Costa Rica

The rise in international food and fuel prices, as well as the slowdown in the world economy, had a negative impact on the growth of the Costa Rican economy, with the growth rate down to 3.3% compared with 7.3% in 2007. At the same time, national open unemployment edged up slightly to 5% (bucking the trend of the last three years). The current account deficit is expected to represent the equivalent of 8% of GDP, while the fiscal deficit of the central government should weigh in at around 0.5% of GDP. Inflation, for its part, posted an increase and will probably stand at around 15% at the end of the year.

According to ECLAC estimates, GDP will grow by 1% in 2009. Economic performance will continue to be influenced by weak external demand. The slowdown in the world economy and recession in the country's main trading partner (United States) will result in low growth in: merchandise exports, tourism revenues and inflows of foreign direct investment (FDI) (particularly investment in the property sector). Lower international prices for fuel and raw materials will ease pressure on the current account deficit and on inflation, with the latter expected to be lower than in 2008 but nonetheless close to 10%.

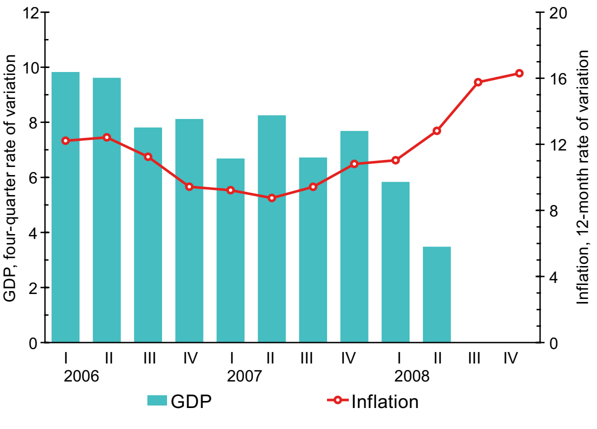
The implementation agenda for the Dominican Republic-Central America-United States Free Trade Agreement (CAFTA-DR) dominated economic policy in 2008. In the context of this agenda, several laws were adopted including a telecommunications act and an insurance act, which laid the foundations for opening the two sectors up to competition. The final bill was approved in November, and CAFTA-DR is therefore expected to enter into force on 1 January 2009. Throughout the year, macroeconomic policy squared up to the external shocks through increases in social spending and changes to monetary and foreign-exchange policy.

The slightly negative balance of the central government in 2008, following the positive balance of around 0.6% of GDP recorded in 2007, was mainly the result of higher investment in infrastructure and increased social spending to tackle the impact of price rises throughout the year. Despite a reduction in the amount of tax evasion, the current revenues of the central government posted moderate growth, owing to the slowdown in receipts from taxes on consumers, income and car imports (as a consequence of slower economic growth).

Exchange-rate and interest-rate patterns in 2008 fall into two contrasting periods. In the first four months of the year, the nominal exchange rate against the United States dollar posted an appreciation of over 5% to reach 494 colones to the dollar in April, mainly as a result of capital inflows. In response to the lower interest rate in the United States and other trading partners, and to discourage such inflows, the monetary policy rate was reduced from 6% to 3.25% in January (and remained at this level until 28 May).

There was a turnaround in the exchange rate from May, as it moved towards the upper limit of the exchange-rate band. Between May and December, the exchange

COSTA RICA: GDP AND INFLATION



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

rate depreciated by over 10%. Upward pressure on the exchange rate is attributable to less favourable short- and medium-term expectations in the wake of weaker external accounts. With a view to offsetting the pressure on the exchange rate, the central bank intervened on the foreign-exchange market by reducing its net reserves by 27% between April and October. The exchange-rate band was also adjusted: the selling rate was reduced from 572.49 colones to the dollar to 555.37, while the buying rate was increased from 488.73 colones to the dollar to 500 colones (with a daily increase of 6 centavos to the upper limit of the band). In terms of the real effective exchange rate, the average variation recorded up to October was a 3% appreciation. In the face of upward pressure on the exchange rate and rising inflation, the authorities increased the monetary policy rate on four occasions to reach 10.87% in early August (at which level it remained subsequently). Despite the increase, the real borrowing rate ended the year in negative figures.

Slower growth in the Costa Rican economy (3.3%) was partly due to the slowdown in consumption (4%, which was two percentage points less than in 2007), which itself was a result of rising inflation. The other contributing factor was the smaller expansion of the world economy (particularly in the United States), which had a negative impact on external demand (an estimated real decline of 3% for exports). Gross fixed investment continued to grow (by around 15%), but at a slower rate than the 16.7% recorded in 2007. The sectors that turned in the best performances were construction, transport and communications, and financial services, although they all posted lower growth rates than in 2007. In contrast, manufacturing and agriculture showed negative growth rates.

Inflation, as measured by the consumer price index, climbed sharply in 2008. Year-on-year inflation from December to December is expected to be approximately 15% (10.8% in 2007), which is above the 9% target set by the central bank at the beginning of the year. Higher international food and fuel prices are partly responsible for this rise, but other contributing factors include the exchange-rate depreciation and expectations of higher inflation (based on monthly surveys of expectations carried out by the central bank). The items that have experienced the largest price rises were transport, food and beverages. Slowing growth has affected job creation, and the national employment rate dropped by half a percentage point. Meanwhile, real wages in the formal sector dipped slightly.

COSTA RICA: MAIN ECONOMIC INDICATORS

	2006	2007	2008 [a]
	Annual growth rates		
Gross domestic product	8.8	7.3	3.3
Per capita gross domestic product	6.9	5.5	1.6
Consumer prices	9.4	10.8	16.3 [b]
Average real wage [c]	1.6	1.4	-1.5 [d]
Money (M1)	37.9	22.6	7.9 [e]
Real effective exchange rate [f]	-1.1	-2.2	-3.1 [g]
Terms of trade	-2.9	-1.0	-3.8
	Annual average percentages		
Unemployment rate	6.0	4.6	4.9
Central government overall balance / GDP	-1.1	0.6	-0.5
Nominal deposit rate	11.4	7.1	5.1 [h]
Nominal lending rate	22.7	17.3	16.3 [h]
	Millions of dollars		
Exports of goods and services	11 073	12 859	13 883
Imports of goods and services	12 449	14 103	16 099
Current account	-1 023	-1 639	-2 442
Capital and financial account	2 053	3 096	1 992
Overall balance	1 031	1 457	-450

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Preliminary estimates.
[b] Twelve-month variation to November 2008.
[c] Average wages reported by workers covered by social security.
[d] Estimate based on data from January to August.
[e] Twelve-month variation to October 2008.
[f] A negative rate indicates an appreciation of the currency in real terms.
[g] Year-on-year average variation, January to October.
[h] Average from January to November, annualized.

The balance-of-payments current account deficit widened considerably from 6.2% of GDP in 2007 to around 8% of GDP in 2008. In the light of less buoyant manufacturing exports from free zones and the inward processing procedure, merchandise exports grew by around 3% (14.9% in 2007). Merchandise imports, on the other hand, expanded by about 15% (13.4% in 2007), mainly thanks to a surge in the oil bill and in imports of other intermediate goods.

Exports of services, spearheaded by "other services" including business support and data processing services and software, are expected to grow by around 20%. Growth in tourism, measured in visitor numbers, has slowed down in recent months, as has growth in revenues from family remittances. Foreign direct investment (FDI) should close the year at around US$ 2.0 billion, which represents annual growth of 8%.