

**LAPSE OF
TIME**

EBS/23/54
Correction 1

June 12, 2023

To: Members of the Executive Board

From: The Acting Secretary

Subject: **Paraguay—First Review Under the Policy Coordination Instrument and Request for Modification of Targets**

Board Action: The attached corrections to EBS/23/54 (5/22/23) have been provided by the staff:

Evident Ambiguity **Page 2**

Factual Errors Not Affecting the Presentation of Staff's Analysis or Views **Page 8**

Questions: Mr. Villafuerte, WHD (ext. 37167)

Approved By
**Ms. Patricia Alonso-Gamo (WHD) and
 Eugenio Cerutti (SPR)**

Discussions were held in Asunción between March 27 and April 4, 2023. The staff team comprised Mauricio Villafuerte (head), Tobias Roy, Mauricio Vargas, Yuanchen Yang, Manuk Ghazanchyan (all WHD), and Jehann Jack (SPR). Maximiliano Appendino, the newly designated Resident Representative in Paraguay joined the mission. Diego Gutiérrez, Mariana Bravo and Nicolás Landeta (WHD) provided research and administrative assistance. Jorge Corvalan (OED) attended the policy meetings. The team met with Central Bank of Paraguay (BCP) President José Cantero, Minister of Finance Óscar Llamosas, other senior officials from the government, and representatives from the donor community.

CONTENTS

CONTEXT	4
RECENT ECONOMIC DEVELOPMENTS AND PROGRAM PERFORMANCE	4
OUTLOOK AND RISKS	8
POLICY DISCUSSIONS	9
A. Pillar I. Ensure Macroeconomic Stability and Resilience	9
B. Pillar II. Enhance Productivity and Foster Economic Growth	12
C. Pillar III. Enhance Social Protection and Inclusiveness	13
PROGRAM MODALITIES AND CAPACITY DEVELOPMENT	14
STAFF APPRAISAL	15
RECENT ECONOMIC DEVELOPMENTS AND OUTLOOK	3939
STRATEGIC OBJECTIVES OF OUR REFORM PROGRAM	4141
PILLAR I. ENSURING MACROECONOMIC STABILITY AND RESILIENCE	4141
PILLAR II: IMPROVING PRODUCTIVITY AND PROMOTING ECONOMIC GROWTH	4646
PILLAR III: IMPROVING SOCIAL PROTECTION AND INCLUSION	4949
PROGRAM MONITORING	5151
A. DEFINITIONS	5454
B. PROGRAM GOALS	5454
C. ADDITIONAL INFORMATION FOR MONITORING/REPORTING OBLIGATION OF THE PROGRAM	5656

13. In addition, the Paraguayan authorities recently published their first annual Fiscal Risk Report. While not a formal reform target, the publication of this report, which was prepared following IMF technical assistance recommendations, had been announced by the authorities in their previous Program Statement of November 2022. The report complements the annual Public Finance Report of the Ministry of Finance, which focuses on macroeconomic risks. Adding to that analysis, the Fiscal Risk Report incorporates specific risks such as those related to Public-Private Partnerships (PPPs), public enterprises, pension system, and climate change.

OUTLOOK AND RISKS

14. The economy is recovering as expected. After last year's significant losses in soy cultivation from a severe drought, estimates and prospects for the ongoing agricultural campaign are good. Economic growth in 2023 continues to be projected at 4.5 percent supported by expected strong exports of agriculture-related products and electricity generation. Inflation is expected to decline to about 4.5 percent by end-2023, assuming global prices moderate and severe weather-related shocks would not occur. However, the April survey on inflation expectations continue to be at 5 percent for end-2023.

15. The external current account is projected to improve in 2023, reflecting recovery in the agriculture exports, stronger external demand, and lower fuel and fertilizer prices. A sharp rebound in agriculture-related exports and a modest increase in hydro-electricity exports, coupled with marginally lower imports would substantially improve the trade balance in 2023. Staff projects reserves to slightly increase to about 7.5 months of imports over the medium-term, a slightly higher level than in the pre-crisis year of 2018. The reserves-to-ARA metric ratio is estimated at about 195 percent for end-2022, safely above the suggested comfort zone of 100-150 percent.

16. The approved central government's budget for 2023 is in line with the objective of reducing the fiscal deficit to 2.3 percent of GDP. Compared to the administration's budget proposal, about 0.2 percent of GDP in expenditures were re-programmed by Congress from public investment to salaries. The Ministry of Finance intends to dampen the impact of these changes on the wage bill by hiring the additional personnel mandated in the approved budget only in the second half of 2023, but these increased outlays will place a burden on the next administration's budget for 2024. Finally, the higher-than-expected fiscal deficit in the first four months of 2023 enhances the pressure for more austere policies in the remainder of the year to stay within the budget envelope toward a fiscal deficit of no more than 2.3 percent of GDP.

17. Risks to the outlook are moderate but arise from several sources. At the domestic level, there are upside risks stemming from potentially stronger than projected agricultural production or faster implementation of large FDI projects in development⁵, and downside risks from lower construction activity by the public sector, particularly given the austerity bias built into the fiscal

⁵ In 2023 and 2024, Paraguay will benefit from its largest FDI projects in recent history. Parcel (paper pulp from eucalyptus foresting) and Omega Green (biofuels) have pledged to invest US\$4 billion in the next few years. Construction activities are projected to lift off in 2023.