

**FOR
AGENDA**

SM/14/37
Supplement 1

January 31, 2014

To: Members of the Executive Board

From: The Secretary

Subject: **Paraguay—Staff Report for the 2013 Article IV Consultation—Informational Annex**

The attached informational annex is being issued as a supplement to the staff report for the 2013 Article IV consultation with Paraguay (SM/14/37, 1/31/14), which is tentatively scheduled for discussion on **Friday, February 14, 2014**. Unless an objection from the authorities of Paraguay is received prior to the conclusion of the Board's consideration, the document will be published. Any requests for modifications for publication are expected to be received two days before the Board concludes its consideration.

Questions may be referred to Mr. Fasano (ext. 36972) and Ms. Perez Marulanda (ext. 39653) in WHD.

Unless the Documents Section (ext. 36760) is otherwise notified, the document will be transmitted, in accordance with the procedures approved by the Executive Board and with the appropriate deletions, to the WTO Secretariat on Monday, February 10, 2014; and to the European Commission, the European Investment Bank, and the Inter-American Development Bank, following its consideration by the Executive Board.

This document will shortly be posted on the extranet, a secure website for Executive Directors and member country authorities. This supplement is not being distributed in hard copy. It can be accessed in the Institutional Repository. A link to this document can be found in the daily list (<http://www-int.imf.org/depts/sec/services/eb/dailydocumentsfull.htm>) for the issuance date shown above.

Att: (1)

Other Distribution:
Department Heads



PARAGUAY

STAFF REPORT FOR THE 2013 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

January 30, 2014

Prepared By

The Western Hemisphere Department

CONTENTS

FUND RELATIONS	2
RELATIONS WITH THE WORLD BANK UNDER JMAP	5
RELATIONS WITH THE INTER-AMERICAN DEVELOPMENT BANK	8
STATISTICAL ISSUES	10

FUND RELATIONS

(As of December 31, 2013)

Article VIII

Membership Status: Joined: December 28, 1945

General Resources Account:	SDR Million	% Quota
Quota	99.90	100.00
Fund holdings of currency	78.43	78.51
Reserve Tranche Position	21.48	21.50

SDR Department:	SDR Million	% Allocation
Net cumulative allocation	95.19	100.00
Holdings	110.64	116.22

Outstanding Purchases and Loans: None

Latest Financial Arrangements:

Type	Date of Arrangement	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

Projected Payments to Fund^{1/}

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

	Forthcoming				
	2014	2015	2016	2017	2018
Principal					
Charges/Interest	0.00	0.00	0.00	0.00	0.00
Total	0.00	0.00	0.00	0.00	0.00

1/When a member has overdue financial obligations outstanding for more than three months, the amount of such arrears will be shown in this section.

Exchange Rate Arrangement: The currency of Paraguay is the Paraguayan guaraní. The exchange rate regime is classified de facto as other managed arrangement (the de jure regime is classified as floating). 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 excessive exchange rate fluctuations due to strong seasonal pressures. The U.S. dollar is the principal intervention currency. Paraguay has accepted the obligations of Article VIII, Sections 2(a), 3 and 4 of the Fund's Articles of Agreement. Its exchange system is free of restrictions on the making of payments and transfer for current international transactions.

Article IV Consultation: The Executive Board concluded the 2012 Article IV consultation on August 2012.

Technical Assistance 2009–13

DPT	Purpose	Date of Delivery
STA	Monetary and Financial Statistics	March 2009
FAD	Performance Budgeting	February 2009
MCM	Banking Supervision	May 2009
MCM	Cooperatives	September 2009
MCM	Cooperatives	September 2009
FAD	Medium-Term Fiscal Framework	September 2009
FAD	Debt Management	February 2010
MCM	First Issuance Sovereign Bond	March 2010
STA	Monetary and Financial Statistics	April 2010
MCM	Banking Supervision	April 2010
STA	National Accounts	August 2010
MCM and WB	FSAP/FSSA	November 2010
FAD	Tax and Customs Administration	December 2010
FAD	Public-Private Partnerships	February 2011
STA	National Accounts Statistics	March–April 2011
FAD	Medium-Term Macro-Fiscal Framework and Public Investment Management	March–April 2011
MCM	Monetary Policy, Central Bank Operations, and Accounting	April 2011
FAD	Public Transport Subsidies	June–July 2011
MCM	Financial Soundness Indicators and Financial Oversight	November 2011
FAD	Improve Fiscal Projections and Financial Planning	December 2011
FAD	Modernization of the Customs Administration	December 2011
FAD	Debt and Cash Management	March 2012
FAD	Tax Policy	March 2012
MCM	Monetary Policy, Central Bank Operations, and Accounting	April 2012
FAD	Tax and Custom Administration	December 2012
FAD	Debt and Public Investment Management	May 2013
MCM/LEG	Launching of the AML/CFT	June 2013
MCM	Inflation Targeting and Central Bank Operations	August 2013
FAD	Revenue Administration	September 2013
FAD	Tax Administration	December 2013

Safeguards Assessment: Under the Fund's safeguards assessment policy, Central Bank of Paraguay (BCP) was subject to a full safeguard assessment in respect to the arrangement approved on May 31, 2006. A safeguards assessment of the BCP was completed in October 2006. The report stated that while the BCP has made some progress in strengthening the safeguards framework since

PARAGUAY

the 2003 safeguards assessment, vulnerabilities remain in certain areas such as financial reporting and program data reporting to the Fund.

Resident Representative: Mr. Kevin Ross is the regional resident representative since July 2011. He is based in Lima, Peru.

RELATIONS WITH THE WORLD BANK UNDER JMAP

1. Meeting of teams. The Fund and Bank Paraguay teams met in November 2013 to exchange views on economic developments in Paraguay, and discuss ongoing work and work plans for the year ahead. This Annex provides a summary of the discussions.

2. The teams agreed that Paraguay's macroeconomic policies must be kept broadly neutral over the medium term. In 2013, the economy recovered sharply from the previous year's severe drought. After contracting 1.2 percent in 2012, the economy rebounded to a 13 percent growth in 2013, as a result of a strong recovery in the primary sector, mainly attributed to higher soy output. Against this background, macroeconomic policies supported the recovery amid low inflation. The fiscal stimulus implemented in 2012 to counterbalance the effect of the exogenous shock in agriculture, reverted to a neutral position in 2013, and is expected to present a modest withdrawal in 2014-15—transition years to a more rigorous fiscal stance under the new Fiscal Responsibility law—and to remain broadly neutral through the end of projected period (2018). Real GDP would grow by 4.8 percent, supported by continuing dynamism in the agricultural and livestock sector and by higher overall investment. Although inflation at the end of 2013 was 3.7 percent, rising food prices and tariffs of public services will most likely push inflation to the central bank target (5 percent) by end-2014. Monetary policy was more accommodative during much of 2013, but the central bank raised the policy rate by a total 100 basis points in December 2013 and January 2014, bringing it up to 6.5 percent and monetary policy to a more neutral position.

3. Over the medium term, policies need to cement economic fundamentals and promote social development. The fiscal responsibility law provides an adequate anchor to maintain fiscal sustainability. The central government deficit will most likely decline on average to about 1 percent of GDP in the period 2015–18, becoming broadly neutral and supporting the gradual closing of the current positive output gap. Regarding monetary policy, after the recent policy rate hikes, the central bank stressed that it will continue to adjust it in the period ahead as necessary to keep inflation within the target. To promote social development and address structural and institutional weaknesses and rising inequality, the government proposed important reforms and the Congress approved key laws in 2013 that will be implemented starting in 2014. Going forward, stronger budget institutions are needed to improve the quality of spending along with strengthened tax and customs administration. A civil service and pension reforms must be part of a medium term strategy, along with improved public enterprises management to bolster access to public service.

4. The following reform areas have been identified as critical:

- *Tax policy and revenue administration reform.* Additional tax policy and reforms are needed to increase low revenues. These include increasing taxation on the financial sector and revenue collection efficiency while reducing exemptions.
- *Public financial management.* Better budget design, monitoring and control is needed along with a medium-term expenditure framework are needed to increase the quality of public spending and improve the allocation of resources.

- *Public-Private Partnerships.* The recently approved PPP law offers potential efficiency gains, but it can also increase fiscal risks. It is important to strengthen public investment management, planning and regulatory capacity. The regulation of the law should provide clear guidelines for risk allocation and accounting of contingent liabilities.
- *Financial system.* Continue reforms to banking and central bank legislation are needed to keep bolstering the banking system and strengthening regulation and supervision. There is also a need to strengthen regulation and supervision for cooperatives and establishing a safety net for the sector.
- *Monetary framework.* To complete the transition to a full-fledged inflation targeting regime, the central bank (BCP) would need to develop an active interbank monetary market, improving communication with market participants and eliminating legal impediments for secondary markets trading.

5. The division of labor between the teams would be along the following lines:

- *Tax and customs administration reform.* The Fund and the Bank will continue providing technical assistance (TA) to support authorities' efforts to reform the tax system and increasing revenue collection productivity.
- *Public financial management.* The Bank will provide TA on strengthening the corporate governance of public enterprises. The Fund will provide TA on strengthening the medium-term budget framework and cash management.
- *Monetary framework.* The Fund plans to provide TA on further strengthening monetary operations and transitioning to an inflation targeting regime.
- *Money Laundering.* The Fund will provide TA to implement the plan on money laundering and control of terrorism financing.
- *Medium-term debt management.* The Fund's will continue providing TA to develop a medium-term debt strategy so as to reduce domestic debt servicing costs and promote the development of a domestic government debt market.
- *Infrastructure and Logistics.* The Bank will provide TA on infrastructure and logistics required for the implementation of PPPs.
- *Poverty assessment and support.* The Bank will provide TA on equity assessment and poverty support. An approved loan of U\$100 million will be used to expand the coverage of the Paraguay Sustainable Agriculture and Rural Development Project.
- *Education and social programs.* The Bank will provide TA on education programs, social assistance, and rural and agricultural development.
- *Pensions.* The Bank will continue providing TA to improve the pension system supervision, including with best practices.
- *Growth volatility.* The Bank will provide TA on mechanisms to mitigate the impact of growth volatility.

6. Work programs. The table below lists the teams' work programs for the year ahead.

Work Programs of the World Bank and IMF Teams

Title	Products	Provisional Timing of Missions	Expected Delivery Date
<i>Bank Work Program</i>			
	Country Partnership Strategy	Spring 2014	
	Public expenditure review	Spring 2014	November 2013. Pending dissemination.
	TA on volatility analysis	Spring 2014	March 2014
	TA on strengthening pension supervision	Spring 2014	Spring 2014
	TA on Equity Assessment and poverty support	Spring 2014	May 2014
	TA strengthening tax administration and SOE corporate governance	Spring 2014	July 2014
	TA on education programs	February 2014	December 2014
	EW Land Reform Report	Spring 2014	January 2014. Pending dissemination.
	TA on Infrastructure and Logistics PPP	Spring 2014	Fall 2014
<i>Fund Work Program</i>			
	Article IV Consultation	December 2013	February 2014
	TA medium-term budget framework	February 2014	April 2014
	TA to strengthen risk based AML/CFT supervision	April 2014	June 2014
	TA on IT implementation	March 2014	June 2014
	TA on revenue administration	March 2014	May 2014
	TA on STA issues (ROSC)	February 2014	April 2014

RELATIONS WITH THE INTER-AMERICAN DEVELOPMENT BANK

(As of December 31, 2013)

The Inter-American Development Bank's Board of Executive Directors approved in 2009 the Country Strategy with Paraguay (2009–2013).¹ Sovereign-guaranteed lending under the program was expected to reach approximately US\$1 billion.

Under the Strategy, the national authorities and the Bank identified the following priority sectors in which the IDB Group would focus both its financial and non-financial products and services: (i) transport; (ii) energy; (iii) water, sanitation, and solid waste; (iv) agriculture and tourism; (v) climate change; (vi) health; (vii) education; (viii) institutional capacity; (ix) financial sector; and (x) urban development. Regarding the Bank's private sector operations, the Bank approved loans and technical assistance in the foreign trade and social responsibility sectors, which derived to an increase in approval of loans to companies: US\$28 million in 2010, US\$52 million in 2011, US\$9 million in 2012 and US\$132 million in 2013.

The strategic areas were selected taking into account the following objectives: (i) strengthen the governability and institutional capacity at the public sector to increase efficiency and transparency; (ii) create the basis for sustainable growth, increasing regional and global integration to promote private investment and improve competitiveness; and (iii) reduce poverty and improve the quality of life of the poor by developing human capital and giving access to basic services.

As of December 31, 2013, the Bank's portfolio in Paraguay included loans for the financing of 25 projects. The lending portfolio amounts to US\$866 million, of which US\$544 million are pending disbursement. Disbursements in 2014 are expected to total US\$74 million. The current portfolio includes lending to support the Government in the following sectors: infrastructure, social, public sector institutional strengthening, competitiveness, and regional integration. The portfolio also includes loans to the private sector for US\$203 million. In 2013, the Bank approved loans to the public sector in the areas of transport and investment promotion.

¹ A new strategy covering the period 2014–18 is under discussion.

Financial Relations with the Inter-American Development Bank¹

(In millions of U.S. dollars)

	Loan Transactions								
	2006	2007	2008	2009	2010	2011	2012	2013	2014
Disbursement	67.2	67.8	85.6	91.3	240.3	91.4	102.8	142.4	73.4
Amortization	66.7	88.1	94.3	91.3	96.2	94.5	91	83.9	97.7
Net Loan Flows	0.5	-20.3	-8.7	0	144.1	-3.1	11.8	58.5	-24.3

Source: Inter-American Development Bank.

^{1/} Only loans with sovereign guarantee are considered.

STATISTICAL ISSUES

(As of December 2013)

Assessment of Data Adequacy for Surveillance

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

1. National Accounts: National accounts estimates, broadly consistent with the guidelines of the 1993 SNA, were released in 2005. However, no comprehensive regular program for data collection through economic surveys exists (an industrial survey was conducted in 2002). An economic census was undertaken in 2011. Source data for nonfinancial services, household consumption, and changes in inventories are insufficient. Major areas of concern include: (i) the 1994 reference year needs to be updated; (ii) excessive use is made of fixed coefficients for value added and household consumption; (iii) changes in inventories are obtained residually; (iv) informal activities are not monitored; and (v) supply and use tables have been compiled only until 1997. Annual GDP meets GDDS recommendations, and QNA meets DSSD timeliness requirements (90 days). Several STA missions on the compilation of quarterly national accounts (QNA) were fielded in August 2007, August 2008, November 2009 and March–April 2011. QNA series were published in December 2010. The STA mission of March–April 2011 assisted the authorities in outlining a work program for updating the national accounts' base year.

2. Labor market: Since the introduction of a regular household survey in 1998, the coverage and quality of employment and unemployment statistics have improved significantly. Since 2010, data are released on a quarterly basis, although the latter covers the Asunción area only. The last available observation for the quarterly series is the third quarter of 2013, whereas the annual data for 2012 has just been released in September 2013.

3. Prices statistics: Both the consumer (CPI) and producer price indices (PPI) are reported on a regular and timely basis. Since January 2008, the Central Bank of Paraguay (BCP) has been using a new CPI index based on the 2005–06 household budget survey (Dec. 2007=100). The geographic coverage of the CPI is limited to Greater Asunción (the capital and metropolitan area) and expenditure weights are representative of the consumption patterns of urban households. The PPI has a base weight period of June 2010 and its basket (185 items) is representative of current national output; electricity, water, and gas are not covered.

4. 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 QNA series. A new ROSC mission has been scheduled for February 2014.

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

Annual data covering general government for 2011 have been reported for publication in the 2012 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.

6. Balance of payments: 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 data on balance of payments and the IIP are available from 2001 onwards, and are reported only once a year to STA for publication in the IFS. In May-2013, the CBP revised the BOP and IIP time series to exclude transactions and positions between residents and the bi-national hydroelectric energy enterprises, they are now considered 50% residents. Improvements have been made in the quality of the data on capital flows, especially in the coverage of foreign direct investment, and in the recording of external debt transactions. Special studies by the central bank have improved the estimation methods for remittances of Paraguayans abroad and unregistered trade transactions, but serious deficiencies remain.

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

7. Monetary and financial statistics: Paraguay reports monetary data for the central bank and other depository corporations (ODCs) using the standardized report forms (SRFs). An integrated

monetary database meeting the data needs of the BCP, STA, and WHD is in operation Data on credit cooperatives, which account for around $\frac{1}{4}$ of deposits and loans of the banking sector, are now included in the ODCs with data beginning in December 2008. The Superintendence of Banks reports 11 of the 12 core and 7 of the 13 encouraged financial soundness indicators for deposit takers to STA on a month basis.

Paraguay: Table of Common Indicators Required for Surveillance

(As of January, 2014)

							Memo Items ⁹
	Date of Latest Observation	Date Received	Frequency of Data ¹	Frequency of Reporting ¹	Frequency of Publication ¹	Data Quality—Methodological Soundness ¹⁰	Data Quality—Accuracy and Reliability ¹¹
Exchange Rates	Daily	Daily	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities ²	Daily	Daily	D	D	D		
Reserve/Base Money	Dec. 2013	Dec. 2013	M	M	M	O, LNO, LO, O	O, O, O, LO, L O
Broad Money	Dec. 2013	Dec. 2013	M	M	M		
Central Bank Balance Sheet	Dec. 2013	Dec. 2013	M	M	M		
Consolidated Balance Sheet of the Banking System	Dec. 2013	Dec. 2013	M	M	M		
Interest Rates ³	Dec. 2013	Dec. 2013	W	W	M		
Consumer Price Index	Dec. 2013	Dec. 2013	M	M	M	O, LO, O, O	O, LO, LNO, O, LO
Revenue, Expenditure, Balance and Composition of Financing ⁴ – General Government ⁵	Dec. 2013	Dec. 2013	M	M	M	LO, LO, LO, LO	LO, LNO, O, LO, LO
Stock of Central Government and Central Government-Guaranteed Debt ⁶	Dec. 2013	Dec. 2013	M	M	M		
External Current Account Balance	Q3 2013	Nov. 2013	Q	Q	Q	O, LO, LO, LO	LO, O, LO, LO, LO
Exports and Imports of Goods and Services ⁷	Q3 2013	Nov. 2013	Q	Q	Q		
GDP/GNP	Q3 2013	Nov. 2013	Q	Q	Q	O, LO, LO, LO	LO, O, LNO, O, LO
Gross External Debt	Q3 2013	Nov. 2013	M	M	M		
International Investment Position ⁸	Q3 2013	Nov. 2013	Q	Q	Q		

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

² Any reserve assets that are pledged or otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.

³ Both market-based and officially-determined, including discount 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 Guaranteed non-financial public sector debt. Including currency and maturity composition.

⁷ Monthly frequencies for goods only.

⁸ Includes external gross financial asset and liability positions vis-à-vis nonresidents.

⁹ 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–February, 2006) for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O); largely observed (LO); largely not observed (LNO); not observed (NO); and not available (NA).

¹⁰ Same as footnote 9, except referring to international standards concerning source data, assessment of source data, statistical techniques, assessment and validation of intermediate data and statistical outputs, and revision studies.

¹¹ Same as footnote 9, except referring to international standards concerning source data, statistical techniques, assessment and validation of source data, assessment and validation of intermediate data and statistical outputs, and revision studies.