GRAY/21/427

February 10, 2021

Statement by Mr. Guerra and Ms. Arevalo Arroyo on Paraguay
(Preliminary)
Executive Board Meeting
February 12, 2021

We thank staff for the comprehensive reports and Mr. Chodos and Mr. Corvalan Mendoza for their helpful Buff statement. In the past decades, Paraguay built a sound policy track record, supported by the Fund and other developmental partners, by strengthening its macroeconomic framework and reducing poverty and inequality in a sustainable fashion. After enduring a climate related shock, Paraguay was no exception to the COVID-19 shock, which affected its recovery efforts.

We commend the authorities for a swift and resolute response to mitigate the effects of the pandemic. Paraguay experienced one of the lowest death tolls in the region and while growth deteriorated, it did to a lesser extent than other countries in the region. *Staff comments are welcome on what lessons can be learned from Paraguay's response to the pandemic compared to its Latin-American peers.*

We take positive note of the authorities' view, as noted in the Buff, that engagement with the Fund through an RFI may have produced a favorable signaling effect that contributed to catalyze necessary resources. In this regard, we are encouraged that the authorities decided not to draw on the RFI, but still benefited from the signaling effect of having a Fund arrangement. Moreover, this allowed the country to keep favorable access to international capital markets with continued sovereign bond issuance.

On the fiscal front, back-to-back shocks warranted the loosening of the fiscal stance, but the authorities' plan to gradually return to the FRL ceiling is encouraging. We consider the plan to reduce the deficit to 4 percent of GDP in 2021 and gradually return to the

FRL limit by 2024 appropriate. The authorities' aim to bring the deficit back to this ceiling by making government expenditure more efficient is welcome. In addition to reforms to boost efficiency in the public sector, other measures, such as increasing tax revenue and reforming the pension system, could be useful to ensure availability of resources given large spending needs, particularly related to public investment.

The Economic Recovery Plan is a step in the right direction in setting the foundation to ensure macroeconomic stability, boost growth and advance the business climate, enhance human capital and improve governance. We agree with staff that further to this agenda, reducing dependence on the energy and agricultural sectors is necessary to enable growth potential. Furthermore, reliance on the agricultural sector makes the economy more vulnerable to climate related shocks. *In this regard, is it envisaged to include in the Economic Recovery Plan measures to enhance resilience to climate change shocks?*

Monetary policy actions have been instrumental in mitigating the impact of COVID-19 in the economy. Although there is still some room to lower policy rates, we believe that, going forward, fiscal policy could play a more important role in case a second wave downside scenario materializes. On the inflation front, we notice that inflation has so far been subdued, particularly food items prices, in contrast to other countries in the region. *Can staff comment on the risk of a potential increase in food items prices as exchange rates with trade partners normalize and commodity prices recover?* Also going forward, it will be instrumental that the exchange rate continues to serve as a shock absorber, with authorities intervening only to prevent disorderly market conditions.

Given difficulties in assessing the underlying situation of the credit portfolio because of the COVID pandemic, supervisory activities will be instrumental to continue to assess the adequacy of capital and liquidity buffers. We welcome the authorities' engagement with the IMF to introduce stress testing. Given the importance of agriculture in the loan portfolio, *can staff comment on how climate related risks to agriculture could be included in the banks stress tests?* This is one of the areas where the IMF can contribute significantly to the region. Other important area of engagement is on AML-CFT. We welcome the authorities' resolve to address risks to correspondent banking relationships in a proactive and timely manner. *Can staff comment on the specific restrictions/reasons to delay IMF TA to prepare for the GAFILAT?*

We welcome the authorities' efforts to further strengthen the governance framework and encourage them to continue work to address fragmentation of institutions and

processes. Amendments to the Government National Plan on Integrity, Transparency and Anticorruption in accordance to the Fund's recommendations are crucial. In this regard, continued engagement with the Fund and the IADB to further advance this agenda will be of the essence. We also take positive note that, as mentioned in the Buff, pandemic related expenditure has been subject to robust transparency and accountability procedures.