MOODY'S RATINGS

CREDIT OPINION
31 July 2024

Update

Send Your Feedback

Contacts

Samar Maziad +1.212.553.4534
VP-Senior Analyst
samar.maziad@moodys.com

Dylan Walsh +1.212.553.3583
Ratings Associate
dylan.walsh@moodys.com

Mauro Leos +1.212.553.1947
Associate Managing Director
mauro.leos@moodys.com

Marie Diron +44.20.7772.1968
MD-Global Sovereign Risk
marie.diron@moodys.com

» *Contacts continued on last page*

CLIENT SERVICES

Americas	1-212-553-1653
Asia Pacific	852-3551-3077
Japan	81-3-5408-4100
EMEA	44-20-7772-5454

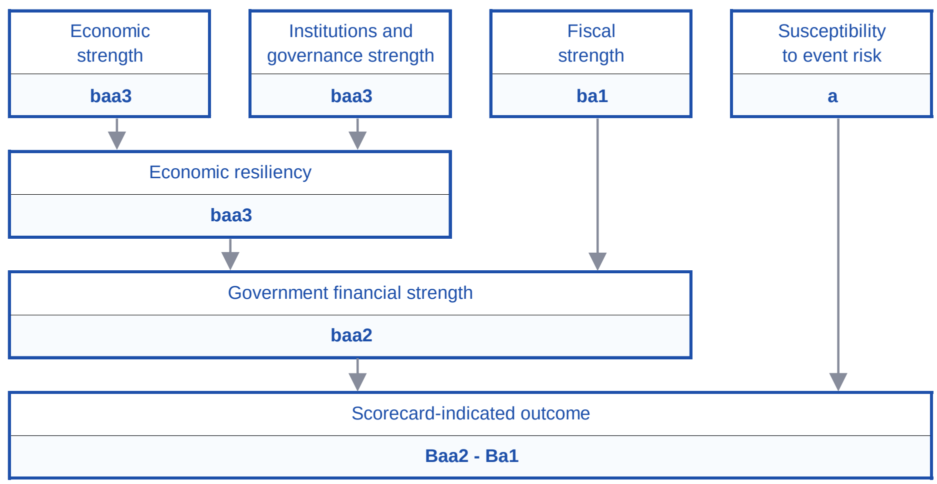
Government of Paraguay – Baa3 stable

Update following upgrade to Baa3, outlook changed to stable from positive

Summary

Paraguay's credit profile balances strong economic growth, improving institutions and limited external vulnerability, against a narrow revenue base relative to peers. In 2024, we expect the debt-to-GDP ratio to be 39%, well below regional peers and Baa-rated sovereigns and the interest-to-revenue ratio to be 11%, broadly in line with the median for regional and 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

» Lower government revenue than that of 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.

Continued implementation of the government's strategy to improve institutions and control of corruption 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	2018	2019	2020	2021	2022	2023	2024F	2025F
Real GDP (% change)	3.2	-0.4	-0.8	4.0	0.2	4.7	3.7	3.5
Inflation rate (% change average)	4.0	2.8	1.8	4.8	9.8	4.6	3.3	4.0
Gen. gov. financial balance/GDP (%)[1]	-1.3	-2.9	-6.1	-3.6	-2.9	-4.2	-2.6	-1.9
Gen. gov. primary balance/GDP (%)[1]	-0.6	-2.0	-5.1	-2.5	-1.7	-2.5	-0.9	-0.3
Gen. gov. debt/GDP (%)[1]	20.8	24.2	35.2	34.6	37.7	38.5	39.3	39.6
Gen. gov. debt/revenues (%)[1]	147.3	170.0	260.5	252.7	268.4	275.3	269.1	271.5
Gen. gov. interest payment/revenues (%)[1]	4.8	5.8	7.9	8.0	8.8	11.9	11.4	10.8
Current account balance/GDP (%)	-0.2	-0.6	1.9	-0.9	-7.5	0.2	-0.4	-2.2
External debt/CA receipts (%)[2]	98.6	108.7	149.2	131.3	123.7	108.0	112.7	107.8
External vulnerability indicator (EVI) [3][4]	50.2	45.4	41.2	31.3	36.0	48.7	43.8	46.7

[1] Central GovernmentCentral GovernmentCentral GovernmentCentral Government
[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 yearExcludes total nonresident deposits over one yearExcludes total nonresident deposits over one yearExcludes total nonresident deposits over one year

Source: Moody's Ratings

Detailed credit considerations

We set Paraguay's **economic strength** score at “baa3,” one notch above the initial score of “ba1,” 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 $43 billion in 2023 and GDP per capita (on a purchasing power parity basis) of $15,531 in 2023 are both well below the Baa median of $264 billion and $33,064, 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 3.6% 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, which affected around 24% and 17% of total exports in 2022, respectively. The economy rebounded in 2023, growing 4.7% and we expect continued robust economic growth of about 3.7% for 2024.

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 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.

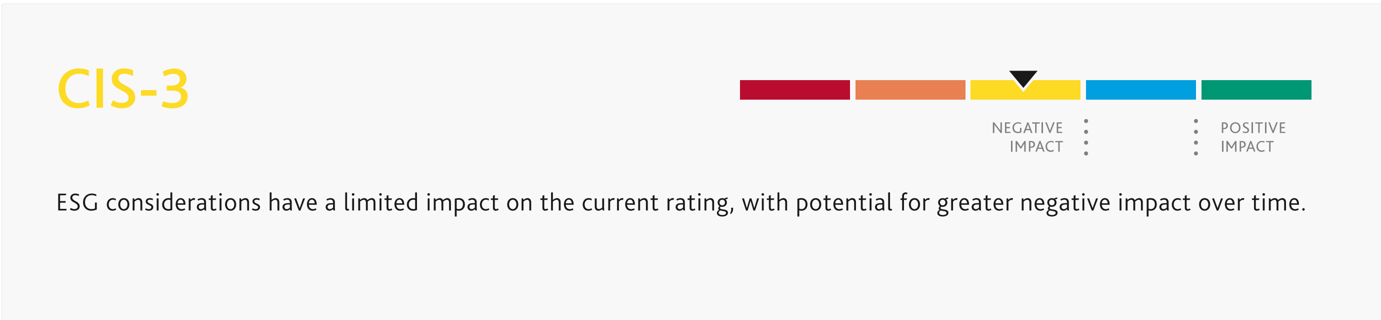
Our assessment of a “ba1” **fiscal strength** score reflects the country’s favorable debt metrics compared with those of its peers in the Baa category. Debt increased to 35% of GDP in 2020 from 24% in 2019 because of an increase in borrowing to finance the response to the coronavirus pandemic. Debt will increase slightly to just over 39% of GDP in 2024 and stabilize around that level through 2025. Despite this increase in debt, Paraguay's estimated debt-to-GDP ratio of 38% in 2023 remains below the median of 55% for Baa-rated sovereigns. Paraguay’s debt affordability, as measured by the ratio of interest payments to revenue has weakened over the past five years (2019-23), with interest payments at around 11% of revenue in 2023, up from 1.3% in 2012, but remains in line with the median for Baa-rated sovereigns of 9.2% for 2023.

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 70% of GDP, 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.

ESG considerations

Paraguay's ESG credit impact score is CIS-3

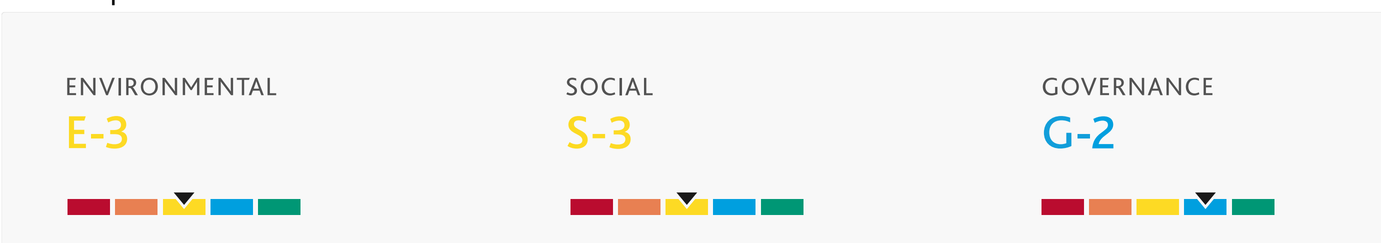
Exhibit 3
ESG credit impact score



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 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.

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.

Recent developments

The Central Bank of Paraguay holds interest rate at 6%, easing cycle remains on pause

On 22 July, the Monetary Policy Committee of the Central Bank of Paraguay voted for the fourth consecutive month to maintain its monetary policy rate at 6%, firmly placing its easing cycle on hold. The last rate cut was in March, (25 basis points (bps)) that brought the total amount of cuts to 250 bps in the easing cycle. In its decision-making process, the central bank noted that month-over-month inflation decreased 0.4% in June, while year-over-year inflation stood at 4.3%, within the central bank's target range of 4% (+/- two percentage points). Furthermore, in the latest central bank poll of economic participants from June, inflation expectations for the next 12 months and 24 months remained anchored at 4%.

Latest fiscal results demonstrate credible path toward achieving fiscal deficit target for 2024

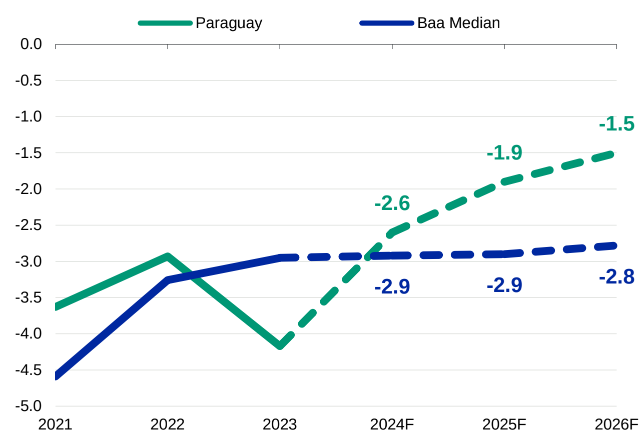
The latest fiscal result from June was an annualized fiscal deficit of 3.2% of GDP and with the expected base effect of about 1% of GDP coming at the end of the year, this puts the government on a credible path to meet its goal for a fiscal deficit of 2.6% of GDP for 2024. Last year the government cleared payment arrears to the healthcare and infrastructure sector by the previous administration and outlined a new fiscal convergence path that began with the fiscal deficit of 4.2% of GDP for 2023 and will converge in 2026 to the target deficit of 1.5% of GDP, in line with the Fiscal Responsibility Law (FRL).

Paraguay's fiscal performance and debt burden compare favorably with Baa-rated peers and we expect this to continue over the coming years (see Exhibits 5 & 6). So far this year, revenue collection is stronger-than-expected and there is potential to outperform relative to the fiscal deficit target of 2.6% of GDP this year, facilitating fiscal consolidation and potentially meeting the deficit target of 1.5% earlier than planned.

Exhibit 5

Paraguay's fiscal deficit is expected to improve over the next three years

General Government Financial Balance - % Nominal GDP

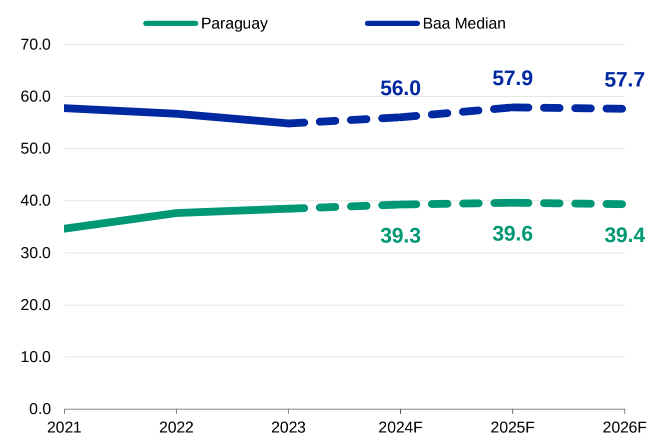


Source: Moody's Ratings

Exhibit 6

Stable government debt ratio to remain nearly 20 percentage points below Baa-rated peers

General Government (Gross) Debt - % Nominal GDP (end of period)

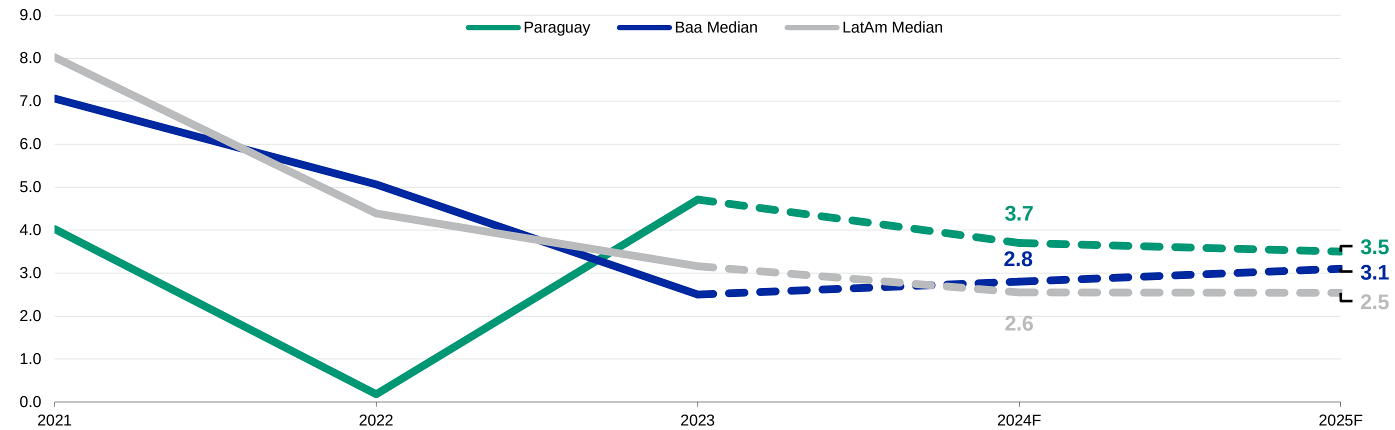


Source: Moody's Ratings

GDP growth in first quarter shows continued strong expansion

Growth in the first quarter of 2024 came in at 4.3% year-over-year. When broken down by supply side sectors, the first-quarter result was supported by strong growth in the manufacturing (5.5%), services (5%) and livestock (4.9%) sectors and, to a lesser extent, in the hydropower (0.8%) and the agricultural (0.4%) sectors. Importantly, when analyzing from the demand side, internal demand grew 3.2% year-over-year, ending five consecutive quarters of negative growth and was supported by strong consumption growth of 4.7%. The positive results enforce our expectation of 3.7% real GDP growth for 2024 with potential to the upside, based on the economic activity indicator (IMAEP) for the months of April and May, which recorded inter-annual expansion of 7.9% and 3.1%, respectively. For 2025, we forecast 3.5% growth as economic activity moderates, in line with Paraguay's potential growth (see Exhibit 7). However, there is still upside potential for medium-term growth performance once large FDI projects begin construction and operation.

Exhibit 7
Economic growth is expected to outpace Baa-rated and regional (LatAm) peers
Real GDP - % change (LCY terms, average of period)



Source: Moody's Ratings

Although traditional infrastructure projects such as roads and bridges have been completed recently, the next area of focus will be the energy sector. Paraguay meets 100% of its energetic needs with hydropower generation (Itaipu, Yacyreta, and Acaray plants) making it one of the few countries in the world with a fully renewable electric grid. However, Paraguay does not fully consume all the renewable energy it generates (selling nearly 50% of its share of energy to Brazil (Ba2 positive)) and thus would gain from important investments in transmission and distribution so that it can fully power all the homes in rural communities and provide affordable energy to new industries.

The recent agreement between Paraguay and Brazil around electricity tariffs would benefit Paraguay as the government expects to receive $200 million in additional revenue annually for the next three years from the sale of electricity, creating an additional source of funding for infrastructure investment. The use of these proceeds will be dedicated to improving electricity generation and distribution to enable Paraguay to take advantage of its share of Itaipu-generated electricity, supporting high investment in the country.

Paraguay is building on the positive foreign investor sentiment to increase local currency issuance and help develop domestic capital markets

The government is working to deepen its access to funding in local currency and has successfully issued a global bond denominated in local currency in February of this year. Over the past year, the share of local currency debt increased as a percentage of total public debt by nearly five percentage points, from 8.2% in May 2023 to 12.6% in May 2024. Furthermore, Paraguay is building on the positive foreign investor sentiment to help develop domestic capital markets with regulation that now allows foreign investors to participate in local markets through a custodial bank. As of April 2024, nonresident investors account for 10% of local bond market.

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				ba1	baa3	50%
Growth dynamics	Average real GDP growth (%)	2019-2028F	2.5	baa3		25%
	MAD Volatility in Real GDP Growth (%)	2014-2023	1.2	baa3		10%
Scale of the economy	Nominal GDP ($ billion)	2023	43.0	ba3		30%
National income	GDP per capita (PPP, Intl$)	2023	15,530.5	baa3		35%
Adjustment to factor 1	*# notches*				1	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				ba1	ba1	
Debt burden	General government debt/GDP (%)	2023	38.5	a1		25%
	General government debt/revenue (%)	2023	275.3	ba2		25%
Debt affordability	General government interest payments/revenue (%)	2023	11.9	baa3		25%
	General government interest payments/GDP (%)	2023	1.7	aa3		25%
Specified adjustments	*Total of specified adjustment (# notches)*			-3	-3	max ±6
	Debt Trend - Historical Change in Debt Burden	2015-2023	21.6	0	0	
	Debt Trend - Expected Change in Debt Burden	2023-2025F	1.1	0	0	
	General Government Foreign Currency Debt/ GDP	2023	33.3	-3	-3	
	Other non-financial public sector debt/GDP	2023	4.2	0	0	
	Government Financial Assets including Sovereign Wealth Funds / GDP	2023	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	2023	--	<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.

REPORT NUMBER 1414521

Contacts

Dylan Walsh +1.212.553.3583
Ratings Associate
dylan.walsh@moodys.com

Mauro Leos +1.212.553.1947
Associate Managing Director
mauro.leos@moodys.com

Marie Diron +44.20.7772.1968
MD-Global Sovereign Risk
marie.diron@moodys.com

Samar Maziad +1.212.553.4534
VP-Senior Analyst
samar.maziad@moodys.com

CLIENT SERVICES

Americas	1-212-553-1653
Asia Pacific	852-3551-3077
Japan	81-3-5408-4100
EMEA	44-20-7772-5454