1 Editorial

Economic activity started the year with a similar momentum to that of previous months. Thus, the growth rate, measured by the IMAEP, remained at 1.3% in the first quarter (0.7% in the fourth quarter 2015).Activities more closely linked to domestic demand, such as trade, construction and industry, continued to fall. In particular, the commercial activities of durable goods such as sales of vehicles, retailing, clothing and household equipment were in negative territory, which related mainly to weakening sales in border cities, due to the lower economic activity in neighbouring countries (especially Brazil). On the positive side, the set of sectors that respond to supply items such as power generation (bi-national) and agriculture continue to have positive results in the first three months.It is estimated that the soy campaign increased by more than 10% over the production of the previous year, due to higher yields, and power generation was boosted by the increased water flow as a result of the “El Niño” weather phenomenon. These elements, on the expenditure side, have resulted in increased exports (soya beans and electricity together have a weight of around 45% of total exports).

We expect that from the second quarter, **the product will begin a process of gradual recovery, and thus GDP in 2016 will record growth of around 3%**. By sectors, activity will be driven by agriculture (for the coming quarters, in addition to soya beans, there are good prospects for other crops), electricity and services, which would continue with the good performance of the first part of the year, and construction, which would begin to show a recovery alongside the reversal of the specific shocks that affected the first quarter. In addition, a recovery in livestock is expected after contracting in 2015 because, according to industry benchmarks, to date, the average price of meat has risen and this would ensure a good margin for the breeder, boosting investment and production. On the expenditure side, growth will be driven by exports (soya beans and their derivatives, electricity and meat) and domestic demand due to increased construction.

On the fiscal side, **we expect that the public deficit will be situated at about 2.0% of GDP this year**, in a context where incomes will be weaker due to the slowdown in tax-significant economic activities and decreased prices of raw materials. Also, **increased capital expenditure will be recorded oriented towards the infrastructure projects prioritised by the government**. While the Transparency and Accountability Act (FRTL) sets a limit for the fiscal deficit at 1.5% of GDP, our forecast assumes that the government, despite making adjustments to keep the deficit within the limits set out in the Act, will not meet the limit established for this year. Going forward we estimate a gradual reduction of the deficit so that the limit in the Transparency and Accountability Act is fulfilled, which will help consolidate the credibility of the fiscal rule.

In the currency market, **the Guaraní recently strengthened**, as did the currencies of other emerging markets and, in general, assets perceived to be higher risk. We believe **that this will be temporary** and that **soon the local currency will resume its upward trend**. Why? Firstly, because our view of what will happen with some of the key factors which affect the short-term exchange rate trend differs somewhat from market consensus. For example, we expect the FED to increase rates during the rest of the year because the labour market remains robust, downward inflationary pressures are beginning to ease off, and global financial tensions have retreated, although market consensus does not expect this to happen. We believe that the market's sense of surprise will trigger upward pressure on interest rates. And secondly, because there are structural factors that support a devaluation of the local currency. Capital inflows towards the more tradable sectors of the economy, such as the agricultural sector, are on the wane and this situation looks set to continue against a background in which we do not expect a substantial recovery in commodity prices, in particular in relation to soya beans, and in which lending conditions worldwide will gradually grow tighter.

The currency will be around PYG 5950 per USD towards the end of the year and closer to PYG 6,200 per USD by the end of 2017.

As for the outlook for prices, **year-on-year inflation registered significant increases** over the rates implemented during 2015. **However , it has started to give way** within a more favourable environment, which is linked to the fall in prices of domestic transport services as a result of lower fuel costs, and lower upward pressures on the exchange rate. **We estimate that in the remainder of the year inflation will remain near the centre of the target range**. In the short term, we estimate that inflation will ease a little further. However, during the latter part of the year inflation will record a slight upturn and will thus **close 2016 at around 4.7%** (this forecast considers the return of the currency to a depreciatory path and a statistical effect that will have an upward effect on inflation in the fourth quarter). In this context of easing inflation, inflation expectations aligned to the target and the absence of demand pressures, the Central Bank will have more room to keep the policy rate at its current level (5.75%) during 2016.

Finally, **the balance of risks on our growth projections for 2016-2017 in Paraguay is skewed downwards**. On the external front, there are downside risks from Brazil and China (due to its indirect effect on Brazil); and on the home front, any possible delays in the execution of the large infrastructure projects.

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