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NICARAGUA

December 2013

2013 ARTICLE IV CONSULTATION – STAFF REPORT, PRESS RELEASE ON THE EXECUTIVE BOARD DISCUSSION, 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 2013 Article IV Consultation with Nicaragua, the following documents have been released and are included in this package:

- The **Staff Report** for the 2013 Article IV Consultation, prepared by a staff team of the IMF for the Executive Board's consideration on December 4, following discussions that ended on September 26, 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 November 14.

- An **Informational Annex** prepared by the IMF.

- A **Debt Sustainability Analysis**.

- A **Press Release** summarizing the views of the Executive Board as expressed during its December 4 consideration of the staff report that concluded the Article IV Consultation with Nicaragua.

- A **Statement by the Executive Director** for Nicaragua.

The publication policy for staff reports and other documents allows for the deletion of market-sensitive information.

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NICARAGUA

STAFF REPORT FOR THE 2013 ARTICLE IV CONSULTATION

November 14, 2013

KEY ISSUES

Context. Macroeconomic stability has been maintained and policies are broadly in line with the recommendations of the 2012 Article IV consultation. Growth is expected to slow somewhat, reflecting in part lower coffee production and slowdown in construction. Inflation expectations are anchored by the crawling peg and core inflation remains stable. The external current account deficit has remained large, while international reserves coverage of imports has been broadly adequate. Bank credit to the private sector increased rapidly over the past year and may pose risks. The Board discussion of the 2012 Article IV took place in June 2012.

Outlook and Risks. Under current policies, growth is expected to decline from about 5.2 percent in 2012 to 4.2 percent in 2013; inflation is projected to pick up marginally to about 7 percent by end-2013. Large external current account deficits with associated financing needs and high external debt will keep vulnerabilities relatively high. Risks to the outlook stem from slower than expected economic recovery in the United States and Europe, higher oil prices, and unexpected changes to the oil collaboration scheme with Venezuela.

Policy recommendations. Sustained implementation of prudent macroeconomic policies has strengthened the economy's resilience to risks but large external and fiscal vulnerabilities remain. The authorities' fiscal strategy is to keep deficits low and to lower public debt ratios over the medium term which will require protecting revenues, reforming the social security system to ensure its long-term financial viability, containing current spending, and rationalizing subsidies to electricity and other economic sectors. Economic collaboration with Venezuela, while beneficial, has generated dependency on financing that could pose risks to external stability, and needs to be made more transparent.

Authorities' views. The authorities broadly agreed with staff's assessment of near-term risks and the need to reduce fiscal and external vulnerabilities. In particular, there was agreement on the need to continue prudent fiscal policy and lower public debt ratios to gain fiscal space, and to further increase transparency of public sector operations. The authorities also concurred with the assessment that rapid credit growth might pose risks and required monitoring. They welcomed close cooperation with the Fund and its role as a trusted advisor.

Approved By
Saul Lizondo and Dhaneshwar Ghura

A staff team comprising Messrs. P. Gajdeczka (Head), J. Gonzalez-Garcia, C. Johnson, I. Samake, (all WHD), and J. Torres (FAD) visited Managua during September 17–26, 2013 to conduct the 2013 Article IV consultation discussions. Mr. J. Zalduendo (Resident Representative) assisted the mission. M. Coronel (OED) participated in the discussions. The team met with Central Bank President Guevara, Finance Minister Acosta, Economic Adviser to the President Arce, senior government and central bank officials, and labor and private sector representatives.

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BACKGROUND

1. **Since the global financial crisis Nicaragua has made significant progress toward restoring sustainable growth, consolidating the fiscal position, and keeping inflation under control.** This achievement was largely due to sustaining prudent policies in the context of the global financial crisis, commodity price shocks, and natural disasters. However, with the second lowest per capita income in the Western Hemisphere and poor other social indicators Nicaragua is facing formidable challenges of achieving higher growth to reduce poverty while addressing fiscal and external vulnerabilities.

2. **Prudent policies implemented during 2012-13 have contributed to strengthening macroeconomic stability.** Following the conclusion of the ECF arrangement with the Fund in 2011, policies have continued to support macroeconomic stability and are in line with the recommendations of the 2012 Article IV consultation (Box 1).[1] Over the past two years, real GDP growth has been stronger and inflation and external current account deficits lower than previously envisaged, a tax reform was implemented in December 2012, and progress has been made in strengthening the electricity sector which had been as source of fiscal vulnerability and a significant impediment to growth.

3. **The government's medium-term economic strategy aims at achieving equitable growth, financial stability, and poverty reduction.**[2] To achieve these objectives, the strategy seeks to balance an ambitious investment and social spending agenda and fiscal sustainability. In addition, the government plans to reduce fiscal and external vulnerabilities by lowering the public debt ratios and lessening dependence on oil imports. The government's policy agenda includes reforms in the fiscal, social, and electricity sectors. The political cycle (general elections in 2016) provides space to implement new structural reforms and the government has stressed its commitment to seek consensus in key areas through broad consultations.

4. **Planned large investment projects have the potential to boost growth.** Changes in government policies and to the regulatory framework in recent years have helped attract private investments in wind, geothermal, and biomass electricity generation, thereby largely eliminating blackouts and improving the system's stability. New energy projects expected to be completed by 2018 would further boost electricity production without significantly increasing oil imports. In addition, the government has signed a concession with a foreign private investor for an inter-oceanic canal. The value of the project is tentatively estimated at nearly 4 times the 2012 GDP.

[1] The Executive Board discussed an Ex-Post Assessment (EPA) of Longer-Term Program Engagement (LTPE) and the Staff Report for the 2012 Article IV Consultation on June 27, 2012. See IMF Country Report No. 12/256.

[2] The government's economic strategy for 2013–16 ("*Programa Economico-Financiero 2013-16")* was published on September 6, 2013.

Feasibility studies, undertaken by reputable international firms, are expected to be completed in 2014, and the costs of the project are expected to be incurred by the foreign investor.[3]

5. Improvements to national accounts methodology and data resulted in an upward adjustment of nominal GDP of about 30 percent (Box 2). Per capital GDP for 2012 is now estimated at US$1,762 (US$1,313 before the change). The revision, supported by technical assistance from CAPTAC-DR, uses improved source surveys and statistical procedures and a new base year (2006) to calculate GDP. As a result, fiscal and external sector ratios to GDP are significantly lower than reported in the 2012 Article IV consultation report.

RECENT DEVELOPMENTS AND OUTLOOK

A. Recent Economic Developments

6. Recent macroeconomic performance has been favorable. After growing 5.2 percent in 2012, real GDP increased by 5 percent in the first half of 2013, as a result of a good basic grain harvest and a robust performance in the maquila sector, notwithstanding a decline in coffee production affected by leaf rust and a slowdown in private construction. Headline inflation increased to 7.4 percent (yoy) in September 2013, boosted by food, housing, and transport prices, but core inflation remained subdued at 5.9 percent.

7. While fiscal deficits remain small, the policy stance has turned expansionary. After having reached a balanced budget in 2011, the combined public sector recorded a deficit of 0.7 percent of GDP in 2012. The deficit is expected to widen to 1.4 percent of GDP in 2013 largely on account of rising capital expenditure in public enterprises despite a robust growth in revenues, particularly from the income tax. Nevertheless, the public debt ratio is projected to continue to decline, to about 42 percent of GDP in 2013 (from 45 percent of GDP in 2011).

8. Bank credit to the private sector increased rapidly, while key financial indicators appear relatively strong. By August 2013, domestic credit increased by about 23 percent (yoy), following an annual increase of 26 percent in 2012. Credit expansion was particularly strong in the consumer sector (43 percent). Deposits increased by nearly 10 percent. The capital adequacy ratio of the Nicaragua's banking system was 13 percent as of August 2013, above the regulatory norm (10 percent) but significantly below its peak of 2010 (16.6 percent).

9. The external position remains vulnerable. The current account deficit for 2011–13 is estimated to be around 13 percent of GDP, while the external private and public debt is projected to be about 74 percent of GDP at end-2013. In the first half of 2013, trade balance was broadly unchanged from the corresponding level of 2012 as *maquila* net exports increased by 6.5 percent

[3] Owing to the uncertainties at this stage, the potential impact of the canal project has not been incorporated in staff's projection.

while other trade flows declined mostly due to lower prices for gold and coffee and lower imports for power plant investments. By August 2013, remittances increased by 7.3 percent (yoy). As of end-October 2013, gross international reserves stood at US$1.9 billion, or equivalent to 3½ months of imports, broadly unchanged from end-2012.

10. **Further progress was made in structural reforms**. The tax reform approved in December 2012 features the elimination of VAT exemptions on some items consumed by higher income households, changes in the personal income tax thresholds, and a plan for further rationalization of tax exemptions over the medium term. The revenue impact in 2013 is estimated at 0.2 percent of GDP. In April 2013, electricity tariffs were increased by 12.8 percent thereby narrowing the gap between indicative (reflecting changes in international oil prices) and actual tariffs to 3 percent. In addition, changes to the regulatory framework enabled anti-theft measures to be strengthened. Both measures are expected to help stabilize the financial position of the electricity distribution company.

B. Outlook and Risks

11. **Under current policies and the baseline scenario about external conditions, near- and medium-term outlook remain broadly favorable (Table 10).** In such scenario, growth is projected to decline to 4.2 percent in 2013 (from 5.2 percent in 2012), and then converge to its long-term trend of 4 percent. Inflation would increase to 6.9 percent by end-2013 (compared to 6.6 percent at end-2012), consistent with the 5 percent rate of crawl of the exchange rate and international prices. The external current account deficit is projected to widen marginally to 13.2 percent of GDP in 2013, and then contract to about 11 percent of GDP over the medium term. The risks to the outlook are on the downside and stem mostly from slower than expected economic recovery in the United States and Europe and higher oil prices. Unanticipated changes to terms or levels in the oil collaboration scheme with Venezuela could generate additional pressures on the external position.

Nicaragua: Risk Assessment Matrix
(Scale: Low (L), Medium (M), and High (H))

Source of risk	Up/Down Side	Risk	Impact		Policy Advice
			Rating	Channel	
Oil price shock	↓	M	H	Worsening of both external and fiscal balances	• Allow pass-through of international prices • Limited use FX reserves to weather shock • Continue changing energy matrix
Deterioration in the terms or level of the Venezuela oil collaboration	↓	L	H	Loss of external financing; worsening of the fiscal balance if quasi-fiscal operations come on-budget	• Limited use FX reserves to weather shock • Rationalize expenses financed through the oil collaboration • Seek access to exceptional financing sources
Sudden loss of confidence in the banking system due to deterioration in asset quality in commercial banks	↓	L	M	Deterioration of the liquidity position of banks; possible increase in solvency risks	• Increase monitoring of banks' liquidity positions • Consider increasing interest rates to counter-balance capital flight risks • Implement contingency plans to facilitate bank restructurings

12. **The authorities agreed with staff's assessment of the near-term outlook and the need to address significant fiscal and external vulnerabilities.** There was broad agreement that prudent fiscal policies needed to be sustained to reduce vulnerabilities, in particular if the

government had to absorb various subsidies currently covered by oil collaboration with Venezuela and channeled to the private sector. The authorities recognized that large external current account deficits would remain a key source of vulnerability over the medium term. This reflects both a high oil import dependency (12 percent of GDP) that can be only gradually reduced over time, as well as the associated reliance on financing from Venezuela. However, the authorities were confident that external inflows, including FDI and from official sources, as well as the oil collaboration scheme with Venezuela, were sufficiently stable to help finance those deficits and maintain adequate international reserves buffers. They concurred with staff assessment that high dollarization and recent rapid increase in private credit could also pose risks.

POLICY DISCUSSIONS

13. The consultation discussions focused on policies aimed at maintaining macroeconomic stability, reducing vulnerabilities, and creating conditions for higher growth. The staff team welcomed the authorities' medium-term strategy which sought to establish foundations for sustainable growth while maintaining macroeconomic stability. Staff agreed that the strategy appropriately targets further lowering of public debt ratios, reducing oil import dependency and protecting the external position to reduce the economy's vulnerabilities. The authorities and staff recognized that to boost economic growth over the long term and significantly raise living standards would require substantial investments in infrastructure and improvements in the education system to achieve sustainable increases in productivity.

A. Fiscal Policies

14. The authorities and staff agreed that the present policy stance is broadly appropriate. As output gap is closing, no policy change was needed for 2014 and maintaining the present deficit level was consistent with a further lowering of public debt ratios over the medium term that would help fiscal sustainability. Accordingly, the draft 2014 budget submitted to the national assembly in October features revenues rising as a ratio of GDP and the deficit of the combined public sector broadly unchanged (1.2 percent of GDP). The authorities stressed that in line with their commitment to fiscal discipline the budget would begin incorporating in 2014 the wage bonus (0.4 percent of GDP), which until 2013 had been funded with grants provided by a private sector entity (CARUNA) from resources originating from oil collaboration with Venezuela, without increasing the deficits by restraining other current expenditure and taking advantage of higher tax revenues.[4]

15. The authorities' strategy aims at strengthening fiscal sustainability and increasing the fiscal space. To strengthen fiscal sustainability over the medium-term, the combined public sector deficits need to remain at about 1-1 ½ percent of GDP, thereby reducing the public debt ratios, consistent with the recommendations arising from the Debt Sustainability Analysis. To this end, it is

[4] The wage bonus ("*bono solidario*") is a wage supplement provided to public employees mostly at the lower end of pay structure.

necessary to strengthen revenue performance, reform the pension system, and rationalize expenditures. To raise public sector revenues as a ratio of GDP, the authorities intend to fully implement the tax reform approved in December 2012 which eliminated various exemptions and included measures to improve tax administration. On the expenditure side, staff and authorities agreed that it would be critical to implement a reform of the pension system along the lines of the proposal submitted for consultation with key stakeholders last October. The key proposed changes included step increases in employers' contributions and some modification of benefits eligibility so as to ensure the system's financial viability over the next 15 years. The reform would also incorporate a new program of reduced pensions for people who are at the retirement age and have contributed to the system but have not yet met all eligibility criteria, and a resolution of government debt to the social security system. In addition, electricity and other subsidies need to be rationalized through better targeting and the financial position of public enterprises strengthened to avoid incurring intra-sector arrears and reduce the vulnerability of the budget. The authorities agreed on the need to review the system of energy and other subsidies and indicated that the key law on electricity subsidies needed to be updated by 2015.

16. Staff supported the authorities' intention to continue increasing transparency of public sector operations. The staff team recognized that economic cooperation with Venezuela had benefited Nicaragua, contributing to higher growth, easing external financing constraints, and boosting social development, but noted that these ties are opaque (Box 3) and subject to risk of political and economic developments in Venezuela. The flow of financing (about 7¼ percent of GDP in 2012) is managed through a private entity in Nicaragua and the stock of associated debt reached 21 percent of GDP at end-2012. Staff welcomed the increase in the electricity tariffs earlier this year which will help strengthen the financial position of the distribution company. However, staff also argued in favor of more transparency in energy subsidies which are currently provided through a system of VAT refunds as well as extra-budgetary channels under the cooperation with Venezuela. The authorities welcomed staff recommendations and committed to continue expanding the provision of information on international cooperation.

B. Monetary and External Sector Policies

17. Staff welcomed the authorities' commitment to increase international reserves and keep inflation under control. Given Nicaragua's highly dollarized system and the rigidity of the exchange regime, monetary policy appropriately focuses on the external position, and the central bank's operations are anchored by its objectives for the stock of international reserves. Staff supported the authorities' objective to increase gross international reserve and maintain them at above the equivalent of three months of imports, which is important for reducing external vulnerabilities.

18. The authorities stressed that the exchange rate regime based on a crawling peg has been beneficial for Nicaragua. It has helped anchor inflation expectations and maintain broad financial stability. Nevertheless, the authorities' agreed with staff assessment that the present rate of crawl (5 percent) has set a relatively high floor for domestic inflation which is generally higher in

Nicaragua than in its regional peers. In addition, it may be a factor contributing to rising dollarization. The authorities agreed with the staff's assessment and noted they would welcome technical assistance to develop a long-term strategy to reduce incentives for dollarization and that in that context would explore alternative exchange rate regime options.

19. The authorities acknowledged that Nicaragua is facing considerable external vulnerabilities. However, they noted that there is no significant misalignment of the exchange rate (Annex 1) and external reserves are above internationally recognized benchmarks. Nonetheless, they recognized risks stemming from the large external current account deficits and oil import dependency, the high level of external debt, and the economy's exposure to potential changes in the levels or terms of the oil collaboration with Venezuela. The authorities were confident that the probability for these risks to materialize was low, while agreeing on the merit of developing a contingency plan to deal with external shocks (to include additional financing and measures to compress expenditure).[5] They also committed to continue negotiations to complete bilateral debt reduction agreements with non-Paris Club creditors.[6]

20. Staff recommended close monitoring of commercial bank credit to the private sector. Staff cautioned that a rapid expansion in the banking system's exposure to the private sector in the context of high dollarization, in particular in the consumer loan sector, could pose risks. In that context, it urged close monitoring of banks' foreign exchange positions and of credit quality. The authorities broadly concurred with staff's assessment while noting that the recent credit expansion represented a rebound from the contraction in the aftermath of the global recession and was slowing in the course of the year. They also pointed to relatively strong capital adequacy indicators, and emphasized the stability of deposits, including those linked to the oil-collaboration scheme with Venezuela (about 8 percent of total deposits). However, they agreed that increased vigilance over credit quality and stress tests based on exchange rate and other shocks were warranted. Staff supported the authorities' intention to strengthen the supervision framework based on the evaluation of risks. Staff welcomed the authorities' commitment to continue providing transfers to the central bank to reduce its operational losses. Staff also encourages the authorities to improve the AML/CFT framework in line with the action plan agreed with the Financial Action Task Force to address remaining strategic deficiencies.

C. Structural Reforms

21. The authorities and staff agreed that achieving higher growth over the medium term would require substantial investments in infrastructure and significant progress in reforming

[5] In 2013, the authorities secured a contingency credit line of US$200 million with the Central American Bank for Economic Integration.

[6] At end-2012, debt to non-Paris Club creditors still subject to relief stood at US$1.5 billion (14 ½ percent of GDP). In 2011, an agreement with Libya was reached but is yet to be finalized. In 2012, an agreement with Iran was signed but the final approval by the Iran authorities is pending. In 2013, a consolidated loan agreement was signed with Taiwan and is pending parliamentary approval.

labor and product markets and education. Nicaragua needs to implement a broad program of structural reforms to boost annual output growth to about 5–6 percent to significantly raise income levels and reduce poverty. Indicators suggest that Nicaragua is behind its peers in key governance and doing business indicators (Annex 1) and there are other significant inefficiencies in the economy, as evidenced by a negative total factor productivity growth (on average -0.2 percent of GDP per year) experienced during 2001–11.[7] Progress is being achieved in some important areas, such as the electricity sector where blackouts have been largely eliminated and generation capacity is expanding, although high generation costs and other inefficiencies constitute an important impediment to growth. Similarly, rationalizing public spending, as well as the system of tax exemptions and subsidies would be important to reduce policy induced distortions. Also, significant reforms are needed in the labor and product markets to reduce informality, allow more competition, and further enhance conditions for private investment.

- **Electricity sector.** Nicaragua is highly dependent on oil imports (12 percent of GDP) which are a key input to electricity generation. However, large distribution losses, consumer subsidies, and below-cost tariff require subsidies to the electricity sector of about 1½ percent of GDP. The authorities' strategy is to expand access to electricity supplies nationwide as part of their social and economic modernization strategy, reduce distribution losses, and lower electricity costs by changing the generation matrix toward renewable energy sources. It is expected that efficiency gains and cost reductions, in part due to falling oil prices, would help eliminate the electricity tariff gap. In addition, they plan to review the tariff policy in view of their social policy objectives and the availability of public resources.
- **Labor and product markets and education.** High degree of informality in the economy hampers growth by inhibiting integration of small firms into the formal sector and limiting incentives to business expansion and productivity improvements. Low education levels also constrain growth in higher productivity areas. Addressing these challenges requires reducing incentives to informality in the economy, for example by easing access to social security schemes, simplifying tax filing, and improving business licensing procedures. It would be also important to better match the skills provided by the education system and those demanded by the labor market.

OTHER ISSUES

22. The authorities welcomed close collaboration with the Fund. They stressed the importance of close cooperation outside of a formal Fund program for maintaining confidence and donor support. The central bank announced that after many years of Fund-supported programs the Fund would continue to act as Nicaragua's trusted advisor in the context of staff visits, Article IV consultations, and technical assistance.

[7] Christian A. Johnson, "Potential Output and Output Gap in Central America, Panama and Dominican Republic" IMF Working Paper, WP/13/145.

23. Data provided to the Fund are broadly adequate for surveillance purposes. The recent revision to national accounts considerably improved reporting on real sector developments. However, the coverage and timelines of public financial accounts could be further improved. In particular, there are incompatible methodologies in the compilation budgetary data from "above" and "below" the line which contribute to delays in the reporting of reconciled revenue, expenditure, and financing accounts.

STAFF APPRAISAL

24. Nicaragua's recent macroeconomic performance has been favorable. The authorities deserve credit for sustaining fiscal discipline and prudent monetary management. In addition, the pursuit of important structural reforms in the areas of taxation, electricity sector, and social security has contributed to strengthening confidence and helped taking advantage of improving external conditions to boost economic growth. However, the economy continues to face important vulnerabilities stemming from high public and private debt and exposure to external shocks that will require careful management over the medium term.

25. Risks to the near-term outlook appear moderate. Under staff's baseline projections, economic growth is expected to slow to its long-term trend level and inflation would remain anchored by the exchange rate crawling peg regime. To support these outcomes and help reduce external vulnerabilities, it will be crucial to sustain the path of fiscal consolidation, implement key structural reforms, and protect the stability of the banking system. On the external side, Nicaragua could be adversely affected by slower than expected economic recovery in the United States and Europe and higher oil prices. Additional risks could arise from changes to the oil collaboration scheme with Venezuela.

26. Sustained fiscal consolidation should be the main anchor of the authorities' macroeconomic strategy. The draft budget for 2014 appropriately maintains the fiscal stance of this year. Staff welcomes the incorporation into the budget of the wage bonus ("*bono solidario*") by taking advantage of rising revenue yields and making adjustments in other expenditures. Staff supports the authorities' medium-term objective to lower public debt ratios to gain fiscal space for dealing with shocks and conducting countercyclical fiscal policy. To this end, it will be crucial to broaden the revenue base by fully implementing the elimination of tax exemptions envisaged in the 2012 reform, rationalize public expenditures, and reform the pension system to ensure its financial viability. This strategy should be complemented by renewed efforts to conclude negotiations on public debt reduction with the remaining non-Paris Club official creditors.

27. Staff welcomes the authorities' commitment to rationalize public expenditure and increase transparency of public sector operations. Key in this area would be a reform of subsidy policies in the electricity and other economic sectors. Staff recommended targeting electricity subsidies to the lowest income groups and providing them through a mechanism that is transparent and insulates the budget from shocks to international prices. This should also involve strengthening the financial position of public enterprises and avoiding intra-public sector arrears. Staff welcomed the increased provision to the public of information on international cooperation and recommended dissemination of full information on the financial flows and economic benefits of oil collaboration with Venezuela.

28. Reducing external vulnerabilities remains one of Nicaragua's key challenges. In this regard, the authorities' strategy to reduce dependence on oil imports through diversification of the generation matrix is welcome. Meanwhile, it will be important to develop contingency plans to address potential vulnerabilities stemming from high oil imports and potential volatility in the financing of large external current account deficits. Monetary policy will also have a role to play by keeping inflation under control to ensure that the real exchange rate remains broadly in line with fundamentals and international reserves coverage stays above the international benchmarks.

29. Financial system soundness indicators are satisfactory, but growing lending to the private sector warrants close monitoring. The average capital adequacy ratios of the banking system and indicators of non-performing loans remain relatively robust, and progress in strengthening risk-based supervision is welcome. However, the recent rapid increase in credit to the private sector in a highly dollarized system may pose risks and needs to be monitored. Staff supports the authorities' commitment to continue recapitalizing the central bank.

30. Staff welcomes the authorities' intention to advance the structural reform agenda and mobilize infrastructure investments needed to boost Nicaragua's productive capacity. It is imperative to build on the progress achieved in the electricity sector by further expanding its capacity and enhancing efficiency to reduce impediments to growth and reduce fiscal risks. Reforms to rationalize public spending and strengthening the framework for private investment would be critical for developing infrastructure. Reducing labor market informality and better matching of skills provided by the education system to those demanded by employers would also raise long-term growth prospects.

31. Staff recommends that the next Article IV Consultation take place on the standard 12-month cycle.

Box 1. Nicaragua: Implementation of Past IMF Policy Advice

During the 2012 Article IV consultation, Directors encouraged the authorities to maintain prudent macroeconomic policies, reduce external vulnerabilities, and step up the pace of structural reform. In particular, they stressed the need for fiscal consolidation, reforms to strengthen the revenue effort and to restore the pension system's viability, current expenditure restraint, and to tackle weaknesses in the energy sector. Overall, policies implemented since 2011 have followed past Fund advice, economic growth has picked up, and progress has been made in key structural areas.

Fiscal consolidation. The tax reform passed in December 2012 will reduce exemptions and help strengthen tax administration and revenues. With current expenditures under control, fiscal deficits have been small and public debt ratios have continued to decline. The adjustment in electricity tariffs and changes to the regulatory framework implemented in April 2013 will strengthen the financial position of public enterprises and reduce fiscal pressures. A social security reform currently under public consultation will also contribute to reducing fiscal risks.

External vulnerabilities. Gross international reserves have increased as envisaged at the last consultation, and reserves coverage of imports exceeds international benchmarks. To reduce dependence on oil imports, the authorities' strategy is to develop alternative energy sources, including with large private and external investment. The authorities are cognizant of the risks associated with large external current account deficits and high oil import bill and are considering developing a contingency plan to deal with unforeseen shocks (including additional financing and measures to compress expenditure).

Box 2. Nicaragua: New National Account Statistics

On September 20, 2012, Nicaragua launched new national account statistics. The improvements involve: (i) a change in base year (from 1994 to 2006); (ii) the implementation of a complete set of integrated economic accounts by institutional sector in accordance with the recommendations of the 1993 System of National Accounts; and (iii) the implementation of classifications and most relevant recommendations of the 2008 System of National Accounts. The revisions were conducted under the supervision of the Central Bank of Nicaragua with financial support from the Inter-American Development Bank. CAPTAC-DR provided technical assistance, in particular with respect to source surveys and statistical procedures for a new GDP base year. It also helped analyze the data on compensation of employees and savings while ensuring full consistency of the complete sequence of accounts among institutional sectors.

As a result of these improvements, nominal GDP was adjusted upward by about 30 percent. GDP per capita for 2012 is now estimated at US$1,762 (US$1,313 before the change); despite these revisions Nicaragua's per capita income remains the second lowest among countries in the Western Hemisphere. Fiscal and other ratios to GDP are markedly lower than reported in the 2012 Article IV report.

Gross Domestic Product: Main Changes in GDP and GDP Composition, 2006

(millions of cordobas)

	Base year		
	Old: 1994	**New: 2006**	**% diff.**
Gross domestic product	**91,897**	**119,235**	**29.7**
Of which, supply side:			
Agriculture, livestock, forestry, and fishing	15,141	18,879	24.7
Mining and quarrying	1,141	1,089	-4.5
Manufacturing	15,289	16,420	7.4
Electricity, gas, and water supply	2,501	1,774	-29.1
Construction	5,020	5,792	15.4
Trade, hotels, and restaurants	12,781	16,060	25.7
Transport and communication	5,037	7,311	45.1
Of which, demand side:			
Consumption expenditures	90,804	114,724	26.3
Gross capital formation	28,263	31,555	11.6
Public gross capital formation	4,720	4,896	3.7
Private gross capital formation	23,542	26,659	13.2
Changes in inventories	1,535	3,538	130.5
Exports of goods and services	41,779	32,240	-22.8
Imports of goods and services	69,626	59,284	-14.9

Source: Central Bank of Nicaragua; and IMF Statistics Department.

Box 3. Nicaragua: Oil Collaboration with Venezuela

Nicaragua's oil collaboration with Venezuela was agreed by Presidents Ortega and Chavez in April 2007. The collaboration is based on a broad framework for oil import-related financing as well as other financing (e.g., FDI) and debt servicing schemes (through in-kind repayments). In a nutshell, the scheme works as follows:

- PDVSA, a Venezuelan state-owned oil company, is Venezuela's representative under the agreement. It supplies petroleum and is a financial agent for FDI and other arrangements in Nicaragua.
- ALBANISA (*ALBA de Nicaragua*) was created in 2008 and is owned by PDVSA (51 percent) and PETRONIC (a Nicaraguan state-owned company; 49 percent). ALBANISA imports oil from PDVSA which is subsequently sold in Nicaragua at market prices. It also serves as Venezuela's agent in FDI in various sectors in Nicaragua's economy. Under the agreement, 100 percent of the oil bill is paid by ALBANISA to PDVSA within 90 days. On behalf of PDVSA, 50 percent of the oil bill (FOB) is then transferred to CARUNA (*Caja Rural Nacional*), a privately owned Nicaraguan financial cooperative, in the form of a long-term loan (payable over 25 years, with a 2-year grace period, 2 percent interest, and grant element of 30 percent).
- Under the oil collaboration scheme, 38 percent of the funds received by CARUNA are used for quasi-fiscal operations (e.g., subsidies and transfers for electricity and transport, and public sector wage bonuses). The remaining 62 percent is used to finance *for-profit* projects.
- Payments to PDVSA for oil or the debt service on oil financing can be made *in-cash* or *in-kind*. The latter can take place only through exports of goods by ALBALINISA (*ALBA Alimentos de Nicaragua*), a joint venture between ALBANISA and PDVSA, to Venezuela. ALBALINISA purchases primary products (e.g., cattle, beef, sugar, coffee, and beans) from domestic private firms and re-sells these to retail chains in Venezuela.

ALBA Collaboration Arrangements

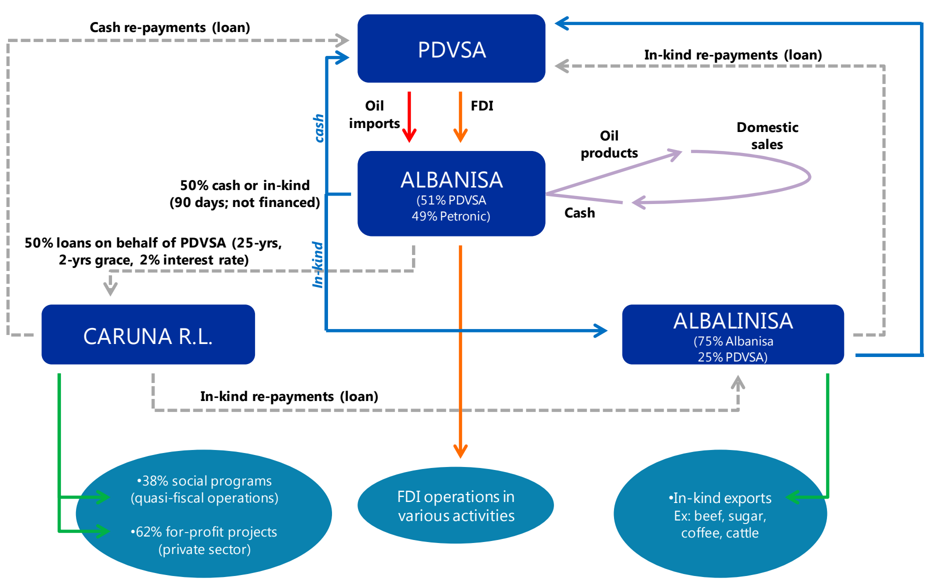
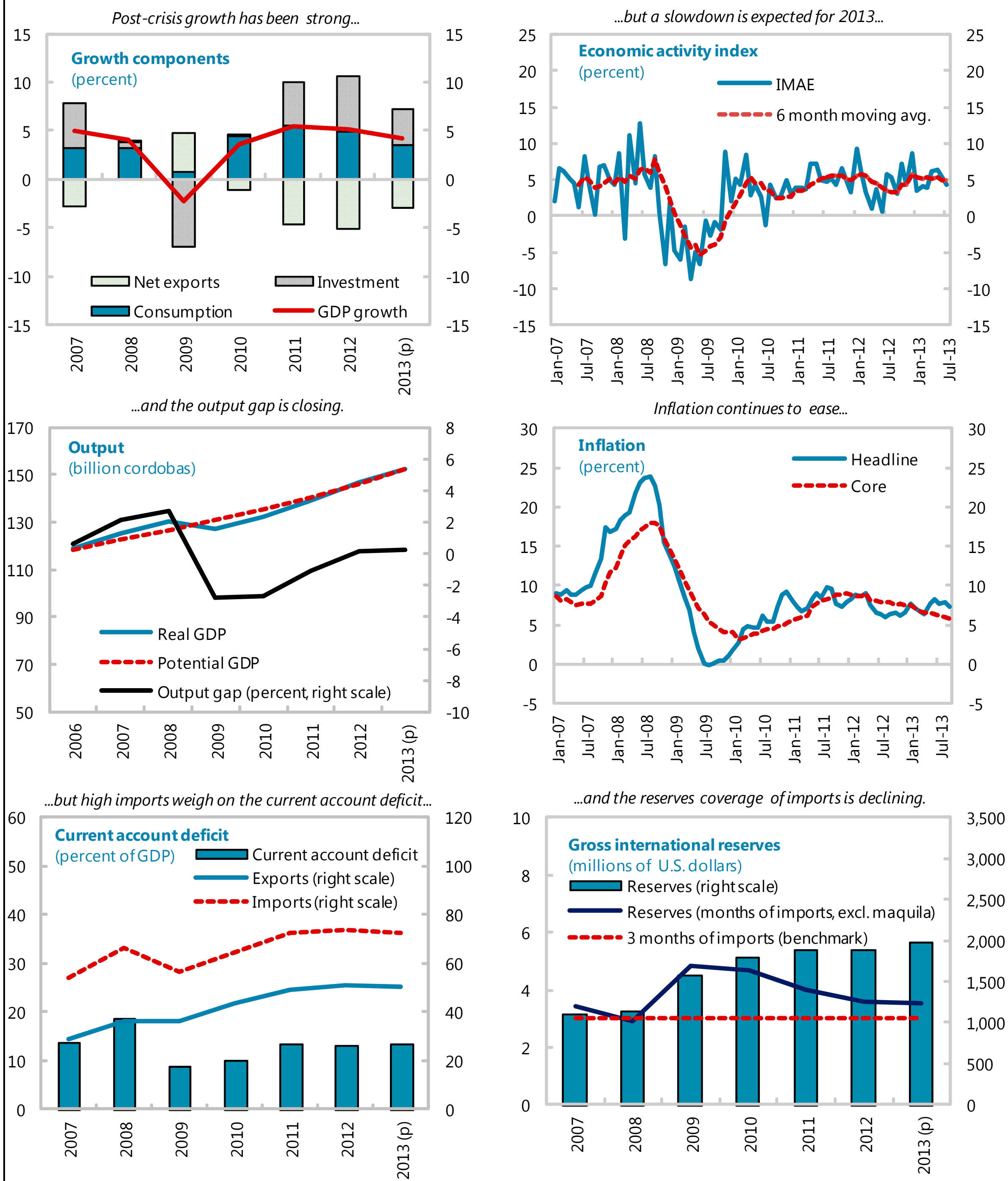
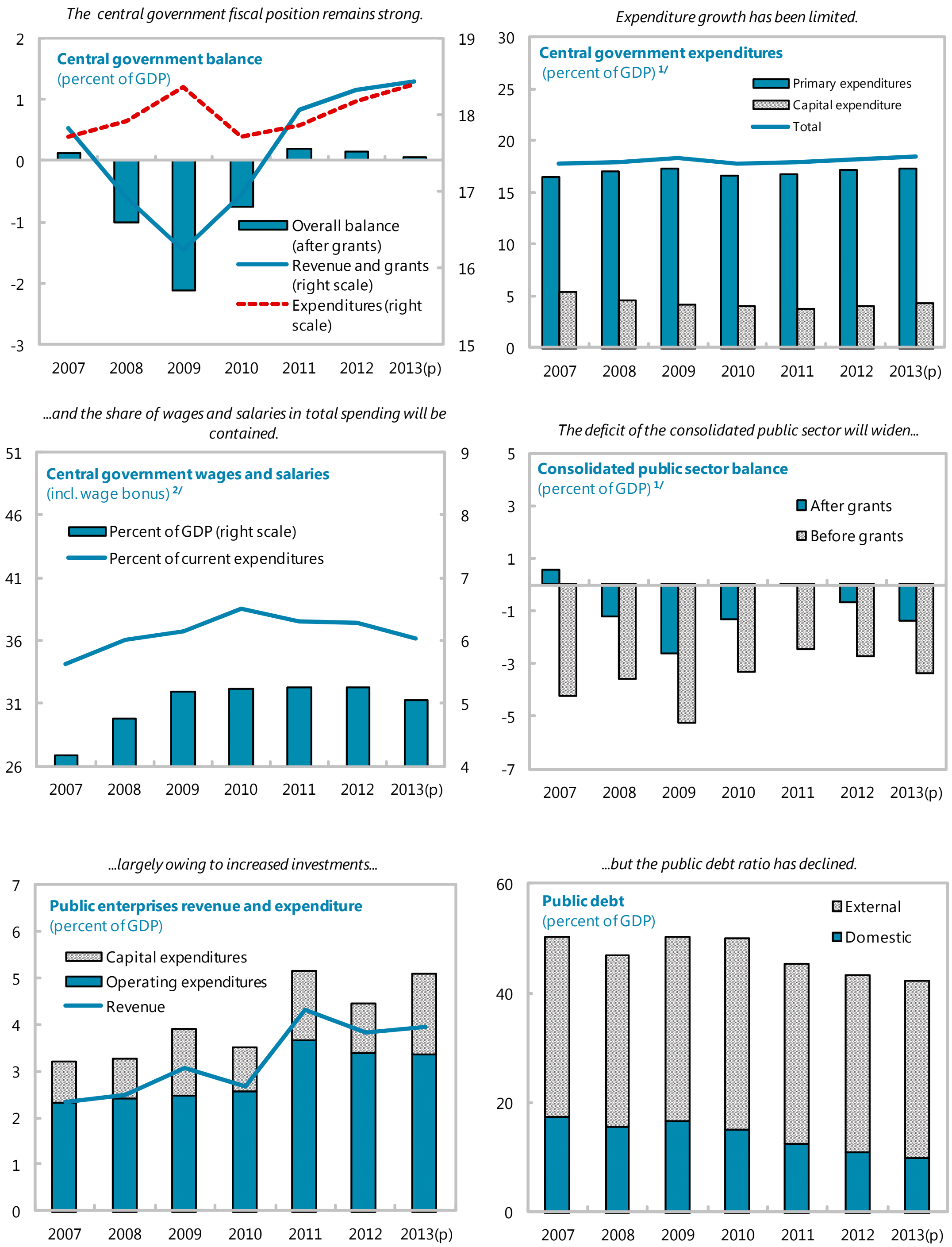


Figure 1. Nicaragua: Recent Economic Developments



Sources: Nicaraguan authorities; and Fund staff estimates and projections.

Figure 2. Nicaragua: Fiscal Developments

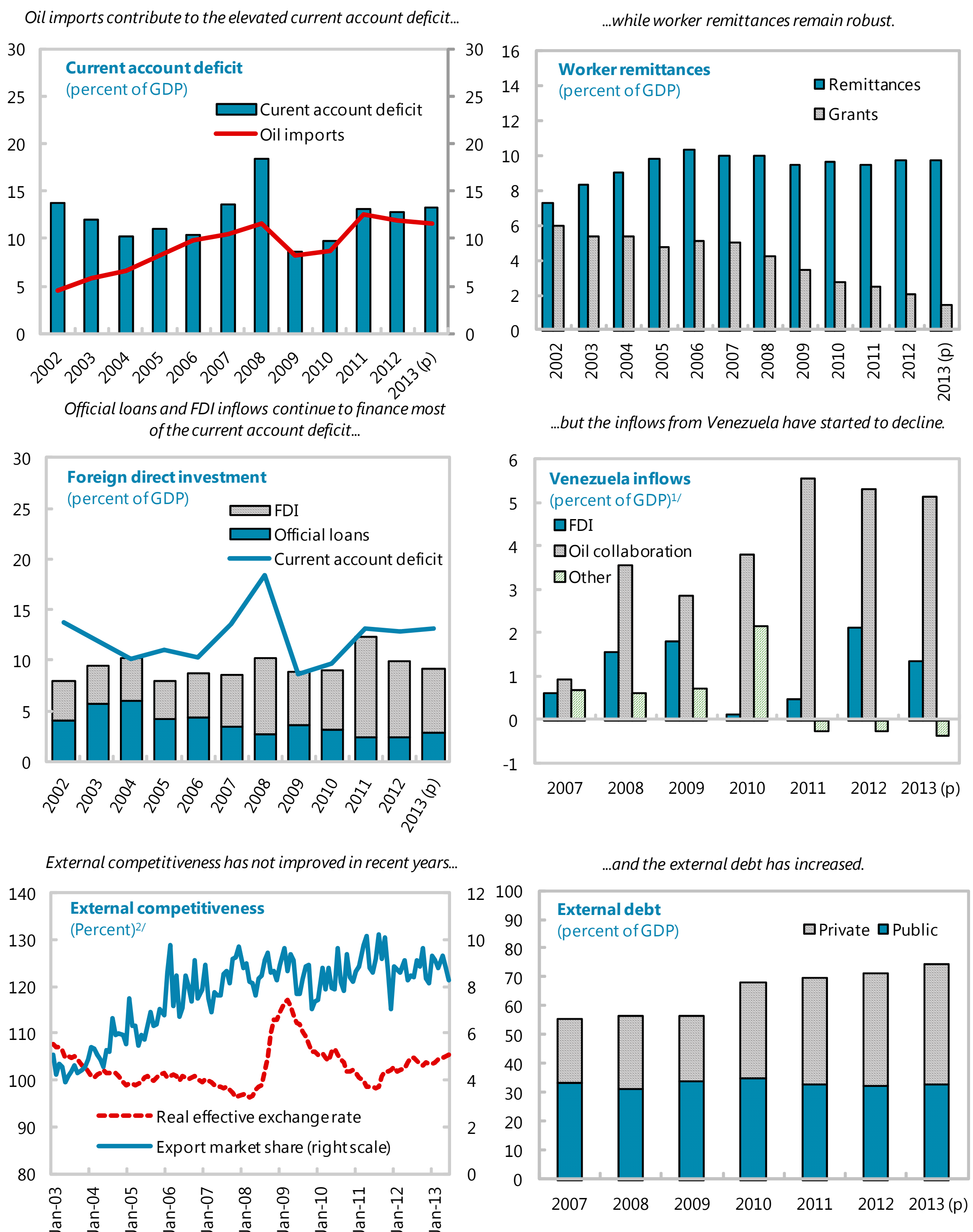


Sources: Nicaraguan Authorities; and Fund staff estimates and projections.

[1/] Includes the wage bonus of 2010-2012.

[2/] The series reflect a transfer of salaries of teachers and service from municipalities to the central government budget that took place in 2007.

Figure 3. Nicaragua: External Sector Developments

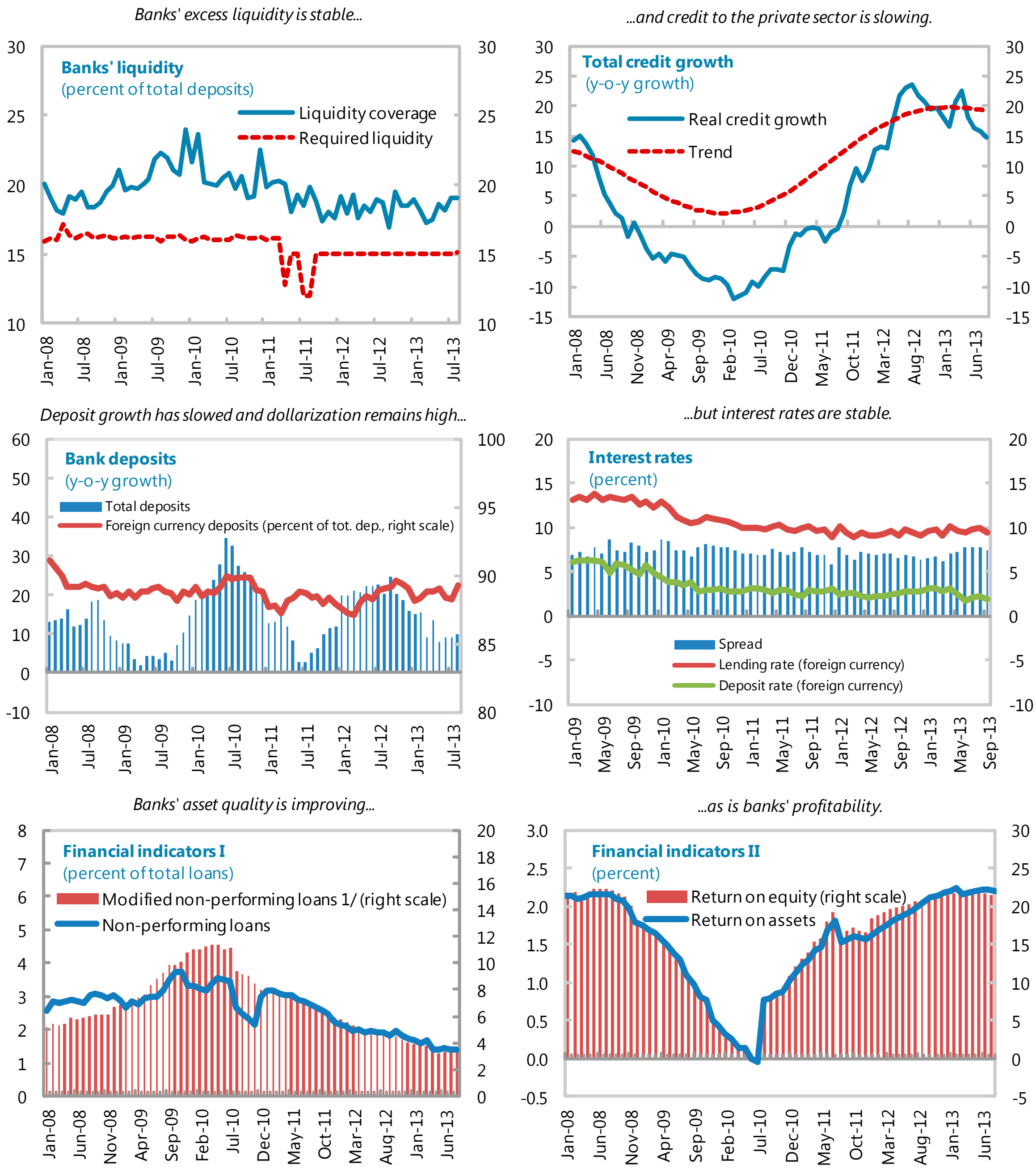


Source: Nicaraguan authorities; and Fund staff calculations.

1/ Include amortization service on debt.

2/ Market share is defined as imports of the US from Nicaragua as share of imports from all CAPDR .

Figure 4. Nicaragua: Monetary and Financial Sector Developments



Sources: Nicaragua authorities; and Fund Staff calculations.
1/ NPLs including restructured and reprogrammed loans.

Table 1. Nicaragua: Selected Social and Economic Indicators, 2010–14[1/]

I. Social and Demographic Indicators

Main export products: coffee, sugar (ethanol), meat, gold.			
GDP per capita (current U.S. dollars, 2012)	1,762	Share of national income of richest 10 percent	41.8
GNI per capita 2010 (Atlas method, current US$)	1,110	Unemployment (percent labor force, 2012)	5.6
GINI Index (2009)	46.0	Poverty rate (national pov. line, in percent, 2009)	42.5
Population (millions, 2012)	6.0	Adult literacy rate (percent, 2009)	83.0
Life expectancy at birth in years (2011)	74.1	Infant mortality rate (per 1,000 live births, 2012)	20.6

II. Economic Indicators

	2010	2011	2012	2013	2014
				Proj.	
Output					
GDP growth (percent)	3.6	5.4	5.2	4.2	4.0
GDP (nominal, US$ million)	8,587	9,636	10,506	…	…
Prices			(Percent)		
GDP deflator	7.0	12.3	8.8	8.1	7.0
Consumer price inflation(end of period)	9.2	8.0	6.6	6.9	7.0
Consumer price inflation (period average)	5.5	8.1	7.2	7.4	7.0
Exchange rate			(Cordobas per US$)		
End of period	21.9	23.0	24.1	…	…
Period average	21.4	22.4	23.6	…	…
Fiscal sector			(Percent of GDP)		
Combined public sector (CPS)					
Revenue	23.1	25.4	25.2	25.4	25.8
Expenditure	26.5	27.8	28.0	28.8	28.2
Current	21.2	22.0	22.1	21.9	21.7
of which : Wages & Salaries[2/]	6.4	6.4	6.5	6.3	6.1
Capital	5.3	5.8	5.9	6.9	6.5
Balance, before grants	-3.3	-2.4	-2.7	-3.4	-2.4
Overall balance, after grants	-1.3	0.0	-0.7	-1.4	-1.2
Money and credit			(Annual percentage change)		
Broad money (M3)	21.7	12.6	15.4	16.3	13.5
Credit to the private sector	5.9	15.6	26.3	16.2	15.7
Net domestic assets of the banking system	1.0	4.1	24.8	14.8	11.3
			(Percent of GDP, unless otherwise indicated)		
External sector					
Current account	-10.0	-13.2	-12.9	-13.2	-12.7
Of which: oil	-8.7	-12.6	-11.9	-11.7	-11.0
Capital and financial account[3/]	12.5	14.0	12.3	13.8	12.8
Of which: FDI	5.9	10.0	7.7	6.2	5.9
Gross reserves (US$ million)[3/]	1,800	1,892	1,887	1,977	2,022
(in months of imports excl. maquilas)	*4.7*	*4.0*	*3.6*	*3.5*	*3.4*
Net international reserves[3/]	1,633	1,711	1,718	1,825	1,891
Public sector debt	50.1	45.4	43.2	42.4	40.6
Private sector external debt	33.2	36.7	39.0	41.8	44.3

Sources: Central Bank of Nicaragua; Ministry of Finance; World Bank; and Fund staff estimates and projections.

[1/] All data are based on the new national accounts data that were launched officially on September 20, 2012.

[2/]Data for 2010–13 include the off-budget wage bonus financed with Venezuela-related resources. For 2014, the wage bonus is assumed to be absorbed by the budget.

[3/]Data for 2010–14 include the SDR allocation for SDR105.1 million (US$165 million) of September 2009.

Table 2a. Nicaragua: Operations of the Central Government, 2010–14

(Millions of Córdobas)

	2010	2011	2012	2013	2014
				Proj.	
Total Revenue	**27,575**	**34,548**	**40,730**	**46,262**	**52,082**
Tax	25,586	31,825	37,222	42,924	48,392
Income and property	8,481	11,335	13,347	15,871	18,417
Net domestic VAT[1/]	4,028	4,605	5,219	5,507	6,141
Excises (domestic and imported)	5,541	6,070	6,884	7,849	8,910
Other (VAT to imports)	7,535	9,814	11,772	13,697	14,924
Nontax and current transfers	1,989	2,723	3,508	3,338	3,689
Total Expenditure	**32,487**	**38,611**	**44,955**	**51,267**	**56,570**
Current expenditures	24,922	30,339	34,802	39,070	42,188
Wages and salaries[2/]	9,606	11,390	13,034	14,129	15,181
of which: bonus	673	1,334	1,571	1,662	0
Goods and services	4,867	6,341	7,606	8,504	9,297
Interest	1,991	2,262	2,465	3,064	2,930
of which: external[3/]	594	709	778	1,040	1,291
Current transfers	8,459	10,346	11,697	13,373	14,779
Capital Expenditures	7,564	8,272	10,154	12,197	14,382
Domestically financed	1,699	2,245	4,385	4,604	5,343
Externally financed	5,866	6,027	5,768	7,593	9,039
Overall balance (before grants)	**-4,912**	**-4,063**	**-4,226**	**-5,005**	**-4,488**
Grants[2/]	3,507	4,485	4,597	5,114	3,358
of which: Project-related	2,396	3,151	3,026	3,452	3,358
Primary balance (after grants)	**586**	**2,684**	**2,836**	**3,173**	**1,800**
Overall balance (after grants)	**-1,405**	**423**	**371**	**109**	**-1,130**
Net Financing	**1,405**	**-423**	**-371**	**-109**	**1,130**
External	3,458	3,019	2,983	3,703	5,031
Amortizations	-921	-865	-817	-1,549	-1,820
Disbursements	4,380	3,884	3,800	5,253	6,851
Project-related	3,470	2,876	2,742	4,141	5,681
Budget support	910	1,008	1,058	1,112	1,170
Domestic	-2,053	-3,442	-3,354	-3,812	-3,901
Memorandum items:					
GDP (nominal)	183,381	216,084	247,421	278,735	310,176

Sources: Central Bank of Nicaragua; Ministry of Finance; and Fund staff estimates and projections.

[1/] Excludes VAT rebates granted as subsidies in the electricity sector.

[2/] From 2011-2013, includes the off-budget wage bonus that was financed with Venezuela-related resources. Starting in 2014 the bonus is included in the budget.

[3/] Assuming that outstanding debt to non-Paris Club bilaterals is settled on HIPC-equivalent terms by the end of 2012. Debt service is recorded on payment basis after debt relief.

Table 2b. Nicaragua: Operations of the Central Government, 2010–14
(Percent of GDP)

	2010	2011	2012	2013	2014
				Proj.	
Total Revenue	**15.0**	**16.0**	**16.5**	**16.6**	**16.8**
Tax	14.0	14.7	15.0	15.4	15.6
Income and property	4.6	5.2	5.4	5.7	5.9
Net domestic VAT[1/]	2.2	2.1	2.1	2.0	2.0
Excises (domestic and imported)	3.0	2.8	2.8	2.8	2.9
Other (VAT to imports)	4.1	4.5	4.8	4.9	4.8
Nontax and current transfers	1.1	1.3	1.4	1.2	1.2
Total Expenditure	**17.7**	**17.9**	**18.2**	**18.4**	**18.2**
Current expenditures	13.6	14.0	14.1	14.0	13.6
Wages and salaries[2/]	5.2	5.3	5.3	5.1	4.9
of which: bonus	0.4	0.6	0.6	0.6	0.0
Goods and services	2.7	2.9	3.1	3.1	3.0
Interest	1.1	1.0	1.0	1.1	0.9
of which: external[3/]	0.3	0.3	0.3	0.4	0.4
Current transfers	4.6	4.8	4.7	4.8	4.8
Capital Expenditures	4.1	3.8	4.1	4.4	4.6
Domestically financed	0.9	1.0	1.8	1.7	1.7
Externally financed	3.2	2.8	2.3	2.7	2.9
Overall balance (before grants)	**-2.7**	**-1.9**	**-1.7**	**-1.8**	**-1.4**
Grants[2/]	1.9	2.1	1.9	1.8	1.1
of which: Project-related	1.3	1.5	1.2	1.2	1.1
Primary balance (after grants)	**0.3**	**1.2**	**1.1**	**1.1**	**0.6**
Overall balance (after grants)	**-0.8**	**0.2**	**0.1**	**0.0**	**-0.4**
Net Financing	**0.8**	**-0.2**	**-0.1**	**0.0**	**0.4**
External	1.9	1.4	1.2	1.3	1.6
Amortizations	-0.5	-0.4	-0.3	-0.6	-0.6
Disbursements	2.4	1.8	1.5	1.9	2.2
Project-related	1.9	1.3	1.1	1.5	1.8
Budget support	0.5	0.5	0.4	0.4	0.4
Domestic	-1.1	-1.6	-1.4	-1.4	-1.3

Sources: Central Bank of Nicaragua; Ministry of Finance; and Fund staff estimates and projections.

[1/] Excludes VAT rebates granted as subsidies in the electricity sector.

[2/] From 2011-2013, includes the off-budget wage bonus that was financed with Venezuela-related resources. Starting in 2014 the bonus is included in the budget.

[3/] Assuming that outstanding debt to non-Paris Club bilaterals is settled on HIPC-equivalent terms by the end of 2012. Debt service is recorded on payment basis after debt relief.

Table 3a. Nicaragua: Operations of the Combined Public Sector, 2010–14
(Millions of Córdobas)

	2010	2011	2012	2013	2014
				Proj.	
Central government balance	**-1,405**	**423**	**371**	**109**	**-1,130**
Revenue	27,575	34,548	40,730	46,262	52,082
Expenditure 1/	32,487	38,611	44,955	51,267	56,570
Grants 1/	3,507	4,485	4,597	5,114	3,358
Social Security Institute (INSS) balance	**1,492**	**1,449**	**370**	**91**	**45**
Revenue	9,627	10,875	11,941	13,905	15,889
Expenditure 3/	8,135	9,440	11,581	13,821	15,847
Managua municipality (ALMA) balance	**86**	**-83**	**-271**	**-503**	**86**
Public Enterprises balance 2/	**-960**	**-1,231**	**-1,334**	**-2,993**	**-1,631**
Revenue	4,908	9,314	9,505	10,971	13,112
Expenditure	6,427	11,174	11,059	14,231	15,175
Grants	164	629	220	267	433
Central Bank (BCN) operating balance	**-1,249**	**-656**	**-796**	**-580**	**-1,022**
Consolidated public sector					
Total Revenue	42,424	54,860	62,411	70,822	80,018
Total Expenditure	48,547	60,105	69,161	80,208	87,516
Current Expenditures	38,830	47,581	54,567	61,042	67,206
Wages and salaries 1/	11,717	13,934	16,040	17,456	18,795
Goods and services	8,088	10,082	11,931	13,691	15,370
Interest	2,187	2,524	2,650	3,297	3,256
Other current expenditures	16,839	21,041	23,947	26,598	29,784
Capital Expenditures	9,717	12,524	14,593	19,165	20,310
Overall balance (before grants)	**-6,124**	**-5,245**	**-6,749**	**-9,386**	**-7,498**
Grants 1/	3,693	5,146	5,089	5,510	3,847
Primary balance (after grants)	**-244**	**2,425**	**990**	**-580**	**-395**
Overall balance (after grants)	**-2,431**	**-99**	**-1,660**	**-3,876**	**-3,651**
Net Financing	**2,431**	**99**	**1,660**	**3,876**	**3,651**
External	4,706	4,070	4,931	6,449	6,651
Amortizations	-940	-996	-840	-1,610	-1,923
Disbursements	5,647	5,066	5,771	8,059	8,574
Domestic	-3,524	-4,628	-4,067	-3,153	-4,022
Central Bank (BCN) operating balance	1,249	656	796	580	1,022
Memorandum items:					
GDP (nominal)	183,381	216,084	247,421	278,735	310,176

Sources: Central Bank of Nicaragua; Ministry of Finance; and Fund staff estimates and projections.

1/ From 2011-2013, includes the off-budget wage bonus that was financed with Venezuela-related resources. Starting in 2014 the bonus is included in the budget.

2/ Includes the state-owned airport, oil, food, water and sewer, electricity generation, electricity transmission, and port companies, as well as the telecommunications and the electricity regulators.

3/ From 2013, it includes the payment of the reduced pension.

Table 3b. Nicaragua: Operations of the Combined Public Sector, 2010–14
(Percent of GDP)

	2010	2011	2012	2013	2014
				Proj.	
Central government balance	**-0.8**	**0.2**	**0.1**	**0.0**	**-0.4**
Revenue	15.0	16.0	16.5	16.6	16.8
Expenditure[1/]	17.7	17.9	18.2	18.4	18.2
Grants[1/]	1.9	2.1	1.9	1.8	1.1
Social Security Institute (INSS) balance	**0.8**	**0.7**	**0.1**	**0.0**	**0.0**
Revenue	5.2	5.0	4.8	5.0	5.1
Expenditure[3/]	4.4	4.4	4.7	5.0	5.1
Managua municipality (ALMA) balance	**0.0**	**0.0**	**-0.1**	**-0.2**	**0.0**
Overall Public Enterprises balance[2/]	**-0.5**	**-0.6**	**-0.5**	**-1.1**	**-0.5**
Revenue	2.7	4.3	3.8	3.9	4.2
Expenditure	3.5	5.2	4.5	5.1	4.9
Grants	0.1	0.3	0.1	0.1	0.1
Central Bank (BCN) operating balance	**-0.7**	**-0.3**	**-0.3**	**-0.2**	**-0.3**
Consolidated public sector					
Revenue	23.1	25.4	25.2	25.4	25.8
Expenditure	26.5	27.8	28.0	28.8	28.2
Current Expenditures	21.2	22.0	22.1	21.9	21.7
Wages and salaries[1/]	6.4	6.4	6.5	6.3	6.1
Goods and services	4.4	4.7	4.8	4.9	5.0
Interest	1.2	1.2	1.1	1.2	1.0
Other current expenditures	9.2	9.7	9.7	9.5	9.6
Capital Expenditures	5.3	5.8	5.9	6.9	6.5
Overall balance (before grants)	**-3.3**	**-2.4**	**-2.7**	**-3.4**	**-2.4**
Grants[1/]	2.0	2.4	2.1	2.0	1.2
Primary balance (after grants)	-0.1	1.1	0.4	-0.2	-0.1
Overall balance (after grants)	**-1.3**	**0.0**	**-0.7**	**-1.4**	**-1.2**
Net Financing	**1.3**	**0.0**	**0.7**	**1.4**	**1.2**
External	2.6	1.9	2.0	2.3	2.1
Amortizations	-0.5	-0.5	-0.3	-0.6	-0.6
Disbursements	3.1	2.3	2.3	2.9	2.8
Domestic	-1.9	-2.1	-1.6	-1.1	-1.3
Central Bank (BCN) operating balance	0.7	0.3	0.3	0.2	0.3

Sources: Central Bank of Nicaragua; Ministry of Finance; and Fund staff estimates and projections.

[1/]From 2011-2013, includes the off-budget wage bonus that was financed with Venezuela-related resources. Starting in 2014 the bonus is included in the budget.

[2/]Includes the state-owned airport, oil, food, water and sewer, electricity generation, electricity transmission, and port companies, as well as the telecommunications and the electricity regulators.

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

Table 4. Nicaragua: Nonfinancial Public Sector Gross Financing Requirements, 2010–14[1/]

	2010	2011	2012	2013	2014
				Proj.	
			(Millions of U.S. dollars)		
a. NFPS primary deficit (before grants)	**184**	**121**	**174**	**246**	**163**
CG and public enterprises	254	185	189	250	165
INSS	-70	-64	-15	-3	-2
b. Debt service obligations	**328**	**445**	**397**	**365**	**411**
External	**74**	**78**	**72**	**109**	**128**
Interest	30	34	36	44	54
Amortization	44	44	36	65	74
Domestic	**254**	**367**	**325**	**256**	**283**
Interest	73	79	77	89	71
Amortization of Bonds	139	155	192	194	151
Other Amortizations	42	133	57	-27	61
c. Gross financing needs (a+b)	**512**	**566**	**571**	**612**	**575**
d. Financing sources	**512**	**566**	**571**	**612**	**575**
External	**406**	**396**	**394**	**481**	**478**
Disbursements	264	226	245	326	330
Grants[2/]	141	170	149	156	148
Domestic	**48**	**141**	**143**	**107**	**57**
Grants (Caruna wage bonus)	32	60	67	67	0
Deposits Central Bank	-39	27	-94	0	-30
Commercial banks	-64	-49	65	-10	-13
Bond issuance (gross)	120	103	104	50	100
Central Bank	**58**	**29**	**34**	**23**	**39**
			(Percent of GDP)		
a. NFPS primary deficit (before grants)	**2.1**	**1.3**	**1.7**	**2.2**	**1.4**
CG and public enterprises	3.0	1.9	1.8	2.2	1.4
INSS	-0.8	-0.7	-0.1	0.0	0.0
b. Debt service obligations	**3.8**	**4.6**	**3.8**	**3.2**	**3.4**
External	**0.9**	**0.8**	**0.7**	**1.0**	**1.1**
Interest	0.3	0.3	0.3	0.4	0.5
Amortization	0.5	0.5	0.3	0.6	0.6
Domestic	**3.0**	**3.8**	**3.1**	**2.3**	**2.4**
Interest	0.8	0.8	0.7	0.8	0.6
Amortization of Bonds	1.6	1.6	1.8	1.7	1.3
Other Amortizations	0.5	1.4	0.5	-0.2	0.5
c. Gross financing needs (a+b)	**6.0**	**5.9**	**5.4**	**5.4**	**4.8**
d. Financing sources	**6.0**	**5.9**	**5.4**	**5.4**	**4.8**
External	**4.7**	**4.1**	**3.8**	**4.3**	**4.0**
Disbursements	3.1	2.3	2.3	2.9	2.8
Grants[2/]	1.6	1.8	1.4	1.4	1.2
Domestic	**0.6**	**1.5**	**1.4**	**0.9**	**0.5**
Grants (Caruna wage bonus)	0.4	0.6	0.6	0.6	0.0
Deposits Central Bank	-0.5	0.3	-0.9	0.0	-0.3
Commercial banks	-0.7	-0.5	0.6	-0.1	-0.1
Bond issuance (gross)	1.4	1.1	1.0	0.4	0.8
Central Bank	**0.7**	**0.3**	**0.3**	**0.2**	**0.3**

Sources: Central Bank of Nicaragua; Ministry of Finance; and Fund staff estimates and projections.

[1/]Includes the central government, Social Security Institute, Managua municipality (ALMA), state-owned airport, oil, food, water and sewer, electricity generation, electricity transmission, and port companies, as well as the telecommunications and the electricity regulators.

[2/]Figures from 2011 includes the off-budget wage bonus financed with Venezuela-related resources.

Table 5. Nicaragua: Summary Accounts of Central Bank and Financial System, 2010—2014
(In billions of Cordobas, unless otherwise indicated)

	2010	2011	2012	2013	2014
				Proj.	
			I. Central Bank		
Net Foreign Assets1/	**-3.2**	**-1.6**	**-1.9**	**0.5**	**2.0**
Net International Reserves	**33.7**	**37.0**	**38.8**	**43.2**	**46.9**
Net International Reserves (In bill. US$)	1.6	1.7	1.7	1.8	1.9
Gross Reserves	37.4	41.2	42.9	47.1	50.4
Gross Reserves (In bill. US$)	1.8	1.9	1.9	2.0	2.0
Short-Term Foreign Liabilities	3.7	4.2	4.1	3.9	3.5
Net Domestic Assets	**19.2**	**20.0**	**21.5**	**21.2**	**21.7**
Net Domestic Credit	43.1	43.6	42.4	44.2	45.2
Capital Accounts	1.4	1.5	2.4	3.0	3.2
o/w Quasi-fiscal loss	1.2	0.7	0.8	0.6	1.0
Other Items (Net)	-7.0	-7.0	-6.9	-7.0	-7.0
Monetary Base (Currency issue)	**16.0**	**18.4**	**19.6**	**21.6**	**23.8**
Currency In Circulation	9.9	11.4	13.2	14.8	16.4
Reserves from Other Depository Corporations	4.6	6.9	5.9	6.8	7.3
			II. Deposit Money Banks		
Net Foreign Assets	**6.8**	**10.9**	**6.7**	**6.3**	**7.5**
Net Foreign Assets (In bill. US$)	0.3	0.5	0.3	0.2	0.3
Net Domestic Assets	**48.9**	**51.5**	**65.6**	**75.4**	**85.0**
Net Domestic Credit	65.2	73.8	86.5	97.0	109.5
Claims on Central Bank2/	23.8	25.8	24.0	25.6	26.2
Net Credit To Other Financial Corporations	-4.6	-4.7	-5.2	-5.9	-6.6
Net Credit To Nonfinancial Public Sector	0.6	0.3	1.4	0.2	0.6
Credit To Private Sector	45.4	52.5	66.3	77.1	89.2
Capital Accounts	-8.6	-9.7	-11.8	-12.3	-13.0
Other Items (Net)	-7.7	-12.6	-9.1	-9.3	-11.5
Liabilities	**55.8**	**62.4**	**72.3**	**81.7**	**92.5**
Deposits in Domestic Currency	6.2	7.5	7.9	8.6	9.6
Deposits in Foreign Currency	49.5	54.8	64.4	73.1	82.9
Deposits in Foreign Currency (In US$)	2.3	2.4	2.7	2.9	3.1
			III. Banking System3/		
Net Foreign Assets	**3.6**	**9.3**	**4.8**	**6.7**	**9.6**
Net Foreign Assets (In US$)	0.2	0.4	0.2	0.3	0.4
Net Domestic Assets	**60.4**	**62.8**	**78.4**	**90.0**	**100.1**
Net Domestic Credit	84.5	91.7	104.9	115.6	128.5
Net Credit To Nonfinancial Public Sector	43.6	43.8	43.7	44.3	45.8
Credit To Private Sector	45.5	52.6	66.4	77.2	89.3
Net Credit To Other Financial Corporations	-4.6	-4.7	-5.2	-5.9	-6.6
Other Items (Net)	-24.1	-28.9	-26.5	-25.6	-28.3
o/w Capital Accounts	-7.3	-8.2	-9.4	-9.3	-9.8
Broad Money (M3)	**64.0**	**72.1**	**83.2**	**96.7**	**109.7**
	(Percent change, y-o-y, unless otherwise specified)				
Memorandum Items					
NIR adjusted (in bill. US$)4/	0.3	0.5	0.6	0.6	0.6
Credit to private sector	5.9	15.6	26.3	16.2	15.7
Net Domestic Assets	1.0	4.1	24.8	14.8	11.3
Currency issue	25.4	14.8	6.5	10.4	10.0
Currency in circulation	30.3	15.0	15.9	12.0	11.0
Deposits in Cordobas	17.5	21.0	4.8	8.4	11.6
Deposits in FX currency	20.4	10.7	17.4	13.6	13.4
M2	26.2	19.2	9.0	25.6	13.5
M2 Velocity (ratio of GDP to M2)	12.7	12.5	13.2	11.8	11.6
M3	21.7	12.6	15.4	16.3	13.5
M3 Velocity (ratio of GDP to M3)	2.9	3.0	3.0	2.9	2.8

Sources: Central Bank; and Fund staff estimates.
1/ Net International Reserves minus Medium and Long-Term net Foreign Assets of the Central Bank.
2/ Reserves and holdings of securities issued by Central Bank.
3/ Banking System excludes other financial institutions.
4/ Gross reserves net of short term foreign currency liabilities to residents and non-residents (including Fund obligations).

Table 6. Nicaragua: Quasi-fiscal Balance of the Central Bank, 2010—2014

	2010	2011	2012	2013	2014
				Proj.	
			(Millions of Cordobas)		
Quasi-fiscal balance	**-1,249**	**-656**	**-796**	**-580**	**-1,022**
Revenue	**422**	**588**	**757**	**742**	**612**
Interest	357	517	683	642	504
International reserves	62	49	54	72	95
Notes and Bonds	45	126	351	339	157
Loans of the CBN (CENI)	218	216	215	219	222
On MTI bonds (fluctuation in price)	31	126	57	10	30
Other revenues	65	71	74	101	108
Expenditure	**1,671**	**1,244**	**1,553**	**1,322**	**1,634**
Administrative	395	409	484	586	702
Interest	1,157	835	716	704	901
External debt	131	114	108	86	96
Securities	676	332	194	180	360
Bonds (banking)	201	208	215	219	222
Other	150	181	198	218	224
Cost of issuing money bills and Other Exp.	118	0	353	33	31
			(Percent of GDP)		
Quasi-fiscal balance	**-0.7**	**-0.3**	**-0.3**	**-0.2**	**-0.3**
Revenue	**0.2**	**0.3**	**0.3**	**0.3**	**0.2**
Interest	0.2	0.2	0.3	0.2	0.2
International reserves	0.0	0.0	0.0	0.0	0.0
Notes and Bonds	0.0	0.1	0.1	0.1	0.1
On SDR-IMF	0.0	0.0	0.0	0.0	0.0
Loans of the CBN	0.1	0.1	0.1	0.1	0.1
On MTI bonds (fluctuation in price)	0.0	0.1	0.0	0.0	0.0
Other revenues	0.0	0.0	0.0	0.0	0.0
Expenditure	**0.9**	**0.6**	**0.6**	**0.5**	**0.5**
Administrative	0.2	0.2	0.2	0.2	0.2
Interest	0.6	0.4	0.3	0.3	0.3
External debt	0.1	0.1	0.0	0.0	0.0
Securities	0.4	0.2	0.1	0.1	0.1
Bonds (banking)	0.1	0.1	0.1	0.1	0.1
Other	0.1	0.1	0.1	0.1	0.1
Cost of issuing money bills	0.1	0.0	0.1	0.0	0.0
Memorandum Items					
Stock of CB Securities (Mill cordobas)	6,249	6,101	6,004	6,511	6,511
Percent of GDP	3.4	2.8	2.4	2.3	2.1

Sources: Central Bank; and Fund staff estimates.

Table 7. Nicaragua: Medium-Term Balance of Payments, 2011–18[1/]

(In millions of U.S. dollars; unless otherwise indicated)

	2011	2012	2013	2014	2015	2016	2017	2018
			Proj.					
Current account	**-1,268**	**-1,350**	**-1,488**	**-1,515**	**-1,542**	**-1,650**	**-1,678**	**-1,688**
Trade balance	-2,068	-2,161	-2,283	-2,346	-2,387	-2,452	-2,492	-2,560
Exports, f.o.b.	4,057	4,628	4,913	5,237	5,572	5,931	6,299	6,691
Imports, f.o.b.	-6,125	-6,789	-7,196	-7,584	-7,960	-8,383	-8,792	-9,251
Of which: oil imports	-1,216	-1,245	-1,315	-1,313	-1,313	-1,325	-1,340	-1,370
Services	-175	-207	-220	-235	-249	-275	-291	-309
Receipts	663	712	755	798	846	897	951	1,008
Payments	-838	-919	-975	-1,033	-1,095	-1,172	-1,242	-1,316
Income	-254	-292	-301	-346	-408	-472	-471	-479
Credits	19	23	17	12	13	21	22	22
Debits	-273	-314	-317	-358	-421	-493	-493	-501
Transfers to the private sector	1,230	1,310	1,316	1,412	1,502	1,548	1,577	1,660
Of which : remittances	912	1,014	1,095	1,197	1,312	1,378	1,425	1,529
Capital and financial account	**1,346**	**1,294**	**1,556**	**1,527**	**1,575**	**1,675**	**1,780**	**1,787**
Official	376	390	401	413	467	499	474	493
Official transfers	232	215	157	171	184	188	180	186
Of which: grants	232	215	157	171	184	188	180	186
Public debt, net (a+b)	159	187	244	242	282	310	293	307
Disbursements (a)	226	245	326	330	386	439	430	465
NFPS	226	245	326	330	386	439	430	465
Other public sector	0	0	0	0	0	0	0	0
Amortization (b)	-67	-58	-82	-88	-103	-129	-137	-158
NFPS	-40	-36	-65	-74	-89	-106	-116	-137
Other public sector	-27	-22	-17	-14	-15	-23	-21	-21
Other	-16	-12	0	0	0	0	0	0
Private	970	904	1,155	1,114	1,108	1,177	1,306	1,295
Foreign direct investment	968	805	699	706	736	803	853	904
Capital transfers	4	0	0	0	0	0	0	0
Financial system and other capital flows	-1	100	456	408	373	374	453	391
Overall balance	**78**	**-56**	**69**	**13**	**33**	**25**	**102**	**100**
Change in gross official reserves (- increase)	-92	5	-90	-45	-72	-65	-134	-128
Exceptional financing	30	38	5	10	10	9	8	8
IMF, ECF Arrangements	-16	13	17	22	29	32	24	20
Purchases	-18	0	0	0	0	0	0	0
Repurchases and Repayments	2	13	17	22	29	32	24	20
Memorandum items								
Current account (in percent of GDP)	-13.2	-12.9	-13.2	-12.7	-12.2	-12.3	-11.8	-11.2
Alba-related flows (in percent of GDP)	5.8	7.2	6.1	6.4	5.0	3.9	3.9	3.3
Gross reserves	1,892	1,887	1,977	2,022	2,094	2,159	2,294	2,422
in months of imports excl. maquila	4.0	3.6	3.5	3.4	3.4	3.3	3.4	3.4
Oil price (average, US$/bbl)	104.0	105.0	104.5	101.3	95.3	91.2	88.5	86.7
Public external debt (in percent of GDP)	33.0	32.2	32.6	32.7	32.9	33.4	33.3	32.4

Sources: Central Bank of Nicaragua; and Fund staff estimates and projections.

[1/] Assuming that HIPC-equivalent terms were applied to the outstanding debt to non-Paris Club bilaterals.

Table 8. Nicaragua: Financial Soundness Indicators, 2009–13

(In percent, unless otherwise indicated)

	2009	2010	2011	2012	2013 Mar.	2013 Jun.	2013 Aug.
Capital adequacy							
Regulatory capital to risk-weighted assets	16.5	16.6	14.8	13.1	12.9	12.9	12.9
Regulatory Tier 1 capital to risk-weighted assets[1/]	10.9	11.1	9.2	8.6	8.4	8.7	8.9
Asset quality							
Nonperforming loans to total gross loans	3.3	3.0	2.2	1.7	1.7	1.4	1.4
Nonperforming loans to total gross loans[2/]	10.9	8.0	5.9	4.0	3.7	3.3	3.3
Nonperforming loans net of provisions to capital	33.4	20.3	12.6	6.5	4.8	3.6	3.5
Sectoral distribution of loans							
Commercial	35.7	35.3	35.4	...	...	...	...
Agricultural	9.5	11.8	13.0	...	...	...	...
Consumer	26.2	24.0	22.2	...	...	...	...
Construction	15.6	15.4	14.3	...	...	...	...
Industrial	9.5	11.2	13.0	...	...	...	...
Others	3.5	2.3	2.1	...	...	...	...
Earnings and profitability							
Return on assets	0.5	1.0	1.6	2.2	2.2	2.2	2.2
Return on equity	4.8	10.8	16.7	21.5	21.5	21.7	21.5
Interest margin to assets	8.7	7.0	6.2	6.4	6.5	6.6	6.7
Liquidity							
Liquid assets to total assets	29.5	28.7	27.2	24.6	24.4	27.9	27.5
Liquid assets to total short-term liabilities	139.4	120.8	129.9	37.8	37.9	43.4	43.2
Exposure to FX risk							
Net open position in foreign exchange to capital	81.4	99.4	92.6	106.3	123.3	116.4	113.4
Number of institutions[3/]	9	8	8	8	8	8	8
Total assets (in millions of cordobas)	79,754	91,681	105,316	113,360	120,114	124,131	126,823
Bank concentration							
Number of banks accounting individually for at least 25% of total assets	1	2	2	2	2	2	2
Share of total assets of 3 largest institutions (percent)	77	81	82	81	81	81	81
Total assets (in percent of GDP)							
Private commercial	63.8	68.7	64.4	77.4	82.1	84.8	86.6
Of which: Foreign banks[4/]	29.1	26.3	18.3	32.0	34.4	35.4	35.6
Bank deposits (percentage of GDP)							
Private commercial	45.2	52.8	50.1	59.1	62.9	64.9	65.8
Of which: Foreign banks[4/]	20.0	20.0	14.6	24.2	26.1	26.6	27.1
Dollarization and maturity structure							
Banking system assets as percentage of GDP	63.8	68.7	64.4	77.4	82.1	84.8	86.6
Assets in foreign currency as percentage of banking system assets	70.2	72.0	71.6	74.4	75.3	74.1	74.3

Sources: Superintendency of Banks; and Central Bank of Nicaragua.

[1/] In 2006 a regulatory change narrowed the definition of Tier 1 capital.

[2/] NPLs including restructured and reprogrammed loans.

[3/] In 2009, HSBC (with deposits less than one percent of total deposits) closed its operations in Nicaragua. In July 2010 Banex closed its operations in Nicaragua.

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

Table 9. Nicaragua: Indicators of Capacity to Repay the Fund, 2012–18

	2012	2013	2014	2015	2016	2017	2018
Fund obligations based on existing and prospective credit							
In millions of SDRs	1.4	4.0	14.4	19.4	21.1	15.7	13.3
In millions of U.S. dollars	2.1	6.1	22.1	29.6	32.1	23.9	20.2
In percent of exports of goods and nonfactor services	0.0	0.1	0.4	0.5	0.5	0.3	0.3
In percent of external public debt service	2.3	4.9	15.5	18.2	16.8	12.0	9.0
In percent of quota	1.1	3.1	11.1	14.9	16.2	12.1	10.2
In percent of gross international reserves	0.1	0.3	1.1	1.4	1.5	1.0	0.8
Fund credit outstanding							
In millions of SDRs	110.0	99.3	84.9	65.7	44.8	29.2	16.0
In millions of U.S. dollars	168.5	152.6	130.1	100.5	68.4	44.5	24.3
In percent of exports of goods and nonfactor services	3.2	2.7	2.2	1.6	1.0	0.6	0.3
In percent of external public debt service	184.8	121.1	91.3	61.6	35.8	22.2	10.8
In percent of quota	84.6	76.4	65.3	50.5	34.5	22.5	12.3
In percent of gross international reserves	8.9	7.7	6.4	4.8	3.2	1.9	1.0
Memorandum items							
Exports of goods and services (millions of U.S. dollars)	5,340	5,668	6,036	6,418	6,827	7,250	7,699
External public debt service (millions of U.S. dollars)	91	126	143	163	191	200	225
Quota (millions of SDRs)	130	130	130	130	130	130	130
Quota (millions of U.S. dollars)	199	200	199	199	198	198	198
Gross international reserves (millions of U.S. dollars)	1,887	1,977	2,022	2,094	2,159	2,293	2,422
SDR per U.S. dollars (period average)	0.7	0.7	0.7	0.7	0.7	0.7	0.7

Source: Fund staff calculations.

Table 10. Nicaragua: Medium-Term Macroeconomic Framework, 2011–18

	2011	2012	2013	2014	2015	2016	2017	2018
					Proj.			
Growth and Prices				(Percent)				
GDP growth	5.4	5.2	4.2	4.0	4.0	4.0	4.0	4.0
GDP deflator	12.3	8.8	8.1	7.0	7.0	7.0	7.0	7.0
Consumer price inflation (eop)	8.0	6.6	6.9	7.0	7.0	7.0	7.0	7.0
Consumer price inflation (average)	8.1	7.2	7.4	7.0	7.0	7.0	7.0	7.0
Saving and Investment				(Percent of GDP)				
Investment (I)	30.8	30.3	30.3	30.4	31.1	31.3	31.7	31.7
Private	25.5	25.0	24.7	24.4	24.5	24.5	24.6	24.6
Public	5.4	5.3	5.6	6.0	6.7	6.8	7.1	7.1
Saving (S)	17.7	17.4	17.1	17.7	19.0	19.0	19.9	20.5
Private	12.4	12.8	12.8	12.9	13.6	14.1	14.1	14.4
Public	5.3	4.6	4.2	4.8	5.4	4.9	5.8	6.1
Net resources (S-I)	-13.2	-12.9	-13.2	-12.7	-12.2	-12.3	-11.8	-11.2
Private	-13.1	-12.2	-11.8	-11.5	-10.9	-10.4	-10.5	-10.2
Public	0.0	-0.7	-1.4	-1.2	-1.3	-1.9	-1.3	-1.0
Public finances								
Combined public sector								
Revenue	25.4	25.2	25.4	25.8	26.2	26.4	26.7	26.8
Expenditure	27.8	28.0	28.8	28.2	28.9	29.6	29.2	29.1
Overall balance, after grants	0.0	-0.7	-1.4	-1.2	-1.3	-1.9	-1.3	-1.0
Public sector debt	45.4	43.2	42.4	40.6	39.7	39.3	38.6	37.5
Balance of payments								
Current account	-13.2	-12.9	-13.2	-12.7	-12.2	-12.3	-11.8	-11.2
(in US$ million)	-1,268	-1,350	-1,488	-1,515	-1,542	-1,650	-1,678	-1,688
Gross reserves (US$ m)[1/]	1,892	1,887	1,977	2,022	2,094	2,159	2,294	2,422
(in months of imports excl. maquilas)	*4.0*	*3.6*	*3.5*	*3.4*	*3.4*	*3.3*	*3.4*	*3.4*
Net international reserves (adjusted)[2/]	1,023	1,125	1,171	1,191	1,240	1,332	1,529	1,443
Memorandum items:								
GDP (US$ million)	9,636	10,506	11,272	11,946	12,660	13,418	14,220	15,071

Sources: Central Bank of Nicaragua; Ministry of Finance; World Bank; and Fund staff estimates and projections.

[1/]Starting in 2009, figures include the SDR allocation for SDR105.1 million (US$165 million) of September 2009.

[2/]Includes deposit insurance fund (FOGADE) and excludes the September 2009 SDR allocation and reserve requirements of commercial banks in foreign currency.

Table 11. Nicaragua: Millenium Development Goals, 1990,1995, and, 2000-2010

	1990	1995	2000	2005	2010[1]
Goal 1: Eradicate extreme poverty and hunger					
Employment to population ratio, 15+, total (%)	55.1/a	53.8	56.2	58.1	59.8/h
Employment to population ratio, ages 15-24, total (%)	46.7/a	46.4	46.2	46.2	46/h
Poverty gap at $1.25 a day (PPP) (%)	5.6/b	3.1/d	3.7/e	2.4	...
Malnutrition prevalence, weight for age (% of children under 5)	9.6/b	10.6/d	7.8/e	4.3/f	...
Prevalence of undernourishment (% of population)	55.1/a	44.9	34.3	26.7	20.1/h
Goal 2: Achieve universal primary education					
Primary completion rate, total (% of relevant age group)	39.5	49.5	66.2	74.6	80.9
School enrollment, primary (% net)	67.5	73.4	81.1	88.0	92.5
Goal 3: Promote gender equality and empower women					
Proportion of seats held by women in national parliaments (%)	14.8	10.8/c	9.7	20.7	40.2/i
Ratio of girls to boys in primary and secondary education (%)	...	106.2/d	105.2	101.9	101.6
Goal 4: Reduce child mortality					
Immunization, measles (% of children ages 12-23 months)	82.0	85.0	86.0	97.0	99.0/h
Mortality rate, infant (per 1,000 live births)	50.3	41.1	31.0	26.3	20.6/i
Mortality rate, under-5 (per 1,000 live births)	66.1	52.3	40.1	31.6	24.4/i
Goal 5: Improve maternal health					
Births attended by skilled health staff (% of total)	...	64.6/d	66.9/e	73.7/g	...
Contraceptive prevalence (% of women ages 15-49)	...	60.3/d	68.6/e	72.4/g	...
Maternal mortality ratio (modeled estimate, per 100,000 live births)	170	150	130	110	95
Goal 6: Combat HIV/AIDS, malaria, and other diseases					
Incidence of tuberculosis (per 100,000 people)	108	85	68	53	40/h
Prevalence of HIV, total (% of population ages 15-49)	0.1	0.1	0.1	0.1	0.2/h
Tuberculosis case detection rate (%, all forms)	66	72	70	66	100
Goal 7: Ensure environment sustainability					
CO2 emissions (metric tons per capita)	0.62	0.60	0.74	0.80	0.78
Forest area (% of land area)	37.5	...	31.7	28.8	25.3/h
Improved sanitation facilities (% of population with access)	43.0	46.0	48.0	50.0	52.1/h
Improved water source (% of population with access)	73.9	76.9	80.0	82.9	85.0/h
Terrestrial protected areas (% of total land area)	15.4	29.3	36.7	36.7	36.7
Goal 8: Develop a global partnership for development					
Internet users (per 100 people)	0	0.03	1.0	2.6	13.5/i
Mobile cellular subscriptions (per 100 people)	0	0.09	1.8	20.6	89.8/i

Source: Millennium Development Goals, World Bank.
[1/]Or latest available data. a) 1991; b) 1993; c) 1997; d) 1998; e)2001; f) 2004; g) 2007; h) 2011; i) 2012
Note: A superscript indicates the nearest available data point for the respective column (year).

ANNEX I. Nicaragua: External Sustainability and External Competitiveness Assessment

I. Exchange Rate and Competitiveness

Estimates based on the CGER methodology (macroeconomic balance approach, external sustainability approach, and equilibrium real exchange rate (ERER) approach) suggest that the exchange rate is overvalued by about 4.9 percent (simple average of the three CGER-based methodologies). This conclusion masks a range of estimates (between 1.8 percent and 7.8 percent) and is subject to significant methodological uncertainties. [1] Analysis based on other indicators points to a mixed picture. The export market shares have moderately improved, but weak business environment, governance and corruption perceptions continue to weigh on Nicaragua's external competitiveness. Over the medium-term, the external current account deficit will decline as changing energy matrix will reduce oil import dependence, but still will remain large at about 12 percent of GDP (on average in 2014–18). As a result, vulnerability stemming from external current account deficits and associated external financing needs will persist.

A. CGER Assessment

Historically, Nicaragua's external current account deficits have been large (on average about 14.3 percent of GDP during 2003–12). The current account deficit for 2013 is expected to widen to 13.2 percent of GDP, from 12.9 percent of GDP in 2012 on account of lower external demand, continued FDI-related imports, and temporary import of machinery for the energy sector. FDI, fiscal balances, global spillovers via remittances and exports, oil imports, and real growth are the key drivers of the current account deficit in Nicaragua.

Exchange Rate Assessment: Baseline Results

	Medium-term
Actual current account (% of GDP)	-12.0
(-) Temporary factors (% of GDP)[1/]	-0.4
Underlying current account (% of GDP) (A)	-11.6
Trade elasticity (D)[2/]	-0.21
Current account gap	
Macroeconomic balance (% of GDP)	
Current account norm (% of GDP) (B)	-10.5
Current account gap (% of GDP) C=A-B	-1.1
Misalignment= C/D	**5.2**
External sustainability (% of GDP)	
Current account norm (% of GDP) (B)	-9.9
Current account gap (% of GDP) C=A-B	-1.6
Misalignment= C/D	**7.8**
Reduced-form approach (FEER)	
REER (E)	128.2
EREER (F)	125.9
Misalignment (G)[3/]	**1.8**

[1/] Excluding imports of machinery for the energy sector.
[2/] Based on estimated elasticity of current account to change in REER, and estimated export and import volume elasticities.
[3/] G=100*(Log(E/100)-Log(F/100))

- **Macroeconomic balance approach.** The current account norm for Nicaragua is estimated at -10.5 percent of GDP considering projected medium-term

[1] Limitations also include sensitivity to staff macroframework and estimates of trade elasticities.

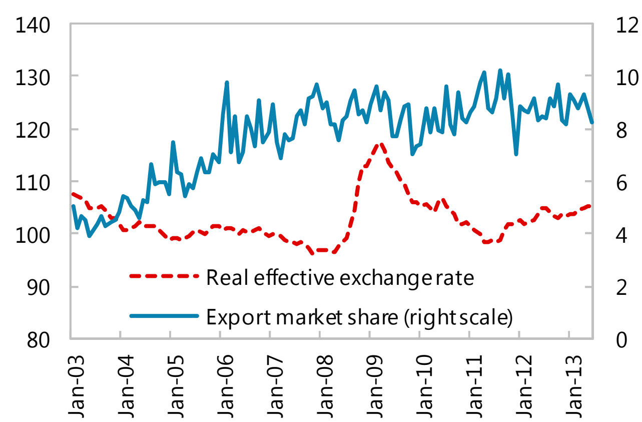
fundamentals through 2018. The underlying current deficit is estimated to be 11.6 of GDP after adjusting the medium-term current account by temporary factors (temporary import of machinery for energy sector estimated at 0.4 percent of GDP). A comparison of the norm and the underlying current account using elasticities of current account to change in REER, and export and import volume estimated for Nicaragua yields an overvaluation of 5.2 percent.

- **External sustainability approach.** As of end-2012, the estimated net International Investment Position was -123.7 percent of GDP. According to the external sustainability approach, an external current account deficit of 9.9 percent would stabilize the net IIP. Given the underlying current account deficit of 11.6 percent of GDP, the resulting overvaluation is estimated at 7.8 percent.

- **The equilibrium real exchange rate approach (ERER).** The ERER is estimated as a function of terms of trade, government consumption, relative productivity (computed as GDP per working population), and remittance and FDI inflows.[2] This approach suggests a modest overvaluation of 1.8 percent.

B. Other Assessment

Various indicators suggest that Nicaragua's competitiveness performance is mixed both relative to historical trends and to its regional peers. Nicaragua's exports as share of trading partners' non-oil imports have moderately increased since 2009. At the same time, Nicaragua has demonstrated its ability to attract high levels of FDI, which is attributed to a positive record on personal safety and low labor cost.



Sources: Information Notice System; Balance of Payments Statistics; and IMF staff estimates.

- **Market share.** There was a moderate increase in the country's exports volume and in the share of exports in trading partners' non-oil imports. The net maquila trade and the manufacturing exports also increased their market shares.

- **Business environment, governance, and global competitiveness.** According to the World Bank's Doing Business Indicators, Nicaragua continues to rank lowest among its regional peers.[3] These indicators suggest

[2] The inclusion of the last two explanatory variables improves the overall fit of the model.

[3] These indicators should be interpreted with caution due to a limited number of respondents, a limited geographical coverage, and standardized assumptions on business constraints and information availability.

that Nicaragua's relative weaknesses are regulatory processes, paying taxes, starting a business, construction permits, and perceived corruption. However, personal safety and low business costs of crime and violence are favorable factors for investment in Nicaragua relative to its regional peers. The global competitiveness index shows similar results.

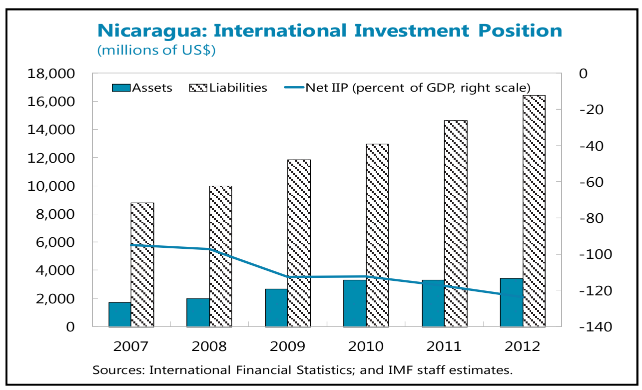
Country ranking, 2005–13

	Doing Business Indicators[1/]			Corruption Perceptions Index			Business Costs of Crime and Violence		
	2011	2012	2013	2005	2011	2012	2007	2010	2013
Nicaragua	120	120	119	107	134	130	74	101	105
Median									
Regional peers	112	112	111.5	79	99	96	104	117	130
Regional peers									
Costa Rica	122	122	110	51	50	48	94	104	108
Dominican Republic	113	113	116	85	129	118	99	120	127
El Salvador	111	111	113	51	80	83	118	131	143
Guatemala	98	98	93	117	120	113	122	132	144
Honduras	129	129	125	107	129	133	117	123	142
Panama	62	62	61	65	86	83	75	89	118

Source: World Bank Doing Business Report; Transparency International; and World Economic Forum Global Competitiveness Reports 2007-2013.
[1/] Lower indicator suggests better business conditions.

II. International Investment Position

The net international investment position of Nicaragua has deteriorated significantly since 2007, particularly on the liability side. While the country's asset position improved marginally, the liabilities increased rapidly, reflecting in part the accumulation of private sector debt. As a result, the net international investment position has deteriorated to -124 percent of GDP in 2012 from -95 percent of GDP in 2007.



III. Reserve Adequacy

Nicaragua's holdings of international reserves will remain broadly in line with international benchmarks. . Based on preliminary information, gross international reserves of Nicaragua are expected to reach US$2.0 billion or equivalent to 3.5 months of imports (excluding maquila) and 110 percent of broad money by end-2013. Reserves adequacy assessment e based on traditional measures suggests that reserves are projected to be above benchmarks such as broad money, short-term debt; three month of imports (excluding maquila). Furthermore using the risk-weighted measure, reserves are expected to stay above the adequacy threshold of 100–150 over the medium-term. Finally, based on the IMF 2011 Optimal Reserve Metric for Low-Income Countries which factor in the cost of holding reserves, the optimal reserve stood at 3.2 months of imports (excluding maquila).

Ratios of Reserves to Optimal Reserves based on Various Measures

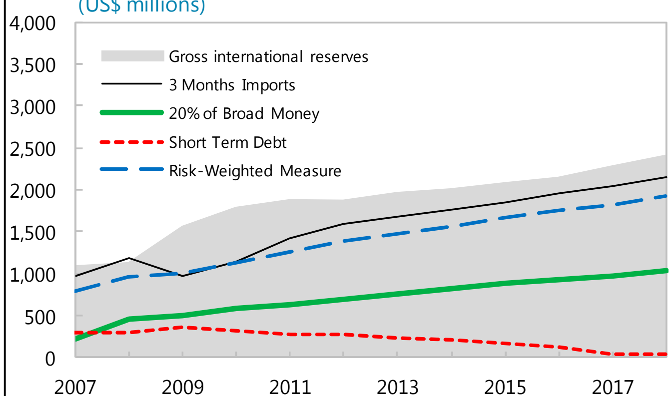
(In percent)

	Risk-Weighted Measure	3 months Import	20% of Broad Money	Short Term Debt
2007	139	114	489	379
2008	120	97	246	382
2009	157	162	312	434
2010	157	157	308	568
2011	149	133	302	682
2012	136	119	274	682
2013	133	118	259	824
2014	129	114	245	993
2015	126	113	238	1,189
2016	123	110	233	1,652
2017	126	112	235	4,693
2018	126	112	234	4,796
Adequate Range	100-150	100	100	100

Sources: Country authorities; and staff estimates.

Gross International Reserves and Adequacy Metrics

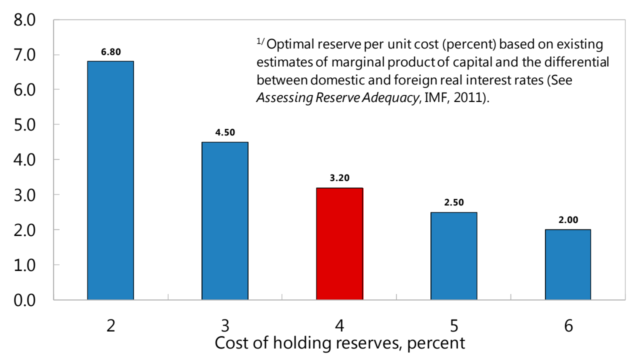
(US$ millions)



Sources: Country authorities; and staff estimates.

Optimal Level of Reserves[1/]

(months of imports)



Sources: Country authorities; and staff estimates.

INTERNATIONAL MONETARY FUND

NICARAGUA

STAFF REPORT FOR THE 2013 ARTICLE IV CONSULTATION—DEBT SUSTAINABILITY ANALYSIS[1]

November 14, 2013

Approved By
Saul Lizondo and Dhaneshwar Ghura (IMF) and J. Humberto Lopez and Jeffrey D. Lewis (IDA)

The Debt Sustainability Analysis (DSA) has been prepared jointly by IMF and World Bank staff, in consultation with the authorities.

The IMF and the World Bank 2013 Debt Sustainability Analysis (DSA) indicates that Nicaragua's risk of external public debt distress remains moderate. All present value debt ratios have declined following the recent reform of the discount rate; however, an alternative scenario points to vulnerabilities arising from contingent liabilities (e.g., if private debt is taken over by the public sector). The DSA of public debt suggests that debt levels are high, but that debt dynamics are sustainable although subject to, contingent liability risks. The DSA underscores the need to: (i) continue borrowing mostly on concessional terms; (ii) build up fiscal buffers over the next decade to lower debt ratios and strengthen the capacity to respond to shocks; (iii) reduce oil dependency; (iv) continue to make efforts to conclude ongoing debt relief negotiations; and (v) remain alert to contingent liability risks.

[1] This appendix was prepared in the context of the Article IV consultation mission held in September 2013. It updates the last comprehensive DSA conducted in June 2010 (SM/10/156, Supplement 1) and a DSA update in the Staff Report for the 7th Review of the ECF (Country Report No. 11/322).

BACKGROUND

1. **This is the third DSA for Nicaragua prepared under the joint Bank-Fund Low-Income Country (LIC) Debt Sustainability Framework since 2007.** As in 2010, the 2013 DSA includes an assessment of the external indebtedness of the financial and non-financial private sector. The 2010 external DSA concluded that Nicaragua was at moderate risk of debt distress, with vulnerabilities arising from a depreciation shock, lower growth, and lack of external adjustment; in addition, less favorable financing terms temporarily deteriorated debt and debt-service ratios. The 2010 DSA of public debt concluded that debt levels were high, but that debt dynamics were sustainable.

2. **Four changes have been included in this comprehensive DSA relative to the one in 2010.** First, nominal GDP has been revised upwards (about 30 percent) on account of the publication of new national accounts data.[2] Second, Nicaragua was reclassified in 2011 as a medium performer (instead of a strong performer) based on its 3–year average CPIA rating (this was also reported to the Board in 2011 during the 7th review of Nicaragua's ECF). Nicaragua has since recorded some improvement in its CPIA rating, but this is not yet sufficient for it to be re-classified again as a strong performer.[3] Third, as per a recent Board decision, the discount rate has been revised upward from 4 percent (in the 2010 DSA) to 5 percent (3 percent in the 2011 DSA).[4] And fourth, this DSA includes remittances in the baseline scenario.[5]

[2] The authorities launched on September 20, 2012 a new set of national accounts with 2006 as the base year. Nominal GDP has been revised upwards by about 30 percent. The revision, supported by technical assistance from CAPTAC-DR, uses improved source surveys an statistical procedures and a new base year (2006) to calculate GDP. The revision in nominal GDP has a large impact on debt-to-GDP ratios.

[3] The IMF-World Bank debt sustainability framework (DSF) uses policy dependent external debt thresholds based on the principle that the debt levels LICs can sustain are influenced by the quality of a country's policies and institutions. Such policies and institutions are assessed by the Country Policy and Institutional Assessment (CPIA) index compiled by the World Bank. The DSF divides countries into three performance categories: strong (CPIA >= 3.75), medium (3.75 > CPIA > 3.25), and poor (CPIA <= 3.25). Nicaragua's current rating (3–year average of 2010-12, as defined in the LIC DSA guidelines) is 3.68.

[4] The Executive Boards of the IMF and World Bank approved on October a reform of the discount rate (SM/13/271). The reform unifies the discount rate used for DSF and grant element calculations at 5 percent.

[5] The joint World Bank-IMF interim guidance on the use of remittances in DSF recommends that countries with large remittances conduct the DSA with remittances in the base case. Nicaragua is considered a large remittances country (i.e., the ratios of remittances-to-GDP and remittances-to-exports of goods and services are 10.3 and 26.6 percent, respectively, during the period 2003-12; these ratios are above the established thresholds of 10 and 20 percent).

DEBT PORTFOLIO

3. Nicaragua's public and publicly-guaranteed external debt ratios have declined, but external debt relief negotiations have progressed slowly. After reaching its completion point in 2004, Nicaragua received debt relief from bilateral (mostly Paris Club members) and multilateral official creditors. Progress was also made in restructuring public debt with private creditors.[6] The government is making efforts to conclude negotiations with non-Paris Club members, but progress with some of these countries has been slower.

Text table 1. Nicaragua: Stock Structure, 2007–12

	Million of US dollars			Percent of total debt			Percent of GDP		
	2007	2010	2012	2007	2010	2012	2007	2010	2012
Total	5,316	7,251	8,799	100.0	100.0	100.0	71.4	85.7	84.8
Public	3,659	4,198	4,429	68.8	57.9	50.3	49.1	50.1	43.2
External[1/]	2,402	2,934	3,307	45.2	40.5	37.6	32.3	35.0	32.2
Domestic	1,257	1,264	1,123	23.6	17.4	12.8	16.9	15.1	10.9
Of Which : BPIs	898	668	545	16.9	9.2	6.2	12.1	7.8	5.2
Private	1,658	3,053	4,370	31.2	42.1	49.7	22.3	35.6	41.6
Of which: ALBA	n.a.	1,084	2,186	n.a.	14.9	24.8	n.a.	12.6	20.8

Sources: Central Bank of Nicaragua; Ministry of Finance; and Fund staff estimates and projections.
[1/]Excluding non-Paris Club outstanding debt relief.

4. At end-2012, debt to non-Paris Club bilateral creditors still subject to relief stood at US$1.5 billion (equivalent to 14½ percent of GDP and 35 percent of total outstanding external debt). This amount excludes Taiwan that is in the process of being resolved. Of the ten countries holding claims on Nicaragua still subject to debt relief, only Taiwan receives debt-service payments as this debt was incurred after the cutoff date and an agreement has recently been reached.[7] In addition, bilateral and multilateral debt relief from Spain, Slovak Republic, FIDA, and Nordic Funds for US$32 million has been granted since the 2010 DSA.[8] It is also worth noting that Nicaragua's public and publicly-guaranteed (PPG) external debt (including debt still subject to relief) is almost equally divided between the central government and the central bank. Most of this PPG external debt is owed to multilateral institutions or to non-Paris Club official creditors.

[6] In 2007-08, a commercial debt buy-back operation (with support from the World Bank's Debt Reduction Facility) resolved outstanding debt to private creditors (both domestic and external) for US$1.4 billion or 19 percent of 2007 GDP; the participation rate exceeded 95 percent and it provided relief for 95 percent of the outstanding principal.

[7] In 2011, an agreement with Libya was reached but is yet to be finalized. In 2012, an agreement with Iran was signed but the final approval by the Iran authorities is pending. In 2013, a consolidated loan agreement was signed with Taiwan and legislative approval is pending.

[8] Negotiations on a US$23.6 million claim by Honduras' electricity company are being settled in the context of official bilateral debt relief negotiations with non-Paris Club member countries.

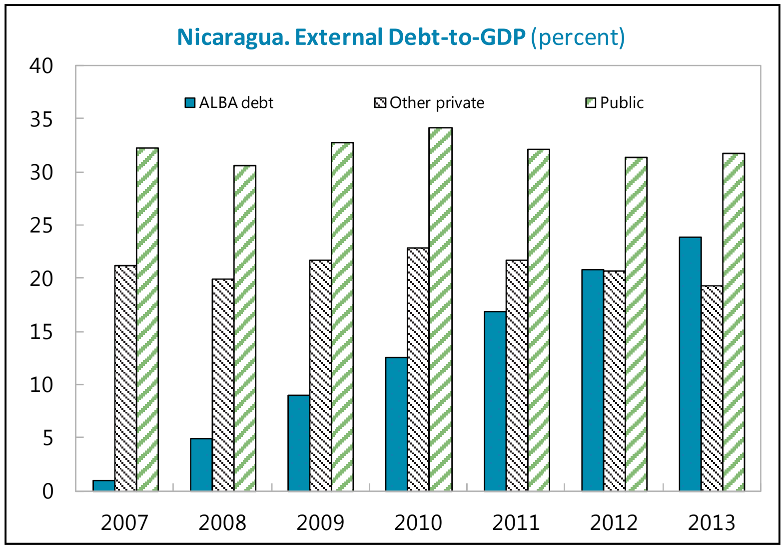
Text table 2. Nicaragua: External Debt Restructurings Pending with Non-Paris Club Creditors

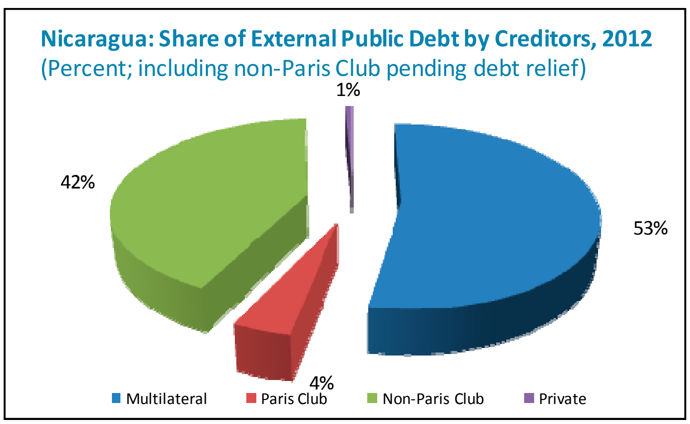
(Million of US dollars)

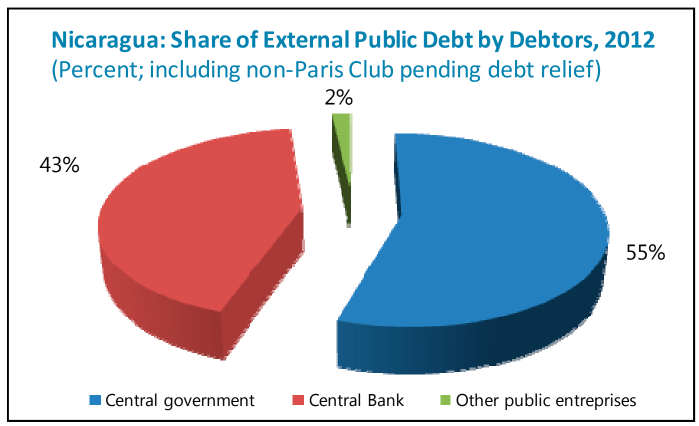
	2007	2012
Outstanding debt[1/]	**1,450.8**	**1,507.1**
Costa Rica	650.4	662.8
Libya	306.7	326.2
Honduras	256.1	274.1
Iran	168.9	171.8
Peru	45.4	48.2
China	18.1	18.9
Uruguay	2.4	2.4
Ecuador	1.6	1.6
India	1.2	1.1

Source: Country authorities.

[1/] Excluding the outstanding debt of Taiwan (Rep. of China)–US$93.6 million (post cut off date).







5. **Public and publicly-guaranteed debt has also declined as a result of the reduction in domestic public debt.** The ratio of domestic debt fell from 29 percent of GDP in 2002–03 to about 11 percent in 2012 reflecting debt buyback (see footnote 6). Most of it is indexed to the U.S. dollar but serviced in córdobas. Property settlement bonds (BPIs) is the largest component of domestic debt. These bonds are issued as part of court settlements on property expropriations that occurred in the 1980s. New issues of BPIs have steadily declined—they averaged US$75 million in 2003–06 and were down to US$21 million in 2012. BPIs represent 49 percent of total domestic debt and their stock fell from 15 to 5 percent of GDP between 2005 and 2012.

6. **Private external debt is rising sharply on account of the ALBA oil collaboration.**[9] Specifically, private external debt rose from 22 percent of GDP in 2007 to 42 percent of GDP in 2012. A large share of this rise is as a result of the ALBA oil collaboration.[10]

MACROECONOMIC ASSUMPTIONS

7. **The 2013 DSA incorporates Nicaragua's revised national accounts and is built on conservative macroeconomic assumptions.** The DSA of external and public debt assumes that growth slows down from 5.2 percent in 2012 to its potential rate (4 percent) by 2014. This is the same medium-term growth as assumed in the 2010 DSA. The staff projection assumes the continuation of (i) prudent macroeconomic management policies, and (ii) reforms that support the change in the electricity generation matrix. The non-interest external current account is programmed to improve in the first 10 years of the projection period (2013–22) broadly in line with a relative decline in the oil bill.

8. **On the external side, the baseline scenario assumes:**

- A relative decline in Nicaragua's dependence on oil imports and, consequently, a lower (non-interest) external current account deficit. The assumed decline reflects programmed non-fossil electricity generation projects. Thus, no significant changes in external imbalances would occur after 2023. This is a more conservative assumption than in the 2010 DSA, which had a similar external imbalance in the first 10 years of the projection period (2013–22), but that also assumed this adjustment continued during the following 10 years.[11]

- Export-to-GDP ratios remain broadly stable at about 50–53 percent of GDP and import-to-GDP ratios will decline mildly from 73 percent to 68 percent in 2013–33, largely reflecting a declining relative dependence on oil imports and lower FDI.

- Completion of negotiations with non-Paris Club bilateral creditors on HIPC-equivalent terms are assumed throughout the projection.[12] This in effect generates debt relief of 9.4 percent of GDP (in stock terms as of end-2012 or US$983 million). HIPC terms were also assumed in the 2010 DSA; most of this debt is currently not serviced.

[9] The Bolivarian Alliance for the Peoples of Our Americas (*Alianza Bolivariana para los Pueblos de Nuestra América*, or ALBA) is an international cooperation organization founded originally by Cuba and Venezuela in 2004. The member countries are Antigua and Barbuda, Bolivia, Cuba, Dominica, Ecuador, Nicaragua, Saint Vincent and the Grenadines, Venezuela, Saint Lucia, and Suriname.

[10] The financial terms assumed on new private borrowing (excluding ALBA) are, for the financial sector, an 8-year maturity with a 3-year grace period and an interest rate of 4 percent and, for the non-financial sector, a 7-year maturity with a 1-year grace period and an interest rate of 7 percent.

[11] This is after adjusting the 2010 DSA for the mentioned changes in nominal GDP.

[12] It is assumed that debt relief amounting to US$982.8 million at end-2012 (excluding Taiwan Republic of China) is obtained (out of US$1,507 million outstanding pending non-Paris Club debt).

- Net official external assistance (official public loans and grants) is expected to decline from 10 percent of GDP, on average, for the period 2007–12 to about 3 percent for 2027–33. Exposure to multilateral development banks is projected to grow. This is similar to the assumptions in the 2010 DSA.

- FDI is assumed to remain about 1¼ percent of GDP below the level recorded in 2010–12, as recent foreign investment in the energy sector is expected to decline. The projected levels are also below those assumed in the 2010 DSA (by about 1½-2 percent of GDP).

- ALBA-related flows are assumed to decline smoothly through 2033. It is also assumed that the ALBA oil collaboration continues to be channeled through the private sector.

9. On the fiscal side, the baseline scenario assumes that:

- In line with the achievements since 2010, fiscal management remains prudent. Primary deficits (after grants) are expected to average less than ½ percent of GDP in the first 10 years of the projection period (this is broadly similar to the level observed in 2010–12) and about ¼ percent of GDP in the following 10 years.

- The baseline assumes a pension reform is implemented in 2013, which is key to keeping debt sustainable. In the absence of such a reform, the social security system would begin incurring deficits by 2015 that would reach about 1-1.5 percent of GDP by 2023 and could rise to nearly 3.5 percent of GDP by 2033.

- Capital expenditures are programmed to increase over the medium-term by about 1½ percent of GDP relative to their 2012 level reflecting increased investment in infrastructure.

- Issuance of BPIs is expected to remain at the level observed in 2012 through 2018, in line with the annual projection in the 2010 DSA (US$21 million).

EXTERNAL PUBLIC DEBT SUSTAINABILITY

Baseline Scenario

10. Under the baseline scenario (with remittances), Nicaragua's external public debt indicators remain below their policy dependent indicative thresholds. The thresholds used are those that apply to medium performers in terms of policies and institutional quality, as measured by a 3–year moving average of the World Bank's CPIA. All present value (PV) external debt stock indicators, which measure the future debt-service burden of debt stocks (repayment risks), are below the policy indicative thresholds and expected to decline over the 20–year projection period. For instance, the PV of the PPG external public debt-to-GDP (plus remittances) ratio declines from 22½ percent in 2013 to 12 percent by 2033 (Table 2 and Text table 3); this is well below the 36 percent threshold (Figure 1 and Text table3). (Table 1 shows the underlying assumptions of the baseline projections presented in Table 2). Likewise, reflecting the relative openness of Nicaragua's economy, the PV of external public debt as a share of exports (plus remittances) remains below indicative thresholds throughout the projection period.

11. Similarly, the projected external public debt service is expected to remain manageable through 2033. This path reflects strong fiscal performance and relatively high concessionality of existing and new public external debt. In fact, the PPG external debt service ratios, which are a measure of the immediate burden posed by debt (liquidity risks), are projected to average 2 percent of exports plus remittances (or about 5 percent of revenues) during 2013–17 (Text table 3). This is despite the assumed small erosion in the concessionality terms of new borrowing.

Text table 3. Nicaragua: Baseline Debt Ratios, 2013–33
(Percent)

	Thresholds[1/]	2013	2013–17 (Average)	2018–33 (Average)
External				
PV of debt-to-GDP[2/]	36.0	22.5	22.3	17.5
PV of debt-to-exports[2/]	120.0	41.1	40.4	31.2
PV of debt-to-revenue	250.0	97.0	94.1	72.2
Debt service-to-exports[2/]	16.0	1.8	2.0	1.1
Debt service-to-revenue	20.0	4.3	4.7	2.5
Fiscal				
PV of debt-to-GDP		34.4	31.7	24.8
PV of debt-to-revenue		125.8	115.1	89.3
Debt service-to-revenue		13.0	11.6	7.2

1/ Remittances-based thresholds.
2/ Denominator plus remittances.

Alternative Scenarios and Stress Tests

12. Under the current discount rate policy (set at 5 percent), none of the standard alternative scenarios and stress tests would breach the policy dependent indicative thresholds (Table 2 and 3, and Figure 1 and 3).[13]

- **Historical scenario**. In an "historical" scenario (i.e., where key variables remain at their historical averages), the PV of the PPG external-debt-to-GDP ratio is projected to grow, but would remain by 2033 below the policy dependent threshold.

- **Non concessional financing**. In the scenario where new borrowing occurs on less favorable terms, which assumes that the interest through 2033 is 2 percentage points higher than in the baseline, all debt ratios deteriorate but stay below the threshold.

- **Exchange rate depreciation**. Similarly, under the standardized stress test of a one-time 30 percent nominal depreciation in 2014, all debt ratios deteriorate but stay below the indicative thresholds.

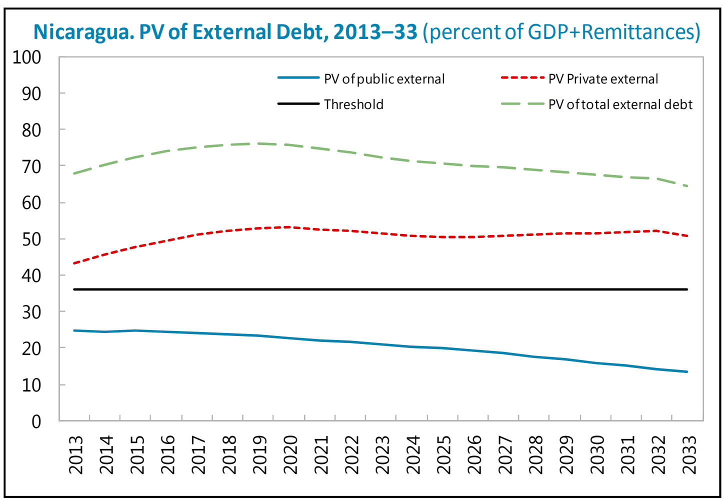
- **Scenario without remittances**. Remittances to Nicaragua are relatively large. Average remittances during 2008–12 were the equivalent of 10 percent GDP and 23 percent exports of

[13] The change in the discount rate has significantly improved all PV of public debt ratios. For example, the PV of public debt to GDP in 2013 is now reduced to 34.4 percent from 41.4 percent.

goods and services. As recommended in the DSF (interim guidance), a scenario without remittances is also conducted. The results in Figure 3 and Table 3 are presented as an alternative scenario and point to conclusions that are similar to those reached in the analysis with remittances (the base case in this DSA).

PRIVATE EXTERNAL DEBT AND EXTERNAL DEBT SUSTAINABILITY

13. The PV of private external debt is well above the indicative thresholds that are used for public external debt.[14] The DSA projections assume that: (i) the ALBA oil collaboration continues through 2033; (ii) these resources will continue to be channeled to the private sector with financial terms similar to those currently under application;[15] and (iii) Venezuela-related oil bills will decline in relative terms as savings from renewable energy sources materialize.[16] Under these assumptions, the pace of accumulation of private external debt eventually decelerates; i.e., it is projected to peak in 2020 (at about 56 percent of GDP, in PV terms) and decline steadily thereafter.

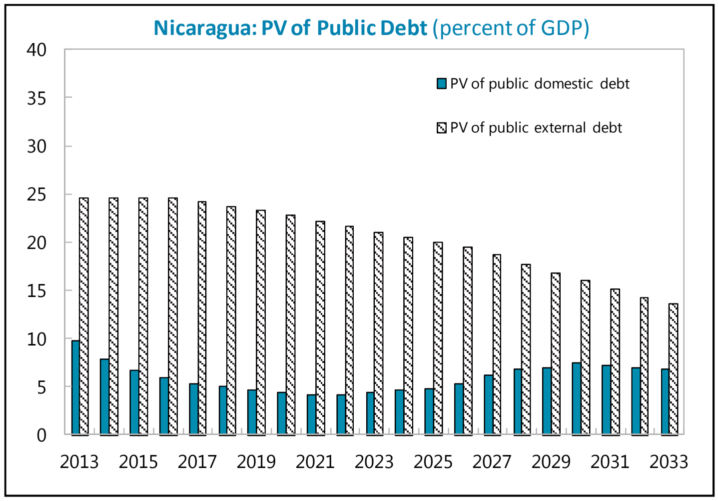


[14] The use of the public DSF threshold to discuss the private sector debt dynamics is for illustrative purpose only as there are no good guidelines on what is a sustainable level of private debt.

[15] Venezuela represents 94 percent of Nicaragua's FOB oil imports; 50 percent of this oil bill is financed with a loan that has a maturity of 25 years, a grace period of 2 years, and an interest rate of 2 percent; this implies the equivalent of a grant element of 37 percent when using a discount rate of 5 percent.

[16] Several non-thermal generation projects are assumed to come into operation to reduce Nicaragua's oil bill; namely, several hydroelectric (Bokobé, Larreynaga, and, in particular, Tumarin in 2018) and a new eolic project (ALBA vientos). It is worth noting that non-thermal energy sources accounted for only 17 of total gross generation in 2007 and this is expected to rise to over 40 percent by end-2013.

PUBLIC DEBT SUSTAINABILITY



14. Nicaragua's total public debt ratios are high, but continue to decline. The baseline scenario (with remittances) assumes the continuation of the prudent fiscal management observed over the past few years. A social security reform is assumed in the baseline scenario as the authorities have publicly announced their intention to introduce such reforms by late 2013—this reform is in fact crucial to strengthen public debt dynamics. Even with some fiscal loosening relative to recent path, it is expected that Nicaragua will continue to experience a gradually declining debt path. As a result, the PV of total public debt-to-GDP is projected to decline to 20.4 percent of GDP by 2033 (from 34.4 percent in 2013 (see Table 5; Figure 2 and Table 4 provide background on the underlying assumptions). Excluding remittances from these debt scenarios has only a marginal impact (Figure 4).

15. Debt service ratios are also expected to improve. Total public debt-service-to-revenue ratios are expected to decline from 13.0 to 4.8 percent between 2013 and 2033. Also, the availability of concessional external financing limits the need to rely on domestic debt, which in Nicaragua's highly dollarized economy involves higher yields and exchange rate risks; the projection assumes the level of dollarization does not change.

Alternative Scenarios and Stress Tests

16. Nicaragua's large share of foreign-currency denominated debt makes it vulnerable to exchange rate shocks. The stress tests for total public debt (Table 5) indicate that a 30 percent depreciation would increase the PV of public debt-to-GDP ratio from 34 percent in 2013 to 47 percent in 2014 and decline only gradually thereafter. In sum, public debt service ratios deteriorate but remain manageable. For instance, total public debt ratios-to-revenues would increase from 126 percent (in PV terms) to 175 percent. Finally, contingent liabilities, such as those that could arise from property confiscations and social security deficits, all add to Nicaragua's public debt vulnerabilities.

17. Should the government be required to assume private debt, this would severely impair debt sustainability. This risks applies to any private debt and, given the rapidly increasing levels of private debt and the potential risks to external current account financing, an alternative scenario is carried out that assumes some private debt being absorbed into the public sector's balance sheet.[17] Specifically, it is assumed that nearly two thirds of private external debt are assumed by the public sector in 2014.[18] This scenario also assumes that no additional debt will be generated from future oil imports. If such a contingent liability risk were to materialize, then this would drive up the PV of public external debt ratio to GDP in 2014 to 41.7 percent (compared to 24.6 percent under the baseline) and the public debt ratio to GDP would rise to 67.8 percent in 2014 (compared to 40.6 percent under the baseline). In both cases the indicative thresholds for the PV of debt-to-GDP ratios would be breached.

18. Other stress tests suggest, with few exceptions, only a temporary deterioration in debt and debt-service ratios. This includes: (i) a 10 percent of GDP increase in other debt-creating flows in 2013; (ii) a GDP growth at its historical average minus one standard deviation in 2013–14; and (iii) a scenario that combines the latter with a primary balance at its historical average minus one standard deviation in 2013–14 (Table 5). The most concerning stress test is the one that results from a depreciation shock; it takes about a decade to recover from such a shock. In all cases, however, PV ratios remain below their thresholds.

DEBT DISTRESS CLASSIFICATION AND CONCLUSIONS

19. In the staff's view Nicaragua should be considered at moderate risk of external debt distress; also, the DSA on public debt suggests that Nicaragua's public debt is high, but that debt dynamics are sustainable. The above assessment is consistent with the 2010 DSA[19] and assumes a continuation of Nicaragua's prudent macroeconomic management of the past few years and its so far successful transformation of the electricity generation matrix. Finally, the rapid increase in private external debt, which includes the debt arising as a result of the oil collaboration with Venezuela, requires continuous monitoring and the government's continued commitment not to extend public guarantees on this debt.

20. The authorities concurred with the thrust of the analysis, findings, and key conclusions. They agreed on the need to keep pace of key reforms, including the social security reform. They also recognized that it is imperative to continue making efforts to conclude ongoing negotiations with non-Paris Club creditors under the HIPC Initiative. The authorities requested the support of the IMF and the World Bank in encouraging the creditors who had not yet reached agreement on debt relief for Nicaragua to participate in the Initiative. Finally, while the authorities noted they had obtained similar results in their own DSA, they have requested that staff shares the final detailed DSA output.

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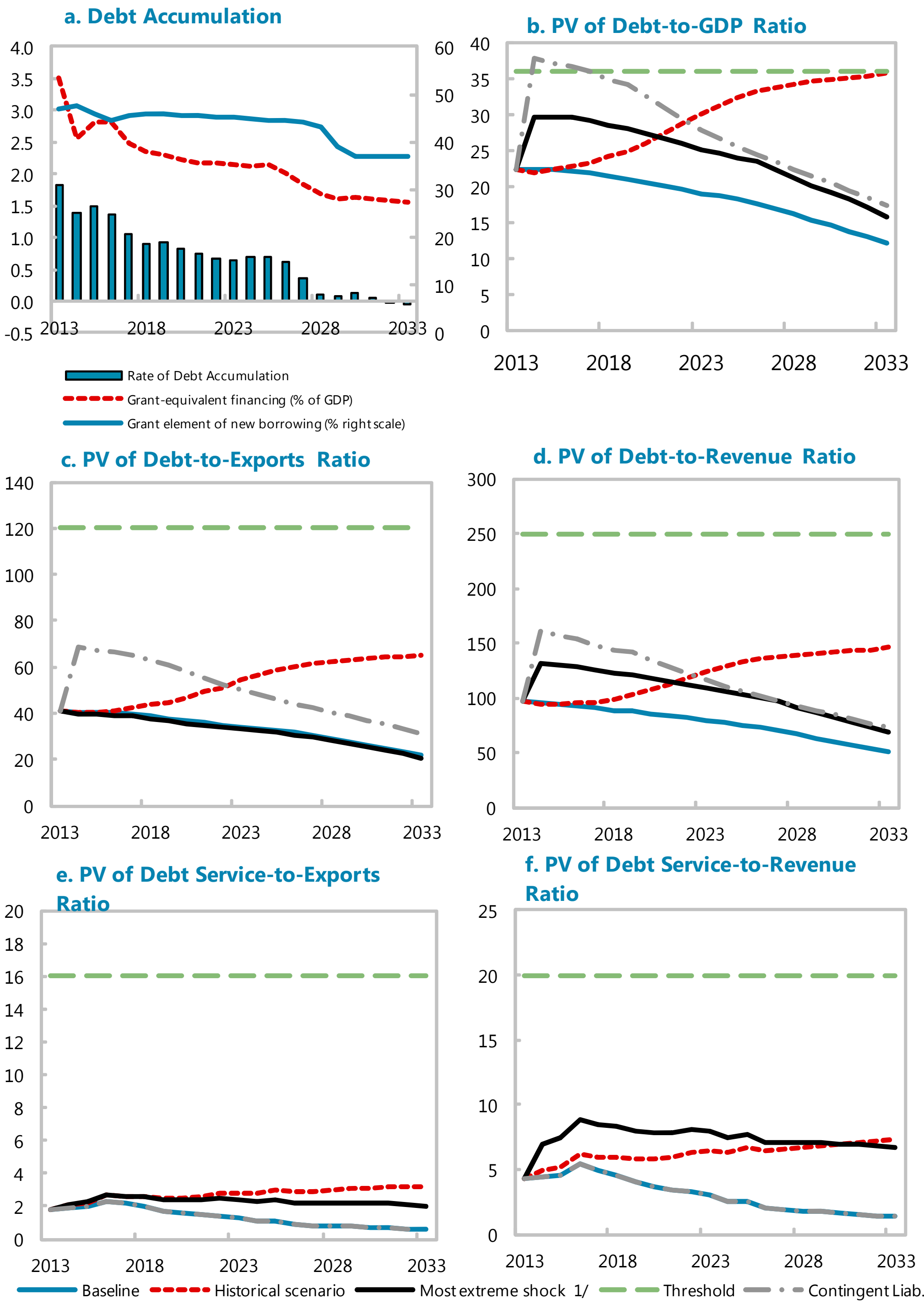
[17] This private debt includes the obligations of CARUNA, a privately-owned Nicaraguan financial cooperative that holds the debt obligations arising from the oil collaboration with Venezuela; according to the authorities, the repayment risks of this debt are borne by PDVSA.

[18] It is further assumed that concessional terms would apply to this new public debt (specifically, 1.8 percent interest rate, 5 years grace period, 30 years maturity; at 5 percent discount rate, this would yield 36 percent grant element).

[19] Adjusting debt and debt service ratios in the 2010 DSA by the level impact of the new national accounts data, the conclusions of the 2013 DSA are similar to those presented in the 2010 DSA; the 2013 DSA also benefits from the recent change in the discount rate.

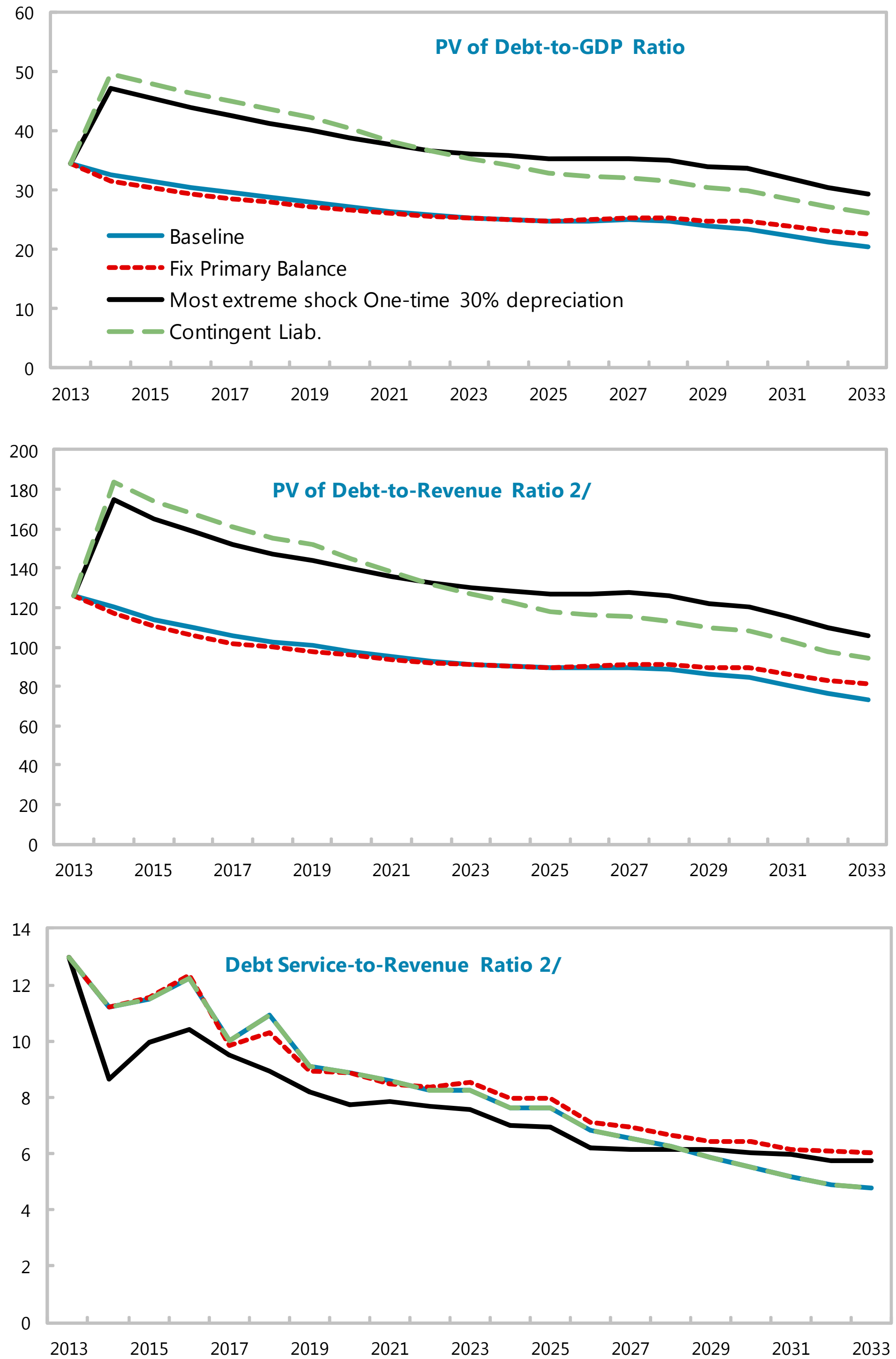
Figure 1. Nicaragua: Indicators of Public and Publicly Guaranteed External Debt under Alternative Scenarios with Remittances, 2013-2033 1/



Sources: Country authorities; and staff estimates and projections.

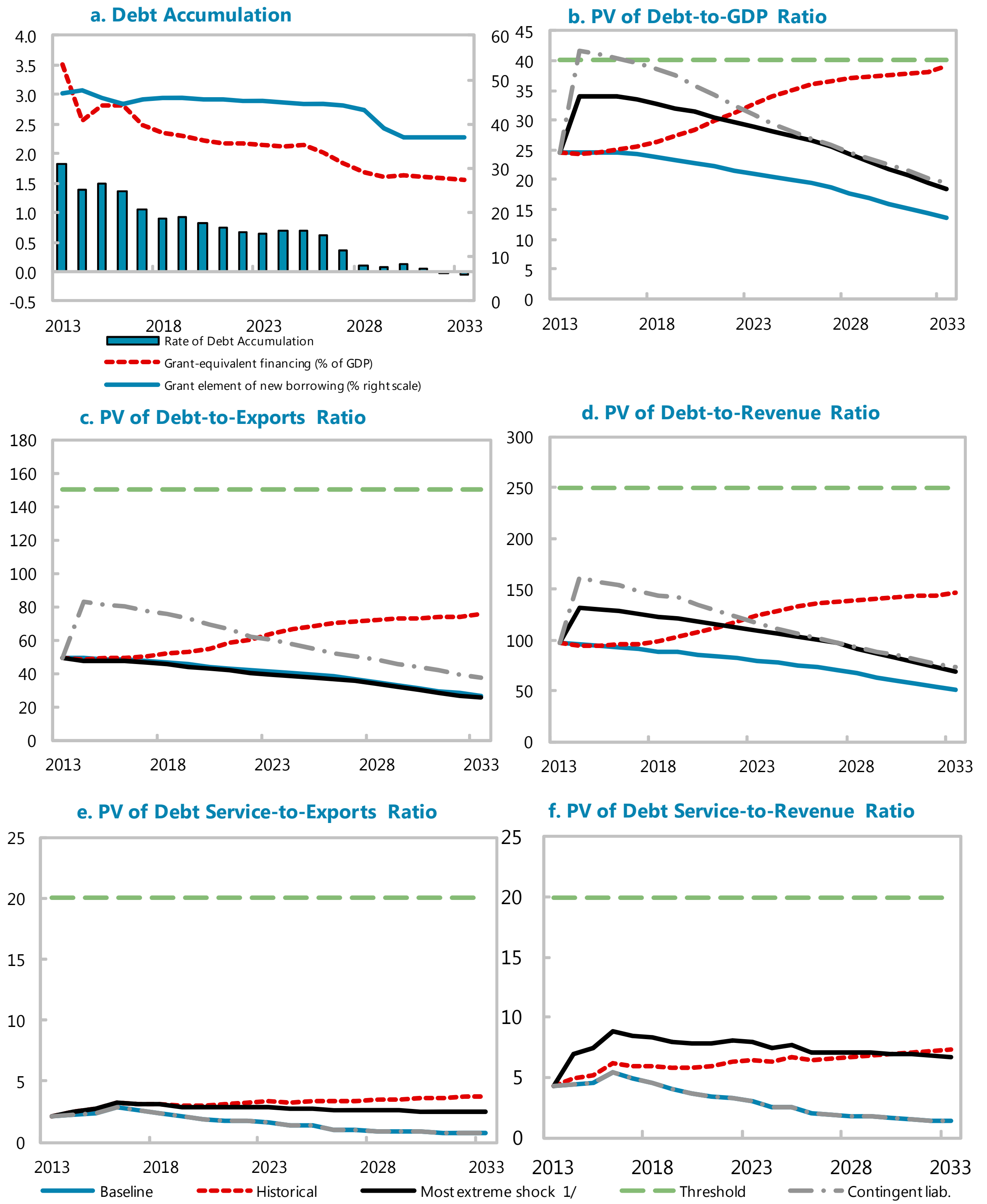
1/ The most extreme stress test is the test that yields the highest ratio in 2023. In figure b. it corresponds to a One-time depreciation shock; in c. to a Terms shock; in d. to a One-time depreciation shock; in e. to a Terms shock and in figure f. to a One-time depreciation shock

Figure 2.Nicaragua: Indicators of Public Debt Under Alternative Scenarios with Remittances, 2013-2033 1/



Sources: Country authorities; and staff estimates and projections.
1/ The most extreme stress test is the test that yields the highest ratio in 2023.
2/ Revenues are defined inclusive of grants.

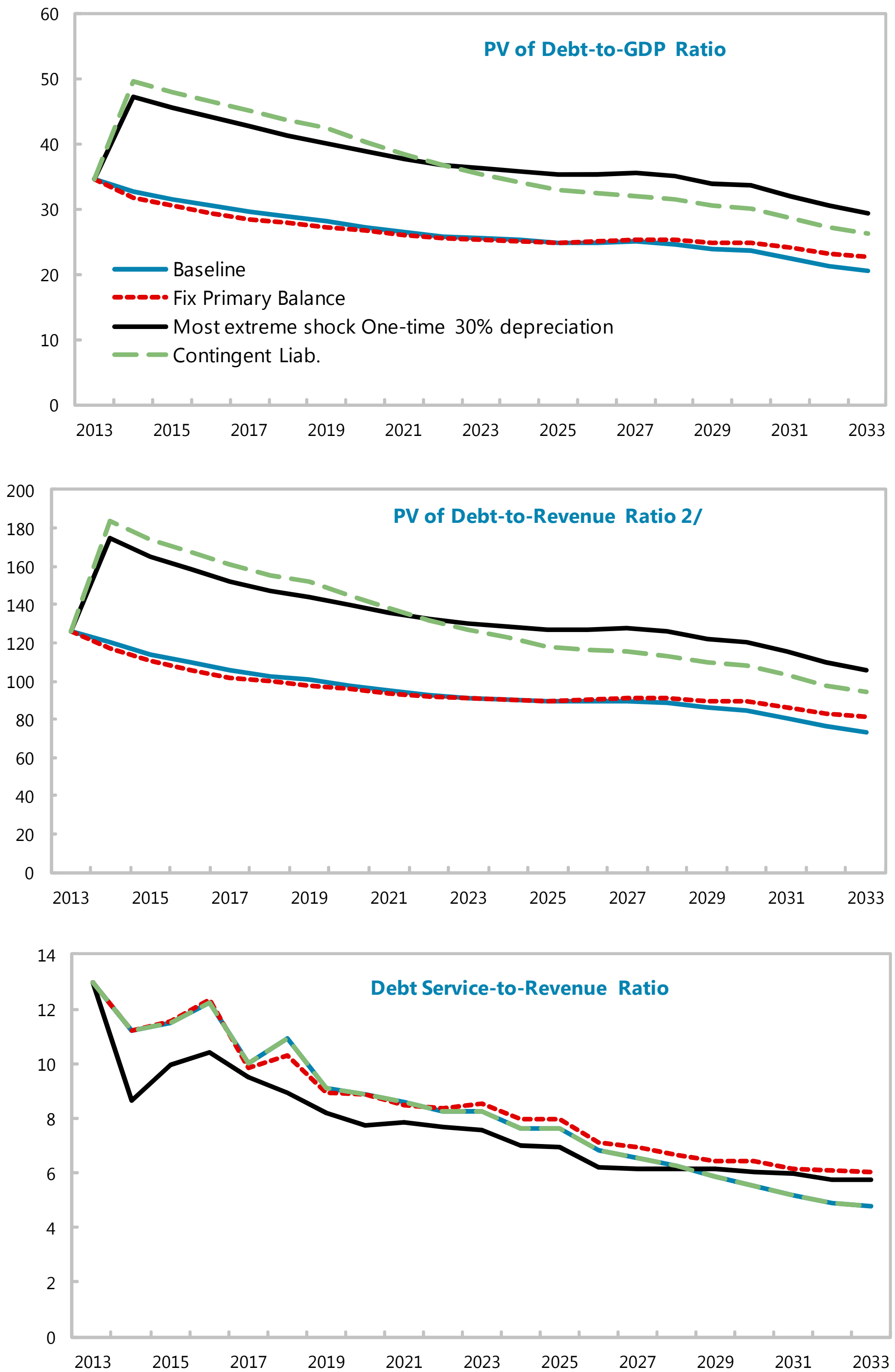
Figure 3. Nicaragua: Indicators of Public and Publicly Guaranteed External Debt under Alternatives Scenarios, 2013-2033[1/]



Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in 2023. In figure b. it corresponds to a One-time depreciation shock; in c. to a Terms shock; in d. to a One-time depreciation shock; in e. to a Terms shock and in figure f. to a One-time depreciation shock

Figure 4. Nicaragua: Indicators of Public Debt Under Alternative Scenarios, 2013-2033[1/]



Sources: Country authorities; and staff estimates and projections.
1/ The most extreme stress test is the test that yields the highest ratio in 2023.
2/ Revenues are defined inclusive of grants.

Table 1: Nicaragua: External Debt Sustainability Framework, Baseline Scenario, 2010–33[1/]

(In percent of GDP, unless otherwise indicated)

	Actual			Historical[6/] Average	Standard[6/] Deviation	Projections									
	2010	2011	2012			2013	2014	2015	2016	2017	2018	2013-2018 Average	2023	2033	2019-2033 Average
External debt (nominal) 1/	**70.6**	**71.6**	**73.8**			**75.8**	**78.4**	**80.7**	**82.8**	**84.3**	**85.1**		**81.9**	**72.4**	
o/w public and publicly guaranteed (PPG)	35.0	33.0	32.2			32.6	32.7	32.9	33.4	33.3	32.9		30.5	21.6	
Change in external debt (a)	6.1	1.1	2.2			2.0	2.5	2.4	2.1	1.5	0.8		-1.3	-2.2	
Identified net debt-creating flows (b)	1.3	-1.3	-0.7			4.1	3.9	3.4	3.3	2.7	2.0		-0.1	-1.1	
Non-interest current account deficit	**8.6**	**11.1**	**10.5**	**10.2**	**2.9**	**10.3**	**9.5**	**9.2**	**9.1**	**8.6**	**8.0**		**6.1**	**6.1**	7.1
Deficit in balance of goods and services	20.7	23.3	22.5			22.2	21.6	20.8	20.3	19.6	19.0		16.5	16.5	
Exports	43.5	49.0	50.8			50.3	50.5	50.7	50.9	51.0	51.1		51.5	51.5	
Imports	64.2	72.3	73.4			72.5	72.1	71.5	71.2	70.6	70.1		68.0	68.0	
Net current transfers (negative = inflow)	-16.5	-15.2	-14.5	-17.6	1.8	-13.1	-13.3	-13.3	-12.9	-12.4	-12.2		-11.5	-12.1	-11.0
o/w official	-2.7	-2.4	-2.0			-1.4	-1.4	-1.5	-1.4	-1.3	-1.2		-1.2	-1.1	
Other current account flows (negative = net inflow)	4.4	3.0	2.4			1.2	1.2	1.7	1.8	1.4	1.2		1.1	1.7	
Net FDI (negative = inflow)	**-5.9**	**-10.0**	**-7.7**	**-5.8**	**2.0**	**-6.2**	**-5.9**	**-5.8**	**-6.0**	**-6.0**	**-6.0**		**-6.0**	**-6.0**	-6.0
Endogenous debt dynamics 2/	**-1.3**	**-2.4**	**-3.5**			**0.1**	**0.3**	**0.0**	**0.2**	**0.1**	**0.1**		**-0.3**	**-1.2**	
Contribution from nominal interest rate	1.4	2.1	2.4			2.9	3.2	3.0	3.2	3.2	3.3		2.9	1.6	
Contribution from real GDP growth	-2.2	-3.4	-3.4			-2.9	-2.9	-3.0	-3.0	-3.1	-3.2		-3.1	-2.8	
Contribution from price and exchange rate changes	-0.6	-1.0	-2.5			...	...	...	...	...	...		...	...	
Residual (a-b) 3/	**4.8**	**2.4**	**2.9**			**-2.1**	**-1.4**	**-1.1**	**-1.2**	**-1.2**	**-1.2**		**-1.2**	**-1.1**	
o/w exceptional financing	-0.4	-0.3	-0.4			0.0	-0.1	-0.1	-0.1	-0.1	-0.1		0.0	0.0	
PV of external debt 4/	...	...	66.2			67.9	70.3	72.4	74.0	75.2	75.9		72.5	64.4	
In percent of exports	...	...	130.2			135.1	139.1	142.9	145.5	147.6	148.6		140.6	125.0	
PV of PPG external debt	**...**	**...**	**24.6**			**24.7**	**24.6**	**24.7**	**24.6**	**24.2**	**23.7**		**21.0**	**13.6**	
In percent of exports	**...**	**...**	**48.3**			**49.0**	**48.7**	**48.6**	**48.3**	**47.5**	**46.5**		**40.8**	**26.4**	
In percent of government revenues	**...**	**...**	**97.4**			**97.0**	**95.4**	**94.2**	**93.1**	**90.8**	**88.5**		**79.1**	**51.1**	
Debt service-to-exports ratio (in percent)	**17.3**	**16.1**	**12.4**			**13.2**	**14.2**	**14.9**	**15.2**	**16.4**	**14.6**		**14.8**	**11.9**	
PPG debt service-to-exports ratio (in percent)	**4.1**	**2.6**	**2.3**			**2.2**	**2.3**	**2.4**	**2.8**	**2.6**	**2.4**		**1.6**	**0.7**	
PPG debt service-to-revenue ratio (in percent)	**7.7**	**4.9**	**4.6**			**4.3**	**4.5**	**4.6**	**5.4**	**4.9**	**4.5**		**3.1**	**1.4**	
Total gross financing need (Millions of U.S. dollars)	1,147	1,231	1,392			1,756	2,153	2,225	2,285	2,317	2,052		2,123	4,315	
Non-interest current account deficit that stabilizes debt ratio	2.5	10.1	8.2			8.3	7.0	6.9	7.0	7.1	7.1		7.5	8.3	
Key macroeconomic assumptions															
Real GDP growth (in percent)	3.6	5.4	5.2	3.7	2.3	4.2	4.0	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)	1.6	6.4	3.6	3.4	2.3	3.0	1.9	1.9	1.9	1.9	1.9	2.1	1.9	1.5	1.9
Effective interest rate (percent) 5/	2.3	3.3	3.7	3.0	0.4	4.3	4.5	4.0	4.2	4.1	4.1	4.2	3.7	2.3	3.2
Growth of exports of G&S (US dollar terms, in percent)	26.4	26.4	13.1	17.0	8.7	6.1	6.5	6.3	6.4	6.2	6.2	6.3	4.7	5.5	6.0
Growth of imports of G&S (US dollar terms, in percent)	20.0	26.3	10.7	13.9	11.5	6.0	5.5	5.1	5.5	5.0	5.3	5.4	5.6	5.6	5.7
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	47.1	47.7	46.0	44.7	45.7	46.1	46.2	45.1	36.9	42.4
Government revenues (excluding grants, in percent of GDP)	23.1	25.4	25.2			25.4	25.8	26.2	26.4	26.7	26.8		26.6	26.6	26.6
Aid flows (in Millions of US dollars) 7/	438.4	455.5	461.1			501.5	389.3	472.9	530.2	474.9	466.2		567.5	588.8	
o/w Grants	172.9	229.5	216.1			222.8	148.1	178.0	182.1	176.4	185.6		248.1	441.9	
o/w Concessional loans	265.5	226.0	245.0			278.7	241.1	294.9	348.2	298.5	280.6		319.4	146.9	
Grant-equivalent financing (in percent of GDP) 8/	...	...	...			3.5	2.6	2.8	2.8	2.5	2.4		2.1	1.6	1.9
Grant-equivalent financing (in percent of external financing) 8/	...	...	...			67.1	63.9	63.0	60.9	62.7	64.2		66.0	73.4	68.8
Memorandum items:															
Nominal GDP (Millions of US dollars)	8,587	9,636	10,506			11,272	11,946	12,660	13,418	14,220	15,071		20,150	35,884	
Nominal dollar GDP growth	5.3	12.2	9.0			7.3	6.0	6.0	6.0	6.0	6.0	6.2	6.0	5.6	6.0
PV of PPG external debt (in Millions of US dollars)			2,520			2,713	2,869	3,046	3,220	3,362	3,492		4,133	4,731	
(PVt-PVt-1)/GDPt-1 (in percent)						1.8	1.4	1.5	1.4	1.1	0.9	1.3	0.6	0.0	0.4
Gross workers' remittances (Millions of US dollars)	823	912	1,014			1,095	1,197	1,312	1,378	1,425	1,529		2,074	3,931	
PV of PPG external debt (in percent of GDP + remittances)	...	...	22.6			22.6	22.5	22.5	22.4	22.1	21.7		19.2	12.5	
PV of PPG external debt (in percent of exports + remittances)	...	...	41.3			41.6	41.2	41.0	40.5	39.9	39.2		34.5	22.5	
Debt service of PPG external debt (in percent of exports + remi	...	...	1.9			1.8	1.9	2.0	2.4	2.2	2.0		1.3	0.6	

Sources: Country authorities; and staff estimates and projections.

1/ Includes both public and private sector external debt. Historical estimates of debt have been revised (upwards) by the Central Bank of Nicaragua. The projections assume that outstanding debt to non-Paris Club bilateral creditors is settled on HIPC-equivalent terms by end-2012.

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).

Table 2.Nicaragua: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2013-2033
(In percent)

	Projections							
	2013	2014	2015	2016	2017	2018	2023	2033
PV of debt-to-GDP+remittances ratio								
Baseline	22	22	22	22	22	22	19	12
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2013-2033 1/	22	22	22	23	23	24	30	36
A2. New public sector loans on less favorable terms in 2013-2033 2/	22	23	24	24	25	25	26	22
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2014-2015	22	22	23	23	22	22	19	12
B2. Export value growth at historical average minus one standard deviation in 2014-2015 3/	22	21	20	20	20	20	17	11
B3. US dollar GDP deflator at historical average minus one standard deviation in 2014-2015	22	22	22	22	22	21	19	12
B4. Net non-debt creating flows at historical average minus one standard deviation in 2014-2015 4/	22	21	21	21	21	20	18	11
B5. Combination of B1-B4 using one-half standard deviation shocks	22	19	14	15	15	14	12	8
B6. One-time 30 percent nominal depreciation relative to the baseline in 2014 5/	22	30	30	30	29	29	25	16
PV of debt-to-exports+remittances ratio								
Baseline	41	41	40	40	40	39	34	22
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2013-2033 1/	41	40	41	41	42	44	54	65
A2. New public sector loans on less favorable terms in 2013-2033 2/	41	41	43	44	45	45	46	39
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2014-2015	41	40	39	39	39	38	33	21
B2. Export value growth at historical average minus one standard deviation in 2014-2015 3/	41	38	36	35	35	34	30	19
B3. US dollar GDP deflator at historical average minus one standard deviation in 2014-2015	41	40	39	39	39	38	33	21
B4. Net non-debt creating flows at historical average minus one standard deviation in 2014-2015 4/	41	38	37	38	38	37	32	20
B5. Combination of B1-B4 using one-half standard deviation shocks	41	32	23	24	23	23	20	12
B6. One-time 30 percent nominal depreciation relative to the baseline in 2014 5/	41	40	39	39	39	38	33	21
PV of debt-to-revenue ratio								
Baseline	97	95	94	93	91	89	79	51
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2013-2033 1/	97	94	94	95	96	99	124	147
A2. New public sector loans on less favorable terms in 2013-2033 2/	97	97	99	102	103	103	106	91
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2014-2015	97	95	96	95	93	90	80	51
B2. Export value growth at historical average minus one standard deviation in 2014-2015 3/	97	91	85	85	82	80	71	45
B3. US dollar GDP deflator at historical average minus one standard deviation in 2014-2015	97	94	93	92	90	87	78	50
B4. Net non-debt creating flows at historical average minus one standard deviation in 2014-2015 4/	97	92	90	89	86	84	75	48
B5. Combination of B1-B4 using one-half standard deviation shocks	97	82	62	62	60	59	52	33
B6. One-time 30 percent nominal depreciation relative to the baseline in 2014 5/	97	132	130	128	125	122	109	69

Table 2.Nicaragua: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2013-2033 (continued)

(In percent)

	Projections							
	2013	2014	2015	2016	2017	2018	2023	2033
Debt service-to-exports+remittances ratio								
Baseline	2	2	2	2	2	2	1	1
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2013-2033 1/	2	2	2	3	3	3	3	3
A2. New public sector loans on less favorable terms in 2013-2033 2/	2	2	2	3	3	3	3	3
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2014-2015	2	2	2	3	3	3	2	2
B2. Export value growth at historical average minus one standard deviation in 2014-2015 3/	2	2	2	3	2	2	2	2
B3. US dollar GDP deflator at historical average minus one standard deviation in 2014-2015	2	2	2	3	3	3	2	2
B4. Net non-debt creating flows at historical average minus one standard deviation in 2014-2015 4/	2	2	2	3	3	3	2	2
B5. Combination of B1-B4 using one-half standard deviation shocks	2	2	2	2	2	2	2	1
B6. One-time 30 percent nominal depreciation relative to the baseline in 2014 5/	2	2	2	3	3	3	2	2
Debt service-to-revenue ratio								
Baseline	4	4	5	5	5	5	3	1
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2013-2033 1/	4	5	5	6	6	6	6	7
A2. New public sector loans on less favorable terms in 2013-2033 2/	4	5	5	6	6	6	6	6
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2014-2015	4	5	6	7	6	6	6	5
B2. Export value growth at historical average minus one standard deviation in 2014-2015 3/	4	5	5	6	6	6	5	4
B3. US dollar GDP deflator at historical average minus one standard deviation in 2014-2015	4	5	5	6	6	6	6	5
B4. Net non-debt creating flows at historical average minus one standard deviation in 2014-2015 4/	4	5	5	6	6	6	6	5
B5. Combination of B1-B4 using one-half standard deviation shocks	4	5	5	5	5	5	5	3
B6. One-time 30 percent nominal depreciation relative to the baseline in 2014 5/	4	7	7	9	9	8	8	7
Memorandum item:								
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	38	37	36	35	34	32	26	15

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 assuming 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: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2013–33

(In percent)

		Projections						
	2013	2014	2015	2016	2017	2018	2023	2033
PV of debt-to GDP ratio								
Baseline	25	25	25	25	24	24	21	14
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2013-2033 1/	25	24	25	25	26	26	33	39
A2. New public sector loans on less favorable terms in 2013-2033 2/	25	25	26	27	27	28	28	24
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2014-2015	25	25	25	25	25	24	21	14
B2. Export value growth at historical average minus one standard deviation in 2014-2015 3/	25	23	22	22	22	22	19	12
B3. US dollar GDP deflator at historical average minus one standard deviation in 2014-2015	25	24	24	24	24	23	21	13
B4. Net non-debt creating flows at historical average minus one standard deviation in 2014-2015 4/	25	24	23	23	23	23	20	13
B5. Combination of B1-B4 using one-half standard deviation shocks	25	21	16	16	16	16	14	9
B6. One-time 30 percent nominal depreciation relative to the baseline in 2014 5/	25	34	34	34	33	33	29	18
PV of debt-to-exports ratio								
Baseline	49	49	49	48	48	46	41	26
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2013-2033 1/	49	48	49	49	50	52	64	76
A2. New public sector loans on less favorable terms in 2013-2033 2/	49	49	51	53	54	54	55	47
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2014-2015	49	47	47	47	46	45	39	25
B2. Export value growth at historical average minus one standard deviation in 2014-2015 3/	49	46	43	42	42	41	36	23
B3. US dollar GDP deflator at historical average minus one standard deviation in 2014-2015	49	47	47	47	46	45	39	25
B4. Net non-debt creating flows at historical average minus one standard deviation in 2014-2015 4/	49	47	46	46	45	44	39	25
B5. Combination of B1-B4 using one-half standard deviation shocks	49	39	28	28	28	27	23	15
B6. One-time 30 percent nominal depreciation relative to the baseline in 2014 5/	49	47	47	47	46	45	39	25
PV of debt-to-revenue ratio								
Baseline	97	95	94	93	91	89	79	51
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2013-2033 1/	97	94	94	95	96	99	124	147
A2. New public sector loans on less favorable terms in 2013-2033 2/	97	97	99	102	103	103	106	91
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2014-2015	97	95	96	95	93	90	80	51
B2. Export value growth at historical average minus one standard deviation in 2014-2015 3/	97	91	85	85	82	80	71	45
B3. US dollar GDP deflator at historical average minus one standard deviation in 2014-2015	97	94	93	92	90	87	78	50
B4. Net non-debt creating flows at historical average minus one standard deviation in 2014-2015 4/	97	92	90	89	86	84	75	48
B5. Combination of B1-B4 using one-half standard deviation shocks	97	82	62	62	60	59	52	33
B6. One-time 30 percent nominal depreciation relative to the baseline in 2014 5/	97	132	130	128	125	122	109	69

Table 3.Nicaragua: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2013–33 (continued)
(In percent)

	Projections							
	2013	2014	2015	2016	2017	2018	2023	2033
Debt service-to-exports ratio								
Baseline	2	2	2	3	3	2	2	1
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2013-2033 1/	2	2	3	3	3	3	3	4
A2. New public sector loans on less favorable terms in 2013-2033 2/	2	3	3	3	3	3	3	3
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2014-2015	2	3	3	3	3	3	3	2
B2. Export value growth at historical average minus one standard deviation in 2014-2015 3/	2	2	3	3	3	3	3	2
B3. US dollar GDP deflator at historical average minus one standard deviation in 2014-2015	2	3	3	3	3	3	3	2
B4. Net non-debt creating flows at historical average minus one standard deviation in 2014-2015 4/	2	3	3	3	3	3	3	2
B5. Combination of B1-B4 using one-half standard deviation shocks	2	2	2	2	2	2	2	2
B6. One-time 30 percent nominal depreciation relative to the baseline in 2014 5/	2	3	3	3	3	3	3	2
Debt service-to-revenue ratio								
Baseline	4	4	5	5	5	5	3	1
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2013-2033 1/	4	5	5	6	6	6	6	7
A2. New public sector loans on less favorable terms in 2013-2033 2/	4	5	5	6	6	6	6	6
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2014-2015	4	5	6	7	6	6	6	5
B2. Export value growth at historical average minus one standard deviation in 2014-2015 3/	4	5	5	6	6	6	5	4
B3. US dollar GDP deflator at historical average minus one standard deviation in 2014-2015	4	5	5	6	6	6	6	5
B4. Net non-debt creating flows at historical average minus one standard deviation in 2014-2015 4/	4	5	5	6	6	6	6	5
B5. Combination of B1-B4 using one-half standard deviation shocks	4	5	5	5	5	5	5	3
B6. One-time 30 percent nominal depreciation relative to the baseline in 2014 5/	4	7	7	9	9	8	8	7
Memorandum item:								
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	38	38	38	38	38	38	38	38

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 assuming 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 4.Nicaragua: Public Sector Debt Sustainability Framework, Baseline Scenario, 2010–33

(In percent of GDP, unless otherwise indicated)

	Actual			Average 5/	Standard Deviation 5/	Estimate	Projections								
	2010	2011	2012			2013	2014	2015	2016	2017	2018	2013-18 Average	2023	2033	2019-33 Average
Public sector debt 1/	50.1	45.4	43.2			42.4	40.6	39.7	39.3	38.6	38.0		34.9	28.4	
o/w foreign-currency denominated	50.1	45.4	43.2			42.4	40.6	39.7	39.3	38.6	38.0		34.9	28.4	
Change in public sector debt	-0.1	-4.7	-2.2			-0.8	-1.8	-0.9	-0.4	-0.7	-0.6		-0.4	-1.0	
Identified debt-creating flows	-1.3	-5.2	-3.0			-1.4	-0.4	-1.1	-0.4	-0.9	-1.2		-1.0	-0.9	
Primary deficit	0.1	-1.1	-0.4	2.3	2.0	0.2	0.1	0.3	0.7	0.3	0.0	0.3	0.0	-0.3	-0.1
Revenue and grants	25.1	27.8	27.3			27.4	27.0	27.6	27.8	27.9	28.0		27.8	27.8	
of which: grants	2.0	2.4	2.1			2.0	1.2	1.4	1.4	1.2	1.2		1.2	1.2	
Primary (noninterest) expenditure	25.2	26.7	26.9			27.6	27.1	27.8	28.4	28.2	28.1		27.8	27.5	
Automatic debt dynamics	-1.5	-4.2	-2.6			-1.9	-0.4	-1.3	-1.0	-1.2	-1.2		-1.1	-0.7	
Contribution from interest rate/growth differential	-1.3	-2.3	-1.8			-1.2	-0.2	-1.2	-1.0	-1.1	-1.1		-1.0	-0.9	
of which: contribution from average real interest rate	0.5	0.3	0.4			0.5	1.4	0.4	0.5	0.4	0.3		0.3	0.2	
of which: contribution from real GDP growth	-1.8	-2.6	-2.2			-1.7	-1.6	-1.6	-1.5	-1.5	-1.5		-1.4	-1.1	
Contribution from real exchange rate depreciation	-0.2	-1.9	-0.8			-0.6	-0.2	-0.1	0.0	0.0	0.0		...	...	
Other identified debt-creating flows	0.1	0.1	0.0			0.3	-0.1	-0.1	-0.1	-0.1	-0.1		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	0.5	0.4	0.4			0.4	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Debt relief (HIPC and other)	-0.4	-0.3	-0.4			0.0	-0.1	-0.1	-0.1	-0.1	-0.1		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	1.1	0.5	0.8			0.5	-1.4	0.2	0.0	0.2	0.6		0.6	-0.1	
Other Sustainability Indicators															
PV of public sector debt	...	...	35.5			34.4	32.5	31.4	30.5	29.5	28.8		25.4	20.4	
o/w foreign-currency denominated	...	...	35.5			34.4	32.5	31.4	30.5	29.5	28.8		25.4	20.4	
o/w external	...	...	...			24.7	24.6	24.7	24.6	24.2	23.7		21.0	13.6	
PV of contingent liabilities (not included in public sector debt)	...	...	...			...	17.1	16.5	15.9	15.3	14.8		9.9	5.8	
Gross financing need 2/	7.6	5.6	5.7			6.1	5.1	5.0	5.4	4.0	3.4		2.5	1.3	
PV of public sector debt-to-revenue and grants ratio (in percent)	...	...	130.2			125.8	120.2	113.9	109.9	105.8	102.7		91.4	73.3	
PV of public sector debt-to-revenue ratio (in percent)	...	...	140.8			135.5	126.0	120.0	115.5	110.8	107.4		95.6	76.7	
o/w external 3/	...	...	...			97.0	95.4	94.2	93.1	90.8	88.5		79.1	51.1	
Debt service-to-revenue and grants ratio (in percent) 4/	16.6	16.0	14.2			13.0	11.2	11.5	12.2	10.0	10.9		8.2	4.9	
Debt service-to-revenue ratio (in percent) 4/	14.6	13.9	14.2			14.0	11.7	12.1	12.9	10.5	11.4		8.6	5.1	
Primary deficit that stabilizes the debt-to-GDP ratio	0.2	3.6	1.8			1.0	1.9	1.2	1.1	1.0	0.6		0.4	0.7	
Key macroeconomic and fiscal assumptions															
Real GDP growth (in percent)	3.6	5.4	5.2	4.0	1.5	4.2	4.0	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)	2.2	2.8	2.8	2.5	0.5	2.6	2.5	2.7	3.2	2.9	2.8	2.8	2.8	2.7	2.8
Real exchange rate depreciation (in percent, + indicates depreciation)	4.5	-4.0	-1.8	-0.2	3.1	-1.5	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	6.7	11.7	8.8	8.5	2.7	8.1	7.0	7.0	7.0	7.0	7.0	7.2	7.0	7.1	7.0
Growth of real primary spending (deflated by GDP deflator, in percent)	0.0	0.1	5.9	0.6	1.9	6.9	2.3	6.7	6.3	3.0	3.5	4.8	4.1	4.0	3.8
Grant element of new external borrowing (in percent)	...	47.3	42.0	44.7	3.7	47.1	47.7	46.0	44.7	45.7	46.1	46.2	45.1	36.9	42.4

Sources: Country authorities; and staff estimates and projections.

1/ Public debt refers to the gross debt of the Consolidated Public Sector. The projections assume that the outstanding debt to non-Paris Club bilateral creditors is settled on HIPC-equivalent terms by end-2012.

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 5.Nicaragua: Sensitivity Analysis for Key Indicators of Public Debt 2013–33

	Projections							
	2013	2014	2015	2016	2017	2018	2023	2033
PV of Debt-to-GDP Ratio								
Baseline	34	33	31	31	30	29	25	20
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	34	33	34	34	35	35	39	46
A2. Primary balance is unchanged from 2013	34	32	31	29	28	28	25	23
A3. Permanently lower GDP growth 1/	34	33	32	31	31	30	31	39
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2014-2015	34	34	34	33	33	34	34	35
B2. Primary balance is at historical average minus one standard deviations in 2014-2015	34	35	37	35	34	33	30	23
B3. Combination of B1-B2 using one half standard deviation shocks	35	35	37	36	35	35	33	31
B4. One-time 30 percent real depreciation in 2014	34	47	45	44	43	41	36	29
B5. 10 percent of GDP increase in other debt-creating flows in 2014	35	40	39	37	36	35	31	25
PV of Debt-to-Revenue Ratio 2/								
Baseline	126	120	114	110	106	103	91	73
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	126	123	122	123	124	126	139	166
A2. Primary balance is unchanged from 2013	126	117	111	106	102	100	91	81
A3. Permanently lower GDP growth 1/	126	121	115	112	110	108	110	138
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2014-2015	126	124	122	120	119	119	122	126
B2. Primary balance is at historical average minus one standard deviations in 2014-2015	126	128	133	128	122	118	106	84
B3. Combination of B1-B2 using one half standard deviation shocks	129	130	133	130	126	123	118	111
B4. One-time 30 percent real depreciation in 2014	126	175	165	158	152	147	130	106
B5. 10 percent of GDP increase in other debt-creating flows in 2014	129	144	141	133	128	124	112	92
Debt Service-to-Revenue Ratio 2/								
Baseline	13	11	12	12	10	11	8	5
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	13	11	12	16	14	15	15	16
A2. Primary balance is unchanged from 2013	13	11	12	12	10	10	9	6
A3. Permanently lower GDP growth 1/	13	11	12	13	11	12	11	13
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2014-2015	13	11	12	14	13	14	13	11
B2. Primary balance is at historical average minus one standard deviations in 2014-2015	13	11	13	19	16	14	9	6
B3. Combination of B1-B2 using one half standard deviation shocks	13	11	12	18	15	15	12	9
B4. One-time 30 percent real depreciation in 2014	13	9	10	10	10	9	8	6
B5. 10 percent of GDP increase in other debt-creating flows in 2014	13	11	13	25	13	16	10	7

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.

INTERNATIONAL MONETARY FUND

NICARAGUA

November 14, 2013

STAFF REPORT FOR THE 2013 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By | Western Hemisphere Department

CONTENTS

FUND RELATIONS

(As of September 30, 2013)

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	97.95	78.65

Outstanding Purchases and Loans:	**SDR Million**	**%Quota**
ECF Arrangements	101.88	78.37

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				
	2013	2014	2015	2016	2017
Principal	2.58	14.42	19.18	20.90	15.60
Charges/Interest	0.00	0.02	0.21	0.16	0.11
Total	2.59	14.44	19.39	21.06	15.71

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 7, 2013, the exchange rate in the official market was C$25.1496 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 June 27, 2012, (Country Report No. 12/256). The last Fund-supported program review (Seventh Review under the ECF Arrangement and Financing Assurances Review) was concluded on October 21, 2011.

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 2011.

Dept.	Purpose	Time of Delivery
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
FAD	Public Financial Management	November 2012
FAD	Customs	November 2012
FAD	Public Financial Management	July 2012
FAD	Customs	June 2012
FAD	Tax Administration	April 2012
FAD	Customs	April 2012
FAD	Revenue Administration	March 2012

FAD	Customs	January 2012
FAD	Public Financial Management	January 2012
FAD	Revenue Administration	October 2011
FAD	Tax Policy	August 2011
FAD	Public Financial Management	April 2011
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
MCM	Stress Testing	August 2012
MCM	Monetary and Foreign Exchange Policy	August 2012
MCM	Payment System Organization	June 2012
MCM	Bank Supervision and Regulations	May 2012
MCM	Monetary and Foreign Exchange Policy	May 2012
MCM	Risk-based Supervision	May 2012
MCM	Stress Test Models and Implementation	May 2012
MCM	Cash Management	April 2012
MCM	Liability Management	March 2012
MCM	Monetary and Foreign Exchange Policy	March 2012
MCM	Application of Models of Stress Testing	February 2012
MCM	Bank Supervision and Regulations	February 2012
MCM	Monetary and Foreign Exchange Policy	December 2011
MCM	Bank Supervision and Regulations	November 2011
MCM	Monetary and Foreign Exchange Policy	October 2011
MCM	Payment Systems Modernization and Oversight	September 2011
MCM	Risk-based Supervision	July 2011
MCM	Review Process of Conducting Open Market Operations	June 2011
MCM	Bank Supervision and Regulations	April 2011
MCM	Risk Management Workshop	March 2011
MCM	Training on Stress Testing	February 2011
MCM	Monetary and Foreign Exchange Policy	February 2011
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
STA	Balance of Payments Statistics BPM6	November 2012

STA	Nat. Acc. Annual and quarterly assessment 2007	September 2012
STA	Producer Price Index	July 2012
STA	Balance of Payments Statistics	June 2012
STA	Export/Import Price Index	June 2012
STA	Nat. Acc. Analysis of results 2007 and IMAE	June 2012
STA	Balance of Payments Statistics	March 2012
STA	Quarterly Nat. Accounts Statistics	March 2012
STA	Monetary and Financial Statistics	January 2012
STA	Balance of Payments Statistics	November 2011
STA	Annual and Quarterly National Accounts Statistics	August 2011
STA	Monetary and Financial Statistics	June 2011
STA	Balance of Payments Statistical Techniques	June 2011
STA	Export and Import Price Indexes	May 2011
STA	Government Finance Statistics	April 2011
STA	Balance of Payments Statistics	February 2011
STA	National Accounts	January 2011

Resident Representative:

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

BANK-FUND COUNTRY LEVEL JOINT MANAGERIAL ACTION PLAN, 2013–14[1]

Products	Mission timing	Expected delivery
A. Mutual information on relevant work programs		
The Fund work program		
Strategy: An ECF arrangement for 2007-2011 was completed on October 21, 2011. The IMF-supported program entailed macroeconomic policies anchored on containing expenditures, paving the way for fiscal consolidation, and protecting the external position. Technical assistance focuses on tax and customs administration, IFRS Implementation, financial regulation on deposit insurance and stress testing. The last IMF staff visit was in September 2013 and the next Article IV mission is scheduled to take place in the fall of 2014.		
Article IV	September 2013	Board discussion in Dec. 2013
FADTA: Tax Administration	November 2013	TA report at the end of the final mission
FADTA: Customs Administration	December 2013	TA report at the end of the final mission
MCMTA: Monitoring IFRS Implementation	December 2013	TA report at the end of the final mission
MCMTA: Deposit Insurance Legislation	December 2013	TA report at the end of the final mission
MCMTA: Capacity Building in the Analysis of Macroeconomic policy in the Region	January 2014	TA report at the end of the final mission
MCM TA: Workshop on Stress Testing	April 2014	TA report at the end of the final mission
The World Bank program		
Strategy: The Bank's operations and analytical activities under the Country Assistance Strategy 2013-2017 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. Productivity and competitiveness, developing human capital (improving social equity and opportunity) and strengthening governance and accountability. Additionally, IFC's strategy focuses on fostering sustainable economic growth, critical infrastructure and job creation, and helping Nicaragua take advantage of regional integration opportunities.		

[1] The Fund and the World Bank teams maintain regular monthly communication and exchange of information and have structured semi-annual discussions in the context of the JMAP.

A. Lending		
A.1 Community Health Project	TBD	Bank approval by February 2014
A.2 Additional Financing Rural Roads Infrastructure Improvement Project	TBD	Bank approval by March 2014
B. Technical assistance and Analytical Work		
B.1. Public Expenditure and Financial Accountability	August 4-9, 2013	Final delivery by July 2014
B.2. Payment Systems Legal and Oversight Framework	February 18-22, 2013	Final delivery by February 2014
B.3. Economics of Sanitation Initiatives	October 9-11, 2013	Final delivery by June 2014
B.4. Strengthening government capacity for Rural and Peri urban WS projects	TBD	Final delivery by October 2014
B.5. Strengthening Rural WSS Sector Institutional Policy and Planning Capacity in Nicaragua	TBD	Final delivery by May 2015
B.6. Nicaragua Trade Logistic and Customs	TBD	Final delivery by May 2015

RELATIONS WITH THE INTER-AMERICAN DEVELOPMENT BANK

(As of October 21, 2013)

Statement of IDB Loans

(In millions of U.S. dollars)

Year	Purpose	Amount
2007	National transmission investments to support SIEPAC	12.5
	Electricity Sector Support Program I	32.7
	Development of Health Networks Phase I	20.0
	Multiphase Low Income Housing Program Phase II	15.0
	Banco de la Producción S.A -TFFP(Non-sovereign)	10.0
2008	Electricity Sector Support Program II	40.2
	Program to Support Agri-food Production	20.0
	Fiscal Management and Social Expenditure Reform I	20.0
	Banco de Finanzas TFFP(Non-sovereign)	3.0
2009	Storm-water Drainage and Development Mgmt. Sub-Watershed III Managua	13.0
	Urban Welfare Program for Children in Extreme Poverty	15.0
	Electricity Sector Support Program III	20.0
	Supplementary Road Infrastructure for Competitiveness Program	43.5
	Global Multi-sector Credit Program	20.0
	Fiscal Management and Social Expenditure Reform II	40.5
	Foreign Trade Support Program	10.0
	Agricorp (Non-sovereign)	10.6
2010	National Sustainable Electrification and Renewable Energy Program I	30.5
	Environmental Program for Disaster Risk and Climate Change	10.0
	Proposal for an additional financing of cost overruns	4.5
	Public Sector Financial Management System Modernization Project	10.0
	Support to Transportation Sector I	20.2
	National Program of Tourism	10.0
	Support to the Improvement of the Fiscal Management and Social	42.5
	Potable Water Program for Managua	30.0
	Comprehensive Child Care Program - PAININ Stage IV	12.5
	San Jacinto-Tizate Geothermal Power Project (Non- sovereign)	30.3
2011	Improving Family and Comm. Health in Highly Vulnerable Municipalities	20.0
	National Sustainable Electrification and Renewable Energy Program II	22.0
	Integral Housing Improvement Program	20.0
	Improving Social Protection and Health expenditures and Public	45.0

	Management	
2012	Program to accompany the implementation of the National Policy for children in Prioritized Communities	20.0
	Sustainable Agricultural Productivity Program	40.0
	Integrated Health Networks	56.2
	Support to the Transportation Sector II	39.2
	National Sustainable Electrification and Renewable Energy Program III	35.0
	Improving Expenditures on Health and Social Protection II	45.0
	Rent to Own: Innovation to Improve Access to Social Housing (Non-sovereign)	10.0
	Progressive introduction of basic services and social housing for PRODEL(Non- sovereign)	5.0
2013	Support program for the Transportation Sector III	91.5
	Extending health care to communities in the Dry Corridor Region	35.0
	Credit Access to Rural Productive Chains*	20.0
	Contingent Loan for natural disaster*	186.0
	Program to strengthen the electricity sector in Nicaragua	45.0
	BAC SME Financing partnership Housing* (Non- sovereign)	30.0
	BANCENTRO SME Financing partnership* (Non- sovereign)	15.0

** Pending for Approval*

IDB Loan Commitments and Disbursements

As of October 21, 2013, there were 25 projects in the IDB's current sovereign loan portfolio with a total commitment of US$702.3 million and an undisbursed balance of US$471.15 million. Basic infrastructure (roads and energy) accounts for almost half the portfolio. Nicaragua is one of four IDB borrowing member countries to receive highly-concessional loans from the Fund for Special Operations (FSO). More precisely, Nicaragua receives a lending blend of 50 percent from the FSO and 50 percent from the Ordinary Capital. The annual sovereign lending envelop depends on the availability of FSO funding as well as an allocation formula that encompasses policy framework, portfolio performance, per capita income and population. The allocation for Nicaragua was US$80.2 million per annum in 2007 and 2008. In early 2009, the overall FSO funding for the four low-income countries was increased as a counter-cyclical response to the global economic crisis, and Nicaragua's allocation increased to US$162.0 million for 2009 and US$170.2 million for 2010. For 2011 and 2012, the FSO allocation increased to US$171.2 million. Finally, the allocation for 2013 and 2014 increased to US$191.5 million.

Technical Assistance

As of October 21 2013, there were 32 non-reimbursable technical cooperations (for the public sector) in execution with an approved commitment of US$12.8 million and an available balance of US$5.9 million. The Multilateral Investment Fund has: (i) 14 non-reimbursable technical cooperation (including regional operations) in execution with an available balance of US$5.7 million; and (ii) 4 loans in execution from the Social Entrepreneurship Program with an approved commitment of US$2.2 million and an available balance of US$1.3 million.

Recent Agreements

The current country strategy with Nicaragua 2012-2017 was approved by the Board of Executive Directors in November 2012.

STATISTICAL ISSUES

(As of October 31, 2013)

Assessment of Data Adequacy for Surveillance
General. Data provision has some shortcomings, but is broadly adequate for surveillance. Areas requiring most improvement are government financing statistics and labor statistics.
National accounts. In September 2012, the Central Bank of Nicaragua (CBN) published new national account statistics. The new statistics include a number of improvements: a change in base year (from 1994 to 2006); the implementation of a complete set of integrated economic accounts by institutional sector in accordance with the recommendations of the 1993 System of National Accounts; and the implementation of classifications and most relevant recommendations of the 2008 System of National Accounts. **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 tax-free zones (i.e., "maquila"). There is 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). Authorities are making significant progress in implementing the *GFSM 2001* methodology. However, the fiscal data still present large discrepancies between the overall balance compiled by the Ministry of Finance and Public Credit (MHCP) and the financing data compiled by the BCN. Therefore, stronger collaboration is needed between the MHCP and the BCN to derive more accurate and timely estimates of external and domestic financing of the nonfinancial public sector. The MHCP disseminates government finance statistics (GFS) covering only the central administration, and compiles annual GFS for the nonfinancial public sector (NFPS) for internal use and for reporting to the Western Hemisphere Department. The BCN reports budgetary central government data, albeit with considerable delay, for publication in the International Financial Statistics. In 2006 the MHCP reported GFS data for publication in the *GFS Yearbook*.
Monetary finance statistics: Monetary statistics are, in general, consistent with the *Monetary and Financial Statistics Manual (MFSM, 2000)*. In January 2012, STA provided technical assistance under the Regional Project on Harmonization of Monetary and Financial Statistics to develop a work plan to compile surveys for the other financial corporations following the recommendations of the *Monetary and Financial Statistics Manual and Monetary* and *Financial Statistics Compilation Guide*. Authorities are encouraged to start the compilation of monthly data for insurance companies and recommended

the compilation of the monetary and financial statistics for credit and savings cooperatives.
External sector statistics: Balance of payments statistics broadly follow the concepts and definitions set out in the fifth edition of the *Balance of Payments Manual (BPM5),* within the limits set by the availability of information sources. A. Resident institutional units are defined in conformity with *BPM5*'s concepts of economic territory, residency, and center of economic interest. However, coverage of the private sector is incomplete; this is the case in both the current and financial accounts. Major coverage weaknesses include areas such as services, compensation of border employees, and financial transactions. Despite some recent progress, there is scope for better coordination with the Superintendency of Banks and Other Financial Institutions to access more disaggregated data on insurance services data and the implementation of insurance's accounts catalog. B. With assistance from CAPTAC, the Central Bank of Nicaragua has been developing a system of Integrated Indices of Prices, Value, and Volume for Imports and Exports. Preliminary unit value indices have been developed. However, some of these unit value indices could be improved.
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 OCTOBER 28, 2013)

	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	10/23/2013	10/23/2013	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	10/23/2013	10/23/2013	D	D	D		
Reserve/Base Money	10/23/2013	10/23/2013	D	D	D		
Broad Money	10/23/2013	10/23/2013	D	D	D	O, LO, LO, LO	LO, O, LO, LO, LO
Central Bank Balance Sheet	8/31/2013	9/26/2012	M	M	M		
Consolidated Balance Sheet of the Banking System	8/31/2013	9/26/2012	M	M	M		
Interest Rates[2]	10/23/2013	10/23/2013	D	D	D		
Consumer Price Index	Sept. 2013	10/23/2013	M	M	M	O, LO, LO, LO	LO, LO, LO, O, LO
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	Sept. 2013	10/23/2013	M	M	M	LO, LNO, LNO, LO	O, O, O, O, LO
Revenue, Expenditure, Balance and Composition of Financing[3] – Central Government	Sept. 2013	10/23/2013	M	M	M		
Stocks of Central Government and Central Government-Guaranteed Debt[5]	Q2 2013	9/26/2013	Q	Q	Q		
External Current Account Balance	Q2 2013	9/26/2013	Q	Q	Q	LO, LO, LNO, LO	LO, O, LO, LO, LO

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

(AS OF OCTOBER 28, 2013)

Exports and Imports of Goods and Services	July 2013	9/26/2013	M	M	M		
GDP/GNP	Q4 2012	9/26/2013	Q	Q	Q	O, O, O, LO	LO, O, LO, O, LNO
Gross External Debt	Aug. 2013	9/26/2013	M	M	M		
International Investment Position[6]	2012	9/26/2013	A	A	A		

[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 7, 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.

Press Release No. 13/508
December 13, 2013

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Concludes 2013 Article IV Consultation with Nicaragua

On December 4, 2013, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation [1] with Nicaragua.

Over the past two years, macroeconomic developments in Nicaragua have been generally favorable. Real gross domestic product (GDP) grew by an average of 5¼ percent during 2011–12, and the annual average inflation was 7¼ percent during the same period. Looking ahead, the macroeconomic outlook also remains broadly positive. Real GDP is expected to grow by 4¼ percent in 2013 and then stabilize at its potential level of 4 percent over the medium-term. Inflation is projected to remain at about 7 percent supported by the crawling-peg exchange rate system that has helped anchor inflation expectations.

Fiscal discipline contributed to lower public debt ratios. After a balanced position in 2011, the combined public sector experienced a deficit of ¾ percent of GDP last year. In 2013, the deficit is expected to widen to 1½ percent of GDP. This reflects mostly an increase in capital spending by public sector enterprises while the accounts of the central government are projected to remain balanced. As a result, the ratio of public debt to GDP is projected to decline to about 42 percent in 2013, compared with 50 percent in 2010.

The external position remains vulnerable. The external current account deficit is projected to be about 13 percent of GDP in 2013, broadly unchanged from the previous year, reflecting a large dependence on oil imports and relatively tepid increases in exports and remittances inflows. Strong capital inflows, mostly foreign direct investment (FDI) and oil-related financing from Venezuela, are expected to help finance the current account deficit and increase gross international reserves to nearly US$2 billion (equivalent to 3½ months of imports).

[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 soundness indicators of the banking system appear robust. The average adequacy ratio of the system was 13 percent as of August 2013, above the regulatory norm of 10 percent and nonperforming loans have declined from their 2009 peak. However, commercial bank credit to the private sector increased rapidly over the past two years. As of August 2013, bank credit increased by 23 percent (yoy), following an annual increase of 26 percent in 2012. Credit expansion was the strongest in the personal loan sector.

Progress is being made in the structural reform area. In 2012, a tax reform was approved featuring the elimination of some VAT exemptions, changes in the personal income tax thresholds, and a plan for further rationalization of tax exemptions over the medium term. In April 2013, electricity tariffs were increased by close to 13 percent to bring the actual tariffs closer in line with international energy prices.

The near-term outlook contains risks. Adverse external shocks, such as the deterioration of Nicaragua's main export prices (e.g., for coffee, gold, and meat) or an increase in oil prices, could widen trade deficits and negatively impact growth. A slowdown in global economic activity could reduce FDI and remittances inflows. Also, the terms and levels of the economic cooperation with Venezuela could change and add to external pressures. On the domestic front, the rapid increase in private sector credit could pose risks and merits careful monitoring.

Executive Board Assessment[2]

Executive Directors welcomed Nicaragua's stable macroeconomic condition despite the weak global environment. They commended the authorities' efforts to maintain fiscal discipline and monetary stability, which, combined with progress in structural reform, have helped to strengthen confidence and boost economic growth. However, Directors noted that downside risks remain, stemming from Nicaragua's large external deficit and uncertainties regarding the global outlook and the oil import financing scheme with Venezuela. They welcomed the authorities' commitment to continue implementing prudent macroeconomic policies and structural reforms and encouraged development of contingency plans to address potential external vulnerabilities.

Directors stressed that fiscal discipline should remain the cornerstone of Nicaragua's macroeconomic policy framework. They supported the fiscal stance of the draft 2014 budget, which, while incorporating a wage bonus, remains consistent with the medium term goals of strengthening fiscal buffers and lowering further public debt ratios. They underscored the importance of broadening the revenue base by fully implementing the 2012 tax reform, rationalizing public expenditures, and reforming the pension system to ensure its financial viability, while reinforcing the social safety net. Directors noted that the risk of external public debt distress remains moderate, and called for renewed efforts to conclude debt relief

[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 summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

negotiations with non-Paris Club official creditors. In this respect, they encouraged all creditors to deliver fully the debt relief envisaged under the HIPC Initiative.

Directors agreed that monetary policy should aim to contain inflation and keep the real exchange rate broadly in line with fundamentals, and that external reserves coverage should stay above the established international benchmarks. Directors also observed that, while financial soundness indicators appear to be satisfactory, the recent rapid, albeit slowing, increase in bank credit to the private sector needs to be monitored closely. They welcomed the progress in strengthening bank supervision and the authorities' commitment to continue recapitalizing the central bank.

Directors encouraged the authorities to advance quickly with structural reforms to spur economic growth and reduce poverty. These would include reforms to lower informality in labor markets, improve and expand education and training, reduce dependence on oil imports, and strengthen the framework for private investment in infrastructure. Directors welcomed the authorities' intention to expand further the electricity sector's capacity and efficiency, and encouraged continued reform of the subsidy system to reduce fiscal risks. Directors commended the increased dissemination of information on international cooperation, and recommended full disclosure of the oil import financing agreement with Venezuela.

Nicaragua: Selected Social and Economic Indicators, 2009–13[1/]

	2009	2010	2011	2012	2013 Proj.
Output					
GDP growth (percent)	-2.2	3.6	5.4	5.2	4.2
GDP (nominal, US$ million)	8,155	8,587	9,636	10,506	…
Prices			(Percent)		
GDP deflator	6.1	7.0	12.3	8.8	8.1
Consumer price inflation(end of period)	0.9	9.2	8.0	6.6	6.9
Consumer price inflation (period average)	3.7	5.5	8.1	7.2	7.4
Exchange rate			(Cordobas per US$)		
End of period	20.8	21.9	23.0	24.1	…
Period average	20.3	21.4	22.4	23.6	…
Fiscal sector			(Percent of GDP)		
Combined public sector (CPS)					
Revenue	22.3	23.1	25.4	25.2	25.4
Expenditure	27.6	26.5	27.8	28.0	28.8
Current	21.7	21.2	22.0	22.1	21.9
of which: Wages & Salaries[2/]	6.2	6.4	6.4	6.5	6.3
Capital	5.9	5.3	5.8	5.9	6.9
Balance, before grants	-5.2	-3.3	-2.4	-2.7	-3.4
Overall balance, after grants	-2.6	-1.3	0.0	-0.7	-1.4
Money and credit			(Annual percentage change)		
Broad money (M3)	14.3	21.7	12.6	15.4	16.3
Credit to the private sector	-7.5	5.9	15.6	26.3	16.2
Net domestic assets of the banking system	-9.3	1.0	4.1	24.8	14.8
			(Percent of GDP, unless otherwise indicated)		
External sector					
Current account	-9.5	-10.0	-13.2	-12.9	-13.2
Of which: oil	-8.3	-8.7	-12.6	-11.9	-11.7
Capital and financial account [3/]	14.8	12.5	14.0	12.3	13.8
Of which: FDI	5.3	5.9	10.0	7.7	6.2
Gross reserves (US$ million)[3/]	1,575	1,800	1,892	1,887	1,977
(in months of imports excl. maquilas)	*4.9*	*4.7*	*4.0*	*3.6*	*3.5*
Net international reserves[3/]	1,424	1,633	1,711	1,718	1,825
Public sector debt	50.2	50.1	45.4	43.2	42.4
Private sector external debt	23.0	33.2	36.7	39.0	41.8

Sources: Central Bank of Nicaragua; Ministry of Finance; World Bank; and Fund staff estimates and projections.

[1/] All data are based on the new national accounts data that were launched officially on September 20, 2012.

[2/] Data for 2010–13 include the off-budget wage bonus financed with Venezuela-related resources.

[3/] Data for 2010–13 include the SDR allocation for SDR105.1 million (US$165 million) of September 2009.

Statement by Mr. Nogueira Batista, Executive Director for Nicaragua, Mr. Torres, Alternate Executive Director, and Mr. Coronel, Advisor to the Executive Director

December 4, 2013

The Nicaraguan authorities appreciate the dialogue with IMF staff. Discussions were forthright, transparent, and the results openly shared with the Nicaraguan people. Following a successful three-year Extended Credit Facility (ECF) program (that ended in 2011) the Fund and the government of Nicaragua have consolidated a constructive relationship.

Solid progress on the reform agenda

Based on its Economic and Financial Program (2013-16), and as part of an ongoing engagement with the Fund, the government made significant progress in major areas. Staff acknowledged the progress made and agreed with the authorities that Nicaragua needs neither external financial support nor a new IMF program.

Progress on the reform agenda can be summarized as follows:

1. A tax reform, the "*Ley de concertacion tributaria*" (Consensus tax law) was approved by the National Assembly in 2012 and entered into full force in January 1st 2013. It will increase revenues and improve tax administration, and is consistent with IMF recommendations. Nicaragua's fiscal authorities estimate that tax revenues will increase by an equivalent of 0.21 percent of GDP.

2. A reform of the electricity sector to provide financial stability and improve competitiveness. A financially sound private company[1] recently acquired almost all the country's electricity distribution facilities. The government has approved new legislation and is already enforcing measures to reduce technical and non-technical losses (including theft)[2]. It is also supporting community-based plans to commercially integrate illegal connections[3]. These actions are part of the deal negotiated with the aforementioned private company and are being supervised by the country's independent regulator. Along with improved maintenance plans and increased infrastructure investment, they will strengthen the sector's performance. Oil price dependency still constitutes the main risk, but the electricity industry continues to reduce its dependence on subsidies as tariffs adjustments progressively narrow the gap between the reference price for distributors (close to the cost of generation) and the actual price charged to consumers.

3. Improvements in providing information on off-budget operations. As staff notes the "solidarity bonus"[4] paid to low-income state employees, formerly an off-budget

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[1] The TSK energy group and the Andalusian Company Melfosur, with which TSK has partnered for several projects, purchased from Gas Natural–Union Fenosa more than 83% of the two biggest distribution utilities in Nicaragua.

[2] Non-technical losses in electricity distribution include mainly electricity theft, but also losses due to poor equipment maintenance, calculation errors and accounting mistakes.

[3] Recent successful experiences in the cities of Leon and Managua have been implemented with IDB and WB financing.

[4] This bonus is a monthly allowance of US$ 20 for each of the approximately 150,000 low-income government employees (those who earn less than US$ 230/month). It costs about US$ 40 million per year or 0.38 percent of GDP.

expenditure financed by Venezuelan cooperation, has been integrated into the 2014 budget. The government decided to include the bonus as a permanent payroll benefit to partially reduce accumulated disparities in public sector salaries.

4. Social security reform ensuring financial sustainability until (at least) 2030. Negotiations between representatives of labor, the private sector and the government are well under way. The purpose is to reach consensus on social security reform based on a proposal presented by the government[5]. It is important to note that in Nicaragua the informal sector is still very large (out of 3 million economically active, only 21 percent are affiliated to the national pension system). Increasing the number of social security subscribers will contribute to the pension's system sustainability and also increase the tax base. The government has acknowledged a debt of US$ 580 million with the Social Security Institute and will start honoring it in 2014. The authorities anticipate that consensus will be attained by the end of the year so that the reform could be enacted by January 2014.

Economic growth has been strong

Nicaragua's growth remains relatively strong, averaging 5.3 percent in the last two years. Quarterly GDP reached an inter-annual growth (y-o-y) of 5.3 percent during the first semester of 2013, mainly driven by construction, industry, and the primary sector. The authorities conservatively project 4.8 percent GDP growth for 2013.

In the authorities' medium term forecast (2014-2017) growth hovers between 4.7 and 5 percent. This projection is based on the performance of the manufacturing industry (mainly food products and textiles), construction, and on estimates of potential gains in agricultural productivity, as well as on further expansion of energy generation and coverage. The authorities' forecast is somewhat higher than that of the IMF staff, which projects medium-term growth at 4 percent . For 2014 (assuming the continued recovery of the economy in the United States, stable commodity prices, and the normalization of local meat production), the Central Bank of Nicaragua (CBoN) projects 4.5 percent growth.

Monetary policy has worked well, yet authorities envisage the possibility of changes in the medium term

Inflation receded in 2012 (partly due to moderation in oil prices) and has remained stable since then. Headline inflation is projected at 7.4 percent and core inflation at 6.5 percent by the end of 2013. 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. Yet the 5 percent annual crawl also provides an undesirable floor to inflation and interest rates, limiting the elbow room for monetary policy. The hyperinflation experienced in the 1980's led to high levels of dollarization in Nicaragua. Consumers and economic agents in general welcomed and got

[5] The proposal puts forward several options, all of which ensure financial sustainability.

used to the crawling peg system. All in all, the authorities are willing to explore with staff alternative policy options for a gradual transition towards a less dollarized economy in the long run.

External sector remains stable and well financed

The external sector reflects the reduction of global demand for commodities. Exports decreased by 9.3 percent in value terms (y-o-y) until August 2013, but manufactured products from free-trade zones (textiles, car harnesses, among others) and tourism continue to perform favorably and total exports are expected to be higher than last year's. Oil imports excluded, the current account deficit is narrowing. While exports have more than doubled since 2009, non-oil imports have increased by 83 percent. Netting-out oil imports, the current account deficit has dropped from 10 percent of GDP in 2002 to 1.5 percent in 2012.

Furthermore, in the medium-run the changes in the electricity matrix are expected to continue reducing oil imports. The current account deficit is still quite high (12.9 of GDP in 2012 and projected at 13.2 percent in 2013), reflecting Nicaragua's dependence on oil imports. However, it is expected to remain stable and be covered mostly by foreign direct investment. International reserve levels are adequate and stable and the CBoN considers that the real effective exchange rate is broadly in line with fundamentals.

Fiscal consolidation efforts paid off

The Central Government's consolidation efforts have paid off as its primary balance has been slightly above equilibrium between 2010 and 2012. In 2013, the primary surplus is expected to reach 1.1 percent of GDP.

The evolution of taxes until September 2013 was consistent with the country's economic performance and the effects of the 2012 tax reform. Until September 2013 government revenue grew at an inter-annual accumulated rate of 13.6 percent, reflecting the general VAT and income tax upturn in the first half of the year.

The overall balance of the "Combined Public Sector" (after grants) went from equilibrium in 2011 to a 0.7 percent deficit in 2012. Despite higher revenues, the deficit is projected to increase to 1.4 percent of GDP in 2013 due to an expansion in capital spending. However, staff and the authorities agree that this is a manageable deficit considering that fiscal revenues are increasing and economic growth, together with prudent fiscal policies, have put public debt firmly on a downward path. According to the CBoN public debt is projected to drop from 42 percent of GDP in 2013 to about 35 percent of GDP by 2018[6].

[6] Staff has a slightly less favorable projection: a decline from 42.4 to 37.5 percent of GDP between 2013 and 2018 (Table 10 of the staff report).

The authorities are committed to pursue further fiscal consolidation and agree with staff that this will require implementing social security reform, concluding debt negotiations with non-Paris Club creditors, better targeting electricity subsidies and strengthening the Water Utility Company (ENACAL).

The country's financial sector remains stable and well capitalized

Staff notes that credit expansion has been rapid and argues that this could increase the financial system's vulnerabilities. This remains one of the few areas of disagreement with staff. By the end of July, average capital adequacy in the banking system was 3 percent higher than the regulatory requirement, and NPLs were less than 2 percent of total loans. Credit expansion follows a period in which credit virtually did not exist. Moreover, the pace of credit expansion is moderating while deposits continue to increase. The CBoN's favorable assessment of the financial system is based on these factors, as well as on positive indicators of the quality of credit and profitability of commercial banks.

Productivity, the Nicaraguan economy's soft spot

Low productivity constitutes the main constraint for long-term growth. The authorities are persuaded that to increase Nicaragua's very low agricultural yields (despite the fertility of its land) and better position the agro-industrial sector in international value-added chains, the government will need to step-up investment in infrastructure and in human capital development. With this in mind the government is striving to strengthen the quality of (and facilitate access to) technical education. The Inter-American Development Bank and the World Bank Group are supporting these efforts.

Concluding remarks

Nicaragua has achieved considerable progress on the macroeconomic and structural reform fronts, as acknowledged by staff. Yet the authorities are mindful of the paramount challenges that remain. Elevated and persistent poverty levels, a long-standing lag in basic infrastructure and competitiveness, as well as relatively weak human development indicators, are reminders of the tasks ahead.

Nicaragua is committed to continue implementing coherent macroeconomic and development policies to remove structural hurdles, achieve higher productivity levels and improve income distribution. The Government counts on the Fund's support through policy advice and capacity building tailored to the country's specific needs and circumstances.