Paraguay

Full Rating Report

Ratings

Foreign Currency

Long-Term IDR	BB
Short-Term IDR	B

Local Currency

Long-Term IDR	BB
Country Ceiling	BB+

Outlooks

Foreign-Currency Long-Term IDR	Stable
Local-Currency Long-Term IDR	Stable

Financial Data

Paraguay

(USDbn)	2015
GDP	28.8
GDP per head (USD 000)	4.1
Population (m)	7
International reserves	6.3
Net external debt (% GDP)	19
Central government total debt (% GDP)	19.0
CG foreign-currency debt	3.6
CG domestically issued debt (PYGbn)	7,109.4

Related Research

Global Economic Outlook (December 2015)

2016 Outlook: Latin America Sovereigns (December 2015)

Paraguay (February 2015)

Analysts

Erich Arispe
+1 212 908 9165
erich.arispe@fitchratings.com

Todd Martinez
+1 212 908 0897
todd.martinez@fitchratings.com

Key Rating Drivers

Balanced Credit Profile: Paraguay's ratings balance a long track record of fiscal prudence through different economic and political cycles, strong fiscal solvency indicators and increased resilience to external shocks against high output volatility due to weather-related shocks, a low tax revenue base and comparatively weak structural factors in terms of investment rates, institutional quality and social development indicators.

Improved External Resilience: Adequate international reserves, exchange rate flexibility and improved credibility of monetary policy allow Paraguay to absorb external pressures derived from lower commodity prices (soy and beef), economic underperformance in key trading partners (most notably deep recession in Brazil) and increased financial market volatility.

Weaker Growth, Moderate Inflation: Growth could slow further to 2.5% in 2016, as Brazil will likely remain in deep recession and commodity prices will stay weak. However, Fitch Ratings expects growth to accelerate in 2017 in line with a less adverse external environment, recovery in large neighbouring economies and the execution of infrastructure projects. Inflation averaged 3.1% in 2015. The central bank increased its policy rate by 25bp to 6% in January, reinforcing its commitment to keep inflation in check in spite of more subdued economic activity.

Manageable Current Account Deficit: The current account deficit rose to an estimated 1.8% of GDP in 2015 and could remain above 2% over the forecast period, balancing a weaker export outlook against reduced prices of oil imports and slower economic activity. Fitch expects the deficit to be financed by FDI. The sovereign will maintain access to external sources of financing, such as multilaterals and external capital markets.

Moderate Deficits, Debt: The central government deficit reached 1.8% of GDP in 2015, up from 1.1% in 2014. Nevertheless, the government missed the deficit ceiling of 1.5% of GDP under the 2013 Fiscal Responsibility and Transparency Law (LRTF). Fitch estimates that general government debt rose to 21.5% of GDP in 2015, from 18.1% in 2014, driven by the guarani depreciation. Debt levels remain less than half the 'BB' median of 44%.

Developing Fiscal Framework: The LRTF continues to face challenges to establish its role as an appropriate institutional anchor for fiscal policy. In contrast to previous practice, the 2016 budget approved by Congress made minimal changes to the proposal submitted by the Ministry of Finance targeting a deficit of 1.5% of GDP. Potential changes to the LRTF will be analysed in the context of improvements to fiscal policy predictability and flexibility, development of a track record and their impact on Paraguay's public finances, currently a key rating strength.

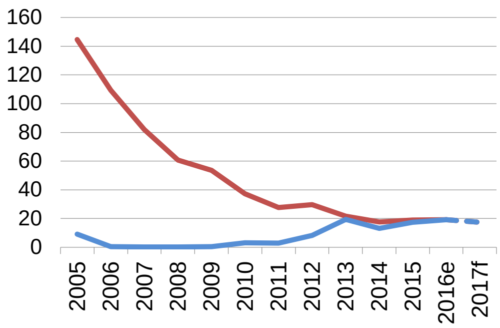
Rating Sensitivities

Higher Growth, External Liquidity: Higher growth trajectory including higher investment levels and macroeconomic stability; strengthening of external liquidity in relation to 'BB' peers; and structural improvements in public finances in terms of revenue base, expenditure rigidity and a continued moderate debt burden would be positive for Paraguay's ratings.

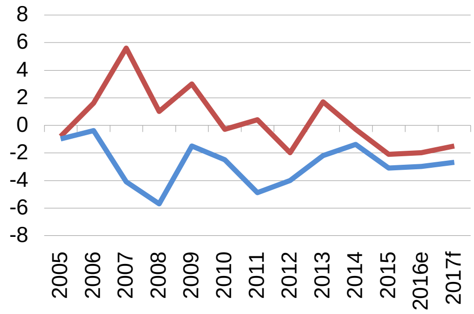
Commodity Shock, Fiscal Slippage: Commodity production shocks or severe export price falls that materially impair external and fiscal solvency ratios, and sustained fiscal deterioration in the context of financing constraints would be negative for creditworthiness.

Peer Comparison

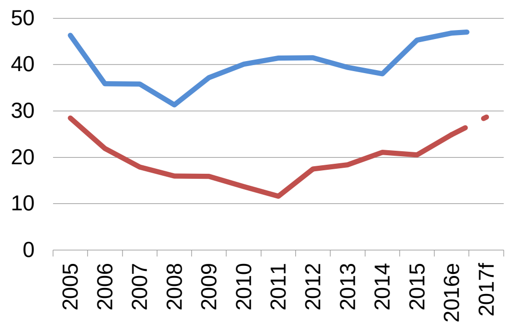
Net External Debt
% of GDP



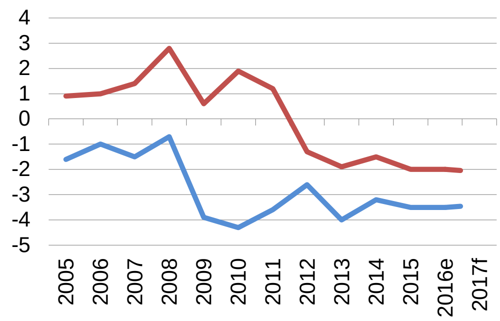
Current Account Balance
% of GDP



General Government Debt
% of GDP

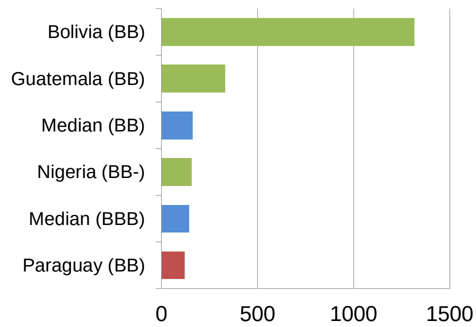


General Government Balance
% of GDP

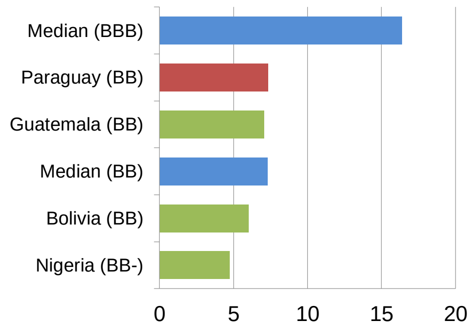


Paraguay   Medians

International Liquidity Ratio, 2016
%



GDP per capita Income, 2015e
At market exchange rates, USA=100



Related Criteria

Sovereign Rating Criteria (August 2014)
Country Ceilings (August 2015)

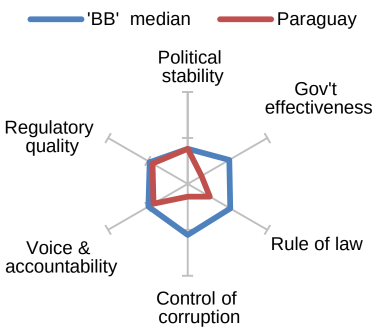
Peer Group

Rating	Country
BB+	Brazil
	Costa Rica
	Hungary
	Macedonia
	Portugal
BB	**Paraguay**
	Bolivia
	Croatia
	Guatemala
BB-	Bangladesh
	Georgia
	Lesotho
	Nigeria
	Seychelles
	Sri Lanka
	Suriname
	Tunisia
	Vietnam

Rating History

Date	Long-Term Foreign Currency	Long-Term Local Currency
29 Jan 15	BB	BB
10 Jan 13	BB-	BB-

Figure 1
Governance Indicators
Percentile rank



Source: Fitch

Rating Factors

Summary: Strengths and Weaknesses

Rating factor	Macroeconomic	Public finances	External finances	Structural issues
Status	Neutral	Strength	Neutral	Weakness
Trend	Stable	Stable	Stable	Stable

Note: Relative to 'BB' category
Source: Fitch

Strengths

Paraguay's five-year average growth of 5% remains higher than the 'BB' median of 4.1%. In spite of the present slowdown, Fitch expects increased export diversification and trade integration, and infrastructure investment to provide a recovery path for the economy. Income per capita remains in line with the 'BB' median.

Paraguay has a long record of fiscal prudence despite its low tax burden and limited dependence on commodity-derived revenue. General government debt and financing needs are lower than 'BB' peers. Recent access to international bond markets and multilateral lending at favourable terms support financing flexibility.

Adequate international reserves coverage and improved exchange rate flexibility provides capacity to manage external shocks and mitigate risks related to financial dollarisation. Paraguay's sovereign net external creditor status contrasts favourably with the median debtor position of the 'BB' category. Paraguay's external debt and liquidity ratios are weakened by the outstanding debt of binational electricity generation companies (Itaipu and Yacereta).

Since the introduction of inflation targeting, inflation has come down in relation to 'BB' peers and has remained within the target band set by the monetary authority in spite of high financial dollarisation and shallow domestic capital markets.

Weaknesses

High dependence on agriculture commodities and hydroelectric generation increases the vulnerability of growth and external accounts to adverse weather conditions. Paraguay also continues to be impacted by extended recession in Brazil.

Domestic investment (16.8% of GDP in 2015) still lags behind the 'BB' median of 21%.

Fitch has maintained a Macro-Prudential Indicator for Paraguay of '3' since 2011, signalling that the potential for financial systemic stress is high due to rapid credit growth and real appreciation in recent years. Slower growth, reduced profitability in the agro sector and the guarani depreciation will continue to test the resilience of the domestic banking system.

Governance indicators compare unfavourably with the 'BB' medians in the control of corruption, government effectiveness and rule of law. The current government has made efforts to improve transparency and build capacity in government institutions in areas such as public investment.

Local Currency Rating

Paraguay's Long-Term Local- and Foreign-Currency Issuer Default Ratings (IDRs) are the same. Despite the low government debt burden, a narrow tax revenue base and the lack of well-developed local capital markets prevent a higher local-currency rating.

Country Ceiling

Paraguay's Country Ceiling is one notch above its IDR. Paraguay has open current and capital accounts, as shown by the large presence of foreign banks and agriculture multinationals operating in the country. The exchange rate system is free of restrictions on the making of payments and transfer for current international transactions.

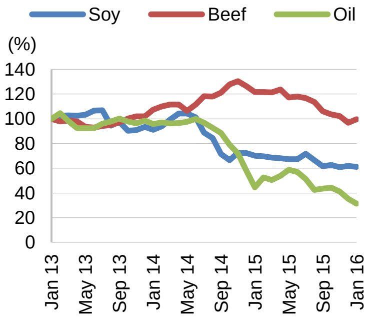
Figure 2

Strengths and Weaknesses: Comparative Analysis

2015	Paraguay BB	BB Median[a]	BBB Median[a]	Bolivia BB	Guatemala BB	Nigeria BB-
Macroeconomic performance and policies						
Real GDP (5yr average % change)	5.0	3.9	3.2	5.3	3.8	4.8
Volatility of GDP (10yr rolling SD)	5.5	2.2	2.8	1.0	1.6	1.6
Consumer prices (5yr average)	4.6	4.6	3.3	6.0	4.0	9.8
Volatility of CPI (10yr rolling SD)	2.9	2.8	1.8	3.6	2.8	2.6
Unemployment rate (%)	5.5	9.3	6.8	4.0	3.0	23.6
Type of exchange rate regime	Managed float	n.a.	n.a.	Crawling peg	Managed float	Managed float
Dollarisation ratio (% of bank deposits)	43.7	38.3	32.2	20.3	17.6	0.0
REER volatility (10yr rolling SD)	7.4	4.9	4.9	5.2	3.1	7.1
Structural features						
GDP per capita (USD, mkt. exchange rates)	4,086	4,086	9,198	3,327	3,901	2,630
GNI per capita (PPP, USD, latest)	8,010	10,270	17,600	5,750	7,260	5,680
GDP (USDbn)	28.8	n.a.	n.a.	36.7	63.4	482.6
Human development index (percentile, latest)	40.8	52.1	63.4	39.7	33.3	18.2
Governance indicator (percentile, latest)[b]	30.8	46.2	57.1	32.5	29.9	14.8
Broad money (% GDP)	47.5	55.4	67.0	64.9	46.9	20.3
Default record (year cured)[c]	2003	n.a.	n.a.	1997	1989	2005
Ease of doing business (percentile, latest)	47.4	50.0	71.3	17.1	61.8	10.7
Trade openness (avg. of CXR + CXP % GDP)	45.5	52.2	41.1	34.4	34.8	17.1
Gross domestic savings (% GDP)	19.0	17.3	22.9	23.9	2.9	-
Gross domestic investment (% GDP)	16.8	21.7	22.1	20.1	13.7	25.0
Private credit (% GDP)	57.5	48.9	62.3	52.6	35.2	16.4
Bank systemic risk indicators[d]	-/-	n.a.	n.a.	bb / 3	bb / 1	b / 1
Bank system capital ratio (% assets)	15.1	13.9	15.5	12.9	13.9	0.0
Foreign bank ownership (% assets)	43.0	20.3	36.7	16.8	15.5	0.0
Public bank ownership (% assets)	6.0	24.4	24.4	12.5	1.2	0.0
External finances						
Current account balance + net FDI (% GDP)	0.3	0.0	0.3	0.1	0.8	-1.9
Current account balance (% GDP)	-1.8	-2.5	-2.1	-4.0	-1.2	-2.5
Net external debt (% GDP)	19.0	17.1	3.8	-34.5	-0.8	-2.6
Gross external debt (% CXR)[e]	136.3	118.4	140.1	83.5	81.4	111.3
Gross sovereign external debt (% GXD)	25.5	46.8	33.0	66.1	43.8	50.5
Sovereign net foreign assets (% GDP)	6.5	-2.2	-0.8	25.3	2.1	-0.1
Ext. interest service ratio (% CXR)	5.5	2.7	4.7	1.2	3.0	2.0
Ext. debt service ratio (% CXR)	13.2	8.9	13.5	8.6	8.7	5.0
Foreign exchange reserves (months of CXP)	5.6	4.1	5.5	13.0	4.1	4.7
Liquidity ratio (latest)[f]	120.2	155.6	158.1	1,317.8	331.9	157.6
Share of currency in global reserves (%)	0	n.a.	n.a.	0	0	0
Commodity export dependence (% CXR, latest)	-	19.0	20.7	74.0	31.2	57.1
Sovereign net foreign currency debt (% GDP)	-11.9	0.7	-5.9	-20.6	-0.8	0.0
Public finances[g]						
Budget balance (% GDP)	-2.2	-3.5	-2.7	-2.4	-2.1	-3.3
Primary balance (% GDP)	-1.6	-1.8	-0.6	-1.6	-0.7	-2.3
Gross debt (% revenue)	95.6	200.7	171.6	91.3	206.4	196.0
Gross debt (% GDP)	21.5	44.4	42.7	31.6	22.5	14.5
Net debt (% GDP)	10.7	39.1	32.7	18.8	17.4	11.3
Foreign currency debt (% total debt)	73.1	50.7	36.8	59.2	49.7	25.1
Interest payments (% revenue)	2.7	8.5	8.2	2.5	13.2	13.2
Revenues and grants (% GDP)	22.5	26.1	28.8	34.6	10.9	7.4
Volatility of revenues/GDP ratio	7.7	5.4	5.7	5.4	5.9	30.2
Central govt. debt maturities (% GDP)	1.0	3.9	5.4	1.7	1.4	3.8

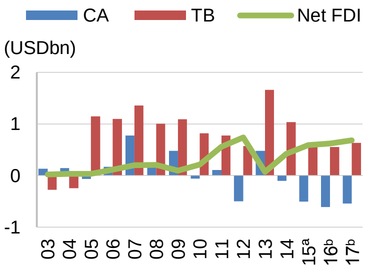
[a] Medians based on three-year centred averages
[b] Composite of six World Bank Governance Indicators used in the Sovereign Rating Model; Government Effectiveness; Rule of Law; Control of Corruption; Voice and Accountability; Regulatory Quality; and Political Stability and Absence of Violence
[c] Paraguay defaulted its domestic debt and incurred arrears on multilateral loans
[d] Bank systemic indicator, which equates to a weighted average Viability Rating; and macro prudential indicator, with 1 'low' systemic risk through to 3 'high'
[e] Gross external debt reached an estimated USD14bn in 2013. Three-fourths of this amount corresponded to the debt that the Paraguayan hydroelectric company pays to its Brazilian counterpart for the construction of the Itaipu dam in the 1970s. The debt is serviced with the proceeds from the sales of electricity and will be fully amortised in 2023
[f] Ratio of liquid external assets, defined as the stock of official FX reserves including gold at the end of the previous calendar year plus banks' liquid external assets, to liquid external liabilities, defined as scheduled external debt service in the current year, plus the stock of short-term external debt and all non-resident holdings of marketable medium- and long-term local-currency debt at the end of the previous calendar year
[g] General government unless stated
Note: Acronyms used: Consumer price inflation (CPI), gross domestic product (GDP), current external receipts (CXR), current external payments (CXP), gross national income (GNI), purchasing power parity (PPP), standard deviation (SD), foreign direct investment (FDI)
Source: Fitch

Figure 3
Commodities Shock
Jan 13 = 100



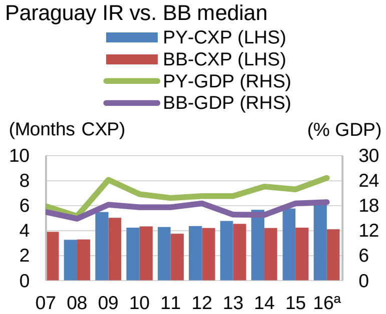
Source: BCP & Fitch

Figure 4
Paraguay Current Account Dynamics



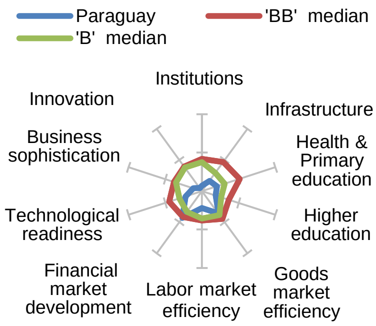
ª Estimate
ᵇ Forecast
Source: IFS, BCP& Fitch

Figure 5
International Reserves Remain Adequate
Paraguay IR vs. BB median



ª forecast
Source: BCP & Fitch

Figure 6
Competitiveness Indicators
Percentile rank



Source: World Economic Forum (2015-16)

Key Credit Developments

Simultaneous Shocks Test External Resilience

Paraguay has a relatively more diversified export base than other 'BB' commodity exporters within three industries: soy, beef and hydropower sales to neighbouring Argentina and Brazil. Average soy[1] prices dropped by 24% in 2015 and 15% since June alone. Beef prices have declined by 21% since the end of 2014. Moreover, Brazil's economy (Paraguay's main trade partner) contracted markedly in 2015, and exports to Russia, a key beef market, fell by 37%. Electricity exports to neighbouring Brazil and Argentina remained stable.

The fall in agricultural receipts has been partly mitigated by lower fuel imports (28% down in USD terms). The trade surplus for 2015 is estimated to have declined to 2.2% of GDP, down from 3.4% in 2014, a current account deficit of 1.8% for 2015, up from a deficit of 0.3% in 2014. Paraguay's CAD could top 2% of GDP over the forecast period, below 'BB' peers, balancing a weak commodity export outlook and continued recession in Brazil in 2016 against low oil prices. Progress towards product (i.e. crops like rice) and market (towards Middle East and East Asia) diversification could support export growth.

Fitch expects FDI to fully finance the current account deficit through investments in the electricity sector, infrastructure and the maquila industry. Dynamism in maquila activities (auto parts, apparel, plastics) benefits from the integration into supply chains targeting the Brazilian market with advantages in terms of proximity, tax competitiveness, low energy costs, cheap labour and regulatory incentives. In addition, the government will continue to have access to multilateral borrowing such as CAF, World Bank and IADB and opportunistically tap international markets.

International reserves declined by USD686m in 2015, as the central bank intervened to smooth the guarani depreciation and the government executed remaining 2014 global bond proceeds. The central bank sold USD233m in net terms between January and November. At USD6200m, reserve coverage remains adequate at 5.8 months of CXP, and Paraguay remains the second-strongest net sovereign external creditor, behind Bolivia.

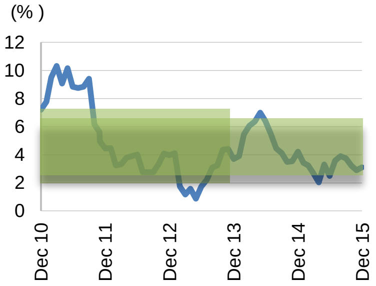
Slowdown with Inflation Under Control

Growth has slowed in line with a weaker agricultural sector, lower electricity generation and the impact of Brazil. Weaker soy prices have ripple effects on domestic confidence and investment. Domestic demand, underpinned by manufacturing and public investment prevented further slowdown. Officials estimate that the economy expanded by 3% in 2015.

The continuation of Brazil's deep recession, the impact of flooding and weak commodity prices could push growth further down in 2016 to 2.5%. Public investment, especially in the infrastructure sector, continued FDI inflows, and recovery in Argentina and Brazil remain potential drivers for the recovery to 3.7% in 2017. Authorities expect to begin execution of the first PPP projects in 2H16, but the full impact on the economy is likely to be felt in 2017. Paraguay has a pipeline of approximately USD2bn projects to be offered for concession over 2016-2017. Reducing infrastructure bottle necks, continued capacity building in public institutions and making progress in improving the local business environment are important to continue attracting and diversifying investment.

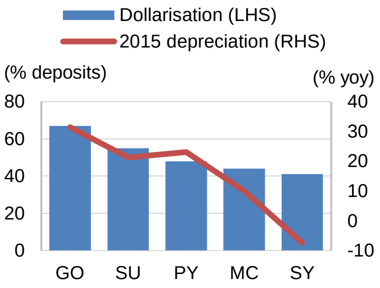
[1] Soy products (seed, oil and meal) account for 35% of total exports, while electricity and beef account for 25% and 14%, respectively.

Figure 7
Improved Mon. Policy Credibility
Inflation remains within target range



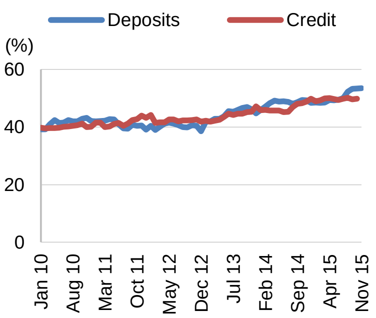
Source: BCP & Fitch

Figure 8
FX Adjustment under Dollarisation
5 most dollarised BB sovereigns, 2015



Source: National Authorities & Fitch

Figure 9
High Financial Dollarisation
% of total (USD)



Source: BCP & Fitch

Inflation ended 2015 at 3.1%, within the central bank target range of 4.5±2%[2]. Food inflation has remained under control, and depreciation vis-à-vis trade partners (Argentina and Brazil) has been much more muted than depreciation against the US dollar. Core inflation, though, moved up to 3.7% in December 2015. This development and increased volatility in global financial markets prompted a 25bps increase to 6% in January, after easing policy by a cumulative 100bps between March and July 2015.

Inflation risks remain moderate over the forecast period, as moderate growth, weak commodity prices and anchored inflation expectations could balance further depreciation pressures on the guarani. Inflation could converge to the target in 2016-2017 in the absence of supply shocks.

Increased FX Flexibility and Financial Stability

The exchange rate depreciated by 23% in 2015, thus demonstrating improved flexibility to absorb the external shock in spite of high financial dollarisation. While dollarisation levels remain above 'BB' peers, the exchange rate adjustment has not resulted in a destabilising impact for macroeconomic or financial stability. Allowing the exchange rate to depreciate was not a result of large external or fiscal imbalances, but a response the external shock.

Fitch has maintained a Macro-Prudential Indicator[3] for Paraguay of '3' since 2011, signalling that the potential for financial systemic stress is high due to the combination of rapid credit growth and real exchange appreciation. Credit to the private sector expanded by 23% in nominal terms yoy in November, driven largely by weaker guarani impact on the dollar-denominated loan portfolio (50% of total credit). Past due loans rose from 1.8% at the end of 2014 to 2.7% in November 2015.

Fitch expects credit growth to moderate further in 2016 and exposure to the agricultural sector, while significant, to be managed in an orderly fashion similar to previous cycles. Credit in FC is largely concentrated in the export-oriented agriculture and livestock sectors, two industries with collateral and without currency mismatches. Limited state ownership and high participation of foreign financial institutions in the domestic market reduce the risks of potential contingent liabilities to the sovereign.

A new banking law increasing supervisory powers of the central bank and bringing regulation closer towards Basel III has been approved by the Senate and should be approved by the lower house in 2016. Interest rates ceilings on credit cards and the transfer of public sector deposits to public banks have shown a more active congress in economic policy, which could risk introducing policy uncertainty.

Fiscal Policy Seeking to Consolidate Credentials

Paraguay has a long track record of fiscal prudence through different economic and political cycles. In 2015, authorities reported that the central government deficit reached an estimated 1.8% of GDP in 2015, an estimated 2.1% at the general government level and the lowest among 'BB' commodity exporters but 0.3pp above the nominal ceiling set by the FRL[4]. Although revenues related to the 4G telecommunications spectrum auction (0.3% of GDP) were not received before the end of the year, weak revenue performance forced the government to tighten spending starting mid-year. The government maintained focus on social

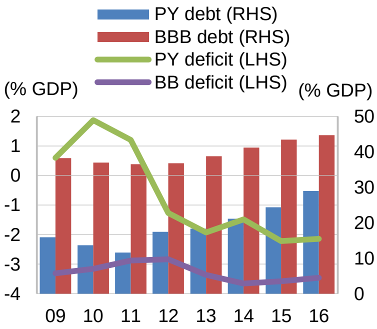
[2] Paraguay formally adopted inflation targeting in 2011. In December 2014, the central bank lowered its inflation target to 4.5% from 5%, 10 months after having narrowed the reference band to ±2% from ±2.5%.

[3] Fitch's Macro-Prudential Indicator (MPI) identifies potential banking system risks often preceded by bank lending growth, real estate, equity price bubbles and real exchange rate appreciation. MPI 2 (moderate) is triggered by credit growth alone, while MPI 3 (high) requires further triggers.

[4] The Cartes administration introduced a Fiscal Transparency and Responsibility Law (LTRF) in 2013 to institutionalise Paraguay's conservative fiscal policy execution and to improve policy predictability. The law established limits to current expenditure (4% real terms), growth, framework for salary adjustments in the event of high inflation, and set a ceiling of 1.5% of GDP for the CG deficit.

Figure 10

Public Finances Stronger Than Peers

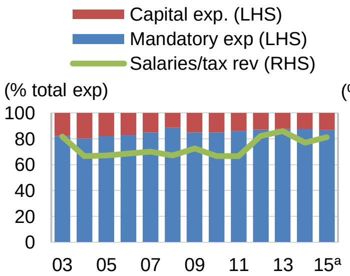


Source: MHP & Fitch

Figure 11

Rigid Expenditure Composition

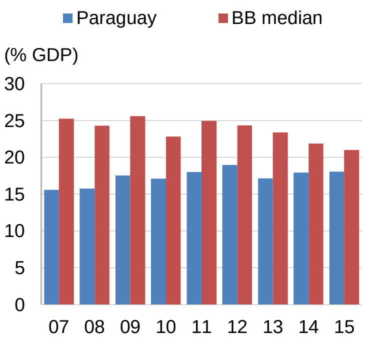
CG expenditure



[a] Preliminary estimates
Source: MHP& Fitch

Figure 12

Lower CG Revenue Base



Source: MHP & Ficth

spending (increasing coverage) in programmes such as conditional cash transfers (Tekopora) and pension for vulnerable seniors. Salaries went up by 9%, while capital spending increased by over 14% financed partly by the proceeds of past external bond issuances.

The current FRL continues to face challenges to establish it role as an appropriate institutional anchor for fiscal policy. The first budget (2015) approved by congress after the law called for a central government deficit of 3.2% of GDP, well above the legal limit of 1.5%, and the 2015 budget law also allowed the government to run a deficit higher than the 1.5% GDP by excluding investments with the use of past global bond proceeds.

In a positive step, the 2016 budget approved by Congress faced with minimal changes (USD20m or 0.08% of GDP) to the proposal submitted by the Ministry of Finance targeting a deficit of 1.5% of GDP. Nevertheless, revenue projections could prove hard to achieve in the context of subdued growth, expenditure related to flooding and continued focus on public investment by the current administration. Thus, Fitch expects the central government deficit to increase to 2.2% in 2016.

Paraguay's revenue base is lower than 'BB' rated sovereigns and expenditure is highly rigid, most notably on the current spending side. Salaries consumed close to 73% of tax revenues in 2015. The expected increase in tax revenues from reforms in 2012 and 2013[5] agricultural value added tax and income taxes could be weighed down by the ongoing weakness in the agricultural sector and the use of deductions to reduce income tax payments. Authorities have indicated that they intend to reduce the number of tax exemptions and broaden the VAT tax base (including cooperatives), which could provide some upside for revenues.

Given the deteriorating external environment and the significant infrastructure and social needs, authorities are currently exploring changes to the rule to make it more responsive to economic cycles and reduce its pro-cyclicality by targeting a structural rather than a nominal balance. In Fitch's view, the potential changes to the fiscal responsibility law will be analysed in the context of improvements to fiscal policy predictability and flexibility, track record and their impact on Paraguay's public finances, presently a key rating strength.

In terms of PPPs, the road linking Asuncion with Ciudad del Este (route 2 and 7) for USD400m represent a future flow of starting the fourth year of the project. The PPP for the Asuncion airport (USD150m) has to be auctioned in 2016. The PP Law limits annual commitments at 0.4% of GDP and stock of 3% of GDP. Law 5074 (turnkey projects) does not provide a limit in terms of commitments, but approval must be accompanied by an analysis of fiscal sustainability. Fitch does not currently expect infrastructure projects to build material contingent liabilities for the sovereign balance sheet over the forecast period.

Fitch estimates that general government debt increased to 21.5% of GDP in 2015, driven by PYG depreciation, still below rating peers. Paraguay last accessed external bond markets in 2015, and the sovereign could return to the external markets (USD700m approval in the 2016 budget) in the event of favourable conditions. The creation of a regulatory body for pension funds (*superintendencia*) could provide guidelines and incentives for long-term investment in assets including government instruments. The cajas (sectoral savings mechanisms) hold close of 6% of GDP that could be directed towards long-term investments.

[5] In 2012, Paraguay introduced personal income taxation with a phased implementation until 2019. In 2014, VAT on agricultural products and agricultural income tax (IRAGRO) started to be implemented.

Fitch uses stylised projections for a sovereign's gross general government debt (GGGD)/GDP ratio to illustrate the sustainability of its debt burden and its sensitivity to economic growth, the cost of borrowing, fiscal policy and the exchange rate.

Public Debt Dynamics

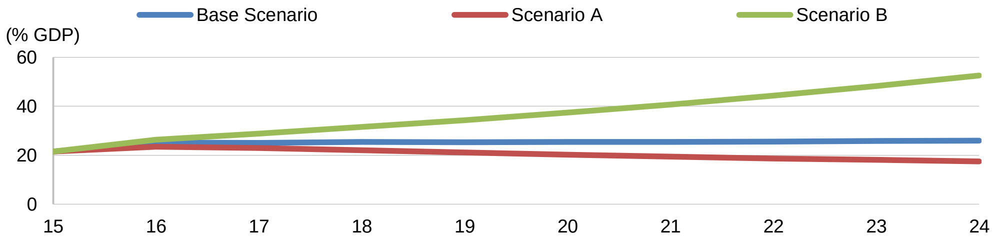
According to Fitch's baseline projections, GGGD should peak at 25.5% of GDP over the medium term. The main risk to debt sustainability would be a failure to reduce the primary budget deficit, continued guarani depreciation and growth underperformance.

Debt Dynamics: Fitch's Baseline Assumptions

	2015	2016	2017	2018	2019	2020	2021
Gross general government debt (% GDP)	21.5	25.2	25.1	25.4	25.3	25.4	25.4
Primary balance (% of GDP)	-1.6	-1.2	-0.8	-0.4	0	0	0
Real GDP growth (%)	3.0	2.5	3.7	3.5	3.5	3.5	3.5
Avg. nominal effective interest rate (%)	3.4	3.9	4.5	5.0	5.6	6.1	6.6
PYG/USD (annual avg.)	5,147.4	5,947.7	6,225.0	6,343.7	6,534.1	6,730.1	6,931.9
GDP deflator (%)	3.3	4.0	4.5	4.5	4.5	4.5	4.5

Sensitivity Analysis

Gross general government debt



Source: Fitch estimates, MHP, IMF

Debt Sensitivity Analysis: Fitch's Scenario Assumptions

Scenario A	Growth reaching 4.5% medium term, generating PS of 0.3% and exchange rate stability
Scenario B	Primary deficits remain at 1.5% of GDP with growth underperforming at 3% MT and +100bps effective interest rate in relation to the baseline scenario

Forecast Summary

	2011	2012	2013	2014	2015	2016e	2017f
Macroeconomic indicators and policy							
Real GDP growth (%)	4.3	-1.2	14.2	4.4	3.0	2.5	3.7
Unemployment (%)	4.3	5.8	5.4	5.5	5.8	6.3	5.6
Consumer prices (annual average % change)	8.3	3.7	2.7	5.0	3.1	3.8	4.5
Short-term interest rate (bank policy annual avg.) (%)	7.5	5.7	4.9	5.8	5.2	5.7	6.3
General government balance (% of GDP)	1.2	-1.3	-1.9	-1.5	-2.2	-2.1	-1.7
General government debt (% of GDP)	11.6	13.9	15.1	18.1	21.5	25.2	25.1
PYG per USD (annual average)	4,191.4	4,424.9	4,320.7	4,462.2	5,147.4	5,947.7	6,225.0
Real effective exchange rate (2000 = 100)	123.6	121.6	127.9	132.0	128.5	120.8	114.8
Real private sector credit growth (%)	15.3	9.5	19.9	14.4	19.5	13.7	10.1
External finance							
Current account balance (% of GDP)	0.4	-2.0	1.7	-0.3	-1.8	-2.1	-1.7
Current account balance plus net FDI (% of GDP)	2.7	1.0	1.9	1.0	0.3	0.0	0.4
Net external debt (% of GDP)	27.7	29.9	20.5	19.8	20.3	19.4	16.0
Net external debt (% of CXR)	49.5	55.7	39.1	41.6	46.4	42.3	34.2
Official international reserves including gold (USDbn)	5.0	5.0	5.9	6.9	6.2	6.5	6.5
Official international reserves (months of CXP cover)	4.3	4.4	4.8	5.7	5.8	6.1	5.9
External interest service (% of CXR)	4.8	4.8	4.2	4.6	5.3	5.5	6.5
Gross external financing requirement (% int. reserves)	25.9	34.2	12.3	19.9	22.0	23.4	20.5
Real GDP growth (%)							
US	1.6	2.2	1.5	2.4	2.5	2.5	2.3
China	9.5	7.7	7.7	7.3	6.8	6.3	6.0
Eurozone	1.7	-0.8	-0.3	0.9	1.5	1.7	1.7
World	3.4	2.5	2.4	2.5	2.3	2.6	2.7
Oil (USD/barrel)	111.0	112.0	108.8	98.9	53.0	45.0	55.0

Source: Fitch

Fiscal Accounts Summary

(% of GDP)	2012	2013	2014	2015	2016e	2017f
General government						
Revenue	**24.3**	**21.5**	**22.8**	**22.5**	**21.8**	**21.7**
Expenditure	**25.6**	**23.5**	**24.2**	**24.7**	**23.9**	**23.4**
O/w interest payments	0.2	0.3	0.5	0.6	0.9	0.9
Primary balance	-1.0	-1.6	-1.0	-1.6	-1.2	-0.8
Overall balance	**-1.3**	**-1.9**	**-1.5**	**-2.2**	**-2.1**	**-1.7**
General government debt	**13.9**	**15.1**	**18.1**	**21.5**	**25.2**	**25.1**
% of general government revenue	57.4	70.3	79.4	95.6	115.9	115.4
Central government deposits	9.5	9.6	11.3	10.7	11.0	9.7
Net general government debt	4.4	5.5	6.8	10.8	14.2	15.4
Central government						
Revenue	**19.0**	**17.1**	**17.9**	**18.0**	**17.7**	**17.9**
O/w grants	0.0	0.0	0.0	0.0	0.0	0.0
Expenditure and net lending	**20.6**	**18.8**	**19.0**	**19.9**	**19.8**	**19.6**
O/w current expenditure and transfers	16.0	15.1	16.6	17.3	17.0	16.9
- Interest	0.2	0.3	0.4	0.6	0.9	0.9
O/w capital expenditure	2.6	2.3	2.4	2.6	2.8	2.6
Current balance	2.5	1.9	-0.1	-1.0	-1.3	-1.0
Primary balance	-1.4	-1.4	-0.7	-1.2	-1.3	-0.7
Overall balance	**-1.7**	**-1.7**	**-1.1**	**-1.8**	**-2.2**	**-1.6**
Central government debt	12.3	13.6	16.2	19.0	23.0	23.0
% of central government revenues	64.9	79.1	90.5	105.5	130.4	128.5
Central government debt (PYGbn)	**13,399.9**	**16,972.7**	**22,348.5**	**27,929.8**	**35,969.2**	**39,017.1**
By residency of holder						
Domestic	5,263.2	6,303.7	7,016.6	7,109.4	-	-
Foreign	8,136.7	10,668.9	15,331.9	20,820.3	-	-
By currency denomination						
Local currency	5,263.2	6,303.7	7,016.6	7,109.4	-	-
Foreign currency	8,136.7	10,668.9	15,331.9	20,820.3	-	-
In USD equivalent (eop exchange rate)	1.9	2.4	3.3	3.6	-	-
Average maturity (years)	-	-	-	-	-	-
Memo						
Nominal GDP (PYGbn)	108,832.3	125,152.2	137,797.7	146,618.3	156,300.1	169,292.1

Source: Ministry of Finance and Fitch estimates and forecasts

External Debt and Assets

(USDbn)	2010	2011	2012	2013	2014	2015
Gross external debt	**16.3**	**16.0**	**16.7**	**16.6**	**17.5**	**17.4**
% of GDP	81.1	63.7	67.7	57.5	56.5	60.5
% of CXR	139.0	113.8	126.1	109.2	119.4	136.3
By maturity						
Medium-and long-term	11.9	11.6	12.0	12.0	12.6	12.5
Short-term	4.4	4.4	4.7	4.6	4.9	4.9
% of total debt	26.9	27.4	28.0	27.9	27.9	27.9
By debtor						
Sovereign	**2.7**	**2.6**	**2.8**	**3.2**	**4.3**	**4.4**
Monetary authorities	0.2	0.2	0.2	0.2	0.2	0.2
General government	2.6	2.5	2.6	3.1	4.2	4.3
O/w central government	2.0	1.9	1.9	2.4	3.3	2.8
Banks	**0.5**	**0.5**	**0.8**	**0.8**	**0.8**	**0.9**
Other sectors	**13.1**	**12.8**	**13.1**	**12.6**	**12.4**	**12.1**
Gross external assets (non-equity)	**8.8**	**9.0**	**9.4**	**10.4**	**12.0**	**11.9**
International reserves, incl. gold	4.2	5.0	5.0	5.9	7.0	6.3
Other sovereign assets nes	0.0	0.0	0.0	0.0	0.0	0.0
Deposit money banks' foreign assets	0.9	0.8	0.9	0.9	0.9	1.1
Other sector foreign assets	3.7	3.2	3.4	3.6	4.0	4.5
Net external debt	**7.5**	**6.9**	**7.3**	**6.3**	**5.5**	**5.5**
% of GDP	37.3	27.7	29.7	21.7	17.7	19.0
Net sovereign external debt	-1.5	-2.3	-2.2	-2.6	-2.7	-1.9
Net bank external debt	-0.4	-0.3	-0.1	-0.1	-0.1	-0.2
Net other external debt	9.4	9.6	9.6	9.0	8.3	7.6
Net international investment position	**-9.9**	**-9.9**	**-10.8**	**-9.8**	**-9.2**	**-9.1**
% of GDP	-49.2	-39.4	-43.9	-33.8	-29.6	-31.7
Sovereign net foreign assets	**1.5**	**2.4**	**2.2**	**2.7**	**2.7**	**1.9**
% of GDP	7.4	9.4	8.9	9.2	8.7	6.5
Debt service (principal & interest)	**1.9**	**1.9**	**1.8**	**1.8**	**1.8**	**1.7**
Debt service (% of CXR)	16.2	13.2	14.0	11.8	12.3	13.2
Interest (% of CXR)	6.0	4.8	4.8	4.3	4.8	5.5
Liquidity ratio (%)	77.4	81.2	93.4	91.5	105.1	120.2
Net sovereign FX debt (% of GDP)	-10.9	-12.1	-12.6	-12.2	-11.8	-11.9
Memo						
Nominal GDP	20.0	25.1	24.6	28.9	31.0	28.8
Inter-company loans	0.6	0.8	1.0	1.1	1.1	1.1

Source: Central Bank, IMF, World Bank and Fitch estimates and forecasts

Government Debt Amortization Schedule on Medium- and Long-Term Debt

(USDm)	2015	2016	2017	2018	2019	2020/21
External						
Official bilateral	34.3	34.9	34.9	34.8	34.7	54.0
Multilateral	117.7	112.7	100.1	92.2	87.6	150.2
O/w IMF	-	-	-	-	-	-
Bonds placed in foreign markets	25.8	25.8	25.8	25.8	25.8	-
Domestic						
Bonds	118.4	211.0	174.5	69.1	35.6	8.7
Total	**424.2**	**507.8**	**453.3**	**335.2**	**293.5**	**423.0**
Non-sovereign public sector						

Source: Ministry of Finance, Central Bank and Fitch

Balance of Payments

(USDbn)	2012	2013	2014	2015	2016e	2017f
Current account balance	**-0.5**	**0.5**	**-0.1**	**-0.5**	**-0.6**	**-0.5**
% of GDP	-2.0	1.7	-0.3	-1.8	-2.3	-2.0
% of CXR	-3.8	3.2	-0.7	-4.0	-5.1	-4.3
Trade balance	**0.6**	**1.7**	**1.0**	**0.6**	**0.5**	**0.6**
Exports, fob	11.7	13.6	13.1	10.9	10.5	11.0
Imports, fob	11.1	11.9	12.1	10.3	9.9	10.4
Services, net	**-0.2**	**-0.2**	**-0.2**	**-0.2**	**-0.2**	**-0.2**
Services, credit	0.8	0.8	0.9	0.8	0.8	0.9
Services, debit	0.9	1.1	1.1	1.0	1.1	1.1
Income, net	**-1.7**	**-1.7**	**-1.5**	**-1.6**	**-1.6**	**-1.6**
Income, credit	0.0	0.0	0.0	0.0	0.1	0.1
Income, debit	1.7	1.7	1.6	1.6	1.7	1.7
O/w: Interest payments	0.6	0.6	0.7	0.7	0.7	0.8
Current transfers, net	**0.8**	**0.7**	**0.6**	**0.7**	**0.7**	**0.7**
Capital and financial accounts						
Non-debt-creating inflows (net)	0.4	0.3	0.6	0.6	0.6	0.7
O/w equity FDI	0.3	0.3	0.6	0.5	0.6	0.6
O/w portfolio equity	0.0	0.0	0.0	0.0	0.0	0.0
O/w other flows	0.1	0.1	0.0	0.0	0.0	0.1
Change in reserves	0.0	1.0	1.1	-0.7	0.1	0.2
Gross external financing requirement	1.7	0.6	1.2	1.5	1.5	1.3
Stock of international reserves, incl. gold	5.0	5.9	6.9	6.2	6.5	6.4

Source: IMF and Fitch estimates and forecasts

The ratings above were solicited by, or on behalf of, the issuer, and therefore, Fitch has been compensated for the provision of the ratings.