Euler Hermes Economic Research

Country Report

Nicaragua

Strengthening the fiscal framework

General Information

GDP	USD10.507bn (World ranking 126, World Bank 2012)
Population	5.99 million (World ranking 109, World Bank 2012)
Form of state	Republic
Head of government	Jose Daniel ORTEGA Saavedra (FSLN)
Next elections	2016, presidential

Strengths

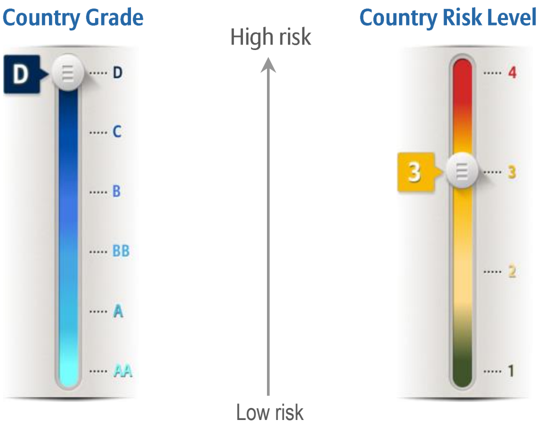
- A functioning democracy
- Large investment projects in infrastructures that might attract foreign investment and sustain growth
- Ongoing reforms to improve public finances framework

Weaknesses

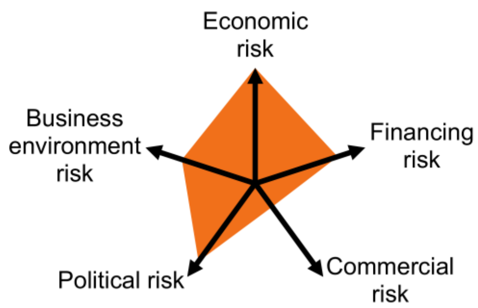
- Left-leaning government with potential to tilt towards radical populism
- Weak political institutions
- High dependency on primary commodities and vulnerability to natural disasters
- Lack of energy ressources
- Wide current account deficit

Country Rating

D3



Risk Dimensions



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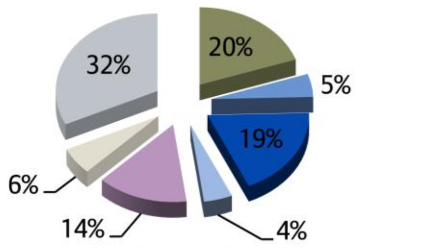
Economic Structure

GDP breakdown (2011)



Sources: Chelem, UnctadStat, IHS Global Insight, Euler Hermes

Trade structure (% of total, 2011)

Exports		Rank		Imports
United States	55%	1	21%	United States
Canada	9%	2	17%	Venezuela
El Salvador	5%	3	9%	China
Venezuela	4%	4	8%	Mexico
Costa Rica	4%	5	8%	Guatemala

Exports (% of total)		Rank		Imports (% of total)
Articles of apparel & clothing accessories	24%	1	21%	Petroleum, petroleum products and related materials
Coffee, tea, cocoa, spices, and manufactures thereof	14%	2	7%	Medicinal and pharmaceutical products
Gold, non-monetary (excluding gold ores and concentrates)	11%	3	6%	Road vehicles
Meat and meat preparations	10%	4	5%	Cereals and cereal preparations
Electrical machinery, apparatus and appliances, n.e.s.	7%	5	4%	Miscellaneous manufactured articles, n.e.s.

Economic Forecast

	2010	2011	2012	2013	2014f	2015f
GDP growth (% change)	3.3	5.4	5.2	4.2	4.0	4.2
Inflation (%, end-year)	9.2	8.0	6.6	6.8	7.4	7.4
Fiscal balance (% of GDP)	-0.8	0.7	0.1	-0.5	-0.1	0.0
Public debt (% of GDP)	50.1	45.4	43.2	42.4	40.5	40.0
Current account (% of GDP)	-9.5	-13.2	-12.7	-11.4	-12.5	-12.0
External debt (% of GDP)	77.9	79.6	78.2	79.0	82.0	83.0

Source: IHS Global Insight, national sources, Euler Hermes

Economic Overview

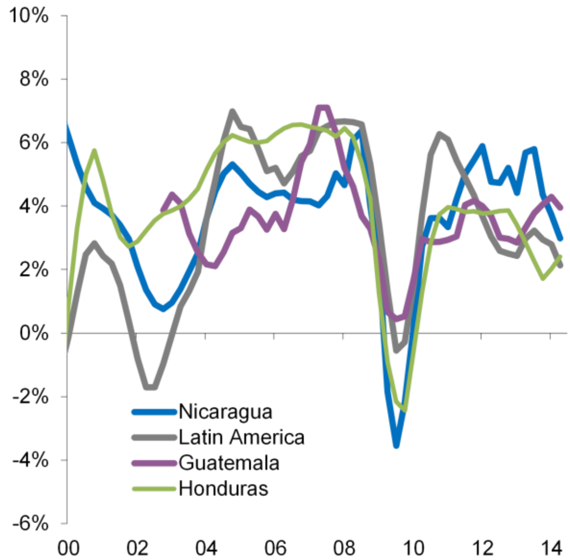
Growth is expected to remain strong

Real GDP expanded by +4.2% in 2013, and we expect it will continue to expand at a fast pace in 2014 (+4%) and 2015 (+4.2%). The construction sector will be an important driver of growth, as large infrastructure programs are underway, notably the construction of an interoceanic canal and several projects in the energy field. However, there is still a long road ahead in terms of economic development. GDP per capita (USD1,800 in 2013) is the second lowest in the region, after Haiti, while poverty and the informal economy remain very elevated. Lack of effective infrastructure is a main concern. World Bank indicators suggest that Nicaragua is far behind its peers in terms of good governance and a business-friendly framework.

Public finances are enhancing, but remain fragile

The Ortega government has focused on the enhancement of public finances over the past few years. A wide tax reform was implemented in 2012 which improved tax collection and administration, set spending restrictions and increased fiscal revenues. The fiscal accounts are broadly in balance, while public debt is on a downward trend. Despite these improvements, public finances remain fragile as they still rely strongly on international aid and poverty-reduction programs.

GDP growth (%)



Sources: IHS Global Insight, Euler Hermes

Economic Overview (continued)

The exchange rate crawling peg anchors inflation

Nicaragua's exchange rate regime is that of a crawling peg set against the U.S. dollar, with a devaluation target against the USD set every year (craw rate). If this system helps to anchor inflation expectations, it might also lead to a surge in consumer prices in the case of a high craw rate as a consequence of imported inflation; given the fact that the vast majority of consumer goods are imported. The craw rate for 2013 was set at 5%, which led to an inflation rate of +7.1% in average, +6.8% at the end of the year. Prices have somewhat slowed since the beginning of the year, and grew by +4.8% y/y in May. We expect inflationary pressures to remain broadly under control in 2014 and 2015.

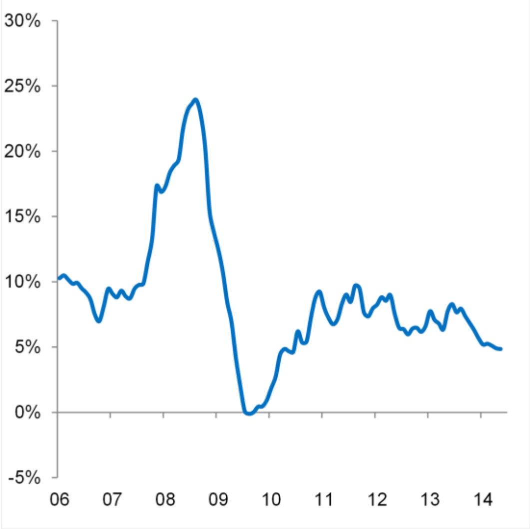
External vulnerabilities are important

The current account deficit is wide (-11.4% of GDP) and it is not expected to narrow as the ongoing investment projects will sustain imports in upcoming years. Moreover, the dollarization of the economy is elevated, which could cause concern in case of strong pressures on the exchange rate. About 70% of the local deposits and 90% of loans are denominated in USD.

Nicaragua is highly dependent on primary commodities, but lacks energy resources. As a result, the country has fully benefitted from the financial support of Venezuela within the framework of the Petrocaribe alliance, which allowed it to purchase Venezuelan crude oil at preferential rates. While this eased Nicaragua's external constraints and sustained economic growth over past years, the outlook for bilateral economic cooperation raises some concerns given the actual political and economic situation of Venezuela.

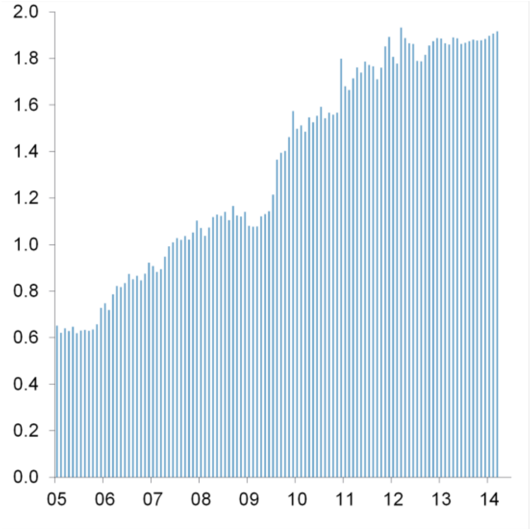
However, a current account crisis is not likely in the short term as the national currency is not strongly overvalued, the authorities have committed to increase international reserves and important FDI inflows are likely to prevail due to the ongoing infrastructure projects. International reserves (excluding gold) amounted to USD2 billion as of April 2014, which represents about 3.3 months of import cover (of goods and services), a relatively low level. However, in agreement with the IMF, national authorities committed to increase international reserves, and to maintain them above three months of imports.

Inflation rate (y/y, %)



Sources: IHS Global Insight, Euler Hermes

FX reserves excluding gold (USD billion)



Sources: IHS Global Insight, Euler Hermes

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