FitchRatings

RATING ACTION COMMENTARY

Fitch Upgrades Nicaragua's Ratings to 'B'; Outlook Stable

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Fitch Ratings - New York - 30 May 2024: Fitch Ratings has upgraded Nicaragua's Long-Term Foreign and Local Currency Issuer Default Ratings (IDRs) to 'B' from 'B-'. The Rating Outlook is Stable.

A full list of rating actions is at the end of this rating action commentary.

KEY RATING DRIVERS

Ratings Upgrade: The upgrade of Nicaragua's ratings reflects prudent policy settings that have led to twin surpluses and the accumulation of financial buffers. This has placed the sovereign in a stronger position to manage the adverse economic consequences of sanctions and broader political tensions. A large current account surplus has allowed for a significant build-up in international reserves, and a fiscal surplus is driving a reduction in debt/GDP and accumulation in cash buffers.

These developments should help the sovereign better manage challenges regarding its narrowing external borrowing options and increased reliance on a single regional lender, which remains a key rating constraint. The ratings are also constrained by low per-capita GDP, narrow local-currency financing flexibility, and weak governance indicators.

Record Fiscal Surplus: Nicaragua's general government surplus rose to 2.8% of GDP in 2023 from 1.0% in 2022, its highest level on record. This strong fiscal position reflects large revenue gains from tax reforms during 2019-2022, and a further improvement in 2023 from tight spending control and the lower cost of fuel subsidies. Fitch projects a fiscal surplus of 2.0% of GDP in coming years.

Social Security Challenge: The social security institute (INSS) continues to present a medium-term fiscal challenge, having relied on central government support since exhausting its reserves in 2018. However, its deficit has remained manageable at 0.5% of GDP after partial parametric changes and a job market recovery.

Debt Reduction; Cash Build-up: A fiscal surplus and external financing have buoyed the sovereign's cash-flow position, which it has used to reduce the stock of higher-interest local bonds and build up its large cash cushion. General government debt fell to 44.5% of GDP in 2023 and will remain on a firm downward path. Deposits have risen considerably to 13.1% of GDP.

CABEI Reliance: Heightened international tensions have resulted in a significant reduction of funding from many multilateral banks, partly because of opposition from the United States, which is linked to the imposition of sanctions. This has rendered the sovereign increasingly reliant on regional lender CABEI, which in 2023 represented nearly all of the sovereign's net external financing (i.e. after repayments).

CABEI's already large exposure to Nicaragua, as well as a recent change in its presidency amid calls for stricter consideration of human rights, pose some uncertainty about how much funding it will continue to provide. Fitch assumes some reduction in CABEI disbursements compared to the large amounts seen in prior years, but views the sovereign as better placed to navigate this in light of its strong fiscal position.

Current Account Shifts to Surplus: The current account shifted to a surplus of 7.7% of GDP in 2023 from a 2.5% deficit in 2022. This large improvement reflects a 44% surge in remittances (following another large surge of 49% in 2022) due to outward migration and strong U.S. labor market. Inward FDI moderated somewhat, but remained strong at 6.9% of GDP, supporting a combined current account + FDI surplus of 14.5%, which is one of the strongest among peers. "Errors and omissions" in balance-of-payments data have grown considerably to 6% of GDP as of 2023. The nature of this is unclear, but it has not prevented significant reserve accumulation.

Reserves at Record High: The current account surplus and continued external financing have enabled the central bank (BCN) to continue growing its international reserve position, which at USD5.7 billion as of April 2024 has more than doubled since a dip during the 2018-2019 crisis. The BCN has also been paying off USD-denominated notes issued in prior years to build up reserves. Reserves now cover 80% of broad money, and approximately six months of current external payments, well above the 'B' peer median. Reserve accumulation has widely outpaced the increase in sovereign external indebtedness, improving the sovereign net foreign debtor position to 17% of GDP in 2023 from 30% in 2019.

Sustained Growth Momentum: Economic growth in Nicaragua accelerated to 4.6% in 2023, consolidating its recovery from previous years' socio-political issues and the pandemic. Private consumption has been the main driver of growth, fueled by credit expansion and a significant rise in remittances (+45% in 2023). Public investment has moderated from high levels, whereas private investment has been strong, but remains well below pre-crisis levels.

Sanctions, Emigration Wave: Fitch expects economic growth to normalize to a 3.2% trend pace over the medium term. Political tensions persist under the administration of President Daniel Ortega, as it continues a crackdown on civil society groups. This has led to new sanctions from the U.S., but targeted on specific individuals and entities, and thus without major economic effects. Fitch believes political developments have posed greater economic consequences via their effects on migration and the country's attractiveness as a place to invest, rather than via sanctions.

Various private estimates indicate a large share of the population has emigrated since 2021 despite a strong economic recovery, suggesting likely political drivers. However, this has also meant a surge in inbound remittances that have mostly offset negative economic effects. Inbound foreign direct investment (FDI) remains high, but with a much higher share of reinvested earning as opposed to new equity inflows, relative to the past.

Inflation Moderates: Inflation has moderated significantly to 5.4% yoy as of April, after experiencing the greatest shock in Central America in the past several years. The BCN has kept its monetary policy at 7.0% since the end of 2022, maintaining a positive differential relative to the U.S. Fed, and as of 2024 has reduced the pace of depreciation under its crawling peg regime to 0%. Credit growth rose to 17.5% in 2023 from 15.8% in 2022, and is likely to remain in double-digits in 2024-2025, given reducing but still abundant liquidity in the sector, and continued normalization in demand and supply conditions following the retrenchment during the past economic crisis.

Country Ceiling Upgrade: Fitch has upgraded Nicaragua's Country Ceiling to 'B+' from 'B-', introducing a +1 notch uplift over the Foreign Currency IDR. This reflects Fitch's view that the risks of imposition of FX controls are limited by the sovereign's free trade agreements, which has been demonstrated by the absence of any such controls during recent crises. Fitch does not anticipate U.S. sanctions with major adverse effects on the private sector.

ESG - Governance: Nicaragua has an ESG Relevance Score (RS) of '5' for both Political Stability and Rights and for the Rule of Law, Institutional and Regulatory Quality and Control of Corruption, as is the case for all sovereigns. These scores reflect the high weight that the Worldwide Governance Indicators have in our proprietary Sovereign Rating Model. Nicaragua has a low WBGI percentile ranking of 16, reflecting episodes of political violence, weak political participation rights and uneven application of the law.

RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

--Structural: Political developments that severely impair macroeconomic stability; for example, due to a tightening of international sanctions and/or social unrest.

--Macro: Policy slippage that results in depletion of financial buffers and heightens macroeconomic vulnerabilities.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

--Structural: Improvements in governance that result in rollback of international tensions and sanctions, enhanced external financing flexibility, and strengthening of the business climate.

--Macro: Maintenance of prudent policy settings and strong economic growth that deliver significant further improvements in financial buffers and public debt/GDP.

SOVEREIGN RATING MODEL (SRM) AND QUALITATIVE OVERLAY (QO)

Fitch's proprietary SRM assigns Nicaragua a score equivalent to a rating of 'B-' on the Long-Term Foreign-Currency (LT FC) IDR scale.

Fitch's sovereign rating committee adjusted the output by +1 notches from the SRM score to arrive at the final LT FC IDR of 'B' by applying its QO, relative to SRM data and output, as follows:

--Macro: +1 notch, introduced to offset the impact of high inflation and GDP growth volatility variables that are still adversely impacting the SRM output, but which are projected to improve in the forecast period.

Fitch's SRM is the agency's proprietary multiple regression rating model that employs 18 variables based on three-year centered averages, including one year of forecasts, to produce a score equivalent to a LT FC IDR. Fitch's QO is a forward-looking qualitative framework designed to allow for adjustment to the SRM output to assign the final rating, reflecting factors within our criteria that are not fully quantifiable and/or not fully reflected in the SRM.

COUNTRY CEILING

The Country Ceiling for Nicaragua is 'B+', one notch above the LT FC IDR. This reflects moderate constraints and incentives, relative to the IDR, against capital or exchange controls being imposed that would prevent or significantly impede the private sector from converting local currency into foreign currency and transferring the proceeds to non-resident creditors to service debt payments.

Fitch's Country Ceiling Model produced a starting point uplift of +1 notch above the IDR. Fitch's rating committee did not apply a qualitative adjustment to the model result.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

Nicaragua has an ESG Relevance Score of '5' for Political Stability and Rights as Worldwide Governance Indicators have the highest weight in Fitch's SRM and are therefore highly relevant to the rating and a key rating driver with a high weight. As Nicaragua has a percentile rank below 50 for the respective Governance Indicator, this has a negative impact on the credit profile.

Nicaragua has an ESG Relevance Score of '5' for Rule of Law, Institutional & Regulatory Quality and Control of

Corruption as Worldwide Governance Indicators have the highest weight in Fitch's SRM and are therefore highly relevant to the rating and are a key rating driver with a high weight. As Nicaragua has a percentile rank below 50 for the respective Governance Indicator, this has a negative impact on the credit profile.

Nicaragua has an ESG Relevance Score of '4' for Human Rights and Political Freedoms as the Voice and Accountability pillar of the Worldwide Governance Indicators is relevant to the rating and a rating driver. As Nicaragua has a percentile rank below 50 for the respective Governance Indicator, this has a negative impact on the credit profile.

Nicaragua has an ESG Relevance Score of '4' for Creditor Rights as willingness to service and repay debt is relevant to the rating and is a rating driver for Nicaragua, as for all sovereigns. As Nicaragua has a fairly recent restructuring of public debt in 2008, this has a negative impact on the credit profile.

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/topics/esg/products#esg-relevance-scores.

RATING ACTIONS

ENTITY / DEBT	RATING			PRIOR
Nicaragua	LT IDR	B	Upgrade	B-
	ST IDR	B	Affirmed	B
	LC LT IDR	B	Upgrade	B-
	LC ST IDR	B	Affirmed	B
	Country Ceiling	B+	Upgrade	B-

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VIEW ADDITIONAL RATING DETAILS

Additional information is available on www.fitchratings.com

PARTICIPATION STATUS

The rated entity (and/or its agents) or, in the case of structured finance, one or more of the transaction parties participated in the rating process except that the following issuer(s), if any, did not participate in the rating process, or provide additional information, beyond the issuer's available public disclosure.

APPLICABLE CRITERIA

- Sovereign Rating Criteria (pub. 06 Apr 2023) (including rating assumption sensitivity)
- Country Ceiling Criteria (pub. 24 Jul 2023)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

- Country Ceiling Model, v2.0.1 (1)
- Debt Dynamics Model, v1.3.2 (1)
- Macro-Prudential Indicator Model, v1.5.0 (1)
- Sovereign Rating Model, v3.14.1 (1)

ADDITIONAL DISCLOSURES

- Dodd-Frank Rating Information Disclosure Form
- Solicitation Status
- Endorsement Policy

ENDORSEMENT STATUS

Nicaragua EU Endorsed, UK Endorsed

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