INTERNATIONAL MONETARY FUND

IMF Country Report No. 16/34

NICARAGUA

February 2016

2015 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR NICARAGUA

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2015 Article IV consultation with Nicaragua, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its January 28, 2016 consideration of the staff report that concluded the Article IV consultation with Nicaragua.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on January 28, 2016, following discussions that ended on October 29, 2015, with the officials of Nicaragua on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on December 11, 2015.
- An **Informational Annex** prepared by the IMF staff.
- A **Debt Sustainability Analysis** prepared by the staffs of the IMF and the International Development Association (IDA).
- A **Statement by the Executive Director** for Nicaragua.

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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February 1, 2016

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IMF Executive Board Concludes 2015 Article IV Consultation with Nicaragua

On January 28, 2016, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Nicaragua.

Economic developments in 2015 have been broadly positive. Growth, after reaching 4.7 percent in 2014, is expected to moderate owing to the effects of a drought and the decline in commodity prices; real GDP grew by 3.9 percent in the first half of the year. Inflation declined to 3 percent in October, mainly reflecting declines in food and transportation costs. Core inflation remained stable at around 6½ percent.

The consolidated public sector deficit widened to 2 percent in 2014 (1.3 percent of GDP in 2013), largely due to a decline in grants originating from the oil collaboration with Venezuela. Nevertheless, the public debt ratio declined to about 41 percent of GDP in 2014 from 43 percent in 2013. The fiscal position through August 2015 improved relative to the same period in 2014. This is largely explained by a better performance at the central government level that has compensated for the deterioration in the fiscal balance of state-owned enterprises.

The current account deficit improved to 7.1 percent of GDP in 2014, largely due to a smaller oil bill. However, the current account deficit deteriorated in the first half of 2015 as the country faced a less favorable external environment. In particular, export performance weakened as a result of the softening of commodities prices and the expiration of the preferential trade agreement with the United States in late 2014.

The financial sector appears to remain robust despite still high credit growth. As of August 2015, capital adequacy ratios (13.3 percent) were above the 10 percent regulatory level, and

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

the non-performing loan ratios, including restructured loans, remained below 3 percent. Private sector credit growth has slowed but remains high (20 percent), in particular for consumer and commercial credit, and continues to exceed the growth rate of deposits.

Poverty has fallen sharply and there has been progress in gender equality, but education attainment remains a drag on growth. The 2014 household survey reveals that 29.6 percent of the population lives in poverty (42.5 percent in 2009), and 8.3 percent in extreme poverty (14.6 percent in 2009). Per capita consumption increased by 33 percent, helped by a fall in the average household size and a rise in per capita remittances. Nicaragua has made inroads in improving gender equality. However, despite some improvement in primary school completion rates (from 74 percent in 2005 to 80.4 percent in 2010), surveys of private firms suggest that labor skills remain a bottleneck to growth.

The medium-term outlook remains broadly favorable. Growth is expected to moderately accelerate in 2016, owing to the projected recovery in foreign demand and an increase in election-related spending, which would result in a more expansionary fiscal policy. In the medium term, staff estimates that growth will converge to its potential of 4 percent. The current account deficit is expected to widen to 8½ percent of GDP as terms of trade are projected to deteriorate. To address large infrastructure and social needs, the government plans to step up spending by over 3 percentage points of GDP over the medium term. As a result, the public debt ratio is projected to stabilize around 41 percent of GDP by 2020.

Executive Board Assessment[2]

Directors commended the Nicaraguan authorities’ sound policies, which have enhanced macroeconomic stability and led to strong economic growth and poverty reduction. They noted, however, that risks to the outlook are tilted to the downside, particularly due to external factors. Against this backdrop, Directors emphasized that, while the policy mix is broadly appropriate to maintain stability over the near term, the country needs to fortify its policy framework to sustain strong growth over the medium term.

Directors noted that the fiscal stance will be moderately expansionary in 2016, but that it remains consistent with the authorities’ plans to stabilize the debt-to-GDP ratio by 2020. They considered, however, that building additional fiscal buffers, following the forthcoming elections, will be essential to insure against potential risks and to put public finances on a more solid footing. This consolidation could be attained by reducing tax exonerations and exemptions and improving the targeting of fiscal subsidies, which in turn would strengthen the efficiency and equity of public finances. From a longer-term perspective, Directors

[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summing up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

stressed the importance of improving the financial viability of the social security institute and loss-making state-owned enterprises.

Directors welcomed the authorities' continued interest in strengthening the fiscal accounts. They emphasized the importance of increasing the institutional coverage of the public sector, improving the quality of fiscal and public debt statistics, and publishing the public institutions' financial statements to enhance transparency.

Directors agreed that rapid credit expansion amid high dollarization warrants close monitoring, especially in light of possible currency mismatches, persistent U.S. dollar strength, and the likely increase in U.S. interest rates. In this regard, they noted that macro-prudential policies could help mitigate some of these risks. Directors also called for additional efforts to strengthen banking supervision and enhance regional financial regulatory cooperation. They encouraged full implementation of the 2009 Safeguards Assessment's recommendations and further strengthening the framework for anti-money laundering and combating the financing of terrorism.

Directors agreed that improvements in competitiveness would reduce the economy's vulnerability to external shocks, support its diversification, and spur its structural transformation. In this context, they recommended further improving infrastructure, enhancing trade networks, investing in human capital, and reducing barriers to entry. Such reforms would also serve to reduce the size of the informal economy, unemployment, and poverty.

Directors called for continued improvements in the timeliness, quality, and reliability of statistics, which will help enhance economic decision-making and transparency. They also recommended following a consistent communication strategy when methodological changes are introduced.

Nicaragua: Selected Economic Indicators, 2012–16

	2012	2013	2014	2015	2016
				Proj.	
Output					
GDP growth (percent)	5.1	4.5	4.7	4.0	4.2
GDP (nominal, U.S.$ million)	10,460	10,851	11,806	12,102	12,754
Prices			(Percent)		
GDP deflator	7.1	4.2	9.1	3.5	6.1
Consumer price inflation (period average)	7.2	7.1	6.0	3.5	6.1
Consumer price inflation (end of period)	6.6	5.7	6.5	3.5	6.1
Exchange rate			(Córdobas per U.S.$)		
Period average	23.5	24.7	26.0	…	…
End of period	24.1	25.3	26.6	…	…
Fiscal sector			(Percent of GDP)		
Consolidated public sector					
Revenue	25.6	25.9	25.8	27.6	28.1
Expenditure	28.5	28.9	28.9	31.5	31.8
Current	23.1	22.9	22.9	24.5	24.8
of which: wages & salaries[1/]	7.3	7.4	7.1	7.4	7.4
Capital	5.3	6.0	6.0	7.0	7.1
Overall balance, before grants	-2.9	-3.0	-3.1	-3.9	-3.7
Overall balance, after grants	-0.8	-1.3	-2.0	-2.7	-2.5
Money and credit			(Annual percentage change)		
Broad money	16.3	18.5	15.9	21.5	10.9
Credit to the private sector	26.3	20.2	20.5	18.7	11.9
Net domestic assets of the banking system	25.4	17.5	6.0	10.9	6.9
External sector			(Percent of GDP, unless otherwise indicated)		
Current account	-10.6	-11.1	-7.1	-8.0	-8.2
of which: oil imports	12.0	10.5	9.2	5.5	5.3
Capital and financial account	20.2	15.1	13.6	9.3	9.8
of which: FDI	6.8	6.5	6.8	6.4	6.2
Gross reserves (U.S.$ million)[2/]	1,778	1,874	2,147	2,273	2,450
In months of imports excl. maquila[2/]	3.4	3.5	4.1	4.1	4.2
Net international reserves[2/]	1,609	1,723	2,018	2,171	2,377
Public sector debt[3/]	41.9	43.0	40.8	42.6	41.9
Private sector external debt	44.8	48.1	46.1	47.9	48.8

Sources: Country authorities; World Bank; and Fund staff calculations and estimates.
[1/]The figures for 2012-13 include an off-budget wage bonus that was financed with Venezuela-related resources. Starting in 2014 the wage bonus is included in the budget.
[2/]Excludes the Deposit Guarantee Fund for Financial Institutions (FOGADE).

[3/]Assumes that HIPC-equivalent terms were applied to the outstanding debt to non-Paris Club bilaterals. Does not include SDR allocations.

INTERNATIONAL MONETARY FUND

NICARAGUA

STAFF REPORT FOR THE 2015 ARTICLE IV CONSULTATION

December 11, 2015

KEY ISSUES

Context. Commitment to macroeconomic stability has characterized government policies. Over the last three years, real GDP growth has averaged 4.8 percent, one of the highest in the region, while inflation has remained anchored by the exchange rate regime. The external current account deficit has declined, reflecting a smaller oil bill due to both lower oil prices and increased reliance on renewable energy sources.

Outlook and Risks. A moderate deceleration in real growth is projected in 2015 followed by a small pickup in 2016, owing to the projected recovery in foreign demand and an increase in election-related spending. Poverty has fallen sharply but unemployment has edged up due in part to a decline in manufacturing activity. The fiscal stance has become modestly more expansionary and, as a result, public debt ratios are expected to stabilize in contrast with the reduction envisaged in previous consultations. Risks are, however, tilted to the downside. A deterioration in the financial terms or levels of the Venezuela oil cooperation could increase pressures to absorb quasi-fiscal spending into the budget. Structurally weak growth in key advanced and emerging economies and a persistent decline in prices of major export products would also negatively impact Nicaragua.

Policy Recommendations. The current policy mix is broadly adequate to maintain macroeconomic stability in the near term, but Nicaragua needs to fortify its policy framework. In particular, reducing tax exonerations and exemptions and improving the targeting of fiscal subsidies would strengthen the efficiency and equity of public finances and contribute to rebuilding fiscal buffers. Greater emphasis needs to be placed on improving public sector accounting and fiscal transparency. With regard to the financial sector, the supranational structure and cross-border activities of financial conglomerates warrant a strengthening of regional cooperation in prudential supervision. The timeliness, quality, and reliability of statistics need to be improved, which will help to enhance economic decision-making and transparency. Additional efforts are needed to improve the investment environment, promote competitiveness, and strengthen the rule of law.

Approved By
Krishna Srinivasan and Vivek Arora

Discussions took place in Managua during October 20–29, 2015. The team comprised G. Peraza (head), F. Grigoli, R. Mowatt, and F. Yang (all WHD). J. Zalduendo (Resident Representative) assisted the mission, and J.L. Saboin provided research assistance at headquarters. Manuel Coronel (Advisor to OED) participated in the discussions. The mission met with officials from the Central Bank, the Ministry of Finance and Public Credit, and other members of the economic cabinet, as well as members of the economic commission of the National Assembly, business community and labor leaders, academic groups, and representatives of think tanks.

CONTENTS

CONTEXT 4

BACKGROUND 5

OUTLOOK AND RISKS 8

KEY POLICY ISSUES 11
A. Building Fiscal Buffers and Improving Transparency 11
B. Strengthening Monetary Framework and Financial Stability 13
C. Improving External Competitiveness and Buffers 14
D. Upgrading Statistical Framework 15
E. Authorities' Views 15

STAFF APPRAISAL 17

BOXES
1. Export Diversification and Quality Upgrading 18
2. Data Revisions to National Accounts and Balance of Payments Statistics 20

FIGURES
1. Real Sector 21
2. Fiscal Developments 22
3. External Sector 23
4. Monetary and Financial Sector Developments 24

TABLES
1. Selected Social and Economic Indicators, 2012–16 25
2a. Operations of the Budgetary Central Government, 2012–20 (GFSM 2001) 26
2b. Operations of the Budgetary Central Government, 2012–20 (GFSM 2001) 27

3a. Operations of the Combined Public Sector, 2012–20 (GFSM 2001) 28
3b. Operations of the Combined Public Sector, 2012–20 (GFSM 2001) 29
4. Nonfinancial Public Sector Gross Financing Requirements, 2012–20 30
5. Summary Accounts of Central Bank and Financial System, 2012–20 31
6. Quasi-fiscal Balance of the Central Bank, 2012–20 32
7. Balance of Payments, 2012–20 33
8. Financial Soundness Indicators, 2011–15 34
9. Indicators of Capacity to Repay the Fund, 2012–20 35
10. Medium-Term Macroeconomic Framework, 2012–20 36
11. Millennium Development Goals, 1990–2014 37
12. Saving-Investment Balance, 2012–20 38

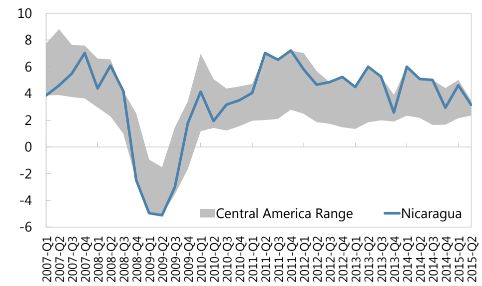
APPENDICES

I. External Assessment 39
II. A Framework for Future Tax Reform 43

CONTEXT

1. **A commitment to macroeconomic stability has characterized government policies**. Following the conclusion of the ECF-supported program in 2011, policies have continued to support macroeconomic stability and growth, which in turn have served to reduce poverty. Over the last three years, real GDP growth has averaged 4.8 percent, one of the highest in the region, while inflation has remained anchored by the crawling peg exchange rate regime. The fiscal stance has become modestly more expansionary and, as a result, public debt ratios are expected to stabilize at around 41 percent of GDP—in contrast with the reduction envisaged in previous consultations. The external current account deficit has declined, reflecting both lower oil prices and increased reliance on renewal energy sources.

Real GDP Growth
(In percent, yoy)



Source: Haver Analytics, Inc.
1/ Includes: Costa Rica, El Salvador, Guatemala and Honduras.

2. **General elections are scheduled for November 2016**. President Ortega's approval ratings remain high and with his party's majority in the National Assembly (61 out of 91 deputies), he has been able to advance a political agenda that includes a constitutional reform in early 2014 that increased presidential powers and eliminated term limits on presidency. His high approval ratings reflect, among others, a sound macroeconomic policy stance and the elimination of widespread electricity blackouts.

3. **There are changes in the administration of the oil collaboration scheme with Venezuela**.[1] First, at the request of the government of Venezuela, all assets and liabilities associated with the oil cooperation scheme are in the process of being transferred from a private financial cooperative (CARUNA) to a limited liability Nicaraguan company ALBANISA, co-owned by the Nicaraguan state petroleum distribution company (49 percent) and the national petroleum company of Venezuela (PDVSA, 51 percent). The government's current policy is not to extend public guarantees on any of the associated liabilities. Second, the number of barrels per day that can be imported under the oil collaboration was increased in 2013 from 27,000 to 30,000, and will represent external financing of about 2.7 percent of GDP in 2015 (5.2 percent in 2014).[2]

4. **Progress in the implementation of Fund recommendations has been mixed**. During the last Article IV consultation, Directors stressed that fiscal discipline should remain the cornerstone of Nicaragua's macroeconomic policy framework. Specific recommendations included broadening the

[1] The oil cooperation agreement involves the purchase of oil by Nicaragua at market prices with 50 percent of the oil bill paid upfront and the remainder over 25 years (including a two-year grace period) at an interest rate of 2 percent. The operation of the oil collaboration scheme prior to current changes was described in the 2013 Article IV Staff Report for Nicaragua (Country Report 13/377).

[2] Moody's upgraded Nicaragua's issuer rating to B2 from B3 in mid-2015 noting that the impact from a sudden stop of Venezuela cooperation has become more manageable.

revenue base by implementing the 2012 tax reform, rationalizing public expenditures while reinforcing the social safety net, and reforming the pension system to ensure its financial viability. In line with this advice, the authorities enacted a tax reform in 2013 aimed at strengthening revenue administration and introduced a parametric reform of social security aimed at extending the solvency of the regime until the end of next decade. However, in late 2014, a new tax reform was passed that repeals the reductions in tax exonerations and exemptions and corporate income tax rates that were planned for 2015–17. At the same time, social security spending has increased more than anticipated, raising doubts about how long the scheme can remain solvent. Progress in the areas of domestic bond market development, central bank recapitalization, and statistics (in part due to capacity weaknesses) has been limited.

BACKGROUND

5. **Economic activity accelerated to 4.7 percent in 2014 from 4.5 percent in 2013 owing to robust external demand that more than compensated for the negative contribution of private investment** (Table 1 and Figure 1). On the supply side, growth has been broad based with the largest contributions coming from commerce and agriculture. Strong growth has been facilitated by a rapid expansion of credit to the private sector. Despite a small and positive output gap, inflation pressures remained subdued owing to developments in commodity prices. Notwithstanding strong economic activity, the unemployment rate increased to 6.8 percent in 2014 from 5.7 percent in 2013, due in part to a decline in employment in the free trade zones (FTZ).

6. **Public finances remained broadly sound, but the fiscal position weakened in 2014**. The central government deficit widened to 0.9 percent of GDP in 2014 from 0.4 percent in 2013 (Table 2 and Figure 2). This was largely due to a decline in grants funded by the oil collaboration scheme with Venezuela that had been used to fund a wage bonus.[3] The deficit of the consolidated public sector widened from 1.3 percent in 2013 to 2 percent in 2014, owing to the deterioration of the operating balance of the social security institute (INSS) and the central bank (Table 3). Nevertheless, the public debt ratio declined to about 41 percent of GDP in 2014 from 43 percent in 2013.

7. **The external position improved in 2014**. The current account deficit for 2014 is estimated at 7.1 percent of GDP, 4 percent of GDP lower than in 2013 (Table 7, Figure 3). The reduction is explained by an increase in exports and a smaller oil bill. The current account deficit was financed by FDI and other investment, particularly from Venezuela. As a result, gross international reserves reached US$2.1 billion at end-2014, with coverage reaching 4.1 months of non-*maquila* imports.[4]

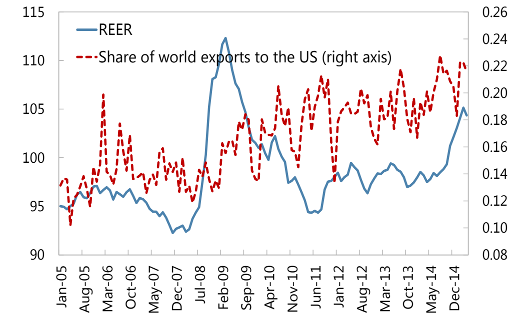
[3] The wage bonus ("*bono solidario*") is a wage supplement provided to public employees mostly at the lower end of the pay structure; it was absorbed into the budget in 2014.

[4] *Non-maquila* imports exclude imports used in the assembly, processing, or manufacturing of goods and services in Nicaragua's FTZ.

8. **The current account balance is close to its norm and the real effective exchange rate (REER) is broadly in line with fundamentals (Appendix I—External Assessment)**. The improvement in the current account balance in 2014 closed the gap with the estimated current account norm (-6.9 percent of GDP). Consequently, there is no significant evidence of misalignment of the REER (1.2 percent overvaluation as of end-2014).

Nicaragua's REER and Export Market Share

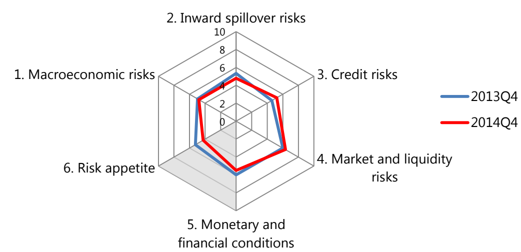
(Percent)



Sources: IMF DOTS and INS.

9. **Macroeconomic risks at end-2014 have decreased somewhat compared with end-2013 driven by an improvement in the external position**. Credit risks, however, have increased due to household financial conditions (indicated by higher unemployment), rapid credit growth, and higher share of foreign exchange liabilities in total liabilities. Meanwhile, inward spillover risks decreased, reflecting an improvement in the buffers against external shocks (as indicated by improved reserve coverage). Portfolio investment and FDI to GDP remained stable, but lower nominal effective exchange rate volatility suggests a lower risk appetite compared with end-2013.

Nicaragua. Financial Stability Map



Source: Fund's Spidergram and Web of Macro-Financial Linkages.
Note: Away from center signifies higher risks, easier monetary and financial conditions, or higher risk appetite.

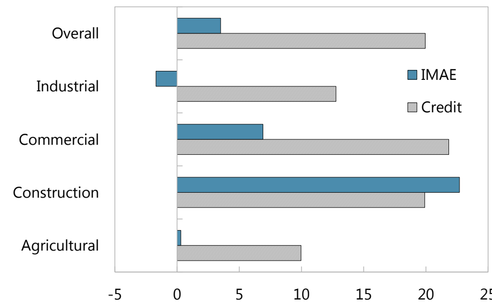
10. **Poverty has fallen sharply and there has been progress in gender equality, but education attainment remains a drag on growth** (Table 11). The 2014 household survey reveals that 29.6 percent of the population live in poverty (42.5 percent in 2009), and 8.3 percent in extreme poverty (14.6 percent in 2009).[5] Per capita consumption increased by 33 percent, helped by a fall in the average household size and a rise in per capita remittances. Nicaragua has made inroads in improving gender equality. For instance, the proportion of seats held by women in the National Assembly has doubled in the last five years. However, despite some improvement in primary school completion rates (from 74 percent in 2005 to 80.4 percent in 2010), surveys of private firms suggest that labor skills remain a significant bottleneck to growth.

[5] A private think-tank that has carried out annual surveys of households in the 2009–13 period estimates more modest declines in poverty; from 44.7 percent in 2009 to 40.5 percent in 2013 and with even less of an impact in extreme poverty among rural households as these are exposed to commodity price shocks. Study available at www.fideg.org/investigaciones-y-publicaciones/116-2014-11-12-20-32-46.

11. **Economic developments in 2015 have been broadly positive**.

- **Growth and inflation are moderating owing to the effects of a drought and the decline in commodity prices**. The Monthly Indicator of Economic Activity (IMAE) decelerated to 3.5 percent (yoy) in January-September compared with 4.9 percent during the same period in 2014, with the strongest contributions coming from commerce and services and construction, which continue to be supported by rapid credit growth. By contrast, the main drags are agriculture (irregular rain cycle) and manufacturing (particularly from FTZ). Real GDP grew by 3.9 percent in the first half of the year. Inflation declined to 3 percent (yoy) in October, almost 4 percentage points below inflation a year ago, owing mostly to declines in food and transportation costs. Core inflation remains stable at around 6½ percent (yoy).

Nicaragua: Monthly Economic Activity and Credit in Key Sectors
(January-September, yoy growth, percent)



Sources: BCN and Fund Staff calculations and estimates.

- **The fiscal position through August 2015 improved relative to the same period in 2014**. This is explained largely by a better performance at the central government level, with revenue growing faster than expenditure, aided in part by the decision to transfer some electricity-related savings onto the budget.[6] In 2015, the stronger performance of the central government has compensated for the deterioration in the fiscal balance of SOEs arising from higher capital spending in the water and sewage (ENACAL) and the electricity generation (ENEL) companies. In October, the government enacted a revised budget that aimed at spending additional tax revenues and loan resources.

- **The current account deficit deteriorated in the first half of 2015 as the country faced a less favorable external environment**. The current account deficit widened to 3.7 percent of GDP in 2015H1 from 3.1 percent in 2014H1. This reflects the lackluster performance of exports as a result of the softening of commodities prices and the expiration of the preferential trade agreement with the United States in late 2014.[7]

[6] CARUNA provided loans during 2011–13 to allow distributors to keep tariffs for residential consumers at their 2005 levels, with repayment occurring when electricity costs fell below a reference level. This began to occur in 2014, due to falling oil prices. Under a law passed in 2015, however, only 30 percent of these savings are now directed towards repayment of CARUNA, while 47 percent will be passed on to the consumer and 23 percent brought onto the budget to finance poverty-reducing expenditure.

[7] Tariff Preference Level (TPL) under the CAFTA-DR free trade agreement allowed apparel made of certain cotton and synthetic fiber to enter the U.S. duty free if assembled in Nicaragua's free trade zones, regardless of the origin of the fabrics.

- **The financial sector appears to remain robust despite still high credit growth** (Text Table and Table 8). As of August 2015, capital adequacy ratios (13.3 percent) were above the 10 percent regulatory level, and the NPL ratios, including restructured and reprogrammed loans, remained below 3 percent. Private sector credit growth has slowed but remains high (20 percent), in particular for consumer and commercial credit, and continues to exceed the growth rate of deposits.

Nicaragua: Financial Soundness Indicator Map

Red	High vulnerability
Yellow	Medium vulnerability
Green	Low vulnerability

	2013Q1	2013Q2	2013Q3	2013Q4	2014Q1	2014Q2	2014Q3	2014Q4	2015Q1	2015Q2	Latest
Overall Financial Sector Rating	H	M	M	M	M	M	M	M	M	M	M
Credit cycle	H	M	L	M	L	M	L	L	L	L	L
Change in credit / GDP ratio (pp, annual)	3.63	3.12	2.83	3.34	2.69	3.15	2.60	1.82	2.17	2.13	2.13
Growth of credit / GDP (%, annual)	14.2	11.9	10.5	11.6	9.2	10.7	8.7	5.7	6.8	6.5	6.5
Credit-to-GDP gap (st. dev)	1.6	1.3	1.1	1.4	0.8	0.5	-0.1	-0.2	-1.6	-2.0	-2.0
Balance Sheet Soundness	M	M	M	M	M	M	M	M	M	M	M
Balance Sheet Structural Risk	M	M	M	M	M	M	M	M	M	M	M
Deposit-to-loan ratio	117.5	118.8	115.5	110.1	119.0	115.7	113.3	106.3	111.0	111.5	111.5
FX liabilities % (of total liabilities)	82.6	82.2	83.1	83.3	82.3	82.5	83.6	84.1	83.2	83.0	83.0
FX loans % (of total loans)	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Balance Sheet Buffers	L	L	L	L	L	L	L	L	L	L	L
Leverage	L	L	L	L	L	L	L	L	L	L	L
Leverage ratio (%)	12.7	12.6	12.7	12.7	12.4	12.6	12.7	13.0	12.9	13.3	13.3
Profitability	L	L	L	L	L	L	L	L	L	L	L
ROA	2.2	2.2	2.2	2.3	1.9	1.9	2.1	2.2	2.2	2.2	2.2
ROE	21.5	21.7	21.4	22.0	18.4	18.1	20.2	20.7	20.7	20.5	20.4
Asset quality	L	L	L	L	L	L	L	L	M	L	L
NPL ratio[1]	3.7	3.3	3.3	2.6	2.4	2.7	2.7	2.7	2.7	2.7	2.7
NPL ratio[1] change (%, annual)	-29.6	-31.5	-25.9	-34.9	-36.4	-16.5	-19.2	1.4	14.2	-1.8	-1.8

Sources: National Authorities and staff calcultion.

1/ Includes restructured and reprogrammed loans.

OUTLOOK AND RISKS

12. **Real GDP growth is projected at 4 percent in 2015, with private consumption partially offsetting the negative contribution of external demand**. The fiscal position of the consolidated public sector is projected to deteriorate to 2.7 percent of GDP, owing in part to increases in capital spending, while the debt-to-GDP ratio is expected to rise to 42.6 percent of GDP. The current account deficit is expected to widen to 8 percent of GDP. Headline inflation is projected at 3.5 percent reflecting an increase in public and private spending toward the end of the year.

13. **The medium-term outlook remains broadly favorable**. Staff expects a moderate acceleration in growth in 2016, owing to the projected recovery in foreign demand and an increase in election-related spending, which would result in a more expansionary fiscal policy. In the medium term, staff estimates potential growth at 4 percent. The current account deficit is expected to widen to 8½ percent of GDP as terms of trade are projected to deteriorate. To address large infrastructure and social needs, the government plans to step up spending by over 3 percentage points of GDP over the medium term. As a result, the public debt ratio is projected to stabilize at around 41 percent of GDP by 2020.

Nicaragua: Medium-Term Macroeconomic Framework, 2013–20

(In percent of GDP, unless otherwise specified)

	2013	2014	2015	2016	2017	2018	2019	2020
			Proj.					
GDP growth	4.5	4.7	4.0	4.2	4.0	4.0	4.0	4.0
Consumer price inflation (e.o.p.)	5.7	6.5	3.5	6.1	6.8	7.2	7.4	7.4
Consolidated public sector								
Revenue	25.9	25.8	27.6	28.1	28.2	28.5	28.6	28.7
Expenditure	28.9	28.9	31.5	31.8	32.0	32.1	32.1	32.4
Overall balance, after grants	-1.3	-2.0	-2.7	-2.5	-2.7	-2.7	-2.5	-2.7
Public sector debt[1/]	43.0	40.8	42.6	41.9	41.8	41.5	41.0	40.8
Current account	-11.1	-7.1	-8.0	-8.2	-8.6	-8.4	-8.4	-8.4
Gross reserves (U.S.$ million)[2/]	1,874	2,147	2,273	2,450	2,610	2,770	2,960	3,145
In months of imports excl. maquila[2/]	3.5	4.1	4.1	4.2	4.3	4.3	4.4	4.4

Sources: Country authorities; and Fund staff calculations and estimates.

[1/] Assumes that HIPC-equivalent terms were applied to the outstanding debt to non-Paris Club bilaterals. Does not include SDR allocations.

[2/] Excludes the Deposit Guarantee Fund for Financial Institutions (FOGADE).

14. **Risks are, however, tilted to the downside**. A potential deterioration in the financial conditions or levels of the Venezuela oil cooperation could increase pressures to absorb some quasi-fiscal spending into the budget. Also, the expansion of credit to the private sector, in the context of high dollarization, persistent dollar strength, and potential hikes in U.S. interest rates, could impose strain on dollar borrowers that do not generate dollar revenues. Structurally weak growth in key advanced and emerging economies and a persistent decline in prices of major export products would also have negative impacts on Nicaragua.

15. **A potential upside risk is the planned construction of the *Gran Canal* through Nicaragua**. In 2013, a private Chinese investor was granted a 100-year license for building and operating a trans-oceanic canal with an estimated construction cost of US$50 billion (more than 4 times Nicaragua's GDP). While such a large project could change Nicaragua's economic outlook, the limited information available on the financing, construction timetable, and its likely enclave features make the assessment of its overall impact difficult. An Environmental and Social Impact Assessment (ESIA) finalized in June 2015 by a consulting firm hired by the investor has recommended additional studies, some of which are expected to be carried out during 2016.[8] Moreover, in the context of a conference organized by Nicaragua's National Academy of Science, a panel of international specialists concluded after reviewing the ESIA report that the information made available is insufficient to evaluate fully the net benefits of the canal and that several aspects of the project design would need to be revised before construction starts.[9]

[8] HKND Group (2015). *Environmental and Social Impact Assessment (ESIA)*. Available at: http://hknd-group.com/portal.php?mod=view&aid=293.

[9] http://www.cienciasdenicaragua.org/images/imagenes/notificas_pdf/II_Taller/DeclaracionFinal2doTaller.pdf.

Nicaragua: Risk Assessment Matrix 1/

Overall level of concern (scale: high, medium, low)

Source of risk	Relative likelihood	Impact if realized	Policy advice
Deterioration in the financial conditions or levels of Venezuela financing.	**High**	**High**. Fifty percent of the oil-import bill returns to Nicaragua in the form of concessional loans used for social (off-budget) and for-profit projects. While the magnitude of the negative potential impact has diminished significantly with lower oil prices, the probability has increased given the deterioration of the Venezuelan economy. There will be increased pressures to absorb some projects into the budget.	Sustain fiscal discipline to keep the public debt ratio falling, and build buffers to face external and fiscal vulnerabilities.
Tighter or more volatile global financial conditions.	**High**	**Low**. The direct impact on non-FDI private capital flows would be modest given Nicaragua's limited reliance on such financing. However, the expansion of credit to the private sector, in the context of high dollarization, persistent dollar strength, and potential hikes in U.S. interest rates, could impose strain on dollar borrowers that do not generate dollar revenues.	Bank credit to the private sector needs to be monitored closely.
Increased volatility in energy prices.	**Medium**	**High**. Volatility in energy prices brings uncertainty about the fiscal cost of electricity subsidies, which are estimated at about 1¼ percent of GDP.	There is scope for phasing out those subsidies which do not benefit the poorest households and introduce mechanisms that target the poor.
Structurally weak growth in key advanced and emerging economies (the "new mediocre").	**High**	**High**. Protracted period of low growth in advanced and emerging economies would reduce growth in Nicaragua, particularly if growth in the U.S. is negatively affected. Lower-than-expected U.S. growth would lower export demand and remittances, in turn reducing activity and tax revenues in Nicaragua.	Measures to improve the investment environment, promote competition, and strengthen the rule of law will be key to promoting robust and sustainable economic growth.
A decline in non-oil commodity prices.	**Medium**	**High**. Nicaragua's dependence on agricultural products would amplify the negative impact of unfavorable terms of trade. The trade balance would worsen, slowing growth and negatively impacting public finances.	Measures to improve export quality, particularly for its major export categories, food/live animals and miscellaneous manufactured articles.

1/ The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path discussed in this report (which is the scenario most likely to materialize in the view of the staff). The RAM reflects staff's views on the source of risks and overall level of concerns as of the time of discussions with the authorities. The relative likelihood of risks listed is the staff's subjective assessment of the risks surrounding this baseline.

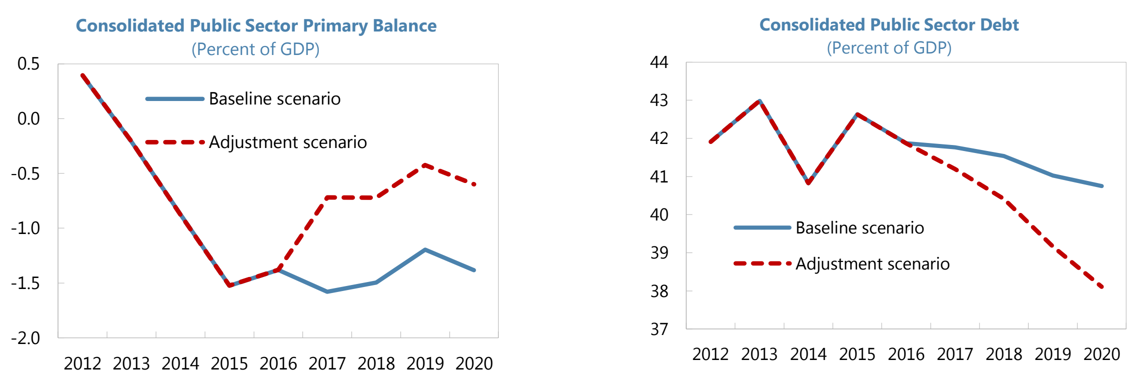
KEY POLICY ISSUES

The current policy mix is broadly adequate to maintain macroeconomic stability, but Nicaragua needs to fortify its policy framework in a number of areas to address risks and promote sustained and more equitable growth while enhancing the transparency of its fiscal operations. In particular, the authorities need to build fiscal buffers to keep public debt stable should some of the identified risks materialize and, given the large debt service obligations faced by the private sector, the policy mix should remain guided by the need to reduce risks to external stability.

A. Building Fiscal Buffers and Improving Transparency

16. **Building additional fiscal buffers will help insure against downside risks and put public finances on a more solid footing**. The continued uncertainty around the Venezuela oil collaboration poses important downside risks to public finances. In addition, the financial position of the INSS has not improved as much as envisaged in the 2014 reform, while the deficits of the state-owned enterprises have weakened the consolidated public sector balance. The 2016 fiscal stance is moderately expansionary, but broadly consistent with the stabilization of the debt ratio by 2020. Nicaragua is still assessed as being at moderate risk of external debt distress, with a heightened risk of overall debt distress.[10] In this context, Fund staff recommends building additional buffers through a fiscal effort of 1 percent of GDP in 2017, following the elections, which is projected to reduce the debt-to-GDP ratio to 38 percent of GDP by 2020. Alternatively, this effort would allow the authorities to confront downside risks if these were to materialize, such as increased pressures to absorb some of the oil-collaboration-funded projects into the budget, while maintaining the debt ratio stable in the medium term.

Nicaragua. Baseline and Adjustment Scenarios



[10] See Nicaragua—Staff Report for the 2015 Article IV Consultation—Debt Sustainability Analysis Update, December 14, 2015.

17. **Such fiscal consolidation could be achieved by re-introducing key elements of the 2012 tax reform that were rolled-back in 2014 and by developing a plan to eliminate electricity subsidies over the medium term**.

- **Tax exonerations and exemptions** (Appendix II—A Framework for Future Tax Reform). Reducing or eliminating tax exonerations and exemptions, particularly in the VAT, would increase revenue while improving tax efficiency and equity and allow space for reducing the headline corporate tax rate.[11]

- **Electricity subsidies**. The current system is complex, costly (about 1¼ percent of GDP), and tends to disproportionately benefit non-vulnerable groups. While a complete elimination is politically difficult in the near term, there is ample room to reduce its costs and ensure that the benefits reach a larger share of poor households. As a first step, the authorities could focus on the elimination of subsidies that generate the biggest distortions and the largest fiscal costs (e.g., consumption-based subsidies that are excessively generous and that in effect represent the highest cost of the existing subsidy system).[12] Over time, consideration should be given to building institutions that can target better the poor (e.g., conditional cash transfer programs or other means testing mechanisms); once these are in place, the remaining distortions of the existing system of electricity subsidies should be eliminated.

18. **The finances of the INSS have not improved as expected following the parametric reform introduced in 2014**. The reform included a phased-in increase in employer contributions and linking pension increases to increases in the average wage, and was calibrated to extend the sustainability of INSS to 2031. While revenue has improved, this has been outweighed by increased expenditure due to the introduction of the "reduced pension" in 2013 and a legislated increase in these pensions in 2015,[13] as well as higher than budgeted expenditures on health services, capital goods, and administration. At the same time, the investment returns of the reserve fund have been low. On current trends, the INSS is projected to start running persistent deficits by 2017, and the reserve fund is expected to be depleted by 2024. Staff recommends reining in expenditure on health and other goods and services to extend the life of the INSS reserve fund. Over the medium term, the authorities need to consider additional parametric reforms to strengthen the system's finances.

19. **The SOEs are expected to remain major contributors to the consolidated public sector deficit over the medium term**. The three largest SOEs (ENEL, ENATREL (electricity transmission)

[11] Tax expenditures in Nicaragua were estimated at 7.6 percent of GDP (90 percent of which correspond to VAT exonerations and exemptions) in 2010, one of the highest in the Central American region.

[12] Consumption-based electricity subsidies, which amount to about ⅔ of the total cost of electricity subsidies, benefit households in three consumption categories (0–50 kWh, 50–100 kWh, and 100–150 kWh) for a total cost of 0.8 percent of GDP; however, only 10 percent of these costs benefit the lowest consumption category where there is a higher concentration of poor households.

[13] A reduced pension was granted to INSS members who have between 250-749 weeks of contributions. Previously, INSS members had to have at least 750 weeks of contributions to be eligible for an old age pension. The current cost of the reduced pension is estimated at between ⅓ and ½ percent of GDP annually.

and ENACAL) have large public investment programs and are expected to run deficits through 2020. In particular, ENACAL requires transfers from the central government to cover its current expenditure. Efforts are therefore needed to address ENACAL's structural problems such as large technical and non-technical losses, and consideration should be given to increasing water tariffs as these are heavily subsidized.

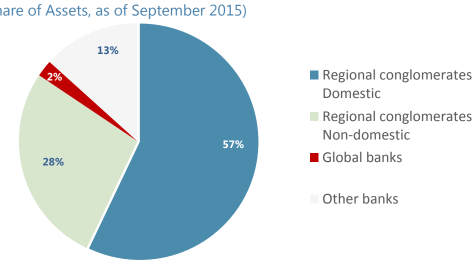
20. **Improving public sector accounting and monitoring and fiscal transparency should remain as policy priorities**. The authorities need to increase institutional coverage of public sector information in line with international standards; increase the quality of information through a consistent application of cash and accrual principles; and improve transparency by publishing the central government's and other institutions' financial statements. Over the longer term, reducing budget rigidities (i.e. earmarking) is key to enhancing the transparency, efficiency, and effectiveness of public spending and strengthening the budget design process.

B. Strengthening Monetary Framework and Financial Stability

21. **The interbank market remains shallow and the interbank rates volatile**. Banks hold reserves at the central bank that are, on average, far in excess of regulatory requirements as they internalize their liquidity risks. These large positions could lead to rapid credit growth that eventually result in higher inflation or international reserves losses. The central bank is moving forward to strengthen the monetary framework within the confines of the crawling peg. In line with Fund's TA advice, the central bank has introduced 7 and 14 day notes to improve short-term liquidity management. The authorities are encouraged to proceed with the recapitalization of the central bank as a condition for strengthening its financial autonomy. In this context, the external audit report for the 2014 audited financial statements of the BCN is qualified due to the uncertainty and valuation surrounding government debt, and its impact on the BCN's financial position. Further, the implementation of International Financial Reporting Standards (IFRS), a key recommendation of the Fund's 2009 safeguards assessment, remains outstanding (see 2015 Informational Annex).

22. **The supranational structure and cross-border activities of financial conglomerates warrant strengthening regional cooperation in prudential supervision**. The Central American Council of Bank Supervisors is playing a more active role in facilitating exchange of financial data across countries. This is particularly relevant for Nicaragua, as its financial system is dominated by the presence of regional conglomerates. The largest three banks belonging to these conglomerates represent about 80 percent of assets, loans, and deposits in the Nicaraguan banking sector. In this context, authorities are encouraged to: (i) monitor the potential risks at the group level given

Nicaragua. Conglomerates' Presence
(Share of Assets, as of September 2015)

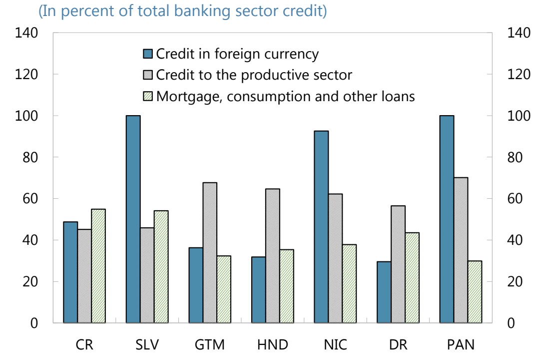


Sources: SIBOIF and Fund staff calculations.
1/ Domestic conglomerates are controlled by holding corporations located in Panamá, but are owned by Nicaraguan economic groups. These holding companies have subsidiaries in Central America and other countries such as Ecuador, Dominican Republic and some Caribbean countries.

their regional interconnectedness; (ii) improve the harmonization of financial data; and (iii) make further efforts to ensure quick response and collaboration from the principal supervisor.[14]

23. **The rapid credit growth of recent years combined with high dollarization warrant closer watch**. Nicaragua has a highly dollarized economy as more than 70 percent of total banking assets are denominated in dollars, and another 20 percent are dollar-indexed. Similarly, about 90 percent of the deposits are in U.S. dollars or dollar-indexed deposits. The expansion of credit to the private sector, in the context of high dollarization, persistent dollar strength, and potential hikes in U.S. interest rates, could pose risks. In particular, U.S. dollar lending to corporations (and households) that do not generate dollar revenue (or income) must be monitored given the persistent dollar strength and the likely increase in U.S. interest rates—70 percent of the loan portfolio is with agents that do not generate dollars. However, the limited exposure by local banks to foreign financing helps contain risks. A review of the macro-prudential tools could strengthen the mitigation of the risks associated with high dollarization.

Loan Dollarization and Sector Allocation[1/]
(In percent of total banking sector credit)



Source: Central American Monetary Council and IMF staff calculations.
[1/] El Salvador and Panama are fully dollarized.

24. **In February 2015, Nicaragua exited the Financial Action Task Force on Money Laundering (FATF) gray list of jurisdictions with strategic deficiencies in their Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) regime**. This was the result of Nicaragua establishment of a legal and regulatory AML/CFT framework, but the country has been encouraged to continue addressing other deficiencies. Nicaragua's AML/CFT regime is scheduled to undergo another full assessment in 2017, under the revised FATF standards, which emphasize the identification, assessment and understanding of ML/TF risks. Efforts to strengthen the AML/CFT regime should continue in order to combat organized crime and corruption (e.g., enhancing measures for politically exposed persons and the suspicious transaction reporting system).

C. Improving External Competitiveness and Buffers

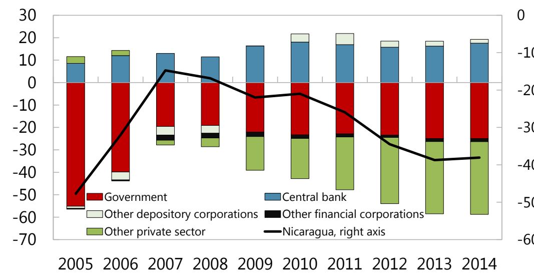
25. **There is room for improvement in Nicaragua's competitiveness** (Box 1). The country's economy remains exposed to increases in oil prices and declines in non-oil commodity prices, which could endanger external sustainability. Nicaragua's export quality is below the CAPDR average in all categories except crude materials. In particular, while the quality of Nicaragua's food and live animal exports is generally superior, the country is underperforming in the quality of manufactured goods and behind those countries that export similar products (e.g., Vietnam). Consistent with the cross-

[14] IMF (2015), Financial Integration in Central America, Panama, the Dominican Republic, and Colombia—Cluster Report.

country analysis conducted by IMF staff, improving infrastructure and trade networks, investing in human capital (from educational outcomes in primary education to training programs that address labor skills bottlenecks), and reducing barriers to entry are needed to promote diversification and structural transformation in low-income countries. Progress in structural reforms in these areas could help to reduce informality and strengthen Nicaragua's poverty-reducing efforts.

26. **The rapid increase in private external debt needs to be closely monitored**. Gross financing needs are projected to increase to 15.9 percent of GDP in 2015, owing to the large debt service obligations of the private sector that are reflected in a large negative net investment position (-116 percent of GDP in 2014). In particular, the private sector was a net creditor in 2006 with a positive net financial position of 3 percent of GDP and has now become a net debtor of about 32 percent of GDP, of which two-thirds correspond to Venezuela oil-financing collaboration being administered by ALBANISA and CARUNA.

Nicaragua: Net Financial Position vis-á-vis Nonresidents
(In percent of GDP[1/])



Sources: Standardized Report Forms; International Investment Position; and Fund Staff calculations and estimates.
1/ Based on financial statistics, excludes FDI and real assets. BSA is not intended to reflect the true economic position of an economy or sector but merely its macroeconomic vulnerability.

D. Upgrading Statistical Framework

27. **Nicaragua's data provision is broadly adequate for surveillance, but there are numerous data shortcomings in national accounts, fiscal, debt, and external sector statistics** (Box 2 and Informational Annex). Fund staff acknowledges the central bank's efforts to enhance intra- and inter-government coordination in the elaboration of statistics. However, the authorities need to continue building on the Fund's technical assistance to improve the timeliness, quality, and reliability of statistics. In particular, authorities are encouraged to make progress on two fronts:

- ***Data quality***: Introduce regulations to enforce data collection; facilitate exchange of information across units and institutions; establish policies to facilitate personnel rotation within institutions that will serve to strengthen cross-fertilization in the use of data methodologies; and establish procedures to monitor data quality.

- ***Communication****:* Establish a predictable timeline for data revisions, observe the advance release calendar, and strengthen communication with users including when introducing methodological changes.

E. Authorities' Views

28. **The authorities agreed with staff's assessment of the economic outlook and risks**. They concurred with staff that growth has decelerated due to external factors, but noted that activity is picking up (they project growth at 4.3 percent or better in 2015). They agreed that growth thus far has been broad-based, and they remain confident in their ability to achieve higher growth rates by

incentivizing private investment and attracting FDI. They believe their policy framework would serve to support growth rates averaging 5 percent over the medium term.

29. **They recognize that the fiscal stance is looser than in the last consultation**. They agreed that fiscal buffers would help insure against downside risks, but believe increases in spending are needed to confront election costs in 2016–17 and support economic activity at a time when the global economy remains weak. They stressed, however, their continued commitment to sustain macroeconomic stability and that their fiscal stance is consistent with a stable level of public debt. Over the medium term, they noted they are willing to consider revenue and expenditure measures if these are deemed necessary. They shared staff's view that these could include reductions in tax exonerations and exemptions and mechanisms to target better electricity subsidies. They also shared staff's concern with the financial sustainability of the INSS, but noted that staff's baseline does not reflect measures they might implement in the future. In this regard, they stressed that their intent is to assess the need for policy measures once the full effects of the parametric pension reform program are known.

30. **In the authorities' view, Nicaragua still faces external vulnerabilities**. They welcomed staff's analysis on external competitiveness and noted that there is no significant misalignment on the real exchange rate and that international reserves exceed the standard benchmarks. They stressed that progress has been made in reducing external risks through lowering oil import dependency and stated that the risks of changes in the levels or terms of the oil collaboration with Venezuela are limited. In this regard, they noted that the oil collaboration has been beneficial, including through boosting social spending and supporting growth. Moreover, if some of this spending would need to be absorbed into the budget, they reiterated their commitment to do so, including through expenditure rationalization, while keeping public debt ratios stable. They also stressed that it is their policy not to extend public guarantees on this debt.

31. **The authorities recognized that bottlenecks to growth remain**. They noted their commitment to improve infrastructure as reflected in their capital spending plans for the remainder of the decade and stressed that they are introducing policies to strengthen education. They highlighted the importance of the dialogue they have developed with the private sector to identify common ground on growth-supportive policies. They also agreed that informality hampers the prospects of small and medium-sized firms by weakening the incentives to expand and invest. To reduce informality, they argued that they have simplified the tax filing systems and are working on improving transport logistics and business climate reforms.

32. **They agreed that more can be done to strengthen the statistical framework**. They recognized that data collection mechanisms need to be strengthened by improving procedures to monitor the quality of statistics. The authorities agreed that additional efforts are needed to improve the quality of public sector operations, including by broadening their coverage and strengthening the monitoring of the public sector's liability and asset position. They stressed their commitment to continue improving their communication strategies and recognized that more information needs to be provided to the public when methodological changes are introduced. They also welcomed the Fund's willingness to support Nicaragua's continuing efforts to improve its statistics.

STAFF APPRAISAL

33. **The policy mix is broadly adequate to maintain macroeconomic stability in the near term, but Nicaragua needs to fortify its policy framework**. Staff agrees that the moderately expansionary 2016 fiscal stance is consistent with the stabilization of the debt ratio by 2020. After the elections in November 2016, authorities are urged to build additional fiscal buffers to insure against risks. This could be attained by reducing tax exonerations and exemptions and improving the targeting of fiscal subsidies. This in turn would strengthen the efficiency and equity of public finances. Looking further ahead, staff strongly recommends identifying economic measures to strengthen the financial viability of the social security institute.

34. **The authorities' interest in strengthening fiscal monitoring is welcome**. In this context, staff is ready to support their efforts to increase institutional coverage of public sector information in line with international standards; and increase the quality of information through a consistent application of cash and accrual principles. Also, publishing the financial statements of the central government and other public institutions would help to enhance transparency. Over the longer term, reducing earmarking is key to lessening budget rigidity and strengthening the budget design process.

35. **The authorities should continue to monitor the rapid growth in credit, strengthen banking supervision, and promote financial stability**. In particular, U.S. dollar lending to corporations (and households) that do not generate dollar revenue (or income) must be monitored given persistent dollar strength and the likely increase in U.S. interest rates. Additional efforts are needed to enhance regional financial regulatory cooperation. Authorities are encouraged to follow up with the recommendation of the Fund's 2009 safeguards assessment.

36. **Improvements in competitiveness would reduce vulnerability to external shocks and spur structural transformation**. Nicaragua remains exposed to increases in oil prices and declines in non-oil commodity prices, which could endanger external sustainability. Improving infrastructure, enhancing trade networks, investing in human capital (from better educational outcomes in primary education to training programs that address labor skills bottlenecks), and reducing barriers to entry are needed to promote diversification and structural transformation. Progress on structural reforms in these areas could also serve to reduce informality and strengthen Nicaragua's poverty-reducing efforts.

37. **The authorities need to continue improving the statistical framework**. In particular, greater efforts are needed in improving the timeliness, quality, and reliability of statistics. This will help to enhance economic decision-making and transparency. In particular, staff recommends (i) introducing regulations to enforce data collection; (ii) establishing procedures to monitor quality; and (iii) following more consistently their communication strategy when methodological changes are introduced.

38. **It is proposed that the next Article IV consultation with Nicaragua be held on the standard 12-month cycle.**

Box 1. Nicaragua: Export Diversification and Quality Upgrading[1]

Nicaragua is one of the least diversified countries in the CAPDR region. In the late 1970s, Nicaragua was the third most diversified economy in CAPDR. By 2005–10, most of the region had diversified at a faster pace, and Nicaragua ranked 6th in terms of export diversification (Table 1).

Table 1. Theil Diversification Index for CAPDR

(1= most diversified)

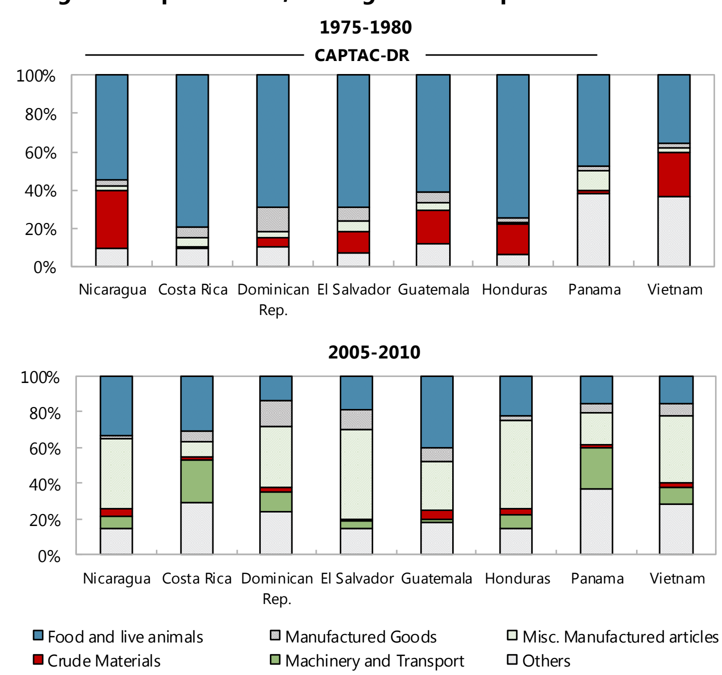
	1975-1980		2005-2010	
	Average	Rank	Average	Rank
Costa Rica	3.78	7	3.56	8
Dominican Republic	3.75	6	2.59	2
El Salvador	3.92	8	3.16	5
Guatemala	3.48	2	2.45	1
Honduras	3.75	5	3.44	7
Nicaragua	**3.57**	**3**	**3.25**	**6**
Panama	2.94	1	2.77	4
LMICs	4.14		3.81	

Source: IMF Diversification Toolkit

The composition of Nicaragua's exports has shifted from agriculture to manufacturing. The majority of Nicaragua's exports in 1975–80 were concentrated in food and live animals, broadly in line with other CAPDR countries (Figure 1). By 2005–10, most of CAPDR (as well as Vietnam—a global competitor of Nicaragua) had diversified, including Nicaragua, into sectors such as manufactured articles and machinery/transport. Meanwhile, food and live animals exports had declined, but continued to represent a large share of Nicaragua's exports.

There is room for improvement in Nicaragua's export quality, particularly for its main export categories. While at par with LMICs in most categories, Nicaragua's export quality is considerably below the CAPDR average in all categories except crude materials (Figure 2A). With respect to major exports, Nicaragua is doing well in the quality of food and live animal exports compared to the rest of the world, but is underperforming in the quality of manufactured articles, and is edged out by Vietnam in the export quality of travel goods and handbags, clothing, and footwear (Figure 2B).

Figure 1. Export Shares, Nicaragua and Comparable countries



Source: IMF Staff estimate

[1] Prepared by Carla Intal (Strategy, Policy and Review Department).

Box 1. Nicaragua: Export Diversification and Quality Upgrading (Concluded)

Figure 2A. Nicaragua's Export Quality Ladder and Share of Exports, 2010

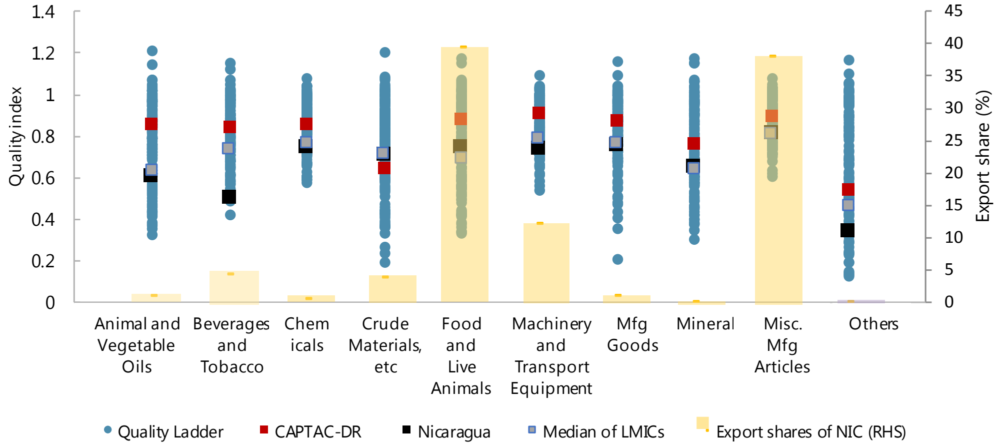
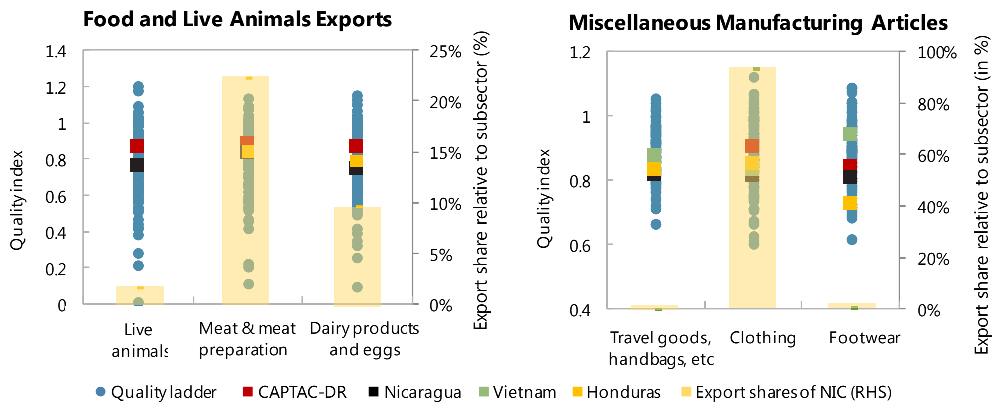


Figure 2B. Selected Subsector Quality Indices, 2010



Source: IMF Diversification Toolkit

Diversification and structural transformation are critical for long-run growth and macroeconomic stability in LICs. An analysis conducted by IMF staff (2014) suggests that improvements in infrastructure and trade networks, investing in human capital, encouraging financial depth, and reducing barriers to entry, are effective in promoting diversification and structural transfomation. Furthermore, while diversification and quality upgrading are mainly focused on the manufacturing sector, about ¼ of Nicaragua's population is still employed in agriculture and for the economic benefits from diversification to include all segm ents of society, agricultural development would need to take a central role, given the productivity and quality gains that can be achieved.

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IMF (2014). Sustaining Long-Run Growth and Macroeconomic Stability in Low-Income Countries – The role of Structural Transformation and Diversification. IMF Policy Paper, Washington DC.

Box 2. Nicaragua: Data Revisions to National Accounts and Balance of Payments Statistics[1]

In March 2015, the Central Bank of Nicaragua (BCN) published revised national accounts (NA) and balance of payments (BOP) data for 2010–13. The new data release introduced methodological refinements by updating trade and producer price indices, using a new employment matrix, and revising agricultural production.

The data release also addressed discrepancies between NA and the BOP trade data. These had emerged largely in the export and import data used in the *maquila* sector. To address these discrepancies, the BCN harmonized the methodology to process trade data by applying the reporting system that enters the preparation of NA also in the BOP statistics. Moreover, it updated the directory of *maquila* firms, which in effect changed both the NA and the BOP statistics.[2]

The impact of these revisions on total GDP was limited, but the changes in the directory of firms imply that care must be exercised when comparing data before and after 2010. In particular, the update of the *maquila* firms' directory affects the calculation of the value added in the *maquila* sector. Specifically, firms are classified into *full package* (FP; those that own the inputs) or *cut, make, and trim* (CMT; those that offer the *maquila* service). For FP firms, the value of imports and exports is known. In contrast, CMT firms rely on a second best *netting method* to estimate manufacturing services on inputs owned by others.[3] This methodology needs to be improved further, however, and the authorities have committed to develop more comprehensive surveys that would make further improvements possible.

An additional methodological improvement affects the estimation of the import of services and FDI. This relates primarily to operations taking place in the energy sector which must be reviewed and mainly affect the primary income. BCN is exploring the introduction of complementary surveys to identify the import of services undertaken by FDI enterprises in Nicaragua. Revisions related to these changes impact both foreign direct investment, import services, and primary income statistics; thus, these are mainly categorical additions with limited impact on aggregate GDP.

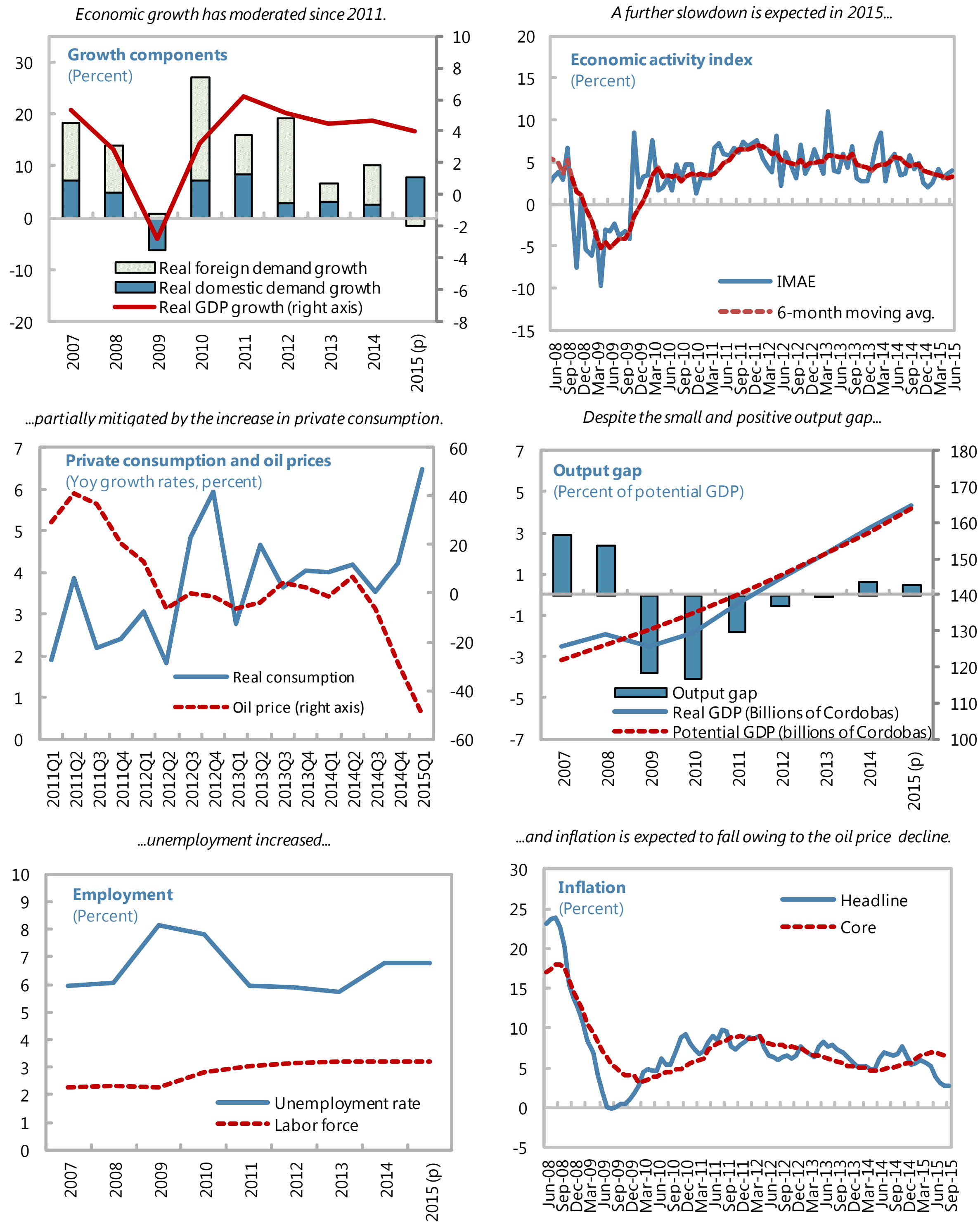
As a result of the harmonization, trade data is now broadly consistent between BOP and NA statistics. However, given the unchanged GDP, its composition is affected. For instance, on the demand side larger imports are offset by higher investment, and on the supply side upward revisions mostly in construction, transport, and communication, and financial intermediation are broadly offset by downward revisions in manufacturing, electricity, gas and water supply, and housing, among others. While changes to the NA start in 2010, the BOP is revised beginning in 2006. This resulted in smaller current account deficits and higher errors and omissions, highlighting the need to investigate further the sources of the latter.

[1] Prepared by Francesco Grigoli and Juan Zalduendo.

[2] *Maquila* exports (goods and manufacturing services) represented about 50 percent of total exports of goods and services in 2014.

[3] If exports are higher than imports, then the company is declaring the value of the exported goods and services, and the difference of exports and imports is equal to the value of the exported services. However, if exports are lower than imports, then it is assumed that the company is declaring the value of the service, which is then set equal to the value of the exports.

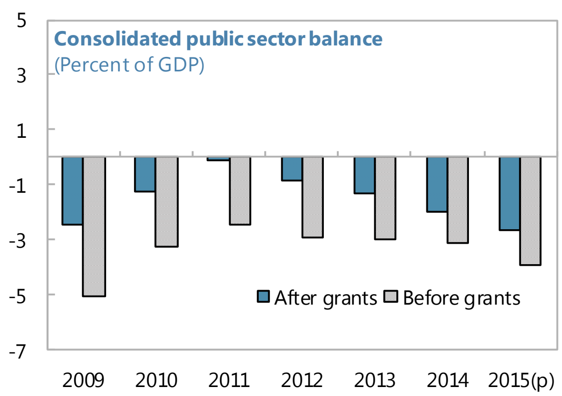
Figure 1. Nicaragua: Real Sector



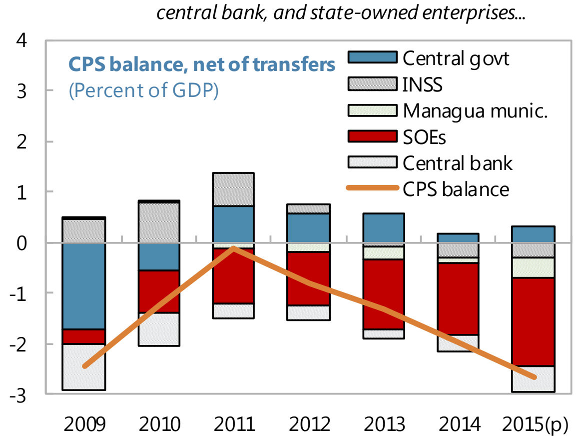
Sources: Country authorities and Fund staff calculations and estimates.

Figure 2. Nicaragua: Fiscal Developments

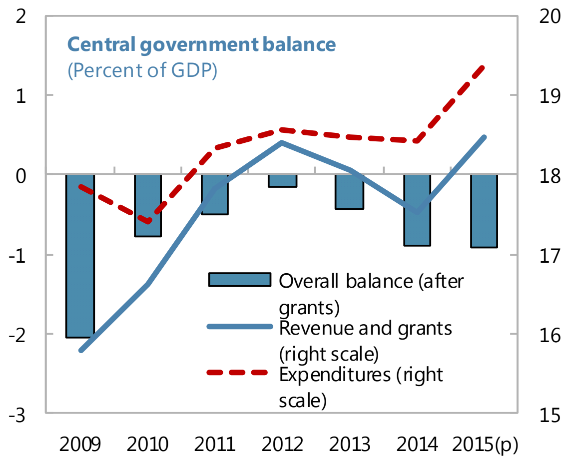
The CPS deficit is expected to widen further in 2015...



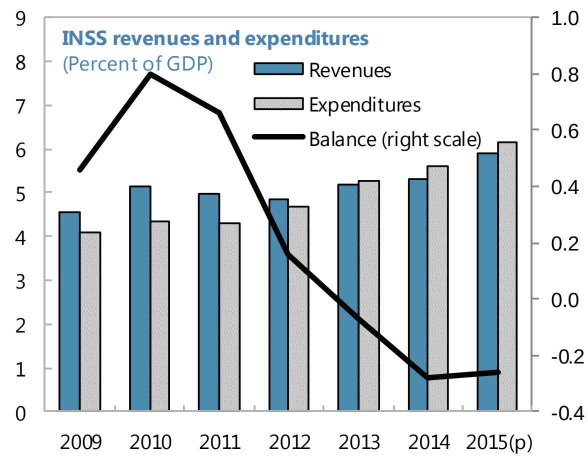
...reflecting higher deficits of Managua municipality, the central bank, and state-owned enterprises...



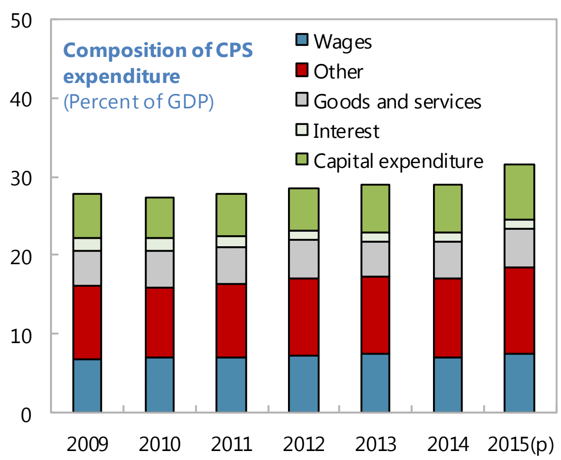
The CG balance is projected to remain unchanged, with stronger revenues matched by higher spending



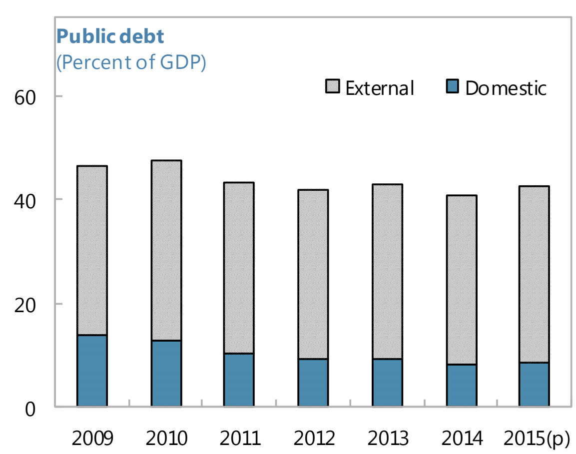
...while the INSS will again post a deficit, in spite of the 2014 parametric reform.



Overall, the higher CPS deficit reflects increases in both capital and current spending...

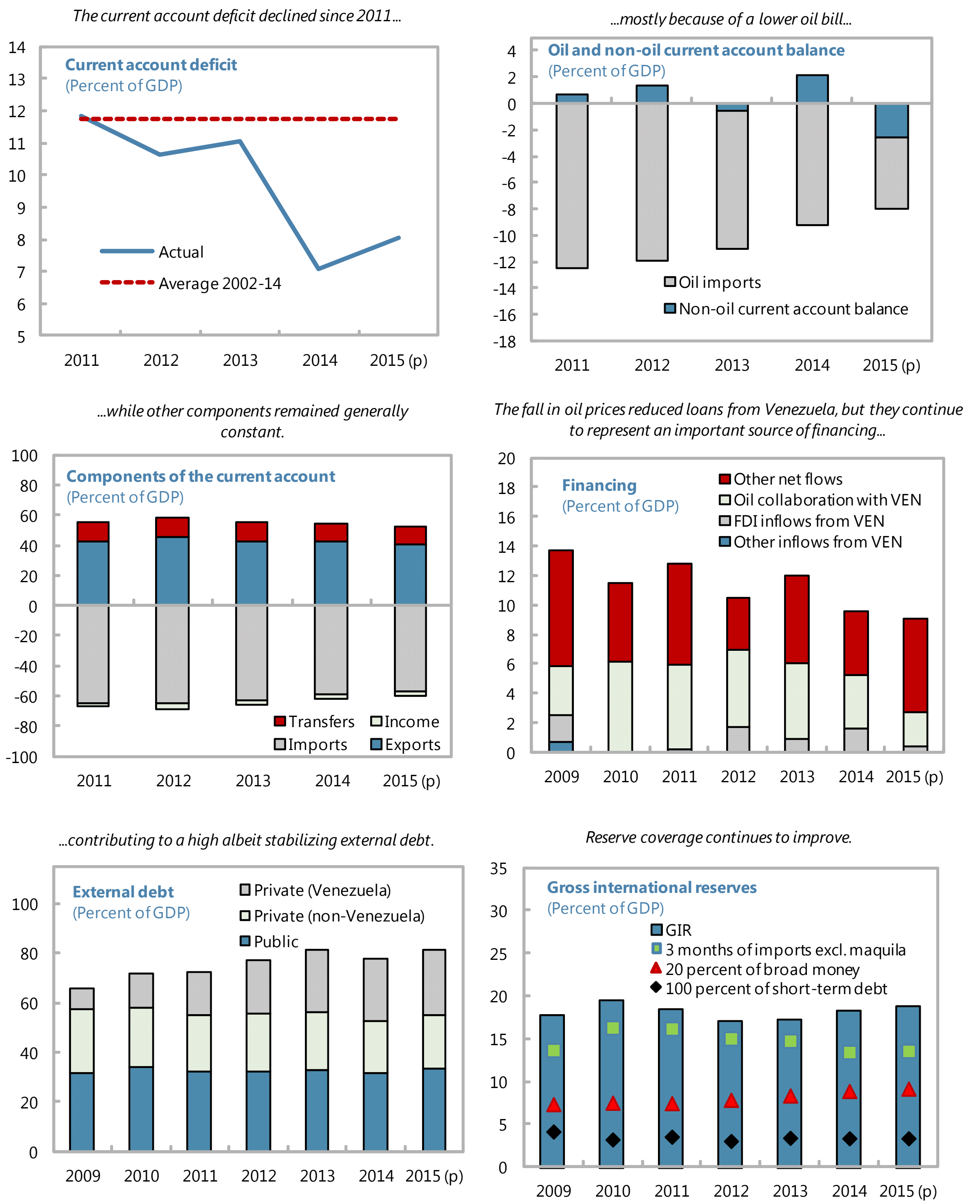


....contributing to a small increase in public debt in 2015.



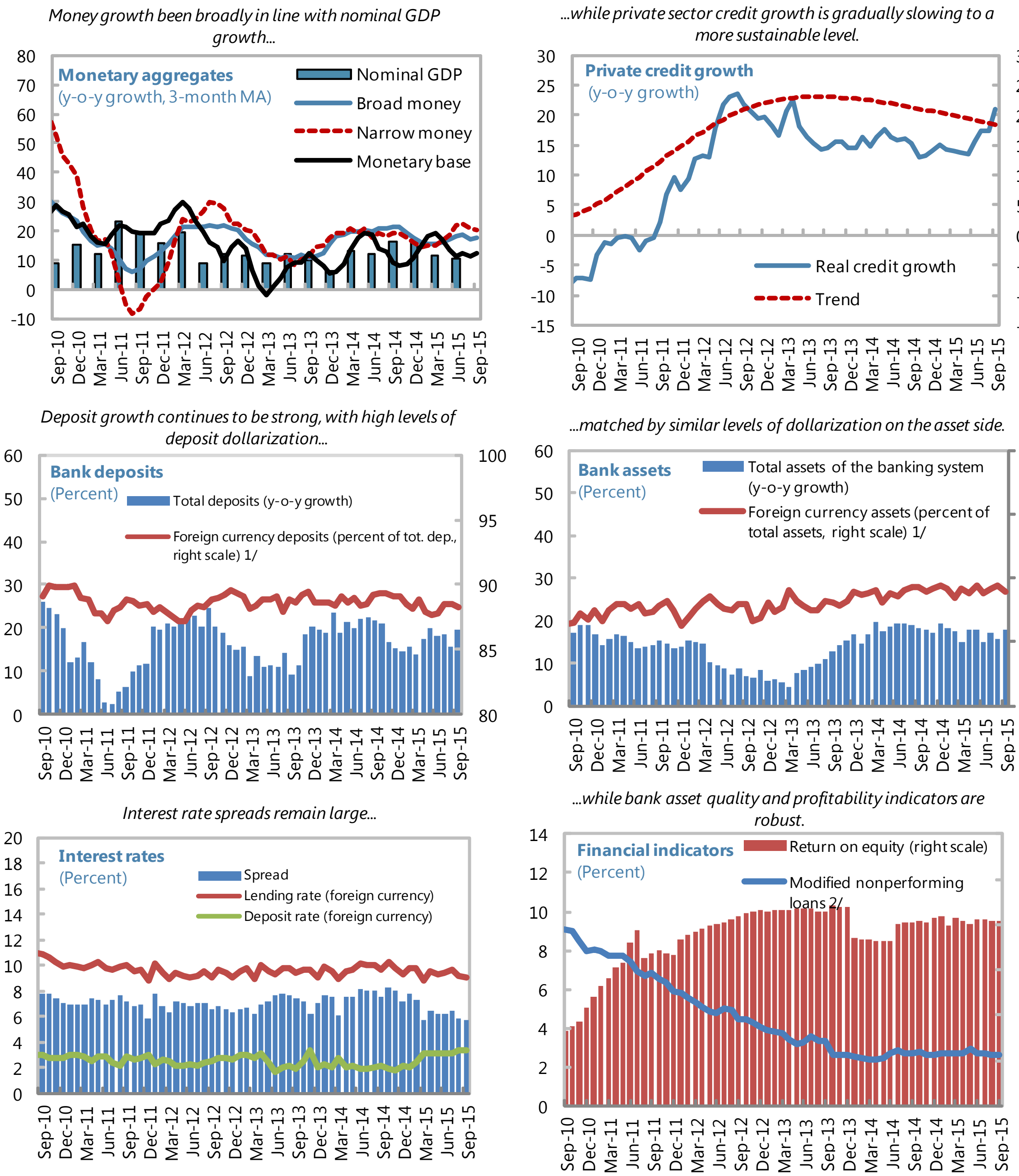
Sources: Country authorities and Fund Staff calculations and estimates.

Figure 3. Nicaragua: External Sector



Sources: Country authorities and Fund staff calculations and estimates.

Figure 4. Nicaragua: Monetary and Financial Sector Developments



Sources: Country authorities; and Fund Staff calculations and estimates.

1/ Includes foreign currency indexed and foreign currency denominated assets/liabilities.

2/ NPLs including restructured and reprogrammed loans.

Table 1. Nicaragua: Selected Social and Economic Indicators, 2012–16 1/

I. Social and Demographic Indicators

Main export products: coffee, sugar (ethanol), meat, and gold.

GDP per capita (current U.S.$, 2014)	1,905	Income share held by the richest 10 percent (2009)	35.2
GNI per capita (Atlas method, current U.S.$, 2014)	1,870	Unemployment (percent of labor force, 2014)	6.8
GINI Index (2009)	45.7	Poverty rate (national pov. line, in percent, 2014)	29.6
Population (millions, 2014)	6.2	Adult literacy rate (percent, 2005)	78.0
Life expectancy at birth in years (2013)	74.8	Infant mortality rate (per 1,000 live births, 2013)	20.0

II. Economic Indicators

	2012	2013	2014	2015	2016
				Proj.	
Output					
GDP growth (percent)	5.1	4.5	4.7	4.0	4.2
GDP (nominal, U.S.$ million)	10,460	10,851	11,806	12,102	12,754
Prices			(Percent)		
GDP deflator	7.1	4.2	9.1	3.5	6.1
Consumer price inflation (period average)	7.2	7.1	6.0	3.5	6.1
Consumer price inflation (end of period)	6.6	5.7	6.5	3.5	6.1
Exchange rate			(Córdobas per U.S.$)		
Period average	23.5	24.7	26.0	...	...
End of period	24.1	25.3	26.6	...	...
Fiscal sector			(Percent of GDP)		
Consolidated public sector					
Revenue	25.6	25.9	25.8	27.6	28.1
Expenditure	28.5	28.9	28.9	31.5	31.8
Current	23.1	22.9	22.9	24.5	24.8
of which: wages & salaries 2/	7.3	7.4	7.1	7.4	7.4
Capital	5.3	6.0	6.0	7.0	7.1
Overall balance, before grants	-2.9	-3.0	-3.1	-3.9	-3.7
Overall balance, after grants	-0.8	-1.3	-2.0	-2.7	-2.5
Money and credit			(Annual percentage change)		
Broad money	16.3	18.5	15.9	21.5	10.9
Credit to the private sector	26.3	20.2	20.5	18.7	11.9
Net domestic assets of the banking system	25.4	17.5	6.0	10.9	6.9
External sector			(Percent of GDP, unless otherwise indicated)		
Current account	-10.6	-11.1	-7.1	-8.0	-8.2
of which: oil imports	12.0	10.5	9.2	5.5	5.3
Capital and financial account	20.2	15.1	13.6	9.3	9.8
of which: FDI	6.8	6.5	6.8	6.4	6.2
Gross reserves (U.S.$ million) 3/	1,778	1,874	2,147	2,273	2,450
In months of imports excl. maquila 3/	3.4	3.5	4.1	4.1	4.2
Net international reserves 3/	1,609	1,723	2,018	2,171	2,377
Public sector debt 4/	41.9	43.0	40.8	42.6	41.9
Private sector external debt	44.8	48.1	46.1	47.9	48.8

Sources: Country authorities; World Bank; and Fund staff calculations and estimates.

1/ All data are based no the new national accounts data that were launched officially on September 20, 2012.

2/ The figures for 2012-13 include an off-budget wage bonus that was financed with Venezuela-related resources. Starting in 2014 the wage bonus is included in the budget.

3/ Excludes the Deposit Guarantee Fund for Financial Institutions (FOGADE).

4/ Assumes that HIPC-equivalent terms were applied to the outstanding debt to non-Paris Club bilaterals. Does not include SDR allocations.

Table 2a. Nicaragua: Operations of the Budgetary Central Government, 2012–20 (GFSM 2001)

(Millions of córdobas)

	2012	2013	2014	2015	2016	2017	2018	2019	2020
						Proj.			
Cash receipts from operating activities	**45,326**	**48,410**	**53,734**	**60,901**	**67,974**	**74,407**	**81,826**	**90,443**	**100,519**
Taxes	37,222	40,785	47,236	53,861	59,288	65,574	72,688	80,705	89,644
Income and property[1/]	13,346	14,832	18,033	21,528	23,790	26,393	29,370	32,749	36,519
Indirect[2/]	22,059	24,067	27,226	30,094	33,061	36,510	40,392	44,748	49,604
Trade	1,816	1,886	1,977	2,239	2,437	2,671	2,926	3,208	3,521
Grants	4,597	4,369	3,046	3,079	4,412	4,131	3,954	4,034	4,505
Other revenue	3,508	3,256	3,452	3,961	4,274	4,702	5,184	5,704	6,370
Cash payments for operating activities	**37,035**	**39,802**	**44,708**	**50,543**	**55,799**	**61,944**	**67,141**	**73,863**	**83,356**
Compensation of employees[3/]	14,491	16,134	17,448	19,707	21,657	23,204	25,522	28,659	32,006
Use of goods and services	7,606	7,291	8,511	9,893	12,059	13,380	13,932	15,939	17,800
Interest[4/]	2,465	2,520	2,639	2,720	3,284	3,769	4,435	5,134	6,025
Subsidies	3,903	4,457	5,356	6,015	5,420	7,061	6,676	6,596	7,916
Grants	7,499	8,488	9,443	11,307	12,566	13,722	15,721	16,642	18,556
Social benefits	467	511	581	577	648	633	673	702	839
Other expense	604	402	729	325	165	174	182	192	214
Net cash inflow from operating activities	**8,292**	**8,609**	**9,026**	**10,358**	**12,175**	**12,463**	**14,685**	**16,579**	**17,163**
Cash flows from investment in non-financial assets (NFAs):									
Purchases of nonfinancial assets	8,668	9,741	11,727	13,356	16,558	17,974	20,594	23,622	25,091
Sales of nonfinancial assets	0	0	0	0	0	0	0	0	0
Net cash outflow: investments in NFAs	8,668	9,741	11,727	13,356	16,558	17,974	20,594	23,622	25,091
Cash surplus / deficit	**-376**	**-1,132**	**-2,701**	**-2,999**	**-4,383**	**-5,511**	**-5,909**	**-7,043**	**-7,928**
Cash flows from financing activities:	**376**	**1,132**	**2,701**	**2,999**	**4,383**	**5,511**	**5,909**	**7,043**	**7,928**
Net acquisition of financial assets other than cas	0	319	290	157	20	20	21	22	23
Domestic	0	0	0	0	0	0	0	0	0
Foreign	0	319	290	157	20	20	21	22	23
Net incurrence of liabilities	2,398	297	5,588	4,718	4,804	5,822	5,920	7,289	8,276
Domestic	-586	-4,205	-240	-2,249	-2,778	-1,791	-2,343	-1,581	-1,235
Foreign	2,983	4,502	5,827	6,967	7,581	7,614	8,263	8,870	9,512
Net cash inflow from financing activities	2,398	-22	5,298	4,561	4,783	5,803	5,899	7,268	8,253
Net change in the stock of cash	2,021	-1,154	2,597	1,562	400	291	-10	225	325

Sources: Country authorities; and Fund staff calculations and estimates.

1/ Includes revenue from electricity distributors arising from changes in the electricity tariff.

2/ Excludes VAT rebates granted as subsidies in the electricity sector.

3/ In 2012-13, includes the off-budget wage bonus that was financed with Venezuela-related resources. Starting in 2014 the bonus is included in the budget.

4/ Assuming that outstanding debt to non-Paris Club bilaterals is settled on HIPC-equivalent terms by the end of 2014. Debt service is recorded on payment basis after debt relief.

Table 2b. Nicaragua: Operations of the Budgetary Central Government, 2012–20 (GFSM 2001)

(Percent of GDP)

	2012	2013	2014	2015	2016	2017	2018	2019	2020
						Proj.			
Cash receipts from operating activities	**18.4**	**18.0**	**17.5**	**18.5**	**18.6**	**18.3**	**18.1**	**17.9**	**17.8**
Taxes	15.1	15.2	15.4	16.3	16.2	16.2	16.1	16.0	15.9
Income and property[1/]	5.4	5.5	5.9	6.5	6.5	6.5	6.5	6.5	6.5
Indirect[2/]	9.0	9.0	8.9	9.1	9.1	9.0	8.9	8.9	8.8
Trade	0.7	0.7	0.6	0.7	0.7	0.7	0.6	0.6	0.6
Grants	1.9	1.6	1.0	0.9	1.2	1.0	0.9	0.8	0.8
Other revenue	1.4	1.2	1.1	1.2	1.2	1.2	1.1	1.1	1.1
Cash payments for operating activities	**15.0**	**14.8**	**14.6**	**15.3**	**15.3**	**15.3**	**14.9**	**14.6**	**14.8**
Compensation of employees[3/]	5.9	6.0	5.7	6.0	5.9	5.7	5.6	5.7	5.7
Use of goods and services	3.1	2.7	2.8	3.0	3.3	3.3	3.1	3.2	3.2
Interest[4/]	1.0	0.9	0.9	0.8	0.9	0.9	1.0	1.0	1.1
Subsidies	1.6	1.7	1.7	1.8	1.5	1.7	1.5	1.3	1.4
Grants	3.0	3.2	3.1	3.4	3.4	3.4	3.5	3.3	3.3
Social benefits	0.2	0.2	0.2	0.2	0.2	0.2	0.1	0.1	0.1
Other expense	0.2	0.1	0.2	0.1	0.0	0.0	0.0	0.0	0.0
Net cash inflow from operating activities	**3.4**	**3.2**	**2.9**	**3.1**	**3.3**	**3.1**	**3.2**	**3.3**	**3.0**
Cash flows from investment in non-financial assets (NFAs):									
Purchases of nonfinancial assets	3.5	3.6	3.8	4.0	4.5	4.4	4.6	4.7	4.5
Sales of nonfinancial assets	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net cash outflow: investments in NFAs	3.5	3.6	3.8	4.0	4.5	4.4	4.6	4.7	4.5
Cash surplus / deficit	**-0.2**	**-0.4**	**-0.9**	**-0.9**	**-1.2**	**-1.4**	**-1.3**	**-1.4**	**-1.4**
Cash flows from financing activities:	**0.2**	**0.4**	**0.9**	**0.9**	**1.2**	**1.4**	**1.3**	**1.4**	**1.4**
Net acquisition of financial assets other than cas	0.0	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Domestic	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign	0.0	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Net incurrence of liabilities	1.0	0.1	1.8	1.4	1.3	1.4	1.3	1.4	1.5
Domestic	-0.2	-1.6	-0.1	-0.7	-0.8	-0.4	-0.5	-0.3	-0.2
Foreign	1.2	1.7	1.9	2.1	2.1	1.9	1.8	1.8	1.7
Net cash inflow from financing activities	1.0	0.0	1.7	1.4	1.3	1.4	1.3	1.4	1.5
Net change in the stock of cash	0.8	-0.4	0.8	0.5	0.1	0.1	0.0	0.0	0.1

Sources: Country authorities; and Fund staff calculations and estimates.

1/ Includes revenue from electricity distributors arising from changes in the electricity tariff.

2/ Excludes VAT rebates granted as subsidies in the electricity sector.

3/ In 2012-13, includes the off-budget wage bonus that was financed with Venezuela-related resources. Starting in 2014 the bonus is included in the budget.

4/ Assuming that outstanding debt to non-Paris Club bilaterals is settled on HIPC-equivalent terms by the end of 2014. Debt service is recorded on payment basis after debt relief.

Table 3a. Nicaragua: Operations of the Combined Public Sector, 2012–20 (GFSM 2001)

(Millions of córdobas)

	2012	2013	2014	2015	2016	2017	2018	2019	2020
						Proj.			
Budgetary central government cash surplus/deficit	**-376**	**-1,132**	**-2,701**	**-2,999**	**-4,383**	**-5,511**	**-5,909**	**-7,043**	**-7,928**
Revenue	45,326	48,410	53,734	60,901	67,974	74,407	81,826	90,443	100,519
of which: grants[1/]	4,597	4,369	3,046	3,079	4,412	4,131	3,954	4,034	4,505
Expenditure[1/]	45,703	49,543	56,435	63,900	72,357	79,918	87,735	97,485	108,447
Social Security Institute (INSS) cash surplus	**386**	**-192**	**-865**	**-852**	**797**	**-75**	**-587**	**-1,392**	**-1,432**
Revenue	11,951	13,963	16,260	19,411	24,035	26,944	30,888	35,109	40,139
of which: grants (external)	10	9	3	3	0	0	0	0	0
Expenditure[2/]	11,565	14,155	17,125	20,262	23,238	27,018	31,475	36,501	41,571
Managua municipality (ALMA) cash surplus	**-260**	**-412**	**-102**	**-837**	**-485**	**232**	**220**	**655**	**429**
Revenue	2,320	2,394	2,699	3,372	3,411	3,717	4,023	4,757	5,312
of which: grants	262	18	18	83	5	5	5	6	7
Expenditure	2,580	2,807	2,801	4,209	3,896	3,485	3,803	4,102	4,883
Public enterprises cash surplus[3/]	**-1,206**	**-1,643**	**-1,707**	**-2,775**	**-4,049**	**-5,678**	**-6,545**	**-5,426**	**-7,524**
Revenue	9,827	11,381	12,679	15,381	14,628	15,897	17,371	18,855	21,124
of which: Grants (external)	213	61	349	871	174	224	299	486	610
Expenditure	11,033	13,024	14,386	18,156	18,676	21,575	23,916	24,281	28,648
Non-financial public sector									
Cash receipts from operating activities	67,748	73,613	82,325	94,887	106,722	117,515	130,821	146,389	164,093
Taxes	38,961	42,772	49,482	56,407	61,881	68,337	75,632	84,257	93,611
Social contributions	11,007	12,805	15,161	18,343	22,477	25,994	29,812	34,030	38,810
Grants[1/]	5,082	4,457	3,416	4,036	4,591	4,360	4,258	4,961	5,608
Other revenue	12,699	13,579	14,267	16,102	17,773	18,824	21,118	23,141	26,064
Cash payments for operating activities	56,098	61,024	69,287	79,344	89,037	99,819	110,617	123,881	139,780
Compensation of Employees[1/]	17,935	19,901	21,720	24,481	26,907	28,800	31,486	35,011	39,099
Use of goods and services	11,912	12,105	14,124	16,306	18,371	20,313	21,423	24,012	26,849
Interest	2,649	2,731	2,826	3,092	3,444	3,911	4,593	5,300	5,925
Subsidies	2,646	2,410	2,823	3,186	3,786	5,191	5,120	5,240	6,411
Grants	7,267	8,200	9,136	10,584	11,469	12,760	14,611	15,829	17,649
Social benefits	10,490	12,665	15,217	17,953	21,405	25,027	29,370	34,263	39,127
Other expense	3,199	3,012	3,441	3,743	3,656	3,816	4,014	4,226	4,719
Net cash inflow from operating activities	11,650	12,589	13,039	15,543	17,685	17,696	20,203	22,508	24,313
Net cash outflow from investments in NFAs	13,106	15,969	18,414	23,005	25,805	28,729	33,025	35,714	40,768
Cash surplus / deficit	**-1,456**	**-3,380**	**-5,375**	**-7,462**	**-8,120**	**-11,032**	**-12,822**	**-13,206**	**-16,455**
Central bank (BCN) cash surplus / deficit	**-536**	**-178**	**-656**	**-1,287**	**-964**	**78**	**820**	**531**	**1,095**
Consolidated Public Sector cash surplus / deficit	**-1,992**	**-3,558**	**-6,031**	**-8,749**	**-9,083**	**-10,954**	**-12,002**	**-12,675**	**-15,359**
Cash flows from financing activities:	**1,992**	**3,558**	**6,031**	**8,749**	**9,083**	**10,954**	**12,002**	**12,675**	**15,359**
Net acquisition of financial assets other than cash	130	2,875	328	361	1,190	247	-137	-1,663	-1,188
Net incurrence of liabilities	4,932	5,608	9,672	8,334	8,912	11,239	12,757	12,489	15,592
Domestic	1	-832	1,628	-353	-642	-525	-847	-1,520	1,238
Foreign	4,931	6,440	8,044	8,687	9,554	11,764	13,605	14,009	14,355
Net cash inflow from financing activities	4,802	2,733	9,344	7,972	7,722	10,993	12,894	14,152	16,780
Net change in stock of cash	3,346	-647	3,969	511	-398	-40	72	946	325
Central bank (BCN) cash surplus/deficit	536	178	656	1,287	964	-78	-820	-531	-1,095
Memorandum items									
GDP (nominal)	246,306	268,261	306,461	329,854	365,019	405,595	452,065	504,850	563,799

Sources: Country authorities; and Fund staff calculations and estimates.

[1/] The figures for 2012-13 include an off-budget wage bonus financed with Venezuela-related resources. Starting in 2014 the wage bonus is included in the budget.

[2/] From 2013, includes the payment of the reduced pension.

[3/] Includes the state-owned airport (EAAI); ports (EPN); oil (PETRONIC); electricity generation, transmission and regulation (ENATREL, ENEL and INE); water and sewer (ENACAL); food (ENABAS); trade and public enterprise corporation (ENIMPORT and CORNAP); telecommunications (TELCOR); technological institute (INATEC); post (CORREOS); and lottery (LOTERIA).

Table 3b. Nicaragua: Operations of the Combined Public Sector, 2012–20 (GFSM 2001)

(Percent of GDP)

	2012	2013	2014	2015	2016	2017	2018	2019	2020
						Proj.			
Budgetary central government cash surplus/deficit	**-0.2**	**-0.4**	**-0.9**	**-0.9**	**-1.2**	**-1.4**	**-1.3**	**-1.4**	**-1.4**
Revenue	18.4	18.0	17.5	18.5	18.6	18.3	18.1	17.9	17.8
of which: grants[1/]	1.9	1.6	1.0	0.9	1.2	1.0	0.9	0.8	0.8
Expenditure[1/]	18.6	18.5	18.4	19.4	19.8	19.7	19.4	19.3	19.2
Social Security Institute (INSS) cash surplus	**0.2**	**-0.1**	**-0.3**	**-0.3**	**0.2**	**0.0**	**-0.1**	**-0.3**	**-0.3**
Revenue	4.9	5.2	5.3	5.9	6.6	6.6	6.8	7.0	7.1
Expenditure[2/]	4.7	5.3	5.6	6.1	6.4	6.7	7.0	7.2	7.4
Managua municipality (ALMA) cash surplus	**-0.1**	**-0.2**	**0.0**	**-0.3**	**-0.1**	**0.1**	**0.0**	**0.1**	**0.1**
Revenue	0.9	0.9	0.9	1.0	0.9	0.9	0.9	0.9	0.9
of which: grants	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Expenditure	1.0	1.0	0.9	1.3	1.1	0.9	0.8	0.8	0.9
Public enterprises cash surplus[3/]	**-0.5**	**-0.6**	**-0.6**	**-0.8**	**-1.1**	**-1.4**	**-1.4**	**-1.1**	**-1.3**
Revenue	4.0	4.2	4.1	4.7	4.0	3.9	3.8	3.7	3.7
of which: Grants (external)	0.1	0.0	0.1	0.3	0.0	0.1	0.1	0.1	0.1
Expenditure	4.5	4.9	4.7	5.5	5.1	5.3	5.3	4.8	5.1
Non-financial public sector									
Cash receipts from operating activities	27.5	27.4	26.9	28.8	29.2	29.0	28.9	29.0	29.1
Taxes	15.8	15.9	16.1	17.1	17.0	16.8	16.7	16.7	16.6
Social contributions	4.5	4.8	4.9	5.6	6.2	6.4	6.6	6.7	6.9
Grants[1/]	2.1	1.7	1.1	1.2	1.3	1.1	0.9	1.0	1.0
Other revenue	5.2	5.1	4.7	4.9	4.9	4.6	4.7	4.6	4.6
Cash payments for operating activities	22.8	22.7	22.6	24.1	24.4	24.6	24.5	24.5	24.8
Compensation of Employees[1/]	7.3	7.4	7.1	7.4	7.4	7.1	7.0	6.9	6.9
Use of goods and services	4.8	4.5	4.6	4.9	5.0	5.0	4.7	4.8	4.8
Interest	1.1	1.0	0.9	0.9	0.9	1.0	1.0	1.0	1.1
Subsidies	1.1	0.9	0.9	1.0	1.0	1.3	1.1	1.0	1.1
Grants	3.0	3.1	3.0	3.2	3.1	3.1	3.2	3.1	3.1
Social benefits	4.3	4.7	5.0	5.4	5.9	6.2	6.5	6.8	6.9
Other expense	1.3	1.1	1.1	1.1	1.0	0.9	0.9	0.8	0.8
Net cash inflow from operating activities	4.7	4.7	4.3	4.7	4.8	4.4	4.5	4.5	4.3
Net cash outflow from investments in NFAs	5.3	6.0	6.0	7.0	7.1	7.1	7.3	7.1	7.2
Cash surplus / deficit	**-0.6**	**-1.3**	**-1.8**	**-2.3**	**-2.2**	**-2.7**	**-2.8**	**-2.6**	**-2.9**
Central bank (BCN) cash surplus / deficit	**-0.2**	**-0.1**	**-0.2**	**-0.4**	**-0.3**	**0.0**	**0.2**	**0.1**	**0.2**
Consolidated Public Sector cash surplus / deficit	**-0.8**	**-1.3**	**-2.0**	**-2.7**	**-2.5**	**-2.7**	**-2.7**	**-2.5**	**-2.7**
Cash flows from financing activities:	**0.8**	**1.3**	**2.0**	**2.7**	**2.5**	**2.7**	**2.7**	**2.5**	**2.7**
Net acquisition of financial assets other than cash	0.1	1.1	0.1	0.1	0.3	0.1	0.0	-0.3	-0.2
Net incurrence of liabilities	2.0	2.1	3.2	2.5	2.4	2.8	2.8	2.5	2.8
Domestic	0.0	-0.3	0.5	-0.1	-0.2	-0.1	-0.2	-0.3	0.2
Foreign	2.0	2.4	2.6	2.6	2.6	2.9	3.0	2.8	2.5
Net cash inflow from financing activities	1.9	1.0	3.0	2.4	2.1	2.7	2.9	2.8	3.0
Net change in stock of cash	1.4	-0.2	1.3	0.2	-0.1	0.0	0.0	0.2	0.1
Central bank (BCN) cash surplus/deficit	0.2	0.1	0.2	0.4	0.3	0.0	-0.2	-0.1	-0.2

Sources: Country authorities; and Fund staff calculations and estimates.

[1/] The figures for 2012-13 include an off-budget wage bonus financed with Venezuela-related resources. Starting in 2014 the wage bonus is included in the budget.

[2/] From 2013, the payment of the reduced pension is included.

[3/] Includes the state-owned airport (EAAI); ports (EPN); oil (PETRONIC); electricity generation, transmission and regulation (ENATREL, ENEL, and INE); water and sewer (ENACAL); food (ENABAS); trade and public enterprise corporation (ENIMPORT and CORNAP); telecommunications (TELCOR); technological institute (INATEC); post (CORREOS); and lottery (LOTERIA).

Table 4. Nicaragua: Nonfinancial Public Sector Gross Financing Requirements, 2012–20 1/

	2012	2013	2014	2015	2016	2017	2018	2019	2020
				Proj.					
				(Millions of U.S. dollars)					
a. NFPS primary deficit (before grants)	**165**	**207**	**230**	**308**	**324**	**382**	**396**	**388**	**464**
CG and public enterprises	182	199	196	277	352	380	377	346	423
INSS	-16	8	33	31	-28	2	19	42	41
b. Debt service obligations	**285**	**264**	**240**	**280**	**309**	**326**	**358**	**385**	**427**
External	72	68	86	123	150	192	225	258	285
Interest	36	41	49	64	70	84	98	111	123
Amortization	36	27	38	59	79	108	128	148	161
Domestic	214	196	154	157	159	135	132	127	143
Interest	77	70	60	50	50	47	48	49	47
Amortization of bonds	127	113	81	86	86	75	71	65	85
Other internal amortizations 3/	10	13	13	21	23	13	13	12	10
c. Gross financing needs (a+b)	**450**	**470**	**470**	**588**	**632**	**708**	**753**	**773**	**891**
d. Financing sources	**450**	**470**	**470**	**588**	**632**	**708**	**753**	**773**	**891**
External	394	399	479	526	573	645	694	707	721
Disbursements	245	288	347	378	413	500	559	571	574
Grants	149	111	132	148	160	145	135	137	147
Domestic	56	71	-9	62	59	64	59	66	170
Bond issuance (gross)	13	94	87	67	26	53	50	60	86
Deposits Central Bank	-91	47	-96	-57	-14	-10	0	-7	-9
Commercial banks	47	-33	-63	39	28	11	-3	-22	0
Grants (Caruna wage bonus) 2/	67	69	0	0	0	0	0	0	0
Other 4/	21	-106	64	14	19	10	12	34	93
				(Percent of GDP)					
a. NFPS primary deficit (before grants)	**1.6**	**1.9**	**1.9**	**2.5**	**2.5**	**2.8**	**2.8**	**2.5**	**2.9**
CG and public enterprises	1.7	1.8	1.7	2.3	2.8	2.8	2.6	2.3	2.6
INSS	-0.2	0.1	0.3	0.3	-0.2	0.0	0.1	0.3	0.3
b. Debt service obligations	**2.7**	**2.4**	**2.0**	**2.3**	**2.4**	**2.4**	**2.5**	**2.5**	**2.6**
External	0.7	0.6	0.7	1.0	1.2	1.4	1.6	1.7	1.8
Interest	0.3	0.4	0.4	0.5	0.6	0.6	0.7	0.7	0.8
Amortization	0.3	0.3	0.3	0.5	0.6	0.8	0.9	1.0	1.0
Domestic	2.0	1.8	1.3	1.3	1.2	1.0	0.9	0.8	0.9
Interest	0.7	0.6	0.5	0.4	0.4	0.3	0.3	0.3	0.3
Amortization of bonds	1.2	1.0	0.7	0.7	0.7	0.6	0.5	0.4	0.5
Other internal amortizations 3/	0.1	0.1	0.1	0.2	0.2	0.1	0.1	0.1	0.1
c. Gross financing needs (a+b)	**4.3**	**4.3**	**4.0**	**4.9**	**5.0**	**5.2**	**5.3**	**5.1**	**5.5**
d. Financing sources	**4.3**	**4.3**	**4.0**	**4.9**	**5.0**	**5.2**	**5.3**	**5.1**	**5.5**
External	3.8	3.7	4.1	4.3	4.5	4.8	4.8	4.6	4.4
Disbursements	2.3	2.7	2.9	3.1	3.2	3.7	3.9	3.7	3.5
Grants	1.4	1.0	1.1	1.2	1.3	1.1	0.9	0.9	0.9
Domestic	0.5	0.7	-0.1	0.5	0.5	0.5	0.4	0.4	1.0
Bond issuance (gross)	0.1	0.9	0.7	0.6	0.2	0.4	0.3	0.4	0.5
Deposits Central Bank	-0.9	0.4	-0.8	-0.5	-0.1	-0.1	0.0	0.0	-0.1
Commercial banks	0.4	-0.3	-0.5	0.3	0.2	0.1	0.0	-0.1	0.0
Grants (Caruna wage bonus) 2/	0.6	0.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other 4/	0.2	-1.0	0.5	0.1	0.1	0.1	0.1	0.2	0.6

Sources: Country authorities; and Fund staff calculations and estimates.

1/ Includes the central government, Social Security Institute (INSS); Managua municipality (ALMA); state-owned airport (EAAI); ports (EPN); oil (PETRONIC); electricity generation, transmission and regulation (ENATREL, ENEL, INE); water and sewer (ENACAL); food (ENABAS); trade and public enterprise corporation (ENIMPORT and CORNAP); telecommunications (TELCOR); technological institute (INATEC); post (CORREOS); and lottery (LOTERIA).

2/ From 2012-2013, includes the off-budget wage bonus financed with Venezuela-related resources. Starting in 2014 the bonus is included in the budget.

3/ Includes CG amortization of bank recapitalization bonds and non-NFPS debts.

4/ Includes SOE suppliers, INSS other investments, floating debt, and privatization receipts.

Table 5. Nicaragua: Summary Accounts of Central Bank and Financial System, 2012–20

(Billions of córdobas, unless otherwise specified)

	2012	2013	2014	2015	2016	2017	2018	2019	2020
						Proj.			
			I. Central Bank						
Net foreign assets[1/]	**-1.9**	**0.7**	**12.0**	**26.3**	**34.1**	**41.5**	**49.3**	**58.3**	**67.7**
Net international reserves[2/]	38.8	43.6	53.7	60.6	69.7	78.8	88.5	99.9	111.7
Net international reserves (billions of US$)[2/]	1.6	1.7	2.0	2.2	2.4	2.6	2.7	2.9	3.1
Net domestic assets	**15.1**	**13.7**	**4.9**	**-6.4**	**-11.9**	**-16.8**	**-21.8**	**-27.8**	**-34.1**
Net claims on nonfinancial public sector	42.4	44.7	39.7	37.8	36.9	36.0	35.4	34.6	33.6
Net credit to banks	-22.7	-26.9	-31.4	-37.1	-39.6	-42.2	-45.1	-49.8	-53.3
of which: reserves	-16.3	-18.7	-23.8	-27.0	-30.3	-33.4	-37.1	-41.3	-46.3
Capital accounts	2.4	2.9	5.3	1.6	0.0	-1.1	-2.3	-2.4	-3.8
Other items (net)	-6.9	-6.9	-8.7	-8.8	-9.1	-9.5	-9.8	-10.2	-10.6
Currency in circulation	**13.2**	**14.4**	**16.9**	**19.9**	**22.3**	**24.7**	**27.5**	**30.4**	**33.6**
			II. Other Depository Corporations						
Net foreign assets	**6.7**	**5.9**	**5.3**	**5.5**	**5.8**	**6.1**	**6.4**	**6.7**	**7.0**
Net foreign assets (billions of US$)	0.3	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Net domestic assets	**65.6**	**81.0**	**95.0**	**117.3**	**130.3**	**144.3**	**161.4**	**180.4**	**203.4**
Net claims on Central Bank[3/]	24.0	27.7	34.1	40.1	43.0	46.0	49.4	54.7	58.8
Net credit to other financial corporations	-5.2	-6.1	-6.4	-6.6	-7.1	-7.5	-8.1	-8.7	-9.3
Net credit to non-financial public sector	1.4	1.6	1.0	1.8	2.1	2.2	1.9	-0.4	1.8
Credit to private sector	66.3	79.7	96.1	114.1	127.7	143.0	162.1	183.8	206.9
Capital accounts	-11.8	-14.0	-17.0	-18.3	-20.2	-22.5	-25.1	-28.0	-31.3
Other items (net)	-9.1	-8.0	-12.8	-13.8	-15.2	-16.9	-18.9	-21.1	-23.5
Liabilities	**72.3**	**86.9**	**100.3**	**122.9**	**136.1**	**150.4**	**167.8**	**187.1**	**210.5**
Deposits in domestic currency	7.9	9.9	10.9	13.3	14.8	16.3	18.2	20.3	22.8
Deposits in foreign currency	64.4	77.0	89.4	109.5	121.3	134.1	149.6	166.8	187.6
			III. Depository Corporations[4/]						
Net foreign assets	**4.8**	**6.5**	**17.2**	**31.9**	**39.9**	**47.6**	**55.7**	**65.0**	**74.7**
Net foreign assets (billions of US$)	0.2	0.3	0.6	1.1	1.4	1.5	1.7	1.9	2.1
Net domestic assets	**83.1**	**97.6**	**103.5**	**114.7**	**122.6**	**132.2**	**144.9**	**158.4**	**175.9**
Net credit to non-financial public sector	43.7	46.2	40.6	39.6	38.9	38.1	37.3	34.0	35.2
Credit to private sector	66.4	79.9	96.2	114.2	127.8	143.2	162.2	184.0	207.1
Net credit to other financial corporations	-5.2	-6.1	-6.4	-6.7	-7.1	-7.5	-8.1	-8.7	-9.3
Capital accounts	-9.4	-11.1	-11.7	-16.6	-20.2	-23.6	-27.4	-30.4	-35.1
Other items (net)	-12.4	-11.2	-15.3	-15.7	-16.8	-17.9	-19.1	-20.5	-22.1
Broad money	**87.9**	**104.2**	**120.7**	**146.6**	**162.6**	**179.9**	**200.6**	**223.4**	**250.6**
				(Percent change, y-o-y, unless otherwise specified)					
Memorandum items									
Gross reserves (billions of US$)[2/]	1.8	1.9	2.1	2.3	2.4	2.6	2.8	3.0	3.1
Adjusted NIR (billions of US$)[5/]	0.6	0.5	0.7	0.8	1.0	1.1	1.3	1.5	1.7
In months of imports excl. maquila[5/]	1.1	1.0	1.4	1.4	1.6	1.9	2.1	2.2	2.3
Monetary base[6/]	4.9	6.7	14.8	19.2	11.5	10.8	11.1	10.8	10.9
Currency in circulation	15.9	8.9	17.1	18.0	11.9	11.0	11.1	10.7	10.3
Deposits in Cordobas	2.9	13.0	12.8	22.5	10.7	10.6	11.6	11.5	12.5
Deposits in FX currency	10.8	12.5	20.6	22.5	10.7	10.6	11.6	11.5	12.5
Credit to private sector	26.3	20.2	20.5	18.7	11.9	12.0	13.3	13.4	12.6
Broad money	16.3	18.5	15.9	21.5	10.9	10.6	11.5	11.4	12.2
Broad money velocity	2.8	2.6	2.5	2.3	2.2	2.3	2.3	2.3	2.3

Sources: Country authorities; and Fund staff calculations and estimates.

1/ Net international reserves minus medium- and long-term net foreign assets of the Central Bank.

2/ Excludes the Deposit Guarantee Fund for Financial Institutions (FOGADE).

3/ Reserves and holdings of securities issued by Central Bank.

4/ Banking system excludes other financial institutions.

5/ Gross reserves net of short-term foreign currency liabilities to residents and non-residents (including Fund obligations).

6/ Currency in circulation plus bank reserves in national currency.

Table 6. Nicaragua: Quasi-fiscal Balance of the Central Bank, 2012–20

	2012	2013	2014	2015	2016	2017	2018	2019	2020
				Proj.					
	(Millions of Córdobas)								
Revenue	**1,017**	**1,049**	**919**	**1,034**	**1,638**	**2,513**	**3,683**	**4,253**	**4,690**
Interest	683	650	483	582	1,065	1,869	2,856	3,720	4,129
Foreign deposits	54	76	31	43	102	201	322	428	479
Notes and bonds	351	341	214	296	695	1,368	2,193	2,916	3,263
Loans of the BCN	215	219	222	224	225	217	210	202	193
On MTI bonds (fluctuation in price)	57	11	12	17	41	80	128	170	191
Other revenues	334	399	436	451	573	644	827	532	561
Of which: recapitalization transfers	260	304	338	373	491	556	734	432	454
Expenditure	**1,553**	**1,227**	**1,575**	**2,321**	**2,602**	**2,435**	**2,863**	**3,722**	**3,595**
Administrative	837	550	638	1,225	1,304	1,049	1,395	1,473	1,195
Interest	716	677	938	1,095	1,298	1,385	1,468	2,249	2,400
External debt	121	98	106	85	81	67	60	869	903
BCN Securities	195	159	417	488	626	663	671	597	700
Bonds (banking)	215	219	222	224	225	217	210	202	193
Other	186	201	193	299	366	439	527	580	605
Quasi-fiscal balance	**-536**	**-178**	**-656**	**-1,287**	**-964**	**78**	**820**	**531**	**1,095**
	(Percent of GDP)								
Revenue	**0.4**	**0.4**	**0.3**	**0.3**	**0.4**	**0.6**	**0.8**	**0.8**	**0.8**
Interest	0.3	0.2	0.2	0.2	0.3	0.5	0.6	0.7	0.7
Foreign deposits	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.1	0.1
Notes and bonds	0.1	0.1	0.1	0.1	0.2	0.3	0.5	0.6	0.6
Bonds (banking)	0.1	0.1	0.1	0.1	0.1	0.1	0.0	0.0	0.0
On MTI bonds (fluctuation in price)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other revenues	0.1	0.1	0.1	0.1	0.2	0.2	0.2	0.1	0.1
Of which: recapitalization transfers	0.1	0.1	0.1	0.1	0.1	0.1	0.2	0.1	0.1
Expenditure	**0.6**	**0.5**	**0.5**	**0.7**	**0.7**	**0.6**	**0.6**	**0.7**	**0.6**
Administrative	0.3	0.2	0.2	0.4	0.4	0.3	0.3	0.3	0.2
Interest	0.3	0.3	0.3	0.3	0.4	0.3	0.3	0.4	0.4
External debt[1/]	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.2	0.2
BCN securities	0.1	0.1	0.1	0.1	0.2	0.2	0.1	0.1	0.1
Bonds (banking)	0.1	0.1	0.1	0.1	0.1	0.1	0.0	0.0	0.0
Other	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Quasi-fiscal balance	**-0.2**	**-0.1**	**-0.2**	**-0.4**	**-0.3**	**0.0**	**0.2**	**0.1**	**0.2**
Memorandum items (in millions of cordobas)									
Net issuance of BCN securities	1,519	-470	1,275	-4,432	-859	-601	-947	497	-1,565
Domestic debt of the central bank	6,422	8,286	7,703	10,077	9,344	8,855	7,993	8,529	6,978
as a percent of GDP	2.6	3.1	2.5	3.1	2.6	2.2	1.8	1.7	1.2

[1/] Projected interest payments on external debt to non-Paris Club creditors pending debt relief, assuming relief was obtained at end-2014.

Sources: Country authorities; and Fund staff calculations and estimates.

Table 7. Nicaragua: Balance of Payments, 2012–20

(Millions of U.S. dollars, unless otherwise specified)

	2012	2013	2014	2015	2016	2017	2018	2019	2020
						Proj.			
Current account	**-1,113**	**-1,200**	**-838**	**-973**	**-1,046**	**-1,156**	**-1,199**	**-1,276**	**-1,368**
Trade balance	-2,447	-2,510	-2,402	-2,566	-2,715	-2,896	-3,025	-3,167	-3,308
Exports, f.o.b.	3,491	3,292	3,622	3,405	3,442	3,582	3,791	3,970	4,147
Imports, f.o.b.	5,938	5,802	6,024	5,972	6,156	6,479	6,816	7,137	7,455
Of which: oil imports	1,253	1,137	1,092	663	674	772	866	936	986
Services	345	254	428	464	478	490	503	511	516
Receipts	1,244	1,325	1,388	1,433	1,490	1,557	1,631	1,703	1,773
Payments	899	1,071	960	969	1,011	1,067	1,129	1,192	1,258
Income	-321	-313	-308	-360	-362	-374	-382	-406	-444
Credits	25	23	20	26	46	76	107	126	131
Debits	346	336	328	386	408	450	489	533	575
Transfers	1,310	1,369	1,443	1,489	1,552	1,625	1,705	1,787	1,869
Of which: workers' remittances	1,014	1,078	1,136	1,174	1,221	1,274	1,332	1,390	1,447
Capital account	**238**	**231**	**276**	**414**	**225**	**238**	**253**	**269**	**286**
Financial account	**-1,872**	**-1,408**	**-1,326**	**-711**	**-1,027**	**-1,100**	**-1,125**	**-1,210**	**-1,274**
Direct investment	-715	-708	-800	-780	-788	-822	-847	-876	-946
Portfolio investment[1/]	-64	-146	-5	0	-3	-1	-2	-1	-1
Other investment	-1,092	-554	-521	69	-236	-277	-276	-333	-327
Of which: general government	209	260	310	319	334	391	431	423	413
Errors and omissions	**-1,000**	**-327**	**-451**	**0**	**0**	**0**	**0**	**0**	**0**
Overall balance	**-3**	**112**	**313**	**152**	**207**	**182**	**179**	**204**	**192**
Financing	**3**	**-112**	**-313**	**-152**	**-207**	**-182**	**-179**	**-204**	**-192**
Change in GIR (increase, -)	15	-95	-292	-125	-177	-160	-160	-190	-185
Change in NIR (increase, -)	3	-112	-313	-152	-207	-182	-179	-204	-192
IMF credit and loans	-13	-16	-22	-27	-29	-22	-19	-14	-7
Purchases and disbursements	0	0	0	0	0	0	0	0	0
Repurchases and repayments	-13	-16	-22	-27	-29	-22	-19	-14	-7
Exceptional financing	0	0	0	0	0	0	0	0	0
Memorandum items									
Current account (percent of GDP)	-10.6	-11.1	-7.1	-8.0	-8.2	-8.6	-8.4	-8.4	-8.4
Goods export volume growth rate (percent)	19.7	2.9	8.9	-2.3	4.3	2.8	5.0	4.5	4.2
Goods import volume growth rate (percent)	6.9	-1.0	4.6	9.0	4.2	4.0	4.0	4.0	4.0
Goods terms of trade growth rate (percent)	-5.6	-7.2	1.8	5.8	-2.0	0.0	-0.4	-0.5	-0.2
ALBA-related flows, gross (percent of GDP)	7.0	6.0	5.2	2.7	2.2	2.3	2.3	2.3	2.1
ALBA-related debt (percent of GDP)	21.2	24.8	25.5	26.1	26.0	25.9	25.7	25.3	24.9
Stock of gross reserves[2/]	1,778	1,874	2,147	2,273	2,450	2,610	2,770	2,960	3,145
In months of imports excl. *maquila*[2/]	3.4	3.5	4.1	4.1	4.2	4.3	4.3	4.4	4.4
Oil price (U.S.$ per barrel)	105	104	96	52	50	55	60	62	63
Public external debt (percent of GDP)[3/]	32.8	33.6	32.5	34.0	34.5	35.1	35.8	36.2	36.3

Sources: Country authorities; and Fund staff calculations and estimates.

[1/] Includes financial derivatives.

[2/] Excludes the Deposit Guarantee Fund for Financial Institutions (FOGADE).

[3/] Assumes that HIPC-equivalent terms were applied to the outstanding debt to non-Paris Club bilaterals. Does not include SDR allocations.

Table 8. Nicaragua: Financial Soundness Indicators, 2011–15

(Percent, unless otherwise specified)

	2011	2012	2013	2014	2015 Mar.	2015 Jun.	2015 Sep.
Capital adequacy							
Regulatory capital to risk-weighted assets	14.8	13.1	12.9	13.0	13.0	13.4	13.2
Regulatory Tier 1 capital to risk-weighted assets	9.2	8.6	8.5	9.1	10.7	11.4	10.7
Asset quality							
Nonperforming loans to total gross loans	2.2	1.7	0.9	1.0	0.9	0.9	0.9
Nonperforming loans to total gross loans[1/]	5.9	4.0	2.6	2.7	2.7	2.7	2.7
Nonperforming loans net of provisions to capital	12.6	6.5	2.0	2.4	2.4	1.5	1.5
Sectoral distribution of loans							
Commercial	34.9	35.2	35.0	35.0	35.6	35.5	35.0
Agricultural	12.8	12.3	11.1	10.0	8.2	7.8	8.8
Consumer	22.3	22.2	24.0	25.0	25.2	25.9	25.7
Construction	14.1	12.9	13.2	13.3	13.5	13.6	13.3
Industrial	12.8	14.3	13.4	13.2	14.1	13.7	13.7
Others	3.1	3.1	3.3	3.5	3.4	3.4	3.4
Earnings and profitability							
Return on assets	1.6	2.2	2.3	2.2	2.2	2.2	2.2
Return on equity	16.7	21.5	22.0	20.7	20.7	20.5	20.4
Interest margin to assets	6.2	6.4	6.7	0.0	0.0	0.0	0.0
Liquidity							
Liquid assets to total assets	27.2	24.6	24.4	26.5	32.5	31.8	29.5
Liquid assets to total short-term liabilities	49.4	37.8	39.1	42.5	42.9	42.5	39.7
Exposure to FX risk							
Net open position in foreign exchange to capital	173.3	166.9	190.2	190.2	199.8	179.9	177.7
Number of institutions	8	8	8	9	9	10	10
Total assets (in millions of cordobas)	105,316	113,360	133,052	158,883	166,882	171,411	178,801
Bank concentration							
Number of banks accounting individually for at least 25% of total assets	2	2	2	2	2	2	2
Share of total assets of 3 largest institutions (percent)	82	81	81	82	82	80	79
Total assets (in percent of GDP)							
Private commercial	48.5	46.1	49.6	52.0	50.8	52.0	54.3
of which: Foreign banks[2/]	47.8	45.6	49.0	50.9	49.7	50.4	51.9
Bank deposits (percentage of GDP)							
Private commercial	38.0	35.0	35.9	38.2	37.6	38.6	39.6
of which: Foreign banks[2/]	14.8	14.3	14.9	15.4	37.6	38.2	38.8
Dollarization and maturity structure							
Banking system assets as percentage of GDP	34.7	34.3	37.4	39.9	38.8	39.4	40.8
Assets in foreign currency as percentage of banking system assets	71.6	74.4	75.4	76.7	76.3	75.6	75.2

Sources: Country authorities.

[1/] NPLs including restructured and reprogrammed loans.

[2/] Refers to banks with more than 49 percent foreign ownership.

Table 9. Nicaragua: Indicators of Capacity to Repay the Fund, 2012–20

	2012	2013	2014	2015	2016	2017	2018	2019	2020
						Proj.			
Fund obligations based on existing and prospective credit									
In millions of SDRs	8.4	10.7	14.5	19.4	21.1	15.7	13.3	9.6	4.8
In millions of U.S. dollars	12.8	16.3	22.0	27.2	29.7	22.3	19.0	13.8	7.0
In percent of exports of goods and nonfactor services	0.3	0.4	0.4	0.6	0.6	0.4	0.4	0.2	0.1
In percent of external public debt service	13.7	15.3	15.5	16.8	16.2	12.1	10.5	7.7	3.9
In percent of quota	6.4	8.3	11.1	14.9	16.2	12.1	10.2	7.4	3.7
In percent of gross international reserves	0.7	0.9	1.0	1.2	1.2	0.9	0.7	0.5	0.2
Fund credit outstanding									
In millions of SDRs	110.0	99.3	84.9	65.7	44.8	29.2	16.0	6.4	1.7
In millions of U.S. dollars	168.5	150.9	128.9	92.1	63.1	41.4	22.8	9.2	2.4
In percent of exports of goods and nonfactor services	3.6	3.3	2.6	1.9	1.3	0.8	0.4	0.2	0.0
In percent of external public debt service	180.8	141.7	90.9	56.9	34.4	22.5	12.6	5.2	1.4
In percent of quota	84.6	76.4	65.3	50.5	34.5	22.5	12.3	4.9	1.3
In percent of gross international reserves	9.5	8.1	6.0	4.1	2.6	1.6	0.8	0.3	0.1
Memorandum items									
Exports of goods and services (millions of U.S. dollars)	4,735	4,617	5,010	4,838	4,931	5,139	5,422	5,673	5,921
External public debt service (millions of U.S. dollars)	93	106	142	162	184	184	181	179	177
Quota (millions of SDRs)	130	130	130	130	130	130	130	130	130
Quota (millions of U.S. dollars)	199	198	197	182	183	184	186	187	188
Gross international reserves (millions of U.S. dollars)	1,778	1,874	2,147	2,273	2,450	2,610	2,770	2,960	3,145
SDR per U.S. dollars (period average)	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7

Sources: Fund staff calculations and estimates.

Table 10. Nicaragua: Medium-Term Macroeconomic Framework, 2012–20

	2012	2013	2014	2015	2016	2017	2018	2019	2020
						Proj.			
Growth and prices					(Percent)				
GDP growth	5.1	4.5	4.7	4.0	4.2	4.0	4.0	4.0	4.0
GDP deflator	7.1	4.2	9.1	3.5	6.1	6.8	7.2	7.4	7.4
Consumer price inflation (average)	7.2	7.1	6.0	3.5	6.1	6.8	7.2	7.4	7.4
Consumer price inflation (e.o.p.)	6.6	5.7	6.5	3.5	6.1	6.8	7.2	7.4	7.4
Public finances					(Percent of GDP)				
Consolidated public sector									
Revenue	25.6	25.9	25.8	27.6	28.1	28.2	28.5	28.6	28.7
Expenditure	28.5	28.9	28.9	31.5	31.8	32.0	32.1	32.1	32.4
Overall balance, after grants	-0.8	-1.3	-2.0	-2.7	-2.5	-2.7	-2.7	-2.5	-2.7
Public sector debt[1/]	41.9	43.0	40.8	42.6	41.9	41.8	41.5	41.0	40.8
Balance of payments					(Percent of GDP, unless otherwise specified)				
Current account	-10.6	-11.1	-7.1	-8.0	-8.2	-8.6	-8.4	-8.4	-8.4
U.S.$ million	-1,113	-1,200	-838	-973	-1,046	-1,156	-1,199	-1,276	-1,368
Gross reserves (U.S.$ million)[2/]	1,778	1,874	2,147	2,273	2,450	2,610	2,770	2,960	3,145
In months of imports excl. maquila[2/]	3.4	3.5	4.1	4.1	4.2	4.3	4.3	4.4	4.4
Net international reserves (U.S.$ million)[2/]	1,609	1,723	2,018	2,171	2,377	2,560	2,738	2,942	3,134
Memorandum items									
GDP (US$ million)	10,460	10,851	11,806	12,102	12,754	13,497	14,327	15,238	16,207

Sources: Country authorities; and Fund staff calculations and estimates.

[1/] Assumes that HIPC-equivalent terms were applied to the outstanding debt to non-Paris Club bilaterals. Does not include SDR allocations.

[2/] Excludes the Deposit Guarantee Fund for Financial Institutions (FOGADE).

Table 11. Nicaragua: Millennium Development Goals, 1990–2014 1/

	1990	1995	2000	2005	2010	2014
Goal 1: Eradicate extreme poverty and hunger						
Employment to population ratio, 15+, total (percent)	55.7 /a	56.6	56.2	58.1	58.8 /j	...
Employment to population ratio, ages 15-24, total (percent)	46 /a	46.7	46.2	43.6	42.9 /j	...
Poverty gap at $1.90 a day (2011 PPP) (percent)	7 /b	4.4 /d	4.9 /e	3.6	3.6 /g	...
Malnutrition prevalence, weight for age (percent of children under 5)	9.6 /b	10.3 /d	7.8 /e	5.7 /f	...	...
Prevalence of undernourishment (percent of population)	54.4 /a	45.1	34.8	24.3	16.8 /j	...
Goal 2: Achieve universal primary education						
Primary completion rate, total (percent of relevant age group)	39.2	49.2	65.8	74.0	80.4	...
School enrollment, primary (percent net)	67.0	73.0	78.6	87.4	91.8	...
Goal 3: Promote gender equality and empower women						
Proportion of seats held by women in national parliaments (percent)	14.8	10.8 /c	9.7	20.7	20.7	42.4
Ratio of girls to boys in primary and secondary education (percent)	...	1.1 /d	1.1	1.0	1.0	...
Goal 4: Reduce child mortality						
Immunization, measles (percent of children ages 12-23 months)	82.0	85.0	86.0	96.0	99.0	99.0
Mortality rate, infant (per 1,000 live births)	50.9	41.4	32.6	26.3	22.0	19.4
Mortality rate, under-5 (per 1,000 live births)	66.9	52.7	40.3	31.7	26.1	22.8
Goal 5: Improve maternal health						
Births attended by skilled health staff (percent of total)	...	64.6 /d	66.9 /e	73.7	74.0	...
Contraceptive prevalence (percent of women ages 15-49)	...	60.3 /d	68.6 /e	72.4	80.4 /i	...
Maternal mortality ratio (modeled estimate, per 100,000 live births)	170.0	160.0	140.0	120.0	100 /j	...
Goal 6: Combat HIV/AIDS, malaria, and other diseases						
Incidence of tuberculosis (per 100,000 people)	80.0	70.0	56.0	44.0	55 /j	...
Prevalence of HIV, total (percent of population ages 15-49)	0.2	0.3	0.4	0.3	0.3	0.3
Tuberculosis case detection rate (percent, all forms)	89.0	87.0	85.0	80.0	87 /j	...
Goal 7: Ensure environmental sustainability						
CO2 emissions (metric tons per capita)	0.6	0.6	0.7	0.8	0.8 /h	...
Forest area (percent of land area)	37.5	34.6	31.7	28.8	25.9 /j	...
Improved sanitation facilities (percent of population with access)	43.9	49.2	54.4	59.6	64.7	67.8
Improved water source (percent of population with access)	72.7	75.8	78.9	81.9	85.0	86.9
Terrestrial protected areas (percent of total land area)	15.4	29.3	30.5	36.7	85.0	86.9
Goal 8: Develop a global partnership for development						
Internet users (per 100 people)	0.0	0.0	1.0	2.6	10.0	17.6
Mobile cellular subscriptions (per 100 people)	0.0	0.1	1.8	20.5	68.1	114.6

Source: Millenium Development Goals, World Bank.

[1/] Or latest available data. a) 1991; b) 1993; c) 1997; d) 1998; e) 2001; f) 2006; g) 2007; h) 2011; i) 2012; j) 2013

Table 12. Nicaragua: Saving-Investment Balance, 2012–20

(Percent of GDP, unless otherwise specified)

	2012	2013	2014	2015	2016	2017	2018	2019	2020
						Proj.			
Gross national disposable income	**109.5**	**109.7**	**109.6**	**109.3**	**109.3**	**109.3**	**109.2**	**109.1**	**108.8**
Nominal GDP	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Net factor payments from abroad	-3.1	-2.9	-2.6	-3.0	-2.8	-2.8	-2.7	-2.7	-2.7
Net transfers from abroad	12.5	12.6	12.2	12.3	12.2	12.0	11.9	11.7	11.5
Consumption	**92.4**	**92.0**	**89.6**	**89.3**	**89.4**	**89.7**	**89.2**	**89.3**	**88.9**
Public sector 1/	7.1	7.0	6.7	7.1	7.1	6.9	6.7	6.7	6.7
Private sector	85.3	85.1	82.9	82.2	82.3	82.7	82.5	82.6	82.2
Gross domestic investment	**27.7**	**28.8**	**27.1**	**28.1**	**28.2**	**28.2**	**28.4**	**28.2**	**28.3**
Public sector 1/	5.6	6.1	6.1	7.0	7.1	7.1	7.4	7.1	7.3
Private sector	22.2	22.7	21.0	21.0	21.0	21.0	21.0	21.0	21.0
National saving	**17.1**	**17.7**	**20.0**	**20.0**	**20.0**	**19.6**	**20.0**	**19.8**	**19.9**
Public sector	4.7	4.7	4.3	4.7	4.8	4.4	4.5	4.5	4.3
Private sector	12.4	13.0	15.7	15.3	15.1	15.3	15.6	15.3	15.6
External saving	**10.6**	**11.1**	**7.1**	**8.0**	**8.2**	**8.6**	**8.4**	**8.4**	**8.4**
Public sector	0.8	1.4	1.8	2.3	2.3	2.8	2.9	2.7	3.0
Private sector	9.8	9.7	5.3	5.7	5.9	5.8	5.5	5.7	5.5
Memorandum items									
Exports of goods and services	45.3	42.5	42.4	40.0	38.7	38.1	37.8	37.2	36.5
Imports of goods and services	65.4	63.3	59.2	57.4	56.2	55.9	55.5	54.7	53.8

Sources: Country authorities; and Fund staff calculations and estimates.

1/ Projections are based on national accounts data increased with growth rates from the fiscal projections.

Appendix I. External Assessment[1]

The recent improvement in the trade balance contributed to a current account deficit close to its norm while the real effective exchange rate (REER) is broadly in line with fundamentals. Similarly, the stock of gross international reserves is adequate. However, according to staff's assessment: (i) the business environment remains weak; (ii) gross financing needs are large; and (iii) the net international investment position continues to deteriorate. Efforts to improve Nicaraguan competitiveness and structural reforms aimed at upgrading export quality would help to address these vulnerabilities.

Exchange Rate Assessment and Competitiveness

Nicaragua's real effective exchange rate (REER) is broadly in line with its fundamentals. Estimates based on the CGER methodology (macroeconomic balance approach, external sustainability approach, and equilibrium real exchange rate approach) and on the external balance assessment suggest that the exchange rate is, on average, overvalued by 1.2 percent. This low average, however, masks substantial uncertainty across methodologies, which present a range of estimates between an overvaluation of 6.5 percent and an undervaluation of 3.9 percent. Consistently, the external current account deficit is close to the estimated norm. The average norm for the external current account deficit is, in fact, 6.9 percent, or 0.2 percent of GDP higher than the actual deficit in 2014.

Exchange Rate Assessment 1/

Macroeconomic Balance Approach (MBA)	
CA norm (percent of GDP)	-5.9
CA gap (percent of GDP)	-1.2
RER gap (percent)	3.7
Equilibrium Real Exchange Rate Approach (ERER)	
RER gap (percent)	6.5
External Sustainability Approach (ES)	
CA norm (percent of GDP)	-7.6
CA gap (percent of GDP)	0.5
RER gap (percent)	-3.9
External Balance Assessment (EBA)-lite	
CA norm (percent of GDP)	-7.1
CA gap (percent of GDP)	0.0
RER gap (percent)	-1.6
Averages	
CA norm (percent of GDP)	-6.9
CA gap (percent of GDP)	-0.2
RER gap (percent)	1.2

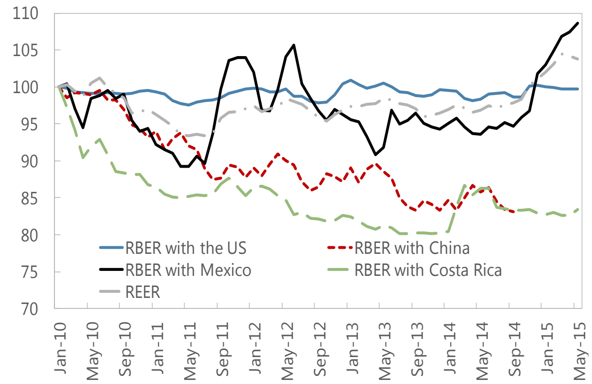
Source: Fund staff calculations and estimates.
1/ Based on IMF CGER methodologies and extensions by Francis Vitek (2009, unpublished), and EBA-Lite methodology.

Other indicators point to a mixed picture:

- Since mid-2011, the REER slightly appreciated and increased its appreciation pace starting in October 2014. This reflects a real appreciation vis-à-vis two of Nicaragua's main trading partners, the U.S. and Mexico. However, Nicaragua's export market share in the U.S. remained relatively stable in terms of world exports and gained ground with respect to other Central American economies and the Dominican Republic, mostly owing to the loss of market share by Costa Rica.

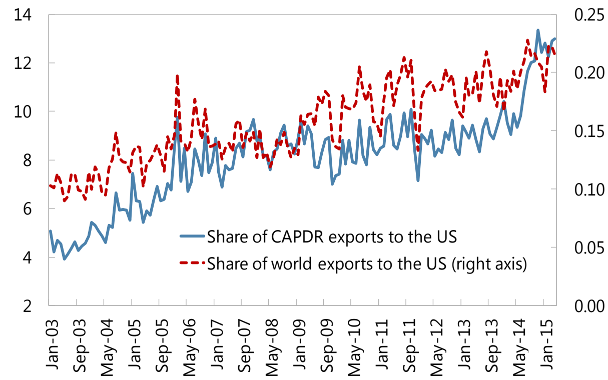
[1] Prepared by Francesco Grigoli and José Luis Saboin.

Real Bilateral and Effective Exchange Rate
(Jan-10=100)



Sources: INS and Fund staff calculations and estimates.

Nicaragua's Export Market Shares
(Percent)

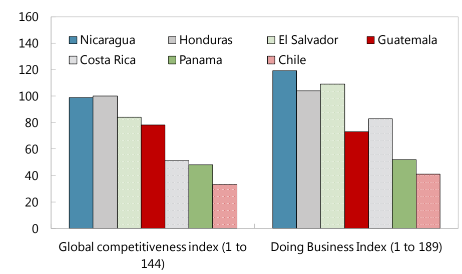


Sources: IMF DOTS and fund staff calculations.

- Competitiveness rankings show that Nicaragua lags behind most other Central American economies. The global competitiveness index indicates that Nicaragua's relative position is the second worst after Honduras; 99th in a ranking of 148 countries. Similarly, the Doing Business index places Nicaragua behind all other CAPDR countries; 125th in a ranking of 189 countries. A closer look at the Doing Business sub-indicators suggest that Nicaragua performs particularly poorly in dealing with construction permits, getting electricity, registering property, and getting credit. Nevertheless, Nicaragua remains one of the safest countries in Latin America. Among Central American peers, only Costa Rica and Panama enjoy a better security risk environment.

- Nicaragua's minimum wages are very competitive. All sectors have hourly minimum wages below US$2. Agriculture and manufacturing, the sectors where Nicaraguan exports are concentrated, are among the most competitive. With respect to the *maquila* sector, Nicaragua presents the lowest minimum wage in Central America.

Competitiveness rankings

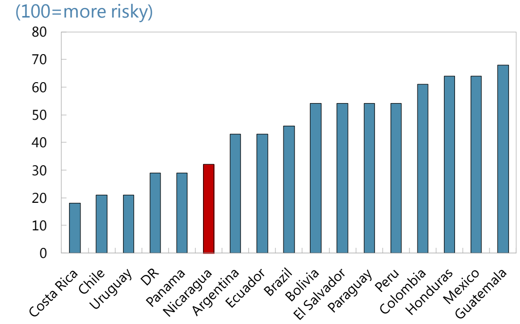


Sources: World Economic Forum Global Competitiveness Report 2014-15; Doing Business Report 2015.

Doing Business indicators
(Percent of rank for Nicaragua in parentheses)

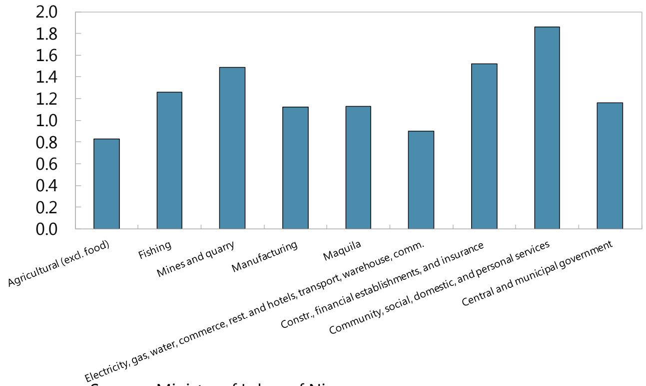
Source: Doing Business database.

Security Risk Index in 2015
(100=more risky)



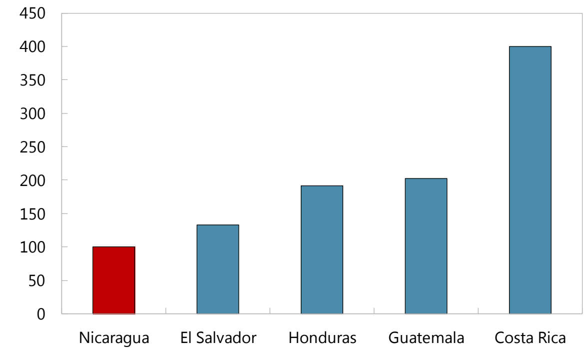
Sources: The Economist Intelligence Unit

Minimum Wage Across Sectors in 2015
(U.S. dollars per hour)



Sources: Ministry of Labor of Nicaragua.

Maquila Minimum Wage in 2015
(Nicaragua=100 percent)

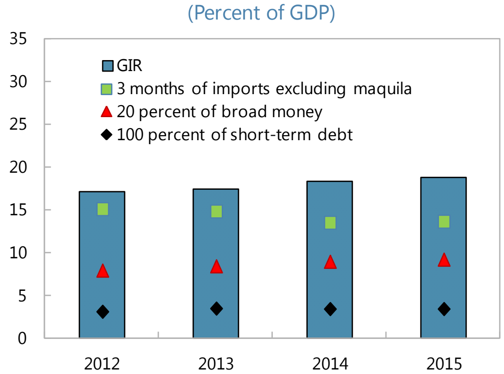


Sources: Ministry of Labor of each country

Reserve Adequacy

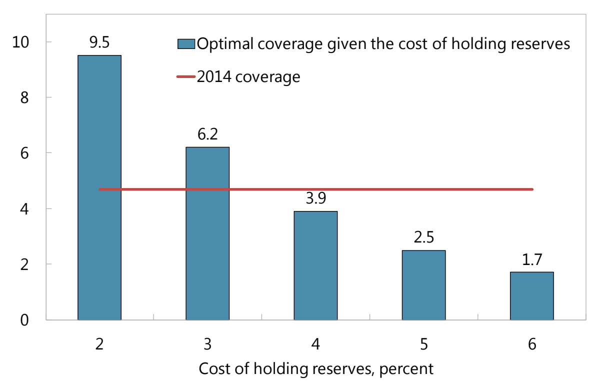
The stock of gross international reserves exceeds standard metrics. At about 18 percent of GDP, gross international reserves exceed the following international benchmarks: 3 months of imports excluding *maquila*, 20 percent of broad money, and 100 percent of short-term debt. A model accounting for Nicaragua's characteristics, however, may produce a better estimate of optimal reserve coverage than generic benchmarks. The framework proposed by Dabla-Norris et al (2011) attempts to measure the benefit of reserves in avoiding crises and in reducing their severity as well as the costs of reserve holdings.[2] The results suggest an optimal level of reserves of about 4 months of imports, which remains below the coverage of 4.7 months of imports at end-2014.

Standard Metrics
(Percent of GDP)



Sources: Central Bank of Nicaragua and Fund staff calculations and estimates.

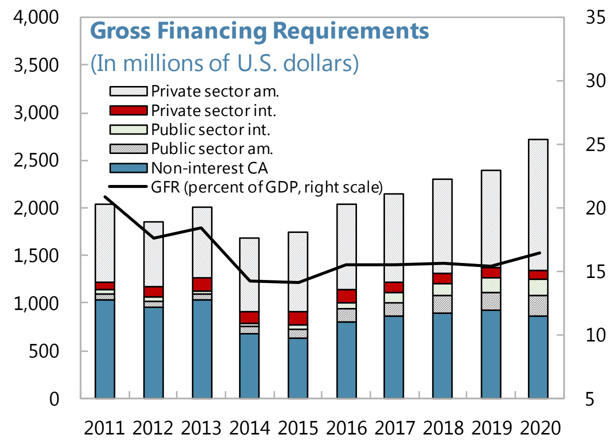
Optimal Level of Reserves
(months of current imports)



[2] This model takes into account shocks that are likely to result in an economic crisis (defined as a drop in domestic absorption). The shock variables (terms of trade, external demand, FDI to GDP, and aid to GDP) were set at the bottom 10 percent of Nicaragua's specific distribution over the 2009-14 period, and are intended to estimate Nicaragua's vulnerability to crisis events. Nicaragua's fundamentals (CPIA, fiscal balance, and imports to GDP), are set at 2014 levels to gauge the potential severity of a crisis event. The frequency of large natural disasters is set at 0.24, relying on the occurrence of these events over the last 50 years.

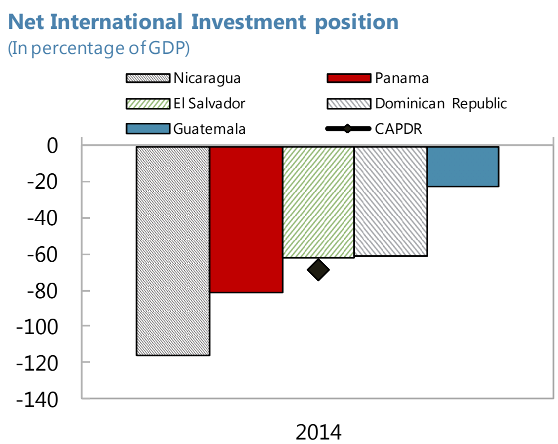
Gross Financing Requirements and International Investment Position

Gross financing needs are large. While the oil price fall contributed to reduce the current account deficit, the external gross financing requirements were 14.6 percent of GDP in 2014 and are projected to increase to 15.9 percent of GDP in 2015, owing mostly to high large debt service obligations of the private sector. In the medium term, gross financing requirements are projected to stabilize around 17 percent of GDP, reflecting high current account deficits and an increase in the amortizations on private sector external debt.

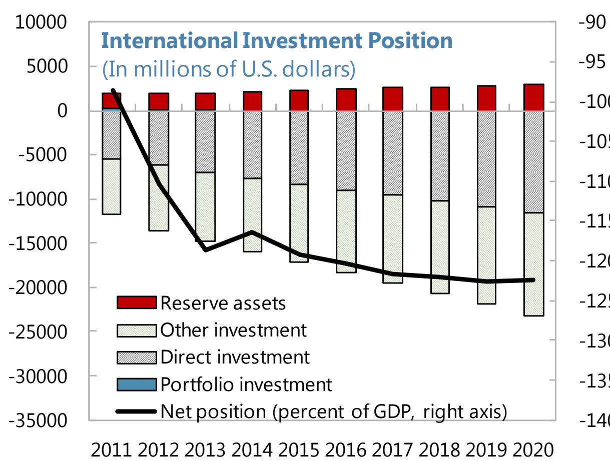


Sources: Central Bank of Nicaragua and Fund staff calculations and estimates.

The net international investment position (IIP) remains significantly negative. In 2014, the net IIP (-116 percent of GDP) was the lowest among Nicaragua's Central American peers (including Dominican Republic). After slightly improving in 2014 owing to the large accumulation of reserves, the net IIP is projected to worsen further to about -139 percent of GDP in the medium term. Large current account deficits are backed by a fast accumulation of private sector liabilities, mostly concentrated in foreign direct investment and other investment.



Sources: Central Bank of Nicaraguaand Fund Staff calculations and estimates.



Sources: Central Bank of Nicaragua and Fund staff calculations and estimates.

Appendix II. A Framework for Future Tax Reform[1]

Nicaragua has successfully undertaken a series of tax reforms that have had a positive impact on fiscal revenues. However, administrative difficulties led the authorities to rescind some of the most recent reforms. In charting the direction of future tax reform, the authorities need to tackle excessive tax incentives and exemptions especially under the income tax and value added tax (VAT), which in turn will improve the equity and efficiency of the tax system. The tax regime for small and medium enterprises also needs to be reformed, to promote formality and growth.

Nicaragua has undertaken a series of reforms to modernize its tax code. The 2009 Law 712 (*Ley de Equidad Fiscal* (LEF)) broadened the income tax base to include capital income and eliminated exemptions in excise taxes. A further package of reforms came into effect in 2013 (2012 Law 822, *Ley de Concertación Tributaria* (LCT)), which aimed to address structural deficiencies in the tax system. Both of these reforms appear to have had a positive impact on tax revenues, with revenue increasing more than two percent of GDP over 2010–12 following the introduction of the LEF, driven largely by corporate income tax (CIT) and VAT gains. Following the 2013 reform, revenue has increased by an estimated 1 percent of GDP over the 2013–15 period. However, key elements of the 2013 reform were put on hold by a law in December 2014 on account of administrative implementation difficulties. The reforms put on hold include the phase-out of business tax incentives and an extension of the VAT base to import services, as well as the planned reduction of the CIT rate from 30 to 25 percent.

Table 1. Central American Tax Revenue to GDP Ratios (2012)

Country	GDP per Capita (US$)	**Total Tax Revenue**	Personal Income Tax	Corporate Income Tax	Property taxes	VAT	Excises
Nicaragua	1,733	**15.0**	1.4	4.1	0.1	6.1	2.8
Costa Rica	9,753	**14.7**	1.4	2.0	0.4	4.9	2.8
El Salvador	3,788	**14.0**	2.9	2.3	0.1	7.1	0.9
Guatemala	3,326	**10.8**	0.4	2.3	0.1	5.3	0.8
Honduras	2,331	**14.5**	1.6	3.2	0.1	5.6	2.6
Panama	9,833	**12.5**	0.1	3.5	0.7	3.3	1.0
Central America	5,127	**13.6**	1.3	2.9	0.3	5.4	1.8
Latin America	7,357	**16.7**	1.5	3.1	0.9	6.8	1.9

Sources: IMF WEO and Revenue databases.

Relative to other Central American countries, Nicaragua raises a higher percentage of GDP in tax revenue despite having one of the lowest per capita incomes. The strong performance (Table 1), despite the large number of tax incentives and exemptions in its revenue code, appears

[1] Prepared by Thornton Matheson (Fiscal Affairs Department).

remarkable; however, given the importance of the informal economy, it could also be caused by an underestimation of GDP. On personal income tax, Nicaragua's top rate is high for the region, but it still has high income level thresholds.

In terms of tax efficiency, Nicaragua's corporate tax efficiency ratio is well above average for the region despite the large number of tax incentives (Table 2). This could be due to a relatively high share of corporate profits in GDP and/or to a high level of tax compliance by state-owned enterprises. By contrast, the consumption or "C-efficiency"[2] indicator for Nicaragua's VAT is more than 10 percentage points below the regional average. This suggests a narrower VAT base than other countries as a result of VAT exemptions and exonerations.

This analysis suggests that there is scope for improving the equity and efficiency of the tax system. In particular, the authorities need to address excessive tax incentives and exemptions under many different taxes, but especially under the income tax and VAT. Broadening the PIT base by reducing the minimum income threshold would help to develop revenues from tax, while broadening the VAT base by reducing exemptions for goods used by wealthier households and reinstating reverse-charging on import services, would improve progressivity and efficiency.

Table 2. Major Tax Parameters for Central America (2012)

Country	Top PIT Rate	Standard CIT Rate	CIT Efficiency Ratio	Standard VAT Rate	VAT Efficiency Ratio
Nicaragua	**30**	**30**	**13.5**	**15**	**48.7**
Costa Rica	25	30	6.7	13	58
El Salvador	30	30	7.7	13	58.9
Guatemala	7	31	7.4	12	51.5
Honduras	25	25	12.8	12	60
Panama	25	25	14	7	80.8
	Regional Unweighted Averages				
Central America	22.4	28.2	9.7	11.4	61.8
Latin America	27.3	26.6	10.7	14.4	70.5

Sources: IMF WEO and Revenue Databases.

There is also a need to revisit the regime for small and medium enterprises to encourage formality and growth. Thus, compliance should be kept simple and rates moderate, avoiding sharp increases in effective tax rates as business income increases.

Finally, the authorities need to consider reinstating many of the elements of the 2013 reform that were rescinded; in some cases, this will require modifying the original reform design. In particular, in considering tax incentives, the authorities should link tax relief to investment expenditure rather than to profits.

[2] C-efficiency measures the efficiency of the VAT collection and is defined as the ratio of VAT revenue to aggregate consumption divided by the standard VAT rate.

INTERNATIONAL MONETARY FUND

NICARAGUA

STAFF REPORT FOR THE 2015 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

December 11, 2015

Prepared By: The Western Hemisphere Department

CONTENTS

FUND RELATIONS 2

BANK-FUND COUNTRY LEVEL JOINT MANAGERIAL ACTION PLAN, 2015–16 7

RELATIONS WITH THE INTER-AMERICAN DEVELOPMENT BANK 10

STATISTICAL ISSUES 12

FUND RELATIONS

(As of October 31, 2015)

Membership Status: Joined: March 14, 1946; Article VIII

General Resources Account:	**SDR Million**	**%Quota**
Quota	130.00	100.00
Fund holdings of currency (Exchange Rate)	130.01	100.01
Reserve Tranche Position	0.00	0.00

SDR Department:	**SDR Million**	**%Allocation**
Net cumulative allocation	124.54	100.00
Holdings	103.51	83.11

Outstanding Purchases and Loans:	**SDR Million**	**%Quota**
ECF Arrangements	69.48	53.44

Latest Financial Arrangements:

Type	Date of Arrangement	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
ECF [1/]	Oct 05, 2007	Oct 31, 2011	78.00	78.00
ECF [1/]	Dec 13, 2002	Dec 12, 2006	97.50	97.50
ECF [1/]	Mar 18, 1998	Mar 17, 2002	148.96	115.32

[1/] Formerly PRGF.

Projected Payments to Fund [2/]
(SDR Million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2015	2016	2017	2018	2019
Principal	3.77	20.90	15.60	13.22	9.54
Charges/Interest	0.00	0.01	0.01	0.01	0.04
Total	3.77	20.91	15.61	13.23	9.58

[2/] When a member has overdue financial obligations outstanding for more than three months, the amount of such arrears will be shown in this section.

Implementation of HIPC Initiative:

I. Commitment of HIPC assistance	Enhanced Framework
Decision point date	Dec 2000
Assistance committed	
by all creditors (US$ Million) [1/]	3,308.00
Of which: IMF assistance (US$ million)	82.20
(SDR equivalent in millions)	63.54
Completion point date	Jan 2004
II. Disbursement of IMF assistance (SDR Million)	
Assistance disbursed to the member	63.54
Interim assistance	2.55
Completion point balance	60.99
Additional disbursement of interest income [2/]	7.62
Total disbursements	71.16

[1/] Assistance committed under the original framework is expressed in net present value (NPV) terms at the completion point, and assistance committed under the enhanced framework is expressed in NPV terms at the decision point. Hence these two amounts cannot be added.

[2/] Under the enhanced framework, an additional disbursement is made at the completion point corresponding to interest income earned on the amount committed at the decision point but not disbursed during the interim period.

Definitions:

Decision point - point at which the IMF and the World Bank determine whether a country qualifies for assistance under the HIPC Initiative and decide on the amount of assistance to be committed.

Interim assistance - amount disbursed to a country during the period between decision and completion points, up to 20 percent annually and 60 percent in total of the assistance committed at the decision point (or 25 percent and 75 percent, respectively, in exceptional circumstances).

Completion point - point at which a country receives the remaining balance of its assistance committed at the decision point, together with an additional disbursement of interest income as defined in footnote 2 above. The timing of the completion point is linked to the implementation of pre-agreed key structural reforms (i.e., floating completion point).

Implementation of Multilateral Debt Relief Initiative (MDRI):

I. MDRI-eligible debt (SDR Million)[1/]	140.48
Financed by: MDRI Trust	91.79
Remaining HIPC resources	48.70

II. Debt Relief by Facility (SDR Million)

	Eligible Debt		
Delivery Date	**GRA**	**PRGT**	**Total**
January 2006	N/A	140.48	140.48

[1/] The MDRI provides 100 percent debt relief to eligible member countries that qualified for the assistance. Grant assistance from the MDRI Trust and HIPC resources provide debt relief to cover the full stock of debt owed to the Fund as of end-2004 that remains outstanding at the time the member qualifies for such debt relief.

Implementation of Post-Catastrophe Debt Relief (PCDR): Not Applicable

Exchange Rate Arrangements:

In December 1995, the Monetary Board of the central bank approved the unification of the exchange rate system effective January 1, 1996. With the unification of the exchange rate, all previous exchange restrictions on payments and transfers for current international transactions and multiple currency practices were eliminated. The central bank buys/sells any amount of foreign currency from/to financial institutions at the official exchange rate, and implements a crawling peg system. Since December 2004, the monthly crawl has been set at an annual rate of 5 percent. As of November 30, 2015, the official exchange rate was C$27.8128 per U.S. dollar. Nicaragua has accepted the obligations of Article VIII, Sections 2, 3, and 4, and maintains an exchange system free of restrictions on the making of payments and transfers for current international transactions.

Article IV Consultation:

The previous consultation was completed by the Executive Board on December 4, 2013 (Country Report No. 13/377).

Safeguards Assessment:

An updated safeguards assessment of the Central Bank of Nicaragua (BCN), required in conjunction with the September 2008 augmentation of access under the PRGF arrangement, was completed in January 2009. The assessment noted continued progress at the BCN in the areas of International Financial Reporting Standards (IFRS) implementation and reserve management operations. Timely publication of the audited financial statements is in place in accordance with the Safeguards Policy. However, while the 2014 financial statements were audited and published on the BCN's website, the external audit opinion is qualified due to the uncertainty and valuation surrounding government debt. Further, implementation of IFRS remains outstanding. The Safeguards Policy requires strong financial reporting principles and practices that ensure transparency of the bank's financial statements.

FSAP Participation:

An FSAP update was completed in October 2009, and the Financial System Stability Assessment report for Nicaragua was issued on April 28, 2010.

Technical Assistance:

Nicaragua has received substantial technical assistance. The schedule below details assistance provided since 2013.

Dept.	Purpose	Time of Delivery
CAPTAC	Credit Risk Stress Testing	November 2015
CAPTAC	Developing Market Risk Analysis Methodologies	May-July 2015
CAPTAC	Strengthening the Monetary Policy Operational Framework	April 2015
CAPTAC	BOP and IIP Statistics	2013-2015
CAPTAC	National Account Statistics	2011-2015
CAPTAC	Simulation Exercise of Banking Resolution	2013
CAPTAC	Medium-Term Budgeting Framework	2010-2013
CAPTAC	Customs Administration	2012-2013
CAPTAC	Strengthening Analysis of Tax Expenditure and Evasion	2012-2013
CAPTAC	Tax Administration	2012-2013
FAD	Government Accounting and Fiscal Statistics	June-September 2015
FAD	Advancing Tax Reform to Promote Equity and Growth	December 2014
FAD	Reform of Electricity and Public Transportation Subsidies	April-September 2014
FAD	Public Financial Management	October 2013
FAD	Customs	September 2013
FAD	Public Financial Management	August 2013
FAD	Customs	July 2013
FAD	Public Financial Management	June 2013
FAD	Customs	April 2013
MCM	Debt Management and Domestic Market Development	July-November 2015
MCM	Risk-based Supervision	Sept. 2014-Feb 2015
MCM	Liquidity Stress Testing	July 2014
MCM	Dev. Sectoral and Macroeconomic Reports	October 2013
MCM	Debt Management Strategy	July 2013
MCM	Sovereign Bond Issuance	June 2013
MCM	Risk-based Supervision	June 2013
MCM	Bank Supervision and Regulations	April 2013

MCM	Monetary and Foreign Exchange Policy	January 2013
STA	Financial Soundness Indicators	April 2015
STA	Balance of Payments Statistics BPM6-IIP	June 2013
STA	Balance of Payments Statistics BPM6-Financial Account	March 2013
STA	Nat. Acc. Employment matrix	February 2013
STA	Producer Price Index	February 2013
STA	Export/Import Price Index	January 2013

Resident Representative:

Mr. Juan Zalduendo assumed the position of Resident Representative in Nicaragua in March 2013.

BANK-FUND COUNTRY LEVEL JOINT MANAGERIAL ACTION PLAN, 2015–16

Products	Mission timing	Expected delivery
A. Mutual information on relevant work programs		
The Fund work program		
Strategy: Since the last IMF-supported program ended in October 2011, the focus has shifted to a relationship based on bilateral surveillance and technical assistance, with close engagement with the authorities facilitated through the Resident Representative office. Technical assistance has been extensive, and has been focused on a range of different topics, including statistics, tax policy, subsidy reform, and financial market development. The last IMF staff visit was in March 2015 and the last Article IV mission took place in October 2015.		
Article IV	October 2015	Board discussion January 2016
LEG/MCM TA on deposit insurance	November 2015	FY2016
MCM TA (joint with World Bank) on strengthening the public debt office and developing the domestic debt market	Series of missions during 2015/16	
Staff Visit	April 2016	
The World Bank work program		
Strategy: The Bank's ongoing operations and analytical activities with Nicaragua are contemplated under the Country Assistance Strategy (CAS) 2013-2017 with a focus on social welfare through improvement of people's access to basic services and a heightened concern on issues of productivity, competitiveness, and export diversification. Additionally, the IFC's strategy focuses on fostering sustainable economic growth, critical infrastructure, and job creation, and helping Nicaragua take advantage of regional integration opportunities. The Bank will start working on the first Systemic Country Diagnosis (SCD), expected to be ready by December 2016. The SCD will identifies the most important challenges and opportunities at the country level, and will inform the partnership with Nicaragua as established in the new approach to country engagement—the Country Partnership Framework (CPF). The CPF will take the place of the CAS and guides the Bank Group's support to a member country.		

A. Lending A.1 Strengthening the Public Health Care System A.2 Caribbean Coast Food Security Project	TBD TBD	Approved in June 2015 Approved in February 2015
B. Technical assistance and analytical work B.1. Constraints and Opportunities Analysis: Transformation of the Agricultural Sector	TBD	Final delivery by September 2015
B.2. Regional Social Expenditure and Institutional Review	TBD	Final delivery by May 2016
B.3. Regional Enhancing Disaster Risk Management	TBD	Final delivery by June 2016
B.4. Regional Central America Energy Assessment	TBD	Final delivery by June 2018
B.5. Regional Trade Facilitation	TBD	Final delivery by April 2017
B.6. Regional PPP	TBD	Final delivery by June 2019
B.7. 2016 – 2021 Education Sector Strategy Preparation	TBD	Final delivery by June 2016
B.8. Central America Migration and Shared Prosperity	In progress	

The table below summarizes the financial relations between Nicaragua and the World Bank (in millions of US dollars).

Project Name	Total loan or grant	Undisbursed through FY15	Projected disbursements in FY16
Second support to the education sector	25.0	7.0	4.8
Education sector strategy support	51.9	27.1	16.3
Climate adaptation and water (GEF)	6.0	4.2	1.3
Caribbean coast food security	42.0	31.4	5.6
Public financial management modernization	25.0	24.0	8.8
Community and family health care services	21.0	10.8	6.5
Strengthening the public health care system	60.0	60.0	13.5
Social protection	19.5	6.5	3.3
Second land administration project	40.0	14.9	5.7
Rural roads infrastructure improvement project	57.0	44.2	21.3
Sustainable rural water supply and sanitation sector	30.0	28.5	6.4

RELATIONS WITH THE INTER-AMERICAN DEVELOPMENT BANK

(As of October 15, 2015)

1. **In November 2012, the IADB approved its country strategy for Nicaragua for the period 2012–2017.** It focused on the following sectors: (i) energy; (ii) transportation; (iii) health; and (iv) comprehensive early childhood development (ECD). The strategy pays particular attention to rural zones where poverty is concentrated, and where there is potential to develop value chains.

2. **As of October 15th 2015, the portfolio of approved sovereign-guaranteed loans under execution amounted to US$789.8 million, with an undisbursed balance of US$451.1 million.**

3. **The existing sovereign guaranteed portfolio focuses on:** (i) health, 29 percent; (ii) transport, 28 percent; (iii) energy, 14 percent; and (iv) trade, 12 percent. In the private sector, the IADB has two non-sovereign projects under execution amounting to US$42 million that contribute to the competitiveness of the country.

4. **The pipeline for IADB approvals in 2015 includes five operations in the public sector for US$275.7 million** distributed as follows: (i) two operations related to energy for US$105 million, focused on: (a) electrification in rural areas, and (b) a Policy-Based Loan to improve the institutional strengthening of the sector; (ii) one operation in the transport sector for US$90.7 million for the improvement of road infrastructure in rural areas; (iii) US$55 million to improve the infrastructure and systems for trade and border integration, and (iv) US$25 million to increase coverage of broad band connectivity. As of October 15th, three operations for US$120 million have been approved, and the rest of the pipeline will be approved in the last trimester of the year.

IADB Sovereign Guaranteed Loan Portfolio in Nicaragua
As of October 15th 2015 (In millions of US Dollars)

Sector	Current Approved	Available Amount
Transport	235.7	128.2
Health	196.2	131.2
Energy	128.0	62.8
Trade	55.0	55.0
Agriculture and Rural Development	40.0	31.7
Social Investment/ECD	35.0	10.8
Water and Sanitation	30.0	4.7
Urban Development and Housing*	20.0	0.0
Private Firms and SME Development	20.0	17.6
Modernization of the State	10.0	5.9

IADB Sovereign Guaranteed Loan Portfolio in Nicaragua (Concluded) As of October 15th 2015 (In millions of US Dollars)		
Environment and Natural Disasters	10.0	0.5
Sustainable Tourism	10.0	2.7
Total	**789.9**	**451.1**
*In process of closing		

IADB Non-sovereign Guaranteed Loan Portfolio in Nicaragua As of October 15th 2015 (In millions of US Dollars)		
Sector	**Current Approved**	**Available Amount**
Private Firms and SME Development	30.0	30.0
Agriculture and Rural Development	12.0	12.0
Total	**42.0**	**42.0**

IADB Disbursement of Sovereign Guaranteed Loan Portfolio in Nicaragua 2010–2014 (In millions of US Dollars)	
Year	**Amount**
2010	147.9
2011	154.8
2012	168.3
2013	154.7
2014	169.7

IADB Annual Net Flows with Sovereign Guarantee 2010–2014 (In millions of US Dollars)					
	2010	**2011**	**2012**	**2013**	**2014**
Repayments	-11.3	-13.0	-14.0	-15.2	-17.8
Disbursement	147.9	154.8	168.3	154.7	169.7
Net Loan Flow	**136.6**	**141.7**	**154.3**	**139.5**	**151.8**
Subscriptions and Contributions	-1.2	-4.7	-6.1	-6.1	-6.7
Net Capital Flow	**135.4**	**137.1**	**148.2**	**133.4**	**145.1**
Interest and Charges	-10.1	-12.3	-14.8	-18.7	-22.1
Net Cash Flow	**125.3**	**124.8**	**133.4**	**114.7**	**123.0**

STATISTICAL ISSUES

(As of November 30, 2015)

Assessment of Data Adequacy for Surveillance
General. Data provision is broadly adequate for surveillance but there are numerous data shortcomings in national accounts, fiscal, debt, and external sector statistics.
National Accounts. The Central Bank of Nicaragua (BCN) changed the base year of the annual national accounts (NA) to 2006 and is finishing the implementation of the complete set of integrated economic accounts by institutional sector in accordance with the recommendations of the System of National Accounts 1993 (1993 SNA) and the classifications and most relevant recommendations of the 2008 SNA for which source data are available. In March 2015, while releasing the 2014 NA data, the BCN revised earlier years, specifically the 2010–13 data. These revisions introduced a number of refinements (i.e., update of trade and producer price indexes, use of a new employment matrix, revised agricultural production, and, in particular, addressed discrepancies between NA and the balance of payments (BOP) trade data in the tax-free zones). However, these revisions led to some discontinuities in the supply and demand series of the GDP with earlier years, complicating the analysis of historical economic activity by sector and subcomponent. **Price and Labor Statistics**. The consumer price index (CPI) uses expenditure weights derived from a 2006/07 household expenditure survey. The CPI covers Managua and eight other cities and is published monthly. Expenditures (weights) and prices in rural areas are excluded. The producer price index (PPI) (July 2006=100) covers a sample of small and medium-size establishments, as well as goods for processing establishments in the *maquila* sector. There is also scope for expanding the coverage of the PPI to the service sector. Labor market statistics are scarce and unemployment figures are available irregularly during the year.
Government Finance Statistics (GFS). Institutional coverage is not in line with international standards, given that extra-budgetary institutions such as public universities and all 153 municipalities, with the exception of Managua, are not included in the accounts of the consolidated public sector. Recording of transactions is mostly on a cash basis but there are inconsistencies; for example, checks are recorded at the moment of issuance rather than when the check is cashed. The Ministry of Finance and Public Credit (MHCP) compiles fiscal statistics with a monthly frequency, and remits these to the BCN for publication on their website and for inclusion into the BCN's quarterly reports on public finances. Typically these statistics are published with about a 5-week lag. Separately the MHCP produces its own quarterly report on the execution of the budget. Annual financial statements of public enterprises are produced, but are not audited externally or published. Data on the budgetary central government and social security institute are reported for publication in the GFS Yearbook, although with a delay.

The monitoring of fiscal performance from the financing side needs significant improvement, and is complicated by some idiosyncrasies in classifying expenditure items in the budgetary central government. There is also a need to strengthen collaboration between the MHCP and the BCN to derive more accurate and timely estimates of external and domestic financing of the nonfinancial public sector, including with respect to the monitoring of domestic public debt in the nonfinancial public sector other than that of the budgetary central government.
Monetary and Financial Statistics. Monetary statistics are, in general, consistent with the *Monetary and Financial Statistics Manual (MFSM, 2000)*. Nicaragua publishes detailed daily, weekly, and monthly monetary data on its website, and remits monthly monetary data to STA on a timely basis. In 2015, with technical assistance from the Fund, the coverage of monetary statistics was enhanced to include insurance companies and microfinance institutions. However, sectorization is incomplete and data on the microfinance sector does not include the *Caja Rural Nacional* (Caruna)—the private cooperative handling until now the Venezuela oil collaboration. Moreover there are major differences between the data remitted to STA and the monetary data published on the BCN's website, which are not consistent with the *MFSM 2000*. The authorities are planning to report Financial Soundness Indicators (FSI) to STA on a regular basis (quarterly). However, the coverage of the FSI needs to be extended to include all deposit taking institutions.
External Sector Statistics. Since September 2013, the BOP statistics follow the concepts and definitions set out in the sixth edition of the *Balance of Payments Manual (BPM6),* within the limits set by the availability of information sources. Resident institutional units are defined in conformity with *BPM6*'s concepts of economic territory, residency, and center of economic interest. However, coverage of the private sector is incomplete for the current and financial accounts. The BCN is in the process of revising the transactions and positions of FDI and reinvested earnings from private financial and non-financial companies with the information available. However, these efforts are hampered by a low survey response ratio and the submission of inconsistent data by enterprises engaged in FDI. The central bank also needs to cross check enterprise-by-enterprise trade flows, FDI and external debt to assess any discrepancies between merchandise trade and financial associated flows. These efforts will help to address in part the large errors and omissions in the balance of payments which hinder the assessment of the external sustainability.
Data Dissemination and Quality. Nicaragua has participated in the General Data Dissemination System (GDDS) since February 2005. Data ROSC was published in December 2005.

Nicaragua: Table of Common Indicators Required for Surveillance

(As of November 30, 2015)

	Date of latest observation	Date received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of Publication[7]	Memo Items: Data Quality – Methodological soundness[8]	Memo Items: Data Quality – Accuracy and reliability[9]
Exchange Rates	10/31/2015	11/20/2015	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	10/31/2015	11/20/2015	D	D	D		
Reserve/Base Money	08/31/2015	09/21/2015	D	D	D	O, LO, LO, LO	LO, O, LO, LO, LO
Broad Money	08/31/2015	11/03/2015	D	D	D		
Central Bank Balance Sheet	09/30/2015	11/03/2015	M	M	M		
Consolidated Balance Sheet of the Banking System	08/31/2015	11/03/2015	M	M	M		
Interest Rates[2]	10/22/2015	10/22/2015	D	D	D		
Consumer Price Index	Oct. 2015	11/17/2015	M	M	M	O, LO, LO, LO	LO, LO, LO, O, LO
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	Sept. 2015	11/17/2015	M	M	M	LO, LNO, LNO, LO	O, O, O, O, LO
Revenue, Expenditure, Balance and Composition of Financing[3] – Central Government	Sept. 2015	11/17/2015	M	M	M		
Stocks of Central Government and Central Government-Guaranteed Debt[5]	Q3 2015	11/20/2015	Q	Q	Q		
External Current Account Balance	Q2 2015	9/22/2015	Q	Q	Q	LO, LO, LO, LNO	LO,LO, LO, LO, LNO

Nicaragua: Table of Common Indicators Required for Surveillance (Concluded)

(As of November 30, 2015)

Exports and Imports of Goods and Services	Q2 2015	9/22/2015	Q	Q	Q	LO, LO, LO, LNO	LO,LO, LO, LO, LNO
GDP/GNP	Q2 2015	11/17/2015	Q	Q	Q	O, O, O, LO	LO, O, LO, O, LNO
Gross External Debt	Q3 2015	10/22/2015	M	M	M		
International Investment Position[6]	Q2 2015	9/22/2015	Q	Q	Q		

[1] Any reserve assets that are pledged or otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.

[2] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.

[3] Foreign banks, domestic banks, and domestic nonbank financing.

[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.

[5] Including currency and maturity composition.

[6] Includes external gross financial asset and liability positions vis-à-vis nonresidents.

[7] Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A), Irregular (I); Not Available (NA).

[8] Reflects the assessment provided in the data ROSC published on December 8, 2005, and based on the findings of the mission that took place during January 11-26, 2005 for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O), largely observed (LO), largely not observed (LNO), or not observed (NO).

[9] Same as footnote 8, except referring to international standards concerning source data, assessment and validation of source data, statistical techniques, assessment and validation of intermediate data and statistical outputs, and revision studies.

INTERNATIONAL MONETARY FUND

NICARAGUA

December 14, 2015

STAFF REPORT FOR THE 2015 ARTICLE IV CONSULTATION—DEBT SUSTAINABILITY ANALYSIS UPDATE

Approved By
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Prepared by the staffs of the International Monetary Fund and the International Development Association

Risk of external debt distress:	Moderate
Augmented by significant risks stemming from domestic public and private external debt	Yes

This debt sustainability analysis (DSA) updates the full DSA that was conducted in November 2013. Staff concludes that Nicaragua remains at moderate risk of debt distress, based on an assessment of public external debt, and that it faces a heightened overall risk of debt distress. On external debt, a customized contingent liability scenario and two of the standardized stress scenarios breach the threshold. Further, while lower oil prices have reduced the risk of debt distress, the magnitude of private external debt elevates Nicaragua's risk, as do questions about the continuation of external financing from Venezuela. On public debt, while macroeconomic management has been prudent, the fiscal position has become more expansionary and is expected to remain so over the medium term, worsening public debt dynamics. In addition, the outlook for the social security institute (INSS) has deteriorated and unless additional reforms are undertaken, this could pose a significant fiscal burden in the long term.[1]

[1] Based on its 2015 Country Policy and Institutional Assessment (CPIA) score of 3.73, Nicaragua remains classified as a medium performer.

A. Underlying Assumptions

1. **The key assumptions of this DSA are broadly in line with those of the 2013 DSA and in particular, growth is assumed to stabilize at its medium-term potential level of 4 percent.** As in the past, this analysis considers the consolidated public sector, which includes debt of the budgetary central government, decentralized entities, social security institute (INSS), the municipality of Managua, state-owned enterprises (SOEs), and the central bank.[1] This DSA also assumes (both in the historical and projection periods) that relief has been obtained on HIPC terms for all eligible debt where negotiations are still pending.[2]

However, differences are most notable in the following areas:

- **Official statistics:** Revisions to the national accounts and balance of payments data have resulted in lower projections for the current account deficit. On average, the current account deficit was revised down by 1.2 percent of GDP over the period 2010–14. Moreover, staff estimates of historical public debt stocks have been revised to consolidate intra-government debt and to include an estimation of the domestic debt stock of SOEs.

- **Current account:** Compared to the 2013 DSA, exports of goods and services are lower, owing to a substantial downward revision of many traditional export prices as well as lower estimated import volumes of Nicaragua's trading partners. Also, since the 2013 DSA oil price projections have been revised downwards, including over the medium to long term, and this has lowered import projections. The net effect has been a reduction in projected current account deficits. Future loan disbursements linked to the oil collaboration with Venezuela, which are recorded as private external debt, are also affected by the revised oil price assumptions.

- **External financing:** Assumptions about the availability and terms of new external financing from multilateral sources have changed, with a higher average real interest rate projected in the long term. In July 2015, Nicaragua was reclassified from an IDA-only to an IDA-gap country, which means that it is no longer subject to IDA's non-concessional borrowing policy and that the IDA terms are less concessional. Also, access to resources from Nicaragua's largest creditor, the Inter-American Development Bank, changed in 2015 from a 50–50 ratio of concessional resources to non-concessional resources to a 40–60 ratio. The trend of a declining grant element in new loans is expected to continue over the medium to long term. On the positive side, these developments should also increase the availability of external financing from official sources. External financing from concessional multilateral and bilateral sources is therefore assumed

[1] In spite of the comprehensive institutional coverage of the public sector, Nicaragua's debt statistics do not cover all domestic debt of state-owned enterprises. In particular, the public debt statistics used in this report differ slightly from the authorities' published numbers due to adjustments by staff to consolidate intra-government debt and to estimate the domestic debt stock of SOEs.

[2] At end-June 2015, outstanding debt subject to relief stood at US$1 billion, most of this on the books of the central bank. Since the 2013 DSA, additional debt relief has been obtained amounting to US$500 million. This DSA shows debt net of pending relief, including for the historical period.

constant at 3.5 percent of GDP from 2020 through 2035, with residual financing needs being met through domestic bond issuance.[3]

- **Fiscal policy:** Fiscal policy has become more expansionary since the 2013 DSA, and the fiscal anchor has shifted from the goal of a gradual declining debt-to-GDP ratio to maintaining an overall deficit of the consolidated public sector at about 2.5 percent of GDP. Over the medium term, fiscal policy is assumed to remain in line with current trends. This results in a higher primary deficit than what was assumed in the 2013 DSA (1.4 percent of GDP versus 0.3 percent in the 2015–20). In addition, the reserve fund of the INSS is projected to be depleted by 2024, following which it is assumed that the central government will transfer resources to INSS to help finance its deficit. This does not affect the CPS primary balance, as the transfers are between two government entities and thus consolidated out. Nevertheless, as the INSS fund is exhausted, these deficits will impact debt dynamics because the central government is required to issue bonds to finance transfers to INSS. The scenario assumes that the bonds are issued domestically, a more expensive source of financing. Securing the INSS's financial sustainability is therefore a key long-term challenge that needs to be tackled.

Key Macroeconomic Assumptions Underlying the DSA for the Baseline Scenario

	Current DSA		2013 DSA		Historical averages
	2015-2020	2021-2035	2013-2018	2019-2033	2005-2014
Real GDP growth (in percent)	4.0	4.0	4.0	4.0	3.8
GDP deflator in US$ terms (in percent)	1.3	2.1	2.1	1.5	3.6
Non-interest current account (in percent of GDP)	-6.8	-6.9	-9.1	-7.1	-8.2
FDI (in percent of GDP)	6.0	5.8	6.0	6.0	6.0
Primary balance (in percent of GDP)	-1.4	-1.4	-0.3	-0.1	0.3
Revenue and grants (in percent of GDP)	29.4	30.3	27.6	27.8	26.0
Primary expenditure (in percent of GDP)	30.8	31.7	27.9	27.7	25.7
Average real interest rate on public debt (percent)	1.3	2.3	1.1	0.9	0.5

B. External Debt Sustainability

2. **External debt as a ratio of GDP is expected to decline marginally over the projection period from 79 percent at end-2014 to 76 percent in 2035.** Private external debt-to-GDP is likely to continue to increase until the mid-2020s, but at a more gradual pace than has been observed ever since the Venezuela oil collaboration began in 2007; current projections for oil prices in effect imply that Venezuela inflows will be lower than anticipated at the time of the 2013 DSA.

3. **Under the baseline scenario, external public debt increases slightly from 33 percent at end-2014 to 36 percent in 2035.**[4] The present value of external public debt is projected to remain

[3] A joint Bank-Fund technical assistance project, in collaboration with CEMLA, is currently underway to assist the authorities in upgrading their debt management practices and developing the domestic debt market.

well below all the relevant thresholds in the baseline scenario. The historical scenario, which notably assumes a higher current account deficit than in the baseline (8.2 percent, based on the average non-interest current account balance over the past 10 years) results in a breach in the outer years. A change in the terms of external financing is also projected to result in a significant (and permanent) increase in the PPG external debt stock. Given that financing from official sources is typically at fixed interest rates, the risk of such a shock is low; nevertheless, this highlights the need for caution in considering external borrowing at market rates.[5]

4. **The rapid increase in private external debt, which includes the debt arising as a result of the oil collaboration with Venezuela, requires continuous monitoring.** While the government has stressed that it is their policy not to extend public guarantees on this debt, this DSA (as was the case in the 2013 DSA) includes a scenario whereby the government of Nicaragua absorbs about 60 percent of private external debt[6] onto its balance sheet. This results in a breach of the PV of PPG external debt-to-GDP+remittances threshold of 36 percent, with the ratio increasing to 38 percent in 2016 (compared to 23 percent in the baseline).[7] While the nominal amount of the additional debt is large (about US$3.2 billion or 25½ percent of GDP), the concessional terms in the debt with Venezuela imply less of an impact in present value terms.

C. Public Debt

5. **Public debt-to-GDP has decreased slightly since the 2013 DSA, standing at 40.8 percent at end-2014.** Under the baseline scenario, public debt-to-GDP is projected to stabilize at around 41 percent by 2020, or 30 percent in present value terms, comfortably below the 56 percent benchmark. However, in the absence of further policy actions to enhance INSS's sustainability, the INSS fund is projected to be fully depleted by 2024.[8] If this materializes, the central government will need to transfer resources to INSS to help cover its obligations, as reflected in the baseline of this DSA update report (from 32 percent of GDP in PV terms in 2015 to 48 percent in 2035). Of all the standardized stress scenarios, a shock to real GDP growth in 2016–17—where growth falls to 1.3 percent in these two years—will result in the least favorable outcome for all indicators. The unchanged primary balance scenario is also worth noting as it highlights the need for

[4] As in the 2013 DSA, remittances are included in denominator of the baseline and standardized stress scenarios. Over the past 3 years, remittances have averaged 10 percent of GDP and 22 percent of exports of goods and services, which is on the borderline of the Fund's thresholds for taking them in to account in the DSA. However, excluding remittances has little impact on this assessment.

[5] The DSA considers, among other shocks, a scenario where key variables are set at 10-year historical averages, and a two percentage point increase in the interest rate over the period of the analysis

[6] This private debt includes the obligations of ALBANISA and CARUNA; the former is a limited liability entity jointly owned by PDVSA and PETRONIC and the latter is a private financial cooperative. The authorities have informed staff that the credit risk on the oil collaboration debt is borne exclusively by PDVSA.

[7] It is assumed that the same concessional terms would apply to this new debt (specifically, 2 percent interest rate, 2 years grace period, 25 year maturity and a 5 percent discount rate), and that the government will not absorb any additional debt generated from future oil imports.

[8] This assessment is sensitive to assumptions about future growth in coverage, real wages, and healthcare costs.

fiscal consolidation—if the fiscal policy stance of 2015 is maintained over the long term, public debt will come close to breaching the benchmark in 2035.

6. **The contingent liability scenario described above in the external DSA is also applied to the public DSA.** The PV of public debt to GDP would increase to 50 percent of GDP in 2016 compared to 32 percent in the baseline scenario. This scenario would eventually exceed the benchmark over the longer term. Not considered in this DSA update is the risk that a deterioration in the financial conditions or levels of the Venezuela oil cooperation could lead to certain projects currently financed by CARUNA being absorbed by the budget. Staff estimates that these projects could amount to about 1 percent of GDP. This risk is one of the factors motivating staff's recommendation to build fiscal buffers beginning in 2017 and also contributes to the staff's assessment that Nicaragua is at a heightened risk of overall debt distress.

D. Conclusion

7. **The staff considers that Nicaragua remains at a moderate risk of external debt distress**. The concessional nature of most of the government's external borrowing and their track record of relatively prudent macroeconomic management results in a manageable baseline scenario. However, the customized scenario and two of the standardized stress scenarios breach the external PPG debt threshold in present value terms. Staff also considers Nicaragua to be at a heightened risk of overall debt distress, given the magnitude of private external debt, the quasi-fiscal nature of some of this debt, and the likelihood that some projects currently financed by Venezuela resources might end up being absorbed by the budget. Moreover, public debt dynamics have worsened since the previous DSA due to a more expansionary fiscal policy, and debt could become unsustainable in the event that no additional action is taken to improve the INSS finances.

8. **The authorities broadly concurred with the findings of the analysis, but noted some important differences with their own debt sustainability analysis.** First, the authorities' growth assumptions are more positive, with an average of 4.7 percent over the 2015–19 period and 5 percent thereafter, consistent with their expectation that stepped-up investment in infrastructure will shift the growth path. Second, the authorities' fiscal balance projections are more optimistic than staff's, owing in particular to higher revenue assumptions. Finally, while the authorities acknowledge that INSS will need reform to ensure its long-term sustainability, they do not include any central government transfers to INSS in their analysis, assuming that additional reforms will be undertaken before any such transfers are required. The authorities reiterated that the debt owed by ALBANISA and CARUNA to PDVSA is private and staff welcomes that the government's policy is neither to absorb nor to extend public guarantees on this debt. They also highlighted the significant progress made on achieving debt relief from non-Paris Club creditors during 2014 and 2015.

Table 1. Nicaragua: External Debt Sustainability Framework, Baseline Scenario, 2012–35 1/

(Percent of GDP unless otherwise indicated)

	Actual			Historical [6/] Average	Standard [6/] Deviation	Projections									
	2012	2013	2014			2015	2016	2017	2018	2019	2020	2015-2020 Average	2025	2035	2021-2035 Average
External debt (nominal) 1/	**77.6**	**81.8**	**78.6**			**82.0**	**83.3**	**84.8**	**86.3**	**87.4**	**88.3**		**88.3**	**76.0**	
of which: public and publicly guaranteed (PPG)	32.8	33.6	32.5			34.0	34.5	35.1	35.8	36.2	36.3		36.9	36.2	
Change in external debt	4.3	4.2	-3.1			3.3	1.3	1.5	1.5	1.1	0.8		-0.5	-1.5	
Identified net debt-creating flows	-1.1	1.8	-5.9			-1.5	-1.3	-0.7	-0.7	-0.6	-0.7		-0.7	-0.4	
Non-interest current account deficit	**9.1**	**9.5**	**5.5**	**8.2**	**1.9**	**6.2**	**6.6**	**7.1**	**7.0**	**6.8**	**6.9**	6.8	**6.9**	**6.9**	6.9
Deficit in balance of goods and services	20.1	20.8	16.7			17.4	17.5	17.8	17.6	17.4	17.2		17.2	17.2	
Exports	45.3	42.5	42.4			40.0	38.7	38.1	37.8	37.2	36.5		36.5	36.5	
Imports	65.4	63.3	59.2			57.4	56.2	55.9	55.5	54.7	53.8		53.8	53.8	
Net current transfers (negative = inflow)	-12.5	-12.6	-12.2	-13.3	0.8	-12.3	-12.2	-12.0	-11.9	-11.7	-11.5		-11.5	-11.5	-11.5
of which: official	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Other current account flows (negative = net inflow)	1.5	1.3	1.0			1.2	1.3	1.3	1.2	1.1	1.2		1.2	1.2	
Net FDI (negative = inflow)	**-6.8**	**-6.5**	**-6.4**	**-6.0**	**1.7**	**-6.4**	**-6.2**	**-6.1**	**-5.9**	**-5.7**	**-5.8**	-6.0	**-5.8**	**-5.8**	-5.8
Endogenous debt dynamics 2/	**-3.4**	**-1.2**	**-5.0**			**-1.2**	**-1.7**	**-1.6**	**-1.8**	**-1.7**	**-1.7**		**-1.8**	**-1.4**	
Contribution from nominal interest rate	1.6	1.6	1.6			1.8	1.6	1.5	1.4	1.6	1.6		1.5	1.5	
Contribution from real GDP growth	-3.5	-3.4	-3.5			-3.1	-3.3	-3.1	-3.2	-3.2	-3.3		-3.3	-2.9	
Contribution from price and exchange rate changes	-1.4	0.6	-3.1			...	...	...	...	...	...		...	...	
Residual (3-4) 3/	**5.4**	**2.5**	**2.8**			**4.8**	**2.6**	**2.2**	**2.2**	**1.7**	**1.5**		**0.2**	**-1.1**	
of which: exceptional financing	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	...	
PV of external debt 4/	...	...	68.3			71.5	73.0	74.4	75.8	76.6	77.2		76.5	67.0	
In percent of exports	...	...	160.9			178.9	188.7	195.4	200.3	205.9	211.2		209.4	183.5	
PV of PPG external debt	**...**	**...**	**22.2**			**23.6**	**24.1**	**24.7**	**25.3**	**25.4**	**25.2**		**25.1**	**27.2**	
In percent of exports	**...**	**...**	**52.3**			**59.0**	**62.4**	**64.9**	**66.9**	**68.1**	**69.0**		**68.7**	**74.5**	
In percent of government revenues	**...**	**...**	**86.0**			**85.5**	**85.9**	**87.6**	**88.9**	**88.7**	**87.7**		**86.2**	**92.2**	
Debt service-to-exports ratio (in percent)	**13.0**	**13.5**	**14.4**			**16.6**	**17.4**	**17.9**	**18.2**	**19.2**	**19.6**		**20.1**	**18.1**	
PPG debt service-to-exports ratio (in percent)	**2.1**	**2.1**	**2.4**			**3.5**	**4.2**	**4.6**	**5.0**	**5.7**	**5.9**		**6.5**	**7.7**	
PPG debt service-to-revenue ratio (in percent)	**3.7**	**3.4**	**4.0**			**5.1**	**5.8**	**6.3**	**6.7**	**7.4**	**7.5**		**8.1**	**9.6**	
Total gross financing need (Millions of U.S. dollars)	1324	1559	1163			1332	1562	1707	1841	1977	2108		2679	3876	
Non-interest current account deficit that stabilizes debt ratio	4.8	5.3	8.6			2.9	5.3	5.5	5.5	5.7	6.0		7.4	8.4	
Key macroeconomic assumptions															
Real GDP growth (in percent)	5.1	4.5	4.7	3.8	2.5	4.0	4.2	4.0	4.0	4.0	4.0	4.0	4.0	4.0	4.0
GDP deflator in US dollar terms (change in percent)	2.0	-0.7	3.9	3.6	3.1	-1.4	1.1	1.8	2.1	2.3	2.3	1.3	2.1	2.1	2.1
Effective interest rate (percent) 5/	2.3	2.1	2.2	2.1	0.2	2.4	2.1	1.9	1.8	2.0	1.9	2.0	1.8	2.1	1.9
Growth of exports of G&S (US dollar terms, in percent)	13.6	-2.5	8.5	15.8	13.5	-3.4	1.9	4.2	5.5	4.6	4.4	2.9	6.1	6.1	6.1
Growth of imports of G&S (US dollar terms, in percent)	8.4	0.5	1.6	11.9	13.5	-0.6	3.3	5.3	5.3	4.8	4.6	3.8	6.1	6.1	6.1
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	30.8	30.4	31.2	28.4	32.3	34.2	31.2	22.9	3.0	17.1
Government revenues (excluding grants, in percent of GDP)	25.6	25.9	25.8			27.6	28.1	28.2	28.5	28.6	28.7		29.1	29.5	29.3
Aid flows (in Millions of US dollars) 7/	216	180	132			286	322	336	315	345	371		406	395	
of which: Grants	216	180	132			148	160	145	135	150	161		217	395	
of which: Concessional loans	...	...	...			138	162	191	180	196	209		189	0	
Grant-equivalent financing (in percent of GDP) 8/	...	...	...			2.2	2.2	2.2	2.0	2.2	2.2		1.8	1.1	1.6
Grant-equivalent financing (in percent of external financing) 8/	...	...	...			50.6	50.2	46.9	42.6	46.6	48.9		40.1	24.7	35.6
Memorandum items:															
Nominal GDP (Millions of US dollars)	10460	10851	11806			12102	12754	13497	14327	15238	16207		21842	39672	
Nominal dollar GDP growth	7.2	3.7	8.8			2.5	5.4	5.8	6.1	6.4	6.4	5.4	6.1	6.1	6.1
PV of PPG external debt (in Millions of US dollars)			2557			2786	3003	3254	3538	3772	3987		5346	10537	
(PVt-PVt-1)/GDPt-1 (in percent)						1.9	1.8	2.0	2.1	1.6	1.4	1.8	1.6	1.9	1.7
Gross workers' remittances (Millions of US dollars)	1014	1078	1136			1174	1221	1274	1332	1390	1447		1950	3542	
PV of PPG external debt (in percent of GDP + remittances)	...	...	20.2			21.5	22.0	22.6	23.2	23.2	23.1		23.0	25.0	
PV of PPG external debt (in percent of exports + remittances)	...	...	42.6			47.5	50.0	52.0	53.7	54.7	55.4		55.2	59.9	
Debt service of PPG external debt (in percent of exports + remittanc	...	...	2.0			2.8	3.4	3.7	4.0	4.6	4.7		5.2	6.2	

Sources: Country authorities; and staff estimates and projections.

1/ Includes both public and private sector external debt.

2/ Derived as [r - g - ρ(1+g)]/(1+g+ρ+gρ) times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, and ρ = growth rate of GDP deflator in U.S. dollar terms.

3/ Includes exceptional financing (i.e., changes in arrears and debt relief); changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate changes.

4/ Assumes that PV of private sector debt is equivalent to its face value.

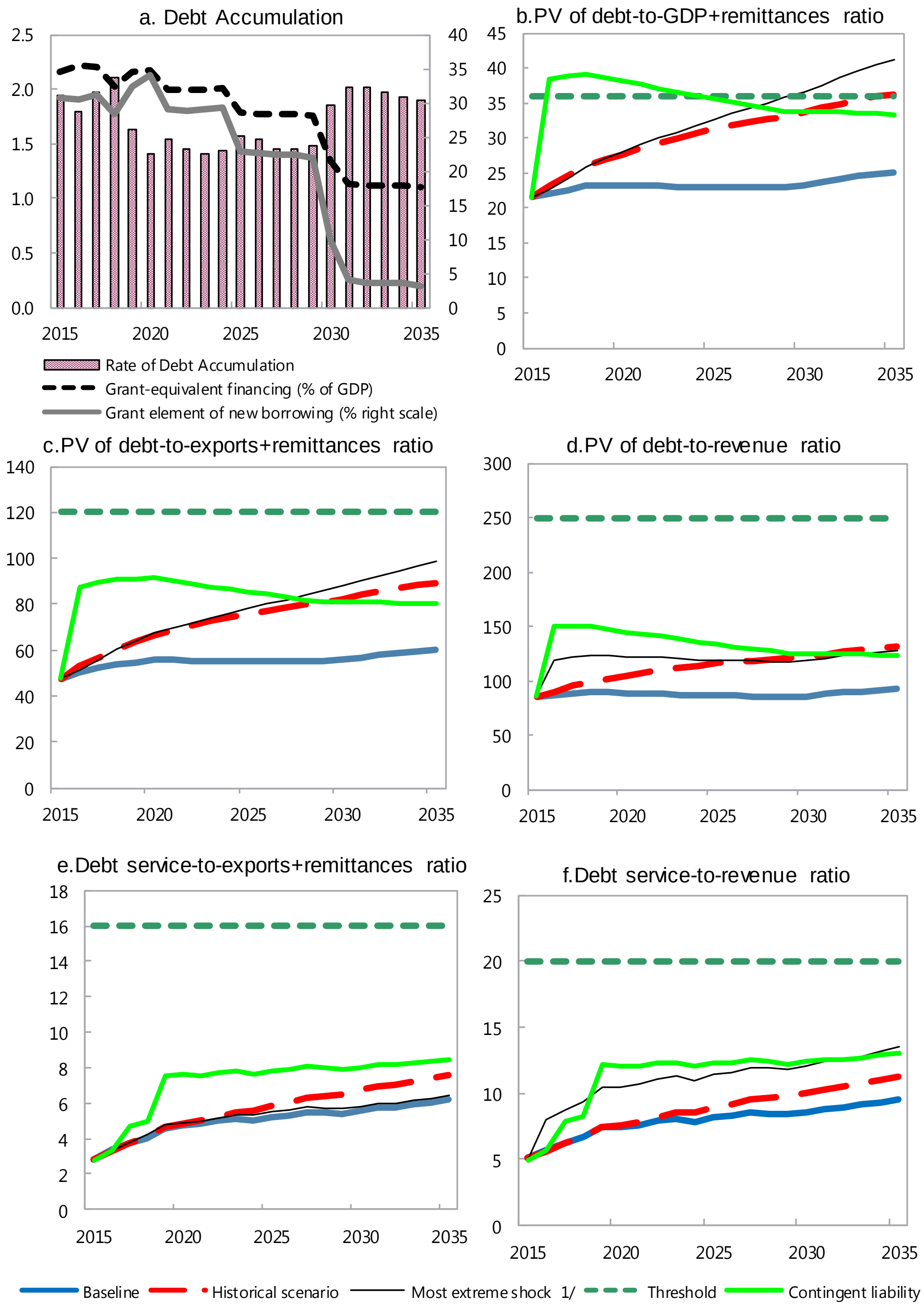
5/ Current-year interest payments divided by previous period debt stock.

6/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

7/ Defined as grants, concessional loans, and debt relief.

8/ Grant-equivalent financing includes grants provided directly to the government and through new borrowing (difference between the face value and the PV of new debt).

Figure 1. Nicaragua: Indicators of Public and Publicly Guaranteed External Debt Under Alternative Scenarios, 2015–35 1/



Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio on or before 2025. In figure b. it corresponds to a Terms shock; in c. to a Terms shock; in d. to a One-time depreciation shock; in e. to a Non-debt flows shock and in figure f. to a One-time depreciation shock

Table 2. Nicaragua: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2015–35

(In percent)

	Projections							
	2015	2016	2017	2018	2019	2020	**2025**	2035
PV of debt-to-GDP+remittances ratio								
Baseline	22	22	23	23	23	23	**23**	25
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2015-2035 1/	22	23	24	26	27	28	**31**	36
A2. New public sector loans on less favorable terms in 2015-2035 2	22	23	24	26	27	28	**33**	41
A3. Contingent liability scenario	22	38	39	39	39	38	**36**	33
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2016-2017	22	22	23	24	24	24	**24**	25
B2. Export value growth at historical average minus one standard deviation in 2016-2017 3/	22	21	22	23	23	23	**23**	24
B3. US dollar GDP deflator at historical average minus one standard deviation in 2016-2017	22	22	22	23	23	23	**23**	25
B4. Net non-debt creating flows at historical average minus one standard deviation in 2016-2017 4/	22	23	24	25	25	25	**24**	25
B5. Combination of B1-B4 using one-half standard deviation shocks	22	20	17	18	18	18	**19**	23
B6. One-time 30 percent nominal depreciation relative to the baseline in 2016 5/	22	29	30	31	31	31	**31**	33
PV of debt-to-exports+remittances ratio								
Baseline	47	50	52	54	55	55	**55**	60
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2015-2035 1/	47	53	57	60	64	67	**76**	89
A2. New public sector loans on less favorable terms in 2015-2035 2	47	51	56	60	64	67	**78**	99
A3. Contingent liability scenario	47	87	89	91	91	91	**85**	80
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2016-2017	47	49	51	52	53	54	**54**	58
B2. Export value growth at historical average minus one standard deviation in 2016-2017 3/	47	48	52	54	55	55	**55**	59
B3. US dollar GDP deflator at historical average minus one standard deviation in 2016-2017	47	49	51	52	53	54	**54**	58
B4. Net non-debt creating flows at historical average minus one standard deviation in 2016-2017 4/	47	51	56	58	59	59	**58**	60
B5. Combination of B1-B4 using one-half standard deviation shocks	47	42	35	37	38	39	**40**	48
B6. One-time 30 percent nominal depreciation relative to the baseline in 2016 5/	47	49	51	52	53	54	**54**	58
PV of debt-to-revenue ratio								
Baseline	85	86	88	89	89	88	**86**	92
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2015-2035 1/	85	90	95	99	102	104	**116**	131
A2. New public sector loans on less favorable terms in 2015-2035 2	85	88	94	100	103	106	**122**	152
A3. Contingent liability scenario	85	150	150	150	148	144	**133**	123
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2016-2017	85	86	90	92	91	90	**89**	94
B2. Export value growth at historical average minus one standard deviation in 2016-2017 3/	85	83	87	88	87	86	**85**	90
B3. US dollar GDP deflator at historical average minus one standard deviation in 2016-2017	85	84	87	88	88	87	**85**	91
B4. Net non-debt creating flows at historical average minus one standard deviation in 2016-2017 4/	85	89	95	95	95	94	**91**	93
B5. Combination of B1-B4 using one-half standard deviation shocks	85	77	67	69	69	69	**70**	84
B6. One-time 30 percent nominal depreciation relative to the baseline in 2016 5/	85	119	121	123	123	121	**119**	127

Table 2. Nicaragua: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2015–35 (Concluded)

				Debt service-to-exports+remittances ratio				
Baseline	3	3	4	4	5	5	**5**	6
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2015-2035 1/	3	3	4	4	5	5	**6**	8
A2. New public sector loans on less favorable terms in 2015-2035 2	3	3	3	3	4	4	**5**	9
A3. Contingent liability scenario	3	3	5	5	8	8	**8**	8
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2016-2017	3	3	4	4	5	5	**5**	6
B2. Export value growth at historical average minus one standard deviation in 2016-2017 3/	3	3	4	4	5	5	**5**	6
B3. US dollar GDP deflator at historical average minus one standard deviation in 2016-2017	3	3	4	4	5	5	**5**	6
B4. Net non-debt creating flows at historical average minus one standard deviation in 2016-2017 4/	3	3	4	4	5	5	**6**	6
B5. Combination of B1-B4 using one-half standard deviation shocks	3	3	3	3	4	4	**4**	5
B6. One-time 30 percent nominal depreciation relative to the baseline in 2016 5/	3	3	4	4	5	5	**5**	6
				Debt service-to-revenue ratio				
Baseline	5	6	6	7	7	7	**8**	10
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2015-2035 1/	5	6	6	7	7	8	**9**	11
A2. New public sector loans on less favorable terms in 2015-2035 2	5	6	5	6	7	7	**8**	15
A3. Contingent liability scenario	5	6	8	8	12	12	**12**	13
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2016-2017	5	6	7	7	8	8	**8**	10
B2. Export value growth at historical average minus one standard deviation in 2016-2017 3/	5	6	6	7	7	7	**8**	10
B3. US dollar GDP deflator at historical average minus one standard deviation in 2016-2017	5	6	6	7	7	7	**8**	10
B4. Net non-debt creating flows at historical average minus one standard deviation in 2016-2017 4/	5	6	6	7	8	8	**9**	10
B5. Combination of B1-B4 using one-half standard deviation shocks	5	6	6	6	7	7	**7**	9
B6. One-time 30 percent nominal depreciation relative to the baseline in 2016 5/	5	8	9	9	10	10	**11**	13
Memorandum item:								
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	13	13	13	13	13	13	**13**	13

Sources: Country authorities; and staff estimates and projections.

1/ Variables include real GDP growth, growth of GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.
2/ Assumes that the interest rate on new borrowing is by 2 percentage points higher than in the baseline., while grace and maturity periods are the same as in the baseline.
3/ Exports values are assumed to remain permanently at the lower level, but the current account as a share of GDP is assumed to return to its baseline level after the shock (implicitly assumin an offsetting adjustment in import levels).
4/ Includes official and private transfers and FDI.
5/ Depreciation is defined as percentage decline in dollar/local currency rate, such that it never exceeds 100 percent.
6/ Applies to all stress scenarios except for A2 (less favorable financing) in which the terms on all new financing are as specified in footnote 2.

Table 3. Nicaragua: Public Sector Debt Sustainability Framework, Baseline Scenario, 2012–35

(Percent of GDP, unless otherwise indicated)

	Actual					Estimate	Projections								
	2012	2013	2014	Average [5/]	Standard Deviation [5/]	2015	2016	2017	2018	2019	2020	2015-20 Average	2025	2035	2021-35 Average
Public sector debt 1/	41.9	43.0	40.8			42.6	41.9	41.8	41.5	41.0	40.8		42.6	56.7	
of which: foreign-currency denominated	40.2	41.4	39.5			41.4	40.8	40.8	40.7	40.3	40.2		42.4	56.8	
Change in public sector debt	-1.3	1.1	-2.2			1.8	-0.8	-0.1	-0.2	-0.5	-0.2		0.8	1.9	
Identified debt-creating flows	-2.2	-0.2	-1.6			1.6	0.3	0.4	0.2	0.0	0.3		0.6	1.4	
Primary deficit	-0.4	0.2	0.9	-0.3	1.5	1.5	1.4	1.6	1.5	1.2	1.4	1.4	1.5	1.4	1.4
Revenue and grants	27.7	27.6	26.9			28.8	29.4	29.3	29.4	29.6	29.7	29.4	30.1	30.5	30.3
of which: grants	2.1	1.7	1.1			1.2	1.3	1.1	0.9	1.0	1.0		1.0	1.0	
Primary (noninterest) expenditure	27.3	27.8	27.8			30.3	30.7	30.8	30.9	30.7	31.1	30.8	31.5	31.9	31.8
Automatic debt dynamics	-1.8	-0.4	-2.4			0.1	-1.1	-1.2	-1.3	-1.2	-1.1		-0.9	0.0	
Contribution from interest rate/growth differential	-1.7	-1.4	-1.6			-0.8	-1.1	-1.2	-1.2	-1.1	-1.0		-0.9	0.0	
of which: contribution from average real interest rate	0.4	0.4	0.4			0.7	0.6	0.4	0.4	0.5	0.5		0.7	2.1	
of which: contribution from real GDP growth	-2.1	-1.8	-1.9			-1.6	-1.7	-1.6	-1.6	-1.6	-1.6		-1.6	-2.1	
Contribution from real exchange rate depreciation	-0.1	0.9	-0.9			0.9	0.0	0.0	0.0	0.0	0.0		...	...	
Other identified debt-creating flows	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Privatization receipts (negative)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Debt relief (HIPC and other)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Residual, including asset changes	0.8	1.3	-0.6			0.2	-1.0	-0.5	-0.4	-0.5	-0.4		0.2	0.5	
Other Sustainability Indicators															
PV of public sector debt	...	...	30.5			32.2	31.5	31.3	31.0	30.2	29.7		30.8	47.7	
of which: foreign-currency denominated	...	...	29.1			30.9	30.4	30.4	30.2	29.5	29.1		30.6	47.8	
of which: external	...	...	22.2			23.6	24.1	24.7	25.3	25.4	25.2		25.1	27.2	
PV of contingent liabilities (not included in public sector debt)	...	...	...			...	...	...	...	...	...		...	...	
Gross financing need 2/	7.6	6.9	7.9			6.4	5.9	5.7	5.5	5.0	5.4		5.0	8.7	
PV of public sector debt-to-revenue and grants ratio (in percent)	...	...	113.3			111.7	107.4	107.0	105.5	102.2	100.0		102.5	156.5	
PV of public sector debt-to-revenue ratio (in percent)	...	...	118.2			116.7	112.2	111.1	109.0	105.7	103.5		106.0	161.8	
of which: external 3/	...	...	86.0			85.5	85.9	87.6	88.9	88.7	87.7		86.2	92.2	
Debt service-to-revenue and grants ratio (in percent) 4/	19.7	15.2	16.6			9.5	9.9	9.9	10.0	10.3	10.6		12.2	26.0	
Debt service-to-revenue ratio (in percent) 4/	21.3	16.2	17.3			9.9	10.4	10.2	10.3	10.7	11.0		12.7	26.9	
Primary deficit that stabilizes the debt-to-GDP ratio	1.0	-0.9	3.0			-0.3	2.1	1.7	1.7	1.7	1.5	1.4	0.7	-0.5	0.2
Key macroeconomic and fiscal assumptions															
Real GDP growth (in percent)	5.1	4.5	4.7	3.8	2.5	4.0	4.2	4.0	4.0	4.0	4.0	4.0	4.0	4.0	4.0
Average nominal interest rate on forex debt (in percent)	3.0	2.7	2.7	2.8	0.7	2.9	2.7	2.8	3.0	3.4	3.6	3.1	3.9	6.2	4.7
Average real interest rate on domestic debt (in percent)	-1.7	1.1	-3.5	-3.4	3.4	0.8	2.0	1.2	1.1	2.1	-1.9	0.9	-1.7	-1.7	-1.7
Real exchange rate depreciation (in percent, + indicates depreciation	-0.2	2.4	-2.2	-1.4	2.7	2.5	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	7.1	4.2	9.1	8.7	3.3	3.5	6.1	6.8	7.2	7.4	7.4	6.4	7.2	7.2	7.2
Growth of real primary spending (deflated by GDP deflator, in percer	8.9	6.5	4.8	2.1	3.4	13.5	5.6	4.4	4.2	3.5	5.1	6.0	4.4	4.0	4.2
Grant element of new external borrowing (in percent)	...	...	...	...	...	30.8	30.4	31.2	28.4	32.3	34.2	31.2	22.9	3.0	...

Sources: Country authorities; and staff estimates and projections.

1/ [Indicate coverage of public sector, e.g., general government or nonfinancial public sector. Also whether net or gross debt is used.]

2/ Gross financing need is defined as the primary deficit plus debt service plus the stock of short-term debt at the end of the last period.

3/ Revenues excluding grants.

4/ Debt service is defined as the sum of interest and amortization of medium and long-term debt.

5/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

Table 4. Nicaragua: Sensitivity Analysis for Key Indicators of Public Debt, 2015–35

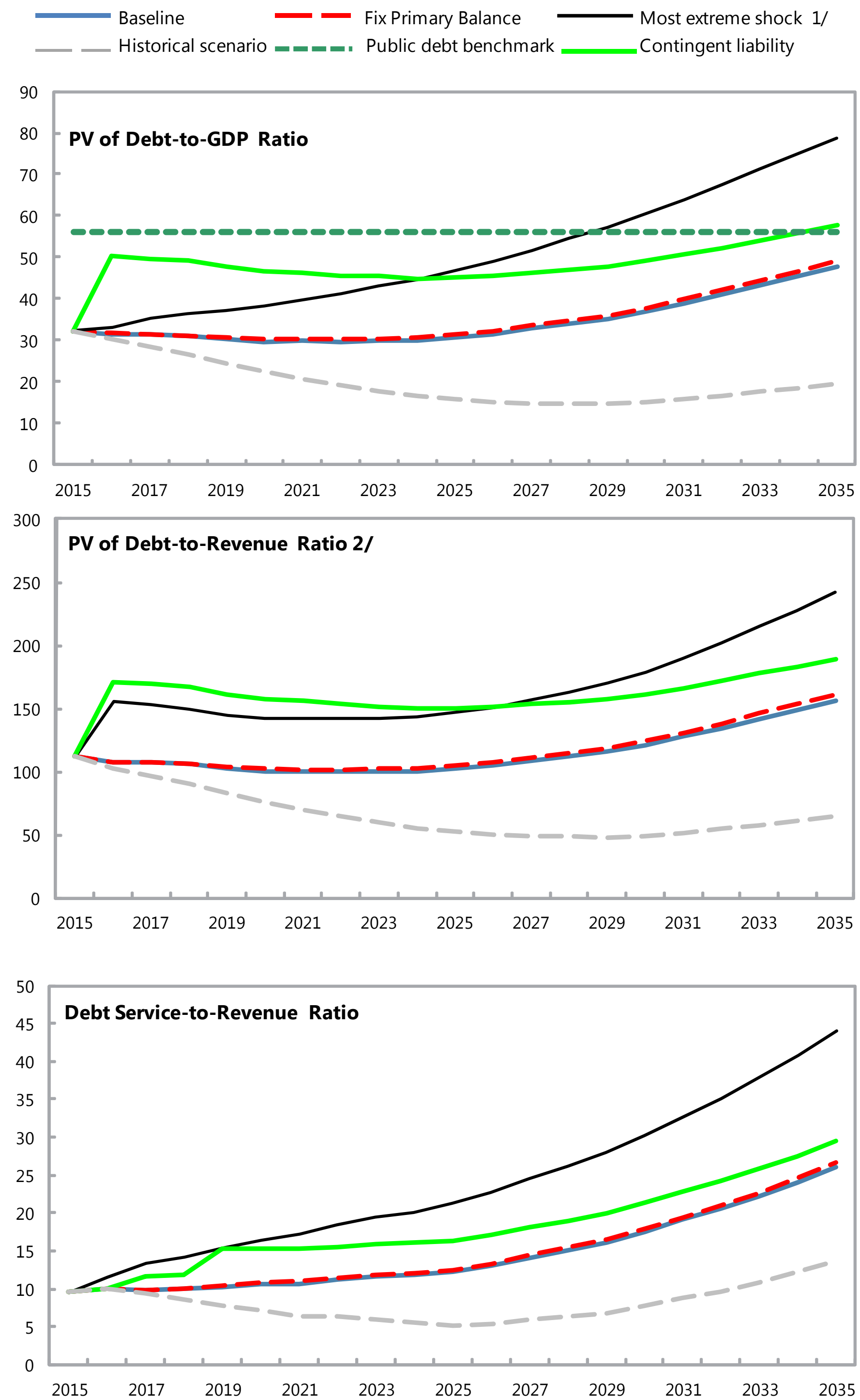
		Projections						
	2015	2016	2017	2018	2019	2020	2025	2035
PV of Debt-to-GDP Ratio								
Baseline	32	32	31	31	30	30	31	48
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	32	30	28	27	24	22	16	20
A2. Primary balance is unchanged from 2015	32	32	31	31	31	30	31	49
A3. Permanently lower GDP growth 1/	32	32	32	32	32	33	40	84
A4. Contingent liability scenario	32	50	50	49	48	47	45	58
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2016-2017	32	33	35	37	37	38	47	79
B2. Primary balance is at historical average minus one standard deviations in 2016-2017	32	31	31	31	30	29	30	47
B3. Combination of B1-B2 using one half standard deviation shocks	32	31	30	31	31	31	37	62
B4. One-time 30 percent real depreciation in 2016	32	46	45	44	43	42	44	74
B5. 10 percent of GDP increase in other debt-creating flows in 2016	32	41	41	40	39	39	40	56
PV of Debt-to-Revenue Ratio 2/								
Baseline	112	108	107	106	102	100	103	157
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	112	103	97	90	82	76	53	65
A2. Primary balance is unchanged from 2015	112	108	107	106	104	102	105	161
A3. Permanently lower GDP growth 1/	112	109	110	110	109	110	134	274
A4. Contingent liability scenario	112	171	170	167	162	157	151	190
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2016-2017	112	113	121	124	126	129	155	257
B2. Primary balance is at historical average minus one standard deviations in 2016-2017	112	107	106	104	101	99	101	156
B3. Combination of B1-B2 using one half standard deviation shocks	112	106	104	105	105	105	122	204
B4. One-time 30 percent real depreciation in 2016	112	156	153	150	145	142	147	242
B5. 10 percent of GDP increase in other debt-creating flows in 2016	112	139	139	137	134	131	132	182
Debt Service-to-Revenue Ratio 2/								
Baseline	10	10	10	10	10	11	12	26
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	10	10	9	9	8	7	5	14
A2. Primary balance is unchanged from 2015	10	10	10	10	10	11	12	27
A3. Permanently lower GDP growth 1/	10	10	10	10	11	12	16	42
A4. Contingent liability scenario	10	10	12	12	15	15	16	29
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2016-2017	10	10	11	12	13	14	19	40
B2. Primary balance is at historical average minus one standard deviations in 2016-2017	10	10	10	10	10	10	12	26
B3. Combination of B1-B2 using one half standard deviation shocks	10	10	10	9	10	11	15	33
B4. One-time 30 percent real depreciation in 2016	10	12	13	14	15	16	21	44
B5. 10 percent of GDP increase in other debt-creating flows in 2016	10	10	13	16	16	17	16	29

Sources: Country authorities; and staff estimates and projections.

1/ Assumes that real GDP growth is at baseline minus one standard deviation divided by the square root of the length of the projection period.

2/ Revenues are defined inclusive of grants.

Figure 2. Nicaragua: Indicators of Public Debt Under Alternative Scenarios, 2015–35 1/



Sources: Country authorities; and staff estimates and projections.
1/ The most extreme stress test is the test that yields the highest ratio on or before 2025.
This corresponds to a shock to real GDP growth of one std. dev. in 2016-2020 for the top two charts and a real depreciation of the exchange rate of 30 percent in 2016 for the bottom chart.
2/ Revenues are defined inclusive of grants.

Statement by Otaviano Canuto, Executive Director for Nicaragua and Manuel Coronel, Advisor to the Executive Director January 28, 2016

On behalf of our Nicaraguan authorities, we thank staff for the useful discussions held in Managua during the 2015 Article IV mission. The balanced report summarizes appropriately the policy priorities being pursued by the Nicaraguan government and provides valuable policy advice.

The big picture remains positive. Since the last article IV Board discussion held in December 2013, Nicaragua has continued to experience a stable macroeconomic environment and robust GDP growth. Inflation–anchored by the crawling-peg exchange rate system–remains moderate while international reserves have grown steadily. The fiscal stance has been moderately expansionary, albeit in line with a stable and sustainable public debt profile. In July 2015, Moody´s upgraded Nicaragua´s credit rating to B2 from B3 and more recently, in December, Fitch assigned a first-time rating of B+ to the country. On the back of lower oil prices and increased reliance on renewable energy sources, the external accounts have strengthened. Over the medium term, the fiscal and external accounts will continue to benefit from the authorities' sound and prudent macroeconomic policies. In view of the government's priority to promote inclusive growth, poverty levels have receded substantially while social stability as well as citizen security have further improved.

The fastest growing economy in Central America. GDP growth in 2014, at 4.7 percent, was the highest among the five economies in Central America. In light of the headwinds stemming from lower commodity prices and slower-than-expected global growth, both staff and the authorities revised down the initial 2015 growth projections. Staff now projects last year's growth at 4 percent while the authorities have a slightly more positive forecast (4.3 percent). Post-crisis growth (2010-2015) is expected to average about 4.7 percent, ranking Nicaragua as the highest growing economy in the Central America region since the great recession. While in 2014 most of the contribution to growth came from the services sector (retail, hotels and restaurants) as well as robust external demand, in 2015 growth has been propelled by a surge in private consumption due to lower oil prices and increased activity in the construction sector. Agriculture–an otherwise significant contributor to growth–has underperformed due to droughts and other weather-related effects.

Nicaragua's social fabric has improved *in tandem* with economic growth. Macroeconomic stability, fiscal discipline and social inclusion are at the core of Nicaragua's platform for growth. In the fight against poverty, prospects have never looked better in recent memory. Continued improvement in the supply of basic services to the most vulnerable (including health, clean water, and electricity) have rendered good dividends in the fight against poverty. The results of the national household surveys compiled by the Nicaraguan Institute of Development Information (INIDE) and World Bank specialists are encouraging: general and extreme poverty have respectively dropped from 48.3 to 29.6 percent and 17.2 to 8.3 percent in the last 10 years. Notwithstanding the still large informal sector of the economy, formal job creation was the fastest growing in Latin America in 2014 according to the UN Economic Commission for Latin America and the Caribbean (ECLAC). Gender equality constitutes yet another strong point of Nicaraguan society. The World Economic Forum's gender-gap index in the last two years (2014 and 2015) ranks Nicaragua among the top performer in Latin America and the Caribbean and among the best performers worldwide.

Revisiting staff's potential growth estimations. As noted in the report, staff estimates Nicaragua's potential growth at 4 percent, despite a sustained track-record of GDP growth close to 5 percent per year since 2010. We are of course aware that measuring potential GDP is intrinsically difficult, more so at times of rapid transformation as being experienced by the Nicaraguan economy. Staff's assessment diverges from the latest empirical evidence captured by experts and the authorities. In the authorities' view, staff's estimates are somewhat outdated. The last potential growth estimation disclosed by the Fund that the authorities are aware of was made in 2013 with data series that extended no further than 2011.[1] It is precisely at that time that the Nicaraguan economy started to grow faster and in a sustainable manner without any signs of overheating. To the authorities, this low potential growth estimation introduces an undesirable downward bias in the Fund's medium-term scenario for the country.

Fiscal discipline remains at the core of the government's economic policy. Nicaragua remains committed to maintaining fiscal discipline while preserving the social safety net and much needed capital investment. The authorities use a consolidated public sector deficit of 2½ percent of GDP as their fiscal anchor. Though the fiscal deficit has averaged 2.4 percent of GDP since 2010 reflecting the government's solid fiscal credentials, the administration has increased capital expenditure in 2015 and the deficit is expected to reach 2.7 percent of GDP. The authorities' public investment medium-term plan–projected to peak in 2016–along with the uptick in spending to finance this year's elections will increase public expenditure by about ½ percent of GDP in 2016, relative to last year. Under current policies, public debt is now expected to stabilize at around 40 percent of GDP by 2020, as opposed to a previously projected 38 percent of GDP.

Not the right time to discuss specific consolidation plans. The authorities take note of staff's recommendation to undergo a fiscal consolidation plan amounting to 1 percent of GDP in 2017, the post-electoral year. They agree that such a plan is attainable and that it would not only return the debt trajectory back to the 38 percent of GDP previously estimated by 2020, but it will also create additional fiscal buffers and reduce fiscal vulnerabilities. However, the authorities believe that the timing for an open discussion on the matter, let along specific planning, should be left to after the elections. It is this chair's opinion that the new elected (or re-elected) government–as well as new Congress–should harness the initial post-electoral momentum to continue the prudent fiscal stance that the current administration has consistently pursued. This should include ramping up the financial position of deficit-contributing state-owned enterprises (SOEs) and the Social Security Institute.

Monetary policy has been efficient in anchoring inflation, preserving exchange rate stability and keeping reserve coverage adequate. Inflation has receded significantly in 2015. Due mostly to declining oil prices and lower domestic price pressures, year-end inflation is estimated at about 3 percent, the lowest in the decade. The preservation of the crawling peg and the maintenance of an adequate level of international reserves have been priorities for monetary policy. The authorities consider that the peg arrangement has successfully anchored inflation while helping to maintain external competiveness over the years. As confirmed in staff's external assessment, the real effective exchange rate (REER) remains broadly aligned with fundamentals. The predictability and stability of the pre-announced crawling peg arrangement has enhanced business and investor confidence. The Central Bank of Nicaragua (BCN), with IMF support, continues to make progress in strengthening the monetary policy framework in a manner consistent with the exchange rate regime, including, for instance, the introduction of short-term notes to improve liquidity management and reduce interest rate volatility in the interbank market. Gross

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[1] "*Potential Output and Output Gap in Central America, Panama and Dominican Republic*," Johnson, C., IMF Working Paper, June 2013. See also "*Raising Potential Output: The Challenge of Inclusive Growth,"* Nicaragua: Selected Issues, September 2012.

international reserves closed 2015 at a historic record high of nearly US$ 2.5 billion (5 months of imports).

The external sector has continued to strengthen, becoming more diversified and stable. The value of exports have increased more than twofold and gross FDI inflows have more than quadrupled since 2007. Exports have significantly diversified in terms of products and export destinations in the last decade. Gross FDI inflows have also diversified in terms of both country of origin and economic sector. Exports have grown faster than imports since 2007 but oil dependence still keeps the current account balance (CAB) negative. As a result of decreasing oil prices and higher exports, the CAB deficit narrowed down to about 7 percent of GDP in 2014 from 11 percent the previous year. For 2015, however, the CAB deficit is expected to slightly deteriorate due to a temporary decline in exports and an uptick in non-oil imports caused by higher consumption by the end of the year. Underpinned by continually strong FDI inflows, the CAB is projected to remain negative at around 8 percent of GDP over the medium term.

The banking system remains stable, well capitalized, and liquid. Since the last Article IV consultation, bank's capital adequacy has remained stable at around 13 percent and credit has grown moderately. At less than 1 percent of total credit, NPLs are the lowest in Central America while bank's liquidity and profitability indicators are the highest in the region. Bank regulation continued to be strengthened, including anti-money laundering and counter-terrorism financing prevention.

Notwithstanding the positive outlook, the authorities recognize that the Nicaraguan economy remains subject to significant downside external risks, as highlighted by staff. Among these risks is a slower recovery of the U.S. economy and the possible effects on financial volatility of the normalization of the U.S. monetary policy. In the previous two Article IV discussions, Executive Directors have agreed with staff that a sudden reduction of Venezuelan flows to Nicaragua constituted a potential source of external risk. Since these inflows are linked to oil prices, such reduction has already materialized and what could have led to an abrupt external adjustment has turned into a gradual transition. This year's external flows expected from Venezuela–reflecting oil price behavior–are less than half with respect to 2013, when the last Article IV discussion was concluded.

Concluding remarks. Nicaragua remains committed to continue implementing coherent macroeconomic and development policies to remove structural hurdles, achieve higher productivity levels and improve competitiveness. In this regard, the authorities continue to count on the Fund's support through policy advice and capacity building, tailored to Nicaragua's specific needs and circumstances.