

PARAGUAY

Table 1 **2021**

Population, million	7.2
GDP, current US\$ billion	39.5
GDP per capita, current US\$	5470.3
International poverty rate (\$2.15) ^a	0.8
Lower middle-income poverty rate (\$3.65) ^a	5.2
Upper middle-income poverty rate (\$6.85) ^a	22.3
Gini index ^a	43.5
School enrollment, primary (% gross) ^b	104.4
Life expectancy at birth, years ^b	74.4
Total GHG emissions (mtCO ₂ e)	98.4

Source: WDI, Macro Poverty Outlook, and official data.

a/ Most recent value (2020), 2017 PPPs.

b/ Most recent WDI value (2020).

Paraguay's economy is expected to contract for the third time since 2019. A severe drought has led to a historically small soybean harvest, suppressed hydropower exports, and higher logistics costs. Although monetary conditions have been significantly tightened, inflation is running at its fastest pace in 14 years. Despite additional social transfers to households, poverty remains higher than before the pandemic and is likely to increase.

Key conditions and challenges

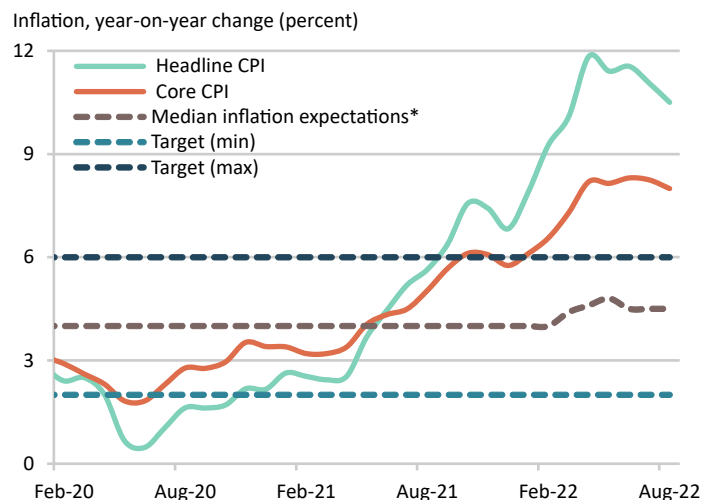
Paraguay has overcome several challenges of being a landlocked country to achieve inclusive growth. From 2004 to 2019, Paraguay grew faster, recorded smaller fiscal deficits, and borrowed less than its peer countries. Much of this growth reflected favorable terms of trade that supported agriculture and hydropower exports, at the expense of natural resources, but institutional reforms such as the inflation targeting mechanism and fiscal responsibility legislation (FRL) helped to safeguard macro stability and sustain growth. Poverty (US\$6.85 per day per capita, 2017 PPPs) fell from 40.2 to 19.7 percent, while inequality fell from 54 to 46 Gini points during the same period. The Human Capital Index rose from 0.51 in 2010 to 0.53 in 2020. More recently, multiple external shocks have suppressed growth and poverty reduction. The economy contracted in 2019 due to droughts and poor trading partner performance, and subsequently in 2020 due to mobility restrictions associated with COVID-19. Despite additional social transfers, poverty increased to 22.3 percent in 2020. The recurrent drought led poverty to remain higher than pre-pandemic levels. With weather shocks projected to be more frequent and intense under climate modeling, structural reforms are needed to boost productivity and resilience. These include strengthening governance and capacity to enforce regulations and spending more on

human capital and infrastructure, especially to adapt to climate change. To finance such investments, Paraguay needs to raise more domestic revenues in a fair and efficient manner, while improving the overall quality of public spending. It also needs to mobilize more private capital, which will require stronger sector regulation and cost recovery of services through consumer tariffs. Additionally, Paraguay needs to tackle the perception of its growing role in the illicit goods trade.

Recent developments

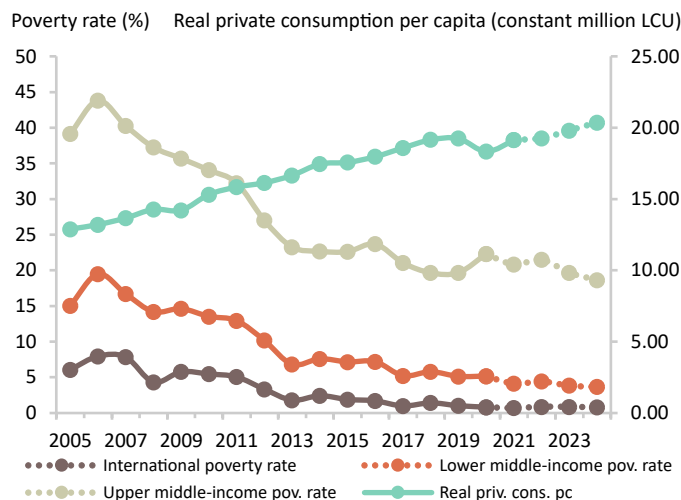
The economy contracted by 2 percent year-on-year (y-o-y) in the first quarter of 2022. Net exports contracted for a fifth consecutive quarter as the drought led to a 69 percent reduction in soybean production. A deeper, broader-based recession occurred in the second quarter as the monthly activity indicator contracted 4.3 percent y-o-y on average, or 1.9 percent excluding agriculture and hydropower. Despite subdued activity, unemployment fell to 6.7 percent from 8.6 percent a year ago. The quality of employment, however, remains a challenge, especially among women in rural areas, who are much more likely to be unemployed or underemployed compared to men. The balance of trade in goods posted a cumulative deficit of US\$586 million or 1.5 percent of GDP at end-August, compared to a surplus of US\$1.6 billion in the same period last year. Nominal exports fell by 1.6 percent as the impact of the drought on volumes outweighed higher commodity

FIGURE 1 Paraguay / Headline and core CPI inflation and inflation expectations



Sources: Central Bank of Paraguay and World Bank staff calculations.
Note: *Monetary policy horizon.

FIGURE 2 Paraguay / Actual and projected poverty rates and real private consumption per capita



Source: World Bank. Notes: see Table 2.

prices, while costlier fuel imports and machinery imports pushed up total nominal imports by 25.5 percent y-o-y.

Exacerbated by the drought and the war in Ukraine, average consumer price inflation from January to August tripled to 10.4 percent compared to the same period last year. The food index rose 17 percent y-o-y, disproportionately impacting poor and vulnerable households who spend a larger share of their budget on food, while non-food inflation rose 8 percent. Strong monetary policy tightening helped keep median inflation expectations within the 2-6 percent target range. The real effective exchange rate remained relatively stable and gross reserves remained ample at US\$9.4 billion as of end-August, equivalent to 8 months of imports. The 12-month cumulative fiscal deficit rose to 4.2 percent of GDP at end-August as real revenues fell faster than expenditures. Adjusting for inflation, revenues declined by 6.1 percent y-o-y, mainly reflecting lower hydropower royalties. Real expenditures, however, only declined by 1 percent y-o-y as personnel, capital and social spending kept the momentum. Public debt rose to 36.4 percent of GDP from 34.6 percent at the end-2021, reflecting January's US\$500 million sovereign bond issuance.

Outlook

The economy is expected to contract by 0.3 percent in 2022 due to the drought, coupled with tighter monetary and fiscal conditions. Assuming favorable weather during the soy planting season in Q4, strong recovery of 5.2 percent is projected for 2023. Fixed investment is expected to remain firm as public and private works progress.

Inflation is projected to decelerate as commodity prices moderate, interest rate hikes take effect and household utility bills decline following energy tariff reductions. In 2023-2024, inflation is expected to return to the upper bound of the target range.

The current account balance is expected to deteriorate due to lower soybean exports and higher fuel imports. It is projected to remain in a small deficit in 2023-2024 as import growth accelerates in line with fixed investment growth. Despite US monetary policy normalization, the financial account is expected to remain stable as residents mainly own domestic currency-dominated assets.

Public finances are expected to remain on a consolidation path. Reforms to improve the efficiency of public procurement, civil service wages, and pensions have been proposed but are unlikely to be executed before the April 2023 elections. With no new revenue reforms planned, a larger consolidation of personnel and capital spending is expected as the government strives to reach the FRL deficit target of 1.5 percent of GDP in 2024. The debt ratio is expected to increase due to the contraction in GDP in 2022, but fall thereafter.

With the recession and high inflation depressing real disposable incomes, poverty is expected to increase to 21.5 percent in 2022. The effects of the war in Ukraine on regional growth and the slow recovery of labor markets may drive poverty higher. Better-targeted social protection programs would help cushion the impact of future crises.

The projected recovery may be adversely impacted by bad weather or by political/economic uncertainty domestically as well as in Brazil and Argentina. Given that only half the population is fully vaccinated against COVID-19, more severe outbreaks may dampen growth and poverty reduction.

TABLE 2 Paraguay / Macro poverty outlook indicators

(annual percent change unless indicated otherwise)

	2019	2020	2021	2022e	2023f	2024f
Real GDP growth, at constant market prices	-0.4	-0.8	4.1	-0.3	5.2	4.2
Private Consumption	1.8	-3.6	5.7	1.8	4.0	4.0
Government Consumption	4.7	5.1	5.3	-1.0	-1.3	-1.7
Gross Fixed Capital Investment	-6.1	5.3	18.6	7.1	6.8	6.1
Exports, Goods and Services	-3.4	-9.0	2.2	-9.0	10.0	6.5
Imports, Goods and Services	-2.0	-15.2	21.4	0.0	5.5	5.0
Real GDP growth, at constant factor prices	-0.2	-0.5	3.7	-0.3	5.2	4.2
Agriculture	-3.1	7.4	-11.6	-15.0	19.0	6.0
Industry	-3.0	0.8	4.7	1.1	2.8	3.5
Services	2.5	-3.1	6.9	1.7	4.4	4.3
Inflation (Consumer Price Index)	2.8	1.8	4.8	9.0	5.3	4.5
Current Account Balance (% of GDP)	-0.5	2.7	0.7	-3.5	-1.1	-0.6
Net Foreign Direct Investment Inflow (% of GDP)	0.6	0.3	0.3	0.8	0.8	0.8
Fiscal Balance (% of GDP)	-2.9	-6.1	-3.7	-3.2	-2.6	-1.5
Debt (% of GDP)	23.4	34.5	34.5	37.4	36.4	35.1
Primary Balance (% of GDP)	-2.0	-5.1	-2.6	-1.9	-1.3	-0.3
International poverty rate (\$2.15 in 2017 PPP)^{a,b}	1.0	0.8	0.7	0.9	0.9	0.8
Lower middle-income poverty rate (\$3.65 in 2017 PPP)^{a,b}	5.1	5.2	4.1	4.4	3.8	3.7
Upper middle-income poverty rate (\$6.85 in 2017 PPP)^{a,b}	19.7	22.3	20.8	21.5	19.7	18.6
GHG emissions growth (mtCO₂e)	2.1	0.7	1.1	-1.4	1.1	2.3
Energy related GHG emissions (% of total)	8.8	8.5	9.5	9.9	9.8	10.0

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices. Emissions data sourced from CAIT and OECD.

Notes: e = estimate, f = forecast. Poverty lines are expressed in 2017 PPP, resulting in changes from earlier editions that used 2011 PPP. See pip.worldbank.org.

a/ Calculations based on SEDLAC harmonization, using 2020-EPH. Actual data: 2020. Nowcast: 2021. Forecasts are from 2022 to 2024.

b/ Projections using microsimulation methodology.