



MONETARY POLICY REPORT

December 2022



Pilar-Ñeembucú

CENTRAL BANK OF PARAGUAY
Federación Rusa y Augusto Roa Bastos
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Asunción-Paraguay

Executive Summary*

World growth

Annual change, percent

	September 2022		December 2022		
	2022	2023	2021	2022	2023
World	2.9	2.5	6.0	2.9	2.2
United States	1.6	0.7	5.9	1.8	0.4
Eurozone	3.0	0.2	5.3	3.2	-0.1
China	3.3	5.0	8.1	3.0	4.9
Brazil	2.5	0.9	4.8	3.0	0.8
Argentina	3.5	0.9	10.4	4.9	0.7
Trading partners	2.4	0.8	7.7	3.2	0.6
Mercosur partners	3.1	1.0	7.7	4.1	0.8

Source: Bloomberg

International and Regional Economy

The growth prospects for the world economy have deteriorated for next year compared to those presented in the September Monetary Policy Report (IPoM), in a context in which price levels remain high, even though less inflationary pressures have been verified in some countries.

The more restrictive monetary conditions, the prolongation of the war in Ukraine, energy supply problems in the European continent, and uncertainty about the health situation in China explain the deterioration of the outlook for the next twelve months. Since the previous IPoM report, the prices of determined agricultural commodities have decreased while crude oil prices have shown volatilities in the period. Inflation in the main advanced economies remains high, and the monetary authorities in these countries have continued to increase their reference rates. In the region, the economic prospects of the principal trading partners have improved for 2022 yet have worsened for 2023. Inflation has moderated in some countries within the region and has accelerated in others, whereby certain central banks have maintained their monetary policy rates and others have continued with the cycle of upward adjustments.

In the United States, the Federal Reserve (Fed), at its last meeting, continued with increases of the target range of its referential rates given the persistently high level of inflation, which, however, is increasing at a slower pace. Since the previous report, inflation registered lower rates, standing at 7.1% y-o-y in November, but still well above the 2% target. At its November and December meetings, the Fed again increased the target range for federal funds rates, by 75 basis points (bps) and 50 bps, placing it at 4.25% - 4.50%. As regards economic activity, in the third quarter of 2022, GDP exhibited a quarterly annualized growth rate of 3.2%, surpassing the market's forecasts, mainly due to increases in exports, consumer spending, non-residential fixed investment, and public spending. The most recent data of the Purchasing Managers' Index (PMI) showed that the

* The Spanish version prevails.

Gross Domestic Product by sectors

Annual change, percent

	2022	2023(f)	2023(i)
Primary Sector	-9.2	20.2	1.9
Agriculture	-13.0	30.0	1.8
Livestock	-2.5	2.3	0.1
Forestry, fishery and mining	1.3	1.4	0.0
Secondary Sector	0.8	2.2	0.7
Manufacturing	1.0	2.0	0.4
Construction	-3.0	0.5	0.0
Electricity & water	4.7	4.8	0.3
Tertiary Sector	1.7	3.2	1.6
Public Administration	0.5	3.7	0.3
Trade	4.5	3.2	0.4
Other Services [†]	1.0	3.1	0.9
Taxes	0.7	4.0	0.3
GDP at market prices	0.2	4.5	4.5
GDP w/o agriculture and binationals	0.9	2.7	

Source: Central Bank of Paraguay

(f): Forecast.

(i): Incidence.

sector decelerated in the fourth quarter, standing in contraction zone in November (47.7). In this scenario, the growth prospects were revised upwards from 1.6% to 1.8% for 2022 and were revised downwards for 2023, dropping from 0.7% to 0.4%.

In the Eurozone, the European Central Bank (ECB) again rose its official interest rates, decreasing the magnitude of the adjustment, while inflation reached a record high during the fourth quarter. Inflation accelerated in October, reaching a historical peak of 10.6% y-o-y, and then slowed down in November (10.1% inter-annually). Given this scenario, the European Central Bank (ECB) raised the three official interest rates by 50 bps, at its December meeting. As regards economic activity, in the third quarter of 2022, there was an increase of 0.3% in GDP as compared to the previous quarter, driven mainly by the positive contributions of spending for final household consumption, gross fixed capital formation, and, to a lesser extent, the variation of inventories. On the other hand, the manufacturing PMI remained in contraction zone during the fourth quarter, standing at a level of 47.1 in November. As regards the growth prospects, they have improved for 2022, (increasing from 3.0% to 3.2%), due to the results of economic activity indicators that surpassed the initial estimates. Notwithstanding, the deceleration foreseen for 2023 has worsened, and it is expected that GDP will fall by 0.1%, in line with the prolongation of the war in Ukraine, difficulties in the supply of energy to the Continent, and the hardening of financial conditions.

In China, the health situation has deteriorated recently, affecting growth prospects for the year, and generating more uncertainty about the forecasts for the upcoming year. The annual growth estimate for the Chinese economy was reduced for the current year by 0.3 p.p., standing at 3.0% annually, due to the restrictions and confinement measures imposed during the last months of the year to curb the spread of COVID-19 contagions. In this context, GDP for the fourth quarter is expected to grow 2.9% y-o-y, below the rate reported in the previous quarter (3.9% inter-annually). Notwithstanding, recently there have been social protests against the government's strict strategies for fighting COVID-19, which has led to the easing of the contention

[†] "This includes transportation, financial intermediation, housing rentals, business services, hotels & restaurants, and services provided to households."

Economic growth and current account

Annual change, percent

	2022	2023(f)
GDP	0.2	4.5
Domestic demand	2.9	-0.7
Gross capital formation	8.8	-10.6
Gross fixed capital formation (GFKF)	-1.1	0.5
Total consumption	1.0	2.7
Private consumption	2.2	2.8
Public consumption	-5.5	2.3
Exports of goods and services	-5.4	12.4
Imports of goods and services	2.8	-4.2
Current account (% of GDP)	-6.2	0.4
GFKF (% of nominal GDP)	23.4	22.7

Source: Central Bank of Paraguay

(f): Forecast.

measures and could allow for greater dynamism of economic activity in the coming year. This situation compensates, in part, the complex outlook regarding latent difficulties in the real estate sector and a lower than anticipated external demand. The forecast for 2023 stands at 4.9%, slightly below the level foreseen in the previous IPoM (5.0%).

In Brazil, the growth forecasts for 2023 show a deceleration, while inflation continues to moderate. In the third quarter, GDP showed an expansion of 0.4% as compared to the previous quarter, given the positive incidence of gross fixed capital formation, private consumption, and government consumption. Thus, the growth projection for the Brazilian economy was revised upwards from 2.5% to 3.0% for 2022. In the fourth quarter, the deterioration of the manufacturing sector's PMI stood out; the index was in contraction zone due to drops in output and new orders, driven, in part by uncertainty about the public policies to be implemented by the new government. This situation, together with the global economic deceleration foreseen for next year, is reflected in the slight deterioration of growth estimates for 2023 (dropping from 0.9% to 0.8%). On the other hand, inter-annual inflation has decelerated significantly, largely due to the reduction of prices in the transportation category, registering a rate of 5.9% in November (7.2% y-o-y in September). Since the last report, the Central Bank of Brazil's Monetary Policy Committee (Copom) has maintained the SELIC rate at 13.75% annually.

In Argentina, an improved rate of growth is expected for 2022, while the prospects show a slight deterioration for the coming year. In the third quarter, GDP grew 5.9% y-o-y, above the expected level, driven by private consumption. In the fourth quarter, the short-term economic activity and manufacturing output indicators registered a favorable dynamism. Thus, the growth rate forecast for 2022 was revised upwards substantially, going from 3.5% to 4.9%. For 2023, a more complex external scenario is foreseen, in a context of high uncertainty about the domestic political overview in which the GDP growth forecast was adjusted downwards by 0.2 p.p., standing at 0.7% annually. As regards price levels, inter-annual inflation continued to accelerate, standing at 92.4% in November (83.0% y-o-y in September). The Central Bank of the Argentine Republic (BCRA) has

maintained the minimum LELIQ rate at 75.0% annually since the last IPoM report.

Domestic Situation and Monetary Policy

Inflation projection

Annual change, percent

	2021	2022(f)	2023(f)	2024(f)
December CPI inflation (*)	6.8	8.6	4.1	
CPI inflation in around two years (**)				4.0
December underlying CPI (*)	6.9	8.3	4.1	
Underlying CPI inflation in around 2 years (**)				4.0

(f) Forecast includes data as of November 2022.

(*) Corresponds to end-of-period inflation.

(**) Corresponds to the projected inflation for the fourth quarter of 2024.

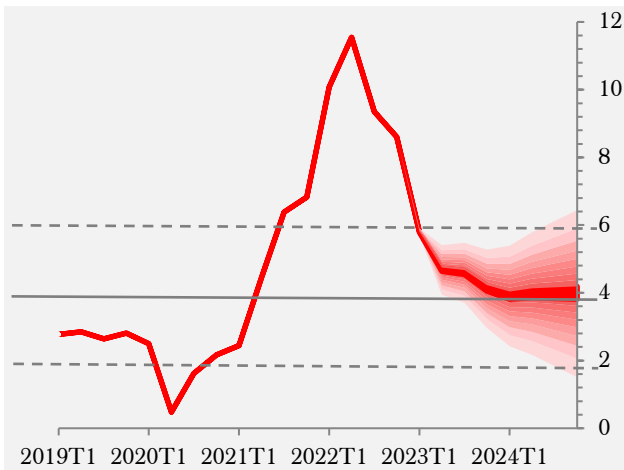
Source: Central Bank of Paraguay

Following the deceleration of total inflation in the third quarter of 2022, a slight rebound was registered in November, explained by increases in the prices of food, fuels, durable goods, and certain services. Average inter-annual inflation in the period October – November was 8.2%, below the level observed in the third quarter (10.3%), although in monthly terms, average inflation registered an increase, rising from 0.4% to 0.6%. The principal price increases within the food category during the two-month period affected volatile items such as fruit and vegetables, while fuel prices registered a punctual increase in November. Likewise, inflation measured by the CPI that excludes food items and energy (IPCSAE) has remained within the target range, even though it showed an increase, at the margin, stemming mainly from the higher prices of imported goods. The second-round effects have moderated, in line with the recent trajectory of the inflation of services. On the other hand, the average of the inflation trend indicators (underlying, underlying X1, and core inflation) was lower in the two-month period October – November as compared to the levels observed in the third quarter, both in monthly and inter-annual terms. Finally, less diffusion of inflation has been noted in recent months.

In the third quarter of 2022, GDP registered a growth rate of 2.8% y-o-y, thus reflecting a recovery of the economy which had been harshly affected by drought in the first quarter of the year. The positive result was explained by the rebound of agriculture with the initiation of the 2022/2023 crops campaign, as well as the favorable performance of services, manufacturing, and the generation of electric power. On the other hand, the construction sector showed an inter-annual contraction. On the expenditures side, GDP expansion was due to private consumption (1.6 p.p.) and gross capital formation (2.9 p.p.), while negative incidences were registered for government consumption (-0.5 p.p.) and net exports (-1.2 p.p.) Thus, GDP presented a cumulative rate of -0.6% at the end of the third quarter. According to the short-term indicators of economic activity, GDP for the fourth quarter would close with a positive annual rate,

CPI inflation forecast

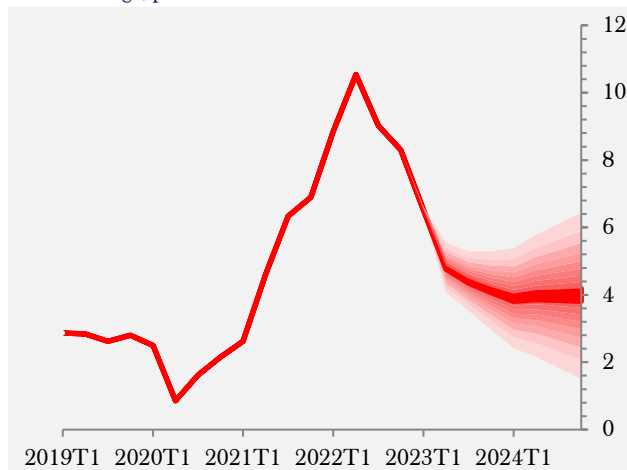
Annual change, percent



Source: Central Bank of Paraguay.

Underlying CPI inflation forecast

Annual change, percent



Source: Central Bank of Paraguay.

driven mainly by the positive results of agricultural activity and greater production of electrical energy by the bi-national hydroelectric entities.

The Monetary Policy Committee (CPM), at its November and December meetings, decided to maintain the MPR at 8.50% annually. The Committee continued to highlight the moderation in commodity prices, as well as the lessened prospects of economic growth in 2023, both for the region and worldwide. Likewise, it stressed the weakening of the dollar and the decrease in sovereign bond yields in the United States, following the release of lower-than-expected inflation data. As for prices, most of the countries in the region showed an acceleration of inter-annual inflation in November, after having registered lower rates in October. In this regard, some central banks have continued to raise their monetary policy rates, while others have decided to maintain their current rates. At the local level, although a slight increase in inflation was observed in November, the CPM highlighted that the trajectory was consistent with the latest projections. Finally, the CPM stressed that inflation expectations over the monetary policy horizon have decreased to stand at the 4% target. For this reason, at its last two meetings of the year, the Committee decided to maintain the reference rate at 8.50% per annum, considering that the contractionary stance of monetary policy could contribute to the gradual convergence of inflation to the target toward the end of 2023.

Baseline Scenario Projections

In the baseline scenario, the GDP growth projection for 2022 remains at 0.2%, and an expansion of 4.5% is foreseen for 2023. After a first semester marked by an important fall in activity, triggered by the severe drought that affected the economy towards the end of 2021 and beginning of 2022, the data compiled in the Monthly Indicator of Economic Activity (IMAEP) have started to show signs of recovery since August. This indicator has registered a rising trajectory in the last few months, and it is expected that GDP growth will converge at 0.2% by the end of 2022, in line with the projections given in the last IPoM report. For 2023, GDP is projected to grow by 4.5%, mainly due to the recovery of agriculture during the first semester after the meager performance registered in 2022. In addition, moderate

expansions in manufacturing, electricity & water sector, and services is foreseen. From the expenditures side, there would be a greater dynamism of net external demand and, to a lesser extent, of domestic demand.

The inflation projections for 2022 and for 2023 have remained at 8.6% and 4.1%, respectively[‡]. As expected, the lower external price pressures observed as of the third quarter, the moderate dynamism of domestic economic activity (negative product gap), and the transmission of the monetary policy rate adjustments to key macroeconomic variables contributed to contain the acceleration of domestic inflation in the last few months. Thus, the projections of inflation for 2022 and for 2023 have remained at 8.6% and 4.1%, respectively, the same levels projected in the September IPoM. Notwithstanding, it is expected that inflation will enter the target range earlier than forecast in the previous Report and that it will converge gradually to the center of the target towards the end of 2023.

Risk Scenarios

The international scenario remains complex, and uncertainty continues regarding both the economic prospects and world inflation. The intensification of the war in the Ukraine or the escalation of other geopolitical conflicts could deteriorate global economic growth. In addition, if the energy crisis in Europe exacerbates, due to supply problems with Russia, this could imply greater economic deceleration than expected. On the other hand, a scenario of a health crisis in China, given the recent upsurge of COVID-19 cases and the potential collapse of the health system, could affect the Chinese government's latest decision to lift its strict confinement restrictions. This might imply a reinstatement of restrictions on the mobility and activities of the population. However, such a scenario would represent downward pressures on world inflation, due to the lower prices of crude oil and food commodities. On the other hand, the occurrence of new inflationary surprises in the advanced economies might lead to greater increases of their referential rates, and, in turn, could lead to the hardening of international financial conditions, and also foster the strengthening of the United States dollar, with

[‡] Projections published at the Conference “Evaluation of 2022 and Perspectives for 2023: Structural Reforms as the Motors of Sustainable Growth”, December 14, 2022. For more information, visit the link: <https://www.bcp.gov.py/economia-paraguaya-crecera-4-5-en-2023-impulsada-principalmente-por-el-agro-y-la-manufactura-agropecuaria-n1838>

negative effects on capital outflows towards emerging markets, currency depreciations, and pressures on fiscal accounts, especially in those countries with high indebtedness expressed in foreign currency.

As regards the region, the uncertainty about the political environment in several countries persists, which could imply greater perception of risks by international investors. Recent elections and upcoming ones in various South American countries have generated uncertainties about the consistency of the public policies to be implemented in the future. In Brazil, particularly, the confidence of both consumers and business entrepreneurs has worsened, due to the perception that the prospects of the deterioration of the country's primary fiscal balance have become more pronounced, given the government's intentions to continue with its social transfers programs and to expand the public expenditure ceiling. Thus, a scenario that involves the deanchoring of fiscal expectations, a greater depreciation of the Brazilian real, and the increase of its risk premium is likely. As regards Argentina, if the targets agreed upon with the International Monetary Fund are not reached, this could generate a market reaction, whereby elevating risk premiums and exerting exchange rate pressures on the peso. The upcoming elections in 2023 entail a greater degree of uncertainty about the achievement of the goals.

At the local level, the risks for the growth of the economy derive mainly from the evolution of the weather. In the last few months, the climate conditions have improved significantly, and therefore the prospects about the results of the 2022/2023 agricultural campaign are quite positive. However, soil moisture deficits were present in December, for which reason the threats of a new drought period due to the weather phenomenon "La Niña" persist. Even so, the predictions of ample rainfall in January 2023 point towards optimistic results for the development of crops.