IMF Country Reports 23/053

Nicaragua: 2022 Article IV Consultation-Press Release; Staff Report; and Statement by the Executive Director for Nicaragua

INTERNATIONAL MONETARY FUND

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IMF Country Report No. 23/53

NICARAGUA

January 2023

2022 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR NICARAGUA

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2022 Article IV consultation with Nicaragua, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its January 23, 2023 consideration of the staff report that concluded the Article IV consultation with Nicaragua.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on January 23, 2023 following discussions that ended on November 15, 2022 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 January 4, 2023.
- An **Informational Annex** prepared by the IMF staff.
- A **Debt Sustainability Analysis** prepared by the IMF staff.
- A **Statement by the Executive Director** for Nicaragua.

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

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International Monetary Fund
Washington, D.C.

PRESS RELEASE

PR23/22

IMF Executive Board Concludes 2022 Article IV Consultation with Nicaragua

FOR IMMEDIATE RELEASE

Washington, DC – **January 27, 2023:** The Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Nicaragua.

Prudent macroeconomic policies, substantial pre-crisis buffers (primarily government deposits) and official external financial assistance helped Nicaragua's economy rebound from a protracted contraction during 2018-2020, caused by the socio-political crisis of 2018, two major hurricanes in 2020, and the pandemic. Real GDP grew by 10.3 percent in 2021 and is projected to have grown by 4 percent in 2022, supported by external demand, remittances, and high prices for commodity exports. Gross international reserves have doubled since end-2018 (to over US$4 billion; about 6 months of imports, excluding *maquila*). Bank deposits are growing, reaching the pre-crisis level (in Córdobas).

Real GDP growth is expected to moderate to 3 percent in 2023, due mainly to the global slowdown. Inflation—which reached 11.4 percent in November 2022, primarily due to import price increases—is projected to decline in 2023 in line with lower growth and an expected significant decline in global inflation.

In the medium-term, real GDP is expected to grow by about 3½ percent, below the pre-crisis historical average, as credit to the private sector and private investment cautiously recover. The favorable outlook is subject to uncertainty and risks on the downside, primarily due to external developments, natural disasters, or a deterioration in the business climate and stricter international sanctions.

Executive Board Assessment[2]

Executive Directors agreed with the thrust of the staff appraisal. They noted the strong economic recovery and favorable outlook. Directors welcomed the authorities' commitment to continued prudent policies to strengthen policy buffers, economic growth, and resilience, given downside risks and vulnerabilities to natural disasters. They underscored the need for further efforts to improve the business climate, transparency, and governance.

Directors called for strengthening medium-term fiscal consolidation to safeguard fiscal sustainability and external stability. This would require streamlining other current expenditures, improving the targeting of subsidies and unwinding crisis-related spending measures while preserving adequate social spending and reducing poverty, addressing imbalances in the

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

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social security system and state-owned enterprises (SOEs), and strengthening domestic revenue mobilization.

Directors underscored the need to continue raising the reference interest rate to maintain the interest-rate differential with the U.S., consistent with the crawling exchange rate peg regime and financial and external stability.

Directors welcomed the sound banking sector capital and liquidity buffers and called for further strengthening the financial sector by increasing provisions for distressed assets, preserving sound lending practices as credit rebounds, enhancing the crisis preparedness framework, and expanding the prudential supervisory perimeter.

Directors welcomed the improvements in the AML/CFT framework and Nicaragua's recent exit from the FATF grey list. They encouraged the authorities to strengthen the effectiveness of the framework further, including in the non-profit sector.

Directors welcomed recent steps toward increasing fiscal transparency. They commended the authorities for publishing their first fiscal risks report and the first external audit report on the use of COVID-19 funds. Directors also encouraged the authorities to publish all audit reports and financial statements of state-owned enterprises.

Directors noted the steps taken to enhance governance and anticorruption frameworks, but stressed the need for further efforts to address remaining shortcomings. They emphasized the need to strengthen the asset declaration regime for public officials and prioritize reviews of politically exposed persons to strengthen anti-corruption efforts. They also recommended ensuring whistleblower protection, fair and impartial access to the court system and to recourse in legal proceedings, to support property rights, contract enforcement, and investment protection.

Directors welcomed the authorities' commitment to improve the quality and consistency of statistics, building on Fund technical assistance recommendations.

Nicaragua: Selected Economic Indicators, 2019–23

	2019	2020	2021	2022	2023
				Projections	
Output		(Annual percent change)			
Real GDP	-3.8	-1.8	10.3	4.0	3.0
Real GDP (nominal, US$ million)	12,611	12,586	14,001	15,737	17,233
Consumer price inflation (period average)	5.4	3.7	4.9	10.2	8.4
Consumer price inflation (end of period)	6.1	2.9	7.2	11.2	6.1
Central Government		(In percent of GDP)			
Revenue (Incl. grants)	19.6	19.2	21.3	19.5	19.0
Expenditure 1/	20.1	21.5	22.6	21.0	19.6
Current	16.6	17.1	16.7	16.4	15.0
Capital	3.5	4.4	5.8	4.6	4.7
Overall balance (after grants)	-0.5	-2.3	-1.2	-1.6	-0.7
Total public sector gross debt 2/	50.2	57.8	56.9	58.1	56.1
External	41.6	46.6	45.3	45.2	44.3
Domestic	8.6	11.2	11.6	12.9	11.8
Money and Credit		(Annual percent change, end of period)			
Broad money	6.2	15.6	13.8	14.9	10.8
Credit to the private sector	-15.6	-3.6	5.3	8.2	9.5
Net domestic assets of the banking system	-15.0	-6.3	2.4	7.9	15.9
Non-performing loans to total loans (ratio)	3.2	3.7	2.4	…	…
External sector		(In millions of U.S. dollars, unless otherwise indicated)			
Current account	754	497	-317	-271	-305
(percent of GDP)	6.0	3.9	-2.3	-1.7	-1.8
Gross official reserves 3/	2,199	3,003	3,828	4,286	4,344
Months of imports excl. maquila	5.0	7.1	6.5	6.3	6.3
Memorandum Items					
Nominal GDP (billions of Córdobas)	417.2	432.3	492.9	565.1	631.1
Per capita GDP, US$	1,924	1,937	2,141	2,382	2,581
Córdoba/U.S. dollar (period average)	33.1	34.3	35.2	…	…

Sources: National authorities and IMF staff calculations.

1/ Central government expenditure include transfers to INSS for repayments of historical debt.

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

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

NICARAGUA

STAFF REPORT FOR THE 2022 ARTICLE IV CONSULTATION

January 4, 2023

KEY ISSUES

Context. Substantial pre-crisis buffers (primarily government deposits), prudent policies, and official external financial assistance helped Nicaragua recover well from a protracted downturn during 2018-2020 caused by the socio-political crisis of 2018, two major hurricanes in 2020, and the pandemic. Real gross domestic product (GDP) grew by 10.3 percent in 2021 and is projected to grow by 4 percent in 2022, despite hurricane Julia that affected the country in October. Inflation on an annual basis reached 11.4 percent in November 2022, mostly due to increases in import prices. The authorities introduced fiscal measures to mitigate the impact of the increases in oil and wheat prices, and also increased the reference interest rate. Bank deposits are growing strongly and reached the pre-crisis level (in Córdobas). Gross international reserves have doubled since end-2018 (to over US$4 billion; about 6 months of imports, excluding *maquila*).

Outlook and Risks. Real GDP is expected to grow by 3 percent in 2023, sustained by the recovery of domestic demand, in turn underpinned by remittances. Inflation is projected to moderate, in line with lower growth, and the significant expected decline in import prices and global inflation next year. Medium-term real GDP growth is expected to converge to 3½ percent, below the pre-crisis growth rates for Nicaragua, as credit to the private sector and investment cautiously recover. Risks to the outlook are mostly to the downside. A more severe global downturn and further external monetary tightening than expected, or a prolongation of Russia's war in Ukraine, could lower demand from trading partners as well as remittances growth, further raise inflation, and pose risks of fiscal slippages. The fiscal position could be strained by natural disasters. Business climate deterioration and stricter international sanctions pose elevated risks to trade and financing flows.

Focus. Prudent fiscal, monetary, and financial policies will be needed to continue strengthening policy buffers and support growth in the context of vulnerabilities and risks. Discussions also focused on policies to achieve sustained medium-term growth, including raising labor force participation, strengthening governance, and increasing resilience to natural disasters.

Key Policy Recommendations:

- *Safeguard fiscal sustainability*. Build fiscal space while reallocating expenditures to support growth, improving taxation and better targeting subsidies.
- *Continue raising the reference interest rate*. Maintain the interest rate differential with the U.S. policy interest rate consistent with the exchange rate crawling peg regime and financial stability.
- *Strengthen financial system resilience* by improving provisioning for distressed assets, enhancing the crisis preparedness framework, and expanding the prudential supervisory perimeter.
- *Support medium-term growth* through a continued adequate policy mix, continued investment in infrastructure, and connectivity, enhancing the business climate, and increasing labor force participation.
- *Enhance* fiscal transparency, public financial management, the governance, anti-corruption, and Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) frameworks, and align them with international standards. Proper application and effective implementation of the AML/CFT frameworks, publication of all audit reports of the use of public funds, public access to the asset declaration system, and reviews of the asset declarations of politically exposed persons will improve perceptions of corruption, and thereby support growth. Ensuring fair and impartial access to the court system and adequate recourse in all legal proceedings would help support property rights, contract enforcement, and investment.

Approved By
James Morsink (WHD) and Maria Gonzalez (SPR)

Discussions took place virtually during November 3-4, 2022 and in person in Managua, Nicaragua during November 8–15, 2022. The mission team comprised Alina Carare (Head), Sandra Marcelino and Julien Reynaud (all WHD), Metodij Hadzi-Vaskov (CAPDR Regional Resident Representative), Camilo Enciso (LEG) and Miguel Otero (MCM). Manuel Coronel, Bruno Saraiva (all OED) and Alejandro Fiorito (WHD) participated in some meetings. Santiago Texidor Mora (LEG) contributed to the staff report and Nicolas Fernandez-Arias, Alejandro Fiorito, and Mario Mansilla (all WHD) contributed to the preparations of the mission. Alejandro Fiorito, Eliana Herrera Porras and Julia Munoz (all WHD) assisted the team through research assistance and editorial support.

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