INTERNATIONAL MONETARY FUND

IMF Country Report No. 17/173

NICARAGUA

June 2017

2017 ARTICLE IV CONSULTATION—PRESS RELEASE AND STAFF REPORT

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 2017 Article IV consultation with Nicaragua, the following documents have been released and are included in this package:

- A **Press Release**.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on lapse of time basis following discussions that ended on May 5, 2017 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 June 8, 2017.
- An **Informational Annex** prepared by the IMF staff.
- A **Debt Sustainability Analysis** prepared by the staffs of the IMF and the International Development Association (IDA).

The document listed below will be separately released:

Selected Issues

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

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June 26, 2017

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IMF Executive Board Concludes 2017 Article IV Consultation with Nicaragua

On June 22, 2017, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Nicaragua, and considered and endorsed the staff appraisal without meeting on a lapse-of-time basis.[2]

Macroeconomic performance in 2016 was robust. Real GDP grew by 4.7 percent in 2016, supported by strong domestic demand, while inflation remained subdued at 3.1 percent as of end-2016, owing largely to the contribution of food prices.

The fiscal deficit increased slightly in 2016. Tax revenues increased by 0.7 percent of GDP in 2016, because of advances in tax administration and the impact of the full implementation of the 2012 tax reform. Nevertheless, the deficit of the consolidated public sector (CPS) widened slightly to 2.4 percent in 2016 from 2.2 percent in 2015 due to election-related spending, expansion of public investment and a further deterioration of the financial position of the Social Security Institute (INSS). The CPS debt ratio edged up to 41.9 percent of GDP in 2016 from 40.7 percent in 2015.

The external position improved moderately from the previous year. The current account deficit for 2016 is estimated to have narrowed to 8.6 percent of GDP, compared with 9 percent in 2015. This consolidation is largely explained by maquila exports, which have been better captured due to improvements in statistical compilation. The current account deficit remained financed by foreign direct investments (FDI) and other long-term inflows. Despite declining Venezuela cooperation inflows, gross international reserves remained broadly stable at US$2.3 billion at end-2016, with coverage of about 4 months of non-maquila imports.

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[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.

[2] The Executive Board takes decisions under its lapse-of-time procedure when the Board agrees that a proposal can be considered without convening formal discussions.

Monetary and financial conditions remained stable. Private sector credit growth slowed to 17.4 percent in 2016 but remained above nominal GDP growth. Bank soundness indicators remain solid, with non-performing loans at below 1 percent of total loans and capital adequacy ratio of 13.5 percent of risk-weighted assets at end-2016.

GDP growth is expected to moderate to its potential. Real GDP growth in 2017 is projected at 4.5 percent, while inflation is expected to remain contained anchored by the crawling peg at about 6 percent. The deficit of the CPS is projected to moderate somewhat, to about 2.3 percent of GDP, implying a broadly neutral fiscal stance in line with the authorities' fiscal anchor. The current account balance is projected to remain stable at about 8.5 percent of GDP.

Executive Board Assessment

In concluding the 2017 Article IV Consultation with Nicaragua, Executive Directors endorsed staff's appraisal as follows:

The fiscal stance is broadly adequate to maintain macroeconomic stability in the near term, but fiscal buffers are needed to confront risks. The need to finance growing INSS deficits and to take over some critical social programs currently financed by Venezuelan cooperation are likely to intensify spending pressures in the next few years. Furthermore, if approved, the potential impact of the NICA Act on public finances could be significant if it affects investment and growth, and rates on public debt. Staff recommends a fiscal consolidation of 1.6 percent of GDP, implemented over two years, to maintain fiscal sustainability in the medium term. This could be achieved primarily through a rationalization of subsidies and tax expenditures, particularly VAT exemptions.

Reforming the social security system is a priority. INSS liquid reserves will be depleted by 2019, which could increase government transfers to finance pensions and health benefits. Urgent action should be taken using a combination of measures to improve sustainability, which, to the extent possible, should be introduced gradually.

In the medium-term, fiscal policy should strive to improve resilience against potential external shocks. Given the risks related to spillovers from U.S. policies, and vulnerability to CCDs, fiscal policy should aim to be more counter-cyclical. A better monitoring of fiscal risks would assist the authorities in calibrating the appropriate fiscal stance. Efforts to improve the oversight of SOEs represent an important step forward in this regard.

External and financial buffers should be strengthened. The combination of a further reduction of Venezuela's cooperation and lower IFI financing, in case of approval of the NICA Act, could put pressure on the FX market. Given the exchange rate framework, a stronger reserve position to reach the IMF's suggested adequacy range would be advisable. Banks should further enhance their liquidity, capital and provisioning buffers to preserve financial stability against the potential impact of declining asset quality, higher interest rates and lower remittances.

The authorities should address the gaps in the supervisory perimeter. Every deposit-taking and systemically important non-bank should be subject to effective risk-based supervision and AML/CFT oversight. Additional efforts are needed to strengthen regional financial regulatory cooperation. The stress test methodology should be further improved in line with best practices. The CBN continues to publish the audited financial statements in accordance with the Safeguards Policy. However, implementation of IFRS remains in progress.

Strengthening liquidity management tools is important to deepen financial markets. Efforts to strengthen short-term liquidity management should continue, with a stronger focus on calibration, choice of instruments, and monitoring of liquidity developments. Introducing a short-term policy rate and a corridor will reduce interest rate volatility, deepen financial markets and, eventually, may provide some cushion against external shocks. The amplification of the negative impact of an external shock on output, competitiveness and exports should be carefully weighed against the price stability anchor provided by the crawling peg exchange regime.

Further improvements in competitiveness would reduce vulnerability to external shocks and spur structural transformation. Key actions include maintaining the investment in infrastructure, increasing human capital development, and addressing labor skills bottlenecks.

The authorities need to further improve data quality and scope of macroeconomic statistics. Recent progress has been significant. Nevertheless, further efforts are needed to strengthen base statistics, complete the rebasing of the national accounts, and increase data quality by applying IMF’s compilation methodologies.

Nicaragua: Selected Economic Indicators, 2012–17

	2012	2013	2014	2015	2016	2017 Proj.
Output			(Annual percentage change)			
GDP growth	6.5	4.9	4.8	4.9	4.7	4.5
GDP (nominal, U.S.$ million)	10,532	10,983	11,880	12,748	13,230	13,942
Prices						
GDP deflator	6.2	4.3	8.4	7.5	4.1	5.9
Consumer price inflation (period average)	7.2	7.1	6.0	4.0	3.5	5.4
Consumer price inflation (end of period)	6.6	5.7	6.5	3.1	3.1	5.8
Exchange rate						
Period average (Cordobas per U.S.$)	23.5	24.7	26.0	27.3	28.6	…
End of period (Cordobas per U.S.$)	24.1	25.3	26.6	27.9	29.3	…
Fiscal sector			(Percent of GDP)			
Consolidated public sector						
Revenue (excl. grants)	25.4	25.3	25.5	26.3	27.9	27.9
Expenditure	28.3	28.3	28.6	29.6	31.2	31.1
Current	23.0	22.4	22.6	23.0	24.2	24.1
of which: wages & salaries[1/]	7.6	7.7	7.4	7.4	7.6	7.5
Capital	5.3	5.9	6.0	6.7	7.0	7.0
Overall balance, before grants	-2.8	-3.0	-3.1	-3.3	-3.3	-3.2
Overall balance, after grants	-0.8	-1.3	-2.0	-2.2	-2.4	-2.3
Money and credit			(Annual percentage change)			
Broad money	15.4	18.3	15.4	19.0	11.0	10.8
Credit to the private sector	26.3	20.2	20.5	23.5	17.4	14.0
Net domestic assets of the banking system	23.9	17.3	5.1	18.7	13.0	11.7
External sector			(Percent of GDP, unless otherwise indicated)			
Current account	-10.7	-10.9	-7.1	-9.0	-8.6	-8.3
of which: oil imports	12.2	10.9	9.6	6.1	5.2	6.1
Capital and financial account	16.9	14.4	13.7	14.0	8.8	9.1
of which: FDI	6.7	6.1	6.7	7.1	6.5	6.3
Gross reserves (U.S.$ million)[2/]	1,778	1,874	2,147	2,353	2,296	2,393
In months of imports excl. maquila[2/]	3.6	3.7	4.2	4.6	4.0	3.9
Net international reserves[2/]	1,609	1,721	2,024	2,262	2,236	2,354
Public sector debt[3/]	41.5	42.3	40.2	40.7	41.9	41.5
Private sector external debt	42.5	45.1	44.7	44.9	44.8	42.6

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

[1/]The figures for 2013 include an off-budget wage bonus that was financed with Venezuela-related resources. Starting in 2014 the wage bonus is included in the budget.

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

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

INTERNATIONAL MONETARY FUND

NICARAGUA

STAFF REPORT FOR THE 2017 ARTICLE IV CONSULTATION

June 8, 2017

KEY ISSUES

Context: Economic activity remains robust and inflation is well-anchored by the crawling peg exchange rate regime. GDP growth is expected to moderate to its potential in 2017 and risks to the outlook are tilted to the downside. The external position is assessed to be broadly consistent with fundamentals. Monetary and financial conditions are stable, with credit growth decelerating in 2016; nonetheless, gaps in financial supervision remain. A slightly more expansionary fiscal stance is projected for the medium term, and, while staff considers public debt to be sustainable over the medium term, stress events could significantly alter its trajectory.

Challenges. The policy agenda should be directed towards enhancing Nicaragua's resilience to shocks and making progress towards development goals. The unwinding of the oil cooperation with Venezuela poses challenges to external and fiscal sustainability.

Policy Advice. In the short-term, urgent action should be taken to address the deteriorating financial position of the social security institute (INSS) and to expand the perimeter of financial supervision. Over the medium to long term, fiscal, financial sector and external buffers should be built, while maintaining development-oriented infrastructure and social expenditure programs. Implementing a more countercyclical fiscal policy and contingency plans, including by maintaining sufficient international reserves as a safeguard and improving competitiveness to reduce vulnerability to external shocks, would contribute to address risks on various fronts, notably the potential spillovers from U.S. policies and exposure to climate change and disasters.

Approved By
Krishna Srinivasan and Zeine Zeidane

Discussions took place in Managua during April 24-May 5, 2017. The mission team comprised F. Delgado (head), R. Mowatt, F. Yang, and X. Ding (all WHD), and A. Nguyen-Duong (MCM). K. Srinivasan (WHD), A. Tombini and M. Coronel (all OED) participated in the discussions.

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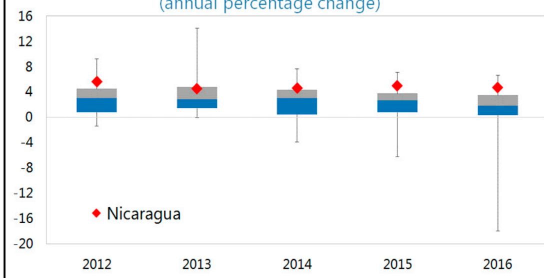
APPENDICES

CONTEXT

1. **The Nicaraguan economy has advanced in recent years**. Nicaragua's real GDP growth has outperformed most Latin American countries for the last 5 years. Exports have diversified and some of the constraints to growth, such as inadequate electricity generation capacity, have been lifted. Improvements in tax policy and revenue collection have allowed an expansion of infrastructure spending and the absorption of some projects that were previously financed by the oil collaboration scheme with Venezuela. Poverty indicators have improved and Nicaragua ranks relatively high in economic inclusion.[1]

LAC Real GDP growth 1/
(annual percentage change)



Source: WEO database and Fund Staff calculations.
1/ Bottom of blue box = 1st quintile; Top of blue box/Bottom of grey box = Median ; Top of grey box = 3rd quintile.

2. **Nicaragua's economy is closely linked to that of the United States**. About 56 percent of Nicaragua's exports are destined for the U.S. market, and the U.S. is an important source country for FDI (Appendix I). Current improved prospects for U.S. growth are positive for the Nicaraguan economy. On the flipside, changes in U.S. policies on trade and immigration could have a detrimental impact.

3. **Relations with the U.S. have become strained**. In 2016, Daniel Ortega was elected president for a third term. Based on alleged irregularities,[2] the Nicaragua Investment Conditionality (NICA) Act was introduced to the U.S. Congress with bipartisan sponsorship. If passed, it would compel the U.S. to vote against loans to Nicaragua by multilateral institutions, unless the Government of Nicaragua were to take effective steps to hold free, fair, and transparent elections.

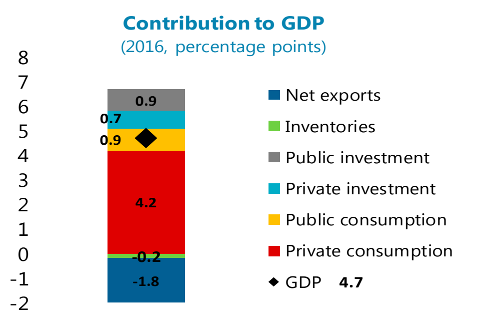
4. **The terms of the oil collaboration scheme with Venezuela changed in 2016**. The import entitlement decreased and upfront payment of the oil bill increased (Appendix II).

5. **Progress has been made in implementing previous recommendations**. Higher than expected revenues in 2016 can partially be attributed to Fund TA in tax administration. Fund TA was instrumental for improving compilation of *maquila* data. A new, consistent 2006–16 trade data series has been published, and work towards rebasing the national accounts to 2018 has already started with TA from the Fund and the Inter-American Development Bank (IaDB). There has been limited progress on other fiscal recommendations, such as reducing tax exonerations and better targeting of subsidies, partly due to the recent election cycle.

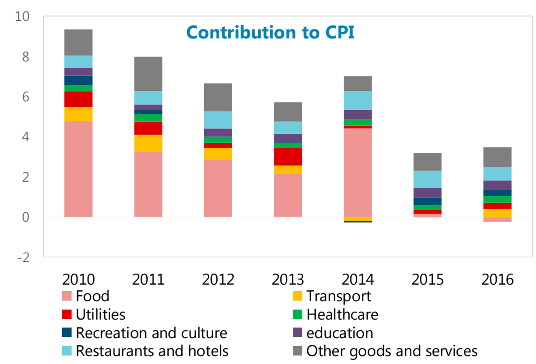
[1] The 2017 Inclusive Growth and Development Report of the World Economic Forum ranks Nicaragua 32 in the inclusive development index out of 79 developing countries, whereas its GDP per capita ranks 51. GINI index declined from 58.0 in 2001 to 47.1 in 2014.
[2] See the text of the bill H.R. 1918.

BACKGROUND

6. **Economic activity remains robust**. Real GDP growth moderated to 4.7 percent in 2016 from 4.9 percent in 2015 and remains slightly above potential. Activity in agriculture, commerce and tourism have been particularly robust, helped by crop innovations (coffee) and ample credit supply. Inflation remained subdued due to lower food prices.



Source: Central Bank of Nicaragua.

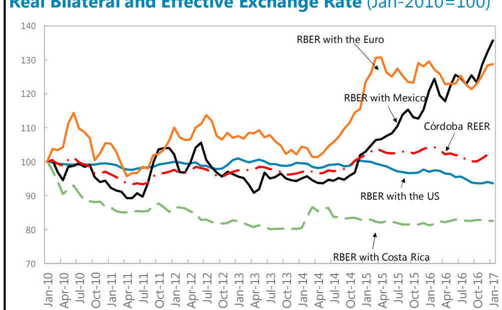


Source: Central Bank of Nicaragua.

7. **The fiscal deficit increased slightly in 2016, reflecting a moderately expansionary fiscal impulse**. The deficit of the consolidated public sector (CPS) widened from 2.2 percent in 2015 to 2.4 percent in 2016 due to election-related spending, an expansion of public investment and a further deterioration of the financial position of the Social Security Institute (INSS). Tax revenue outperformed expectations, increasing by 0.7 percentage points to 16.4 percent of GDP, because of advances in tax administration and the impact of the full implementation of the 2012 tax reform. The public debt ratio increased from 40.7 percent of GDP in 2015 to 41.9 percent of GDP, but remains within sustainable limits.

8. **The external current account deficit narrowed to 8.6 percent of GDP from 9 percent in 2015**. Traditional exports continued to decline, while exports from the free trade zone increased significantly. Remittances increased by 6 percent to US$1.3 billion (9.6 percent of GDP). The current account deficit continued to be financed by FDI and other long-term inflows. Gross international reserves remained broadly stable at US$2.3 billion at end-2016 and above standard metrics, with coverage of about 4 months of non-*maquila* imports.

Real Bilateral and Effective Exchange Rate (Jan-2010=100)



Sources: INS and Fund staff calculations and estimates.

9. **Nicaragua's external position is estimated to be broadly consistent with fundamentals** (Appendix III). Both the real exchange rate model and external sustainability approach confirm that the external position is in line with fundamentals and desirable policies. The current account model

shows an external position weaker than predicted by fundamentals, due in part to a temporary shock to main export commodity prices in 2015–16.

Nicaragua: Financial Soundness Indicator Map

Nicaragua	2014Q2	2014Q3	2014Q4	2015Q1	2015Q2	2015Q3	2015Q4	2016Q1	2016Q2	2016Q3	2016Q4	Latest
Overall Financial Sector Rating	M	M	M	M	M	M	M	M	M	M	M	M
Credit cycle	M	L	L	L	L	L	M	L	M	L	L	L
Change in credit / GDP ratio (pp, annual)	3.0	2.8	1.5	1.4	1.2	2.3	3.0	2.8	3.4	2.7	2.7	2.7
Growth of credit / GDP (%, annual)	11.0	10.1	5.1	4.7	3.8	7.4	9.7	9.1	10.6	8.3	7.8	7.8
Credit-to-GDP gap (st. dev)	0.3	-0.5	-1.1	-2.1	-2.2	-1.5	-1.0	-1.5	-1.2	-1.1	-0.5	-0.5
Balance Sheet Soundness	M	M	M	M	M	M	M	M	M	M	M	M
Balance Sheet Structural Risk	M	M	M	M	M	M	M	M	M	M	M	M
Deposit-to-loan ratio	127.1	124.6	119.7	122.0	119.9	115.0	108.7	113.6	108.2	106.0	100.1	100.1
FX liabilities % (of total liabilities)	66.9	68.1	69.8	68.4	69.8	71.5	73.7	71.8	74.2	74.3	74.8	74.8
FX loans % (of total loans)	98.5	98.5	98.2	98.4	98.3	98.3	97.3	98.0	98.2	98.0	97.7	97.7
Balance Sheet Buffers	L	L	L	L	L	L	L	L	L	L	L	L
Leverage	L	L	L	L	L	L	L	L	L	L	L	L
Leverage ratio (%)	7.4	7.7	7.7	7.4	8.1	7.8	7.7	7.1	7.6	7.4	7.5	7.5
Profitability	L	L	L	L	L	L	L	L	L	L	L	L
ROA	3.0	3.0	3.0	3.1	3.1	3.1	3.2	3.3	3.3	3.3	3.4	3.4
ROE	28.7	28.8	28.7	28.8	28.2	28.2	29.0	29.7	29.6	29.2	30.5	30.5
Asset quality	L	L	M	M	L	L	L	L	M	L	L	L
NPL ratio	1.0	1.0	1.0	0.9	0.9	0.9	0.9	0.9	1.0	0.9	0.9	0.9
NPL ratio change (%, annual)	-30.4	-29.6	11.9	6.5	-8.5	-10.7	-11.2	-0.6	7.2	3.2	-2.8	-2.8

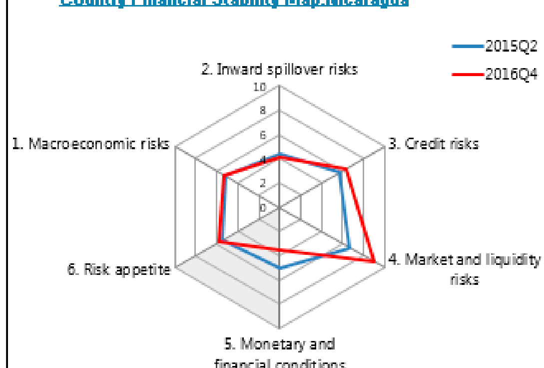
High vulnerability | Medium vulnerability | Low vulnerability

Source: National authorities and staff calculation

10. Financial and bank soundness indicators appear robust. Private sector credit growth slowed to 17.4 percent in 2016, above nominal GDP growth. Deposit growth slowed to 11.0 percent in 2016, forcing banks to rely on foreign lines of credit, which increased by 50 percent during 2016, compared to an average annual growth of 20.5 percent from 2011 to 2015. Easy access to relatively inexpensive lines of credit augurs well for the maintenance of correspondent bank relations (CBR). Only two correspondent banks have closed the accounts for one small bank[3] and, while it is unlikely that additional CBR are terminated, it remains a concern for the region. Bank soundness indicators remain solid, with non-performing loans at 1 percent of total portfolio and a capital adequacy ratio of 13.5 percent of risk-weighted assets at end-2016. Liquidity coverage ratio requirements in córdobas and U.S. dollars, aligned with Basel III, are being gradually implemented.

11. The Financial Stability Map shows an increase in market and liquidity risks since the last Article IV. Monetary and financial conditions tightened slightly and market and liquidity risks increased driven by higher reliance on foreign liabilities. Credit risks increased slightly, driven by the increase in unhedged foreign exchange (FX) lending. Inward spillover risks, and risk appetite remain broadly unchanged.

Country Financial Stability Map:Nicaragua



Note: Away from center signifies higher risks, easier monetary and financial conditions, or higher risk appetite.

[3] This bank represents 2½ percent of total banking assets, and still has other correspondent bank accounts.

OUTLOOK AND RISKS

12. Real GDP growth is projected at 4.5 percent in 2017 and the medium term, in line with potential GDP growth (Box 1). Inflation is expected to continue to be anchored by the crawling peg at about 6 percent. The current account deficit is expected to remain broadly unchanged in 2017, assuming prices of major export commodities recover and REER remains broadly stable.

Nicaragua: Medium-Term Macroeconomic Framework, 2015–22
(In percent of GDP, unless otherwise specified)

	2015	2016	2017	2018	2019	2020	2021	2022
			Proj.					
GDP growth	4.9	4.7	4.5	4.3	4.5	4.5	4.5	4.5
Consumer price inflation (e.o.p.)	3.1	3.1	5.8	7.4	7.1	7.3	7.2	7.3
Consolidated public sector								
Revenue (incl. grants)	27.6	28.8	28.8	28.6	28.6	28.5	28.2	28.2
Expenditure	29.6	31.2	31.1	31.0	30.6	30.3	30.6	30.7
Overall balance, after grants	-2.2	-2.4	-2.3	-2.2	-1.9	-1.7	-2.4	-2.5
Public sector debt[1/]	40.7	41.9	41.5	40.0	39.1	38.2	38.5	38.5
Current account	-9.0	-8.6	-8.5	-8.5	-8.6	-8.5	-8.4	-8.6
Gross reserves (U.S.$ million)[2/]	2,353	2,296	2,365	2,449	2,551	2,658	2,730	2,751
In months of imports excl. maquila[2/]	4.6	3.9	3.9	3.8	3.8	3.8	3.6	3.4

Sources: Country authorities; and Fund staff calculations and estimates.
[1/]Assumes that HIPC-equivalent terms were applied to the outstanding debt to non-Paris Club bilaterals.
Does not include SDR allocations.
[2/]Excludes the Deposit Guarantee Fund for Financial Institutions (FOGADE).

Box 1. Potential GDP

The decomposition of changes in output suggests that the contribution from factor accumulation to Nicaragua's growth has been relatively stable since 2000. A Cobb-Douglas production function was used to decompose the changes in output to factor inputs, namely, labor, capital and total factor productivity (TFP), using 1994-2015 data on labor and gross capital formation. The input of capital stock was generated using the perpetual inventory model. The contribution of labor to GDP growth declined from an average 1.8 percentage points in 2000-2009 to 1.3 percentage points in 2010-2015. However, this does not consider improvements in education and health. The capital input contribution increased from 2.3 to 2.6 percentage points.

Growth and Input Contribution

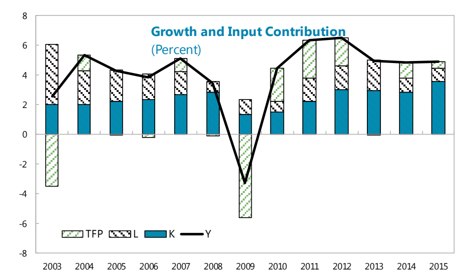
	2000-2009	2010-2015
GDP	2.9	5.3
Capital	2.3	2.6
Labor	1.8	1.3
TFP	-1.2	1.4

Source: IMF staff estimation.

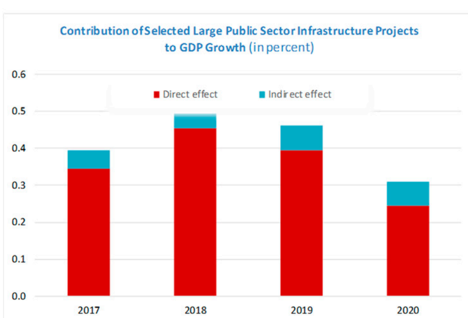
Investments in infrastructure advanced productivity. Electricity generation increased almost 50 percent during 2005-15, and electricity coverage increased from about 50 percent to over 90 percent of the population, removing one of the critical bottlenecks for growth. Significant investments were made in transportation and telecommunications, in part from FDI. Because of better infrastructure, the average contribution of TFP to GDP growth turned from negative in the decades between 2000-2009 to 1.4 percentage points in 2010-2015.

Potential growth has been revised upwards. Growth was well above 4.5 percent while prices remained largely stable during the last 5 years. Using backward-looking data with several filters, potential GDP growth is estimated at about 4.4 percent. However, staff is of the view that this methodology underestimates potential output once improvements in infrastructure and the accompanying structural changes of the economy are considered. The estimate of potential growth has therefore been revised upwards from 4 percent to 4.5 percent.

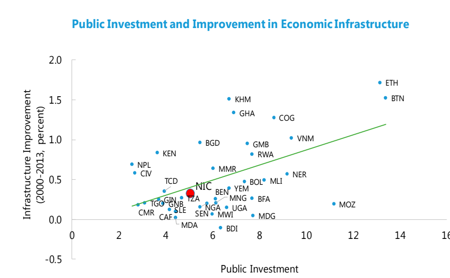
Closing infrastructure gaps and improving efficiency of public investments would further enhance productivity. Public sector planned investment in major infrastructure projects for 2017-2020 amount to about US$ 0.5 billion or 3.5 percent of 2016 GDP. Staff estimates that these investments would contribute about 0.4 percentage points to GDP growth per year.[1] Meanwhile, Nicaragua is broadly on track in terms of public investment quality and efficiency, as compared with other low income countries. If these projects are implemented as planned and efficiency further improves, it could advance productivity and accelerate FDI, contributing to sustained high growth over the medium term. The public-private partnerships (PPP) law approved in 2016 should further boost infrastructure investment.



Source: Staff estimate.



Source: National authorities and staff estimate.



Sources: United Nations; World Bank; World Economic Outlook; and IMF staff estimates.

1/ Assuming an import component of 60-70 percent, and an output elasticity between 0.04 for road construction and 0.12 of health facilities.

13. **The CPS deficit is projected at 2.3 percent of GDP in 2017, implying a broadly neutral fiscal impulse**. The expected contraction of the CPS deficit in 2017 is mainly due to an improvement in the balance of Managua municipality as various capital projects are completed, while public debt is projected to be relatively stable. Gross financing needs should be adequately met, mostly through concessional loans and grants.

14. **Gaps in the supervisory framework remain a risk to financial stability**. Savings & loans (S&L) cooperatives and some microfinance institutions are not subject to risk-based regulation and supervision, and only the largest are monitored by the AML/CFT vigilance unit. Information gaps remain despite progress in consolidated supervision of cross-border banking groups. The Financial Action Task Force of Latin America (GAFILAT) withdrew Nicaragua from the "gray list" in 2015, following the strengthening of its AML/CFT framework. However, further effort is needed to ensure that the legal framework is enforced effectively, including for non-banks and regarding Politically Exposed Persons.

15. **Credit quality may deteriorate as financial conditions tighten in a context of high dollarization and potential financial spillovers from U.S. policies**. Asset quality may deteriorate as credit growth moderates. A stronger U.S. dollar and higher interest rates, in the context of high dollarization, could strain banks and unhedged borrowers' balance sheets. Banks' increased reliance on foreign liabilities to obtain liquidity in U.S. dollars may put upward pressure on lending rates and increases risks of cross-border financial spillovers. U.S. dollar interest rate increases are expected to be largely passed on to borrowers and, along with lower remittances, may deteriorate credit quality. Climate change may affect the repayment capacity of borrowers, particularly in the agriculture sector.

16. **Uncertainties are heightened and risks are tilted to the downside** (Appendix IV). Sources of concern are spillovers related to U.S. policies, the decline in Venezuelan oil cooperation, and exposure to climate change and disasters (CCDs).

U.S. policy spillovers (Appendix I)

- Potential trade disruptions may have a significant negative impact on Nicaragua through a reduction of exports, investments and foreign financing.
- Tighter U.S. immigration policy could reduce remittances and increase deportations.
- The possible passage of the NICA Act could reduce the availability of external financing from multilateral institutions and increase the cost of borrowing. It could also affect investment, growth, and tax revenue.

Venezuelan oil cooperation (Appendix II)

- A further decline in Venezuela's cooperation may threaten the continuity of some social programs, while placing pressure on the budget to absorb others. Debt service of the US$3.2 billion of private sector debt associated with the Venezuela oil collaboration is projected at 1.3–1.4 percent of GDP per year in the medium term, which may encumber the FX market.

CCDs (Selected Issues Paper—SIP)

- Nicaragua is highly vulnerable to the significant economic and social costs of CCDs. The probability and average economic losses from disaster events are above the regional average, and could have a substantial impact on long-term growth and revenue.

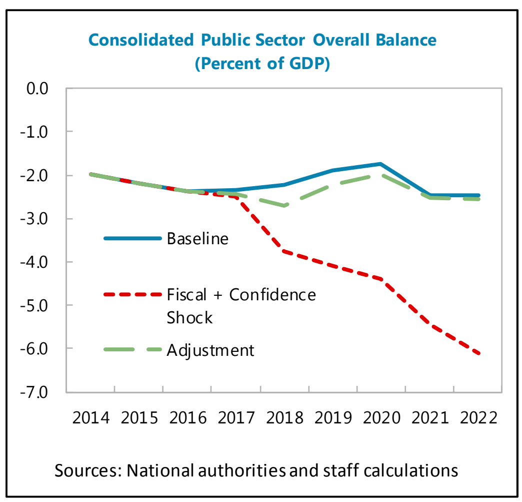
KEY POLICY ISSUES

Given potential spillovers from changes in U.S. policies, the dwindling Venezuela cooperation, the fragile financial situation of the INSS, and the high vulnerability to disasters, Nicaragua needs to continue strengthening its policy framework to stave off downside risks and promote sustained growth. The authorities should aim to build buffers against external, financial sector and fiscal contingencies over the medium term, without jeopardizing social and infrastructure programs.

A. Creating Fiscal Space to Manage Risks and Promote Sustained Growth

17. The fiscal stance for 2017 is broadly appropriate. With the output gap closed and a stable external debt ratio (Debt Sustainability Analysis—DSA) the projected CPS deficit of 2.3 percent of GDP represents a broadly neutral fiscal stance. Adhering to the fiscal anchor of no more than 2 percent of GDP for the CPS deficit, consistent with debt sustainability given current financial conditions, would help increase the transparency and credibility of the fiscal policy stance.

18. An adverse scenario envisages the materialization of the risks from a stop in Venezuela inflows and impact from the passage of the NICA Act. The authorities indicate that they may absorb social programs currently financed by Venezuelan cooperation for about 0.6 percent of GDP if the cooperation winds down. Also, if passed, the NICA Act could put pressure on public finances by increasing borrowing costs. Staff projects that replacing half of anticipated financing from the World Bank and the IaDB over the 2018-2022 period with less concessional external and domestic resources would raise the average interest rate on public debt by about two percentage points relative to the baseline. Moreover, it could impact investor confidence, reducing FDI and affecting growth and tax revenue. Considering the spending pressures from the weakening financial situation of INSS, fiscal consolidation amounting to about 1.6 percent of GDP over two years would be adequate to cope with these risks, provided that a comprehensive pension reform is also undertaken. This assumes that investment and output recover once adjustment measures are implemented, restoring tax revenue to close to baseline levels. Fiscal savings would increase by the gradual phasing out of the 0.6 percent of GDP of social programs absorbed by the budget and the medium-term savings stemming from the pension reform.



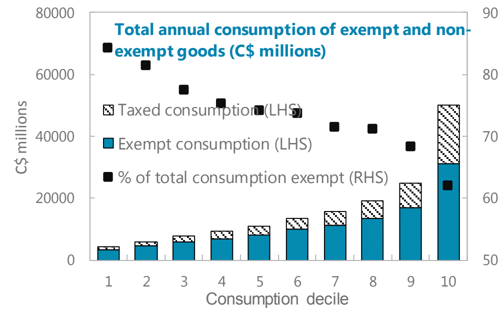
19. Policy efforts should focus on broadening the tax base, further strengthening tax administration, and improving expenditure composition and quality. Measures to reduce tax expenditures (Box 2) and rationalize some subsidies (SIP) could yield around 1.2 percent of GDP.[4] The remaining 0.4 percent could come from the implementation of legislation on international taxation,[5] further improvements in tax administration, and a gradual phasing out of some of the social programs financed by Venezuelan resources. Quality of expenditure could be improved by enhancing the efficiency and oversight of the major state-owned enterprises (SOEs) and strengthening public investment management processes and practices. Progress made by the authorities on the analysis of fiscal risks is welcome, and further advances in this area are encouraged (Box 3).

[4] Staff estimates that increasing the VAT rate on exempt goods to a low rate of 5 percent, apart from those goods whose exemption is constitutionally mandated, would yield 0.6 percent of GDP. Eliminating electricity and transport subsidies for all except the neediest could yield an additional 0.6 percent of GDP.

[5] To be effective, legislation due to come into effect in 2017 will require strengthening regulations and the implementation capacity of tax administration.

Box 2. Who Benefits from VAT Exemptions in Nicaragua?

Nicaragua has an extensive list of VAT exemptions. Many countries exempt basic goods from VAT for poverty reduction purposes or to reduce the regressive effects of the tax. However, the large number of exempt goods exacerbates the complexity of the VAT system. FAD estimates that VAT tax expenditures amount to 2.6 percent of GDP, which is on the high end for Latin America. Moreover, Nicaragua has a high estimated level of tax evasion, which may be related to the system's complexity. The list of exempt goods includes three main types (i) all goods that are part of the "*canasta básica",* an indicative basket of 53 food and household items deemed necessary to sustain a household of five, plus books and medicines; (ii) constitutional exemptions for universities, religious organizations, and non-profits; and (iii) exemptions for intermediate goods and capital goods, repairs and machinery parts for agricultural producers, small enterprises and producers of books, magazines and newspapers.



Sources: National authorities and IMF staff calculations

Nearly one-half of the benefits of VAT exemptions are concentrated in the top two household consumption deciles. The most recent official household survey from 2014 contains detailed data on consumption patterns, allowing for an analysis of how the benefits of VAT exemptions are distributed. We classify households by consumption decile as a proxy for income and then calculate the annual consumption of exempt and non-exempt goods by household decile, subtracting consumption of items that are self-produced, such as food items and housing. As expected, wealthier households consume significantly more exempt goods in absolute terms. Thus, nearly one-half of the benefits of VAT exemptions are concentrated in the top two deciles. Meanwhile, the poorest fifth of households receive only 8 percent of the benefits. This pattern is broadly in line with estimates for other countries in Central America.

It is difficult to know ex ante the impact of eliminating VAT exemptions on the poor. The consumption basket of the poorest consumers is currently subject to very little tax. Thus, while the largest benefits are retained by wealthier consumers and an elimination of exemptions would improve the efficiency and overall equity of the tax, the poor would likely be adversely impacted. However, the impact is difficult to quantify ex ante because it will depend on the extent to which the VAT is passed through from suppliers and producers to consumers. Also, the poorest consumers are more likely to shop in informal locations, which are unlikely to be registered for VAT. Both factors could lessen the negative impact of the tax on the poor, although they would also reduce potential gains in revenue. Consideration could be given to maintaining exemptions on a few basic goods that are most consumed by the poor (such as rice, beans, and maize) and/or introducing a second, lower VAT rate of 5 percent which could be applied to certain goods in the *canasta básica* rather than the full 15 percent. Such measures could be complemented by other forms of focused assistance for the poorest on the expenditure side.

20. Ensuring the sustainability of the INSS remains a priority (SIP). Under current policies, the INSS will continue to run deficits and deplete its liquid reserves by 2019, given the liquidity structure of the reserve fund, potentially necessitating transfers from the government and posing a threat to debt sustainability. Lower contributions and more beneficiaries of reduced pensions than anticipated, plus higher wage and capital expenditures have worsened the outlook relative to the 2015 Article IV. The authorities' latest projections include cuts to administrative and capital expenditure. However, a sustainable outcome will only be achieved through a combination of measures aimed at revenues, costs, efficiency and possibly the limited assumption of some expenditures by the government. The table on the right illustrates potential reform packages which could balance the main pension system until 2040. The government, labor unions, and the private sector should arrive at a mutually agreeable solution as a matter of priority, as delaying the reforms will lead to a worsening of the situation and will increase the costs of reform.

Indicative Reform Packages for the Pension System
(in percent of GDP)

			2020	2025	2030	2035	2040
Reform package 1	Index all pensions to US$ exchange rate; increase retirement age to 63 by 2025; reduce average benefits by 20%	IVM system balance	0.8	1.5	1.2	1.1	0.7
		Savings rel. to baseline	0.9	2.0	2.4	2.7	3.1
Reform package 2	Index all pensions to US$ exchange rate; reduce average benefits by 20%; increase contribution rate by 2%	IVM system balance	0.8	1.5	1.4	1.0	0.6
		Savings rel. to baseline	1.0	2.1	2.4	2.7	3.0
Reform package 3	Index all pensions to inflation[1/]; reduce average benefits by 30%; contributions for war victims to IVM[2/]	IVM system balance	0.9	1.4	1.2	0.8	0.3
		Savings rel. to baseline	1.0	2.0	2.2	2.4	2.7
Reform package 4	Index all pensions to inflation[1/]; increase retirement age to 65 by 2025; contributions for war victims shifted to IVM[2/]	IVM system balance	0.8	1.4	1.1	0.8	0.3
		Savings rel. to baseline	1.0	2.0	2.1	2.4	2.7

21. Fiscal policy should aim to improve resilience against potential shocks. Given the fiscal risks related to changes in the U.S. policies and Nicaragua's vulnerability to CCDs, fiscal policy should aim to be more counter-cyclical, building space in good times to avoid volatility in expenditure and the need for abrupt adjustments should tail risks materialize. Investments in climate-resilient infrastructure and mitigation and adaptation policies will further contribute to fiscal sustainability. Based on preliminary hypotheses, changes in U.S. trade policies could reduce GDP growth by 2.3 percentage points from the baseline, and increase CPS deficit by 0.9 percent of GDP and public debt by 4.3 percent of GDP. Potential changes in immigration policies would reduce GDP growth by 0.1 percentage points and increase fiscal deficit and debt by 0.2 percent and 0.8 percent of GDP, respectively. Estimates of the impact of disasters are shown in the table.[6]

	Storm	Flood	Earthquake	Drought
Number of Events in Model	8	9	5	4
Probability	0.12	0.14	0.08	0.06
Impact on revenue as % of GDP	-0.16	-0.39	-0.09	-0.11

Source: EM-DAT and staff calculation.

[6] Climate change is reducing annual GDP growth by about 0.03 to 0.04, in absence of adaptation and mitigation policies.

Box 3. Mapping Fiscal Risks in Nicaragua

Fiscal risks are factors that may cause fiscal outcomes to deviate from expectations or forecasts. The staff's fiscal baseline is subject to important downside risks. Compiling information and building capacity to analyze explicit and implicit contingencies is essential for risk management, robust public finances, and, if sovereign issuance were to be considered, for building market credibility.

Nicaragua is a highly open economy, and its public finances are vulnerable to a range of fiscal risks. These include fluctuations in the terms of trade, external demand, oil prices, private capital flows, remittances, CCDs, loss-making SOEs, financial sector stability, and the INSS.

For some fiscal risks, reliable information is available. Among these are a registry of claims against the state by the Attorney General's office, quantifications of the fiscal impact of disasters, and the publication of a debt sustainability analysis based on relatively comprehensive public debt statistics. The financial supervision authority (SIBOIF) collects detailed data on financial institutions, which allows for an analysis of risks arising from most of the financial sector.

However, there are areas where risk analysis could be strengthened:

- *Macroeconomic risks:* Sensitivity analysis could be prepared to examine the impact of deviations from public finances' baseline macroeconomic assumptions.
- *CCDs:* The authorities have made progress in mitigating the financial effect of these events through contingent credit lines and insurance; nevertheless, there is scope for further risk mitigation.
- *Municipalities:* Only the accounts of Managua municipality are included in the consolidated public sector accounts while the other 152 municipalities are excluded. Further, although there are regulations which limit the extent to which municipalities can borrow, monitoring of compliance with these regulations appears inadequate.
- *SOEs:* Monitoring the assets and liabilities of SOEs is challenging as financial statements are not standardized. Debt to suppliers is not recorded in public debt statistics and, on occasion, is settled through budget transfers. The priority should be harmonizing and consolidating statistics. The compilation of SOE's domestic debt and the recent establishment of a new unit in the Ministry of Finance to provide greater oversight to the SOE sector are steps in the right direction.
- *DSA:* Further efforts should be made to increase the scope of the standardized stress scenarios to include newly compiled SOEs' and municipalities' domestic debt.
- *Financial sector:* The authorities should attempt to estimate of the government's probable maximum loss for financial system bailouts, and incorporate this in a stress scenario in their DSA.
- *INSS:* Risk scenarios and stress testing should be an important addition to the authorities' monitoring of INSS finances.
- *PPPs:* Debt-like obligations could be generated where the government commits to paying for services over the life of the contract and may commit the government to a range of contingent obligations. The Ministry of Finance needs to urgently develop the capacity to analyze related risks to implement the recently approved PPP law.

Publishing an annual report on fiscal risks would provide a roadmap for risk mitigation and contingency planning. The report should be coordinated by the Ministry of Finance, with inputs from various other government entities, and be submitted to the Economic Cabinet as part of the budget process. The report could focus initially on the most salient risks, which would seem to stem from macroeconomic shocks, disasters, and SOEs. An important proportion of fiscal revenues are earmarked, leaving little space to confront risks and creating incentives to underestimate revenues during the budget process. A better understanding of fiscal risks and a more flexible use of revenues would help the authorities safeguard the hard-won credibility of their macroeconomic management.

22. Nicaragua is assessed at a moderate risk of external debt distress. Although external public debt is sustainable in the baseline, the threshold is breached under the adverse scenario described above. Under current policies, total public debt would stabilize at around 40 percent of GDP over the medium term, and then begin to increase due to transfers to the INSS. In the absence of policy action, debt would eventually become unsustainable in the baseline scenario, although not within the 20-year time horizon of the DSA.

B. Strengthening the Monetary, Financial and AML Frameworks

23. Gaps in the financial supervisory perimeter need to be addressed. The regulatory framework for the microfinance industry is incomplete and some small institutions could escape oversight. S&L cooperatives are not subject to any type of financial supervision. While most of the 268 S&L are small, they manage almost 10 percent of the total savings accounts in the country, and a few are relatively large, including CARUNA, which acts as financial agent for Venezuela's oil cooperation funds and has about 40,000 savings accounts. While some progress has been achieved since the establishment of the Liaison Committee at the Regional Group of Financial Sector Superintendents and the commissioning of the regional college of supervisors, efforts to supervise banking groups on a consolidated basis must continue.

24. Additional efforts are needed to strengthen the AML/CFT regime. Nicaragua has made significant progress in improving the AML/CFT regime and is no longer subject to the FATF's monitoring process under the International Cooperation Review Group. Nevertheless, efforts should continue to ensure the effective implementation of the AML/CFT regime particularly regarding preventive measures. Nicaragua is scheduled to undergo a full assessment in 2017, under the revised FATF standards that emphasize implementation and effectiveness. The assessment should be finalized before the end of the year and the authorities are encouraged to implement its recommendations.

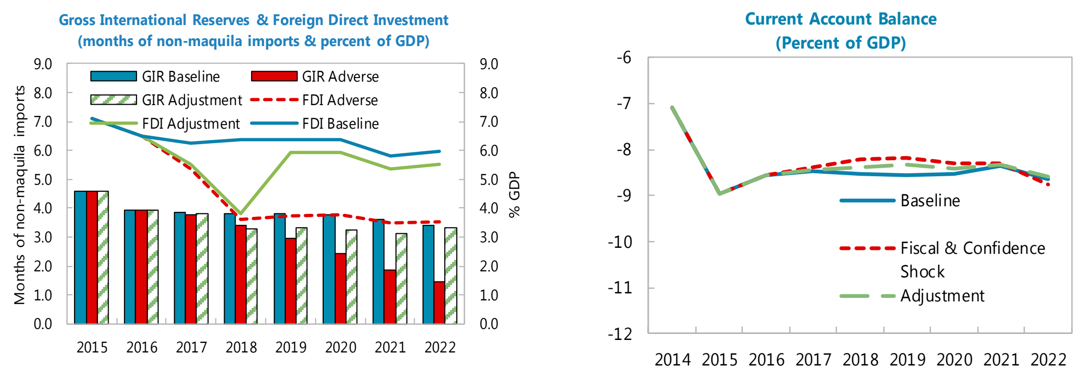
25. Spillovers related to U.S. policies and risks stemming from disasters call for tightening and improving the macroprudential framework. The Central Bank of Nicaragua (CBN) and the SIBOIF should continue strengthening monitoring and reinforcing their macroprudential framework, including conducting regular systemic stress tests to assess the resilience of banks and crafting contingency plans. Banks' internal risk procedures should properly evaluate CCDs' risks. The authorities are encouraged to publish their financial stability report.

26. The CBN should continue developing its monetary operations framework and strengthening its capacity. Efforts to strengthen its liquidity management capacity through better liquidity forecasting and introducing shorter-term liquidity management tools are welcome. The CBN should aim to gradually establish a short-term policy rate and a corridor, reduce interest rate volatility, and deepen the interbank and domestic bond markets. Attention should be devoted to improving calibration of the monetary policy tools, monitoring liquidity developments and forecast errors, and publishing daily liquidity forecasts to increase banks' participation. As monetary operations gain importance, efforts to capitalize the CBN should continue, to the extent possible, given fiscal constraints.

C. Improving External Resilience and Competitiveness

27. Vigilance against external shocks is warranted. Higher interest rates would increase external debt service, and FDI and reserves would decline under the adverse scenario. To preserve external stability, the authorities should increase the level of reserves to above the standard norms. The crawling peg exchange regime has been effective in anchoring inflation expectations. However, the peg will likely exacerbate the negative impact of an external shock on output, competitiveness and exports. There is, therefore, a tradeoff between the price stability anchor provided by the peg and the cost of limited adjustment policy tools, which warrants consideration of phasing in higher exchange rate flexibility over the medium term. Better understanding and continuous monitoring of the spillover effects of a persistently strong dollar, higher interest rates and other U.S. policy changes would help the authorities in making the appropriate policy choice.

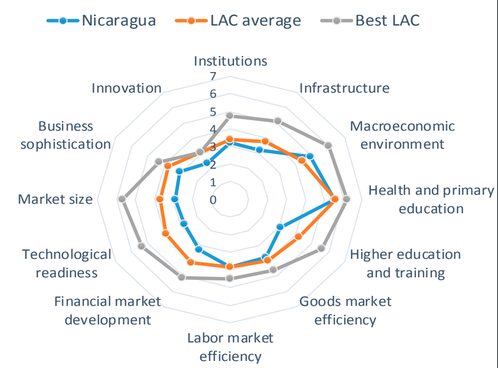
Adverse Scenario: External Sector



Sources: National authorities and staff calculations

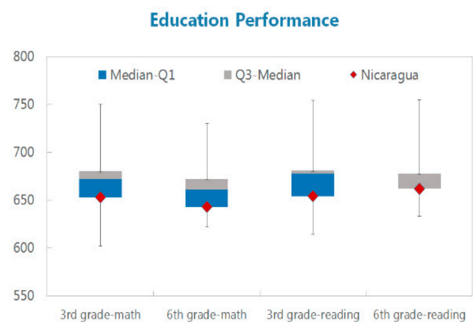
28. Improvements in competitiveness would reduce vulnerability to external shocks. Supply-side reform policies should focus on strengthening medium and long-term competitiveness to reduce external dependence and diversify products and markets. Although Nicaraguan wages remain the most competitive in Central America, and security is better than in other countries in the region, other aspects of competitiveness are lagging. Improving infrastructure, investing in human capital, and addressing labor skills bottlenecks would facilitate structural transformation and enhance potential growth. To facilitate structural transformation and enhance potential growth, anti-corruption efforts need to be strengthened by enforcing the AML/CFT framework. Per the World Economic Forum's Global Competitiveness Report, Nicaragua competitiveness ranks below the average for Latin

Global Competitiveness Scores 2016-2017 (higher=better)

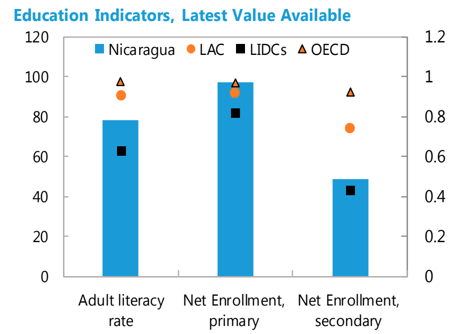


Source: World Economic Forum Global Competitiveness Report

America, at position 103 out of 138 countries.[7] Emphasis should be put on further strengthening quality of institutions, higher education and innovation. Securing lower-income families' access to quality education at the secondary level and above is key for long-term economic development.

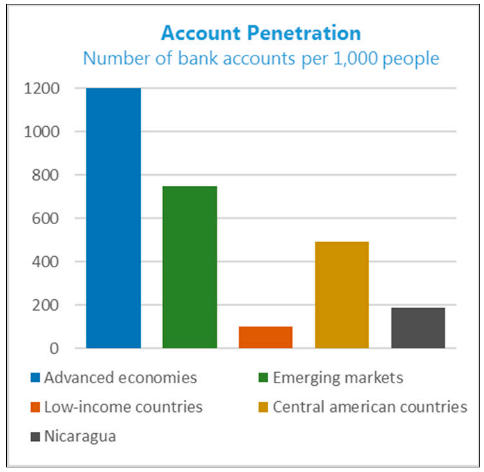


Sources: Third Regional Comparative and Explanatory Study (TERCE 2013) and staff calculation.



Source: World Bank

29. Increasing financial inclusion is critical to reduce poverty and ensure sustainable growth. While significant progress has been made towards poverty reduction, financial access remains below the regional average. Policies should focus on increasing financial literacy and facilitating access to financial services. Use of radio, TV and social media should aim to increase knowledge and awareness of financial products and to improve the level of confidence in financial institutions. Promoting simplified savings accounts, improving access to ATMs and branches, considering FinTech innovations, and reducing fees for basic banking services have been used successfully in peer countries[8]. Fostering financial inclusion through well supervised non-banks would increase the demand for financial assets and contribute to developing domestic markets.



D. Upgrading the Statistical Framework

30. Significant progress has been made in strengthening macroeconomic statistics, but shortcomings remain. The scope of data on public debt should improve substantially with the compilation of domestic debt of SOEs and municipalities.[9] Addressing remaining shortcomings in national accounts, fiscal, debt, and external sector statistics—particularly FDI—entails building on Fund TA to improve the timeliness, quality, and reliability of statistics. Regulations to enforce data

[7] Central American countries, excluding Costa Rica, rank 78 to 105.

[8] The 2014 World Bank Global Financial Development Report contains successful initiatives to improve financial inclusion that could be considered by the authorities.

[9] The authorities provided preliminary end-2016 data to the mission, which is incorporated in this report.

collection and facilitate exchange of information across units and institutions should be implemented, and procedures need to be established to monitor data quality.

E. Authorities' Views

31. The authorities broadly agreed with staff's assessment of the economic outlook and risks. However, they are of the view that the cost and security advantages provided by Nicaragua compared with other countries in Central America outweighs the uncertainty arising from the potential passage of the NICA Act and, thus, have a more sanguine assessment of the potential macroeconomic impact of the risks to the outlook.

32. Agreement was reached on the need to create fiscal buffers to avoid downside risks. The authorities committed to create additional fiscal space over the next two years, mainly by reducing tax expenditures, rationalizing and better targeting subsidies and implementing the legislation on international taxation, while strengthening tax administration. In the medium term, they intend to adopt a more counter-cyclical policy stance to increase resilience against potential external shocks. Nonetheless, they emphasized the need for gradualism in the reforms. They also intend to continue with the strengthening of liquidity ratios and countercyclical provisions and capital requirements. Their monetary program for 2017 already factors in an increase in international reserves.

33. The authorities acknowledged the need to reach a broad social consensus on social security reform. There was a consensus on leaving all options open to reach a long-term solution. They expressed their intention to start discussions in the short term. In this context, the authorities have requested technical assistance from FAD.

34. The authorities are willing to strengthen the supervisory perimeter, but pointed to the need for legal and institutional reforms. Creating the legal and institutional framework to allow for effective risk-based supervision of all deposit-taking and systemically important non-banks could take substantial time and resources. The authorities believe that, due to their small size, failure of a non-bank would not endanger financial stability, but they would like to assess this risk, including as part of a FSSR that they are likely to request.

35. The authorities are of the view that the exchange rate framework is adequate given the current economic conditions. Given the strong commercial ties with the U.S. and the high level of dollarization, the authorities consider that a crawling peg to the U.S. dollar guarantees competitive access to their main market and provides an effective anchor for inflation. Nonetheless, they will remain vigilant to potential external shocks and the costs of surrendering an instrument of shock absorption.

36. The authorities expressed their commitment to implement STA recommendations to strengthen macroeconomic statistics. The CBN statistical yearbook incorporates a methodological note in line with STA recommendations. Future developments include compilation of the domestic public debt of SOEs and municipalities.

STAFF APPRAISAL

37. **The fiscal stance is broadly adequate to maintain macroeconomic stability in the near term, but fiscal buffers are needed to confront risks**. The need to finance growing INSS deficits and to take over some critical social programs currently financed by Venezuelan cooperation are likely to intensify spending pressures in the next few years. Furthermore, if approved, the potential impact of the NICA Act on public finances could be significant if it affects investment and growth, and rates on public debt. Staff recommends a fiscal consolidation of 1.6 percent of GDP, implemented over two years, to maintain fiscal sustainability in the medium term. This could be achieved primarily through a rationalization of subsidies and tax expenditures, particularly VAT exemptions.

38. **Reforming the social security system is a priority**. INSS liquid reserves will be depleted by 2019, which could increase government transfers to finance pensions and health benefits. Urgent action should be taken using a combination of measures to improve sustainability, which, to the extent possible, should be introduced gradually.

39. **In the medium-term, fiscal policy should strive to improve resilience against potential external shocks.** Given the risks related to spillovers from U.S. policies, and vulnerability to CCDs, fiscal policy should aim to be more counter-cyclical. A better monitoring of fiscal risks would assist the authorities in calibrating the appropriate fiscal stance. Efforts to improve the oversight of SOEs represent an important step forward in this regard.

40. **External and financial buffers should be strengthened**. The combination of a further reduction of Venezuela's cooperation and lower IFI financing, in case of approval of the NICA Act, could put pressure on the FX market. Given the exchange rate framework, a stronger reserve position to reach the IMF's suggested adequacy range would be advisable. Banks should further enhance their liquidity, capital and provisioning buffers to preserve financial stability against the potential impact of declining asset quality, higher interest rates and lower remittances.

41. **The authorities should address the gaps in the supervisory perimeter.** Every deposit-taking and systemically important non-bank should be subject to effective risk-based supervision and AML/CFT oversight. Additional efforts are needed to strengthen regional financial regulatory cooperation. The stress test methodology should be further improved in line with best practices. The CBN continues to publish the audited financial statements in accordance with the Safeguards Policy. However, implementation of IFRS remains in progress.

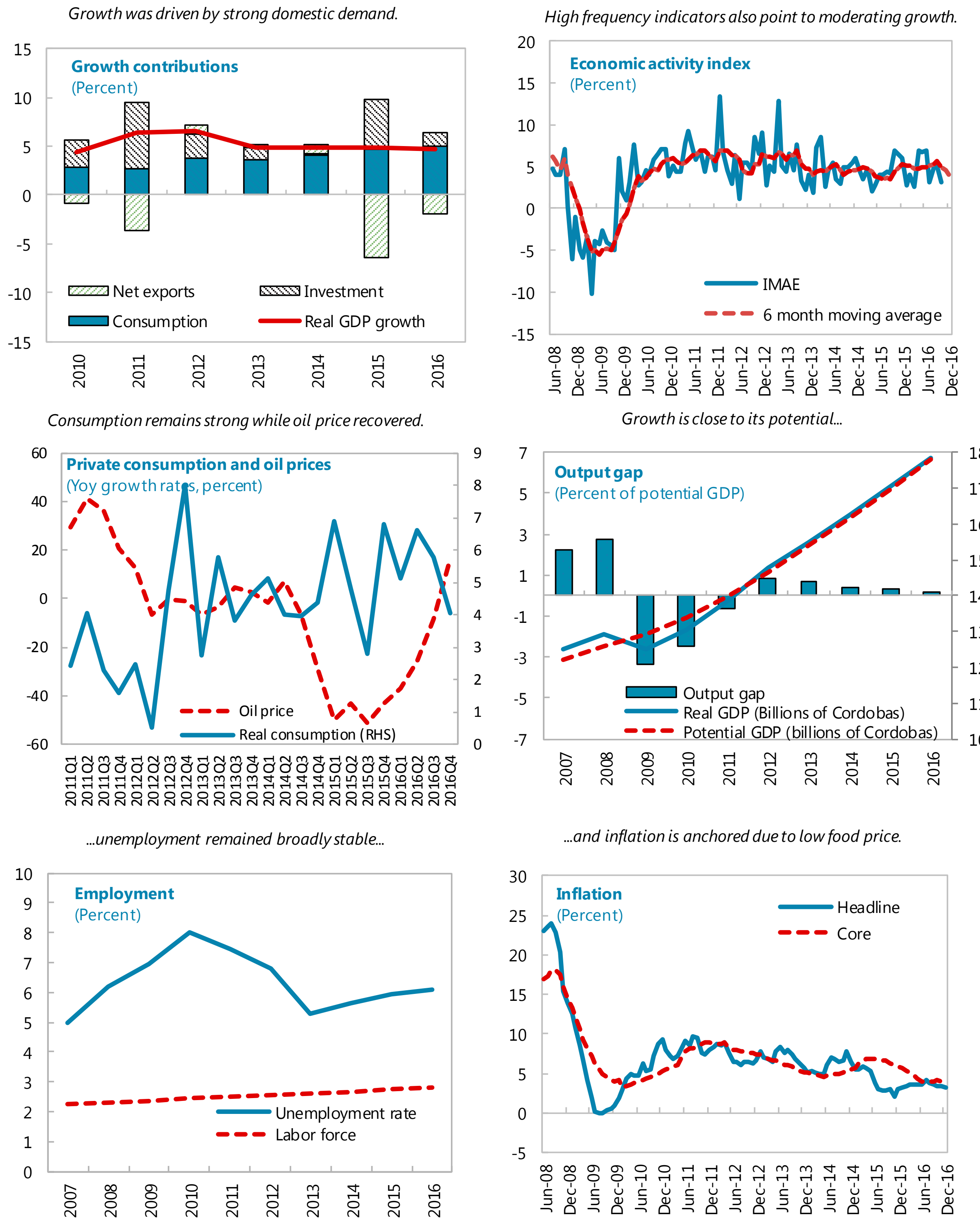
42. **Strengthening liquidity management tools is important to deepen financial markets**. Efforts to strengthen short-term liquidity management should continue, with a stronger focus on calibration, choice of instruments, and monitoring of liquidity developments. Introducing a short-term policy rate and a corridor will reduce interest rate volatility, deepen financial markets and, eventually, may provide some cushion against external shocks. The amplification of the negative impact of an external shock on output, competitiveness and exports should be carefully weighed against the price stability anchor provided by the crawling peg exchange regime.

43. Further improvements in competitiveness would reduce vulnerability to external shocks and spur structural transformation. Key actions include maintaining the investment in infrastructure, increasing human capital development, and addressing labor skills bottlenecks.

44. The authorities need to further improve data quality and scope of macroeconomic statistics. Recent progress has been significant. Nevertheless, further efforts are needed to strengthen base statistics, complete the rebasing of the national accounts, and increase data quality by applying IMF's compilation methodologies.

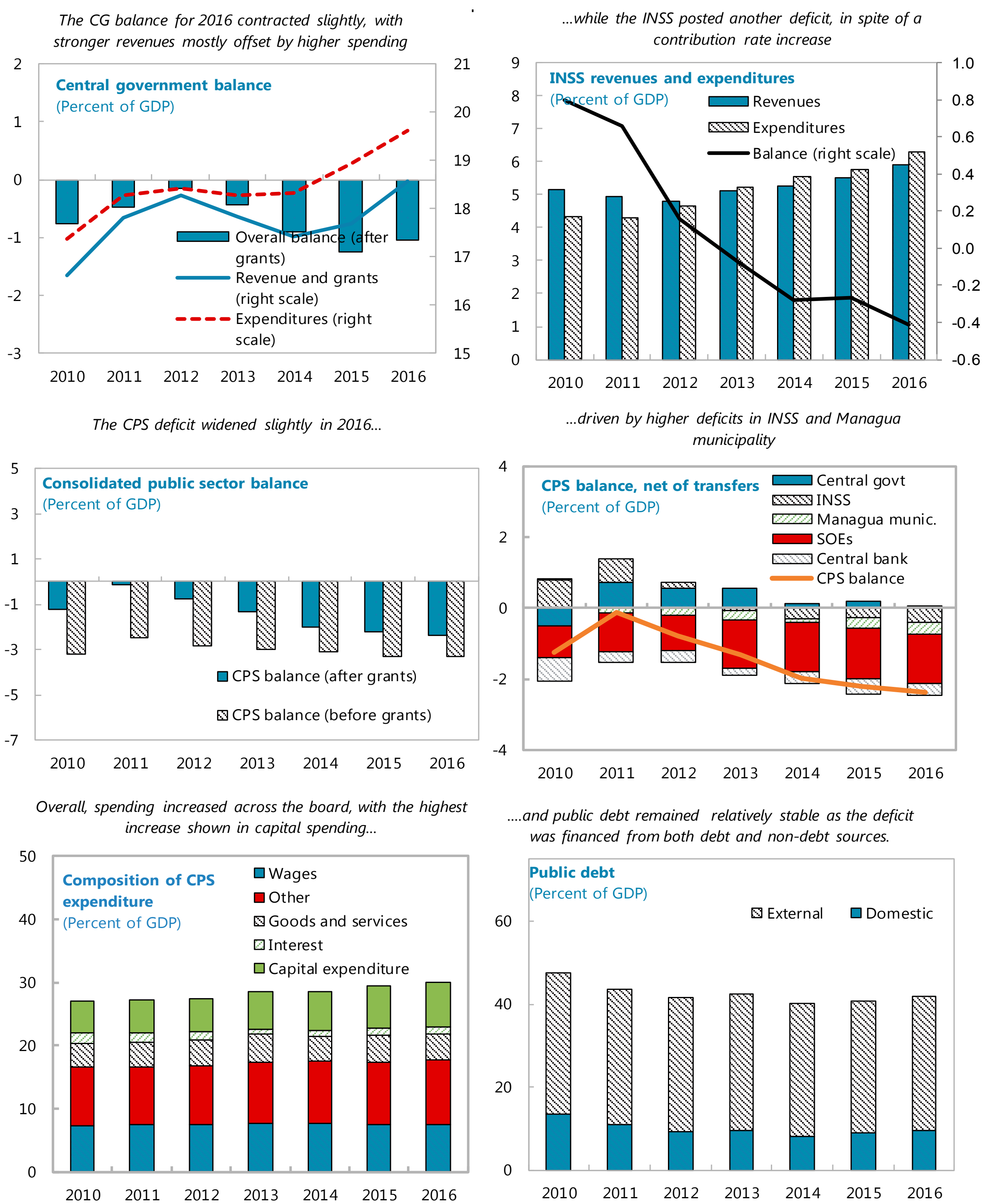
45. It is proposed that the next Article IV consultation with Nicaragua be held on the standard 12-month cycle.

Figure 1. Nicaragua: Real Sector



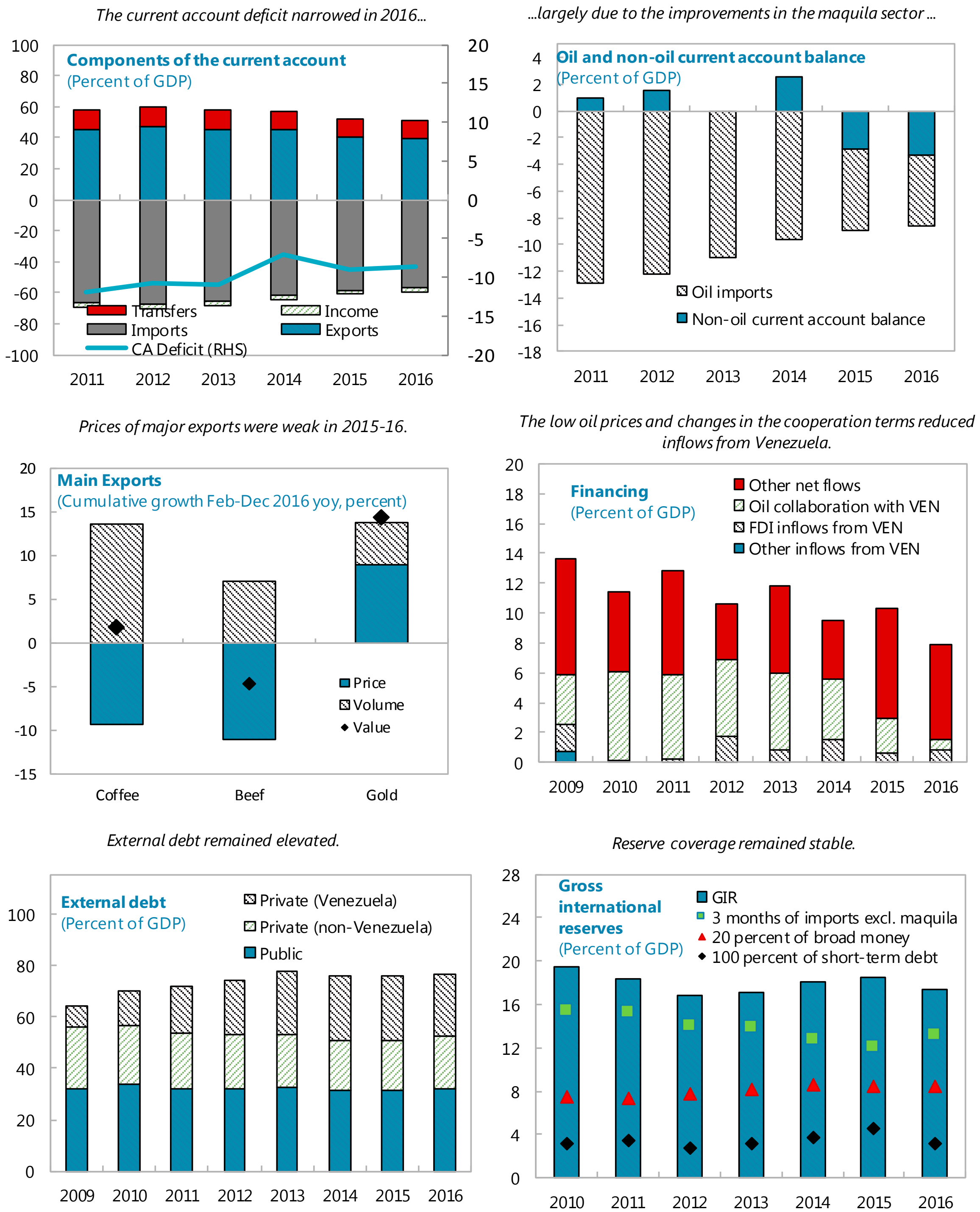
Source: Country authorities and Fund staff calculations and estimates.

Figure 2. Nicaragua: Fiscal Developments



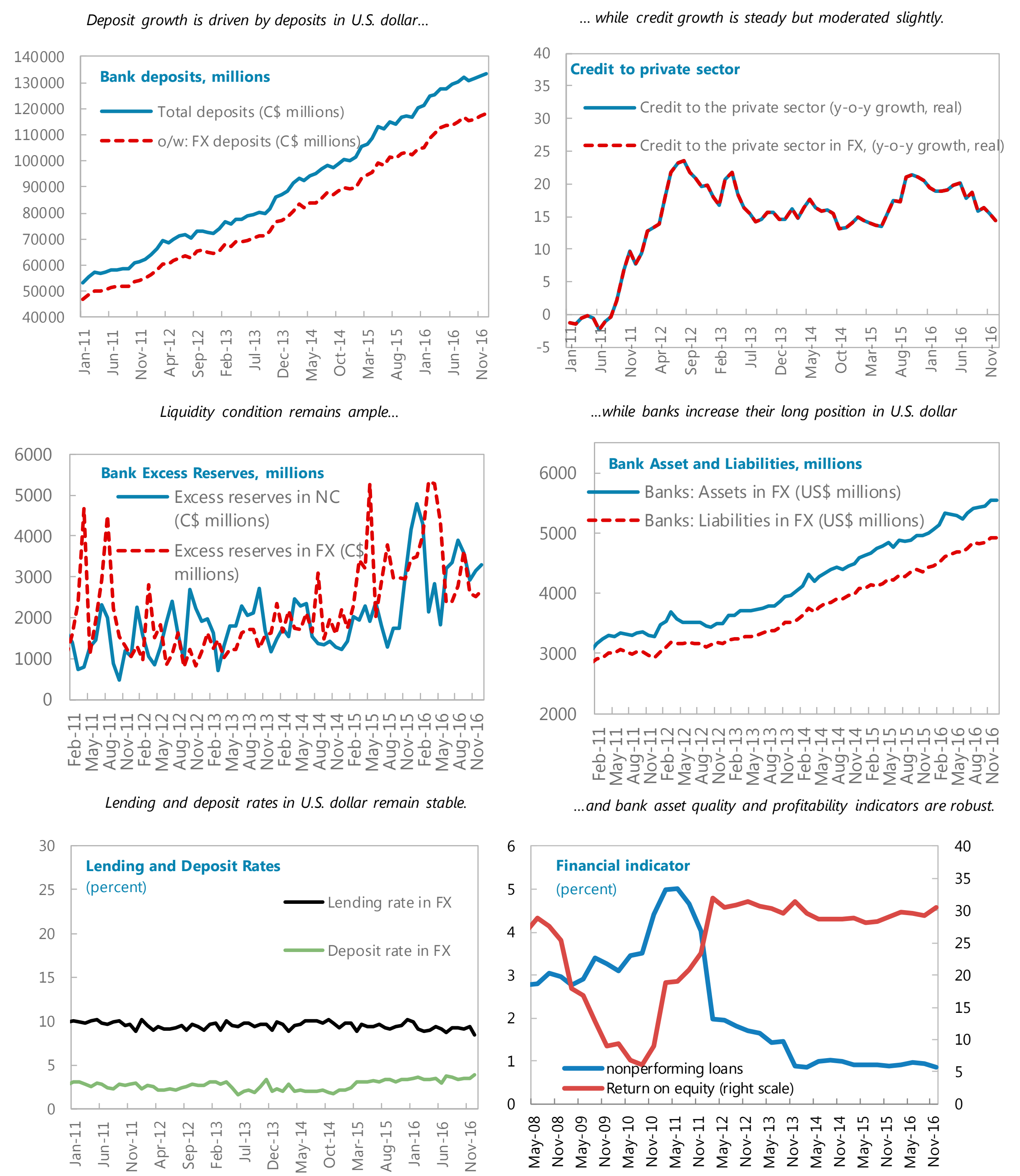
Sources: Country authorities and Fund Staff calculations and estimates.

Figure 3. Nicaragua: External Sector



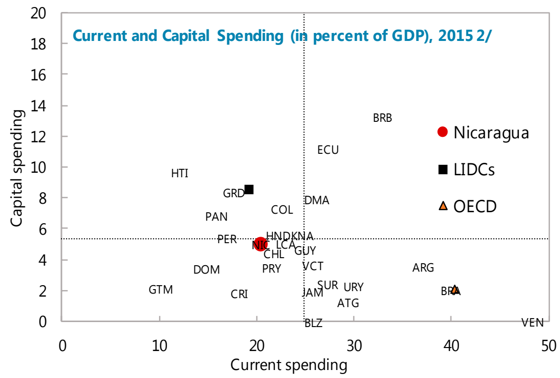
Source: Country authorities and Fund staff calculations and estimates.

Figure 4. Nicaragua: Monetary and Financial Sector Developments

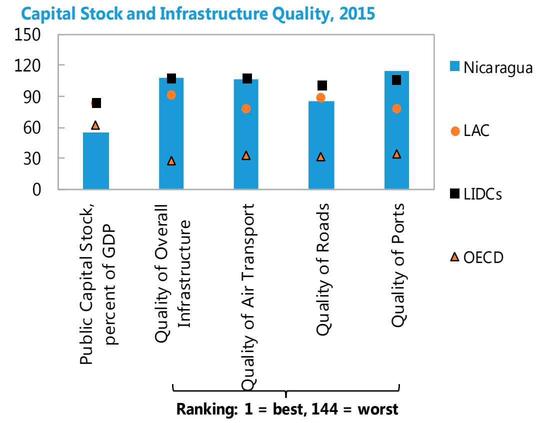


Sources: Country authorities and Fund Staff calculations and estimates.

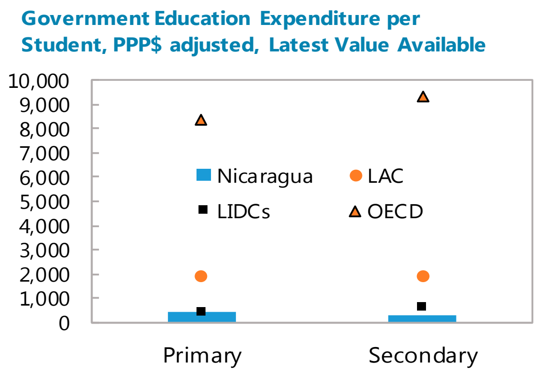
Figure 5. Nicaragua: Indicators of Expenditure Composition



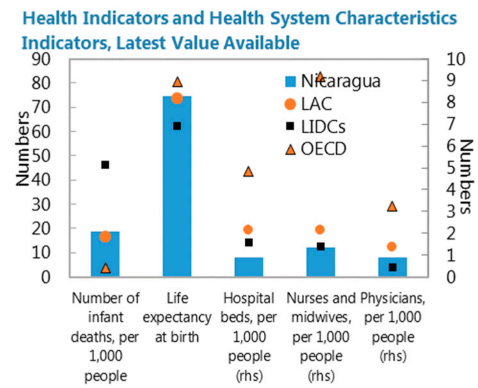
Sources: IMF FAD Expenditure Assessment Tool (EAT), World Economic Outlook.
1/ Coverage refers to general government as per World Economic Outlook metadata.
2/ Dashlines are the average of LAC.



Sources: IMF FAD Expenditure Assessment Tool; IMF Investment and Capital Stock Dataset; and World Economic Forum



Sources: IMF FAD Expenditure Assessment Tool, World Bank



Source: World Bank

Table 1. Nicaragua: Selected Social and Economic Indicators, 2012–17 1/

I. Social and Demographic Indicators

Main export products: beef, coffee, and gold.			
GDP per capita (current U.S.$, 2016)	2,091	Income share held by the richest 10 percent (2014)	37.9
GNI per capita (Atlas method, current U.S.$, 2015)	1,940	Unemployment (percent of labor force, 2016)	6.1
GINI Index (2014)	47.1	Poverty rate (national pov. line, in percent, 2014)	29.6
Population (millions, 2016)	6.3	Adult literacy rate (percent, 2015)	82.5
Life expectancy at birth in years (2014)	74.8	Infant mortality rate (per 1,000 live births, 2015)	18.8

II. Economic Indicators

	2012	2013	2014	2015	2016	2017
						Proj.
Output			(Annual percentage change)			
GDP growth	6.5	4.9	4.8	4.9	4.7	4.5
GDP (nominal, U.S.$ million)	10,532	10,983	11,880	12,748	13,230	13,942
Prices						
GDP deflator	6.2	4.3	8.4	7.5	4.1	5.9
Consumer price inflation (period average)	7.2	7.1	6.0	4.0	3.5	5.4
Consumer price inflation (end of period)	6.6	5.7	6.5	3.1	3.1	5.8
Exchange rate						
Period average (Cordobas per U.S.$)	23.5	24.7	26.0	27.3	28.6	…
End of period (Cordobas per U.S.$)	24.1	25.3	26.6	27.9	29.3	…
Fiscal sector			(Percent of GDP)			
Consolidated public sector						
Revenue (excl. grants)	25.4	25.3	25.5	26.3	27.9	27.9
Expenditure	28.3	28.3	28.6	29.6	31.2	31.1
Current	23.0	22.4	22.6	23.0	24.2	24.1
of which: wages & salaries 1/	7.6	7.7	7.4	7.4	7.6	7.5
Capital	5.3	5.9	6.0	6.7	7.0	7.0
Overall balance, before grants	-2.8	-3.0	-3.1	-3.3	-3.3	-3.2
Overall balance, after grants	-0.8	-1.3	-2.0	-2.2	-2.4	-2.3
Money and credit			(Annual percentage change)			
Broad money	15.4	18.3	15.4	19.0	11.0	10.8
Credit to the private sector	26.3	20.2	20.5	23.5	17.4	14.6
Net domestic assets of the banking system	23.9	17.3	5.1	18.7	13.0	12.5
External sector			(Percent of GDP, unless otherwise indicated)			
Current account	-10.7	-10.9	-7.1	-9.0	-8.6	-8.5
of which: oil imports	12.2	10.9	9.6	6.1	5.2	6.5
Capital and financial account	16.9	14.4	13.7	14.0	8.8	9.1
of which: FDI	6.7	6.1	6.7	7.1	6.5	6.3
Gross reserves (U.S.$ million) 2/	1,778	1,874	2,147	2,353	2,296	2,365
In months of imports excl. maquila 2/	3.6	3.7	4.2	4.6	3.9	3.9
Net international reserves 2/	1,609	1,721	2,024	2,262	2,236	2,326
Public sector debt 3/	41.5	42.3	40.2	40.7	41.9	41.5
Private sector external debt	42.5	45.1	44.7	44.9	44.8	42.6

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

1/ The figures for 2013 include an off-budget wage bonus that was financed with Venezuela-related resources. Starting in 2014 the wage bonus is included in the budget.

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

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

Table 2a. Nicaragua: Operations of the Budgetary Central Government, 2014–22 (GFSM 2001)

(Millions of córdobas)

	2014	2015	2016	2017	2018	2019	2020	2021	2022
						Proj.			
Cash receipts from operating activities	**53,731**	**61,470**	**70,328**	**77,575**	**86,596**	**96,150**	**107,029**	**118,999**	**133,419**
Taxes	47,236	54,725	62,163	69,003	76,974	85,860	95,677	106,788	119,730
Income and property[1/]	18,033	21,832	25,599	27,562	30,869	34,552	38,751	43,402	48,653
Indirect[2/]	27,226	30,576	33,862	38,297	42,632	47,467	52,714	58,727	65,851
Trade	1,977	2,317	2,703	3,144	3,473	3,841	4,211	4,659	5,226
Grants	3,046	2,787	3,540	3,519	3,980	3,976	4,273	4,273	4,789
Other revenue	3,449	3,959	4,625	5,053	5,642	6,314	7,080	7,939	8,900
Cash payments for operating activities	**44,650**	**51,733**	**57,735**	**62,959**	**67,721**	**74,676**	**83,230**	**94,082**	**105,203**
Compensation of employees[3/]	18,305	20,547	22,736	25,136	27,318	30,804	34,248	38,383	43,026
Use of goods and services	7,433	8,589	11,239	11,625	12,284	12,793	14,230	18,278	18,933
Interest[3/]	2,639	3,050	3,755	4,049	3,721	3,881	4,105	4,478	6,558
Subsidies	5,072	5,693	6,041	6,914	7,042	7,832	8,411	8,330	9,220
Grants	9,368	12,075	12,107	13,437	15,251	16,940	19,437	21,381	23,968
Social benefits	1,104	1,224	1,423	1,654	1,923	2,235	2,598	3,020	3,262
Other expense	729	556	433	145	182	192	201	211	237
Net cash inflow from operating activities	**9,081**	**9,737**	**12,593**	**14,616**	**18,875**	**21,474**	**23,799**	**24,918**	**28,216**
Cash flows from investment in non-financial assets (NFAs):									
Purchases of nonfinancial assets	11,883	14,058	16,514	19,341	21,765	24,398	28,242	32,851	36,825
Sales of nonfinancial assets	3	6	0	0	0	0	0	0	0
Net cash outflow: investments in NFAs	11,881	14,052	16,514	19,341	21,765	24,398	28,242	32,851	36,825
Cash surplus / deficit	**-2,800**	**-4,315**	**-3,921**	**-4,725**	**-2,890**	**-2,924**	**-4,444**	**-7,933**	**-8,609**
Cash flows from financing activities:	**2,800**	**4,315**	**3,921**	**4,725**	**2,890**	**2,924**	**4,444**	**7,933**	**8,609**
Net acquisition of financial assets other than cash	290	84	387	439	174	182	191	201	0
Domestic	0	-66	230	240	174	182	191	201	0
Foreign	290	150	157	199	0	0	0	0	0
Net incurrence of liabilities	5,686	6,284	4,498	6,320	5,024	4,788	6,396	9,454	9,761
Domestic	105	-701	-1,261	-4,212	-4,127	-4,957	-4,859	-2,953	-5,238
Foreign	5,581	6,986	5,759	10,532	9,151	9,745	11,255	12,407	14,999
Net cash inflow from financing activities	5,397	6,200	4,111	5,881	4,851	4,606	6,205	9,253	9,761
Net change in the stock of cash	2,597	1,885	190	1,156	1,961	1,682	1,761	1,320	1,152

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

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

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

[3/] Assumes that HIPC-equivalent terms were applied to the outstanding debt to non-Paris Club bilaterals. Does not include SDR allocations. Debt service is recorded on payment basis after debt relief.

Table 2b. Nicaragua: Operations of the Budgetary Central Government, 2014–22 (GFSM 2001)

(Percent of GDP)

	2014	2015	2016	2017	2018	2019	2020	2021	2022
						Proj.			
Cash receipts from operating activities	**17.4**	**17.7**	**18.6**	**18.5**	**18.5**	**18.3**	**18.2**	**18.0**	**18.0**
Taxes	15.3	15.7	16.4	16.5	16.4	16.3	16.2	16.2	16.2
Income and property[1/]	5.8	6.3	6.8	6.6	6.6	6.6	6.6	6.6	6.6
Indirect[2/]	8.8	8.8	8.9	9.1	9.1	9.0	8.9	8.9	8.9
Trade	0.6	0.7	0.7	0.8	0.7	0.7	0.7	0.7	0.7
Grants	1.0	0.8	0.9	0.8	0.8	0.8	0.7	0.6	0.6
Other revenue	1.1	1.1	1.2	1.2	1.2	1.2	1.2	1.2	1.2
Cash payments for operating activities	**14.5**	**14.9**	**15.2**	**15.0**	**14.4**	**14.2**	**14.1**	**14.3**	**14.2**
Compensation of employees[3/]	5.9	5.9	6.0	6.0	5.8	5.9	5.8	5.8	5.8
Use of goods and services	2.4	2.5	3.0	2.8	2.6	2.4	2.4	2.8	2.6
Interest[3/]	0.9	0.9	1.0	1.0	0.8	0.7	0.7	0.7	0.9
Subsidies	1.6	1.6	1.6	1.7	1.5	1.5	1.4	1.3	1.2
Grants	3.0	3.5	3.2	3.2	3.3	3.2	3.3	3.2	3.2
Social benefits	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.5	0.4
Other expense	0.2	0.2	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Net cash inflow from operating activities	**2.9**	**2.8**	**3.3**	**3.5**	**4.0**	**4.1**	**4.0**	**3.8**	**3.8**
Cash flows from investment in non-financial assets (NFAs):									
Purchases of nonfinancial assets	3.9	4.0	4.4	4.6	4.6	4.6	4.8	5.0	5.0
Sales of nonfinancial assets	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net cash outflow: investments in NFAs	3.9	4.0	4.4	4.6	4.6	4.6	4.8	5.0	5.0
Cash surplus / deficit	**-0.9**	**-1.2**	**-1.0**	**-1.1**	**-0.6**	**-0.6**	**-0.8**	**-1.2**	**-1.2**
Cash flows from financing activities:	**0.9**	**1.2**	**1.0**	**1.1**	**0.6**	**0.6**	**0.8**	**1.2**	**1.2**
Net acquisition of financial assets other than cash	0.1	0.0	0.1	0.1	0.0	0.0	0.0	0.0	0.0
Domestic	0.0	0.0	0.1	0.1	0.0	0.0	0.0	0.0	0.0
Foreign	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net incurrence of liabilities	1.8	1.8	1.2	1.5	1.1	0.9	1.1	1.4	1.3
Domestic	0.0	-0.2	-0.3	-1.0	-0.9	-0.9	-0.8	-0.4	-0.7
Foreign	1.8	2.0	1.5	2.5	2.0	1.9	1.9	1.9	2.0
Net cash inflow from financing activities	1.7	1.8	1.1	1.4	1.0	0.9	1.1	1.4	1.3
Net change in the stock of cash	0.8	0.5	0.1	0.3	0.4	0.3	0.3	0.2	0.2

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

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

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

[3/] Assumes that HIPC-equivalent terms were applied to the outstanding debt to non-Paris Club bilaterals. Does not include SDR allocations. Debt service is recorded on payment basis after debt relief.

Table 3a. Nicaragua: Operations of the Combined Public Sector, 2014–22 (GFSM 2001)
(Millions of córdobas)

	2014	2015	2016	2017	2018	2019	2020	2021	2022
						Proj.			
Budgetary central government cash surplus/deficit	**-2,802**	**-4,321**	**-3,921**	**-4,725**	**-2,890**	**-2,924**	**-4,444**	**-7,933**	**-8,609**
Revenue	53,731	61,470	70,328	77,575	86,596	96,150	107,029	118,999	133,419
of which: grants	3,046	2,787	3,540	3,519	3,980	3,976	4,273	4,273	4,789
Expenditure	56,533	65,791	74,248	82,300	89,486	99,074	111,473	126,932	142,028
Social Security Institute (INSS) cash surplus/deficit	**-865**	**-921**	**-1,564**	**-1,784**	**-1,350**	**-1,449**	**-1,355**	**-2,572**	**-3,959**
Revenue	16,260	19,148	22,340	24,628	28,564	32,809	37,282	41,744	46,781
of which: grants (external)	3	3	2	1	0	0	0	0	0
Expenditure	17,125	20,069	23,904	26,412	29,914	34,258	38,636	44,316	50,740
Managua municipality (ALMA) cash surplus/deficit	**-101**	**442**	**-556**	**44**	**-148**	**-161**	**-175**	**-238**	**-267**
Revenue	2,699	4,451	3,657	4,087	4,534	4,353	4,673	5,186	5,813
of which: grants	18	198	7	6	6	7	7	7	8
Expenditure	2,801	4,009	4,213	4,042	4,682	4,514	4,848	5,424	6,080
Public enterprises cash surplus/deficit [1/]	**-1,694**	**-1,843**	**-2,205**	**-2,247**	**-4,877**	**-4,908**	**-4,372**	**-4,441**	**-5,041**
Revenue	12,692	15,406	16,626	18,094	18,909	20,187	21,993	22,729	25,354
of which: Grants (external)	349	806	6	340	373	236	261	0	0
Expenditure	14,386	17,250	18,831	20,341	23,787	25,095	26,366	27,170	30,395
Non-financial public sector									
Cash receipts from operating activities	81,863	95,193	108,745	120,182	134,456	149,659	166,687	184,814	207,234
Taxes	49,501	57,323	65,078	72,100	80,272	89,373	99,419	110,775	124,200
Social contributions	15,161	18,194	21,296	24,311	28,356	32,640	37,154	41,613	46,648
Grants	3,416	3,866	3,555	3,866	4,359	4,219	4,540	4,280	4,798
Other revenue	13,785	15,811	18,816	19,905	21,469	23,427	25,574	28,146	31,589
Cash payments for operating activities	68,756	78,606	90,369	99,747	108,731	121,335	134,785	152,761	172,159
Compensation of Employees	22,946	25,835	28,824	31,366	33,944	38,040	42,044	46,774	52,433
Use of goods and services	12,937	14,284	17,713	18,490	19,445	20,521	22,545	27,226	28,963
Interest	2,310	3,183	3,770	4,445	4,130	4,354	4,474	4,757	6,859
Subsidies	2,460	2,531	2,961	3,895	4,314	4,986	5,183	5,799	6,508
Grants	9,104	10,590	11,496	12,694	14,275	16,374	18,795	20,487	22,965
Social benefits	15,772	18,634	21,970	25,143	28,752	32,951	37,379	43,079	49,230
Other expense	3,227	3,549	3,635	3,715	3,871	4,109	4,365	4,639	5,200
Net cash inflow from operating activities	13,107	16,587	18,376	20,436	25,725	28,323	31,902	32,052	35,075
Net cash outflow from investments in NFAs	18,567	23,224	26,622	29,147	34,990	37,765	42,248	47,236	52,951
Cash surplus / deficit	**-5,460**	**-6,637**	**-8,246**	**-8,711**	**-9,265**	**-9,441**	**-10,346**	**-15,184**	**-17,876**
Central bank (BCN) cash surplus / deficit	**-658**	**-1,027**	**-801**	**-875**	**-1,073**	**-434**	**131**	**-374**	**-496**
Consolidated Public Sector cash surplus / deficit	**-6,118**	**-7,664**	**-9,047**	**-9,586**	**-10,338**	**-9,875**	**-10,215**	**-15,558**	**-18,372**
Cash flows from financing activities:	**6,118**	**7,664**	**9,047**	**9,586**	**10,338**	**9,875**	**10,215**	**15,558**	**18,372**
Net acquisition of financial assets other than cash	80	1,272	72	-606	-893	-1,140	-264	651	449
Net incurrence of liabilities	9,686	9,761	9,281	8,410	9,144	9,677	11,803	18,959	20,979
Domestic	1,888	694	437	-4,613	-5,494	-6,351	-5,404	-1,257	-1,260
Foreign	7,798	9,066	8,844	13,022	14,638	16,028	17,207	20,215	22,240
Net cash inflow from financing activities	9,607	8,489	9,209	9,015	10,036	10,817	12,067	18,308	20,531
Net change in stock of cash	4,147	1,852	963	304	772	1,376	1,721	3,124	2,655
Central bank (BCN) cash surplus/deficit	658	1,027	801	875	1,073	434	-131	374	496
Memorandum items									
GDP (nominal)	308,403	347,463	378,661	418,968	469,237	525,216	589,047	659,751	739,567

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

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

Table 3b. Nicaragua: Operations of the Combined Public Sector, 2014–22 (GFSM 2001)

(Percent of GDP)

	2014	2015	2016	2017	2018	2019	2020	2021	2022
						Proj.			
Budgetary central government cash surplus/deficit	**-0.9**	**-1.2**	**-1.0**	**-1.1**	**-0.6**	**-0.6**	**-0.8**	**-1.2**	**-1.2**
Revenue	17.4	17.7	18.6	18.5	18.5	18.3	18.2	18.0	18.0
of which: grants	1.0	0.8	0.9	0.8	0.8	0.8	0.7	0.6	0.6
Expenditure	18.3	18.9	19.6	19.6	19.1	18.9	18.9	19.2	19.2
Social Security Institute (INSS) cash surplus/deficit	**-0.3**	**-0.3**	**-0.4**	**-0.4**	**-0.3**	**-0.3**	**-0.2**	**-0.4**	**-0.5**
Revenue	5.3	5.5	5.9	5.9	6.1	6.2	6.3	6.3	6.3
Expenditure	5.6	5.8	6.3	6.3	6.4	6.5	6.6	6.7	6.9
Managua municipality (ALMA) cash surplus/deficit	**0.0**	**0.1**	**-0.1**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Revenue	0.9	1.3	1.0	1.0	1.0	0.8	0.8	0.8	0.8
of which: grants	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Expenditure	0.9	1.2	1.1	1.0	1.0	0.9	0.8	0.8	0.8
Public enterprises cash surplus/deficit [1/]	**-0.5**	**-0.5**	**-0.6**	**-0.5**	**-1.0**	**-0.9**	**-0.7**	**-0.7**	**-0.7**
Revenue	4.1	4.4	4.4	4.3	4.0	3.8	3.7	3.4	3.4
of which: Grants (external)	0.1	0.2	0.0	0.1	0.1	0.0	0.0	0.0	0.0
Expenditure	4.7	5.0	5.0	4.9	5.1	4.8	4.5	4.1	4.1
Non-financial public sector									
Cash receipts from operating activities	26.5	27.4	28.7	28.7	28.7	28.5	28.3	28.0	28.0
Taxes	16.1	16.5	17.2	17.2	17.1	17.0	16.9	16.8	16.8
Social contributions	4.9	5.2	5.6	5.8	6.0	6.2	6.3	6.3	6.3
Grants	1.1	1.1	0.9	0.9	0.9	0.8	0.8	0.6	0.6
Other revenue	4.5	4.6	5.0	4.8	4.6	4.5	4.3	4.3	4.3
Cash payments for operating activities	22.3	22.6	23.9	23.8	23.2	23.1	22.9	23.2	23.3
Compensation of Employees	7.4	7.4	7.6	7.5	7.2	7.2	7.1	7.1	7.1
Use of goods and services	4.2	4.1	4.7	4.4	4.1	3.9	3.8	4.1	3.9
Interest	0.7	0.9	1.0	1.1	0.9	0.8	0.8	0.7	0.9
Subsidies	0.8	0.7	0.8	0.9	0.9	0.9	0.9	0.9	0.9
Grants	3.0	3.0	3.0	3.0	3.0	3.1	3.2	3.1	3.1
Social benefits	5.1	5.4	5.8	6.0	6.1	6.3	6.3	6.5	6.7
Other expense	1.0	1.0	1.0	0.9	0.8	0.8	0.7	0.7	0.7
Net cash inflow from operating activities	4.2	4.8	4.9	4.9	5.5	5.4	5.4	4.9	4.7
Net cash outflow from investments in NFAs	6.0	6.7	7.0	7.0	7.5	7.2	7.2	7.2	7.2
Cash surplus / deficit	**-1.8**	**-1.9**	**-2.2**	**-2.1**	**-2.0**	**-1.8**	**-1.8**	**-2.3**	**-2.4**
Central bank (BCN) cash surplus / deficit	**-0.2**	**-0.3**	**-0.2**	**-0.2**	**-0.2**	**-0.1**	**0.0**	**-0.1**	**-0.1**
Consolidated Public Sector cash surplus / deficit	**-2.0**	**-2.2**	**-2.4**	**-2.3**	**-2.2**	**-1.9**	**-1.7**	**-2.4**	**-2.5**
Cash flows from financing activities:	**2.0**	**2.2**	**2.4**	**2.3**	**2.2**	**1.9**	**1.7**	**2.4**	**2.5**
Net acquisition of financial assets other than cash	0.0	0.4	0.0	-0.1	-0.2	-0.2	0.0	0.1	0.1
Net incurrence of liabilities	3.1	2.8	2.5	2.0	1.9	1.8	2.0	2.9	2.8
Domestic	0.6	0.2	0.1	-1.1	-1.2	-1.2	-0.9	-0.2	-0.2
Foreign	2.5	2.6	2.3	3.1	3.1	3.1	2.9	3.1	3.0
Net cash inflow from financing activities	3.1	2.4	2.4	2.2	2.1	2.1	2.0	2.8	2.8
Net change in stock of cash	1.3	0.5	0.3	0.1	0.2	0.3	0.3	0.5	0.4
Central bank (BCN) cash surplus/deficit	0.2	0.3	0.2	0.2	0.2	0.1	0.0	0.1	0.1

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

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

Table 4. Nicaragua: Nonfinancial Public Sector Gross Financing Requirements, 2014–22 1/

	2014	2015	2016	2017	2018	2019	2020	2021	2022
						Proj.			
				(Millions of U.S. dollars)					
a. NFPS primary deficit (before grants)	**253**	**269**	**281**	**271**	**301**	**281**	**299**	**403**	**412**
CG and public enterprises	220	235	226	211	258	237	260	332	309
INSS	33	34	55	59	43	44	39	70	103
b. Debt service obligations	**243**	**286**	**318**	**377**	**368**	**377**	**352**	**355**	**392**
External	97	109	134	182	181	198	213	242	311
Interest	50	59	68	86	70	74	84	97	145
Amortization	47	51	66	97	112	124	129	145	166
Domestic	146	177	184	194	187	179	139	113	82
Interest	39	58	63	62	61	58	45	33	34
Amortization of bonds	81	85	86	119	114	110	82	67	35
Other internal amortizations 2/	26	34	35	13	11	11	12	13	13
c. Gross financing needs (a+b)	**496**	**555**	**599**	**647**	**669**	**658**	**651**	**758**	**805**
d. Financing sources	**496**	**555**	**599**	**647**	**669**	**658**	**651**	**758**	**805**
External	479	522	499	659	714	735	754	816	871
Disbursements	347	383	375	530	576	608	623	698	746
Grants	132	139	124	129	138	127	131	117	125
Domestic	17	32	100	-11	-45	-78	-103	-57	-66
Bond issuance (gross)	87	82	111	17	16	15	0	82	26
Deposits Central Bank	-96	-74	-7	-38	-62	-51	-51	-36	-30
Commercial banks	-63	6	-27	28	38	9	1	-49	-39
Other 3/	89	18	23	-18	-36	-51	-53	-54	-23
					(Percent of GDP)				
a. NFPS primary deficit (before grants)	**2.1**	**2.1**	**2.1**	**1.9**	**2.0**	**1.8**	**1.8**	**2.2**	**2.1**
CG and public enterprises	1.8	1.8	1.7	1.5	1.7	1.5	1.5	1.8	1.6
INSS	0.3	0.3	0.4	0.4	0.3	0.3	0.2	0.4	0.5
b. Debt service obligations	**2.0**	**2.2**	**2.4**	**2.7**	**2.5**	**2.4**	**2.1**	**2.0**	**2.0**
External	0.8	0.9	1.0	1.3	1.2	1.2	1.3	1.3	1.6
Interest	0.4	0.5	0.5	0.6	0.5	0.5	0.5	0.5	0.8
Amortization	0.4	0.4	0.5	0.7	0.8	0.8	0.8	0.8	0.9
Domestic	1.2	1.4	1.4	1.4	1.3	1.1	0.8	0.6	0.4
Interest	0.3	0.5	0.5	0.4	0.4	0.4	0.3	0.2	0.2
Amortization of bonds	0.7	0.7	0.6	0.9	0.8	0.7	0.5	0.4	0.2
Other internal amortizations 2/	0.2	0.3	0.3	0.1	0.1	0.1	0.1	0.1	0.1
c. Gross financing needs (a+b)	**4.2**	**4.4**	**4.5**	**4.6**	**4.5**	**4.1**	**3.8**	**4.2**	**4.2**
d. Financing sources	**4.2**	**4.4**	**4.5**	**4.6**	**4.5**	**4.1**	**3.8**	**4.2**	**4.2**
External	4.0	4.1	3.8	4.7	4.8	4.6	4.5	4.5	4.5
Disbursements	2.9	3.0	2.8	3.8	3.9	3.8	3.7	3.9	3.9
Grants	1.1	1.1	0.9	0.9	0.9	0.8	0.8	0.6	0.6
Domestic	0.1	0.3	0.8	-0.1	-0.3	-0.5	-0.6	-0.3	-0.3
Bond issuance (gross)	0.7	0.6	0.8	0.1	0.1	0.1	0.0	0.5	0.1
Deposits Central Bank	-0.8	-0.6	-0.1	-0.3	-0.4	-0.3	-0.3	-0.2	-0.2
Commercial banks	-0.5	0.0	-0.2	0.2	0.3	0.1	0.0	-0.3	-0.2
Other 3/	0.8	0.1	0.2	-0.1	-0.2	-0.3	-0.3	-0.3	-0.1

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

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

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

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

Table 5. Nicaragua: Summary Accounts of CBN and Financial System, 2014–22

(Billions of córdobas, unless otherwise specified)

	2014	2015	2016	2017	2018	2019	2020	2021	2022
				Proj.					
I. Central Bank									
Net foreign assets[1/]	**12.0**	**26.4**	**30.4**	**36.6**	**42.3**	**48.9**	**56.1**	**62.1**	**66.4**
Net international reserves[2/]	53.8	63.2	65.6	71.6	78.5	86.3	94.7	102.2	108.1
Net international reserves (billions of US$)[2/]	2.0	2.3	2.2	2.3	2.4	2.5	2.7	2.7	2.8
Net domestic assets	**4.9**	**-7.6**	**-9.6**	**-13.7**	**-17.1**	**-20.6**	**-25.1**	**-28.0**	**-28.1**
Net claims on nonfinancial public sector	39.7	37.6	37.2	36.0	34.1	32.4	30.5	29.0	27.7
Net credit to banks	-31.7	-37.0	-36.4	-41.1	-42.7	-43.9	-45.6	-46.6	-46.0
of which: reserves	-24.1	-29.3	-29.8	-34.1	-38.1	-39.4	-42.2	-43.6	-44.3
Capital accounts	5.3	0.6	1.7	5.2	6.0	5.8	5.4	5.8	7.0
Other items (net)	-8.4	-8.8	-12.0	-13.8	-14.4	-15.0	-15.6	-16.2	-16.8
Currency in circulation	**16.9**	**18.8**	**20.8**	**22.9**	**25.2**	**28.2**	**30.9**	**34.1**	**38.2**
II. Other Depository Corporations									
Net foreign assets	**3.8**	**-7.3**	**-11.5**	**-17.9**	**-22.1**	**-26.6**	**-31.3**	**-36.6**	**-42.7**
Net foreign assets (billions of US$)	0.1	-0.3	-0.4	-0.6	-0.7	-0.8	-0.9	-1.0	-1.1
Net domestic assets	**96.4**	**128.2**	**145.1**	**166.1**	**187.8**	**212.8**	**238.2**	**265.9**	**298.6**
Net claims on Central Bank[3/]	34.1	40.5	40.1	44.9	47.1	48.8	51.2	53.0	53.2
Net credit to other financial corporations	-6.4	-7.2	-6.9	-7.3	-7.8	-8.4	-9.0	-9.7	-10.4
Net credit to non-financial public sector	1.0	1.2	2.9	1.7	1.2	-0.3	-2.0	-4.6	-7.2
Credit to private sector	96.1	118.8	139.5	159.9	183.9	213.2	242.4	276.8	317.9
Capital accounts	-17.0	-20.5	-25.0	-27.6	-31.0	-34.7	-38.9	-43.5	-48.8
Other items (net)	-11.4	-4.6	-5.6	-5.4	-5.5	-5.8	-5.5	-6.1	-6.1
Liabilities	**100.3**	**120.4**	**133.6**	**148.2**	**165.7**	**186.3**	**206.9**	**229.3**	**255.9**
Deposits in domestic currency	10.9	15.9	15.4	17.1	19.1	21.5	23.9	26.5	29.6
Deposits in foreign currency	89.4	104.5	118.2	131.0	146.5	164.7	183.0	202.8	226.3
III. Depository Corporations[4/]									
Net foreign assets	**15.8**	**19.1**	**18.9**	**18.7**	**20.2**	**22.3**	**24.8**	**25.5**	**23.7**
Net foreign assets (billions of US$)	0.6	0.7	0.6	0.6	0.6	0.7	0.7	0.7	0.6
Net domestic assets	**97.8**	**116.0**	**131.2**	**147.6**	**165.3**	**186.1**	**206.2**	**230.3**	**261.8**
Net credit to non-financial public sector	40.6	38.7	40.0	37.6	35.2	32.0	28.4	24.4	20.5
Credit to private sector	96.2	118.9	139.6	159.9	183.9	213.3	242.5	276.9	318.0
Net credit to other financial corporations	-6.4	-7.2	-6.9	-7.3	-7.8	-8.4	-9.0	-9.7	-10.4
Capital accounts	-11.7	-20.0	-23.3	-22.4	-25.0	-28.9	-33.4	-37.8	-41.8
Other items (net)	-21.0	-14.0	-18.3	-20.3	-21.0	-22.0	-22.2	-23.6	-24.3
Broad money	**113.6**	**135.1**	**150.0**	**166.3**	**185.5**	**208.4**	**231.0**	**255.7**	**285.5**
(Percent change, y-o-y, unless otherwise specified)									
Memorandum items									
Gross reserves (billions of US$)[2/]	2.1	2.4	2.3	2.4	2.4	2.6	2.7	2.7	2.8
Adjusted NIR (billions of US$)[5/]	0.7	0.9	0.8	0.8	0.9	1.1	1.2	1.3	1.3
In months of imports excl. maquila[5/]	1.5	1.8	1.4	1.3	1.5	1.6	1.7	1.7	1.7
Monetary base[6/]	16.3	24.7	-1.8	10.2	10.5	9.3	8.2	7.7	7.4
Currency in circulation	17.1	11.3	10.8	10.3	10.0	12.0	9.5	10.2	12.2
Deposits in Cordobas	12.8	16.6	4.0	10.9	11.8	12.4	11.1	10.8	11.6
Deposits in FX currency	20.6	13.0	11.7	10.9	11.8	12.4	11.1	10.8	11.6
Credit to private sector	20.5	23.5	17.4	14.6	15.0	16.0	13.7	14.2	14.8
Broad money	15.4	19.0	11.0	10.8	11.6	12.4	10.8	10.7	11.7
Broad money velocity	2.7	2.6	2.5	2.5	2.5	2.5	2.6	2.6	2.6

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

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

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

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

4/ Banking system excludes other financial institutions.

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

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

Table 6. Nicaragua: Quasi-fiscal Balance of the CBN, 2014–22

	2014	2015	2016	2017	2018	2019	2020	2021	2022
						Proj.			
					(Millions of Córdobas)				
Revenue	**919**	**987**	**1,353**	**1,259**	**1,508**	**1,994**	**2,563**	**2,297**	**2,393**
Interest	483	526	678	907	1,226	1,664	2,038	2,174	2,261
Foreign deposits	31	6	17	27	39	56	71	77	81
Notes and bonds	214	284	423	566	831	1,198	1,513	1,632	1,727
Loans of the BCN	222	226	225	220	213	206	197	184	166
On MTI bonds (fluctuation in price)	12	8	10	20	32	47	58	68	61
Other revenues	436	461	675	353	282	330	525	123	132
Of which: recapitalization transfers	338	373	491	258	181	222	410	0	0
Expenditure	**1,577**	**2,014**	**2,154**	**2,134**	**2,581**	**2,427**	**2,432**	**2,671**	**2,889**
Administrative	638	998	1,101	998	1,210	1,288	1,218	1,511	1,693
Interest	939	1,016	1,053	1,136	1,371	1,139	1,213	1,161	1,196
External debt	106	101	112	111	106	98	90	60	61
BCN Securities	417	461	443	343	436	122	128	0	0
Bonds (banking)	222	226	225	220	213	206	197	184	166
Other	194	229	272	463	615	713	798	918	969
Quasi-fiscal balance	**-658**	**-1,027**	**-801**	**-875**	**-1,073**	**-434**	**131**	**-374**	**-496**
					(Percent of GDP)				
Revenue	**0.3**	**0.3**	**0.4**	**0.3**	**0.3**	**0.4**	**0.4**	**0.3**	**0.3**
Interest	0.2	0.2	0.2	0.2	0.3	0.3	0.3	0.3	0.3
Foreign deposits	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Notes and bonds	0.1	0.1	0.1	0.1	0.2	0.2	0.3	0.2	0.2
Bonds (banking)	0.1	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0
On MTI bonds (fluctuation in price)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other revenues	0.1	0.1	0.2	0.1	0.1	0.1	0.1	0.0	0.0
Of which: recapitalization transfers	0.1	0.1	0.1	0.1	0.0	0.0	0.1	0.0	0.0
Expenditure	**0.5**	**0.6**	**0.6**	**0.5**	**0.6**	**0.5**	**0.4**	**0.4**	**0.4**
Administrative	0.2	0.3	0.3	0.2	0.3	0.2	0.2	0.2	0.2
Interest	0.3	0.3	0.3	0.3	0.3	0.2	0.2	0.2	0.2
External debt	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
BCN securities	0.1	0.1	0.1	0.1	0.1	0.0	0.0	0.0	0.0
Bonds (banking)	0.1	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0
Other	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Quasi-fiscal balance	**-0.2**	**-0.3**	**-0.2**	**-0.2**	**-0.2**	**-0.1**	**0.0**	**-0.1**	**-0.1**

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

Table 7. Nicaragua: Balance of Payments, 2014–22

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

	2014	2015	2016	2017	2018	2019	2020	2021	2022
						Proj.			
Current account	**-844**	**-1,144**	**-1,133**	**-1,181**	**-1,267**	**-1,358**	**-1,445**	**-1,509**	**-1,666**
Trade balance	-2,169	-2,545	-2,612	-2,722	-2,902	-3,052	-3,183	-3,305	-3,549
Exports, f.o.b.	4,150	3,859	3,772	4,082	4,218	4,405	4,583	4,881	5,190
Imports, f.o.b.	6,319	6,405	6,384	6,803	7,120	7,457	7,766	8,186	8,739
Of which: oil imports	1,145	777	690	912	948	974	1,015	1,069	1,141
Services	188	232	247	244	242	233	217	191	204
Receipts	1,194	1,254	1,394	1,459	1,528	1,594	1,655	1,718	1,834
Payments	1,006	1,021	1,148	1,215	1,286	1,361	1,438	1,527	1,630
Income	-314	-345	-354	-369	-363	-388	-427	-447	-484
Credits	21	24	37	57	99	136	146	155	166
Debits	335	369	391	427	461	523	573	603	650
Transfers	1,450	1,515	1,586	1,666	1,755	1,849	1,948	2,053	2,163
Of which: workers' remittances	1,136	1,193	1,264	1,327	1,394	1,463	1,537	1,613	1,694
Capital account	**299**	**375**	**141**	**148**	**158**	**168**	**180**	**192**	**205**
Financial account	**-1,329**	**-1,405**	**-1,023**	**-1,123**	**-1,210**	**-1,305**	**-1,378**	**-1,391**	**-1,483**
Direct investment	-790	-905	-860	-872	-947	-1,010	-1,082	-1,048	-1,149
Portfolio investment[1/]	-64	7	146	148	158	168	180	192	205
Other investment	-474	-508	-309	-399	-422	-463	-476	-535	-538
Of which: general government	-294	-343	-322	-433	-464	-484	-495	-553	-580
Errors and omissions	**-501**	**-439**	**-86**	**0**	**0**	**0**	**0**	**0**	**0**
Overall balance	**282**	**197**	**-57**	**90**	**101**	**116**	**113**	**74**	**21**
Financing	**-304**	**-224**	**28**	**-90**	**-101**	**-116**	**-113**	**-74**	**-21**
Change in GIR (increase, -)	-282	-197	57	-69	-83	-103	-107	-72	-21
Change in NIR (increase, -)	-304	-224	28	-90	-101	-116	-113	-74	-21
IMF credit and loans	-22	-27	-29	-21	-18	-13	-6	-2	0
Purchases and disbursements	0	0	0	0	0	0	0	0	0
Repurchases and repayments	-22	-27	-29	-21	-18	-13	-6	-2	0
Exceptional financing	0	0	0	0	0	0	0	0	0
Memorandum items									
Current account (percent of GDP)	-7.1	-9.0	-8.6	-8.5	-8.5	-8.6	-8.5	-8.4	-8.6
Goods export volume (percent)	6.4	-3.6	2.7	7.8	2.0	2.6	3.0	5.0	5.0
Goods import volume (percent)	5.1	10.8	6.0	2.1	3.2	2.3	2.3	4.0	5.9
Terms of trade (percent)	3.0	5.4	1.2	-3.9	-0.2	-0.6	-0.8	0.1	0.5
ALBA-related flows, gross (percent of GDP)	5.6	2.9	1.6	0.4	0.3	0.3	0.3	0.3	0.3
ALBA-related debt (percent of GDP)	25.8	25.3	24.2	22.3	20.3	18.4	16.6	14.9	13.4
Stock of gross reserves[2/]	2,147	2,353	2,296	2,365	2,449	2,551	2,658	2,730	2,751
In months of imports excl. *maquila*[2/]	4.2	4.6	3.9	3.9	3.8	3.8	3.8	3.6	3.4
Oil price (U.S.$ per barrel)	96	51	43	55	55	54	54	54	55
Public external debt (percent of GDP)[3/]	32.0	31.7	32.4	33.5	34.2	34.9	35.4	36.0	36.5

Sources: Country authorities; and Fund staff calculations and estimates.
[1/]Includes financial derivatives.
[2/]Excludes the Deposit Guarantee Fund for Financial Institutions (FOGADE).
[3/]Assumes that HIPC-equivalent terms were applied to the outstanding debt to non-Paris Club bilaterals. Does not include SDR allocations.

Table 8. Nicaragua: Financial Soundness Indicators, 2012–16

(Percent, unless otherwise specified)

	2012	2013	2014	2015				2016			
				Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep.	Dec.
Capital adequacy											
Regulatory capital to risk-weighted assets	13.1	12.9	13.0	13.0	13.4	13.2	13.0	13.8	13.4	13.4	13.5
Regulatory Tier 1 capital to risk-weighted assets	8.6	8.5	9.1	8.8	9.5	9.0	8.7	8.8	9.1	8.7	8.8
Asset quality											
Nonperforming loans to total gross loans	1.7	0.9	1.0	0.9	0.9	0.9	0.9	0.9	1.0	0.9	0.9
Nonperforming loans net of provisions to capital	-5.9	-7.2	-7.2	-7.5	-7.3	-7.4	-7.5	-7.7	-7.5	-7.4	-7.6
Sectoral distribution of loans											
Commercial	35.2	35.0	35.0	35.6	35.5	35.0	34.9	35.0	36.0	35.3	36.0
Agricultural	12.3	11.1	10.0	8.2	7.8	8.8	9.4	8.0	7.9	8.5	9.2
Consumer	22.2	24.0	25.0	25.2	25.9	25.7	25.6	26.4	26.9	27.2	26.9
Construction	12.9	13.2	13.3	13.5	13.6	13.3	13.1	13.4	13.2	13.1	12.9
Industrial	14.3	13.4	13.2	14.1	13.7	13.7	13.4	13.6	12.5	12.3	11.3
Others	3.1	3.3	3.5	3.4	3.4	3.4	3.5	3.5	3.5	3.5	3.6
Earnings and profitability											
Return on assets	3.0	3.3	3.0	3.1	3.1	3.1	3.2	3.3	3.3	3.3	3.4
Return on equity	31.4	31.3	28.7	28.8	28.2	28.2	29.0	29.7	29.6	29.2	30.5
Liquidity											
Liquid assets to total assets	24.6	24.4	26.6	27.5	26.2	23.8	23.5	25.5	23.1	23.5	22.5
Liquid assets to total short-term liabilities	38.0	38.5	42.9	45.2	43.7	40.2	39.6	42.9	38.8	39.8	38.1
Exposure to FX risk											
Net open position in foreign exchange to capital	106.9	113.5	114.3	122.7	115.9	113.7	112.7	128.7	112.8	114.8	114.6
Number of institutions	8	8	9	9	10	10	10	10	11	11	11
Bank concentration											
Number of banks accounting individually for at least 25% of total assets	2	2	2	2	2	2	1	2	1	1	2
Share of total assets of 3 largest institutions (percent)	81	81	82	82	80	79	78	78	77	76	77
Dollarization and maturity structure											
Banking system assets as percentage of GDP	34.3	37.3	50.6	51.6	51.4	51.8	52.4	53.5	52.9	53.9	55.6
Assets in foreign currency as percentage of banking system assets 1/	88.0	88.9	89.4	89.1	88.8	88.9	87.2	89.3	88.2	88.6	89.4

Sources: Country authorities.

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

Table 9. Nicaragua: Medium-Term Macroeconomic Framework, 2014–22

	2014	2015	2016	2017	2018	2019	2020	2021	2022
						Proj.			
Growth and prices					(Percent)				
GDP growth	4.8	4.9	4.7	4.5	4.3	4.5	4.5	4.5	4.5
GDP deflator	8.4	7.5	4.1	5.9	7.4	7.1	7.3	7.2	7.3
Consumer price inflation (average)	6.0	4.0	3.5	5.4	7.4	7.1	7.3	7.2	7.3
Consumer price inflation (e.o.p.)	6.5	3.1	3.1	5.8	7.4	7.1	7.3	7.2	7.3
Public finances					(Percent of GDP)				
Consolidated public sector									
Revenue	26.6	27.4	28.8	28.8	28.8	28.7	28.5	28.2	28.2
Expenditure	28.6	29.6	31.2	31.1	31.0	30.6	30.3	30.6	30.7
Overall balance, after grants	-2.0	-2.2	-2.4	-2.3	-2.2	-1.9	-1.7	-2.4	-2.5
Public sector debt[1/]	40.2	40.7	41.9	41.5	40.0	39.1	38.2	38.5	38.5
Balance of payments					(Percent of GDP, unless otherwise specified)				
Current account	-7.1	-9.0	-8.6	-8.5	-8.5	-8.6	-8.5	-8.4	-8.6
U.S.$ million	-844	-1,144	-1,133	-1,181	-1,267	-1,358	-1,445	-1,509	-1,666
Gross reserves (U.S.$ million)[2/]	2,147	2,353	2,296	2,365	2,449	2,551	2,658	2,730	2,751
In months of imports excl. maquila[2/]	4.2	4.6	3.9	3.9	3.8	3.8	3.8	3.6	3.4
Net international reserves (U.S.$ million)[2/]	2,024	2,262	2,236	2,326	2,427	2,543	2,656	2,730	2,752
Memorandum items									
GDP (US$ million)	11,880	12,748	13,230	13,942	14,871	15,853	16,933	18,062	19,283

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

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

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

Table 10. Nicaragua: Saving-Investment Balance, 2014–22

(Percent of GDP, unless otherwise specified)

	2014	2015	2016	2017	2018	2019	2020	2021	2022
						Proj.			
Gross national disposable income	**109.6**	**109.2**	**109.3**	**109.3**	**109.4**	**109.2**	**109.0**	**108.9**	**108.7**
Nominal GDP	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Net factor payments from abroad	-2.6	-2.7	-2.7	-2.6	-2.4	-2.4	-2.5	-2.5	-2.5
Net transfers from abroad	12.2	11.9	12.0	12.0	11.8	11.7	11.5	11.4	11.2
Consumption	**89.3**	**88.1**	**88.5**	**88.5**	**88.1**	**88.2**	**88.0**	**87.7**	**87.8**
Public sector[1/]	7.7	7.6	8.3	8.0	7.7	7.5	7.4	7.5	7.4
Private sector	81.7	80.5	80.2	80.5	80.4	80.7	80.6	80.2	80.4
Gross domestic investment	**27.3**	**30.0**	**29.4**	**29.3**	**29.8**	**29.5**	**29.5**	**29.5**	**29.5**
Public sector[1/]	6.0	7.1	7.2	7.1	7.6	7.3	7.3	7.3	7.3
Private sector	21.3	22.9	22.2	22.2	22.2	22.2	22.2	22.2	22.2
National saving	**20.2**	**21.1**	**20.8**	**20.8**	**21.3**	**21.0**	**21.0**	**21.2**	**20.9**
Public sector	4.2	4.8	4.9	4.9	5.5	5.4	5.4	4.9	4.7
Private sector	16.0	16.3	16.0	16.0	15.8	15.6	15.6	16.3	16.1
External saving	**7.1**	**9.0**	**8.6**	**8.5**	**8.5**	**8.6**	**8.5**	**8.4**	**8.6**
Public sector	1.8	2.3	2.3	2.2	2.1	1.9	1.9	2.4	2.5
Private sector	5.3	6.7	6.3	6.3	6.4	6.6	6.6	5.9	6.1
Memorandum items									
Exports of goods and services	45.0	40.1	39.0	39.7	38.6	37.8	36.8	36.5	36.4
Imports of goods and services	61.6	58.3	56.9	57.5	56.5	55.6	54.4	53.8	53.8

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

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

Table 11. Nicaragua: Millennium Development Goals, 1990-2015 1/

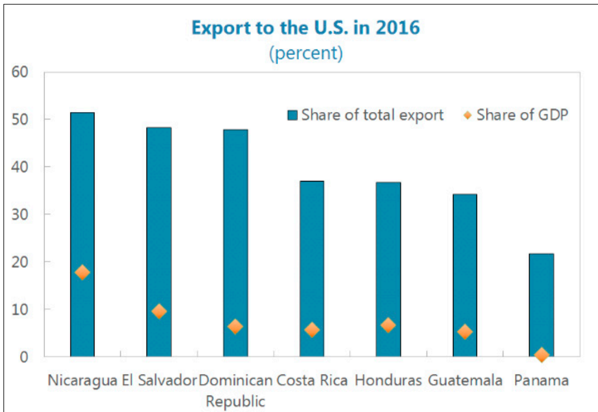
	1990	1995	2000	2005	2010	2015
Goal 1: Eradicate extreme poverty and hunger						
Employment to population ratio, 15+, total (percent)	49.9 /a	48.4	53.8	58.0	58.0	60.6
Employment to population ratio, ages 15-24, total (percent)	40.9 /a	37.4	41.3	43.8	42.1	42.6
Poverty gap at $1.90 a day (2011 PPP) (percent)	7 /b	4.4 /d	4.9 /e	3.6	3.6 /g	…
Malnutrition prevalence, weight for age (percent of children under 5)	9.6 /b	10.3 /d	7.8 /e	5.7 /f	…	…
Prevalence of undernourishment (percent of population)	54.4 /a	45.1	34.8	24.3	20.3	16.6
Goal 2: Achieve universal primary education						
Primary completion rate, total (percent of relevant age group)	39.6	50.1	65.7	81.0	85.4	…
School enrollment, primary (percent net)	67.5	73.4	81.7	92.4	97.0	…
Goal 3: Promote gender equality and empower women						
Proportion of seats held by women in national parliaments (percent)	14.8	10.8 /c	9.7	20.7	20.7	41.3
Ratio of girls to boys in primary and secondary education (percent)	…	1.1 /d	1.1	1.0	1.0	…
Goal 4: Reduce child mortality						
Immunization, measles (percent of children ages 12-23 months)	82.0	85.0	86.0	96.0	99.0	99.0
Mortality rate, infant (per 1,000 live births)	50.9	41.4	32.6	26.3	22.0	18.8
Mortality rate, under-5 (per 1,000 live births)	66.9	52.7	40.3	31.7	26.1	22.1
Goal 5: Improve maternal health						
Births attended by skilled health staff (percent of total)	…	64.6 /d	89.7 /e	73.7	74.0	…
Contraceptive prevalence (percent of women ages 15-49)	…	60.3 /d	68.6 /e	72.4	80.4 /i	…
Maternal mortality ratio (modeled estimate, per 100,000 live births)	173.0	212.0	202.0	190.0	166.0	150.0
Goal 6: Combat HIV/AIDS, malaria, and other diseases						
Incidence of tuberculosis (per 100,000 people)	0.0	0.0	60.0	44.0	53.0	51.0
Prevalence of HIV, total (percent of population ages 15-49)	0.3	0.4	0.4	0.3	0.3	0.3
Tuberculosis case detection rate (percent, all forms)	0.0	0.0	80.0	80.0	80.0	80.0
Goal 7: Ensure environmental sustainability						
CO2 emissions (metric tons per capita)	0.6	0.6	0.7	0.8	0.8	0.8 /h
Forest area (percent of land area)	37.5	34.6	31.7	28.8	25.9	25.9 /j
Improved sanitation facilities (percent of population with access)	43.9	49.2	54.4	59.6	64.7	67.9
Improved water source (percent of population with access)	72.7	75.8	78.9	81.9	85.0	87.0
Terrestrial protected areas (percent of total land area)	15.4	0.0	36.7	0.0	85.0	87.0
Goal 8: Develop a global partnership for development						
Internet users (per 100 people)	0.0	0.0	1.0	2.6	10.0	19.7
Mobile cellular subscriptions (per 100 people)	0.0	0.1	1.8	20.5	68.1	116.1

Source: Millenium Development Goals, World Bank.

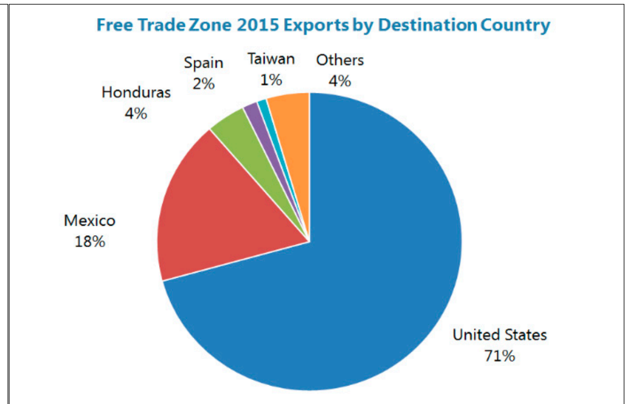
1/ Or latest available data. a) 1991; b) 1993; c) 1997; d) 1998; e) 2001; f) 2006; g) 2009; h) 2011; i) 2012; j) 2013

Appendix I. Exposure to the U.S. Economy

Nicaragua is highly integrated with the U.S. economy, with external exposure well above regional peers. Direct exports to the U.S. are at an all-time high at 52 percent of Nicaragua's total exports (71 percent for FTZ exports) and 18 percent of GDP, the highest share in Central America. Nicaragua's second and third largest international partners are Central America and Mexico, which receive 11.9 percent of exports and 10.7 percent of exports, respectively. Roughly 78 percent of exports from Central America and Mexico are also directed to the U.S., including products containing inputs produced or assembled in Nicaragua, thus adding to total trade dependence from the U.S. market.

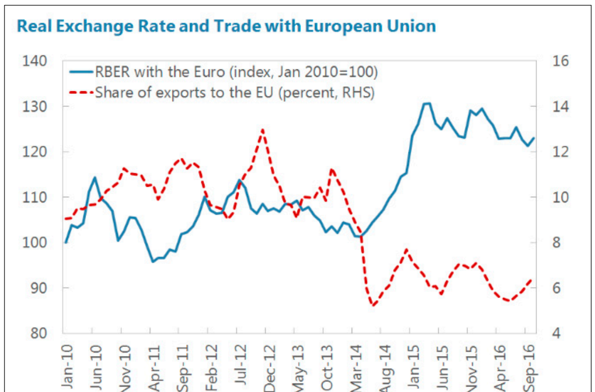


Source: Direction of Trade Statistics and Staff Estimate.



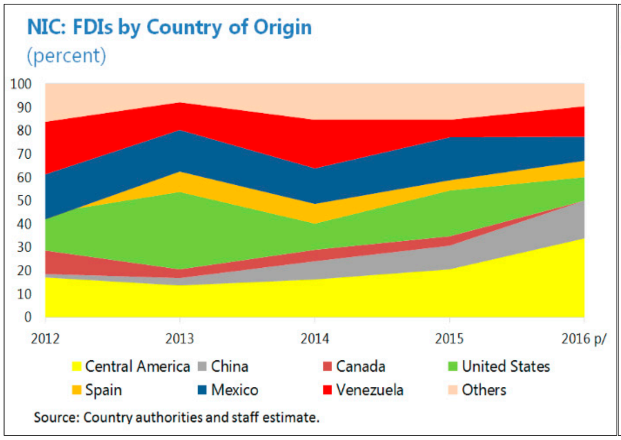
Source: Country authorities and staff estimates.

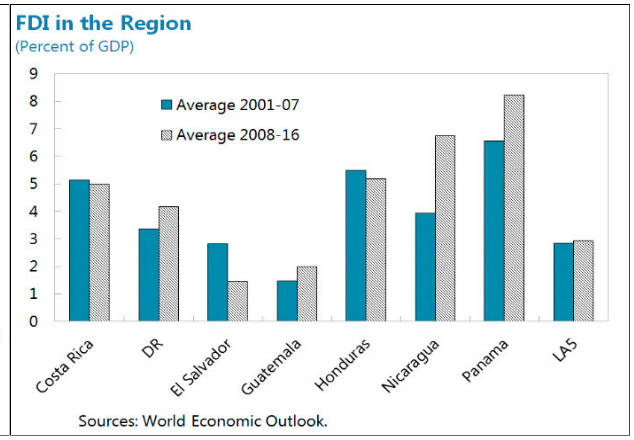
The share of exports to the U.S. is increasing. Exports to the U.S. grew by 60 percent since 2006, mainly due to the participation in CAFTA-DR and the indirect benefits of NAFTA. Simultaneously, Nicaraguan share of exports to other major markets has declined despite the Central American free trade agreement with the European Union, in part due to the loss in competitiveness associated to the depreciation of the euro.



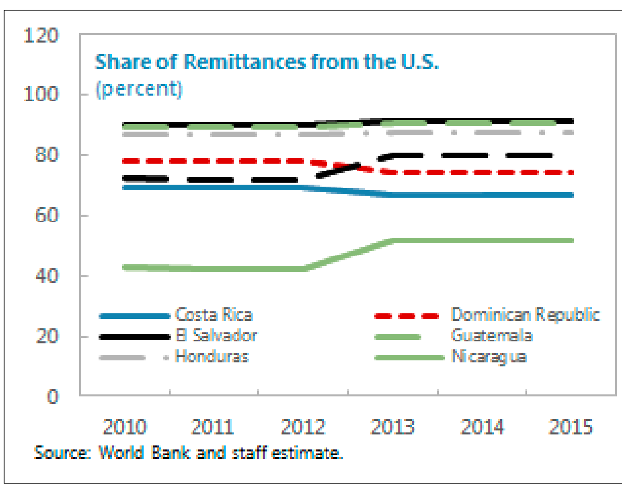
Source: Direction of Trade Statistics and staff estimate.

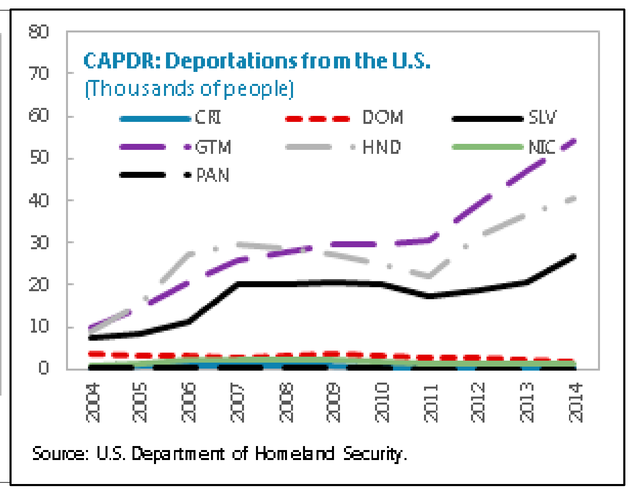
Open trade and investment policy designed to foster global integration has promoted Nicaragua's attractiveness for FDI. FDI increased from 3.9 percent of GDP between 2001–07, on average, to 6.7 percent between 2008-2016, boosted by FTZ's tax incentives (SIP) and low comparative salaries. Major FDI was attracted in textile, auto harnesses and medical equipment sectors. Out of total FDI between 2012 and 2016, most came from Central America, United States and Mexico, 20.5 percent, 17.8 percent, and 16.2 percent, respectively. Free capital flows and exchange rate stability further increased the attractiveness of both U.S. portfolio and long-term investors.





Remittances from migrant Nicaraguan workers in the U.S. are an important offsetting factor of trade deficits. During 2014–16, remittances offset over 45 percent of the trade deficit, on average. Out of total remittances, over 50 percent come from the 300,000 Nicaraguans currently residing in the U.S. (about 4.5 percent of Nicaragua's population), and has been growing over the last years. The current 0.5 percent deportation rate, as a share of total stock of migrants, is among the lowest in Central America.





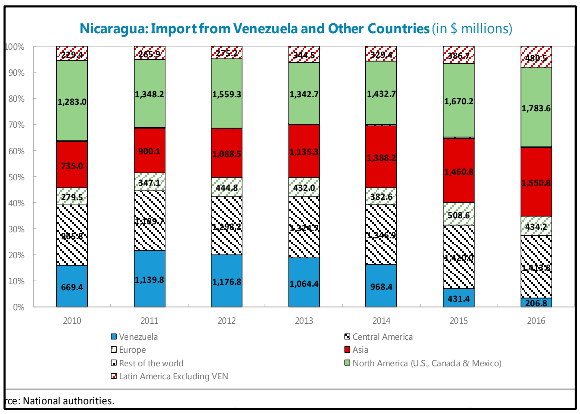
Monetary and financial conditions. The existing peg and dollarization levels imply that inflation and interest rates are largely determined by U.S. domestic economic conditions and monetary policies. Loose monetary conditions in the U.S. contributed to credit growth in Nicaragua since 2011.

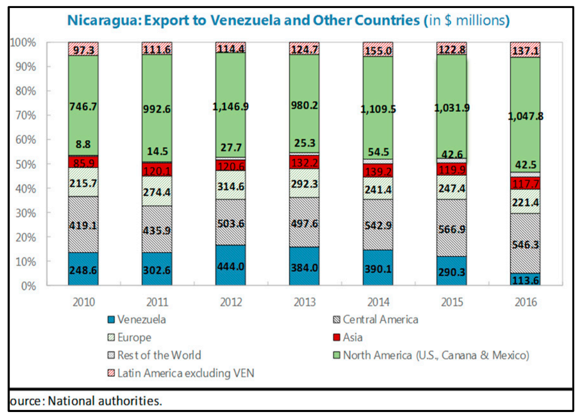
Macroeconomic impact of spillovers from the U.S. is expected to be higher in Nicaragua than in the rest of the region.[1] Potential trade effects from a CAFTA-DR or NAFTA revision. would be magnified by the comparatively large trade exposure of Nicaragua. However, a tightening of U.S. immigration policy would reduce the amount of remittances and strain the labor market on a lesser scale than Central America's northern triangle; and a U.S. tax reform that provides incentives to relocate investments in the U.S. would have little effect on Nicaragua's low-value added industrial production. Tighter financial conditions in the U.S. would likely spill into Nicaraguan rates as fast as in the fully dollarized economies of the region and might appreciate the córdoba REER.

[1] A note quantifying the macroeconomic impact of spillovers from changes in U.S. policies is included in the SIP.

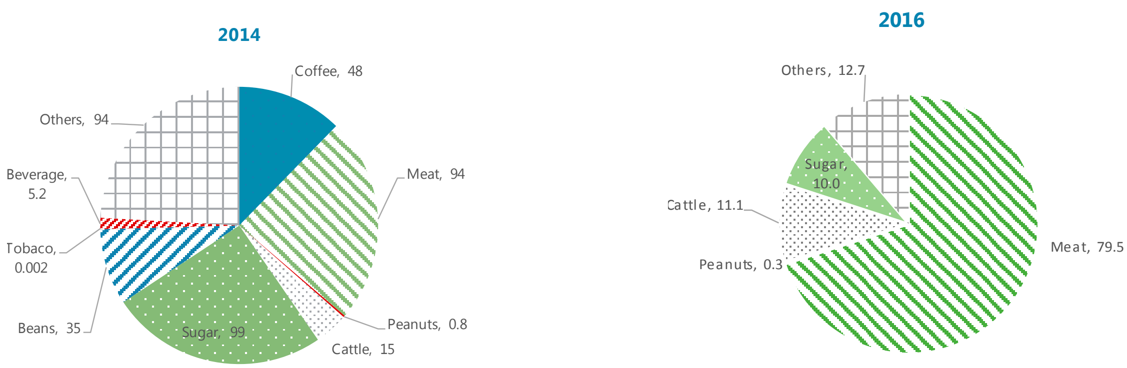
Appendix II. Venezuela Oil Cooperation with Nicaragua: An Update

After 2014, economic transactions with Venezuela declined substantially, in line with falling oil prices and Venezuela's economic developments. Imports decreased to 1.6 percent of GDP in 2016, from 8.2 percent of GDP in 2014, due mainly to lower oil prices. Exports declined to 0.85 percent of GDP in 2016 from 3.3 percent of GDP in 2014. About ¾ of exports are agricultural products and food.





Composition of Export to Venezuela in 2014 and 2016

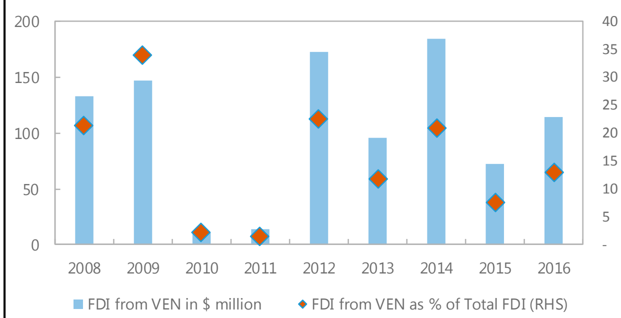


Source: National Authorities

FDI from Venezuela rebounded in 2016, after declining in 2015. FDI declined significantly in 2015 to about $72 million (0.56 percent of GDP) from $184 million (1.55 percent of GDP) in 2014, but bounced back to $115 million (0.87 percent of GDP) in 2016, largely because of investments in oil storage capacity. Total FDI from Venezuela during 2008-2016 amounts to $944 million and is mainly invested in power generation (47 percent), and oil storage and refining facilities (50 percent).

Total cooperation was adjusted downwards in 2016. After being renegotiated upwards in 2013 (Nicaragua: Staff Report for the 2015 Article IV Consultation, Country Report 16/34), a revised cooperation agreement with Venezuela was signed in 2016, reducing oil imports from 30,000 barrels per day to 10,000 bpd. Concessional financing also declined from 50 percent of the oil bill to 25 percent. The possibility to import oil from third parties using Venezuela's concessional financing, in case Venezuela was not able to provide the volume of oil committed, was discontinued. Oil imports can still be paid in kind. The institutional arrangement to import oil on concessional terms through the private sector company ALBANISA and its financial agent, CARUNA, still holds.

FDI from Venezuela



Source: National authorities and staff calculation.

ALBANISA's debt. About US$3.2 billion (24 percent of GDP) of private external loans have been accumulated since the start of the oil collaboration until end-2016. Reportedly, ⅓ of these funds were used to finance social programs while ⅔ were invested with an average return of 8 percent, which was considered sufficient to service the debt at 2 percent interest rate and 25 years' maturity with 2-year grace period, under the initial terms of the agreement. As of end-2016, approximately 20 percent of total ALBANISA assets were loans to SOEs and municipalities.

Social Programs Financed by Oil Cooperation with Venezuela (in $ millions)

	2010	2011	2012	2013	2014	2015	2016
Total	**129**	**178.2**	**209.2**	**212.2**	**165.5**	**116.6**	**34.5**
Food safety and nutrition	19.4	16.6	3.5	25.2	36.5	18.3	4.0
Urban and Rural developments	11	10.8	10.4	11.3	9.2	8.5	4.2
Humanitarian Assistance	15.4	0.7	3.2	3.4	6.8	13.5	1.4
Housing Infrastructure	6	31.3	18.9	15.1	23.8	13.7	5.9
Education, Culture and Recreatior	10	0.2	9.3	7.1	9.8	7.4	7.1
Health, water and sanitation				7.5	10.6	6.7	2.6
Transport subsidies		45.9	48.6	45.5	43.4	16.5	0
Solidarity Bonus		59.4	66.7	65.3	0	0	0
Other complimentary projects	8	2.7	8.6	12.5	5.8	10.2	3.7
Operational costs				6.6	9.1	4.1	2.0
Social Investment				11.2	4.2	7.7	3.1
Liquidity	59.2	10.6	40	1.5	6.3	10	0.5

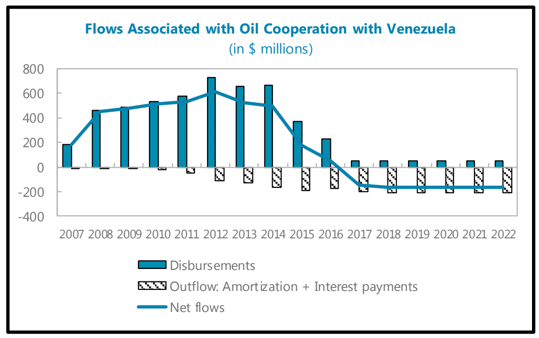
Source: National Aathorities and staff estimates.

Balance Sheet of the Scheme of the Cooperation with Venezuela (in $ millions)

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
												Proj.			
Assets	**149**	**437.2**	**645.2**	**990.8**	**1296.7**	**1614.4**	**1846.6**	**1,986**	**2,021**	**2,004**	**2,007**	**2038.5**	**2070**	**2082.4**	**2092.4**
Liquidity			51.3	156.7	164.9	136.8	128.7	97.6	76.6	28.7	-0.1	-0.1	-0.1	-0.1	-0.1
Investments	**149**	**437.2**	**593.9**	**834.1**	**1131.8**	**1477.6**	**1717.9**	**1,888**	**1,944**	**1,976**	**2,007**	**2,039**	**2,070**	**2,082**	**2,092**
Energy			98.5	245.7	333.7	467.4	571.7	645.2	670.9						
Housing Infrastructure			3.9	7.7	32.7	45.5	54.5	61.5	63.8						
Rail and Marine Transport			3.7	6.2	15.2	22.1	27.5	43.2	44.5						
Fair trade development			9	35.8	120.8	151.2	171.9	188.6	193.6						
Agricultura and forestry development			12.5	38.3	68.3	92	110.5	117.7	121.5						
MSME development				14.3	39.3	63.4	79.2	86.8	89.9						
Industry						37	57.5	77.8	83.1						
Service projects						16.3	27	34.7	36.9						
Financial investment						32.2	47.2	55.2	57.7						
Program usury zero			1.6	3.8	10.5	10.5	10.5	10.5	10.5						
Other projects			27.5	45.1	74.1	74.1	74.1	74.1	134.4						
Liabilities	**677**	**965**	**1,196**	**1,744**	**2,226**	**2,696**	**3,060**	**3,223**	**3,198**	**3,109**	**3,007**	**2,900**	**2,791**	**2,682**	**2,571**
Loans	677	965	1,196	1,744	2,226	2,696	3,060	3,223	3,198	3,109	3,007	2,900	2,791	2,682	2,571
Implied Equity	**-528**	**-528**	**-551**	**-753**	**-929**	**-1,082**	**-1,214**	**-1,237**	**-1,178**	**-1,105**	**-1,000**	**-861**	**-721**	**-599**	**-478**

Source: IMF staff estimates based on publicly available information. Not an official statement.

Petrocaribe debt service. Outflows have surpassed ALBANISA's return on investments since 2012. Given the lower oil imports volume and finance, debt repayments are estimated to exceed disbursements from 2017.



Source: National authorities and IMF staff estimates.

Oil Cooperation Scheme with Venezuela: Projected Income and Debt Flows

(in $ millions unless otherwise indicated)

		2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
													Proj.			
	Interest Payments	5	11	19	29	40	44	52	58	59	58	57	55	53	51	49
	Amortization	0	0	3	16	75	89	114	138	116	137	150	154	156	158	160
A	Total Debt Service (interest payments and Amortization)	5	11	22	45	114	133	166	195	175	195	206	208	209	209	209
	A as % of GDP	0.1	0.1	0.2	0.5	1.1	1.2	1.4	1.5	1.3	1.4	1.4	1.3	1.2	1.2	1.1
B	Investment Income assuming return of 8 percent of productive assets	9.2	23.4	41.2	57.1	78.6	104.4	127.8	144.2	153.3	147.0	159.3	161.8	164.3	166.1	167.0
C=B-A	Investment Income - Debt Service	4.5	12.8	19.5	12.0	-35.6	-28.4	-37.8	-51.1	-21.7	-47.9	-47.0	-46.6	-44.2	-42.6	-42.3
	Use of Liquid Assets for Debt Service 1/					35.6	28.4	37.8	51.1	21.7	47.9	28.8	0.0	0.0	0.0	0.0
	Memorandum item															
	C as % of GDP	0.1	0.2	0.2	0.1	-0.3	-0.3	-0.3	-0.4	-0.2	-0.3	-0.3	-0.3	-0.3	-0.2	-0.2

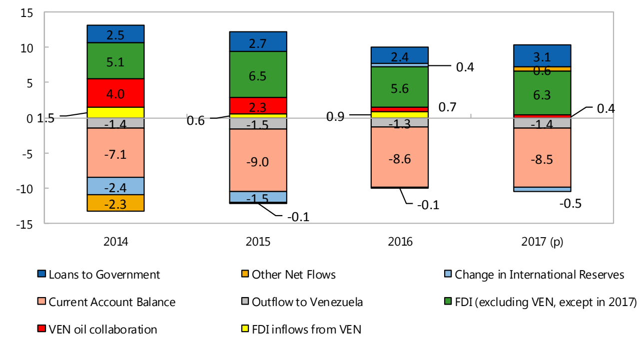
1/ Indicates the need to use cash or assets sales for debt service.
Source: Staff estimates based on publicly available information.

Macroeconomic impact. Winding down oil cooperation with Venezuela introduces two challenges to macroeconomic stability. The FX market would need to accommodate an annual net outflow of about $145–160 million US dollar, equivalent to 1.2–1.3 percent of total FX transactions in 2016. This increases the need to consolidate the trade account and to find alternative sources of finance. The decline in the volume of cooperation could increase pressures to absorb some quasi-fiscal spending into the budget. In fact, since 2014, social programs amounting to at least 0.4 percent of GDP that were once totally or partially financed by Venezuelan cooperation have been transferred to the budget. While it is not clear if and how much additional social expenditures will be taken over by the budget, staff estimates that these could range between 0.5 and 0.7 percent of GDP.

Countervailing factors have supported the transition to lower Venezuelan cooperation.

Venezuela inflows decreased by over 80 percent from their peak in 2014 and are projected at only 0.3 percent of GDP in 2017. This decline has been compensated by an increase in non-Venezuelan FDI and other investments, as well as a decline in reserve accumulation. Projections for 2017 show higher IFI loans allowing to resume the reserve accumulation path.

Financing the Current Account Deficit (Percent of GDP)



Source: National authorities and staff calculation.

Appendix III. External Assessment

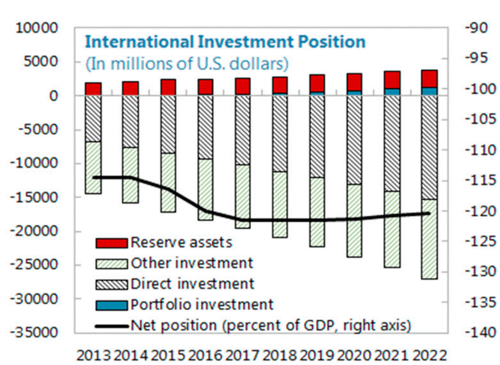
The current account balance improved slightly in 2016 while the real effective exchange rate (REER) and the stock of gross international reserves remained broadly stable. Gross financing needs are large and the net international investment position remains negative. Staff estimates that capital net inflows, mainly FDI, grants and concessional loans, will finance current account deficits over the medium term. Extensive infrastructure investments and affordable salaries continue to sustain Nicaragua's competitiveness, but other aspects of the business environment remain weak. Efforts to improve Nicaraguan competitiveness and structural reforms would help to address these vulnerabilities.

Exchange Rate Assessment and Competitiveness

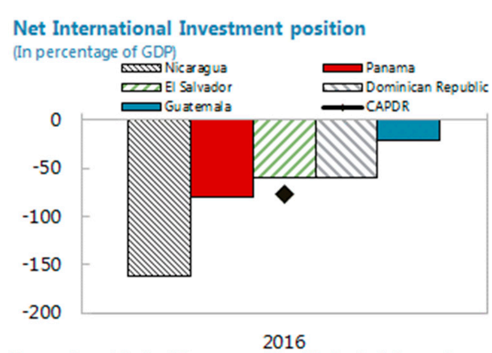
Nicaragua's external position is estimated to be broadly consistent with fundamentals based on the real exchange rate model and external sustainability approach, while the current account model shows a weaker position. The estimated REER gap ranges between -3.8 undervaluation (ES) and 6.8 percent overvaluation (CA model). Part of the overvaluation estimated through the CA model could be attributed to a temporary shock to main export commodity prices. Staff projects that the current account deficit will remain at about 8½ percent of GDP in the medium term, due to the countervailing effects of higher export volume and prices, and sustained import demand and higher commodity import prices. The real exchange rate model estimated only 1.2 percent REER gap. The net international investment position (IIP) remains negative at about -120 percent of GDP at end-2016 and is projected to remain broadly unchanged in the medium term. As the financing through Venezuela oil cooperation declines, the international investment positions would accrue mainly in foreign direct investment and loans.

Exchange Rate Assessment EBA-Lite 1/	
Current Account Panel Regression	
CA norm (percent of GDP)	-6.5
CA gap (percent of GDP)	-2.1
REER gap (percent)	6.8
Index REER Panel Regression	
REER norm (log)	4.6
REER actual (log)	4.6
REER gap (percent)	1.2
External Sustainability (ES) approach	
CA norm (percent of GDP)	-9.4
CA gap (percent of GDP)	1.1
REER gap (percent)	-3.8

Source: Fund staff calculations and estimates.
1/ Based on IMF EBA-Lite methodology.



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

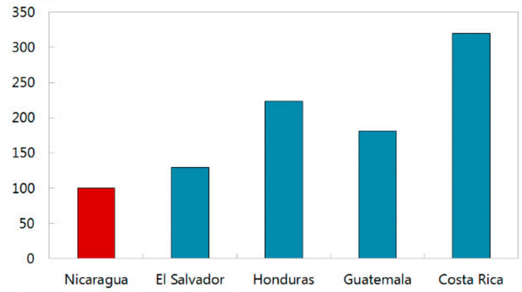


Sources: Central Bank of Nicaragua and Fund Staff calculations and

Other indicators seem to confirm the results of the real exchange rate model and external sustainability approach:

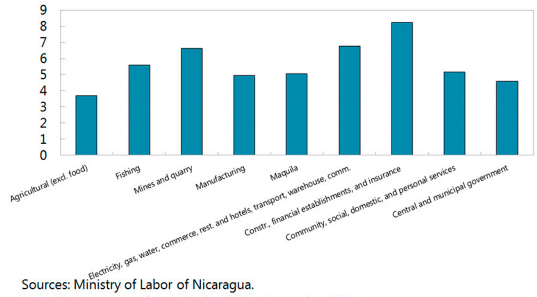
- Nicaragua's minimum wages are very competitive. Nicaragua has the lowest minimum wage for maquila workers in Central America.

Maquila Minimum Wage in 2016
(Nicaragua=100 percent)



Sources: Ministry of Labor of each country.
Note: Minimum wages for Honduras and Costa Rica are approximated using manufacturing sector and overall wage.

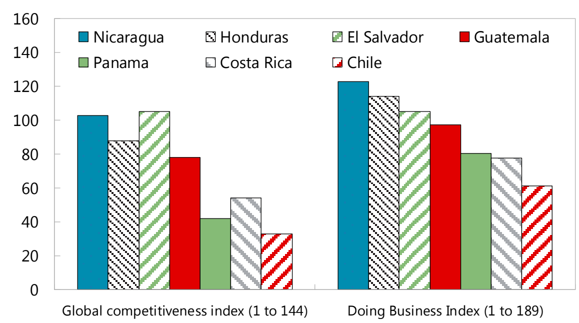
Minimum Wage Across Sectors in 2017
(Monthly Salary, thousands of Cordobas)



Sources: Ministry of Labor of Nicaragua.
Note: Data coverage from March 2017 to December 2017.

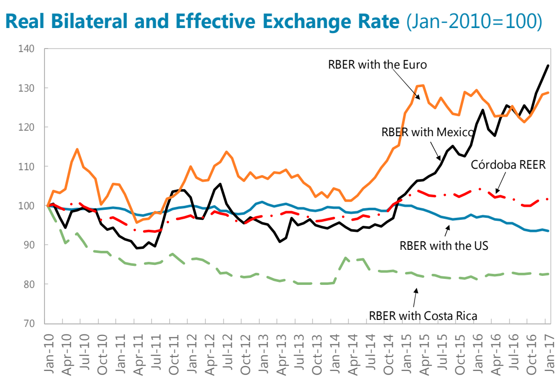
- Competitiveness rankings show mixed results for Nicaragua. While the Doing Business index places Nicaragua behind all other CAPDR countries, a closer look at its sub-indicators suggest that Nicaragua performs better than other Central American peers in enforcing contracts, resolving insolvency and protecting investors. However, Nicaragua lags in dealing with construction permits, getting electricity, registering property, getting credit and paying taxes. These and other deficiencies in the competitiveness framework account for the second worst position of Nicaragua in the global competitiveness index, only above El Salvador, ranking 99th among 148 countries. Nevertheless, Nicaragua remains one of the safest countries in Central American as measured by the security risk index.

Competitiveness rankings

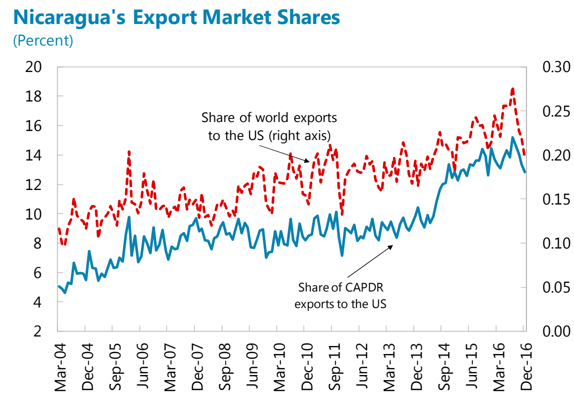


Sources: World Economic Forum Global Competitiveness Report 2014-15; Doing Business Report 2016.

- While the REER appreciated moderately vis-à-vis Mexico since 2015, lower inflation resulted in a depreciating bilateral real exchange rate vis-a-vis US, leaving the REER broadly unchanged. Nicaragua's exports continued to gain market share in the U.S. in terms of total world exports and CAPDR economies.



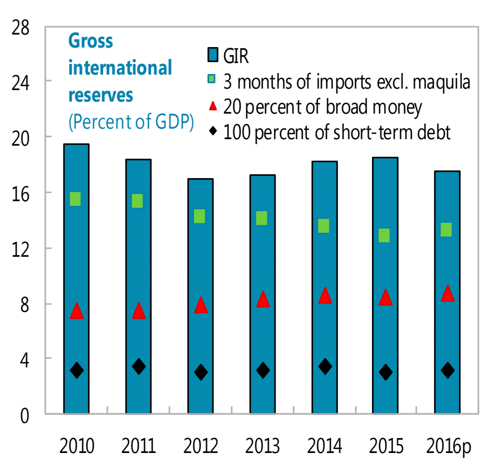
Sources: INS and Fund staff calculations and estimates.

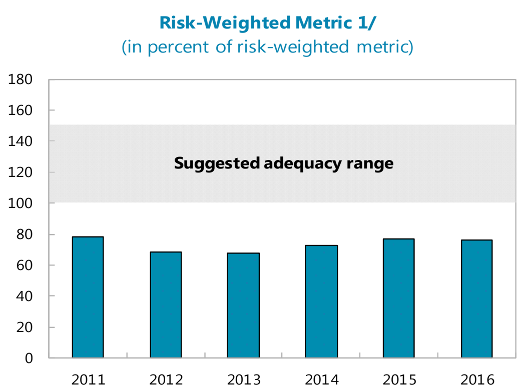


Sources: IMF DOTS and fund staff calculations.

Reserve Adequacy

The reserve coverage is about four months of non-*maquila* imports. Gross international reserves (GIR) remained broadly stable in 2016 at about 17.4 percent of GDP. GIR exceed benchmarks on months of imports excluding *maquila*, percent of broad money, and percent of short-term debt. However, reserves are below the Fund's suggested adequacy metric. Although Nicaragua relies heavily on concessional financing from IFIs and is not fully integrated in the international capital market, given the heightened external uncertainties and the lack of exchange rate flexibility, a stronger reserve position would be desirable.





1/ Defined as 30% of short-term external debt, 20% of other portfolio liabilities, 10% of broad money, and 10% of exports of goods and services.

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

Appendix IV. Risk Assessment Matrix 1/, 2/

Source of risk	Overall level of concern (scale: medium)		
	Relative likelihood	**Impact if realized**	**Policy advice**
Retreat from cross-border integration	**Medium**	**High**. Curb or reverse trade agreements that affect direct and/or indirect trade with major partners would significantly hurt Nicaragua's export, investment, growth and poverty reduction progress. On the other hand, full implementation of CAFTA-DR, while beneficial from a macro perspective, might have severe microeconomic impact on certain subsectors and regions. Remittances and labor market will also be affected.	Measures to improve investment climate, productivity and competitiveness.
Policy and geopolitical uncertainty [3/]	**High**	**High**. The policy uncertainty associated with the major partners may delay investments, affect remittance and labor market, and hurt growth in the short-term.	Measures to improve the investment environment, promote competition, and strengthen the rule of law will be key to promoting a robust and sustainable economic growth.
Significant further strengthening of the US dollar REER and/or higher interest rates	**High**	**Medium.** Persistent dollar strength may impose strain on dollar borrowers that do not generate dollar revenues. Significant strengthening of the U.S. dollar would boost import demand and hurt Nicaragua's competitiveness against other trading partners. Debt sustainability would likely not be significantly affected, given that most public debt is at fixed interest rates.	Prudential measures for non-hedged borrowers shall be strengthened and bank credit to the private sector be monitored closely. Policy measures to maintain macro-financial stability.
Reduced financial services by correspondent banks	**Low**	**Medium.** Loss of correspondent banks would limit the capacity of the banking sector to support economic activities and incur reputational costs.	Strengthen AML/CFT framework.
Weaker-than-expected global growth	**Low/Medium**	**Medium.** Lower-than-expected growth in key trading partners would lower export demand and remittances, in turn reducing activity and tax revenues. It may also delay investments and hurt growth in the short-term.	Measures to improve the investment environment, promote competition, and strengthen the rule of law will be key to promoting a robust and sustainable economic growth.
Lower energy prices	**Low**	**Low**. Low oil prices benefit the economy as external financing needs fall and households and firms have more resources at their disposal.	There is scope for phasing out fuel and electricity subsidies which do not benefit the poorest households and introduce mechanisms that target better the poor.
Further reduction in volume and concessionality of Venezuela cooperation.	**High**	**Medium**. Further deterioration in the financial conditions or levels of Venezuela financing will add pressure to private sector and balance of payment financing and may threaten the continuity of some social programs.	Maintain fiscal discipline to keep the public debt sustainable and to build buffers to face external and fiscal vulnerabilities. Enhance oversight on financial intermediaries depending on Venezuela's financing.

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

2/ To quantify the risks from a change in U.S. policies, staff will also present the results of a stress scenario in the staff report, which will be developed with the assistance of the Research Department. The scenario will estimate the impact on the Nicaraguan economy of potential U.S. spillovers using the FSGM, and then to feed this information into staff's projections of an alternative medium-term macroeconomic framework.

3/ Including the risk of the U.S. congress passing the NICA Act in 2017.

INTERNATIONAL MONETARY FUND

NICARAGUA

June 8, 2017

STAFF REPORT FOR THE 2017 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By | Western Hemisphere Department

CONTENTS

FUND RELATIONS

(As of March 31, 2017)

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

General Resources Account:	**SDR Million**	**%Quota**
Quota	260.00	100.00
Fund holdings of currency (Exchange Rate)	227.51	87.5
Reserve Tranche Position	32.5	12.5

SDR Department:	**SDR Million**	**%Allocation**
Net cumulative allocation	124.54	100.00
Holdings	76.97	61.80

Outstanding Purchases and Loans:	**SDR Million**	**%Quota**
ECF Arrangements	42.97	16.53

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

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

	Forthcoming				
	2017	2018	2019	2020	2021
Principal	13.76	13.22	9.54	4.78	1.67
Charges/Interest	0.14	0.20	0.20	0.20	0.20
Total	13.90	13.42	9.74	4.98	1.86

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

[1] Formerly PRGF.

[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

system. Since December 2004, the monthly crawl has been set at an annual rate of 5 percent. As of April 30, 2017, the official exchange rate was C$29.7989 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 January 28, 2016 (Country Report No. 16/34).

Safeguards Assessment:

An updated safeguards assessment of the Central Bank of Nicaragua (CBN), was completed in January 2009. The assessment noted continued progress at the CBN in the areas of International Financial Reporting Standards (IFRS) implementation and reserve management operations. Timely publication of the audited financial statements is in place in accordance with the Safeguards Policy. The 2015 financial statements were audited and published on the CBN's website, however, the external audit opinion continues to be qualified due to the uncertainty surrounding the valuation of government debt. Further, implementation of IFRS remains in progress.

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 April 2015.

Dept.	Purpose	Time of Delivery
	Fiscal	
CAPTAC	Improving Auditing Processes	January 2017
CAPTAC	Adjust and Monitor the Strategic Plan for Tax Administration	2016-2017
CAPTAC	Public Financial Management	2016-2017
CAPTAC	Tax Administration	2016
CAPTAC	Customs Administration, Business Process Management	2016
CAPTAC	Fiscal Risks and Financial Programming	2016
FAD	General diagnostic and revenue mobilization	2016
FAD	Diagnostic mission on tax administration and customs administrations	2016
CAPTAC	Treasury Single Account	2015
FAD	Government Accounting and Financial Statistics	2015
	Monetary and Financial sector	
CAPTAC	Liquidity risk supervision	On-going
CAPTAC	Strengthening the Monetary Policy Operational Framework	On-going
CAPTAC	Strengthening the Systemic Risk Monitoring Framework	March 2017
CAPTAC	Credit risk supervision	2015-2017
CAPTAC	Credit scoring model	2016-2017
CAPTAC	Credit risk Stress Testing	2016
CAPTAC	Regional Macroprudential Policies	2015-2016
CAPTAC	IT risk supervision	2016
CAPTAC	Strengthening of the Central Bank's capacity for economic analysis and forecasting	2015-2016
CAPTAC	Stress Testing	2015
CAPTAC	Regulation and Supervision of Operational Risk	2015
CAPTAC	Market Risk Monitoring	2015
CAPTAC	Macroeconomic policy analysis and development of models and projection	2015
MCM	Deposit Insurance System	2015
MCM	International Arrangements and Domestic Debt Market Development	2015
	Statistics	
CAPTAC	Export and Import Price Index (XMPI)	On-going
CAPTAC	Survey of margins	On-going
CAPTAC	Annual National Accounts rebasing process	February 2017
CAPTAC	Balance of Payments Statistics	2015-2017
CAPTAC	Financial Account and Cash Flow	2016
CAPTAC	National Accounts Statistics	2015
CAPTAC	Government Finance Statistics	2015-2016
CAPTAC	External Sector Statistics	
STA	Financial Soundness Indicators	2015
STA	Government Finance Statistics	2015

BANK-FUND COUNTRY LEVEL JOINT MANAGERIAL ACTION PLAN, 2017

A. Mutual information on relevant work programs
The Fund work program
Strategy: Since the last IMF-supported program ended in October 2011, the focus has shifted to a relationship based on bilateral surveillance and technical assistance. The Resident Representative office closed in 2016, but close engagement between Fund staff and the authorities continues through regular videoconferences. TA has been extensive, and has been focused on a range of different topics, including statistics, tax policy, tax administration, public financial management, and financial supervision. The last IMF staff visit was in November/December 2016 and the last Article IV mission took place in April/May 2017.
The World Bank work program
Strategy: The Bank's ongoing operations and analytical activities with Nicaragua are contemplated under the Country Assistance Strategy (CAS) 2013-2017 with a focus on social welfare through improvement of people's access to basic services and a heightened concern on issues of productivity, competitiveness, and export diversification. Additionally, the IFC's strategy focuses on fostering sustainable economic growth, critical infrastructure, and job creation, and helping Nicaragua take advantage of regional integration opportunities. The Bank is working on the first Systematic Country Diagnostic (SCD), expected to be ready by June 2017. The SCD aims to identify the most important challenges and opportunities at the country level to make progress towards the twin goals on a sustainable manner, and will inform the partnership with Nicaragua as established in the new approach to country engagement—the Country Partnership Framework (CPF). The CPF takes the place of the CAS and guides the Bank Group's support to a member country.

NICARAGUA

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

Project Name	Total loan or grant	Undisbursed through FY17	Projected disbursements in FY18
Second support to the education sector	30.0	6.0	6.0
Education sector strategy support	48.02	6.35	6.35
Climate adaptation and water (GEF)	6.0	2.82	2.82
Caribbean coast food security	33.90	26.54	8.00
Public financial management modernization	35.0	16.75	16.75
Strengthening the public health care system	60.0	44.46	21.00
Social protection	19.5	1.00	0
Second land administration project	36.00	7.04	7.04
Rural roads infrastructure improvement project	92.0	4.62	4.62
Sustainable rural water supply and sanitation sector	30.0	24.36	6.4

A. Technical assistance and analytical work		
B.1. Constraints and Opportunities Analysis: Transformation of the Agricultural Sector		September 2015
B.2. Regional Social Expenditure and Institutional Review		May 2016
B.3. Regional Enhancing Disaster Risk Management		June 2016
B.4. Water Services and Sanitation Reform		June 2017
B.5. Regional Central America Energy Assessment		June 2018
B.6. Regional Trade Facilitation		April 2017
B.7. Regional PPP		June 2019
B.8. 2016 – 2021 Education Sector Strategy Preparation		June 2019

RELATIONS WITH THE INTER-AMERICAN DEVELOPMENT BANK

(As of March 31, 2017)

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

2. **As of March, 31st 2017, the portfolio of approved sovereign-guaranteed loans under execution amounted to US$983.5 million, with an undisbursed balance of US$674 million.**

3. **The existing sovereign guaranteed portfolio focuses on:** (i) transport, 34 percent; (ii) energy, 20.7 percent; (iii) health, 18.6 percent; and (iv) value chains, 18.3 percent. In the private sector, the IADB has an exposure of US$97.7 million in operations focused on financial services; energy; agro-industry & manufacture; SMEs; and non-financial services (tourism and low income housing).

4. **The pipeline for IADB approvals in 2017 includes three operations in the public sector for US$197.5 million** distributed as follows: (i) a Policy-Based Loan for US$65 million to improve productivity in Nicaragua through strengthen financial regulations, improving access to financing, and enhancing the business climate and competition; (ii) US$87,5 million to improve basic human needs services for the rural population of the Dry Corridor, focusing on integrated health services, water and sanitation, road access and rural electrification; and (iii) a Water and Sanitation program of US$45 million to improve the living conditions of poor vulnerable populations in urban and peri-urban areas by increasing the coverage of sewage services in an efficient and sustainable manner, and improving the management of water and sanitation services. As of March 31, the Policy-Based Loan of US$65 million has been approved, and the rest of the pipeline will be approved later in the year.

IADB Sovereign Guaranteed Loan Portfolio in Nicaragua

As of March, 31, 2017 (In millions of US Dollars)

Sector	Current Approved	Available Amount
Transport	330.7	229.2
Health	221.2	125.2
Energy	191.6	139.8
Science and Technology	50	48.9
Value Chains and Financial Markets	85.0	74.6
Trade	55.0	46.6
Agriculture and Rural Development	40.0	6.8
Modernization of the State	10.0	2.9
Total	**983.5**	**674**

IDBG Non-sovereign Guaranteed Loan Portfolio in Nicaragua As of February, 28 2017 (In millions of US Dollars)		
Sector	**Current Approved**	**Exposure**
Financial services	32.5	26.2
Energy	9.5	23.9
Agro-industry & Manufacture	42.1	10.9
SMEs	40	33.3
Non-financial services	20	3.4
Total	**144.1**	**97.7**

IADB Disbursement of Sovereign Guaranteed Loan Portfolio in Nicaragua 2012–16 (In millions of US Dollars)	
Year	**Amount**
2012	168.3
2013	154.7
2014	169.7
2015	207.2
2016	151.9

IADB Annual Net Flows with Sovereign Guarantee 2012–16 (In millions of US Dollars)					
	2012	**2013**	**2014**	**2015**	**2016**
Repayments	15.8	17.2	19.6	24.4	30.6
Disbursement	168.3	154.7	169.7	207.2	151.9
Net Loan Flow	**152.5**	**137.5**	**150.1**	**182.8**	**121.3**
Subscriptions and Contributions	6.1	6.1	6.7	1.7	1.7
Net Capital Flow	**146.4**	**131.4**	**143.4**	**181.1**	**119.6**
Interest and Charges	16.1	20.1	23.1	26.3	33.8
Net Cash Flow	**130.3**	**111.3**	**120.3**	**154.8**	**85.8**

STATISTICAL ISSUES

(As of March 31, 2017)

Assessment of Data Adequacy for Surveillance
General. Data provision is broadly adequate for surveillance but there are numerous data shortcomings in national accounts, fiscal, debt, and external sector statistics.
National Accounts. The Central Bank of Nicaragua (CBN) changed the base year of the annual national accounts (NA) to 2006. As part of this dataset the complete set of integrated economic accounts by institutional sector for 2005-06 are disseminated, in accordance with the recommendations of the System of National Accounts 1993 (1993 SNA), and the classifications and most relevant recommendations of the 2008 SNA for which source data are available. In March 2017, while releasing the 2016 NA data, the CBN had revised earlier years, specifically the 2010–13 data comprising number of refinements (i.e., update of trade and producer price indexes, use of a new employment matrix, revised agricultural production, and, in particular, addressed discrepancies between NA and the balance of payments (BOP) trade data in the tax-free zones). **Price and Labor Statistics**. The consumer price index (CPI) uses expenditure weights derived from a 2006/07 household expenditure survey. The CPI covers Managua and eight other cities and is published monthly. Expenditures (weights) and prices in rural areas are excluded. The producer price index (PPI) (July 2006=100) covers a sample of small and medium-size establishments, as well as goods for processing establishments in the *maquila* sector. There is also scope for expanding the coverage of the PPI to the service sector. Labor market statistics are scarce and unemployment figures are available irregularly during the year.
Government Finance Statistics (GFS). Institutional coverage is not in line with international standards, given that extra-budgetary institutions such as public universities and 152 of 153 municipalities, Managua municipality being the exception, are not included in the accounts of the consolidated public sector. Recording of transactions is mostly on a cash basis but there are inconsistencies; for example, checks are recorded at the moment of issuance rather than when the check is cashed. The Ministry of Finance and Public Credit (MHCP) compiles fiscal statistics with a monthly frequency, and remits these to the CBN for publication on their website and for inclusion into the CBN’s quarterly reports on public finances. Typically, these statistics are published with about a 5-week lag. Separately the MHCP produces its own quarterly report on the execution of the budget. Annual financial statements of public enterprises are produced, but are not audited externally or published. Data on the budgetary central government and social security institute are reported for publication in the GFS Yearbook, although with a delay.
The monitoring of fiscal performance from the financing side needs significant improvement, and is complicated by some idiosyncrasies in classifying expenditure items in the budgetary central

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

Nicaragua: Table of Common Indicators Required for Surveillance

(As of April 30, 2017)

	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	4/28/2017	4/28/2017	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	4/27/2017	4/28/2017	D	D	D		
Reserve/Base Money	04/27/2017	4/28/2017	D	D	D		
Broad Money	04/27/2017	4/28/2017	D	D	D	O, LO, LO, LO	LO, O, LO, LO, LO
Central Bank Balance Sheet	02/28/2017	4/26/2017	M	M	M		
Consolidated Balance Sheet of the Banking System	03/31/2017	4/26/2017	M	M	M		
Interest Rates[2]	4/30/2017	4/30/2017	D	D	D		
Consumer Price Index	March 2017	4/7/2017	M	M	M	O, LO, LO, LO	LO, LO, LO, O, LO
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	Dec. 2016	3/8/2017	M	M	M	LO, LNO, LNO, LO	LO, LO, LO, LO
Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government	Dec. 2016	3/8/2017	M	M	M		O, O, O, O, O
Stocks of Central Government and Central Government-Guaranteed Debt[5]	Q1 2017?	3/3/2017	Q	Q	Q		
External Current Account Balance	Q4 2016	4/7/2017	Q	Q	Q	LO, LO, LO, LNO	LO, LO, LO, LO, LNO

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

(As of April 30, 2017)

Exports and Imports of Goods and Services	Q4 2016	4/7/2017	Q	Q	Q	LO, LO, LO, LNO	LO, LO, LO, LO, LNO
GDP/GNP	Q4 2016	4/7/2017	Q	Q	Q	O, O, O, LO	LO, O, LO, O, LNO
Gross External Debt	Q4 2016	4/7/2017	M	M	M		
International Investment Position[6]	Q4 2016	4/7/2017	Q	Q	Q		

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

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

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

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

[5] Including currency and maturity composition.

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

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

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

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

INTERNATIONAL MONETARY FUND

NICARAGUA

June 8, 2017

STAFF REPORT FOR THE 2017 ARTICLE IV CONSULTATION—DEBT SUSTAINABILITY ANALYSIS

Approved By
Krishna Srinivasan and Zeine Zeidane (IMF), and Paloma Anos-Casero (IDA)

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

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

This debt sustainability analysis (DSA) indicates that Nicaragua's risk of external debt distress remains moderate. Real GDP growth projections for the forecast horizon have been revised upward, based on improvements in infrastructure, and financing on relatively concessional terms is expected to continue. Nevertheless, external risks have also increased, which argues against a low risk rating.[1] Notably the risks arising from the unwinding of the Venezuela cooperation, as well as the potential passage of the NICA Act[2], drive staff's assessment that Nicaragua remains at a moderate risk of external debt distress. Moreover, the external public risk rating continues to be augmented by risks stemming from domestic public debt and external private debt. The former is related to the financial problems of the social security institute (INSS) which, in the absence of policy action, is expected to run increasingly larger deficits due to demographic dynamics. External private debt risks result from debt with Venezuela, which has financed some government social programs and public infrastructure, among other investments. The DSA, therefore, underscores the need for Nicaragua to continue to borrow as much as possible on concessional terms, to implement comprehensive social security reforms, and to strengthen fiscal and external buffers. The authorities should also increase oversight of private debt, remain vigilant with respect to the risks posed by the unwinding of the oil collaboration with Venezuela, and should try to advance as much as possible on negotiations for relief of outstanding debt.

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[1] The World Bank's Country Policy and Institutions Assessment (CPIA) ranks Nicaragua as a medium performer in terms of the quality of policy and institutions (the average CPIA in 2013–15 is 3.73). Thus, the external debt burden thresholds for Nicaragua are (i) PV of debt-to-GDP ratio: 40 percent; (ii) PV of debt-to-exports ratio: 150 percent; (iii) PV of debt-to-revenue ratio: 250 percent; (iv) debt service-to-exports ratio: 20 percent: and (v) debt service-to-revenue ratio: 20 percent.

[2] The Nicaragua Investment Conditionality Act (NICA) Act is a bill currently being considered by the U.S. Congress which would require U.S. Executive Directors to oppose loans to Nicaragua from IFIs unless the Nicaraguan government takes concrete steps to hold free, fair and transparent elections. See the text of the bill H.R. 1918.

BACKGROUND

1. **Nicaragua's debt statistics are reported at the consolidated public sector (CPS) level.** This DSA therefore covers the consolidated debt of the budgetary central government, decentralized entities, the state-owned enterprises, and the central bank.[3] Consistent with the 2013 DSA and the 2015 DSA, we assume that relief has been obtained on HIPC terms for all eligible debt where negotiations are still pending.[4]

2. **There is a large stock of debt to non-Paris Club creditors which is still pending debt relief under the HIPC Initiative.** This debt amounts to about US$1 billion, with total relief expected to be in the range of US$700 million. Most of this debt is on the books of the Central Bank of Nicaragua, and two official creditors account for the bulk of this debt. Although agreements exist between the central bank and these two creditors at a technical level, progress at the political level has been a stumbling block in both cases and discussions have been put on hold for some time. The Nicaraguan authorities expect to resume negotiations in the forthcoming year. This debt is not currently being serviced.

3. **Public and publicly guaranteed (PPG) external debt stands at 32 percent of GDP and is mostly owed to multilateral creditors.** About 76 percent of external debt is held by multilaterals, with the largest being the Inter-American Development Bank (IaDB), accounting for 38 percent of outstanding external PPG debt, followed by the Central American Bank for Economic Integration (CABEI) at 14 percent. Nicaragua is eligible for blended loans from both the IaDB and CABEI. In the IaDB's case, 40 percent of new funding is on a highly concessional basis and 60 percent carries a low but market-linked adjustable rate. Until 2015, Nicaragua was subject to a concessionality requirement by the World Bank as an IDA-only country and contracted loans had a grant element of at least 35 percent; however, since 2015 it has been an IDA-gap country and this requirement no longer applies. About 72 percent of PPG external debt outstanding is at fixed rates.

	2013	2014	2015	2016
External debt in USD				
Official multilateral 1/	2,502	2,703	2,954	3,165
Official bilateral	1,014	1,002	982	994
Commercial	7	5	4	10
TOTAL	3,522	3,711	3,940	4,169
External debt in % of GDP				
Official multilateral	23	23	24	25
Official bilateral	9	9	8	8
Commercial	0	0	0	0
TOTAL	33	32	32	32
Share of total external debt				
Official multilateral	71	73	75	76
Official bilateral	29	27	25	24
Commercial	0	0	0	0

1/ Does not include SDR allocations
Source: Central Bank of Nicaragua and staff calculations

[3] The authorities are in the process of compiling official domestic debt of state-owned enterprises and municipalities, which was previously not included in the otherwise comprehensive institutional coverage of the public sector, a development which staff welcomes. For the 2017 DSA, the authorities have made available preliminary data on the domestic debt of SOEs and municipalities as of end-2016, which has been included in staff's estimate of the debt of the consolidated public sector.

[4] All discussions in this note refer to this definition of public debt. Thus, there are differences with official statistics, which include debt pending HIPC relief.

4. Public domestic debt is about 10 percent of GDP. Of this, 28 percent is comprised of *Bonos de la República de Nicaragua* (BRNs), which are government bonds with an original maturity of 3–7 years. Another 24 percent is *Bonos Para la Indemnización* (BPIs), issued as compensation to those who lost property in the expropriations of the 1980s. BPIs are not used for funding purposes, and their issuance has declined substantially in recent years as most claims have been resolved. The total stock of BPIs has declined from US$975 million at end-2006 to US$312 million at end-2016.[5] A further 11 percent consists of *Bonos Bancarios* (banking bonds), which were issued to banks during the banking crisis of the early 2000s and here again the outstanding stock is gradually declining. About 29 percent represents the domestic debt of SOEs and municipalities, mainly to the banking sector and institutions associated with the cooperation with Venezuela, such as CARUNA, Bancorp and ALBANISA. The remainder are outstanding central bank securities used by the central bank for open market operations. Of these domestic debt instruments, most are dollar-denominated or dollar indexed, except for a portion of the banking bonds. A recent joint technical assistance mission from the Bank, Fund and CEMLA to promote the development of the domestic debt market, identified market segmentation as an issue which needs to be addressed going forward. This is due to the existence of several debt instruments coupled with a small investor base. The mission made recommendations on ways to increase liquidity in this market, including by issuing BRNs with shorter maturities.

	2013	2014	2015	2016
Domestic debt in USD				
BRNs 1/	62	111	179	348
BPI/CBPI 1/	456	407	355	301
Banking bonds	164	157	149	139
BCN securities	163	132	128	90
SOE & municipalities 2/	166	146	340	356
TOTAL	1,012	955	1,151	1,233
Domestic debt as a % of GDP				
BRNs	1	1	1	3
BPI/CBPI	4	4	3	2
Banking bonds	2	1	1	1
BCN securities	2	1	1	1
SOE & municipalities	2	1	3	3
TOTAL	9	8	9	10
Share of total domestic debt				
BRNs	6	12	16	28
BPI/CBPI	45	43	31	24
Banking bonds	16	16	13	11
BCN securities	16	14	11	7
SOE & municipalities	16	15	30	29

1/ Consolidates out bonds held by the reserve fund of INSS
2/ Pre-2016 data represents staff estimates. End-2016 data is preliminary.
Sources: National authorities and staff calculations

5. Fiscal risks arise from several sources. Nicaragua is vulnerable to the impact of climate change and disasters such as earthquakes and floods, which can have considerable fiscal impacts (see Selected Issues Paper). The authorities are in the process of broadening the scope of debt statistics by compiling data on domestic debt of municipalities and SOEs. Preliminary data was provided to staff and is incorporated in this analysis. The financial sector is sound and well-supervised, although there are gaps in the supervisory perimeter. Box 3 of the Staff Report highlights the main fiscal risks for Nicaragua and stresses areas where data and analysis could be improved.

6. Private external debt has increased in recent years due to the oil cooperation with Venezuela, but is on a declining trend. Private external debt rose by about 8 percentage points of GDP between 2010 and 2013, when the flows from Venezuela were at their peak. Since 2013, it has been declining gradually, and stood at 45 percent of GDP at end-2016.

[5] Includes the BPIs held by INSS, which are consolidated out of total debt at the CPS level.

UNDERLYING ASSUMPTIONS

7. **The macroeconomic framework underlying the DSA assumes a continuation of the current relatively favorable macroeconomic conditions.** Real GDP growth is assumed to converge to its potential level of 4.5 percent from 2019 onwards. Staff has revised up its estimate of potential GDP growth from 4 percent in the 2013 and 2015 DSAs (Box 1 of the Staff Report), grounded in revised quantitative estimates and considering the significant investments in infrastructure over the past decade. Inflation should continue to be anchored by the crawling peg exchange rate regime, with the GDP deflator in dollar terms broadly reflecting U.S. inflation.

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

- The non-interest current account deficit will remain between 6½ and 8 percent of GDP, slightly higher than the 2015 DSA assumptions. This is due in part to the higher growth rate and propensity to import, which is only partially compensated by a marginally lower oil price forecast.[6] Remittances will decline slightly as a percentage of GDP from 9½ percent to 9 percent over the medium term because of slightly lower comparative average GDP growth in source countries.

- FDI inflows will moderate somewhat from their 10-year historical average of 6½ percent of GDP as investment in the telecommunications and energy sectors slows.

- External borrowing by the public sector will remain at 3.9 percent of GDP annually over the medium term, and will continue to be sourced mainly from multilateral creditors, although with declining concessionality.

- The 2016 revision of the terms of the Venezuela cooperation has resulted in a shift in the assumptions on the flows from Venezuela. Concessional financing flows are assumed to continue but at a level of about 0.3 percent of GDP annually. This is substantially lower than in the 2015 DSA which assumed a gradual decline in financing from 2.3 percent in 2017 to 0.9 percent in 2037. The resulting net outflows to Venezuela are expected to gradually decline from around 1 percent of GDP in 2017 to 0.1 percent of GDP by 2037.

9. **The baseline scenario for the public debt DSA assumes:**

- A steadily rising primary deficit beyond 2019. This is driven by an assumption that public investment will remain at current levels and that pensions and healthcare spending of the social security institute will continue to grow in percentage of GDP terms, due to demographic factors.

- The liquid assets of the INSS reserve fund are projected to be depleted by 2019 and it is assumed that transfers from the budget are required to finance its deficits up until 2037. The

[6] The 2006-16 external sector statistics series were extensively revised in 2017. Therefore, the 2015 DSA baseline is not directly comparable with the 2017 DSA baseline.

difference between the CPS primary balance, revenue, and expenditure projections from the 2015 DSA is mainly due to refinements in the projection methodology and less optimistic assumptions on the expansion of INSS's active coverage, defined as INSS contributors as a percentage of the labor force. External grants have also been revised downwards relative to the 2015 DSA, and are projected to stabilize at 0.6 percent of GDP.

- The real interest rate on public debt declines initially due to higher inflation, declining domestic debt, and a favorable external financing profile, but then begins to rise because of increased domestic bond issuance and a reduced grant element from external financing sources. Domestic debt issuance is the residual and no further issuance of BPIs is assumed.

Key Macroeconomic Assumptions Underlying the DSA for the Baseline Scenario

	Current DSA				2015 DSA				Historical averages
	2016	2017 (p)	2017-2022	2023-2037	2016 (p)	2017 (p)	2015-2020	2021-2035	2010-2016
Real GDP growth (in percent)	4.7	4.5	4.5	4.5	4.2	4.0	4.0	4.0	5.2
GDP deflator in US$ terms (in percent)	-0.9	0.8	1.9	2.1	1.1	1.8	1.3	2.1	1.6
Non-interest current account (in percent of GDP)	-6.8	-6.9	-7.0	-7.3	-6.6	-7.1	-6.8	-6.9	-8.0
Net FDI (in percent of GDP)	6.5	6.3	6.2	6.1	6.2	6.1	6.0	5.8	6.8
Primary balance (in percent of GDP)	-1.2	-1.1	-1.2	-2.3	-1.4	-1.6	-1.4	-1.4	-0.3
Revenue and grants (in percent of GDP)	28.8	28.8	28.6	28.2	29.4	29.3	29.4	30.3	27.3
Primary expenditure (in percent of GDP)	30.1	29.9	29.8	30.5	30.7	30.8	30.8	31.7	27.5
Ave. real int. rate on public debt (FX-denominated)	1.8	1.6	0.4	1.9	1.5	1.1	1.3	2.3	1.3

EXTERNAL DEBT SUSTAINABILITY

10. The evolution of external debt in the baseline scenario is relatively benign. PPG external debt is expected to increase slightly over the projection period in percent of GDP terms (Table 1 and Figure 1). The present value of PPG external debt will rise from 21 percent to 28 percent of GDP, but will remain well under the threshold of 40 percent. A similar trend—a slight increase but still under the threshold—can be observed for other solvency and liquidity indicators (Figure 1). At the same time, private external debt is projected to decline as the debt owed to Venezuela is paid down.

11. Two of the standardized stress scenarios exhibit a small breach of the thresholds for external PPG debt (Table 2 and Figure 1). This includes the shock of a one-time nominal depreciation of 30 percent in 2018. Under the probability approach, however, the probability of debt distress is lower than the threshold value, so this breach is not considered in formulating the external risk rating.[7] Additionally, given the crawling peg exchange rate regime, staff considers such a depreciation to be unlikely. The terms (interest rate) shock of 2 percentage points also results in a breach towards the end of the projection

[7] The key difference between the traditional approach and the probability approach is that it incorporates a country's individual CPIA score and average GDP growth rate, whereas the traditional approach uses one of three discrete CPIA values (see 2013 Staff Guidance Note on the Application of the Joint Bank-Fund Debt Sustainability Framework for Low-Income Countries).

period. This is a more likely shock, given the possible passage of the NICA Act and the country's eventual accessing of international financial markets.

12. Private external debt appears to have peaked but risks remain. A significant decline in the inflows from Venezuela implies that from 2017 onwards, there will be net outflows as debt service is higher than new loans. Debt service depends on the capacity of ALBANISA's assets to generate sufficient returns and maintain a low level of losses. Reportedly, the average return on assets during the operation of the oil cooperation with Venezuela has been 7.5 percent, close to the target return of investments of 8 percent, which would indicate a low level of losses. However, neither ALBANISA's nor CARUNA's assets are subject to supervision and externally audited accounts are not published. Thus, the quality of their investment portfolio is unknown.[8]

13. The ALBANISA contingent liability scenario no longer breaches any of the thresholds. As in the 2013 and 2015 DSAs, a customized scenario has been included which assumes a one-time absorption of the private debt to Venezuela at end-2017, amounting to 22 percent of 2017 GDP, or US$3.2 billion. In present value terms, however, the increase in external debt is less significant (from 20 percent of GDP in 2017 to 35 percent of GDP in 2018), due to the concessional terms. Unlike in the 2013 and 2015 DSAs, this scenario no longer breaches the threshold of PV debt-to-GDP, due primarily to a slightly lower stock amount in GDP terms and the upward revisions to GDP growth for the forecast horizon.

14. The adverse scenario presented in the staff report, which simulates the combined impact of a complete halt of flows from Venezuela and the passage of the NICA Act, is included as an additional customized scenario.[9] The Venezuela shock represents the continuation of a declining trend in the cooperation. The assumption is that this results in an additional 0.6 percent of GDP in expenditure as social projects are absorbed by the budget, as well as a reduction in private capital flows beginning in 2017. There is, however, more uncertainty around the impact of the NICA Act. It is not clear yet whether the bill will pass into law, and its potential impact on investment and the availability of concessional resources. Staff's assumptions include a one-time 25 percent reduction in both FDI and domestic investment in 2018 relative to baseline levels, and a reduction by 50 percent of financing from the IaDB and World Bank from 2018 onwards, which is replaced by other external (but less concessional) and domestic sources. At the same time, FDI and loan financing from Venezuela is assumed to come to a complete stop by 2018. The combined impact on FDI is a drop of 1 percentage point of GDP in 2017 due to the Venezuela shock, plus a further 2 percentage points in 2018 (0.4 attributable to Venezuela and 1.6 to the NICA Act) The shocks lead to a gradual increase in the average interest rate on external debt over the baseline.[10] Growth falls from 4.5 percent over the medium term in the baseline to 2.9 percent in 2018, the effective interest rate averages

[8] The obligations are from ALBANISA, a limited liability entity jointly owned by PDVSA (51 percent of capital) and the state-owned oil company, PETRONIC (49 percent of capital). CARUNA, a savings and loans cooperative, acts as the financial agent of ALBANISA for the oil cooperation agreement flows. The authorities have informed staff that the credit risk on the oil collaboration debt is borne exclusively by PDVSA.

[9] The model and assumptions are explained in the Technical Note on Macroeconomic Scenarios in the Selected Issues Paper.

[10] Staff acknowledges that these assumptions are relatively conservative, but considers that they have a realistic probability of materializing, particularly given the importance of FDI from the U.S. in total FDI.

3.7 percent over the medium term, and FDI declines to an average of about 4 percent of GDP. Following the shock, the economy gradually returns to the baseline steady state by 2027.

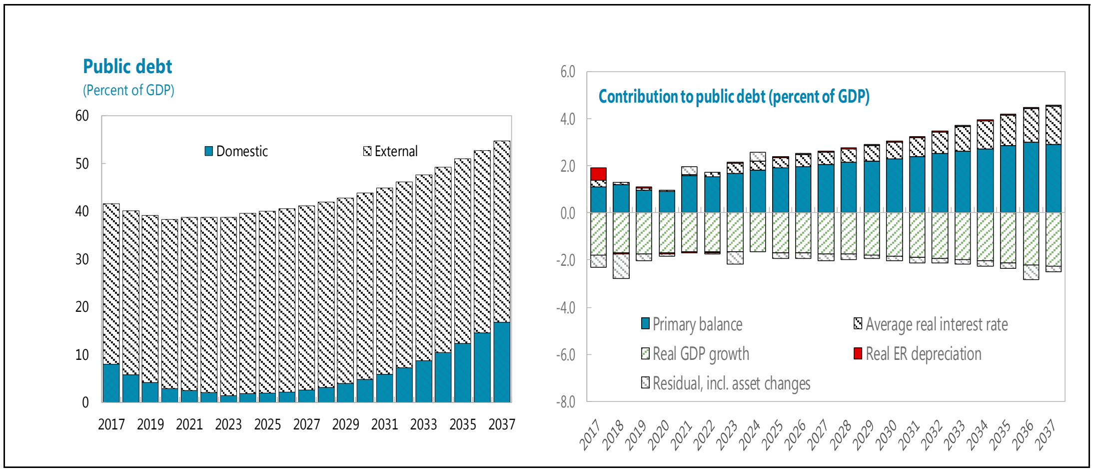
15. The adverse scenario breaches the threshold for PV of external PPG debt-to-GDP. Projections for the adverse scenario show a breach of the threshold by 2022. It also briefly breaches the PV of the debt-to-exports ratio. This result, together with the terms (interest rate) shock, drives staff's assessment that Nicaragua remains at moderate risk of external debt distress.

Key Assumptions for Adverse Scenario: NICA Act/Venezuela

	Current 2017-2027	Adverse 2017-2027
Real GDP growth (in percent)	4.5	4.0
GDP deflator in US$ terms (in percent)	2.0	2.0
Non-interest current account (in percent of GDP)	-7.0	-7.5
FDI (in percent of GDP)	6.1	4.5
Remittances (in percent of GDP)	9.0	9.2
Average effective interest rate (percent)	2.6	3.5

PUBLIC DEBT SUSTAINABILITY

16. In the baseline scenario, public debt is projected to increase to 55 percent of GDP by 2037 (Table 3 and Figure 2). External public debt remains largely stable over the forecast horizon. Domestic public debt is projected to decline initially in percentage of GDP terms as legacy debt is paid down, and then to rise again due to the issuance of new debt to cover pension and healthcare obligations of INSS. The baseline scenario does not breach the PV public debt benchmark of 56 percent of GDP. The chart below shows the contribution of various elements to the increase in debt—the rising primary balance plays the major role, but the increasing average real interest rate also contributes. This is due to an increasing shift to domestic debt, which has a market-determined rate of interest, as well as a gradual decline in access to the most concessional resources of the multilateral development banks.



17. The standardized shock scenarios demonstrate the sensitivity of public debt to growth shocks (Table 4 and Figure 2). The shock scenario which has the most adverse impact by 2027 is a shock to real GDP growth in 2017-2018, where real GDP growth falls to 1.4 percent in these two years (Table 4), demonstrating the impact that just two years of slow growth could have on debt ratios in the medium term. Long run GDP growth at 3.8 percent, one standard deviation below the historical average, instead of 4.5 percent has the most negative impact beyond 2027. A primary balance fixed at current levels, however, would lead to a scenario which is more favorable than the baseline, while the historical scenario, with a lower primary deficit, would result in a decline in public debt. The difference between the baseline and the primary balance scenario illustrates the potential impact of INSS on public debt.

18. The two customized scenarios described in the discussion of external debt sustainability are also applied to the public DSA. A one-off absorption of ALBANISA's debt to Venezuela would increase the public debt-to-GDP ratio from 42 percent in 2017 to 63 percent in 2018, and would breach the PV public debt benchmark by 2035. The adverse scenario, including the impact of the NICA Act and a sudden stop of Venezuela inflows, would exceed the public debt benchmark by 2031.

CONCLUSIONS

19. The staff considers that Nicaragua remains at a moderate risk of external debt distress. Under the baseline projection external debt in PV terms increases only slightly over the projection horizon. The concessional nature of most of Nicaragua's external debt, prudent macroeconomic management, and a continuation of relatively strong FDI inflows and real GDP growth, imply a debt dynamic which is sustainable over the medium term. Nicaragua also appears relatively resilient in some of the standardized shock scenarios. However, the unwinding of the Venezuela cooperation also continues to pose a risk, and the magnitude of negative spillovers from events such as the potential passage of the NICA Act are unknown. These risks may not be fully captured by the standardized shock scenarios. Given the heightened uncertainty at the current juncture, staff believes that it would not be appropriate to change the risk rating.

20. Public debt dynamics show an upward trend in the baseline scenario. In the absence of reform to the social security system, the INSS will run increasing deficits over the next 20 years, which are projected to be financed through issuance of domestic debt. The baseline scenario for the public DSA therefore points to a worsening outlook for public debt over the medium term unless action is taken to improve the finances of INSS. Several shock scenarios also cross the public debt benchmark, including the two customized scenarios.

21. The authorities questioned aspects of staff's analysis. The authorities consider the assumption of no action on INSS in the baseline scenario to be unrealistic, and note that continued financing of INSS deficits from the budget would not be feasible. Their own baseline scenario therefore has lower primary deficits and shows a decline in the public debt to GDP ratio, as the legacy domestic debt is paid down while external debt remains relatively stable. The authorities also project potential growth at 5 percent to GDP, compared to staff's 4.5 percent. They consider that the impact on investment of the NICA Act is overstated in the adverse scenario, even if the bill were to be passed. Furthermore, they argue that the Venezuela cooperation has already declined significantly and that fiscal and external balances have not been significantly affected. Finally, they reiterated that there is no intention for the government to absorb any of ALBANISA's debt to Venezuela, and that the return on ALBANISA's assets is sufficient to be able to service this debt, even with no additional inflows.

Table 1. Nicaragua: External Debt Sustainability Framework — Baseline Scenario. 2014–37 1/

(In percent of GDP, unless otherwise indicated)

	Actual			Historical Average 6/	Standard Deviation 6/	Projections													
	2014	2015	2016			2017	2018	2019	2020	2021	2022	2017-2022 Average	2023	2024	2025	2026	2027	2037	2023-2037 Average
External debt (nominal) 1/	**76.7**	**76.5**	**77.2**			**76.1**	**74.2**	**72.5**	**70.7**	**69.2**	**67.6**		**66.2**	**64.9**	**63.6**	**62.3**	**61.0**	**50.4**	
of which: public and publicly guaranteed (PPG)	32.0	31.7	32.4			33.5	34.2	34.9	35.4	36.0	36.5		37.1	37.6	38.0	38.2	38.4	37.9	
Change in external debt	-1.3	-0.2	0.6			-1.1	-1.9	-1.7	-1.8	-1.5	-1.6		-1.4	-1.3	-1.3	-1.3	-1.3	-0.8	
Identified net debt-creating flows	-5.4	-3.3	-0.7			-1.1	-0.9	-0.9	-0.9	-0.4	-0.2		-0.2	-0.1	0.0	0.2	0.2	1.1	
Non-interest current account deficit	**5.6**	**7.3**	**6.8**	**7.9**	**1.6**	**6.9**	**7.2**	**7.1**	**7.0**	**6.9**	**6.9**	**7.0**	**6.8**	**6.8**	**7.0**	**7.0**	**7.1**	**7.8**	7.3
Deficit in balance of goods and services	16.7	18.1	17.9			17.8	17.9	17.8	17.5	17.2	17.3		17.4	17.4	17.5	17.6	17.6	18.0	
Exports	45.0	40.1	39.0			39.7	38.6	37.8	36.8	36.5	36.4		36.4	36.3	36.3	36.2	36.1	35.8	
Imports	61.6	58.3	56.9			57.5	56.5	55.6	54.4	53.8	53.8		53.8	53.8	53.8	53.8	53.8	53.8	
Net current transfers (negative = inflow)	-12.2	-11.9	-12.0	-12.8	0.8	-12.0	-11.8	-11.7	-11.5	-11.4	-11.2		-11.2	-11.2	-11.2	-11.2	-11.2	-11.2	-11.2
of which: official	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	0.0	0.0	0.0	0.0	
Other current account flows (negative = net inflow)	1.1	1.0	0.9			1.1	1.1	1.0	1.0	1.0	0.8		0.6	0.6	0.7	0.7	0.7	1.0	
Net FDI (negative = inflow)	**-6.7**	**-7.1**	**-6.5**	**-6.6**	**1.3**	**-6.3**	**-6.4**	**-6.4**	**-6.4**	**-5.8**	**-6.0**	**-6.2**	**-6.0**	**-6.0**	**-6.0**	**-6.0**	**-6.1**	**-6.1**	-6.1
Endogenous debt dynamics 2/	**-4.4**	**-3.5**	**-1.0**			**-1.7**	**-1.7**	**-1.7**	**-1.5**	**-1.5**	**-1.2**		**-0.9**	**-0.9**	**-0.9**	**-0.9**	**-0.9**	**-0.6**	
Contribution from nominal interest rate	1.5	1.7	1.8			1.6	1.3	1.4	1.6	1.5	1.7		1.9	1.9	1.8	1.8	1.8	1.6	
Contribution from real GDP growth	-3.4	-3.5	-3.5			-3.3	-3.1	-3.1	-3.1	-3.0	-2.9		-2.9	-2.8	-2.7	-2.7	-2.6	-2.2	
Contribution from price and exchange rate changes	-2.4	-1.7	0.7			...	...	...	...	...	...		...	...	...	...	...	...	
Residual (3-4) 3/	**4.2**	**3.2**	**1.3**			**0.0**	**-1.0**	**-0.8**	**-0.9**	**-1.0**	**-1.4**		**-1.3**	**-1.2**	**-1.3**	**-1.4**	**-1.5**	**-1.9**	
of which: exceptional financing	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	0.0	0.0	0.0	0.0	
PV of external debt 4/	...	...	66.9			65.5	63.5	61.9	60.4	59.3	57.7		56.2	54.8	53.5	52.3	51.1	42.4	
In percent of exports	...	...	171.3			164.8	164.4	163.5	164.0	162.2	158.5		154.6	150.9	147.5	144.5	141.4	118.7	
PV of PPG external debt	**...**	**...**	**22.1**			**22.9**	**23.6**	**24.3**	**25.1**	**26.1**	**26.6**		**27.1**	**27.5**	**27.9**	**28.3**	**28.5**	**29.9**	
In percent of exports	**...**	**...**	**56.6**			**57.6**	**61.0**	**64.1**	**68.1**	**71.4**	**73.1**		**74.5**	**75.7**	**76.9**	**78.1**	**78.9**	**83.6**	
In percent of government revenues	**...**	**...**	**79.3**			**82.1**	**84.5**	**86.9**	**90.4**	**94.5**	**96.6**		**98.2**	**99.7**	**101.1**	**102.6**	**103.6**	**108.8**	
Debt service-to-exports ratio (in percent)	**13.2**	**15.7**	**13.8**			**15.2**	**14.5**	**14.4**	**14.4**	**13.8**	**14.2**		**14.3**	**13.7**	**13.5**	**13.3**	**13.2**	**11.7**	
PPG debt service-to-exports ratio (in percent)	**2.5**	**3.0**	**1.4**			**4.1**	**3.9**	**3.9**	**3.9**	**4.1**	**4.9**		**5.6**	**5.6**	**5.9**	**6.2**	**6.5**	**7.9**	
PPG debt service-to-revenue ratio (in percent)	**4.4**	**4.6**	**1.9**			**5.9**	**5.4**	**5.3**	**5.2**	**5.5**	**6.5**		**7.3**	**7.3**	**7.8**	**8.1**	**8.6**	**10.3**	
Total gross financing need (Billions of U.S. dollars)	1.1	1.4	1.4			1.7	1.7	1.7	1.8	2.0	2.1		2.2	2.2	2.3	2.4	2.5	3.9	
Non-interest current account deficit that stabilizes debt ratio	6.9	7.4	6.2			8.0	9.1	8.8	8.8	8.3	8.5		8.2	8.2	8.3	8.3	8.5	8.6	
Key macroeconomic assumptions																			
Real GDP growth (in percent)	4.8	4.9	4.7	4.2	2.8	4.5	4.3	4.5	4.5	4.5	4.5	4.5	4.5	4.5	4.5	4.5	4.5	4.5	4.5
GDP deflator in US dollar terms (change in percent)	3.2	2.3	-0.9	2.7	3.4	0.8	2.3	2.0	2.2	2.1	2.2	1.9	2.1	2.1	2.1	2.1	2.1	2.1	2.1
Effective interest rate (percent) 5/	2.1	2.4	2.4	2.3	0.1	2.1	1.9	2.1	2.3	2.3	2.6	2.2	3.0	3.0	3.0	3.0	3.0	3.3	3.1
Growth of exports of G&S (US dollar terms, in percent)	7.7	-4.3	1.0	9.9	11.4	7.3	3.7	4.4	4.0	5.8	6.4	5.3	6.5	6.5	6.4	6.5	6.5	6.7	6.5
Growth of imports of G&S (US dollar terms, in percent)	1.7	1.4	1.4	7.8	12.5	6.5	4.8	4.9	4.4	5.5	6.8	5.5	6.7	6.7	6.7	6.7	6.7	6.7	6.7
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	34.2	33.6	33.0	25.3	24.6	26.9	29.6	24.4	24.9	22.8	19.2	19.0	14.2	17.1
Government revenues (excluding grants, in percent of GDP)	25.5	26.3	27.9			27.9	27.9	27.9	27.8	27.6	27.6		27.6	27.6	27.6	27.6	27.5	27.5	27.5
Aid flows (in Billions of US dollars) 7/	0.1	0.1	0.1			0.3	0.3	0.3	0.2	0.2	0.3		0.3	0.3	0.3	0.3	0.3	0.5	
of which: Grants	0.1	0.1	0.1			0.1	0.1	0.1	0.1	0.1	0.1		0.1	0.1	0.2	0.2	0.2	0.3	
of which: Concessional loans	0.0	0.0	0.0			0.2	0.2	0.2	0.1	0.1	0.2		0.2	0.2	0.2	0.1	0.1	0.2	
Grant-equivalent financing (in percent of GDP) 8/	...	...	...			2.2	2.2	2.0	1.7	1.6	1.7		1.6	1.6	1.5	1.4	1.4	1.2	1.3
Grant-equivalent financing (in percent of external financing) 8/	...	...	...			47.3	46.7	44.8	38.5	35.7	37.6		35.5	35.9	34.1	31.0	30.9	26.8	29.4
Memorandum items:																			
Nominal GDP (Billions of US dollars)	11.9	12.7	13.2			13.9	14.9	15.9	16.9	18.1	19.3		20.6	21.9	23.4	25.0	26.6	50.7	
Nominal dollar GDP growth	8.2	7.3	3.8			5.4	6.7	6.6	6.8	6.7	6.8	6.5	6.7	6.7	6.7	6.7	6.7	6.7	6.7
PV of PPG external debt (in Billions of US dollars)			2.9			3.1	3.4	3.8	4.1	4.6	5.0		5.4	5.9	6.4	6.9	7.4	14.8	
(PVt-PVt-1)/GDPt-1 (in percent)						2.0	2.2	2.2	2.5	2.6	2.3	2.3	2.2	2.2	2.2	2.2	2.1	1.9	2.1
Gross workers' remittances (Billions of US dollars)	1.1	1.2	1.3			1.3	1.4	1.5	1.5	1.6	1.7		1.8	1.9	2.1	2.2	2.3	4.5	
PV of PPG external debt (in percent of GDP + remittances)	...	...	20.2			20.9	21.5	22.2	23.0	23.9	24.5		24.9	25.3	25.6	26.0	26.2	27.5	
PV of PPG external debt (in percent of exports + remittances)	...	...	45.5			46.5	49.1	51.5	54.7	57.4	58.9		60.0	60.9	61.9	62.8	63.5	67.1	
Debt service of PPG external debt (in percent of exports + remittances)	...	...	1.1			3.3	3.1	3.1	3.2	3.3	3.9		4.5	4.5	4.7	5.0	5.3	6.4	

Sources: Country authorities; and staff estimates and projections.

1/ Includes both public and private sector external debt.

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

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

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

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

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

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

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

Table 2. Nicaragua: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2017–37

(In percent)

	Projections							
	2017	2018	2019	2020	2021	2022	**2027**	2037
PV of debt-to GDP ratio								
Baseline	23	24	24	25	26	27	**29**	30
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2017-2037 1/	23	24	25	26	27	27	**30**	29
A2. New public sector loans on less favorable terms in 2017-2037 2/	23	24	26	28	30	31	**37**	45
A3. Alternative Scenario: Contingent Liability Scenario	22	37	38	38	39	39	**38**	37
A4. Alternative Scenario: NICA Act/Venezuela	23	25	28	32	36	40	**51**	51
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2018-2019	23	24	25	26	27	27	**29**	31
B2. Export value growth at historical average minus one standard deviation in 2018-2019 3/	23	24	28	29	30	30	**31**	30
B3. US dollar GDP deflator at historical average minus one standard deviation in 2018-2019	23	24	25	26	27	27	**29**	31
B4. Net non-debt creating flows at historical average minus one standard deviation in 2018-2019 4/	23	24	25	26	27	27	**29**	29
B5. Combination of B1-B4 using one-half standard deviation shocks	23	24	25	26	27	28	**30**	31
B6. One-time 30 percent nominal depreciation relative to the baseline in 2018 5/	23	32	33	35	36	37	**39**	41
PV of debt-to-exports ratio								
Baseline	58	61	64	69	72	74	**79**	83
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2017-2037 1/	58	62	66	71	74	76	**82**	81
A2. New public sector loans on less favorable terms in 2017-2037 2/	58	63	69	76	82	86	**104**	126
A3. Alternative Scenario: Contingent Liability Scenario	56	97	100	104	106	107	**106**	103
A4. Alternative Scenario: NICA Act/Venezuela	58	64	74	86	97	108	**140**	142
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2018-2019	58	60	63	67	70	72	**77**	80
B2. Export value growth at historical average minus one standard deviation in 2018-2019 3/	58	67	84	88	91	93	**97**	94
B3. US dollar GDP deflator at historical average minus one standard deviation in 2018-2019	58	60	63	67	70	72	**77**	80
B4. Net non-debt creating flows at historical average minus one standard deviation in 2018-2019 4/	58	62	66	70	73	75	**80**	81
B5. Combination of B1-B4 using one-half standard deviation shocks	58	59	63	67	70	72	**77**	80
B6. One-time 30 percent nominal depreciation relative to the baseline in 2018 5/	58	60	63	67	70	72	**77**	80
PV of debt-to-revenue ratio								
Baseline	82	84	87	90	94	97	**104**	109
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2017-2037 1/	82	85	88	93	97	99	**108**	106
A2. New public sector loans on less favorable terms in 2017-2037 2/	82	87	93	100	108	113	**136**	165
A3. Alternative Scenario: Contingent Liability Scenario	82	134	135	138	140	140	**139**	135
A4. Alternative Scenario: NICA Act/Venezuela	82	91	102	116	130	143	**185**	187
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2018-2019	82	85	90	93	98	100	**107**	111
B2. Export value growth at historical average minus one standard deviation in 2018-2019 3/	82	88	101	104	108	110	**114**	110
B3. US dollar GDP deflator at historical average minus one standard deviation in 2018-2019	82	85	90	93	97	99	**106**	111
B4. Net non-debt creating flows at historical average minus one standard deviation in 2018-2019 4/	82	85	89	93	97	99	**104**	107
B5. Combination of B1-B4 using one-half standard deviation shocks	82	85	91	94	98	100	**107**	111
B6. One-time 30 percent nominal depreciation relative to the baseline in 2018 5/	82	117	120	125	130	133	**142**	149

Table 2. Nicaragua: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2017–37 (Concluded)

(In percent)

Debt service-to-exports ratio

Baseline	4	4	4	4	4	5	**7**	8
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2017-2037 1/	4	4	4	4	4	5	**7**	8
A2. New public sector loans on less favorable terms in 2017-2037 2/	4	4	4	4	4	5	**6**	11
A3. Alternative Scenario: Contingent Liability Scenario	4	4	5	5	7	8	**9**	10
A4. Alternative Scenario: NICA Act/Venezuela	4	4	5	5	7	9	**11**	13
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2018-2019	4	4	4	4	4	5	**7**	8
B2. Export value growth at historical average minus one standard deviation in 2018-2019 3/	4	4	5	5	5	6	**8**	9
B3. US dollar GDP deflator at historical average minus one standard deviation in 2018-2019	4	4	4	4	4	5	**7**	8
B4. Net non-debt creating flows at historical average minus one standard deviation in 2018-2019 4/	4	4	4	4	4	5	**7**	8
B5. Combination of B1-B4 using one-half standard deviation shocks	4	4	4	4	4	5	**7**	8
B6. One-time 30 percent nominal depreciation relative to the baseline in 2018 5/	4	4	4	4	4	5	**7**	8
Debt service-to-revenue ratio								
Baseline	6	5	5	5	5	6	**9**	10
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2017-2037 1/	6	5	5	5	6	7	**9**	10
A2. New public sector loans on less favorable terms in 2017-2037 2/	6	5	5	5	5	6	**8**	15
A3. Alternative Scenario: Contingent Liability Scenario	6	5	7	7	9	10	**12**	13
A4. Alternative Scenario: NICA Act/Venezuela	6	5	6	7	9	11	**15**	17
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2018-2019	6	6	6	6	6	7	**9**	11
B2. Export value growth at historical average minus one standard deviation in 2018-2019 3/	6	5	6	6	6	7	**10**	11
B3. US dollar GDP deflator at historical average minus one standard deviation in 2018-2019	6	6	6	6	6	7	**9**	11
B4. Net non-debt creating flows at historical average minus one standard deviation in 2018-2019 4/	6	5	5	5	6	7	**9**	10
B5. Combination of B1-B4 using one-half standard deviation shocks	6	6	6	6	6	7	**9**	11
B6. One-time 30 percent nominal depreciation relative to the baseline in 2018 5/	6	8	8	7	8	9	**12**	15
Memorandum item:								
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	16	16	16	16	16	16	**16**	16

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
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: Public Sector Debt Sustainability Framework—Baseline Scenario 2017–37

(In percent of GDP, unless otherwise indicated)

	Actual					Estimate	Projections								
	2014	2015	2016	Average 5/	Standard Deviation 5/	2017	2018	2019	2020	2021	2022	2017-22 Average	2027	2037	2023-37 Average
Public sector debt 1/	40.2	40.7	41.9			41.5	40.0	39.1	38.2	38.5	38.6		41.0	54.7	
of which: foreign-currency denominated	38.9	39.6	40.8			40.5	39.2	38.4	37.6	38.0	38.2		41.0	54.7	
Change in public sector debt	-2.1	0.5	1.1			-0.4	-1.5	-0.9	-0.9	0.3	0.1		0.6	2.0	
Identified debt-creating flows	-1.3	-0.6	0.9			0.1	-0.5	-0.7	-0.8	0.0	0.0		0.9	2.2	
Primary deficit	1.1	1.1	1.2	-0.1	1.2	1.1	1.1	0.9	0.9	1.6	1.5	1.2	2.1	2.9	2.3
Revenue and grants	26.6	27.4	28.8			28.8	28.8	28.7	28.5	28.3	28.2	28.6	28.2	28.1	28.2
of which: grants	1.1	1.1	0.9			0.9	0.9	0.8	0.8	0.6	0.6	0.8	0.6	0.6	0.6
Primary (noninterest) expenditure	27.7	28.6	30.1			29.9	30.0	29.7	29.4	29.8	29.8	29.8	30.3	31.0	30.5
Automatic debt dynamics	-2.3	-1.7	-0.4			-1.0	-1.6	-1.6	-1.7	-1.6	-1.5		-1.2	-0.6	
Contribution from interest rate/growth differential	-1.8	-1.2	-1.2			-1.5	-1.6	-1.6	-1.6	-1.6	-1.4		-1.2	-0.6	
of which: contribution from average real interest rate	0.2	0.6	0.6			0.4	0.1	0.1	0.1	0.1	0.2		0.6	1.6	
of which: contribution from real GDP growth	-1.9	-1.9	-1.8			-1.8	-1.7	-1.7	-1.7	-1.6	-1.7		-1.7	-2.3	
Contribution from real exchange rate depreciation	-0.5	-0.5	0.8			0.5	-0.1	0.0	-0.1	0.0	0.0		...	...	
Other identified debt-creating flows	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Privatization receipts (negative)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Debt relief (HIPC and other)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Residual, including asset changes	-0.8	1.1	0.3			-0.5	-1.0	-0.2	-0.1	0.3	0.0		-0.3	-0.2	
Other Sustainability Indicators															
PV of public sector debt	...	...	31.6			30.9	29.3	28.4	27.9	28.6	28.7		31.1	46.8	
of which: foreign-currency denominated	...	...	30.5			30.0	28.5	27.7	27.4	28.1	28.3		31.1	46.8	
of which: external	...	...	22.1			22.9	23.5	24.2	25.1	26.1	26.7		28.6	29.9	
PV of contingent liabilities (not included in public sector debt)	...	...	...			...	...	...	...	...	...		...	...	
Gross financing need 2/	6.0	5.8	5.1			5.8	4.7	3.8	3.4	3.8	3.8		5.0	9.7	
PV of public sector debt-to-revenue and grants ratio (in percent)	...	...	109.6			107.3	101.8	99.0	97.9	101.0	101.5		110.4	166.1	
PV of public sector debt-to-revenue ratio (in percent)	...	...	113.3			110.8	105.1	101.9	100.6	103.4	103.9		113.0	170.0	
of which: external 3/	...	...	79.3			82.1	84.4	86.8	90.4	94.5	96.6		103.7	108.9	
Debt service-to-revenue and grants ratio (in percent) 4/	9.2	9.6	6.8			10.9	10.0	9.3	8.2	7.8	8.0		10.5	24.1	
Debt service-to-revenue ratio (in percent) 4/	9.6	10.0	7.0			11.2	10.3	9.5	8.4	7.9	8.2		10.8	24.7	
Primary deficit that stabilizes the debt-to-GDP ratio	3.2	0.6	0.1			1.5	2.7	1.8	1.8	1.3	1.5		1.5	0.9	
Key macroeconomic and fiscal assumptions															
Real GDP growth (in percent)	4.8	4.9	4.7	4.2	2.8	4.5	4.3	4.5	4.5	4.5	4.5	4.5	4.5	4.5	4.5
Average nominal interest rate on forex debt (in percent)	2.3	2.9	2.9	3.0	0.6	3.0	2.6	2.4	2.2	2.1	2.7	2.5	3.5	5.3	4.0
Average real interest rate on domestic debt (in percent)	-2.8	-2.0	1.3	-2.3	3.5	-0.4	-1.9	-1.5	-1.7	-1.6	-0.8	-1.3	-1.6	...	-1.6
Real exchange rate depreciation (in percent, + indicates depreciation	-1.4	-1.2	2.2	-1.0	2.9	1.2	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	8.4	7.5	4.1	7.9	3.6	5.9	7.4	7.1	7.3	7.2	7.2	7.0	7.1	7.1	7.1
Growth of real primary spending (deflated by GDP deflator, in percer	5.6	8.3	10.2	2.4	4.0	3.9	4.5	3.5	3.7	5.9	4.2	4.3	4.7	4.1	4.8
Grant element of new external borrowing (in percent)	...	...	...	...	...	34.2	33.6	33.0	25.3	24.6	26.9	29.6	19.0	14.2	...

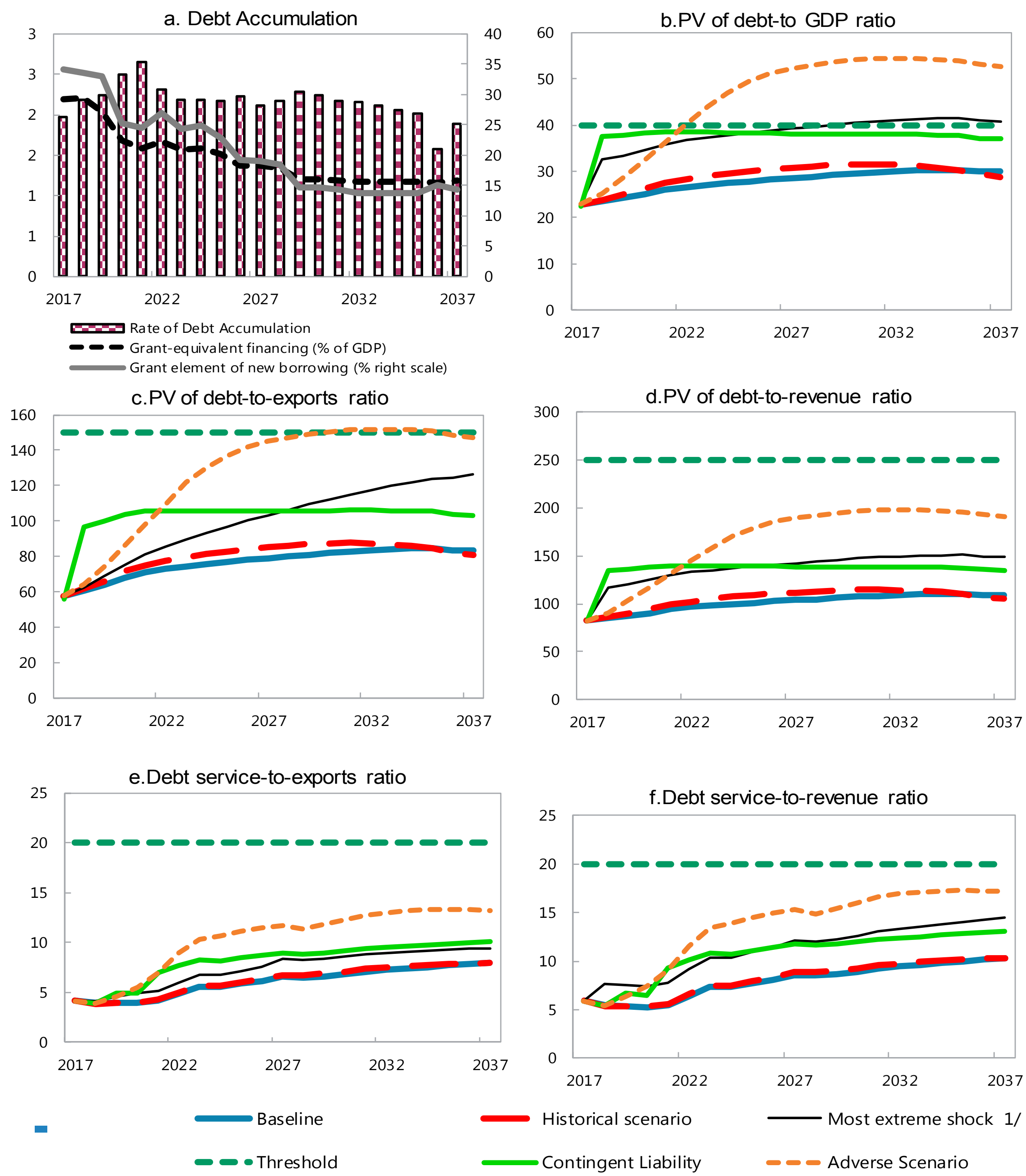
Sources: Country authorities; and staff estimates and projections.
1/ Consolidated public sector
2/ Gross financing need is defined as the primary deficit plus debt service plus the stock of short-term debt at the end of the last period.
3/ Revenues excluding grants.
4/ Debt service is defined as the sum of interest and amortization of medium and long-term debt.
5/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

Table 4. Nicaragua: Sensitivity Analysis for Key Indicators of Public Debt 2017–37

	Projections							
	2017	2018	2019	2020	2021	2022	2027	2037
PV of Debt-to-GDP Ratio								
Baseline	31	29	28	28	29	29	31	47
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	31	28	26	25	24	23	17	11
A2. Primary balance is unchanged from 2017	31	29	29	28	28	28	27	30
A3. Permanently lower GDP growth 1/	31	30	29	29	31	32	41	84
A4. Alternative Scenario : ALBA debt contingent liability	31	46	45	44	45	45	47	61
A5. Adverse Scenario	31	31	32	33	36	38	49	80
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2018-2019	31	31	33	34	36	37	47	76
B2. Primary balance is at historical average minus one standard deviations in 2018-2019	31	29	29	28	29	29	31	47
B3. Combination of B1-B2 using one half standard deviation shocks	31	29	28	29	30	31	38	61
B4. One-time 30 percent real depreciation in 2018	31	43	41	40	40	40	43	69
B5. 10 percent of GDP increase in other debt-creating flows in 2018	31	39	38	37	38	38	39	54
PV of Debt-to-Revenue Ratio 2/								
Baseline	107	102	99	98	101	101	110	166
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	107	98	92	88	86	81	60	40
A2. Primary balance is unchanged from 2017	107	102	99	99	100	99	95	106
A3. Permanently lower GDP growth 1/	107	103	102	103	109	113	147	298
A4. Alternative Scenario : ALBA debt contingent liability	107	160	156	154	158	159	167	217
A5. Adverse Scenario	107	107	111	116	126	134	173	285
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2018-2019	107	107	113	118	127	132	167	271
B2. Primary balance is at historical average minus one standard deviations in 2018-2019	107	102	99	98	101	102	111	166
B3. Combination of B1-B2 using one half standard deviation shocks	107	101	98	100	106	110	133	215
B4. One-time 30 percent real depreciation in 2018	107	148	143	141	143	142	153	244
B5. 10 percent of GDP increase in other debt-creating flows in 2018	107	135	133	131	134	134	140	191
Debt Service-to-Revenue Ratio 2/								
Baseline	11	10	9	8	8	8	10	24
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	11	10	9	5	4	2	-6	-14
A2. Primary balance is unchanged from 2017	11	10	9	8	8	8	6	6
A3. Permanently lower GDP growth 1/	11	10	9	9	9	10	20	60
A4. Alternative Scenario : ALBA debt contingent liability	11	10	11	9	11	12	14	28
A5. Adverse Scenario	11	10	10	9	9	10	16	38
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2018-2019	11	10	10	11	13	16	27	53
B2. Primary balance is at historical average minus one standard deviations in 2018-2019	11	10	9	8	8	8	11	24
B3. Combination of B1-B2 using one half standard deviation shocks	11	10	9	7	7	9	17	38
B4. One-time 30 percent real depreciation in 2018	11	12	12	13	13	15	24	53
B5. 10 percent of GDP increase in other debt-creating flows in 2018	11	10	13	34	13	27	17	31

Sources: Country authorities; and staff estimates and projections.
1/ Assumes that real GDP growth is at baseline minus one standard deviation divided by the square root of the length of the projection period.
2/ Revenues are defined inclusive of grants.

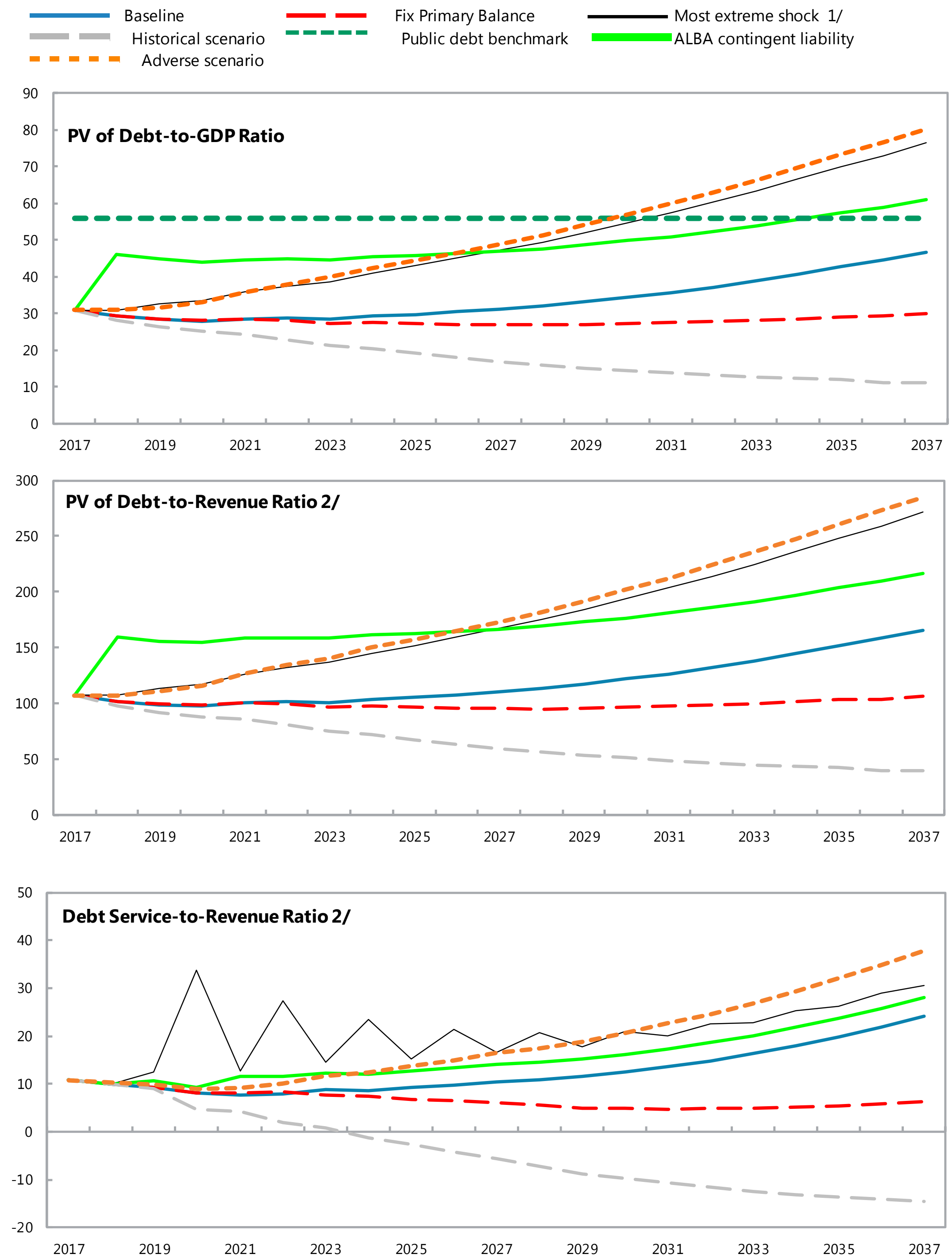
Figure 1. Nicaragua: Indicators of Public and Publicly Guaranteed External Debt under Alternative Scenarios, 2017–37 1/



Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio on or before 2027. 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 Exports shock and in figure f. to a One-time depreciation shock

Figure 2. Nicaragua: Indicators of Public Debt Under Alternative Scenarios, 2017–37 1/



Sources: Country authorities; and staff estimates and projections.
1/ The most extreme stress test is the test that yields the highest ratio on or before 2027.
2/ Revenues are defined inclusive of grants.