

## COSTA RICA

### 1. General trends

Economic activity expanded by 4.3% in 2016, down from 4.7% in 2015. The slowdown was mainly due to contraction in the construction sector and a loss of dynamism in basic services. Year-on-year inflation, at 0.8%, came in below the Central Bank of Costa Rica target (3%, with tolerance of 1 percentage point either way) for the second year running. Although higher than in 2015, when the index actually fell by 0.8%, this was a low rate, with consumer prices being kept down by a fresh decline in average annual international fuel costs and a drop in agricultural goods prices. The central government fiscal deficit, at 5.2% of GDP, was lower than in 2015 (5.7% of GDP) thanks to tax collection efforts and public spending restraint, combined with a favourable inflation and interest-rate environment. The current account deficit fell as a percentage of GDP for the second year running (to 3.3% from 4.3% in 2015) thanks to a fresh improvement in the terms of trade and higher exports. The average annual national unemployment rate was 9.5%, close to that of 2015 (9.6%).

For 2017, the Economic Commission for Latin America and the Caribbean (ECLAC) forecasts real-term GDP growth of 4.1%, slightly down on 2016, mainly because domestic demand growth has slowed in the face of rising interest rates and international fuel prices. This increase in prices will negatively affect the terms of trade, which will in turn lead to a larger current account deficit (of some 4% of GDP) and a resurgence of inflation, which is expected to converge on a value within the central bank target range. The fiscal balance will come under pressure again in a less favourable price and interest-rate environment, so that the deficit is expected to worsen to between 5.5% and 6.0% of GDP.

### 2. Economic policy

With the current government now in its third year, fiscal disequilibrium is still the main macroeconomic concern. The main fiscal revenue reform plans have yet to be approved, particularly those for the introduction of value added tax (VAT) and changes to income tax.

#### (a) Fiscal policy

Total central government revenues grew by 9.2% in real terms, up from 9.1% in 2015. Tax revenue expanded by 9.9%, driven by the dynamism of income tax receipts, which rose at double-digit rates for the second year running (13.6% in 2016 and 13.4% in 2015), thanks to increased economic activity and administrative measures. The Ministry of Finance implemented a number of measures as part of a fiscal intelligence strategy, including steps to facilitate the detection of evaders in customs and promote the use of electronic payment mechanisms, and advertising campaigns to publicize fiscal obligations and encourage taxpayers to comply with them. In addition to these measures, laws rationalizing the pension regime and State treasury operations were passed with a view to improving the efficiency of resource use. Tax revenue totalled 13.8% of GDP, up from 13.4% in 2015.

Total central government spending rose at a real average annual rate of 6.0% in 2016, down from 8.9% in 2015. Low inflation allowed pay growth, which is index-linked, to be reduced to 3.1% in real terms from 6.5% in 2015. Capital spending contracted by 8.6% owing to the completion of public infrastructure works in 2015 and a slow start to new projects in 2016. Efforts to hold down outlays also

benefited from the implementation of expenditure oversight provisions and a public sector pay restraint policy.

The narrowly defined global public sector presented a cumulative financing deficit of 4.6% at the end of 2016, this being 0.7 percentage points less than in 2015, thanks to the improved central government financial performance already mentioned. The primary balance, which excludes debt interest payments, was in deficit by the equivalent of 2.4% of GDP, down from 3.0% of GDP in 2015.

The decision by the public sector not to turn to international markets to finance the deficit meant that the funds had to be raised on the domestic market, mainly from institutional clients of the public sector, such as the Costa Rican Social Security Fund (CCSS) and public sector commercial banks. The total gross public debt (which includes central government, the rest of the non-financial public sector and the financial public sector) was equivalent to 62% of GDP at the end of 2016, a rise of 2.3 percentage points from end-2015. Total domestic public debt rose from 40.8% of GDP in 2015 to 43.0% of GDP in 2016. Public debt interest service represented 2.8% of GDP, having exhibited a rising trend over recent years.

The Government of Costa Rica has continued to strive to contain expenditure in 2017, issuing fresh guidelines that limit the scope for creating new public sector jobs in the last three quarters of the year and restrict vehicle purchases by ministries, among other measures. Progress has also been made towards implementing electronic invoicing and passing the Legal Persons Tax Act.

Total central government revenues rose by 10% in real terms year on year in the first five months of 2017 thanks to substantial growth in income and profit tax receipts. Total spending rose by 11.8%, with the transfers category being particularly dynamic.

#### **(b) Monetary and exchange-rate policies**

The central bank adjusted the inflation target for 2016 down by 1 percentage point to 3%, with a tolerance of 1 percentage point either side. This adjustment was motivated by a gradual decline in long-term inflation, which has averaged 3.5% year on year over the last eight years. The monetary policy interest rate was held at 1.75% in 2016, following a cumulative reduction of 350 basis points over the course of 2015.

The interest rate cuts of 2015 continued to pass through gradually to the rest of the financial system in 2016. The average lending interest rate in the financial system fell from 15.46% in December 2015 to 14.25% in the same month of 2016. The basic deposit rate fell from 5.95% in December 2015 to 4.45% a year later, thus returning to the levels seen before the global financial crisis of 2008 and 2009.

Lending to the non-financial private sector grew at a nominal year-on-year rate of 12.3%, a 1.5 percentage point increase on the 2015 growth rate. Agriculture and services were most dynamic, with lending rising by 23.3% and 16.5%, respectively, while the largest outstanding loan balances continued to be in the areas of housing and consumption, which between them represented 51.3% of total credit to the private sector. In 2016, unlike 2015, more was lent in local than in foreign currency.

Cash held by the public and balances in current accounts, which make up the M1 monetary aggregate, grew at a nominal year-on-year rate of 8.2% in 2016 (equivalent to 7.3% in real terms). Term deposits in colones expanded by 8.9% in nominal terms, while those in foreign currency rose by 14.5%, so that the share of savings denominated in dollars increased.

The nominal exchange rate depreciated by a cumulative 3.3% in 2016, ending the year at 556 colones per dollar. The effective real exchange rate depreciated by 3.2% in the same period. Among the factors bearing down on the colón over the year were higher import demand because of rising oil prices in the second half, increased net public sector requirements and a smaller private sector currency surplus. The international reserves of the central bank totalled US\$ 7.574 billion at the end of 2016, a decline of US\$ 260 million from end-2015. To further bolster the managed float regime, a capital increase from US\$ 328.1 million to US\$ 656.3 million was agreed with the Latin American Reserve Fund (FLAR).

The central bank raised the monetary policy interest rate on five occasions in the first six months of 2017 by a total of 275 basis points, leaving it at 4.5%. The monetary authority argued that this new stance was necessary because of exchange-rate and inflation pressures, a growing preference for foreign-currency saving and upward movements in the interest rates of major trading partners. The exchange rate was 598 colones per dollar by the end of May 2017, and this led the central bank to increase intervention by selling off international reserves, in addition to the rise in the benchmark interest rate referred to. The result was that the exchange rate had strengthened to 572 colones per dollar by the end of June 2017, although this still represented a nominal depreciation of 2.9% from the end-2016 value.

### **(c) Other policies**

Negotiations over the free trade agreement between Central America and the Republic of Korea concluded in November 2016. This treaty is expected to be sent to the countries' legislatures around mid-2017 for the debate and approval process to begin. In May 2017, meanwhile, the bill to reform several articles of the Narcotics, Psychotropic Substances, Unauthorized Drugs, Related Activities, Money Laundering and Financing of Terrorism Act was passed, the aim being to prevent Costa Rica from being included on the Financial Action Task Force (FATF) list of non-cooperative countries.

As regards the country's application to join the Organization for Economic Cooperation and Development (OECD), preparation of the 22 technical reviews that are part of the accession process continued. The first approval, relating to foreign trade, was received in January 2017, and this was followed by approvals in the areas of health and agriculture. The current government has set itself the challenge of completing the technical phase before its term of office ends on 8 May 2018.

## **3. The main variables**

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

Goods exports grew by 7.4% year on year in 2016, after falling by 0.1% in 2015. This progress was made, despite a weak international environment, thanks to a recovery in shipments of agriculture produce (11.2%), driven by coffee, bananas and pineapples, and of manufactures (6.8%), and to exports of medical equipment and devices, which became the main goods export category after the closure of manufacturing operations at the Intel plant. The United States continued to be the main trade destination for Costa Rican exports, taking 40.3% of the total, while the rest of Central America (mainly Guatemala, Nicaragua and Panama) took 22.2%, and 19.6% went to the countries of the European Union, with Belgium and the Netherlands accounting for large shares.

Goods imports, meanwhile, expanded by a moderate 1.2%, in contrast with a decline of 2.8% in 2015. Growth in purchases of consumer goods (6.6%) was partially offset by large reductions in imports of fuels and lubricants (-12.2%) and capital goods (-4.4%). The goods balance ended the year with a deficit of around US\$ 4.50 billion, 9.4% less than the 2015 deficit. The terms of trade improved by 3.1% in 2016, mainly thanks to the average annual fuel price decline.

Services exports continued to grow solidly in 2016 (11.2%). The travel (tourism) segment set a new record of US\$ 3.681 billion, an increase of US\$ 415 million over 2015. Exports of other services, with business services and telecommunications, information technology and information services foremost among them, totalled US\$ 4.332 billion, which represents annual growth of 11.2%. The services balance presented a surplus of around US\$ 5.10 billion, outweighing the goods deficit.

Foreign direct investment totalled US\$ 3.18 billion, slightly more (US\$ 35 million) than in 2015, and the equivalent of 5.5% of GDP. The main sectors it went to were manufacturing (49.7%) and services (28.0%). Investment in free zones continued to expand strongly.

Goods exports grew at a year-on-year rate of 4.9% in the first five months of 2017, driven mainly by shipments from free zones, particularly of medical equipment and devices. Imports, meanwhile, expanded by 4.5% over the same period in 2015, owing mainly to a recovery in fuel purchases.

#### **(b) Economic activity**

It is important to begin by noting that the central bank made a substantial upward revision to 2015 GDP growth, from 3.7% to 4.7%, once it had incorporated final data on all economic agents' activity.

In 2016, GDP grew by an average of 4.9% in the first half before slowing in the second, with average expansion of 3.8%. The service sector continued to register solid growth (4.8%), driven particularly by financial and insurance activities (13.8%), information and communications services (7.9%) and professional, scientific and technical activities (7.6%). Agricultural activity recovered strongly, with annual growth of 5.0% (up from -3.4% in 2015), owing to better weather conditions and a greater supply of products, allowing external sales of banana and pineapple to expand. Manufacturing expanded by 5.5%, driven by free zone activity. Growth in these sectors was partly offset by a downturn in construction (-6.3%), as a number of public sector infrastructure and non-residential private investment projects had been completed in 2015 and new projects got off to a slow start in 2016.

By spending component, economic activity in 2016 was driven by both domestic demand (up 3.9%) and external demand (up 9.5%). Private consumption expanded by 4.6%, driven by higher disposable incomes and the expansion of credit in a context of low inflation and low interest rates. Gross fixed capital formation contracted (by 1.5%) because of the construction downturn mentioned earlier.

There was a marked change in the contribution of demand factors to GDP growth in 2016. Gross exports, whose contribution to GDP growth was zero in 2015, contributed 2.8% in 2016. In net terms, i.e., after subtracting imports, their contribution to GDP rose from -1.6% in 2015 to 0.4% in 2016. Conversely, the contribution of domestic demand to GDP fell sharply, from 6.2% in 2015 to 3.9% in 2016, largely because of the contraction in gross fixed capital formation.

The monthly index of economic activity (IMAE) rose by 3.5% in the first four months of 2017, down from 5.3% in the same period of 2016. Economic activity is expected to pick up over the coming months, ending the year at the forecast 4.1%.

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

Inflation was below the bottom of its target range in 2016, and indeed was negative in the first half of the year. Year-on-year changes in the monthly consumer price index turned positive again in July 2016, after 12 months of negative figures. The price indices for wearing apparel and transport dropped year on year, while the largest increases were in the education and health indices. Annual core inflation, which excludes short-term fluctuations resulting from supply shocks, averaged 0.7%.

There were no significant changes in employment indicators in 2016. The urban unemployment rate fell marginally from 9.7% in 2015 to 9.6% in 2016, while the rural rate was unchanged at 9.4%. The nominal minimal wage was increased by 1.4% (0.6% in real terms). By sector, the manufacturing minimum wage rose by 1.6% year on year (0.9% in real terms), while the services minimum wage rose by 2.0% (1.2% in real terms).

Year-on-year inflation remained below the central bank target range in the first five months of 2017, standing at 1.67% in May. It is expected to pick up gradually over the coming months. The unemployment rate, meanwhile, was 9.1% in the first quarter of 2017, down from 9.5% in the same period of 2016.

Table 1  
**COSTA RICA: MAIN ECONOMIC INDICATORS**

	2008	2009	2010	2011	2012	2013	2014	2015	2016 a/
	<b>Annual growth rates b/</b>								
Gross domestic product	2.7	-1.0	5.0	4.5	5.2	2.3	3.7	4.7	4.3
Per capita gross domestic product	1.3	-2.3	3.6	3.2	3.9	1.1	2.5	3.6	3.3
Gross domestic product, by sector									
Agriculture, livestock, hunting, forestry and fishing	-3.2	-2.8	6.7	0.6	5.0	0.1	2.2	-3.4	5.0
Mining and quarrying	-5.6	-14.2	-7.1	-3.2	5.7	5.8	1.2	8.1	-5.3
Manufacturing	-3.7	-3.9	4.0	3.8	5.7	0.1	1.5	0.1	5.5
Electricity, gas and water	-0.6	3.3	2.7	2.5	6.9	-14.0	3.6	22.4	4.7
Construction	14.6	-3.0	-4.1	-3.8	6.1	-9.5	2.1	10.6	-6.3
Wholesale and retail commerce, restaurants and hotels	3.4	-6.0	4.2	4.0	4.0	2.6	2.1	1.2	1.3
Transport, storage and communications	7.6	3.0	6.9	8.3	6.2	4.0	6.2	7.6	6.6
Financial institutions, insurance, real estate and business services	8.5	5.6	6.5	7.5	6.9	4.6	4.6	7.4	7.1
Community, social and personal services	4.5	5.2	4.2	2.4	2.5	3.5	3.6	2.2	2.1
Gross domestic product, by type of expenditure									
Final consumption expenditure	3.5	2.3	4.5	4.2	3.8	3.0	4.0	4.2	4.1
Government consumption	4.4	6.7	4.7	1.4	1.0	3.2	2.9	2.3	2.3
Private consumption	3.4	1.7	4.5	4.6	4.2	2.9	4.2	4.8	4.6
Gross capital formation	20.2	-34.7	33.4	13.0	7.7	-0.3	3.3	8.8	-1.5
Exports (goods and services)	-2.0	-6.0	5.5	5.5	9.3	3.3	5.2	0.0	9.5
Imports (goods and services)	6.5	-18.9	16.5	9.1	8.7	1.7	5.1	4.6	7.7
Investment and saving c/	<b>Percentajes of GDP</b>								
Gross capital formation	25.8	15.2	19.3	20.5	20.5	19.0	18.8	20.2	19.7
National saving	17.4	13.4	16.1	15.1	15.3	14.1	13.9	15.9	16.4
External saving	8.4	1.9	3.3	5.4	5.2	4.9	4.9	4.3	3.3
Balance of payments	<b>Millions of dollars</b>								
Current account balance	-2 581	-561	-1 214	-2 265	-2 411	-2 431	-2 447	-2 077	-2 046
Goods balance	-5 145	-2 582	-3 548	-5 027	-5 348	-5 559	-5 329	-4 628	-4 520
Exports, f.o.b.	7 514	6 623	7 493	8 301	8 923	8 866	9 456	9 432	10 166
Imports, f.o.b.	12 659	9 205	11 040	13 329	14 271	14 425	14 784	14 059	14 686
Services trade balance	2 738	2 678	3 132	3 833	3 984	4 564	4 541	4 609	5 132
Income balance	-589	-1 001	-1 186	-1 418	-1 456	-1 828	-2 109	-2 515	-3 124
Net current transfers	416	345	388	348	408	392	450	457	465
Capital and financial balance d/	2 233	821	1 775	2 397	4 521	2 892	2 334	2 721	1 811
Net foreign direct investment	2 240	1 340	1 589	2 328	1 803	2 401	2 798	2 839	2 603
Other capital movements	-7	-519	186	69	2 718	491	-464	-118	-791
Overall balance	-348	260	561	132	2 110	461	-113	644	-235
Variation in reserve assets e/	348	-260	-561	-132	-2 110	-461	113	-644	235
Other external-sector indicators									
Real effective exchange rate (index: 2005=100) f/	94.1	92.8	82.4	79.7	76.6	74.1	77.4	73.5	75.0
Terms of trade for goods (index: 2010=100)	100.8	104.1	100.0	96.3	95.8	96.1	97.0	98.0	96.7
Net resource transfer (millions of dollars)	1 644	-180	589	979	3 065	1 064	225	205	-1 313
Total gross external debt (millions of dollars)	8 827	8 276	9 527	11 286	15 381	19 629	21 671	24 030	26 437
Employment g/	<b>Average annual rates</b>								
Labour force participation rate	56.7	60.4	59.1	60.7	62.5	62.2	62.6	61.2	58.4
Open unemployment rate h/	4.8	8.5	7.1	7.7	9.8	9.1	9.5	9.7	9.6
Visible underemployment rate	10.5	13.5	11.2	13.4	11.3	12.5	12.8	12.4	9.0

Table 1 (concluded)

	2008	2009	2010	2011	2012	2013	2014	2015	2016 a/
<b>Prices</b>	<b>Annual percentages</b>								
Variation in consumer prices (December-December)	13.9	4.0	5.8	4.7	4.6	3.7	5.1	-0.8	0.8
Variation in industrial producer prices (December-December)	23.5	-1.2	4.5	7.4	3.5	1.6	4.9	-0.4	0.3
Variation in nominal exchange rate (annual average)	1.9	8.9	-8.3	-3.8	-0.5	-0.6	7.7	-0.6	1.9
Variation in average real wage	-2.0	7.7	2.1	5.7	1.3	1.3	2.0	4.1	2.6
Nominal deposit rate i/	5.4	8.6	6.1	5.3	6.5	5.0	4.7	4.4	3.5
Nominal lending rate j/	16.7	21.6	19.8	18.1	19.7	17.4	16.6	15.9	14.7
<b>Central government</b>	<b>Percentajes of GDP</b>								
Total revenue	15.5	13.7	13.9	14.1	14.0	14.2	13.9	14.3	14.6
Tax revenue	15.2	13.4	13.0	13.3	13.2	13.5	13.1	13.4	13.8
Total expenditure	15.3	17.0	19.0	18.1	18.3	19.6	19.5	19.9	19.8
Current expenditure	13.2	15.2	16.7	16.7	16.9	18.0	17.8	18.1	18.0
Interest	2.1	2.1	2.1	2.1	2.0	2.5	2.6	2.7	2.8
Capital expenditure	1.7	1.7	2.3	1.4	1.4	1.6	1.7	1.8	1.8
Primary balance	2.4	-1.2	-3.0	-1.9	-2.3	-2.8	-3.0	-3.0	-2.4
Overall balance	0.3	-3.7	-5.0	-4.0	-4.3	-5.4	-5.6	-5.7	-5.2
Central government public debt	24.1	26.5	28.4	29.8	34.3	36.0	38.9	40.9	44.9
Domestic	17.1	20.9	22.6	25.0	28.4	28.9	30.1	30.8	34.5
External	7.0	5.6	5.8	4.8	5.9	7.1	8.8	10.1	10.3
<b>Money and credit</b>	<b>Percentages of GDP, end-of-year stocks</b>								
Domestic credit	43.7	42.0	37.3	39.0	37.4	40.4	42.9	43.0	42.4
To the public sector	2.5	3.8	3.6	4.4	2.7	4.4	5.5	6.7	7.0
To the private sector	50.3	49.4	45.8	47.1	49.1	51.9	56.2	58.5	60.7
Others	-9.1	-11.3	-12.0	-12.5	-14.4	-15.9	-18.8	-22.2	-25.3
Monetary base	7.1	7.0	6.9	7.0	7.5	7.8	7.8	8.0	7.9
Money (M1)	14.5	13.6	14.2	14.9	15.3	16.2	16.0	17.2	17.8
M2	33.6	32.5	31.4	31.1	33.0	35.4	36.1	36.6	34.0
Foreign-currency deposits	21.0	22.5	17.5	16.6	14.9	13.6	14.4	13.9	13.6

**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 2012 prices. Up to 2014, local currency at constant 1993 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 2012; the data are not comparable with the previous series.

h/ Urban total.

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

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

Table 2  
**COSTA RICA: MAIN QUARTERLY INDICATORS**

	2015				2016				2017	
	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/	3.7	5.8	5.8	3.7	5.1	4.6	3.4	4.2	3.6	...
Gross international reserves (millions of dollars)	7 640	8 342	8 197	7 880	7 794	7 816	7 889	7 624	7 417	7 067 c/
Real effective exchange rate (index: 2005=100) d/	73.4	73.7	73.6	73.3	72.9	74.9	76.0	76.3	76.5	78.9 c/
Consumer prices (12-month percentage variation)	3.0	1.6	-0.9	-0.8	-1.1	-0.9	0.4	0.8	1.6	1.7 c/
Wholesale prices (12-month percentage variation)	2.2	0.7	0.1	-0.4	-1.5	-1.7	-0.7	0.3	1.1	2.6 c/
Average nominal exchange rate (colones per dollar)	536.4	535.0	536.1	534.3	536.8	540.3	551.4	554.2	559.5	570.1
Nominal interest rates (average annualized percentages)										
Deposit rate e/	4.8	4.6	4.3	3.8	3.5	3.5	3.5	3.5	3.5	3.6 f/
Lending rate g/	16.7	16.0	15.3	15.6	15.4	14.7	14.2	14.3	14.2	14.1 f/
Interbank rate	4.4	3.6	3.0	2.3	1.7	1.6	1.7	1.9	1.9	3.5 c/
Monetary policy rates	4.8	3.8	3.0	2.3	1.8	1.8	1.8	1.8	1.8	3.1
International bond issues (millions of dollars)	1 000	-	-	127	-	500	-	-	-	300
Stock price index (national index to end of period, 31 December 2005 = 100)	203	200	196	191	207	212	259	250	253	...
Domestic credit (variation from same quarter of preceding year)	11.7	11.2	9.0	7.8	7.8	8.5	6.8	5.5	6.0	6.9 f/
Non-performing loans as a percentage of total credit	1.6	1.7	1.7	1.7	1.7	1.6	1.6	1.6	1.6	1.6 f/

**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 2012 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.