EBS/86/75

CONFIDENTIAL

March 31, 1986

To: Members of the Executive Board

From: The Acting Secretary

Subject: Nicaragua - Exchange System and Real Effective Exchange Rate - Information Notice

Attached for the information of the Executive Directors is a paper on recent changes in the exchange system of Nicaragua and an information notice on the real effective exchange rate of the Nicaraguan córdoba.

Mr. Belanger (ext. 8671) or Mr. Umana (ext. 8503) is available to answer technical or factual questions relating to this paper.

Att: (1)

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INTERNATIONAL MONETARY FUND

Nicaragua--Exchange System and Real Effective Exchange Rate Information Notice

Prepared by the Western Hemisphere Department and the Exchange and Trade Relations Department

(In consultation with the Legal and Research Departments)

Approved by S. T. Beza and Manuel Guitián

March 28, 1986

In the attached document, the Nicaraguan authorities advise the Fund that Nicaragua had introduced certain changes in its exchange system with effect from February 1, 1986. In addition to setting out these changes, this paper describes developments in Nicaragua's real effective exchange rate under the Fund's information notice system.

I. Background

The exchange system of Nicaragua at the end of 1985 comprised six basic exchange rates:

(i) An official exchange rate of C$10 per U.S. dollar applicable to interest and principal payments on external loans disbursed up to February 8, 1985. Debt service payments on external loans disbursed after that date were settled at the exchange rates applicable to imports of goods and services for which the foreign loans were used.

(ii) An exchange rate of C$20 per U.S. dollar applicable to imports of raw materials, spare parts, and certain essential consumer goods.

(iii) An exchange rate of C$28 per U.S. dollar applicable to all export proceeds; receipts from freight, insurance and port services, investment income, and expenditures by foreign embassies; and imports of petroleum products and nonessential consumer goods.

(iv) An exchange rate of C$40 per U.S. dollar applicable to imports of most capital goods.

(v) An exchange rate of C$50 per U.S. dollar applicable to exports of printed materials, international communication services, and foreign grants. On the payments side, this rate applied to business and official travel, medical expenses, student expenditures abroad, foreign subscriptions, expenses for international communications, professional fees for foreign experts, and transactions through foreign credit cards.

(vi) A "free" exchange rate administered by a single exchange house (opened in May 1985). This rate applied to receipts from tourism, private remittances, and other invisibles not subject to the fixed exchange rates. On the payments side, this rate applied to imports of all other goods and invisibles for which the fixed exchange rates did not apply. 1/

In addition, starting December 12, 1985 a mixed exchange rate arose as 50 percent of the commissions of travel agencies in Nicaragua was converted at the official rate and 50 percent at the "free" rate.

All purchases of foreign exchange at the fixed rates were subject to licensing requirement by the Central Bank. No licensing requirement applied to purchases of foreign exchange in the "free" market; however, allocation of foreign exchange was administered by the exchange house on a first-come first-served basis (giving priority to certain imports and invisibles payments) with the rate being moved only at irregular intervals. The exchange rate (buying) in the "free" exchange market was quoted initially at C$650 per U.S. dollar, and was moved to C$750 in December 1985 and to C$900 in late February 1986. It is reported that an illegal black market continued to exist, in which foreign exchange was sold at a substantial premium with respect to the official and "free" rates.

II. Modification of the Exchange System

The modification of the exchange system, effective February 1, 1986, involved the adoption of a more depreciated official rate for most transactions and the establishment of mixed exchange rates for certain export proceeds 2/ and invisible receipts. Most exchange transactions are to be conducted at an official exchange rate of C$70 per U.S. dollar, with the following exceptions:

(i) 25 percent of proceeds from nontraditional exports (exports other than coffee, cotton, sugar, sesame and beef) and 50 percent of receipts from certain invisibles (see attachment) and cash transfers from abroad can be used for approved imports of goods and payments for medical expenses, travel, student or similar expenditures abroad, or can be converted at the "free" rate; 3/

1/ Transactions through the "free" market were estimated, on an annual basis, at about 1 percent of Nicaragua's total current account transactions in 1985.

2/ Mixed exchange rates were applied to the surrender of certain export proceeds in 1984 but they were eliminated in February 1985.

3/ Until used for approved foreign payment or converted at the "free" rate, the funds in question are deposited in a special U.S. dollar current account in the recipient's name. Alternatively, a document can be issued by the Central Bank for the relevant amount of foreign exchange.

(ii) imports of petroleum are to be handled at C$28 per U.S. dollar;

(iii) the servicing of external debt disbursed prior to February 8, 1985 is to be made at C$10 per U.S. dollar;

(iv) the servicing of foreign debt disbursed during the period February 8, 1985 to May 31, 1986 is to be made at the exchange rate applicable to imports and services financed with the proceeds of the loans; and

(v) transactions not included (see attachment) or not satisfied in the official market will be handled at the "free" rate.

It is estimated that the above-mentioned changes involve an implicit nominal devaluation of the cordoba of about 64 percent on average (in foreign currency terms). 1/ Foreign exchange receipts transferred from the official to the "free" market are estimated to amount to US$30-40 million on an annual basis. Including foreign exchange payments, the share of the "free" market in total current account transactions is estimated to increase to 3-4 percent.

III. Real Effective Exchange Rate Information Notice

The recent evolution of Nicaragua's real effective exchange rate, as measured by the standard index developed in connection with the information notice system, is set out in the attached table and chart. Based on this index, as of January 1986, the Nicaraguan cordoba had appreciated in real effective terms by more than 10 percent since the last occasion on which Nicaragua's exchange rate developments were brought to the attention of the Executive Board in an information notice issued in early December 1985. 2/ The appreciation from November 1985 to January 1986 is estimated to have amounted to 21.7 percent (Table 1). 3/

1/ The corresponding change in real effective terms cannot be calculated yet because price changes of Nicaragua and its trading partners for February are not yet available.

2/ Since the conclusion of the latest Article IV consultation (EBM/85/34 and SUR/85/35), the Executive Board was informed about Nicaragua's exchange rate developments by means of a joint exchange system-exchange rate information notice in March (EBS/85/43) and information notices in July and December (EBS/85/179 and EBS/85/273).

3/ For purposes of the information notice system, the effective value of the cordoba is based on a composite rate, representing a trade-weighted average of the multiple exchange rates.

The estimated appreciation of the cordoba in real effective terms since November 1985 reflected entirely the high rate of domestic inflation. Wages were increased in two stages in early 1986 in the cumulative amount of 185 percent (90 percent in January and 50 percent in March).

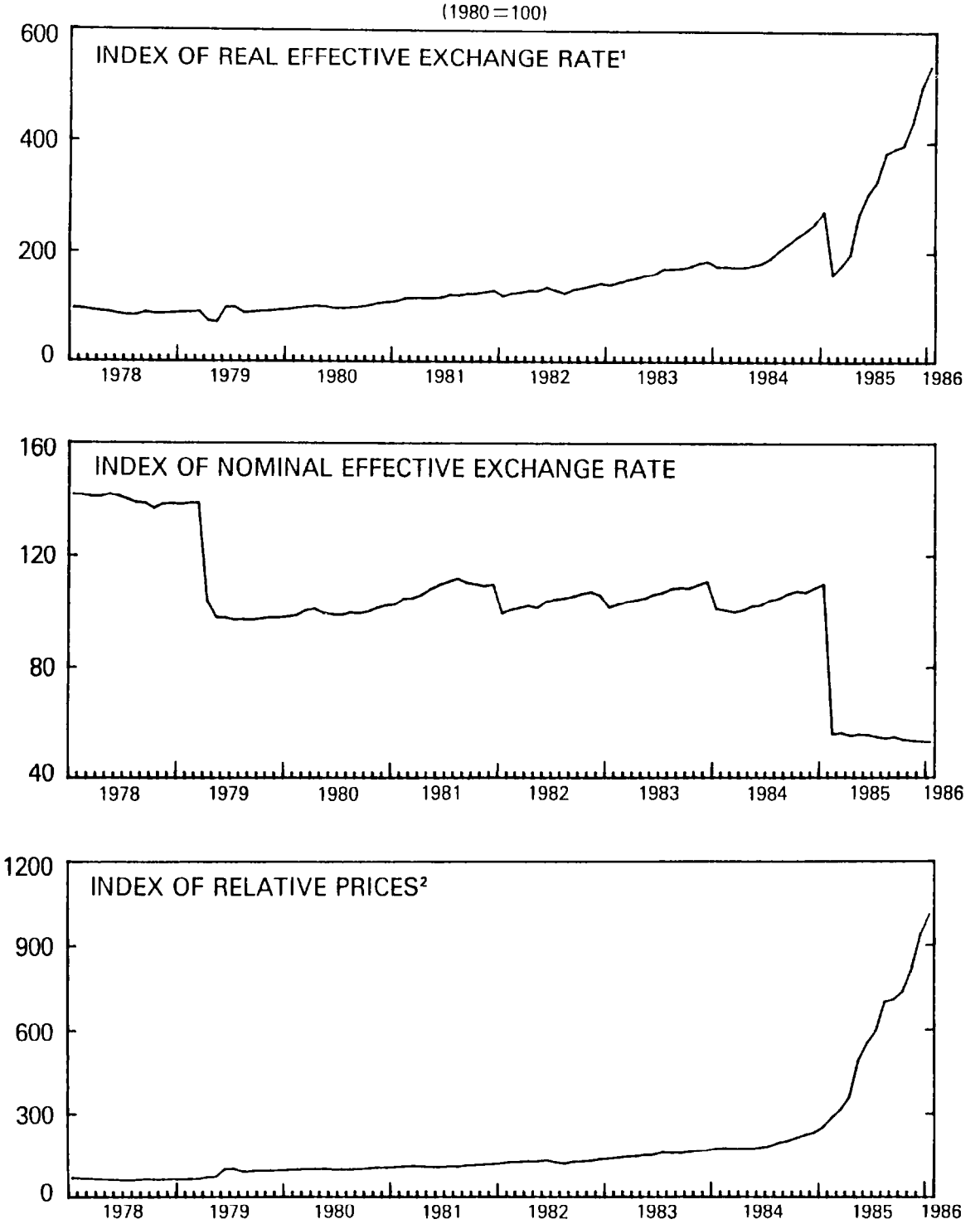
The modification of the exchange system described in Section II above can be expected to have produced a large change in the nominal effective exchange rate of the cordoba in February 1986 following a very large real appreciation over the last five years. However, it is not possible to indicate at this stage the effects on the real effective exchange rate, and therefore on competitiveness, in view of the high and variable rate of inflation. The staff considers that the changes represent some simplification of the exchange system and are a further step in the right direction. Nevertheless, the system remains complex, with adverse consequences for the efficiency of resource allocation. A fuller appraisal of the recent changes in the exchange system and a review of their effect on the real effective exchange rate will be included in the staff report for the 1986 Article IV consultation with Nicaragua, which is expected to be circulated to the Board in April 1986. In the meantime, no action by the Executive Board is being recommended.

CHART 1

NICARAGUA

INFORMATION NOTICE SYSTEM INDEX OF EFFECTIVE EXCHANGE RATE

(1980=100)



Source: Information Notice System

[1] Trade weighted index of nominal effective exchange rate deflated by seasonally adjusted consumer prices; a rise (fall) in the index reflects an appreciation (depreciation) of the cordoba.

[2] Relative prices as measured by seasonally adjusted consumer price indices.

Table 1. Nicaragua: Real Effective Exchange Rate and Related Series

(Indices: 1980 = 100)

	Real Effective Exchange Rate 1/ 2/	Nominal Effective Exchange Rate 1/	Relative Consumer Prices (Local Currencies)	Exchange Rate in Terms of U.S. Dollars 1/	Consumer Price Index (Seasonally Adjusted)	Consumer Price Index (Not Seasonally Adjusted)
Quarterly						
1981						
I	113.3	104.3	108.7	100.0	117.1	111.8
II	115.9	108.1	107.2	100.0	118.6	121.5
III	121.8	111.2	109.6	100.0	125.0	130.3
IV	126.7	109.8	115.4	100.0	134.8	131.9
1982						
I	123.2	100.6	122.5	89.6	145.6	138.1
II	131.4	102.5	128.2	89.6	155.5	159.5
III	129.1	105.2	122.7	89.6	152.5	160.7
IV	138.9	106.7	130.2	89.6	164.3	160.0
1983						
I	145.0	102.8	141.0	86.2	180.1	169.7
II	157.3	105.4	149.4	86.2	194.5	199.5
III	171.1	108.2	158.2	86.2	210.5	223.8
IV	180.2	109.8	164.2	86.2	223.6	217.4
1984						
I	174.7	100.7	173.6	78.0	241.8	226.1
II	177.5	101.9	174.3	78.0	247.5	254.0
III	203.6	105.4	193.2	78.0	279.5	299.0
IV	240.1	107.9	222.4	78.0	328.8	318.6
1985						
I	204.1	74.1	283.5	52.0	428.4	398.8
II	258.6	55.6	464.9	38.9	717.6	742.9
III	366.5	54.8	669.0	38.9	1,046.5	1,122.7
IV	444.0	53.6	828.9	38.9	1,321.8	1,275.8
Monthly						
1985						
Nov. 3/	436.7	53.6	815.3	38.9	1,299.4	1,255.6
Dec.	499.5	53.4	936.0	38.9	1,503.5	1,412.9
1986						
Jan.	531.5	53.2	999.7	38.9	1,616.7	1,498.9
Percentage change						
Nov. 1985- Jan. 1986	21.7	-0.7	22.6	0.0	24.4	

Source: Information Notice System.

1/ Increases mean appreciation.
2/ Using seasonally adjusted price indices.
3/ Date of latest consideration by Executive Board.

CENTRAL BANK OF NICARAGUA

Managua, Nicaragua

CURRENCY REGULATIONS - 1986 1/

TITLE I

Central Bank Policy Instruments

CHAPTER I

Exchange Rates

Section 1

Legal Parity

Article 1. The legal parity of the cordoba vis-a-vis the United States dollar is hereby set at C$70.0 per US$1.0 (C$70.00 = US$1.00).

Section 2

Exchange Rate for Purchase and Sale of Foreign Exchange

Article 2. The Central Bank shall settle the foreign exchange proceeds of visible exports of traditional products at the official exchange rate. Traditional exports shall be understood to be all exports of products covered by the support price system.

Article 3. Visible exports of nontraditional products shall be settled as follows: 75 percent at the official exchange rate, and the remaining 25 percent shall be settled at the free market exchange rate authorized by the Central Bank or released in full or in part to the exporter in the form and for the uses, purposes and objectives specified in Article 13 of these regulations.

Article 4. The foreign exchange proceeds of invisible exports shall be sold to the Central Bank at the exchange rates and in the manner specified below:

4.1 The following shall be settled at the official exchange rate:

1/ Effective February 1, 1986.

(i) Foreign exchange proceeds of invisible exports directly linked to the import and export process, such as:

Freight,
Insurance of merchandise,
Warehousing and storage,
Loading and unloading,
Packing and repacking,
Labeling and packaging,
Trucking, haulage and shipment,
Handling and transfer;

(ii) Foreign exchange proceeds for services rendered by Nicaraguan embassies, consulates, interests sections and commercial offices abroad;

(iii) Mandatory conversion of foreign exchange by foreigners at points of entry into Nicaragua;

(iv) Commissions collected by the National Financial System for services rendered in connection with international operations;

(v) Foreign exchange proceeds for communications services generated by the Nicaraguan Institute of Telecommunications and Posts;

(vi) Premiums received by insurance companies for direct insurance and bonding not related to merchandise;

(vii) Indemnification and compensation received from foreign insurance companies for losses covered by insurance and bonding not related to merchandise;

(viii) Indemnification and compensation from foreign companies for losses under assigned reinsurance and rebonding not related to merchandise;

(ix) Other foreign exchange received by insurance companies for services rendered by them in their line of business.

4.2 The invisible exports specified below shall be settled as follows: 50 percent at the official exchange rate and the remaining 50 percent at the free market exchange rate;

(i) Reimbursements of local outlays by branches or agents of foreign companies;

(ii) Foreign exchange sold by airlines to cover local outlays in cordobas;

(iii) Communications services, e.g., foreign exchange proceeds for services rendered by radiotelegraph, courier and similar communications enterprises, including foreign exchange received for settlements related to these enterprises;

(iv) Foreign exchange sold by hotels and hostels to cover local outlays in cordobas;

(v) Foreign exchange proceeds for commissions of travel agents and shipbrokers;

(vi) Foreign exchange proceeds from commissions of representatives and distributors of foreign firms;

(vii) Subscriptions. The foreign exchange income of companies resident in Nicaragua from newspapers, magazines and similar subscriptions;

(viii) Foreign exchange received from the leasing of land transport vehicles, aircraft and vessels;

(ix) Foreign exchange proceeds for news services provided by resident companies;

(x) Foreign exchange which embassies, consulates, international missions and offices of international organizations and institutions accredited in Nicaragua convert to cordobas to meet local outlays;

(xi) Foreign exchange proceeds earned by resident enterprises for tourist travel and tours, net of their direct outlays in foreign currencies;

(xii) Funds received by ports not related to merchandise, e.g., provision of fuel, food, stores and other supplies, port and airport fees and charges, lighterage, stowage, maintenance, repair, tugging, pilotage, towing, and other services not covered by freight charges;

(xiii) Foreign exchange proceeds earned by resident enterprises for film rentals.

Article 5. Foreign exchange proceeds of gifts and grants shall be settled as follows:

5.1 Cash gifts and grants: 50 percent shall be settled at the official exchange rate and the remaining 50 percent shall be settled at the free market exchange rate or released to the recipient in the form and for the uses, purposes or objectives specified in Article 13 of these regulations.

5.2 Gifts in kind: these shall be settled for accounting purposes at the official exchange rate.

Section 3

Exchange Rates for Sales of Foreign Exchange

Article 6. The exchange rate for settlement of foreign exchange to meet payments for visible and invisible imports and for the recording and payment of principal, interest and commissions on external debt shall be the official exchange rate.

Article 7. The exchange rate for contracted and disbursed foreign loans before February 8, 1985 shall be, for recording purposes and for repayment of the loans and payment of the interest and charges and commissions on them, C$10.00 x US$1.00. The exchange rate for external debt which was utilized and became due starting on February 8, 1985 and before June 1, 1986, shall be for the repayment of the loans and payment of the interest and charges and commissions on them, equal to the exchange rate applicable to the goods or services imported with the loaned Funds.

Article 8. The exchange risk shall be assumed by the direct or indirect importer, as the case may be; this shall be stipulated in any contracts and/or credit documents that are signed in accordance with the Monetary Law in effect.

Section 4

Free Foreign Exchange Market Authorized by the Central Bank

Article 9. All foreign exchange transactions not specified in the foregoing articles may be bought and sold in the free foreign exchange market authorized by the Central Bank.

Section 5

Application of Exchange Rates and Release of Foreign Exchange

Article 10. For visible exports, the new official exchange rate shall be applied on the basis of the date of shipment; the supporting document shall thus be the bill of lading, airwaybill, or waybill for the operation.

Article 11. For visible imports payable at sight the exchange rates shall be applied as follows:

1. Payment by letter of credit

If the letter of credit has been opened, i.e., if the foreign exchange has already been transferred from the country, the applicable

exchange rate shall be the rate assigned to the import on the date the letter of credit was opened.

2. Payment by sight draft

Imports for payment by sight draft shall be settled at the exchange rate prevailing on the date the merchandise was admitted into the country.

Article 12. For visible imports with deferred payment, the exchange rates shall be applied as follows:

1. Payment by time letter of credit

The applicable exchange rate for these imports shall be the rate in effect on the date of payment of the letter of credit.

2. Payment by time draft

The applicable exchange rate for these imports, irrespective of whether there is a central bank guarantee, shall be the rate prevailing on the date of payment of the draft.

Article 13. A. Foreign exchange proceeds in cash from nontraditional visible exports, invisible exports under Article 4.2 of these regulations and gifts and donations in cash, shall be released to the exporter or recipient in the percentages provided in these regulations, by crediting the amount to deposit in a special U.S. dollar demand deposit account, or in the form of a document to be issued for these purposes by the Central Bank. The foreign exchange referred to previously may be used only as follows:

1. The special demand deposit account in U.S. dollars or the document referred to previously will be earmarked in all cases to the creditor bank, if there is one, and even to the credit of the same bank which opened the account. The creditor bank shall agree with the client it has financed, on the sale of the foreign exchange necessary to cover the financing or any other balances, in accordance with existing arrangements. The creditor bank may serve as intermediary in the sale of the foreign exchange in the free market or to the Central Bank.

2. Foreign exchange deposited in the special demand deposit account or covered by the document may be used only as follows:

(a) In payment for the holder's own visible imports under the own funds arrangement set up by the Central Bank;

(b) To meet medical, travel, educational, and similar expenses in foreign exchange by the recipient and his family, with the authorization from the Central Bank;

(c) To make payments to the recipient's domestic currency liabilities to banks or meet any domestic currency outlays, through sale of the foreign exchange to an authorized exchange house or to the Central Bank at the free market exchange rate in effect on the transaction date.

B. Nontraditional visible exports which are made through barter, payments agreements and special agreements, shall be settled by the Central Bank at the official and free exchange rates in effect at the date of the transaction and in the percentages stipulated in the norms.

C. The Central Bank shall issue special regulations for the settlement of imports made through barter, special, and commercial agreements.

Article 14. Imports of crude petroleum, partially refined petroleum and petroleum derivatives shall be at the exchange rate of C$28.00 per US$1.00