Moody's

Rating Action: Moody's upgrades Nicaragua's ratings to B2; maintains stable outlook

15 Mar 2024

New York, March 15, 2024 -- Moody's Ratings (Moody's) has today upgraded the Government of Nicaragua's long-term local and foreign currency issuer ratings to B2 from B3. The outlook remains stable.

The upgrade of Nicaragua's ratings to B2 from B3 reflects Moody's view that the sovereign's credit profile has structurally strengthened due to the accumulation of substantial fiscal and external buffers above Moody's prior expectations, as a result of the authorities' concerted policy efforts to mitigate challenges from international sanctions. Although the sanctions constrain the sovereign's external financing options and pose downside risks for economic activity should they disrupt investment flows, twin fiscal and current account surpluses alongside efforts to attract Chinese financing and investment, enhance the economy's resilience to potential shocks compared to Moody's previous assessment. The authorities' track record of navigating prior shocks while maintaining a prudent policy mix that safeguarded macroeconomic stability supports this view. The B2 rating also takes into account weak institutions, and high susceptibility to event risk, particularly political risk.

The stable outlook balances the positive trends above against continued challenges that could weigh on Nicaragua's credit profile more than Moody's currently assumes, as a result of domestic and external political risks that could include stricter sanctions, and a decline in the share of highly concessional borrowing in overall government debt that is likely to raise debt servicing costs on a durable basis.

Nicaragua's local-currency country ceiling has been raised to Ba3 from B1, while the foreign-currency country ceiling was raised to B1 from B2. The two-notch gap between the local-currency ceiling and the sovereign rating reflects a relatively limited government footprint in the economy, weak predictability and reliability of institutions, moderate external imbalances, and elevated domestic political risks. The one-notch gap between the foreign-currency ceiling and the local-currency ceiling reflects the economy's moderate level of external indebtedness, a relatively open capital account a moderate level of policy effectiveness.

RATINGS RATIONALE

RATIONALE FOR THE UPGRADE OF THE RATINGS TO B2

SUBSTANTIAL INCREASE IN FISCAL BUFFERS STRENGTHENS THE CREDIT PROFILE

A shift to fiscal surpluses since 2022 has led to a substantial accumulation of liquid assets deposited at the central bank. The general government financial balance shifted from a deficit of 1.6% of GDP in 2021 to a 0.8% surplus in 2022 due to an increase in tax revenues reflecting the ongoing effects of the 2019 tax reform and a moderation in public wages and social spending, despite a temporary increase in subsidies due to the inflationary shock. Moody's estimates that the surplus widened to 1.5% of GDP in 2023 allowing the sovereign to accumulate 10.2% of GDP in central bank deposits as of October 2023. Moody's forecasts a small fiscal surplus of around 0.1% of GDP at the general government level in 2024, with a possibility of stronger outcomes given that the authorities are once again enacting measures to reduce expenditures.

General government debt stood at 45% of GDP in 2022 and Moody's estimates that it declined to 42.4% of GDP in 2023. Nicaragua's debt remains lower than most 'B'-rated peers, despite facing multiple consecutive shocks including widespread protests in 2018-19 that paralyzed economic activity and the 2020 pandemic. Moody's forecasts that Nicaragua's general government debt will continue to decline gradually, reaching 41.2% of GDP at the end of 2024 and easing to 40.7% in 2025. A further accumulation of government deposits at the central bank is likely, based on the broadly balanced budget expectations mentioned above allowing an accumulation of liquidity as amortizations come due and debt is rolled over (external and domestic debt amortization will be on average 3% of GDP per year in the next few years).

The accumulation of fiscal buffers and strong fiscal performance limits the sovereign's reliance on borrowing from multilateral development banks to cover its financing needs. This is particularly relevant for the sovereign's creditworthiness in the context of existing sanctions that could disrupt financing and trade flows. Through 2023 the net flow of funds from key multilateral institutions has remained positive such that the stock of outstanding debt to all multilateral development banks has continued to increase, albeit at a slowing pace. Although access to official external credit so far has not been materially constrained under the Nicaraguan Investment Conditionality Act (NICA) and the Renacer Act, the US has increased the number of sanctioned individuals in Nicaragua and tightened enforcement of existing sanctions. However, Moody's estimates that in a downside scenario where financing flows to Nicaragua are completely halted, current fiscal buffers would cover the sovereign's gross financing needs through 2026.

ACCUMULATION OF FOREIGN EXCHANGE RESERVES AND EFFORTS TO DIVERSIFY INTERNATIONAL TRADE LINKAGES ALSO HELP MITIGATE POTENTIAL RISKS

Following the post pandemic recovery in 2021 when real GDP rebounded 10.3%, the economy has continued to grow in the 3.5%-4% range, higher than Moody's initial estimates of 2%-3%, supported by a substantial increase in remittances which have more than doubled since 2021. Remittance growth slowed to a still-high 45% at the end of 2023 from a peak of 62%, and the level of remittances reached 27% of GDP from less than 13% in 2018. The large inflows from remittances have led to a structural shift in the current account. The foreign exchange inflows from the remittances have pushed the current account back to surplus, while sustained foreign direct investment (FDI) inflows have contributed to a rapid accumulation of gross international reserves above Moody's earlier projections such that the external reserve buffer is likely to reach 30% of GDP by the end of 2024. The international reserve buffer, combined with the fiscal reserve buffer, helps to mitigate risks from potential shocks while granting the authorities a high level of policy flexibility.

Additionally, the authorities have continued efforts to diversify international trade linkages through the signing and implementation of multiple free trade agreements (FTAs), including a recent FTA with China that came into effect in

January 2024. This latest agreement has the potential to boost investment flows and favorably alter the structure of Nicaragua's export markets toward another large economy with ample demand for its export products, making it more likely that the economy will remain resilient to possible disruptions in trade and financial flows from western countries. Approximately half of Nicaragua's exports are currently sent to the US and around 25% to Central America, Panama and the Dominican Republic, all covered under FTAs signed in 2004.

CREDIT CHALLENGES CONTINUE TO CONSTRAIN THE RATING

The B2 rating also takes into account weak institutions, and high susceptibility to event risk, in particular political risk.

Nicaragua scores below the median for B-rated sovereigns in all categories of the Worldwide Governance Indicators except for political stability that is recovering following the 2018-19 protests. A particular weakness of Nicaragua's institutional profile involves rule of law and control of corruption, where it ranks among the lowest of sovereigns rated by Moody's. The lack of a credible system of political checks and balances that fosters policy debate and hinders voice and accountability, and a diminished perception that the country's institutions uphold the respect for contracts and private property and grant investment security, weigh on Nicaragua's institutions and governance strength.

The sovereign's high susceptibility to event risk is a reflection of lingering domestic political risks and the continued threat of stricter sanctions that could halt the flow of capital in and out of Nicaragua. Although the accumulation of large buffers partially mitigates this risk, it does not fully offset it, constraining Nicaragua's credit profile. Low income levels and the small scale of the economy also limit the sovereign's economic strength, despite improved growth prospects.

RATIONALE FOR THE STABLE OUTLOOK

The stable outlook reflects Moody's view that upside and downside risks to Nicaragua's credit profile remain balanced. The sovereign's strong adjustment capacity will continue to guide prudent fiscal policymaking that has led to the accumulation of the sizable buffers and the structural shift toward stronger external and public finances. These improvements will help mitigate the effects of potential future shocks. Nevertheless, domestic and external political tensions heighten the risk of harsher sanctions being imposed on the country that could jeopardize trade and financial flows and lead to economic shocks that would reduce existing buffers. Although the country is likely to begin diversifying its international trade linkages, the process will be gradual.

ENVIRONMENTAL, SOCIAL, AND GOVERNANCE CONSIDERATIONS

Nicaragua's CIS-4 ESG Credit Impact Score reflects social and governance risks as a result of persistent social tensions within the country and weak political institutions despite the authorities' capacity to respond to shocks. Environmental risks also weigh on Nicaragua's rating.

Nicaragua's exposure to environmental risks (E-4) stems from physical climate, water management and natural capital risks. Nicaragua's geography is dominated by a region known as the Dry Corridor, characterized by recurrent drought and heavy precipitation events that lead to flooding and landslides, or in dry periods, wildfires. The steady rise in the frequency and severity of drought and other climate-related shocks poses a moderate threat to Nicaragua's agricultural sector, which employs nearly 30% of the country's population and accounts for about 15% of GDP.

Nicaragua's S-4 social issuer profile score reflects its exposure to various social risks, including labor and income, education, housing, health and safety and access to basic services. Social considerations have played a role in increasing political risk in the country. While Nicaragua does not experience gang-related violence as other neighbors in the region, the country's domestic politics were embroiled in a national political conflagration in 2018-19 following the government's attempt to reform the pension system in April 2018, with violent protests disrupting economic activity. Although the protests have ceased, sociopolitical tensions persist.

Nicaragua's G-4 governance issuer profile score reflects of the sovereign's ongoing challenges with respect to the weak rule of law and control of corruption, issues that we expect to persist over the medium term. These challenges more than offset the benefits from more than a decade-long record of prudent monetary and fiscal policy, which was partly cultivated through strong relationships with the IMF and multilateral creditors.

GDP per capita (PPP basis, US$): 7,229 (2022) (also known as Per Capita Income)

Real GDP growth (% change): 3.8% (2022) (also known as GDP Growth)

Inflation Rate (CPI, % change Dec/Dec): 11.6% (2022)

Gen. Gov. Financial Balance/GDP: 0.8% (2022) (also known as Fiscal Balance)

Current Account Balance/GDP: -1.6% (2022) (also known as External Balance)

External debt/GDP: 90% (2022)

Economic resiliency: b1

Default history: At least one default event (on bonds and/or loans) has been recorded since 1983.

On 12 March 2024, a rating committee was called to discuss the rating of the Nicaragua, Government of. The main points raised during the discussion were: The issuer's economic fundamentals, including its economic strength, have materially increased. The issuer's institutions and governance strength, have materially increased. The issuer's fiscal or financial strength, including its debt profile, has materially increased. The issuer's susceptibility to event risks has not materially changed.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

FACTORS THAT COULD LEAD TO AN UPGRADE OF THE RATINGS

A lifting of international sanctions that ensures sustained access to financing and trade flows, or a continued increase in fiscal and external buffers and reduction in public debt that further mitigates the impact of potentially stricter sanctions, could lead to an upgrade. Progress on structural reforms that support economic strength through an improvement in the business climate and a softening of domestic political tensions would enhance the sovereign's creditworthiness.

FACTORS THAT COULD LEAD TO A DOWNGRADE OF THE RATINGS

Downward pressure on the sovereign's credit profile would emerge if fiscal metrics were to deteriorate significantly, reversing the progress achieved on the accumulation of liquidity buffers. A prolonged period of weak economic activity as a result of social or political tensions would substantially weaken Nicaragua's credit profile and could lead to a rating downgrade.

The principal methodology used in these ratings was Sovereigns published in November 2022 and available at https://ratings.moodys.com/rmc-documents/395819. Alternatively, please see the Rating Methodologies page on https://ratings.moodys.com for a copy of this methodology.

The weighting of all rating factors is described in the methodology used in this credit rating action, if applicable.

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For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found on https://ratings.moodys.com/rating-definitions.

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