MISSION CONCLUDING STATEMENT

Nicaragua: Staff Concluding Statement of an IMF Staff Visit

February 6, 2018

A Concluding Statement describes the preliminary findings of IMF staff at the end of an official staff visit (or 'mission'), in most cases to a member country. Missions are undertaken as part of regular (usually annual) consultations under Article IV of the IMF's Articles of Agreement, in the context of a request to use IMF resources (borrow from the IMF), as part of discussions of staff monitored programs, or as part of other staff monitoring of economic developments.

The authorities have consented to the publication of this statement. The views expressed in this statement are those of the IMF staff and do not necessarily represent the views of the IMF's Executive Board. Based on the preliminary findings of this mission, staff will prepare a report that, subject to management approval, will be presented to the IMF Executive Board for discussion and decision.

Economic performance in 2017 was above expectations and the 2018 outlook is favorable. To minimize downside risks, Nicaragua needs to further fortify its policy framework by (i) hastening the implementation of the international taxation law, reducing tax expenditures, rationalizing subsidies, and implementing a comprehensive reform of the Social Security, (ii) enhancing the supervisory perimeter, (iii) reinforcing the AML/CFT framework, and (iv) building financial buffers and further increasing international reserves.

I. Economic Performance in 2017

1. Real GDP increased about 4.9 percent, supported by buoyant agricultural exports, tourism and remittances. Headline inflation increased to 5.7 percent, reflecting raising oil and food prices, while core inflation stood at 4.1 percent. The external current account (CA) deficit declined sharply to 6.1 percent of GDP (8.6 percent of GDP in 2016) and gross international reserves (GIR) rose by US$297 million to US$2.59 billion, reaching a coverage of about 4.2 months of imports. Private sector credit growth, financed in part by a substantial increase in external obligations, decelerated slightly to 17 percent. NPL remained low at 1.2 percent, while the capital adequacy ratio increased to 13.8 percent and profitability remained stable at 20.9 percent (ROE).

2. The consolidated public sector (CPS) balance remained broadly unchanged at an estimated 2.5 percent of GDP. The deterioration in the finances of the Nicaraguan Social Security Institute (INSS) was partially compensated by a slightly lower deficit in the Central Government (CG) and the Managua Municipality (ALMA)

II. Outlook

3. GDP is projected to grow in 2018 above potential, at 4.7 percent. Domestic demand is expected to strengthen, supported by a surge in public infrastructure investment projects. Exports are expected to respond favorably in the wake of the pickup in U.S. growth, partially cushioning the impact of higher oil prices. Inflation and the CA deficit are projected to increase to 6.3 percent and 7.7 percent of GDP, respectively. FDI and concessional loans are expected to continue financing the CA deficit. GIR are projected to grow to US$2.67 billion with the coverage declining to about 4 months of imports.

4. The CPS deficit is projected to increase by 0.8 ppts to 3.3 percent of GDP. In the absence of a fiscal reform, the modest reduction in current spending of the CG would be offset by the increase in capital expenditure of the ALMA and several state-owned enterprises (SOE). The deficit of the INSS will continue to increase until a reform is put in place. However, public debt is projected to remain stable in terms of nominal GDP, due to the expected dynamism of the latter. Over the medium term, the CPS deficit is projected to improve marginally, as capital spending gradually returns to historical levels. A substantial improvement in the CPS deficit would require a fiscal reform and a comprehensive INSS reform, in line with the 2017 Article IV Staff Report recommendations.

III. Main Policy Challenges

5. Risks to Nicaragua’s growth appear broadly balanced in the near term, but remain skewed to the downside over the medium term. On the upside, the firm up of the global recovery is expected to increase external demand. The stimulus of the U.S. activity, stemming from tax policy changes, is highly correlated with Nicaraguan GDP growth. On the downside, spillovers from the U.S. migration, trade and monetary policies continue to pose substantial risks. The latter coincides with the potential approval of the NICA Act by the U.S. Senate, while Venezuela’s oil cooperation no longer plays a substantial role. Therefore, the mission advises increasing fiscal space and maintaining a stronger international reserves position. Furthermore, financial institutions should continue to build financial buffers in case risks affecting economic growth materialize.

6. Building fiscal buffers is essential to stave off potential shocks. The mission encourages the authorities to take advantage of the strong economic performance to complete the design and implementation of a tax reform aimed at creating additional fiscal space, as discussed in 2017 Article IV Staff Report. The mission welcomes the recent measures to better target electricity subsidies and eliminate some VAT exemptions, [1] and encourages the authorities to include the remaining recommendations of the Fiscal Affairs Department (FAD) of the IMF within their fiscal reform plan. The FAD proposals on subsidy rationalization, elimination of VAT exemptions, international taxation law implementation, and further strengthening of tax administration will help eliminate inequalities and increase fiscal resilience.

7. Staff recommends that the INSS reform plan secures its long-term viability and corrects the inequities within the system. Staff welcomes the authorities' efforts to alleviate INSS' financing needs through payments of outstanding arrears and resumption of full government contributions in 2018. In addition to measures seeking to address the imminent cash balance constraint, the mission advises the authorities to implement the measures recommended by the FAD mission, aimed at restoring the long-term sustainability of the INSS finances while reducing the existing system's inequities.

8. The mission welcomes the authorities' measures to enhance the resilience of the banking sector to absorb shocks and reiterates the importance of expanding the supervisory perimeter. The gradual adoption of prudential regulations in line with Basel III includes the liquidity coverage ratio, the conservation capital buffer, and countercyclical provisions. However, while there is consensus to expand the financial supervisory perimeter to savings and loans cooperatives, a decision on the allocation of institutional regulatory and supervisory responsibilities is still needed. Authorities are encouraged to take advantage of the upcoming Financial Sector Stability Review mission from the IMF's Monetary and Capital Markets Department to discuss the best institutional arrangement.

9. The mission welcomes the authorities' efforts to implement the recommendations of the 2017 Financial Action Task Force (FATF) Mutual Evaluation Report . Laws to enforce record keeping, due diligence and notification of suspicious operations have been approved by the National Assembly. The authorities' plan includes additional legal initiatives to address the remaining FTAF recommendations.

10. The mission acknowledges the progress made and encourages the authorities to continue improving data quality and availability. Financial management of public accounts, and proper debt sustainability analysis, requires regular compilation and dissemination of domestic debt statistics for SOE and municipalities. Compliance with the 2001 Government Finance Statistics Manual would go a long way towards improving macro-fiscal management. External sector data would further improve after completing the ongoing review of FDI base statistics and compilation methodology.

IV. Next Steps

11. The mission suggests conducting the next Article IV Consultation during August 28-September 11, 2018, covering energy reform and financial inclusion as analytical topics. Staff will follow up on the authorities' capacity development requests in the context of the IMF Spring Meetings.

Table 1. Nicaragua: Selected Social and Economic Indicators, 2014–19

I. Social and Demographic Indicators			
Main export products: beef, coffee, and gold.			
GDP per capita (current U.S.$, 2016)	2,151	Income share held by the richest 10 percent (2014)	37.9
GNI per capita (Atlas method, current U.S.$, 2015)	1,960	Unemployment (percent of labor force, 2016)	6.2
GINI Index (2014)	47.1	Poverty rate (national pov. line, in percent, 2014)	29.6
Population (millions, 2016)	6.1	Adult literacy rate (percent, 2015)	82.5
Life expectancy at birth in years (2014)	74.8	Infant mortality rate (per 1,000 live births, 2015)	18.8
II. Economic Indicators			

	2014	2015	2016	2017	2018	2019
				Est.	Proj.	Proj.
Output				(Annual	percentage	change)
GDP growth	4.8	4.9	4.7	4.9	4.7	4.5
GDP (nominal, U.S.$ million)	11,880	12,748	13,230	13,727	14,532	15,499
Prices						
GDP deflator	8.4	7.5	4.1	3.8	6.2	7.2
Consumer price inflation (period average)	6.0	4.0	3.5	3.9	6.2	7.2
Consumer price inflation (end of period)	6.5	3.1	3.1	5.7	6.3	7.4
Exchange rate						
Period average (Cordobas per U.S.$)	26.0	27.3	28.6	…	…	…
End of period (Cordobas per U.S.$)	26.6	27.9	29.3	…	…	…

Fiscal sector						(Percent of GDP)
Consolidated public sector						
Revenue (excl. grants)	25.5	26.3	27.9	28.2	27.9	27.8
Expenditure	28.6	29.6	31.2	31.8	31.9	32.1
Current	22.6	23.0	24.2	24.7	24.2	24.0
of which: wages & salaries	7.4	7.4	7.6	7.6	7.4	7.4
Capital	6.0	6.7	7.0	7.1	7.8	8.1
Overall balance, before grants	-3.1	-3.3	-3.3	-3.5	-4.1	-4.3
Overall balance, after grants	-2.0	-2.2	-2.4	-2.5	-3.3	-3.5
Money and credit						(Annual percentage change)
Broad money	15.4	19.0	11.0	14.4	13.8	16.7
Credit to the private sector	20.5	23.5	17.5	16.6	15.9	16.5
Net domestic assets of the banking system	5.1	18.7	13.0	15.3	15.6	15.5

External sector						(Percent of GDP, unless otherwise indicated)
Current account	-7.1	-9.0	-8.6	-6.1	-7.7	-7.6
of which: oil imports	9.6	6.1	5.2	6.4	7.9	7.2
Capital and financial account	9.3	11.1	5.7	8.5	8.3	8.3
of which: FDI	6.7	7.1	6.5	6.0	5.6	5.7
Gross international reserves (U.S.$ million)1/	2,147	2,353	2,296	2,593	2,667	2,772
In months of imports excl. maquila	4.2	4.6	4.0	4.2	4.0	4.0
Net international reserves1/	2,024	2,262	2,236	2,554	2,647	2,766
Public sector debt2/	40.2	40.7	41.9	42.6	42.6	41.9
Private sector external debt	44.7	44.9	44.8	43.3	40.9	38.5

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

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

2/ Assumes that HIPC-equivalent terms were applied to the outstanding debt to non-Paris Club bilaterals. Does not include SDR allocations. From 2016 onwards includes preliminary data on the domestic debt of SOEs and municipalities. Prior to 2016, the stock of domestic debt of SOEs and municipalities is calculated based on the capitalization of flows.

---

[1] On February 1, 2018, the authorities submitted to the National Assembly a proposal to replace general electricity subsidies with targeted subsidies according to consumption brackets, increasing gradually the VAT rate, adjusting the electricity tariff paid by retirees, and updating the tariff schedule.

IMF Communications Department

MEDIA RELATIONS

PRESS OFFICER: RAPHAEL ANSPACH

PHONE: +1 202 623-7100**EMAIL:** MEDIA@IMF.ORG