Nicaragua: Policies to Support Sustained and Equitable Growth

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By [Gerardo Peraza]

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Since the end of the last IMF-supported program in 2011, Nicaragua has continued to maintain macroeconomic stability and strong economic growth, which, in turn, has helped to reduce poverty.

Looking ahead, the country needs to strengthen policies to safeguard its achievements and adapt to a more uncertain external environment. The IMF's recent annual report on the health of the Nicaraguan economy recommends policies in a number of areas to help the country secure strong, sustained, and equitable growth.

Over the past four years, Nicaragua's real GDP growth has averaged 4.6 percent, one of the highest in the region (see Chart 1). Inflation has remained low, anchored by the crawling peg exchange rate regime and helped, in part, by the decline in oil prices since 2014. The government has maintained a broadly prudent budget that has helped stabilize public debt as a share of GDP (see Chart 2). This strong performance has helped reduce poverty sharply—from 42.5 percent in 2009 to 29.6 percent in 2014.

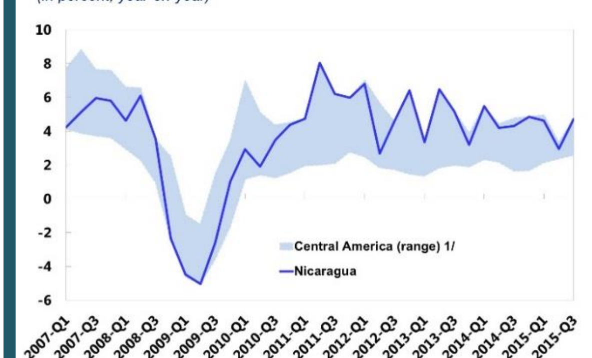

Chart 1
Central America: Real GDP Growth
(in percent, year-on-year)

Sources: Haver Analytics, Inc; and IMF staff calculations.
1/ Includes: Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua.

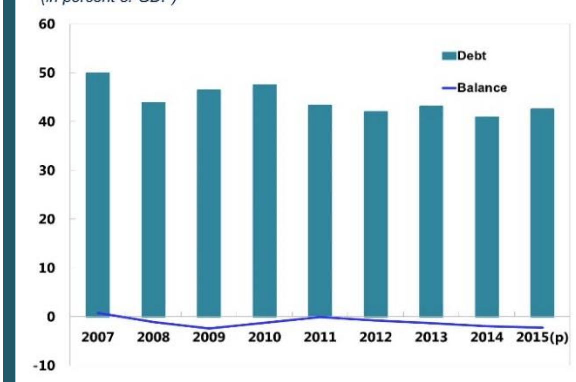

Chart 2
Nicaragua: Consolidated Public Sector Balance and Debt
(in percent of GDP)

Sources: Country authorities; and IMF staff calculations.

Going forward, what more can Nicaragua do to boost growth? The IMF report recommends policy actions in four key areas:

Fortifying the fiscal scaffolding

To further strengthen Nicaragua's fiscal accounts and put debt on a declining path, it would be important to reduce excessive tax incentives and exemptions—particularly those pertaining to income and value-added taxes—and improve the targeting of electricity subsidies. Tax incentives and exemptions narrow the tax base, requiring higher and more distortive tax rates on those segments of the economy that are still taxed. High tax rates and the perception of inequity created by numerous tax incentives and exemptions favoring high-income households contribute to a high rate of informality. Similarly, the tax regime for small and medium-sized enterprises should be aimed at reducing informality and boosting growth. In particular, tax rates should not be onerous, avoiding sharp increases in effective tax rates as business income increases, and compliance should be kept simple. There is also room to reduce the cost of subsidies and ensure that their benefits reach a larger share of poor households. Equally important, all these efforts need to be accompanied by an improvement in the monitoring and transparency of public sector accounts.

Strengthening financial sector stability

The largest three Nicaraguan banks belong to regional financial groups (conglomerates), and account for about 80 percent of domestic banking sector assets. It is therefore very important for local regulators to monitor the potential risks at the "group level," given their interconnections with other countries in the region. Moreover, since approximately 90 percent of the assets and liabilities of banks are denominated (or indexed) in U.S. dollars, financial dollarization deserves special attention. In particular, rapid credit growth, persistent dollar strength, and potential increases in U.S. interest rates could make it difficult for some borrowers to honor their debt, especially if they do not generate dollar earnings. In this context, bank regulators need to constantly review the macro-prudential tools available to them to mitigate the risks associated with high dollarization.

Improving external competitiveness

Nicaragua's economy remains vulnerable to increases in oil prices and declines in non-oil commodity prices. The country already faces a high external current account deficit, which is financed by foreign direct investment and rising private debt. To bolster competitiveness, Nicaragua needs to improve its infrastructure facilities, bolster trade networks, invest in human capital by improving educational outcomes in primary education and training programs that address labor skills bottlenecks, and increase competition by reducing barriers to entry. Such efforts, if well implemented, will assist in reducing informality and poverty.

Upgrading the statistical framework

Good data dissemination practices are essential for the formulation and implementation of economic policies aimed at promoting growth and macroeconomic stability. Improving data dissemination would facilitate monitoring and analyses by market participants, the media, and the general public. In the case of Nicaragua, we see benefits from introducing regulations to enforce data collection, establishing procedures to monitor data quality, and strengthening communication with users.

We remain ready and committed to continue supporting the Nicaraguan authorities in their efforts to maintain macroeconomic stability and sustainable, equitable growth through policy advice and technical assistance.

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