Research Update:

Nicaragua Long-Term Ratings Raised To 'B' On Economic And Fiscal Recovery; Outlook Is Stable

October 25, 2022

Overview

- Nicaragua's economy is recovering following successive domestic and external shocks over recent years.
- Cautious fiscal and monetary policies have stabilized the economy and should support continued GDP growth.
- We raised our long-term sovereign credit ratings on Nicaragua to 'B' from 'B-'.
- The stable outlook reflects our expectation of continued economic recovery and fiscal prudence despite a challenging external scenario.

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Rating Action

On Oct. 25, 2022, S&P Global Ratings raised its foreign and local currency long-term sovereign credit ratings on Nicaragua to 'B' from 'B-'. The outlook is stable. We affirmed our short-term ratings on Nicaragua at 'B'. We also raised our transfer and convertibility assessment to 'B+' from 'B-'.

Outlook

The stable outlook reflects our view of continued economic recovery coupled with fiscal and monetary policies that sustain economic stability amid a complex international scenario of higher inflation and rising interest rates.

Downside scenario

We could lower the ratings in the next six to 18 months if Nicaragua's current economic recovery were to be undermined by weaker domestic and external demand, or further potential negative shocks or unexpected political tensions. Heightened pressures on the domestic financial system that hurt stability could also lead us to lower the rating.

Upside scenario

We could raise the ratings over the next six to 18 months if favorable political and policy developments raise investor confidence, lead to higher-than-expected economic growth, and improve the sovereign's access to external funding. A track record of strengthening economic and fiscal results that lower Nicaragua's exposure to negative external shocks on a sustainable basis could lead to an upgrade.

Rationale

The ratings on Nicaragua reflect its low per capita income, institutional weaknesses, vulnerability to external shocks, and limited monetary flexibility. On the other hand, the ratings incorporate the government's capacity to stabilize the economy following severe shocks over the past years through active and timely fiscal and monetary policy measures. The ratings also reflect our expectation of low fiscal deficits, broadly stable government debt levels, and a resilient financial sector, which has been recovering from a period of significant stress.

Institutional and economic profile: Nicaragua's economy is recovering despite institutional weaknesses, and relatively weak labor market and business confidence

- Nicaragua's economic recovery is being driven by external demand thanks to rising exports, and remittances.
- We expect GDP growth of 3%-4% over the next three years, below the pre-2018 crisis pace of around 5%.
- The country's institutions remain constraints on the rating, with weak checks and balances and rule of law.

Nicaragua's political institutional framework is a credit weakness, with high concentration of power in the presidency, few checks and balances between institutions, and weak rule of law. President Daniel Ortega of the governing Sandinista Party is now serving his fourth consecutive term (2022-2027). Controversies surrounding the fairness of the national elections held in 2021, including the disqualification of several opposition candidates, could sustain domestic political polarization and potentially lead to further international sanctions.

We expect the government to continue prioritizing economic stability, including a cautious approach to fiscal and monetary policies. However, a continued political impasse between the government, opposition parties, and other sectors of society could negatively affect long-term GDP growth prospects, as well as limit Nicaragua's access to official lending from multilateral banks.

Nicaragua's economy is recovering, backed by strong remittances sustaining domestic consumption, favorable terms of trade boosting traditional exports, and good external demand for exports from the country's free-trade zones. The recovery follows a three-year recession during 2018-2020 because of the economic downturn sparked by political turmoil in 2018, the COVID-19 pandemic, and natural disasters.

These successive shocks have changed the country's economic structure, potentially weighing on long-term economic growth prospects. The once closely organized relationship between the private sector and the government, coordinated through various chambers of commerce, ended with the political turmoil of 2018. Ties between the private and public sectors are now less institutional. Nevertheless, private and foreign investment has recovered, with foreign direct investment (FDI) currently back to pre-2018 levels. The labor market is suffering from lower participation rates and higher informality, as well as migration outflows. In this context, we expect GDP growth to be 3%-4% over the next three years, below the strong pre-2018 crisis pace of around 5%. Our forecasts incorporate a shallow recession in the U.S.--weaker economic growth in North America would directly affect Nicaragua, through exports and remittances.

Flexibility and performance profile: Fiscal buffers and a relatively favorable debt profile mitigate external vulnerabilities

- Nicaragua's fiscal deficits will remain low and debt levels steady as the government continues to prioritize economic stability.
- Strong dollar inflows are reducing the country's external vulnerabilities.
- Monetary policy flexibility remains limited, as the current spike in inflation is mostly driven by external factors and the financial sector remains underdeveloped and highly dollarized.

Nicaragua's government remains committed to fiscal consolidation and sound macroeconomic policies, providing a key buffer against domestic and external shocks. Despite the recession over the past few years, the government prioritized measures aimed at preserving financial and monetary stability, while public spending related to COVID-19 pandemic has been modest compared with other countries in the region.

We expect fiscal deficits to remain relatively low as strong government revenues compensate the pressures from high inflation and energy subsidies. The government passed tax reform in 2019, whose benefits are being mostly collected this year. It also passed two pension reforms in 2014 and 2019 (our general government figures include the social security system, INSS), which helped contain pension deficits and generated savings to pay down long-standing central government obligations owed to the pension fund (these outstanding obligations have been fully repaid in 2022). Despite this improvement, the pension system's long-term financial health will likely depend on the recovery of formal employment, which boosts the number of affiliates in the social security system.

We expect the general government deficit will slightly expand but remain less than 2% of GDP in 2022, from barely 1.2% in 2021. As a result, the change in net general government debt would average 3.2% of GDP in the coming three years owing to a combination of fiscal deficits, additional debt stemming from quasi-fiscal activities, and the valuation effect on the debt burden from currency depreciation.

The legacy of the political protests in 2018, including international pressure against the Ortega administration, has affected the government's capacity to obtain external funding. These events led the U.S. to oppose new lending to Nicaragua by some multilateral development banks, other than for humanitarian purposes (loans already approved but not disbursed are not affected by this policy). In our opinion, Nicaragua will maintain its access to external lending to cover the government's financing needs in the coming years. However, uncertainty will likely persist given the risk of new sanctions from the U.S. government or diminishing access to official lenders like the Inter-American Development Bank and the World Bank. Financing from the Central American Bank for Economic Integration (CABEI) has significantly increased over the past few years (at somewhat higher interest rates than from other multilateral lenders). On the domestic front, sales of Nicaraguan treasury bonds should remain broadly constant given the limited size of the domestic market, despite favorable interest rates and high liquidity in the system.

Despite the severe recent shocks, we expect Nicaragua's net government debt to remain broadly stable, at around 48% of GDP in 2022-2025 from barely 45% in 2018, and interest payments will remain just below 5% of general government revenues. Nicaragua's debt profile is relatively favorable, as most of the debt is with official creditors at concessional rates. Despite general government debt denominated in foreign currency, the country's crawling peg arrangement limits the risk of abrupt changes in the exchange rate.

We consider banks' contingent liabilities to be limited. The banking sector has strong capitalization, liquidity, and profitability ratios, despite the severe shocks over the past few years when deposits fell by around 30% in a single year. Moreover, the financial sector is relatively small, with gross assets accounting for around 50% of GDP.

Nicaragua's external vulnerabilities are being partially mitigated by high dollar inflows from exports and remittances, and lower external financing requirements. As a result of the economic recovery and higher commodity prices, we expect imports to grow rapidly and be only partially compensated by higher exports of traditional goods and free-trade zones. Furthermore, remittances are growing substantially and will account for around 19% of GDP by 2022, given the increase in outward migration.

Nevertheless, Nicaragua's external position is subject to volatility given potential swings in commodity prices and terms of trade, mainly from gold and oil (which account for a significant share of Nicaragua's exports and imports, respectively). We project moderate current account deficits, around 3.5% of GDP during 2022-2025, covered entirely through FDI. We project FDI will remain about 5% of GDP over the next three years.

We expect narrow net external debt to decrease to 74% of current account receipts (CARs) in 2022-2025. Furthermore, external liquidity is likely to remain strong as gross international reserves have shown resilience to external shocks, increasing to a record high of about $4 billion, or above 20% of GDP. We expect Nicaragua's gross external financing needs to average 93% of CARs and usable reserves for 2022-2025. Furthermore, the central bank has access to revolving credit lines for liquidity management, including from CABEI for US$200 million (which could be expanded to US$500 million over the next year).

Nicaragua has limited monetary flexibility because the financial system remains underdeveloped and highly dollarized. Almost all loans and 80% of deposits are denominated in foreign currency. Banks currently have high capitalization and liquidity ratios, and nonperforming loans (NPLs) are relatively low. Deposits have recovered to pre-2018 levels, after falling around 30% in one year. However, credit to the private sector has recovered at a slower pace. The recent spike in inflation, which we expect to close at 9.5% by the end of the year, is mainly driven by external factors.

Despite periods of substantial stress in the financial sector, the central bank did not impose any capital restrictions, consistent with a transfer and convertibility assessment of 'B+', one notch above the sovereign credit rating.

Key Statistics

Table 1

Nicaragua--Selected Indicators

	2016	2017	2018	2019	2020	2021	2022f	2023f	2024f	2025f
Economic indicators (%)										
Nominal GDP (bil. LC)	380.26	414.28	410.99	417.22	432.26	492.85	561.26	612.78	659.60	709.99
Nominal GDP (bil. $)	13.29	13.79	13.03	12.60	12.59	14.01	15.64	16.75	17.67	18.65
GDP per capita (000s $)	2.1	2.2	2.0	1.9	1.9	2.1	2.3	2.5	2.6	2.7
Real GDP growth	4.6	4.6	(3.4)	(3.8)	(1.8)	10.3	4.0	3.0	3.5	3.5
Real GDP per capita growth	3.5	3.6	(4.4)	(4.8)	(2.8)	9.2	2.9	1.9	2.4	2.4
Real investment growth	(0.3)	1.2	(25.1)	(29.5)	15.0	26.7	5.0	5.0	5.0	5.0
Investment/GDP	34.8	33.1	25.8	17.7	19.8	23.4	23.8	23.8	24.2	23.6
Savings/GDP	26.3	25.9	24.0	23.6	23.8	21.1	20.0	20.5	21.1	20.5
Exports/GDP	38.9	41.3	42.3	45.1	42.2	46.8	49.2	47.4	46.3	44.9
Real exports growth	4.6	10.1	(1.6)	5.6	(8.9)	18.0	14.0	(3.9)	(0.8)	0.3
Unemployment rate	4.5	3.7	5.4	5.6	5.0	4.5	5.5	5.0	5.0	5.0
External indicators (%)										
Current account balance/GDP	(8.5)	(7.2)	(1.8)	6.0	3.9	(2.3)	(3.9)	(3.3)	(3.1)	(3.1)
Current account balance/CARs	(16.4)	(13.4)	(3.2)	10.0	6.8	(3.6)	(5.6)	(5.0)	(4.9)	(5.0)
CARs/GDP	51.6	53.5	55.9	60.2	58.1	63.1	68.4	65.7	64.0	62.0
Trade balance/GDP	(18.8)	(17.2)	(12.3)	(8.4)	(7.4)	(13.4)	(18.6)	(17.3)	(16.6)	(16.0)
Net FDI/GDP	7.0	7.0	5.9	3.5	5.6	8.6	6.4	4.8	4.5	4.3
Net portfolio equity inflow/GDP	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Gross external financing needs/CARs plus usable reserves	109.9	113.6	100.5	96.3	92.2	95.6	95.1	93.4	92.5	92.3
Narrow net external debt/CARs	116.1	109.1	121.1	111.8	111.9	90.5	75.7	74.7	73.8	73.5
Narrow net external debt/CAPs	99.7	96.3	117.4	124.2	120.1	87.3	71.7	71.1	70.4	70.0
Net external liabilities/CARs	204.5	199.3	212.9	196.3	202.0	180.0	159.1	163.1	166.8	171.4
Net external liabilities/CAPs	175.6	175.8	206.3	218.0	216.8	173.8	150.6	155.2	159.0	163.3
Short-term external debt by remaining maturity/CARs	18.4	22.0	20.9	22.1	17.2	15.5	14.6	13.4	12.3	12.0
Usable reserves/CAPs (months)	2.3	2.0	2.7	2.2	2.5	2.8	3.0	3.1	3.1	3.1
Usable reserves (mil. $)	1,415	1,707	1,246	1,445	2,167	2,825	2,941	3,019	3,097	3,170

Table 1

Nicaragua--Selected Indicators (cont.)

	2016	2017	2018	2019	2020	2021	2022f	2023f	2024f	2025f
Fiscal indicators (general government; %)										
Balance/GDP	(1.1)	(1.3)	(3.0)	(0.3)	(1.8)	(1.2)	(1.5)	(1.3)	(1.3)	(1.3)
Change in net debt/GDP	4.1	4.6	7.7	4.3	5.2	6.5	3.4	3.1	3.1	3.0
Primary balance/GDP	(0.2)	(0.2)	(1.9)	1.0	(0.5)	0.0	(0.2)	(0.0)	(0.0)	(0.0)
Revenue/GDP	25.4	25.7	24.7	27.6	27.4	29.4	29.0	29.0	28.8	28.7
Expenditures/GDP	26.5	27.0	27.8	27.9	29.2	30.6	30.5	30.3	30.1	29.9
Interest/revenues	3.9	4.2	4.6	4.8	4.7	4.3	4.4	4.3	4.3	4.3
Debt/GDP	43.0	45.5	51.3	55.7	61.4	61.5	56.6	54.2	52.6	51.2
Debt/revenues	169.4	176.8	207.3	202.1	223.8	209.5	194.8	186.5	182.4	178.6
Net debt/GDP	35.7	37.4	45.4	49.0	52.5	52.6	49.5	48.5	48.2	47.7
Liquid assets/GDP	7.3	8.1	5.9	6.7	8.9	8.9	7.0	5.6	4.5	3.4
Monetary indicators (%)										
CPI growth	3.5	3.9	4.9	5.4	3.7	4.9	9.5	6.0	4.0	4.0
GDP deflator growth	4.6	4.1	2.7	5.5	5.5	3.3	9.5	6.0	4.0	4.0
Exchange rate, year-end (LC/$)	29.32	30.79	32.33	33.84	34.82	35.52	36.23	36.96	37.70	38.45
Banks' claims on resident non-gov't sector growth	17.5	16.8	(4.2)	(18.0)	(5.9)	5.6	8.9	12.2	10.6	10.6
Banks' claims on resident non-gov't sector/GDP	37.2	39.9	38.5	31.1	28.3	26.2	25.0	25.7	26.5	27.2
Foreign currency share of claims by banks on residents	74.6	75.8	73.0	84.5	83.1	82.1	92.4	94.3	94.6	94.7
Foreign currency share of residents' bank deposits	79.1	78.0	77.0	71.6	73.1	72.7	74.1	75.6	77.1	78.7
Real effective exchange rate growth	0.1	(3.7)	(2.8)	(0.0)	0.2	N/A	N/A	N/A	N/A	N/A

Sources: Central Bank of Nicaragua, Nicaragua's Ministry of Finance and Public Credit, and National Institute of Information and Development (INIDE).

Adjustments: We include pension system (INSS) as part of our central government definition; we subtract debt issued by the central bank for monetary policy purpuses.

Definitions: Savings is defined as investment plus the current account surplus (deficit). Investment is defined as expenditure on capital goods, including plant, equipment, and housing, plus the change in inventories. Banks are other depository corporations other than the central bank, whose liabilities are included in the national definition of broad money. Gross external financing needs are defined as current account payments plus short-term external debt at the end of the prior year plus nonresident deposits at the end of the prior year plus long-term external debt maturing within the year. Narrow net external debt is defined as the stock of foreign and local currency public- and private- sector borrowings from nonresidents minus official reserves minus public-sector liquid claims on nonresidents minus financial-sector loans to, deposits with, or investments in nonresident entities. A negative number indicates net external lending. N/A--Not applicable. LC--Local currency. CARs--Current account receipts. FDI--Foreign direct investment. CAPs--Current account payments. f--Forecast. The data and ratios above result from S&P Global Ratings' own calculations, drawing on national as well as international sources, reflecting S&P Global Ratings' independent view on the timeliness, coverage, accuracy, credibility, and usability of available information.

Ratings Score Snapshot

Table 2

Nicaragua--Ratings Score Snapshot

	Score	Explanation
Key rating factors		
Institutional assessment	5	Weak predictability of policymaking in the context of highly centralized decision-making, few checks and balances, and weak rule of law.
Economic assessment	5	Based on GDP per capita (US$) and growth trends as per Selected Indicators in table 1.
External assessment	5	Based on narrow net external debt and gross external financing needs/(CAR + useable reserves) as per Selected Indicators in Table 1.
		There is a risk of marked deterioration in the cost of or access to external financing. The lack of negotiated political solution to 2018's political crisis and the sanctions imposed by the U.S. government have reduced external financing options for Nicaragua. The net external liability position is worse than the narrow net external debt position by about 90% of CAR, as per Selected Indicators in Table 1.
		The country is exposed to significant volatility in terms of trade, due to volatility in the price of main export goods (such as gold, tobacco, beans and coffee) and import goods (such as oil and its derivatives).
Fiscal assessment: flexibility and performance	4	Based on the change in net general government debt (% of GDP) as per Selected Indicators in Table 1.
		The sovereign faces shortfalls in basic services and infrastructure that will continue to weigh on the fiscal deficits in the future. The country falls into the "Medium Human Development" category (126 out of 191 countries) according to the UNDP 2022.
Fiscal assessment: debt burden	2	Based on net general government debt (% of GDP) and general government interest expenditures (% of general government revenues) as per Selected Indicators in Table 1.
		All of the gross government debt is denominated in foreign currency.
Monetary assessment	5	Nicaragua has a crawling peg exchange rate. The central bank (BCN) further reduced the annual rate at which the cordoba depreciates against the U.S. dollar to 2% from 3% by end-2020, and from 5% in 2019. We expect the exchange rate regime to be maintained in coming years.
		The central bank has limited independence with regard to the executive power. It also has limited ability to act as a lender of last resort for the financial system. The domestic bond an equity markets are small.
		The level of dollarization of the financial system is very high. All credits are in U.S. dollars, and 80% of deposits are held in foreign currency.
Indicative rating	b	
Notches of supplemental adjustments and flexibility	0	
Final rating		
Foreign currency	B	
Notches of uplift	0	Default risks do not apply differently to foreign-and local-currency debt.

Table 2

Nicaragua--Ratings Score Snapshot (cont.)

	Score	Explanation
Local currency	B	

S&P Global Ratings' analysis of sovereign creditworthiness rests on its assessment and scoring of five key rating factors: (i) institutional assessment; (ii) economic assessment; (iii) external assessment; (iv) the average of fiscal flexibility and performance, and debt burden; and (v) monetary assessment. Each of the factors is assessed on a continuum spanning from 1 (strongest) to 6 (weakest). S&P Global Ratings' "Sovereign Rating Methodology," published on Dec. 18, 2017, details how we derive and combine the scores and then derive the sovereign foreign currency rating. In accordance with S&P Global Ratings' sovereign ratings methodology, a change in score does not in all cases lead to a change in the rating, nor is a change in the rating necessarily predicated on changes in one or more of the scores. In determining the final rating the committee can make use of the flexibility afforded by §15 and §§126-128 of the rating methodology.

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- Criteria | Governments | Sovereigns: Sovereign Rating Methodology, Dec. 18, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011
- General Criteria: Methodology: Criteria For Determining Transfer And Convertibility Assessments, May 18, 2009

Related Research

- Global Sovereign Rating Trends: Third-Quarter 2022, Oct. 19, 2022
- Sovereign Risk Indicators, Oct. 10, 2022
- Sovereign Ratings History, Oct. 5, 2022
- Economic Outlook Emerging Markets Q4 2022: Further Growth Slowdown Amid Gloomy Global Prospects, Sept. 26, 2022
- Economic Outlook Latin America Q4 2022: A Period Of Below-Trend Growth Ahead, Sept. 26, 2022
- Why Central America's Low Sovereign Credit Ratings Are Diverging, Sept. 5, 2022
- 2021 Annual Global Sovereign Default And Rating Transition Study, May 4, 2022
- Sovereign Debt 2022: Borrowing Will Stay High On Pandemic And Geopolitical Tensions, April 5, 2022
- Nicaragua, Sept. 30, 2021

In accordance with our relevant policies and procedures, the Rating Committee was composed of analysts that are qualified to vote in the committee, with sufficient experience to convey the appropriate level of knowledge and understanding of the methodology applicable (see 'Related Criteria And Research'). At the onset of the committee, the chair confirmed that the information provided to the Rating Committee by the primary analyst had been distributed in a timely manner and was sufficient for Committee members to make an informed decision.

After the primary analyst gave opening remarks and explained the recommendation, the Committee discussed key rating factors and critical issues in accordance with the relevant criteria. Qualitative and quantitative risk factors were considered and discussed, looking at track-record and forecasts.

The committee's assessment of the key rating factors is reflected in the Ratings Score Snapshot above.

The chair ensured every voting member was given the opportunity to articulate his/her opinion. The chair or designee reviewed the draft report to ensure consistency with the Committee decision. The views and the decision of the rating committee are summarized in the above rationale and outlook. The weighting of all rating factors is described in the methodology used in this rating action (see 'Related Criteria And Research').

Ratings List

Upgraded

	To	From
Nicaragua		
Transfer & Convertibility Assessment		
Local Currency	B+	B-

Upgraded; Ratings Affirmed

	To	From
Nicaragua		
Sovereign Credit Rating	B/Stable/B	B-/Stable/B