Macro scenario - Paraguay

July 7, 2026

A more benign inflation outlook

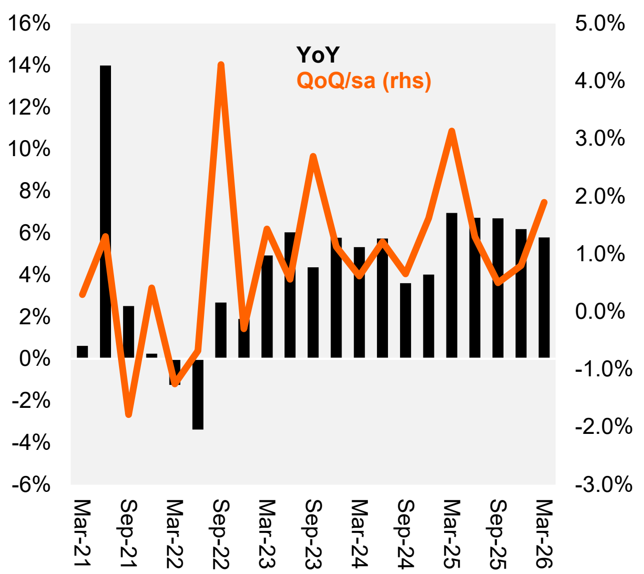
- **Our baseline GDP growth forecast of 4.0% for 2026 is subject to upside risks, largely driven by a favorable agricultural outlook**. A solid soybean harvest is expected to underpin export performance and generate positive second-round effects across services and industry, helping to sustain aggregate demand.
- **We revised our YE26 inflation forecast to 3.5% from 4.0% in our previous scenario, reflecting a sequence of softer-than-expected inflation prints and subdued cumulative inflation through June**. Recent downside surprises, supported by currency strength and lower fuel prices, suggest weaker near-term inflation dynamics. Nevertheless, some persistence in food and services inflation should prevent a sharper disinflation process, leading us to expect a gradual convergence toward our revised forecast.
- **We expect the policy rate to remain at 5.50% through 2026, with risks becoming more balanced**. On the one hand, robust growth could keep domestic demand conditions firm. On the other, a sequence of lower-than-expected inflation readings, currency strength, and easing fuel prices point to reduced inflationary pressures. As a result, the BCP is likely to remain comfortably on hold while assessing whether the recent disinflation trend proves durable.

Robust GDP expansion continues

GDP rose by 5.8% YoY in 1Q26, easing marginally from 6.2% in 4Q25, with broad-based strength across sectors—particularly services, manufacturing, and agriculture. Sequentially, activity expanded by 1.9% QoQ/SA, implying a solid 3.1% carryover for 2026.

On the demand side, annual growth moderated (4.8% YoY vs. 6.7% in 4Q25), driven by consumption, while investment gained traction (+3.7% YoY). External demand improved, with exports accelerating to 3.1% YoY on stronger soy and industrial shipments, partly offset by weaker re-exports and meat exports. Imports edged up just 0.3% YoY, pointing to a more mixed domestic demand backdrop.

GDP

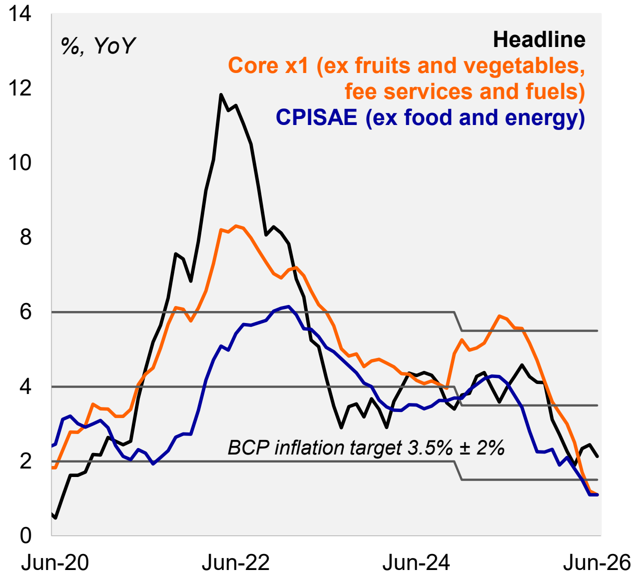


Source: BCP, Itaú

Broad-based disinflation gains traction

Even though activity continues to outperform, the inflation outlook seems benign, likely reflecting the effects of the currency's appreciation. In fact, headline inflation fell by 0.3% MoM in June, mainly driven by lower prices for fruits and vegetables, meat, fuels, and durable goods. Services inflation remained positive but moderate, partially offsetting the decline in goods prices. Underlying inflation measures also softened, with CPI X1 falling 0.1% MoM, suggesting that disinflationary pressures have become more broad-based. On an annual basis, headline inflation eased to 2.1% YoY from 2.4% in May, while core X1 inflation moderated to 1.1% YoY. Inflation remains comfortably within the tolerance range of the BCP's inflation target, while core measures continue to hover near the lower bound, pointing to well-contained underlying price pressures. Sequential indicators also strengthened the disinflation narrative, with three-month annualized headline inflation slowing to 3.1% from 4.4% in May, reinforcing the view that inflationary pressures remain subdued.

Inflation Dynamics

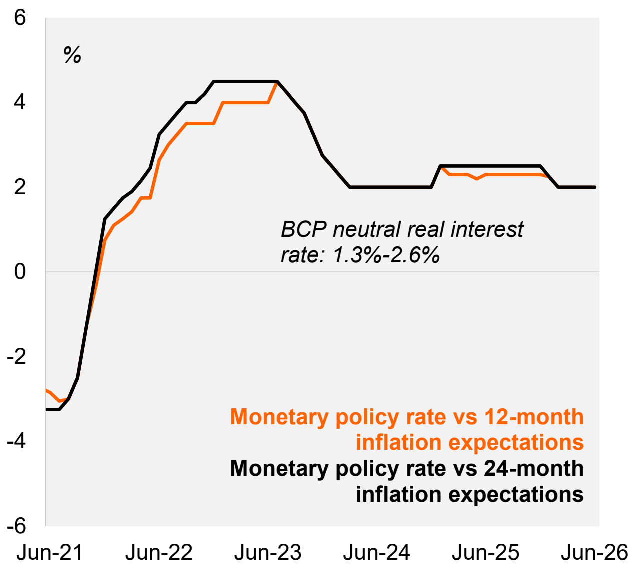


Source: BCP

BCP on hold again amid solid growth and anchored inflation

At its June meeting, the BCP unanimously left the policy rate at 5.50% for the fourth consecutive month, maintaining a neutral stance. The Committee highlighted solid economic momentum, in line with 4.2% GDP growth in 2026, while inflation remains driven by volatile items, with core pressures contained and expectations anchored at 3.5%. Going forward, despite lower oil prices, external risks persist—including potential Fed tightening—so the BCP will maintain a data-dependent stance to ensure inflation converges to target. We estimate the one-year ex-ante real policy rate at rough 2.0%, within the BCP's neutral range of 1.3%–2.6%.

Ex-ante real interest rate



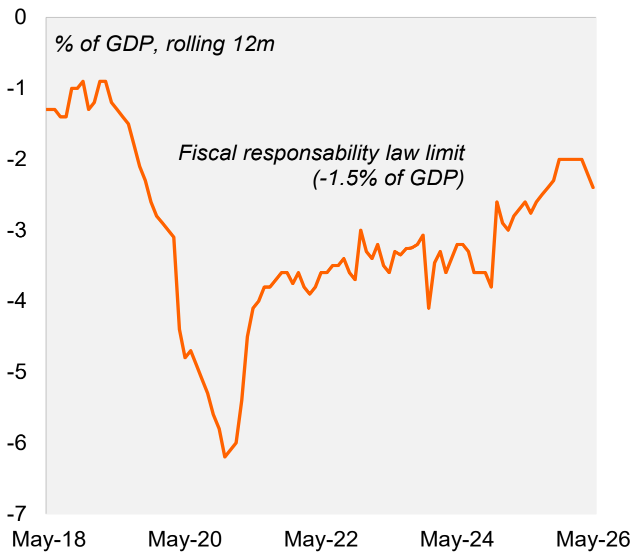
Source: BCP

Fiscal deficit widens, risks to consolidation

The 12-month rolling fiscal deficit widened to 2.4% of GDP in May, from 2.0% of GDP at end-2025. In the quarter ending in May, real tax revenues increased by 1.9% YoY, improving from a 3.7% contraction in 1Q26. In nominal terms, tax collection grew 3.6% YoY in the same period (up from 0.9% YoY in 1Q26). On the expenditure side, real primary spending accelerated to 9.6% YoY, largely driven by a sharp, yet transitory, increase in goods and services outlays (+74.5% YoY). A greater deficit reflects a combination of still-weak revenue dynamics, particularly due to softer non-tax revenues and the impact of the currency appreciation on external collections—and a marked acceleration in spending, partly associated with arrears normalization and higher current expenditures.

In this context, the IMF's Article IV Mission concluding statement stresses the need to strengthen efforts to ensure convergence toward the 1.5% of GDP nominal deficit anchor. In the absence of a more meaningful revenue recovery or tighter expenditure control in 2H26, current trends point to downside risks to the fiscal trajectory, according to the IMF.

Fiscal Balance



Source: Ministry of Economy

Solid growth, contained Inflation, and policy on hold

We see upside risks to our 2026 GDP growth forecast of 4.0%, primarily driven by a strong agricultural outlook, which should remain the key engine of activity. Favorable crop prospects—particularly for soy—are likely to support exports and generate positive spillovers to services and industry, sustaining broader momentum. That said, we will closely monitor high-frequency indicators for May to assess whether recent dynamics point to further upside in activity.

We now expect inflation to end 2026 at 3.5%, down from our previous 4.0% forecast. The revision reflects a series of softer-than-expected inflation readings in recent months, resulting in muted cumulative inflation through June. Exchange-rate strength and early declines in administered fuel prices should continue to support benign inflation dynamics in the near term. While food and services prices remain relatively persistent, we believe the balance of risks has shifted toward a lower inflation outcome.

We expect the policy rate to remain at 5.50% through 2026. The recent moderation in inflation, together with well-anchored expectations, supports a prolonged pause by the BCP. While stronger economic activity could sustain a positive output gap, the current inflation backdrop reduces the need for further tightening. If disinflationary trends persist, risks to our baseline may gradually shift toward a more accommodative policy outlook.

A potential El Niño event poses downside risks to the 2027 outlook, potentially disrupting activity—especially soybean harvesting and construction—due to excessive rainfall. On inflation, risks are skewed to the upside through higher food prices, as floods could affect livestock and crop supply. However, uncertainty remains high, so we keep our baseline unchanged.

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Paraguay | Forecasts and Data

	2022	2023	2024	2025	2026F		2027F	
					Current	*Previous*	*Current*	*Previous*
Economic Activity								
Real GDP growth - %	0.0	5.3	4.7	6.6	**4.0**	4.0	**4.0**	4.0
Nominal GDP - USD bn	41.8	43.1	44.7	50.6	**63.5**	63.6	**67.1**	67.5
Unemployment Rate - year avg	6.8	5.9	5.8	4.8	**4.8**	4.8	**4.8**	4.8
Inflation								
CPI - %	8.1	3.7	3.8	3.1	**3.5**	4.0	**3.5**	3.5
Interest Rate								
Reference rate - eop - %	8.50	6.75	6.00	6.00	**5.50**	5.50	**5.50**	5.50
Balance of Payments								
PYG / USD - eop	7340	7275	7913	6598	**6450**	6450	**6500**	6500
Trade Balance - USD bn	-1.3	1.3	-0.6	-1.5	**-1.4**	-1.4	**-1.0**	-1.0
Current Account - % GDP	-7.1	-0.4	-3.3	-3.2	**-3.2**	-3.2	**-2.8**	-2.8
Net Foreign Direct Investment - % GD	2.3	1.9	2.1	1.9	**2.0**	2.0	**2.0**	2.0
International Reserves - USD bn	9.8	10.2	9.9	11.0	**11.5**	11.5	**12.0**	12.0
Public Finance								
NFPS Nominal Balance - % GDP	-3.0	-4.1	-2.6	-2.0	**-1.5**	-1.5	**-1.5**	-1.5
Gross Public Debt - % GDP	35.9	38.4	40.0	41.1	**40.0**	40.0	**38.3**	38.3

Source: FMI, Haver, Bloomberg, BCP, Itaú.

Macro Research – Itaú

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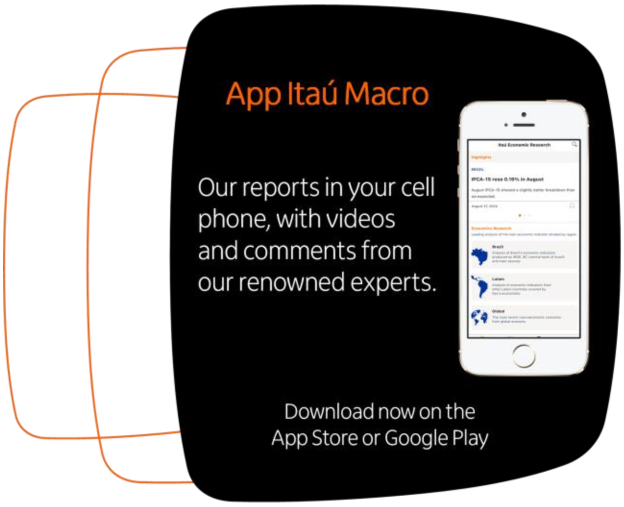

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