



# MONETARY POLICY REPORT

September  
2021



**CENTRAL BANK OF PARAGUAY**

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[www.bcp.gov.py](http://www.bcp.gov.py)

Asunción - Paraguay

## Executive Summary\*

### World growth

Annual change, percent

	June 2021		September 2021		
	2020	2021	2020	2021	2022
World	-3.3	6.0	-3.1	5.9	4.5
United States	-3.5	6.6	-3.4	5.8	4.0
Eurozone	-6.5	4.5	-6.4	5.0	4.3
China	2.3	8.5	2.3	8.2	5.5
Brazil	-4.1	5.1	-4.1	5.2	1.9
Argentina	-9.9	6.0	-9.9	7.2	2.3
Trading partners	-6.0	5.7	-6.0	6.5	2.8
Mercosur partners	-6.9	5.6	-6.9	6.2	2.2

Source: Bloomberg

### International and Regional Economy

The growth prospects for the world economy have been revised slightly downwards as compared to the projections given in the previous Monetary Policy Report (IPoM), mostly due to the lower growth rates foreseen for some of the main world economies. The international scenario during the third quarter of 2021 showed a favorable dynamism from the demand side, although, on the side of supply, the production of some goods has been limited by the scarcity of certain basic materials and supplies, as well as by logistical difficulties. Furthermore, the health context has again become more complex with the increased levels of COVID-19 contagion caused by the Delta variant. This situation has led to an adjustment in the growth prospects for economies such as the United States and China. In the region, the outlook seems to be more encouraging. From the standpoint of the health situation, the COVID-19 contagion curves have remained moderate. In line with this, the economic forecasts improved as the reactivation of certain economic activities was observed, especially those tied to the services sector. The more persistent disruptions of supply and the swifter recovery of demand have triggered inflationary pressures that are less transitory than anticipated.

**In the United States, the economic prospects have been adjusted downwards, while inflation has remained high.** In the second quarter of 2021, GDP registered a growth rate of 12.2% inter-annually, explained in part by the lower comparison base. In the third quarter, the most recent data of the PMI (Purchasing Managers' Index) showed that the manufacturing sector decelerated the expansion pace that had been observed previously, registering a figure of 60.7 in September. Growth prospects for 2021 have been revised downwards, going from 6.6% to 5.8%. Regarding prices, the inflation rate has remained high, standing at 5.4% y-o-y in September. In this context, although the Federal Reserve (Fed) maintained the range of reference rates at 0.0% - 0.25% during the third quarter, at its last meeting it announced

\* The Spanish version prevails.

### Gross Domestic Product by sectors

Annual change, percent

	2020	2021(f)	2021(i)
<b>Primary Sector</b>	<b>7.8</b>	<b>-3.2</b>	<b>-0.4</b>
Agriculture	10.0	-8.0	-0.7
Livestock	4.7	11.5	0.3
Forestry, fishery and mining	-4.3	7.0	0.1
<b>Secondary Sector</b>	<b>1.7</b>	<b>4.6</b>	<b>1.6</b>
Manufacturing	-0.5	7.2	1.4
Construction	12.6	13.5	0.9
Electricity & water	-1.8	-11.0	-0.8
<b>Tertiary Sector</b>	<b>-3.3</b>	<b>6.3</b>	<b>3.0</b>
Public Administration	5.2	-2.5	-0.2
Trade	-7.8	10.0	1.0
Other Services	-4.4	8.0	2.2
<b>Taxes</b>	<b>-5.6</b>	<b>5.0</b>	<b>0.4</b>
<b>GDP at market prices</b>	<b>-0.6</b>	<b>4.5</b>	<b>4.5</b>
<b>GDP w/o agriculture and binationals</b>	<b>-1.5</b>	<b>7.1</b>	

Source: Central Bank of Paraguay

(f): Forecast.

(i): Incidence.

that it might initiate the reduction of assets purchases this year. The decision regarding this matter will be made at the Federal Reserve's November meeting.

**In the Eurozone, a greater recovery of the economy is expected in 2021, while an increase of the inflation rate has been verified in the last few months.** In the second quarter of 2021, an inter-annual variation of GDP of 14.3% was recorded, partly explained by a significant base effect. On the other hand, the most recent data of the manufacturing indicator (PMI) for the third quarter showed a slower expansion pace, standing at 58.6 in September. As regards the growth prospects for 2021, these stand at 5.0% annually, above the rate reported in the previous IPoM report (4.5%). Regarding prices, the inflation rates were above those registered in the second quarter of 2021, standing at 3.4% inter-annually in September.

**In China, GDP for the third quarter exhibited lower growth than observed in the previous quarters this year.** The data for the third quarter of 2021 showed an expansion of 4.9% for GDP in inter-annual terms, below the growth rates registered in the first and second quarters. Likewise, the manufacturing sector indicators showed a deceleration in the third quarter, explained in part by outbreaks of Delta variant contagions, although the PMI stood at the neutral zone (50.0) as of September. Thus, the growth forecasts for 2021 dropped from 8.5% to 8.2% annually.

**In Brazil, the growth prospects have improved slightly and the monetary authorities have continued with the process of the normalization of monetary policy.** In 2021, GDP registered an increase of 12.4% y-o-y in the second quarter, due in part to a lower comparison base. On the other hand, the manufacturing PMI has shown less dynamism since July, standing at 54.4 in September. Concerning the growth projection for the Brazilian economy in 2021, there was a slight upward revision, as compared to the June IPoM, going from 5.1% to 5.2% annually. As for prices, inflation continued to increase in the third quarter, reaching a level of 10.3% y-o-y in September. In this context, the Central Bank of Brazil's Monetary Policy Committee (Copom) increased the SELIC rate by 200 basis points to stand at 6.25% annually, thus continuing with the process of the normalization of its monetary policy.

### Economic growth and current account

Annual change, percent

	2020	2021(f)
<b>GDP</b>	<b>-0.6</b>	<b>4.5</b>
<b>Domestic demand</b>	<b>-2.8</b>	<b>8.2</b>
<b>Gross capital formation</b>	<b>-4.8</b>	<b>21.9</b>
Gross fixed capital formation (GFKF)	6.3	17.2
<b>Total consumption</b>	<b>-2.2</b>	<b>4.6</b>
Private consumption	-3.5	4.9
Public consumption	5.2	3.0
<b>Exports of goods and services</b>	<b>-10.3</b>	<b>2.1</b>
<b>Imports of goods and services</b>	<b>-17.0</b>	<b>14.3</b>
<b>Current account (% of GDP)</b>	<b>2.3</b>	<b>1.1</b>
GFKF (% of nominal GDP)	20.1	22.1

Source: Central Bank of Paraguay

(f): Forecast.

**In Argentina, growth prospects have improved, while inflation has accelerated.** The GDP data in the second quarter showed a growth rate of 17.9% y-o-y, explained largely by the lower levels registered in the second quarter of 2020. In the third quarter, the industrial production indicator showed an inter-annual growth rate of 13.8% in August. In this context, the economic growth forecast for 2021 rose to 7.2%. As regards prices, higher inflation has been observed, reaching a rate of 52.5% y-o-y in September. The Central Bank of the Republic of Argentina (BCRA) has maintained the lower limit of the LELIQ rate at 38% annually since November 2020, while the government has implemented additional foreign exchange measures and has extended the regime of price controls to various food and household products.

### Domestic Situation and Monetary Policy

**Economic activity and internal demand have continued to evolve favorably in recent months, in a context of improved health conditions and greater reopening of the economy.** In the second quarter, seasonally adjusted GDP grew 2.8% as compared to the first quarter, explained by the dynamism of construction, livestock production, manufacturing, and services, while the electricity & water sector continued with a downward trajectory. On the side of expenditures, the recovery was mainly due to the significant rebound of investment, accompanied by a gradual improvement of private consumption. In line with this, an increase in imports has also been observed in the last quarters. In inter-annual terms, the expansion of GDP reached 14.5%, explained in part by the lower comparison base. At the end of the first semester, cumulative growth stood at 6.9%. According to the short-term indicators, economic activity continued to expand in inter-annual terms in the third quarter. The decrease in the number of COVID-19 contagions, the advance in the process of immunization of the population, and the greater mobility of individuals could continue to favor consumers' expectations and the recovery of those segments of the services sector that have been most affected by the pandemic since 2020.

**Since the last IPoM, total inflation and the underlying measures have continued to show an upward trajectory, explained mainly by the increase of food and fuel prices, which have been affected by the increase of commodity**

### Inflation projection

Annual change, percent

	2020	2021(f)	2022(f)	2023(f)
Average CPI inflation (*)	2.0	6.7	4.3	
December CPI inflation (**)	2.2	6.7	4.0	
CPI inflation in around two years (***)				4.0
Average underlying CPI inflation(*)	2.0	6.6	4.4	
December underlying CPI (**)	2.2	6.6	4.0	
Underlying CPI inflation in around 2 years (***)				4.0

(f) Forecast

(\*) Corresponds to the average of the fourth quarter.

(\*\*) Corresponds the inflation on the end of the period.

(\*\*\*) Corresponds to the projected inflation for the third quarter of 2023.

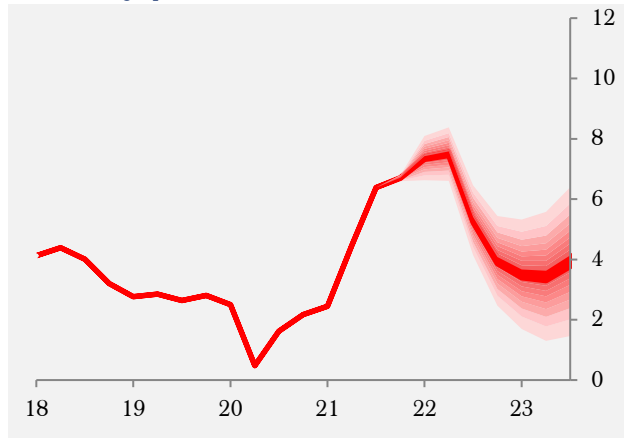
Source: Central Bank of Paraguay

**prices in the international markets and the greater external demand for Paraguayan beef.** In the third quarter, the average total inflation stood at 5.7%, above the average of 3.6% observed between April and June 2021, and greater than the average of 1.4% observed in the same quarter last year. It is noted that the lower comparison base also had an influence on the high inter-annual rates recorded in the third quarter of 2021. Underlying inflation and core inflation averaged rates of 5.8% and 5.1%, respectively, and both of these measures registered higher rates than those observed in the second quarter of 2021 (each of the two indicators stood at 3.9%). When excluding the prices of energy and food items from the Consumer Price Index (IPCSAE), inter-annual inflation averaged a variation rate of 2.1%, slightly below the 2.2% average registered in the last IPoM, reflecting the high concentration of inflation in two categories (food items and energy).

**The Central Bank of Paraguay initiated the process of normalization of its monetary policy in August, and currently the MPR stands at 2.75% annually.** As regards the international scenario, the Monetary Policy Committee (CPM) highlighted the improvement of the economic growth prospects of the country's main trade partners and the high inflation rates that are being registered in both the principal advanced economies and in the countries of the region. At the domestic level, the CPM highlighted the positive dynamism of economic activity observed recently and the favorable outlook in light of the more encouraging health scenario, the greater reopening of the various economic sectors, and the greater mobility of the population. As for inflation, there has been a rebound in the recent months, rising above the anticipated levels, and explained by the high prices of commodities and the greater external demand for Paraguayan beef. However, in a scenario of less capacity allowances of the economy and a highly accommodative monetary policy stance, it is possible to create conditions such that the initial impacts of external shocks propagate with greater magnitude and speed to other components of the CPI, as well as exert a negative incidence on the medium-term inflation expectations. Given this scenario, the Committee deemed it prudent to initiate the withdrawal of monetary stimuli in August with an upward adjustment of the MPR, by 25 basis points; this process accelerated in September (50 basis points) and in October (125 basis points). Likewise, it is foreseen that the changes

### CPI inflation forecast

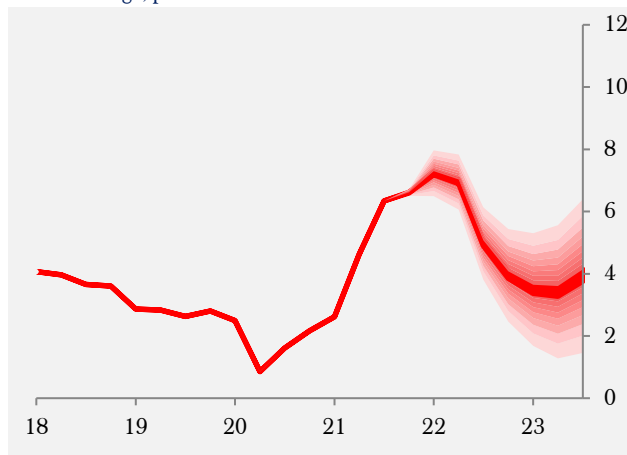
Annual change, percent



Source: Central Bank of Paraguay.

### Underlying CPI inflation forecast

Annual change, percent



Source: Central Bank of Paraguay.

in the referential rate, at the November and December meetings, will be of a similar magnitude.

### Baseline Scenario Projections

**The central projection of GDP growth for 2021 remained at 4.5%, with internal re-compositions at the sectoral level.** The primary sector is expected to register a negative rate of around 3.2%, which implies a greater drop than projected in the previous IPoM, mainly due to lower agricultural production, given the lower yields of soybeans, corn, and wheat, resulting from climatic shocks. In the case of soybeans, the drought caused losses during the early sowing season (2020/2021 agricultural campaign), which has partially impacted the final output. Meanwhile, a series of frosts at the end of June has diminished the production of corn and wheat. Livestock production continues in expansion, although it has moderated in the last few months, leading to a downward adjustment, at the margin, of 0.5 percentage points, thus reaching a rate of 11.5%. The secondary sector foresees a growth rate of 4.6%, below the 6.6% projected in the previous report. The downward revision is explained largely by the sharp correction of the growth rate of the electricity & energy sector (going from -6% to -11%). This sector continues to experience one of its greatest crisis as regards electricity output, due to the problems of low water flow of the Parana River, which provides water for the country's main hydro-electrical power plants. The construction sector is projected to expand by 13.5%, slightly less than the rate of 14% indicated in the previous revision. As regards the services sector, a growth rate of around 6.3% is estimated, above the 4.8% foreseen in the previous IPoM. The opening of economic activities related to greater social interaction, such as services provided to households, hotels & restaurants, and business services sustains such growth. In addition, taxes on products will grow at a rate of 5%, consistent with the dynamics of economic activity.

**On the expenditures side, the improved prospects for internal demand, both for private consumption and investment, is highlighted, while net external demand was adjusted downwards.** The current projection shows a growth rate of 8.2% for internal demand, above the rate of 5.9% foreseen in the previous report. Private consumption will experience an increase of around 4.9%, higher than the 3.9%

foreseen in the June IPoM, explained especially by the better prospects for the consumption of services that had been restricted in both supply and demand during the pandemic (commercial centers, restaurants, artistic and cultural events, sport events, etc.), and which could rebound with greater vitality during the last part of the year, given the more favorable health outlook. As regards gross fixed capital formation, even though construction has moderated, the impetus of investment in machinery and equipment has been far greater than anticipated, which has influenced the upward correction of this component. Net external demand was revised downwards, due, on the one hand, to the reduction of the exports estimate (which dropped from 6.9% to 2.1%), sustained by decreased volumes of soybeans and soy derivatives shipments, and on the other hand, the lower export of electrical power. Imports are expected to register a growth rate of 14.3%, above the 12.1% projected in the previous report, consistent with the better performance foreseen for internal demand.

**The inflation projection for 2021 was adjusted from 4.0% to 6.7%, consistent with the recent behavior of prices.** In the third quarter of 2021, observed inflation data stood significantly above the level forecasted for this period, showing an increase in the annual rates and in the velocity. This implies a higher starting point for the projections and slows down the convergence of inflation to the 4% target. These increments, even though concentrated in food products and energy, have placed total inter-annual inflation above the upper limit of the target range, in September. The increase is mainly due to supply shocks that are more persistent than previously anticipated. Thus, when taking into account the most likely assumptions about the future behavior of the internal and external macroeconomic variables, inflation would remain at high levels in the first semester of 2022 (important base effect) and would later begin its process of convergence starting in the third quarter, reaching its target level over the relevant horizon of monetary policy.

### **Risk Scenarios**

**At the international level, while the growth prospects of the world economy continue to be favorable, downside risks persist.** In various countries, contagions caused by the Delta variant remain high, and the risk that this variant or new

strains of coronavirus might spread again remains latent, thus posing a public health risk and triggering new restrictions on the mobility of individuals. While the advances in vaccination have been favorable in many regions, at the global level, the percentage of the population with full vaccination remains low, further exacerbating the probability of new mutations of the virus. In counterpart, the approval of more vaccines for a greater range of ages, together with greater availability of such vaccines in the countries that have the greatest lags, could help to counter this risk.

**The high levels of food and energy commodity prices explain, to a large extent, the existing inflationary pressures at global and regional levels.** The greater persistence of these shocks might increase the risk of de-anchoring inflation expectations, which, in turn, could lead to greater increases of prices. Moreover, the problem of energy shortages and power outages in Asian and European countries, which has led to lower production in factories that produce other raw materials, could also boost the risk of inflation. The more persistent disruptions of the global supply chains that limit supply in a context of quicker recovery of demand might also exacerbate the inflationary pressures. To mitigate these risks, various advanced economies could accelerate the normalization of monetary policy. This, in turn, would imply a tightening of international financial conditions, which could especially affect emerging and developing economies with high levels of indebtedness in foreign currency and ample financing needs.

**Paraguay's main trade partners in the region are exposed to fiscal risks and uncertainty about their political landscape which could affect the dynamism of their economies or induce a greater perception of risk in the region.** In Brazil, even though the debt sustainability indicators have improved, the risks of a deterioration derived from new social transfers programs, a potential increase of government spending given the proximity of the electoral period and the uncertainty about the duration of the improvements observed in tax collection levels. In a similar manner, in Argentina, the public finance risks stem from the political cycle.

**In the domestic context, the health situation has improved substantially, although risks stemming from the appearance**



**or expansion of new variants of the virus (SARS-Cov-2) persist.** The number of new contagion cases, hospitalized persons, and deaths caused by COVID-19 have dropped to minimum levels since September, allowing for a greater reopening of economic sectors and greater mobility of the population. However, a new outbreak of the disease, due to the expansion of the Delta variant or the appearance of more aggressive strains, continues to represent a latent risk over the upcoming months. To the extent that the process of immunization continues with the pace observed since mid-July, this risk would be significantly mitigated, which would continue to favor economic recovery, especially in the services sector.