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INTERNATIONAL MONETARY FUND AND
INTERNATIONAL DEVELOPMENT ASSOCIATION

REPUBLIC OF NICARAGUA

Addendum to the Joint Staff Advisory Note on the Poverty Reduction Strategy Paper

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1. **This addendum to the Joint Staff Advisory Note (JSAN) on Nicaragua's Poverty Reduction Strategy Paper updates Executive Directors of developments** since the JSAN was distributed to the Boards of the Fund and the Bank on April 22, 2010.[1]

2. **Board discussion on the JSAN was delayed.** The JSAN was originally expected to be discussed at the Fund Board on May 5, 2010, together with the Article IV and the Fourth Review of the ECF-supported program, and at the Bank Board on May 18, 2010. However, Board discussion was postponed following a decision in late-April by the Nicaraguan authorities to grant a large wage increase to government employees, breaching understandings under the Fund-supported program. The wage bonus would increase the wage bill by ½ percent of GDP in 2010, and imply a 10 percent increase in the nominal wage bill (instead of the 3½ agreed percent under the program). Discussions are ongoing between Fund Staff and the Nicaraguan authorities to identify measures that would allow bringing the ECF-supported program back on track.

3. **The thrust of the JSAN remains broadly unchanged,** but there are a few new elements that Executive Directors may want to consider in their consideration and discussion of the JSAN.

4. **Signs of an incipient economic recovery are emerging.** After a GDP contraction of over 1½ percent in 2009, there are indications that the economy is bottoming out. The index of economic activity increased by 1.1 percent in the first quarter of 2010 (q-o-q, SA), with significant recoveries in agriculture, industry and commerce. Also, in line with regional trends, exports, imports and remittances have picked up, fiscal revenues have rebounded (particularly on the trade side), and the demand for currency has strengthened. Inflation remains contained though rising

[1] The JSAN is expected to be discussed by the IMF Executive Board together with Nicaragua's 2010 Article IV consultation.

commodity prices are putting upward pressure (cumulative inflation through May reached 3.9 percent). Projected real GDP growth for 2010 remains at about 1¾ percent, on the back of improved prospects for global demand.

Election-related spending pressures are also emerging, though the fiscal deficit is projected to decline to 3.3 percent of GDP in 2010 (down from 3.9 percent in 2009), on the back of a combination of tax, expenditure and pension measures. The authorities have indicated that the wage bonus granted in May will be financed with a grant from Venezuela and will be treated off-budget, thereby not affecting the 2010 fiscal deficit. Going forward, it will be essential to rationalize expenditures, including by containing the growth in public sector wages, reducing large budgetary earmarks and streamlining generalized subsidies, to put public debt on a firmly declining path, and to create the space for higher pro-poor spending.