



MONETARY POLICY REPORT



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CENTRAL BANK OF PARAGUAY

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Executive Summary*

International and Regional Economy

Global growth prospects remain at 3.1% for 2024 and 2025, and monetary policy easing has continued in most countries. Global economic growth this year is being driven specially by the strength of the United States' economy. Inflation in the U.S. has increased slightly, a context in which the U.S. Federal Reserve (Fed) continued with its cycle of federal funds rate cuts, but in a more gradual manner, while fewer interest rate decreases are foreseen for next year. Crude oil prices remain at levels similar to those observed in September, although there have been oscillations. As for agricultural commodity prices, their behavior has been mixed. In the case of soybeans, a slight reduction was observed, driven by favorable prospects for the next harvest, a moderation of global demand, and the strength of the U.S. dollar.

In the United States, economic activity has maintained a solid pace of expansion and inflation registered a slight rebound. The strong performance of the economy in the third quarter was driven by the resilience of private consumption and the labor market. Given this scenario, a 2.7% growth rate is foreseen for 2024, above the expected level in September (2.6%), while a moderation is expected for 2025 (2.1%). In the fourth quarter, the Fed continued to reduce the target range for federal funds, and anticipates fewer cuts in 2025, as compared to the September projection. In this context, US Treasury bond yields have increased, and the U.S. dollar has strengthened globally.

The economic growth rates of the Eurozone and China exceeded expectations in the third quarter. In the Eurozone, GDP growth in the third quarter was explained by domestic demand, offsetting weaker external demand. As regards prices, inflation showed a slight rebound in the recent months, as expected, due to base effects. In this context, the European Central Bank (ECB) continued with its monetary easing policy at the October and December meetings. In China, inter-annual GDP growth decelerated in the third quarter, as compared to previous quarters, while growth projections for 2024 and 2025 remained unchanged. Inflation has continued to decrease, reflecting moderate demand and weakened confidence. Given this scenario, the People's Bank of China reduced its referential rates in October and government authorities announced that they will continue with the monetary flexibilization process and implement new fiscal stimulus measures in 2025.

In the region, the growth forecast for Brazil has been revised upward, while inflation has increased in a context of the unanchored expectations and rising concerns about public finances, leading the Central Bank of Brazil (BCB) to implement a more restrictive monetary policy. In the third quarter, economic activity grew slightly above expectations, motivating an adjustment of the GDP growth forecast for 2024, from 2.8% to 3.1%. Furthermore, in consideration of fiscal policy developments and the acceleration of both expected and effective inflation, the BCB's Monetary Policy Committee (Copom)

*The Spanish version prevails



increased the Selic rate in November and December. Likewise, the BCB anticipates similar adjustments in future meetings if the expected scenario is confirmed.

In Argentina, inflation has continued to decelerate, while less economic contraction is expected for this year. In the last months, economic activity has shown certain signs of recovery, leading to the revision of the GDP projection for 2024, from -3.8% to -3.6%. A positive growth rate of around 4.0% is expected for 2025. Inflation has continued to decelerate, and the Central Bank of the Republic of Argentina (BCRA) reduced the monetary policy rate at the November and December meetings, backed by lower inflation expectations. The gap between the official exchange rate and the parallel rate has reduced, due partly to the assets regularization measures adopted by the government, which increased the foreign currency supply.

Domestic Situation and Monetary Policy

Economic activity and domestic demand continued to show positive momentum in the third quarter. In this period, GDP expanded 3.4% inter-annually, explained by the positive performance of services, manufacturing, livestock production, construction, and taxes on products. The electricity & water sector registered a contraction, mainly due to lower generation of electric power, which was affected by less water flow of the Parana River. GDP that excludes agriculture and the bi-national hydroelectric entities registered a growth rate of 4.8% y-o-y. On the expenditure side, the components with the greatest positive incidence were private consumption, gross fixed capital formation (GFCF), and governmental consumption, while net exports had a negative incidence. With these results, at the end of the third quarter, GDP increased 4.3% in cumulative terms.

Since the previous IPoM, total inflation, inflation trend measures, and inflation expectations have remained consistent with the inflation target. In the fourth quarter, average inter-annual inflation was 3.6%, below the average observed in the third quarter (4.2%). Inter-annual inflation was explained by price increases of goods (especially food items) and, to less extent, services. In the same period, underlying inflation, underlying X1 inflation, and core inflation averaged inter-annual rates of 3.9%, 4.7%, and 3.2%, respectively. Finally, inflation expectations remained around the 4% target for all the consulted horizons.

During the fourth quarter of the year, the Monetary Policy Committee (CPM) decided to maintain the MPR at 6.00% annually. The BCP had initiated the reduction of the MPR in August 2023, from 8.50% to 6.00% by March 2024. Since the second quarter, the CPM has kept the referential rate unchanged, pointing out that it stands around the neutral range, which is deemed appropriate given the current dynamics of inflation and economic activity, a context that has persisted throughout the fourth quarter of 2024. Inflation trend measures, inflation projections, and economic agents' expectations have remained in line with the target. Likewise, GDP stands in accordance with its potential.

The Central Bank of Paraguay's Board of Directors recently decided to reduce the inflation target for the monetary policy horizon, adjusting it from 4.0% to 3.5%, maintaining the tolerance range at +/- 2 percentage points. This decision was based



on key factors, such as the favorable evolution of inflation under the inflation targeting framework, which in general has remained below the established objectives, the effectiveness of monetary policy and the Central Bank's credibility as regards the orientation of economic agents' expectations. A lower inflation target contributes towards the protection of the population's purchasing power, particularly that of low-income households. Furthermore, lower and more stable inflation is a fundamental element for long-term planning.

Projections

The GDP growth forecast for 2024 remains at 4.0%, with certain internal re-compositions (Tables A and B). The livestock production sector registered an upward revision (from 5.4% to 6.2%), explained by a greater cattle slaughter rate in the last months. Similarly, the construction sector had an upward adjustment, from 3.0% to 4.8%, driven by greater execution of both public and private sector works. On the other hand, the Water & Electricity sector was revised downward (from -4.0% to -4.9%), due to lower-than-expected generation of electric energy by the binational entities. The projection for manufacturing showed a reduction (from 4.4% to 4.1%), explained mainly by lower production of vegetable oils. On the demand side, no major changes were observed, excepting public consumption, which rose from 4.8% to 6.8%, due to the favorable dynamism of goods and services purchased by the central government. With these results, the GDP growth projection remained at 4.0%, while the forecast of GDP that excludes both agriculture and the binational entities stood at 5.4%.

For 2025, the GDP growth forecast stands at 3.8% (Table A). This rate is explained mainly by the services sector, which is projected to grow 3.4%, supported by the positive momentum expected for various categories of the tertiary sector, particularly trade, services provided to households, and financial intermediation. Meanwhile, the secondary sector is expected to grow 5.0%, due to the positive performance estimates for manufacturing industries and the construction sector. Likewise, a rebound in the production of electrical power is expected. Lastly, the primary sector growth estimate is 1.8%, in line with the expected expansion of agriculture, livestock production, and other primary sector activities.

On the side of expenditures, GDP growth is expected to result from increased domestic demand (Table B). When analyzing their contribution to growth, the positive incidence of total consumption is highlighted (3.3% estimated growth), explained by the projected increase of both private consumption (3.6% variation), and public consumption (2.0% variation). Gross fixed capital formation would also register an expansion (3.9%), in line with positive prospects for construction and investments in machinery & equipment. Likewise, net exports would contribute to growth, although to a lesser extent. The expected growth rates of exports and imports are 3.5% and 2.4%, respectively.

The inflation forecast for 2025 stand at 3.7%, with expectations of convergence to the 3.5% target in the projection horizon (Table C). As stated in the previous report, no significant pressures of the main determinants of inflation that could divert it from its expected trajectory have been observed. At the domestic level, GDP is at levels close to its potential, and at the external level, no pressures stemming from the product gap of Paraguay's trading partners, or the prices of food and energy commodities are expected.



In addition, a reduction of external interest rates will continue to be observed. In the absence of important shocks, inflation is projected to reach 3.7% by the end of 2025, converging to the 3.5% target within the two-year projection horizon.

Risks

The risks derived from the international scenario remain similar to those outlined in the previous report. Ongoing geopolitical tensions, and expectations of lower global demand, particularly from China, are two of the principal factors that continue to add volatility to oil prices and their derivatives. As regards the international prices of food commodities relevant to Paraguay, these have shown a declining trajectory on the average during most of 2024, explained by abundant supply and favorable harvest prospects. However, some adverse weather conditions or an increase of geopolitical conflicts could create upward pressures on food prices. On the other hand, international financial conditions have eased since the last report, but more cautious monetary policy decisions by the FED in 2025 are expected. In addition, further protectionist policies and fiscal risks in some advanced and regional economies create uncertainty, especially as related to inflation and interest rates.

At the local level, the risk scenario is tied to the evolution of weather conditions. According to the latest weather forecasts, the probability of the occurrence of the "La Niña" climatic phenomenon, as well as its anticipated severity, has diminished in recent months. If it were to occur, this phenomenon could affect, to some extent, both agricultural production and the generation of electrical power in 2025. On the other hand, the livestock production sector might register better-than-expected results, given the potential opening of new markets and the favorable general outlook for the sector.


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

	2024(f)	2025(f)	2025(i)
Primary Sector	3.2	1.8	0.2
Agriculture	1.8	2.0	0.1
Livestock	6.2	0.3	0.0
Secondary Sector	2.2	5.0	1.6
Manufacturing	4.1	3.9	0.8
Construction	4.8	4.3	0.3
Electricity & water	-4.9	8.7	0.6
Tertiary Sector	4.5	3.4	1.7
General government	3.4	2.4	0.2
Trade	5.1	3.3	0.4
Other Services	4.6	3.6	1.1
Taxes	9.5	3.7	0.3
GDP at market prices	4.0	3.8	
GDP w/o agriculture and binationals	5.4	3.6	

(f) Forecast. (i) Incidence

Source: Central Bank of Paraguay

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

	2024 (f)	2025 (f)
GDP	4.0	3.8
Domestic demand	5.6	3.3
Gross fixed capital formation	5.8	3.9
Total consumption	5.0	3.3
Private consumption	4.7	3.6
Public consumption	6.8	2.0
Exports of goods and services	0.4	3.5
Imports of goods and services	4.1	2.4
Current account (% of GDP)	-3.9	-0.9

(f) Forecast.

Source: Central Bank of Paraguay

Table C. Inflation projection. Annual change, percent.

	2023	2024	2025(f)	2026(f)
December CPI inflation (*)	3.7	3.8	3.7	
CPI inflation around 2 years (**)				3.5
December underlying CPI (*)	3.2	4.5	3.7	
Underlying CPI inflation around 2 years (**)				3.5

(f) Forecast includes data as of December 2024.

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

(**) Corresponds to the projected inflation for the fourth quarter of 2026.

Source: Central Bank of Paraguay