



Summary

Right when Paraguay seemed to have recovered from an earlier outbreak of foot and mouth disease, a new outbreak was reported in early January. Meanwhile, Paraguay has also been hit by a drought, which is likely to damage a number of crops, including the soybeans, Paraguay's most important export product. This is bad news for a country that is strongly dependent on agricultural exports. Meanwhile, after lengthy negotiations Brazil has finally started to pay Paraguay more for the electricity from the Itaipu hydroelectric power plant. This will improve the fiscal and current account positions, which both have deteriorated recently. Paraguay's currency, the *guarani*, has been under pressure since August 2011. The central bank has tried to stem the fall of the currency by selling some of its foreign reserves. However, its stock of foreign reserves remains sizeable and grew over 2011 as a whole.

Things to watch:

- The impact of the drought and the new outbreak of foot and mouth disease
- Ability of the minister of finance to control spending
- Depreciation of the *guarani*

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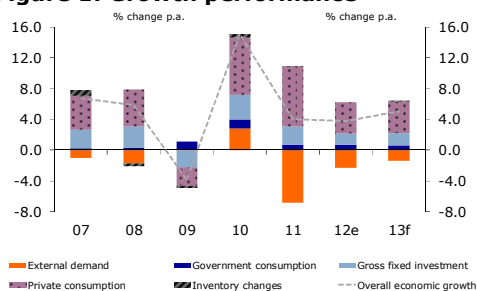
Paraguay			
National facts		Social and governance indicators	
Type of government	Constitutional republic	Human Development Index (rank)	107 / 187
Capital	Asuncion	Ease of doing business (rank)	102 / 183
Surface area (thousand sq km)	406	Economic freedom index (rank)	77 / 179
Population (millions)	6.5	Corruption perceptions index (rank)	154 / 183
Main languages	Spanish	Press freedom index (rank)	54 / 178
	Guarani	Gini index (income distribution)	51.95
Main religions	Roman Catholic (90%)	Population below \$1.25 per day (PPP)	6%
	Protestant (6%)		
Head of State (president)	Fernando Armindo Lugo	Foreign trade	
Monetary unit	guarani (PYG)	2011	
		<i>Main export partners (%)</i>	<i>Main import partners (%)</i>
		Brazil 21	Argentina 29
		Argentina 14	Brazil 18
		Uruguay 11	China 14
Economy		2011	
<i>Economic size</i>		<i>Main export products (%)</i>	
	<i>bn USD</i> <i>% world total</i>	Soybeans	33
Nominal GDP	23 0.03	Cereals	19
Nominal GDP at PPP	35 0.04	Wood	12
Export value of goods and services	12 0.05	Meat products	2
IMF quatum (in mln SDR)	100 0.05		
<i>Economic structure</i>		<i>Main import products (%)</i>	
	2011 5-year av.	Capital goods	40
Real GDP growth	4.0 5.6	Consumer goods	33
Agriculture (% of GDP)	23 24	Intermediate goods	27
Industry (% of GDP)	19 21		
Services (% of GDP)	58 56		
<i>Standards of living</i>		<i>Openness of the economy</i>	
	<i>USD</i> <i>% world av.</i>	Export value of G&S (% of GDP)	52
Nominal GDP per head	3444 32	Import value of G&S (% of GDP)	57
Nominal GDP per head at PPP	5373 44	Inward FDI (% of GDP)	2.1
Real GDP per head	1543 19		

Source: EIU, CIA World Factbook, UN, Heritage Foundation, Transparency International, Reporters Without Borders, World Bank.

Introduction and update

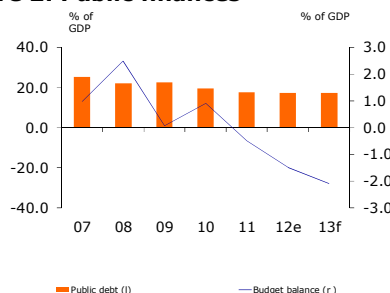
Paraguay's economy grew 4.3% year-on-year in the first three quarters of 2011. This is much lower than the record 15.8% of the same period in 2010, when the strongly agricultural economy benefitted from good weather conditions and recovered from the 2009 crisis. Growth continues to be predominantly driven by private consumption (see figure 1). In recent months, inflation has gone down. It fell from 9.4% year-on-year in September 2011 to 4.9% in December. The fall in inflation was the result of lower food prices in late 2011 and a hike in food prices in the last quarter of 2010. It looks likely that inflation will remain within the target zone of 2 percentage points above or below the Banco Central del Paraguay's (BCP) central 5% target. Faced with a decline in economic sentiment, the BCP has lowered the interest rate. The central bank lowered its

Figure 1: Growth performance



Source: EIU

Figure 2: Public finances



Source: EIU

benchmark 14-days rate by 50 basis points in November and by 75 basis points in December, bringing the rate to 7.25%. Meanwhile, the *guarani*, Paraguay's currency, has been depreciating recently. It has fallen by 21% against the USD since early August. Although the *guarani* has surely not been the only currency to depreciate, its depreciation has been relatively fierce, and was bigger than the roughly 16% depreciation of the Brazilian *real*. This can partially be explained by lower meat exports due to the outbreak of mouth and foot disease (see last chapter) and a usual pre-Christmas increase in imports. The BCP has tried to limit the fall of the currency by selling some of its foreign exchange reserves, but total foreign reserves grew over 2011 as a whole and are still close to USD 5bn, which is equal to roughly 4.7 months of imports. Nevertheless, Paraguay's current account deficit, which is expected to have increased to 3.8% in 2011 and is likely to remain at approximately that level in the coming years, is a weakness.

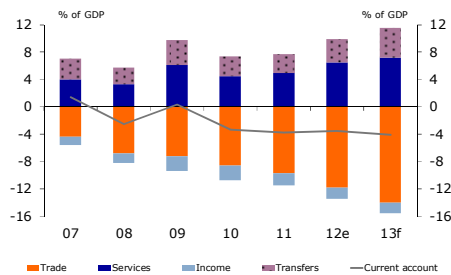
A tale of two plagues

In September 2011, Paraguay, an important beef exporter, was hit by an outbreak of foot and mouth disease, one of the most contagious animal diseases, in the San Pedro region. To prevent the disease from spreading, about 1,000 animals were slaughtered and the state of emergency was imposed in the region. Neighboring countries banned imports of Paraguayan meat and livestock and Paraguay suspended its beef exports in September 2011, which resulted in total beef exports falling from about USD 900mln in 2010 to USD 700mln in 2011. In late 2011, the beef sector seemed to start to recover from the outbreak. However, just four days after the state of emergency had been lifted, a new outbreak of the disease was reported in early January 2012. The new outbreak happened at a location close to the September outbreak. The authorities have slaughtered 168 animals, but it remains to be seen how big the new outbreak itself and its impact will be.

Allegedly, the number of animals to be slaughtered at the farm affected in September was reduced by splitting the farm into three separate farms after the outbreak. Only the animals of one of these farms were slaughtered. According to rumors, the head of the health and food quality department was aware of this manipulation, but looked aside to help the farmer, whose family was related to his own. Paraguayan media report that an investigation is now under way following orders from president Lugo.

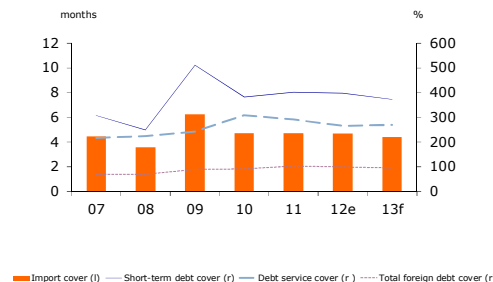
Meanwhile, a severe drought, which has also hit southern Brazil and Argentina, is likely to lead to substantial damages to crops. Although it is still unclear how big the impact will be, it looks likely that the important soy and corn sectors will be affected. On January 17, president Fernando Lugo declared a 90-day food emergency. The government has committed itself to help farmers and local communities to deal with the drought.

Figure 3: Current account



Source: EIU

Figure 4: External liquidity



Source: EIU

The 2012 budget and the 2013 elections

After lengthy negotiations, Brazil finally passed legislation in May 2011 that will result in an increase of the yearly revenues Paraguay's government gets from the Itaipu hydroelectric power plant of about USD 240 million. This extra revenue is very welcome, as it will help to reduce both the fiscal and the current account deficits. Meanwhile, thanks to the booming economy, government revenue has continued to grow rapidly during 2011, with an increase of the total revenue in the first 11 months of 2011 of 17.1% year on year. The risk right now is that this might tempt the government to spend too much. In this respect, we note that the budget is likely to have fallen into deficit in 2011. Congress favored an expansionary 2012 budget, but the minister of finance, Dionisio Borda, has been able to push the senate to implement some cuts and hopes that the lower house will vote for an even more austere budget. Borda is also trying to get congressional approval for a tax on grain exports and a personal income tax. Attempts to make a less expansionary budget and increase tax income are not easy though, as the 2013 general elections are not that far away. The opposition forces in the upper house managed to block an attempt by president Lugo to amend the constitution to take away the ban on presidential re-election. This means that the president will not be able himself to protect his social reforms after his term has ended. Right now, Horacio Cartes, who will probably be the candidate of the conservative Partido Colorado that ruled Paraguay uninterruptedly until Lugo became president, is the favorite to win the 2013 presidential elections.

Paraguay							
Selection of economic indicators	2007	2008	2009	2010	2011	2012e	2013f
<i>Key country risk indicators</i>							
GDP (% real change pa)	6.8	5.8	-3.8	15.0	4.0	3.8	5.0
Consumer prices (average % change pa)	8.1	10.2	2.6	4.7	8.5	6.0	6.6
Current account balance (% of GDP)	1.4	-2.5	0.3	-3.4	-3.8	-3.6	-4.1
Total foreign exchange reserves (mln USD)	2461	2845	3839	4137	5067	5300	5530
<i>Economic growth</i>							
GDP (% real change pa)	6.8	5.8	-3.8	15.0	4.0	3.8	5.0
Gross fixed investment (% real change pa)	14.4	15.8	-11.1	18.0	13.0	7.0	8.0
Private consumption (real % change pa)	6.2	6.8	-3.4	10.4	11.2	5.6	5.4
Government consumption (% real change pa)	3.0	3.5	13.7	12.0	7.0	7.0	6.0
Exports of G&S (% real change pa)	8.1	12.1	-13.9	36.0	-0.9	5.2	5.6
Imports of G&S (% real change pa)	10.7	15.9	-13.7	30.0	11.5	8.8	7.3
<i>Economic policy</i>							
Budget balance (% of GDP)	1.0	2.5	0.1	0.9	-0.5	-1.5	-2.1
Public debt (% of GDP)	25	22	23	19	17	17	17
Money market interest rate (%)	3.9	4.5	5.0	4.5	6.0	5.5	5.5
M2 growth (% change pa)	39	19	29	16	13	10	12
Consumer prices (average % change pa)	8.1	10.2	2.6	4.7	8.5	6.0	6.6
Exchange rate LCU to USD (average)	5032.7	4363.2	4965.4	4735.5	4188.1	4439.2	4685.0
Recorded unemployment (%)	5.6	5.4	7.9	7.0	6.6	6.3	6.0
<i>Balance of payments (mln USD)</i>							
Current account balance	172	-425	43	-596	-860	-840	-1020
Trade balance	-533	-1147	-1032	-1527	-2214	-2790	-3500
Export value of goods	5652	7798	5805	8312	9982	10070	10840
Import value of goods	6185	8945	6837	9839	12196	12860	14330
Services balance	487	558	868	792	1119	1520	1780
Income balance	-155	-251	-312	-382	-391	-370	-380
Transfer balance	373	414	519	522	626	800	1090
Net direct investment flows	199	275	201	423	469	470	500
Net portfolio investment flows	0	0	0	0	0	0	0
Net debt flows	39	423	75	585	461	370	500
Other capital flows (negative is flight)	349	128	680	-106	859	230	250
Change in international reserves	759	401	999	305	929	230	230
<i>External position (mln USD)</i>							
Total foreign debt	3570	4161	4323	4545	4997	5350	5850
Short-term debt	803	1146	752	1082	1266	1340	1490
Total debt service due, incl. short-term debt	1143	1272	1597	1341	1750	1990	2060
Total foreign exchange reserves	2461	2845	3839	4137	5067	5300	5530
International investment position	-276	-684	1099	1441	n.a.	n.a.	n.a.
Total assets	4842	5341	7677	8547	n.a.	n.a.	n.a.
Total liabilities	5118	6024	6578	7107	n.a.	n.a.	n.a.
<i>Key ratios for balance of payments, external solvency and external liquidity</i>							
Trade balance (% of GDP)	-4.4	-6.8	-7.2	-8.6	-9.8	-11.9	-14.1
Current account balance (% of GDP)	1.4	-2.5	0.3	-3.4	-3.8	-3.6	-4.1
Inward FDI (% of GDP)	1.7	1.7	1.4	2.4	2.1	2.0	2.0
Foreign debt (% of GDP)	29	25	30	26	22	23	24
Foreign debt (% of XGSIT)	49	43	54	43	39	40	39
International investment position (% of GDP)	-2.3	-4.1	7.7	8.1	n.a.	n.a.	n.a.
Debt service ratio (% of XGSIT)	16	13	20	13	14	15	14
Interest service ratio incl. arrears (% of XGSIT)	2	2	2	1	1	1	1
FX-reserves import cover (months)	4.4	3.6	6.2	4.7	4.7	4.7	4.4
FX-reserves debt service cover (%)	215	224	240	308	290	266	268
Liquidity ratio	125	118	133	126	122	121	119

Source: EIU

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