

Costa Rica

1. General trends

Real GDP in Costa Rica grew by 2.6% compared with 7.8% in 2007. Per capita GDP was up 0.9%, well below the rate for prior years. Inflation ended the year at 13.9% (10.8% in 2007). The unemployment rate stood at 4.9%, following a reverse in the downward trend seen in recent years. The public-sector balance showed a small deficit, while the central government balance was slightly positive. The balance-of-payments current account deficit increased significantly from 6.3% of GDP in 2007 to 9% in 2008.

In an effort to mitigate the negative effects of external shocks that occurred during the year, the government applied macroeconomic policy measures such as increased social spending and changes in monetary and exchange-rate policies. Activity in the production sectors suffered a widespread deceleration in 2008, particularly in agriculture and manufacturing which experienced negative growth. The negative repercussions of the international crisis took the form of a strong drop in exports and tourism income in Costa Rica. Higher inflation was due to rising world prices for fuel and raw materials, along with growth in domestic demand in the first half of the year.

According to ECLAC estimates, GDP will slip by 3% in real terms in 2009, mainly owing to weakened exports and consumption. As was the case in 2008, external demand is expected to fall and tourist arrivals to drop. Flows of foreign direct investment (FDI) are also expected to weaken. Private consumption will be dented by falling real household income. Given that inflationary pressures have subsided, inflation is expected to remain in single digits. The fiscal deficit will rise owing to declining revenues and the need for higher spending, while the external deficit will shrink as a result of improved terms of trade. The Dominican Republic-Central America-United States Free Trade Agreement (CAFTA-DR) entered into force on 1 January 2009.

2. Economic policy

Macroeconomic policy in 2008 faced shifting challenges arising from different types of external turmoil. In the first four months of the year, capital inflows were strong, which led to exchange-rate appreciation and a reduction in interest rates. Inflation picked up from May onwards and the exchange rate moved towards the ceiling of the band, which translated into a surge in interest rates.

(a) Fiscal policy

The narrowly-defined global public sector (which includes the non-financial public sector and the central bank) posted a negative balance of 0.4% of GDP, as compared with a surplus of 0.8% in 2007. This result was due to an increase in the non-financial public sector deficit, despite the reduction of the central bank's deficit.

The central government posted a surplus for the second year in a row, equivalent to 0.2% of GDP and slightly smaller than the 2007 surplus (0.6%).

The central government's current revenue grew by 3.9% in real terms, significantly less than the 2007 figure (16%). Reflecting modest growth in GDP, the tax burden rose slightly from 15.2% in 2007 to 15.7% in 2008. The slowdown in economic activity impacted negatively on revenues from taxes on sales, external trade and income.

Central government spending rose by 6.6% in real terms (4% in 2007). Current and capital transfers, mainly for social housing programmes, welfare payments, education and road infrastructure, were the fastest growing item (13.7%). As part of the measures taken to mitigate the effects of the crisis, the central government transferred resources to non-contributory pension schemes and disbursed US\$ 117.5 million to capitalize State banks.

The rest of the non-financial public sector posted a deficit equivalent to 0.4% of GDP, as compared with a 1% surplus in 2007, as a result of the weakening financial position of State enterprises. For a third straight year, the central bank deficit was smaller than the previous year (0.2% of GDP compared with 0.7% in 2007), reflecting lower interest rates, exchange-rate earnings and fewer open-market operations.

External public debt decreased slightly in 2008, to US\$ 3.629 billion (US\$ 3.637 billion in 2007). As a proportion of GDP, this drop was significant: from 13.8% in 2007 to 12.2% in 2008. Domestic public debt fell from 32.7% of GDP in 2007 to 27.1% in 2008. Net issue of debt was lower than in 2007, thanks to the central government's financial surplus and the smaller deficit posted by the central bank.

Tax authorities have been under pressure in 2009, faced with falling revenues due to slowing economic activity, on the one hand, and increased spending—a key element in countercyclical policies—on the other. Overall public sector debt is expected to reach approximately 4% of GDP. In the early months of 2009, the government's plan for addressing the crisis (Plan Escudo) was hampered by lack of capacity to invest in infrastructure, delays in the approval of international loans and falling public revenues. In the first four months of the year, total central government revenues dropped 8.5% in nominal terms (21% in real terms) as compared with the same period in 2008.

(b) Monetary and exchange-rate policy

In 2008 monetary and exchange-rate policy focused on counteracting the negative effects of international market turmoil and easing inflationary pressure, in the framework of a transition towards a flexible exchange

rate. Throughout the year, the problem known as the “impossible trinity” worsened. This term refers to the great difficulty that countries face in simultaneously controlling exchange rates and maintaining monetary independence in an environment of free movement of capital.

Exchange-rate and interest-rate patterns in 2008 fell into two distinct periods. In the first four months of the year, the nominal exchange rate rose more than 5% against the dollar, due chiefly to capital inflows. Despite strong inflationary pressure, the monetary policy interest rate was lowered from 6% to 3.25% in January as a result of lower interest rates in the United States and other trading partners, and in an attempt to discourage capital inflows.

Starting in May, the exchange rate hovered at the upper limit of the band, as the weakened external accounts eroded economic expectations for the short and medium terms. The parameters of the band were adjusted in July in an effort to reduce volatility. Given this pressure on the exchange rate and rising inflation, the authorities raised the monetary policy interest rate four times until it hit 10.87% in August. The increase in nominal rates during the second half of the year, together with the rise in inflation, led to a negative average real deposit rate at year's end (-5.6%). The average real lending rate in the financial system closed the year at 6.8%.

Capital inflows drove the central bank's net international reserves to a record high of US\$ 4.937 billion in April 2008. The central bank was forced to intervene in the currency market as of May in order to alleviate pressure on the exchange rate. As a result, net international reserves gradually decreased, reaching US\$ 3.799 billion at year's end (7.6% down on the figure at the end of 2007).

At the close of 2008, the nominal exchange rate stood at 553 colones per dollar, 8.3% higher than in December 2007, while the yearly average was 526.2 colones. The real bilateral exchange rate against the dollar rose for the fourth consecutive year (2.5%), while the real effective exchange rate (with all of Costa Rica's trading partners) went up 3.2%.

M1 grew by 1.5% in 2008 (22.6% in 2007). Higher inflation, exchange-rate volatility and negative interest rates on deposits encouraged long-term deposits, principally in foreign currency. Long-term deposits in national currency were up by 19.4%, while those in foreign currency expanded by 40%. This represented an increase in dollarization and put an end to the de-dollarization trend observed in the previous three years. Foreign-currency deposits made up 47% of M3 (broad money), as compared with 41.4% in 2007.

Credit to the private sector grew significantly thanks to the drop in interest rates during the first half of 2008. Total credit was up 32% in nominal terms, compared

with 38.7% in 2007. The increase was particularly sharp in loans to construction (50.1%), services (48.3%) and housing (40.4%), while consumer credit was up 29.9%. Lending slowed in the last months of 2008, owing to higher interest rates and tighter credit conditions.

The international crisis posed little complication for the stability of the Costa Rican financial system in the early months of 2009. The exchange rate maintained its earlier course. In July, the nominal exchange rate was 5% higher than in December 2008. As part of the Plan Escudo, loans from the International Monetary Fund (IMF), the World Bank and the Inter-American Development Bank (IDB) should be sufficient to maintain fiscal and external solvency in the Costa Rican economy in 2009.

(c) Trade policy

CAFTA-DR was approved by referendum in October 2007, paving the way for preparations to implement the

Agreement. The implementation agenda was discussed in 2008. Following intensive negotiations, the complete package of bills was passed in November, ready to enter into force in January 2009.

The government of President Arias continued to take measures to strengthen trade relations with Asia. In 2008 it was agreed to begin negotiations on a free trade agreement with China—Costa Rica's second largest trading partner—and the first rounds of talks took place in 2009. Negotiations for a free trade agreement with Singapore were also begun.

Eight rounds of negotiations for an association agreement between Central America and the European Union were held during 2008 and the first semester of 2009. The process is expected to conclude in 2009. With respect to Central American integration, the countries concluded negotiations on the 2009-2011 Multi-Year Plan of the Central American Integration System and signed off on the Plan.

3. The main variables

(a) Economic activity

The slowdown in real GDP growth in 2008 was attributable mainly to a drop-off in exports—the engine of growth during the recent expansionary cycle—and slacker consumption. Aggregate demand slowed (3.4% compared with 6.6% in 2007), owing to smaller expansion in consumption (4.3% compared with 6.8% in 2007) and a decrease in exports of goods and services, which were down 1.3% in real terms. Consumption was impacted by higher inflation and more sluggish economic activity, as well as strongly deteriorating expectations. Gross fixed investment was up significantly (11.9%) due to inertial growth in private construction and public investment in infrastructure.

Manufacturing was the hardest hit industry in 2008, shrinking by 4.3%. Production in free zones, which makes up 41% of manufacturing, shrank by 7.9%. Growth in the agriculture, livestock, forestry and fishing sector declined 2.3% owing to shrinking external demand and supply issues (including weather and pests). The construction sector expanded by 13.1%, slightly above half the rate for 2007. Growth in the commerce, restaurants and hotels sector was down 3.8%, while the financial services and insurance sector remained buoyant (9%).

In April 2009, the monthly economic activity index (IMAE) showed a negative average monthly variation (-5.2%), marking seven straight months of contraction. The worst hit sectors were manufacturing (-16.1%), hotels (-15.9%) and agriculture (-8.1%). Construction contracted by an average of 3.7%.

(b) Prices, wages and employment

The inflation rate—as measured by the consumer price index (CPI)—rose in 2008 for the second straight year, closing at 13.9% (10.8% in 2007) and exceeding the central bank's target rate (8% with a one-point margin on either side). The main drivers of inflation were food and non-alcoholic beverages, transport and housing services. This rise in the rate reflected higher international prices, buoyant domestic demand in the first semester, increased lending to the private sector and the difficulty of keeping the inflation outlook close to target amid severe external shocks. Food prices had a strong impact on the year-on-year core inflation rate (14.0%).

The open unemployment rate stood at 4.9%, slightly higher than the 2007 figure (4.6%). The effects of the crisis were lagged in the real sector and the repercussions on employment are therefore expected to be greater in

Table 1
COSTA RICA: MAIN ECONOMIC INDICATORS

	2000	2001	2002	2003	2004	2005	2006	2007	2008 ^a
Annual growth rates^b									
Gross domestic product	1.8	1.1	2.9	6.4	4.3	5.9	8.8	7.8	2.6
Per capita gross domestic product	-0.5	-1.0	0.9	4.4	2.4	4.0	6.9	6.0	0.9
Gross domestic product, by sector									
Agriculture, hunting, forestry and fishing	0.7	1.4	-3.3	7.4	0.7	4.3	12.7	5.1	-2.3
Mining and quarrying	6.3	6.4	-3.1	4.2	7.7	7.6	25.7	-1.6	-3.1
Manufacturing	-2.9	-9.1	3.4	8.4	4.0	10.8	10.8	7.0	-4.3
Electricity, gas and water	6.4	4.1	5.3	5.8	4.0	5.9	6.1	2.4	3.1
Construction	4.4	14.4	-1.5	4.8	6.3	-0.2	18.2	21.6	13.1
Wholesale and retail commerce, restaurants and hotels	1.5	1.9	1.6	3.4	3.9	4.0	4.8	6.8	3.8
Transport, storage and communications	10.2	9.2	12.0	13.7	12.0	9.6	10.5	9.1	7.7
Financial institutions, insurance, real estate and business services	8.1	6.8	4.8	7.1	6.6	5.4	11.1	9.2	10.4
Community, social and personal services	2.6	2.0	3.0	3.0	1.4	3.3	2.3	3.7	3.6
Gross domestic product, by type of expenditure									
Final consumption expenditure	1.1	1.5	3.0	2.8	2.9	3.9	5.4	6.8	4.3
Government consumption	1.4	3.6	2.3	-0.3	1.3	0.2	2.9	2.2	2.4
Private consumption	1.0	1.2	3.1	3.2	3.1	4.4	5.7	7.4	4.5
Gross domestic investment	-0.9	2.6	6.6	7.2	-0.5	4.3	10.8	18.0	12.3
Exports (goods and services)	-0.1	-9.6	3.6	12.1	8.2	12.8	10.3	10.0	-1.3
Imports (goods and services)	-2.6	1.3	6.9	0.9	9.1	12.4	8.1	4.5	5.0
Percentages of GDP									
Investment and saving^c									
Gross domestic investment	16.9	20.3	22.6	20.6	23.1	24.3	26.4	24.6	25.6
National saving	12.6	16.6	17.5	15.6	18.9	19.4	21.9	18.3	16.5
External saving	4.3	3.7	5.1	5.0	4.3	4.9	4.5	6.3	9.0
Millions of dollars									
Balance of payments									
Current account balance	-691	-603	-857	-880	-791	-981	-1 023	-1 647	-2 676
Goods balance	-210	-820	-1 278	-1 089	-1 421	-2 159	-2 727	-2 985	-4 813
Exports, f.o.b.	5 813	4 923	5 270	6 163	6 370	7 099	8 102	9 299	9 738
Imports, f.o.b.	6 024	5 743	6 548	7 252	7 791	9 258	10 829	12 285	14 551
Services trade balance	679	746	685	776	857	1 116	1 351	1 733	2 111
Income balance	-1 252	-679	-440	-776	-440	-209	4	-865	-407
Net current transfers	93	151	175	209	212	270	349	470	433
Capital and financial balance ^d	539	616	1 020	1 219	872	1 374	2 053	2 795	2 328
Net foreign direct investment	400	451	625	548	733	904	1 371	1 634	2 010
Other capital movements	138	165	395	671	139	470	682	1 161	318
Overall balance	-152	13	163	339	80	393	1 031	1 148	-348
Variation in reserve assets ^e	152	-13	-163	-339	-80	-393	-1 031	-1 148	348
Other external-sector indicators									
Real effective exchange rate (index: 2000=100) ^f	100.0	97.5	98.6	104.5	106.1	107.3	106.2	103.5	100.0
Terms of trade for goods (index: 2000=100)	100.0	98.4	96.9	95.5	91.9	88.3	85.8	84.9	81.7
Net resource transfer (millones de dólares)	-714	-63	580	443	432	1 166	2 058	1 930	1 921
Gross external public debt (millions of dollars)	5 307	5 265	5 310	5 575	5 710	6 485	6 994	8 341	9 082
Average annual rates									
Employment									
Labour force participation rate ^g	53.6	55.8	55.4	55.5	54.4	56.8	56.6	57.0	56.7
Open unemployment rate ^h	5.2	6.1	6.4	6.7	6.5	6.6	6.0	4.6	4.9
Visible underemployment rate ^h	10.5	11.3	12.3	15.2	14.4	14.6	13.5	11.5	10.5
Prices									
Annual percentages									
Variation in consumer prices (December-December)	10.2	11.0	9.7	9.9	13.1	14.1	9.4	10.8	13.9
Variation in industrial producer prices (December-December)	10.2	8.6	8.4	11.0	17.7	12.1	13.7	14.6	23.5
Variation in nominal exchange rate (annual average)	7.9	6.7	9.4	10.8	9.8	9.2	7.0	1.0	1.9
Variation in average real wage	0.8	1.0	4.1	0.4	-2.6	-1.9	1.6	1.4	-1.5
Nominal deposit rate ⁱ	15.3	13.4	14.0	12.6	11.5	12.1	11.4	7.1	5.4
Nominal lending rate ⁱ	28.1	26.7	26.8	26.2	23.4	24.0	22.7	17.3	16.7

Table 1 (concluded)

	2000	2001	2002	2003	2004	2005	2006	2007	2008 ^a
	Percentages of GDP								
Non-financial public sector									
Total income	23.5	25.5	24.7	25.0	24.4	25.2	25.8	26.7	26.8
Current income	24.0	24.8	24.8	24.7	24.4	25.2	25.8	26.7	26.9
Tax income	18.5	19.6	19.8	19.9	19.7	20.2	20.7	22.2	22.8
Capital income	-0.5	0.7	-0.1	0.4	-0.0	-0.0	-0.0	-0.0	-0.1
Total expenditure ^k	25.0	27.1	28.6	27.4	26.4	25.6	24.5	24.8	26.9
Current expenditure	20.6	22.2	23.3	22.8	22.2	21.8	21.0	20.7	21.1
Interest	3.6	4.0	4.3	4.3	4.1	4.2	3.8	3.1	2.2
Capital expenditure	4.4	4.8	5.2	4.5	4.1	3.8	3.5	4.1	5.3
Primary balance	2.0	2.4	0.4	1.9	2.1	3.8	5.2	4.9	2.1
Overall balance	-1.6	-1.6	-3.9	-2.4	-2.0	-0.4	1.3	1.8	-0.1
Non-financial public sector debt									
Domestic	41.8	43.2	45.1	45.6	46.9	42.9	38.4	31.9	29.9
External	26.9	28.1	28.7	27.0	27.6	25.5	23.4	19.6	18.1
	14.9	15.2	16.4	18.6	19.3	17.4	15.0	12.3	11.8
Money and credit^l									
Domestic credit	28.6	27.5	31.2	33.3	36.1	36.8	36.3	39.7	45.0
To the public sector	7.5	3.8	5.6	6.5	9.0	6.7	4.4	2.2	2.2
To the private sector	21.0	23.5	25.4	26.5	26.7	29.4	31.1	36.6	41.7
Other	0.1	0.1	0.1	0.3	0.4	0.7	0.8	0.9	1.1
Liquidity (M3)	33.4	33.8	36.3	37.1	42.6	44.0	44.3	43.8	46.8
Currency outside banks and local-currency deposits (M2)	20.0	19.1	20.4	20.9	21.0	22.3	23.5	25.7	24.8
Foreign-currency deposits	13.3	14.7	16.0	16.2	21.6	21.7	20.8	18.2	22.0

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

^a Preliminary figures.

^b Based on figures in local currency at constant 1991 prices.

^c Based on figures in local currency expressed in dollars at current prices.

^d Includes errors and omissions.

^e A minus sign (-) denotes an increase in reserves.

^f Annual average, weighted by the value of goods exports and imports.

^g Economically active population as a percentage of the working-age population; nationwide total.

^h Percentage of the economically active population; nationwide total.

ⁱ 90-day deposits at State-owned banks.

^j Rate on loans to industry from State-owned banks.

^k Includes net lending.

^l The monetary figures are end-of-year stocks.

2009. As a result of the rise in inflation, the real minimum wage index fell 1.3%.

The inflation target set by the central bank for 2009 was 9%, with a tolerance of one percentage point on either side. Inflationary pressure has eased, given falling international prices and the slowdown of economic activity. In the first five months of 2009, cumulative inflation was 1.04% (5.08% for the same period in 2007), whereas year-on-year inflation reached 9.52% (11.9% in 2008). The inertia caused by three decades of inflation in excess of 10% makes the achievement of a significant reduction in inflation a challenge for Costa Rica.

(c) The external sector

The current account deficit increased significantly in 2008. Goods exports amounted to US\$ 9.738 billion, which represents a growth rate of 4.7%, well below the average for the three previous years. Of the increase in export value, 56% may be attributed to greater volumes and the rest to higher prices.

Non-traditional exports grew only 3.2% owing to falling exports from free zones and maquila industries. In particular, exports of clothing and modular circuitry parts dropped significantly. Traditional exports, on the other hand, grew by 7% thanks to coffee and meat exports, which were driven by international price rises.

Imports of goods were up by 18.4% in 2008 (13.4% in 2007), reflecting rising global prices for fuels and raw materials. As a consequence, the merchandise trade deficit widened to US\$ 4.813 billion (US\$ 2.986 billion in 2007), or approximately 16% of GDP. Imports of intermediate goods jumped 21.5%, especially goods for agriculture (64.3%), fuels and lubricants (45.8%) and construction materials (40.7%). The terms of trade deteriorated for the eighth consecutive year (-3.8%). They have worsened by 18.3% this decade.

Services exports grew considerably (15.3%), particularly the “other services” category. Tourism revenues slowed (11.1% growth compared with 18.7% in 2007) because of the international crisis. The positive services balance (US\$ 2.111 billion) helped offset the deficit in the goods trade balance. The income balance

Table 2
COSTA RICA: MAIN QUARTERLY INDICATORS

	2007				2008 ^a				2009 ^a	
	I	II	III	IV	I	II	III	IV	I	II
Gross domestic product (variation from same quarter of preceding year) ^b	7.5	8.6	7.2	7.9	6.1	3.5	2.8	-1.8	-4.8	...
Goods exports, f.o.b. (millions of dollars)	2 252	2 414	2 287	2 384	2 408	2 521	2 404	2 171	2 061	...
Goods imports, c.i.f. (millions of dollars)	3 004	3 003	3 304	3 642	3 610	4 105	4 087	3 569	2 539	...
Gross international reserves (millions of dollars)	3 492	3 734	3 886	4 114	4 891	4 334	3 814	3 799	4 167	3 971
Real effective exchange rate (index: 2000=100) ^c	104.4	104.5	103.3	101.8	98.6	101.0	103.9	96.7	96.1	99.1 ^d
Consumer prices (12-month percentage variation)	9.2	8.7	9.4	10.8	11.0	12.8	15.8	13.9	12.3	8.2
Average nominal exchange rate (colones per dollar)	519	519	519	511	496	508	548	555	562	574
Average real wage (variation from same quarter of preceding year)	0.9	1.5	2.5	0.4	-6.1	0.8	-3.5	1.2	13.6	...
Nominal interest rates (annualized percentages)										
Deposit rate ^e	8.7	6.8	6.6	6.5	5.0	3.7	5.1	7.6	8.5	8.5
Lending rate ^f	19.8	17.1	16.2	16.1	15.3	14.6	16.7	20.2	21.4	22.0
Interbank interest rate	7.2	5.6	5.4	5.7	2.9	2.7	6.8	4.8	4.4	6.4
Stock price index (national index to end of period, 31 December 2000=100)	178	187	186	193	235	232	209	177	114	116
Domestic credit (variation from same quarter of preceding year)	20.2	21.2	23.1	28.7	28.3	31.4	32.4	31.4	26.2	19.5
Non-performing loans as a percentage of total credit	1.4	1.4	1.2	1.2	1.3	1.2	1.3	1.5	1.9	2.1

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

^a Preliminary figures.

^b Based on figures in local currency at constant 1991 prices.

^c Quarterly average, weighted by the value of goods exports and imports.

^d Data to May.

^e 90-day deposits at State-owned banks.

^f Rate on loans to industry from State-owned banks.

showed a deficit of US\$ 400 million, which contributed to the negative current account balance.

Family remittances totalled US\$ 584 million (US\$ 596 million in 2007), representing a 2% drop attributable to the slacker economic activity in the United States (their principal source). Remittances sent to other countries—chiefly Nicaragua—came to US\$ 264 million, similar to the 2007 figure. This was the first time in four years that those outward remittances did not rise, which reflects the slowdown in the Costa Rican economy.

For the first time in seven years, the financial account posted a surplus (US\$ 2.053 billion) that was smaller than the current account deficit (US\$ 2.676 billion). Portfolio investment showed a surplus, particularly debt instruments (US\$ 547 million), which helped finance the current account deficit.

FDI inflows reached US\$ 2.016 billion, which represents significant growth (6.3%) given the current

international environment. The reduction of FDI in real estate was offset by flows into the free-zone firms and the sale of two Costa Rican firms to foreign investors.

The current account deficit could shrink in 2009 as imports slow, owing to falling average international prices for food and fuels and the impact of slackening economic activity on demand for imported capital and consumer goods. Goods exports are also expected to fall, along with tourism revenues and FDI flows.

In the first four months of 2009, goods exports dropped 16.4%. Free-zone and manufacturing exports slowed heavily, continuing the trend that has been observed since late 2007. Exports of traditional products also declined. Goods imports fell faster than exports (34%) and, as a result, the trade deficit narrowed significantly, from US\$ 1.816 billion in January-April 2008 to US\$ 478 million in the same period of 2009.