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)	2014f
GDP	30.2
GDP per head (USD 000)	4.4
Population (m)	6.9
International reserves	7
Net external debt (% GDP)	18.2
Central government total debt (% GDP)	19.7
CG foreign-currency debt	3.3
CG domestically issued debt (PYGbn)	11.8

Related Research

Global Economic Outlook (December 2014)

2015 Outlook: Latin America Sovereigns (December 2014)

Paraguay (February 2014)

Fiscal Rigidity: The Achilles Heel of LatAm Sovereigns (June 2013)

Analysts

Cesar Arias
+1 212 908 0358
cesar.arias@fitchratings.com

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

Key Rating Drivers

Resilience Drives Upgrade: The resilience of Paraguay's external accounts and economic growth has increased, underpinned by export diversification and productivity enhancements in the primary sector. Export receipts are generated by three industries that are relatively uncorrelated and less exposed to the current downturn in global commodity prices: soy, beef and electricity. Fitch Ratings expects the sovereign to remain a net external creditor and international reserves to cover over five months of current external payments in 2015-2016.

Per Capita Income Convergence: Paraguay's five-year average growth of 7% exceeded the 'BB' median of 4% in 2014. Higher growth has facilitated the convergence of the country's per capita income with the 'BB' median. Fitch forecasts that growth will keep pace at 4.5% in 2015-2016, driven by construction, infrastructure, private consumption and a rising maquila industry.

Price Stability Despite Constraints: Monetary authorities have been able to maintain moderate inflation rates despite the challenges imposed by low financial intermediation, high dollarisation and underdeveloped local capital markets. The central bank has met its inflation target since the adoption of the regime in 2011, and expectations point to consumer price increases in line with the new official reference mid-point of 4.5% in 2015-2016.

Prudent Use of Fiscal Space: Fitch projects that Paraguay's debt burden will reach 23% of GDP by 2016 but remain well below the 'BB' median of 40%. Fitch expects the central government deficit to widen to 2.4% of GDP in 2014-2015. The revenue base is expected to increase with the gradual introduction of new taxes. Access to international bond markets and multilateral funding at favourable conditions support fiscal financing flexibility.

Budget Deficits Exceed Targets: The 2015 budget calls for a budget deficit of 3.5% of GDP, above the limit established by the new fiscal responsibility law of 1.5%. Real wage adjustments awarded to teachers and doctors and transfers to subnational governments in an electoral year make it difficult to abide by the current spending targets. The authorities seem willing to accept deviations from the deficit limits if they are driven by increased public investment.

Emerging Financial Vulnerabilities: Banks have strengthened since the 2003 crisis and maintain adequate capitalisation, liquidity and credit quality. Rapid lending growth, rising household indebtedness and high dollarisation of credit could become sources of vulnerability.

Stable Balance of Risks: Paraguay's ratings balance a record of fiscal prudence through different economic and political cycles and strong fiscal solvency against high output volatility due to weather-related shocks, a low tax base and comparatively weak structural factors in terms of investment rates, GDP per capita, institutional quality and social development.

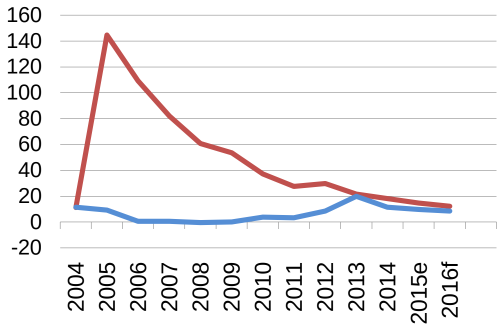
Rating Sensitivities

Higher Growth, External Liquidity: The ratings could be positively affected by higher growth in the context of macroeconomic and financial stability; strengthening of the economy's external liquidity position in line with the peer median; and structural improvements in public finances in terms of revenue base, expenditure rigidity and a continued moderate debt burden.

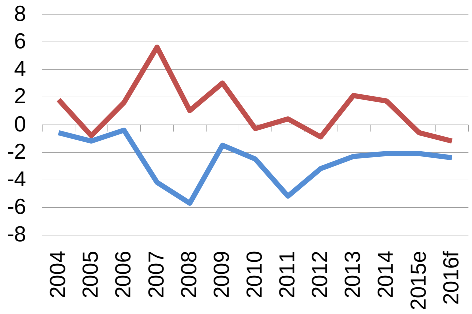
Commodity Shocks, Fiscal Slippage: The ratings could be negatively affected by commodity production shocks or severe export price falls that materially impair external and fiscal solvency ratios and sustained fiscal deterioration in the context of financing constraints.

Peer Comparison

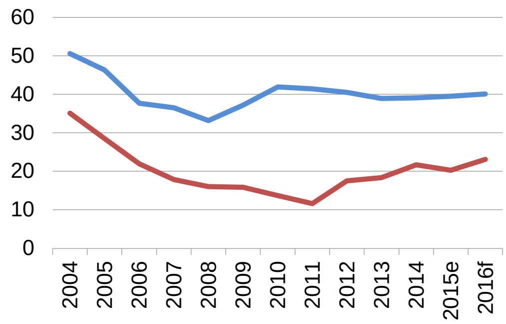
Net External Debt
% of GDP



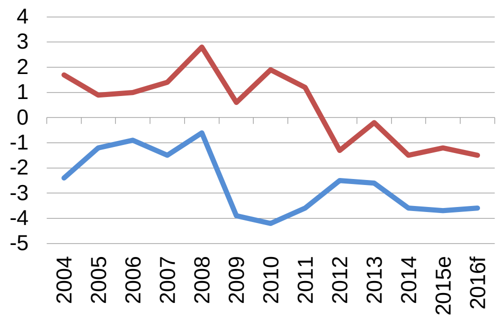
Current Account Balance
% of GDP



General Government Debt
% of GDP

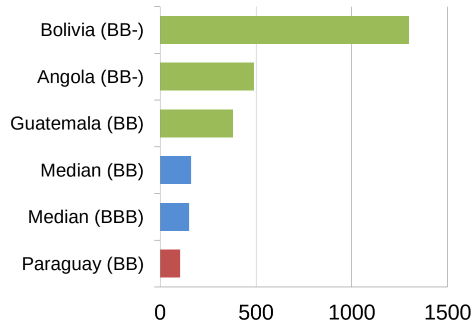


General Government Balance
% of GDP

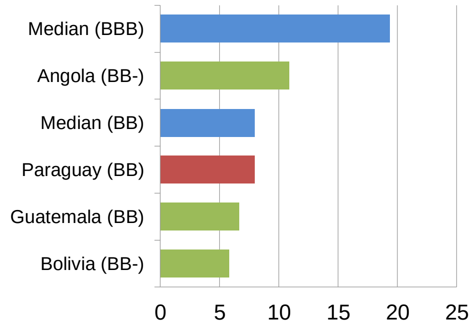


Paraguay   Medians

International Liquidity Ratio, 2015
%



GDP per capita Income, 2014e
At market exchange rates, USA=100



Related Criteria

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

Rating Factors

Peer Group

Rating	Country
BB+	Costa Rica
	Hungary
	Macedonia
	Portugal
BB	**Paraguay**
	Croatia
	Guatemala
BB−	Angola
	Bangladesh
	Bolivia
	El Salvador
	Gabon
	Georgia
	Lesotho
	Nigeria
	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–

Summary: Strengths and Weaknesses

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

Note: Relative to 'BB' category
Source: Fitch

Strengths

- Paraguay's five-year average growth of 6.9% is higher than the 'BB' median of 4.2%. An improving business environment relative to regional and similarly-rated peers supports foreign direct investment, economic diversification and income convergence prospects.
- A more diversified commodity export basket than peers and productivity enhancements in the agriculture and livestock sectors have strengthened the economy's capacity to generate current external receipts and could smooth the volatility of growth performance.
- 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 half the 'BB' medians. Access to international bond markets and multilateral lending at favourable terms support financing flexibility.
- Adequate international reserves coverage provides a cushion against external shocks and mitigates risks related to financial dollarisation. Paraguay's sovereign net external creditor status contrasts favourably with the median debtor position of the 'BB' category.

Weaknesses

- High dependence on agriculture commodities and hydroelectric generation increases the vulnerability of growth and external accounts to adverse weather conditions. Strong real effective exchange appreciation could reduce the profitability of the commodity sector and affect the competitiveness of local production in the medium term.
- Domestic investment increased to 16% of GDP in 2014, but lagged behind the 'BB' median of 21%. Human capital and infrastructure limitations hamper capital accumulation. Institutional capacity constraints prevent higher execution of public investment and could weigh on the government's ambitious pipeline of public-private infrastructure projects.
- Fitch has maintained a Macro-Prudential Indicator for Paraguay of '3' since 2011, signalling that the potential for financial systemic stress is high. Rapid lending growth, rising household indebtedness and high dollarisation of credit could become sources of vulnerability for financial institutions.
- Governance indicators compare unfavourably with the 'BB' medians in the control of corruption, government effectiveness, rule of law, political stability and regulatory quality.

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.

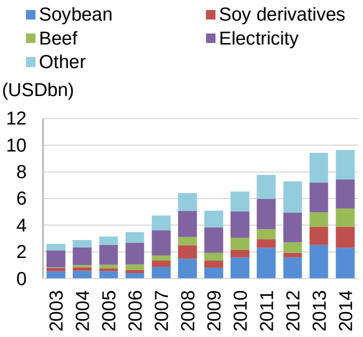
Figure 1

Strengths and Weaknesses: Comparative Analysis

2014	Paraguay BB	BB median[a]	BBB median[a]	Guatemala BB	Angola BB−	Bolivia BB−
Macroeconomic performance and policies						
Real GDP (5yr average % change)	6.9	4.2	3.0	3.5	4.5	5.4
Volatility of GDP (10yr rolling SD)	5.6	2.2	2.6	1.6	7.8	1.0
Consumer prices (5yr average)	4.8	4.8	3.7	4.3	10.5	5.8
Volatility of CPI (10yr rolling SD)	2.8	2.8	1.8	2.9	3.2	3.5
Unemployment rate (%)	5.5	11.2	7.1	3.0	n.a.	3.2
Type of exchange rate regime	Managed float	n.a.	n.a.	Managed float	Managed float	Crawling peg
Dollarisation ratio (% of bank deposits)	43.7	41.8	29.0	17.8	42.4	22.7
REER volatility (10yr rolling SD)	8.6	5.2	5.0	5.8	6.9	5.9
Structural features						
GDP per capita (USD, mkt exchange rates)	4,356	4,356	10,654	3,642	5,962	3,156
GNI per capita (PPP, USD, latest)	7,640	9,470	16,700	7,130	6,770	5,750
GDP (USDbn)	30.2	n.a.	n.a.	57.6	131.2	34.2
Human development index (percentile, latest)	40.8	46.2	64.5	33.3	20.4	39.7
Governance Indicator (percentile, latest)[b]	28.4	46.5	55.3	29.9	15.2	32.5
Broad money (% GDP)	45.1	49.3	67.5	48.2	40.8	56.7
Default record (year cured)[c]	2003	n.a.	n.a.	1989	2006	1997
Ease of doing business (percentile, latest)	51.6	47.9	71.3	61.8	4.3	17.1
Trade openness (CXR and CXP % GDP)	49.9	52.5	42.3	36.3	49.8	42.8
Gross domestic savings (% GDP)	19.3	19.0	22.1	2.9	13.8	25.2
Gross domestic investment (% GDP)	15.5	20.9	23.0	14.3	14.2	20.2
Private credit (% GDP)	51.4	45.7	66.0	28.7	26.4	48.7
Bank systemic risk indicators[d]	-/3	n.a.	n.a.	bb/1	-/3	bb/3
Bank system capital ratio (% assets)	15.1	15.0	15.5	14.5	18.5	12.7
Foreign bank ownership (% assets)	43.0	32.3	32.3	16.9	36.5	18.7
Public bank ownership (% assets)	6.0	15.3	18.2	1.3	23.7	13.5
External finances						
Current account balance + net FDI (% GDP)	3.6	-0.5	0.3	-0.5	-1.2	7.8
Current account balance (% GDP)	1.7	-2.1	-1.9	-2.1	3.4	2.4
Net external debt (% GDP)	18.2	14.8	4.6	-0.3	-36.3	-33.5
Gross external debt (% CXR)[e]	114.6	110.1	127.8	81.0	50.3	57.9
Gross sovereign external debt (% GXD)	24.7	53.4	32.8	46.5	64.2	64.7
Sovereign net foreign assets (% GDP)	8.8	0.6	0.3	1.4	11.5	30.2
Ext. interest service ratio (% CXR)	4.6	2.8	4.9	2.8	0.7	1.1
Ext. debt service ratio (% CXR)	11.8	9.1	12.8	8.2	8.9	6.1
Foreign exchange reserves (months of CXP)	5.7	4.1	5.4	4.2	6.5	12.8
Liquidity ratio (latest)[f]	105.8	153.6	162.5	381.2	489.4	1,297.2
Reserve currency flexibility	0	n.a.	n.a.	0	0	0
Commodity export dependence (% CXR, latest)	82.7	16.3	23.1	31.4	-	77.9
Sovereign net foreign currency debt (% GDP)	-12.4	1.7	-7.4	-1.1	-12.9	-26.3
Public finances[g]						
Budget balance (% GDP)	-1.5	-3.7	-3.0	-2.1	-0.3	-0.7
Primary balance (% GDP)	-1.1	-1.2	-0.8	-1.0	0.8	0.2
Gross debt (% revenue)	84.2	163.8	160.4	194.0	79.6	89.7
Gross debt (% GDP)	21.7	39.2	41.2	22.5	26.7	32.1
Net debt (% GDP)	9.7	34.9	33.8	16.9	10.4	15.8
Foreign currency debt (% total debt)	50.7	52.3	33.0	53.4	48.8	56.3
Interest payments (% revenue)	1.5	7.4	8.3	9.2	3.4	2.6
Revenues and grants (% GDP)	25.7	25.7	30.2	11.6	33.6	35.7
Volatility of revenues/GDP ratio	11.2	5.5	5.3	5.0	6.1	5.8
Central govt. debt maturities (% GDP)	1.1	3.9	5.4	1.2	6.1	1.6

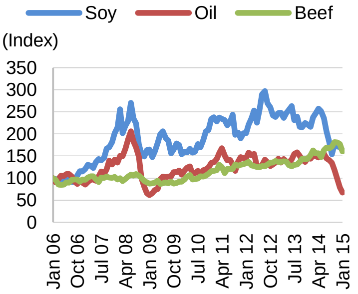
[a] Medians based on three-year centred averages
[b] Composite of six World Bank Governance Indicators used in the Sovereign Rating Model; Government Effectiveness; Rule of Law; Control of Corruption; Voice and Accountability; Regulatory Quality; and Political Stability and Absence of Violence
[c] Paraguay 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 2
Export Diversification



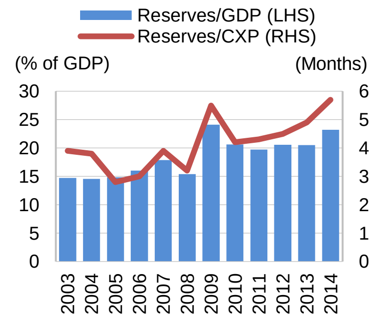
Source: Central Bank of Paraguay

Figure 3
Still Supportive Global Export Prices
Indexed prices (Jan 2006 = 100)



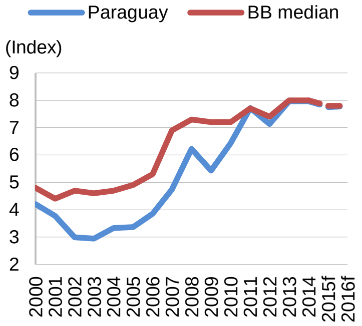
Source: Bloomberg

Figure 4
Adequate Reserve Coverage



Source: Central Bank of Paraguay

Figure 5
GDP per Capita Index
(100 = US level)



Source: Fitch

Key Credit Developments

Diversification Enhances External and Growth Resilience

Paraguay's diversified export base, industrialisation of agriculture and emerging maquila industry improve its economic performance and capacity to absorb terms-of-trade shocks. Unlike most mono-product and hydrocarbon-dependent producers in the 'BB' category, Paraguay's export receipts are generated from three industries that are relatively uncorrelated and less exposed to the current downturn in global commodity prices: soy, beef and hydropower sales to neighbouring Argentina and Brazil. Although the primary sector represents 25% of GDP, its wide profitability margins, low leverage and adequate capitalisation mitigate the potential for negative spillovers into other economic sectors and the financial system.

Productivity enhancements are cushioning the decline in agriculture prices and supporting a transition toward the commercialisation of higher value-added goods. Soy prices fell 20% from their historical average of USD440 per metric ton in 2007-2013, but remain well above the estimated breakeven price of USD170 for the industry. The primary sector has installed capacity to transform 40% of soybean output into oleaginous products and feedstock, which could result in a 60% mark-up in prices. The country was certified free of foot-and-mouth disease in 2013, thanks to genetic and sanitary improvements in cattle farming after a virus outbreak in 2011. Beef exports have grown 70% since then, representing 14% of exports in 2014.

Dynamism in maquila activities (auto parts, apparel, plastics) integrated into supply chains targeting the Brazilian market benefits from proximity, tax competitiveness, low energy costs, cheap labour and regulatory incentives[1]. Nearly 400 multinational projects have been established near the border, contributing USD600m (2% of GDP) in foreign investment and 9,000 new jobs since 2012. The agricultural sector is also attracting capital inflows from Mercosur economies due to higher production and taxation costs in Argentina and Brazil.

Exports are vulnerable to weather conditions and currency differentials with neighbour economies. Soy output declined 40% after severe droughts in 2009 and 2012, the only two years when the country has registered current account deficits since 2005. Low rain in the Itaipu reservoir led to a 9% drop in electricity sales in 2014, the largest contraction since 2001. Re-exports of goods at the triple border fell 15% to USD3.5bn (11% of GDP) in 2014, mainly reflecting slowing imports and currency depreciation in Brazil, Paraguay's largest trading partner.

Fitch forecasts that international reserves will continue to grow, averaging USD7.4bn or 5.4 months of current external payments in 2015-2016, thus improving the economy's cushion against external shocks. Current account surpluses could gradually shift to moderate deficits, driven by softer commodity prices, investment-led imports and profit repatriations. However, continued foreign direct investment in agriculture and manufacturing, multilateral lending and occasional global bond issuances to finance infrastructure projects could provide sufficient capital inflows to maintain a positive result in the balance of payments in 2015-2016.

Economic Growth Supports Per Capita Income Convergence

Sustained growth has facilitated the convergence of the country's per capita income with the 'BB' median. The Paraguayan economy grew an estimated 4% in 2014, after the exceptional performance of 14.2% in 2013. Services, manufacturing, commerce, construction and beef production were the largest contributors to economic activity. Lower hydroelectricity generation by binational enterprises due to less precipitation, falling international soybean prices and lower exports to Brazil weighed on external demand, shaving up to 1pp from real output growth.

[1] In 2014, a new law guaranteed new foreign investment projects the invariability of corporate income tax rates for 10 years. The provision could be extended for up to 20 years.

Figure 6

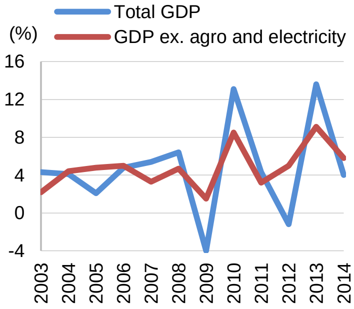
Public-Private Projects

Sectors	USDm	% of total	% of GDP
New roads	500	40.3	1.6
Road expansion	330	26.6	1.1
Airport	260	21.0	0.9
Oil exploration	150	12.1	0.5
Total	**1,240**	**100**	**4.1**

Source: Secretary of Planning of Paraguay

Figure 7

Dynamic Non-Commodity Growth

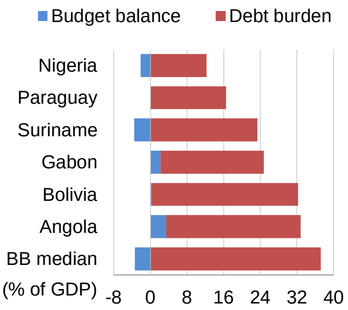


Source: Central Bank of Paraguay

Figure 8

Ample Fiscal Space

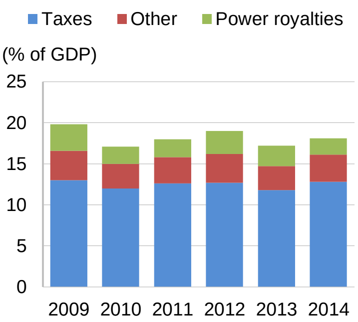
Peer commodity exporters, 5Y avg.



Source: Fitch

Figure 9

CG Revenue Composition



Source: Ministry of Finance of Paraguay

Fitch forecasts that economic growth will converge to the country's estimated potential of 4.5% in 2015-2016. Investment will benefit from construction activity in commercial real estate, public-sector spending on infrastructure and the establishment of manufacturing plants near the Brazilian border. Higher employment will continue to fuel credit growth and private consumption. Rising beef import demand from traditional (Russia) and new markets (Chile, Hong Kong) could support agriculture exports.

Public investment under-execution and price distortions in Argentina could detract from economic performance in 2015-2016. The authorities completed the regulatory framework for public-private partnerships[2] in 1Q14 and intend to bid out the first set of projects (roads, airports, waterways) of a pipeline of USD1.2bn in 2H15. Public works agencies have received technical assistance from multilaterals and hired consultants to overcome institutional capacity constraints, but execution delays cannot be ruled out. Paraguay's production is losing competitiveness, and consumption of basic staples is partially leaking out through the border, taking advantage of Argentina's proximity, generalised subsidies and weakening currency.

Prudent Use of Fiscal Space, Increased Public Investment

Paraguay has a long record of fiscal prudence through different economic and political cycles. The general government recorded an average surplus of 1.2% of GDP in 2003-2011, and public debt declined to 12% of GDP from 40% during the same period. In the absence of major tax-enhancing reforms or commodity windfalls[3], the authorities under-executed capital investment and social spending to accommodate rising public-sector wages and pension transfers. The ratio of rigid expenditure to tax revenue reached 100% in 2013.

The incoming Horacio Cartes administration introduced reforms to increase fiscal flexibility and improve the composition of public spending in 2013. Stricter compliance, broadening the income tax base and phasing in new value-added and profit levies on the agricultural sector could yield 1.8% of GDP in additional revenue in 2014-2016. The expiration of temporary work contracts granted during the last election and single-digit inflation rates could contain personnel costs, which climbed to 9.4% of GDP in 2013. The government intends to use the proceeds of two global bonds placements for USD1.5bn (5% of GDP) to accelerate public investment in electricity transmission, road infrastructure and social development in 2014-2016.

The implementation of a new fiscal responsibility law has already proved challenging, weakening its role as an institutional anchor for fiscal policy. The first budget (2015) approved by congress after the law calls for a central government deficit of 3.5% of GDP, well above the legal limit of 1.5%. Real wage rises awarded to teachers and doctors and increased transfers to subnational entities in anticipation of the municipal elections in November 2015 make it difficult to abide by the primary current spending growth ceiling of 4% above inflation. The authorities seem willing to accept deviations from the legal deficit threshold if they are derived from public investment projects with secure external financing.

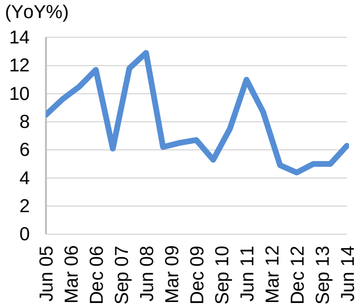
Fitch expects the central government deficit to widen to 2.4% of GDP in 2014-2015[4] and converge to the 1.5% target only in 2016. Two long-standing institutional factors will help to preserve fiscal restraint. The minister of finance has legal authorisation to limit current spending to the availability of tax revenue and hydropower royalties, although this prerogative might not apply for constitutional rights such as salary increases. Capacity constraints in the public sector and delays in the execution of infrastructure projects would limit growth in capital expenditure.

[2] The public-private partnership law stipulates that contingent liabilities cannot increase by more than 0.4% of GDP every year and cannot exceed a total of 2% of GDP.

[3] A revision of the Brazilian tariffs for Itaipu energy increased fiscal receipts by 0.5% of GDP in 2009. Royalties for hydropower projects with Brazil and Argentina represented 2.5% of GDP in 2013.

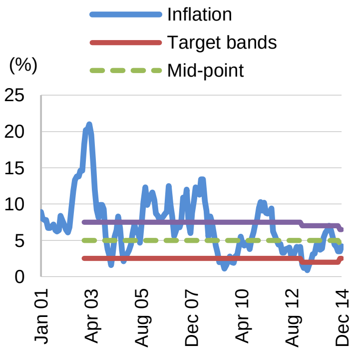
[4] Fitch's 2014 budget deficit estimate incorporates nearly 1% of GDP in on-lending operations from the central government to public enterprises that were registered as expenditure. This figure could be revised downwards once the fiscal authorities complete the transition from the 1986 Government Finance Statistics Manual to the more updated 2001 accounting standards.

Figure 10
Wage Growth Moderates
2001 Salary index



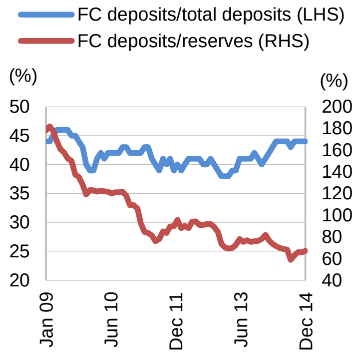
Source: Central; Bank of Paraguay

Figure 11
Inflation Targeting



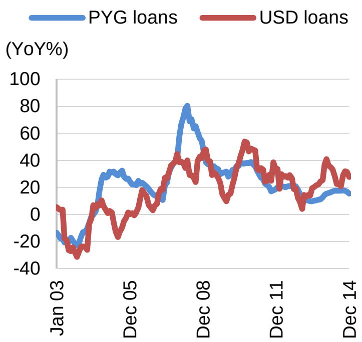
Source: Central Bank of Paraguay

Figure 12
Dollarisation of Deposits



Source: Central Bank of Paraguay

Figure 13
Rapid Credit Growth



Source: Central Bank of Paraguay

Paraguay has built enough fiscal space to advance its public investment and social development programmes without compromising debt sustainability. Fitch forecasts that general government debt[5] and financing needs could remain at half the 'BB' medians of 40% of GDP and 7% of GDP, even after factoring in the transition toward moderate budget deficits and a pick-up in external issuance in 2014-2016. Access to long-term financing in global capital markets[6] and concessional lending reduces market and rollover risks. Government deposits at the central bank, including public-sector social security contributions, averaged 9.7% of GDP in 2009-2013, one of the largest buffers among commodity exporters in the 'BB' category.

Broad Macroeconomic and Financial Stability

Paraguay's inflation averaged 5% in 2014, finishing the year at 4.2% after approaching 7% in 2Q14. The central bank increased its monetary policy rate by 175bp to 6.75% between December 2013 and February 2014 to contain second-round effects. Present inflation expectations for 2015 and 2016 remain anchored at 4.5%-4.6%.

Despite challenges to the full implementation of inflation targeting due to low financial intermediation, underdeveloped local capital markets and financial dollarisation, authorities have been able to meet their inflation target since the adoption of the regime in 2011. Fitch expects inflation to stay around the new official reference mid-point of 4.5% in 2015-2016.[7] The balance of risks is broadly neutral. Robust consumption and a more accommodative fiscal stance could result in a resumption of demand pressures and require further monetary tightening. On the other hand, falling oil prices and imports from Argentina could ease external inflation. Salary increases have also slowed down in line with lower inflation in recent years.

The banking sector has strengthened in recent years and currently maintains adequate levels of capitalisation, liquidity and asset quality. Credit is largely concentrated in the export-oriented agriculture and livestock sectors, two industries with solid 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.

Fitch has maintained a Macro-Prudential Indicator[8] 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. Non-performing consumer loans picked up to 6% of total loans in 1Q14, above the 2% average in other segments, evidencing emerging repayment strains among households. Dollarisation of credit reversed its declining trend in 2010 and currently stands at 48% of total loans. Bank supervisors have enforced strict foreign exchange position limits and tightened lending standards for unhedged borrowers to mitigate currency and credit risks.

[5] Government debt includes the issuance of PYG3.bn in perpetual bonds carrying a 0.25% coupon to recapitalise the central bank. This represented 3% of GDP or 15% of total public debt in 2014.

[6] Paraguay first issued USD500m in 10-year global bonds yielding 4.6% in January 2013, followed by USD1.5bn in 30-year bonds yielding 6.1% in August 2014.

[7] 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%.

[8] 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.

Fitch uses stylised projections for a sovereign's gross general government debt/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.

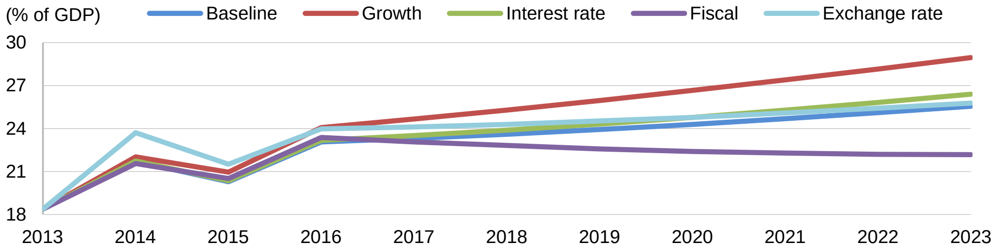
Public Debt Dynamics

Fitch forecasts that general government debt will grow gradually and reach 24% of GDP by 2019 if the sovereign continues leveraging on external borrowing to advance its public infrastructure and social programmes. The debt trajectory is particularly sensitive to economic growth, fiscal performance and currency depreciation. A high share of concessional lending and market bonds at long maturities make the projections more robust to interest rates shocks.

Strengths and Weaknesses: Comparative Analysis

	2013	2014	2015	2016	2017	2018	2023
Gross general government debt (% GDP)	18.4	21.7	20.3	23.1	23.3	23.6	25.6
Primary balance (% of GDP)	0.1	-1.1	-0.6	-0.9	-1.5	-1.5	-1.5
Real GDP growth (%)	14.2	4.0	4.5	4.5	4.3	4.3	4.3
Avg. nominal effective interest rate (%)	1.9	2.1	2.3	2.6	2.8	3.0	4.1
PYG /USD (annual avg.)	4,320.7	4,458.6	4,705.9	4,807.2	4,831.2	4,855.3	4,978.0
GDP deflator (%)	0.4	3.6	4.5	4.5	4.5	4.5	4.5

Sensitivity Analysis
Gross general government debt



Source: Fitch estimates, national sources, IMF

Debt Sensitivity Analysis: Fitch's Scenario Assumptions

Growth	GDP growth 2pp below the estimated potential of 4.5%
Interest rate	Marginal interest rate 100bp higher
Fiscal	Adherence to the legal budget deficit ceiling of 1.5% of GDP
Exchange rate	25% devaluation at end-2014

Forecast Summary

	2010	2011	2012	2013	2014	2015e	2016f
Macroeconomic indicators and policy							
Real GDP growth (%)	13.1	4.3	-1.2	14.2	4.0	4.5	4.5
Unemployment (%)	5.7	5.6	5.8	5.4	5.5	5.5	5.5
Consumer prices (annual average % change)	4.7	8.3	3.7	2.7	5.0	4.5	4.6
Short-term interest rate (bank policy annual avg.) (%)	1.8	7.5	5.7	4.9	5.8	6.0	6.0
General government balance (% of GDP)	1.9	1.2	-1.3	-0.2	-1.5	-1.2	-1.5
General government debt (% of GDP)	13.7	11.6	17.5	18.4	21.7	20.3	23.1
PYG per USD (annual average)	4,735.5	4,191.4	4,424.9	4,320.7	4,458.6	4,705.9	4,807.2
Real effective exchange rate (2000 = 100)	123.5	110.9	105.5	96.9	91.9	86.3	80.7
Real private sector credit growth (%)	31.0	15.3	9.5	19.9	15.3	14.4	13.3
External finance							
Current account balance (% of GDP)	-0.3	0.4	-0.9	2.1	1.7	-0.6	-1.2
Current account balance plus net FDI (% of GDP)	0.8	2.7	1.0	3.5	3.6	1.5	0.9
Net external debt (% of GDP)	37.2	27.7	29.7	21.7	18.2	14.8	12.2
Net external debt (% of CXR)	63.8	49.5	55.6	41.5	36.0	29.9	24.2
Official international reserves including gold (USDbn)	4.1	5.0	5.1	5.9	7.0	7.2	7.6
Official international reserves (months of CXP cover)	4.2	4.3	4.5	4.9	5.7	5.5	5.3
External interest service (% of CXR)	6.0	4.8	4.8	4.3	4.6	4.5	4.3
Gross external financing requirement (% int. reserves)	32.5	26.1	29.1	10.4	10.1	16.5	18.6
Real GDP growth (%)							
US	2.5	1.6	2.3	2.2	2.4	3.1	3.0
China	10.4	9.3	7.7	7.7	7.4	6.8	6.5
Eurozone	2.0	1.6	-0.7	-0.5	0.9	1.3	1.5
World	4.0	3.2	2.4	2.5	2.6	3.0	3.1
Oil (USD/barrel)	79.6	111.0	112.0	108.8	100.0	70.0	80.0

Source: Fitch

Fiscal Accounts Summary

(% of GDP)	2011	2012	2013	2014	2015e	2016f
General government						
Revenue	**22.7**	**24.3**	**24.9**	**25.7**	**26.9**	**26.6**
Expenditure	**21.5**	**25.6**	**25.1**	**27.2**	**28.1**	**28.0**
O/w interest payments	0.3	0.2	0.3	0.4	0.6	0.6
Primary balance	1.5	-1.0	0.1	-1.1	-0.6	-0.9
Overall balance	**1.2**	**-1.3**	**-0.2**	**-1.5**	**-1.2**	**-1.5**
General government debt	**11.6**	**17.5**	**18.4**	**21.7**	**20.3**	**23.1**
% of general government revenue	51.1	72.0	73.9	84.2	75.5	86.9
General government deposits	10.2	9.5	9.6	12.0	8.6	9.0
Net general government debt	1.4	8.0	8.8	9.7	11.7	14.0
Central government						
Revenue	**18.0**	**19.0**	**17.2**	**17.8**	**18.3**	**19.0**
O/w grants	0.0	0.0	0.0	0.0	0.0	0.0
Expenditure and net lending	**17.3**	**20.8**	**19.1**	**20.2**	**20.8**	**20.5**
O/w current expenditure and transfers	13.3	16.0	15.1	15.5	15.7	15.7
- Interest	0.3	0.2	0.3	0.4	0.6	0.6
O/w capital expenditure	4.0	4.8	4.0	4.7	5.1	4.8
Current balance	4.1	2.5	1.9	2.2	3.1	4.1
Primary balance	1.0	-1.6	-1.6	-2.0	-1.9	-0.9
Overall balance	**0.7**	**-1.8**	**-1.9**	**-2.4**	**-2.5**	**-1.5**
Central government debt	9.6	15.9	16.9	19.7	19.7	20.7
% of central government revenues	53.5	83.6	98.1	110.8	107.6	108.9
Central government debt (PYGbn)	**10,145.2**	**17,259.8**	**21,044.3**	**26,511.3**	**28,965.9**	**33,277.5**
By residency of holder						
Domestic	1,535.3	9,123.1	10,375.3	11,179.9	12,938.4	13,652.5
Foreign	8,609.9	8,136.7	10,668.9	15,331.4	16,027.5	19,625.1
By currency denomination						
Local currency	1,535.3	9,123.1	10,375.3	11,179.9	12,938.4	13,652.5
Foreign currency	8,609.9	8,136.7	10,668.9	15,331.4	16,027.5	19,625.1
In USD equivalent (eop exchange rate)	1.9	1.9	2.4	3.3	3.3	4.1
Average maturity (years)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Memo						
Nominal GDP (PYGbn)	1,05,203.2	1,08,832.3	1,24,853.1	1,34,529.6	1,46,886.9	1,60,376.8

Source: Ministry of Finance and Fitch estimates and forecasts

External Debt and Assets

(USDbn)	2009	2010	2011	2012	2013	2014
Gross external debt	**16.0**	**16.3**	**16.0**	**16.7**	**16.6**	**17.5**
% of GDP	100.6	81.1	63.7	67.7	57.5	58.1
% of CXR	179.9	139.0	113.8	126.7	110.1	114.6
By maturity						
Medium- and long-term	12.0	11.9	11.6	12.0	12.0	12.6
Short -term	4.1	4.4	4.4	4.7	4.6	4.9
% of total debt	25.3	26.9	27.4	28.0	27.9	27.9
By debtor						
Sovereign	**2.6**	**2.7**	**2.6**	**2.8**	**3.2**	**4.3**
Monetary authorities	0.2	0.2	0.2	0.2	0.2	0.2
General government	2.5	2.6	2.5	2.6	3.1	4.2
O/w central government	1.9	2.0	1.9	1.9	2.4	3.3
Banks	**0.3**	**0.5**	**0.5**	**0.8**	**0.8**	**0.8**
Other sectors	**13.1**	**13.1**	**12.8**	**13.1**	**12.6**	**12.4**
Gross external assets (non-equity)	**7.5**	**8.8**	**9.0**	**9.4**	**10.4**	**12.0**
International reserves, incl. gold	3.8	4.1	5.0	5.1	5.9	7.0
Other sovereign assets nes	0.0	0.0	0.0	0.0	0.0	0.0
Deposit money banks' foreign assets	0.7	0.9	0.8	0.9	0.9	1.0
Other sector foreign assets	2.8	3.7	3.2	3.4	3.6	4.0
Net external debt	**8.5**	**7.5**	**7.0**	**7.3**	**6.3**	**5.5**
% of GDP	53.6	37.2	27.7	29.7	21.7	18.2
Net sovereign external debt	-1.3	-1.5	-2.3	-2.2	-2.6	-2.7
Net bank external debt	-0.4	-0.4	-0.3	-0.1	-0.1	-0.1
Net other external debt	10.2	9.4	9.6	9.6	9.0	8.3
Net international investment position	**-10.6**	**-9.9**	**-9.9**	**-10.8**	**-9.8**	**-9.2**
% of GDP	-66.6	-49.2	-39.4	-43.9	-33.8	-30.4
Sovereign net foreign assets	**1.3**	**1.5**	**2.4**	**2.2**	**2.7**	**2.7**
% of GDP	7.9	7.4	9.4	8.9	9.2	8.8
Debt service (principal & interest)	**2.0**	**1.9**	**1.9**	**1.8**	**1.8**	**1.8**
Debt service (% of CXR)	22.1	16.2	13.2	14.1	11.9	11.8
Interest (% of CXR)	8.1	6.0	4.8	4.8	4.3	4.6
Liquidity ratio (%)	58.2	77.0	80.8	92.8	92.4	105.8
Net sovereign FX debt (% of GDP)	-12.3	-10.7	-12.0	-12.8	-12.3	-12.4
Memo						
Nominal GDP	15.9	20.0	25.1	24.6	28.9	30.2
Inter-company loans	0.4	0.6	0.8	1.0	1.1	1.1

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

External Debt Service Schedule on Medium- and Long-Term Debt at January 2015

(USDbn)	2013	2014	2015	2016	2017	2018	2019+
Sovereign: Total debt service	**263.7**	**261.4**	**305.8**	**296.8**	**278.8**	**266.1**	**257.8**
Amortisation	202.6	195.0	177.8	173.4	160.8	152.8	148.1
Official bilateral	41.9	37.5	34.4	34.9	35.0	34.8	34.7
Multilateral	122.0	118.7	117.7	112.7	100.1	92.2	87.6
O/w IMF	0	0	0	0	0	0	0
Other	0	0	0	0	0	0	0
Bonds placed in foreign markets	38.7	38.7	25.8	25.8	25.8	25.8	25.8
Interest	61.1	66.4	128.0	123.4	118.6	113.3	109.7
Non-sovereign public sector	**6.1**	**6.6**	**29.7**	**11.5**	**10.4**	**11.0**	**10.8**

Source: Ministry of Finance, Central Bank and Fitch

Balance of Payments

(USDbn)	2011	2012	2013	2014	2015e	2016f
Current account balance	**0.1**	**-0.2**	**0.6**	**0.5**	**-0.2**	**-0.4**
% of GDP	0.4	-0.9	2.1	1.7	-0.6	-1.2
% of CXR	0.8	-1.8	4.1	3.3	-1.1	-2.3
Trade balance	**0.8**	**0.5**	**1.6**	**1.9**	**1.3**	**1.4**
Exports, fob	12.5	11.5	13.4	13.8	13.7	14.7
Imports, fob	11.7	11.0	11.9	11.9	12.4	13.3
Services, net	**-0.1**	**-0.1**	**-0.1**	**-0.2**	**-0.1**	**-0.2**
Services, credit	0.8	0.8	0.9	1.1	1.2	1.6
Services, debit	0.9	0.9	1.1	1.2	1.3	1.8
Income, net	**-1.3**	**-1.4**	**-1.5**	**-1.7**	**-1.8**	**-2.0**
Income, credit	0.0	0.0	0.0	0.0	0.1	0.1
Income, debit	1.3	1.4	1.5	1.7	1.9	2.1
O/w: Interest payments	0.7	0.6	0.6	0.7	0.7	0.7
Current transfers, net	**0.7**	**0.8**	**0.7**	**0.4**	**0.4**	**0.4**
Capital and financial accounts						
Non-debt-creating inflows (net)	0.3	0.4	0.3	0.6	0.7	0.7
O/w equity FDI	0.3	0.3	0.3	0.6	0.6	0.7
O/w portfolio equity	0.0	0.0	0.0	0.0	0.0	0.0
O/w other flows	0.0	0.1	0.1	0.0	0.0	0.0
Change in reserves	0.8	0.0	1.0	1.1	0.1	0.4
Gross external financing requirement	1.1	1.4	0.5	0.6	1.2	1.3
Stock of international reserves, incl. gold	5.0	5.1	5.9	7.0	7.2	7.6

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.