Nicaragua

Economic growth in Nicaragua slowed slightly from 4.0% in 2005 to 3.7% in 2006, owing to the reduced buoyancy of domestic demand (although this was partly offset by a strong increase in exports). The uncertainty caused by growing political tensions in a situation dominated by the presidential election in November was not conducive to private-sector consumption or investment. The country's economic performance was also affected by hikes in the international prices of oil and some industrial commodities, which resulted in a deterioration in the terms of trade (-1.9%), an energy crisis and an inflation rate of 9.1% for 2006.

The framework for economic policy was the financial support programme agreed with the International Monetary Fund (IMF) since December 2002. The fiscal deficit of the non-financial public sector (NFPS) after grants (1.1% of GDP) remained at much the same level, which made it easier to achieve monetary policy objectives. The balance-of-payments current-account deficit (14.2% of GDP) shrank by almost two percentage points. Greater net capital inflows were sufficient to finance the external imbalance and boost net international reserves. Also in 2006, the Heavily Indebted Poor Countries (HIPC) Debt Initiative and the Multilateral Debt Relief Initiative (MDRI) made it possible to reduce external public debt from 109% of GDP to 86%, while debt servicing fell to just 5% of the value of exports.

Former President Daniel Ortega won the presidential elections and indicated that he would continue to implement recent economic policy with a view to consolidating the achievements made to date in terms of stability. He also announced that the authorities had contacted IMF with a view to presenting the government's economic programme and opening negotiations for a new agreement.

The results of fiscal policy were a key factor in economic performance. Thanks to the implementation of the Fiscal Equity Act and improvements in administrative efficiency, total central government revenues exceeded expectations. This combined with higher grants to finance the increase in expenditure (1.6% of GDP), which was caused by the demands of health and education workers, higher capital expenditure, the elections, increased public security and the urban public transport subsidy in Managua. Against that backdrop, the deficit after grants (1.6% of GDP) shrank slightly. As in 2005, uncertainty surrounding the election process and the associated low demand for public bonds made it difficult to use domestic financing.

The main aims of monetary policy were to build up international reserves, strengthen domestic and exchange-rate stability, and improve certain vulnerability indicators such as coverage of the monetary base and of imports. As a precautionary measure and to ensure it achieved its objectives in an electoral year, the central bank raised the legal reserve requirement from 16.25% to 19.25% in June. This was also designed to reduce the effects of the US$ 100 million or so that had come into circulation following the redemption or payment of compensation bonds, bills and other government paper, and to contain the expansion of credit and protect international reserves (which are key in maintaining confidence in the exchange-rate regime).

Export growth and the availability of external financial resources facilitated a build-up of international reserves without a loss of liquidity. This deepened the financial system as deposits and credit played a more important role in economic activity. At the same time, interest rates rose in line with higher international rates. The structure of the loan portfolio showed buoyant consumer credit, especially in the form of credit cards, mortgages and business loans.

The central bank maintained the exchange-rate policy of daily mini-devaluations consistent with a pre-announced annual devaluation rate (5%) to serve as an anchor for inflationary expectations. In the area of structural reforms, amendments to the Tax Code were approved.

Real production growth slowed from 4.0% to 3.7%. This was mainly due to the impact of the political uncertainty on investment and consumption decisions in the private sector and to high international oil prices, which affected the structure of production costs, caused breaks in electricity supply, raised domestic prices and cut disposable income. In contrast, strong growth in the world economy, particularly in the United States and the countries of the Central American Common Market (CACM) boosted external demand for the country's goods and services. This, combined with the entry into force of the Dominican Republic-Central America-United States Free Trade Agreement (CAFTA-DR), contributed to the surge in exports. Other aspects of performance included wage increases, the credit boom, the hike in family remittances and the positive performance of the tourism sector.

Inflation is estimated to have stood at 9.1% in 2006, slightly lower than the previous year. The figure is nonetheless high, and this due to oil prices and the direct pressure they exert on domestic prices for fuel, electricity and transport.

In the external sector, the current-account deficit went from 16.3% in 2005 to 14.2% in 2006, thanks to the significant increase in current transfers (15.2% of GDP) —especially family remittances. The trade balance deficit (27.1% of GDP) is expected to expand slightly, while the income account deficit should remain about the same. Higher net capital inflows served to finance the current account deficit and build up net international reserves. Foreign direct investment (FDI) stood at US$ 290 million (5.4% of GDP), the highest level recorded since 1999. These resources were mainly channelled into free-trade zones and tourism.

Merchandise exports grew by 24%, and imports by 14.7%. The increase in exports was due to a good harvest and improved prices for some of the main traditional exports, such as gold, sugar, coffee and meat. Net exports were also buoyant from free-trade zones, especially maquila textile products. The rise in imports was in turn due to the significant rise in the oil bill and increased external purchases of consumer goods.

Table 1
NICARAGUA: MAIN ECONOMIC INDICATORS

	2004	2005	2006 [a]
	Annual growth rates		
Gross domestic product	5.1	4.0	3.7
Consumer prices	8.9	9.6	9.1 [b]
Average real wage	-2.2	0.2	1.8 [c]
Money (M1)	24.2	24.5	20.7 [d]
Real effective exchange rate [e]	1.9	-0.5	-0.3 [d]
Terms of trade	-1.9	-1.4	-1.9
	Annual average percentages		
Urban unemployment rate	9.3	7.0	...
Central government overall balance/GDP	-2.2	-1.8	-1.6
Nominal deposit rate	4.7	4.0	4.8 [f]
Nominal lending rate	13.5	12.1	11.5 [f]
	Millions of dollars		
Exports of goods and services	1 651	1 861	2 273
Imports of goods and services	2 827	3 292	3 738
Current account	-696	-800	-764
Capital and financial account	594	794	823
Overall balance	-102	-6	59

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Preliminary estimates.
[b] Twelve-month variation to November 2006.
[c] Estimate based on data from January to September.
[d] Year-on-year average variation, January to October.
[e] A negative rate indicates an appreciation of the currency in real terms.
[f] Average from January to October, annualized.