

# Macro scenario - Paraguay



May 16, 2024

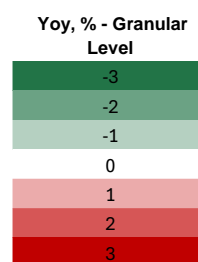
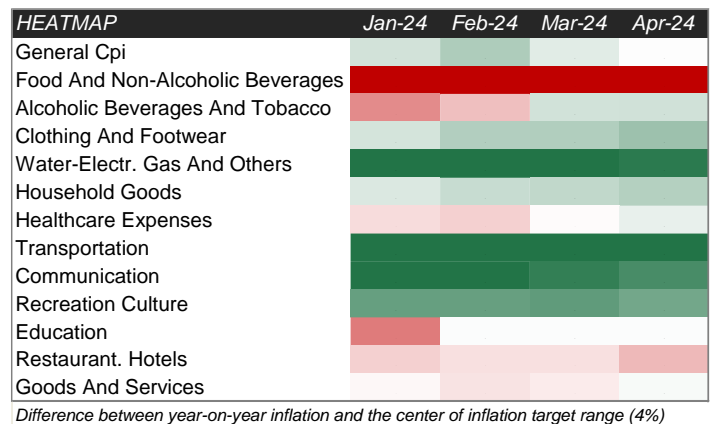
## Central Bank pauses its easing cycle

- ▶ The BCP paused its easing cycle in April. We expect only one additional rate cut by the end of the year, to 5.75%, along with the start of the Fed's easing cycle, with risks tilted toward no cuts this year.
- ▶ While inflation came in above expectations in April, the surprise was in volatile prices, which have led us to maintain our year-end inflation forecast of 4.0%.
- ▶ We revised our exchange rate forecast to PYG 7,500/USD by YE24, from 7,400 in our previous scenario, given the more challenging external backdrop, reflected in the strong dollar and heightened geopolitical risks.
- ▶ The governments of Paraguay and Brazil signed an agreement to increase the Itaipú binational energy tariff until 2026, representing a positive step for Paraguay's fiscal accounts. We maintained our 2024 GDP growth projection at 3.5%, now with upside risks.

### Higher-than-expected inflation, strongly influenced by volatile prices

**CPI rose by 0.8% MoM in April (from 0.4% a year ago), exceeding the market consensus of 0.5% (according to the BCP survey).** The increase was driven primarily by volatile prices, particularly for fruits and vegetables (contribution of 0.6 pp), which were offset by a decline in fuel prices. Core CPI ex-fruits and vegetables, regulated service prices, and fuel stood at 0.4% (versus 0.5% a year ago). On an annual basis, headline inflation was 4.0% in April (versus 3.6% in March), while core CPI x1 ex-fruit and vegetables, regulated service prices, and fuel stood at 4.3% (versus 4.5% in the previous month). We note that the headline inflation rate is at the 4% target, while the core rate is at 4.3%, within the 4% target's +/-2% tolerance band.

**Our heatmap shows that 83% of selected items (taking the year-over-year reading) are below the central bank's 4% inflation target, up from 58% at the end of 2023.**



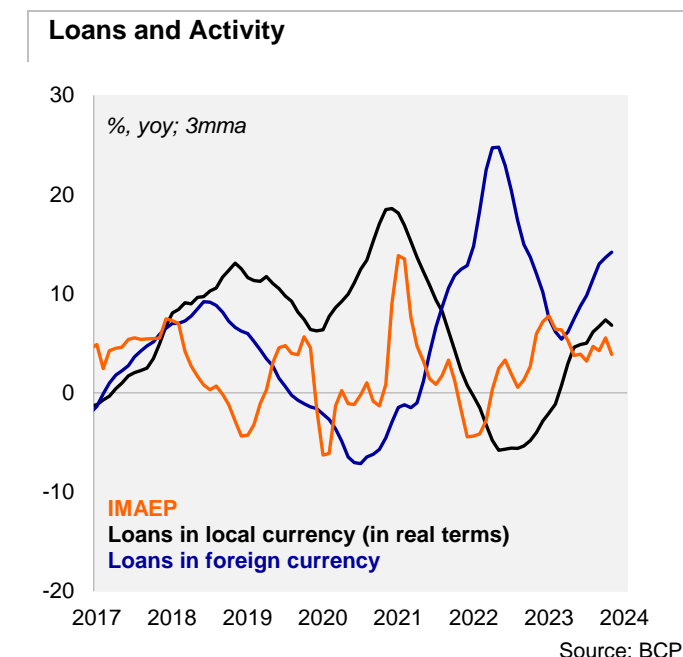
### The BCP pauses its easing cycle

**An expected pause.** The board of the central bank of Paraguay (BCP) unanimously maintained the monetary policy rate at 6.00% in April, after cutting by a total of 250 bps between August 2023 and March 2024. The Committee highlighted that the current monetary policy rate is around the neutral range. In our view, the level of the policy rate remains contractionary at 2.00% (using expectations for the monetary policy horizon),

compared with the BCP’s neutral real-rate range of 0.4%-1.4%. Thus, the central bank seems to prioritize a cautious stance amid persistent global uncertainty.

### Activity expanded in 1Q24

**Sequential growth in 1Q24.** Using the central bank’s seasonally adjusted series, the monthly GDP proxy (IMAEP) rose by 1.5% qoq/sa in 1Q24, following a 0.6% expansion in 4Q23. On an annual basis, the IMAEP increased by 3.9% in 1Q24 (from 4.7% in 4Q23). The IMAEP, excluding agriculture and utilities, increased by 2.9% qoq/sa and by 5.3% yoy in 1Q24. Services and agricultural sectors led the expansion in the first quarter, partially offset by construction, which was affected by the fiscal consolidation. On the other hand, loans in local currency rose 6.8% yoy in 1Q24 in real terms, while loans in foreign currency expanded 14.2% in the same period.



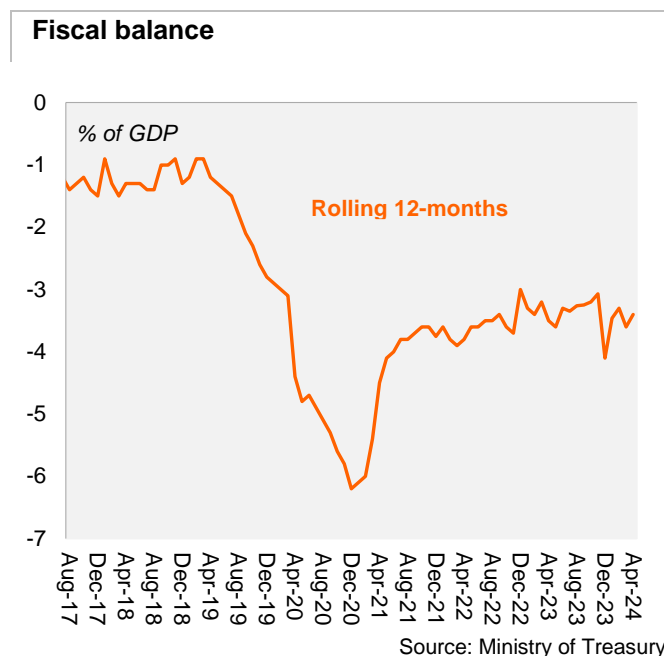
### Habemus deal on Itaipú

**The governments of Paraguay and Brazil signed an agreement to increase the Itaipú binational energy tariff by 15.4% to USD 19.3 kW/month between 2024 and 2026.** The increase represents an annual increase of roughly USD 300 million with respect to the previous arrangement, mostly to be used on social expenditures. On the fiscal side, the deal could lead to additional revenues for around 0.1% of GDP due to higher royalties and energy

compensation. Thus, the gross total income from Itaipú to Paraguay should reach USD 1,250 million in 2024.

### Meanwhile, fiscal accounts continue to improve.

The estimated 12-month cumulative fiscal deficit fell to 3.4% of GDP, from 3.6% in March 2024 and 4.1% in December 2023. This represents a positive development toward fiscal consolidation. Tax revenues rose by 19.4% YoY in real terms in the quarter ended in April (14.2% yoy in 1Q24), in line with the strong activity and likely helped by lower expenditures abroad due to the appreciation of the parallel exchange rate in Argentina. On the other hand, primary expenditures fell by 2.0% yoy in real terms in the quarter ended in April (-4.4% yoy in 1Q24), led by lower capital expenditures (-44.8% in the period).



### No more rate cuts in the near term, with an eye on inflation

**We maintain our 3.5% GDP growth forecast for this year.** Leading indicators, such as monthly GDP proxy, loans, and tax revenues, point to strong growth in 1Q24, supporting our upside bias.

**We kept our year-end inflation forecast at 4.0%, despite the upside surprise in April.** We noted that monthly inflation was driven primarily by volatile prices, particularly in fruits and vegetables. In our view, the upside risks come from higher oil prices, amid elevated geopolitical uncertainty.

**A prolonged pause ahead.** We expect only one cut by the end of the year, to take place with the start of the Fed's easing cycle. Thus, we maintained our terminal monetary policy rate at 5.75%. Having said that, we cannot rule out a scenario in which no more rate cuts take place this year, amid higher-than-expected volatility in inflation and persistent global economic uncertainty.

**We revised our exchange rate forecast to PYG 7,500/USD by YE24, from 7,400 in our previous scenario given the more challenging international scenario (strong dollar globally and geopolitical risks).**

**Andrés Pérez M.  
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### Paraguay | Forecasts and Data

	2019	2020	2021	2022	2023	2024F		2025F	
						Current	Previous	Current	Previous
<b>Economic Activity</b>									
Real GDP growth - %	-0.4	-0.8	4.0	0.2	4.7	<b>3.5</b>	3.5	<b>4.0</b>	4.0
Nominal GDP - USD bn	38.8	36.1	40.3	42.1	44.7	<b>46.9</b>	47.7	<b>50.4</b>	50.8
Unemployment Rate - year avg	6.6	7.7	7.5	6.8	5.9	<b>6.0</b>	6.0	<b>6.0</b>	6.0
<b>Inflation</b>									
CPI - %	2.8	2.2	6.8	8.1	3.7	<b>4.0</b>	4.0	<b>4.0</b>	4.0
<b>Interest Rate</b>									
Reference rate - eop - %	4.00	0.75	5.25	8.50	6.75	<b>5.75</b>	5.75	<b>5.50</b>	5.50
<b>Balance of Payments</b>									
PYG / USD - eop	6465	6912	6877	7340	7275	<b>7500</b>	7400	<b>7600</b>	7500
Trade Balance - USD bn	0.5	1.5	1.0	-1.3	1.6	<b>1.2</b>	1.2	<b>0.9</b>	0.9
Current Account - % GDP	-0.6	1.9	-0.9	-7.1	0.7	<b>0.6</b>	0.6	<b>0.1</b>	0.1
Net Foreign Direct Investment - % GD	1.4	0.4	0.2	1.7	1.0	<b>2.0</b>	2.0	<b>2.0</b>	2.0
International Reserves - USD bn	7.7	9.5	9.9	9.8	10.2	<b>11.0</b>	11.0	<b>11.0</b>	11.0
<b>Public Finances</b>									
NFPS Nominal Balance - % GDP	-2.9	-6.1	-3.6	-3.0	-4.1	<b>-2.6</b>	-2.6	<b>-1.9</b>	-1.9
NFPS Debt - % GDP	22.9	33.8	33.8	35.8	38.2	<b>40.0</b>	40.0	<b>38.1</b>	38.1

Source: FMI, Haver, Bloomberg, BCP,

## Macro Research – Itaú

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