NICARAGUA

1. General trends

For the second consecutive year, the Nicaraguan economy experienced a sharp slowdown. In 2001, GDP increased by 3%, which represented a decrease of more than two percentage points with respect to the previous year. This translated into a virtual standstill of per capita GDP and a 10.7% increase in open unemployment. The electoral cycle and the prolonged banking crisis also hurt the country's economic performance.

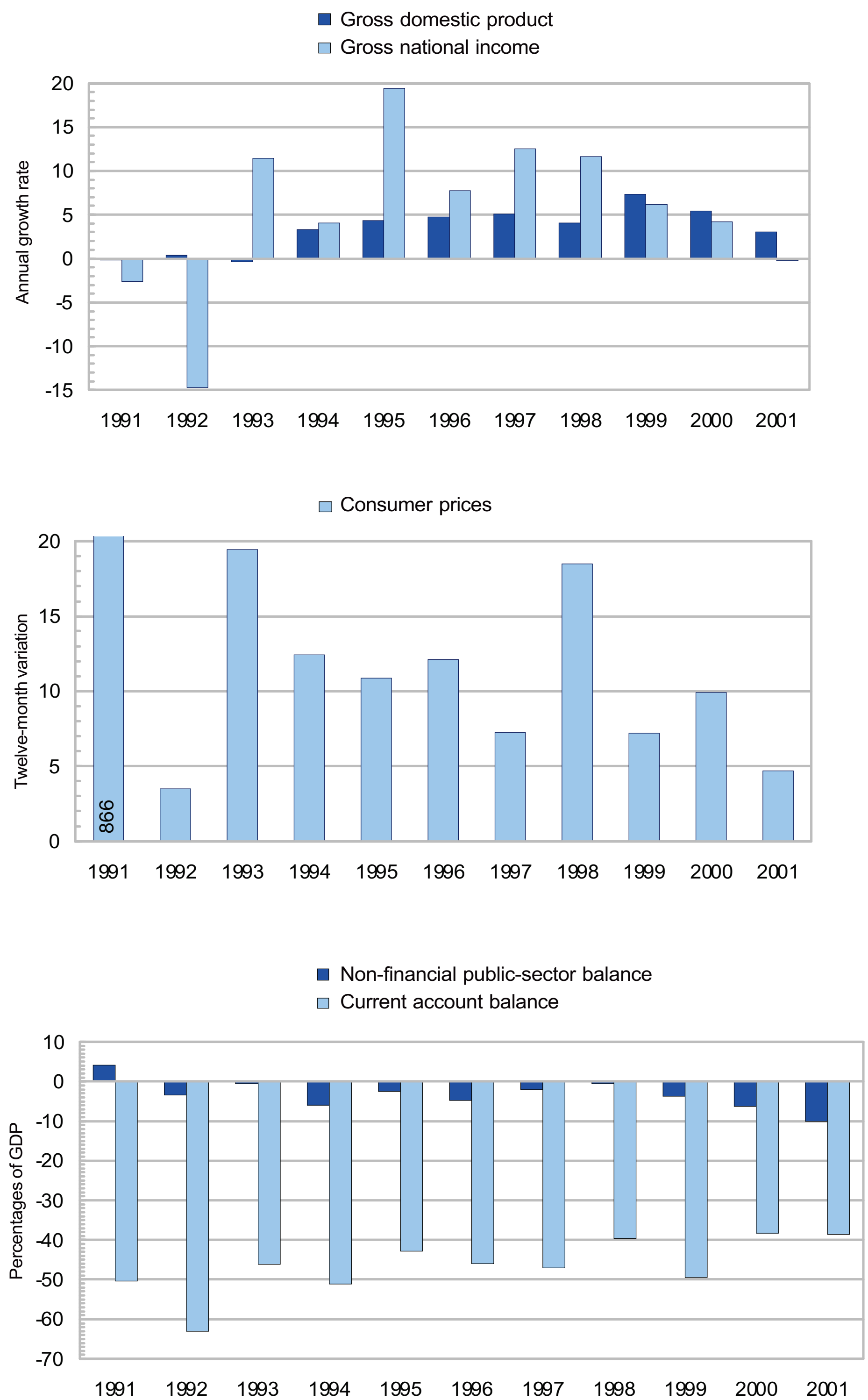
WITH DOMESTIC demand expanding only slightly, growth was fuelled mainly by exports, although these were weaker than in the previous year. Because of the deterioration in the terms of trade and the global slowdown, however, real income increased only slightly and export figures fell for some products, especially coffee.

Despite cuts in public investment, the deficit of the non-financial public sector, excluding donations, widened from 7.3% of GDP in 2000 to 10% in 2001, owing to the smaller expansion in fiscal revenues and the increase in current expenditures. Monetary policy was tight, while open market operations were stepped up. This helped to keep inflation low (4.7%) and to maintain the crawling peg devaluation (6%), which brought about a real depreciation of the córdoba. Financial vulnerability grew, however, as both the central bank's liabilities and quasi-fiscal deficit and the domestic public debt expanded. In the external sector, the current account deficit remained very high (39% of GDP) and exceeded capital inflows, resulting in a significant drawdown in net international reserves.

In view of the country's failure to meet the targets agreed upon with the International Monetary Fund in the second year of the Poverty Reduction and Growth Facility, the government managed to secure only an interim programme for the second half of 2001.

Projections for 2002 point to GDP growth of between 1.5% and 2%, inflation of 9% and a slight rise in the unemployment rate. The rate of currency depreciation will be maintained and monetary policy will continue to be tight. Assuming that the authorities succeed in increasing tax receipts and reducing public expenditure, the fiscal deficit should not exceed 9% of GDP. At the same time, the balance-of-payments current account deficit is expected to narrow to 37% of GDP.

Figure 1
NICARAGUA; MAIN ECONOMIC INDICATORS



Source: ECLAC, on the basis of official figures.

2. Macroeconomic policy

With the projections for growth still favourable in early 2001, the authorities adopted a looser macroeconomic policy, especially regarding fiscal affairs, as they sought to offset the decline in private-sector activity that was to be expected in an electoral year and to avert a worsening of the economic slowdown recorded in 2000.

This strategy did not have the desired effect, however, as the expected increase in aggregate demand failed to materialize. Economic performance was seriously undermined by political tensions as the elections neared and by the persistent difficulties besetting the banking sector. These tensions, together with the resulting political and financial uncertainty, marred the investment climate and led to a decline in flows of international financial cooperation funds, a run on deposits, an outflow of capital and a flight to short-term or demand instruments denominated in dollars. The reduction in term deposits forced banks to be more selective in issuing loans and to maintain a higher liquidity ratio to deal with the possibility of a massive run on deposits.

A number of fiscal adjustments, especially in the area of capital expenditure, were made to cope with the unfavourable external and domestic climate. At the same time, monetary policy was tightened in order to staunch the outflow of international reserves and to preserve currency and price stability. These measures were reflected in modest growth in domestic demand, which, in combination with the slackening of external demand and the deterioration in the terms of trade, steepened the decline in the activity rate.

Macroeconomic policy management was complicated by external conditions, which were much less favourable than originally expected, and by some domestic factors, particularly the electoral process, the hefty fiscal deficit, problems in the banking sector and the spillover from the crisis in the coffee sector and from the drought affecting some parts of the country. These constraints also prevented the authorities from meeting the targets agreed upon within the framework of the International Monetary Fund interim programme.

In this context, structural reforms progressed more slowly and less successfully than in previous years. The most significant headway was made in upgrading regulations for prudential regulation and supervision of the banking system and in the reform of the Office of the Comptroller General of the Republic and the State procurement system. By contrast, the privatization process was hampered by a variety of legal and administrative obstacles. In late August, a Swedish-Honduran group bought a 40% stake in the Nicaraguan Telecommunications Company and assumed management control of the firm. The sale price was US$ 83 million, of which US$ 33 million was to be paid up front and the balance in five annual instalments. However, legal conflicts over debts that the State enterprise owed to third parties (including the Office of the Mayor of Managua) delayed the disbursement of the first payment. The privatization of the generating units of the Nicaraguan Electricity Corporation could not go ahead as prospective bidders were discouraged by the steep starting price and by the legal and administrative provisos attached to the sale. During the year, delays in restructuring the Nicaraguan Social Security Institute and in establishing a superintendency for pensions also held back the start-up of private pension fund administrators.

(a) Fiscal policy

Budget performance was hampered by an economic context far removed from the situation that had prevailed when the budget was adopted. In the course of the year, demand for expenditure had to be curbed to match available resources. Despite the corrective measures adopted, current savings of the non-financial public sector (NFPS) fell from 4.5% to 0.6% of GDP, owing to the downturn in fiscal inflows and the expansion of current expenditure, which was largely due to wage rises (in the health sector, teaching profession, police and army) and to outlays on the organization of the presidential and parliamentary elections in early November. Although capital expenditure decreased owing to constraints on both domestic financing and external resources, the NFPS deficit, after grants (which were equivalent to 6.1% of GDP) widened from 7.3% of GDP in 2000 to 10% in 2001. The deficit was financed using funds from the central bank, external loans and the proceeds of the privatization operations carried out in the course of the year.

The tax burden lightened somewhat to stand at 28% of GDP, due primarily to the effects of the economic slowdown and to the process of tariff reduction. The main culprits were a downturn in revenues from import duties, a further sharp fall owing to an increase in the number of exempted items, a lowering of the rates of excise taxes on diesel, petrol, cigarettes and carbonated beverages and a subsidy granted to the transport sector.

Table 1
NICARAGUA: MAIN ECONOMIC INDICATORS

	1993	1994	1995	1996	1997	1998	1999	2000	2001[a]
				Annual growth rates [b]					
Growth and investment									
Gross domestic product	-0.4	3.3	4.3	4.8	5.1	4.1	7.4	5.5	3.0
Per capita gross domestic product	-3.4	0.3	1.3	1.9	2.3	1.3	4.5	2.7	0.3
Gross domestic product, by sector									
Goods	1.0	6.6	5.2	6.4	7.0	4.4	10.1	7.3	3.2
Agriculture	1.8	10.9	5.0	7.1	8.3	3.5	7.5	11.4	3.1
Mining	2.7	-10.1	30.3	30.9	24.7	44.6	21.7	-20.0	2.5
Manufacturing	0.0	0.8	2.8	2.4	3.8	2.1	3.7	2.8	2.6
Construction	1.5	17.8	17.5	18.1	10.0	10.4	47.3	10.4	5.2
Basic services	-2.0	1.0	5.4	5.2	5.6	4.1	3.8	3.1	2.9
Electricity, gas and water	1.4	3.4	5.8	5.9	6.0	3.1	1.0	2.0	2.5
Transport, storage and communications	-4.0	-0.6	5.1	4.7	5.3	4.7	5.7	3.7	3.1
Other services	-1.8	-0.3	2.9	2.5	2.3	3.6	4.0	3.0	2.9
Commerce, restaurants and hotels	-2.4	1.6	5.1	5.1	5.3	4.9	5.6	3.7	3.2
Financial establishments, insurance, real estate and business services	-0.3	0.9	3.3	3.5	4.1	3.4	4.8	3.8	3.8
Consumption	-3.0	1.3	2.5	7.3	6.8	5.0	4.6	-1.8	1.9
General government	-3.3	-2.7	-0.4	6.4	-0.4	0.1	11.3	2.0	9.4
Private	-2.9	2.3	3.2	7.5	8.4	6.0	3.3	-2.7	0.3
Gross domestic investment	-18.4	26.5	19.6	10.8	18.3	10.8	38.7	-9.7	-1.1
Exports of goods and services	6.5	14.7	14.2	6.9	20.3	7.0	8.3	13.9	6.8
Imports of goods and services	-9.6	12.3	11.6	13.7	22.2	9.8	14.9	-8.0	1.8
				Percentages of GDP [c]					
Gross national income	73.6	73.7	84.3	86.5	92.3	99.0	97.8	96.2	93.1
Gross domestic investment	17.6	21.4	24.3	25.4	28.8	30.7	39.4	32.7	30.9
National saving	-33.6	-31.1	-18.6	-19.6	-16.0	-10.4	-7.8	-2.9	-6.6
External saving	51.2	52.5	43.0	45.0	44.8	41.0	47.2	35.6	37.5
				Percentages					
Employment and wages									
Open unemployment rate	17.8	17.1	16.9	16.0	14.3	13.2	10.7	9.8	10.7
Real average wage (index: 995=100)	93.3	98.2	100.0	97.9	97.7	104.9	109.6	111.3	116.1
				Growth rates					
Prices (December-December)									
Consumer prices	19.5	12.4	10.9	12.1	7.3	18.5	7.2	9.9	4.7
External sector									
Terms of trade (index: 1995=100) [c]	81.3	95.5	100.0	88.1	83.9	87.4	81.1	77.3	70.9
Nominal exchange rate (gold córdobas per dollar)	5.6	6.7	7.5	8.4	9.4	10.6	11.8	12.7	13.4
Real effective exchange rate for imports (index: 1995=100) [d]	82.3	95.3	100.0	101.6	105.8	105.3	106.7	105.3	103.1
				Millions of dollars					
Balance of payments									
Current account	-883	-912	-785	-881	-927	-820	-1,092	-917	-980
Trade balance (goods and services)	-477	-489	-488	-652	-813	-834	-1,195	-1,035	-1,071
Exports	364	464	612	644	797	830	838	956	911
Imports	841	953	1,100	1,296	1,610	1,665	2,034	1,991	1,982
Capital and financial accounts [e]	-91	-250	108	421	1,000	590	1,001	717	714
Overall balance	-975	-1 162	-677	-460	73	-230	-90	-199	-266
Variation in reserve assets (- indicates an increase)	91	-85	12	-53	-173	31	-156	16	114

Table 1 (concluded)

	1993	1994	1995	1996	1997	1998	1999	2000	2001[a]
					Percentages				
External debt									
Gross debt (as a percentage of GDP)	574.4	656.4	558.5	317.4	304.9	304.0	296.0	274.9	250.6
Net interest (as a percentage of exports) [f]	115.2	98.2	56.1	43.3	26.5	15.3	16.0	13.9	18.9
					Percentages of GDP				
Central government									
Current income	19.6	20.3	21.5	21.7	24.9	26.9	25.8	24.8	22.5
Current expenditure	20.6	21.5	19.2	19.7	20.4	21.8	20.2	20.8	24.2
Current saving	-1.0	-1.2	2.4	2.0	4.5	5.1	5.5	4.0	-1.7
Capital expenditure (net)	6.3	8.8	11.2	10.4	10.2	10.1	17.9	18.0	14.8
Financial balance	0.0	-5.2	-0.5	-1.5	-1.3	-1.9	-4.9	-7.8	-11.5
Domestic financing	0.0	-1.2	0.7	-3.6	-0.1	-5.8	-5.0	-2.5	5.5
External financing	0.0	6.4	-0.2	5.1	1.4	7.7	9.9	5.5	4.5
					Growth rates				
Money and credit									
Net international reserves	-51.6	132.6	-10.1	185.6	137.0	-4.5	4.7	-4.8	-14.0
Net domestic credit	80.5	54.7	51.4	24.9	25.4	50.5	29.8	11.4	17.3
To public sector	6.3	6.5	-6.1	-17.9	18.2	7.3	7.2	10.9	30.0
To private sector	49.9	33.6	26.6	-8.2	39.8	45.3	39.9	28.2	-10.6
Money (M1)	-4.4	36.9	16.3	26.8	30.7	18.1	24.9	6.4	17.6
Local currency savings and time deposits	48.8	99.2	24.8	29.9	75.7	17.8	30.0	-5.8	-5.4
M2	8.0	56.9	19.8	28.1	50.1	18.0	27.5	0.1	6.5
Dollar deposits	70.8	77.6	59.8	61.3	57.2	35.3	19.6	11.5	12.2
					Annual rates				
Real interest rate (annualized, %) [g h]									
Deposit rate (savings accounts)	-7.2	3.8	0.0	0.0	2.0	-1.9	-0.9	-1.9	0.9
Lending rate (short-term loans)	0.0	11.6	7.9	7.5	9.7	7.8	9.8	8.8	13.2
Equivalent interest rate in foreign currency (30 days) [i]	2.3	11.5	10.2	12.2	13.4	10.6	10.1	9.3	8.8

Source: ECLAC, on the basis of official figures.

[a] Preliminary figures. [b] Based on constant 1980 new córdobas. [c] Based on constant 1995 dollars. [d] Official exchange rate. [e] Includes errors and omissions. [f] Refers to net interest as shown in the balance of payments, divided by exports of goods and services. [g] Does not include the effects of the maintenance-of-dollar-value provision, which affects bank deposit-taking and issue of instruments. [h] These figures represent a simple average of the floor and ceiling rates in the State and private banking systems. [i] Interest rate on deposits, deflated by the variation in the exchange rate.

External public debt came in at US$ 6.374 billion, which represented a moderate decline with respect to the previous year. The Administration arrived at an important agreement to reduce the debt of US$ 544 million owed to Guatemala. By means of a triangulation arrangement with the Government of Spain, Guatemala agreed to forgive 80% of Nicaragua's debt and accept payment of the balance over a period of 23 years following a six-year grace period. Further relief of US$ 42 million was obtained on external debt servicing in the framework of the Highly Indebted Poor Countries (HIPC) Debt Initiative. In connection with the HIPC Initiative, in July, the Government submitted its finalized poverty reduction strategy to the international agencies for consideration. The HIPC framework establishes a direct link between debt relief and an increase in social spending geared towards poverty reduction. Consequently, the approval and implementation of the strategy is one of the prerequisites for the "completion point" –the point at which the country gains access to the full benefits of the Initiative, consisting of a considerable reduction in external debt and a significant decrease in the cost of annual debt servicing.

Table 2
NICARAGUA: MAIN QUARTERLY INDICATORS

	1999				2000				2001 [a]				2002 [a]
	I	II	III	IV	I	II	III	IV	I	II	III	IV	I
Consumer prices (12-month variation, %)	12.0	8.2	13.6	7.2	14.5	14.0	10.1	9.9	7.7	7.7	7.4	4.7	3.8
Exports (millions of dollars)	160	153	105	125	211	164	137	133	166	183	134	115	142
Imports (millions of dollars)	378	412	480	414	422	418	415	393	406	442	424	368	377
International reserves (millions of dollars)	414	514	488	510	471	473	422	488	413	368	337	380	409
Real effective exchange rate [b] (index: 1995=100)	105.2	107.4	107.5	106.9	105.3	104.5	106.2	105.4	104.6	103.7	100.3	103.7	100.1
Real interest rates (annualized, %)													
Deposit rate	-3.9	1.0	-1.5	1.0	-1.8	-4.0	-1.8	0.0	0.4	1.2	1.2	3.2	-3.5
Lending rate	6.8	12.0	8.6	11.7	8.2	6.3	9.2	11.4	12.5	13.7	14.2	17.2	9.0

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. [b] Refers to exchange rate for imports.

(b) Monetary policy

Monetary policy remained tight in response to imbalances generated by the widening fiscal deficit and by the crisis in the banking sector, which has been ongoing since August 2000. Problems of liquidity and solvency, which were caused in part by a number of irregular operations, obliged the authorities to intervene in two banks –Banco Mercantil and Banco Nicaragüense de Industria y Comercio– and ultimately led to their failure and the sale of their main assets and liabilities.

In this context, public-sector deposits with the central bank declined, while net credit from the central bank to the NFPS increased. In order to curb the expansion of liquidity and preserve exchange-rate and price stability, the central bank stepped up its open-market operations, which consisted of sales of foreign currency to the private sector and the issue of indexed debt instruments, including negotiable investment certificates, special investment certificates (acquired through the social insurance system) and special liquidity bonds (purchased by commercial banks as part of the higher reserve requirements). The central bank's foreign currency sales contributed, however, to a steep decline in international reserves, while new bond issues heightened its financial vulnerability by increasing its liabilities and quasi-fiscal deficit (to 2% of GDP).

Following a contraction of 0.5% in 2000, the monetary base expanded by 23.5% in 2001. This was mainly attributable to increases in commercial banks' deposits with the central bank in response to the steady rise in the legal reserve requirement, which was up by three percentage points to 19.25% in September. As a result of this, broad money (M3) expanded by 10.3%. At the same time, narrow money increased as a proportion of the local-currency liquidity structure (M2), while savers showed a tendency to shift from savings deposits to demand deposits, which reflected a sharpening of existing trends. Also noteworthy was the steady increase in dollar deposits, which exceeded 70% of the total.

Private-sector credit declined significantly (11%) as a result of unfavourable growth expectations, the increase in the real cost of money, the banking crisis and the toughening of standards for banking regulation and supervision, particularly with regard to the risk assessment of credit operations. In the course of the year, lending rates rose in real terms, while interest-rate spreads widened. In terms of credit composition, the most substantial contractions occurred in loans to the agricultural, industrial and commercial sectors. By contrast, consumer and housing loans expanded considerably.

(c) Foreign exchange policy

The system of pre-announced daily mini-devaluations continued to operate at the annual rate of 6% that had applied since November 1999. In this context, the real effective exchange rate depreciated slightly against the United States dollar.

3. The main variables

(a) Economic activity

GDP grew at a lower rate in 2001, reflecting a significant slowdown in agriculture and construction, a contraction in fisheries output and modest growth in all the other sectors. On the demand side, exports grew strongly, albeit at a lower rate than the previous year, led by non-traditional goods, manufacturing exports from the free zones and income generated by the tourist industry. Meanwhile, domestic demand showed a slight increase.

The performance of the agricultural sector was hurt by a combination of adverse conditions: unfavourable weather, a fall in the international prices of some of its principal exports and financing problems.

Although the output of staple grains, except for soybeans, increased significantly, agricultural activity grew by a meagre 2.9%, which was attributable to a slump in export crops, especially coffee and banana. The livestock sector performed well (6.5%), with increases in beef production and in exports of livestock on the hoof and an upturn in milk and poultry production. Output was sharply down (11%) in the fisheries sector, mainly because of a decline in the lobster catch caused by over-fishing in recent years and a downturn in the output of shrimp (most of which is trawled) due to the cyclical factors affecting production and depressed export prices. Conversely, fish catches expanded thanks to the higher number of boats involved in this activity.

Box 1
CRISIS IN THE COFFEE SECTOR

In the wake of the downturn in international coffee prices, Nicaraguan coffee producers found themselves unable to meet their repayment obligations to private banks and suppliers. In view of this, they requested the government to intervene by implementing a contingency plan and taking measures to avoid the auction of their properties. Assistance for the coffee-growers was slow in materializing, however. Nevertheless, the government ultimately consented to offer support to producers who were indebted to the banks and to exporters, in the form of an eight-year loan of US$ 25 per quintal exported (until late 2001, this measure had been accessible to only 15% of coffee-growers). In fact, however, this solution benefitted the weakened financial system more than the producers, since debt restructuring is not enough to meet their medium- and long-term borrowing requirements, especially in the case of small producers, who lack access to formal credit.

In order to offset the lower prices, producers cut back on expenditure by limiting investment in inputs and labour to a minimum, eliminating a number of cropcare practices, lowering wages and resorting to payment in kind. In addition, many farms were abandoned or left untended, which resulted in a significant reduction in coffee output (13.2%). An even sharper fall in output is expected in 2002, due mainly to cutbacks in investment and particularly in spending on maintenance.

Growth in manufacturing (2.6%) was lower than in the previous year, mainly because of the downturn in food processing. This modest growth was based on a higher output of beverages, petroleum products, non-metallic minerals, transport equipment, chemicals, furniture, clothing and footwear.

Having soared under the reconstruction programme launched in the aftermath of Hurricane Mitch (1998), public investment declined in 2001. Private investment in non-residential construction was also down as the main hotel projects entered their final stages. These two factors were reflected in a marked slowdown in construction, which was one of the main causes of the loss of momentum in the economy as a whole. Nevertheless, in 2001, the sector continued to grow strongly, at a rate of 5.2%, thanks to a surge in private investment (13.6%).

Services, which accounted for 35% of GDP, expanded by 2.9%, which was a lower rate than in the previous year. The largest slowdown was seen in commerce, despite an upturn in the final months of the year, which was fuelled mainly by consumer spending on imported goods, thanks to higher family remittances and to personal bank loans.

(b) Prices, wages and employment

In 2001, inflation stood at its lowest level in nine years (4.7%). This was attributable to the economic slowdown, lower domestic fuel prices following the decline in international petroleum prices, tight monetary policy and the decision not to adjust a number of government-controlled prices, especially public utility rates. The items that showed the highest rises were education, food and beverages, and housing.

The real average wage improved substantially, by 4.4%, thanks to a 12% increase in the minimum wage (the first since 1999), pay adjustments in the public sector and wage rises in a number of other sectors. The slackening of economic activity drove up unemployment from 9.8% to 10.7%, however, while underemployment increased to 12.4%.

(c) The external sector

The current account deficit was US$ 980 million, or US$ 63 million more than in 2000. This was attributable to the increase in the trade deficit and to higher interest, profit and dividend payments. Meanwhile, current transfers, especially family remittances, remained as high as in previous years. Consequently, when measured as a proportion of GDP, they rose from 38% to 39% of GDP. Reductions in the capital and financial accounts widened the balance-of-payments deficit to more than 10% of GDP, however, and caused losses in net international reserves of US$ 114 million, which was equivalent to 4.3% of GDP. Net capital inflows declined, due mainly to the fact that foreign direct investment fell back to US$ 132 million in 2001, for which delays in the privatization process were partly to blame.

The merchandise trade deficit remained very high at 37.5% of GDP, especially in view of the recessionary situation in the country. Exports, including the net external sales of firms operating under the free zone regime, contracted by 6.7%, which was sharper than the downturn of 1.1% recorded in imports.

Goods exports f.o.b., not including the sales of the free zones, totalled US$ 592 million (23% of GDP). This represented a decline of 8%, which was attributable to a sharp reduction (16%) in the sales of the traditional products that account for more than half of Nicaragua’s total exports. Within this category, the heaviest falls were sustained by sales of coffee, because of the slump in international prices (39%), and by exports of lobster and shrimp (32%). Receipts from the sale of these three products plummeted by US$ 102 million with respect to the previous year, a loss equivalent to 4% of GDP. Conversely, other exports (beef, sugar and bananas, among others) recorded an increase thanks in part to stronger international prices and a larger exportable supply.

In 2001, exports of non-traditional products expanded again, this time by 8%, with a good performance by staple grains and onions destined for the Salvadoran and Honduran markets and an expansion in exports of tropical fruits, peanuts, fish and manufactures.

Merchandise imports c.i.f. were down slightly (0.6%), at US$ 1.789 billion. The slowdown in economic activity led to a reduction in purchases of capital goods (7.4%), while there was a decline in imports of raw materials and intermediate goods (3.9%) due primarily to a downturn in purchases of petroleum, fuels and lubricants (7.5%). Conversely, imports of consumer goods expanded considerably (9.6%), reflecting an increase in imports of non-durables (13.3%), including food, medicinal products and household items.