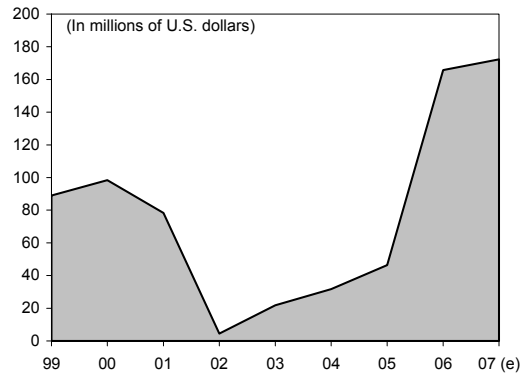
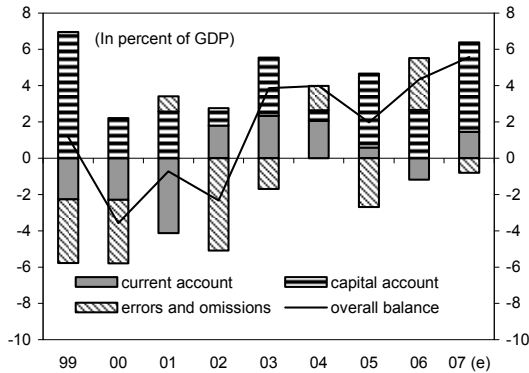
^{1/} The sector comprises five main enterprises: ANDE (electricity); COPACO (telecommunications); ESSAP (water and sewerage); INC (cement); and PETROPAR (oil distribution).

Figure 5. Paraguay: Balance of Payments Developments

The external environment remains favorable and the external position was strong in 2007. The outlook for 2008 remains good, but the current account surplus is expected to contract slightly.

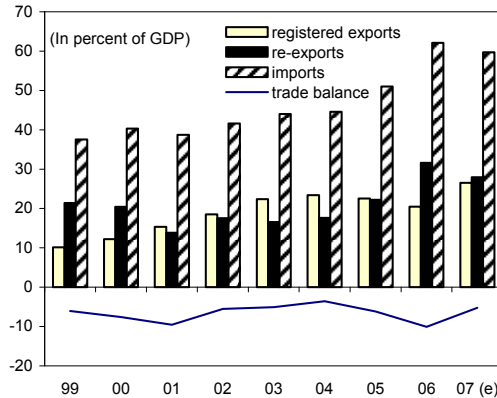
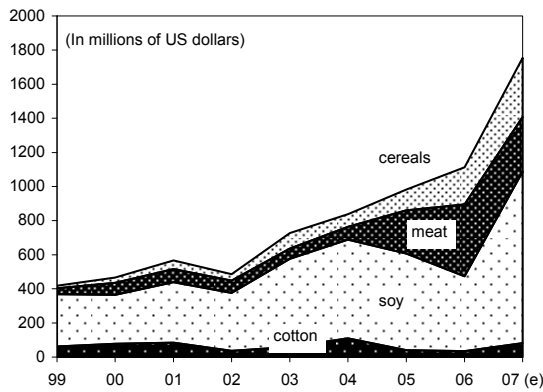
The BOP is expected to post a current account surplus.

FDI has been high in the past and is expected to remain high in 2008...



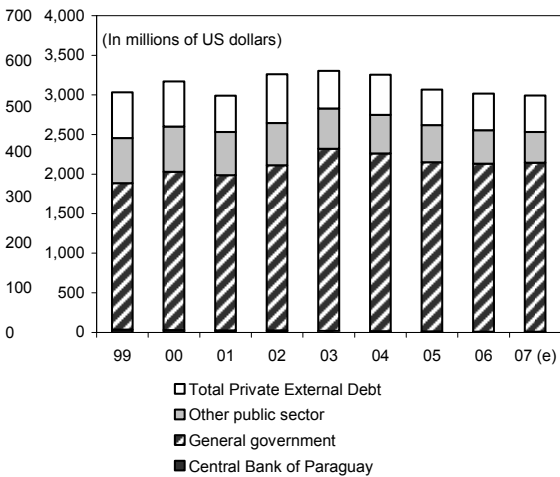
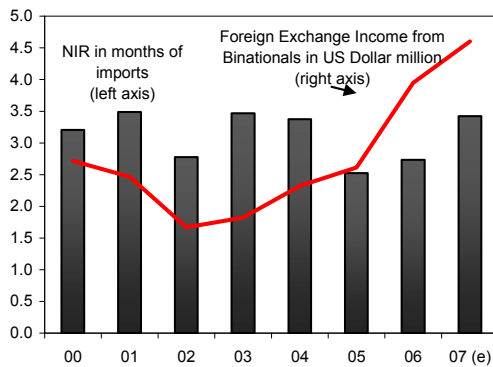
The current account improved in 2007, mainly due to a surge in soy exports.

Re-exports drove imports to a record high following customs reform in late 2005.



...with NIR increases driven by large inflows from binationals.

External public debt remains at moderate levels, as few new loans are contracted.



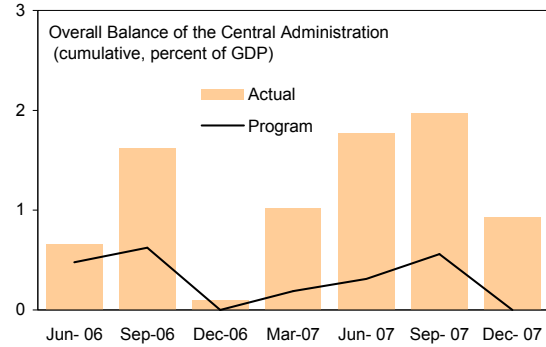
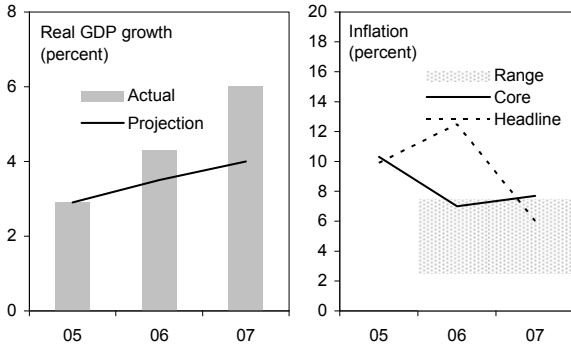
Sources: Paraguayan Authorities and Fund staff estimates.

Figure 6. Paraguay: Program Performance

The program has remained on track throughout the period. Fiscal discipline has resulted in surpluses of the central and general government over the past two years. The external position has strengthened but its impact on currency has been sterilized to a large extent.

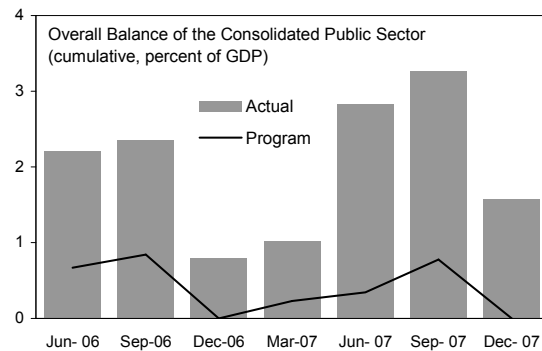
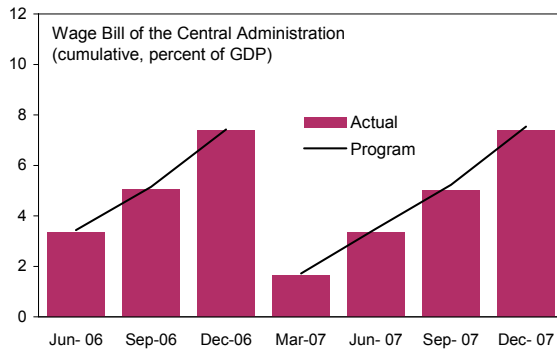
Real GDP growth has exceeded program projections while inflation has remained under control.

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



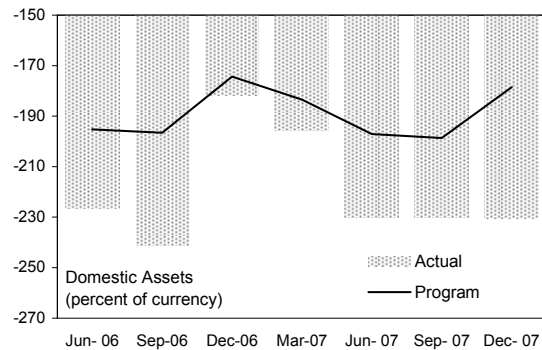
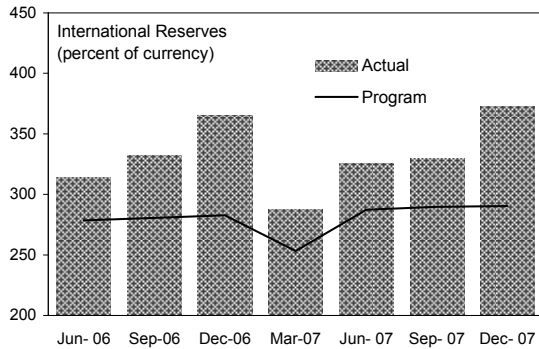
Wages have been carefully managed too...

...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.

external environment. The authorities hope that similar policies would be followed by the new administration after the arrangement expires in August 2008.⁷

A. Policy Framework

14. **Synopsis.** The good macroeconomic conditions are expected to continue in 2008 despite political uncertainties. However, real GDP growth is expected to slow to the 4-5½ percent range after its record-high growth of 2007 as agricultural yields return to more normal levels. Given the recent volatile pattern of inflation, the authorities favored maintaining a core inflation target similar to that of 2007, namely 5 percent within a range of $\pm 2\frac{1}{2}$ percent. The staff believes that the target is credible. The external current account surplus will decline somewhat in 2008 (¶5).⁸

Paraguay: Macroeconomic Framework				
	2006	Prog. 2007	Est. 2007	Prog. 2008
(Annual percent change)				
Real GDP	4.3	4.0	6.4	4-5½
Inflation (e.o.p.)	12.5	2½-7½	6.0	2½-7½
(In percent of GDP)				
External current account	-1.2	-1.3	1.5	1.0
Overall fiscal balance	0.1	0.0	0.9	0.0
Consolidated public debt	34.0	32.8	28.9	26.2

Sources: Paraguayan authorities; and staff estimates

B. Fiscal Policy

15. **2008 budget.** Discussions centered on policies and measures needed to maintain fiscal discipline during the rest of the program and contingencies in case of a less benign external environment. While the government submitted a draft 2008 budget that aimed at broad fiscal balance (after its implementation), Congress increased budgeted outlays for the central government by 1½ percent of GDP. Wages and salaries of all public servants were raised on average by 18 percent (½ percent of GDP over budget), and other expenditures were increased by 1 percent of GDP. Full implementation of the approved budget would lead to a large deterioration in the fiscal accounts, which would be difficult to finance in a non-inflationary way.

16. **Policy response.** To maintain fiscal discipline, the authorities have designed a financial plan (for the fifth consecutive year) to conduct an orderly containment of expenditures. While the plan envisages cuts in budgeted capital spending, these outlays would still be significantly higher than in 2007. The plan also includes cuts in current expenditures, mainly goods and services and transfers (about ¾ percent of GDP). Nonetheless, wages and salaries will increase by about ¾ percent of GDP, thereby increasing the already high budget rigidities (¶6). Staff expressed concern at the high salary increases for 2008 and its potential inflationary impact. The authorities acknowledged the problem and

⁷ While discussions covered the whole year, performance criteria and structural benchmarks are proposed for the first half of 2008. The sixth and last review is scheduled for June 2008, but it is likely to be delayed a few weeks given the political calendar. In that event, there would be an opportunity to assess program performance through end-June 2008.

⁸ The symbol ¶ refers to the paragraph number in the authorities' MEFP (Appendix 2).

argued that it was difficult to contain wages given that Congress had announced and approved the salary increase.⁹ It was agreed that in the event of a sharp economic downturn, the authorities should use automatic stabilizers on the revenues side and should support private spending by rapidly changing the composition of public expenditures to those items with the highest impact on aggregate demand (like the conditional cash transfer program).

17. **Consolidated public sector.** The authorities agreed to maintain the zero balance target for the consolidated public sector in 2008. The mission encouraged them to continue pursuing flexible pricing arrangements for SOEs to enhance performance, transparency and accountability. SOEs are expected to continue generating surpluses in 2008, which would be sufficient to offset the potential losses of the Central Bank and will facilitate achieving the zero fiscal balance target for the consolidated public sector in 2008 (¶8).

Regarding PETROPAR, staff welcomed diesel price adjustments of 7½ and 5¾ percent in October 2007 and February 2008 and the reduction in arrears to suppliers, but noted that additional price adjustments will be needed given the large increases in international oil prices.¹⁰

	2006	2007		Budget 2008		Prog.
		Prog.	Actual	Gov.	Cong.	
Total Revenues	18.3	18.2	18.0	18.5	18.6	18.5
o/w Tax	12.0	12.1	11.6	11.2	11.2	11.8
Total Expenditures	17.9	18.1	17.2	19.2	20.6	18.5
o/w Wages	7.4	7.7	7.3	7.6	8.1	8.1
o/w Capital	4.2	4.4	3.8	5.2	5.7	4.4
Discrepancy	-0.4	--	0.1	--	--	--
Overall Balance	0.1	0.0	0.9	-0.7	-2.0	0.0

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

C. Monetary Policy

18. **Concerns.** Discussions focused on the high growth of monetary aggregates, the need to curb inflation and the expectations thereof, the large foreign exchange inflows, and the appropriate sterilization policy. Staff noted with some concern the rapid pace of currency growth and the attendant inflationary pressures. The authorities argued that the high currency growth was due to a strengthening in money demand as evidenced by: (i) the success of the program at reestablishing stability and confidence; (ii) the appreciation of the *guaraní*; (iii) the high remittances from abroad that disproportionately flow to segments of the population without access to banking services; and (iv) the continued decline in dollarization (from 50 percent of deposits in 2006 to about 45 percent in 2007) and the rising maturities of *guaraní* deposits. While acknowledging the possibility of a strengthened demand for money, staff noted that an increase money demand of such magnitude was unlikely to be repeated and that a tighter monetary policy was needed to contain pressures and anchor inflationary

⁹ While the wage bill in Paraguay is broadly in line with the average of its MERCOSUR trading partners (8 percent of GDP), it is now higher than the average for Latin America (7 percent of GDP)

¹⁰ PETROPAR's policy is to smooth out domestic diesel prices without providing subsidies for the year. For most of the first half of 2007 PETROPAR reported profits from the distribution of diesel, but recent international oil price increases have led to an estimated 5 percent subsidy on the domestic diesel price.

expectations. The authorities agreed that a recurrence of the large increase in the demand for currency is unlikely and designed a monetary program with a more conservative assessment of money demand.

19. **Monetary program.** Monetary policy will be geared towards achieving the objective of reducing core inflation to 5 percent in 2008 through a monetary program that is consistent with a growth in currency issue of 12 percent (and an increase in the real demand for money of about 6½ percent, implying a small slowdown in velocity of circulation). The authorities agreed to maintain flat the level of BCP's net domestic assets for the year as a whole in order to anchor expectations and facilitate the process of reducing inflation. All the sources of monetary creation in 2008 would come from purchases of foreign exchange, with net international reserves rising by US\$100 million to over US\$2½ billion at end-2008 (¶11). Higher-than-expected increases in the demand for money will be accommodated through further accumulation of international reserves. Use of monetary control instruments (LRMs) will continue to be the main policy instrument. Interest rates on LRMs may need to continue rising in the short run to achieve the inflation objective.

	2006	Prog.	Actual	Prog.
		2007		2008
Currency issue	15.3	12.0	28.3	11.8
Net international reserves	87.1	32.9	114.9	18.1
Net domestic assets	-71.8	-20.9	-86.6	0.0
Credit to public sector	-13.5	-2.7	-18.3	-8.1
Credit to banks	-27.4	-33.4	-58.7	4.5
Other items	-30.9	15.2	-9.6	3.6

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

D. External Policy

20. **Balance of payments.** Discussions on the external environment evolved around the need to lock in the gains made in the balance of payments and the downside risks to the outlook posed by a potential global slowdown. Notwithstanding these risks, the external position is expected to remain strong for 2008. The current account surplus is expected to narrow slightly to 1 percent of GDP in 2008 as exports of agricultural products return to more normal levels and the terms of trade remain favorable.¹¹ The capital account is expected to be driven by foreign direct investment (going mostly to telecommunications and meat processing industries) and some public borrowing, allowing for a modest reserve accumulation.¹²

	2006	Prog.	Est.	Prog.
		2007		2008
Current Account	-1.2	-1.3	1.5	1.0
o/w Exports	52.1	47.4	54.4	53.0
o/w Imports	-62.1	-55.2	-59.6	-58.2
Capital Account	5.5	3.4	5.2	-0.3
Public sector (net) 1/	-0.2	0.2	0.3	0.2
Private sector (net) 2/	5.7	3.3	4.9	-0.5
Overall Balance	4.3	2.1	6.7	0.7

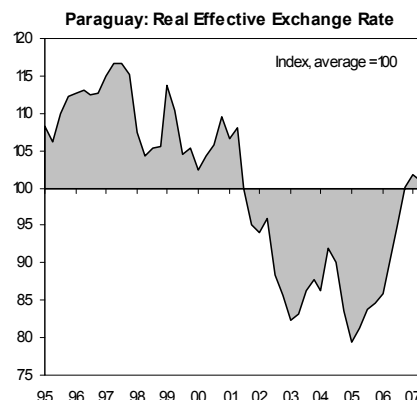
Sources: Paraguayan authorities; and Fund staff estimates.
1/ General government only.
2/ Includes errors and omissions

¹¹ Paraguay's balance of payments remains vulnerable to external price shocks. Staff estimates that a 10 percent deterioration in the terms of trade would lead to a 2½ percent of GDP worsening in the external current account.

¹² The authorities continue to be engaged in resolving claims in dispute amounting to 1½ percent of GDP at end-December 2007, including (i) Belgium's Ex-Herstal (US\$7 million); (ii) import verification companies

(continued)

21. **Exchange rate.** Discussions centered on the proper mix between exchange rate flexibility and reserve accumulation. The authorities and staff agreed on the need to maintain a flexible exchange rate regime while accommodating the net international reserve target under the program and smoothing out bulky or seasonal transactions. There was agreement that the strengthened fundamentals have led to upward pressure on the *guaraní* and that if strong fundamentals prevail, further appreciation of the *guaraní* would be warranted (¶10). While committed to maintaining the flexible regime, the authorities noted the possible adverse effect of an appreciated currency on competitiveness. In the staff's view, the exchange rate is broadly in line with fundamentals and is not a source of concern as the terms of trade remain favorable, the current account is in surplus, and the tradable sector continues expanding.¹³



E. Structural Policies

22. **Approach.** It was agreed that given the forthcoming electoral phase and the short period remaining under the program, the number of measures under the reform agenda for 2008 should be limited. For that reason, the authorities decided to include only one structural benchmark in each of the structural policy pillars under the program.

23. **Public sector reform.** The authorities have been addressing weaknesses in budget preparation, cash management, and monitoring systems. Expenditure control mechanisms have been enhanced through the adoption of a control system at the commitment level, and the authorities are progressing toward the implementation of a public investment framework that prioritizes needs and improves the quality of capital expenditure. For 2008, priority will be given to establishing a treasury single account (TSA), through the identification of all existing public accounts and their consolidation into a TSA (¶13). The government will centralize all the accounts that are currently not established by law into the TSA.

24. **Financial sector reform.** The authorities have made significant progress in many financial sector areas, most notably by moving forward the implementation of prudential regulations; strengthening the National Development Bank (BNF); and improving the financial position of the Central Bank (BCP). For 2008, the authorities will focus on strengthening the balance sheet of the Central Bank. To that end, the authorities will continue

(US\$75 million); and (iii) a Swiss court ruling in favor of several European and American banks (US\$85 million).

¹³ For an assessment of the exchange rate, see Box 3 in “Paraguay—Staff Report for the 2007 Article IV Consultation and Second and Third Reviews Under the Stand-By Arrangement” (www.imf.org) June 18, 2007.

implementing the strategy they designed in August 2007, and will seek the review and clearance of the Attorney General on the claims on the public sector that are recorded on the balance sheet of the BCP but not recorded in the debt reporting system of the Ministry of Finance. The authorities will subsequently submit legislation to Congress to transfer tradable bonds to BCP to compensate for these disputed claims (¶15).¹⁴

25. **State-owned enterprise reform.** In addition to the significant progress made in different areas to foster growth (Box 3), the government intends to enhance the strategic planning and monitoring framework of the five largest SOEs in 2008. The adoption of the performance-based contracts and monitoring was a substantial first step toward enhancing SOE performance. Nevertheless, the government will need to reinforce the current mechanism in light of the weak performance of some SOEs, and to improve the overall results of the SOE. Going forward, the government intends to strengthen accountability and governance of SOEs by developing business plans to address weaknesses identified in 2007, and to establish targets for new result-oriented management contracts (¶17).

Paraguay: Structural Reforms for 2008	
Benchmarks	Date
1. Consolidate all Treasury accounts not established by law into one account	Jun 2008
2. Send to Attorney General for his review and clearance the claims in dispute between BCP and MinFin	May 2008
3. Sign result-oriented management contracts for 2008 with ANDE, COPACO, ESSAP, INC & PETROPAR	May 2008
4. Increase coverage of the conditional cash transfer program to 19,000 families	May 2008

Sources: Paraguayan authorities.

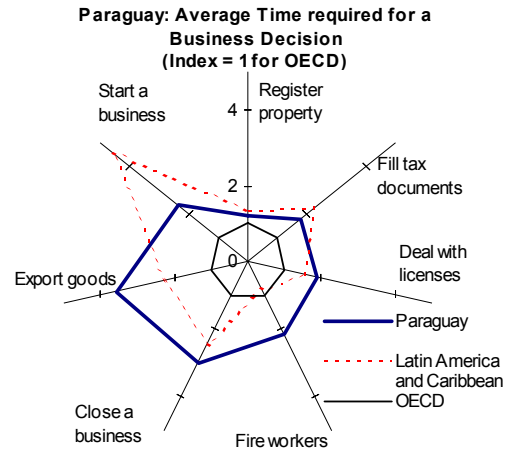
26. **Poverty alleviation.** While efforts continue to be made in increasing social spending, there are concerns that the poor may not have benefited yet from the higher growth while being hurt by the recent sharp increase of food prices. In this context, a strong social safety net, such as the *Tekoporã* program—the conditional cash transfer program implemented by the government—is crucial.¹⁵ *Tekoporã* is part of the broader national strategy for fighting poverty that focuses on social protection and economic inclusion of vulnerable families providing financial and technical support to improve quality and productivity of small farmers and firms. For 2008, the authorities intend to triple the coverage of the *Tekoporã* program to 50,000 families (with an intermediate target of 19,000 families by end-May) (¶19), while strengthening the monitoring mechanisms to ensure that families use the required health and education services. Staff estimates that about 25 percent of the families living under conditions of extreme poverty would have access to the conditional cash transfer program by end-2008.

¹⁴ Following transfers of about ¼ percent of GDP on account of the reconciliation of undisputed claims between the Ministry of Finance and the Central Bank, staff estimates that additional transfers of some 5¼ percent of GDP could be needed to settle the disputed claims.

¹⁵ The *Tepokorã* program is based on contracts with families living in extreme poverty (usually with children under 15 years of age or with pregnant woman) to give a monthly cash allowance of about US\$35 per month in return for, among others, meeting minimum school attendance and immunization of beneficiaries' children. The program is expected to cost 0.2 percent of GDP in 2008.

Box 3. Paraguay: Strategy to Improve Investment Climate

Given the relatively poor business environment, the government embarked in 2006 on a strategy to improve the investment climate. In the 2007 World Bank survey on the cost of doing business, Paraguay was ranked 110 out of 175 countries in the world and 20 out of 30 countries in Latin America. Although Paraguay performed relatively better in terms of access to credit, investor protection, and property registration, it was classified near the bottom in terms of ease for starting a business, contract enforcement, and employment flexibility (where it was ranked 169 in the world). As a result of such a business climate, private investment is lower than in other Latin American countries. In addition, the informal sector is estimated to account for about 30 percent of GDP while 40 percent of rural properties are held without the correct supporting legal documents.



The authorities' strategy focused on achievable objectives that could be implemented in the short-term. This was to be done through changes in administrative procedures, improved coordination between existing institutions, and modifications of the legal framework. The authorities also sought to reach a consensus with the private sector for legal and institutional changes related to the investment climate. The strategy rested on five main pillars: (i) facilitate private enterprise creation; (ii) reinforce land property rights; (iii) create a one-stop window for exporters; (iv) reinforce the competitiveness of the export sector; and (v) improve the mechanism for reimbursing VAT.

Paraguay advanced in the 2008 World Bank ranking by 7 positions in the world (2 positions within Latin America). This reflects mostly improvements in the ease of starting a business, from an initial level comparable to Latin American's average to a much better situation. The implementation is generally on track with the timetable initially set by the government.

Paraguay: Implementation of the Business Climate Strategy

Pillar	Some achievement as of December 2007
1) Enterprise creation	Time to start a business, cost, and procedures were reduced by half.
2) Land property rights	Adoption of new legal framework, opening of regional offices.
3) One-stop export window	Unification of registry, simplified proceedings on pilot cases.
4) Export competitiveness	Strengthening of sanitary supervision; dissemination of information.
5) Reimbursing VAT	Completed: clearance of all tax-areas; Internet based reimbursement.

1/ *Doing Business*, World Bank, 2006 and 2007 and <http://www.doingbusiness.org/>

V. STAFF APPRAISAL

27. **Overall.** Macroeconomic outcomes were significantly better than anticipated and program implementation continued to be strong. Paraguay is going through a period of sustained high growth with stability, while strengthening efforts to reduce extreme poverty. All performance criteria and the bulk of the structural measures for end-September and end-December 2007 were fully observed. The authorities should be commended for their accomplishments and the strong performance, and encouraged to continue with a solid implementation of good policies in the last months of the program. Although the structural challenges are many, the authorities have successfully begun the road to reform which the next administration would be well advised to continue.

28. **Fiscal policy.** The authorities have maintained sound fiscal policies despite trying political circumstances. Fiscal performance in 2007 has been particularly good, and the authorities have appropriately adopted a counter-cyclical stance in view of the strength of the economy. Furthermore, in view of the approved expansionary budget for 2008, staff welcomes the authorities' decision to implement a financial plan that continues with an appropriate fiscal stance. Regrettably, the increase in salaries included in the budget risks fueling inflation pressures, and will lead to budget rigidities as well as the worsening of the quality and composition of expenditures as the government will be forced to make expenditure cuts in other areas. Going forward, there is a need to implement a properly sequenced civil service reform, adopt guidelines to conduct fiscal policy, and curtail excessive unfunded expenditure mandates by Congress to avoid the use of financial plans as a tool for budgetary control.

29. **Monetary policy.** While there is evidence of strengthening money demand and financial deepening, the BCP should monitor monetary aggregates closely to prevent a monetary overhang and consequent inflationary pressures. Thus far, the uptick of core inflation appears to be driven mostly by food supply shocks, but that could change, especially once higher private and public wages impinge on aggregate demand. In this context, staff welcomes the preemptive monetary tightening of the second half of 2007, and encourages the authorities to remain vigilant and continue on this path to anchor inflationary expectations.

30. **Exchange rate policy.** Staff welcomes the continued flexible exchange rate policy followed by the authorities (the *guaraní* appreciated by 10 percent against the U.S. dollar in 2007). The strengthened external position has led to an accumulation of international reserves that is substantially higher than the target, helping reduce Paraguay's vulnerability to external shocks. Staff supports the authorities' commitment to maintaining the flexible exchange rate regime and encourages their continued efforts to increase resilience to external shocks.

31. **Structural reform.** Significant progress was made in many areas of the reform agenda. After some setbacks in late 2006 and early 2007, financial sector reform gathered

momentum and the authorities began to adopt key measures, especially on strengthening the Central Bank's income position. On SOE reform, the methodology used and the anticipated disclosure of information was a good first step towards improving the efficiency and accountability of the SOE, even if the results of the performance contracts were not satisfactory in all cases. There were delays in some structural areas, particularly on the payment system law. The authorities are encouraged to make up for previous delays.

32. **Risks.** On the external front, foreign demand for exports 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, the pre-electoral and political environment may force the adoption of measures contrary to the program. Similarly, the conduct of fiscal policy could be difficult even with the design of a solid financial plan as expenditure pressures may continue.

33. **Review.** The staff supports completion of the fifth SBA review in light of the good performance and program ownership.

Table 1. Paraguay: Quantitative Performance Criteria

	2006				2007							
	End-June		End-September		End-December		End-September		End-December			
	Prog.	Actual	Prog.	Actual	Prog.	Actual	Prog.	Actual	Prog.	Actual		
Fiscal targets												
1. Overall balance of the central administration (floor, in billions of guaraníes) 1/ 2/	250	807 ✓	325	848 ✓	0	48 ✓	184	1,054 ✓	330	1,162 ✓	0	546 ✓
2. Wage bill of the central administration (ceiling, in billions of guaraníes) 1/	1,795	1,740 ✓	2,695	2,636 ✓	3,880	3,857 ✓	2,055	1,940 ✓	3,086	2,949 ✓	4,443	4,360 ✓
3. Overall balance of the public sector (floor, in billions of guaraníes) 1/	350	1,153 ✓	440	1,231 ✓	0	413 ✓	202	1,669 ✓	459	1,830 ✓	0	930 ✓
Monetary targets												
4. Net international reserves (floor, in millions of U.S. dollars) 3/	1,297	1,463 ✓	1,319	1,546 ✓	1,329	1,703 ✓	1,903	1,900 ✓	1,915	2,182 ✓	1,920	2,462 ✓
5. Net domestic assets (ceiling, in billions of guaraníes) 3/	-5,711	-6,635 ✓	-5,676	-7,059 ✓	-5,026	-5,312 ✓	-6,594	-6,645 ✓	-6,700	-7,756 ✓	-6,016	-8,231 ✓
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	0 ✓	500	27 ✓	500	0 ✓	500	10 ✓	500	40 ✓
Continuous PCs												
7. Contracted or guaranteed short-term external debt by the NFPS	0	0 ✓	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 ✓	0	0 ✓

Sources: Paraguayan authorities; and Fund staff estimates.

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

2/ For 2007 adjusted downward for any cash transfer or payment of interest costs on securities used to strengthen the financial position of the Central Bank.

3/ 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.
Financial Sector Reform			
G. Audited and inspected CAR (fully provisioned) of 5 percent for BNF at end-June 2006	SB	end-Sep 2006	● Done.
H. 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.
I. Announce a strategy to strengthen the financial position of the Central Bank and a timetable for its implementation	SB	end-Jun 2007	● Done.
J. Audited and inspected CAR (fully provisioned) of 10 percent for BNF at end-December 2006	PC	end-Mar 2007	● Done.
K. 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.
L. 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.
M. Develop legal and regulatory framework to revamp the payment system and preparing a draft payment system law	SB	end-Sep 2007	◐ Partly done. Law drafted by BCP being reviewed internally.
N. Development of an effective supervisory and regulatory framework for the cooperative sector	SB	end-Sep 2007	● Done.
O. 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.
P. Design a strategy for the development of capital markets	SB	end-Dec 2007	● Done.
Q. Implement prudential regulations in line with BCP operational plan	SB	end-Dec 2007	● Done.
Pro-Growth Reform			
R. Design a plan to improve business climate	SB	end-Sep 2006	● Done.
S. Implement result-oriented management contract for ANDE, COPACO, ESSAP, INC, and PETROPAR	SB	end-Dec 2006	● Done.
T. Implement the plan to improve the investment climate designed in September 2006	SB	end-Sep 2007	● Done.
U. 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 2 of the 5 state-owned enterprises did not meet performance standards.
Social Safety Net			
V. Create a conditional cash transfer mechanism for 7,000 families living under extreme poverty based on contracts with beneficiaries	SB	end-Dec 2006	● Done.
W. 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.

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)	406.8	Income distribution (2002)				
		By highest 20 percent of households (percent)				
		By lowest 20 percent of households (percent)				
Population (2005)		Health (2004)				
Total (in millions-2004)	5.7	Physicians per 1,000 people				
Rate of increase (percent a year)	1.9	Hospital beds per 1,000 people				
Density (per sq. km.)	14.1	Access to a water source (percent)				
Unemployment	10.9	Access to a sanitation facility (percent)				
		Population characteristics (2004)				
	70.6	Life expectancy at birth (years)				
	29.7	Crude birth rate (per thousand)				
	5.0	Crude death rate (per thousand)				
	21.0	Infant mortality (per thousand live births)				
		Education (2003; in percent)				
		Male literacy rate (percent)				
		Female literacy rate (percent)				
		Primary school enrollment (percent)				
		Secondary school enrollment (percent)				
II. Economic Indicators, 2002-2007						
	2004	2005	2006	2007		2008
				Prog.	Est.	Proj.
Annual percent change; unless otherwise specified						
National accounts and prices 1/						
GDP at current prices	16.4	11.2	13.2	10.6	13.8	11.2
GDP at constant prices	4.1	2.9	4.3	4.0	6.4	4.0-5.5
Per capita GDP (U.S. dollars, thousands)	1.2	1.3	1.6	1.9	2.0	2.2
GDP deflator	11.8	8.1	8.5	6.3	6.9	6.9
Consumer prices (end-of-period)	2.8	9.9	12.5	2.5-7.5	6.0	2.5-7.5
Real effective exchange rate 2/						
Average (depreciation -)	3.7	-6.5	13.0	...	9.2	...
End-of-period (depreciation -)	-8.5	4.5	20.1	...	7.3	...
In millions of U.S. dollars						
External sector						
Exports, f.o.b. (percentage change)	32.0	17.4	44.2	13.3	32.7	11.1
Imports, c.i.f. (percentage change)	27.0	22.9	51.4	10.2	21.8	11.4
Net oil exports and imports	-434	-507	-701	-729	-710	-740
Current account	143	44	-110	-146	172	133
(in percent of GDP)	2.1	0.6	-1.2	-1.3	1.5	1.0
Capital account	41	304	247	257	617	-33
Overall balance	277	147	402	244	789	100
Terms of trade (percentage change)	-1.3	-9.5	-2.2	4.8	6.1	0.3
In percent of GDP						
Savings-investment balance						
Gross domestic investment	20.8	19.8	19.6	22.8	19.7	20.2
Private sector	16.1	14.8	14.7	17.2	14.7	14.7
Public sector	4.7	5.0	4.9	5.6	5.0	5.5
Gross national savings	22.9	20.4	18.5	21.5	21.1	21.2
Private sector	16.4	14.5	12.8	15.9	14.6	15.8
Public sector	6.5	5.8	5.7	5.6	6.5	5.4
Public sector						
Central government primary balance	2.7	1.9	1.5	0.9	1.7	0.8
Central government overall balance	2.0	0.6	0.1	0.0	0.9	0.0
Consolidated public sector primary balance 3/	3.2	2.8	3.7	1.9	3.1	1.5
Consolidated public sector overall balance 3/	1.8	0.9	0.8	0.0	1.6	0.0
Public sector debt (end-of-year) 4/	45.1	37.7	27.6	25.4	22.2	20.6
External	40.9	34.3	25.2	23.1	20.2	18.9
Domestic	4.2	3.4	2.4	2.3	2.0	1.7
Consolidated public sector debt 5/	48.8	42.7	34.0	32.8	28.9	26.2
Annual percent change						
Money and credit						
Monetary base	17.6	4.3	13.0	11.1	35.3	10.4
M2	24.6	16.1	15.3	12.0	40.2	12.0
M5 5/	11.7	7.7	7.9	11.9	8.2	12.0
Credit to the private sector 6/	13.9	14.1	6.8	6.3	46.3	12.5
Velocity of M2	7.7	7.2	7.0	6.8	6.2	5.6
Memorandum items:						
International reserves (in millions of U.S. dollars)	1,168	1,297	1,703	1,920	2,462	2,562
(In months of imports)	3.4	2.5	2.7	3.2	3.6	3.3
GDP (in billions of guaranies)	41,522	46,169	52,270	57,520	59,460	66,130
Population (millions)	5.7	5.8	5.9	6.0	6.0	6.2

Sources: Paraguayan authorities; and Fund staff estimates.

1/ Revised GDP growth rates and GDP ratios reflects the use of a new national account data recently published by the authorities. However, program GDP ratios were not revised.

2/ INS calculations of real effective exchange rates. 2007 data up to Q3.

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

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

5/ Includes Central Bank Bills (LRMs).

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

Table 4. Paraguay: Central Government Operations

	2004	2005	2006	2007				2008			
				Jan-Sep		Jan-Dec		Jan-Mar	Jan-Jun	Jan-Sep	Jan-Dec
				Prog.	Actual	Prog.	Actual				
In billion of guaranies											
Total revenues	7,637	8,419	9,588	7,533	7,831	10,450	10,719	2,620	5,570	8,726	12,246
Tax revenues	4,929	5,471	6,295	5,043	5,144	6,954	6,900	1,677	3,557	5,576	7,834
Income taxes	880	967	1,009	820	1,017	1,147	1,221	279	622	951	1,290
Excises	1,000	1,007	1,049	856	944	1,165	1,287	292	649	1,026	1,483
Value added tax	1,939	2,372	2,786	2,277	2,352	3,130	3,257	839	1,724	2,735	3,775
Import Duties	904	843	938	657	595	910	846	218	440	682	975
Other	205	282	513	432	236	603	290	49	121	182	312
Nontax revenues 1/ o/w: Public pension contributions	2,696	2,946	3,262	2,488	2,686	3,493	3,794	924	1,976	3,094	4,337
Itaipu-Yacyreta	440	541	560	477	535	646	752	202	392	599	795
Capital revenues	1,640	1,651	1,883	1,258	1,500	1,755	2,042	452	931	1,444	2,015
	12	2	31	2	1	3	25	19	37	56	75
Current expenditures:	5,363	6,231	7,138	5,557	5,402	7,905	7,964	2,091	4,222	6,448	9,384
Wages and salaries	2,984	3,334	3,857	3,086	2,949	4,443	4,360	1,195	2,429	3,665	5,372
Goods and services	447	546	674	528	414	784	705	184	374	564	827
Interest payments	483	560	519	423	410	518	515	159	275	440	562
Transfers	1,431	1,771	2,067	1,505	1,618	2,141	2,366	547	1,133	1,763	2,602
Of which: pensions and benefits	940	1,126	1,207	946	896	1,320	1,264	322	649	985	1,434
Other	18	19	22	14	11	19	19	5	11	16	21
Capital expenditures and net lending	1,625	1,860	2,185	1,647	1,239	2,544	2,280	434	1,135	1,906	2,861
Statistical discrepancy 2/	181	-39	-216	0	-29	0	72	0	0	0	0
Overall balance	830	289	48	330	1,162	0	546	95	213	373	0
Financing	-830	-288	-48	-330	-1,162	0	-546	-95	-213	-373	0
External debt (increase +)	103	-295	-122	-76	-339	89	-208	-136	-9	29	192
Disbursements	763	658	832	694	421	1,040	724	139	437	749	1,090
o/w: Program loans	0	0	81	0	0	0	0	0	0	0	0
Amortizations	660	954	954	771	760	950	932	274	445	719	898
Domestic bonds (increase +)	-78	-137	147	-91	-12	2	186	0	0	0	0
New TB issues	0	0	318	101	178	194	382	143	143	155	155
Amortizations	78	137	171	192	190	192	196	143	143	155	155
Net credit from the banking system 1/	-162	-44	-373	-162	-673	-91	-831	41	-204	-402	-192
Net credit from Central Bank	-114	55	-466	-162	-667	-91	-835	41	-204	-402	-192
Net credit from commercial banks	-48	-99	93	0	-6	0	4	0	0	0	0
Other	-693	188	300	0	-122	0	307	0	0	0	0
In percent of GDP											
Total revenues	18.4	18.2	18.3	13.1	13.2	18.2	18.0	4.0	8.4	13.2	18.5
Tax revenues:	11.9	11.8	12.0	8.8	8.7	12.1	11.6	2.5	5.4	8.4	11.8
Income taxes	2.1	2.1	1.9	1.4	1.7	2.0	2.1	0.4	0.9	1.4	2.0
Excises	2.4	2.2	2.0	1.5	1.6	2.0	2.2	0.4	1.0	1.6	2.2
Value added tax	4.7	5.1	5.3	4.0	4.0	5.4	5.5	1.3	2.6	4.1	5.7
Import duties	2.2	1.8	1.8	1.1	1.0	1.6	1.4	0.3	0.7	1.0	1.5
Other	0.5	0.6	1.0	0.8	0.4	1.0	0.5	0.1	0.2	0.3	0.5
Nontax revenues 2/ o/w: public pension contributions	6.5	6.4	6.2	4.3	4.5	6.1	6.4	1.4	3.0	4.7	6.6
Itaipu-Yacyreta	1.1	1.2	1.1	0.8	0.9	1.1	1.3	0.3	0.6	0.9	1.2
Capital revenues	3.9	3.6	3.6	2.2	2.5	3.1	3.4	0.7	1.4	2.2	3.0
	0.0	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.1	0.1	0.1
Current expenditures	12.9	13.5	13.7	9.7	9.1	13.7	13.4	3.2	6.4	9.7	14.2
Wages and salaries	7.2	7.2	7.4	5.4	5.0	7.7	7.3	1.8	3.7	5.5	8.1
Goods and services	1.1	1.2	1.3	0.9	0.7	1.4	1.2	0.3	0.6	0.9	1.2
Interest payments	1.2	1.2	1.0	0.7	0.7	0.9	0.9	0.2	0.4	0.7	0.8
Transfers	3.4	3.8	4.0	2.6	2.7	3.7	4.0	0.8	1.7	2.7	3.9
Capital expenditures and net lending	3.9	4.0	4.2	2.9	2.1	4.4	3.8	0.7	1.7	2.9	4.3
Statistical discrepancy 3/	0.4	-0.1	-0.4	0.0	0.0	0.0	0.1	0.0	0.0	0.0	0.0
Overall balance	2.0	0.6	0.1	0.6	2.0	0.0	0.9	0.1	0.3	0.6	0.0
Financing	-2.0	-0.6	-0.1	-0.6	-2.0	0.0	-0.9	-0.1	-0.3	-0.6	0.0
External debt (increase +)	0.2	-0.6	-0.2	-0.1	-0.6	0.2	-0.3	-0.2	0.0	0.0	0.3
Disbursements	1.8	1.4	1.6	1.2	0.7	1.8	1.2	-0.2	0.0	0.0	1.6
Amortizations	1.6	2.1	1.8	1.3	1.3	1.7	1.6	0.2	0.7	1.1	1.4
Domestic bonds (increase +)	-0.2	-0.3	0.3	-0.2	0.0	0.0	0.3	0.0	0.0	0.0	0.0
Net credit from the banking system	-0.4	-0.1	-0.7	-0.3	-1.2	-0.2	-1.4	0.1	-0.3	-0.6	-0.3
Other	-1.7	0.4	0.6	0.0	-0.2	0.0	0.5	0.0	0.0	0.0	0.0
Memorandum Item:											
Primary balance	2.7	1.9	1.5	1.3	2.7	0.9	1.7	0.4	0.7	1.2	0.8
Balance of the Caja Fiscal 4/	-1.2	-1.3	-1.2	-0.8	-0.6	-1.2	-0.9	-0.2	-0.4	-0.6	-1.0

Sources: Ministry of Finance; and Fund staff estimates.

1/ Excludes banks' holdings of government bonds.

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

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

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-Sep		Jan-Dec		Jan-Mar	Jan-Jun	Jan-Sep	Jan-Dec
				Prog.	Est.	Prog.	Actual	Prog.	Proj.		
In billion of guaranies											
Revenue	8,959	10,114	11,821	9,088	9,818	12,702	13,520	3,306	6,975	10,844	15,209
Tax revenue	4,936	5,483	6,320	5,054	5,162	6,975	6,931	1,682	3,568	5,594	7,868
Nontax revenue and grants	4,010	4,596	5,469	4,022	4,649	5,714	6,558	1,605	3,360	5,187	7,261
Capital revenue	14	35	32	11	7	13	31	20	48	63	80
Current expenditure	6,959	7,908	9,177	6,958	6,925	10,157	10,169	2,571	5,260	8,107	11,841
Wages and salaries	3,634	4,087	4,711	3,632	3,630	5,271	5,314	258	584	926	6,434
Goods and services	755	994	1,200	814	703	1,235	1,200	258	476	747	1,376
Interest payments	678	751	858	743	707	1,103	910	602	1,269	2,031	971
Transfers	1,699	2,048	2,373	1,723	1,864	2,470	2,708	737	1,584	2,521	3,012
Other	193	27	35	45	21	77	38	11	21	34	48
Capital expenditure and net lending	1,956	2,306	2,580	2,236	1,473	3,247	2,969	580	1,442	2,362	3,630
Of which: capital expenditure	2,189	2,550	2,844	2,375	1,645	3,468	3,231	619	1,536	2,545	3,921
Primary balance	1,315	1,298	1,960	1,203	2,636	1,103	1,840	431	729	1,263	971
Public enterprises' operating surplus	593	646	1,039	565	510	702	548	18	-20	141	262
Statistical discrepancy 2/	119	-132	-689	0	0	0	0	0	0	0	0
Overall balance	756	414	413	459	1,930	0	930	172	253	516	0
Financing	-756	-415	-413	-459	-1,930	0	-930	-172	-253	-516	0
External financing net	-42	-445	-257	-240	-468	-134	-385	-134	-40	-51	157
Disbursements	808	771	939	694	421	1,040	724	-134	-40	-51	1,240
Amortizations	850	1,216	1,196	934	889	1,174	1,109	272	477	799	1,083
Domestic financing net	72	-201	-476	-219	-1,340	134	-545	-39	-1,193	-1,340	-157
Bond financing	-78	-137	147	-91	-12	2	186	0	-44	-12	0
Net credit from the banking system	-183	-176	-728	-317	-1,348	-296	-774	-63	-1,182	-1,348	-333
Net credit from commercial banks	-257	-146	-252	-155	-681	-205	56	-273	-624	-681	-142
Net credit from Central Bank	74	-30	-476	-162	-667	-91	-831	211	-558	-667	-192
Quasifiscal deficit financing	333	112	105	190	21	429	44	24	49	77	176
Other	-786	232	320	0	-122	0	0	0	0	0	0
In percent of GDP											
Revenue	21.6	21.9	22.6	15.8	16.5	22.1	22.7	5.6	11.7	18.2	23.0
Tax revenue	11.9	11.9	12.1	8.8	8.7	12.1	11.7	2.8	6.0	9.4	11.9
Nontax revenue and grants	9.7	10.0	10.5	7.0	7.8	9.9	11.0	2.7	5.7	8.7	11.0
Capital revenue	0.0	0.1	0.1	0.0	0.0	0.0	0.1	0.0	0.1	0.1	0.1
Current expenditure	16.8	17.1	17.6	12.1	11.6	17.7	17.1	4.3	8.8	13.6	17.9
Wages and salaries	8.8	8.9	9.0	6.3	6.1	9.2	8.9	2.4	4.9	7.3	9.7
Goods and services	1.8	2.2	2.3	1.4	1.2	2.1	2.0	0.4	1.0	1.6	2.1
Interest payments	1.6	1.6	1.6	1.3	1.2	1.9	1.5	0.4	0.8	1.3	1.5
Transfers	4.1	4.4	4.5	3.0	3.1	4.3	4.6	1.0	2.1	3.4	4.6
Other	0.5	0.1	0.1	0.1	0.0	0.1	0.1	0.0	0.0	0.1	0.1
Capital expenditure and net lending	4.7	5.0	4.9	3.9	2.5	5.6	5.0	1.0	2.4	4.0	5.5
Of which: capital expenditure	4.9	5.0	4.9	3.9	2.5	5.6	5.0	1.0	2.4	4.0	5.5
Public enterprises' operating surplus	1.4	1.4	2.0	1.0	0.9	1.2	0.9	0.0	0.0	0.2	0.4
Statistical discrepancy 2/	0.3	-0.3	-1.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	1.8	0.9	0.8	0.8	3.2	0.0	1.6	0.3	0.4	0.9	0.0
Financing	-1.8	-0.9	-0.8	-0.8	-3.2	0.0	-1.6	-0.3	-0.4	-0.9	0.0
External financing net	-0.1	-1.0	-0.5	-0.4	-0.8	-0.2	-0.6	-0.2	-0.1	-0.1	0.2
Disbursements	1.9	1.7	1.8	1.2	0.7	1.8	1.2	0.2	0.7	1.3	1.9
Amortizations	2.0	2.6	2.3	0.0	0.0	2.0	1.9	0.0	0.0	0.0	1.6
Domestic financing net	0.2	-0.4	-0.9	-0.4	-2.3	0.2	-0.9	-0.1	-0.4	-0.8	-0.2
Of which: quasifiscal deficit financing	0.8	0.2	0.2	0.3	0.0	0.7	0.1	0.0	0.1	0.1	0.3
Other	-1.9	0.5	0.6	0.0	-0.2	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum item:											
Primary balance	3.2	2.8	3.7	2.1	4.4	1.9	3.1	0.7	1.2	2.1	1.5

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, 2003-08
(In billions of guaraníes; end-of-period; valued at constant exchange rate)

	2004		2005		2006		2007		2008				
	Actual 1/	Actual 2/	Mar	Jun		Sep		Dec					
				Prog.	Actual	Prog.	Actual	Prog.	Actual				
Currency issue	2,488	2,925	3,371	3,045	3,219	3,067	3,370	3,776	4,326	3,866	3,865	3,906	4,836
Growth	12.7	17.6	15.3	19.3	26.2	15.7	27.1	12.0	28.3	24.2	20.1	15.9	11.8
Net international reserves	7,335	8,146	8,684	9,690	10,981	9,767	11,126	9,792	12,557	12,302	12,557	12,812	13,067
(In millions of U.S. dollars)	1,168	1,297	1,703	1,900	2,153	1,915	2,182	1,920	2,462	2,412	2,462	2,512	2,562
Net domestic assets	-4,848	-5,221	-5,312	-6,645	-7,762	-6,700	-7,756	-6,016	-8,231	-8,436	-8,692	-8,906	-8,231
Net nonfinancial public sector	1,366	1,410	728	375	220	258	243	638	111	130	-94	-297	-86
Net credit to the central government	967	1,063	425	419	-121	-70	-99	334	-241	-200	-446	-644	-433
Net credit to the rest of NFPS	398	347	303	328	341	328	342	304	352	330	352	347	347
Net credit to the banking system	-4,376	-5,026	-5,484	-6,727	-7,477	-6,584	-7,295	-6,611	-7,461	-7,362	-7,450	-7,506	-7,216
Reserve requirements	-2,195	-2,331	-2,209	-2,345	-2,653	-2,530	-2,787	-2,531	-3,089	-2,764	-3,024	-3,190	-3,239
Free reserves	-1,012	-883	-651	-1,174	-986	-1,159	-744	-521	-1,022	-1,007	-992	-977	-962
Monetary control bills (LRM)	-1,171	-2,014	-2,644	-3,208	-2,942	-3,847	-2,910	-3,772	-3,352	-3,592	-3,436	-3,340	-3,017
Other	2	2	2	15	9	15	9	15	2	2	2	2	2
Other assets and liabilities (net)	-1,838	-1,605	-556	-462	-504	-374	-705	-43	-881	-1,204	-1,148	-1,103	-929
Capital and reserves	-1,722	-1,368	-116	-94	-192	-11	-120	228	162	185	208	235	334
Other assets net 3/	-116	-237	-440	-368	-312	-363	-585	-271	-1,043	-1,389	-1,357	-1,338	-1,263
Memorandum items:													
Total stock of LRMs outstanding	1,552	2,293	3,224	3,545	4,354	3,506	4,393	4,305	3,907	4,490	4,295	4,175	3,771
Quasifiscal balance 4/	-333	-112	-105	-107	-32	-190	-21	-429	-44	-24	-49	-77	-176
In percent of GDP	-0.8	-0.2	-0.2	-0.2	-0.1	-0.3	0.0	-0.7	-0.1	0.0	-0.1	-0.1	-0.3
Costs of monetary policy operations 4/	181	179	331	100	199	320	291	583	386	99	201	307	399
In percent of GDP	0.4	0.4	0.6	0.2	0.3	0.6	0.5	1.0	0.6	0.1	0.3	0.5	0.6
Monetary base	4,006	4,180	4,724	5,165	5,154	5,158	5,188	5,248	6,390	5,918	6,045	6,143	7,052
annual growth (in percent)	18	4	13.0	36.3	36.4	32.2	33.0	11.1	35	15	17	18	10
Narrow monetary base 5/	3,122	3,667	4,169	4,011	4,256	4,034	4,493	4,762	5,507	5,050	5,192	5,306	6,229
annual growth (in percent)	5.7	17.5	13.7	20.1	21.3	17.9	31.3	14.2	32.1	25.9	22.0	18.1	13.1

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

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

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

3/ Includes LRM held by the nonbanking sector.

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

5/ Narrow monetary base comprises currency requirement deposits in guaraní held at the BCP.

Table 7. Paraguay: Summary Accounts of the Banking System, 2003-08
(In billions of guaraníes; end-of-period; valued at constant exchange rate)

	2003		2004		2005		2006		2007		2008			
	Actual 1/	Actual 2/	Actual 1/	Actual 2/	Actual	Prog.	Actual	Prog.	Actual	Prog.	Mar	Jun	Sep	Dec
I. Central Bank														
Net international reserves	6,175	7,335	8,146	10,693	8,684	9,767	11,126	9,792	12,557	12,302	12,557	12,557	12,812	13,067
(in millions of U.S. dollars)	983	1,168	1,297	1,703	1,703	1,915	2,182	1,920	2,462	2,412	2,462	2,462	2,512	2,562
Net domestic assets	-3,969	-4,848	-5,221	-7,322	-5,312	-6,700	-7,756	-6,016	-8,231	-8,436	-8,692	-8,692	-8,906	-8,231
Credit to public sector, net	1,163	1,366	1,410	1,015	728	258	243	638	111	130	-94	-94	-297	-86
Credit to banking system, net 3/	-2,760	-3,205	-3,012	-3,185	-2,840	-3,673	-3,523	-3,038	-4,109	-3,770	-4,014	-4,014	-4,165	-4,199
Central bank securities	-1,071	-1,552	-2,293	-3,224	-3,224	-3,506	-4,393	-4,305	-3,907	-4,490	-4,295	-4,295	-4,175	-3,771
Other	-1,301	-1,457	-1,326	-1,928	24	222	-83	689	-326	-306	-289	-289	-268	-175
Currency issue	2,207	2,488	2,925	3,371	3,371	3,067	3,370	3,776	4,326	3,866	3,865	3,865	3,906	4,836
II. Monetary Survey														
Net foreign assets	8,405	9,478	10,028	12,491	10,140	11,394	12,654	11,469	13,507	13,142	13,494	13,494	13,837	14,639
(in millions of U.S. dollars)	1,338	1,509	1,597	1,989	1,988	2,234	2,481	2,249	2,648	2,577	2,646	2,646	2,713	2,870
Net domestic assets	2,152	2,313	2,671	2,398	3,564	2,731	3,332	3,859	4,466	4,315	4,688	4,688	4,627	5,490
Credit to the public sector	699	531	237	-188	-411	-1,424	-1,716	-700	-1,665	-1,920	-2,151	-2,151	-2,635	-2,003
Credit to the private sector	5,081	5,788	6,601	7,760	7,051	7,282	9,037	7,496	10,316	10,435	11,148	11,148	11,596	11,609
Other	-3,628	-4,006	-4,167	-5,174	-3,077	-3,128	-3,990	-2,937	-4,186	-4,200	-4,309	-4,309	-4,334	-4,116
Broad Liquidity (M4)	10,558	11,791	12,699	14,890	13,704	14,124	15,985	15,328	17,972	17,457	18,182	18,182	18,464	20,128
Bonds and issued securities	31	0	0	0	0	0	0	0	0	0	0	0	0	0
Other monetary liabilities	9	10	9	32	17	53	24	84	96	84	49	49	56	38
Central bank securities with private se	469	440	465	580	321	596	621	732	380	344	306	306	223	351
Broad liquidity (M3)	10,047	11,285	12,334	14,278	13,098	13,475	15,339	14,568	17,334	16,538	17,309	17,309	17,603	19,282
Foreign currency deposits	5,253	5,310	5,396	6,280	5,100	5,588	5,972	5,610	6,105	5,632	6,105	6,105	6,455	6,719
Money and quasi-money (M2)	4,794	5,974	6,938	7,998	7,998	7,886	9,367	8,958	11,213	10,906	11,205	11,205	11,148	12,563
Quasi-money	1,208	1,482	1,472	1,668	1,668	1,850	2,208	1,869	2,339	2,535	2,562	2,562	2,644	2,614
Money (M1)	3,587	4,492	5,466	6,330	6,330	6,037	7,159	7,089	8,875	8,371	8,643	8,643	8,504	9,949
(Annual percentage change)														
M0 (Currency issued)	29.9	12.7	17.6	15.3	15.3	15.7	27.1	12.0	28.3	24.2	20.1	20.1	15.9	11.8
Credit to the private sector	-18.4	13.9	14.1	17.6	6.8	0.9	37.9	6.3	46.3	43.0	41.9	41.9	28.3	12.5
M1	35.8	25.2	21.7	15.8	15.8	17.6	39.5	12.0	40.2	31.8	25.3	25.3	18.8	12.1
M2	24.9	24.6	16.1	15.3	15.3	17.8	39.9	12.0	40.2	32.7	25.8	25.8	19.0	12.0
M3	17.7	12.3	9.3	15.8	15.7	3.6	29.8	11.2	32.3	21.6	18.2	18.2	14.8	11.2
Of which: foreign currency deposits	11.8	1.1	1.6	16.4	16.4	-11.4	16.6	10.0	20.0	4.7	6.4	6.4	8.1	9.8
Memorandum items:														
Ratio of foreign currency deposits to M3 (percent)	52.3	47.1	43.7	44.0	38.9	41.5	38.9	38.5	35.3	34.1	35.3	35.3	36.7	34.8
Ratio of foreign currency deposits to private sector deposits in banks (per	63.5	57.1	54.6	55.4	50.3	51.5	48.0	49.8	45.3	42.8	43.7	43.7	45.5	44.9

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

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

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

3/ Reflects debt write-offs of central bank credit to commercial banks during 1997 and 1998.

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				Year
				Jan-Sep		Jan-Dec		Jan-Mar	Apr-Jun	Jul-Sep	Oct-Dec	
				Prog.	Actual	Prog.	Est.					
Current account	143	44	-110	-44	302	-146	172	-51	91	121	-28	133
Trade balance	-248	-459	-935	-525	-280	-886	-613	-254	-84	-82	-281	-702
Exports	2,854	3,352	4,834	4,258	4,767	5,414	6,416	1,592	1,760	1,936	1,842	7,130
Registered	1,627	1,688	1,903	1,985	2,399	2,513	3,144	780	919	1,050	824	3,574
Unregistered	1,228	1,664	2,931	2,273	2,368	2,901	3,273	812	841	886	1,017	3,556
Imports	-3,102	-3,811	-5,769	-4,783	-5,047	-6,300	-7,029	-1,846	-1,845	-2,019	-2,123	-7,832
Registered	-2,658	-3,251	-5,254	-4,423	-4,636	-5,779	-6,427	-1,688	-1,662	-1,847	-1,958	-7,154
Unregistered	-444	-560	-515	-360	-411	-521	-602	-158	-183	-172	-165	-678
Services (net)	327	349	413	223	281	336	391	97	87	111	119	413
Factor income	-134	-70	-15	48	6	79	-47	-17	-15	-19	-10	-61
Transfers	194	224	426	210	296	325	440	124	104	111	144	482
Capital and financial account	41	304	247	150	220	257	617	1	-41	-71	78	-33
General government	-26	-107	-21	-14	-55	18	38	-28	26	8	33	38
Disbursements	139	107	184	137	86	202	214	28	61	63	69	221
Amortization	-133	-175	-169	-151	-148	-185	-184	-56	-35	-56	-36	-183
Other	-32	-39	-36	0	7	0	7	0	0	0	0	0
Private Sector 1/	67	411	268	164	275	240	580	29	-67	-79	46	-71
Direct investment	32	46	166	166	116	236	172	45	45	45	45	179
Foreign currency deposits	30	423	151	0	259	0	259	0	0	0	0	0
Other	6	-58	-49	-2	-100	4	149	-16	-111	-123	0	-250
Errors and Omissions	93	-201	266	133	-46	133	0	0	0	0	0	0
Overall Balance	277	147	402	239	476	244	789	-50	50	50	50	100
Net International Reserves (increase -)	-186	-128	-406	-212	-479	-217	-759	50	-50	-50	-50	-100
Gross Reserves	-185	-129	-406	-212	-479	-217	-759	50	-50	-50	-50	-100
Reserve Liabilities	-1	1	0	0	0	0	0	0	0	0	0	0
Exceptional Financing	-92	-19	3	-27	3	-27	-29	0	0	0	0	0
Arrears deferral (+)/clearance (-) 2/	-92	-19	3	-27	3	-27	-29	0	0	0	0	0
Reschedulings	0	0	0	0	0	0	0	0	0	0	0	0
Memorandum items:												
Current account in percent of GDP	2.1	0.6	-1.2	-0.5	3.2	-1.3	1.5	-1.5	2.7	3.6	-0.9	1.0
Gross reserves (millions of U.S. dollars)	1,168	1,298	1,703	1,915	2,182	1,920	2,462	2,412	2,462	2,512	2,562	2,562
in months of imports of GNFS	3.4	2.5	2.7	3.2	3.2	3.2	3.6	3.1	3.2	3.2	3.3	3.3
External public debt in percent of GDP 3/	41.3	34.6	25.3	22.3	20.1	23.2	20.6	18.8	19.0	19.0	19.3	19.3
Debt service in percent of exports GNFS	7.3	8.6	5.9	5.8	4.9	5.8	5.1	5.5	3.6	4.5	4.8	5.0
Export Volume (percentage change) 4/	17.8	11.1	8.9	34.3	27.5	23.7	32.0	8.0	2.7	11.3	3.6	6.5
Import Volume (percentage change) 4/	17.1	13.3	54.3	16.6	14.7	8.2	15.2	2.6	8.8	8.7	4.1	6.8
Terms of trade (percentage change)	-1.3	-9.5	-2.2	4.8	6.1	0.3

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

1/ Includes public enterprises and binationals.

2/ Reflects PETROPAR's arrears on suppliers credits, which are not considered sovereign arrears (see definition in the TMU).

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

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	15.7	32.3
Credit to the private sector, real (percentage change) 1/	-25.5	10.9	3.9	-4.9	38.2
Share of nonperforming loans in total loans (percent)	20.6	10.8	6.6	3.3	3.4
Average domestic lending rate, real	19.3	17.4	18.6	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	44.2	32.7
Merchandise imports (percentage change)	14.4	27.0	22.9	51.4	21.8
Merchandise terms of trade (percentage change)	0.0	-1.3	-9.5	-2.2	6.1
Real effective exchange rate (percentage change)	-6.6	3.7	-6.5	13.0	10.7
Current account balance (percent of GDP)	2.3	2.1	0.6	-1.2	1.5
Capital and financial account (percent of GDP)	3.2	0.6	4.1	2.7	5.2
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	0.5	3.5
External public debt (percent of GDP) 2/	48.1	41.3	34.6	25.3	20.6
Debt service (in percent of exports GNFS)	11.5	7.3	8.6	5.9	5.1
Gross reserves (in US\$)	983	1,168	1,297	1,703	2,462
In months of imports of GNFS	3.5	3.4	2.5	2.7	3.6
Over short-term external debt 3/	1.7	1.7	1.9	2.5	3.4
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 of Gs. 6,280 per U.S. dollar.

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	June 2007 Phasing	October 2007 Phasing	Conditions
	Amount of Purchase		
	Percent of Quota 1/		
May 31, 2006	25.0	25.0	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-September 2007 performance criteria
December 15, 2007 2/	6.0	1.0	Fifth review and end-December 2007 performance criteria 3/
March 15, 2008	5.0	1.0	End-December 2007 performance criteria
June 15, 2008	2.5	1.0	Sixth review and end-March 2008 performance criteria
August 28, 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 fifth review has been delayed and it is expected to be completed at end-March, 2008.

3/ The fifth review was originally scheduled to be completed by mid-December 2007, and was controlled by end-September 2007 performance criteria. However, due to delays in completing the fifth review, the end-September 2007 performance criteria are no longer relevant, and the review is controlled by the end-December 2007 performance criteria.

Table 12. Paraguay: Medium-Term Scenario

	2004	2005	2006	2007	2008	2009	2010	2011	2012
	Projections								
	(Annual percentage change, unless otherwise indicated)								
Real sector									
Real GDP growth	4.1	2.9	4.3	6.4	4.0	4.5	5.0	5.0	5.0
Consumer prices	2.8	9.9	12.5	6.0	5.0	3.0	3.0	3.0	3.0
GDP per capita (US dollars)	1,220	1,289	1,570	1,955	2,187	2,256	2,350	2,454	2,561
	(In percent of GDP)								
Gross domestic investment	20.8	19.8	19.6	19.7	20.2	20.8	21.3	21.7	22.0
Private sector	16.1	14.8	14.7	14.7	14.7	15.1	15.3	15.5	15.7
Public sector	4.7	5.0	4.9	5.0	5.5	5.7	6.0	6.2	6.3
Gross national savings	22.9	20.4	18.5	21.1	21.2	21.2	21.5	21.9	21.9
Private sector	16.4	14.5	12.8	14.6	15.8	15.6	15.7	15.8	15.8
Public sector	6.5	5.8	5.7	6.5	5.4	5.6	5.9	6.1	6.2
Public finances 1/									
Revenues	21.6	21.9	22.6	22.7	23.0	23.0	23.3	23.5	22.7
Current primary expenditures	15.1	15.5	15.9	15.6	16.4	16.3	16.1	16.0	15.8
Interest payments	1.6	1.6	1.6	1.5	1.5	1.4	1.5	1.5	0.9
Capital expenditures	4.7	5.0	4.9	5.0	5.5	5.7	6.0	6.2	6.3
Public enterprise operating surplus	1.4	1.4	2.0	0.9	0.4	0.5	0.3	0.3	0.3
Primary balance	3.2	2.8	3.7	3.1	1.5	1.4	1.5	1.5	0.9
Overall balance	1.8	0.9	0.8	1.6	0.0	0.0	0.0	0.0	0.0
Public sector debt 2/ 3/	45.1	37.7	27.6	22.2	20.6	20.1	19.7	19.2	18.7
Consolidated public sector debt 3/	49.2	43.0	34.1	29.0	26.3	26.1	25.4	24.7	23.9
	(In millions of U.S. dollars)								
Public sector debt 2/	3,027	2,876	2,807	2,739	2,744	2,845	2,959	3,064	3,173
Balance of payments									
Exports	2,854	3,352	4,834	6,416	7,130	7,933	8,756	9,651	10,596
Imports	3,102	3,811	5,769	7,029	7,832	8,633	9,505	10,469	11,536
Current account	143	44	-110	172	133	60	42	38	-4
(In percent of GDP)	2.1	0.6	-1.2	1.5	1.0	0.4	0.3	0.2	0.0
Capital and financial account	41	304	247	617	-33	214	232	236	278
Gross international reserves	1,168	1,297	1,703	2,462	2,562	2,836	3,110	3,383	3,657
(In months of imports)	3.4	2.5	2.7	3.6	3.3	3.3	3.6	3.6	3.5

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 1. LETTER OF INTENT

Asunción, Paraguay
March 17, 2008

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

Dear Mr. Strauss-Kahn:

1. This letter and the attached memorandum of economic and financial policies (MEFP) update and supplement our previous correspondence (of May 8, 2006, September 12, 2006, June 15, 2007, and October 2, 2007), describe performance under the government's economic program for 2007, and propose our economic program for 2008. The attached MEFP articulates the economic policies that the government intends to pursue during 2008 as well as the key targets and objectives under the program (performance criteria and structural benchmarks are included in Tables 1 and 2 of the MEFP). As the program comes to an end in August 2008, the government's objectives continue to be the consolidation of the stabilization gains achieved over the past few years while reducing poverty and deepening the structural reform agenda.
2. The program has been designed for the whole of 2008 to facilitate the task of articulating adequate policies for the new administration that takes over in August 2008. With the presidential elections of April 2008 approaching, the political situation will become more complex and implementation of the program more challenging.
3. The program remains on track. Performance under our economic program for 2007, supported by a 27-month Stand-By Arrangement (SBA), has been very good. All performance criteria through end-September and end-December 2007 have been observed. While most structural benchmarks for end-September and end-December 2007 were fully met, there were delays in a few cases due to logistical problems, which are being addressed.
4. Macroeconomic conditions have improved markedly since the adoption of the program in May 2006. Economic growth accelerated and inflation remained within the target band in 2007 despite some price pressures in the second half of the year due to food supply shocks. The public finances remain on a strong footing anchored by the financial plan, and international reserves are at an all time high.

5. Against this background of good economic performance, the Government of Paraguay hereby requests completing the fifth review under the SBA supported program.

6. The Government of Paraguay will maintain the productive and fruitful dialogue we have had with the Fund in the past. We believe that the policies set forth in the attached MEFP are adequate to reach the program objectives, but we will take additional measures, if necessary, to achieve those objectives. In the spirit of cooperation, we will consult and provide Fund staff with all the relevant information required to complete program reviews and monitor performance.

7. As part of our communication policy, we intend to publish this letter on 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 and the MEFP.

Sincerely yours,

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

_____/s/_____
César Barreto
Minister of Finance

**APPENDIX 2. MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES
OF THE GOVERNMENT OF PARAGUAY (MEFP)**

I. BACKGROUND

1. The economic reforms undertaken by the administration of President Duarte-Frutos are beginning to bear fruit, and have established a strong base for the next government. Following the successful stabilization of the period 2003–05, the government adopted another ambitious economic program for 2006-08 to promote growth and reduce poverty while entrenching macroeconomic stability. Both programs have been supported by precautionary Stand-By Arrangements from the IMF. As a result, growth has rebounded to twice its long-term average, and extreme poverty has been reduced by one-third. Public finances have been put on a solid footing mainly through a tax reform which has improved the tax system and strengthened tax administration, increasing the formalization of the economy; and the public debt level has been put on a firm downward path. The financial system has been considerably strengthened, and confidence in the banking system has increased. The external position has been reinforced significantly, thereby allowing an increase in international reserves to record highs, while maintaining a flexible exchange rate regime.

2. **The program remains on track, and considerable progress has been made in all areas of the structural reform agenda.** All quantitative performance criteria for end-September and end-December 2007 were met with large margins, and most structural measures were observed.^{1, 2}

3. **The economy strengthened further in 2007.** Real GDP is expected to have grown by almost 6½ percent (against 4⅓ percent in 2006), driven mainly by buoyant exports,

¹ The variables subject to quarterly quantitative performance criteria under the program include: (i) overall balance of the Central Administration; (ii) wage bill of the Central Administration; (iii) overall balance of the public sector; (iv) net international reserves of the Central Bank; (v) net domestic assets of the Central Bank; (vi) contracting or guaranteeing of nonconcessional external debt by the nonfinancial public sector; (vii) contracting or guaranteeing of short-term external debt by the nonfinancial public sector (on a continuous basis); and (viii) non-accumulation of external debt arrears (on a continuous basis).

² The list of structural measures observed through end-December 2007 includes: (i) the establishment of an expenditure commitment control system; (ii) the design of a public sector investment program; (iii) the design of a strategy for the development of capital markets; (iv) the implementation of a number of prudential regulations in line with the BCP's operational plan to strengthen the regulatory and supervisory framework of the banking system; and (v) the increase in the coverage of the conditional cash transfer program to over 15,000 families. A new payments system legislation was drafted and will be elevated to the Economic Cabinet by mid-April 2008. The benchmark related to the implementation of the result-oriented management contracts for five public enterprises for end-December 2007 was observed, although the results were positive for only three of them (ANDE, COPACO, and PETROPAR). We are taking action in the other two public enterprises (ESSAP and INC) to ensure that these management contracts are observed in the first half of 2008.

especially for soybeans. Headline inflation fell to 6 percent in 2007 (from 12½ percent in 2006) despite sharp increases in food prices. Public finances recorded another surplus against a program objective of fiscal balance, mainly due to continued solid tax collections and firm expenditure controls. The Central Bank managed to accumulate over US\$¾ billion in reserves in 2007, and the *guaraní* strengthened further against major hard currencies.

4. **The program for 2008 envisages leaving a solid economic base on which the next administration can build in order to achieve higher and sustainable growth, and a meaningful reduction in poverty.** The structure of the 2008 program will be similar to that of 2007. The program will continue to be based on five policy pillars, a strong macroeconomic program anchored by four structural reform areas: (i) public sector reform; (ii) financial sector reform; (iii) pro-growth agenda; and (iv) a social safety net to alleviate poverty. Performance criteria and structural benchmarks for 2008 related to these policies are specified in Tables 1 and 2, and further defined in the attached technical memorandum of understanding.

II. MACROECONOMIC PROGRAM FOR 2008

5. **The macroeconomic framework for the 2008 program seeks to buttress growth, while maintaining sound policies.** After a record harvest in 2007, economic growth is expected to moderate to the 4-5½ percent range in 2008, as crop yields return to more normal levels. Still, given high and volatile inflation in the recent months, the government believes that it is prudent to maintain a similar target of core inflation in 2008, namely 5 percent within a band of ± 2½ percent. Fiscal and monetary policies will be designed with a view to achieve these growth and inflation objectives for 2008.

A. Fiscal Policy

6. **The program continues to aim at preserving fiscal discipline, despite strong expenditure pressures.** While the 2008 budget submitted to Congress envisaged a small deficit (which is broadly consistent with fiscal balance once historical levels of expenditure execution are taken into account), Congress approved a 2008 budget with a deficit of 2 percent of GDP. We will be guided by the expenditure priorities included in the budget approved by Congress, but we have introduced a financial plan for 2008 to align expenditure intentions with available financing (as has been the practice over the last few years). In line with the broad mandate from Congress, our policy will be to restrain non-social current spending to accommodate a higher level of social and capital spending to support our poverty alleviation efforts and growth objectives, while preserving fiscal discipline.

7. **As in previous years, the program will allow an enhancement of quality investments in the social sectors.** In particular, in 2008 the government will aim to achieve higher-than-projected levels of capital and targeted social expenditures provided that macroeconomic conditions are appropriate to absorb these additional expenditures and there

are higher-than-expected revenues or else financing on appropriate terms directed to quality projects. This issue will be addressed in the context of program reviews.

8. **The 2008 program safeguards the objective of broad fiscal balance.** Overall fiscal balance at the consolidated public sector level will continue to be a key objective for 2008. The rest of the public sector is expected to maintain its surplus position by strong revenue performance and restraining of current expenditures. The Central Bank is expected to strengthen its balance sheet position once legislation is approved on the recent initiative to make transfers from the Treasury.

9. **Going forward, the government intends to increase capital expenditures in order to address serious weaknesses in economic and social infrastructure.** To this end, the government is preparing a long-term plan whose key objectives are to boost growth and achieve well-defined development landmarks in different sectors of the economy, including the millennium development goals. In order to ensure that the plan does not undermine the hard-won macroeconomic stability, the government is designing, in cooperation with the international community, a consistent long-term development program.

B. Monetary Policy

10. **Monetary policy will aim at containing core inflation at 5 percent in 2008.** While the range for the inflation objective in 2008 is similar to that of 2007 (i.e., 5 percent within a band of $\pm 2\frac{1}{2}$ percent), efforts will be made to bring down core inflation from the upper end of the range. To respond adequately to external shocks and reduce vulnerabilities in the inflation outlook, we will continue to follow a flexible exchange rate regime with intervention limited to the achievement of our international reserve target.

11. **To anchor inflationary expectations, the monetary authority will pursue a policy of no expansion in the net domestic assets of the Central Bank for 2008 as a whole.** We believe that the inflation objective can be achieved by limiting the growth in currency. We will accommodate the expansion in currency through purchases of foreign exchange, and expect to accumulate at least US\$100 million in 2008. There will be occasional fluctuations in the net domestic assets of the Central Bank during periods when the demand for money has a different seasonality than the balance of payments but the Central Bank will pursue a policy of maintaining stable its net domestic assets for the year as a whole to anchor expectations. The main instrument of monetary control will continue to be the “*Letras de Regulación Monetaria*” whose rates will be set by the Central Bank to achieve its monetary and inflation objectives. The monetary program will continue to be flexible, accommodating higher-than-programmed increases in money demand by allowing a higher growth in currency, accompanied by a commensurate increase in reserve accumulation.

III. STRUCTURAL REFORMS FOR 2008

12. **The structural reform agenda for 2008 will aim at solidifying the gains of the past years.** Given the limited time under the program, the general elections and the difficult political environment, the structural reform agenda needs to be well-focused. There will be one main reform for each of the four structural pillars of the program. Nonetheless, the government will continue to pursue reforms already under way in all areas, with emphasis on legislation that could be adopted by the next Congress.

A. Public Sector Reform

13. **Expenditure control mechanisms will be strengthened further.** To that end, the management of Treasury accounts will be enhanced. Currently, there is a large number of such accounts, some of which are virtually dormant. In order to improve financial management, expenditure control, and transparency, the government will identify all the Central Government accounts and gradually close them, aiming at centralizing all public resources into a single account at the Central Bank. As an initial milestone toward this objective, it will consolidate all the accounts that are currently not established by law into a Single Treasury Account (structural benchmark for end-June 2008), and also initiate the process to incorporate those accounts that are established by law.

14. **The institutional framework of the tax and customs administration will be enhanced.** In particular, the government will concentrate efforts on conducting audits to ensure tax liabilities are properly discharged. We will also focus on strengthening the operations of the large taxpayer unit at the tax agency, with a view to improving taxpayer selection, through the use of a risk-based approach, and auditing activities. The government will also work on developing a systematic approach to strategic management and performance monitoring for revenue administration. Customs administration will continue to be strengthened through tighter operational controls, with a view of improving ex-post audits operations, and also the consolidation of the bank collection system.

B. Financial Sector Reform

15. **The process of strengthening the financial position of the Central Bank will continue in 2008.** This process began with the design of a strategy for this purpose in August 2007 and continued with the submission of legislation to Congress in December 2007 to allow for transfers of 0.2 percent of GDP from the Ministry of Finance to the Central Bank. We have entered a process of reconciliation of claims between the public debt records of the Ministry of Finance and the Central Bank's balance sheet, and have already resolved those claims that are recognized by both institutions. We will send to the attorney general the remaining claims for his information and ruling (structural benchmark for end-May 2008). Once the attorney general gives a positive ruling, we plan to send to Congress legislation to allow a transfer of public bonds to the Central Bank for those amounts that are recorded on

its balance sheet but are not included in the public debt records of the Ministry of Finance, which we expect to take place by mid-2008.

16. **We will continue to implement our strategy toward strengthening prudential regulations for the banking system.** Following our plan designed in June 2007 to enhance the soundness of the banking system and increase compliance with Basel Core Principles to at least 80 percent, the Central Bank approved a modified resolution to upgrade loan classification and provisioning requirements (a modified version of the former Resolution 8/03) in September 2007 and adopted a set of additional regulations in December 2007 under its operational plan. We will continue our work on strengthening the regulatory and supervisory frameworks but some of the needed changes require amendments to the banking law. We will begin consultations with the financial community and Congress to strengthen ownership in this reform area, and assess the viability of sending appropriate legislation to Congress.

C. Pro-Growth Agenda

17. **There is a need to further improve the efficiency of public enterprises to provide better public services and increase productivity.** To this end, the government signed result-oriented management contracts with the five largest public enterprises in December 2006. While the performance of ANDE, COPACO has been acceptable, and that of PETROPAR uneven, the government believes that ESSAP and INC will need to improve their managerial, operational and financial performance in order to reach acceptable standards under these contracts. In the case of ESSAP, the main problem is a weak financial position derived from an unclear ownership structure as it was made a corporation in 2002 in an unsuccessful privatization attempt. To address this problem, the government sent legislation to Congress in November 2007 to reduce ESSAP's debt burden, clarify its ownership structure, and improve its financial accountability and monitoring. We believe that, once approved, this legislation will strengthen significantly the performance of ESSAP. In the case of INC, there are a number of performance problems that we intend to address by strengthening the governance structure. We intend to establish new targets and sign new result-oriented management contracts for these enterprises in 2008 (structural benchmark for end-May 2008). As part of the contracts, these enterprises will develop strategic business plans that will serve to address weaknesses identified in 2007 by the Public Enterprises Council.

18. **Sustained improvements in Paraguay's investment climate are needed in order to promote higher levels of foreign and domestic investment.** With the assistance of the World Bank and the IDB, the government designed a master plan to help promote the investment climate in September 2006. The Ministry of Industry is taking the lead in its implementation, and progress so far has been satisfactory. Going forward, the government intends to attain the following key targets under the plan in 2008: (i) completion of the one-

stop window for opening a business; and (ii) completion of the plan to improve the competitiveness of the export sector, by improving quality standards and sanitary regulation.

D. Social Safety Net

19. **We intend to strengthen the conditional cash transfer program.** This program has been very effective in reducing extreme poverty in the country. While its coverage is still limited (8,800 families in 2006 and over 17,000 families in 2007), we would like to continue expanding this program. Against this background, we expect to have 19,000 families covered under this program in the first five months of the year (structural benchmark for end-May 2008). It has been challenging to ensure the proper administration and implementation of the program, but we intend to continue strengthening the monitoring mechanisms and the required provision of health and education services while at the same time making a budgetary effort to increase the coverage of the program to 50,000 families by end-2008.

IV. OTHER

20. **We will continue to seek resolution to the disputed claims, negotiating in good faith.** There are a number of existing claims in dispute, which we hope to resolve during the program.

Table 1. Paraguay: Quantitative Program Targets

	2008	
	End-March	End-June
Fiscal targets		
1. Overall balance of the central administration (floor, in billions of guaranies) 1/ 2/	95	213
2. Wage bill of the central administration (ceiling, in billions of guaranies) 1/	1,195	2,429
3. Overall balance of the public sector (floor, in billions of guaranies) 1/	172	253
Monetary targets		
4. Net international reserves (floor, in millions of U.S. dollars) 3/	2,412	2,462
5. Net domestic assets (ceiling, in billions of guaranies) 3/	-8,436	-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	500
Continuous PCs		
7. Contracted or guaranteed short-term external debt by the NFPS	0	0
8. Non-accumulation of external debt arrears	0	0

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

2/ For 2008 adjusted downward for any cash transfer or payment of interest costs on securities used to strengthen the financial position of the central bank.

3/ NIR stock 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 for 2008

Measure	Conditionality ^{1/}	Timing
Public Sector Reform		
A. Consolidate all Treasury accounts not established by law into one account	SB	end-June 2008
Financial Sector Reform		
B. Send to attorney general claims in dispute between BCP and the Ministry of Finance for his clearance	SB	end-May 2008
Pro-Growth Reform		
C. Sign and implement result-oriented management contracts for 2008 with ANDE, COPACO, ESSAP, INC and PETROPAR	SB	end-May 2008
Social Safety Net		
D. Increase the coverage of the conditional cash transfer program to 25,000 families	SB	end-May 2008

1/ SB = structural benchmarks.

APPENDIX 3. PARAGUAY—TECHNICAL MEMORANDUM OF UNDERSTANDING

This Technical Memorandum of Understanding (TMU) defines the variables subject to quantitative targets (performance criteria and indicative targets), specified in the Memorandum of Economic and Financial Policies (MEFP). It also describes the methods to be used in assessing the program performance and the information requirements to ensure adequate monitoring of the targets.

A. Fiscal Targets

1. Targets on the Overall Balance of the Central Administration

Cumulative balance	Floor (In billions of <i>guaraníes</i>)
Cumulative balance from December 31, 2007	
End-January 2008 (program projection)	-12
End-February 2008 (program projection)	38
End-March 2008 (performance criterion)	95
End-April 2008 (program projection)	84
End-May 2008 (program projection)	165
End-June 2008 (performance criterion)	213
End-July 2008 (program projection)	261
End-August 2008 (program projection)	367
End-September 2008 (program projection)	373
End-October 2008 (program projection)	481
End-November 2008 (program projection)	580
End-December 2008 (program projection)	0

For the purposes of the program, the central administration (CA) includes the executive, judicial and legislative branches. The overall balance of the CA will be measured and monitored from the financing side, as equal to *minus* the net financing of the CA. The net financing of the CA is defined as the sum of: (i) net external financing to the central government; (ii) the change in net credit to the central government from the financial system, excluding government bonds; (iii) the net issuance of government bonds; (iv) net financing from all other sources to the government (consisting of any form of financing other than government bonds) including by the private sector; (v) asset sales; (vi) the net change in domestic floating debt (*deuda flotante*), as defined below; and (vii) the net change in external arrears. Items denominated in foreign currency will be converted into *guaraníes* at the average exchange rate for each month.

For the purposes of the program, any government bonds issued to (i) capitalize the central bank, (ii) capitalize the Banco Nacional de Fomento (BNF), or (iii) finance the deposit guarantee will not be included in the definition of fiscal deficit.

Net external financing is defined as central government's foreign borrowing, including bonds issued abroad, less amortization payments (including debt prepayments) of foreign debt. Net credit from the financial system is defined as the change in net credit to government, as reported in the monetary accounts of the BCP, excluding government bonds. Net change in domestic floating debt is defined as the difference between accrued expenditure (*gastos obligados*) and payments transferred (*gastos transferidos*). Net change in external arrears is defined as the difference in the stock of arrears to external creditors during a period of reference, as reported by the ministry of finance's SIGADE system. Data will be provided to the Fund by the ministry of finance with a lag of not more than three weeks past the test date.

The floor on the Cumulative Central Administration Overall Balance for 2008 will be adjusted downward by the full amount of cumulative transfers and/or interest due on any bonds issued during 2008 as part of the program to strengthen the financial position of the Central Bank.

2. Targets on the Central Administration Wage Bill

Cumulative flows	Ceiling (In billions of <i>guaraníes</i>)
Cumulative flows from December 31, 2007	
End-January 2008 (program projection)	389
End-February 2008 (program projection)	793
End-March 2008 (performance criterion)	1,195
End-April 2008 (program projection)	1,605
End-May 2008 (program projection)	2,017
End-June 2008 (performance criterion)	2,429
End-July 2008 (program projection)	2,846
End-August 2008 (program projection)	3,257
End-September 2008 (program projection)	3,665
End-October 2008 (program projection)	4,083
End-November 2008 (program projection)	4,523
End-December 2008 (program projection)	5,372

The wage bill of the CA is defined as the accrued remuneration to all central administration employees (*servicios personales*), including overtime and effective social contributions

(budget line items 100–199),¹ as reported in by the ministry of finance's monthly *Situación Financiera de la Administración Central*. Data will be provided to the Fund by the ministry of finance with a lag of not more than three weeks past the test date.

3. Targets on the Overall Balance of the Consolidated Public Sector

Cumulative flows	Floor (In billions of <i>guaraníes</i>)
Cumulative flows from December 31, 2007	
End-January 2008 (program projection)	-63
End-February 2008 (program projection)	482
End-march 2008 (performance criterion)	172
End-April 2008 (program projection)	162
End-May 2008 (program projection)	234
End-June 2008 (performance criterion)	253
End-July 2008 (program projection)	398
End-August 2008 (program projection)	571
End-September 2008 (program projection)	516
End-October 2008 (program projection)	721
End-November 2008 (program projection)	821
End-December 2008 (program projection)	0

For the purposes of the program, the consolidated public sector comprises: (i) the non-financial public sector (NFPS) and (ii) the Central Bank of Paraguay (BCP).

The NFPS includes the CA as defined above, the social security institutes, the provincial governments, autonomous decentralized agencies, and the nonfinancial public enterprises.²

Under the program, the consolidated public sector's overall balance will be measured and monitored as equal to *minus* the net financing of the NFPS, *plus* the operating balance of the BCP. The net financing of the NFPS is defined as the sum of: (i) net external financing; (ii) the change in net domestic credit to public sector from the financial system, excluding government bonds; (iii) the net issuance of government bonds; and (v) other net financing of

¹ It will exclude any Treasury transfers to the Caja Fiscal registered as wages for new employment positions authorized in the budget but not yet appointed.

² Altogether they include: Pension funds (Instituto de Previsión Social (IPS), Caja Bancaria, Caja Ande, Caja Ferroviaria, Caja de Empleados Municipales), the public universities (UNA, UNE, UNP, UNI), 17 provinces (*gobiernos departamentales*), 17 autonomous regulatory and development agencies, the public enterprises (PETROPAR, ANDE, ANNP, DINAC, and INC) and incorporated enterprises owned by the state (ESSAP and COPACO).

the nonfinancial public sector by the private sector, including net increase in the stock of domestic floating debt, external arrears, and asset sales. Items denominated in foreign currency will be converted into *guaraníes* at the average exchange rate for each month.

Net external financing of the NFPS is defined as all external disbursements less amortization paid by the NFPS as defined above. The change in net credit is defined as the net flow of gross domestic credit (excluding treasury bonds) plus use of deposits by the NFPS in the domestic financial system. Domestic floating debt of the NFPS is defined as the difference between accrued expenditure (*gastos obligados*) and payments transferred (*gastos transferidos*) vis-à-vis the private sector. It will be measured as the central government floating debt net of debts with the rest of the NFPS as defined herein. External arrears are defined as the sum of (i) any principal and interest accrued by the NFPS and not paid by the due date as reported by the ministry of finance's SIGADE; (ii) the net change in arrears to foreign suppliers of the NFPS. The operating balance of the BCP is measured as all administrative and financial revenues minus costs (including costs of monetary policy and interest on BCP external debt). Data will be provided to the Fund by the ministry of finance and the central bank with a lag of not more than three weeks past the test date.

B. Monetary Targets

4. Targets on Net International Reserves of the Central Bank of Paraguay (BCP)

Outstanding stock as of:	Floor (In millions of U.S. dollars)
End-December 2007	2,462
End-January 2008 (program projection)	2,442
End-February 2008 (program projection)	2,422
End-March 2008 (performance criterion)	2,412
End-April 2008 (program projection)	2,432
End-May 2008 (program projection)	2,447
End-June 2008 (performance criterion)	2,462
End-July 2008 (program projection)	2,477
End-August 2008 (program projection)	2,487
End-September 2008 (program projection)	2,512
End-October 2008 (program projection)	2,522
End-November 2008 (program projection)	2,532
End-December 2008 (program projection)	2,562

For monitoring purposes, net international reserves (NIR) of the BCP are defined as the U.S. dollar value of gross foreign assets in foreign currencies minus gross liabilities in foreign currencies with original maturity of less than one year. Data will be provided by the BCP to the Fund with a lag of not more than five days past the test date.

Gross foreign assets are defined consistent with the Fund Data Template for International Reserves and Foreign Currency Liquidity, and include all liquid foreign currency-denominated claims of BCP, including monetary gold, holdings of SDRs, the reserve position in the IMF, and foreign currency in the form of cash, deposits abroad, and Paraguay's net cash balance within the Latin America Trade Clearing System (ALADI). Excluded from gross foreign assets are participations in international financial institutions (including *Corporación Andina de Fomento* (CAF), IDB, IBRD, *Asociación Internacional de Fomento*, and *Banco de Desarrollo del Caribe*), the holdings of nonconvertible currencies, and holdings of precious metals other than gold. Gross foreign liabilities are all foreign currency denominated BCP liabilities of contracted maturity up to and including one year plus the use of Fund financing. Non-U.S. dollar denominated foreign assets and liabilities will be converted into U.S. dollars at the market exchange rates of the respective currencies as of December 31, 2007.

NIR targets will be adjusted *upward (downward)* for any *increase (decrease)* in reserve requirement deposits (*encaje*) associated with foreign currency deposits in commercial banks, compared to the following levels: March 31, 2008: US\$ 271 million; June 30, 2008: US\$298 million; September 30, 2008: US\$305 million; and December 31, 2008: US\$295 million.

NIR targets will also be adjusted upward (downward) by the surplus (shortfall) in program disbursements relative to the baseline projection. Program disbursements are defined as uncommitted external disbursements that are usable for the financing of the overall central government budget.

External Program Disbursements (Baseline Projection)

Cumulative flows	(In millions of U.S. dollars)
Cumulative flows from December 31, 2007	
End-January 2008 (program projection)	0
End-February 2008 (program projection)	0
End-March 2008 (program projection)	0
End-April 2008 (program projection)	0
End-May 2008 (program projection)	0
End-June 2008 (program projection)	0
End-July 2008 (program projection)	0
End-August 2008 (program projection)	0
End-September 2008 (program projection)	0
End-October 2008 (program projection)	0
End-November 2008 (program projection)	0
End-December 2008 (program projection)	0

5. Targets on Net Domestic Assets

Net domestic assets (NDA) of the BCP are defined as the difference between currency issue (provided by the BCP) and the net international reserves (NIR) of the BCP, both measured based on end-of-period data. Data will be provided to the Fund by the BCP with a lag of not more than five days past the test date.

Outstanding stock as of:	Ceiling (In billions of <i>guaraníes</i>)
End-December 2007	-8,231
End-January 2008 (program projection)	-8,746
End-February 2008 (program projection)	-8,578
End-march 2008 (performance criterion)	-8,436
End-April 2008 (program projection)	-8,475
End-May 2008 (program projection)	-8,702
End-June 2008 (performance criterion)	-8,692
End-July 2008 (program projection)	-8,695
End-August 2008 (program projection)	-8,796
End-September 2008 (program projection)	-8,906
End-October 2008 (program projection)	-8,968
End-November 2008 (program projection)	-8,917
End-December 2008 (program projection)	-8,231

For the purpose of NDA calculation, NIR will be converted into *guaraníes* at an accounting (program) exchange rate of G 5,100/US\$. The ceiling on NDA will be adjusted *upward* (*downward*) by the equivalent in *guaraníes* of the *downward* (*upward*) adjustments made to the floor on the NIR of the BCP as described above.

NDA targets will also be adjusted downward (upward) by the surplus (shortfall) in program disbursements relative to the baseline projection. Program disbursements are defined as uncommitted external disbursements that are usable for the financing of the overall central government budget.

C. Public Debt and Arrears Targets³

6. Targets on Contracting or Guaranteeing of New Nonconcessional External Debt by the Consolidated Public Sector

Cumulative flows:	Ceiling (In millions of U.S. dollars)
Cumulative flows from December 31, 2007:	
End-January 2008 (program projection)	500
End-February 2008 (program projection)	500
End-march 2008 (performance criterion)	500
End-April 2008 (program projection)	500
End-May 2008 (program projection)	500
End-June 2008 (performance criterion)	500
End-July 2008 (program projection)	500
End-August 2008 (program projection)	500
End-September 2008 (program projection)	500
End-October 2008 (program projection)	500
End-November 2008 (program projection)	500
End-December 2008 (program projection)	500

The limit applies to the contracting or guaranteeing by the consolidated public sector within the calendar year of new nonconcessional external debt with an original maturity of more than one year, including commitments contracted or guaranteed.⁴ For program purposes, a debt is concessional if it includes a grant element of at least 35 percent on the basis of currency- and maturity-specific discount rates based on the commercial interest reference rates (CIRR) published monthly by the OECD.⁵ Excluded from the limits are credits

³ The stock of debt does not include disputed claims to the following parties: Belgium's Ex-Herstal, a South African supplier; French and Swiss import verification companies; the National Bank of Argentina, and claims by a syndicate of European and American banks against the state of Paraguay resulting from a judgment made by the Swiss Federal Supreme Court on May 31, 2005. Any of these claims that would be considered as debt will be added to the stock figure.

⁴ The term "debt" has the meaning set forth in point No. 9 of the Guidelines on Performance Criteria with respect to Foreign Debt adopted on August 24, 2000 (Board Decision No. 12274-(00/85). In line with Paraguayan law, debt will be deemed contracted only if it has received approval by Congress.

⁵ The grant element is calculated as the difference between the net present value (NPV) of debt and its nominal value, expressed as a percentage of the nominal value of the debt (i.e., Grant Element = (Nominal Value—NPV)/Nominal Value). The NPV of debt is calculated by discounting the future stream of payments of debt

(continued)

extended by the IMF and balance of payments support loans extended by multilateral and bilateral creditors. The Ministry of Finance will provide data to the Fund with a lag of not more than 30 days from the test date.

The concessionality of loans in currency baskets will be assessed on the basis of U.S. dollar interest rate tables. For loans with interest rates based on the internal policy of the creditors, the relevant interest rate to define concessionality will be the interest rate for each creditor at the time of the commitment. Loans or portions of loans extended in the context of a debt rescheduling or a debt reduction operation will be excluded from the ceiling.

7. Performance Criterion on Short-Term External Debt of the Nonfinancial Public Sector

As a continuous performance criterion, the NFPS will neither contract nor guarantee any short-term external debt during the program period. Short-term debt is defined as debt with a contractual maturity of one year or less. Excluded are normal import-related credits, forward contracts, swaps, and other futures market contracts. The public enterprises will provide the necessary information to the ministry of finance, which will provide the data to the Fund, with a lag of not more than 30 days from the test date.

8. Performance Criteria on External Payments Arrears of the Consolidated Public Sector

The Consolidated Public Sector, excluding PETROPAR, will accumulate no new external arrears during the program period. The stock of external arrears of the PS will be calculated based on the schedule of external payments obligations reported by SIGADE. Data on external arrears will be reconciled with the relevant creditors, and any necessary adjustments will be incorporated in these targets as they occur. For the purposes of this performance criterion, an arrear will be defined as a payment, which has not been made within 30 days after falling due. In addition, the public enterprises will report to the ministry of finance and the BCP arrears on any external debt that is not recorded under SIGADE. The same 30-day grace period will be applied to all external payments of public enterprises, except where explicit agreements exist with creditors on an extended grace period. The Ministry of Finance will provide the final data on the stock of consolidated public sector external arrears to the Fund, with a lag of not more than 30 days from the test date.

In addition, the government is engaged in good faith efforts to resolve overdue claims in dispute, and will attempt to negotiate and resolve these as soon as possible. Claims by a syndicate of European and American banks against the state of Paraguay resulting from a

service due on this debt. For debt with a maturity of at least 15 years, the ten-year average CIRR will be used to calculate the NPV of debt. For debt with a maturity of less than 15 years, the six-month average CIRR will be used.

judgment made by the Swiss Federal Supreme Court on May 31, 2005, will be considered claims in dispute.

D. Reporting

Monitoring the program requires accurate and timely data. All information on performance criteria, indicative targets, and balance of payments support loans will be reported to Fund staff within the timeframes prescribed above. Debt stocks and associated flows broken down by both creditor and debtor types and maturity will be provided on a quarterly basis.

The Ministry of Finance will be responsible for gathering data on a monthly basis from all the institutions that comprise the consolidated public sector, including the incorporated enterprises (*Sociedades Anónimas*) COPACO and ESSAP. It will compile this information according to the standard format of the Ministry of Finance's monthly financial situation report (*Situación Financiera*). The data will be supplied to the Fund and published on the Ministry of Finance's external website within 30 days of each test date.

ANNEX 1. PARAGUAY—FUND RELATIONS
(As of February 29, 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	27.62	201.66

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 *guarani*. 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 February 29, 2008, the average interbank rate for the U.S. dollar was G4,610 =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
MAE	Policy Advisory to the Central Bank	March 1994–2004
FAD	Tax Policy	February 1999
FAD	Tax Administration	March 1999
STA	Monetary Statistics	February 2000
STA	Balance of Payments Statistics	June 2000
STA	Multisector, GDDS accession	February 2001
MAE	Currency Operations	March–September 2002
FAD	Customs Administration	May 2002
MAE	Financial Sector Surveillance	July 2002
FAD	ROSC	August 2002
STA	Multisector, follow-up	September 2002
MAE	Banking Supervision	September–November 2002
MAE	Central Bank Operations	November 2002
TRE	Safeguards Assessment	January 2003
MFD	Banking Supervision	January 2003–April 2004
MFD	Currency Handling and Reform	February 2002–April 2004
MFD	Payment System	July 2003
FAD	Customs and Tax Administration	December 2003
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

Department	Purpose	Date of Delivery
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
MCM	Bank regulation and supervision	February - March 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 February 29, 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 consist 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\$119.1 million remain undisbursed as of February 4, 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, and the Bank is currently discussing with the authorities the best way to support this agenda.

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, and the Policy Notes for the New Administration are currently under preparation and will be presented to the incoming administration late in FY08.

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 which would take over in August 2008 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 February 29, 2008)

	Committed (Net of Cancellations)	Disbursed	Undisbursed
Active loans			
Community development	9.0	8.2	0.8
Education Reform	24.0	17.2	6.8
Road Maintenance	74.0	0.0	74.0
Sustainable Agricultural Development	37.5	0.0	37.5
Total active loans	144.5	25.4	119.1
Total IBRD/IDA Repaid		1,083.8	
Total outstanding		228.9	
O/w IBRD (including exchange rate adjustment)		211.2	
O/w IDA		17.7	

II. IFC Operations (as of February 29, 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

ANNEX 3. PARAGUAY—INTER-AMERICAN DEVELOPMENT BANK RELATIONS²
(As of February 29, 2008)

Portfolio

As of February 29, 2008, the active loan portfolio amounts to US\$799.9 million, with an undisbursed balance of US\$435.7 million. In addition, there are 71 active Technical Cooperation operations (regular TCs, MIF, and Small Projects) for US\$24.6 million, of which US\$15.0 million are undisbursed. Loan approvals in 2007 reached US\$6.2 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. Strengthening of the Customs Administration II Phase , US\$9.0 million
- b. Strengthening of the Fiscal Administration II Phase US\$5.5 million
- c. Integrated Municipal Fiscal Management and Development, US\$120 million
- d. Conditional Line of Credit for AFD, US\$50 million
- e. Trade Facilitation Banco Sudameris, US\$5 million
- f. Environmental System Support II Phase, US\$7 million

Expected Total 2008: US\$196.5 million

² Prepared by the staff of the IDB.

ANNEX 4. PARAGUAY—STATISTICAL ISSUES

While data provision is broadly adequate for program purposes, there is a need to improve the timeliness and accurate reporting of statistics. 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.

E. 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 of 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 is becoming obsolete; (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.

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.

F. Fiscal Sector

Government finance statistics 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). Data on the operations of the local governments are not included in the GFS. 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*.

G. 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 begin including monthly data of the 20 largest credit cooperatives in the monetary survey by mid-2008. The superintendency of banks publishes a detailed and informative report on the soundness of the financial system.

H. 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 international investment position (IIP) are available from 2001 onwards on the central bank website, and are reported to STA. 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 in November 2006 assisted the BCP 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	Dec 07	1/22/08	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities ²	Aug. 2007	09/11/07	D	M	D		
Reserve/Base Money	Nov. 2007	12/7/07	D	M	D	O, LNO, LO, O	O, O, O, LO, LO
Broad Money	Nov 2007	1/25/08	M	M	M		
Central Bank Balance Sheet	Nov. 2007	12/14/07	D	M	D		
Consolidated Balance Sheet of the Banking System	Nov. 2007	1/15/08	M	M	M		
Interest Rates ³	Nov. 2007	1/22/08	M	M	M		
Consumer Price Index	Dec. 2007	1/17/08	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	Jun. 2006	08/03/07	M	M	M		
GDP/GNP	2006	08/03/07	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.

ANNEX 5. PARAGUAY—WORK PROGRAM

Mission	Dates
Sixth SBA Review	
Mission	May 21–June 4, 2008
Board Meeting	August 1, 2008
Memorandum items:	
Approval of SBA	May 31, 2006
First SBA Review	September 29, 2006
Second and Third SBA Reviews and 2007 Article IV Consultation	June 29, 2007
Fourth SBA Review	October 15, 2007
Fifth SBA Review	March 28, 2008



Press Release No.08/65
FOR IMMEDIATE RELEASE
March 28, 2008

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Completes Fifth Review Under Paraguay's Stand-By Arrangement

The Executive Board of the International Monetary Fund (IMF) today completed the fifth 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). Completion of the review will make up to SDR 28 million (about US\$46 million) available to Paraguay immediately. However, 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) by 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](#)).

Following the Board discussion on the fourth review, Mr. Takatoshi Kato, Deputy Managing Director and Acting Chair, said:

“Paraguay is enjoying the best macroeconomic conditions in many years, supported by a Stand-By Arrangement from the Fund. The economy is estimated to have grown robustly in 2007, and the public finances were in surplus for the fourth consecutive year, leading to a substantial fall in the consolidated public debt. At the same time, the health of the financial system has improved, the external position remains strong, and international reserves have reached new record highs.

“The authorities appropriately adopted a countercyclical fiscal stance during 2007, recording a budget surplus for the central government. Following the approval by Congress of an expansionary budget for 2008, the authorities have adopted a financial plan aimed at maintaining fiscal discipline. Looking ahead, there is a need to reform the budgetary process to prevent the financial plan from becoming a tool for budgetary control in place of the budget that is adopted by Congress.

“Given the inflationary pressures that emerged during the second half of 2007, the tightening of monetary policy was appropriate. To contain core inflation to 5 percent (within a band of $\pm 2\frac{1}{2}$ percent) for 2008, monetary policy will need to remain tight. A flexible exchange rate policy should be maintained, with exchange market intervention aimed only at achieving the international reserve target.

“Structural reforms have intensified. Considerable progress was made in strengthening the central bank balance sheet, reinforcing prudential regulations, and developing an expenditure commitment control system. For 2008, reforms rightly focus on consolidating the Treasury accounts, continuing the process of strengthening the Central Bank’s income position, signing new results-oriented management contracts with the five largest state-owned enterprises, and extending the coverage of the conditional cash transfer program.

“The Fund encourages the authorities to continue pursuing prudent fiscal and monetary policies to consolidate macroeconomic stability and to further deepen structural reforms. The aim should be to leave the incoming administration a solid economic foundation on which it will be able to build sustainable long-term growth and meaningful poverty reduction,” Mr. Kato said.

**Statement by Javier Silva-Ruete, Executive Director for Paraguay
and Jose H. Maciel, Senior Advisor to Executive Director
March 28, 2008**

1. On behalf of the Paraguayan authorities, we thank the staff for an insightful report and for the candid policy discussions held with the Paraguayan authorities in the context of the fifth review of the current Stand-By Arrangement (SBA). As the staff rightly points out, the broad macroeconomic outcomes were significantly better than anticipated and the program remains on track. All performance criteria have been met since the approval of the SBA on May 31, 2006 and most structural benchmarks for end-September and end-December 2007 were fully implemented.
2. The authorities wish to express their commitment to meeting the objectives under the program in order to achieve sustained and high growth, create stability, and diminish poverty, despite the political complexities of an election year.

The Real Sector

3. As noted by the staff, macroeconomic conditions are the best in many years. Paraguay has not had such a good performance since the construction of the Itaipú hydroelectric dam in the 1970s. As a result of the policies implemented under the program, supported by strong exports, improved productivity in the agricultural sector, and high commodity prices, GDP grew by 6 ½ percent last year, duplicating the long-term average of the Paraguayan economy, and exceeding the 5 percent estimate projected by the staff during the last review. It was the fifth consecutive year of positive growth, with an average annual growth of 4.7 percent.
4. Most productive sectors achieved high annual growth rates, especially agriculture, which was by far the highest, at 25 percent. The top performer was soybean production, which increased by more than 71 percent relative to 2006. Other sectors with positive outcomes were services and construction, with growth rates of around 9 percent. The IMAEP or Monthly Index of Economic Activity reached 9.8 percent in 2007.¹ Registered exports posted a record 70 percent increase.
5. In general, these positive outcomes have placed the country in a favorable position to confront possible external shocks as a consequence of the global slowdown. The expectations are to achieve sustainable growth over the medium and long term and, consequently, a decrease in the level of poverty.

¹ Preliminary estimates. The IMAEP is prepared by the Central Bank of Paraguay to deliver short-term economic trends, in constant numbers.

The Fiscal Sector

6. Over the last five years, public finances have been consolidated, resulting in a continued surplus. At the end of last year, the consolidated public sector posted a surplus of 1 percent of GDP and the overall balance registered a surplus of 1.6 percent of GDP. These results were achieved thanks to a tax reform that has improved revenues and the administration of the tax system, and to greater expenditure control.

7. The Ministry of Finance reported that import duties and tax collections grew by 28 percent in dollar terms in 2007. Moreover, since 2002 they have increased by 176 percent, reflecting a buoyant economy and a broader tax base—although import duties grew at a slower pace due to the appreciation of the currency. As the staff mentions in the report, Paraguay has one of the strongest fiscal positions compared to its neighboring countries. All these indicators were better than projected.

8. The 2008 budget approved by Congress points to a deficit of 2 percent of GDP, including increases in salaries for all public servants. Although not originally planned, the salary raise was granted to prevent unrest among public sector employees, whose salaries have been frozen for several years. To offset this imbalance, the authorities have prepared a financial plan to maintain expenditures within a balanced budget. They have expressed their commitment to restrain non-social current spending to create room for higher social and capital expenses to alleviate poverty and to continue with the Social Safety Net program.

The Monetary Sector

9. The monetary targets included in the SBA were fully met during 2007. Although headline inflation has been very volatile, reflecting food supply shocks, it fell to 6 percent at the end of the year, significantly less than the 12.5 percent at the end of 2006. This achievement was, in part, thanks to the prompt reaction of the Central Bank, which started to increase its interest rate in the second half of last year. As the staff explains, 70 percent of the inflation level is due to higher food prices. Starting this year, the Central Bank is using a new CPI index, where the share of food will be reduced to 35 percent from its previous share of 40 percent in the index; although at 35 percent, this level is still the highest in the region. The expectations are that the new index will bring less volatility to the inflation movements. However, inflation has jumped to 10½ year-on-year in the first months of 2008 and the authorities are ready to switch to a tougher stance in order to comply with the program objective of reducing core inflation within a 2½-7½ range.

10. A matter of concern for the staff is the rapid pace of currency growth and the risks of inflationary pressures attached to it. However, as pointed out by the Paraguayan authorities, there is a strengthening in money demand and a deepening in financial intermediation, as evidenced by the reestablishing of stability and confidence in the economy, the appreciation of the currency, high remittances from abroad, a continued decline in dollarization, and rising

maturities of term deposits. Nevertheless, the monetary authorities are committed to monitoring currency growth to anchor inflationary expectations.

11. By the end of 2007, international reserves had increased by almost 30 percent, to a level equivalent to 3½ months of imports or near 20 percent of GDP, well above projections. Despite increased pressures to curb the appreciation of the *guaraní*, the authorities are committed to preserving a flexible exchange rate regime, with mild interventions to prevent sudden variations of the exchange rate.

The Financial System

12. The continued improvement of the financial system can be measured by the sustained expansion of credit to the private sector, with 55 percent annual growth by January 2008, increased private sector deposits (30 percent annual growth), a substantial reduction of non-performing loans, narrowing interest rate spreads, increased profits, and well-capitalized banks. In this regard, the authorities are thankful for the continued support from Fund missions and technical assistance, which enabled a successful restructuring of the financial system—after the painful crisis of a decade ago—mainly through adequate banking regulations.

The External Sector

13. The continued boost in commodity prices over the last year, as well as increased productivity, contributed to an impressive growth in exports, which led to a current account surplus of 1½ percent of GDP in 2007. Also, the capital account registered a surplus thanks to increased foreign direct investments, large inflows from bi-national hydroelectric plants, and high remittances from expatriates—although in a lesser amount than in 2006. These results led to favorable balance of payments for the fifth consecutive year and the outlook for 2008 remains favorable.

14. The *guaraní*-dollar exchange rate appreciated by near 13 percent year-on-year at the end of 2007 and this trend is expected to continue in 2008. The staff agreed with the Paraguayan authorities that the exchange rate is in line with fundamentals and is not a source of concern.

15. The authorities have pointed out that the accumulation of international reserves and the fact that most of the capital inflows to Paraguay are directed to the current account, as opposed to the capital account, provide resilience against a global slowdown and would shield the economy against spillovers. Regarding the international claims in dispute, the authorities are engaged in reaching a prompt settlement with the involved parties.

Structural Reforms

16. As mentioned before, most of the structural conditions for end-September and end-December 2007 were complied. Regarding the partial implementation of the Central Bank norm that strengthens loan classification and provisioning requirements, the staff pointed out that, although the authorities approved the norm on the due date, its implementation was delayed to October 2008 to ensure consensus and adequate support from all stakeholders.

17. With respect to the delay in the Economic Cabinet's approval of the legislation draft to revamp the payment system, the Central Bank has informed that the draft was shared with the involved parties to muster ownership of the proposed bill, in order to avoid setbacks when presented for approval. The Association of Paraguayan Banks welcomed this initiative and has already sent some comments on the draft bill.

18. Regarding the compliance of the benchmark for State Owned Enterprises (SOE), which sought the adherence to performance standards by the five largest public enterprises (suppliers of electricity, telecommunications, water and sanitation, fuel, and cement), two of them felt short of expectations. However, the authorities are committed to continuing with the reform of the SOE to further improve their efficiency and productivity. During the course of the present year, the government will persist with the practice of signing result-oriented contracts with these enterprises, which has proven to be a useful tool to measure performance. At the end of last year, a draft bill was sent to Congress to reduce the debt burden and to address the governance problem of one of them (ESSAP), whose ownership structure was altered after a failed privatization attempt. The new result-oriented contracts will include the elaboration and compliance of strategic business plans addressing the weaknesses already identified in previous assessments.

19. We would also like to mention the progress regarding some aspects of the financial sector reform. As indicated by the staff, the monetary and fiscal authorities will continue to strengthen the financial position of the Central Bank. A reconciliation of claims between the public records of the Ministry of Finance and the Central Bank has finally been agreed and is likely to be resolved shortly. The remaining claims were sent to the Attorney General to rule on the subject before submitting a draft legislation to Congress authorizing the corresponding payments to the Central Bank.

20. The Social Safety Net program has proved to be an effective tool to reduce extreme poverty. Last year, 17,000 families were assisted by the program—a structural benchmark under the SBA. For 2008, the authorities are planning to extend the coverage to 50,000 families.

Closing Remarks

21. As highlighted in the World Bank's Doing Business Report 2008, Paraguay has been among the top ten reformers on the starting business indicator. This is a strong signal that the authorities are committed to achieving the necessary reforms to improve the business climate and attain a high level of investment. In this context, the assistance from the Fund and other

multilateral organizations is highly appreciated by the authorities, who look forward to a continuing support from staff and Management and commit to maintaining a frank policy dialogue.