MOODY'S
RATINGS

Rating Action: Moody's Ratings upgrades Paraguay's ratings to Baa3, changes outlook to stable from positive

26 Jul 2024

New York, July 26, 2024 -- Moody's Ratings (Moody's) has today upgraded the Government of Paraguay's long-term issuer and senior unsecured bond ratings to Baa3 from Ba1 and changed the outlook to stable from positive. We have also upgraded the senior secured notes rating of Bioceanico Sovereign Certificate Limited, a government related entity to Baa3 from Ba1 and changed the outlook to stable from positive. The principal remaining credit risk related to Bioceanico arise from the credit quality of the government of Paraguay, that is ultimately responsible for making the payments on the notes that the entity acquired.

The upgrade of Paraguay's ratings reflects a combination of factors, including robust and sustained economic growth and our expectations that the economy has become more resilient to shocks, and a track-record of institutional reforms that has improved our assessment of institutional and governance strength. Successive governments have pursued a strategy of economic diversification and public investment in infrastructure, while preserving Paraguay's fiscal strength and increasing and diversifying the sovereign's access to market funding. Investment in infrastructure is alleviating Paraguay's transportation bottlenecks that will support continued robust flow of private investment in non-traditional sector, including light manufacturing, forestry, and clean energy.

The stable outlook reflects our expectations that economic growth will remain robust, supported by public and private investment in key infrastructure projects, mitigating risks related to Paraguay's exposure to commodity prices and climate-related shocks. We also expect the government will preserve Paraguay's fiscal strength, while efforts to reduce the share of foreign currency debt will reduce exposure to exchange rate risk, although most of the government debt will likely remain in foreign currency for the foreseeable future.

Paraguay's country ceilings were raised by two notches. The local-currency country ceiling is positioned four notches above the sovereign rating at A2 from Baa1, reflecting the economy's robust growth, sound macroeconomic fundamentals and resiliency to shocks, limited government intervention in the economy and political stability, and improving institutional framework. The foreign-currency country ceiling is positioned one notch below the local-currency ceiling at A3 from Baa2, to reflect exposure to external shocks balanced against a strong external position, floating exchange rate and an open capital account, which all reduce convertibility risks.

RATINGS RATIONALE

RATIONALE FOR THE UPGRADE

ECONOMIC DIVERSIFICATION AND PUBLIC INVESTMENT IN INFRASTRUCTURE SUPPORT RESILIENCY TO SHOCKS WHILE PRESERVING FISCAL STRENGTH

Over the past decade, Paraguay's economy has been on a path of economic diversification, which has increased its resiliency to shocks materially reducing economic and GDP growth volatility, factors that have led to improve our assessment of economic strength.

The agriculture and hydropower generation sectors still play a key role in economic activity, but Paraguay has been diversifying its economy and attracting investments in non-traditional sectors as the processing and value-added of agriculture output has increased and the light manufacturing sector has grown rapidly.

Evidence of increased economic resilience was observed in the face of multiple shocks, including droughts in 2019 and 2022, as well as the pandemic shock. In 2020, Paraguay's economy contracted by just 0.6%, less than regional peers and recovered sharply in 2021. Growth experienced another shock in 2022, due to the impact of the drought on agriculture production; however, the economy did not contract as in earlier drought episodes.

Countercyclical policies and focused public investment on infrastructure supported economic resiliency and mitigated the impact of these shocks. Our expectations of robust growth in light manufacturing and strong FDI flows over the coming years support prospects of steady growth in non-agriculture sectors and improved resiliency to climate shocks.

We expect average GDP growth around 3.5% over the coming years, in line with Paraguay's potential growth. However, there is still upside potential for growth performance once large FDI projects like those in forestry and green fertilizers deliver positive spillovers beyond their own construction and operations.

Under the baseline scenario, and considering Paraguay's fiscal consolidation path, we expect fiscal strength to be preserved with potential for improvement in fiscal metrics on account of lower fiscal deficits and broadly stable interest payments. We expect the debt burden as a share of GDP to remain around 40%, well-below Baa3-rated peers, although debt-to-revenue ratio is in line with Baa3-rated sovereigns due to Paraguay's narrow revenue base.

The government is working to deepen its access to funding in local currency allowing non-resident investors to access the local government debt market in order to diversify its investor base. The share of local currency debt increased as a percentage of total public debt by five percentage points to 16% in April 2024 from 11% in July 2023. The share is likely to increase further, although Paraguay will remain reliant on foreign-currency debt for the foreseeable future. In addition, around 45% of foreign currency-denominated debt is owed to multilateral development banks, significantly reducing refinancing risk, although exposure to exchange rate risk remains a source of vulnerability.

RECORD OF INSTITUTIONAL REFORMS SUPPORT PUBLIC SECTOR EFFICIENCY AND INSTITUTIONAL STRENGTH

Successive governments have prioritized institutional reforms to strengthen the effectiveness of fiscal policy, public institutions, and control of corruptions. A track-record of implementation of institutional reforms coupled with Paraguay's long-standing sound monetary and fiscal policy frameworks support our improved assessment of institutions and governance strength.

Our expectations of continued fiscal consolidation and of the authorities' willingness and ability to address emerging fiscal risks are key elements behind the rating upgrade. To achieve greater efficiency in public policy planning and implementation, the government passed a new public procurement law; it also established a unified agency combining domestic revenue administration and customs to strengthen and optimize efforts in revenue collection and management. The merger and other administrative changes have facilitated the exchange of information and strengthened efficacy and efficiency of public policy implementation.

Additional efforts to improve the structure of the public administration and civil service, and the management of social programs are underway. These measures will contribute to improved government effectiveness and control of corruption in the provision of public services. The government is also proactively addressing potential contingent fiscal risks and administrative deficiencies by improving the supervision and governance of public enterprises. Meanwhile, we expect the creation of the superintendency of pensions and parametric reform of the public pension fund to reduce fiscal risks.

Given the importance of agriculture and hydropower generations, Paraguay is exposed to climate change. To this end, the administration has committed to a set of measures under the IMF's Resilience and Sustainability Facility (RSF). While Paraguay already consumes 100 percent of its electricity from renewable energy and is an exporter of hydropower, the government is working on developing other sources of sustainable electricity generation capacity to reduce the effects of climate shocks on the production of hydropower. The government is also working to incorporate resiliency to climate change in the public investment process, and to introduce a carbon tax. The government mitigation efforts are focused on reducing deforestation and the carbon footprint of the agriculture sector.

RATIONALE FOR THE STABLE OUTLOOK

The stable outlook reflects our expectations that the process of economic diversification and increasing resilience to shocks will continue, supported by Paraguay's effort to invest in critical infrastructure and attract more foreign direct investment, further integrating into export-oriented supply chains. Progress in these areas will mitigate risks related to Paraguay's exposure to volatility in commodity prices and climate shocks.

Continued implementation of the government's strategy to improve institutions and control of corruption will solidify improvements in institutional strength. We also expect the government will preserve Paraguay's fiscal strength and ongoing efforts to reduce the share of foreign currency debt in total government debt will reduce exposure to exchange rate risk, although, as mentioned, most of the government debt will likely remain in foreign currency for the foreseeable future.

ENVIRONMENTAL, SOCIAL, GOVERNANCE CONSIDERATIONS

Paraguay's ESG Credit Impact Score is CIS-3, reflecting effective macroeconomic and fiscal policies, and moderately strong governance profile. Social risks are driven by shortcomings in education and labor productivity and some deficiency in access to basic services. Exposure to environmental risks is driven by climate shocks and reliance on agriculture. Strong fiscal metrics mitigate these risks.

Paraguay's exposure to environmental risks (E-3 issuer profile score) reflects the recurrence of droughts and flooding, which impacts the agriculture sector and hydro-electric generation. Paraguay also benefits from its position as a producer and exporter of clean energy with limited reliance on hydrocarbon.

Paraguay's exposure to social risks (S-3 issuer profile score) reflects positive demographic trends and rising income levels, but relatively weak educational outcomes which weakens economic and labor force competitiveness.

The influence of governance on Paraguay's credit profile (G-2 issuer profile score) reflects improving institutional and governance strength, moderate policy effectiveness, political stability, and a track record of sound macroeconomic and fiscal policies.

GDP per capita (PPP basis, US$): 15,531 (2023) (also known as Per Capita Income)

Real GDP growth (% change): 4.7% (2023) (also known as GDP Growth)

Inflation Rate (CPI, % change Dec/Dec): 3.7% (2023)

Gen. Gov. Financial Balance/GDP: -4.2% (2023) (also known as Fiscal Balance)

Current Account Balance/GDP: 0.2% (2023) (also known as External Balance)

External debt/GDP: 48.7% (2023)

Economic resiliency: baa3

Default history: At least one default event (on bonds and/or loans) has been recorded since 1983.

On 25 July 2024, a rating committee was called to discuss the rating of the Paraguay, Government of. The main points raised during the discussion were: The issuer's economic fundamentals, including its economic strength, have materially increased. The issuer's institutions and governance strength, have materially increased. The issuer's fiscal or financial strength, including its debt profile, has not materially changed. The issuer's susceptibility to event risks has not materially changed.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

We would upgrade Paraguay's sovereign rating if the government implementation of structural reforms continues to enhance the country's institutional and governance framework, and efforts to raise government revenues and reduce the share of foreign currency debt are likely to yield significant credit benefits, improving Paraguay's fiscal strength and overall credit quality. Successful efforts to increase private investment in the country's infrastructure and renewable energy sectors and reduce vulnerability to shocks would also contribute to a higher rating.

Negative pressure on the rating could emerge if efforts to modernize the economy and increase resiliency seem increasingly likely to fall short of our expectations, weighing on economic strength. A prolonged period of weaker private investment or economic growth would likely change our assessment of Paraguay's credit profile. Equally important, if efforts to maintain and improve Paraguay's fiscal strength prove insufficient, leading to higher debt and/or a rising interest burden, this would likely lead to a rating downgrade. The rating would also come under pressure if implementation of the structural reform agenda stalls and falls short of our expectations for the improvement in Paraguay's institutional strength.

The principal methodology used in these ratings was Sovereigns published in November 2022 and available at https://ratings.moodys.com/rmc-documents/395819 . Alternatively, please see the Rating Methodologies page on https://ratings.moodys.com for a copy of this methodology.

The weighting of all rating factors is described in the methodology used in this credit rating action, if applicable.

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found on https://ratings.moodys.com/rating-definitions .

For any affected securities or rated entities receiving direct credit support/credit substitution from another entity or entities subject to a credit rating action (the supporting entity), and whose ratings may change as a result of a credit rating action as to the supporting entity, the associated regulatory disclosures will relate to the supporting entity. Exceptions to this approach may be applicable in certain jurisdictions.

For ratings issued on a program, series, category/class of debt or security, certain regulatory disclosures applicable to each rating of a subsequently issued bond or note of the same series, category/class of debt, or security, or pursuant to a program for which the ratings are derived exclusively from existing ratings, in accordance with Moody's rating practices, can be found in the most recent Credit Rating Announcement related to the same class of Credit Rating.

For provisional ratings, the Credit Rating Announcement provides certain regulatory disclosures in relation to the provisional rating assigned, and in relation to a definitive rating that may be assigned subsequent to the final issuance of the debt, in each case where the transaction structure and terms have not changed prior to the assignment of the definitive rating in a manner that would have affected the rating.

Moody's does not always publish a separate Credit Rating Announcement for each Credit Rating assigned in the Anticipated Ratings Process or Subsequent Ratings Process.

These ratings are solicited. Please refer to Moody's Policy for Designating and Assigning Unsolicited Credit Ratings available on its website https://ratings.moodys.com.

Regulatory disclosures contained in this press release apply to the credit rating and, if applicable, the related rating outlook or rating review.

At least one ESG consideration was material to the credit rating action(s) announced and described above. Moody's general principles for assessing environmental, social and governance (ESG) risks in our credit analysis can be found at https://ratings.moodys.com/documents/PBC_1355824 .

The Global Scale Credit Rating(s) discussed in this Credit Rating Announcement was(were) issued by one of Moody's affiliates outside the EU and UK and is(are) endorsed for use in the EU and UK in accordance with the EU and UK CRA Regulation.

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