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Research Update:

Nicaragua 'B+/B' Sovereign Credit Ratings Affirmed; Outlook Remains Stable

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Ratings

Foreign Currency: B+/Stable/B
Local Currency: B+/Stable/B
For further details see Ratings List.

Overview

- We expect Nicaragua will continue to enjoy relatively high economic growth and manageable fiscal deficits, which will support a gradual reduction of the country's moderate debt burden.
- We are affirming our 'B+/B' sovereign credit ratings on Nicaragua.
- The outlook is stable, based on our expectation that solid growth prospects and cautious fiscal policies will continue to facilitate low budget deficits and contain the country's external financing needs.

Rating Action

On Feb. 16, 2018, S&P Global Ratings affirmed its 'B+' long-term local and foreign currency sovereign credit ratings on the Republic of Nicaragua. The outlook on the long-term ratings remains stable. At the same time, we affirmed the 'B' short-term local and foreign currency sovereign credit ratings.
In addition, we affirmed our transfer and convertibility (T&C) assessment at 'BB-'.

Outlook

The outlook is stable, based on our expectation that solid growth prospects and cautious fiscal policies will continue to facilitate low budget deficits and contain the country's external financing needs.

We may raise the ratings within the next two years if we see a lasting improvement of Nicaragua's external vulnerabilities, through a sustained reduction of the country's financing needs or of its indebtedness, along with a further enhancement of the quality of its external statistics.

Conversely, we could lower the ratings within the next two years if we perceive a reversal of the positive trends seen over recent years in the country's fiscal performance and government debt burden, coupled with an unexpected decision of the government to assume private-sector debt owed to

Venezuela under the PetroCaribe program.

Rationale

Our ratings on Nicaragua are supported by the sovereign's track record of steady GDP growth and pragmatic economic policies, its low fiscal deficits, and moderate government debt burden, which counterbalance its low GDP per capita, weak external position, and monetary policy rigidities.

Flexibility and performance profile: The debt burden is decreasing, but large external vulnerabilities remain a constraint.

- The country has maintained cautious fiscal policies, allowing for a gradual improvement in its moderate debt burden amid sustained economic growth.
- Nicaragua's large current account deficits (CADs) characterize its relatively weak external position.
- A crawling peg exchange rate, along with a high level of financial dollarization, limits monetary policy flexibility.

We expect the government will remain committed to fiscal caution, with general government deficits at 1.3% of GDP on average in 2018-2021. Revenue growth has been solid, and tax revenues have risen above 10% annually over the past five years, on the back of steady and impressive GDP growth.

On the expenditure side, the government has gradually included some social programs previously financed by funding from Venezuela (under the PetroCaribe program) into its budget. The gradual absorption of these programs reduces the risk of a potentially material rise in government spending in the future because of the local impact of financial difficulties in Venezuela. However, shortfalls in basic services and physical infrastructure--principally in the rural areas of the country--continue to weigh on potential spending in the future. Our projections assume modest additional decreases in electricity subsidies over the next two years, in line with recent changes in law. The social security institute (INSS, in its Spanish acronym), which provides pensions and other services to workers in the formal sector (around 25% of the total workforce) has faced consistent deficits since 2013 because of more beneficiaries. Reforming the parameters of the social security system to strengthen its own finances would alleviate future spending pressure on the government. We expect that the government will undertake measures to strengthen INSS in the coming years, along with steps to continue improving tax revenue collection, through the elimination of some value-added tax exemptions and other measures.

We expect that stable fiscal policy will result in an annual change in net general government debt averaging 2.2% of GDP during 2018-2021, exceeding the reported headline fiscal deficit. We understand that the difference between the annual general government net borrowing requirements and its reported headline deficit over the past few years stems mainly from the depreciation of the local currency and from some budgetary transactions between the government and the central bank or the government and public-sector companies.

We project the general government deficit will continue to be mainly financed through external borrowing. We expect Nicaragua's general government net debt burden to exceed 30% of GDP in 2018 and to decline to 28.5% of GDP by 2021 because of good economic growth and declining domestic debt. External debt currently accounts for 85% of the total public-sector debt stock, of which 99% is owed to official creditors. All of the general government debt is denominated in foreign currency, making it vulnerable to unexpected changes in the exchange rate. We project interest payments on the debt to remain below 5% of general government revenues in 2018-2021, assuming that Nicaragua will maintain access to external financing under favorable conditions. We believe that the sovereign's contingent liabilities from the financial sector and nonfinancial public enterprises are limited, according to our criteria.

Nicaragua's external vulnerabilities remain a rating weakness, reflected in large CADs. The CAD likely narrowed temporarily to 6% of GDP in 2017, before likely widening again this year. The lower deficit in 2017 reflects a recovery in major commodities exports and low import growth (in turn because of weaker private consumption).

In recent years, Nicaragua's current account has benefited from growth of the country's tourism industry as well as from sizable remittances (which account for 10% of GDP) and a declining oil import bill. Successful development of renewable energy (now accounting for 54% of power generation) has reduced oil import needs. We expect the CAD to stabilize at 8% of GDP for 2018-2021 and to continue to be financed by a combination of external borrowing and foreign direct investment inflows. Our assessment of external risks reflects still-sizable shortcomings in data on the country's balance of payments.

Nicaragua's external indebtedness is relatively high, despite substantial debt relief in earlier years under various multilateral initiatives. Private-sector external debt accounts for 54% of total external debt. All debt owed to Venezuela under the PetroCaribe program (likely the largest component of private-sector external debt) is classified as private-sector debt and does not have a sovereign guarantee.

Official lenders have provided the lion's share of Nicaragua's net external financing needs in recent years. We project that narrow net external debt will be around 105% of current account receipts (CARs) in 2018 and rise modestly to 110% by 2021. Nicaragua's reliance on external funding, with net external liabilities projected at 236% of CARs in 2018, reflects the country's vulnerability to changes in investor and official lender sentiment.

Our assessment of Nicaragua's monetary flexibility reflects the country's crawling peg exchange rate, high level of dollarization (deposits and loans denominated in U.S. dollars), and small domestic capital market which limits the effectiveness of monetary policy. The country has used the crawling peg since 1991, and we believe that the government is committed to this arrangement. The exchange rate is set to depreciate 5% annually against the U.S. dollar, contributing to stable inflation expectations. We assume an average inflation rate around 6% during 2018-2021. The high share of deposits and loans in U.S. dollars--which remain well above 50% of the total--further impairs the effectiveness of Nicaragua's monetary policy as it does in several economies across the region. The central bank has taken measures to strengthen its liquidity management instruments in recent years in order to support the development of domestic markets. Financial indicators that the central bank and the superintendent have published appear relatively robust.

Institutional and economic profile: We expect policy continuity and steady economic growth.

- Political decision-making is centralized within the office of President Daniel Ortega and his dominant Sandinista political party.
- We expect that a continued commitment to pragmatic pro-business policies will underpin strong economic performance.
- We expect real GDP to increase on average between 4% and 5% per year in 2018-2021 (and 3.5% growth per capita), with slowly diversifying sources of economic growth.

President Daniel Ortega, who remains popular according to surveys, is running the second year of his third consecutive mandate (2016-2021). Over the past 10 years, the Ortega Administration and the private sector have established policy cooperation through official mechanisms for consultation, contributing to continued consensus on key economic policies.

We assume that the government's commitment to pragmatic pro-investment policies, in tandem with good relations with official creditors, will support growth and macroeconomic stability in the coming years. Nevertheless, Nicaragua's institutional and governance effectiveness continues to be constrained by weak political checks and balances, as well as by shortfalls in transparency. Political power is highly centralized in the presidency and the governing Frente Sandinista de Liberación Nacional (FSLN). The FSLN controls 71 out of the 92 seats in Congress and faces a weak and divided political opposition.

Criticism over the conduct of national elections held in November 2016 (including the disqualification of some opposition candidates by the country's electoral authority) led the government to ask the Organization of American States (OAS) to observe municipal elections held in November 2017. The FSLN's position was further strengthened by winning 135 of 153 municipal governments. Opposition groups again raised concerns over irregularities in the electoral process.

Electoral controversies have led some members of the U.S. Congress to promote legislation to limit multilateral lending to Nicaragua. The U.S. House of Representatives recently passed the Nicaraguan Investment Conditionality Act, which, if eventually approved by the Senate and signed by the president, would direct the U.S. government to oppose loans (other than for humanitarian purposes) to Nicaragua from multilateral institutions where the U.S. is a member country (including the World Bank and the Inter-American Development Bank). If the act is approved, we assume that it will likely have a limited impact on external funding, affecting only a minor share of such inflows.

Continued GDP growth and expanding public services have led to a steady increase in per capita income and living standards in recent years. We expect real GDP per capita to be $2,200 in 2018, compared with $1,470 10 years ago. The poverty rate is around 25% (from nearly 46% in 2011), and the extreme poverty rate is 7% (from 15%).

We project Nicaragua's economic growth will stabilize around 4.6% in real terms between 2018 and 2021 (3.5% in per capita terms), assuming continued growth in the U.S. and stable domestic economic and political conditions. Growing economic diversification (agriculture, manufacturing, and expanding tourism) and public investment in infrastructure should sustain GDP growth in the coming years. A new cross-country highway that now connects the Pacific and Caribbean coasts will integrate isolated areas and help develop tourism and port activities. Moreover, the country's business environment benefits from low violence compared with other Central American countries. Nicaragua's success in containing crime through innovative policing strategies should continue to support private-sector activity and investment.

In the long term, the government faces the challenge of improving the business environment to boost both domestic and foreign investment. Inadequate worker skills, poor infrastructure, and constraints related to land registration are among the most pressing issues that the government needs to tackle, according to the private sector. Exports remain vulnerable to weaker demand from the U.S., to weather conditions, and to potentially lower commodity prices.

Key Statistics

Table 1

Nicaragua--Selected Indicators										
	2011	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018f**	**2019f**	**2020f**
ECONOMIC INDICATORS (%)										
Nominal GDP (bil. LC)	219.18	247.99	271.53	308.40	347.46	378.66	412.12	457.38	506.64	561.20
Nominal GDP (bil. $)	9.77	10.53	10.98	11.88	12.74	13.23	13.71	14.49	15.29	16.13
GDP per capita ($000s)	1.6	1.7	1.8	1.9	2.0	2.1	2.1	2.2	2.3	2.4
Real GDP growth	6.3	6.5	4.9	4.8	4.9	4.7	4.8	4.7	4.5	4.5
Real GDP per capita growth	5.0	5.2	3.8	3.7	3.8	3.6	3.7	3.6	3.4	3.4
Real investment growth	28.6	7.7	2.7	1.2	21.1	5.6	1.0	4.6	7.0	6.0
Investment/GDP	37.4	34.0	33.5	30.4	34.7	33.0	30.1	30.1	30.8	31.3
Savings/GDP	25.3	23.4	23.4	23.3	26.5	24.4	24.1	23.1	23.2	23.5
Exports/GDP	45.0	47.5	45.2	45.0	40.0	39.0	40.3	40.5	40.7	40.8
Real exports growth	8.3	12.4	3.8	6.4	(1.8)	5.5	8.5	5.0	5.0	5.0
Unemployment rate	5.9	5.9	5.7	6.6	6.6	6.6	6.6	6.6	6.6	6.6

Table 1

Nicaragua--Selected Indicators (cont.)

	2011	2012	2013	2014	2015	2016	2017	2018f	2019f	2020f
EXTERNAL INDICATORS (%)										
Current account balance/GDP	(12.0)	(10.6)	(10.0)	(7.1)	(8.2)	(8.6)	(6.0)	(7.0)	(7.7)	(7.8)
Current account balance/CARs	(21.7)	(18.3)	(18.2)	(13.0)	(16.4)	(16.7)	(11.5)	(13.5)	(14.7)	(15.1)
CARs/GDP	55.6	57.7	55.1	54.6	49.9	51.4	52.6	52.3	52.0	51.6
Trade balance/GDP	(24.8)	(23.2)	(22.5)	(20.2)	(21.5)	(19.7)	(18.8)	(19.4)	(19.8)	(19.7)
Net FDI/GDP	9.5	6.7	6.1	6.7	7.1	6.5	6.5	6.3	6.2	6.2
Gross external financing needs/CARs plus usable reserves	122.2	115.8	117.7	112.5	111.2	106.7	105.5	104.8	106.6	107.2
Narrow net external debt/CARs	93.3	96.6	109.7	104.4	106.2	112.9	107.3	104.9	105.7	107.9
Narrow net external debt/CAPs	76.7	81.7	92.8	92.3	91.2	96.8	96.3	92.4	92.1	93.7
Net external liabilities/CARs	174.4	181.9	208.5	206.6	224.6	233.5	232.7	236.1	242.4	250.1
Net external liabilities/CAPs	143.3	153.8	176.4	182.8	192.9	200.2	208.8	208.0	211.3	217.2
Short-term external debt by remaining maturity/CARs	30.3	24.4	26.3	24.5	23.7	18.6	19.4	19.0	18.8	18.1
Usable reserves/CAPs (months)	2.4	2.4	2.3	2.4	2.7	2.7	2.6	2.8	2.7	2.5
Usable reserves (mil. $)	1,412	1,376	1,444	1,653	1,819	1,731	1,998	2,015	2,024	2,024
FISCAL INDICATORS (%, General government)										
Balance/GDP	1.1	0.6	(0.2)	(0.6)	(0.8)	(1.2)	(1.4)	(1.1)	(1.1)	(1.2)
Change in net debt/GDP	2.9	0.9	4.9	0.3	0.2	3.7	2.9	2.0	2.0	2.0
Primary balance/GDP	2.1	1.6	0.8	0.2	0.1	(0.2)	(0.3)	0.1	0.0	(0.1)
Revenue/GDP	23.0	23.4	23.2	23.6	24.5	25.4	25.9	25.8	25.8	25.9
Expenditures/GDP	21.9	22.8	23.4	24.2	25.2	26.6	27.3	26.9	26.9	27.1
Interest /revenues	4.5	4.3	4.0	3.7	3.6	3.9	4.1	4.6	4.3	4.2
Debt/GDP	53.5	50.8	51.3	47.8	44.5	44.9	46.4	44.8	43.3	42.1
Debt/Revenue	233.3	216.9	220.8	202.7	181.6	176.5	179.3	173.6	168.0	162.5
Net debt/GDP	39.6	35.9	37.7	33.5	29.9	31.1	31.5	30.4	29.4	28.6
Liquid assets/GDP	14.0	14.9	13.6	14.3	14.6	13.8	14.9	14.4	13.9	13.5
MONETARY INDICATORS (%)										
CPI growth	8.1	7.2	7.1	6.0	4.0	3.5	3.9	6.0	6.0	6.0
GDP deflator growth	10.2	6.2	4.3	8.4	7.5	4.1	3.9	6.0	6.0	6.0
Exchange rate, year-end (LC/$)	22.98	24.13	25.33	26.60	27.93	29.32	30.79	32.33	33.95	35.64
Banks' claims on resident non-gov't sector growth	15.6	25.8	20.1	20.5	24.7	17.2	12.0	11.0	10.8	10.8
Banks' claims on resident non-gov't sector/GDP	24.2	26.9	29.5	31.3	34.7	37.3	38.3	38.3	38.3	38.3
Foreign currency share of claims by banks on residents	0.0	60.7	62.4	62.9	63.8	65.0	64.3	64.4	64.6	64.7

Table 1

Nicaragua--Selected Indicators (cont.)

	2011	2012	2013	2014	2015	2016	2017	2018f	2019f	2020f
Real effective exchange rate growth	(4.0)	2.1	0.4	0.6	5.1	(0.8)	N/A	N/A	N/A	N/A

Note: 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 assets held by nonresidents minus financial-sector loans to, deposits with, or investments in nonresident entities. A negative number indicates net external lending. 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. f--Forecast. LC--Local currency. CARs--Current account receipts. FDI--Foreign direct investment. CAPs--Current account payments. N/A--Not available.

Ratings Score Snapshot

Table 2

Nicaragua--Ratings Score Snapshot

Key rating factors	Assessments
Institutional assessment	4
Economic assessment	5
External assessment	6
Fiscal assessment: flexibility and performance	3
Fiscal assessment: debt burden	1
Monetary assessment	5

Note: 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

- 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: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- General Criteria: Methodology: Criteria For Determining Transfer And Convertibility Assessments, May 18, 2009

Related Research

- Sovereign Ratings History, Feb. 7, 2018
- Banking Industry Country Risk Assessment Update: February 2018, Feb. 2, 2018

- Sovereign Risk Indicators, also available at www.spratings.com/sri
- Latin American And Caribbean Sovereign Rating Trends 2018, Jan. 11, 2018
- Global Sovereign Rating Trends 2018, Jan. 10, 2018
- Q&A: How Will Global Sovereigns Fare In 2018?, Dec. 20, 2017
- Stronger Growth In Latin America For 2018, But Downside Risks Are Substantial, Nov. 30, 2017
- How Corruption May Affect Sovereign Ratings In Latin America, Nov. 28, 2017
- 2016 Sovereign Ratings Update: Outlook And CreditWatch Resolutions, April 18, 2017
- 2016 Annual Sovereign Default Study And Rating Transitions, April 3, 2017
- Sovereign Debt 2017: Global Borrowing To Drop By 4% To US$6.8 Trillion, Feb. 23, 2017

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 agreed that the fiscal and debt assessments had improved. All other key rating factors were unchanged.

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

Ratings Affirmed

Nicaragua	
Sovereign Credit Rating	B+/Stable/B
Transfer & Convertibility Assessment	BB-

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.