Perspectives

Edition: **January-March 2024**

State of the financial market in Paraguay

UCB Research and Investment Strategy, April 2024

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¡Welcome 2024!

Last year ended on a cheerful note, as slowing inflation and declining inflationary risks generated a wave of optimism about the prospects for the global economy. However, concerns about recession are still on the table: for example, the New York Federal Reserve's recession probability model estimates that there is a 57.81% chance that the United States will enter a recession in the next 12 months (compared to 47.3% in December).

In other words, inflation, interest rates and recession risks will continue to shape the outlook for global financial markets in 2024 and perhaps beyond.

The International Monetary Fund (IMF) forecasts similar global growth dynamics to that in 2023 (3.1%), although much of this projected growth is due to emerging market activity, while growth in advanced economies is expected to be moderate at best.

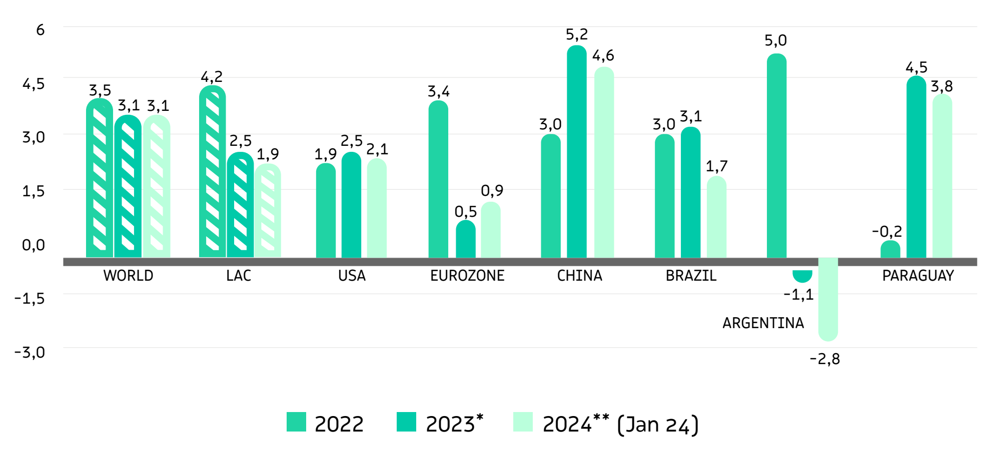
From an international point of view, the new balance of risks will be shaped by how the November presidential elections in the USA affect expectations, when and at what pace will begin the cuts in international interest rates, whether the growth dynamics in India will be able to compensate for the slowdown in China, and whether and how the continuing geopolitical conflicts affect the key global commodity prices.

In the region, a slowdown is projected for the Brazilian economy in 2024 (1.7% vs. 3.1% in 2023), even as the expectations have recently been adjusted upwards (October projections stood at 1.5%). However, in January Brazil´s economy experienced a greater than expected drop in industrial production (-1.6%) and the agents' confidence still remains in the pessimistic zone. The inflation picked up in February (0.83%, higher than expected), but it still remains (4.5%) within the target range.

For the Argentine economy, growth projections for 2024 have been recently strongly adjusted downward, from 2.8% expected in October to -2.8% in expected in January (WEO, IMF). The country continues to experience a strong contraction of real income. In January, Argentina reached an agreement with the IMF (US$ 4.7 billion), based on understandings on a strengthened set of policies to restore the country´s macroeconomic stability and advance the structural reforms.

The country has managed to slow down inflation (13.2% in February, 20.6% in January, 25.5% in December), contain the exchange rate (relatively stable at around $1,000/USD, with an exchange gap that passed from 177% prior to the elections to 19%), reduce the fiscal deficit (showing a surplus in January), begin to rebuild international reserves (+USD 7,000 million), and lower the country risk to 2021 levels (EMBI: 1645). However, sustainability and progress in terms of stabilization and growth - in addition to the expected results of the 2024 agricultural harvest - will depend on a governance that manages to remove structural distortions from the economy.

Graph 1. Level of activity (percentage changes, real GDP)



*Source: WEO-IMF (Ene 24). *: estimate, **: proyection*

Inflation, interest rates and recession risks will continue to shape the outlook for global financial markets in 2024 and perhaps beyond.

Local economic context

At the local level, the year began with an improvement in Paraguay's sovereign debt rating by Santadard & Poors, which leaves the country just a step away from an investment grade. In addition to a successful placement for the first time of Government Bonds in local currency, the markets confirmed a country risk* corresponding to that status (EMBI = 1.71). This placement internalizes the good prospects for growth (around 3.8% for 2024 (after 4.7% in 2023) and macroeconomic stability of the country.

The first quarter of 2024 ended with a year-on-year inflation of 3.6% (Graph 2), following eight consecutive cuts in the monetary policy rate (MPR). To the extent that the MPR approaches a neutral range, in the future its behavior could be more conditioned by the pace of international rate cuts.

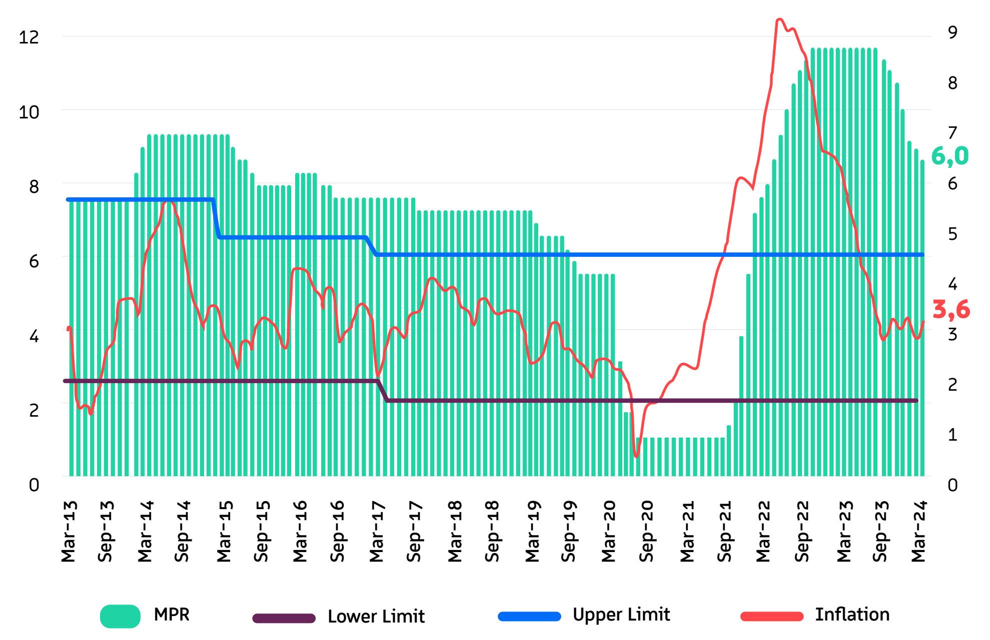
In terms of economic activity, as of the end of January the Monthly Economic Activity Indicator (IMAEP) showed an expansion in the economic activity levels over the previous 12 months of 5.5% (4.4% as of Dec 23), or 5.0% when excluding the impact of agriculture and the binational hydropower projects of Itaipu (Brazil-Paraguay) and Yacyreta (Argentina-Paraguay).

Although agricultural sector is expected to perform well in 2024 relative to 2023, it is the industrial and commercial sectors that are projected to become more prominent drivers of economic activity this year, while the construction sector is expected to retake its earlier dynamics as MPOC begins to make debt payments to contractors.

Looking ahead, the dynamization of the domestic demand will play a key role as the global foreign trade slows down. In this regard, the closing data for 2023 show a gradual and progressive improvement in the labor market (unemployment Q4´23 5.2%, vs. 5.8% a year ago), with a real increase of 5.7% in income (average per hour), which, added to lower interest rates, should have a positive effect on household consumption. In this regard, the Consumer Confidence Index as of February (56.4) continued in an optimistic zone, completing 14 months of year-on-year recovery.

With the boost of greater tax collection, and with spending growing at a significantly slower pace than income, as of January the fiscal results - including the debt not recorded in the previous administration and equivalent to 1.1% of GDP - were in line with the fiscal convergence plan for 2026.

Graph 2. Internanual inflation (left axis, %) and Monetary Policy Rate (MPR) (right axis, %)



Source: BCP. Note: The "Lower Limit" and "Upper Limit" define the monetary policy objective range for the inflation in Paraguay

According to the Emerging Markets Bond Indicator (EMBI), Paraguay currently belongs to a group of countries with lowest level of risk for investors in the Latin American region. It is the fourth country in Latin America with the lowest level of risk and capacity to comply with its obligations, behind Uruguay, Peru and Chile.

Market continues to grow...

Trading Volumes

The stock market continues its robust growth trajectory: during the first three months of the year, the Asunción Stock Exchange (Bolsa de Valores de Asunción, BVA) has already recorded trading volumes in the amount of Gs. 9,287.850 million, which represents a 30% year-on-year growth compared to the same period in 2023.

The repo market represents the largest part of the volume traded on the market (74.7% of the total). The repo operations allow the security holders to access and manage liquidity, while also providing alternative investment opportunity to those seeking to generate returns in the short term.

We expect to see an increase in trading volumes throughout the year, especially within the primary market, partly as a result of the expected continuing decreases in interest rates, both in guaraníes and dolars.

Primary Placements

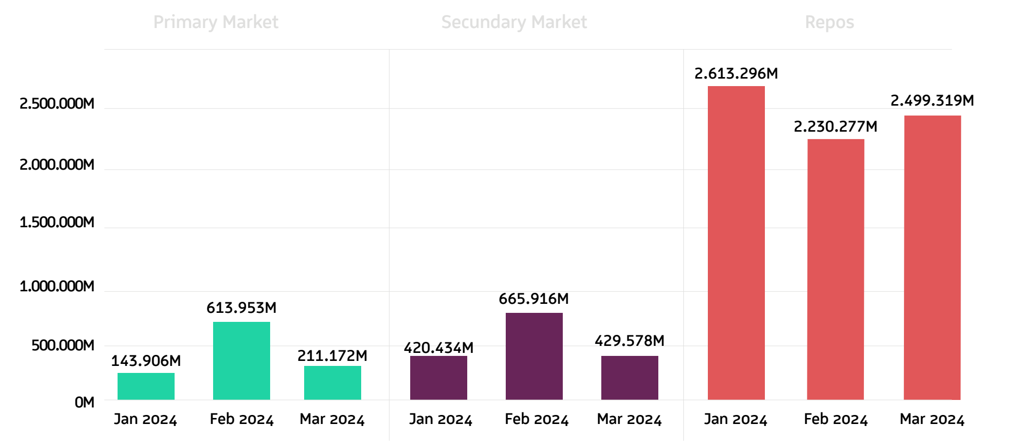
During the first three months of this year, prominent companies from various economic sectors accessed the stock market to raise funds and support their financial projects, managing to raise a total of Gs. 996.031 million.

The public, finance and commerce sectors were the largest attractors of investor funds, representing 92.7% of the total volume generated. The commerce sector was also one with the most diversified set of investors (277), followed by commerce and services sectors.

Regarding the financing instruments issued, 97.7% of the total amount placed was through debt securities, 1,9% through investment funds and the remaining 0.5% via stock shares.

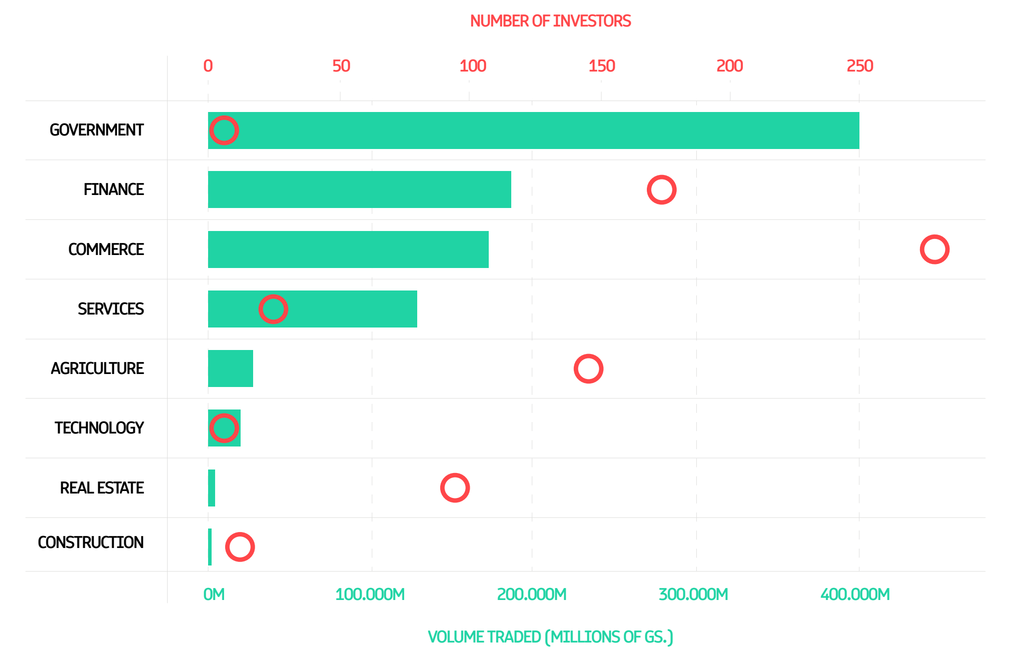
> "We expect to see an increase in trading volumes throughout the year, especially within the primary market."

Graph 3. Trading Volume (SEN)



Source: Superintendence of securities, Central Bank of Paraguay.

Graph 4. Primary Emisions



Source: Superintendence of securities, Central Bank of Paraguay.

...offering oportunities

Sovereign Yield Curve

As the economic environment stabilized, the rates negotiated in the auctions of government securities have decreased significantly compared to the same period of the previous year. In line with this development, the slope of the yield curve has further increased with shorter maturities accompanied by lower yields and longer maturities by higher yields.

The yields on short-term Monetary Bills (Letras de Regulación Monetaria, LRM) have dropped the most between March 2023 and March 2024, having experienced decreases of 270-280 basis points in shorter maturities (1 and 6 months), and up to 300-330 basis points in maturities equal to or greater than 1 year.

With regard to the government debt, we highlight the issue of Sovereign Bonds (BOSOB) of the Ministry of Economy and Finance - the first issue of debt securities in guaraníes by the Paraguayan government in international markets. This 7Y issue raised USD 500 million at an annual interest rate of 7.90%.

Finally, in March 2024, and the first auction in years of the Treasury Bonds was held through the Central Bank of Paraguay instead of the Stock Exchange (BVA). This auction set new records both in size and time. It is important to mention that in addition to the BOTS shown in Table 1, a 15-year Treasury Bond issue was also carried out in March with an allotment rate of 7.95%.

Trades in the Stock Market

During the first quarter of the year, transactions in the primary and secondary securities markets have adjusted to current economic conditions and fluctuations in interest rates. The gap between the yields of both currencies has decreased since December 2023, mainly due to the continuous decrease in the local reference rate (TPM), which has been adjusting since last year, while the United States Federal Reserve has not yet adjusted its reference rate for the dollar (Federal Funds Rate).

In terms of purchase and sale transactions in the stock market, trades with securities in guaraníes, excluding BOTES, reached a total of approximately USD 215 million, with an average market yield of 8.8% and an average maturity of 5.8 years (Table 2). The corresponding trades in dollar bonds reached USD 63 million, with an average market yield of 7.0% and an average maturity of 4.0 years (Table 3).

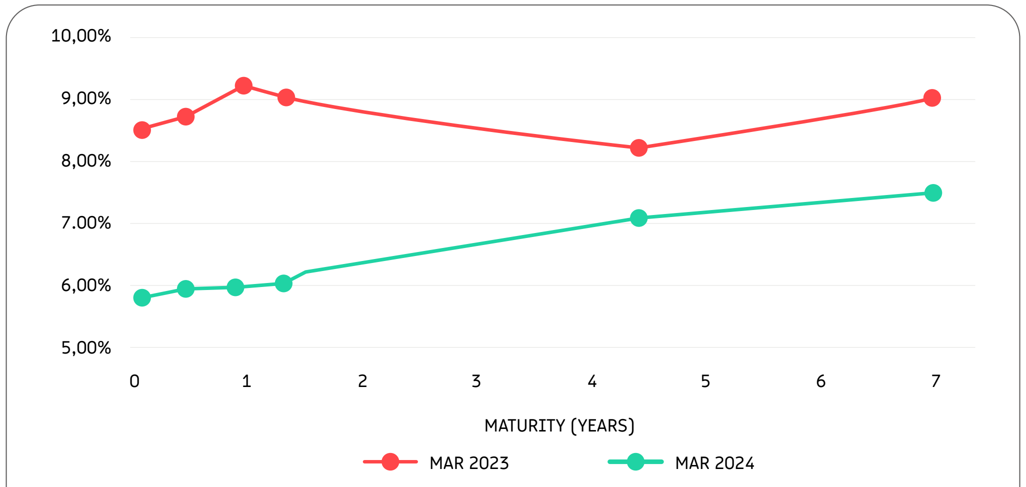
Focusing only on primary market issues, the guaraní bonds presented residual terms ranging from 3.5 years to 9.5 years (Table 5), with rates ranging from 5.50% to over 15.00 %, depending on the level of credit risk (Table 4). In contrast, rates for issues in dollar denominated bonds had rates that ranged between 7.30% and 8.86%. However, we note that dollar issuers during the first quarter of the year had credit risk ratings ranging from A to BB, while guaraní bond issuers covered the entire credit risk spectrum, from AAA to BB.

Table 1. Returns on Government Bonds

INSTRUMENT	MAR 2023	MAR 2024	DIFFERENCE
LRM - 1 MONTH	8,50%	5,80%	-2,70%
LRM- 6 MONTH	8,70%	5,90%	-2,80%
LRM - 1 YEAR	9,25%	5,95%	-3,30%
LRM - 1,5 YEARS	9,00%	6,00%	-3,00%
BOTES - 5 YEARS	8,25%	7,05%	-1,20%
BOTES - 7 YEARS	9,03%	7,45%	-1,58%

*LRM: Monetary Regulation Bills: instruments issued by the Central Bank of Paraguay (Last Auction - March 2024).
*BOTES: Public Treasury Bonds: instruments issued by the Ministry of Economy and Finance (Last Auction - March 2024).

Graph 5. Sovereign Yield Curve



Source: Central Bank of Paraguay & Ministry of Economy and Finance.

Table 2. Fixed Issues - Bond Characteristics by Risk Rating (Guaraníes)

	AVERAGES					
	COUPON (%)	PRICE ($)	YIELD (%)	MATURITY (YEARS)	DURATION (YEARS)	AMOUNT (MIL. GS.)
Corporate, Financial, Municipal and Subordinated Bonds in Guaraníes						
Market	**8,74**	**99,76**	**8,81**	**5,77**	**5,04**	**1.574.215**
AAA	5,69	100,05	5,66	4,82	4,68	430.953
AA	9,08	101,47	8,78	5,22	4,72	153.388
A	9,53	99,12	9,73	7,17	5,92	720.555
BBB	11,26	100,08	11,37	3,85	3,45	262.560
BB	13,45	98,77	13,82	3,78	3,41	6.432

Table 3. Fixed Issues - Bond Characteristics by Risk Rating (Dolars)

	AVERAGES					
	COUPON (%)	PRICE ($)	YIELD (%)	MATURITY (YEARS)	DURATION (YEARS)	AMOUNT (USD)
Corporate, Financial, Municipal and Subordinated Bonds in Dolars						
Market	**7,07**	**100,02**	**7,04**	**3,98**	**3,77**	**63.527.754**
AAA	4,85	99,34	5,21	1,47	1,47	2.727.856
AA	5,92	100,13	5,81	4,00	3,80	18.431.028
A	7,54	100,13	7,48	4,28	4,05	31.555.528
BBB	8,21	99,69	8,28	3,70	3,50	10.391.914
BB	9,01	99,91	9,02	3,27	3,16	421.428

Source: Superintendency of Securities, Central Bank of Paraguay

Table 4. Coupon Rates (%) - Primary Emissions

DOLAR	AAA	AA	A	BBB	BB
AGRICULTURE				8,86	
COMMERCE			7,75	7,96	
FINANCE			7,30		
REAL ESTATE					9,25
SERVICES			8,45		

GUARANÍ	AAA	AA	A	BBB	BB
AGRICULTURE				14,27	
COMMERCE			11,55	13,21	14,00
CONSTRUCTION				12,75	
FINANCE		9,25	10,73	9,55	
REAL ESTATE				15,44	13,33
GOVERNMENT	5,50				
SERVICES			8,13		
TECHNOLOGY				10,50	

Source: Superintendency of Securities, Central Bank of Paraguay.

Table 5. Maturity (Years) - Primary Emissions

DOLAR	AAA	AA	A	BBB	BB
AGRICULTURE				3,29	
COMMERCE			2,99	4,44	
FINANCE			6,50		
REAL ESTATE					3,29
SERVICES			3,75		

GUARANÍ	AAA	AA	A	BBB	BB
AGRICULTURE				5,34	
COMMERCE			3,24	4,75	4,31
CONSTRUCTION				3,59	
FINANCE		4,98	9,02	3,66	
REAL ESTATE				4,40	3,81
GOVERNMENT	5,01				
SERVICES			9,55		
TECHNOLOGY				7,95	

Source: Superintendency of Securities, Central Bank of Paraguay.

Important Information

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No risk management technique or process can guarantee profitability or eliminate risk in any market environment.

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