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**Paraguay:** Letter of Intent, Memorandum of Economic and Financial Policies and Technical Memorandum of Understanding

March 17, 2008

The following item is a Letter of Intent of the government of Paraguay, which describes the policies that Paraguay intends to implement in the context of its request for financial support from the IMF. The document, which is the property of Paraguay, is being made available on the IMF website by agreement with the member as a service to users of the [IMF](#) website.

Asunción, Paraguay  
March 17, 2008

Mr. Dominique Strauss-Kahn  
Managing Director  
International Monetary Fund  
Washington, D.C. 20431

Dear Mr. Strauss-Kahn:

1. This letter and the attached memorandum of economic and financial policies (MEFP) update and supplement our previous correspondence (of May 8, 2006, September 12, 2006, June 15, 2007, and October 2, 2007), describe performance under the government's economic program for 2007, and propose our economic program for 2008. The attached MEFP articulates the economic policies that the government intends to pursue during 2008 as well as the key targets and objectives under the program (performance criteria and structural benchmarks are included in Tables 1 and 2 of the MEFP). As the program comes to an end in August 2008, the government's objectives continue to be the consolidation of the stabilization gains achieved over the past few years while reducing poverty and deepening the structural reform agenda.
2. The program has been designed for the whole of 2008 to facilitate the task of articulating adequate policies for the new administration that takes over in August 2008. With the presidential elections of April 2008 approaching, the political situation will become more complex and implementation of the program more challenging.
3. The program remains on track. Performance under our economic program for 2007, supported by a 27-month Stand-By Arrangement (SBA), has been very good. All performance criteria through end-September and end-December 2007 have been observed. While most structural benchmarks for end-September and end-December 2007 were fully met, there were delays in a few cases due to logistical problems, which are being addressed.
4. Macroeconomic conditions have improved markedly since the adoption of the program in May 2006. Economic growth accelerated and inflation remained within the target band in 2007 despite some price pressures in the second half of the year due to food supply shocks. The public finances remain on a strong footing anchored by the financial plan, and international reserves are at an all time high.

5. Against this background of good economic performance, the Government of Paraguay hereby requests completing the fifth review under the SBA supported program.

6. The Government of Paraguay will maintain the productive and fruitful dialogue we have had with the Fund in the past. We believe that the policies set forth in the attached MEFP are adequate to reach the program objectives, but we will take additional measures, if necessary, to achieve those objectives. In the spirit of cooperation, we will consult and provide Fund staff with all the relevant information required to complete program reviews and monitor performance.

7. As part of our communication policy, we intend to publish this letter on the websites of the Ministry of Finance and Central Bank to maintain our citizens informed about our policy intentions. We also authorize the Fund to publish this letter and the MEFP.

Sincerely yours,

\_\_\_\_\_/s/\_\_\_\_\_  
Germán Rojas  
President  
Central Bank of Paraguay

\_\_\_\_\_/s/\_\_\_\_\_  
César Barreto  
Minister of Finance

**MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES OF THE GOVERNMENT  
OF PARAGUAY (MEFP)**

**I. BACKGROUND**

1. The economic reforms undertaken by the administration of President Duarte-Frutos are beginning to bear fruit, and have established a strong base for the next government. Following the successful stabilization of the period 2003–05, the government adopted another ambitious economic program for 2006-08 to promote growth and reduce poverty while entrenching macroeconomic stability. Both programs have been supported by precautionary Stand-By Arrangements from the IMF. As a result, growth has rebounded to twice its long-term average, and extreme poverty has been reduced by one-third. Public finances have been put on a solid footing mainly through a tax reform which has improved the tax system and strengthened tax administration, increasing the formalization of the economy; and the public debt level has been put on a firm downward path. The financial system has been considerably strengthened, and confidence in the banking system has increased. The external position has been reinforced significantly, thereby allowing an increase in international reserves to record highs, while maintaining a flexible exchange rate regime.

2. **The program remains on track, and considerable progress has been made in all areas of the structural reform agenda.** All quantitative performance criteria for end-September and end-December 2007 were met with large margins, and most structural measures were observed.<sup>1, 2</sup>

3. **The economy strengthened further in 2007.** Real GDP is expected to have grown by almost 6½ percent (against 4⅓ percent in 2006), driven mainly by buoyant exports,

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<sup>1</sup> The variables subject to quarterly quantitative performance criteria under the program include: (i) overall balance of the Central Administration; (ii) wage bill of the Central Administration; (iii) overall balance of the public sector; (iv) net international reserves of the Central Bank; (v) net domestic assets of the Central Bank; (vi) contracting or guaranteeing of nonconcessional external debt by the nonfinancial public sector; (vii) contracting or guaranteeing of short-term external debt by the nonfinancial public sector (on a continuous basis); and (viii) non-accumulation of external debt arrears (on a continuous basis).

<sup>2</sup> The list of structural measures observed through end-December 2007 includes: (i) the establishment of an expenditure commitment control system; (ii) the design of a public sector investment program; (iii) the design of a strategy for the development of capital markets; (iv) the implementation of a number of prudential regulations in line with the BCP's operational plan to strengthen the regulatory and supervisory framework of the banking system; and (v) the increase in the coverage of the conditional cash transfer program to over 15,000 families. A new payments system legislation was drafted and will be elevated to the Economic Cabinet by mid-April 2008. The benchmark related to the implementation of the result-oriented management contracts for five public enterprises for end-December 2007 was observed, although the results were positive for only three of them (ANDE, COPACO, and PETROPAR). We are taking action in the other two public enterprises (ESSAP and INC) to ensure that these management contracts are observed in the first half of 2008.

especially for soybeans. Headline inflation fell to 6 percent in 2007 (from 12½ percent in 2006) despite sharp increases in food prices. Public finances recorded another surplus against a program objective of fiscal balance, mainly due to continued solid tax collections and firm expenditure controls. The Central Bank managed to accumulate over US\$¾ billion in reserves in 2007, and the *guaraní* strengthened further against major hard currencies.

4. **The program for 2008 envisages leaving a solid economic base on which the next administration can build in order to achieve higher and sustainable growth, and a meaningful reduction in poverty.** The structure of the 2008 program will be similar to that of 2007. The program will continue to be based on five policy pillars, a strong macroeconomic program anchored by four structural reform areas: (i) public sector reform; (ii) financial sector reform; (iii) pro-growth agenda; and (iv) a social safety net to alleviate poverty. Performance criteria and structural benchmarks for 2008 related to these policies are specified in Tables 1 and 2, and further defined in the attached technical memorandum of understanding.

## II. MACROECONOMIC PROGRAM FOR 2008

5. **The macroeconomic framework for the 2008 program seeks to buttress growth, while maintaining sound policies.** After a record harvest in 2007, economic growth is expected to moderate to the 4-5½ percent range in 2008, as crop yields return to more normal levels. Still, given high and volatile inflation in the recent months, the government believes that it is prudent to maintain a similar target of core inflation in 2008, namely 5 percent within a band of ± 2½ percent. Fiscal and monetary policies will be designed with a view to achieve these growth and inflation objectives for 2008.

### A. Fiscal Policy

6. **The program continues to aim at preserving fiscal discipline, despite strong expenditure pressures.** While the 2008 budget submitted to Congress envisaged a small deficit (which is broadly consistent with fiscal balance once historical levels of expenditure execution are taken into account), Congress approved a 2008 budget with a deficit of 2 percent of GDP. We will be guided by the expenditure priorities included in the budget approved by Congress, but we have introduced a financial plan for 2008 to align expenditure intentions with available financing (as has been the practice over the last few years). In line with the broad mandate from Congress, our policy will be to restrain non-social current spending to accommodate a higher level of social and capital spending to support our poverty alleviation efforts and growth objectives, while preserving fiscal discipline.

7. **As in previous years, the program will allow an enhancement of quality investments in the social sectors.** In particular, in 2008 the government will aim to achieve higher-than-projected levels of capital and targeted social expenditures provided that macroeconomic conditions are appropriate to absorb these additional expenditures and there

are higher-than-expected revenues or else financing on appropriate terms directed to quality projects. This issue will be addressed in the context of program reviews.

8. **The 2008 program safeguards the objective of broad fiscal balance.** Overall fiscal balance at the consolidated public sector level will continue to be a key objective for 2008. The rest of the public sector is expected to maintain its surplus position by strong revenue performance and restraining of current expenditures. The Central Bank is expected to strengthen its balance sheet position once legislation is approved on the recent initiative to make transfers from the Treasury.

9. **Going forward, the government intends to increase capital expenditures in order to address serious weaknesses in economic and social infrastructure.** To this end, the government is preparing a long-term plan whose key objectives are to boost growth and achieve well-defined development landmarks in different sectors of the economy, including the millennium development goals. In order to ensure that the plan does not undermine the hard-won macroeconomic stability, the government is designing, in cooperation with the international community, a consistent long-term development program.

## B. Monetary Policy

10. **Monetary policy will aim at containing core inflation at 5 percent in 2008.** While the range for the inflation objective in 2008 is similar to that of 2007 (i.e., 5 percent within a band of  $\pm 2\frac{1}{2}$  percent), efforts will be made to bring down core inflation from the upper end of the range. To respond adequately to external shocks and reduce vulnerabilities in the inflation outlook, we will continue to follow a flexible exchange rate regime with intervention limited to the achievement of our international reserve target.

11. **To anchor inflationary expectations, the monetary authority will pursue a policy of no expansion in the net domestic assets of the Central Bank for 2008 as a whole.** We believe that the inflation objective can be achieved by limiting the growth in currency. We will accommodate the expansion in currency through purchases of foreign exchange, and expect to accumulate at least US\$100 million in 2008. There will be occasional fluctuations in the net domestic assets of the Central Bank during periods when the demand for money has a different seasonality than the balance of payments but the Central Bank will pursue a policy of maintaining stable its net domestic assets for the year as a whole to anchor expectations. The main instrument of monetary control will continue to be the “*Letras de Regulación Monetaria*” whose rates will be set by the Central Bank to achieve its monetary and inflation objectives. The monetary program will continue to be flexible, accommodating higher-than-programmed increases in money demand by allowing a higher growth in currency, accompanied by a commensurate increase in reserve accumulation.

### III. STRUCTURAL REFORMS FOR 2008

12. **The structural reform agenda for 2008 will aim at solidifying the gains of the past years.** Given the limited time under the program, the general elections and the difficult political environment, the structural reform agenda needs to be well-focused. There will be one main reform for each of the four structural pillars of the program. Nonetheless, the government will continue to pursue reforms already under way in all areas, with emphasis on legislation that could be adopted by the next Congress.

#### A. Public Sector Reform

13. **Expenditure control mechanisms will be strengthened further.** To that end, the management of Treasury accounts will be enhanced. Currently, there is a large number of such accounts, some of which are virtually dormant. In order to improve financial management, expenditure control, and transparency, the government will identify all the Central Government accounts and gradually close them, aiming at centralizing all public resources into a single account at the Central Bank. As an initial milestone toward this objective, it will consolidate all the accounts that are currently not established by law into a Single Treasury Account (structural benchmark for end-June 2008), and also initiate the process to incorporate those accounts that are established by law.

14. **The institutional framework of the tax and customs administration will be enhanced.** In particular, the government will concentrate efforts on conducting audits to ensure tax liabilities are properly discharged. We will also focus on strengthening the operations of the large taxpayer unit at the tax agency, with a view to improving taxpayer selection, through the use of a risk-based approach, and auditing activities. The government will also work on developing a systematic approach to strategic management and performance monitoring for revenue administration. Customs administration will continue to be strengthened through tighter operational controls, with a view of improving ex-post audits operations, and also the consolidation of the bank collection system.

#### B. Financial Sector Reform

15. **The process of strengthening the financial position of the Central Bank will continue in 2008.** This process began with the design of a strategy for this purpose in August 2007 and continued with the submission of legislation to Congress in December 2007 to allow for transfers of 0.2 percent of GDP from the Ministry of Finance to the Central Bank. We have entered a process of reconciliation of claims between the public debt records of the Ministry of Finance and the Central Bank's balance sheet, and have already resolved those claims that are recognized by both institutions. We will send to the attorney general the remaining claims for his information and ruling (structural benchmark for end-May 2008). Once the attorney general gives a positive ruling, we plan to send to Congress legislation to allow a transfer of public bonds to the Central Bank for those amounts that are recorded on

its balance sheet but are not included in the public debt records of the Ministry of Finance, which we expect to take place by mid-2008.

16. **We will continue to implement our strategy toward strengthening prudential regulations for the banking system.** Following our plan designed in June 2007 to enhance the soundness of the banking system and increase compliance with Basel Core Principles to at least 80 percent, the Central Bank approved a modified resolution to upgrade loan classification and provisioning requirements (a modified version of the former Resolution 8/03) in September 2007 and adopted a set of additional regulations in December 2007 under its operational plan. We will continue our work on strengthening the regulatory and supervisory frameworks but some of the needed changes require amendments to the banking law. We will begin consultations with the financial community and Congress to strengthen ownership in this reform area, and assess the viability of sending appropriate legislation to Congress.

### C. Pro-Growth Agenda

17. **There is a need to further improve the efficiency of public enterprises to provide better public services and increase productivity.** To this end, the government signed result-oriented management contracts with the five largest public enterprises in December 2006. While the performance of ANDE, COPACO has been acceptable, and that of PETROPAR uneven, the government believes that ESSAP and INC will need to improve their managerial, operational and financial performance in order to reach acceptable standards under these contracts. In the case of ESSAP, the main problem is a weak financial position derived from an unclear ownership structure as it was made a corporation in 2002 in an unsuccessful privatization attempt. To address this problem, the government sent legislation to Congress in November 2007 to reduce ESSAP's debt burden, clarify its ownership structure, and improve its financial accountability and monitoring. We believe that, once approved, this legislation will strengthen significantly the performance of ESSAP. In the case of INC, there are a number of performance problems that we intend to address by strengthening the governance structure. We intend to establish new targets and sign new result-oriented management contracts for these enterprises in 2008 (structural benchmark for end-May 2008). As part of the contracts, these enterprises will develop strategic business plans that will serve to address weaknesses identified in 2007 by the Public Enterprises Council.

18. **Sustained improvements in Paraguay's investment climate are needed in order to promote higher levels of foreign and domestic investment.** With the assistance of the World Bank and the IDB, the government designed a master plan to help promote the investment climate in September 2006. The Ministry of Industry is taking the lead in its implementation, and progress so far has been satisfactory. Going forward, the government intends to attain the following key targets under the plan in 2008: (i) completion of the one-



stop window for opening a business; and (ii) completion of the plan to improve the competitiveness of the export sector, by improving quality standards and sanitary regulation.

#### **D. Social Safety Net**

19. **We intend to strengthen the conditional cash transfer program.** This program has been very effective in reducing extreme poverty in the country. While its coverage is still limited (8,800 families in 2006 and over 17,000 families in 2007), we would like to continue expanding this program. Against this background, we expect to have 19,000 families covered under this program in the first five months of the year (structural benchmark for end-May 2008). It has been challenging to ensure the proper administration and implementation of the program, but we intend to continue strengthening the monitoring mechanisms and the required provision of health and education services while at the same time making a budgetary effort to increase the coverage of the program to 50,000 families by end-2008.

#### **IV. OTHER**

20. **We will continue to seek resolution to the disputed claims, negotiating in good faith.** There are a number of existing claims in dispute, which we hope to resolve during the program.

**Table 1. Paraguay: Quantitative Program Targets**

	2008	
	End-March	End-June
<b>Fiscal targets</b>		
1. Overall balance of the central administration (floor, in billions of guaranies) 1/ 2/	95	213
2. Wage bill of the central administration (ceiling, in billions of guaranies) 1/	1,195	2,429
3. Overall balance of the public sector (floor, in billions of guaranies) 1/	172	253
<b>Monetary targets</b>		
4. Net international reserves (floor, in millions of U.S. dollars) 3/	2,412	2,462
5. Net domestic assets (ceiling, in billions of guaranies) 3/	-8,436	-8,692
<b>Public debt and arrears targets</b>		
6. Contracting or guaranteeing of nonconcessional external debt by the NFPS (ceiling, in millions of US\$) 1/	500	500
<b>Continuous PCs</b>		
7. Contracted or guaranteed short-term external debt by the NFPS	0	0
8. Non-accumulation of external debt arrears	0	0

1/ Cumulative flows from the beginning of the calendar year.

2/ For 2008 adjusted downward for any cash transfer or payment of interest costs on securities used to strengthen the financial position of the central bank.

3/ NIR stock is adjusted upward (downward) for any increase (decrease) in reserve requirement for foreign currency deposits (above pre-specified amounts) and upward by the amount of any program disbursements. Similarly, the NDA target will be adjusted downward (upward) following the adjustment in the NIR.

**Table 2. Paraguay: Structural Conditionality Under the Program for 2008**

Measure	Conditionality <sup>1/</sup>	Timing
<b>Public Sector Reform</b>		
A. Consolidate all Treasury accounts not established by law into one account	SB	end-June 2008
<b>Financial Sector Reform</b>		
B. Send to attorney general claims in dispute between BCP and the Ministry of Finance for his clearance	SB	end-May 2008
<b>Pro-Growth Reform</b>		
C. Sign and implement result-oriented management contracts for 2008 with ANDE, COPACO, ESSAP, INC and PETROPAR	SB	end-May 2008
<b>Social Safety Net</b>		
D. Increase the coverage of the conditional cash transfer program to 25,000 families	SB	end-May 2008

1/ SB = structural benchmarks.

## PARAGUAY—TECHNICAL MEMORANDUM OF UNDERSTANDING

This Technical Memorandum of Understanding (TMU) defines the variables subject to quantitative targets (performance criteria and indicative targets), specified in the Memorandum of Economic and Financial Policies (MEFP). It also describes the methods to be used in assessing the program performance and the information requirements to ensure adequate monitoring of the targets.

### A. Fiscal Targets

#### 1. Targets on the Overall Balance of the Central Administration

Cumulative balance	Floor (In billions of <i>guaraníes</i> )
Cumulative balance from December 31, 2007	
End-January 2008 (program projection)	-12
End-February 2008 (program projection)	38
End-March 2008 (performance criterion)	95
End-April 2008 (program projection)	84
End-May 2008 (program projection)	165
End-June 2008 (performance criterion)	213
End-July 2008 (program projection)	261
End-August 2008 (program projection)	367
End-September 2008 (program projection)	373
End-October 2008 (program projection)	481
End-November 2008 (program projection)	580
End-December 2008 (program projection)	0

For the purposes of the program, the central administration (CA) includes the executive, judicial and legislative branches. The overall balance of the CA will be measured and monitored from the financing side, as equal to *minus* the net financing of the CA. The net financing of the CA is defined as the sum of: (i) net external financing to the central government; (ii) the change in net credit to the central government from the financial system, excluding government bonds; (iii) the net issuance of government bonds; (iv) net financing from all other sources to the government (consisting of any form of financing other than government bonds) including by the private sector; (v) asset sales; (vi) the net change in domestic floating debt (*deuda flotante*), as defined below; and (vii) the net change in external arrears. Items denominated in foreign currency will be converted into *guaraníes* at the average exchange rate for each month.

For the purposes of the program, any government bonds issued to (i) capitalize the central bank, (ii) capitalize the Banco Nacional de Fomento (BNF), or (iii) finance the deposit guarantee will not be included in the definition of fiscal deficit.

Net external financing is defined as central government's foreign borrowing, including bonds issued abroad, less amortization payments (including debt prepayments) of foreign debt. Net credit from the financial system is defined as the change in net credit to government, as reported in the monetary accounts of the BCP, excluding government bonds. Net change in domestic floating debt is defined as the difference between accrued expenditure (*gastos obligados*) and payments transferred (*gastos transferidos*). Net change in external arrears is defined as the difference in the stock of arrears to external creditors during a period of reference, as reported by the ministry of finance's SIGADE system. Data will be provided to the Fund by the ministry of finance with a lag of not more than three weeks past the test date.

The floor on the Cumulative Central Administration Overall Balance for 2008 will be adjusted downward by the full amount of cumulative transfers and/or interest due on any bonds issued during 2008 as part of the program to strengthen the financial position of the Central Bank.

## 2. Targets on the Central Administration Wage Bill

Cumulative flows	Ceiling (In billions of <i>guaraníes</i> )
Cumulative flows from December 31, 2007	
End-January 2008 (program projection)	389
End-February 2008 (program projection)	793
End-March 2008 (performance criterion)	1,195
End-April 2008 (program projection)	1,605
End-May 2008 (program projection)	2,017
End-June 2008 (performance criterion)	2,429
End-July 2008 (program projection)	2,846
End-August 2008 (program projection)	3,257
End-September 2008 (program projection)	3,665
End-October 2008 (program projection)	4,083
End-November 2008 (program projection)	4,523
End-December 2008 (program projection)	5,372

The wage bill of the CA is defined as the accrued remuneration to all central administration employees (*servicios personales*), including overtime and effective social contributions

(budget line items 100–199),<sup>1</sup> as reported in by the ministry of finance's monthly *Situación Financiera de la Administración Central*. Data will be provided to the Fund by the ministry of finance with a lag of not more than three weeks past the test date.

### 3. Targets on the Overall Balance of the Consolidated Public Sector

Cumulative flows	Floor (In billions of <i>guaraníes</i> )
Cumulative flows from December 31, 2007	
End-January 2008 (program projection)	-63
End-February 2008 (program projection)	482
End-march 2008 (performance criterion)	172
End-April 2008 (program projection)	162
End-May 2008 (program projection)	234
End-June 2008 (performance criterion)	253
End-July 2008 (program projection)	398
End-August 2008 (program projection)	571
End-September 2008 (program projection)	516
End-October 2008 (program projection)	721
End-November 2008 (program projection)	821
End-December 2008 (program projection)	0

For the purposes of the program, the consolidated public sector comprises: (i) the non-financial public sector (NFPS) and (ii) the Central Bank of Paraguay (BCP).

The NFPS includes the CA as defined above, the social security institutes, the provincial governments, autonomous decentralized agencies, and the nonfinancial public enterprises.<sup>2</sup>

Under the program, the consolidated public sector's overall balance will be measured and monitored as equal to *minus* the net financing of the NFPS, *plus* the operating balance of the BCP. The net financing of the NFPS is defined as the sum of: (i) net external financing; (ii) the change in net domestic credit to public sector from the financial system, excluding government bonds; (iii) the net issuance of government bonds; and (v) other net financing of

<sup>1</sup> It will exclude any Treasury transfers to the Caja Fiscal registered as wages for new employment positions authorized in the budget but not yet appointed.

<sup>2</sup> Altogether they include: Pension funds (Instituto de Previsión Social (IPS), Caja Bancaria, Caja Ande, Caja Ferroviaria, Caja de Empleados Municipales), the public universities (UNA, UNE, UNP, UNI), 17 provinces (*gobiernos departamentales*), 17 autonomous regulatory and development agencies, the public enterprises (PETROPAR, ANDE, ANNP, DINAC, and INC) and incorporated enterprises owned by the state (ESSAP and COPACO).

the nonfinancial public sector by the private sector, including net increase in the stock of domestic floating debt, external arrears, and asset sales. Items denominated in foreign currency will be converted into *guaraníes* at the average exchange rate for each month.

Net external financing of the NFPS is defined as all external disbursements less amortization paid by the NFPS as defined above. The change in net credit is defined as the net flow of gross domestic credit (excluding treasury bonds) plus use of deposits by the NFPS in the domestic financial system. Domestic floating debt of the NFPS is defined as the difference between accrued expenditure (*gastos obligados*) and payments transferred (*gastos transferidos*) vis-à-vis the private sector. It will be measured as the central government floating debt net of debts with the rest of the NFPS as defined herein. External arrears are defined as the sum of (i) any principal and interest accrued by the NFPS and not paid by the due date as reported by the ministry of finance's SIGADE; (ii) the net change in arrears to foreign suppliers of the NFPS. The operating balance of the BCP is measured as all administrative and financial revenues minus costs (including costs of monetary policy and interest on BCP external debt). Data will be provided to the Fund by the ministry of finance and the central bank with a lag of not more than three weeks past the test date.

## B. Monetary Targets

### 4. Targets on Net International Reserves of the Central Bank of Paraguay (BCP)

Outstanding stock as of:	Floor (In millions of U.S. dollars)
End-December 2007	2,462
End-January 2008 (program projection)	2,442
End-February 2008 (program projection)	2,422
End-March 2008 (performance criterion)	2,412
End-April 2008 (program projection)	2,432
End-May 2008 (program projection)	2,447
End-June 2008 (performance criterion)	2,462
End-July 2008 (program projection)	2,477
End-August 2008 (program projection)	2,487
End-September 2008 (program projection)	2,512
End-October 2008 (program projection)	2,522
End-November 2008 (program projection)	2,532
End-December 2008 (program projection)	2,562

For monitoring purposes, net international reserves (NIR) of the BCP are defined as the U.S. dollar value of gross foreign assets in foreign currencies minus gross liabilities in foreign currencies with original maturity of less than one year. Data will be provided by the BCP to the Fund with a lag of not more than five days past the test date.

Gross foreign assets are defined consistent with the Fund Data Template for International Reserves and Foreign Currency Liquidity, and include all liquid foreign currency-denominated claims of BCP, including monetary gold, holdings of SDRs, the reserve position in the IMF, and foreign currency in the form of cash, deposits abroad, and Paraguay's net cash balance within the Latin America Trade Clearing System (ALADI). Excluded from gross foreign assets are participations in international financial institutions (including *Corporación Andina de Fomento* (CAF), IDB, IBRD, *Asociación Internacional de Fomento*, and *Banco de Desarrollo del Caribe*), the holdings of nonconvertible currencies, and holdings of precious metals other than gold. Gross foreign liabilities are all foreign currency denominated BCP liabilities of contracted maturity up to and including one year plus the use of Fund financing. Non-U.S. dollar denominated foreign assets and liabilities will be converted into U.S. dollars at the market exchange rates of the respective currencies as of December 31, 2007.

NIR targets will be adjusted *upward (downward)* for any *increase (decrease)* in reserve requirement deposits (*encaje*) associated with foreign currency deposits in commercial banks, compared to the following levels: March 31, 2008: US\$ 271 million; June 30, 2008: US\$298 million; September 30, 2008: US\$305 million; and December 31, 2008: US\$295 million.

NIR targets will also be adjusted upward (downward) by the surplus (shortfall) in program disbursements relative to the baseline projection. Program disbursements are defined as uncommitted external disbursements that are usable for the financing of the overall central government budget.

### **External Program Disbursements (Baseline Projection)**

Cumulative flows	(In millions of <i>U.S. dollars</i> )
Cumulative flows from December 31, 2007	
End-January 2008 (program projection)	0
End-February 2008 (program projection)	0
End-March 2008 (program projection)	0
End-April 2008 (program projection)	0
End-May 2008 (program projection)	0
End-June 2008 (program projection)	0
End-July 2008 (program projection)	0
End-August 2008 (program projection)	0
End-September 2008 (program projection)	0
End-October 2008 (program projection)	0
End-November 2008 (program projection)	0
End-December 2008 (program projection)	0



## 5. Targets on Net Domestic Assets

Net domestic assets (NDA) of the BCP are defined as the difference between currency issue (provided by the BCP) and the net international reserves (NIR) of the BCP, both measured based on end-of-period data. Data will be provided to the Fund by the BCP with a lag of not more than five days past the test date.

Outstanding stock as of:	Ceiling (In billions of <i>guaraníes</i> )
End-December 2007	-8,231
End-January 2008 (program projection)	-8,746
End-February 2008 (program projection)	-8,578
End-march 2008 (performance criterion)	-8,436
End-April 2008 (program projection)	-8,475
End-May 2008 (program projection)	-8,702
End-June 2008 (performance criterion)	-8,692
End-July 2008 (program projection)	-8,695
End-August 2008 (program projection)	-8,796
End-September 2008 (program projection)	-8,906
End-October 2008 (program projection)	-8,968
End-November 2008 (program projection)	-8,917
End-December 2008 (program projection)	-8,231

For the purpose of NDA calculation, NIR will be converted into *guaraníes* at an accounting (program) exchange rate of G 5,100/US\$. The ceiling on NDA will be adjusted *upward* (*downward*) by the equivalent in *guaraníes* of the *downward* (*upward*) adjustments made to the floor on the NIR of the BCP as described above.

NDA targets will also be adjusted downward (upward) by the surplus (shortfall) in program disbursements relative to the baseline projection. Program disbursements are defined as uncommitted external disbursements that are usable for the financing of the overall central government budget.

### C. Public Debt and Arrears Targets<sup>3</sup>

#### 6. Targets on Contracting or Guaranteeing of New Nonconcessional External Debt by the Consolidated Public Sector

Cumulative flows:	Ceiling (In millions of U.S. dollars)
Cumulative flows from December 31, 2007:	
End-January 2008 (program projection)	500
End-February 2008 (program projection)	500
End-march 2008 (performance criterion)	500
End-April 2008 (program projection)	500
End-May 2008 (program projection)	500
End-June 2008 (performance criterion)	500
End-July 2008 (program projection)	500
End-August 2008 (program projection)	500
End-September 2008 (program projection)	500
End-October 2008 (program projection)	500
End-November 2008 (program projection)	500
End-December 2008 (program projection)	500

The limit applies to the contracting or guaranteeing by the consolidated public sector within the calendar year of new nonconcessional external debt with an original maturity of more than one year, including commitments contracted or guaranteed.<sup>4</sup> For program purposes, a debt is concessional if it includes a grant element of at least 35 percent on the basis of currency- and maturity-specific discount rates based on the commercial interest reference rates (CIRR) published monthly by the OECD.<sup>5</sup> Excluded from the limits are credits

<sup>3</sup> The stock of debt does not include disputed claims to the following parties: Belgium's Ex-Herstal, a South African supplier; French and Swiss import verification companies; the National Bank of Argentina, and claims by a syndicate of European and American banks against the state of Paraguay resulting from a judgment made by the Swiss Federal Supreme Court on May 31, 2005. Any of these claims that would be considered as debt will be added to the stock figure.

<sup>4</sup> The term "debt" has the meaning set forth in point No. 9 of the Guidelines on Performance Criteria with respect to Foreign Debt adopted on August 24, 2000 (Board Decision No. 12274-(00/85). In line with Paraguayan law, debt will be deemed contracted only if it has received approval by Congress.

<sup>5</sup> The grant element is calculated as the difference between the net present value (NPV) of debt and its nominal value, expressed as a percentage of the nominal value of the debt (i.e., Grant Element = (Nominal Value—NPV)/Nominal Value). The NPV of debt is calculated by discounting the future stream of payments of debt

(continued)

extended by the IMF and balance of payments support loans extended by multilateral and bilateral creditors. The Ministry of Finance will provide data to the Fund with a lag of not more than 30 days from the test date.

The concessionality of loans in currency baskets will be assessed on the basis of U.S. dollar interest rate tables. For loans with interest rates based on the internal policy of the creditors, the relevant interest rate to define concessionality will be the interest rate for each creditor at the time of the commitment. Loans or portions of loans extended in the context of a debt rescheduling or a debt reduction operation will be excluded from the ceiling.

#### **7. Performance Criterion on Short-Term External Debt of the Nonfinancial Public Sector**

As a continuous performance criterion, the NFPS will neither contract nor guarantee any short-term external debt during the program period. Short-term debt is defined as debt with a contractual maturity of one year or less. Excluded are normal import-related credits, forward contracts, swaps, and other futures market contracts. The public enterprises will provide the necessary information to the ministry of finance, which will provide the data to the Fund, with a lag of not more than 30 days from the test date.

#### **8. Performance Criteria on External Payments Arrears of the Consolidated Public Sector**

**The Consolidated Public Sector, excluding PETROPAR, will accumulate no new external arrears during the program period.** The stock of external arrears of the PS will be calculated based on the schedule of external payments obligations reported by SIGADE. Data on external arrears will be reconciled with the relevant creditors, and any necessary adjustments will be incorporated in these targets as they occur. For the purposes of this performance criterion, an arrear will be defined as a payment, which has not been made within 30 days after falling due. In addition, the public enterprises will report to the ministry of finance and the BCP arrears on any external debt that is not recorded under SIGADE. The same 30-day grace period will be applied to all external payments of public enterprises, except where explicit agreements exist with creditors on an extended grace period. The Ministry of Finance will provide the final data on the stock of consolidated public sector external arrears to the Fund, with a lag of not more than 30 days from the test date.

In addition, the government is engaged in good faith efforts to resolve overdue claims in dispute, and will attempt to negotiate and resolve these as soon as possible. Claims by a syndicate of European and American banks against the state of Paraguay resulting from a

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service due on this debt. For debt with a maturity of at least 15 years, the ten-year average CIRR will be used to calculate the NPV of debt. For debt with a maturity of less than 15 years, the six-month average CIRR will be used.

judgment made by the Swiss Federal Supreme Court on May 31, 2005, will be considered claims in dispute.

#### **D. Reporting**

Monitoring the program requires accurate and timely data. All information on performance criteria, indicative targets, and balance of payments support loans will be reported to Fund staff within the timeframes prescribed above. Debt stocks and associated flows broken down by both creditor and debtor types and maturity will be provided on a quarterly basis.

The Ministry of Finance will be responsible for gathering data on a monthly basis from all the institutions that comprise the consolidated public sector, including the incorporated enterprises (*Sociedades Anónimas*) COPACO and ESSAP. It will compile this information according to the standard format of the Ministry of Finance's monthly financial situation report (*Situación Financiera*). The data will be supplied to the Fund and published on the Ministry of Finance's external website within 30 days of each test date.