Costa Rica

Growth in the Costa Rican economy accelerated from 5.9% in 2005 to 6.8% in 2006, driven mainly by buoyant exports. Against this backdrop, the open unemployment rate eased from 6.6% to 6.0%, while year-on-year inflation fell by four percentage points to around 10%, which was below the target rate of 11% set by the central bank for 2006.

Despite increased tax revenue and measures to improve the management of public funds, the primary surplus was not large enough to bring about a reduction in the overall central government deficit, which actually widened from 2.1% to 2.4% of GDP. Moreover, stronger economic growth put pressure on the balance of payments, raising the current account deficit to 5.0% of GDP.

According to ECLAC estimates, real GDP growth should be 5% in 2007. On the inflation front, measures adopted to improve the monetary policy transmission mechanism and strategy for attracting deposits, and the replacement of mini-devaluations with an exchange-rate band, are expected to maintain the positive trend seen in the last few months of 2006. The central government deficit will be between 2.5% and 3.0% of GDP, while the balance-of-payments current account deficit is likely to shrink slightly in GDP terms.

Economic growth was unaffected by the uncertainty surrounding the electoral process. In February 2006, former President Óscar Arias Sánchez was re-elected (20 years after last holding that office) and took office in May. Nonetheless, lack of parliamentary support for government initiatives hindered implementation of a number of important economic policy measures, including approval of the tax reform bill and ratification of the Dominican Republic-Central America-United States Free Trade Agreement (CAFTA-DR).

The central government fiscal deficit remained under control at 2.4% of GDP, despite the failure to get the new tax reform bill through parliament. Current income rose on the buoyancy of the economy and improvements in tax administration. Nonetheless, wage and salary hikes, in conjunction with interest payments, produced an even larger increase in expenditure.

The central bank's key monetary policy goal in 2006 was to reduce inflation, and measures were therefore taken to absorb the liquidity overhang generated the previous year. The monetary policy interest rate was gradually lowered to discourage speculative capital inflows and their subsequent monetization; and new monetary absorption instruments, such as Monetary Stabilization Bonds (BEM), were introduced through an electronic deposit facility.

Nonetheless, the relative stability on the foreign-exchange market, which was achieved through the mini-devaluation policy and opening of the capital account, continued to hinder the effectiveness of monetary policy by fomenting increased money creation and reducing the impact of domestic interest rates on the level of monetary aggregates.

Higher-than-forecast economic growth, together with positive expectations in relation to the country's economic situation, excess liquidity in the financial system and the reduction of interest rates, particularly on home loans, combined to push lending to the private sector beyond the central bank's target. This could cause an increase in the delinquency rate at some future date, particularly if a slowdown occurs in economic activity. Lending was concentrated in construction, tourism, housing and consumption.

As for foreign-exchange policy, in mid-October a decision was taken to replace the system of daily adjustments to the nominal colón/dollar exchange rate with an exchange-rate band. This band was initially set at a narrow range of 3%, but is to be expanded over time. Under this scheme, the central bank will allow the exchange rate to be determined by the market, while reserving the right to intervene if the price of transactions among foreign-exchange intermediaries and between them and the central bank rises above or falls below the intervention rates. The initial value of the buy rate was established at 514.78 colones per dollar and will be raised by 0.06 colones each business day. The initial sell rate was set at 530.22 colones per dollar, rising by 0.14 colones each business day. These parameters can be changed by the board of directors of the central bank as and when prevailing financial and macroeconomic conditions so warrant.

The Costa Rican economy expanded by more than expected (6.8%) in 2006, and the national open unemployment rate fell from 6.6% to 6.0%, mainly owing to robust export growth. At the sector level, there was an increase in value added in manufacturing, in particular reflecting production by firms operating in free trade zones and enterprises exporting primarily to Central America. Activity was also stronger in the construction and agriculture sectors. In addition, telecommunications services (especially mobile telephones and the Internet), international tourism, financial intermediation services, commerce and international business services (production of computer programs, call centres and business assistance centres) continued to post high growth rates.

The introduction of a new method for calculating the consumer price index (CPI) from August onward helped to reduce the reported inflation rate, since the index based on the new shopping basket gives greater weight to transport and less to food and beverages. Thus, the reduction in fuel prices caused a steeper fall in inflation, while higher food prices had less of an impact on the overall CPI. The colón also appreciated in nominal terms.

The balance-of-payments current account posted a deficit of 5.0% of GDP. The shortfall on the income account, reflecting a higher level of repatriated profits and dividends associated with foreign direct investment (FDI), and a widening of the trade gap (10% of GDP) outweighed the net surplus recorded on trade in services. Nonetheless, capital inflows from abroad were sufficient for net monetary reserves to grow by US$ 760 million.

Total FDI flows in 2006 amounted to US$ 1.61 billion, equivalent to 7.4% of GDP, with the property and financial sectors absorbing larger volumes of investment, along with agribusiness, commerce and tourism.

Table 1
COSTA RICA: MAIN ECONOMIC INDICATORS

	2004	2005	2006 [a]
	Annual growth rates		
Gross domestic product	4.1	5.9	6.8
Consumer prices	13.1	14.1	9.4 [b]
Average real wage [c]	-2.6	-1.9	1.2 [d]
Money (M1)	12.5	13.7	20.6 [e]
Real effective exchange rate [f]	3.3	1.4	-0.4 [g]
Terms of trade	-3.8	-3.8	-3.8
	Annual average percentages		
Urban unemployment rate	6.5	6.6	6.0
Central government overall balance/GDP	-2.7	-2.1	-2.4
Nominal deposit rate	10.0	10.4	10.0 [h]
Nominal lending rate	21.2	22.0	21.3 [h]
	Millions of dollars		
Exports of goods and services	8 612	9 721	11 248
Imports of goods and services	9 175	10 740	12 220
Current account	-796	-964	-1 120
Capital and financial account	876	1 358	1 880
Overall balance	80	393	760

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 2006.
[c] Average wages reported by workers covered by social security.
[d] Estimate based on data from January to September.
[e] Year-on-year average variation, January to November.
[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 October, annualized.

Goods exports grew overall by 19% in f.o.b. terms. The strongest-growing agricultural products included banana, pineapple and mango; prominent among manufactured exports were integrated circuits, electrical microstructures and components for modular circuits, and exports to the Central American Common Market. Import growth of 15% was concentrated in raw materials and intermediate goods, largely reflecting the country's rising oil bill and foreign purchases by companies operating in its free trade zones.