Statement by Mr. Afonso Bevilaqua, Executive Director for Nicaragua, Mr. Bruno Saraiva, Alternate Executive Director, and Mr. Manuel Coronel, Advisor to the Executive Director for Nicaragua

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On behalf of our Nicaraguan authorities, we thank staff for the fruitful and candid discussions during the 2022 Article IV mission, held in Managua last November. The authorities welcome the quality, dedication, and professionalism of the IMF team and the analytical value of the staff report. The authorities are also grateful for the consistent cooperation through policy dialogue and technical assistance and look forward to continuing the close engagement with the Fund.

Nicaragua—a small and open market-oriented economy—features a long-standing track record of sound policy implementation underpinned by macroeconomic stability, fiscal discipline, and social inclusion. However, as other small and open economies in Central America, it is highly vulnerable to external shocks and natural disasters, among them, earthquakes, landslides, and—with increasing frequency because of climate change—droughts, hurricanes, and tropical storms. This vulnerability is particularly relevant, given that exports rely substantially on primary agricultural products, and infrastructure damage represents a disproportionately high burden to the economy.

Notwithstanding these vulnerabilities, nimble macroeconomic management supported a successful recovery from the latest sequence of shocks. Staff described the multiple shocks faced by Nicaragua between 2018 and 2020, which disrupted the economy's impressive growth path during the previous decade. The economy slipped into a three-year recession in which GDP contracted by 9 percent cumulatively. The report also accurately describes the authorities' measures on each stage to preserve financial and economic stability as the shocks unfolded. Yet the recovery would have been stronger if the effective macroeconomic measures were supported by timely and adequate external financial assistance.

Since the last Article IV discussion in February 2020, economic conditions have improved markedly. The economy has returned to positive growth and despite downside risks the outlook remains favorable. The main drivers of economic recovery have been exports, remittances, and FDI, which have offset lesser dynamism in tourism, hospitality, and construction. In 2021, real GDP growth rebounded by 10.3 percent, subsequently cooling down to a still robust 5 percent in the first half of 2022. While the global economic slowdown has led to further growth accommodation in the third quarter, preliminary data from the Central Bank of Nicaragua (BCN) suggest that higher remittances-driven-consumption will support growth in Q4, resulting in a projected yearly real growth of 4 percent in 2022. This is in line with both the staff and the authorities' projections, which for the first time in several years have converged.

Some post-pandemic scarring remains, particularly, in labor-intensive sectors such as construction and hospitality, which have not fully recovered. Nevertheless, unemployment

has reached its lowest since its five-year peak in 2019, yet while many unemployed workers were absorbed by the informal sector, others have chosen to emigrate. A significant increase in emigration has been a consequence of the job losses brought about by the three-year recession combined with the strong labor demand in the United States. As the authorities expressed during the mission, more analysis is needed to understand the long-term economic and labor market impact of the recent emigration dynamics.

The authorities welcome staff's assessment that the growth outlook is broadly positive and agree that risks are tilted to the downside given the headwinds from external shocks. In 2022, Nicaragua tightened fiscal and monetary policies to cope with higher food and energy prices, tighter financial conditions, and weaker external demand, albeit recognizing the limitations of domestic macroeconomic policies to control the ongoing external shocks. The protracted war in Ukraine, amidst trade-disruptive geopolitical tensions and uncertainties, continue to cloud the global outlook for 2023. Nevertheless, the authorities are slightly more optimistic than staff and expect growth to exceed 3 percent in 2023, buoyed by tailwinds from having joined China's Belt and Road Initiative in early 2022. As staff, the authorities expect inflation to recede in tandem with the global slowdown.

Enhanced public services and infrastructure have supported continued progress in social and sustainable development, despite the hindrances from the adverse scenario. Even under the impact of severe shocks, health and education infrastructure have expanded and improved, coverage of the national electricity grid reached 99 percent of households early last year, and major urban, inter-city, and rural transportation arteries have been built, including a highway connecting the main Caribbean city with the center and pacific regions. Gender equality and citizen security have also been policy priorities, with significant results. The 2022 World Economic Forum Global Gender Gap Report ranks Nicaragua 7th in their gender gap index; and the World Bank shows that homicides are amongst the lowest in Latin America. These achievements notwithstanding, the latest shocks interrupted the sharp downward trend in poverty. That said, the authorities remain committed to protecting the poor and vulnerable, a core principle guiding Nicaragua's policies.

Despite the surge in inflation, effective macroeconomic management has contained the risk of second-round effects and de-anchoring inflation expectations. With the global inflationary escalation, headline inflation in 2022 rose significantly above Nicaragua's long-term trend for the first time in more than a decade. Inflation went from 7.2 percent in 2021 to 11.5 percent as of November 2022. The BCN projects inflation to close 2022 at 11.6 percent, slightly higher than expected by both staff and the authorities. In response, the BCN has gradually increased the reference rate to 7 percent, a level that they expect will restrain price increases, support the crawling peg, and not be excessively detrimental to economic activity. While the authorities have relied on the crawling peg as a key nominal anchor with good results for more than two decades, they are now considering, in line with regional peers, embedding more flexibility within the exchange-rate regime.

Public finances remain underpinned by a strong sense of fiscal discipline. The public sector deficit widened from 1.4 in 2021 to a projected 3.3 percent of GDP in 2023, as the

authorities accommodated temporary spending measures to address the social impact of higher prices. However, medium-term budget plans for 2023-26 point towards a gradual narrowing of the deficit, and a decline in public debt to 54 percent of GDP by end-2027. As the economy coped with the multiple shocks, in contrast with regional peers, Nicaragua did not rely on significant debt-financing. As a result, macroeconomic adjustment may have been more painful than otherwise, but the economy started to recover on sounder footing, with improved resilience and debt sustainability.

External sector developments have contributed to the recovery. Remittances in 2022 reached a historic peak and are projected to exceed US$ 3 billion, which is 50 percent higher than 2021 and equivalent to 20.3 percent of GDP. Exports also outperformed expectations at US$ 7.3 billion, an increase of 15.5 percent in value and 5 percent in volume, with respect to 2021. Central Bank reserves, which have increased by a yearly average of 23 percent since 2020, also reached a historic high at US$ 4.4 billion (almost twice their 2018 level). The authorities expect these trends to continue, as they remain committed to a prudent policy mix, and the credit rating agencies are seemingly broadly in line with this view. Fitch rates the country at B- and stable perspective, Moody's at B3 and stable perspective, while S&P has recently upgraded its rating from B- to B, with stable perspective.

The banking system has stabilized and remains well capitalized, highly liquid, and profitable. After experiencing a real-life stress test during the compounded shocks in 2018-2020, and with the support of the BCN's liquidity measures, the financial sector emerged sound and more resilient. Capitalization is significantly higher than regional levels, distress assets continue to decrease, and NPLs fell to 1.9 percent. Credit stock is growing moderately, yet it hasn't reached pre-crisis levels, while bank deposits have already surpassed it. The Bank's Superintendency (SIBOIF) has welcomed staff's advice on enhancing the resolution framework, increasing the level of provisions for distressed assets, and preserving sound lending practices as credit growth gradually rebounds.

External financial support helped mitigate the pandemic crisis, and the authorities have honored their transparency and accountability commitments in the use of funds. Between 2020 and 2021, the Word Bank stepped in with various programs totaling US$216 million to strengthen the response to the pandemic and mitigate the impact of hurricanes Eta and Iota; CABEI and the IDB also contributed with the emergency financing. The IMF joined in the effort in November 2020 with the approval of an RCF/RFI of 50 percent of quota, yet half was disbursed through third party agencies and did not help fill in the BOP gap. The first independent external audit report on all pandemic-related use of funds has already been published. All details of pandemic-related spending and procurement contracts have been published on the Finance Ministry's website, including beneficiary ownership. Unfortunately, execution of external finance by third party agencies have not been as effective as envisaged and have proven to be time-costly, underperforming government implementation capacity and accountability procedures.

The authorities underscore that additional multilateral financial support to tackle climate-change related natural disasters would have strengthened the recovery and

prevented the diversion of critical resources. Nicaragua was hit by two consecutive hurricanes in December 2020, estimated to have caused damage of about US$ 1 billion, or 8 percent of GDP. Last year, hurricane Julia hit the country in October and the authorities preliminary estimate points to damage of about 2½ percent of GDP. Given the difficulties in obtaining additional financing, Nicaragua has drawn scarce budgetary resources to provide support for those most severely affected by natural disasters, complementing financing obtained from IFIs. IMF financing in that circumstance would have been very impactful, especially for the most vulnerable population.

The authorities have a high response rate to IMF policy recommendations. During the present Article IV cycle, the authorities have made good efforts to heed staff's advice on a series of fiscal, monetary, structural, and statistical issues. Significant progress has been made on at least 12 of the 17 items as per past Fund policy advice. The authorities also welcomed staff's inputs on governance and transparency, however, the scope and purview of the Central Bank in these matters is very limited. Most of the advice on these issues seem to be directed towards independent agencies and/or powers of the state, such as the attorney general's office, the comptroller's office, and the legislative and judicial powers. Nevertheless, all agencies and state powers are making progress towards improving the governance and anticorruption frameworks.

The authorities also welcomed the discussions and advice on competitiveness and AML/CFT framework. As highlighted by staff, the Financial Action task Force (FATF) Plenary of October 2022 recognized Nicaragua's progress on AML/CFT and removed it from the list of jurisdictions subject to increased monitoring (the so-called "Grey list"). Nicaragua's financial intelligence unit (UAF) remains committed to addressing all issues of concern in a thorough and timely manner.

In closing, the authorities remain committed to implementing coherent macroeconomic and development policies. In this regard, they continue to count on the Fund's support through policy advice and capacity building, tailored to Nicaragua's specific needs and circumstances.