Nicaragua

1. General trends

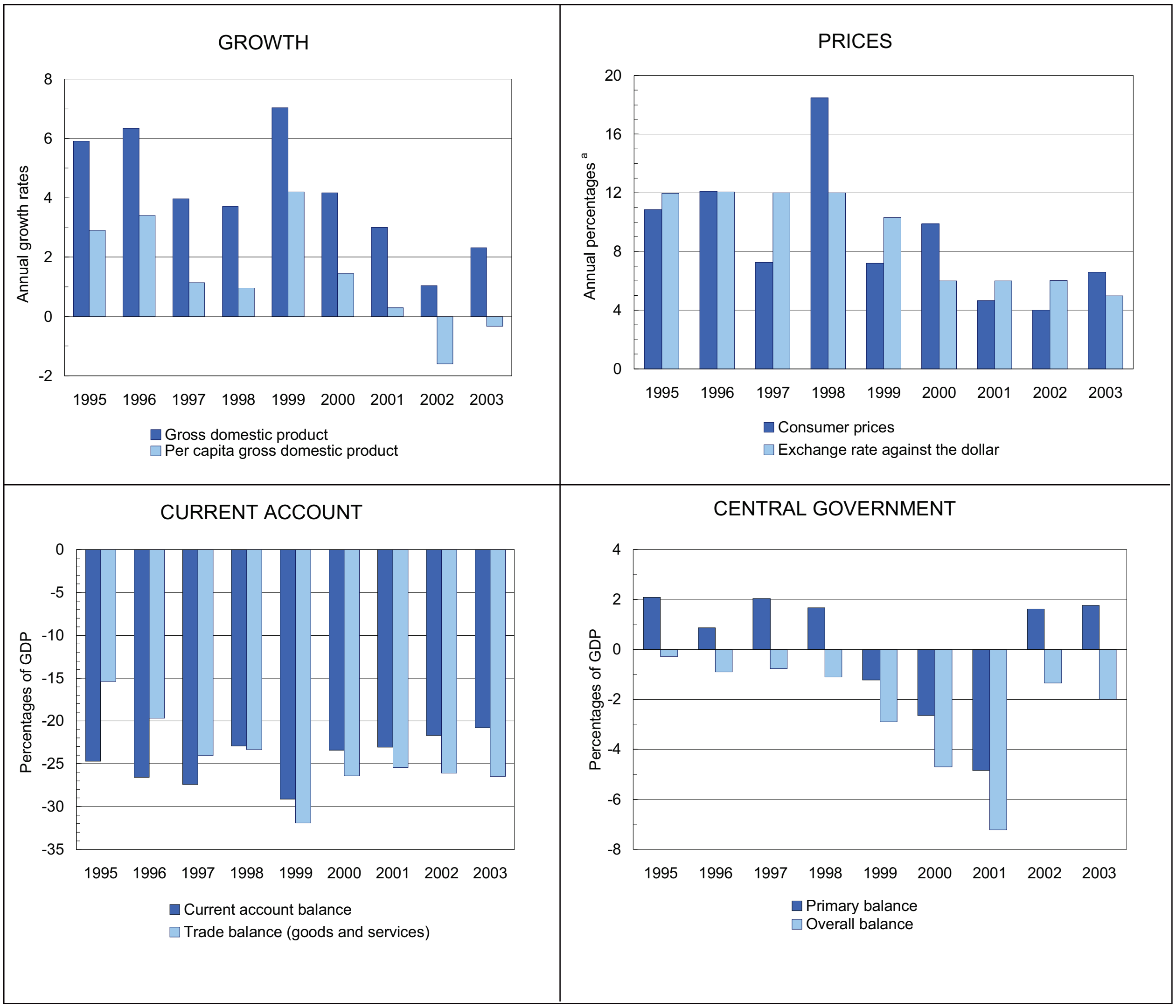
After losing momentum sharply for three consecutive years, the Nicaraguan economy showed signs of recovery in 2003. At the same time, the authorities took steps to consolidate overall macroeconomic stability. Real GDP grew by 2.3%, boosted by an upturn in exports and an expansion in domestic demand engendered by higher consumption and government investment. However, as this revival was quite modest, there was a further decline in per capita GDP (-0.3%). Moreover, despite a deterioration in the terms of trade, per capita national income increased for the second year in a row (0.5%) thanks to an increase in current transfers, especially family remittances.

Economic policy design was consistent with the financial support programme signed in December 2002 with the International Monetary Fund (IMF). The substantial expansion in public expenditure helped to spur the economy, but also caused a slight deterioration in the fiscal accounts, though without compromising the fulfilment of monetary policy targets. Inflation was moderate (6.6%) and the devaluation rate was maintained (6%), leading to a depreciation in the real exchange rate. Bank deposits grew significantly, as did credit levels. Real interest rates went down considerably.

In the external sector, the balance-of-payments current account deficit narrowed slightly. This, together with higher capital inflows, helped to boost international reserves; however, by the end of the year net international reserves stood at just US$ 288.8 million, equivalent to only 1.7 months' worth of merchandise imports. The country's fulfilment of its IMF commitments enabled it to reach the completion point under the Heavily Indebted Poor Countries (HIPC) Initiative. This means that 80% of the balance of its external public debt, estimated at some US$ 6.6 billion, will be cancelled.

The government forecasts that in 2004 real GDP growth will rise to 3.6% and inflation will fall to 5%. In addition, it plans to reduce the devaluation rate to 5%. The fiscal adjustment process should help to improve the situation of public finances, while the balance-of-payments current account deficit is expected to decline to 18.5% of GDP.

Figure 1
NICARAGUA: MAIN ECONOMIC INDICATORS



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] December-December variation.

2. Economic policy

In 2004 economic policy will continue to be shaped by the performance criteria laid down in the three-year IMF agreement. The general objectives of the programme are to promote economic growth and alleviate poverty in a context of low inflation and fiscal sustainability. The proposed strategy involves combining a lower fiscal deficit with higher and more efficient social spending geared to poverty reduction. Monetary policy will seek to keep prices stable, improve the central bank's financial position and build up international reserves.

(a) Fiscal policy

As in previous years, the outcome of Nicaragua's fiscal policy will be a key determinant of its macroeconomic performance. According to projections for 2004, the central government will reduce its financial deficit (not including grants) to 3.7% of GDP, but without sacrificing public investment or the poverty reduction strategy. It will achieve this mainly through higher tax receipts generated by the reforms implemented in 2002 and 2003, a reduction in external public debt servicing and an increase in international assistance in the form of grants and soft loans. Thus, the management of public finances will facilitate the fulfilment of monetary policy targets, especially through the reduction of net credit to the central government.

In order to achieve the fiscal targets and strengthen the poverty reduction strategy, in February 2003 the National Assembly adopted reforms to the Tax Base Expansion Act. In addition, at the end of April it adopted two more reforms, one relating to the tax system and the other to the general budget for 2003. The tax reform seeks to improve the tax system and provides tax incentives to promote exports. The budget provides for higher allocations to various social sectors and a significant increase in infrastructure investment.

The central government's current revenues expanded by 18.5% and the tax burden rose to 15.8% of GDP, from 14.3% in 2002. In addition, grants increased to 4.5% of GDP. Consequently, total revenue rose from 19.6% of GDP in 2002 to 21.1% in 2003. The fastest-growing revenue items were income tax and customs duties, which were up by 51.9% and 13.5%, respectively. General sales tax receipts increased by 7%, following the decline observed in 2002 (-1.8%).

Total expenditure rose from 20.9% to 23.1% of GDP, reflecting a substantial increase in capital expenditure (35.6%), as well as a rise in current expenditure (13.4%) that was due essentially to a significant upturn in interest payments (38.2%) related to external debt servicing and the cost of bank bailouts following the 2000-2001 crisis. Consequently, the fiscal deficit widened from 5.8% of GDP in 2002 to 6.8% in 2003. This deterioration is less severe (from 1.3% to 2% of GDP) if grants are taken into account. It should be pointed out that the government transferred the equivalent of 1.6% of GDP to the central bank. However, external financing almost doubled.

(b) Monetary policy

In 2004 monetary policy will continue to be directed towards controlling the money supply in order to shore up the weak international reserve position and keep prices stable. The target in terms of the central bank's international reserves is to maintain a level equivalent to twice the monetary base. As in 2003, a prudent fiscal policy and access to external financial resources to support the balance of payments will be used to keep the goal of price stability (made easier to achieve by the lower devaluation rate) consistent with the central bank's domestic debt reduction policy. The liquidity expansions resulting from quasi-fiscal losses and the net redemption of securities will be sterilized through government debt payments to the central bank.

The tighter fiscal policy in 2003 was designed in conjunction with a looser monetary policy. The main aims were to ensure that international reserves remained at a level conducive to the maintenance of exchange-rate stability as an anchor against inflation and to reduce domestic debt with a view to increasing liquidity in the banking sector, thus narrowing interest-rate spreads. At the same time, the authorities began the process of recovering the assets of commercial banks that had been liquidated in previous years.

In the first half of the year the reserve requirement was maintained at 19.25%, of which three percentage points bore interest. The central bank decided to gradually reduce the interest-bearing portion starting in July, so that in December the reserve requirement stood at 16.25%. In the second half of the year the central bank took steps to sell off the assets of banks that had been taken over and to restructure and reduce the domestic debt. Public auctions were held to sell off the movable and immovable property and the loan portfolios of the banks being liquidated. In addition, a major portion of

Table 1
NICARAGUA: MAIN ECONOMIC INDICATORS

	1995	1996	1997	1998	1999	2000	2001	2002	2003 [a]
	Annual growth rates [b]								
Gross domestic product	5.9	6.3	4.0	3.7	7.0	4.2	3.0	1.0	2.3
Per capita gross domestic product	2.9	3.4	1.1	0.9	4.2	1.4	0.3	-1.6	-0.3
Gross domestic product, by sector									
Agriculture, livestock, hunting, forestry and fishing	8.7	9.4	-0.6	-0.4	6.5	12.6	2.1	1.2	3.2
Mining	25.6	22.6	16.1	36.2	19.1	-14.9	4.8	5.1	3.4
Manufacturing	6.6	7.6	7.6	-0.3	5.0	6.0	6.6	1.6	2.1
Electricity, gas and water	1.9	3.8	4.9	11.0	0.1	-0.2	0.1	2.4	1.7
Construction	8.7	-1.4	-8.6	-1.4	39.1	0.3	0.2	-12.5	3.9
Wholesale and retail commerce, restaurants and hotels	4.8	8.1	5.6	7.2	10.3	4.0	3.9	2.3	2.6
Transport, storage and communications	7.2	9.0	3.9	6.5	9.2	2.0	0.4	4.4	3.8
Financial institutions, insurance, real estate and business services	6.1	4.1	6.3	8.4	7.6	3.9	1.6	4.8	3.9
Community, social and personal services	2.2	-0.5	3.8	2.6	4.7	-2.6	0.5	1.0	1.7
Gross domestic product, by type of expenditure									
Consumption	4.3	3.4	3.7	4.7	4.5	3.8	2.4	1.4	3.8
General government	7.7	1.8	-4.1	4.4	8.2	3.7	-4.5	-20.7	3.8
Private	3.9	3.6	4.6	4.7	4.1	3.8	3.2	3.7	3.8
Gross domestic investment	14.1	21.3	23.6	4.3	31.2	-13.1	-6.0	4.8	-5.8
Exports (goods and services)	22.1	16.2	14.4	5.8	12.3	12.5	10.8	-6.1	8.1
Imports (goods and services)	14.1	12.9	22.1	7.2	20.7	-5.3	0.1	-0.3	3.2
	Percentages of GDP								
Investment and saving [c]									
Gross domestic investment	20.4	22.0	25.8	31.2	31.0	39.6	33.4	31.0	30.3
National saving	-9.3	-9.0	-5.5	4.0	-3.1	13.3	7.2	8.0	8.8
External saving	29.6	31.0	31.3	27.1	34.1	26.3	26.1	23.0	21.5
	Millions of dollars								
Balance of payments									
Current account balance	-787	-883	-928	-819	-1 090	-925	-932	-870	-860
Merchandise trade balance	-412	-574	-790	-817	-1 146	-1 003	-897	-936	-972
Exports, f.o.b.	471	470	582	580	552	650	723	681	748
Imports, f.o.b.	882	1 044	1 371	1 397	1 698	1 653	1 620	1 618	1 720
Services trade balance	-78	-80	-24	-17	-48	-40	-130	-109	-123
Income balance	-372	-324	-265	-185	-197	-202	-240	-200	-203
Net current transfers	75	95	150	200	300	320	336	377	439
Capital and financial balance [d]	-177	135	635	417	695	469	665	660	638
Net foreign direct investment	89	120	203	218	337	267	150	660	638
Financial capital [e]	-266	15	432	199	358	202	515	204	201
Overall balance	-964	-748	-293	-402	-395	-456	-266	-210	-221
Variation in reserve assets [f]	11	-53	-173	30	-157	17	114	-71	-50
Other financing [g]	953	801	466	372	552	439	153	281	271
Other external-sector indicators									
Real effective exchange rate (index: 2000=100) [h]	95.8	98.1	102.1	102.7	103.1	100.0	101.4	104.8	108.7
Terms of trade for goods (index 1997=100)	119.3	105.0	100.0	104.2	96.7	92.2	84.5	83.2	80.4
Net resource transfer (% of GDP)	12.7	18.4	24.7	16.9	28.1	17.9	14.3	18.5	17.1
Gross external public debt (millions of dollars)	10 248	6 094	6 001	6 287	6 549	6 660	6 374	6 363	6 596
Gross external public debt (% of GDP)	321.8	183.5	177.4	176.0	175.0	168.6	157.8	158.8	159.5
Net profits and interest (% of exports) [i]	-60.7	-50.4	-33.2	-22.3	-23.4	-21.2	-25.4	-22.1	-20.4
Employment									
Labour force participation rate [j]	46.8	48.9	…	…	…	…	…	57.5	…
Open unemployment rate [k]	16.9	16.0	14.3	13.2	10.7	9.8	10.5	11.6	10.2

Table 1 (concluded)

	1995	1996	1997	1998	1999	2000	2001	2002	2003 [a]
				Average annual rates					
Prices									
Variation in consumer prices (December-December)	10.9	12.1	7.3	18.5	7.2	9.9	4.7	4.0	6.6
Variation in nominal exchange rate (December-December)	12.0	12.1	12.0	12.0	10.3	6.0	6.0	6.0	6.0
Variation in average real wage	1.8	-2.1	-0.2	7.4	4.4	1.6	4.3	4.3	2.6
Nominal deposit rate [l]	...	...	...	...	...	...	11.6	7.8	5.6
Nominal lending rate [m]	...	...	...	...	...	...	18.6	18.4	15.5
				Percentages of GDP					
Non-financial public sector									
Current income	18.2	18.5	20.1	22.1	20.6	19.4	19.0	19.8	21.1
Current expenditure	14.6	15.3	15.6	16.3	15.5	16.6	18.7	17.7	18.2
Current balance	3.7	3.1	4.5	5.8	5.1	2.8	0.3	2.2	2.9
Net capital expenditure	10.3	11.6	8.7	7.5	12.5	11.7	10.5	8.0	9.6
Primary balance	1.0	-0.8	2.4	3.7	-0.3	-2.3	-3.9	2.1	2.3
Overall balance	-1.5	-2.9	-1.0	0.4	-2.2	-4.5	-6.3	-0.8	-1.4
Public debt	331.2	198.2	205.4	201.0	196.2	196.0	198.3	207.6	…
Domestic	9.4	14.6	28.0	25.1	21.3	27.4	40.5	48.8	…
External	321.8	183.5	177.4	176.0	175.0	168.6	157.8	158.8	159.5
Interest payments (% of current income)	13.3	11.1	17.0	14.7	9.5	11.5	12.6	14.8	17.8
Money and credit [n]									
Domestic credit [o]	18.9	17.2	21.6	24.0	29.0	32.9	27.3	23.5	24.0
To the public sector	0.2	0.5	2.8	1.5	1.8	2.8	2.5	3.6	3.7
To the private sector	18.7	16.7	18.8	22.5	27.3	30.1	24.8	19.9	20.3
Liquidity (M3)	20.3	24.2	31.5	36.7	39.5	39.4	38.9	42.7	43.4
Money stock and local-currency deposits (M2)	10.9	11.3	13.4	14.4	15.0	14.6	13.8	14.1	14.5
Foreign-currency deposits	9.4	12.8	18.1	22.3	24.5	24.8	25.1	28.6	28.8

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Preliminary figures. [b] Based on figures in local currency at constant 1994 prices. [c] Based on figures in local currency at current prices. [d] Includes errors and omissions. [e] Refers to the capital and financial balance (including errors and omissions), minus net foreign direct investment. [f] A minus sign (-) denotes an increase in reserves. [g] Includes the use of IMF credit and loans and exceptional financing. [h] Annual average, weighted by the value of merchandise exports and imports. [i] Refers to net investment income as a percentage of exports of goods and services as shown on the balance of payments. [j] Economically active population as a percentage of the working-age population, nationwide total. [k] Unemployed population as a percentage of the economically active population, nationwide total. [l] Monthly average of the weekly rate on one-month deposits in local currency. [m] Monthly average of the system-wide weekly rate on short-term loans in local currency. [n] The monetary figures are annual averages. [o] Refers to net credit extended to the public and private sectors by commercial banks and other financial and banking institutions.

bank debt was renegotiated through the issuance of standardized financial instruments. Thus, the interest rate was lowered and the repayment schedule was extended to 10 years. This renegotiation should facilitate the management of monetary and fiscal policy in the coming years; enable the authorities to introduce more flexibility into the fiscal programme for the benefit of the production sector and social programmes; and foster the development of a secondary market for public securities.

The national financial system was healthier, as shown by a number of positive developments. On the one hand, total deposits grew considerably, as did bank assets and equity. On the other, the level of credit increased, real interest rates went down and the number of non-performing loans declined. The structure of the loan portfolio reveals brisk growth in credit for housing, consumption and trade, as well as an upsurge in credit for industry and agriculture.

(c) Exchange-rate policy

In 2004 the authorities will continue to implement daily mini-devaluations of the local currency under the crawling-peg system. However, the central bank decided to reduce the devaluation rate from 6% to 5% on the grounds that slower annual devaluation will help to reduce inflation, given the economy's high degree of dollarization and the increasing tendency to index prices

Table 2
NICARAGUA: MAIN QUARTERLY INDICATORS

	2002				2003 [a]				2004 [a]	
	I	II	III	IV	I	II	III	IV	I	II
Merchandise exports. f.o.b. (millions of dollars)	163	159	147	127	152	152	148	152	155	...
Merchandise imports. c.i.f. (millions of dollars)	417	436	455	465	456	443	464	524	660	...
International reserves (millions of dollars)	409	389	364	448	436	508	489	502	571	616
Real effective exchange rate (index: 2000=100) [b]	103.4	104.1	104.9	106.8	106.8	108.0	109.2	110.8	110.5	109.9
Consumer prices (12-month percentage variation)	4.2	3.4	4.5	4.0	5.1	5.3	4.7	6.6	7.3	7.7
Average nominal exchange rate (córdobas per dollar)	13.94	14.14	14.35	14.57	14.78	14.99	15.21	15.44	15.65	15.79
Nominal interest rates (annualized percentages)										
Deposit rate [c]	9.4	7.9	7.1	6.7	6.6	6.1	4.9	4.6	...	...
Lending rate [d]	19.5	18.4	18.2	17.3	17.1	16.1	14.5	14.5	...	...
Domestic credit [e] (variation from same quarter of preceding year)	-2.7	-17.9	-13.7	14.9	18.1	13.9	...	...	...	...
Non-performing loans as a percentage of total loans [f]	3.8	4.0	3.9	3.4	3.5	3.9	3.3	2.7	...	...

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Preliminary figures. [b] Quarterly average, weighted by the value of merchandise exports and imports. [c] Weighted average rate on 30-day deposits. [d] Weighted average rate on short-term loans. [e] Refers to net credit extended to the public and private sectors by commercial banks and other financial and banking institutions. [f] Refers to total credit extended by the banking system.

to the nominal exchange rate. Moreover, as a debtor institution, the central bank also stands to benefit from this measure, since a slower devaluation rate should reduce the cost of maintaining the value of monetary stabilization bonds. In 2003 the real effective exchange rate against the United States dollar showed a further depreciation (3.1%).

(d) Other policies

In the area of structural reform, the most significant developments in 2004 include the draft law on fiscal responsibility and the launching of a pension system based on private pension fund managers (AFPs). The main objectives of the fiscal responsibility legislation are to set limits on both the level of the deficit and the extent of public-sector borrowing, to design a multi-year budget system and to set up a stabilization fund that will help to reduce the procyclical bias of fiscal policy.

The trade liberalization process begun in the mid-1990s was continued in 2003. Nicaragua, along with the other Central American countries, concluded its free-trade negotiations with the United States. In this context, in February the authorities decided to abolish the 35% tariff on imports from Honduras. Nicaragua had imposed this tariff in 1999 in retaliation for Honduras's ratification of a maritime border treaty with Colombia, which Nicaragua felt was against its national interests. In addition, in order to advance towards the formation of a Central American customs union, further efforts were made to harmonize tariffs and standardize customs procedures.

3. The main variables

(a) Economic activity

The Nicaraguan economy showed signs of a mild recovery in 2003, after having slowed down considerably for three straight years. Real GDP growth (2.3%) was based on both an upturn in exports and an expansion of domestic demand as a result of higher consumption and a surge in public investment.

Exports displayed buoyant growth (8.1%), while domestic demand strengthened slightly (1.4%). The rise in public consumption (2.8%) after a two-year slide was due to an increase in current expenditure on goods and services and an upturn in employment in many government institutions. The expansion of private consumption (3.9%) was stimulated mainly by an increase in family remittances, higher real wages and the freer availability of consumer and housing loans. Despite a considerable upswing in public investment in infrastructure works (10.3%), capital formation contracted owing to a reduction in private investment spending (-3.6%), which was affected by the macroeconomic adjustment process, a rise in the prices of some raw materials and intermediate goods and the climate of political uncertainty.

On the supply side, GDP growth largely reflected both a recovery in agricultural output (3.2%) and higher value added in construction (3.9%) and manufacturing (2.1%), especially in the free-trade zones. In addition to a modest increase in export-oriented agricultural production, there was an expansion in the output of basic grains thanks to technical assistance programmes. Services as a whole, which generated 48.6% of GDP, expanded at a rate similar to the one recorded in 2002. The most vibrant sectors were financial services, telecommunications and commerce.

The monthly index of economic activity was still on the rise in March 2004, accumulating growth of 4.8%, which was more than twice the rate recorded in the same period of 2003. This was due mainly to the buoyancy of activities in agriculture, industry, mining, commerce and transport and communications, which, as a whole, contributed 2.9 percentage points to the annual average increase in the index.

(b) Prices, wages and employment

At 6.6%, year-on-year inflation in 2003 was in line with the established target, even though it was more than two percentage points higher than its 2002 level. This acceleration reflected short-term factors such as a rise in fuel and transport prices, public utility rate adjustments and the effects of a tax reform on production costs, and was not indicative of any deterioration in monetary conditions or any increase in domestic spending.

The surge in inflation observed in the first four months of 2004 brought cumulative inflation in that period (4.2%) to its highest level in the past five years. Inflation continues to be driven mainly by the rise in the international prices of key raw materials, especially petroleum. Consequently, inflation is expected to be higher in 2004 than in 2003.

Nicaragua’s economic recovery in 2003 had a favourable effect on average real wages and employment. However, economic growth fell short of the rate needed, over the long term, to bring down the high level of unemployment and to improve the precarious situation in which much of the population now lives. An increase in the minimum wage, public-sector pay adjustments and higher wages in certain sectors resulted in an improvement in the average real wage (2.6%). At the same time, open unemployment declined from 11.6% to 10.2%.

(c) The external sector

The upturn in economic activity was accompanied by a slight decrease in the external imbalance. The balance-of-payments current account deficit narrowed from 21.7% of GDP in 2002 to 20.8% in 2003. This reflected a considerable increase in current transfers (16.5%), especially family remittances, since the trade deficit (26.5% of GDP) and the negative factor services balance increased slightly. Current transfers were equivalent to 10.6% of GDP and to 33.8% of the trade and income deficit. Official and private capital inflows, together with disbursements for balance-of-payments support, were sufficient to finance the current account deficit. Moreover, this led to a build-up of net international reserves that improved the foreign-exchange backing of the monetary base.

The merchandise trade deficit continued to be very high (23.5% of GDP). Exports, including those of firms in the free-trade zones, grew by 9.8%, while imports increased by 6.3%.

Merchandise exports (f.o.b.), which amounted to US$ 748.2 million, or 18.1% of GDP, expanded primarily because of an increase in external sales of non-traditional agricultural and manufactured products (15.5%). The former included basic grains exports to the other Central American countries and fruit and tobacco exports to the United States. In the case of industrial products, the biggest increases were in exports of food products and chemicals to the Central American countries and of textiles and clothing to the United States. At the same time, the net exports of free-trade-zone companies, which consist mainly of textiles, kept up their brisk growth of recent years, while the number of such companies increased and more jobs were created. Exports of traditional products expanded by only 2.4% following the decline posted in the previous two years. Coffee showed the most substantial rise in export value, thanks to the surge in international prices, which resulted in the drawdown of inventories. Exports of meat and livestock to El Salvador, Mexico and the United States also contributed to the modest rally in sales of traditional products.

Merchandise imports (c.i.f.) were also up, at US$ 1.887 billion (45.6% of GDP), thanks to an increase in purchases of raw materials and intermediate goods (16.2%), primarily oil, fuels and lubricants (29.4%). Imports of raw materials for industry and construction were also higher. Purchases of consumer goods showed considerable growth (10.6%), which mainly reflects the easier availability of credit. On the other hand, external sales of capital goods fell (-16.1%), largely because the investment cycle driven by the modernization and privatization of State enterprises drew to a close.

By February 2004 the cumulative balance-of-payments current account deficit had narrowed considerably (-18.9%), thanks to a decrease in the trade deficit and a recovery in tourism, as well as to lower public-sector external debt-servicing payments and an increase in family remittances. The decline in the merchandise trade deficit was due to a 5.9% upturn in exports and a 1.7% downturn in imports that mainly reflected a volume decrease in purchases of petroleum and petroleum products.