

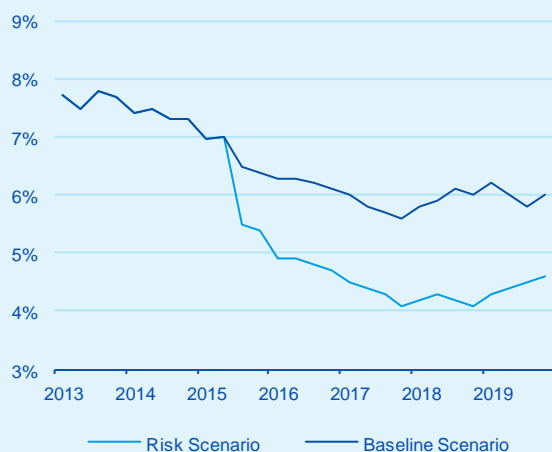
## Box 2. What would be the impact on Paraguay of a harder landing for China?

## A risk scenario for China: persistent slowdown

Even though our central scenario assumes that the authorities will continue to support growth of no less than 6% YoY, it is well worth examining the effect of a sudden and persistent slowdown in China which leads to growth that is significantly below these levels.

Such a scenario could, for example, arise from excess pressure on the parallel banking system or a sharp tightening in the interbank market, such as occurred in June 2013, which might lead to a financial crisis and a drop in confidence among both consumers and corporates. A shock of this kind could produce a collapse of consumption due to a deceleration for disposable income. Nonetheless, the main impact would be on investment, owing to financial instability and decreased appetite for risk. Such a weakening of domestic demand could drag down growth to rates of around 4% instead of the figure of 6% posited in the central scenario (see Figure B.2.1).

Figure B.2.1  
China: gross domestic product  
(% var. YoY)



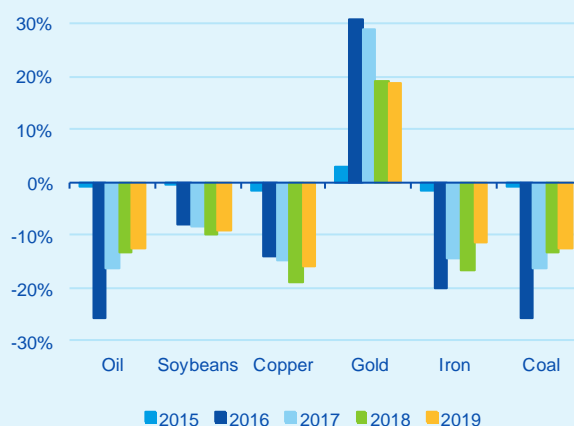
Source: IMF and BBVA Research

## A negative shock for growth in China: the transmission channels

The above-mentioned risk scenario would affect Paraguay via two main channels: i) a direct channel, which would materialise in heavier and more persistent falls in commodity prices<sup>1</sup> (see Figure B.2.2), including soybeans, since China represents over 60% of demand worldwide, and ii) an indirect path due to weaker external demand for Brazil (which is very vulnerable to shocks in China).

In this context, Paraguay's growth rate would suffer a downward correction (see Figure B.2.3). On a sector level, there would be effects on the agriculture side (from lower soybean margins, that lead to a scaling down of cultivated land) and in the services sector (owing to greater sluggishness in the trade subsector, especially border trade with Brazil). The adverse effect will also be noted in industry, especially *la maquila* (low-cost assembly activity) that targets the Brazilian market.

Figure B.2.2  
Effect on key commodity prices\*  
(% difference with respect to the baseline scenario)



\*Potential impact on commodity prices one year after a 1pp drop in the growth of fixed asset investment in China  
Source: BBVA Research

<sup>1</sup> It should be noted that prices of energy commodities (such as oil) would also be strongly affected, which would benefit Paraguay.

On the expenditure side, the main effects will be noted in: i) exports, especially those of soybeans given the lower production levels, as well as assembly and re-exports, due to the increased weakness of demand from Brazil; ii) investment, with the rise in the PYG's exchange rate (this raises the cost in PYG of imported machinery, equipment and inputs) and a lower level of reinvestment of the profits of foreign companies, especially those in agriculture and those oriented towards satisfying domestic demand; iii) consumption, due to fewer jobs being created and a higher cost of credit. Beyond this, families would not ease up on their consumption because the negative shock is permanent as regards GDP level and its growth rate, and iv) imports, in line with lower domestic demand, especially in relation to investment, and depreciation of the PYG.

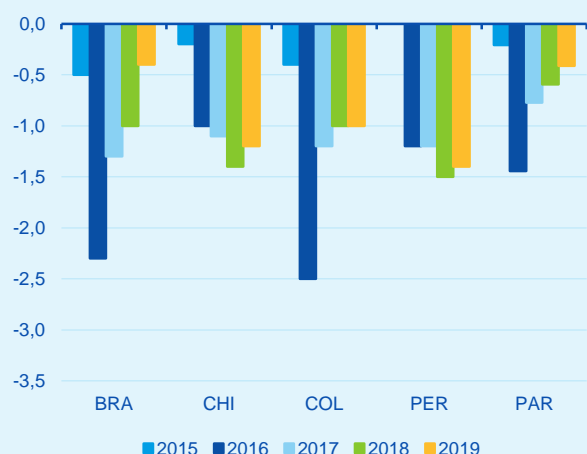
On the fiscal front, there is some margin to implement counter-cyclical fiscal policies (at least initially) that would soften the effects of the initial impact, although at the moment the intention is to consolidate the credibility of the fiscal rule, which only permits a deficit of 3% in the event of a national emergency, international crisis or a fall in domestic economic activity. In such circumstances, implementing counter-cyclical fiscal policies is far more tricky if we also bear in mind the permanent nature of the shock.

On the external side, the strong dip in domestic demand would more than outweigh the decline in external demand and the terms of trade, which would mean the external deficit being worse off in relation to the baseline scenario.

It is worth noting that this scenario has been replicated as regards other economies in the region, which enables comparison of which ones would be most sorely hit. The findings from a simulation of this kind show that most of the region's countries would be affected to the tune of over 1pp, given a shock from China. Brazil and Colombia would come off the worst, since they have high exposures to China. This would be more so in Brazil's case, given that it would have to face up to the shock with very badly weakened fundamentals, and because it has to press ahead with its fiscal adjustment. Therefore, in the risk scenario, Brazil would be beset by a truly punishing recession in 2016 (deeper than that included in our baseline scenario), which would compromise Paraguay's growth, shrinking it by around 1.4 percentage points in 2016 in relation to our baseline scenario (for which reason GDP growth would be 2.0%, and consequently lower than the level of 3.4% that we forecast in our baseline scenario).

Figure B.2.3

**Impact on growth**  
(difference with respect to the baseline scenario in percentage points)



Source: BBVA Research

**DISCLAIMER**

This document has been prepared by BBVA Research Department, it is provided for information purposes only and expresses data, opinions or estimations regarding the date of issue of the report, prepared by BBVA or obtained from or based on sources we consider to be reliable, and have not been independently verified by BBVA. Therefore, BBVA offers no warranty, either express or implicit, regarding its accuracy, integrity or correctness.

Estimations this document may contain have been undertaken according to generally accepted methodologies and should be considered as forecasts or projections. Results obtained in the past, either positive or negative, are no guarantee of future performance.

This document and its contents are subject to changes without prior notice depending on variables such as the economic context or market fluctuations. BBVA is not responsible for updating these contents or for giving notice of such changes.

BBVA accepts no liability for any loss, direct or indirect, that may result from the use of this document or its contents.

This document and its contents do not constitute an offer, invitation or solicitation to purchase, divest or enter into any interest in financial assets or instruments. Neither shall this document nor its contents form the basis of any contract, commitment or decision of any kind.

In regard to investment in financial assets related to economic variables this document may cover, readers should be aware that under no circumstances should they base their investment decisions in the information contained in this document. Those persons or entities offering investment products to these potential investors are legally required to provide the information needed for them to take an appropriate investment decision.

The content of this document is protected by intellectual property laws. It is forbidden its reproduction, transformation, distribution, public communication, making available, extraction, reuse, forwarding or use of any nature by any means or process, except in cases where it is legally permitted or expressly authorized by BBVA.

This report has been produced by the Peru Unit

**Chief Economist for Peru**

Hugo Perea  
hperea@bbva.com  
+51 1 2112042

Francisco Grippa  
fgrippa@bbva.com

Yalina Crispin  
Yalina.crispin@bbva.com

Vanessa Belapatiño  
Vanessa.belapatinho@bbva.com

Ismael Mendoza  
Ismael.mendoza@bbva.com

Marlon Broncano  
Marlon.broncano@bbva.com

## BBVA Research

**Group Chief Economist**

Jorge Sicilia Serrano

**Developed Economies Area**

Rafael Doménech  
r.domenech@bbva.com

*Spain*

Miguel Cardoso  
miguel.cardoso@bbva.com

*Europe*

Miguel Jiménez  
mjimenezg@bbva.com

*US*

Nathaniel Karp  
Nathaniel.Karp@bbva.com

**Emerging Markets Area**

*Cross-Country Emerging Markets*

*Analysis*  
Alvaro Ortiz  
alvaro.ortiz@bbva.com

*Asia*

Le Xia  
le.xia@bbva.com

*Mexico*

Carlos Serrano  
carlos.serrano@bbva.com

*Turkey*

Alvaro Ortiz  
alvaro.ortiz@bbva.com

*LATAM Coordination*

Juan Manuel Ruiz  
juan.ruiz@bbva.com

*Argentina*

Gloria Sorensen  
gsorensen@bbva.com

*Chile*

Jorge Selaive  
jselaive@bbva.com

*Colombia*

Juana Téllez  
juana.tellez@bbva.com

*Peru*

Hugo Perea  
hperea@bbva.com

*Venezuela*

Julio Pineda  
juliocesar.pineda@bbva.com

**Financial Systems and Regulation Area**

Santiago Fernández de Lis  
sfernandezdelis@bbva.com

*Financial Systems*

Ana Rubio  
arubiog@bbva.com

*Financial Inclusion*

David Tuesta  
david.tuesta@bbva.com

*Regulation and Public Policy*

María Abascal  
maria.abascal@bbva.com

*Digital Regulation*

Álvaro Martín  
alvaro.martin@bbva.com

**Global Areas**

*Economic Scenarios*

Julián Cubero  
juan.cubero@bbva.com

*Financial Scenarios*

Sonsoles Castillo  
s.castillo@bbva.com

*Innovation & Processes*

Oscar de las Peñas  
oscar.delaspenas@bbva.com

## Contact details:

**BBVA Research Perú**

Av. República de Panamá 3055  
San Isidro  
Lima 27 - Perú  
Tel: + 51 1 2112042  
E-mail: bbvaresearch\_peru@bbva.com  
**www.bbvaresearch.com**