



# MONETARY POLICY REPORT

December  
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

	September 2021		December 2021		
	2021	2022	2020	2021	2022
World	5.9	4.5	-3.1	5.8	4.4
United States	5.8	4.0	-3.4	5.6	3.9
Eurozone	5.0	4.3	-6.4	5.1	4.2
China	8.2	5.5	2.2	8.0	5.2
Brazil	5.2	1.9	-3.9	4.9	0.8
Argentina	7.2	2.3	-9.9	8.0	2.2
Trading partners	6.5	2.8	-5.9	6.8	2.5
Mercosur partners	6.2	2.2	-6.9	6.5	1.6

Source: Bloomberg

### International and Regional Economy

The growth prospects of the world economy for 2021 and 2022 have been revised slightly downwards as compared to the projections given in the September Monetary Policy Report (IPoM). During the last quarter of 2021, world demand has shown a favorable dynamism, in general, while supply has been limited by the prolongation of disruptions in global supply chains, with which global inflationary pressures remained latent. This situation, together with the outbreaks of cases of coronavirus contagion resulting from the Delta variant, have influenced the slight reduction of the world GDP growth rate estimate for 2021. In addition, the variant known as Omicron has been recently discovered, and according to the World Health Organization (WHO) it poses a global risk of “high” infection rates, even though it seems to be less severe than other strains. Notwithstanding, this has generated greater uncertainty about 2022, which is reflected in the downward revision of the growth rate of the world economy.

**In the United States, forecasts for economic growth have been reduced, while efforts to contain inflation have accelerated, given a more persistent inflation than expected.** In the third quarter of 2021, GDP registered an annualized growth rate of 2.3%, lower than the 6.7% rate recorded in the previous quarter, mainly due to less spending on personal consumption. The most recent data of the PMI (Purchasing Managers’ Index) showed that the manufacturing sector decelerated its expansion pace compared to the level observed at the end of the previous quarter, registering a level of 58.3 in November. Growth prospects have been revised downwards, dropping from 5.8% to 5.6% for 2021, and from 4.0% to 3.9% for 2022. Inflation remained high, standing at 6.8% y-o-y in November. In this context, although the Federal Reserve (Fed) maintained the range of reference rates at 0.0% - 0.25% during the fourth quarter, at its December meeting it decided to accelerate the pace of reduction of asset purchases initiated in November.

\* The Spanish version prevails.

### Gross Domestic Product by sectors

Annual change, percent

	2021	2022(f)	2022(i)
<b>Primary Sector</b>	<b>-4.1</b>	<b>1.6</b>	<b>0.2</b>
Agriculture	-8.0	1.0	0.1
Livestock	6.0	0.5	0.0
Forestry, fishery and mining	8.0	8.4	0.1
<b>Secondary Sector</b>	<b>5.2</b>	<b>3.5</b>	<b>1.2</b>
Manufacturing	7.2	3.8	0.7
Construction	13.5	4.5	0.3
Electricity & water	-8.4	1.5	0.1
<b>Tertiary Sector</b>	<b>7.1</b>	<b>4.3</b>	<b>2.1</b>
Public Administration	-2.5	2.6	0.2
Trade	14.0	3.0	0.3
Other Services	8.0	5.3	1.6
<b>Taxes</b>	<b>5.5</b>	<b>4.0</b>	<b>0.3</b>
<b>GDP at market prices</b>	<b>5.0</b>	<b>3.7</b>	<b>3.7</b>
<b>GDP w/o agriculture and binationals</b>	<b>7.5</b>	<b>4.1</b>	

Source: Central Bank of Paraguay

(f): Forecast.

(i): Incidence.

**In the Eurozone, there has been an improvement in the growth prospects for 2021 and a deterioration for 2022.** In the third quarter of 2021, a 2.2% increase of GDP was verified as compared to the previous quarter, driven by improvements in consumption and exports. The most recent data of the manufacturing indicator (PMI) showed a slower expansion pace as compared to the levels verified in the third quarter, standing at 58.4 in November. As regards the growth prospects, an annual growth rate of 5.1% is foreseen for 2021 (5.0% in the previous IPoM report); and for 2022, a growth rate of 4.2% is predicted (4.3% in the September IPoM). Regarding prices, the inflation rates were higher than those registered in the third quarter of 2021, standing at 4.9% y-o-y in November. Regarding monetary policy, the European Central Bank (ECB) has maintained its benchmark interest rates and has announced the beginning of the gradual reduction of its asset purchases during the upcoming quarters.

**In China, lower economic growth rates are foreseen for both 2021 and 2022.** The most recent data for the manufacturing sector's PMI (49.9 in November 2021) showed a deceleration, explained partially by the resurgence of Delta variant contagions and the zero tolerance policy implemented in the country, and by the problems related to energy outages and supply chain disruptions. Thus, the growth forecasts for 2021 decreased from 8.2% to 8.0% annually; for 2022, the growth prospects fell from 5.5% to 5.2%.

**In Brazil, the growth prospects have deteriorated, while inflation remains high.** In the third quarter of 2021, a slight decrease of 0.1% in GDP was registered compared to the previous quarter, explained mainly by negative results in the agriculture and livestock sectors. In addition, the manufacturing PMI showed less dynamism since September, reaching a contraction zone (49.8 in November). In this context, the growth projections for the Brazilian economy were revised downwards with respect to the September IPoM, going from 5.2% to 4.9% for 2021 and from 1.9% to 0.8% for 2022. As for prices, inflation remained high, reaching a level of 10.7% y-o-y in November. In this context, the Central Bank of Brazil's Monetary Policy Committee (Copom) increased the SELIC rate by 300 basis points, during the period October to December 2021, to stand at 9.25% annually.

### Economic growth and current account

Annual change, percent

	2021	2022(f)
<b>GDP</b>	<b>5.0</b>	<b>3.7</b>
<b>Domestic demand</b>	<b>9.2</b>	<b>5.1</b>
<b>Gross capital formation</b>	<b>24.7</b>	<b>8.3</b>
Gross fixed capital formation (GFKF)	18.3	4.6
<b>Total consumption</b>	<b>5.1</b>	<b>4.1</b>
Private consumption	5.6	4.5
Public consumption	2.5	2.5
<b>Exports of goods and services</b>	<b>3.6</b>	<b>-2.1</b>
<b>Imports of goods and services</b>	<b>17.3</b>	<b>2.2</b>
<b>Current account (% of GDP)</b>	<b>0.6</b>	<b>-1.0</b>
GFKF (% of nominal GDP)	21.8	21.6

Source: Central Bank of Paraguay

(f): Forecast.

**In Argentina, the growth prospects have improved, and a slight reduction of inflation has been registered.** The GDP data in the third quarter showed a growth rate of 4.1% compared to the previous quarter. In the fourth quarter, the available monthly data for October showed an inter-annual expansion rate of 6.7% for economic activity and an inter-annual increase of 4.3% for output in the manufacturing sector. In this context, the economic growth forecast for 2021 increased from 7.2% to 8.0%, while for 2022 the forecast stood at 2.2% (2.3% in the previous report). As regard price levels, a moderation of inter-annual inflation was observed, standing at 51.2% y-o-y in November (52.5% y-o-y in September). The Central Bank of the Republic of Argentina (BCRA) has maintained the minimal LELIQ rate at 38% annually since November 2020, while the government has implemented additional price control measures.

### Domestic Situation and Monetary Policy

**Economic activity and internal demand have continued to expand as compared to the previous year, in a context where the health situation has remained favorable, allowing for a greater mobility and the opening of the economy.** In the third quarter, the GDP grew 3.8% y-o-y, driven by services, construction, manufacturing, and livestock production, while agriculture and the electricity & water sector registered retractions. On the side of expenditures, gross fixed capital formation and private consumption largely explained the results. Together with the favorable performance of internal demand, imports have also shown an important rebound. At the end of the third semester, the cumulative variation of GDP stood at 5.8%. According to the short-term indicators, economic activity would continue to expand during the fourth quarter. Regarding the health scenario, even though there has been a slight increase in the number of COVID-19 contagions, the situation remained contained, favoring economic performance, especially in the services sector.

**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 high prices of commodities and the greater external demand for Paraguayan beef.** Between October and November 2021, the inter-annual inflation average was 7.5%, greater than the 5.7% verified in the third quarter of the year, and also above the 2% average

### Inflation projection

Annual change, percent

	2020	2021(f)	2022(f)	2023(f)
December CPI inflation (*)	2.2	7.1	4.5	
CPI inflation in around two years (**)				4.0
December underlying CPI (*)	2.2	7.0	4.5	
Underlying CPI inflation in around 2 years (**)				4.0

(f) Forecast

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

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

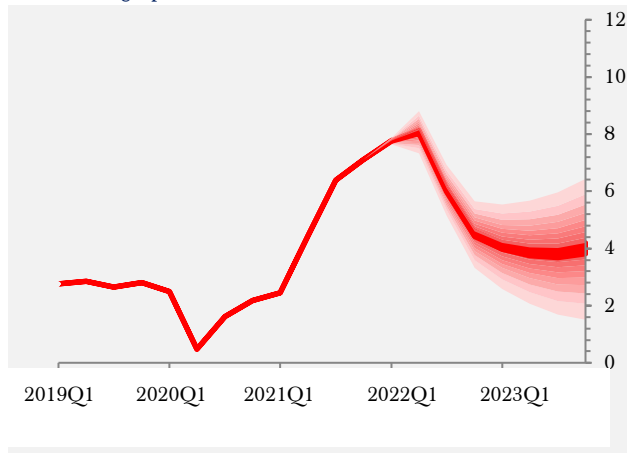
Source: Central Bank of Paraguay

registered in the fourth quarter of the previous year. Notwithstanding, it is important to point out that the monthly inflation rate moderated in November, as compared to the previous months, due to a lower increase in the prices of food items and fuels. On the other hand, underlying X1 inflation (which excludes fruit & vegetables, tariffed services, and fuels) and core inflation averaged inter-annual rates of 6.1% and 4.7%, respectively (5.1% and 3.5%, in the third quarter). When excluding the prices of energy and food items from the Consumer Price Index (IPCSAE), inter-annual inflation averaged a variation rate of 2.7% in the reference period, above the 2.1% registered in the third quarter.

**In the last two months of 2021, the Monetary Policy Committee (CPM) increased the reference rate by 250 basis points, to stand currently at 5.25% annually.** As regards the international scenario, the improvement of the global production indicator was highlighted and it was stressed that inflation continues to remain high in the main advanced economies. The prices of petroleum and natural gas moderated towards the end of 2021, although they have remained at high levels. Likewise, during the meetings of the Monetary Policy Committee (CPM), the initiation and later acceleration of the pace of the reduction of asset purchases by the United States Federal Reserve was emphasized. Regarding the pandemic, the worsening of the contagion levels in the United States and in various European countries was mentioned, while, in the region, the health situation was more favorable. At the domestic level, the economic activity continued with positive dynamism, leading to an upward revision of the growth projection for 2021. As for inflation, the high rates of inflation have continued to be explained by the prices of food items and fuels. Taking into account the better economic outlook, it was highlighted that the second-round effects of external shocks could become more relevant, as well as exert a negative incidence on the medium-term inflation expectations. In order to mitigate these risks, the CPM decided to continue with the cycle of adjustments announced in October, increasing the monetary policy rate (MPR) by 125 basis points in November and by 125 basis points in December.

### CPI inflation forecast

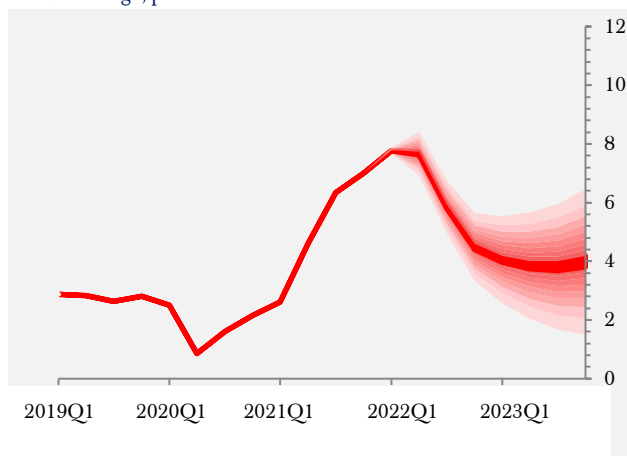
Annual change, percent



Source: Central Bank of Paraguay.

### Underlying CPI inflation forecast

Annual change, percent



Source: Central Bank of Paraguay.

### Baseline Scenario Projections

In the baseline scenario, the GDP annual growth projection for 2021 was revised upwards from 4.5% to 5.0%, and for 2022, a growth rate of 3.7% is foreseen. The economy rebounded in the second quarter and it is projected to close the year with a 5% expansion. This growth would be sustained by the economic results of commerce, expected to reach 14%, as well as the dynamism of other services<sup>†</sup> and manufacturing, with increases estimated to reach 8% and 7.2%, respectively. On the side of demand, private consumption and investment have been the most dynamic components of expenditures, with projected growth rates of 5.6% and 18.3%, respectively. For 2022, it is expected that the economy will grow around 3.7%, explained mainly by manufacturing, construction, and other services (supply). Meanwhile, on the side of expenditures, it is forecasted that there will be a positive incidence of domestic demand. The reduction of health restrictions will continue to contribute towards the recovery of the private consumption of goods and services, which are expected to expand around 4.5%. Investments would grow by around 4.6% and imports are expected to increase by 2.2%; however, exports are expected to register a 2.1% drop.

The inflation projection for 2021 was adjusted from 6.7% to 7.1%, while for 2022 the forecast is 4.5%. In the fourth quarter, prices continued to be affected by supply shocks, concentrated mainly in food products and energy goods. This situation, predominant in the first half of the fourth quarter, elevated the inter-annual inflation rate above what was initially projected, thereby increasing the baseline for both short-term and medium-term forecasts. Considering 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, mainly due to the lower comparison base. Starting in the third quarter, a moderation of inflation is foreseen, and it is expected that inflation would stand at 4.5%, towards the end of the year 2022, converging to the target over the monetary policy horizon, in the fourth quarter of 2023.

<sup>†</sup> The category Other Services includes financial intermediation, housing rentals, services provided to businesses, hotels & restaurants, and services provided to households.

## Risk Scenarios

**At the international level, the growth prospects of the world economy for 2022 were revised downwards, in the face of the uncertainty caused by the SARS-CoV-2 variant known as Omicron.** Although the studies related to this variant are preliminary, the high transmission rate of Omicron and the potential lower efficacy of vaccines against this strain are matters of concern. Meanwhile, policy decision makers await further information about the severity of contagions caused by the Omicron variant. Therefore, as has been observed in some European countries during the final weeks of 2021, new restrictive measures to contain the health crisis might be extended into 2022. To mitigate this risk, it is important to accelerate the vaccination process, including booster shots for those who have already received the two doses of coronavirus vaccines.

**For 2022, a slight reduction in the prices of food commodities and greater stability is expected; however, various risks remain that could generate important changes. These risk factors include the evolution of the weather conditions known as La Niña, the increasing prices of agricultural fertilizers, and the greater use of food crops for the elaboration of biofuels.** As regards the prices of energy commodities, although these are expected to remain high in light of the recovery of demand and the recent energy shortages in Europe; if there are greater restrictions for the mobility of the population to contain the health crisis, energy prices might decrease significantly. On the other hand, new measures or regulations for power companies might be instated due to the commitments made by governments regarding the reduction of emissions at COP26<sup>†</sup> that would exert pressure on the prices of fossil fuels and non-renewable energy commodities. Likewise, it is foreseen that the disruptions of the global supply chains will be prolonged, especially if China continues with its policy of zero tolerance of COVID-19, which might lead to temporary closings of more secondary ports and sea transport operations. In this way, the risks for world inflation in 2022 remain, even though processes for the normalization of monetary policy - which are intended to mitigate inflationary pressures - continue in both advanced and emerging economies.

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<sup>†</sup> 2021 United Nations Climate Change Conference

Paraguay's main trade partners in the region continue to be exposed to the deterioration of their fiscal accounts, while recent increases of COVID-19 contagions point towards the risk of a deterioration of the health situation. In Brazil, prospects for 2022 have weakened recently due to leading indicators that suggest a slower pace of economic activity, high inflationary pressures and an increase in the country risk, in line with a potential deterioration of the fiscal accounts. Moreover, the future growth of the Brazilian economy could be further revised downwards if the disruptions of production chains are prolonged for a greater period of time, negatively affecting business confidence. Likewise, the need for a more contractive monetary policy stance to fight inflation might have an incidence on the dynamism of economic activity. In Argentina, in addition to the risk of the fiscal situation and the country's external vulnerability given the reduction of its international reserves, the recent increase of new cases of COVID-19 contagion is also highlighted, which exacerbates the risk of a new wave of infections in Argentina.

**In the domestic context, the main risk factors are related to the evolution of climatic conditions and the COVID-19 pandemic.** Since the closing days of October, the number of new COVID-19 contagion cases has increased, although the number is minimal as compared to the peaks observed at the end of May. However, the risks remain latent, taking into account the appearance of new strains of the virus. Given this scenario and, in the light of international experience, the steady process of vaccination continues to be a fundamental factor to mitigate the health and economic impact of an eventual outbreak of COVID-19. On the other hand, the weather has evolved favorably since the end of November, allowing for a favorable advance in crop farming, especially of soybeans. However, in December, soils exhibited insufficient humidity, which could significantly affect crop yields.