



MONETARY POLICY REPORT



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CENTRAL BANK OF PARAGUAY

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Asunción · Paraguay





Executive Summary*

International and Regional Economy

Inflationary pressures have continued to moderate globally, in a context of tighter financial conditions and less pressures derived from commodity prices. The reference interest rates of the leading advanced economies have continued to increase, while, in the region, the central banks have started to reduce their respective monetary policy rates. Despite tighter financial conditions, the global economy has been more resilient than previously anticipated and, consequently, the global growth forecast has improved slightly for 2023, increasing from 2.6% to 2.8%.

In the United States, the economy has shown a better-than-expected performance and growth projections for 2023 were adjusted upward from 1.3% to 2.1%. In particular, robust consumption and investment indicators and the resilience shown by the labor market are highlighted. Total inflation showed a certain rebound in the third quarter, due mainly to the increase of housing and energy prices. As regards monetary policy, the Federal Reserve (Fed) increased the target range for federal funds rates in July and kept these rates unchanged in September. In this scenario of high interest rates and some signs of easing conditions in the labor market, it is expected that expenditure will moderate towards the end of this year and could lead to a slowdown in GDP growth in 2024.

In contrast, the prospects for the Eurozone and China have weakened as compared to the previous IPoM report. In the Eurozone, the deterioration of the growth projection for 2023 (from 0.6% to 0.5%) is explained by the more restrictive financial conditions following the additional hikes of ECB's interest rates. On the other hand, the economic recovery of China has lost momentum in the second quarter, attributed largely to weak demand and the deepening problems in its real estate sector. In this context, growth projections for this year were revised downward, from 5.5% to 5.0%.

In Brazil, the growth forecast was adjusted upward due to better results in the second quarter. In this period, GDP grew 3.4% inter-annually, above market expectations (2.7%), explained by the positive performance of consumption (both private and public sectors) and exports. Regarding prices, a rebound in inter-annual inflation was verified in the last few months, although monthly rates have continued at levels compatible with the target range. At its August and September meetings, the Central Bank of Brazil reduced the SELIC rate to 12.75% annually. In this context of better-than-expected results in economic activity, coupled with the potential boost from a less contractionary monetary policy, the growth projection for this year was revised upward, from 2.1% to 3.0%.

In Argentina, an economic contraction is foreseen for 2023 along with higher inflation. GDP in the second quarter exhibited a sharp drop due to the impact of a drought that affected both farming activity and livestock production, and which consequently affected the country's exports. The leading indicators suggest that activity remained weak in the third quarter. On the other hand, a greater acceleration of inflation was observed, reaching an inter-annual rate of 138.3% in September. In the most recent period, a high volatility has been observed in financial

*The Spanish version prevails



markets, due to the increase in uncertainty regarding the upcoming Presidential elections and the policies that might be implemented by the next elected administration.

Domestic Situation and Monetary Policy

Economic activity has continued with positive dynamism in the last few months. In the second quarter, the GDP registered a growth rate of 5.9% inter-annually (0.8% inter-quarterly in the seasonally adjusted series), explained by the positive results of agriculture, the generation of electric power, services, and manufacturing. However, construction and livestock production showed a contraction. The GDP that excludes agriculture and the binational hydroelectric entities expanded by 2.6% y-o-y (1.1% inter-quarterly in the seasonally adjusted series). On the expenditures side, inter-annual growth of private consumption, gross fixed capital formation, and net exports was observed. According to the Monthly Indicator of Economic Activity (IMAEP), it is expected that economic activity will continue to exhibit a positive inter-annual rate in the third quarter.

Total inflation and its different trend measures have continued to show a downward trajectory since the last IPoM report. The factors that have contributed to the deceleration of inflation in the last few quarters are the lower pressures stemming from the external scenario (particularly the prices of commodities), the restrictive stance of monetary policy, and market expectations that are in alignment with the inflation target. In September, CPI inter-annual inflation was 3.5%, below the rate registered in June (4.2%). The inter-annual inflation rate of the CPI that excludes food and energy items (IPCSAE) decreased from 5.1% to 4.6% y-o-y in this period. Likewise, the monthly rates for these indicators remained at low levels in the third quarter (average of 0.1% for the total CPI and 0.3% for the IPCSAE).

During the third quarter, the Monetary Policy Committee (CPM) decided to reduce the MPR, by 50 basis points (bps), to stand at 8.00% at the end of September. In the last few months, the domestic macroeconomic scenario has evolved favorably. On one hand, inflationary pressures have continued to moderate, and on the other, activity and demand indicators have continued to show signs of recovery. In addition, in the reference period, inflation expectations for all the horizons stand at the 4% target. In these conditions, the Committee decided to decrease the referential rate by 25 bps at its August meeting, and by 25 bps at the September meeting. The CPM deemed it prudent to gradually reduce the reference rate, considering that risks derived mainly from the external scenario persist, which could eventually impact on the behavior of local prices.

Projections and Risks

The GDP growth forecast for 2023 remained at 4.5%, although there were some internal recomposition adjustments (Table A). In the primary sector, the recovery of agriculture continues to largely explain GDP growth, although lower growth is expected in agriculture, as compared to the previous revision (decreasing from 30% to 22.5%). Less wheat and corn output justifies the downward adjustment. For its part, livestock production exhibited a lower-than-expected slaughter rate, in line with lower export prices and the uncertainty about external demand. Accordingly, it is estimated that livestock production will contract by 0.9% in 2023 (1.8 p.p. below the previous report). In the secondary sector, manufacturing was adjusted downward (decreasing from 1.7% to 1.1%), due to the weaker dynamism expected for the sub-sectors associated with farming and livestock endeavors. However, greater generation of electric energy by the binationals allowed for an upward revision of the projection for the



electricity & water sector, increasing from 10.3% to 13.8%. Regarding the construction sector, a 4% retraction continues to be projected for this year. As regards the tertiary sector, more favorable than expected dynamism has been observed, accompanied by positive expectations for the last quarter of 2023. Greater growth is foreseen for trade (increasing from 2.9% to 5.2%), explained mainly by the boost in imports subject to the Tourism regime. Likewise, positive performances were registered for hotels & restaurants, business services, services provided to households, financial intermediation, and government services, which allowed for upward adjustments of other services (from 3.2% to 3.4%) and the government sector (increasing from 3.7% to 4.5%).

In the revision of GDP growth on the expenditure side, greater export and import volumes are expected, as well as a lower contraction of fixed investment (Table B). The upward adjustment in the export of goods and services (increasing from 19.1% to 26.2%) is explained by greater exports of electrical power, and re-exports, as compared to the values foreseen in the previous report. Greater growth is expected for imported goods and services (from 1.5% to 7.8%), explained mainly by the important expansion of imports subject to the Tourism regime. The favorable dynamism of imports of machinery and equipment related to agricultural activities also explains the upward revision. As regards domestic demand, less contraction of gross fixed capital formation is expected (from -3.0% to -2.5%), in line with the performance of machinery & equipment imports. Lastly, greater growth is expected for public consumption (increasing from 2.4% to 7.2%), whereas the expected expansion of private consumption remained with no changes at 3.2%.

The inflation projection for the end of 2023 was adjusted downward from 4.1% to 3.8%, while for 2024 it remained at 4%. These results are explained largely by the lower pressures on commodity prices observed during most of the third quarter. At the domestic level, a more rapid moderation of total inflation was verified at the beginning of this quarter, explained by food and fuel prices. While a rebound in inflation was registered in September – due to the increase of the prices of fuels and beef – the observed data stand below the levels foreseen in the previous IPoM report. Looking forward, in consideration of the most likely assumptions about the future behavior of both the internal and external macroeconomic variables, and in the absence of new shocks, inter-annual inflation is expected to continue its process of convergence towards the center of the target range in the next few months. It is expected that inter-annual inflation will oscillate at around 4% starting in the third quarter of 2024 and over the monetary policy horizon (Table C).

The main risks for inflation stem from the international scenario. The most relevant threats are a slower pace of convergence of global inflation, high international interest rates for longer, lower risk appetite and uncertainty about the evolution of petroleum prices. The resilience of the United States' economy and the recent rebound in energy prices are factors that could slow the convergence of inflation in that country. In this scenario, the Federal Reserve might maintain its reference rates at high levels for a longer period than previously anticipated. For emerging and developing economies, this would imply more restrictive financial conditions, and could eventually lead to capital outflows and pressures on their respective currencies. Likewise, risk premiums could increase in this context of greater uncertainty. As regards commodity prices, the global slowdown, particularly in China, might contribute to either stabilize or decrease the prices of agricultural and energy commodities. However, cuts in the supply of crude oil and the recent armed conflict in the Middle East have increased the volatility of petroleum prices, marked by an upward bias. In this regard, in addition to the upward risks in fuel prices, a divergence in the evolution of energy and food commodity prices could deteriorate the terms of trade of the countries that export agricultural commodities. As regards the performance of



Paraguay's main trading partners, the uncertainty about the outcome of the electoral process in Argentina is highlighted.

At the local level, the foremost risk for economic activity continues to be related to weather conditions. In the previous IPoM, the negative effects that the climate event “El Niño” might have on economic activity was highlighted. Such effects have already materialized in the agricultural sector, resulting in lower yields of wheat crops due to the excess moisture of soils. At the present, the risk linked to the “El Niño” phenomenon has decreased. However, the probability of insufficient rainfall has increased, particularly in the Northern zone of the Eastern region, where the sowing of soybeans has been delayed. However, it is important to mention that at the close of this report, the scenario has become more favorable due to the latest rains recorded.

Table A. Gross Domestic Product Growth by sectors. Annual change, percent.

	2022	2023(f)	2023(i)
Primary Sector	-8.7	15.0	1.4
Agriculture	-12.7	22.5	1.4
Livestock	-0.3	-0.9	0.0
Secondary Sector	0.4	2.6	0.9
Manufacturing	0.1	1.1	0.2
Construction	-4.3	-4.0	-0.3
Electricity & water	6.8	13.8	0.9
Tertiary Sector	1.6	4.0	2.0
General government	-0.5	4.5	0.4
Trade	3.4	5.2	0.6
Other Services	1.6	3.4	1.0
Taxes	0.5	4.0	0.3
GDP at market prices	0.1	4.5	4.5
GDP w/o agriculture and binationals	0.7	2.6	

(f) Forecast. (i) Incidence

Source: Central Bank of Paraguay

Table B. Economic growth and current account. Annual change, percent.

	2022	2023 (f)
GDP	0.1	4.5
Domestic demand	2.5	-1.0
Gross fixed capital formation	-2.3	-2.5
Total consumption	1.0	3.8
Private consumption	2.2	3.2
Public consumption	-5.7	7.2
Exports of goods and services	-1.6	26.2
Imports of goods and services	5.6	7.8
Current account (% of GDP)	-7.2	0.2

(f) Forecast. (i) Incidence

Source: Central Bank of Paraguay



Table C. Inflation projection. Annual change, percent.

	2022	2023(f)	2024(f)	2025(f)
December CPI inflation (*)	8.1	3.8	4.0	
CPI inflation around 2 years (**)				4.0
December underlying CPI (*)	7.9	3.9	4.0	
Underlying CPI inflation around 2 years (**)				4.0

(f) Forecast includes data as of September 2023.

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

(**) Corresponds to the projected inflation for the third quarter of 2025

Source: Central Bank of Paraguay