



MONETARY POLICY REPORT



December, 2023

CENTRAL BANK OF PARAGUAY

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Asunción - Paraguay





Executive Summary*

International and Regional Economy

Since the last IPoM, inflationary pressures have continued to moderate globally, in a context of lower commodity prices and tight financial conditions. The reference interest rates of the leading advanced economies have remained high. Notwithstanding, market expectations point to possible rate cuts starting in the first semester of 2024. The central banks in the region have continued to reduce their respective monetary policy rates. The global economy continues to show resilience and third quarter data was more positive than previously expected. Thus, the global growth forecast for 2023 increased marginally to stand at 2.9%.

In the United States, the growth projections for 2023 were adjusted upward from 2.1% to 2.4%, while inflation continues to decelerate. The improvement of GDP was due mainly to increases in consumption and investment, while the labor market remains resilient. The deceleration in total inflation can be attributed to the decrease in energy costs and a slower increase in the prices of food items and shelter. As regards monetary policy, the Federal Reserve kept the target range for federal funds rates unchanged during the fourth quarter and signaled a less restrictive policy at its December meeting. In this context, expectations regarding the first interest rate cut in 2024 have advanced as compared to the market's previous expectations. In the financial markets, long-term bond yields have decreased, the U.S. dollar has weakened, and stock exchange indexes have rebounded in a scenario of lower volatility.

Likewise, the economic prospects for China have improved slightly as compared to the previous IPoM report, while those of the Eurozone have remained unchanged. The upward revision of China's growth prospects for 2023 (from 5.0% to 5.2%) was driven by more positive data in the third quarter, as compared to initial expectations. On the other hand, the Eurozone registered its first reduction of quarterly GDP in the third quarter of 2023, due to lower demand in a context of restrictive financial conditions. Despite this decrease, the growth projection for 2023 remained at 0.5%, while for 2024 it was revised slightly downward, from 0.8% to 0.6%.

In Brazil, the growth forecast has remained stable at 3.0% for 2023 and a moderation is expected for 2024 (1.6%). In the third quarter, GDP grew 2.0% inter-annually, above the 1.8% expected by the market. This result was explained by the favorable dynamism of exports and consumption (private and public). Regarding inflation, it has moderated in the fourth quarter, to stand within the target range set by the Central Bank of Brazil. At its November and December meetings, the Central Bank of Brazil reduced the SELIC rate, concluding the year at 11.75% annually.

In Argentina, the economic contraction for 2023 is now anticipated to be less severe than initially expected, with estimates revised from -3.0% to -2.1%. In the third quarter, GDP showed an inter-annual variation of -0.8%, explained largely by a drop in exports linked to the drought that affected the agricultural sector. On the other hand, an acceleration of inflation was recorded in the fourth quarter, reaching an inter-annual rate of 160.9% in November. The new government administration has implemented a series of economic measures in the recent

*The Spanish version prevails



period to advance towards fiscal balance, however uncertainty about the impact of these measures remains latent.

Domestic Situation and Monetary Policy

Economic activity has continued to exhibit a positive dynamism in the last few months. In the third quarter, GDP registered an inter-annual variation of 3.6% (0.7% inter-quarterly), boosted by the positive results of services, electricity & water, manufacturing, agriculture, and livestock production. However, growth was attenuated by the construction sector. Likewise, the GDP that excludes agriculture and the bi-national hydroelectric entities expanded by 2.9% y-o-y (1.2% inter-quarterly). On the expenditures side, a positive incidence of private and public consumption and of net exports was registered, while gross fixed capital formation decreased inter-annually. 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 fourth quarter, in line with the growth estimates for the economy in 2023.

Total inflation has stabilized below 4% since the last IPoM report, while the trend measures have continued to show a downward trajectory. The reduction of the prices of commodities, the restrictive stance of monetary policy, and inflation expectations in line with the Central Bank of Paraguay's 4% target are key factors that have explained the moderation of inflationary pressures during 2023. In December, CPI inter-annual inflation was 3.7%, slightly higher than the rate registered in September (3.5%). The IPCSAE inter-annual inflation rate decreased from 4.6% to 4.0% y-o-y in the same period.

During the fourth quarter, the Monetary Policy Committee (CPM) decided to reduce the MPR by 125 basis points (bps), to stand at 6.75% at the end of December. Following the CMP's meeting in October, when it decided to decrease the MPR by 25 bps due to external risks, the international macroeconomic scenario has evolved favorably, with signs of the Federal Reserve adopting a less restrictive monetary policy stance and reduced pressures from commodity prices, particularly petroleum. In the domestic scenario, economic activity has maintained a positive dynamism, in line with the GDP growth prospects for 2023. As regards inflation indicators, upward pressures have remained limited, while inflation expectations for all the horizons remain anchored to the 4% target. In these conditions, the Committee decided to decrease the reference rate by 50 bps at its November meeting, and by 50 bps at the December meeting.

Projections and Risks

For 2023, the economic growth forecast remained at 4.5%. This expansion is explained mainly by the positive incidences of agriculture and the generation of electric energy, although manufacturing and services also showed favorable dynamism. Notwithstanding, the retraction of the construction sector attenuated GDP growth. In comparison to the previous revision (IPoM September 2023), the upward adjustments for both livestock production (from -0.9% to 0%) and manufacturing (from 1.1% to 2.3%) are highlighted. The increase in manufacturing is supported by beef output, which exceeded the forecast provided in the last revision. On the side of expenditures, the upward revision of exports and the import of goods and services (from 26.2% to 31.1% and 7.8% to 12.3%, respectively) stands out, in line with an important increase of re-export operations and imports subject to the Tourism regime. Public and private



consumption are expected to increase by 7.2% and 3.0%, respectively. On the other hand, gross fixed capital formation was adjusted downward (from -2.5% to -3.0%) in accordance with the revision of construction.

The GDP growth forecast for 2024 stood at 3.8%, explained by an expansion in all three sectors of the economy (Tables A and B). In the primary sector, a growth rate of 4.2% is expected, based mainly on the favorable climatic prospects that would again favor agricultural production. The expected growth of livestock production (1.6%) is in line with the better prospects for this sector, especially due to the reopening of the United States market and the recent decrease of uncertainty regarding external demand. With respect to the secondary sector, a 4.7% recovery of the construction sector is foreseen, boosted mainly by the private sector. The positive economic prospects, lower interest rates, and the stabilization of inflation near the target level are factors that would contribute favorably to the sector's performance. The positive dynamism projected for construction and the primary sector would also be transferred to the manufacturing industry, with a foreseen growth rate of 3.6%. Likewise, it is anticipated that the El Niño weather phenomenon would have a positive incidence on the water flow of the Parana River, thus allowing for a greater generation of electric energy. Lastly, the expansion of the services sector by around 3.5% is justified by the favorable performance foreseen for trade, services provided to households, and business services, among others. On the side of expenditures, an increase of domestic demand is estimated, explained by the growth of private consumption (3.6%) and a rebound of gross fixed capital formation (5.0%), while exports and imports are also expected to register increases (3.0% and 2.8%, respectively).

The inflation projection for 2024 and over the forecast horizon remained at 4%. During 2023, the restrictive monetary policy, the anchoring of inflation expectations at the middle-term target, and the lower pressures from food and energy commodity prices explain the achieved inflationary results, whereby inflation closed the year at 3.7%, below the target. For 2024, the projection of domestic and external output gaps practically closed, international interest rates that are expected to decrease during the first semester, and an important comparative base for domestic inflation during the first months of next year, led projections to oscillate around the lower limit of the target range during the first quarters of 2024. Later, starting in the third quarter, and in the absence of new shocks, inflation is projected to converge gradually to 4% (Table C).

The risks derived from the international scenario have attenuated as compared to those indicated in the September IPoM; however, these risks persist. Lower external impulse due to greater-than-expected global slowdown and a potential increase in the price of crude oil given the intensification of geopolitical tensions are the most relevant threats currently. The deepening of the real estate crisis in China, in addition to deteriorating the country's growth prospects, would affect the expected dynamism of the global economy. As for the prices of commodities, the effects of the El Niño phenomenon continue to generate risks for price hikes of food items internationally, while the global deceleration might contribute to either stabilizing or reducing the prices of agricultural and energy commodities. On the other hand, cuts in supply and the escalation of the geopolitical tensions could push oil prices upward or at least generate greater volatility. Recently, the prices of crude oil showed certain upward pressures due to attacks to merchant marine ships in the Red Sea, generating disruptions in shipping routes that are key for global trade. In this sense, as mentioned in the previous IPoM, in addition to the upside risks for 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.



At the local level, the risks stemming from the climatic factor have also mitigated in the last months. As indicated in the previous IPoM, the outlook for agriculture – particularly, soybean crops – has become more favorable since the end of October due to the latest rains recorded. These positive conditions have been maintained in the following months. Although the higher probability of insufficient rainfall in the Northern zone of the Eastern region was pointed out, this risk has diminished in the recent period. In a scenario of excessive rainfall due to the El Niño phenomenon, the construction sector could be affected adversely, while such rainfall would be a positive factor for the generation of electricity.

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

	2023(f)	2024(f)	2024(i)
Primary Sector	15.3	4.2	0.4
Agriculture	22.5	4.9	0.3
Livestock	0.0	1.6	0.0
Secondary Sector	2.9	4.0	1.3
Manufacturing	2.3	3.6	0.7
Construction	-5.7	4.7	0.3
Electricity & water	13.8	4.3	0.3
Tertiary Sector	3.8	3.5	1.7
General government	4.5	3.4	0.3
Trade	5.2	3.4	0.4
Other Services	3.0	3.5	1.0
Taxes	4.0	3.7	0.3
GDP at market prices	4.5	3.8	3.8
GDP w/o agriculture and binationals	2.6	3.6	

(f) Forecast. (i) Incidence

Source: Central Bank of Paraguay

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

	2023 (f)	2024 (f)
GDP	4.5	3.8
Domestic demand	-0.8	3.7
Gross fixed capital formation	-3.0	5.0
Total consumption	3.6	3.0
Private consumption	3.0	3.6
Public consumption	7.2	0.0
Exports of goods and services	31.1	3.0
Imports of goods and services	12.3	2.8
Current account (% of GDP)	0.3	0.0

(f) Forecast.

Source: Central Bank of Paraguay



Table C. Inflation projection. Annual change, percent.

	2023	2024(f)	2025(f)	2026(f)
December CPI inflation (*)	8.1	3.7	4.0	
CPI inflation around 2 years (**)				4.0
December underlying CPI (*)	7.9	3.2	4.0	
Underlying CPI inflation around 2 years (**)				4.0

(f) Forecast includes data as of December 2023.

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

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

Source: Central Bank of Paraguay