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March 10, 1987

To: Members of the Executive Board
From: The Secretary
Subject: Paraguay - Real Effective Exchange Rate - Information Notice

Attached for the information of the Executive Directors is an information notice on the real effective exchange rate of the Paraguayan guaraní.

Mr. Lachman (ext. 8648) is available to answer technical or factual questions relating this paper.

Att: (1)

INTERNATIONAL MONETARY FUND

PARAGUAY

Real Effective Exchange Rate--Information Notice

Prepared by the Western Hemisphere Department and the Exchange and
Trade Relations Department

(In consultation with the Legal Department and the Research Department)

Approved by E. Wiesner and Manuel Guitian

March 9, 1987

The recent evolution of Paraguay's real effective exchange rate, as measured by the standard index developed in connection with the Information Notice System, is set out in Table 1 and Chart 1. 1/ Based on this index, as of December 1986 the Paraguayan guarani had depreciated in real effective terms by more than 10 percent since the last occasion on which developments in Paraguay's exchange rate were brought to the attention of the Executive Board--the 1986 Article IV consultation discussion with Paraguay on October 8, 1986. 2/ The depreciation from October to December 1986 is estimated to have amounted to 25 percent. 3/

Over the past several years, Paraguay has maintained a complex system of multiple exchange rates that penalizes exports and that

1/ The exchange rate used for the purposes of maintaining the effective exchange rate in the information notice system is a composite rate representing a weighted average of Paraguay's multiple exchange rates.

2/ Chairman's Summing Up circulated as SUR/86/103 (10/9/87).

3/ Starting in November 1986, calculations of nominal and real effective exchange rates have been based on a new weighting scheme involving, in particular, a more comprehensive representation of direct and third market competition for trade in manufactures and primary commodities. The new methodology is explained in detail in the quarterly report on Indicators of Real Effective Exchange Rates (EBS/86/278, 12/18/86). In general, the new weights did not change substantially the estimates of real effective exchange rates. In the case of Paraguay, indices of effective exchange rates based on the new weights and on the weights used previously both show a depreciation of 25 percent in real effective terms during the period from October to December 1986.

subsidizes government debt service payments and petroleum imports. However, as described more fully in the staff report for the 1986 Article IV consultation ^{1/}, while the authorities have been reluctant to change the official exchange rates for government transactions, in response to balance of payments pressures they have taken substantive measures in the past three years insofar as private sector foreign exchange transactions are concerned. Thus, in early 1984 the bulk of private sector nonpetroleum import transactions was moved to the free market and in early 1986 the effective exchange rate for exports was raised from ¢ 320 per U.S. dollar to around ¢ 500 per U.S. dollar through a substantial reduction in the minimum exchange surrender requirements for such exports at the official exchange rate.

On December 10, 1986 the authorities introduced a number of basic changes in the exchange rate system along the lines that had been announced on September 22, 1986. ^{2/} These changes, which are listed in Table 2 and which resulted in a depreciation of approximately 20 percent in the effective exchange rate of the guarani in terms of the U.S. dollar, may be summarized as follows: (a) the exchange rate for the minimum surrender of export proceeds to the Central Bank was raised from ¢ 320 per U.S. dollar to ¢ 550 per U.S. dollar; (b) the exchange rate for the imports of petroleum and petroleum products was raised from ¢ 240 per U.S. dollar to ¢ 400 per U.S. dollar; (c) the exchange rate for public sector purchases of goods and nonfactor services, with certain exceptions, was raised from ¢ 240 per U.S. dollar to ¢ 400 per U.S. dollar; (d) the exchange rate for external debt service and capital transactions of the public sector was raised from ¢ 160 per U.S. dollar to ¢ 240 per U.S. dollar; and (e) the rate of exchange for the disbursement of new official borrowing was raised from ¢ 160 per U.S. dollar to ¢ 320 per U.S. dollar with immediate effect and to ¢ 400 per U.S. dollar effective January 1, 1987. This latter rate was subsequently raised to ¢ 550 per U.S. dollar, effective January 1, 1987 for the disbursement of loans from the Inter-American Development Bank and from the World Bank.

Staff Appraisal

In concluding the most recent Article IV consultation with Paraguay in October 1986, Executive Directors expressed their concern about the substantial widening in Paraguay's balance of payments deficit and the marked acceleration in inflation to rates not experienced in Paraguay in the past generation. While recognizing the adverse impact of recent climatic conditions and the performance of Paraguay's export prices, Directors observed that Paraguay's present economic difficulties stemmed from a fundamental disequilibrium in the public finances and the serious

^{1/} See SM/86/219.

^{2/} Reported to the Executive Board in SM/86/219, Supplement 1 (10/7/86).

distortions to the economy caused by Paraguay's complex and unrealistic multiple exchange rate system.

The exchange rate measures recently introduced constitute a step in the direction of making Paraguay's exchange system more realistic, and the staff strongly encourages the authorities to continue along this path. However, the staff would underline that these exchange rate measures in themselves will not correct the domestic and external imbalances currently characterizing the Paraguayan economy unless they are accompanied by supporting measures in the areas of the public finances and of monetary policy.

Table 1. Paraguay: Real Effective Exchange Rate and Related Series

(Indices: 1980 = 100)

	Real Effective Exchange Rate <u>1/</u> <u>2/</u>	Nominal Effective Exchange Rate <u>1/</u>	Relative Consumer Prices (Local Currencies)	Exchange Rate in Terms of U.S. Dollars <u>1/</u>	Consumer Price Index (Seasonally Adjusted)	Consumer Price Index (Not Seasonally Adjusted)
(Quarterly)						
1982						
I	108.8	175.1	61.9	93.1	118.6	119.1
II	103.7	179.9	57.5	86.7	121.0	119.9
III	105.1	204.2	51.4	85.1	121.4	121.2
IV	112.7	234.2	48.0	85.1	125.7	126.5
1983						
I	117.1	264.6	44.2	81.8	131.0	131.5
II	125.4	316.4	39.5	80.8	134.8	133.4
III	124.0	355.8	34.8	77.2	141.8	141.6
IV	126.5	429.0	29.5	78.1	144.6	145.7
1984						
I	128.9	491.9	26.1	76.7	149.5	150.2
II	102.3	432.7	23.5	58.3	159.0	157.1
III	77.8	367.9	21.1	40.9	170.8	170.6
IV	88.1	465.8	18.9	42.3	184.5	186.3
1985						
I	87.5	539.7	16.1	39.8	189.2	189.9
II	72.6	517.0	14.0	31.3	197.2	194.7
III	62.0	474.4	13.0	25.4	214.8	214.5
IV	68.3	559.0	12.2	27.3	230.1	232.6
1986						
I	65.5	558.5	11.7	24.8	257.2	258.1
II	73.0	607.2	12.0	26.4	276.1	272.6
III	75.3	649.6	11.6	28.3	278.0	277.4
IV	73.2	646.1	11.3	27.5	284.7	287.9
(Monthly)						
1986						
Oct. <u>3/</u>	80.3	698.5	11.5	30.1	282.5	288.5
Nov.	79.0	697.9	11.3	29.6	284.2	286.5
Dec.	60.3	541.8	11.1	22.7	287.3	288.7
(Percentage changes)						
Oct-Dec. 1986	-25.0	-22.4	-3.3	-24.7	1.7	

Source: Information Notice System.

1/ Increases mean appreciation.

2/ Using seasonally adjusted price indices.

3/ Date of latest consideration by Executive Board.

Table 2. Paraguay: Main Features of the Exchange Rate System

Exchange Rate (¢ per U.S. dollar)	System Prior to Dec. 10, 1986	System After Dec. 10, 1986
160	External debt service and capital transactions of the public sector.	--
240	Imports of petroleum and petroleum products and of agricultural and industrial imports. Public sector purchases of goods and nonfactor services. Registered private sector capital transactions. Some transactions of binational entities.	External debt service and capital transactions of the public sector. <u>1/</u> Imports of the following public enterprises: the, electricity enterprise, the water and sanitation enterprise, and the state merchant marine.
320	Surrender to the Central Bank of export proceeds, up to a minimum surrender price.	Disbursements of new official borrowing. <u>2/</u>
400	--	Imports of petroleum and petroleum products. Public sector purchases of goods and nonfactor services.
550	--	Surrender of export proceeds to the Central Bank, up to a minimum surrender price. Imports of agricultural products.
Free market <u>3/</u>	All other transactions, including: most non-oil imports, export proceeds above the minimum surrender prices, profit remittances and private service payments, and some transactions of the binational entities.	All other transactions including: most non-oil imports of the private sector, profit remittances and private service payments, private sector capital transactions, and some transactions of bilateral entities.

Source: Central Bank of Paraguay.

1/ Effective July 1987, these transactions will occur at ¢ 320 per U.S. dollar.

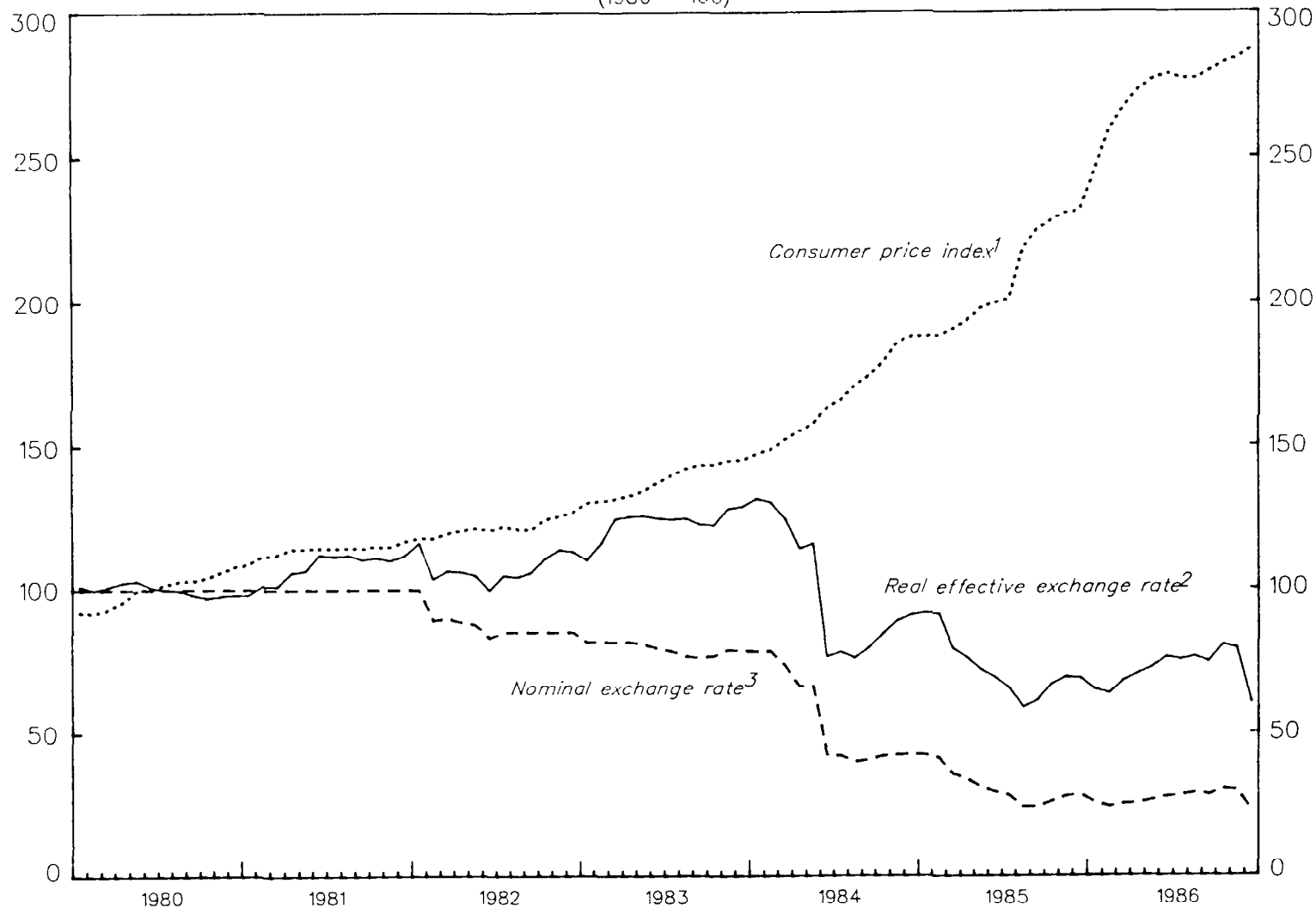
2/ Effective January 1987, these transactions were to take place at ¢ 400 per U.S. dollar. On January 28, 1987, the exchange rate for disbursements of new borrowing from the IDB and the IBRD was changed to ¢ 550 per U.S. dollar, effective January 1, 1987.

3/ The free market rate was ¢ 630 per U.S. dollar on December 10, 1986.



CHART
PARAGUAY
INFORMATION NOTICE SYSTEM INDEX OF REAL EFFECTIVE EXCHANGE RATE

(1980 = 100)



Source: Information Notice System.

1 Seasonally adjusted.

2 Trade-weighted index of nominal exchange rates deflated by seasonally adjusted relative consumer prices, increases mean appreciation.

3 U.S. dollars per local currency.

