

## COSTA RICA

### 1. General trends

The Costa Rican economy posted growth of 3.5% in 2014, compared with 3.4% the previous year. This expansion was primarily driven by domestic private sector consumption, which contributed 2.5 percentage points to GDP growth. Average open unemployment for the year was 9.6%, versus 9.3% in 2013. Year-on-year inflation stood at 5.1% in December 2014, placing it slightly above the central bank's target range of between 3% and 5%. The central government fiscal deficit widened further to 5.7% of GDP and, in line with the deterioration of public finances, total non-financial public sector debt rose by 1.5 percentage points to 56.7% of GDP.

The balance-of-payments current account deficit narrowed from 5.1% of GDP in 2013 to 4.9% in 2014. Goods exports contracted by 3.6%, while goods imports suffered an even sharper fall of 4.8%; these two factors combined to produce a smaller goods trade deficit (10.5% of GDP in 2014 versus 11.4% in 2013). In the first quarter of 2015, the trade deficit stood at 2.5% of projected year-end GDP, an improvement of 0.8 percentage points on the same period of 2014.

Measured by the trend-cycle series of the monthly index of economic activity (IMAE), the country's output was up 1.1% year on year in April 2015, compared with 4.1% for the same period of 2014. It is estimated that economic growth will be 3.4% in 2015, led by construction, financial services, and transport, storage and telecommunications.

Year-on-year inflation to May 2015 was 0.97%, below the lower bound of the central bank's target range. The main factors contributing to this low rate were price trends for raw materials (in particular hydrocarbons), the central bank's monetary and credit controls, and price cuts for some regulated services. Inflation is expected to remain close to the lower end of the target range.

### 2. Economic policy

#### (a) Fiscal policy

In spite of efforts to contain public spending, the fiscal deficit of the narrowly defined non-financial public sector widened by 0.2 percentage points to 5.5% in 2014. The cause was an expansion of 0.3 percentage points in the central government deficit to 5.7% of GDP, although this was partially offset by a reduction of 0.2 percentage points in the central bank deficit.

Total central government revenues expanded by 7.4% in nominal terms, and tax revenues by 7.0%. Total expenditure rose by 9.3%. The income tax take grew by 7.6%, while sales tax proceeds were up 7.7% owing to greater receipts from the import tax (13.2%), partly due to exchange-rate depreciation. Large rises in current transfers (8.2%), wages (8.3%) and capital spending (16.1%) continued to drive total expenditure growth. The difficulty of containing current expenditure stems from automatic wage adjustments in the public sector and statutory transfers to the Special Fund for the Financing of State

Higher Education (FEES), the Fund for Social Development and Family Allowances (FODESAF) and the Costa Rican Social Security Fund (CCSS).

In line with the worsening fiscal position, total public debt increased by 1.5 percentage points of GDP to 15.1 trillion colones (56.7% of GDP) in 2014. Domestic public debt rose by 7.3% and represented 42.5% of GDP in 2014, while external debt climbed by 25.8% to 14.2% of GDP. In 2014 and the first quarter of 2015, the central government continued to raise financing by issuing long-term bonds, as permitted under Law No. 9070. Thus, a 30-year international bond worth US\$ 1.0 billion was issued in April 2014, followed by another for the same amount in March 2015.

As a result of the deterioration in the public finances, the credit rating agency Moody's announced in September 2014 that it was downgrading the risk rating on debt issued by the Government of Costa Rica on international markets from Baa3 (with a negative outlook) to Ba1 (with a stable outlook). This meant that the country's sovereign debt bonds lost their investment grade status.

In early June 2015, Costa Rica signed the Agreement on Exchange of Information on Tax Matters of the Organization for Economic Cooperation and Development (OECD), which is aimed at strengthening international efforts to combat tax evasion.

The central government deficit widened in the first four months of 2015, with revenue growth of 10.0% outstripped by an 11.6% increase in total expenditure. Tax revenues were up 8.0%, thanks to a rise of 18.7% in receipts from income and profit taxes, although the impact of this was tempered by slower growth in sales tax receipts (3.5%) and a dip of 1.0% in import tax receipts. Growth in total expenditure, meanwhile, reflected a sharp increase of 24.1% in interest payments on the public debt and an 11.0% rise in spending on wages.

## **(b) Monetary and financial policy**

Although the board of directors of the central bank had indicated in early 2014 that it would hold the monetary policy rate at 3.75%, significant increases in the prices of regulated goods and services, in conjunction with nominal exchange-rate depreciation, especially during the first quarter, raised inflationary expectations. In this context, the central bank raised the monetary policy rate by 100 basis points in March and by a further 50 basis points in May, taking it to 5.25%.

Monetary and credit aggregates grew faster in 2014 than in the previous year and by more than nominal GDP (8.4%), something that was consistent with the forecasts in the central bank's macroeconomic programme. The monetary base expanded by 10.4%, which took it to 7.2% of GDP.

Total net domestic credit rose by a nominal 19.2% in 2014. It was fuelled by lending to the non-financial private sector, which expanded by 17.6% to the equivalent of 54.7% of GDP, 4.3 percentage points of GDP more than in 2013. The private sector also showed a greater preference for borrowing in colones, since outstanding colón-denominated credit rose by 19.7% in nominal terms in 2014, as against 14.6% for foreign currency-denominated lending. As regards the use made of credit, most went to consumption and housing, which between them accounted for about 60% of total private-sector borrowing.

Starting in early February 2015, the board of directors of the central bank lowered the monetary policy rate four times, from 5.25% (the rate until the end of January 2015) to 3.75% (the rate from 21 May). This action was motivated by the lack of inflationary pressures from aggregate demand, lower inflation expectations and greater exchange-rate stability.

The base deposit rate stood at 7.2% in December 2014, versus 6.5% in December 2013. In keeping with reduced inflationary expectations and a lower monetary policy rate, it began to trend slowly downward in 2015, falling to 6.8% on 11 June 2015.

### **(c) Exchange-rate and other policies**

The first and second halves of 2014 presented very different exchange-rate behaviour. In the first half of the year, and particularly its first three months, the exchange rate came under pressure, depreciating from 502 colones to the dollar in late 2013 to 569 colones on 11 March 2014, a movement of 13.3%.

In this context, the central bank intervened in the currency market to limit intraday exchange-rate fluctuations, selling US\$ 508 million during the first half of the year, US\$ 356.8 million of this during the first four months. It also implemented a new strategy for managing foreign exchange in the non-banking public sector. Given the high proportion of currency operations the agencies concerned are responsible for, the board of directors agreed to meet their needs directly by drawing on international reserves, using the market to replenish these when private sector settlement operations freed up enough foreign currency. It was determined that the balance of these transactions was not to exceed 8% of the adequate reserve level. By year-end 2014, non-banking public sector operations had totalled US\$ 362.9 million, equivalent to 6.8% of the country's estimated adequate reserve balance.

Lastly, as a precautionary measure, the board of directors approved a programme to purchase up to US\$ 250 million in international reserves between August 2014 and December 2015. From October to December 2014, the bank bought US\$ 226.8 million as part of this programme.

In the second half of the year, in contrast, the exchange rate tended to appreciate and was less variable. It was in part because of the policy actions of the central bank that this indicator was more stable in that period than during the first half of the year. Consistently with the above, lower volatility translated into narrower spreads. The nominal exchange rate has remained stable since January 2015 and stood at 532.1 colones to the dollar at the end of April 2015, versus 535.0 colones at year-end 2014.

International reserves fell by US\$ 113.0 million in 2014 to US\$ 7.182 billion at the end of the year, equivalent to 14.6% of GDP and 1.6 times the broad money base. In May 2015, reserves had risen to US\$ 8.377 billion following the issuance of US\$ 1.0 billion in Ministry of Finance external bonds in early March.

In April 2014, the Legislative Assembly enacted Law No. 9232, approving the free trade agreement between the member States of the European Free Trade Association (EFTA) and the Central American States.

## **3. The main variables**

### **(a) The external sector**

The balance-of-payments current account deficit narrowed from 5.1% of GDP in 2013 to 4.9% in 2014. This was the result of a smaller goods deficit (10.5% of GDP in 2014 versus 11.4% in 2013) in

conjunction with a larger services surplus (8.7% of GDP in 2014 as compared with 8.2% in 2013). These two factors were offset somewhat by an increase in the income account deficit (3.7% of GDP in 2014 versus 2.4% in 2013).

Goods trade slowed in 2014 and exports contracted by 3.6% in nominal terms, since companies operating under special regimes experienced a 9.0% fall in external sales, mainly affecting electronic components and microprocessors. This was partially counterbalanced by a 4.4% rise in firms' sales (particularly of agricultural and food products) under the customs regime for permanent exports. Imports were down 4.8%, mainly owing to a 23.2% drop in purchases by companies operating under special regimes, especially in the area of high technology, this being partially offset by an 8.0% increase in consumer goods imports. Net services exports expanded by 6.0%, with business support services (34.2%) and, to a lesser degree, inbound tourism (4.1%) featuring strongly.

The current transfers account balance was practically unchanged in 2014, while the income account deteriorated, chiefly owing to higher interest payments on a larger external public debt and an increase in profit remittances abroad by direct investment companies. The financial account surplus shrank, mainly because inflows of foreign direct investment (FDI) were lower. The government increased its liabilities, mainly by issuing US\$ 1.0 billion worth of bonds, although the impact of this was offset to some extent because US\$ 250 million worth of external bonds (BDE 14) matured.

The trade deficit was 2.5% of projected year-end GDP in the first quarter of 2015, an improvement of 0.8 percentage points on the deficit for the first quarter of 2014. This was the outcome of an 18.5% drop in goods imports resulting from lower spending on inputs for the electrical industry and on hydrocarbons, partially offset by a 17% contraction in exports, principally owing to a decline in foreign sales of electronic products and processors by companies operating under special regimes.

## **(b) Economic activity**

The Costa Rican economy grew by 3.5% in 2014, compared with 3.4% in 2013. Its performance in the first half of the year was more robust and GDP expanded by 3.8%, while in the second half there was a slowdown, with growth slipping to 3.3%, partly due to the closure of Intel operations and falling external demand for business services.

With regard to the components of expenditure in 2014, the main impetus for growth was provided by domestic consumption, which expanded by 3.9%. Gross investment made a negative contribution, falling by 2.0%, although gross fixed capital formation grew by 4.5% (down from 12.3% in 2013), fuelled by private investment (6.3%); this was partially offset by a contraction in public investment (-2.2%), mainly in infrastructure (-3.5%). Domestic consumption growth was primarily driven by private consumption (3.9%) and, to a lesser extent, government spending (3.5%). Net exports made a positive contribution, since the 1.7% contraction in external demand for goods and services (-0.9 percentage points of GDP) was smaller than the 4.0% decline in goods and services imports (-2.1 percentage points of GDP).

The strongest growth in 2014 was in transport, storage and communications (5.8%), commerce, restaurants and hotels (3.7%) and financial services (7.2%). Growth in the first of these sectors was due to greater demand for mobile telephony, Internet telephony, and passenger and cargo transportation. Commercial activity was powered by higher retail sales of entertainment and telecommunications items and plastic and textile products. The rise in tourism-related services and higher domestic demand likewise

had a positive impact on the hotel and restaurant business. Lastly, buoyant activity in the financial services sector reflected higher lending to the private sector and increased savings deposits.

Measured by the IMAE trend-cycle series, the country's output was up 1.1% year on year in the first four months of 2015, versus 4.1% for the year-earlier period. Economic activity was sluggish in most sectors and actually contracted in others, such as agriculture and manufacturing.

### **(c) Prices, wages and employment**

Headline inflation, measured as the year-on-year change in the consumer price index (CPI), was 5.1% to December 2014, slightly above the upper bound of the range targeted by the central bank (3% to 5%). Higher inflation in 2014 was the result not of monetary imbalances, but of exchange-rate depreciation passing through to domestic prices and of increases in the prices of regulated goods and services.

The CPI began to rise strongly from March 2014 and often breached the upper limit of the target range in the second half of the year. In late 2014 and the first quarter of 2015, however, inflation tended to converge on the lower bound of the range thanks to the control of monetary and credit aggregates, increases in the monetary policy rate in the first half of 2014, exchange-rate stability in the second half of 2014 and the first half of 2015, and lower hydrocarbon prices.

The regulated component went up by 5.7% in 2014, with the most significant price increases being for electricity (12.1%) and water (10.8%).

The Continuous Employment Survey identified a rise in the average annual employment rate from 56.4% to 56.6%. However, a still larger increase in the participation rate (from 62.2% to 62.6%) meant that the unemployment rate rose from 9.3% to 9.6%.

The average monthly income rose by 2.0% year on year in real terms to the fourth quarter of 2014. The largest increases were in construction (11.2%), commerce and repairs (10.3%) and hotels and restaurants (8.3%).

Table 1  
COSTA RICA: MAIN ECONOMIC INDICATORS

	2006	2007	2008	2009	2010	2011	2012	2013	2014 a/
	<b>Annual growth rates b/</b>								
Gross domestic product	8.8	7.9	2.7	-1.0	5.0	4.5	5.2	3.4	3.5
Per capita gross domestic product	7.0	6.2	1.2	-2.5	3.5	3.1	3.8	2.1	2.2
Gross domestic product, by sector									
Agriculture, livestock, hunting, forestry and fishing	12.7	5.6	-3.2	-2.8	6.7	0.6	5.0	-0.3	3.7
Mining and quarrying	25.7	-1.5	-5.6	-14.2	-7.1	-3.2	5.7	2.7	2.1
Manufacturing	10.8	7.0	-3.7	-3.9	4.0	3.8	5.7	4.2	2.4
Electricity, gas and water	6.1	2.3	-0.6	3.3	2.7	2.5	6.9	-2.5	1.3
Construction	18.2	21.3	14.6	-3.0	-4.1	-3.8	6.1	3.6	3.1
Wholesale and retail commerce, restaurants and hotels	4.8	6.6	3.4	-6.0	4.2	4.0	4.0	3.8	3.7
Transport, storage and communications	10.5	9.8	7.6	3.0	6.9	8.3	6.2	4.8	5.8
Financial institutions, insurance, real estate and business services	11.1	9.3	8.5	5.6	6.5	7.5	6.9	6.0	5.1
Community, social and personal services	2.3	3.4	4.5	5.2	4.2	2.4	2.5	3.2	3.0
Gross domestic product, by type of expenditure									
Final consumption expenditure	5.4	6.9	3.5	2.3	4.5	4.2	3.8	3.3	3.9
Government consumption	2.9	2.3	4.4	6.7	4.7	1.4	1.0	2.8	3.5
Private consumption	5.7	7.5	3.4	1.7	4.5	4.6	4.2	3.3	3.9
Gross capital formation	13.9	-1.2	20.2	-34.7	33.4	13.0	7.7	0.7	-2.0
Exports (goods and services)	10.3	9.9	-2.0	-6.0	5.5	5.5	9.3	3.6	-1.7
Imports (goods and services)	8.1	4.3	6.5	-18.9	16.5	9.1	8.7	2.1	-4.0
	<b>Percentajes of GDP</b>								
Investment and saving c/									
Gross capital formation	26.4	24.7	27.6	16.3	20.6	21.9	21.9	20.6	19.3
National saving	21.9	18.4	18.2	14.3	17.1	16.8	16.6	15.8	14.7
External saving	4.5	6.3	9.3	2.0	3.5	5.0	5.3	4.7	4.6
	<b>Millions of dollars</b>								
Balance of payments									
Current account balance	-1,023	-1,646	-2,787	-576	-1,281	-2,081	-2,401	-2,333	-2,270
Goods balance	-2,727	-2,985	-5,013	-2,039	-3,440	-5,053	-5,460	-5,748	-5,675
Exports, f.o.b.	8,102	9,299	9,555	8,838	9,516	8,304	8,833	8,879	9,139
Imports, f.o.b.	10,829	12,285	14,569	10,877	12,956	13,357	14,294	14,627	14,814
Services trade balance	1,351	1,734	2,201	2,188	2,537	3,696	4,022	4,617	4,756
Income balance	4	-865	-417	-1,084	-745	-1,021	-1,272	-1,470	-1,619
Net current transfers	349	470	442	359	366	298	310	269	268
Capital and financial balance d/	2,053	2,794	2,439	836	1,842	2,213	4,510	2,794	2,156
Net foreign direct investment	1,371	1,634	2,072	1,339	1,441	2,216	1,915	2,474	1,838
Other capital movements	682	1,160	367	-503	401	-3	2,595	319	319
Overall balance	1,031	1,148	-348	260	561	132	2,110	461	-113
Variation in reserve assets e/	-1,031	-1,148	348	-260	-561	-132	-2,110	-461	113
Other external-sector indicators									
Real effective exchange rate (index: 2005=100) f/	99.6	97.4	94.1	92.8	82.4	79.7	76.6	74.1	77.4
Terms of trade for goods (index: 2010=100)	105.7	104.7	100.8	104.1	100.0	96.3	95.8	96.1	97.0
Net resource transfer (millions of dollars)	2,058	1,929	2,022	-247	1,097	1,192	3,239	1,323	538
Total gross external debt (millions of dollars)	7,191	8,444	9,105	8,238	9,135	10,919	14,509	17,654	19,234
	<b>Average annual rates</b>								
Employment g/									
Labour force participation rate	56.6	57.0	56.7	60.4	59.1	60.7	60.1	59.8	59.5
Open unemployment rate	6.0	4.8	4.8	8.5	7.1	7.7	7.8	8.2	8.5
Visible underemployment rate	13.5	11.5	10.5	13.5	11.2	13.4	11.3	12.5	12.8

Table 1 (concluded)

	2006	2007	2008	2009	2010	2011	2012	2013	2014 a/
<b>Prices</b>	<b>Annual percentages</b>								
Variation in consumer prices (December-December)	9.4	10.8	13.9	4.0	5.8	4.7	4.5	3.7	5.1
Variation in industrial producer prices (December-December)	13.7	14.6	23.5	-1.2	4.5	7.4	3.5	1.6	4.9
Variation in nominal exchange rate (annual average)	7.0	1.0	1.9	8.9	-8.3	-3.8	-0.5	-0.6	7.7
Variation in average real wage	1.6	1.4	-2.0	7.7	2.1	5.7	1.3	1.3	2.0
Nominal deposit rate h/	11.4	7.1	5.4	8.6	6.1	5.3	6.5	5.0	4.7
Nominal lending rate i/	22.7	17.3	16.7	21.6	19.8	18.1	19.7	17.4	16.6
<b>Central government</b>	<b>Percentajes of GDP</b>								
Total revenue	14.2	15.5	15.9	14.0	14.4	14.5	14.4	14.4	13.9
Tax revenue	14.0	15.2	15.6	13.8	13.4	13.6	13.5	13.6	13.2
Total expenditure	15.3	14.9	15.7	17.4	19.5	18.6	18.8	19.8	19.6
Current expenditure	14.3	13.6	13.5	15.6	17.2	17.1	17.3	18.2	17.8
Interest	3.8	3.1	2.2	2.1	2.1	2.2	2.1	2.6	2.6
Capital expenditure	0.9	1.3	1.8	1.8	2.3	1.5	1.5	1.6	1.7
Primary balance	2.7	3.7	2.4	-1.3	-3.0	-1.9	-2.3	-2.9	-3.1
Overall balance	-1.1	0.6	0.2	-3.4	-5.1	-4.1	-4.4	-5.4	-5.6
Central government public debt	33.3	27.6	24.8	27.4	28.8	30.3	35.2	36.2	38.8
Domestic	22.8	19.2	17.5	21.6	22.9	25.4	29.2	28.9	30.0
External	10.4	8.3	7.2	5.8	5.9	4.9	6.0	7.1	8.8
<b>Money and credit</b>	<b>Percentages of GDP, end-of-year stocks</b>								
Domestic credit	42.9	44.5	47.8	48.5	45.3	47.8	46.7	50.8	54.9
To the public sector	5.1	2.7	2.6	3.9	3.7	4.5	2.7	4.4	5.6
To the private sector	37.9	44.3	50.5	49.2	45.3	47.2	49.0	50.8	55.1
Others	0.0	-2.4	-5.2	-4.6	-3.6	-3.9	-5.0	-4.5	-5.8
Monetary base	6.7	7.6	7.3	7.2	7.0	7.2	7.7	7.9	8.0
Money (M1)	14.7	16.5	14.9	13.9	14.6	15.3	15.7	16.3	16.4
M2	32.5	36.5	34.5	33.4	32.2	31.9	33.9	35.8	36.9
Foreign-currency deposits	21.5	18.7	21.6	23.1	18.0	17.0	15.3	13.7	14.7

**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 values calculated in national currency and expressed in current dollars.

d/ Includes errors and omissions.

e/ A minus sign (-) indicates an increase in reserve assets.

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

g/ Nationwide total. New measurements have been used since 2009; the data are not comparable with the previous series.

h/ Average local-currency deposit rate in the financial system.

i/ Average local-currency lending rate in the financial system.

Table 2  
COSTA RICA: MAIN QUARTERLY INDICATORS

	2013				2014				2015	
	Q.1	Q.2	Q.3	Q.4	Q.1	Q.2	Q.3	Q.4	Q.1	Q.2 a/
Gross domestic product (variation from same quarter of preceding year) b/	1.4	3.5	5.0	3.9	3.9	3.8	3.4	3.0	2.6	...
Gross international reserves (millions of dollars)	6,834	7,908	7,687	7,390	7,106	7,658	7,292	7,182	7,640	8,377 c/
Real effective exchange rate (index: 2005=100) d/	74.7	73.8	73.6	74.3	77.4	80.0	76.9	75.3	73.3	73.6 c/
Consumer prices (12-month percentage variation)	6.2	5.6	5.5	3.7	3.0	4.0	5.3	5.6	3.7	1.4 c/
Wholesale prices (12-month percentage variation)	3.5	2.9	2.3	1.4	2.8	5.3	5.2	5.0	3.8	1.3 c/
Average nominal exchange rate (colones per dollar)	501	500	500	500	528	550	539	537	536	535
Nominal interest rates (average annualized percentages)										
Deposit rate e/	5.8	5.0	4.7	4.5	4.3	4.6	4.8	4.9	4.8	4.7 f/
Lending rate g/	19.6	17.4	16.2	16.1	16.4	16.8	16.6	16.7	16.7	16.0 c/
Interbank rate	4.8	4.8	3.9	4.0	4.0	5.0	5.3	5.1	4.4	3.9 f/
Monetary policy rates	5.0	5.0	4.0	4.0	4.1	5.1	5.3	5.3	4.9	4.1
International bond issues (millions of dollars)	-	1,500	500	1,000	-	1,000	-	-	1,000	-
Stock price index (national index to end of period, 31 December 2005 = 100)	154	172	183	190	197	208	212	211	203	200
Domestic credit (variation from same quarter of preceding year)	8.6	5.6	7.8	14.7	18.7	20.6	21.5	18.7	13.0	16.3 f/
Non-performing loans as a percentage of total credit	1.9	2.0	1.9	1.8	1.7	1.6	1.7	1.6	1.6	1.7 c/

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/ Figures as of May.

d/ Quarterly average, weighted by the value of goods exports and imports.

e/ Average local-currency deposit rate in the financial system.

f/ Figures as of April.

g/ Average local-currency lending rate in the financial system.