S&P Global Ratings

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Research Update:

Paraguay Outlook Revised To Positive On Potential Improvement In Growth And Fiscal Trajectory; 'BB+/B' Ratings Affirmed

January 8, 2025

Overview

- Large forestry and energy projects augur well for Paraguay's economic diversification, more sustainable GDP growth, and lower external vulnerability.
- Growth, coupled with the government's commitment to fiscal austerity, should help stabilize the debt burden after the recent increase.
- We revised our outlook to positive from stable and affirmed our 'BB+/B' sovereign credit ratings on Paraguay.
- The positive outlook suggests a one-in-three chance of an upgrade if robust growth and fiscal prudence bolster the sovereign's finances and stabilize its debt burden at a low level, strengthening the country's resilience against unexpected shocks.

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Rating Action

On Jan. 8, 2025, S&P Global Ratings revised its outlook on its 'BB+' long-term foreign currency and local currency sovereign credit ratings on Paraguay to positive from stable. We also affirmed these ratings and our 'B' short-term sovereign credit ratings. The transfer and convertibility assessment remains 'BBB-'.

Outlook

The positive outlook indicates a one-in-three chance of an upgrade in the next 12-24 months if consistently strong economic growth, following the completion of several large investment projects, leads to fiscal consolidation, and stabilizing the debt burden and reduce economic volatility.

Upside scenario

We could raise our sovereign ratings to investment grade in the next 12-24 months if economic growth and diversification strengthen Paraguay's resilience to shocks. This, coupled with commitment to and improvement of fiscal outcomes--as measured by the annual increase in net general government (GG) debt as percentage of GDP--should help stabilize debt burden at its currently moderate level.

Downside scenario

We would revise our outlook on our sovereign ratings to stable in the next 12-24 months if the economic growth momentum subsides, limiting improvements in public finances. In addition, a structurally higher debt level in the foreseeable future could lead to the outlook revision to stable.

Rationale

The 'BB+' ratings reflect Paraguay's track record of prudent macroeconomic policies and moderate GG debt to GDP of just below 30% in net terms (although higher than the 2019 ratio of 11.3%).

The fiscal profile has suffered from a series of external shocks that slowed growth, while countercyclical policies increased spending. Active revenue measures and slower expenditure growth have narrowed the fiscal gap since the pandemic, and we think stronger growth could further improve Paraguay's fiscal outcomes.

The sovereign's external position remains strong but exposed to significant volatility in terms of trade. However, the floating exchange rate and a monetary policy regime based on an inflation-targeting framework conducted by an autonomous central bank have strengthened monetary flexibility, despite shallow domestic capital markets. While income levels remain weak, we expect consistent growth to gradually improve Paraguay's socioeconomic conditions.

Institutional and economic profile: GDP growth will remain robust in 2025 despite weaker commodity prices.

- Fiscal prudence remains key to macroeconomic stability amid still evolving economic institutions.
- Strong domestic demand should sustain economic growth at about 3.8% during 2025-2028.
- There is some economic upside potential from the completion of large projects in the country.

Paraguay's economic policies stem from a broad political consensus on pro-business policies and macroeconomic prudence, while reforms implemented in the last decade have bolstered credibility of economic institutions. Broad consensus on economic policy direction goes beyond the ruling Colorado Party, which has dominated Paraguayan politics for the last few decades. Nevertheless, tensions within the party have sometimes delayed approval of legislation and created episodes of political uncertainty.

The Peña administration, which took office in August 2023, has maintained good working relations across party lines, bolstering the reform momentum. The government is focused on tackling longstanding inefficiencies that have hindered the business environment--foreign direct investment (FDI) levels have remained below those of Latin American peers in the last decade--as well as on rebuilding fiscal buffers. Approved legislation such as the pension fund oversight law, the civil service reform, and the strengthened autonomy of the General Controller illustrate some progress in enhancing institutions over the medium term.

Moreover, the development of a special tax scheme and other incentives for large investments, coupled with Paraguay's natural capital, could result in total investment of $6.8 billion for 2025-2028 (averaging 3.7% of GDP per year) in sectors such as pulp and paper, green fertilizers, and green energy. Implementation of these projects will bolster economic growth and its diversification. We think there could be some delays in these projects, and we only partially incorporate them in our forecast. Nonetheless, we expect growth to average 3.8% in 2025-2028, exceeding the 2.1% pace in 2020-2023. The development of the Paracel pulp mill alone should generate investments equivalent to 9% of GDP in 2025-2027.

Traditionally, agriculture and hydroelectric energy have been key economic pillars. A series of external shocks slowed growth in 2019-2022. However, services and manufacturing activities have gained relevance as domestic demand has strengthened. Correlation with the economic cycles of Paraguay's main trading partners, Brazil and Argentina, and volatility of GDP growth, have declined. We estimate growth at 4.1% in 2024, despite weaker-than-average rainfall levels and subdued commodity prices. Low inflation and the normalization of the price differential with Argentina have also bolstered domestic consumption. We expect GDP per capita to reach $7,100 this year and grow to $8,100 by 2028. This suggests per capita growth rates above 3% for the next three years.

Flexibility and performance profile: Strong commitment to consolidation and medium-term growth prospects could strengthen the fiscal profile.

- We expect strong growth and active revenue measures will help reduce the GG deficit to about 1.7% of GDP in 2025, from about 3.1% in 2021-2024.
- Weaker commodity prices and import pressure from higher investment will result in modest current account deficits through 2027, but external debt should remain stable.
- The flexible exchange rate and the central bank's growing track record of price stability should help absorb negative shocks.

We expect the government's conservative fiscal strategy will reduce GG deficits to the Fiscal Responsibility Law's target of 1.5% by 2026-2027, from an estimated deficit of 2.6% in 2024. This law, enacted in 2013, has been important to guide budget discussions in Congress, although compliance with it has been subpar amid a series of external shocks in recent years. The government complied with its target in 2024, the first time since 2018 thanks to robust economic growth, stronger tax enforcement, and the correction of price distortions with Argentina.

We estimate GG revenue grew 17% year over year, pushing revenue to GDP to 15.4%, 1.4 percentage points above the 2022-2023 levels, although still lower than of sovereign peers, particularly those in the investment-grade category. The still high levels of tax exemptions and evasion present an opportunity for GG revenue to increase, despite the administration's commitment to keeping the tax burden low.

Nonetheless, the ITAIPU dam's new tariff will generate nearly $650 million in annual proceeds in 2024-2026 that will be used for social and infrastructure spending, which should provide some budget flexibility against unexpected shocks. (Both Brazil and Paraguay own the dam.) This revenue and spending will be accounted as off-budget items.

We think the planned fiscal correction and a more balanced currency mix in government funding could slow the increase in government debt and improve the fiscal profile. Our key measure of the government's fiscal performance is the change in the net general government debt stock, expressed as a percentage of GDP. This captures more than headline deficits. We estimate the payment of the one-off arrears in 2023 accounted for around 1.3% of GDP, which coupled with the guaraní's depreciation, likely pushed the change in net GG debt closer to 5.8% in 2024.

We expect net GG debt to stabilize at nearly 30% of GDP in the forecast period, after increasing from 11% in 2019. We think the interest burden could fall to 8% by 2027, after surging to 11% in 2024, considering our expectation of lower global interest rates. While our debt projections are subject to volatility given the sovereign's exposure to foreign-currency debt, the government aims to improve its debt profile. In February 2024, Paraguay issued the first series of global bonds denominated in domestic currency. However, we think the de-dollarization strategy will likely be gradual, and we estimate foreign-currency debt to account for 80% of total debt by 2026.

While Paraguay will continue to rely on external markets for financing, we expect narrow net external debt to remain roughly stable at 45% of current account receipts (CAR) over the forecast period. This is because current account deficits in 2025-2027 of 2.8% of GDP stemming from higher imports, will result from higher investment, which will be mostly funded by FDI, while exports would grow only modestly. We estimate the current account deficit widened to 3% in 2024, from 0.6% in 2023 as soy prices fell 20% (soy exports account for 25% of CAR). The cellulose plant should boost exports starting in 2028 (around US$1 billion per year according to the company) and reduce import pressure.

Paraguay's flexible exchange rate has helped absorb external shocks and gradually boost the country's economic resilience. International reserves currently account for 22% of GDP. The central bank occasionally intervenes in the foreign exchange market to dampen volatility without targeting the exchange rate.

We view that monetary policy effectiveness has strengthened in the last decade, underpinned by an independent central bank guided by an inflation-targeting regime since 2011. Inflation at the end of 2024 was 3.8%, after peaking at 11.8% in April 2022. The central bank has recently announced the reduction of its target to 3.5% +/- 2%. Despite the track record of price stability, dollarization in Paraguay remains higher than in other Latin American economies; around 45% of resident loans and deposits are denominated in dollars. This is partly due to the significance of the agricultural sector in the economy and its natural dollarization, but also reflects shallow domestic markets.

Still, we think risks to the financial sector remain limited in a scenario of sudden spikes in the exchange rate, given that the sectors, which have high exposure to foreign currency, generate dollar-denominated revenues. The banking system has generally had relatively high profitability. Paraguay's regulatory framework has been improving in the past few years but is still in the process of fully aligning with international standards such as Basel III requirements. (See "Banking Industry Country Risk Assessment: Paraguay", published Dec. 6, 2024.)

Key Statistics

Table 1

Selected indicators

	2018	2019	2020	2021	2022	2023	2024e	2025bc	2026bc	2027bc	2028bc
Nominal GDP (bil. LC)	230,576.5	236,681.5	239,914.7	270,633.9	292,946.8	314,282.0	335,019.6	360,964.8	388,542.5	418,227.2	447,582.5
Nominal GDP (bil. $)	40.2	37.9	35.4	40.0	42.0	43.1	44.3	45.6	48.1	50.7	53.2
GDP per capita (000s $)	6.6	6.2	5.7	6.4	6.7	6.8	7.0	7.1	7.4	7.8	8.1
Real GDP growth	3.2	(0.4)	(0.8)	4.0	0.2	5.0	4.1	3.8	4.0	4.0	3.4
Real GDP per capita growth	2.2	(1.4)	(1.8)	3.3	(0.4)	4.3	3.4	3.1	3.3	3.3	2.8
Real investment growth	6.9	(6.1)	5.3	18.2	(1.8)	(2.8)	6.5	7.5	13.0	7.0	(4.0)
Investment/GDP	22.8	21.7	20.0	24.0	27.7	20.2	21.4	22.2	24.2	24.7	22.7
Savings/GDP	22.5	21.1	21.9	22.9	20.5	19.6	18.4	19.7	21.2	21.6	22.7
Exports/GDP	36.9	36.1	33.3	35.5	34.4	42.1	39.2	38.4	37.7	37.0	37.0
Real exports growth	(0.4)	(3.4)	(9.0)	2.1	(1.1)	35.0	3.5	2.0	2.0	2.0	3.5
Unemployment rate	5.6	5.7	7.2	6.8	5.8	5.2	5.3	5.7	5.7	5.7	5.7
External indicators (%)											
Current account balance/GDP	(0.2)	(0.6)	1.9	(1.1)	(7.2)	(0.6)	(3.0)	(2.5)	(2.9)	(3.1)	0.1
Current account balance/CARs	(0.6)	(1.4)	5.1	(2.8)	(19.0)	(1.2)	(6.8)	(5.8)	(7.1)	(7.6)	0.2
CARs/GDP	40.5	40.2	36.9	38.9	37.6	45.7	43.2	42.3	41.5	40.7	40.7
Trade balance/GDP	1.4	0.5	3.5	1.6	(4.6)	1.6	(1.9)	(1.2)	(2.0)	(2.4)	0.7
Net FDI/GDP	1.0	0.6	0.7	0.5	1.9	0.8	0.6	1.2	2.3	2.3	0.9
Net portfolio equity inflow/GDP	1.3	1.1	6.1	0.5	0.5	0.4	0.0	0.0	0.0	0.0	0.0
Gross external financing needs/CARs plus usable reserves	79.8	81.2	75.5	74.9	86.6	81.0	85.0	87.1	89.7	91.0	85.0
Narrow net external debt/CARs	5.3	11.9	19.5	26.2	41.3	37.1	43.0	45.3	45.0	45.2	43.1
Narrow net external debt/CAPs	5.2	11.7	20.6	25.5	34.7	36.7	40.3	42.8	42.0	42.0	43.2
Net external liabilities/CARs	70.9	74.4	82.9	74.9	90.8	76.7	85.6	90.9	94.8	99.2	92.1
Net external liabilities/CAPs	70.5	73.4	87.4	72.9	76.3	75.7	80.1	85.9	88.6	92.3	92.3

Table 1

Selected indicators (cont.)

	2018	2019	2020	2021	2022	2023	2024e	2025bc	2026bc	2027bc	2028bc
Short-term external debt by remaining maturity/CARs	13.3	16.4	19.0	13.7	13.5	14.6	16.5	18.3	19.4	19.6	17.4
Usable reserves/CAPs (months)	5.1	5.3	6.4	6.5	5.3	5.1	5.1	4.8	4.6	4.4	4.5
Usable reserves (mil. $)	6,868	6,649	8,668	8,364	8,469	8,630	8,202	8,202	8,202	8,202	8,202
Fiscal indicators (general government; %)											
Balance/GDP	(1.0)	(2.4)	(5.7)	(3.4)	(2.6)	(3.9)	(2.6)	(2.1)	(1.6)	(1.5)	(1.5)
Change in net debt/GDP	2.4	3.6	8.1	3.3	5.2	2.6	5.8	2.7	2.2	2.0	2.0
Primary balance/GDP	(0.3)	(1.6)	(4.7)	(2.3)	(1.4)	(2.2)	(0.6)	(0.3)	(0.1)	0.0	0.0
Revenue/GDP	17.5	17.7	17.1	17.1	17.5	17.4	18.4	18.4	18.6	18.6	18.6
Expenditures/GDP	18.5	20.1	22.8	20.4	20.2	21.3	21.0	20.5	20.2	20.1	20.1
Interest/revenues	3.8	4.7	6.2	6.4	7.0	9.5	11.1	9.6	8.3	8.2	8.1
Debt/GDP	16.2	19.2	29.3	29.4	32.3	32.9	36.7	36.8	36.3	35.8	35.5
Debt/revenues	92.4	108.4	171.5	172.4	184.2	189.0	199.5	200.0	195.4	192.5	190.7
Net debt/GDP	7.9	11.3	19.2	20.4	24.0	24.9	29.2	29.8	29.9	29.8	29.9
Liquid assets/GDP	8.3	7.9	10.1	9.0	8.3	8.0	7.5	7.0	6.5	6.0	5.6
Monetary indicators (%)											
CPI growth	4.0	2.8	1.7	4.8	9.8	4.7	3.8	3.8	3.5	3.5	3.5
GDP deflator growth	2.0	3.1	2.2	8.4	8.1	2.2	2.4	3.8	3.5	3.5	3.5
Exchange rate, year-end (LC/$)	5,960.5	6,453.1	6,916.8	6,879.1	7,331.3	7,273.6	7,831.0	8,000.0	8,160.0	8,323.2	8,489.7
Banks' claims on resident non-gov't sector growth	15.1	9.6	8.1	10.6	11.6	9.6	14.0	10.0	10.0	8.0	8.0
Banks' claims on resident non-gov't sector/GDP	42.9	45.8	48.9	47.9	49.4	50.4	53.9	55.1	56.3	56.5	57.0
Foreign currency share of claims by banks on residents	40.6	39.5	36.5	36.3	39.4	39.8	39.8	39.8	39.8	39.8	39.8
Foreign currency share of residents' bank deposits	41.1	42.6	43.8	44.0	44.1	44.3	44.3	44.3	44.3	44.3	44.3

Table 1

Selected indicators (cont.)

	2018	2019	2020	2021	2022	2023	2024e	2025bc	2026bc	2027bc	2028bc
Real effective exchange rate growth	3.1	(3.0)	(1.3)	(1.0)	1.9	(3.0)	0.0	0.0	0.0	0.0	0.0

Definitions: Savings is defined as investment plus the current account surplus (deficit). Investment is defined as expenditure on capital goods, including plant, equipment, and housing, plus the change in inventories. Banks are other depository corporations other than the central bank, whose liabilities are included in the national definition of broad money. Gross external financing needs are defined as current account payments plus short-term external debt at the end of the prior year plus nonresident deposits at the end of the prior year plus long-term external debt maturing within the year. Narrow net external debt is defined as the stock of foreign and local currency public- and private-sector borrowings from nonresidents minus official reserves minus public-sector liquid claims on nonresidents minus financial-sector loans to, deposits with, or investments in nonresident entities. A negative number indicates net external lending. e--Estimate. bc--Base-case. LC--Local currency. CARs--Current account receipts. FDI--Foreign direct investment. CAPs--Current account payments. The data and ratios above result from S&P Global Ratings' own calculations, drawing on national as well as international sources, reflecting S&P Global Ratings' independent view on the timeliness, coverage, accuracy, credibility, and usability of available information.

Ratings Score Snapshot

Table 2

Ratings score snapshot

Key rating factors	Score	Explanations
Institutional assessment	4	Long-standing commitment to macroeconomic stability and fiscal prudency, which have been key at promoting balanced growth. We perceive higher level of policy predictability. Checks and balances have been gradually improving. Political tensions are less likely than before to constrain overall policy implementation and effectiveness.
Economic assessment	4	Based on GDP per capita ($) as per Selected Indicators in Table 1.
External assessment	3	Based on narrow net external debt and gross external financing needs/(CAR +useable reserves) as per Selected Indicators in Table 1.
		The country is exposed to significant volatility in terms of trade, due to its dependence on agricultural exports.
Fiscal assessment: flexibility and performance	3	Based on the change in net general government debt (% of GDP) as per Selected Indicators in Table 1
Fiscal assessment: debt burden	3	Based on net general government debt (% of GDP) and general government interest expenditures (% of general government revenues) as per Selected Indicators in Table 1
		Over 50% of gross government debt is denominated in foreign currency.
		Nonresidents are estimated to hold over 60% of government commercial debt.
Monetary assessment	4	The Guaraní exchange rate regime is floating and the central bank intervenes only occasionally in foreign exchange markets.
		The central bank has operational independence and uses market-based instruments monetary instruments. CPI as per Selected Indicators in Table 1. The central bank has the ability to act as lender of last resort for the financial system. Depository corporation claims on residents in local currency and nonsovereign local currency bond market capitalization combined amount to less than 50% of GDP.
Indicative rating	bb+	
Notches of supplemental adjustments and flexibility	0	
Final rating		

Table 2

Ratings score snapshot (cont.)

Key rating factors	Score	Explanations
Foreign currency	BB+	
Notches of uplift	0	Default risks do not apply differently to foreign- and local-currency debt
Local currency	BB+	

S&P Global Ratings' analysis of sovereign creditworthiness rests on its assessment and scoring of five key rating factors: institutional assessment; economic assessment; external assessment; the average of fiscal flexibility and performance, and debt burden; and monetary assessment. Each of the factors is assessed on a continuum spanning from 1 (strongest) to 6 (weakest). S&P Global Ratings' "Sovereign Rating Methodology," published on Dec. 18, 2017, details how we derive and combine the scores and then derive the sovereign foreign currency rating. In accordance with S&P Global Ratings' sovereign ratings methodology, a change in score does not in all cases lead to a change in the rating, nor is a change in the rating necessarily predicated on changes in one or more of the scores. In determining the final rating the committee can make use of the flexibility afforded by §15 and §§126-128 of the rating methodology.

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- Criteria | Governments | Sovereigns: Sovereign Rating Methodology, Dec. 18, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011
- General Criteria: Methodology: Criteria For Determining Transfer And Convertibility Assessments, May 18, 2009

Related Research

- Paraguay Long-Term Ratings Raised To 'BB+' On Greater Economic Resiliency; Outlook Stable, Feb. 1, 2024

In accordance with our relevant policies and procedures, the Rating Committee was composed of analysts that are qualified to vote in the committee, with sufficient experience to convey the appropriate level of knowledge and understanding of the methodology applicable (see 'Related Criteria And Research'). At the onset of the committee, the chair confirmed that the information provided to the Rating Committee by the primary analyst had been distributed in a timely manner and was sufficient for Committee members to make an informed decision.

After the primary analyst gave opening remarks and explained the recommendation, the Committee discussed key rating factors and critical issues in accordance with the relevant criteria. Qualitative and quantitative risk factors were considered and discussed, looking at track-record and forecasts.

The committee's assessment of the key rating factors is reflected in the Ratings Score Snapshot above.

The chair ensured every voting member was given the opportunity to articulate his/her opinion. The chair or designee reviewed the draft report to ensure consistency with the Committee decision. The views and the decision of the rating committee are summarized in the above rationale and outlook. The weighting of all rating factors is described in the methodology used in this rating action (see 'Related Criteria And Research').

Ratings List

Ratings Affirmed		
Paraguay		
Transfer & Convertibility Assessment		
Local Currency	BBB-	
Paraguay		
Senior Unsecured	BB+	
Ratings Affirmed; CreditWatch/Outlook Action		
	To	**From**
Paraguay		
Sovereign Credit Rating	BB+/Positive/B	BB+/Stable/B