FOR AGENDA

EBS/08/101

August 28, 2008

To: Members of the Executive Board

From: The Acting Secretary

Subject: **Nicaragua—First Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility, Review of Financing Assurances, and Requests for Waiver of Nonobservance of Performance Criteria and Augmentation of Access**

Attached for consideration by the Executive Directors is a paper on the first review under the three-year arrangement under the Poverty Reduction and Growth Facility for Nicaragua, the review of financing assurances, and requests for a waiver of nonobservance of performance criteria and augmentation of access, which is tentatively scheduled for discussion on **Wednesday, September 10, 2008**. A draft decision appears on pages 26–28. At the time of circulation of this paper to the Board, the Secretary's Department has not received a communication from the authorities of Nicaragua indicating whether or not they consent to the Fund's publication of this paper; such communication may be received after the authorities have had an opportunity to read the paper.

Questions may be referred to Mr. Cubeddu (ext. 36231), Ms. Jenkner (ext. 35861), and Mr. Di Bella (ext. 37483) in WHD.

Unless the Documents Section (ext. 36760) is otherwise notified, the document will be transmitted, in accordance with the procedures approved by the Executive Board and with the appropriate deletions, to the WTO Secretariat on Monday, September 8, 2008; and to the European Commission, the European Investment Bank, and the Inter-American Development Bank, following its consideration by the Executive Board.

This document, together with a supplement providing an informational annex, will shortly be posted on the extranet, a secure website for Executive Directors and member country authorities. The supplement, which is not being distributed in hard copy, will also be available in the Institutional Repository; a link can be found in the daily list (http://www-int.imf.org/depts/sec/services/eb/dailydocumentsfull.htm) for the issuance date shown above.

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INTERNATIONAL MONETARY FUND

NICARAGUA

First Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility, Review of Financing Assurances, and Requests for Waiver of Nonobservance of Performance Criteria and Augmentation of Access

Prepared by the Western Hemisphere Department
(In collaboration with other departments)

Approved by David J. Robinson (WHD) and Anthony Boote (PDR)

August 28, 2008

- **Arrangement**. A three-year PRGF-arrangement for SDR 71.5 million (55 percent of quota) was approved in October 2007. The next Article IV consultation is expected to take place in October in tandem with the second review.
- **Mission**. Discussions on the first review were conducted during February 25–March 7 and June 11–20 in Managua, and during March 26–28 and July 23 in Washington. The team comprised L. Cubeddu (Head), G. Di Bella, E. Jenkner (all WHD), A. Segura (FAD), F. Zanna (PDR) and G. Mitchell-Casselle (MCM). H. Arbulú (Resident Representative) assisted the team. A. Singh and D. J. Robinson (WHD) participated in some of the discussions, as did J. Rojas and R. Umaña (OED). The mission liaised with the World Bank and IDB, and met with Vice President Morales, Central Bank President Rosales, Finance Minister Guevara, as well as other senior officials, deputies of the National Assembly, private sector and civil society representatives, and the donor community.
- **Political and economic context.** The political situation has remained fluid ahead of the November municipal elections, and governance concerns have grown. Economic performance has weakened owning to a more challenging external environment, despite prudent macroeconomic policies. Growth is projected to slow in 2008, reflecting higher energy prices and a slowdown in U.S. growth, while inflation has jumped sharply, mainly owing to commodity-related shocks.
- **Main review issues**. Discussions focused on the macroeconomic framework for 2008, in the context of an increasingly challenging external environment. Emphasis was placed on policies to bring down inflation, protect the poor, and safeguard the stability of the banking system, while implementing the structural reform agenda, particularly through actions to strengthen the energy sector and improve the transparency of external aid. The authorities are requesting waivers of nonobservance of two structural performance criteria and an increase in access to help cope with the balance of payments impact of last year's hurricane and the recent commodity price shock. Staff supports these requests.

Contents Page

Appendix

Appendix Box

Appendix Figure

Appendix Tables

EXECUTIVE SUMMARY

Economic performance has weakened due to a more challenging external environment. Growth has slowed and inflation has increased sharply, mainly on account of commodity price shocks, though underlying pressures have emerged. The current account deficit has widened, but remains comfortably financed, largely reflecting increased external assistance.

The political situation remains fluid. Campaigning is well under way ahead of the November municipal elections, in the context of increased social tensions resulting in part from a slowing economy and rising inflation. Meanwhile, rekindled cooperation between the Sandinista and the Liberal Parties has paved the way for approval of key legislation in the Assembly.

Performance under the PRGF-supported program has been broadly satisfactory. Quantitative performance criteria (QPCs) through end-2007 and end-June 2008 were met, except for a small slippage in NIR accumulation during the first half of this year. The structural reform agenda has been implemented, albeit with some delays, including increases in utility tariffs and approval of legislation to discourage electricity theft.

Completion of the review was delayed following the suspension of debt service on public bonds during a legal investigation, potentially causing two major banks to become severely undercapitalized. Restructuring agreements were reached in June/July, and a bond swap was implemented in August. The central bank board has been without quorum since May following the resignation of three out of six board members over the handling of this issue.

The revised program for 2008 reflects a deteriorated external outlook and the authorities' continued commitment to sound policies:

- ***Fiscal policy:*** The 2008 fiscal stance remains unchanged, but the 2009 fiscal program envisages a slower pace of consolidation to help protect vulnerable groups from the commodity price shock. The expansion of energy and transport price subsidies should be gradually dismantled and targeted social programs strengthened. Steps must be taken to improve budget controls and reduce the actuarial gap of the pension system.

- ***Inflation:*** While measures to boost food production may help to reduce inflation over the medium term, resisting wage pressures will be key to avoid a wage-price spiral.

- ***Financial sector:*** The swift re-establishment of a central bank board will be critical to restore the institutional framework for monetary policy and provide the restructuring agreements with a legal basis. The Superintendency must ensure banks comply over an agreed period with prudential norms and improved accounting standards.

- ***Aid Monitoring and Transparency:*** The monitoring of external assistance must be strengthened to ensure the timely adjustment of policies, while further efforts to improve the transparency of aid from non-traditional sources will be critical.

Staff recommends that the Board complete the first review and approve the authorities' requests for waivers of observance of performance criteria and augmentation under the arrangement. Fund support is expected to help anchor prudent policies ahead of the elections and in the context of an adverse external environment. The small augmentation (of 5 percent of quota) will help Nicaragua cope with the negative impact of last year's natural disasters.

I. Political Context

1. **The political situation remains fluid ahead of the November municipal elections, and governance concerns have grown.**

- Campaigning is well under way ahead of the municipal elections. A slowing economy and increasing food and energy prices have contributed to rising social tensions, affecting the administration's approval ratings. A two-week long transport strike in May prompted the government to expand public transport subsidies, while the Assembly recently approved an extension of electricity subsidies to small consumers.
- Rekindled cooperation between the Sandinista (FSLN) and the Liberal (PLC, led by former President Aleman) Parties since June has paved the way for approval of key legislation and an agreement to continue sharing key Supreme Court appointments. Previously, the Assembly was in deadlock for months, as the government only holds 38 of the 92 seats.
- Governance concerns have grown over decisions by the Electoral Council to ban two opposition parties and to postpone elections in the North Atlantic Region, which was badly affected by Hurricane Felix in late 2007. In addition, charges have been levied by the Attorney General against many former government officials, including a key opposition leader who is running for mayor of Managua, over their role in the handling of the banking crisis of 2000–01 (¶4).

II. Recent Economic Developments and Program Implementation

2. **Economic performance has weakened reflecting a more challenging external environment, though macro policies remain prudent.**

- *Growth has slowed reflecting increased energy prices and declining U.S. growth* (Panel 1). Real GDP growth was 3.8 percent in 2007, with the negative impact of higher oil prices, natural disasters, and electricity blackouts broadly offset by a pick-up in domestic demand following election-related uncertainties in 2006. Economic activity has slowed during 2008 though, reflecting a further rise in oil prices and declining U.S. growth. The growth rates in industry and agriculture have declined the sharpest (with the latter sector still affected by the hurricane and floods of late 2007).
- *Inflation has increased sharply, reflecting mainly commodity price shocks* (Box 1, Panel 2). Headline inflation was 16.9 percent in 2007, owing mainly to the increase in commodity prices, as well as natural-disaster-related shortages. It jumped to 23.6 percent by July as a result of these same factors, as well as further increases in administered electricity prices, shortages caused by the recent transport strike and second-round price effects on input costs. In this context, core inflation has also been rising.

Box 1. Inflation Developments and Determinants

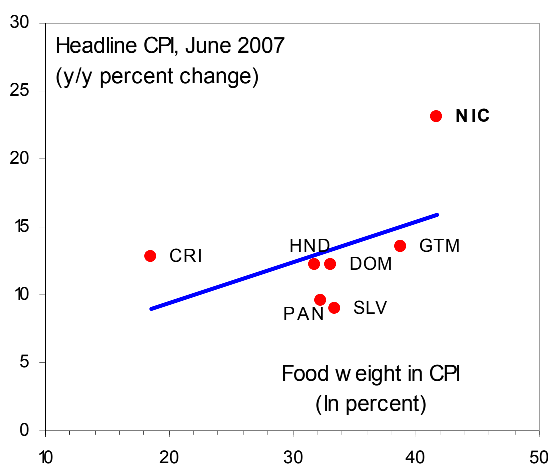
Recent developments and inflation determinants. High inflation in Nicaragua is mainly the result of commodity price shocks and the large weight of food (42 percent) in the CPI. Food and fuel price inflation account for about two-thirds of headline inflation through July. Staff analysis also illustrates the important role played by: (i) the crawling peg regime with an automatic annual depreciation vis-à-vis the dollar of 5 percent; (ii) the high pass-through of foreign inflation to domestic prices; and (iii) the considerable persistence in the inflation process.[1] While core inflation has also risen to 11 percent in July, this can be attributed largely to higher imported inflation and rising input costs, with most indicators pointing to a reduction in demand pressures.

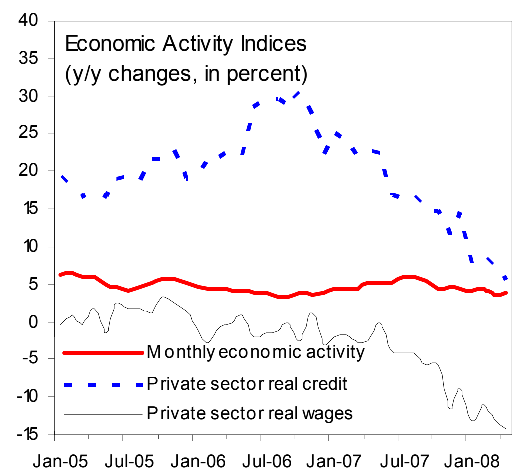
Determinants of Inflation in Nicaragua

Dependent variable: CPI	
CPI(-4)	0.69***
US$ exchange rate	-0.67***
Trading partners' inflation	0.72***
Commodity food price index	0.15***

*** denotes significance at 1 % level.

Regional comparison. While inflation has been increasing across the region, it has been higher in Nicaragua due to: (i) the relative importance of food items in the CPI; (ii) a more significant exchange rate depreciation and imported inflation; and (iii) a greater reliance on fuel-based electricity generation, which has been feeding into second-round effects. Additional factors affecting Nicaragua specifically have been the utility tariff adjustments under the program and the impact of last year's natural disasters.





Impact on the poor. Given their high consumption share of food, the poor have been particularly affected by recent commodity price developments. The World Bank estimates that the *Poor Person's Price Index* (PPPI) in Nicaragua increased by 27 percent (y/y) through June. The rural poor are partially protected by their own food production–about 12 percent of households in the poorest quintile are net food producers, and as such stand to gain from food price increases. However, as net consumers of food the urban poor have been hit particularly hard.

[1] Analysis was based on quarterly data for the period 1997Q1–2008Q2. Standard errors were found to be robust to heteroscedasticity and autocorrelation.

- *The current account has widened, though international reserves have risen* (Panel 3). The external current account deficit jumped to 18.3 percent of GDP in 2007, from 13.6 percent of GDP in 2006, reflecting largely higher oil prices and a pickup in imports of capital and intermediate goods, which were partly offset by an increase in commodity and nontraditional exports.[1] The deficit was financed mainly through FDI, official aid from nontraditional sources, and likely some repatriation of assets following outflows related to election uncertainties in late 2006. Gross international reserves now exceed US$1.1 billion (3.4 months of imports, excluding maquilas) and net international reserve (NIR) accumulation since 2007 is over US$100 million above the program target.

- *Credit conditions have been tightened, and the financial system remains sound* (Panel 4). The large increase in NIR in 2007 was largely sterilized through a buildup in government deposits, and the ceiling on net domestic assets (NDA) was met with a large margin. More recently, the central bank raised interest rates to absorb part of the seasonal decline in money demand and the liquidity injection associated with maturing government debt through open-market operations (OMOs). Banks remain very liquid, despite buoyant—though slowing—private credit growth. Prudential norms were recently strengthened to curb consumer lending and contain the slight deterioration in asset quality.

- *Fiscal performance has been stronger than expected*. Fiscal outcomes for 2007 were much stronger than programmed, as the consolidated public sector posted an overall surplus of 0.9 percent of GDP in 2007, compared with a deficit of 1 percent of GDP under the program. This overperformance mainly reflected delays in the execution of investment spending. For 2008, the fiscal targets are expected to remain in line with those agreed under the original program; preliminary information through end-June suggests continued underexecution of investment spending, though there are signs of sluggish revenue performance, particularly of domestic VAT and excises on petroleum products (which are indexed to the exchange rate).[2]

3. **Performance under the PRGF-supported program has been broadly satisfactory.**

- *All quantitative performance criteria (PCs) through end-2007 were met with large margins (Table 1).* Available data through end-June indicate that most quantitative PCs were also met, except for NIR accumulation, which came in US$14 million below program (a waiver will be requested at the time of the second review). However, the larger-than-programmed accumulation during 2007 (by about US$150 million) more than compensated the small deviation observed in 2008.

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[1] While Nicaragua is a net food exporter (9½ percent of GDP in 2007) it imports the equivalent of 3½ percent of GDP of its key staples rice, vegetable oil, and wheat.

[2] The under execution of infrastructure spending mainly reflected: (i) delays in the approval of the 2008 budget, and certain foreign-financed projects; (ii) difficulties in granting contracts on construction projects, resulting from post-auction increases in construction costs; and (iii) restrictions on equipment spending.

- *The structural reform agenda has been implemented, albeit with some delays (Table 2):* (i) a budget for 2008 consistent with the program was approved in mid-February (*December 2007 structural PC*); (ii) electricity tariffs have been raised to better reflect costs, and legislation criminalizing electricity theft was approved in early June (*December 2007 structural PC*); and (iii) an action plan to revamp public financial management practices was finished in a timely manner (*June 2008 structural PC*). Waivers are being requested for the first two as they reflect delays in their approval by the Assembly, where the administration does not hold a majority.

4. **Completion of the review was delayed following the suspension of debt service on public bonds (*CENIs*) with potentially significant implications for financial stability.** An investigation by the Attorney General into alleged improprieties in the handling of the 2000-01 banking crisis led the courts in April to order the suspension of public debt service on *CENIs* held by two major banks. These two banks risked becoming severely undercapitalized as questions were being raised on the legality of these bonds. Against this background, negotiations between the banks and the central bank resumed in May and restructuring agreements were reached in June/July. Subsequently, the courts lifted the sequestering order and banks recently executed the agreed bond swap. However, the main bank holding *CENIs* was downgraded marginally by a credit rating agency. The central bank board has been without quorum since May, however, following the resignation of three out of six board members over the handling of this issue, impeding board approval of the restructurings and complicating monetary policy management more generally.

III. Policy Discussions

A. The Macroeconomic Outlook for 2008

5. **Growth has been revised downward, inflation is now expected to reach double digits, and the external current account is projected to widen further, reflecting a more complicated external environment.**

- Given Nicaragua's high oil dependency and strong links with the U.S. economy (mainly through exports and remittances), real GDP growth is now projected at 3–4 percent in 2008 (compared with a program projection of 4.7 percent).[3] Increased agricultural production and higher external aid are expected to partially offset the negative external shocks.
- Inflation is expected in the 15–17 percent range by year-end, 10 percentage points higher than programmed, assuming prudent policies are maintained, particularly on wages.
- The external current account deficit is projected to widen to about 25.7 percent of GDP in 2008, though a strong capital account—reflecting increased official aid, particularly from non-traditional sources—should allow further reserve accumulation. The current account widening reflects mainly: (i) increased intermediate and capital imports (e.g.,

[3] Staff estimates that a one-percentage point decline in U.S. growth below trend is associated with roughly a one-percentage point decline in the cyclical component of Nicaragua's growth.

fertilizers, agricultural machinery, power plants) resulting from FDI and external assistance; (ii) higher oil imports, owing to higher prices as well as the expansion of public transport and electricity subsidies; and (iii) the envisaged fiscal expansion. The private sector is expected to continue to absorb the bulk of the commodity price shock, as fuel and food prices remain largely unregulated in Nicaragua and electricity tariffs are projected to rise with costs for the bulk of consumers.

Nicaragua: Key Macroeconomic Indicators

			2007		2008	
	2005	2006	Prog.	Prel.	Prog.	Proj.
Real GDP growth	4.3	3.7	4.2	3.8	4.7	3-4
CPI Inflation (percent change, eop)	9.6	9.5	7.3	16.9	7.0	15-17
CPI Inflation (percent change, average)	9.6	9.1	8.2	11.1	7.3	19.5
External current account balance (in percent of GDP)	-14.9	-13.6	-15.8	-18.3	-16.3	-25.7
According to 5th Manual 1/	...	*-12.3*	...	*-16.7*	...	*-21.9*
Gross International Reserves (US$ million)	730	924	925	1,103	1,043	1,230
in months of imports of goods (excl. Maquilas)	3.1	3.4	3.1	3.4	3.2	3.0
Net international reserves (US$ million, adjusted)	282	535	595	737	665	797
Oil price (US$ per bbl, period average)	53.4	64.3	63.8	71.1	68.8	117.0
Food price index (2004=100, eop)	99.6	113.2	…	140.8	…	147.5

Source: Nicaraguan authorities and staff estimates.
1/ Includes official grants and transfers above the line.

B. Fiscal Policy

6. **The 2008 fiscal program remains appropriate, though budget execution ahead of the elections will have to be closely monitored.** The temporary fiscal expansion envisaged in the program for 2008, financed mainly through concessional assistance, remains appropriate given Nicaragua's social and infrastructure needs and relatively subdued domestic demand pressures. The budget approved in February was consistent with a much lower combined public sector deficit (0.9 percent of GDP compared with a program target of 1.8 percent), with the understanding that budget supplements would be prepared with the availability of financing to allow for increased spending. A supplementary budget was approved in June, with higher external support and savings derived from the restructuring of the bank bonds to finance higher wages, electricity subsidies, and increased social transfers. A second supplementary budget, in line with the agreed deficit target (*continuous structural PC through end-December 2008*) is expected in late 2008 to allocate the revenue overperformance. Staff welcomed the fiscal overperformance, but warned that care should be exercised in the

Operations of the Combined Public Sector, 2007-08
(in percent of GDP)

	2007		2008	
	Prog.	Prel.	Prog. 1/	Proj.
CPS overall balance	-1.0	0.9	-1.8	-1.8
Primary balance	0.8	2.4	-0.1	0.0
Total interest	1.8	1.5	1.7	1.8
a. Central government	-0.9	0.4	-1.2	-1.3
Revenue	19.6	19.5	19.7	18.5
Expenditure 1/	24.7	22.8	25.1	23.9
Current	15.7	15.7	17.1	16.7
of which: interest	1.6	1.5	1.4	1.3
Capital and net lending	9.0	7.1	8.0	7.3
Grants	4.2	3.7	4.2	4.1
b. INSS and Managua Municipality	1.5	1.7	1.5	1.7
c. Public enterprises	-1.2	-0.9	-1.5	-1.3
d. Central bank	-0.4	-0.3	-0.6	-0.9

1/ Adjusted to reflect reclassification of capital to current spending.

execution of the budget during the remainder of the year, particularly in light of election-related spending pressures, high inflation and uncertainties related to aid inflows (¶17).

7. **The 2009 fiscal program envisages a slower pace of consolidation to help protect vulnerable groups from the commodity price shock.** The 2009 consolidated fiscal deficit is now targeted at 1.2 percent of GDP, slightly higher than the 1 percent of GDP in the original program, to accommodate partially the impact of higher fuel prices on public spending. In particular, the government plans to maintain subsidized tariff rates for urban transport, as well as make room for the Assembly-approved 5-year extension of the subsidy to small electricity consumers, and the preferential VAT rate for medium-sized electricity consumers. In light of the strong fiscal performance thus far and the importance of protecting the poor, staff accepted the proposed higher deficit target for 2009, while stressing the need to avoid further increases to preserve debt sustainability.

8. **Concerns have arisen, however, over the implications of higher subsidies for long-term fiscal sustainability (Box 2).** Public transport and electricity subsidies have been expanded to partly shield households from rising fuel costs. In the case of public transport, subsidies have been extended to include taxis and inter-urban transport and scaled up to maintain urban transport fares unchanged. Preliminary estimates suggest that transport subsides could reach 1.2 percent of GDP in 2008, albeit largely off-budget, compared to a budget transfers of 0.1 percent in 2007. Moreover, slippages in the adjustment of electricity tariffs during 2007 increased arrears to the sector by roughly 0.4 percent of GDP, and similar costs are expected for 2008, despite recent tariff increases (¶18). The authorities explained that the bulk of these subsidies would be financed through a grant provided by Venezuela under the oil-collaboration scheme, thus not affecting public finances.[4] Staff underscored the risk that the government may be forced to maintain these subsidies even in the absence of financing, and encouraged the authorities to gradually dismantle them, particularly as commodity prices soften.

9. **Social programs should be strengthened and carefully assessed to ensure their effectiveness**. Given the impact of food price inflation on the poor, social safety nets should be strengthened within the existing budgetary envelope, while care should be taken to limit direct food-price subsidies. In line with World Bank advice, staff recommended the expansion of school lunch and nutritional programs with a particular focus on infants and pregnant or breast-feeding women, and that consideration be given to relaunching the conditional cash transfer program (*Red de Protection Social*). Staff argued that the government's flagship program *Hambre Cero* had a rural focus and that greater emphasis was required to protect the urban and extreme poor, including by bolstering *Usura Cero* (its other flagship program which provides cheap credit primarily to female heads of households). The authorities countered that recent poverty-reduction efforts had resulted in

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[4] In the case of public transport, the Venezuela grant is off-budget since it is channeled directly to the transport cooperative. Some observers argue that this mechanism seeks to circumvent the system of earmarked transfers. Currently, 10 percent of total expenditures must be assigned to the Assembly and Judiciary, while 8 percent of total revenues is shared with municipalities. The authorities agreed to discuss measures to address these budget rigidities following the municipal elections.

improvements in access to education, health care and water and sanitation, as summarized in the draft National Development Plan and the recently-published social indicators report (*June 2008 structural benchmark*). The government agreed to conduct an independent impact assessment of its flagship programs, the precise timing of which would be discussed during the second review.

10. **Further efforts to contain wage increases are needed to avoid fueling a wage-price spiral.** Staff commended the authorities for ensuring approval of a 2008 supplementary budget consistent with an average increase in public sector wages of 14 percent, while recognizing the importance of compensating lags in the adjustment of real wages for certain priority sectors. However, further efforts are necessary to contain the legally-mandated minimum wage hikes resulting from the tripartite negotiations (involving the government, employers and workers) that were initiated in July.[5] Staff argued that while minimum wages were currently binding for a small share of formal sector employees only, these increases could affect wage-setting more generally (particularly in the current inflationary environment) and lead to a wage-price spiral, increased unemployment and loss in competitiveness. The authorities concurred with staff, but noted that links between minimum wage increases and inflation have historically been very weak.

Nicaragua- Public Sector Wages

		2008	
	2007	Prog.	Proj.
Wage bill			
in C$ millions	7,693	8,741	9,078
in percent of GDP	7.3	7.4	7.1
nominal percent change	14.7	13.6	18.0
Wages 1/			
nominal percent change	14.0	10.2	14.0
of which:			
Education sector	17.6	12.6	16.0
Health sector	18.6	12.6	16.0
Other	8.6	6.7	13.4
real percent change	5.8	2.9	-5.5

Source: Nicaraguan authorities and staff estimates.

1/ Excludes effect of new hires and one-off salaries of elections.

11. **Recent measures to boost food production, alleviate supply-side constraints, and reduce tariffs may help to lower inflation over the medium term**. The government is implementing a number of initiatives to increase agricultural production, particularly by small farmers, through improved access to seeds, fertilizers, agricultural machinery, and financing. Moreover, the role of the state-owned food marketing board (ENABAS) in preventing large food price fluctuations is being revamped, while import tariffs have been temporarily lowered on key staples (such as beans, wheat flour and vegetable oil) with a negligible fiscal impact. Staff agreed on the need to boost food production but stressed the importance of managing the financing channeled to the agricultural sector transparently (¶17) while preserving the role of private microfinance institutions. Moreover, staff warned against actively managing domestic market conditions through ENABAS and policies to restrict exports. The authorities agreed to maintain open trade policies and to address supply-side constraints in a market-friendly fashion within the existing budgetary envelope.

[5] In June 2007, the Assembly approved a new minimum wage law that requires bi-annual adjustments in the minimum wage with a floor on wage increases equivalent to accumulated inflation plus real GDP growth. Minimum wages have been raised by an average of 33 percent since June 2007, far above the floor established in the law.

Box 2. Transport, Electricity, and Water Subsidies

Transport Subsidies

- **Budget transfers:** Until recently, transport subsidies were limited to urban bus transport in Managua and financed through central government transfers (0.1 percent of GDP in 2007). This subsidy bridged the gap between the regulated bus tariff (currently set at C$2.5 per passenger) and the cost-based tariff, calculated by the transport regulator using a formula with detailed cost and traffic data. The central government transfers resources to the transport regulator, who in turns compensates the urban bus cooperative.

- **Expansion of urban bus transport subsidies:** In 2007, Venezuela (through its local PDVSA Trust Fund) began providing a direct grant to the urban bus cooperative, to finance increased subsides arising from higher diesel prices. The grant stabilizes the diesel prices paid at the pump (at about US$2 per gallon), allowing the government to maintain the bus tariff at C$2.5. In turn, the PDVSA Trust reimburses pump operators for the difference between the market and reduced price for diesel. Budgetary and off-budget transfers to the bus cooperative reached 0.3 percent of GDP in 2007.

Transport, Electricity and Water Subsidies
(in percent of GDP)

	2007 Prel.	2008 Proj.
Transport subsidies	**0.3**	**1.2**
a. Budget transfers	0.1	0.1
b. Venezuela grant	0.2	1.1
Managua bus	0.2	0.3
Taxis	0.0	0.3
Inter-urban	0.0	0.3
Other	0.0	0.1
Electricity subsidies	**1.0**	**0.9**
a. Budget transfers	0.4	0.4
b. VAT preferential rate	0.2	0.2
c. Tariff slippages 1/	0.4	0.3
Water subsidies	**0.4**	**0.4**

Source: Authorities and staff estimates

1/ Reflects cost of tariff slippages and delays in raising distribution fees. In 2008, the government transferred US$20 million (0.4% of GDP) to compensate for slippages in 2007.

- **Extension of subsidy:** In May 2008, transport subsidies were extended to other forms of transport, without direct fiscal cost. A specific subsidy equivalent to US$1.3 per gallon of diesel (relative to the current market of about US$4.8 per gallon) is now provided to licensed taxis, urban bus transport outside Managua, inter-urban buses, and lake-crossing ferries. A maximum daily consumption quota has been established by transport type, and electronic cards are gradually being distributed among public transport providers in an effort to reduce leakages. The subsidy is financed through a direct grant from the PDVSA Trust to the transport cooperatives. Currently about 15–20 percent of fuel consumed domestically is subsidized, costing roughly 1.2 percent of GDP.

Electricity subsidies

- **Targeted subsidies** reached about 0.4 percent of GDP in 2007, reflecting assistance to: (i) households consuming under 150 kWh (costing US$12–15 million); (ii) households living in low-income neighborhoods or *asentamientos* (US$8–10 million); and (iii) retirees who receive a 50 percent discount on the first 150kWh of consumption (US$1–2 million). Furthermore, the recently-introduced **preferential VAT rate** (of 7 percent compared to the standard 15 percent) on medium-sized consumers (300–1000kwh) cost an additional US$10 million. In August 2008, the Assembly approved a 5-year extension to the subsidy for small consumers (representing about 20 percent of total consumption) and to the preferential VAT rate on medium-sized consumers.

- **Slippages in tariff adjustments** during 2007 was associated with an increase in arrears to the sector of roughly US$25 million and similar costs are expected in 2008. The 2008 budget supplement included transfers of US$20 million to clear half the stock of arrears accumulated through end-2007.

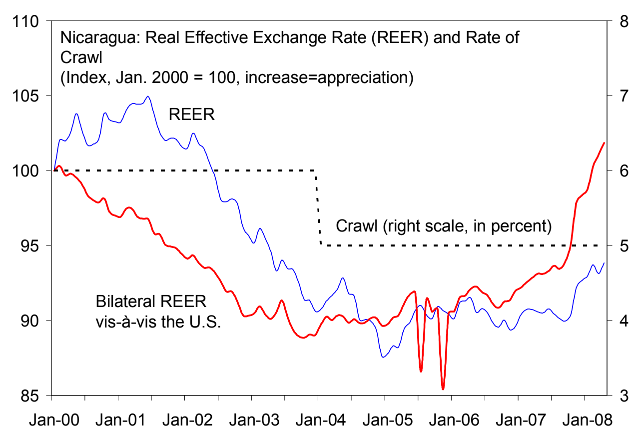
Water and sewer subsidies. Central government-financed water subsidies were limited to 0.4 percent of GDP in 2007, targeted to: (i) households who consume under $50m^3$ (about US$14 million); (ii) households living in *asentamientos* (about US$7.5 million); and (iii) retirees who receive a 30 percent discount on their water bills (about US$0.6 million).

C. Monetary and Exchange Rate Policies

12. **Monetary policy will aim to control inflation, while allowing for a further buildup in international reserves (Panel 4).** The monetary program for 2008 is consistent with a growth in monetary aggregates roughly in line with nominal GDP but a somewhat lower than originally programmed buildup in international reserves.[6] The central bank (BCN) has been aiming to tighten bank liquidity conditions through open-market operations (OMOs), although the suspension of debt service on the *CENIs* limited the BCN's ability to place debt with banks despite interest rate hikes (400 basis points in since the start of the year) and transmission of these increases to bank interest rates has been limited. The authorities expect that this situation will be reversed with the completion of the *CENI* restructuring agreements, and pointed out that increased demand from public sector institutions has helped to sterilize liquidity and more than compensated for shortfalls in private sector placements.[7] Moreover, steps have been taken toward developing a longer-term treasury bill market, better suited for investments by the public pension system.[8]

13. **It will be critical to restore the institutional framework of monetary policy by establishing quickly a new central bank board.** While the absence of a board has thus far not directly impaired the BCN's ability to conduct OMOs (as debt issuance is still US$100 million below the annual ceiling of about US$400 million approved in late 2007), any decision to raise reserve requirements or increase the ceiling of bond issuance is subject to board approval. The President recently submitted to the Assembly his nominations to fill central bank board vacancies (*prior action*) and agreed to seek their ratification by end-September (*structural PC*), noting that building a majority in the Assembly would require some time.

14. **The exchange rate regime remains adequate and competitiveness does not appear to have been impaired by the recent surge in inflation (Panel 5).** While the REER has risen in recent months, real appreciation has been small in comparison with other countries in the region. Moreover, real wages have fallen over this period and manufacturing exports remain buoyant, suggesting that the *cordoba* is not overvalued–as also indicated by relative productivity levels.



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[6] While the agreed monetary program is consistent with a NIR accumulation of US$60 million, a program floor of US$40 million was established, given transitory factors associated with last year's large overperformance.

[7] In recent months, the Social Security Institute has been investing its surplus in BCN paper through the noncompetitive window, while reducing its deposits in commercial banks. The rate in the noncompetitive window is referenced to that in the competitive auction, where only banks participate.

[8] The Ministry of Finance has issued US$18 million in treasury bills (with maturity of up to 3 years) through end-May out of projected total of US$45 million in 2008.

Staff advised against reducing the rate of crawl, and given Nicaragua's exposure to large terms of trade shocks, it suggested that a move toward increased flexibility would seem more desirable over the medium term.[9] Staff expressed concern about increased vulnerabilities (growing current account deficit and dependency on official aid inflows, as well as rising dollarization) and stressed the need to maintain prudent policies.

D. Financial Sector Policies

15. **A durable solution to the *CENIs* controversy is critical to safeguard the stability of the banking system (Box 3).** Staff expressed concern over the uncertainties generated by the handling of the bank bonds and urged the authorities to provide a sound legal basis to the restructuring agreements by ensuring their approval by the BCN board as soon as the new members were ratified. It will be critical for the central bank to resume debt-service obligations to banks according to the newly agreed terms, on the basis of budgetary transfers provided by the government. Given the impact of the restructuring on the banks' financial position, the Superintendency of Banks (SIBOIF) must enforce banks' compliance with prudential norms and recently-introduced international accounting standards over a reasonable period of time. In that regard, the following strategy has been agreed:

- Banks recently submitted action plans including measures to achieve compliance with local prudential norms dealing with market risks (*prior action*). The SIBOIF is currently evaluating these plans to ensure that banks remain well-capitalized and that any mismatches (in maturity, interest rates and currency denominations) arising from the restructuring are resolved within a reasonable period of time.
- To avoid an immediate impairment in the banks' capital position, the SIBOIF informed banks of its intention to waive the requirement (established in the new chart of accounts that came into effect in January 2008) to apply NPV accounting standards to the restructured bonds (*prior action*). Staff underscored that any forbearance must be implemented transparently and granted for a limited time period only. In this regard, the SIBOF agreed to discuss during the second review a calendar for phasing out this forbearance, while coordinating this decision closely with the Panamanian supervisor, since the banks' holding companies will be subject to similar accounting standards.

16. **The newly-adopted prudential and accounting frameworks should be enforced, in line with regional coordination and harmonization efforts**. Staff emphasized the importance of limiting forbearance to the newly restructured bonds and ensuring implementation of the new chart of accounts, including key internationally accepted accounting standards. The authorities argued that banks may need some time to comply with these new accounting standards (e.g., the valuation of restructured assets) and that consideration was also being given to revising prudential norms for market risks to better reflect local conditions. Moving away from the already adopted international regulatory and accounting standards would hinder regional harmonization efforts and complicate effective supervision of cross border conglomerates.

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[9] The official exchange rate of the Córdoba against the U.S. dollar is preannounced by the BCN and depreciates by 5 percent a year.

BOX 3. THE CENIS CONTROVERSY–BACKGROUND AND RECENT RESTRUCTURINGS

Background: During the 2000–01 banking crisis, the central bank issued roughly US$400 million (about 10 percent of GDP) in bonds (*Certificados Negociables de Inversion,* CENIs) to cover the difference between performing assets and liabilities of insolvent banks that were intervened and absorbed by other private banks. The CENIs were indexed to the U.S. dollar, had maturities of up to 3 years, and carried market interest rates of roughly 14½ percent. In 2003, banks holding CENIs agreed to provide debt-service relief to the government by accepting new *bonos bancarios* of 10-year maturity, semi-annual principal payments, and lower interest rates of 8¼ percent. This restructuring was approved by the central bank board, and subsequent annual central government budgets have included transfers to the central bank to cover debt-service obligations. These *bonos bancarios* were held by two large privately-owned local banks, which together account for close to 60 percent of total banking system deposits, and represent an important share of their capital and assets.

Bonos Bancarios and Selected Financial Indicators

	Total
(in percent, at end-March 2008)	
Bonos bancarios / Regulatory capital	122.0
Bonos bancarios / Risk-weighted assets	16.4
Total public sector debt / Risk-weighted assets 1/	32.9
Memorandum items	
Regulatory capital to risk-weighted assets	13.5
Liquid assets to total assets 2/	19.2
Return on Equity 2/	21.8
Assets (in percent of total banking system)	44.1
Deposits (in percent of total banking system)	54.7

Source: Superintendency of Banks and Staff estimates.

1/ Includes bonos bancarios and Property Indemenization Bonds (BPIs) at end-2007.

2/ Based on simple average of banks.

Legal challenges: These bonds have long been mired in controversy. In 2005, the Comptroller General questioned the authority of the central bank to issue and restructure these bonds, and in late 2007 the Attorney General (AG) initiated an investigation on the adequacy of the amounts of CENIs issued in 2000–01 and the subsequent restructuring of 2003. In April 2008, responding to the AG's investigation, the courts temporarily sequestered the bonds falling due in 2008, halting debt service payments to banks. In July, the AG levied criminal charges against 39 individuals, mainly former public officials, for improprieties in resolving the banking crisis, including allegedly overcompensating private banks and failing to conduct proper audits and competitive public auctions.

The 2008 restructurings: In light of legal challenges, in June/July the banks again agreed to the central bank's request to replace the outstanding bonds (US$186 million or 3½ percent of GDP) with new debt instruments at the same face value. The restructuring agreement (involving the early redemption of the *bonos bancarios* bonds and issuance of new bonds) extended the maturity to 20 years, lowered interest rates (to 5 percent for the initial 15 years and 5¼ percent for the last 5 years) and allowed banks to extend the use of these new bonds for liquidity purposes and dividend payments. In addition, a technical committee was formed to address a past-due government obligation (US$10 million) to one of the banks linked to the resolution of an intervened bank in 2000–01.

Impact of restructurings: The 2008 restructuring will impact the banks' capital levels (CAR), liquidity and market risks and compliance with prudential norms for concentration limits. Local prudential norms require banks to maintain a minimum CAR at 10 percent. New accounting rules introduced in Nicaragua in January 2008 would require any NPV loss to be reflected by discounting future debt service flows at the original interest rate. Preliminary estimates suggest that of the two banks holding *bonos bancarios* only one could suffer losses resulting in a CAR slightly under the required 10 percent.

Regional dimension: The two affected banks are subsidiaries of regional financial groups incorporated in Panama, which have a small presence in Costa Rica, Honduras, El Salvador and Guatemala. Coordination with the Panamanian supervisor and other supervisors in the region will be critical.

E. Aid Management and Transparency

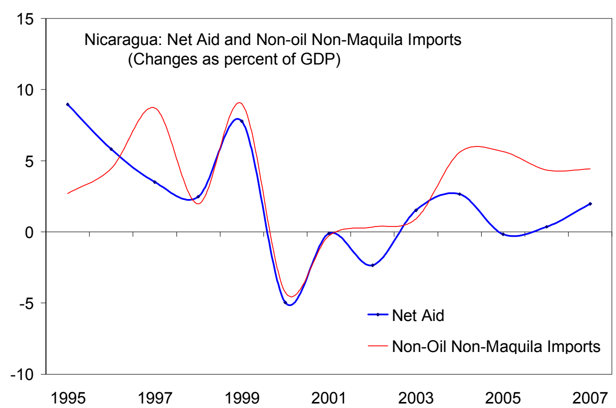
17. **While increased aid inflows have helped Nicaragua weather the impact of rising oil prices, it will be critical to continue monitoring closely and reporting transparently all official assistance (Box 4)**. Total official assistance to Nicaragua is estimated to reach 19 percent of GDP in 2008, from 12 percent of GDP in 2007. Specifically, official financing from Venezuela, under the auspices of ALBA (*Alternativa Bolivariana de las Americas*), is projected to grow from 2.7 percent of GDP in 2007 to 9.4 percent in 2008. While staff analysis shows that increased aid does not appear to have serious implications for absorption capacity and external debt sustainability, the authorities agreed to monitor developments closely. Moreover, the uncertainty and mechanisms through which part of the official aid is being channeled present additional challenges.[10]

Nicaragua - Official Assistance (in percent of GDP)

	2006	2007	2008
Total Assistance	12.2	14.7	20.6
Grants	6.6	8.7	8.0
Public sector 1/	6.5	7.9	5.0
Private sector 2/	0.1	0.8	3.1
Loans	5.6	5.3	8.3
Public sector	5.6	4.5	5.7
Private sector	0.0	0.8	2.6
FDI (private sector)	0.0	0.7	4.3
Memorandum item			
ALBA-related	0.0	2.7	9.4

Source: Authorities and staff estimates
1/ Includes natural disaster grants (US$80m), yet excludes debt buy-back grant for US$58m.
2/ Includes ALBA and Millenium Challenge Account grants.

- **Absorption capacity:** Though about half of the increase in aid is associated with higher FDI (3½ percent of GDP) for electricity generation and oil storage (which should not have a direct impact on inflation), the remaining half is in the form of concessional financing and transfers to the private sector. While high rates of unemployment, slowing growth, and the high import-content of any additional spending indicate that additional aid could be absorbed comfortably, the authorities agreed to tighten policies should demand pressures emerge.



- **External sustainability (Appendix):** Given that the bulk of additional assistance is channeled through the private sector, and according to the authorities does not generate public debt (direct or contingent), staff's external debt sustainability analysis has been extended to include increased indebtedness by the private sector. Preliminary analysis suggests that although total external debt rises in the next five years, debt levels seem to be sustainable and debt-service obligations manageable (under 15 percent of exports) over the medium to long term, as most of the financing to private cooperatives is concessional.

[10] The original program's baseline projections excluded ALBA financing. However, given uncertainties, an adjustor for ALBA-related financing for the public sector was established, equivalent to 2½ percent of GDP. This adjustor remains dormant as the bulk of ALBA collaboration has been benefiting the private sector.

Box 4. Nicaragua-Venezuela/ALBA Collaboration

The economic ties between Venezuela and Nicaragua strengthened significantly since the new government took office in early 2007. Although an important share of the exchange between the two countries has been linked to oil imports and oil-related financing, Venezuela has also been active in: (i) FDI through a binational firm, ALBANISA (51-percent owned by PDVSA and 49-percent by the Nicaragua's state-oil company PETRONIC); (ii) private sector financing (including through its development bank, BANDES); and (iii) the provision of grants for budgetary support, including aid after Hurricane Felix.

Venezuela/ALBA Collaboration (US$m)

	2007	2008
Total	**154**	**624**
in % of GDP	*2.7*	*9.4*
a. FDI	**42**	**284**
o/w: power plants	39	164
b. Grants	**68**	**170**
Public	20	0
Private	48	170
o/w: PDVSA-Trust	36	170
c. MLT Loans	**45**	**170**
Public	0	0
Private	45	170
o/w: to CARUNA R.L.	36	170
<u>Memorandum items:</u>		
Shortterm loans 1/	33	44

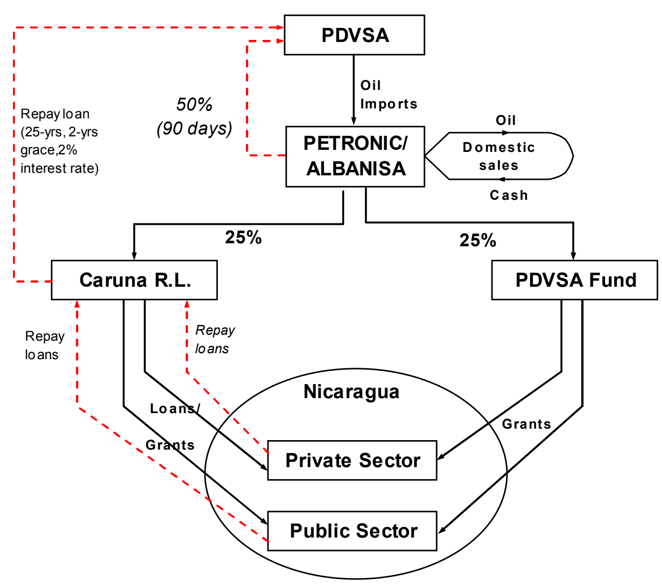
Source: Authorities and staff estimates

1/ Includes 90-day oil-import commercial credits.

The oil collaboration scheme is different than that with other countries in the region (i.e., PetroCaribe). The scheme, which according to the authorities does not involve the contracting of direct and/or contingent public debt, works as follows: (i) 50 percent of the oil bill from Venezuela (effected through PETRONIC and/or ALBANISA) is paid on commercial terms within 90 days; (ii) a local rural credit cooperative (*Caja Nacional Rural*, CARUNA R.L.) receives a loan equivalent to 25 percent of the oil bill on concessional terms (payable over 25 years, with a 2-year grace period, at an interest rate of 2 percent) that can be used to provide financing to both the private and public sectors; and (iii) the remaining 25 percent goes to a Trust Fund owned by PDVSA but managed by CARUNA R.L. that can only be used for purposes and financing terms (including grants) approved by Venezuela. On this basis, the grant element of the oil-financing is close to 60 percent, compared to about 40 percent for PetroCaribe (where 50-60 percent of the oil bill on concessional terms depending on oil prices).

Financing from Venezuela is projected to grow further in 2008. The increase reflects higher FDI (US$284 million) in the form of fuel-based electricity plants and oil storage facility collaboration, as well as increased oil collaboration (US$340). PETRONIC imports from Venezuela are projected to increase to about 55 percent of Nicaragua's oil bill (compared to 25 percent in 2007) as a result of an agreement reached with a private oil multinational to purchase/lease some of its storage tanks. The PDVSA Trust Fund is expected to provide grants to the private sector (mainly to finance transport and electricity subsidies), while CARUNA R.L. is expected to lend to small rural cooperatives.

Oil Collaboration Scheme

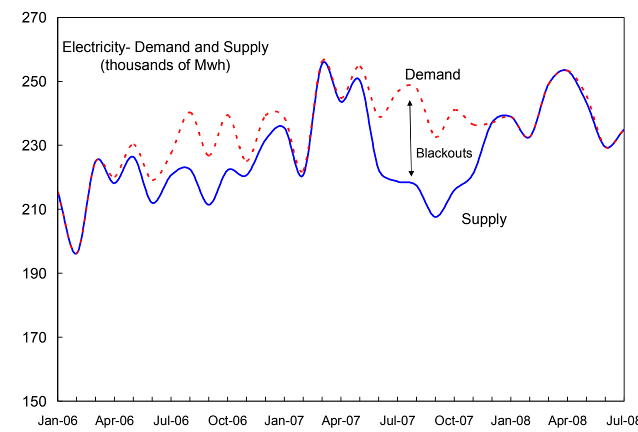


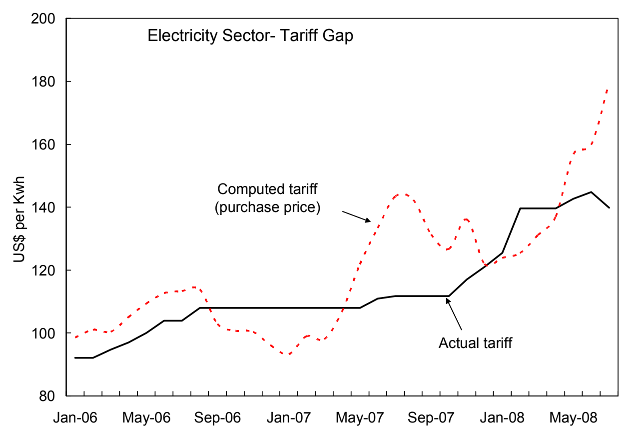
- **Transparency:** In line with staff recommendations that all aid be subject to the same reporting standards, the authorities plan to publish a report on the sources and uses of all official development assistance during 2007 channeled to both the public and private sector (*prior action*). This report will be updated bi-annually, and information for the first half of 2008 will be published by October (*structural benchmark*). The authorities have clarified the different modalities of ALBA-related assistance, but noted that the mechanisms through which ALBA-related assistance is being received remain fluid, as multilateral institutions are still in the process of being created. Staff urged the authorities to seek publication of all contracts (including those involving private cooperatives) to clarify that these financing operations do not constitute public debt.

F. Structural Reforms

Energy sector reforms

18. **Progress is being made in reforming the energy sector, though these efforts must be sustained to solidify the finances of the sector.** Generation has been expanded, tariffs have increased to better reflect costs, and efforts are under way to reduce the high levels of electricity theft and improve distribution services.





- **Expanding electricity generation**: Blackouts have been largely eliminated through installation of new fuel-based electricity plants and the reconciliation of arrears between generators and the private distribution company.[11] The authorities indicated that while the recent expansion in generation increased Nicaragua's dependency on oil, their objective is to change the energy matrix over the medium term, through a number of projects for hydroelectric, wind, and geothermal generation, and for which financing (from private and multilateral sources) has already been identified.

- **Ensuring tariffs reflect energy costs:** While electricity tariffs have been raised by close to 27 percent in

[11] The binational energy company ALBANISA installed two plants with total capacity of 60MW during 2007, and several other plants with capacity 180 MW are expected to be incorporated during 2008–09 to meet growing electricity demand. The plants will be operated by ENEL, the state electricity generation company.

the year through August 2008 to reflect higher generation costs and the legally-mandated increase in distribution fees (*July 2008 structural benchmark*), deviations between the actual tariff and input costs emerged reflecting the spike in oil prices. The authorities plan to compensate the costs of tariff deviations during the first eight months of 2008 (US$20 million) as well as remaining arrears at end-2007 (US$20 million) through a direct grant from Venezuela, hence not affecting the fiscal deficit. Looking forward, the authorities agreed to adjust tariffs in line with costs, explaining that recent slippages reflected unusually large increases in energy costs, which have softened significantly since.[12] Staff stressed the importance of de-politicizing tariff setting to reduce fiscal risks and enhance transparency.[13]

- **Addressing electricity theft:** The Assembly approved a law penalizing electricity theft in June (*December 2007 structural PC*) as well as amendments to the Penal Code aimed at discouraging electricity theft, including criminalizing theft for higher-end residential consumers and industry. To ensure implementation, the authorities are in the process of increasing the number of inspectors and have recently finalized a study identifying and addressing the sources of the high distribution losses (*April 2008 structural benchmark*). This study will be used to develop a plan, in collaboration with the private distribution company, for gradually reducing losses. The swift and uniform implementation of the new law remains a key challenge.
- **Improving electricity services:** The government and the private distributor signed an agreement in June aimed at improving the sector's performance and eliminating cross-arrears. This agreement, which is currently being considered by the Assembly, would result in the government acquiring a minority stake (16 percent) in the distribution company, in exchange for assuming the arrears that the distribution company has with the public generation company. Under the agreement, the government is expected to adjust tariffs in line with costs, while the distribution company is committed to a multi-year investment plan to improve service provision.

Fiscal reforms

19. **Steps have been taken to improve budgetary controls, and the focus has shifted to implementing a carefully-sequenced action plan.** An action plan to revamp public financial management (PFM) practices was finalized in June (*structural PC*) broadly in line with Fund TA recommendations. The plan includes measures to improve and update the platform used to register fiscal accounts (SIGFA) to allow for better planning, management and monitoring of the budget process in all its different stages. In addition, good progress was made in revising the chart of accounts and budget classification in line with new government accounting standards (*April 2008 structural benchmark*), though its finalization is now only expected in September and its effective implementation will have to await the installation of the new SIGFA platform. The authorities agreed to discuss a timetable for

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[12] Oil prices (WTI) have fallen to US$115 per barrel from a peak of US$145 in early July 2008. At current prices, tariffs would need to be raised by 8–10 percent to close the gap. The cost of keeping tariffs unchanged is estimated at US$3 million per month (0.2 percent of GDP until the end of the year).

[13] The formula for adjusting tariffs with input costs was published in December 2007 (*structural benchmark*).

further steps in this area during the second review. Some of these steps would form part of program conditionality in 2009.

20. **Efforts to strengthen revenues must be stepped up to ensure a sustainable fiscal consolidation:**

- In the area of revenue administration, some progress has been made in adopting a plan to strengthen: (i) the taxpayer registry system, (ii) large taxpayer audits; and (iii) custom inspections and controls. However, final adoption of this plan (*March 2008 structural benchmark*) has been postponed until end-September, to take into account recent Fund TA recommendations. Staff stressed the importance of not losing momentum, as well as the need to frame these actions in the context of ongoing regional integration efforts, including the Central American Customs Union Agreement that was approved by the Assembly in December 2007.
- Technical work has progressed in the design of a tax reform aimed at improving the equity of the system through a streamlining of tax exemptions, while preserving revenue-neutrality. A proposal is expected to be ready by end-2008, and TA has been requested from the IDB.

21. **Work is progressing technical assistance a much-needed reform of the pension system.** An actuarial study of the pension system (*June 2008 structural benchmark*) was recently finalized, and an inter-ministerial commission has been setup to develop a reform proposal to correct the actuarial gap. The authorities plan to request Fund TA to provide options for a parametric reform, the timing and content of which will be discussed in the context of the second review. Staff stressed the need to adapt the INSS's investment norms to international best practices and prevent past practices of granting direct loans to government-friendly private firms. The Supreme Court recently declared Law 539 unconstitutional. The Law—approved in 2005, but never implemented—could have further undermined the sustainability of the pension system, as it proposed unfunded increases in entitlements, as well as reductions in the retirement age for certain workers.

Central bank, financial sector, and governance reform

22. **Strengthening central bank finances is critical for the effective conduct of monetary policy.** A recent Fund TA mission found that the BCN's balance sheet was very large by international standards, owing to the presence of sizable external liabilities in the process of renegotiation that constantly generate revaluation losses. A comprehensive assessment of the BCN's financial position in line with IFRS is expected by September 2008 (*June 2008 structural benchmark*), as more time was required to reflect TA recommendations.[14] The authorities have also been implementing the recommendations of the safeguards assesment completed in November 2007, and a timetable of additional measures including for 2008 has been agreed (TMU ¶7). In particular, an external auditor has been appointed for 2006–08, and the audited financial statements for 2004/05 have been

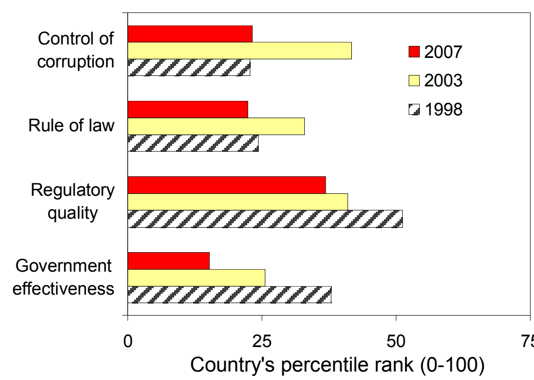
[14] Among other elements, the mission recommended that the government assume debt-service obligations on the rescheduled foreign debt in exchange for a cancellation of all BCN claims on the central government.

published. However, the 2006 and 2007 external audits are still overdue. A streamlined safeguards assessment update, focusing on measures taken since November 2007, is being conducted in the context of the augmentation request and is expected to be completed by end-2008.

23. **The oversight of nonbank financial institutions must be strengthened.** While improving farmers' access to credit is essential to allow Nicaragua to benefit from the opportunities offered by high world food prices, the oversight and monitoring of nonbank institutions that provide an increasing share of agricultural credit must be strengthened. Particular emphasis should be given to strengthening the agency responsible for monitoring activities of rural cooperatives (*InfoCoop*). A new state-development bank (*Produzcamos*) that consolidates a number of state-run financial institutions was created in November 2007. The bank is not yet fully-functioning, will not be permitted to capture deposits, and will be subject to the oversight of the Superintendency of Banks. Ensuring the bank is subject to the similar regulatory and corporate governance treatment as private commercial banks will be critical to limit quasi-fiscal risks.

24. **Improvements in governance and the business climate are critical to achieving Nicaragua's growth and poverty reduction objectives.** Key governance indicators have weakened in recent years, reflecting mainly concerns about the quality of institutions and the rule of law. The authorities argued that steps were being taken to improve governance, including through: (i) the issuance in June of regulations governing the appointment of judges aimed at depoliticizing this process; (ii) the approval of a new Transparency Law aimed at strengthening the accountability of public enterprises; and (iii) the adoption of a Penal Code that in addition to permitting the criminalization of the theft of public utilities, brought Nicaragua's anti-money laundering practices closer to international best practices. Staff agreed with the merits of these initiatives, and stressed the importance of ensuring full implementation of these laws and resolving any potential conflicts with the private sector in a market-friendly fashion.

Nicaragua's Governance Quality Indicators Ranking



Source: Kaufmann D., A. Kraay, and M. Mastruzzi 2008: Governance Matters VII: Governance Indicators for 1996-2007.

IV. Program Financing and Augmentation

25. **The program remains adequately financed and further progress has been made on the external debt restructuring front.**

- The larger-than-programmed current account deficit is expected to be financed through increased external assistance, including from nontraditional sources. Budget support from traditional sources, including the World Bank and IDB, is projected to exceed program estimates, partly reflecting the sharp appreciation of the *euro*. While delays have emerged in the disbursements of this budget support, completion of the first review and finalization of the government's new National Development Plan (expected by end-September), should help leverage donor support for the remainder of the year.

- The commercial debt buy-back operation (US$1.3 billion) launched in October 2007 with the support of IDA's Debt Reduction Facility and additional donor financing was successfully completed with participation exceeding 95 percent. The government remains willing to resolve in good faith any pending claims. On the Non-Paris-Club bilateral front, Venezuela and Poland provided debt relief of US$33 million and US$31 million, respectively. Negotiations with other non-Paris Club bilateral creditors continue; the total debt outstanding to these creditors was US$1.8 billion at end-2007.

26. **The authorities have requested a small augmentation to the PRGF arrangement to help cope with the negative impact of last year's natural disasters.** An independent assessment by ECLAC estimated the damages from last year's hurricane and floods at close to 8 percent of GDP, a large share of which related to capital stock losses, though the direct balance of payments impact has been estimated at roughly 1.5 percent of GDP (US$85 million) in 2007.[15] An augmentation of 5 percent of quota (US$10 million) will help Nicaragua cope with the negative effect on agricultural production of these disasters. This would complement efforts by other donors and multilateral institutions who in late 2007 provided emergency assistance of roughly US$65 million.[16]

V. Program Risks and Monitoring

27. **Growing political and social tensions and a more adverse external environment have raised risks and may complicate program implementation.**

- *Macroeconomic risks*: Further increases in commodity prices could result in lower growth and higher inflation, and further social tensions. Softer growth in the U.S. and the region may compound these risks. Aid from traditional sources could drop on heightened governance concerns, particularly in the context of the municipal elections, while uncertainties in ALBA-related inflows present additional challenges. In that regard, it may be difficult to dismantle the recent expansion of subsidies should the associated external assistance drop.
- *Institutional risks*: Passing legislation in the Assembly will continue to require negotiations with the opposition. Failure to reach compromises could again result in deadlock, as earlier this year, and delay approval of key legislation, including the 2009 budget, external financing, and ratification of the new BCN Board nominees.
- *Policy implementation risks:* It will be important to maintain sound policies ahead of the municipal elections, and resist the likely intensification of spending and wage pressures, particularly in light of inflation risks. Program implementation may also

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[15] This includes forgone food exports of 0.2 percent of GDP, and increased imports of food, medical supplies, and construction materials of 1.3 percent of GDP.

[16] Emergency-related official assistance in 2007 included US$20 million through the UNDP flash appeal (with participation of donors), US$17 million from the World Bank, and US$28 million from Venezuela.

suffer in response to worsening economic conditions, and a drop in external financing could unduly pressure a cash-constrained government.

28. **Program implementation will continue to be reviewed every six months.** Quantitative performance criteria have been established through end-2008, while indicative targets have been set through end-June 2009 (Table 1). A revised structural reform agenda has been established (Table 2), with changes in definitions, conditionality, and reporting requirements reflected in the revised Technical Memorandum of Understanding. Prior actions for completion of the first review are summarized below.

Nicaragua: Prior Actions for Completion of First Review of the PRGF

	Status
1. Submission to the Assembly of candidates to fill vacancies on the central bank board.	Done (August 2008).
2. Completion of agreed-action plans of affected banks to comply with regulatory norms.	Done (August 2008).
3. Communicate to banks decision to grant forbearance in the application of certain accounting standards.	Done (August 2008).
4. Publication of a report on official external aid.	Pending.

VI. Staff Appraisal

29. **Adverse external conditions have led to a weakening in economic performance, despite prudent macroeconomic policies.** Real GDP growth is expected to fall and inflation to rise relative to the original program, as a result of a weaker global environment and higher commodity prices. The external current account deficit is projected to widen, though increased FDI and external assistance will allow for some buildup in international reserves. Most quantitative targets through end-June 2008 were comfortably met, reflecting the continued implementation of prudent macroeconomic policies.

30. **Containing inflation and protecting the poor from recent commodity price shocks remains a key policy challenge.** Efforts must continue to limit second-round price effects and contain wage pressures (including in the ongoing minimum wage negotiations) ahead of the November municipal elections, as well as comply with the established fiscal targets. Measures to boost food production may help reduce inflation over the medium term, though care will need to be taken to maintain open trade policies and to address supply-side bottlenecks in a market-friendly fashion. Social safety nets need to be strengthened, within the program's budgetary envelope, through well-targeted subsidies. The recent expansion of transport and energy price subsidies should be dismantled gradually to limit fiscal risks.

31. **Monetary policy should remain vigilant and the central bank's institutional framework needs to be restored urgently.** The onset of tightening of credit conditions has been appropriate, though further efforts need to be made to curb credit growth and improve monetary policy management. Swift filling of central bank board vacancies will be key to restore the credibility and framework of monetary policy.

32. **A durable solution to the bank-bond problem is necessary to safeguard the stability of the banking sector.** In order to address uncertainties generated by this episode, quick approval of the restructuring agreements should be sought once the central bank board is reconstituted. Meanwhile, the Superintendent of Banks needs to ensure that any forbearance granted to the affected banks in meeting prudential norms, including recently-introduced international accounting practices, is guided by a transparent and time-bound action plan. Implementation of these plans needs to be closely monitored and coordinated with regional supervisors. More generally, the newly-adopted prudential and accounting frameworks should be enforced, in line with regional harmonization and cross-border supervision efforts.

33. **Some progress has been made in implementing the structural reform agenda, though further efforts will be required.**

- **Energy sector reforms.** Progress has been made in adjusting electricity tariffs to better reflect costs, eliminating blackouts, and establishing a new legal framework to discourage theft and fraud. Looking forward, it will be important to establish a more predictable mechanism for adjusting tariffs, and to ensure the swift and uniform implementation of the new anti-theft law, while providing the distribution company with the leeway to improve compliance. Staff welcomes efforts to boost electricity generation and gradually reduce Nicaragua's dependency on oil through private-sector led initiatives.
- **Public financial management reforms.** The preparation of a comprehensive action plan is an important step forward; it will be important to establish realistic priorities and milestones to ensure effective implementation. Improved budget management and control is critical to improve the productivity and prioritization of spending.
- **Pension reform.** Policy options need to be formulated to address the system's unfunded liabilities assessed by the recent actuarial study. Investment rules should be revised in line with international best practices and direct lending by the INSS avoided.

34. **Aid monitoring and transparency will need to be strengthened.** Staff welcomed the authorities' intention to publish a bi-annual report on the sources and uses of all official aid with the available information. However, further efforts are needed in communicating the mechanisms for ALBA-related assistance, and in clarifying that it does not generate direct or contingent public debt through publication of the agreements. Staff underscored the risks associated with large and variable levels of aid, and stressed that policies may need to be tightened should demand pressures arise.

35. **Improving governance and the business climate will enhance growth prospects.** Recent measures to strengthen the independence of the judiciary and accountability of public enterprises are steps in the right direction. However, care should be taken in resolving conflicts with the private sector in a transparent manner to avoid discouraging investment and growth.

36. **Fund support will continue to provide a policy anchor.** Given Nicaragua's exposure to sudden reversals in investor confidence and external shocks, it will be critical for the authorities to maintain prudent policies in the context of the municipal elections and

rising inflation. In this regard, Fund support is expected to help bolster this policy stance within the administration.

37. **Staff recommends:**

- *Granting waivers* for the nonobservance of structural performance criteria related to the delays in approving a budget for 2008 consistent with program targets and the approval of a law criminalizing electricity theft.
- *Completing the first review* under the PRGF arrangement, in view of broadly satisfactory program implementation and commitments made for the remainder of the year.
- *Approving the requested augmentation* of resources under the PRGF, equivalent to 5 percent of Nicaragua's quota, in light of the negative impact of various shocks on the economy.

Proposed Decision

The following draft decision, which may be adopted by a majority of the votes cast, is proposed for adoption by the Executive Board:

1. Nicaragua has consulted with the Fund in accordance with paragraph 4(d) of the Three-Year Arrangement under the Poverty Reduction and Growth Facility for Nicaragua (the "PRGF Arrangement"), (EBS/07/103, 09/04/07), and paragraph 3 of the letter dated August 24, 2007, from the President of the Central Bank of Nicaragua and the Minister of Finance and Public Credit, in order to review program implementation.

2. The letter dated August 28, 2008, from the President of the Central Bank of Nicaragua and the Minister of Finance and Public Credit (the "August 2008 Letter") together with its Technical Memorandum of Understanding (the "August 2008 TMU"), shall be attached to the PRGF Arrangement for Nicaragua, and the letter dated August 24, 2007 from the President of the Central Bank of Nicaragua and the Minister of Finance and Public Credit, and its attachment shall be read as supplemented and modified by the August 2008 Letter and the August 2008 TMU.

3. Accordingly, the PRGF Arrangement for Nicaragua shall be amended as follows:

(a) Paragraph 1(a) shall be amended to replace "SDR 71.5 million" with "SDR 78 million".

(b) Paragraph 1(b) shall be amended to read as follows:

"(b) Disbursements under this arrangement shall not exceed the equivalent of SDR 30.3 million until the beginning of the second year of the arrangement and the equivalent of SDR 54.1 million until the beginning of the third year of the arrangement."

(c) Paragraph 2(b) shall be amended to read as follows:

"(b) the second disbursement, in an amount equivalent to SDR 18.4 million, will be available on or after March 31, 2008 at the request of Nicaragua and subject to paragraphs 4 and 5 below;"

(d) A new paragraph 2(d) shall be added to read as follows:

"(d) the fourth disbursement, in an amount equivalent to SDR 11.9 million, will be available on or after March 31, 2009, at the request of Nicaragua and subject to paragraphs 4 and 5 below;"

(e) New paragraphs 4.A.(c)(ii) and (iii) shall be added to read as follows:

"(ii) by September 30, 2008, the Central Bank Monetary Board has not approved the bond restructurings, as set forth in paragraph 16 of the August 2008 Letter; or"

"(iii) by October 31, 2008, Nicaragua has not carried out its intention to submit to the Assembly a draft 2009 budget consistent with program objectives, as set out forth in paragraph 11 of the August 2008 Letter, or"

(f) A new paragraph 4.AA. shall be added to read as follows:

"AA. the fourth disbursement under this arrangement specified in paragraph 2(d) above:"

"(a) if the Managing Director of the Trustee finds that with respect to the fourth disbursement, the data as of December 31, 2008 indicate that the floors and ceilings set forth in paragraph 4.A.(a)(i) through (iii) above, specified in paragraphs 1 and 2 and Table 1 of the August 2008 TMU, was not observed;" or

(g) A new paragraph 4.AA.(b) shall be added as follows:

"(b) until the Trustee has determined that with respect to the fourth disbursement, that the third program review, referred to in paragraph 2 of the [August] 2008 Letter, has been completed: or

(h) a new paragraph 5(a)(iii) shall be added to read as follows:

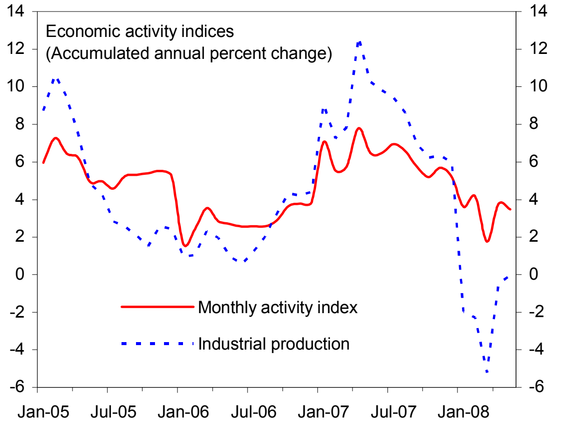
"(iii) If Nicaragua has not carried out its intention through December 31, 2008, to approve 2008 budget supplements consistent with a public sector deficit of 1.8 percentage points of GDP, as set forth in paragraph 11 of the August 2008 Letter; or"

4. The Fund decides that:

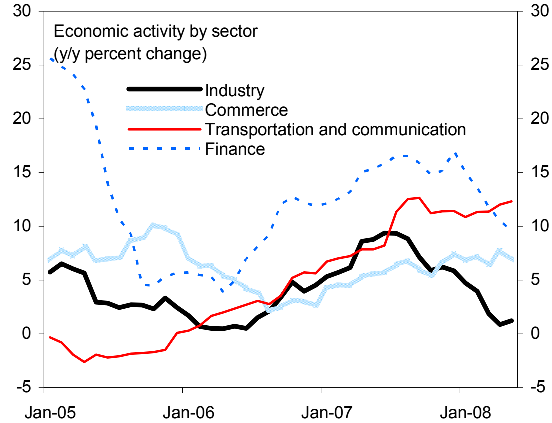
The first review contemplated in paragraph 4(d) of the PRGF arrangement for Nicaragua and the financing assurances review in paragraph 5(c) are completed. Nicaragua may request the second disbursement referred to in paragraph 2(b) of the PRGF arrangement for Nicaragua, notwithstanding the nonobservance of the end-December 2007 structural performance criteria on (i) approval of the 2008 budget consistent with a consolidated public sector deficit of 1.8 percentage points of GDP and (ii) introduction of measures establishing criminal penalties to discourage fraud in the consumption of electricity, as set forth in paragraph 4A.(b)(i) and (ii), respectively, on the condition that information provided by Nicaragua on performance under these criteria is accurate and on the further condition that information provided by Nicaragua on performance under prior actions as set forth in Table 2 of the August 2008 Letter is accurate.

Figure 1. Nicaragua: Real Sector Developments

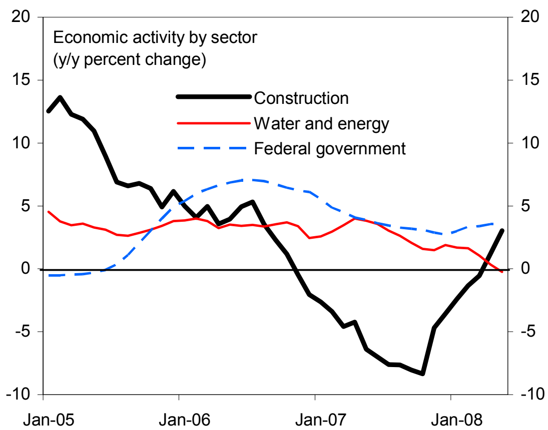
Economic activity recovered following the 2006 elections, though it has slowed in recent months.



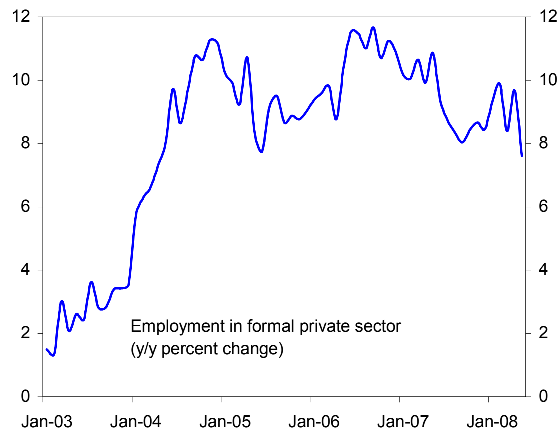
The slowdown has been most pronounced in the industry and finance sectors...



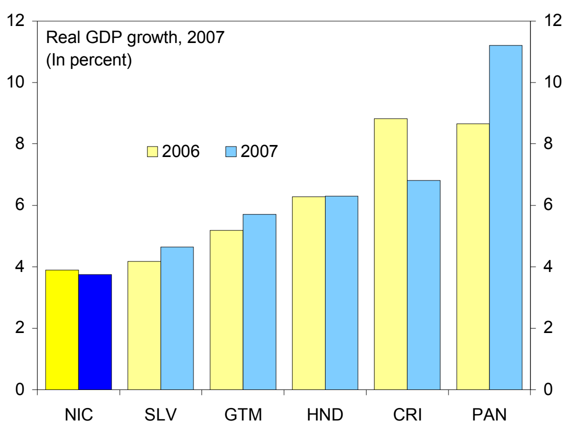
...while construction has stabilized after a sharp downturn.



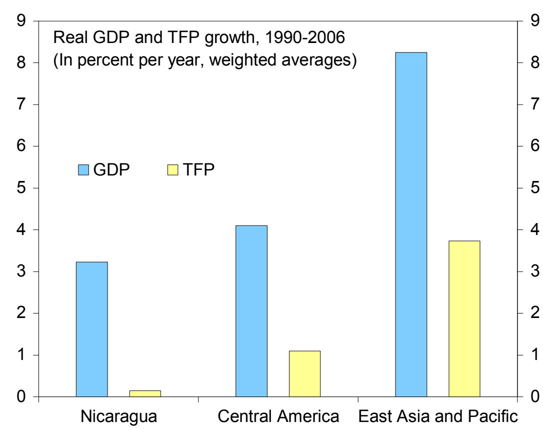
Employment continues to expand, though there are signs of some softening.



Nicaragua's growth has been lower than that of other countries in the region, reflecting low productivity increases...

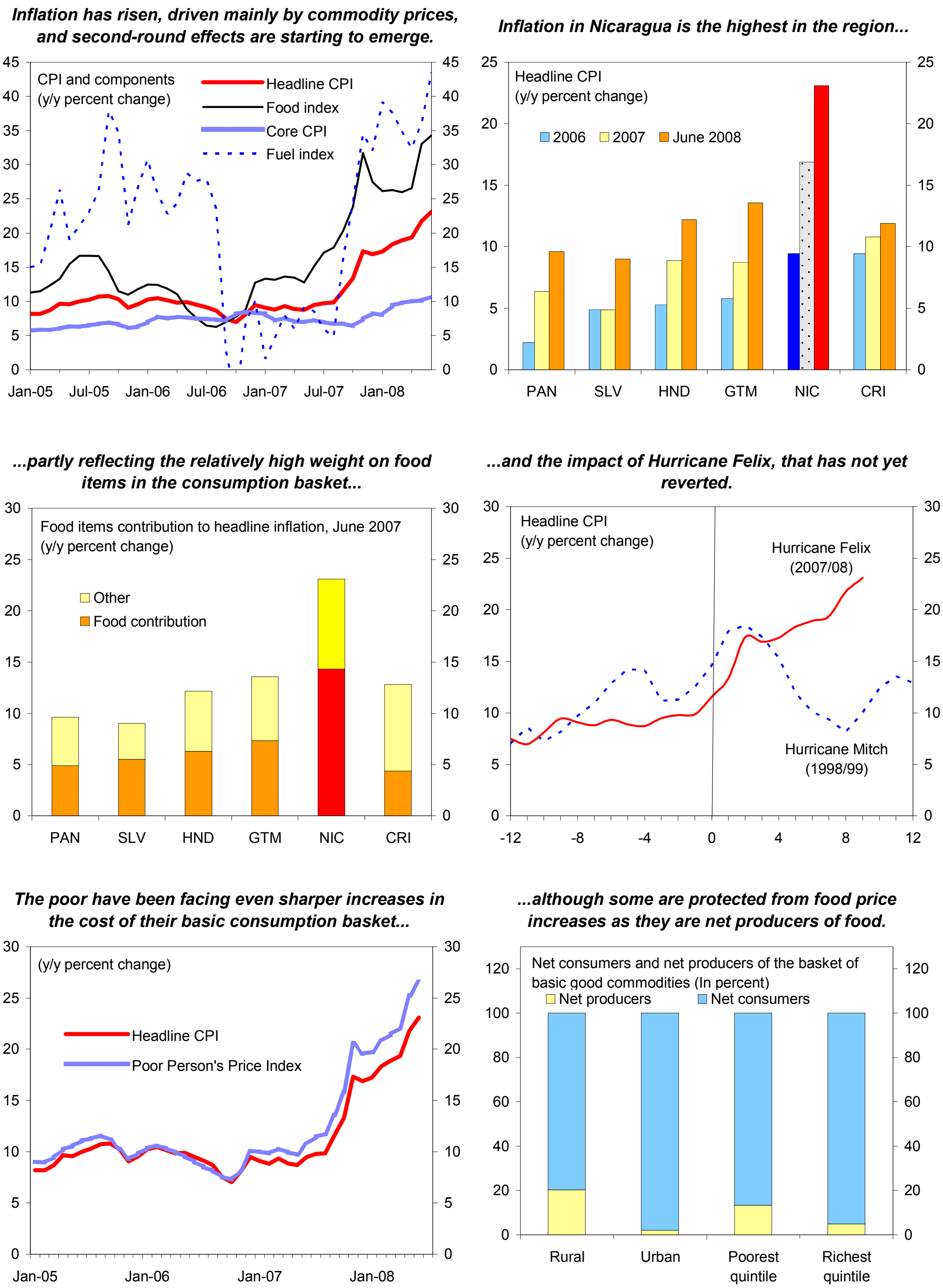


...which can be attributed to deficiencies in infrastructure and high fuel-dependency.



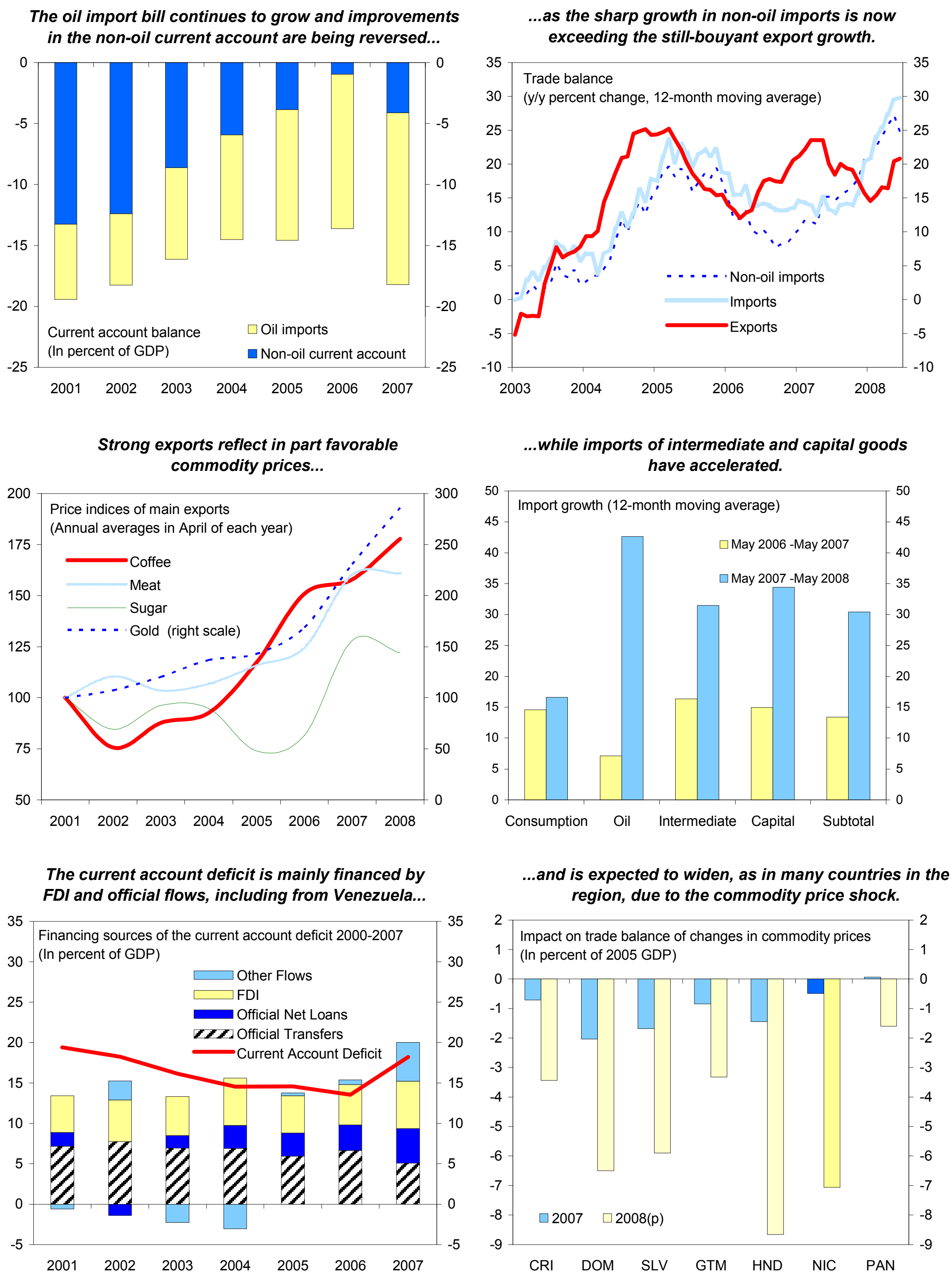
Sources: Central Bank of Nicaragua; IMF World Economic Outlook; and IMF staff calculations.

Figure 2. Nicaragua: Inflation Developments



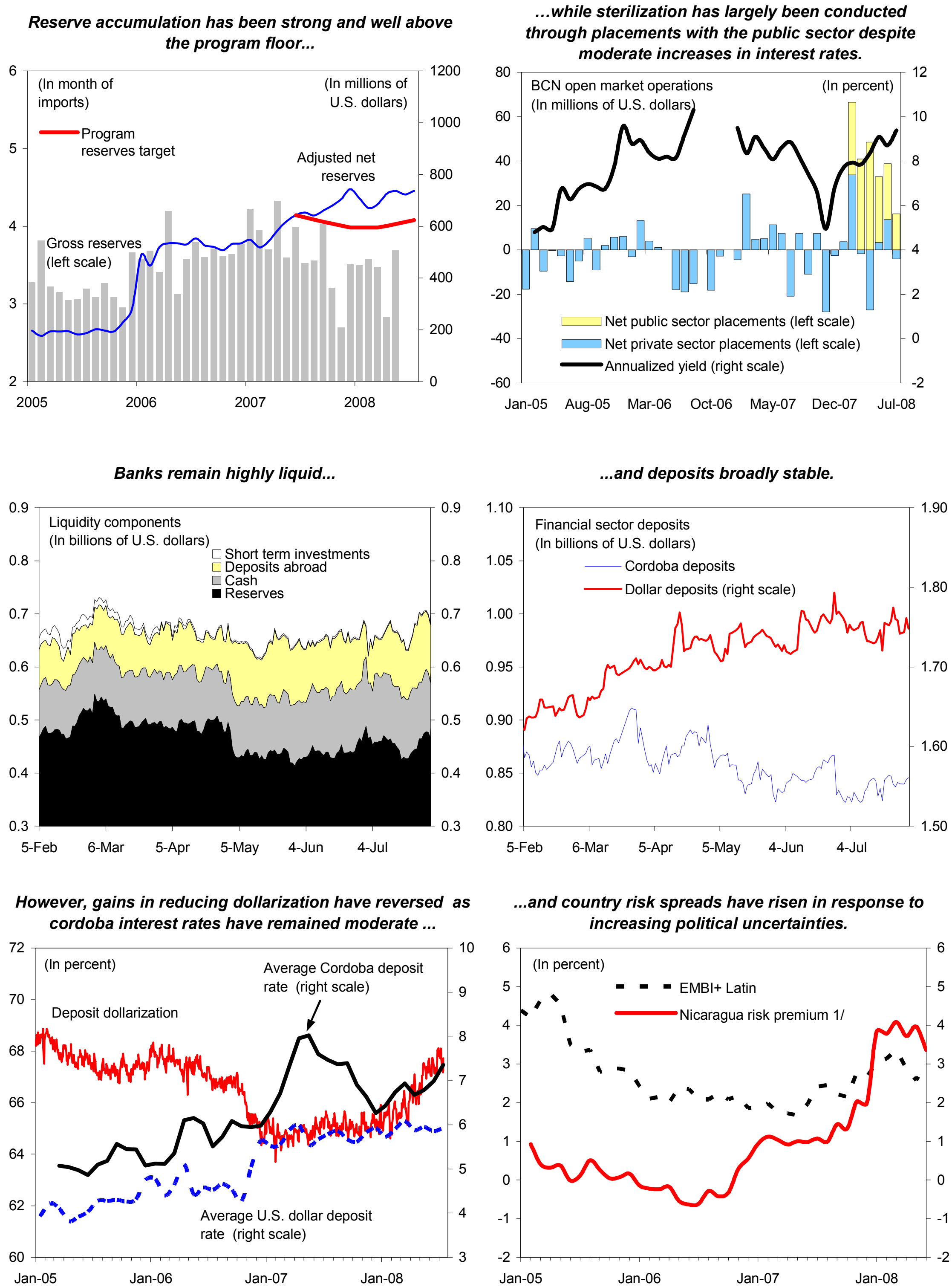
Sources: Central Bank of Nicaragua; World Bank; and IMF staff calculations.

Figure 3. Nicaragua: External Developments



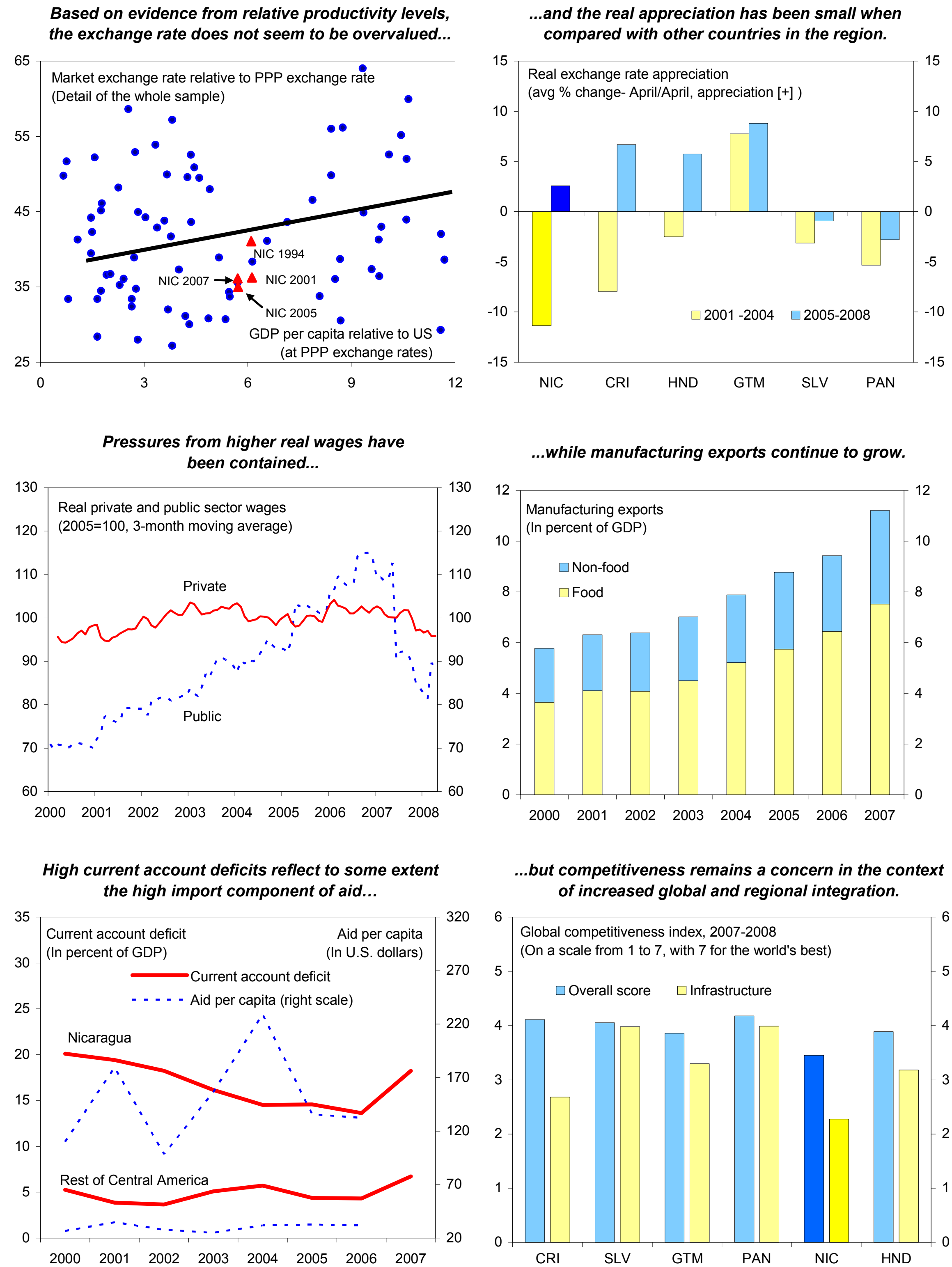
Sources: Central Bank of Nicaragua; IMF World Economic Outlook; and IMF staff calculations.

Figure 4. Nicaragua: Financial Sector Developments



Sources: Bloomberg L.P.; Central Bank of Nicaragua; and IMF staff calculations.
1/ Difference between 6-month US$ deposit rates and US$ 6-month Libor.

Figure 5. Nicaragua: Competitiveness Indicators



Sources: Central Bank of Nicaragua; IMF World Economic Outlook; The Global Competitiveness Report 2007-2008; World Development Indicators; and IMF staff calculations.

Table 1. Nicaragua: Quantitative Performance Criteria and Indicative Targets, 2007-09 1/

	2007			2008							2009	
	Jan.- Dec.			Jan.- Mar.		Jan.- Jun.			Jan.- Sep.	Jan.-Dec.	Jan.- Jun.	Jan.-Dec.
	Prog.	Adjusted	Prel.	Prog.	Prel.	Prog.	Adjusted	Prel.	Rev. Prog.	Rev. Prog.	Rev. Prog.	Rev. Prog.
Performance Criteria (for end-Jun. 2008 and end-Dec. 2008, indicative targets otherwise)												
						(In millions of Córdobas)						
1. Floor on combined public sector overall balance, after grants	-1,064	-1,180	988	-59	1,265	-1,036	-1,403	822	-392	-2,340	-342	-1,786
2. Ceiling on change in net domestic assets of the central bank 2/	-560	-451	-2,593	-179	374	-849	-409	-526	-702	416	-534	-532
						(In millions of US dollars)						
3. Floor on change in net international reserves of the central bank	60	54	202	0	-52	22	-1	-14	7	40	0	80
4. Continuous ceiling on nonconcessional external debt contracted or guaranteed by the consolidated public sector	0	0	0	0	0	0	0	0	0	0	0	0
5. Continuous ceiling on the accumulation of new external arrears of the combined public sector	0	0	0	0	0	0	0	0	0	0	0	0
Indicative targets												
						(In millions of Córdobas)						
1. Ceiling on central government primary expenditure 3/	24,181	24,181	22,512	6,328	5,161	13,552	13,552	12,012	19,756	29,114	14,822	32,912
2. Floor on poverty-related expenditures of the central government 4/	15,349	14,330	14,226	3,749	2,916	8,061	6,945	7,207	12,351	18,558	7,763	20,067

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

1/ Cumulative flows starting at the beginning of the calendar year. Definitions are specified in the TMU.
2/ Defined as the difference between Currency and Net International Reserves at an accounting exchange rate specified in the TMU.
3/ Defined as the difference between expenditures and interest.
4/ Adjusted for shortfall in external financing as specified in TMU.

Table 2. Nicaragua: Structural Performance Criteria and Benchmarks, 2007–08

	Date				Requested
	Program	Revised Program	Type	Status	Waiver
Energy					
1. Introduce measures establishing criminal penalties to discourage fraud in the consumption of electricity (MEFP ¶27, TMU ¶28).	End-Dec. 2007		PC	Done. Penal code published in May 2008 and law approved by Assembly in June 2008	√
2. Preparation of a diagnostic assessment of the causes for the technical and nontechnical distribution losses, including recommendations for reducing them (MEFP ¶27, TMU ¶30).	End-Apr. 2008		SB	Done (August 2008)	
3. Publish the formula for adjusting electricity tariffs in response to changes in costs (MEFP ¶27, TMU ¶31).	End-Dec. 2007		SB	Done (December 2007)	
4. Introduce new tariff schedule to cover distributing fees as required by law (MEFP ¶27, TMU ¶32).	End-Jul. 2008		SB	Done (July 2008)	
Fiscal					
5. Approval of the 2008 budget consistent with a combined public sector deficit of 1.8 percentage point of GDP (MEFP ¶19).	End-Dec. 2007		PC	Done (February 2008)	√
6. Prepare an action plan for strengthening the public sector financial administration system (MEFP ¶28, TMU ¶29).	End-Jun. 2008		PC	Done (June 2008)	
7. Approval of the 2008 budget supplements consistent with a combined public sector deficit of 1.8 percentage point of GDP (LOI First Review ¶11)		Continuous (through end-Dec. 2008)	PC	First budget supplement approved in June 2008 consistent with program	
8. Submission to Assembly of a draft 2009 budget consistent with program objectives (LOI First Review ¶11).		End-Oct. 2008	PC		
9. Finalize the revision of the Budget Classification system and the chart of accounts (MEFP ¶28).	End-Apr. 2008	End-Sep. 2008	SB	First draft finalized. Final revision is pending.	
10. Complete the study on the actuarial status of the pension system (MEFP ¶29, TMU ¶33).	End-Jun. 2008		SB	Done (August 2008)	
11. Adopt measures to strengthen tax administration (MEFP ¶30, TMU ¶34).	End-Mar. 2008	End-Sep. 2008	SB	Fund TA mission in Mar-08; Measures in process of implementation.	
Monetary					
12. Approval of renegotiation with banks by the Central Bank Board (LOI First Review ¶16)		End-Sep. 2008	PC		
13. Complete an assessment of the financial position of the central bank and make recommendations to strengthen its finances (MEFP ¶31, TMU ¶35).	End-Jun. 2008	End-Sep. 2008	SB	Fund TA mission in Apr-08.	
14. Submission of Central Bank Board Nominees to the Assembly (LOI First Review ¶16)		Aug. 2008	PA	Done	
15. Communicate to affected banks decision to gradually apply International Reporting Standards on newly issued bonds (LOI First Review ¶16)		Aug. 2008	PA	Done	
16. Submission of action plans by affected banks to comply with prudential norms (LOI First Review ¶16)		Aug. 2008	PA	Done	
Social					
17. Initiate the bi-annual publication of the principal social indicators for the health, education, and water and sanitation sectors (MEFP ¶6).	End-Jun. 2008		SB	Done (July 2008). Publication will now be annual.	
Transparency					
18. Publication of a report on all official aid inflows with information through end-2007 (LOI First Review ¶18).		End-Aug. 2008	PA	Pending	
19. Publication of a report on all official aid inflows with information through mid-2008 (LOI First Review ¶18).		End-Oct. 2008	SB		

1/ PC= Performance criterion; SB= Structural benchmark; PA=Prior action

Table 3. Nicaragua: Selected Economic Indicators

		2007		2008		2009	2010
	2006	Prog.	Prel.	Prog.	Proj.	Proj.	Proj.
GDP growth (percent)	3.9	4.2	3.8	4.7	3-4	4.5	4.7
CPI (eop, in percent)	9.5	7.3	16.9	7.0	15-17	9.3	7.0
CPI (avg, in percent)	9.1	8.2	11.1	7.3	18.1	9.3	7.5
GDP deflator (percent)	9.8	7.9	9.5	7.6	16.8	11.2	8.3
		(in US$ millions)					
Current account	-717	-914	-1048	-994	-1704	-1861	-1897
Exports of goods, f.o.b	2,034	2,185	2,313	2,520	2,742	2,943	3,342
Imports of goods, f.o.b.	-3,451	-3,735	-4,117	-4,186	-5,077	-5,455	-5,831
of which, oil	-666	-659	-807	-716	-1,236	-1,382	-1,428
Capital and Financial Account 1/	814	710	1,139	975	1,641	1,808	1,894
		(in percent of GDP)					
Current account	-13.6	-16.1	-18.3	-16.3	-25.7	-25.4	-24.0
Exports of goods, f.o.b	38.6	38.5	40.4	41.4	41.4	40.1	42.2
Imports of goods, f.o.b.	-65.6	-65.8	-71.9	-68.7	-76.6	-74.4	-73.6
of which, oil	-12.7	-11.6	-14.1	-11.7	-18.7	-18.9	-18.0
Capital and Financial Account 1/	15.5	12.5	19.9	16.0	24.8	24.7	23.9
of which, Alba-related	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Nonfinancial public sector							
Revenue	26.5	27.8	27.9	28.5	28.0	28.7	28.8
of which, Central Government	18.8	19.6	19.5	19.7	18.5	18.9	18.9
Expenditure	30.3	33.2	30.9	34.4	33.2	33.4	33.3
of which, Central Government	22.7	24.7	22.8	25.1	23.9	23.3	23.1
interest	1.8	1.6	1.5	1.4	1.3	1.2	1.1
Overall balance before grants	-3.8	-5.4	-3.0	-6.0	-5.2	-4.6	-4.5
Central bank							
Operational balance of central bank	-0.4	-0.4	-0.3	-0.6	-0.9	-0.8	-0.8
of which, net interest payments	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Combined public sector							
Overall balance before grants	-4.1	-5.8	-3.1	-6.4	-6.2	-5.4	-5.1
Grants	4.3	4.7	4.0	4.6	4.3	4.2	3.9
Primary balance after grants	2.2	0.8	2.4	-0.1	0.0	0.5	-0.1
Overall balance after grants	0.2	-1.0	0.9	-1.8	-1.8	-1.2	-1.2
Memorandum items:							
Nominal GDP (C$ mn)	93,007	104,702	105,644	117,991	128,327	149,121	169,089
GDP (US$ mn)	5,264	5,675	5,726	6,092	6,625	7,332	7,917
Gross reserves	924	925	1,103	1,044	1,230	1,374	1,508
(in months of imports of G&NFS excl. maquil	3.4	3.1	3.4	3.2	3.0	3.1	3.2

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

1/ The 2008 estimate excludes 158 million of budget support that covers the financing gap

2/ Projections include deposits accumulated by public sector entities, with the exception of INSS.

3/ Observed values up to 2007 correspond to the legal situation. The 2008 projection assumes that outstanding debt to non-Paris Club bilaterals has been settled on HIPC-equivalent terms.

4/ Excludes restructuring of debt owed to non-Paris Club bilaterals (includes HIPC and MDRI debt relief from IDB).

Table 4a. Nicaragua: Operations of the Central Government
(in percent of GDP)

	2006	2007 Prog.	2007 Prel.	2008 Prog.	2008 Proj.	2009 Proj.	2010 Proj.
Total revenue	18.8	19.6	19.5	19.7	18.5	18.9	18.9
Tax	17.5	18.2	18.0	18.3	17.1	17.4	17.5
Income and property	5.1	5.5	5.4	5.5	5.5	5.5	5.6
VAT	2.8	3.0	2.9	3.0	2.6	2.8	2.9
Excises	2.9	2.9	2.9	2.9	2.6	2.6	2.6
Trade	5.5	5.7	5.7	5.8	5.5	5.3	5.3
Other	1.1	1.1	1.0	1.1	1.0	1.2	1.2
Nontax and current transfers	1.3	1.4	1.5	1.4	1.4	1.5	1.4
Total expenditures	22.7	24.7	22.8	25.1	23.9	23.3	23.1
Current expenditures	15.4	15.7	15.7	15.6	16.7	16.3	16.2
Wages and salaries 1/	4.5	5.5	5.4	6.1	6.0	5.9	5.9
Goods and services	2.9	3.2	2.8	3.2	3.9	3.9	3.9
Interest	1.8	1.6	1.5	1.4	1.3	1.2	1.1
of which: external	0.9	0.5	0.4	0.4	0.5	0.5	0.6
Current transfers	6.3	5.4	6.0	4.9	5.5	5.3	5.3
Capital expenditures 2/	7.3	9.0	7.1	9.2	6.9	6.9	6.9
Domestically financed	2.9	2.2	2.1	2.0	0.6	1.1	1.1
Externally financed	4.4	6.8	5.0	7.2	6.3	5.8	5.9
Net lending	0.0	0.0	0.0	0.3	0.3	0.0	0.0
Overall balance (before grants)	-3.9	-5.1	-3.3	-5.4	-5.4	-4.4	-4.2
Grants	4.0	4.2	3.7	4.2	4.1	3.9	3.5
Primary balance (after grants)	1.9	0.7	1.9	0.2	0.0	0.7	0.5
Overall balance (after grants)	**0.1**	**-0.9**	**0.4**	**-1.2**	**-1.3**	**-0.6**	**-0.6**
Net Financing	-0.1	0.9	-0.4	1.2	1.3	0.6	0.6
External	2.9	3.9	2.6	4.0	3.4	2.8	3.1
Amortization	-0.7	-1.8	-1.7	-0.6	-0.6	-0.6	-0.6
Exceptional financing (debt buy back grant)	0.0	1.1	1.1	0.0	0.0	0.0	0.0
Disbursements	3.6	4.5	3.2	4.6	4.0	3.4	3.6
Change in Arrears	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Domestic	-3.2	-3.0	-3.0	-2.8	-2.1	-2.2	-2.4
Central bank	-1.4	-1.6	-2.3	-1.4	-0.5	-0.8	-1.3
Rest of financial system	-0.4	0.0	0.0	0.0	0.0	0.0	0.0
Indemnity bond redemptions	-1.2	-1.8	-1.6	-1.9	-1.8	-1.7	-1.4
Other (net)	-0.2	0.4	0.9	0.5	0.2	0.3	0.2
Privatization	0.2	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:							
Central government primary spending	20.9	23.1	21.3	23.7	22.7	22.1	22.0
Central government poverty spending	12.2	14.7	13.5	15.0	14.5	13.5	13.5
Nominal GDP (millions of Cordobas)	93,007	104,702	105,644	117,991	128,327	149,121	169,089

Source: Ministry of Finance and Public Credit, Nicaragua; staff estimates and projections.
1/ In 2007 and 2008, the increase "wages and salaries" reflects inter alia, the reclassification of *Centros Autonomos* wages from 'current transfers' to 'wages and salaries'; wages under both classifications are captured under the "monitorable wage bill".
2/ In 2008, Prog. includes 1.4 percent of GDP reclassified from capital to current spending.

Table 4b. Nicaragua: Operations of the Central Government
(in millions of Córdobas)

		2007		2008		2009	2010
	2006	Prog.	Prel.	Prog.	Proj.	Proj.	Proj.
Total revenue (exc. Grants)	17,514	20,521	20,579	23,272	23,796	28,111	31,993
Tax	16,262	19,023	18,984	21,592	21,951	25,923	29,563
Income and property	4,781	5,759	5,746	6,489	7,034	8,212	9,423
VAT	2,643	3,128	3,103	3,500	3,337	4,222	4,845
Excises	2,675	3,020	3,036	3,404	3,294	3,849	4,365
Trade	5,135	5,988	6,016	6,893	7,020	7,887	8,943
Other	1,028	1,128	1,083	1,306	1,266	1,753	1,988
Nontax and current transfers	1,251	1,498	1,595	1,679	1,844	2,188	2,430
Total expenditures	21,143	25,872	24,092	29,601	30,723	34,742	39,036
Current expenditures	14,361	16,441	16,562	18,447	21,396	24,373	27,322
Wages and salaries 1/	4,147	5,757	5,745	7,242	7,743	8,862	10,049
Goods and services	2,704	3,303	2,915	3,796	4,960	5,834	6,549
Interest	1,684	1,691	1,580	1,636	1,609	1,830	1,827
of which: external	829	553	463	515	593	724	1,093
Current transfers	5,825	5,691	6,322	5,772	7,083	7,847	8,898
Capital expenditures 2/	6,782	9,431	7,488	10,838	8,913	10,302	11,713
Domestically financed	2,655	2,350	2,192	2,397	795	1,579	1,791
Externally financed	4,127	7,081	5,296	8,441	8,118	8,723	9,922
Net lending	0	0	42	316	415	66	0
Overall balance (before grants)	-3,629	-5,352	-3,513	-6,329	-6,928	-6,631	-7,043
Grants	3,692	4,443	3,912	4,935	5,279	5,778	5,981
Primary balance (after grants)	1,747	783	1,979	243	-39	977	766
Overall balance (after grants)	**63**	**-908**	**399**	**-1,394**	**-1,649**	**-853**	**-1,061**
Net Financing	-63	908	-399	1,394	1,649	853	1,061
External	2,676	4,034	2,754	4,662	4,341	4,118	5,190
Amortization	-646	-1,840	-1,757	-749	-773	-918	-931
Exceptional financing (debt buy back grant)	0	1,122	1,122	0	0	0	0
Disbursements	3,322	4,752	3,389	5,411	5,114	5,036	6,121
Change in Arrears (net)	0	0	0	0	0	0	0
Domestic	-2,962	-3,146	-3,154	-3,290	-2,693	-3,265	-4,128
Central bank	-1,319	-1,644	-2,389	-1,606	-615	-1,235	-2,143
Rest of financial system	-333	-7	11	-5	0	0	0
Domestic Amortization (including BPIs)	-1,137	-1,862	-1,724	-2,257	-2,319	-2,490	-2,324
Other (net)	-174	367	948	578	241	459	339
Privatization	224	21	1	22	0	0	0
Memorandum items:							
Central government primary spending	19,459	24,181	22,512	27,965	29,114	32,912	37,209
Poverty spending	11,381	15,349	14,226	17,743	18,558	20,067	22,838
Total "monitorable" wage bill 1/	6,705	7,658	7,693	8,698	9,074	10,425	11,821

Source: Ministry of Finance and Public Credit, Nicaragua; staff estimates and projections.

1/ In 2007 and 2008, the increase "wages and salaries" reflects inter alia, the reclassification of *Centros Autonomos* wages from 'current transfers' to 'wages and salaries'; wages under both classifications are captured under the "monitorable wage bill".

2/ In 2008, Prog. includes C$1,805.9 million reclassified from capital to current spending.

Table 5a. Nicaragua: Operations of the Combined Public Sector (CPS)
(in percent of GDP, unless otherwise indicated)

		2007		2008		2009	2010
	2006	Prog.	Prel.	Prog.	Proj.	Proj.	Proj.
Central government overall balance	0.1	-0.9	0.4	-1.2	-1.3	-0.6	-0.6
Revenue	18.8	19.6	19.5	19.7	18.5	18.9	18.9
Expenditure	22.7	24.7	22.8	25.1	23.9	23.3	23.1
Current	15.4	15.7	15.7	15.6	16.7	16.3	16.2
of which: interest	1.8	1.6	1.5	1.4	1.3	1.2	1.1
Capital and net lending 1/	7.3	9.0	7.1	9.5	7.3	7.0	6.9
Grants	4.0	4.2	3.7	4.2	4.1	3.9	3.5
Social Security Institute (INSS) balance	1.3	1.4	1.6	1.4	1.7	1.7	1.6
Contributions and revenues	4.9	5.3	5.4	5.5	5.7	5.8	5.8
Payments and expenses	3.6	3.9	3.8	4.1	4.1	4.1	4.2
Managua municipality (ALMA) balance	0.0	0.1	0.1	0.1	0.0	0.0	0.1
Overall public enterprise sector balance 2/	-0.7	-1.2	-0.9	-1.5	-1.3	-1.5	-1.5
Revenue	2.8	2.9	3.0	3.2	3.7	4.1	4.1
Expenditure	3.9	4.5	4.2	5.2	5.2	5.9	5.9
Grants	0.4	0.4	0.3	0.4	0.2	0.3	0.3
Central bank (BCN) operating balance	-0.4	-0.4	-0.3	-0.6	-0.9	-0.8	-0.8
Overall CPS balance (after grants)	**0.2**	**-1.0**	**0.9**	**-1.8**	**-1.8**	**-1.2**	**-1.2**
Primary balance (after grants)	2.2	0.8	2.4	-0.1	0.0	0.5	-0.1
Total interest	2.0	1.8	1.5	1.7	1.8	1.7	1.1
Net Financing	-0.2	1.0	-0.9	1.8	1.8	1.2	1.2
External	3.5	4.7	3.1	5.4	4.2	4.3	4.6
Amortization	-0.7	-1.8	-1.7	-0.6	-0.6	-0.6	-0.5
Exceptional financing (debt buy back grant)	0.0	1.1	1.1	0.0	0.0	0.0	0.0
Disbursements	4.2	5.4	3.7	6.1	4.9	4.9	5.1
Change in Arrears	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Domestic	-3.9	-3.7	-4.0	-3.6	-2.4	-3.1	-3.4
Central bank (BCN)	-1.5	-2.1	-2.8	-1.4	-1.0	-1.0	-1.0
Rest of financial system	-1.5	-0.9	0.6	-1.4	-0.4	-1.5	-1.5
Other	-1.0	-0.7	-1.8	-0.9	-1.0	-0.6	-0.9
Privatization	0.2	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:							
Primary balance CPS before grants (% of GDP)	-2.1	-4.0	-1.6	-4.7	-4.3	-3.7	-3.9
Overall balance CPS before grants (% of GDP)	-4.1	-5.8	-3.1	-6.4	-6.2	-5.4	-5.1
Nominal GDP (millions of Cordobas)	93,007	104,702	105,644	117,991	128,327	149,121	169,089

Source: Ministry of Finance and Public Credit, Nicaragua; staff estimates and projections.

1/ In 2008, Prog. includes 1.4 percent of GDP reclassified from capital to current spending.

2/ The public enterprise sector is defined as a sub-group of four public enterprises (ENACAL, ENATREL, ENEL, and ENAP) and one government regulating agency (TELCOR).

Table 5b. Nicaragua: Operations of the Combined Public Sector (CPS)
(in millions of Córdobas)

	2006	2007 Prog.	2007 Prel.	2008 Prog.	2008 Proj.	2009 Proj.	2010 Proj.
Central government overall balance	63	-908	399	-1,394	-1,649	-853	-1,061
Revenue (exc. Grants)	17,514	20,521	20,579	23,272	23,796	28,111	31,993
Expenditure	21,143	25,872	24,092	29,601	30,723	34,742	39,036
Current	14,361	16,441	16,562	18,447	21,396	24,373	27,322
of which: interest	1,684	1,691	1,580	1,636	1,609	1,830	1,827
Capital and net lending	6,782	9,431	7,530	11,154	9,328	10,369	11,713
Grants	3,692	4,443	3,912	4,935	5,279	5,778	5,981
Social Security Institute (INSS) balance	1,183	1,486	1,687	1,645	2,136	2,463	2,742
Contributions and revenues	4,535	5,583	5,682	6,504	7,359	8,645	9,802
Payments and expenses	3,352	4,097	3,995	4,859	5,223	6,182	7,060
Managua municipality (ALMA) balance	42	57	100	62	-46	8	114
Overall public enterprise sector balance 2/	-673	-1,265	-905	-1,790	-1,674	-2,244	-2,544
Revenue	2,632	3,014	3,211	3,807	4,751	6,090	6,905
Expenditure	3,647	4,717	4,420	6,089	6,727	8,837	10,020
of which: interest	28	27	13	0	34	45	56
Grants	342	438	304	492	302	503	570
Central bank (BCN) operating balance	-408	-433	-292	-664	-1,108	-1,160	-1,315
Overall CPS balance (after grants)	**207**	**-1,064**	**989**	**-2,141**	**-2,340**	**-1,786**	**-2,065**
Primary balance (after grants)	2,060	798	2,553	-84	22	815	-121
Total interest	1,853	1,863	1,565	2,057	2,362	2,600	1,943
Net Financing	-207	1,064	-988	2,141	2,340	1,786	2,065
External	3,237	4,923	3,276	6,418	5,443	6,395	7,793
Amortization	-646	-1,840	-1,757	-766	-803	-936	-912
Exceptional financing (debt buy back grant)	0	1,122	1,122	0	0	0	0
Disbursements	3,883	5,641	3,911	7,183	6,246	7,331	8,705
Change in Arrears	0	0	0	0	0	0	0
Domestic	-3,668	-3,879	-4,265	-4,299	-3,103	-4,609	-5,728
Central bank (BCN)	-1,354	-2,227	-2,986	-1,606	-1,299	-1,478	-1,676
Rest of financial system	-1,361	-915	617	-1,658	-555	-2,252	-2,554
Other	-952	-737	-1,896	-1,035	-1,249	-879	-1,498
Privatization	224	21	1	22	0	0	0
Memorandum items:							
Primary balance CPS before grants	-1,983	-4,163	-1,663	-5,511	-5,560	-5,466	-6,673
Overall balance CPS before grants	-3,836	-6,025	-3,228	-7,568	-7,921	-8,066	-8,616

Source: Ministry of Finance and Public Credit, Nicaragua; staff estimates and projections.

1/ In 2008, Prog. includes C$1,805.9 million reclassified from capital to current spending.

2/ The public enterprise sector is defined as a sub-group of four public enterprises (ENACAL, ENATREL, ENEL, and ENAP) and one government regulating agency (TELCOR).

Table 6. Nicaragua: Summary Accounts of the Central Bank
(Flows in millions of Cordobas; unless otherwise stated)

		2007		2008					
		Jan.-Dec.		Jan.-Jun.		Jan.-Dec.		2009	2010
	2006	Prog.	Prel.	Prog.	Prel.	Prog.	Proj.	Proj.	Proj.
Exchange rate (cordobas/US$)	17.6	18.4	18.4	19.4	19.4	19.4	19.4	20.3	21.4
Net international reserves (adjusted) 1/	**4,448**	**1,106**	**3,729**	**426**	**-275**	**1,356**	**1,163**	**1,627**	**1,922**
(In millions of US$)	253	60	202	22	-14	70	60	80	90
Net domestic assets	**-3,855**	**-560**	**-2,593**	**-849**	**-526**	**-630**	**29**	**-532**	**-988**
Net credit to public sector (NFPS)	-1,347	-2,290	-3,119	211	-357	-1,606	-882	-737	-2,144
Net credit to central government	-1,319	-1,644	-2,389	211	743	-1,606	-615	-1,235	-2,144
Net credit to RNFPS	-28	-646	-730	0	-1,100	0	-267	497	0
Net credit to the financial system	-1,339	274	-753	-545	-68	-587	-105	-805	-675
Operational losses	408	433	292	408	484	664	1,108	1,160	816
Central bank bonds (net)	1,628	676	769	-1,099	-729	552	-429	-497	622
Net open market operations	1,028	173	262	-1,365	-729	-79	-452	-545	36
Placements	-1,182	-3,563	-2,669	-2,131	-1,553	-2,879	-2,751	-2,011	-1,891
Amortization	2,210	3,735	2,931	766	824	2,800	2,299	1,466	1,927
Amortization of banking bonds (*bonos bancarios*)	601	504	507	266	0	630	23	48	586
Medium- and long-term foreign liabilities	229	272	234	128	128	258	268	286	317
Other	-3,434	74	-17	47	17	89	69	62	76
Currency	**593**	**547**	**1,136**	**-423**	**-800**	**727**	**1,192**	**1,095**	**934**
Memorandum items:									
Currency (stock)	4,401	4,948	5,537	4,525	4,737	5,675	6,729	7,824	8,758
Currency (annual change; in percent)	15.6	12.4	25.8	16.1	21.3	14.7	21.5	16.3	11.9

Sources: Central Bank of Nicaragua; and Fund staff estimates/projections.
1/ Net international reserves less reserve requirements of commercial banks in foreign currency deposited at the central bank.

Table 7. Nicaragua: Summary Accounts of Deposit Banks and the Financial System
(Flows in millions of Cordobas; unless otherwise stated)

		2007		2008		2009	2010
	2006	Prog.	Prel.	Prog.	Proj.	Proj.	Proj.
		Commercial banks 1/					
NIR adjusted	**-279**	**-547**	**-91**	**-420**	**-479**	**-866**	**-343**
Adjusted NIR in US$ millions	-13	-30	-4	-23	-21	-35	-16
Net domestic assets	**1,319**	**2,825**	**3,808**	**4,081**	**4,809**	**6,687**	**5,620**
Net credit to nonfinancial public sector	-1,393	-835	-765	-1,846	-1,411	-1,772	-2,498
Net credit to the financial system	1,443	-393	508	395	-154	643	475
Net credit to the private sector	6,235	7,383	8,163	9,032	8,457	9,671	11,552
Medium- and long-term foreign liabilities	-1,769	-1,665	-1,352	-1,736	-1,357	-1,424	-2,052
Other net assets	-3,198	-1,665	-2,745	-1,763	-726	-432	-1,857
Liabilities	**1,040**	**2,277**	**3,716**	**3,661**	**4,329**	**5,821**	**5,277**
		Financial sector					
Net International reserves	**4,170**	**559**	**3,637**	**937**	**684**	**761**	**1,579**
(In millions of US dollars)	240	30	198	48	39	44	74
Net domestic assets	**-2,536**	**2,265**	**1,215**	**3,451**	**4,837**	**6,155**	**4,633**
Net credit to nonfinancial public sector	-2,740	-3,125	-3,884	-3,453	-2,294	-2,510	-4,642
Net credit to the private sector	6,235	7,383	8,163	9,032	8,457	9,671	11,552
Medium- and long-term foreign liabilities	-1,540	-1,393	-1,118	-1,478	-1,088	-1,138	-1,735
Other net assets	-4,492	-600	-1,946	-650	-238	131	-542
Liabilities to the private sector	**1,634**	**2,823**	**4,852**	**4,387**	**5,521**	**6,916**	**6,211**
Memorandum items:							
Credit to the private sector in percent of GDP	33.6	38.6	39.0	44.0	40.4	43.0	44.8
Credit to the private sector (Annual growth rate)	31.9	29.1	31.6	28.0	25.8	23.9	18.0

Sources: Central Bank of Nicaragua; and Fund staff estimates/projections.
1/ Includes Financiera Nicaraguense.

Table 8. Nicaragua: Balance of Payments 1/
(In millions of U.S. dollars; unless otherwise indicated)

		2007		2008		2009	2010	2011	2012
	2006	Prog.	Prel.	Prog.	Proj.	Proj.	Proj.	Proj.	Proj.
Current account	**-717**	**-914**	**-1,048**	**-994**	**-1,704**	**-1,861**	**-1,897**	**-1,906**	**-1,912**
According to 5th Manual Definition 2/	*-647*	*-854*	*-958*	*-935*	*-1,451*	*-1,573*	*-1,623*	*-1,645*	*-1,641*
Trade balance	-1,417	-1,551	-1,804	-1,666	-2,335	-2,512	-2,489	-2,506	-2,518
Exports, f.o.b.	2,034	2,185	2,313	2,520	2,742	2,943	3,342	3,743	4,159
Imports, f.o.b.	-3,451	-3,735	-4,117	-4,186	-5,077	-5,455	-5,831	-6,249	-6,676
Of which: oil imports	-666	-659	-807	-716	-1,236	-1,382	-1,428	-1,497	-1,570
Of which: , FTZ	-696	-725	-784	-855	-853	-897	-987	-1,085	-1,193
Services	-137	-147	-184	-157	-250	-266	-274	-299	-317
Income	-124	-132	-135	132	-163	-180	-205	-251	-307
Credits	41	49	48	48	28	36	64	65	66
Debits	-166	-181	-183	-180	-191	-216	-269	-316	-373
Of which: official interests	-64	-63	-58	-45	-46	-48	-55	-64	-99
Transfers to the Private Sector	961	915	1,075	960	1,043	1,096	1,070	1,149	1,229
Of which : remittances	698	715	740	760	793	846	870	949	1,029
Capital account	814	710	1,139	975	1,641	1,808	1,894	1,908	1,885
Official	494	365	497	497	462	527	570	608	570
Official transfers	1,492	1,352	1,513	221	245	281	281	296	296
Of which: grants	350	211	372	221	245	281	281	296	296
Of which , MDRI and HIPC grants	1,142	1,142	1,142	0	0	0	0	0	0
Disbursements	296	261	259	332	292	321	347	372	334
Amortization	-1,308	-1,250	-1,263	-57	-74	-75	-58	-60	-59
Of which: MDRI and HIPC write-offs	-1,178	-1,169	-1,169	0	0	0	0	0	0
Other	14	1	-13	1	0	0	0	0	0
Private	320	345	642	477	1,178	1,280	1,324	1,300	1,315
Foreign direct investment	287	291	377	330	643	635	650	650	680
Of which, ALBA collaboration	0	0	42	0	284	90	6	0	0
Capital Transfers	3	0	47	0	202	260	251	236	216
Of which: ALBA collaboration	0	0	36	0	170	190	196	206	216
Financial system and other private capital flows	30	54	218	147	333	386	422	415	419
Assets	83	-46	-38	35	33	60	38	70	80
Medium and long term liabilities	104	90	118	90	240	266	307	295	279
Of which: ALBA collaboration	0	0	45	0	170	188	187	189	190
Other, including errors and omissions 3/	-157	9	137	23	60	60	78	50	60
Of which: ALBA collaboration	0	0	33	0	44	25	40	29	43
Overall balance	**97**	**-204**	**91**	**-20**	**-64**	**-54**	**-4**	**2**	**-27**
Change in external assets (- increase)	-194	-1	-179	-119	-127	-144	-134	-99	-70
Net change in arrears (- decrease)									
Exceptional financing	97	72	88	5	18	20	0	0	0
Of which: buy-back operation	0	61	58	0	0	0	0	0	0
Financing Gap 4/	0	133	0	134	173	177	138	96	97
IMF	0	18	0	36	49	39	20	0	0
World Bank	0	25	0	20	20	20	20	20	20
IDB	0	16	0	16	21	21	21	20	20
Bilaterals and Other Multilaterals	0	74	0	63	83	98	78	56	56
Memorandum items:									
Current account (in percent of GDP)	**-13.6**	**-16.1**	**-18.3**	**-16.3**	**-25.7**	**-25.4**	**-24.0**	**-22.5**	**-21.1**
According to 5th Manual Definition (in percent of GDP) 2/	*-12.3*	*-15.1*	*-16.7*	*-15.3*	*-21.9*	*-21.5*	*-20.5*	*-19.4*	*-18.1*
Excluding official interest obligations (in percent of GDP)	-11.1	-13.9	-15.7	-14.6	-21.2	-20.8	-19.8	-18.7	-17.0
Non-oil, excluding interest (in percent of GDP)	1.6	-2.3	-1.6	-2.9	-2.6	-1.9	-1.8	-1.0	0.3
Gross reserves	924	925	1,103	1,044	1,230	1,374	1,508	1,606	1,676
in months of imports of G&NFS excluding maquilas	3.4	3.1	3.4	3.2	3.0	3.1	3.2	3.2	3.1
Average oil price (US$/bbl)	64.3	63.8	71.1	68.8	116.5	125.0	123.5	123.5	123.5

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

1/Assuming that outstanding debt to non-Paris Club bilaterals has been settled on HIPC-equivalent terms in 2008. Debt service is measured in accrual basis.

2/ Untied grants are treated above the line.

3/ Includes short-term credits for importing oil under ALBA.

4/ Only budget support loans and grants. The 2008 financing gap covered by the IMF includes the augmentation.

Table 9a. Nicaragua: Indicators of Capacity to Repay the Fund, 2006–12 1/

	2006	2007	2008 Proj.	2009 Proj.	2010 Proj.	2011 Proj.	2012 Proj.
Fund repurchases and charges							
In millions of SDRs	141.3	0.2	0.7	2.5	3.3	3.3	2.3
In millions of U.S. dollars	207.9	0.3	1.1	4.0	5.4	5.4	3.8
In percent of exports of goods and nonfactor services	8.8	0.0	0.0	0.1	0.1	0.1	0.1
In percent of external public debt service	325.8	0.6	2.4	8.4	9.8	8.4	3.9
In percent of quota	159.9	0.3	0.9	3.1	4.2	4.2	2.9
In percent of gross international reserves	22.5	0.0	0.1	0.3	0.4	0.3	0.2
Fund credit outstanding							
In millions of SDRs	41.8	53.7	84.0	107.8	117.5	98.0	63.4
In millions of U.S. dollars	61.5	82.2	135.8	175.0	191.3	160.0	103.8
In percent of exports of goods and nonfactor services	2.6	3.1	4.3	5.1	5.0	3.7	2.2
In percent of external public debt service	96.4	141.0	297.2	364.4	348.2	249.4	104.8
In percent of quota	32.1	41.3	64.6	82.9	90.4	75.4	48.7
In percent of gross international reserves	6.7	7.4	11.0	12.7	12.7	10.0	6.2
Memorandum items							
Exports of goods and services (millions of U.S. dollars)	2,375	2,685	3,168	3,406	3,851	4,302	4,774
External public debt service (millions of U.S. dollars) 2/	64	58	46	48	55	64	99
Quota (millions of SDRs)	130	130	130	130	130	130	130
Quota (millions of U.S. dollars)	191	199	210	211	212	212	213
Gross international reserves (millions of U.S. dollars)	924	1,103	1,230	1,374	1,508	1,606	1,676
SDR per U.S. dollars (period average)	0.68	0.65	0.62	0.62	0.61	0.61	0.61

Sources: IMF, Finance Department and Fund staff estimates and projections.

1/ Under the assumption of an augmentation of 5 percent of the quota.

2/ Assuming all debt relief.

Table 9b. Nicaragua: Schedule of Disbursements Under the PRGF Arrangement and Augmentation

Date	Current PRGF		Augmentation		PRGF and Augmentation		Conditions
	In millions of SDRs	In percent of quota 1/	In millions of SDRs	In percent of quota 1/	In millions of SDRs	In percent of quota 1/	
Oct. 5, 2007	11.9	9.2			11.9	9.2	Board approval of PRGF arrangement
Sep. 10, 2008	11.9	9.2	6.5	5.0	18.4	14.2	Observance of end-December 2007 performance criteria and completion of first review
Dec. 15, 2008	11.9	9.2			11.9	9.2	Observance of end-June 2008 performance criteria and completion of second review
Apr. 7, 2009	11.9	9.2			11.9	9.2	Observance of end-December 2008 performance criteria and completion of third review
Oct. 7, 2009	11.9	9.2			11.9	9.2	Observance of end-June 2009 performance criteria and completion of fourth review
Apr. 7, 2010	6.0	4.6			6.0	4.6	Observance of end-December 2009 performance criteria and completion of fifth review
Oct. 7, 2010	6.0	4.6			6.0	4.6	Observance of end-June 2010 performance criteria and completion of sixth review
Total	71.5	55.0	6.5	5.0	78.0	60.0	

1/ Nicaragua's quota is SDR 130 million.

Table 10. Nicaragua: External Financing Requirements 1/

(In millions of U.S. dollars)

	2006	2007	Proj.				
		Prel.	2008	2009	2010	2011	2012
Gross financing requirements	**-2,219**	**-2,489**	**-1,906**	**-2,080**	**-2,089**	**-2,064**	**-2,041**
Current account deficit (excluding official transfers)	-717	-1,048	-1,704	-1,861	-1,897	-1,906	-1,912
Debt amortization (excl. IMF)	-1,308	-1,263	-74	-75	-58	-60	-59
Of which MDRI write-off of liabilities	-827	-786	0	0	0	0	0
Of which HIPC write-off of liabilities	-351	-383	0	0	0	0	0
GIR accumulation	-194	-179	-127	-144	-134	-99	-70
Gross financing sources	**2,219**	**2,489**	**1,733**	**1,903**	**1,952**	**1,968**	**1,945**
Foreign direct investment (net) and capital transfers	290	423	845	895	901	886	896
Debt financing from private creditors	44	205	333	386	422	415	419
Official transfers	1,492	1,513	245	281	281	296	296
Of which grants	350	372	245	281	281	296	296
Of which MDRI grants	818	770	0	0	0	0	0
Of which HIPC grants	324	371	0	0	0	0	0
Disbursements (medium- and long-term loans)	296	259	292	321	347	372	334
Net Exceptional Financing	97	88	18	20	0	0	0
Gap 2/	**0**	**0**	**173**	**177**	**138**	**96**	**97**
IMF	0	0	49	39	20	0	0
World Bank	0	0	20	20	20	20	20
IDB	0	0	21	21	21	20	20
Bilaterals and Other Multilaterals	0	0	83	98	78	56	56
Memorandum items:							
Gross international reserves	924	1,103	1,230	1,374	1,508	1,606	1,676
In months of imports of G&NFS excluding maquilas	3.4	3.4	3.0	3.1	3.2	3.2	3.1
Change in gross international reserves (+ = increase)	194	179	127	144	134	99	70

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

1/Assuming that outstanding debt to non-Paris Club bilaterals has been settled on HIPC-equivalent terms in 2008. Debt service is measured in accrual basis.

2/ Only budget support loans and grants. The 2008 financing gap covered by the IMF includes the augmentation.

Table 11. Nicaragua: Public Debt Dynamics

	2006	2007 Prel.	Proj. 2008	2009	2010	2011	2012
			(In US$ millions)				
Gross CPS Debt	**5,648**	**3,888**	**3,354**	**3,484**	**3,698**	**3,949**	**4,196**
External 1/	3,755	2,719	2,267	2,488	2,770	3,086	3,440
Domestic	1,234	1,169	1,087	996	928	863	757
NFPS	1,214	1,160	1,073	986	920	863	757
Central bank	20	10	14	11	8	1	0
Net CPS Debt							
Net of NFPS assets (deposits) 2/	...	**3,720**	**3,140**	**3,186**	**3,302**	**3,440**	**3,587**
Net of NFPS and INSS assets 3/	...	3,653	2,989	2,943	2,958	2,990	3,029
			(in percent of GDP)				
Gross CPS Debt	**94.1**	**67.3**	**53.0**	**51.9**	**51.6**	**51.5**	**50.6**
External 1/	70.8	47.0	35.8	37.1	38.7	40.3	41.5
Domestic	23.3	20.2	17.2	14.8	13.0	11.3	9.1
NFPS	22.9	20.1	17.0	14.7	12.8	11.3	9.1
Central bank	0.4	0.2	0.2	0.2	0.1	0.0	0.0
Net CPS Debt							
Net of NFPS assets (deposits) 2/	...	**64.4**	**49.6**	**47.5**	**46.1**	**44.9**	**43.3**
Net of NFPS and INSS assets 3/	...	63.2	47.3	43.8	41.3	39.0	36.5
Memorandum items							
CPS Debt in NPV terms	...	...	**41.6**	**38.7**	**36.9**	**35.9**	**34.3**
External	...	...	27.8	28.3	29.5	31.3	32.5
Domestic 4/	...	...	13.8	10.4	7.4	4.6	1.8
External debt (in percent of total)	66.5	69.9	67.6	71.4	74.9	78.1	82.0
Debt to Revenue ratio	5.0	3.5	2.9	2.6	2.6	2.6	2.5
Implied interest rate (in US$)	1.7	2.3	3.0	3.0	2.6	2.9	2.8
External	2.2	1.8	1.8	1.8	2.3	2.4	2.5
Domestic	4.7	4.7	5.0	5.6	4.6	4.5	4.5

Source: Nicaraguan authorities and staff estimates.

1/ Observed values up to 2007 correspond to the legal situation. Projections for 2008 assume that outstanding debt to non-Paris Club bilaterals has been settled on HIPC-equivalent terms.

2/ For projections, defined as gross debt less stock of deposits accumulated by NFPS in the banking system, excluding the social security institute (INSS).

3/ For projections, defined as gross debt less assets accumulated by INSS and stock of deposits accumulated by the rest of the NFPS.

4/ Nominal gross debt less deposits of NFPS excluding INSS.

Table 12. Nicaragua: Financial Soundness Indicators: Core and Encouraged Sets, and Structure and Performance (in percent)

	2004	2005	2006	2007	2008 1/
I. Core Set (Deposit taking institutions)					
Capital Adequacy					
Regulatory capital to risk-weighted assets	14.3	13.6	14.5	14.1	14.1
Regulatory Tier 1 capital to risk-weighted assets	13.9	13.8	14.8	14.6	14.6
Asset Quality					
Non performing loans to total gross loans	2.2	2.1	2.0	2.5	2.9
Non performing loans to total gross loans 2/	9.3	7.2	6.2	5.2	5.9
Non performing loans net of provisions to capital	31.2	19.0	16.2	10.2	11.9
Sectoral distribution of loans to total loans					
Commercial	28.8	28.4	28.1	27.6	30.9
Agricultural	12.5	11.2	9.5	8.6	6.7
Consumer	26.5	28.3	30.0	31.6	31.8
Construction	12.4	13.0	13.5	13.4	13.7
Industrial	10.5	10.3	10.0	9.0	9.4
Others	9.3	8.8	9.1	9.9	7.5
Earnings and Profitability					
Return on assets	2.8	2.6	2.4	2.2	2.2
Return on equity	34.9	29.7	25.1	22.5	22.3
Interest margin to assets	8.4	8.0	8.0	9.1	9.6
Noninterest expenses to gross income	66.6	68.6	68.8	70.1	70.6
Liquidity					
Liquid assets to total assets	20.6	18.9	21.9	19.4	23.0
Liquid assets to total short-term liabilities	178.1	150.5	172.8	137.3	127.5
Exposure to FX risk					
Net open position in foreign exchange to capital	66.7	81.1	75.3	81.7	90.5
II. Encouraged Set (Deposit taking institutions)					
Capital to assets	9.1	9.1	10.3	10.7	10.7
Interest margin to total assets	8.4	8.0	8.0	9.1	9.6
Foreign currency-denominated loans to total loans	84.1	84.5	83.7	83.1	83.6
Foreign currency-denominated liabilities to total liabilities	68.9	70.6	70.4	70.3	71.3
Foreign currency deposits (in percent of GIR)	196.2	191.7	152.9	144.4	153.0
Ratio of real estate loans to total loans	12.4	13.2	13.5	13.4	13.7
Large exposures to capital	56.5	59.1	48.0	45.3	42.9
Personnel expenses to noninterest expenses	41.7	39.5	38.9	41.4	42.6
Spread between reference lending and deposit rates	13.4	13.1	13.1	14.1	13.3
Customer deposits to total (non-interbank) loans	169.6	146.7	123.6	110.1	111.6
III. Structure and Performance of the Financial Sector					
Number of institutions	10	9	9	10	10
Total assets (in millions of cordobas)	39,231	45,826	54,164	64,484	70,851
Bank concentration					
Number of banks accounting for at least					
25 percent of total assets	1	1	1	1	1
75 percent of total assets	9	8	8	9	9
Bank assets (percentage of GDP)					
Private commercial	54.7	55.8	66.0	69.7	67.3
Foreign banks 3/	0.3	12.4	29.3	30.4	30.0
Bank deposits (percentage of GDP)					
Private commercial	43.5	42.9	47.2	49.1	46.9
Foreign banks 3/	0.0	8.8	20.8	21.0	21.7
Dollarization and maturity structure					
Banking system assets as percentage of GDP	54.0	55.5	66.0	69.7	67.3
Assets in foreign currency					
as percentage of banking system assets	56.7	61.4	65.2	66.8	68.4
Contingent and off-balance sheet accounts					
(as percentage of total assets)	9.1	11.1	19.3	21.5	24.7

Sources: Superintendency of Banks and Central Bank of Nicaragua.

1/ May 2008

2/ NPLs including restructured and reprogrammed loans.

3/ Refers to banks with more than 49 percent foreign ownership.

APPENDIX. NICARAGUA: EXTERNAL DEBT SUSTAINABILITY—PRELIMINARY ANALYSIS OF IMPLICATIONS OF INCLUDING PRIVATE SECTOR DEBT[1]

This appendix updates the external DSA by primarily using available information of external private sector debt and ALBA-related financing. The analysis indicates that Nicaragua still has a moderate risk of external public debt distress. It also suggests that total external debt (public and private) is sustainable in the medium/long term, despite the increase in ALBA-related assistance. Nevertheless, as current information is preliminary these findings should be treated with a degree of caution.

Recent Developments

1. **Nicaragua recently received significant additional debt relief.** In 2007, the IDB provided relief for US$786 million in nominal terms (14 percent of GDP) in the context of MDRI, while Venezuela and Poland granted relief for US$64 million (1.1 percent of GDP) under the HIPC initiative. Moreover with the support of the World Bank Debt Reduction Facility (DRF), Nicaragua obtained debt relief for an additional US$1.3 billion (22 percent of GDP), equivalent to 94.2 percent of the total eligible commercial debt balance and a participation rate of over 95 percent.

Public Debt–Baseline Scenario

2. **Under the baseline scenario, all external public debt indicators continue to remain below the policy-dependent debt burden thresholds.** The debt-burden thresholds correspond to those of medium performers with a three year CPIA moving average equal to 3.74.[2] In the baseline scenario, almost all the external debt indicators are expected to improve over the 20-year projection period (Figure 1), and remain below the indicative risk thresholds for public debt distress (Appendix Box 1 describes the main assumptions underlying this baseline).

3. **In addition, public debt service is expected to remain manageable throughout the projection horizon, reflecting the high concessionality of both existing and projected new debt**. Debt service as a percentage of exports is projected to be below the threshold during the DSA horizon despite a slight increase during the later years of the projection period. The increase is explained by the projected reduction in concessionality of new borrowing as Nicaragua has more access to international capital markets.

4. **Further, the rate of external debt accumulation under the baseline scenario appears manageable**. The annual increase in the NPV of public external debt is substantially below 5 percent of GDP per annum during 2008–10 and declines gradually for the rest of the

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[1] This appendix was prepared by IMF staff and updates the last joint External DSA conducted in October 2007. A full-fledged comprehensive (public and external) DSA will be conducted jointly with the World Bank during the next Article IV consultation, scheduled for October 2008. In particular, the public DSA will incorporate the recent CENIs restructuring, which is expected to result in an NPV gain of about US$50 million.

[2] The cut-off value of the CPIA index for strong performers is 3.75.

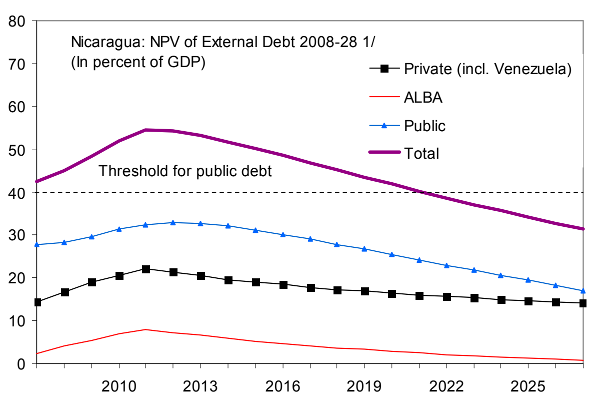
projection period. In addition, it is expected that as Nicaragua graduates as a PRGF and IDA country, access to highly concessional borrowing will gradually decrease over the medium term, as reflected in the reduction in grant element indicators (see Figure).

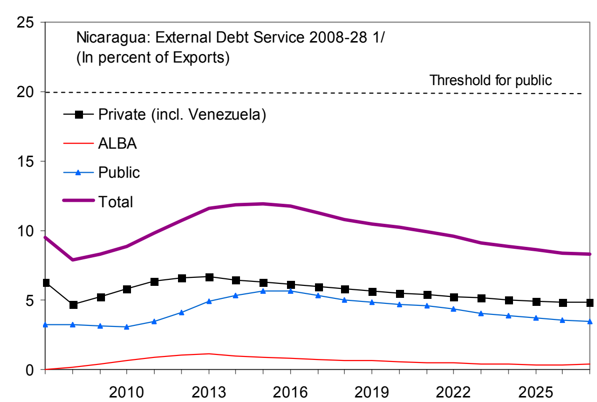
Public Debt–Vulnerabilities

5. **However, standard stress tests reveal some potential vulnerabilities**. In particular, the NPV of the debt-to-GDP ratio breaches the threshold of 40 percent under standardized bound tests that simulate negative shocks to real GDP growth, the contracting terms of new public sector loans, and current account adjustment, among other things. Moreover, under the historical scenario the current account (after untied grants) remains high and debt levels would increase without bound (Figure). It is worth noting that the vulnerabilities analyzed exclude contingent claims arising from the ALBA assistance, or the possibility that the government would be required to assume these private sector obligations.

Impact of Private External Debt

6. **Total external debt, including private, appears sustainable over the medium term.** The analysis reveals that despite the envisaged increase of ALBA-related flows, the NPV of total external debt to GDP ratio declines in the medium to long run. Similarly, debt service ratios are manageable (below 15 percent of exports) over the projection period. These results are partly explained by: (i) the assumed limited duration of the financing from Venezuela (2007–12) and its associated high degree of concessionality; and (ii) the assumption that private external borrowing will increase in tandem with nominal GDP. Relaxing these reasonable assumptions would affect the sustainability of total external debt.





APPENDIX BOX: ASSUMPTIONS IN THE UPDATED BASELINE SCENARIO

Real GDP growth is projected to average 4.7 percent for the period 2008–13 (slightly lower than before, reflecting the oil shock and the U.S. slowdown), increasing to 5½ for the subsequent years.

The external current account is assumed to widen at a faster pace at the outset of the projection period as a result of higher oil prices and the surge of aid flows, including assistance under ALBA. Then it gradually improves as exports benefit from (i) increased market access resulting from CAFTA-DR, (ii) enhanced competitiveness through the implementation of structural reforms under the program; and (iii) continued investment in the tradable sector. Imports are expected to grow at over 10 percent per annum, while export growth is expected to remain robust, averaging over 13 percent during 2008–12.

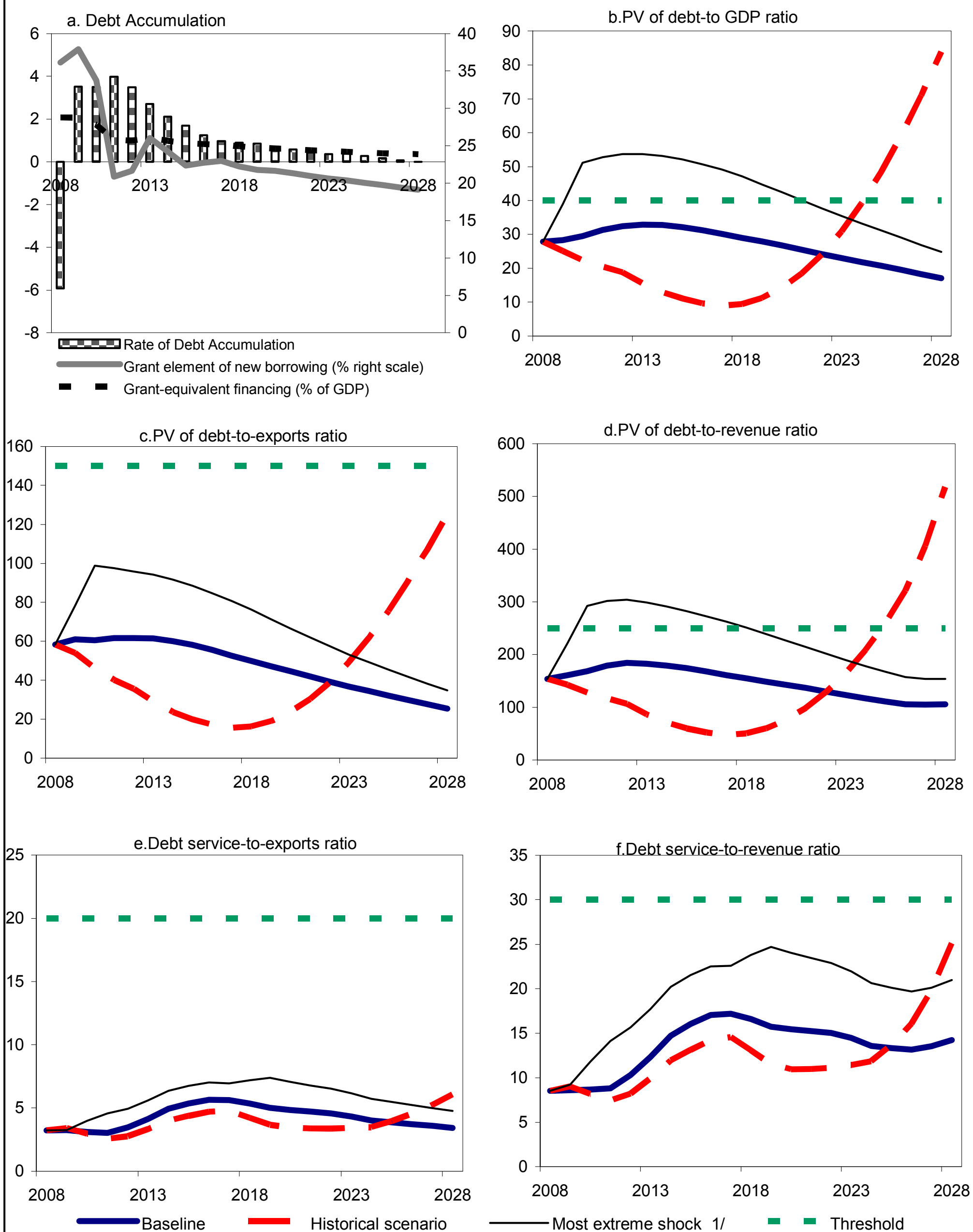
Negotiations with non-Paris Club bilaterals are assumed to be settled on HIPC-equivalent terms in 2008. As a result, the nominal external debt is expected to fall from 59 percent of GDP in 2007 to 38 percent with a minor impact on external debt-service obligations paid in cash.

Net official external assistance (loans and grants) excluding assistance under ALBA is expected to decline from about 10 percent of GDP in 2008 to under 1 percent by 2028, as Nicaragua becomes an emerging economy and attracts more private capital inflows. New external public borrowing after 2010 is projected to increase at an annual rate of 1 percent. Exposure to multilaterals and bilaterals is projected to remain unchanged at the average level during 2008–10, with the gap filled through commercial non-concessional loans.

ALBA-related assistance: Aid flows (concessional loans and grants) under ALBA will continue to be channeled through the private sector and are projected to average about 5 percent of GDP per annum for 2008–12. Except for 2008 and 2009, which considers substantial FDI flows of 4.2 and 1.3 percent of GDP respectively, the assistance is assumed to be concessional loans and grants linked to the ALBA oil collaboration.

External private debt and borrowing: According to preliminary BCN data, the stock of private external debt reached about 10 percent of GDP in 2007. The financial sector borrowed on average at an interest rate of 5 percent, with 8-year maturity and 3-year grace periods. Meanwhile, the non-financial sector borrowed on average at slightly higher rates and lower maturities (interest rate of 7 percent, 7-year maturity, and 1-year grace period). The updated baseline uses these terms and assumes that disbursements grow at the same long run rate as nominal GDP in US$ (7 percent per annum).

Appendix Figure. Nicaragua: Indicators of Public and Publicly Guaranteed External Debt under Alternatives Scenarios, 2008-28 1/



Source: Staff projections and simulations.

1/ The most extreme stress test is the test that yields the highest ratio in 2018. In figure b. it corresponds to a Combination shock; in c. to a Combination shock; in d. to a Combination shock; in e. to a Combination shock and in picture f. to a Combination shock

Appendix Table 1. Nicaragua: External Debt Sustainability Framework, Baseline Scenario, 2005-2028 1/
(In percent of GDP, unless otherwise indicated)

	Actual			Historical	Standard	Projections									
				Average	Deviation							2008-2013			2014-2028
	2005	2006	2007			2008	2009	2010	2011	2012	2013	Average	2018	2028	Average
External debt (nominal) 1/	**104.0**	**82.1**	**57.7**			**49.0**	**53.3**	**57.6**	**61.5**	**64.5**	**64.2**		**55.9**	**37.5**	
o/w public and publicly guaranteed (PPG)	96.4	70.8	47.0			35.8	37.1	38.7	40.3	41.5	42.1		38.1	23.9	
Change in external debt	-10.9	-21.9	-24.5			-8.6	4.3	4.3	3.9	3.0	-0.3		-1.9	-1.8	
Identified net debt-creating flows	-5.6	-6.8	-1.7			6.0	6.1	5.7	5.2	4.5	5.6		0.1	-14.0	
Non-interest current account deficit	**6.9**	**5.2**	**9.3**	**7.4**	**2.3**	**16.1**	**15.2**	**14.7**	**13.9**	**12.8**	**13.8**		**7.6**	**-7.5**	3.0
Deficit in balance of goods and services	29.6	29.4	34.7			39.0	37.9	34.9	33.1	31.3	29.4		19.9	1.0	
Net current transfers (negative = inflow)	-23.5	-24.7	-26.1	-21.5	3.3	-23.8	-23.7	-21.2	-20.5	-19.8	-16.9		-13.8	-10.2	-12.8
Other current account flows (negative = net inflow)	0.8	0.6	0.7			0.9	1.0	1.0	1.3	1.3	1.3		1.5	1.7	
Net FDI (negative = inflow)	**-4.6**	**-5.7**	**-6.4**	**-6.0**	**1.7**	**-9.7**	**-8.7**	**-8.2**	**-7.7**	**-7.5**	**-7.4**		**-6.9**	**-6.0**	-6.7
Endogenous debt dynamics 2/	**-7.8**	**-6.3**	**-4.6**			**-0.4**	**-0.4**	**-0.7**	**-1.0**	**-0.8**	**-0.8**		**-0.7**	**-0.4**	
Contribution from nominal interest rate	1.8	1.8	1.7			1.6	1.5	1.6	1.7	2.1	2.2		2.0	1.4	
Contribution from real GDP growth	-4.6	-3.5	-3.0			-2.0	-1.9	-2.3	-2.7	-2.9	-3.0		-2.7	-1.8	
Contribution from price and exchange rate changes	-5.0	-4.6	-3.3			…	…	…	…	…	…		…	…	
Residual (3-4) 3/	**-5.3**	**-15.1**	**-22.8**			**-14.6**	**-1.9**	**-1.4**	**-1.3**	**-1.5**	**-5.9**		**-2.0**	**12.2**	
PV of external debt 4/	...	...	48.7			41.0	44.6	48.4	52.5	55.5	54.9		46.7	30.7	
In percent of exports	...	...	103.9			85.8	95.9	99.6	103.4	105.3	102.6		80.4	45.8	
PV of PPG external debt	**...**	**...**	**38.1**			**27.8**	**28.3**	**29.5**	**31.3**	**32.5**	**32.9**		**28.9**	**17.1**	
In percent of exports	**...**	**...**	**81.3**			**58.2**	**61.0**	**60.6**	**61.6**	**61.7**	**61.4**		**49.9**	**25.5**	
In percent of government revenues	**...**	**...**	**196.3**			**153.4**	**160.9**	**168.4**	**178.7**	**183.9**	**182.6**		**154.6**	**105.5**	
Debt service-to-exports ratio (in percent)	**17.2**	**11.5**	**11.1**			**9.5**	**7.9**	**8.3**	**8.9**	**9.8**	**10.8**		**11.3**	**8.3**	
PPG debt service-to-exports ratio (in percent)	**9.4**	**8.2**	**5.7**			**3.2**	**3.3**	**3.1**	**3.0**	**3.5**	**4.1**		**5.4**	**3.4**	
PPG debt service-to-revenue ratio (in percent)	**21.1**	**19.4**	**13.7**			**8.5**	**8.6**	**8.7**	**8.8**	**10.3**	**12.3**		**16.6**	**14.2**	
Total gross financing need (Millions of U.S. dollars)	1,070	899	1,248			1,420	900	985	1,062	1,105	1,343		1,146	-2,013	
Non-interest current account deficit that stabilizes debt ratio	17.8	27.1	33.8			24.8	10.9	10.3	10.0	9.8	14.1		9.6	-5.7	
Key macroeconomic assumptions															
Real GDP growth (in percent)	4.3	3.9	3.8	3.8	1.7	4.0	4.5	4.7	5.0	5.0	5.0	4.7	5.0	5.0	5.0
GDP deflator in US dollar terms (change in percent)	4.6	4.7	4.2	1.6	2.7	11.2	6.2	3.1	1.9	1.9	1.9	4.4	1.9	1.9	1.9
Effective interest rate (percent) 5/	1.7	1.9	2.2	2.3	0.4	3.2	3.3	3.2	3.2	3.6	3.7	3.4	3.8	3.9	3.8
Growth of exports of G&S (US dollar terms, in percent)	18.6	21.0	13.1	11.9	8.8	18.0	7.5	13.1	11.7	10.9	8.8	11.7	8.7	8.5	8.6
Growth of imports of G&S (US dollar terms, in percent)	18.8	15.4	19.0	10.9	8.7	23.1	7.5	7.0	7.5	7.0	5.7	9.6	5.7	5.5	5.6
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	36.1	37.9	33.7	20.9	21.6	26.0	29.4	22.2	19.1	21.3
Government revenues (excluding grants, in percent of GDP)	18.0	18.9	19.4			18.1	17.6	17.5	17.5	17.7	18.0		18.7	16.2	18.4
Aid flows (in Millions of US dollars) 7/	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Grant-equivalent financing (in percent of GDP) 8/	...	...	...			2.1	2.1	1.7	1.0	1.0	1.1		0.7	0.3	0.6
Grant-equivalent financing (in percent of external financing) 8/	...	...	...			36.1	37.9	33.7	20.9	21.6	26.0		22.2	19.1	21.3
Memorandum items:															
Nominal GDP (Millions of US dollars)	4,872	5,288	5,726			6,625	7,332	7,917	8,472	9,065	9,699		13,604	26,761	
Nominal dollar GDP growth	9.1	8.5	8.3			15.7	10.7	8.0	7.0	7.0	7.0	**9.2**	7.0	7.0	7.0
PV of PPG external debt (in Millions of US dollars)			2,183			1,844	2,077	2,334	2,649	2,945	3,190		3,938	4,567	
(PVt-PVt-1)/GDPt-1 (in percent)						-5.9	3.5	3.5	4.0	3.5	2.7	1.9	0.9	0.0	0.7

Source: Staff simulations.

1/ Includes both public and private sector external debt.

2/ Derived as [r - g - r(1+g)]/(1+g+r+gr) times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, and r = 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).

Appendix Table 2. Nicaragua: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2008-28
(In percent)

	Projections								
	2008	2009	2010	2011	2012	2013	**2018**	2023	2028
PV of debt-to GDP ratio									
Baseline	27.8	28.3	29.5	31.3	32.5	32.9	**28.9**	23.0	17.1
A. Alternative Scenarios									
A1. Key variables at their historical averages in 2008-2028 1/	27.8	25.1	22.4	20.4	18.8	15.5	**9.4**	30.9	83.9
A2. New public sector loans on less favorable terms in 2008-2028 2	27.8	29.2	30.9	32.9	35.6	37.6	**38.3**	35.5	31.6
B. Bound Tests									
B1. Real GDP growth at historical average minus one standard deviation in 2009-2010	27.8	28.9	30.8	32.7	33.9	34.4	**30.2**	24.0	17.8
B2. Export value growth at historical average minus one standard deviation in 2009-2010 3/	27.8	30.0	36.6	38.2	39.2	39.5	**34.7**	26.8	19.3
B3. US dollar GDP deflator at historical average minus one standard deviation in 2009-2010	27.8	30.4	33.0	35.0	36.4	36.9	**32.4**	25.8	19.1
B4. Net non-debt creating flows at historical average minus one standard deviation in 2009-2010 4/	27.8	37.0	43.9	45.4	46.3	46.3	**40.5**	30.6	21.5
B5. Combination of B1-B4 using one-half standard deviation shocks	27.8	38.9	51.2	52.8	53.7	53.8	**47.1**	35.4	24.8
B6. One-time 30 percent nominal depreciation relative to the baseline in 2009 5/	27.8	39.5	41.1	43.6	45.3	45.8	**40.3**	32.0	23.8
PV of debt-to-exports ratio									
Baseline	58.2	61.0	60.6	61.6	61.7	61.4	**49.9**	36.8	25.5
A. Alternative Scenarios									
A1. Key variables at their historical averages in 2008-2028 1/	58.2	54.0	46.0	40.2	35.6	29.0	**16.2**	49.4	125.2
A2. New public sector loans on less favorable terms in 2008-2028 2	58.2	62.8	63.5	64.7	67.7	70.2	**66.0**	56.8	47.1
B. Bound Tests									
B1. Real GDP growth at historical average minus one standard deviation in 2009-2010	58.2	61.0	60.6	61.6	61.7	61.4	**49.9**	36.8	25.5
B2. Export value growth at historical average minus one standard deviation in 2009-2010 3/	58.2	67.5	86.1	86.1	85.3	84.4	**68.5**	49.1	33.1
B3. US dollar GDP deflator at historical average minus one standard deviation in 2009-2010	58.2	61.0	60.6	61.6	61.7	61.4	**49.9**	36.8	25.5
B4. Net non-debt creating flows at historical average minus one standard deviation in 2009-2010 4/	58.2	79.6	90.3	89.3	87.8	86.5	**69.8**	49.0	32.2
B5. Combination of B1-B4 using one-half standard deviation shocks	58.2	78.2	98.8	97.5	95.7	94.2	**76.1**	53.2	34.8
B6. One-time 30 percent nominal depreciation relative to the baseline in 2009 5/	58.2	61.0	60.6	61.6	61.7	61.4	**49.9**	36.8	25.5
Debt service-to-exports ratio									
Baseline	3.2	3.3	3.1	3.0	3.5	4.1	**5.4**	4.3	3.4
A. Alternative Scenarios									
A1. Key variables at their historical averages in 2008-2028 1/	3.2	3.4	2.9	2.6	2.8	3.3	**4.2**	3.4	6.1
A2. New public sector loans on less favorable terms in 2008-2028 2	3.2	3.3	3.1	3.2	3.5	3.9	**3.9**	3.4	2.8
B. Bound Tests									
B1. Real GDP growth at historical average minus one standard deviation in 2009-2010	3.2	3.3	3.1	3.0	3.5	4.1	**5.4**	4.3	3.4
B2. Export value growth at historical average minus one standard deviation in 2009-2010 3/	3.2	3.4	3.7	4.1	4.6	5.3	**6.7**	5.7	4.5
B3. US dollar GDP deflator at historical average minus one standard deviation in 2009-2010	3.2	3.3	3.1	3.0	3.5	4.1	**5.4**	4.3	3.4
B4. Net non-debt creating flows at historical average minus one standard deviation in 2009-2010 4/	3.2	3.3	3.8	4.2	4.6	5.2	**6.8**	5.7	4.4
B5. Combination of B1-B4 using one-half standard deviation shocks	3.2	3.3	4.0	4.6	4.9	5.6	**7.2**	6.2	4.8
B6. One-time 30 percent nominal depreciation relative to the baseline in 2009 5/	3.2	3.3	3.1	3.0	3.5	4.1	**5.4**	4.3	3.4
Memorandum item:									
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	12.1	12.1	12.1	12.1	12.1	12.1	**12.1**	12.1	12.1

Source: Staff projections and simulations.

1/ Variables include real GDP growth, growth of GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.

2/ Assumes that the interest rate on new borrowing is by 2 percentage points higher than in the baseline., while grace and maturity periods are the same as in the baseline.

3/ Exports values are assumed to remain permanently at the lower level, but the current account as a share of GDP is assumed to return to its baseline level after the shock (implicitly assuming an offsetting adjustment in import levels).

4/ Includes official and private transfers and FDI.

5/ Depreciation is defined as percentage decline in dollar/local currency rate, such that it never exceeds 100 percent.

6/ Applies to all stress scenarios except for A2 (less favorable financing) in which the terms on all new financing are as specified in footnote 2.

Appendix Table 3. Nicaragua: NPV of Private and Public External Debt and External Debt Service, 2008-28

NPV of External Debt (in percent of GDP)

	2008	2009	2010	2011	2012	2013	2018	2023	2028
Private (incl. ALBA)	14.5	16.8	18.9	20.7	22.0	21.3	17.9	15.6	14.2
Financial	9.4	10.2	10.8	11.3	11.4	11.5	11.3	11.2	11.1
Non-Financial	2.8	2.6	2.6	2.6	2.6	2.5	2.4	2.3	2.3
Venezuela	2.3	4.0	5.5	6.8	8.0	7.3	4.2	2.2	0.9
Public	27.8	28.3	29.5	31.3	32.5	32.9	28.9	23.0	17.1
Private (excl. ALBA)	12.2	12.8	13.4	13.9	14.0	14.0	13.7	13.5	13.3
Total	42.3	45.1	48.4	52.0	54.5	54.2	46.8	38.6	31.3

External Debt Service (in percent of Exports of goods and services)

	2008	2009	2010	2011	2012	2013	2018	2023	2028
Private (incl. ALBA)	6.3	4.7	5.2	5.8	6.4	6.6	6.0	5.3	4.9
Financial	4.6	2.9	3.4	3.8	4.2	4.3	4.0	3.7	3.5
Non-Financial	1.7	1.6	1.4	1.3	1.3	1.3	1.2	1.1	1.0
Venezuela	0.0	0.2	0.4	0.7	0.9	1.0	0.7	0.5	0.4
Public	3.2	3.3	3.1	3.0	3.5	4.1	5.4	4.3	3.4
Private (excl. ALBA)	6.3	4.5	4.8	5.2	5.5	5.6	5.2	4.8	4.5
Total	9.5	7.9	8.3	8.9	9.8	10.8	11.3	9.6	8.3

Source: Staff projections and simulations.

ANNEX: SUMMARY OF ANNEXES

Fund Relations

Nicaragua's outstanding purchases amount to SDR 53.68 million, 41.29 percent of quota. The central bank implements a crawling peg system. The last Article IV consultation was concluded by the Executive Board on January 18, 2006 (EBS/05/201). FAD, MCM, and STA have provided extensive TA since 2000 and an FSAP was carried out in 2003. An update safeguards assessment mission completed in November 2007 concluded that there are a number of vulnerabilities in the BCN's internal controls, financial reporting framework and external audit mechanisms. Staff continues to monitor progress in the implementation of the mission's recommendations to strengthen safeguards.

Relations with the World Bank Group[1]

As of July 25, 2008, total loans/credits disbursed and undisbursed from the World Bank/IDA amounted to US$1,646 million. The currently active portfolio consists of 11 projects for a total commitment of US$211 million, of which US$149 million remain to be disbursed. Areas covered in the current portfolio include: education, health, transport, telecommunications, rural energy, rural development, natural disaster prevention, land administration, public sector reform (PSTAC) and access to financial services. A new Country Assistance Strategy for FY2008–12 was approved by the board on October 11, 2007 for an indicative total of US$240 million. The strategy includes US$100 million for budget support operations and US$85 million for water and sanitation operations and support to SMEs, with the remainder for programs to address impact of food price shock.

Relations with the Inter-American Development Bank[2]

As of August 18, 2008, there were 29 projects in the IDB's loan portfolio for US$677 million, with an undisbursed balance of US$320 million. In the Special Fund Operations allocation for 2007–08, Nicaragua received US$80 million for each year. Total HIPC debt relief from the IDB to Nicaragua reached US$727 million, of which US$17 million was granted in 2007. Total MDRI debt relief from IDB to Nicaragua of US$984 million was granted in 2007. The last country strategy update was approved by the Board in May 2005. A new country strategy is expected to be approved in late-2008.

Statistical Issues

Economic data reported to the Fund are generally adequate for surveillance purposes despite shortcomings in government financing data and monetary statistics. Nicaragua formally began participation in the General Data Dissemination System (GDDS) in February 2005.

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[1] Adapted from text prepared by World Bank staff in July 2008.

[2] Adapted from text prepared by IDB staff in July 2008.