COSTA RICA

1. General trends

Costa Rica's real GDP grew by 2.7% in 2018, following the previous year's 3.4% expansion. This sharp slowdown was the result of slower growth in consumption —by both households and government— and also in investment, in a context marked by uncertainty surrounding the fiscal situation and the adverse effect of the strike by civil servants in the last quarter. Inflation ended the year at 2.0% (down from 2.6% in 2017), coinciding with the floor of the central bank's target range of 3% plus or minus 1 percentage point. The current account deficit was unchanged from end-2017, at 3.1% of GDP, with the buoyancy of goods exports, particularly from free zones, being offset by a fall in the terms of trade. The slowdown in economic activity produced an uptick in unemployment, with the average rate for 2018 rising to 10.3% from the previous year's 9.1%.

The central government's cumulative deficit in 2018 represented 5.9% of GDP —0.2 percentage points less than at that registered at the end of 2017. This reduction reflects the adoption of various measures to contain expenditure, and also exceptional revenues obtained from a tax amnesty approved at the end of 2018. The Law on the Strengthening of Public Finances was finally passed in December 2018; and, while the main effects of this fiscal reform will be felt only gradually, it is an important step towards easing pressure on the public finances.

The first and second rounds of the presidential elections were held on 4 February and 1 April 2018, respectively. The candidate of the governing Citizen's Action Party (PAC), Carlos Alvarado, was elected with over 60% of the total vote and took office as President of the Republic in May. As PAC obtained just 10 of the 57 seats in the Legislative Assembly, this is a government with a very fragmented structure, as was the case in previous administrations.

ECLAC forecasts growth of 2.5% for the Costa Rican economy in 2019, mainly reflecting adverse climate events which have hurt agricultural production, slower international trade growth and poor consumer and business confidence. Inflation is expected to remain within the central bank's target range, while the central government deficit should narrow to 5.5% of GDP, as the effects of the fiscal reform on government finances start to make themselves felt. The current account deficit is expected to be around 3% of GDP.

2. Economic policy

The first 11 months of 2018 were characterized by major uncertainty over the negotiations to pass the Law on the Strengthening of Public Finances. In conjunction with the administrative reforms, this legislation will make it possible to reduce the fiscal deficit by around 2 or 3 percentage points of GDP in the long term. Once all direct and indirect effects have materialized, it will be important to assess whether or not the reforms need to be deepened, with a view to ensuring long-term fiscal sustainability. In the short run, however, the challenge remains to improve the conditions of the debt, in order to alleviate the growing burden of interest payments.

(a) Fiscal policy

The aforementioned legislation turns the former sales tax into a value added tax as from 1 July 2019, levied at a general rate of 13%. It also provides for several reduced rates for a selected group of goods, including those of the basic shopping basket. On the revenue side, the law also provides for a flat rate income tax to be assessed on a taxpayer's total income. On the expenditure side, the law sets wage ceilings for senior officials and curbs the growth of benefits paid in addition to the basic wage. Moreover, the "fiscal rule" —under which the government can borrow only if the economy grows— puts a cap on current expenditure growth.

The narrowly defined global public sector posted a cumulative deficit of 4.8% of GDP at the end of 2018, compared to 5.3% a year earlier. This improvement reflects a reduction of 0.2 percentage points of GDP in the central government deficit, together with an increase of 0.3 percentage points in the surplus recorded by the rest of the non-financial public sector. The primary deficit (which excludes interest payments) stood at 2.3% of GDP, 0.7 percentage points less than at end-2017.

Total central government revenues grew by 1.5% in real terms in 2018 (2.2% in the previous year), with a reduction in foreign trade taxes (4.3%) being offset by an increase in revenue from income taxes (6.3%). The Law on the Strengthening of Public Finances included a tax amnesty that waived interest and certain penalties for taxpayers who paid off their debts. Official estimates show that this amnesty increased revenue by 0.5 percentage points of GDP in 2018; further effects are expected in respect of the first two months of 2019, when the concession was still in force. The overall tax burden was 13.4% of GDP in 2018, very slightly down on the previous year's 13.5%.

Total expenditure increased by 1.2% in real terms (7.3% in 2017), with a sharp contraction in capital spending (27.1%). Conversely, interest payments continued to grow in real terms at double-digit rates (by 15.0% in 2017 and by 17.6% in 2018). The growth of expenditure on employee compensation and transfers slackened in real terms: the former from 3.5% in 2017 to 2.3% in 2018, and the latter from 6% to 2.1% in the same period. In May 2018, the new government announced various measures to contain the growth of spending on wages, employment and public sector procurement of goods and services. These included filling just 25% of job vacancies, cutting the overtime payment budget by 50%, and reducing advertising, consulting and travel expenses.

Central government debt represented 52.9% of GDP at the end of 2018 —4.2 percentage points higher than a year earlier. The main source of financing was domestic debt issuance, given the institutional restrictions on public borrowing on international markets. Thus, of the total central government public debt, 79.9% is domestic, and the remaining 20.1% is held externally. The total public debt —which includes that of the central government and both the financial and non-financial public sectors— increased to 69.6% of GDP (up from 64.3% in 2017).

On 25 September 2018, the central bank purchased close to US$ 860 million in treasury bills (*Letras del Tesoro*) issued by the Ministry of Finance. Under current legislation, this type of credit can be extended only once a year and must be repaid within 90 days. The Ministry of Finance used this instrument to solve liquidity problems, but prepaid it on 20 December 2018.

In the first five months of 2019, the central government's total revenue grew by 8.2% in real terms year-on-year, driven by higher incomes and profits, thanks mainly to the tax amnesty mentioned earlier. In the same period, total central government expenditures increased by 8.1% in real terms.

(b) Monetary policy and exchange-rate policy

On 31 January 2018, the Board of Governors of the Central Bank officially announced the end of the transition toward a flexible monetary system that had begun in 2005, and has an explicit inflation target as its central pillar. Prior to this announcement, however, the central bank had already designed and implemented its policy in alignment with this system. A managed floating exchange-rate regime also remains in force.

In 2018 the central bank raised its monetary policy rate to 5.25% through two 25-basis-point hikes, the first on 31 January and the second on 31 October. These increases reflected the higher inflation expectations reported by the economic agents periodically surveyed by the bank, compounded by a rise in international fuel prices and fears that the exchange-rate depreciation would be passed through to domestic prices. In fact, these expectations failed to materialize, and inflation stayed within the central bank's target range, as noted above.

The higher benchmark interest rate and the increase in the cost of central government financing pushed up interest rates in the domestic financial system, and the average lending rate had risen to 15.93% by the end of 2018 (a real rate of 13.7%), compared to 14.87% (12.0% real) a year earlier. The basic interest rate on deposits was 6% (3.9% in real terms) in December 2018, versus 5.95% (3.3% in real terms) in the same month of 2017.

Bank lending to the private sector slackened in 2018, with nominal annual growth of 5.5%, compared to 7.2% the previous year, amid uncertainty surrounding the economic situation, particularly on the fiscal front. The strongest expansion occurred in credit for construction (9.8%) and services (7.5%), while lending to the fishery sector (4.1%) and transport (1.5%) both weakened. Net credit in local currency expanded by 6.3% in 2018, while lending in foreign currency shrank by 0.7% (thereby neutralizing the exchange-rate effect).

In 2018 the exchange rate remained stable at around 570 colones to the United States dollar until mid-August, after which uncertainty over the fiscal situation pushed it up to 630 colones to the dollar by early November. The pressure eased in December, when the fiscal reform was passed, and the rate ended 2018 at 610 colones per dollar, representing a nominal depreciation of 7.0% over the year. The real exchange-rate index depreciated by a slight 2.0%.

International reserves closed 2018 at US$ 7.495 billion, compared to US$ 7.15 billion in December 2017 (year-on-year growth of 4.8%). In 2018, the central bank made several direct interventions to stabilize the foreign-exchange market, selling a cumulative total of US$ 414.5 million, which caused a drain on the country's reserves. Nonetheless, this development was mitigated by a US$ 1 billion credit line negotiated with the Latin American Reserve Fund, which took effect in March 2018.

For the first time since January 2016, the central bank lowered the monetary-policy rate in 2019, with successive 25-basis-point cuts in March, May and June taking it to 4.50%. These adjustments responded to a moderation of inflation expectations amid lacklustre economic growth. The domestic currency appreciated by 4.8% in the first six months of 2019, and the exchange rate had fallen to 581 colones per dollar by the end of June.

(c) Other policies

Trade policy continued to focus on managing existing agreements and optimizing their use. Nevertheless, the government is keen to keep its trade treaty platform, both bilateral and multilateral, up-to-date with economic developments. The free trade agreement with the Republic of Korea was endorsed by the Legislative Assembly on 5 March 2019 and subsequently signed by President Carlos Alvarado. It will enter into force once ratified by the Republic of Korea.

The Organization for Economic Cooperation and Development (OECD) has approved Costa Rica's evaluation in 13 of the 22 areas needed for accession to membership. The Ministry of Trade expects the accession process to be concluded successfully in 2020.

3. The main variables

(a) The external sector

Goods exports totalled US$ 11.477 billion in 2018, following a year-on-year expansion of 6.2% (compared to 7.0% growth in 2017). Among exports in the regular regime, bananas and pineapples were again the leading items, with foreign sales totalling US$ 1.028 billion and US$ 1.033 billion, respectively. Exports of medical equipment and devices under special regimes (free zones and inward processing) totalled US$ 2.599 billion, representing annual growth of 15.1%.

The United States remained Costa Rica's main trading partner in 2018, absorbing a 39.4% share of its goods exports. The next largest partners were other Central American countries, which jointly took a 20.6% share. Costa Rica's trade with the rest of Central America slowed in 2018 (growth of 1.5%, compared with 4.4% in 2017), owing mainly to the socioeconomic crisis in Nicaragua.

Services exports totalled US$ 9.092 billion, 4.5% more than in 2017. The "Other services" category, which includes business services, expanded by 6.0% and accounted for 52.7% of total service exports. As in previous years, the services trade surplus (US$ 5.245 billion) offset the merchandise trade deficit (US$ 4.394 billion).

Merchandise imports expanded by 4.8% in 2018, to post a cumulative total of US$ 15.871 billion for the year. Imports under special regimes grew by 7.6%, while purchases of fuels and lubricants expanded by 14.7%. The latter reflected the higher average international price for these products, which drove the terms of trade index down by 3.1%.

Foreign direct investment (FDI) totalled US$ 2.735 billion in 2018, compared to US$ 2.856 billion the previous year. Investment in free trade zones represented 57.5% of the total, while in sectoral terms manufacturing accounted for 53.1%. Flows from the United States represented 62% of total inward FDI in 2018.

Goods exports posted year-on-year growth of 0.9% in the first five months of 2019, well below the rate of 7.0% recorded in the year-earlier period. Agricultural exports contracted in the wake of adverse weather conditions, while exports of medical equipment and devices remained buoyant.

(b) Economic activity

In the first half of 2018, real GDP expanded at an average annual rate of 3.4%; but, in the second half activity slackened sharply, with average year-on-year growth slipping to 2.0%; and this fall steepened further in the fourth quarter, when the growth rate was just 1.4%.

Uncertainty over the fiscal situation and the strike by civil servants detracted from the momentum of domestic demand, which in 2018 expanded at an average year-on-year rate of 1.2%, versus 2.8% in 2017. The annual growth rate of total consumption fell from 2.8% in 2017 to 1.8% in 2018, with a particularly sharp slowdown in the case of public consumption (up just 0.5% in 2018, compared with the previous year's 3.1%), partly reflecting the austerity measures adopted by the new government. Private consumption slowed less abruptly (up 2.2% in 2018, versus 2.8% in 2017), being undermined by weaker consumer confidence and bank lending. Gross domestic investment increased by 2.7% (6.5% in 2017), with a 5.5% expansion in private investment offsetting a significant 8.9% contraction in the public sector. Gross capital formation rebounded by 1.9%, following a 3.1% fall in 2017; and external demand grew by 4.1%, boosted by exports of goods (commodities and free trade zones) and also of services.

On the supply side, activity slowed in nearly all sectors of activity in 2018. Manufacturing expanded by 2.9% (down from 3.3% in 2017), mainly due to free zone activity. Agriculture grew by 2.4% (3.7% in 2017), driven by pineapple exports, but with a negative performance in other crops such as coffee and sugar cane. By contrast, construction staged a remarkable recovery (growing by 6.6% following a 2.1% contraction in 2017), thanks to greater private investment for commercial and industrial purposes. Within the services sector, information and communications (6.6%) and professional, scientific and technical activities (4.2%) posted the strongest expansions.

The monthly index of economic activity (IMAE) reported average year-on-year growth of 1.8% in the first four months of 2019, compared to 3.1% in the prior-year period. The average increase in IMAE was higher in the finance and insurance and information and communications sectors. In contrast, the agriculture and commerce sectors contracted.

(c) Prices, wages and employment

The monthly year-on-year variation of the consumer price index was within the target range set by the central bank in every month throughout 2018. The December–December hike in transport prices (6.2%), caused by higher international fuel prices, was offset by lower prices for communications (0.5%) and for clothing and footwear (3.6%).

In keeping with the slowdown in economic activity, national open unemployment increased in the second half of 2018, when the average rate climbed to 11.1%, compared to 9.3% in the year-earlier period.. The nominal minimum wage index rose by 2.43% year-on-year in 2018 (representing a real increase of 0.4%).

In the first three months of 2019, year-on-year inflation averaged 1.5%, which was below the central bank's target range; and in April and May it edged up above the lower end of the range (2.32% in May). In the first quarter of 2019, the rate of national unemployment rose to 11.3% from 10.3% in the year-earlier period.

Table 1
COSTA RICA: MAIN ECONOMIC INDICATORS

	2010	2011	2012	2013	2014	2015	2016	2017	2018 a/
	Annual growth rates b/								
Gross domestic product	5.0	4.3	4.8	2.3	3.5	3.6	4.2	3.4	2.7
Per capita gross domestic product	3.6	3.0	3.6	1.1	2.4	2.6	3.2	2.4	1.8
Gross domestic product, by sector									
Agriculture, livestock, hunting, forestry and fishing	6.6	0.7	4.8	0.1	1.5	-2.7	5.2	3.7	2.4
Mining and quarrying	-8.5	-7.4	5.5	5.8	1.2	7.7	3.9	-5.3	4.2
Manufacturing	6.3	3.0	3.4	0.1	0.8	-5.1	4.5	3.3	2.9
Electricity, gas and water	2.2	3.4	5.8	-14.0	3.6	11.0	5.3	3.5	2.1
Construction	-4.7	1.1	4.6	-9.5	2.1	9.4	-3.4	-2.1	6.6
Wholesale and retail commerce, restaurants and hotels	5.6	4.9	3.8	6.8	4.8	4.4	4.1	2.5	2.2
Transport, storage and communications	11.7	9.6	7.6	4.0	6.3	8.2	3.7	5.3	4.7
Financial institutions, insurance, real estate and business services	5.4	6.7	9.0	4.6	4.6	6.6	6.2	4.8	3.5
Community, social and personal services	3.7	1.8	1.7	3.5	3.4	2.0	3.0	3.3	1.1
Gross domestic product, by type of expenditure									
Final consumption expenditure	4.7	5.1	4.9	3.0	3.9	4.2	3.6	2.8	1.8
Government consumption	4.1	1.0	0.2	3.2	2.9	2.4	2.4	3.1	0.5
Private consumption	4.9	6.2	6.1	2.9	4.2	4.6	4.0	2.8	2.2
Gross capital formation	4.3	3.2	9.9	-0.3	3.3	3.0	4.8	-3.1	1.9
Exports (goods and services)	9.3	7.0	5.6	3.3	5.0	2.6	9.4	5.0	4.1
Imports (goods and services)	18.7	10.7	7.8	1.7	5.0	4.5	8.9	3.2	-0.4
Investment and saving c/	**Percentages of GDP**								
Gross capital formation	19.7	19.9	20.5	19.0	18.8	18.4	18.4	18.8	18.6
National saving	16.5	14.5	15.3	14.1	14.0	14.9	16.2	15.7	15.4
External saving	3.3	5.4	5.2	4.9	4.9	3.5	2.2	3.1	3.3
Balance of payments	**Millions of dollars**								
Current account balance	-1 214	-2 265	-2 411	-2 431	-2 453	-1 921	-1 257	-1 815	-1 878
Goods balance	-3 548	-5 027	-5 348	-5 559	-5 329	-4 607	-4 426	-4 343	-4 394
Exports, f.o.b.	7 493	8 301	8 923	8 866	9 456	9 452	10 100	10 808	11 477
Imports, f.o.b.	11 040	13 329	14 271	14 425	14 784	14 059	14 526	15 150	15 871
Services trade balance	3 132	3 833	3 984	4 564	4 539	4 609	5 110	5 000	5 245
Income balance	-1 186	-1 418	-1 456	-1 828	-2 114	-2 380	-2 452	-2 976	-3 193
Net current transfers	388	348	408	392	450	457	510	503	464
Capital and financial balance d/	1 775	2 397	4 521	2 892	2 340	2 565	1 022	1 397	2 268
Net foreign direct investment	1 589	2 328	1 803	2 401	2 818	2 541	2 127	2 583	2 076
Other capital movements	186	69	2 718	491	-478	24	-1 105	-1 186	191
Overall balance	561	132	2 110	461	-113	644	-235	-419	390
Variation in reserve assets e/	-561	-132	-2 110	-461	113	-644	235	419	-390
Other external-sector indicators									
Real effective exchange rate (index: 2005=100) f/	82.4	79.7	76.6	74.1	77.4	73.5	75.0	79.2	79.1
Terms of trade for goods (index: 2010=100) g/	100.0	96.3	95.8	96.1	97.0	97.3	97.0	95.0	92.5
Net resource transfer (millions of dollars)	589	979	3 065	1 064	226	185	-1 429	-1 579	-925
Total gross external debt (millions of dollars)	9 527	11 286	15 381	19 629	21 671	24 030	25 565	27 159	28 655
Employment h/	**Average annual rates**								
Labour force participation rate	59.1	60.7	62.5	62.2	62.6	61.2	58.4	58.8	60.7
Open unemployment rate i/	7.1	7.7	9.8	9.1	9.5	9.7	9.6	9.0	10.3
Visible underemployment rate	11.2	13.4	11.3	12.5	12.8	12.4	9.0	8.1	8.7

Table 1 (concluded)

	2010	2011	2012	2013	2014	2015	2016	2017	2018
Prices	**Annual percentages**								
Variation in consumer prices (December-December)	5.8	4.7	4.6	3.7	5.1	-0.8	0.8	2.6	2.0
Variation in industrial producer prices (December-December)	4.5	7.4	3.5	1.6	4.9	-0.4	0.3	2.7	4.3
Variation in nominal exchange rate (annual average)	-8.3	-3.8	-0.5	-0.6	7.7	-0.6	1.9	4.2	1.7
Variation in average real wage	2.1	5.7	1.3	1.3	2.0	4.1	2.6	1.2	1.7
Nominal deposit rate j/	8.6	6.1	5.3	6.5	5.0	4.7	4.4	4.9	6.9
Nominal lending rate k/	21.6	19.8	18.1	19.7	17.4	16.6	15.9	14.7	15.6
Central government	**Percentages of GDP**								
Total revenue	13.9	14.2	14.0	14.2	14.0	14.3	14.7	14.4	14.3
Tax revenue	13.0	13.3	13.2	13.5	13.2	13.4	13.9	13.5	13.4
Total expenditure	19.0	18.1	18.3	19.6	19.6	20.0	19.9	20.5	20.2
Current expenditure	16.7	16.7	16.9	18.0	17.9	18.2	18.1	18.5	18.8
Interest	2.0	2.1	2.0	2.5	2.6	2.7	2.8	3.1	3.5
Capital expenditure	2.3	1.4	1.4	1.6	1.7	1.8	1.8	2.0	1.4
Primary balance	-3.0	-1.9	-2.3	-2.8	-3.1	-3.0	-2.4	-3.0	-2.3
Overall balance	-5.0	-4.0	-4.3	-5.4	-5.6	-5.7	-5.2	-6.1	-5.9
Central government public debt	28.4	29.9	34.3	35.9	38.5	41.0	44.9	48.7	52.9
Domestic	22.6	25.1	28.4	28.8	29.8	30.9	34.6	38.4	42.2
External	5.8	4.8	5.9	7.1	8.7	10.1	10.3	10.2	10.7
Money and credit	**Percentages of GDP, end-of-year stocks**								
Domestic credit	59.2	61.6	62.2	69.2	73.9	78.1	81.4	83.9	84.6
To the public sector	10.6	12.4	12.0	14.7	16.1	17.8	18.9	20.3	20.7
To the private sector	44.6	46.4	48.0	50.7	54.4	56.6	60.0	61.6	62.0
Others	4.1	2.8	2.1	3.7	3.4	3.8	2.5	2.0	1.9
Monetary base	6.9	7.0	7.5	7.8	7.8	8.0	8.0	8.3	8.1
Money (M1)	15.6	16.0	16.5	17.5	17.4	18.8	19.3	18.2	18.4
M2	32.8	32.2	34.2	36.8	37.5	37.0	35.6	33.2	31.7
Foreign-currency deposits	18.8	17.7	16.0	14.9	16.4	15.2	15.0	15.3	15.8

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/ 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/ Economic Development Division, calculations for Economic Survey of Latin America and the Caribbean, 2019.
h/ Nationwide total. New measurements have been used since 2012; the data are not comparable with the previous series.
i/ Urban total.
j/ Average local-currency deposit rate in the financial system.
k/ Average local-currency lending rate in the financial system.

Table 2
COSTA RICA: MAIN QUARTERLY INDICATORS

	2017				2018				2019	
	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	3.7	2.8	3.4	3.0	3.8	2.5	1.4	...	...
Gross international reserves (millions of dollars)	7 417	6 982	6 877	6 945	7 537	8 089	7723.7	6971.4	7831.6	7957 c/
Real effective exchange rate (index: 2005=100) d/	76.7	79.3	81.0	80.0	79.4	78.3	77.9	81.0	81.5	80.2 c/
Consumer prices (12-month percentage variation)	1.6	1.8	1.6	2.6	2.6	2.1	2.2	2.0	1.4	2.3 c/
Wholesale prices (12-month percentage variation)	1.1	2.5	3.1	3.1	3.6	3.1	2.9	4.3	4.1	3.5 c/
Average nominal exchange rate (colones per dollar)	559.5	570.1	574.8	569.0	569.3	566.6	594.9	603.3	607.4	596.4 c/
Nominal interest rates (average annualized percentages)										
Deposit rate e/	5.4	5.7	6.8	6.9	7.0	6.9	6.9	6.8	7.7	7.7 c/
Lending rate f/	14.2	14.2	14.8	14.8	15.1	15.4	16.1	15.8	13.7	13.9 c/
Interbank rate	1.9	3.7	5.2	4.6	5.0	5.0	5.1	5.6	5.8	5.2 c/
Monetary policy rates	1.8	3.1	4.5	4.7	4.9	5.0	5.0	5.2	5.2	4.8
International bond issues (millions of dollars)	-	300	-	-	-	-	-	-	0	0
Stock price index (national index to end of period, 31 December 2005 = 100)	114	117	117	116	110	102	98	92	80	78
Domestic credit (variation from same quarter of preceding year)	11.3	12.0	11.0	9.9	7.0	5.2	4.9	6.5	5.3	3.8 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 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/ Average local-currency lending rate in the financial system.

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