

SUMMARY

In the first half of 2012, growth in most of the advanced economies remains modest. On the side of the developing countries, while growth has moderated recently, still is being solid. The perspectives for the global economy are a gradual recovery, while the especially delicate situation in the euro zone is still facing substantial downside risks.

In Latin America, after the strong growth recorded in 2010, growth had declined in 2011 when was a rate of 4.5 %, meanwhile, for the current year are expected a greater moderation with a forecast rate of 3.7 %, due to the impact of the crisis in Europe and the moderate growth in United States. In Brazil, growth remains weak, primarily reflecting the slowdown in the industrial sector and the impact of the global situation. During the first quarter, the Brazilian economy grew at an annual rate of 0.8 % and is predicted to expand at just below 2 %, after the positive rate of 2.7 % in 2011.

The forecast of the Paraguayan Gross Domestic Product (GDP) growth rate for 2012 is still in -1.5 %, mainly as a result of the reduction in the estimated agricultural production, especially soybeans, due to the drought that affected the sector at the end of 2011 and at the beginning of this year. Even so, the Non- Agricultural GDP would grow by 3.9 % at the end of 2012. From the demand side, total consumption presented a minor expansion. However, bet-

ween its components, the Government Consumption had the greatest growth in the last years, while also Private Consumption grew, but at a rate much lower than the average in the previous quarters.

For its part, the Balance Of Payments recorded a negative net balance during the first half of the year, as opposed to the nine previous consecutive years. It is estimated a reversal of the Balance Of Payments deficit to a surplus in the second half, in the way that at the end of this year, the positive result is predicted, mainly due to the private external capital flows related with the economic activity in services, trade of agricultural goods, telephony, transportation, cargo, etc.

The incorporation of Electricity in the National Accounts Statistics and Balance Of Payments is highlighted the fact that Paraguay is a major world producer of this source of energy and first exporter. In fact, the export structure allowed displays the relative importance of this energy source with reference to to the agricultural goods and re-exports trade.

Regarding to the annual domestic core inflation, by the month of August, was a rate of 2.8 %, still below the center of the referential range of medium and long term inflation (5 % with a tolerance range of +/- 2.5 %). With this result, total inflation complete eleven consecutive months of inter-annual variations located within the target range.

On the other hand, annual underlying inflation fell to a rate of 2.5 % in August, lower than the observed in the previous three months. This variable is also for eleven consecutive months of inter-annual variations located within the target range, and at a level even below the verified core inflation.

Since the decision of the Boards of Directors of the Central Bank of Paraguay (BCP) to migrate the regime of the monetary policy to the inflation targeting scheme, it has been implemented several measures to deepen the money market and provide new tools of monetary policy.

In this sense, it was setting into operation the Liquidity Facilitating Mechanism (FLIR, for its acronym in Spanish), so that the financial system be assured of getting liquidity in case of not getting it in the private market.

In order to facilitate the participation of a larger number of entities in the interbank market, it was also made operating the instrument called the Interbank Liquidity Window (VLI, acronym in Spanish) that somehow will help to strengthen and eliminate or reduce the segmentation in the money market, since the segmentation means that only certain entities have access to the interbank call through open lines of credits, otherwise, they could not get liquidity through this mechanism.

Other important measures taken by the BCP, through the Management of Markets, was the full dematerialization of the Letters of Monetary Regulation (LRM for its

acronym in Spanish), which has allowed smaller cuts. This allows the demands of liquidity through Repo (VLI) be adjusted to the needs of the financial system. In addition, all placements of long-term of the LRM are made by expiration, facilitating the negotiation of them together, getting a higher volume for similar maturities. This system allows to the holders of titles a more accurate and timely assessment of their instruments, enabling its negotiation among entities of the financial system.

The change in the profile of the monetary policy applied by the BCP, from the second half of 2011 continued on the same path in the first half of 2012, according to the inflation forecast and the development of economic activity for 2012, this latter affected by negative shocks in the production, such as the drought and the outbreak of foot and mouth disease.

In order to create a more favorable environment, and in response to the economic situation, the 14 days rate of monetary policy (TPM for its acronym in Spanish) was reduced twice during the first half, 75 basis points in January, and 25 basis points in May, and by June 2012 the TPM was 6.25 %. Thus, the position of the monetary policy in the first half of 2012 was in general with an expansive nature due to the contraction in the economic growth, so, the Monetary Authority implemented a counter cyclical policy to mitigate the possible adverse effects of the recession.

According to the Survey's Expectation of Economic Variables (EVE for its acronym

in Spanish), published monthly by the BCP, it was noted that the outlook of the economic agents in relation to inflation were gradually downward adjusted until May 2012. Thus, after closing 2011 with an inflation expectation of 6.3 per cent by the year 2012, this value was decreasing gradually until it reaches the level of 5.4% in May, ending at the half of the year with an expectations rate of 5.5%. In terms of inflation expectations for 2013, it fell from 6.3 per cent in January to 5.8 per cent last May, ending in a rate of 6.0%.

The Real Effective Exchange Rate appreciated in almost all the first half of 2012, with a change in its initial trend in June, recording a depreciation of 1.27% in that month. These five initial months of the year show a break in the alignment maintained

during the last months of 2011 (depreciation), but it is well to notice that the registered in the month of June it suggests to redirect the deviation, which will help the sustainability of the Balance of Payments.

In this economic spectrum, the central path of core inflation in the passive stage projection realizes a rate of 4.99% by the ending of 2012, and 4.66% to the end of 2013. However, the cumulative probability that inflation is located below the central path to the end of 2012 is 76.4%, which observed a strong bias to fall in the projection of inflation for this year. Similar situation occurs when it is estimated the accumulated probabilities for 2013, in this case, there is a bias from 68.4% to allow inflation to close in that year under the projection of the base path.