SUMMARY

The International Monetary Fund trimmed their 2013 forecast for global growth from 3.5 % to 3.2 %. Large part of this cut is due to the failure of emerging economies to meet growth expectations. However, global growth is still highly dependent on emerging markets as they are still growing at a faster pace than advanced economies.

The reduction in the projection for global growth is caused by a decrease in domestic demand in emerging markets combined with the recession still experienced in the euro-area. According to the same sources, the largest down-side risk faced by emerging markets is the pull-back from massive monetary stimulus in the United States which could trigger reversals in capital flows that could cause a hardening of credit conditions in the rest of the world.

Growth expectations in Latin America and the Caribbean have been cut. Growth for 2013 is now projected to be 3.0 % and 3.4 % for 2014. The downward revision is mainly caused by weak domestic demand and slower external demand growth. Brazil has experienced a slow-down in industrial production, along with an increase in the policy rate due to a rising inflation outlook, which could hurt domestic consumer demand. Mexico has also experienced deterioration in consumer and business confidence as exports lag behind.

Domestically, the Gross Domestic Product, after a second review, stands at 13 %, 2.5 % above the previous forecast in December 2012 which stood at 10.5 %.

The solid economic growth in Paraguay is driven by various factors including a rapid recovery in the agricultural sector which experienced climate shocks in 2011-2012, the resurgence of cattle farming and its supply chain, which staged a come-back with higher exports after overcoming the foot-and-mouth outbreak in 2011, and a favorable construction outlook in both the public and private sector.

From an expenditure approach, the surge in GDP to 13 % is primarily due to external demand. The bulk component of the expenditures in terms of structure, private consumption, validates an apparent recovery. On the other hand, there is a significant increase in gross capital formation, explained in part by the flood of foreign investment due to the “magnet effect” triggered by the excellent economic conditions in which Paraguay finds itself.

For the remainder of 2013, the balance of payments is expected to hold a surplus which reflects an increase in reserve assets. We estimate the reserve-to-GDP ratio to stand close to 20.1 %, which would cover around 8.7 months of imports.

In regards to inflation, the year-on-year rate stood 1.7 % below the target rate of 5 %. Meanwhile, the year-on-year core inflation rate stood 2.1 % below the target rate. The downward pressure on inflation is closely correlated to food prices, and goods and services related to the energy and durable

goods sectors.

Given the favorable inflationary scenario and the better-than-expected economic recovery in the first quarter, the BCP Board decided to keep the target rate unchanged (since August of 2012). Thus, the target rate for the first semester of 2013 stood at 5.5 %.

The Main Economic Indicators survey, prepared by the BCP on a monthly basis, shows that year-on-year inflation forecasts for 2013 were trimmed since the beginning of the year to close the first semester forecast at 4.6 %. The inflation forecast for 2014 has kept its alignment with the target rate as it has fallen from 5.6 % in January to 5.4 % in June 2013.

The Real Effective Exchange Rate index in June slumped 0.5 % compared to the prior month. In both, year-on-year and cummulative terms there has been an appreciation of 5.7 % and 0.7 %, respectively compared to the basket of currencies of Paraguay´s major trading partners. Throughout 2013 the domestic currency´s real appreciation has experienced a downward trend against the basket of currencies of major trading partners. The real appreciation is expected to stay throughout 2013 considering foreign trade estimates and the influx of foreign capital.

In the current economic environment, the year-on-year inflation forecasts ending 2013 fell to 3.8 % compared to the 4.2 % forecast in this year´s first Monetary Policy statement, with expectations of a reversal in the deceleration of prices in 2014. Moreover, even with the downward revision of the inflation forecast for the year, there exists an important bias that inflation will end up below the modal value (3.54 %) of this forecast by year-end.