# Costa Rica

Having contracted by 1% in 2009, the GDP of Costa Rica is expected to grow by 4% in 2010. This upturn is attributable to the strong performance by exports (8.1%) and a moderate expansion in consumption (3.5%) and gross fixed investment (3.4%). The central government balance continued to deteriorate and will likely close the year at 5.5% of GDP (it was 3.4% in 2009). Inflation is projected to stand at about 5.5%, which is in line with the central bank's target. The balance-of-payments current account deficit will end the year at 3.7% (compared with 2% in 2009), while the employment situation will show a modest improvement, as the unemployment rate eases down from 7.8% in 2009 to 7.3% in 2010.

ECLAC forecasts GDP growth of 3.5% for Costa Rica in 2011. Sluggish activity among the main trading partners and weaker trade flows will lead to a slowdown in the Costa Rican economy. Commitments related to transfers and compensation will continue to exert pressure on the fiscal balance, which will surpass the 5% level in the absence of any significant improvement in fiscal revenues. Given that situation, the fiscal reform proposal to be presented by the executive branch is expected to spark lively debate. The central bank predicts that inflation will once again be close to 5%, as long as there are no external shocks.

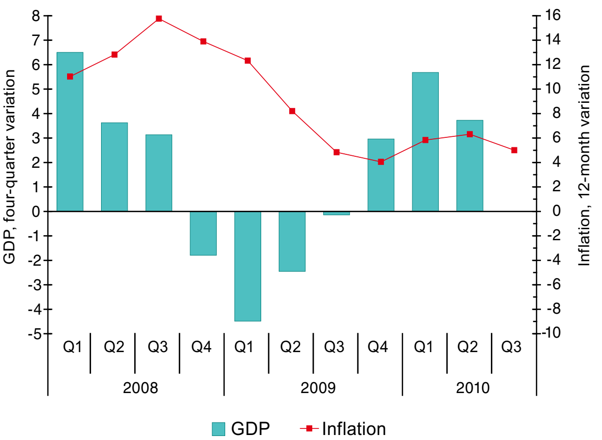
Fiscal revenue is projected to rise by 5.7% in real terms in 2010, after falling by a marked 8.7% in 2009. Because of the natural lag in the payment of taxes, income tax receipts will increase slightly, but most of the expansion will be in foreign trade and sales tax receipts. The tax burden will stand at 13.4% of GDP.

Central government spending continued to climb rapidly in 2010, as commitments assumed in 2009 were paid out; the overall expected rise will be of 18.5% in real terms. The wage bill will burgeon under a programme to gradually raise public-sector salaries, and transfers will increase following the creation of a special support fund for higher education.

The growing fiscal deficit was financed by issuing domestic debt, which thus increased from 40.9% of GDP in September 2009 to 42.2% of GDP in September 2010. External debt stood at 12.1% of GDP in the same month, compared with 11.8% in 2009. In September, Moody's Investors Service upgraded the country's government bond rating from Ba1 to investment grade of Baa3.

Monetary and exchange-rate policy continued to operate in an environment of transition towards a flexible exchange rate and inflation targeting. The foreign-exchange market was highly volatile throughout the year, trending towards appreciation of the colon. In November, the exchange rate averaged 513 colones to the dollar (close to the 500 colon floor of the band), which represented a 10% appreciation over the beginning of the year. The bilateral real exchange rate with the United States dollar appreciated by 8.5% in the first nine months of 2010, as a result of capital inflows and lower foreign currency holdings in the national banking system. In September, the central bank announced a programme to accumulate,

**COSTA RICA: GDP AND INFLATION**




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

as a precautionary measure, international reserves totalling up to US$ 600 million between 2 September 2010 and 31 December 2011; by the end of November, the central bank's reserves stood at US$ 180.6 million.

The central bank relaxed its monetary policy in the second half of 2010 as pressure on prices eased and the exchange rate appreciated. On 19 August, the monetary policy rate, which had remained unchanged since 16 July 2009, was lowered by 150 basis points to 7.5%; on 21 October 2010, it was lowered by a further 100 basis points. Despite this, the central bank continues to face the challenge of how to ensure better pass-through of this benchmark rate to the rates of the financial system. The financial system's average nominal lending rate is expected to close the year at 22.1% (compared with 23.2% in 2009), which translates into a real rate of 14.5%; the average nominal deposit rate is projected to end the year at 7.6%, which is equivalent to a slightly positive real rate of 0.9%. Private sector credit is projected to contract by 3.7% in real terms because of high real interest rates and the need to reduce agents' high leverage. Consumer credit and home loans in particular have felt the impact of this contraction.

In May 2010, the association agreement between Central America and the European Union was signed and the ratification process began. Free trade agreement negotiations with China and Singapore were concluded in April and the resulting agreements are expected to be approved in early 2011. With a view to further widening access to Asian markets, an agreement was reached with the Government of the Republic of Korea to begin discussions on a free trade agreement in 2011.

Economic activity in the first two months of 2010 continued at the strong pace observed in the fourth quarter of 2009. However, since March a gradual slowdown has been seen in the year-on-year growth rate of the monthly index of economic activity, owing to less robust exports. As the areas damaged by adverse weather events in 2009 return to production, annual growth is expected in the agricultural sector (5.7%), as well as in manufactures (5.1%) and in transport and communications (5.7%), driven by an upturn in external and domestic demand. In the face of continued oversupply and sluggish credit growth, the construction sector again shrank (by 6.4%).

The consumer price index saw a slight uptick of 1.5 percentage points over the previous year, on the back of international price hikes for fuels and primary goods and a rally in domestic demand. The upswing in economic activity led to lower unemployment, which nevertheless remained much higher than before the economic crisis. The employment rate crept down from 55.4% in 2009 to 54.8% in 2010, while real wages increased by 3.8% year-on-year in the first 10 months of 2010.

**COSTA RICA: MAIN ECONOMIC INDICATORS**

| | 2008 | 2009 | 2010 [a] |
|---|---|---|---|
| | **Annual percentage growth rates** | | |
| Gross domestic product | 2.8 | -1.1 | 4.0 |
| Per capita gross domestic product | 1.5 | -2.3 | 2.6 |
| Consumer prices | 13.9 | 4.0 | 6.1 [b] |
| Average real wage [c] | -2.0 | 7.7 | 2.5 [d] |
| Money (M1) | 1.5 | -0.4 | 7.3 [e] |
| Real effective exchange rate [f] | -3.6 | -0.1 | -10.9 [g] |
| Terms of trade | -3.8 | 3.3 | -7.3 |
| | **Annual average percentages** | | |
| Urban unemployment rate | 4.8 | 7.6 | ... |
| Central government overall balance / GDP | 0.2 | -3.4 | -5.2 |
| Nominal deposit rate | 5.4 | 8.6 | 6.2 [h] |
| Nominal lending rate | 16.7 | 21.6 | 19.5 [h] |
| | **Millions of dollars** | | |
| | 13 639 | 12 431 | 13 661 |
| Imports of goods and services | 16 451 | 12 280 | 14 708 |
| Current account | -2 787 | -574 | -1 474 |
| Capital and financial account [i] | 2 439 | 835 | 2 025 |
| Overall balance | -348 | 260 | 551 |

**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 2010.
[c] Average wages reported by workers covered by social security.
[d] Estimate based on data from January to September.
[e] Twelve-month variation to September 2010.
[f] A negative rate indicates an appreciation of the currency in real terms.
[g] Year-on-year variation, January to October average.
[h] Average from January to November.
[i] Includes errors and omissions.

The wider current account deficit is due primarily to increased imports of intermediate goods (industrial components and inputs, including fuels) at a time when international prices are higher and the manufacturing industry is recovering. Goods exports are projected to grow by an annual rate of 10.1%, particularly on the strength of the increased volume and value of agricultural products. Total exports from free zones slowed towards the end of the year, owing to a drop in sales of high-technology products.

Services exports posted annual growth of 15.5%, with particularly strong growth in business services. Foreign direct investment for the year as a whole is expected to total US$ 1.450 billion, which is US$ 100 million more than in 2009. Worthy of particular note were the entry of new competitors in the recently opened insurance sector and investment in business services exports.