CREDIT OPINION

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Update

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Government of Paraguay – Baa3 stable

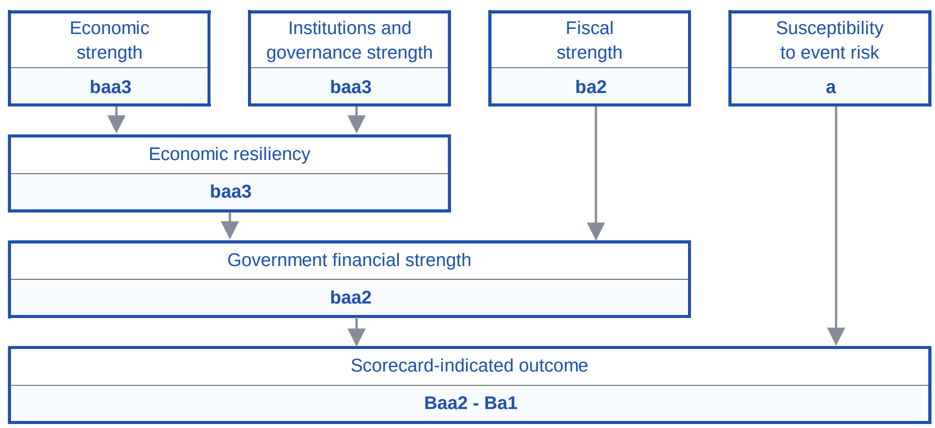
Update following change in factor score for fiscal strength

Summary

Paraguay's credit profile balances strong economic growth, improving institutions and limited external vulnerability, against a narrow revenue base relative to peers. In 2025, we expect the debt-to-GDP ratio to be around 43%, well below the median for regional peers and Baa-rated sovereigns and the interest-to-revenue ratio to be 12%, broadly in line with the median for regional peers and slightly above that of similarly rated peers. Main credit challenges include the economy's dependence on agriculture, which is exposed to climate shocks, and weak governance indicators.

Exhibit 1

Paraguay's credit profile is determined by four factors



Source: Moody's Ratings

Credit strengths

» Low government debt burden in absolute and relative terms

» Robust GDP growth and ongoing economic diversification

» Compliance with fiscal targets support stable debt burden

Credit challenges

» Agriculture-dependent economy subject to climate shocks

» Relatively low, albeit improving, government revenue collection compared to peers

» Relatively weak governance indicators

Rating outlook

The stable outlook reflects our expectations that the process of economic diversification and increasing resilience to shocks will continue, supported by Paraguay's effort to invest in critical infrastructure and attract more foreign direct investment, further integrating into export-oriented supply chains. Progress in these areas will mitigate risks related to Paraguay's exposure to volatility in commodity prices and climate shocks.

Ongoing implementation of the government's strategy to improve institutions and control of corruption such as approval of public procurement system and civil service reform will solidify improvements in institutional strength. We also expect the government will preserve Paraguay's fiscal strength and ongoing efforts to reduce the share of foreign currency debt in total government debt will reduce exposure to exchange rate risk, although, most of the government debt will likely remain in foreign currency for the foreseeable future.

Factors that could lead to an upgrade

We would upgrade Paraguay's sovereign rating if the government implementation of structural reforms continues to enhance the country's institutional and governance framework, and efforts to raise government revenues and reduce the share of foreign currency debt are likely to yield significant credit benefits, improving Paraguay's fiscal strength and overall credit quality. Successful efforts to increase private investment in the country's infrastructure and renewable energy sectors and reduce vulnerability to shocks would also contribute to a higher rating.

Factors that could lead to a downgrade

Negative pressure on the rating could emerge if efforts to modernize the economy and increase resiliency seem increasingly likely to fall short of our expectations, weighing on economic strength. A prolonged period of weaker private investment or economic growth would likely change our assessment of Paraguay's credit profile. Equally important, if efforts to maintain and improve Paraguay's fiscal strength prove insufficient, leading to higher debt and/or a rising interest burden, this would likely lead to a rating downgrade. The rating would also come under pressure if implementation of the structural reform agenda stalls and falls short of our expectations for the improvement in Paraguay's institutional strength.

Key indicators

Exhibit 2

Paraguay	2019	2020	2021	2022	2023	2024	2025F	2026F
Real GDP (% change)	-0.4	-0.8	4.0	0.2	5.0	4.2	3.5	3.5
Inflation rate (% change average)	2.8	1.8	4.8	9.8	4.6	3.8	3.1	3.6
Gen. gov. financial balance/GDP (%)[1]	-2.9	-6.1	-3.6	-2.9	-4.1	-2.6	-1.9	-1.5
Gen. gov. primary balance/GDP (%)[1]	-2.0	-5.1	-2.5	-1.7	-2.4	-0.6	-0.1	0.4
Gen. gov. debt/GDP (%)[1]	24.2	35.2	34.6	37.7	38.3	42.1	42.5	42.3
Gen. gov. debt/revenues (%)[1]	170.0	260.0	252.7	268.4	274.2	278.2	291.1	291.9
Gen. gov. interest payment/revenues (%)[1]	5.8	7.9	8.0	8.8	11.9	13.2	12.2	12.9
Current account balance/GDP (%)	-0.6	1.9	-1.1	-7.0	-0.4	-3.7	-2.5	-2.2
External debt/CA receipts (%)[2]	108.7	149.2	131.4	123.9	108.9	108.8	106.3	105.1
External vulnerability indicator (EVI) [3][4]	45.4	41.2	31.3	36.0	33.8	50.4	51.9	54.1

[1] Public Sector
[2] Current Account Receipts
[3] (Short-Term External Debt + Currently Maturing Long-Term External Debt + Total Nonresident Deposits Over One Year)/Official Foreign Exchange Reserves
[4] Excludes total nonresident deposits over one year

Source: Moody's Ratings

Detailed credit considerations

We set Paraguay's **economic strength** score at “baa3,” to reflect expectation of stronger average growth, along with increased diversification of the economy. Paraguay's relatively small economy and low wealth levels partially offset these factors.

Paraguay's nominal GDP of around $44 billion in 2024 and GDP per capita (on a purchasing power parity basis) of $18,593 in 2024 are both well below the Baa median of $289 billion and $39,439, respectively. Between 2010 and 2019, Paraguay's economy expanded at an average annual rate of 4.3% in real terms, above the average growth rates of 3.8% for the Baa median. Paraguay's economy contracted by only 0.8% in 2020, marking the least severe contraction among the Latin American economies, and recovered in 2021 with more than 4% growth. In 2022, Paraguay's economy grew minimally at 0.2% in real terms as severe drought conditions hampered the soy and grain production and hydropower sector. The economy rebounded in 2023, growing 5% and then 4.2% in 2024. We expect continued robust economic growth of about 3.5% for 2025-26.

Although climate-related shocks and the agriculture sector's significant contribution to output have historically resulted in some economic volatility, the ongoing positive developments in economic diversification, particularly related to the government's efforts to increase the value-added of agricultural exports, light manufacturing and upgrade infrastructure through public investment, indicate a reduction in the volatility of economic output.

We set the score for **institutions and governance strength** at “baa3” to reflect Paraguay's improving institutional framework, and still somewhat weak governance indicators. Our assessment incorporates the Worldwide Governance Indicator scores for Paraguay (specifically, government effectiveness, rule of law and control of corruption), which are consistently at or below the 25th percentile of sovereigns that we rate and are weaker than the median for its Baa-rated peers.

Nevertheless, Paraguay’s institutional framework has improved with the passage of several laws, including the Fiscal Responsibility Law (FRL), the Law to Modernize the State’s Financial Administration, the Public-Private Partnership Law and the recently created superintendency of pensions. Other institutional reforms relate to the public procurement system, civil service, the social security system and further enhancements to the FRL. In addition, the government’s track record of sound fiscal management indicates a higher degree of government effectiveness than that suggested by the country’s governance indicators alone.

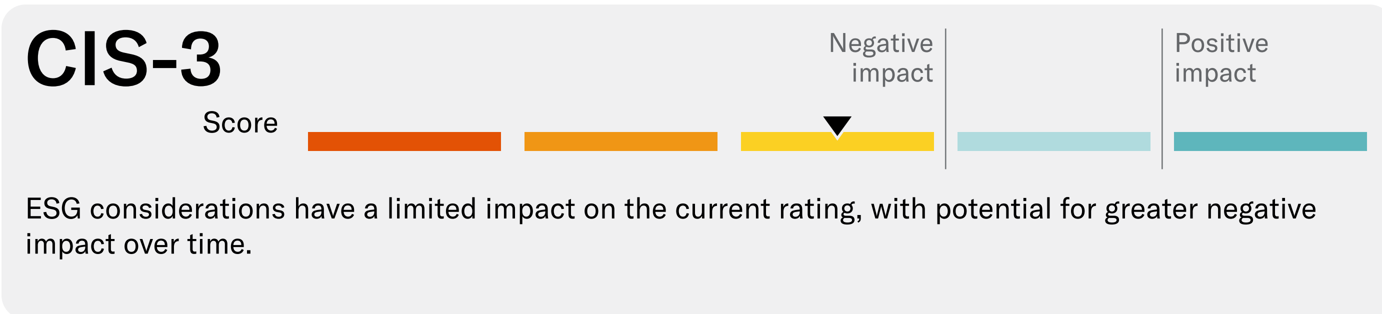
Paraguay's **fiscal strength** score changed to “ba2” from “ba1,” following the update of our sovereign scorecard fiscal metrics to 2024 annual data. The decline in fiscal strength was driven by weaker debt affordability metrics relative to 2023. Our assessment of a “ba2” fiscal strength score reflects the country’s favorable debt metrics compared with those of its peers in the Baa category. Debt increased to 35% of GDP in 2020 from 24% in 2019 because of an increase in borrowing to finance the response to the coronavirus pandemic. Debt increased to just over 42% of GDP in 2024 and we expect it to stabilize around that level in 2025-26. Despite this increase in debt, Paraguay's debt-to-GDP ratio of about 42% in 2024 remains below the median of 57% for Baa-rated sovereigns. Paraguay’s debt affordability, as measured by the ratio of interest payments to revenue weakened in 2024, with interest payments at around 13%, up from 11.9% in 2023 and 1.3% in 2012, and above the median for Baa-rated sovereigns of around 9.4% for 2024.

The **susceptibility to event risk** score is set at “a,” driven by our “a” score for political risk, which reflects our expectation that political events will not substantially affect the sovereign's credit metrics, leading to significant changes in economic policies, or impairing the government's willingness or ability to service debt. Our government liquidity risk score of “a” reflects a track record of narrow government deficits and low gross borrowing requirements. The banking sector risk score of “a” reflects the relatively small size of the banking sector, with banking sector assets at around 72% of GDP in 2024, and Paraguayan banks' persistently high liquidity ratios, loan loss reserves and capitalization ratios. Finally, our external vulnerability risk score of “a” reflects Paraguay’s low debt burden, adequate reserve buffer and flexible exchange rate. Despite the relatively high financial dollarization in Paraguay, we do not see significant vulnerability to external shocks due to borrowers natural hedge in foreign currency earnings.

ESG considerations

Paraguay's ESG credit impact score is CIS-3

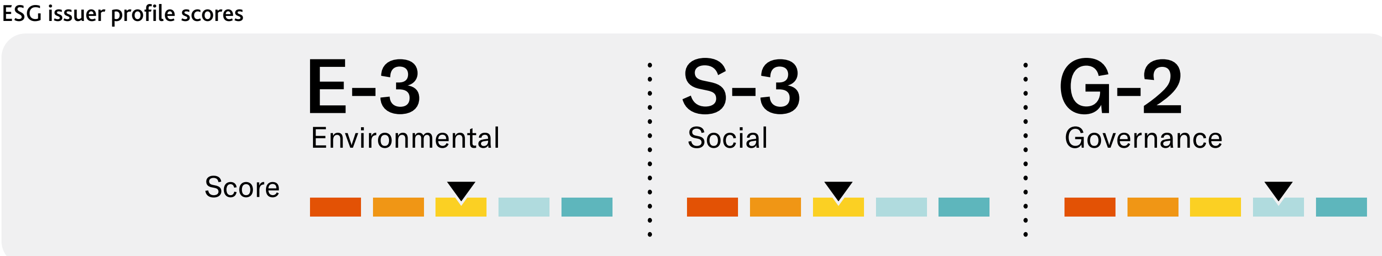
Exhibit 3
ESG credit impact score



Source: Moody's Ratings

Paraguay's ESG Credit Impact Score (**CIS-3**) reflects effective macroeconomic and fiscal policies, and moderately strong governance profile. Social risks are driven by shortcomings in education and labor productivity and some deficiency in access to basic services. Exposure to environmental risks is driven by climate shocks and reliance on agriculture. Strong fiscal metrics and economic diversification mitigate these risks.

Exhibit 4
ESG issuer profile scores



Source: Moody's Ratings

Environmental

Paraguay's exposure to environmental risks (**E-3** issuer profile score) reflects the recurrence of droughts and flooding, which impacts the agriculture sector and hydro-electric generation. Paraguay also benefits from its position as a producer and exporter of clean energy with limited reliance on hydrocarbon.

Social

Paraguay's exposure to social risks (**S-3** issuer profile score) reflects positive demographic trends and rising income levels, but relatively weak educational outcomes which weakens economic and labor force competitiveness.

Governance

The influence of governance on Paraguay's credit profile (**G-2** issuer profile score) reflects improving institutional and governance strength, moderate policy effectiveness, political stability, and a track record of sound macroeconomic and fiscal policies.

ESG Issuer Profile Scores and Credit Impact Scores for the rated entity/transaction are available on Moodys.com. In order to view the latest scores, please click here to go to the landing page for the entity/transaction on MDC and view the ESG Scores section.

All of these considerations are further discussed in the "Detailed credit considerations" section above. Our approach to ESG is explained in our report on how the scores depict varied and largely credit-negative impact of ESG factors and our cross-sector methodology General Principles for Assessing Environmental, Social and Governance Risks Methodology.

Moody's rating methodology and scorecard factors: Paraguay – Baa3 stable

Factor / Sub-Factor	Metric	Indicator Year	Indicator	Initial Factor Score	Final Factor Score	Weights
Factor 1: Economic strength				**baa3**	**baa3**	**50%**
Growth dynamics	Average real GDP growth (%)	2020-2029F	3.0	baa1		25%
	MAD Volatility in Real GDP Growth (%)	2015-2024	0.9	baa2		10%
Scale of the economy	Nominal GDP ($ billion)	2024	44.5	ba3		30%
National income	GDP per capita (PPP, Intl$)	2024	18,593.0	baa2		35%
Adjustment to factor 1	*# notches*				0	max ±9
Factor 2: Institutions and governance strength				**baa3**	**baa3**	**50%**
Quality of institutions	Quality of legislative and executive institutions			ba		20%
	Strength of civil society and the judiciary			ba		20%
Policy effectiveness	Fiscal policy effectiveness			baa		30%
	Monetary and macroeconomic policy effectiveness			baa		30%
Specified adjustment	Government default history and track record of arrears				0	max -3
Other adjustment to factor 2	*# notches*				0	max ±3
F1 x F2: Economic resiliency				**baa3**	**baa3**	
Factor 3: Fiscal strength				**ba2**	**ba2**	
Debt burden	General government debt/GDP (%)	2024	42.1	a2		25%
	General government debt/revenue (%)	2024	278.2	ba2		25%
Debt affordability	General government interest payments/revenue (%)	2024	13.2	ba2		25%
	General government interest payments/GDP (%)	2024	2.0	a1		25%
Specified adjustments	*Total of specified adjustment (# notches)*			-3	-3	max ±6
	Debt Trend - Historical Change in Debt Burden	2016-2024	24.3	0	0	
	Debt Trend - Expected Change in Debt Burden	2024-2026F	0.2	0	0	
	General Government Foreign Currency Debt/ GDP	2024	36.6	-3	-3	
	Other non-financial public sector debt/GDP	2024	4.3	0	0	
	Government Financial Assets including Sovereign Wealth Funds / GDP	2024	2.9	0	0	
Other adjustment to factor 3	*# notches*				0	max ±3
F1 x F2 x F3: Government financial strength				**baa2**	**baa2**	
Factor 4: Susceptibility to event risk				**a**	**a**	Min
Political risk				a		
	Domestic political risk and geopolitical risk			a		
Government liquidity risk				a	a	
	Ease of access to funding			a		
Specified adjustment	High refinancing risk				0	max -2
Banking sector risk				a	a	
	Risk of banking sector credit event (BSCE)	Latest available	ba2	ba1-ba2		
	Total domestic bank assets/GDP	2024	72.2	<80		
Adjustment to F4 BSR	*# notches*				0	max ±2
External vulnerability risk				a	a	
	External vulnerability risk			a		
Adjustment to F4 EVR	*# notches*				0	max ±2
Overall adjustment to F4	*# notches*				0	max -2
F1 x F2 x F3 x F4: Scorecard-indicated outcome				**Baa2 - Ba1**	**Baa2 - Ba1**	

Note: While information used to determine the grid mapping is mainly historical, our ratings incorporate expectations around future metrics and risk developments that may differ from the ones implied by the scorecard-indicated outcome. Thus, the rating process is deliberative and not mechanical, meaning that it depends on peer comparisons and should leave room for exceptional risk factors to be taken into account that may result in an assigned rating outside the scorecard-indicated outcome. For more information please see our Sovereign Ratings Methodology.

Footnotes: (1) Initial factor score: scorecard indicators combine with the automatic adjustments to produce an initial factor score for every rating factor, as detailed in Moody's Sovereign Ratings Methodology. **(2) Final factor score:** where additional analytical considerations exist, initial factor scores are augmented to produce a final factor score. Guidance on additional factors typically considered can be found in Moody's Sovereign Ratings Methodology; details on country-specific considerations are provided in Moody's research. **(3) Scorecard-indicated outcome:** Factor 1: Economic Strength, and Factor 2: Institutions and Governance Strength, combine with equal weight into a construct we designate as Economic Resiliency (ER). An aggregation function then combines ER and Factor 3: Fiscal Strength, following a non-linear pattern where Fiscal Strength has higher weight for countries with moderate ER and lower weight for countries with high or low ER. As a final step, Factor 4, a country's Susceptibility to Event Risk, is a constraint which can only lower the government financial strength as given by combining the first three factors. **(4) There are 20 ranking categories for quantitative sub-factors:** aaa, aa1, aa2, aa3, a1, a2, a3, baa1, baa2, baa3, ba1, ba2, ba3, b1, b2, b3, caa1, caa2, caa3, ca and 8 ranking categories for qualitative sub-factors: aaa, aa, a, baa, ba, b, caa, ca **(5) Indicator value:** if not explicitly stated otherwise, the indicator value corresponds to the latest data available.

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