COSTA RICA

1. General trends

Costa Rica recorded economic growth of 3.2% in 2017, compared with 4.2% in the year-earlier period. This marked slowdown stemmed primarily from weaker momentum in private consumption and investment, and from adverse weather events which affected the country in the second half of the year. External demand was also slacker, especially for services exports. Inflation moved into the central bank's target range (3%, with a tolerance range of one percentage point), and was up 2.6% year-on-year in December, after two years below the lower limit of this range. The current account deficit edged up to 3.0% of GDP (up from 2.6% in 2016), as a result of a deterioration in the terms of trade and a wider income account deficit. The central government deficit came to 6.2% of GDP (compared with 5.3% the previous year), owing to an increase in public spending, particularly in interest payments. At the national level, average unemployment fell from 9.5% in 2016 to 9.1% in 2017.

Carlos Alvarado, candidate of the ruling Partido Acción Ciudadana (PAC), won the second round of presidential elections on 1 April 2018. PAC won 10 of the 57 seats in the Legislative Assembly. As a result, like previous governments, it will need to forge alliances with other parties to advance the legislative agenda, including fiscal reform.

ECLAC expects economic growth to pick up slightly in 2018, to 3.3% in real terms. External demand should be buoyed by stronger growth in the country's main trading partners, while investment will be boosted by rebuilding efforts to repair the damage caused by various weather events in 2017. The current account deficit is expected to edge up (to 3.2% of GDP), owing to further deterioration in the terms of trade, while the fiscal deficit is estimated to come to around 6.5% of GDP unless there are significant changes to public income and spending. Inflation is expected to remain within the central bank’s target range.

2. Economic policy

Given the failure to pass the main fiscal reform proposals, the negative balance of central government finances rose above 6% at the end of 2017 and remains the main macroeconomic concern. The new government has announced its firm intention to reduce the fiscal deficit and one of its first moves will be the implementation of a fiscal austerity programme. With respect to monetary policy, the central bank has raised the benchmark interest rate considerably, particularly in response to pressure on the foreign-exchange market.

(a) Fiscal policy

The narrowly defined global public sector posted a deficit of 5.4% of GDP at the end of 2017 (0.6 percentage points higher than the end-2016 level), mainly as a result of the deterioration in central government finances.

The central government deficit widened primarily owing to an increase in interest payments, along with a deceleration in tax revenues. Total central government spending rose by 7.3% in real terms in 2017 (compared with 6.1% the previous year), driven by higher interest payments (up 15.0% in real terms) and larger transfers to the public sector (7.8%). Interest payments accounted for 15.1% of total central government spending (one percentage point higher than in 2016) as a result of the rising level of debt and the cost of that debt in light of higher interest rates. Capital spending increased considerably (11.2% in real terms) because of stronger public spending on road and education infrastructure.

Total central government revenues grew by 2.2% in real terms, compared with 9.3% in 2016. The income tax take remained solid (up 8.5% in real terms) thanks to administrative measures to incentivize tax compliance, while sales tax revenues rose by 1.1% (compared with 5.9% in 2016), affected by domestic demand.

The previous government, which left office in May 2018, made some progress on the fiscal front with the approval of proposals relating to the treasury, pensions and taxes on legal persons, among other things. The law on the strengthening of public finances, which was in the process of being adopted by the Legislative Assembly in July, includes key unfinished projects relating to revenues (introduction of a value added tax to replace the sales tax and modernization of income tax) and to spending (introduction of a fiscal rule that limits current spending and reforms the public sector wage system).

Central government debt amounted to 49.2% of GDP at the end of 2017 (compared with 45.0% in December 2016), the highest level seen since the early 1980s. For the second year in a row, the domestic market was the primary target of new debt, especially institutional clients. Total gross public debt —which includes central government, the central bank, the financial public sector and the non-financial public sector— represented 65.1% of GDP in December 2017, which was 2.6 percentage points higher than the level seen the previous year. This debt ratio was the highest recorded in the past 27 years.

The new government has reaffirmed its commitment to fiscal reform and has thrown its support behind the law on the strengthening of public finances which is in the process of being adopted. If the main income and spending projects are approved, the negative balance of central bank finances could narrow by 2-2.5 percentage points of GDP, in line with Ministry of Finance estimates.

In the first four months of 2018, total central government revenues grew by 3.8%. Meanwhile, total expenditure rose by 7.6%. The failure to approve the main fiscal reform projects in the first half of the year implies that the central government's debt ratio will exceed 50% of GDP.

(b) Monetary policy and exchange-rate policy

On 31 January 2018, the central bank's board of directors officially concluded the transition towards a flexible monetary framework, which had begun in 2005, and of which the central pillar was an explicit inflation target.

Monetary policy was tight in 2017, with an increase of 300 basis points in the central bank's benchmark rate, which stood at 4.75% at the end of the year. The monetary policy rate was raised five times in April and June, and a sixth time at the end of November. These hikes occurred amid rising demand for dollars in the financial system, which exerted upward pressure on the nominal exchange rate, especially in May, when it peaked at 595 colones to the dollar. The higher premium of saving in colones and the approval in October 2017 of a US$ 1 billion loan from the Latin American Reserve Fund (FLAR) to strengthen international reserves (for which the funds were disbursed in March 2018) eased the pressure on the exchange rate.

There is tension between fiscal and monetary policy. While fiscal policy reflects the need to increase central government financing, monetary policy, focused on guaranteeing price stability, has considerably increased the cost of money. However, the indexation of public sector wages to inflation means that the central bank's control of inflation plays a significant role in mitigating increases in the fiscal deficit.

In 2017 —especially in May and June— the central bank sold US 771 million to stabilize the exchange rate. The central bank’s international reserves amounted to US 7.150 billion in December 2017, US$ 424 million less than at the end of 2016. This led the central bank to request the abovementioned loan from FLAR.

At the end of December, the exchange rate stood at 570 colones to the dollar, which reflects nominal depreciation of 2.5% with respect to the level seen at the end of 2016. In real terms, the colon appreciated by 3% (against the United States dollar).

The benchmark rate increases were gradually passed on to the financial system. Rates also came under pressure from the central government's growing need for domestic financing. The basic interest rate on deposits stood at 5.95% in nominal terms in December 2017, compared with 4.45% in the same month in 2016. The average lending interest rate in the financial system stood at 14.9% in nominal terms in December 2017, compared with 14.25% in the same month of 2016.

The higher cost of money contributed to the deceleration of lending to the private sector, which grew by 7.2% year-on-year in 2017 (compared with 12.3% the previous year). The decline in growth was particularly evident in loans granted to the agricultural, industrial and construction sectors.

The monetary policy rate was raised again at the end of January 2018, to 5.0%. In the first six months of the year, the nominal exchange rate remained stable at around 570 colones to the dollar.

(c) Other policies

On the trade policy front, 2017 saw the conclusion of negotiations and the legal review of the free trade agreement between Central America and the Republic of Korea. The Minister of Foreign Trade signed the agreement on 21 February 2018. In November 2017, the Colombian and Costa Rican authorities held the second meeting of the administrative commission of their free trade agreement, in which they agreed to improve the conditions of access to various markets, such as automobile tyres, sanitary ware, and some textile products.

In September 2017, the national council on trade facilitation (CONAFAC) was officially launched, in accordance with the World Trade Organization's Trade Facilitation Agreement. CONAFAC aims to facilitate the internal coordination and implementation of the agreement's requirements, to promote dialogue and coordination with the private sector, and to foster public-private partnerships. At the same time, work continued on preparing the 22 technical reviews required for Costa Rica’s accession to the Organization for Economic Cooperation and Development (OECD), with recent progress in fiscal and innovation policy.

3. The main variables

(a) The external sector

The current account deficit amounted to 3.0% of GDP, which was 0.4 percentage points higher than the level seen at the end of 2016. As in previous years, the goods trade deficit was partly offset by the growing surplus in services. Goods exports amounted to US$ 10.808 billion, representing annual growth of

7.0% (compared with 6.9% in 2016). Bananas and pineapples were among the commodities exported. Medical instruments and devices, which fall under free trade zone rules, were the main manufactured product exports. In 2017, the United States remained the principal destination of Costa Rican exports (39.7%), followed by Belgium and Luxembourg (6.4%) and the Netherlands (5.6%).

Meanwhile, goods imports amounted to US$ 15.150 billion, up 4.3% on an annual basis (compared with 3.3% in 2016). Annual fuel and lubricant imports jumped 25.2%, amid rising international prices. This led to a goods trade deficit of US$ 4.311 billion.

Trade in services recorded a surplus of US$ 5.093 billion, which implies an annual decrease of 0.6%. Services exports slowed sharply (to 3.5% compared with 13.3% in 2016), owing mainly to a strong contraction (of 6.4%) in transport service revenues. Services imports also decelerated (to 8.1% compared with 12.9% in 2016).

The widening of the current account deficit derived mainly from a 1.7% deterioration in the terms of trade and an increase in the primary income deficit, owing to increased interest payments and repatriation of earnings.

Foreign direct investment flows to Costa Rica amounted to US$ 2.997 billion in 2017, which was 1.3% higher than the level seen in 2016. Manufacturing (42.3%) and services (22.6%) recorded the largest investment inflows. By country of origin, the strongest flows originated from the United States (54.9%), Switzerland (9.5%) and Colombia (5.9%).

In the first four months of 2018, cumulative exports amounted to US$ 3.658 billion, indicating an increase of 6.4% with respect to the year-earlier period. Meanwhile, imports posted year-on-year growth of 5.4%.

(b) Economic activity

The economy posted average annual growth of 3.5% in the first half of the year. In the second half, economic growth slowed to 2.9%, owing to adverse weather events, weaker growth in consumer spending and the contraction of investment, in light of the increase in interest rates and commodity prices.

The deceleration in 2017, compared with the strong momentum seen in 2016, affected virtually all the main economic activities. Agriculture and livestock were hit by strong rains in the second half of the year (posting growth of 3.8% compared with 5.3% in 2016), notably tropical storm Nate in October. Natural phenomena also affected construction, which posted a stronger contraction of 6.4% (compared with 4.3% in 2016). Services, which represented 69.5% of GDP in 2017, also slowed (to 3.8% compared with 4.5% in 2016). In the services sector, professional, scientific and technical activities maintained strong momentum (5.8%), while financial and insurance activities decelerated sharply (from 14.9% in 2016 to 5.8% in 2017), affected by the higher cost of loans. Meanwhile, manufacturing grew by 3.8% (compared with 4.8% in 2016), boosted by the production of medical instruments and devices.

In terms of spending items, domestic demand contributed 2.6 percentage points to GDP growth, while external demand contributed 1.6 percentage points. Consumption and investment slowed, particularly the private components of both categories. Total consumer spending grew by 2.7% in 2017, which was 0.6 percentage points lower than in 2016: government spending rose by 2.9% (compared with 2.4% in 2016) and private consumption edged up by 2.6% (compared with 3.5% in 2016), amid weaker growth in disposable income and the higher cost of bank loans. Annual gross fixed investment contracted to 3.1%, owing to a 5.2% decline in private investment and weaker imports of capital goods for transport and agriculture. By contrast, public investment rose by 5.3% following three years of contraction, thanks to the jump in infrastructure works on schools, hospitals and water systems. External demand also slowed, from 11.4% in 2016 to 4.9% in 2017.

In the first four months of 2018, the year-on-year variation in the trend-cycle series of the monthly index of economic activity (IMAE) was 2.6%, down from 3% in the same period in 2017. Growth was driven mainly by services.

(c) Prices, wages and employment

As from October 2017, year-on-year inflation moved above the floor of the central bank's target range (2.0%) for the first time in two years. Year-on-year inflation in December amounted to 2.6%, compared with 0.8% in the year-earlier period. The biggest year-on-year change was seen in prices for transport (5.9%), health (4.3%) and education (4%). By contrast, activities related to clothing and footwear and to communications posted price declines of 1.9% and 3.2%, respectively. Core inflation also rose, posting a year-on-year change of 2.1% on average in December 2017.

In 2017, the average national unemployment rate stood at 9.1%, which was 0.4 percentage points lower than the level seen in 2016. The national employment rate rose, and its annual average stood at 53.8% (compared with 52.8% in 2016). Similarly, the net average annual participation rate rose to 58.8% (as against 58.4% in 2016). The primary sector recorded the largest annual increase in the number of employed persons, of 5.4%.

The real minimum wage index recorded a year-on-year decline of 0.2%. The average monthly real income of employees in the secondary and tertiary sectors diminished by 2.9% and 3.3%, respectively, while for those in the primary sector, it rose by 1.4%.

In May 2018, year-on-year inflation stood at 2.04%, which was once again near the lower limit of the range established by the central bank. The open unemployment rate stood at 10.3% in the first quarter of 2018, compared with 9.1% in the first quarter of 2017.

Table 1
COSTA RICA: MAIN ECONOMIC INDICATORS

	2009	2010	2011	2012	2013	2014	2015	2016	2017 a/
	Annual growth rates b/								
Gross domestic product	-1.0	5.0	4.3	4.8	2.3	3.5	3.6	4.2	3.2
Per capita gross domestic product	-2.3	3.6	3.0	3.6	1.1	2.4	2.6	3.1	2.2
Gross domestic product, by sector									
Agriculture, livestock, hunting, forestry and fishing	-3.4	6.6	0.7	4.8	0.1	1.5	-2.7	5.3	3.8
Mining and quarrying	-17.1	-8.5	-7.4	5.5	5.8	1.2	7.7	8.2	1.8
Manufacturing	-8.0	6.3	3.0	3.4	0.1	0.8	-5.1	4.8	3.8
Electricity, gas and water	2.6	2.2	3.4	5.8	-14.0	3.6	11.0	4.0	2.7
Construction	-2.4	-4.7	1.1	4.6	-9.5	2.1	9.4	-4.3	-6.4
Wholesale and retail commerce, restaurants and hotels	-6.0	5.6	4.9	3.8	6.8	4.8	4.4	2.9	2.7
Transport, storage and communications	2.6	11.7	9.6	7.6	4.0	6.3	8.2	4.6	6.3
Financial institutions, insurance, real estate and business services	6.1	5.4	6.7	9.0	4.6	4.6	6.6	6.5	4.6
Community, social and personal services	4.1	3.7	1.8	1.7	3.5	3.4	2.0	3.0	2.9
Gross domestic product, by type of expenditure									
Final consumption expenditure	2.0	4.7	5.1	4.9	3.0	3.9	4.2	3.3	2.7
Government consumption	6.0	4.1	1.0	0.2	3.2	2.9	2.4	2.4	2.9
Private consumption	0.9	4.9	6.2	6.1	2.9	4.2	4.6	3.5	2.6
Gross capital formation	-12.6	4.3	3.2	9.9	-0.3	3.3	3.0	4.0	-3.1
Exports (goods and services)	-8.3	9.1	7.1	5.5	3.3	5.0	2.6	11.4	4.9
Imports (goods and services)	-18.8	18.7	10.7	7.8	1.7	5.0	4.4	8.7	2.8
Investment and saving c/	**Percentajes of GDP**								
Gross capital formation	18.4	19.7	19.9	20.5	19.0	18.8	18.4	17.9	18.0
National saving	14.5	13.6	14.2	15.2	14.0	15.0	17.7	16.1	15.0
External saving	4.0	6.1	5.7	5.2	4.9	3.8	0.8	1.8	3.0
Balance of payments	**Millions of dollars**								
Current account balance	-561	-1 214	-2 265	-2 411	-2 431	-2 453	-1 921	-1 326	-1 692
Goods balance	-2 582	-3 548	-5 027	-5 348	-5 559	-5 329	-4 607	-4 426	-4 343
Exports, f.o.b.	6 623	7 493	8 301	8 923	8 866	9 456	9 452	10 100	10 808
Imports, f.o.b.	9 205	11 040	13 329	14 271	14 425	14 784	14 059	14 526	15 150
Services trade balance	2 678	3 132	3 833	3 984	4 564	4 539	4 609	5 126	5 093
Income balance	-1 001	-1 186	-1 418	-1 456	-1 828	-2 114	-2 380	-2 482	-2 949
Net current transfers	345	388	348	408	392	450	457	456	507
Capital and financial balance d/	821	1 775	2 397	4 521	2 892	2 340	2 565	1 091	1 273
Net foreign direct investment	1 340	1 589	2 328	1 803	2 401	2 818	2 541	2 127	2 583
Other capital movements	-519	186	69	2 718	491	-478	24	-1 036	-1 310
Overall balance	260	561	132	2 110	461	-113	644	-235	-419
Variation in reserve assets e/	-260	-561	-132	-2 110	-461	113	-644	235	419
Other external-sector indicators									
Real effective exchange rate (index: 2005=100) f/	92.8	82.4	79.7	76.6	74.1	77.4	73.5	75.0	79.4
Terms of trade for goods (index: 2010=100)	104.1	100.0	96.3	95.8	96.1	97.0	97.3	97.0	95.0
Net resource transfer (millions of dollars)	-180	589	979	3 065	1 064	226	185	-1 391	-1 676
Total gross external debt (millions of dollars)	8 276	9 527	11 286	15 381	19 629	21 671	24 030	25 470	26 885
Employment g/	**Average annual rates**								
Labour force participation rate	60.4	59.1	60.7	62.5	62.2	62.6	61.2	58.4	58.8
Open unemployment rate h/	8.5	7.1	7.7	9.8	9.1	9.5	9.7	9.6	9.0
Visible underemployment rate	13.5	11.2	13.4	11.3	12.5	12.8	12.4	9.0	8.1

Table 1 (concluded)

	2009	2010	2011	2012	2013	2014	2015	2016	2017
Prices	**Annual percentages**								
Variation in consumer prices									
(December-December)	4.0	5.8	4.7	4.6	3.7	5.1	-0.8	0.8	2.6
Variation in industrial producer prices									
(December-December)	-1.2	4.5	7.4	3.5	1.6	4.9	-0.4	0.3	3.1
Variation in nominal exchange rate									
(annual average)	8.9	-8.3	-3.8	-0.5	-0.6	7.7	-0.6	1.9	4.2
Variation in average real wage	7.7		5.7	1.3	1.3	2.0	4.1	2.6	1.2
Nominal deposit rate i/	8.6	6.1	5.3	6.5	5.0	4.7	4.4	3.5	3.5
Nominal lending rate j/	21.6	19.8	18.1	19.7	17.4	16.6	15.9	14.7	14.7
Central government	**Percentajes of GDP**								
Total revenue	13.5	13.9	14.2	14.0	14.2	14.0	14.3	14.7	14.5
Tax revenue	13.2	13.0	13.3	13.2	13.5	13.2	13.4	13.9	13.7
Total expenditure	16.8	19.0	18.1	18.3	19.6	19.6	20.0	20.0	20.7
Current expenditure	15.0	16.7	16.7	16.9	18.0	17.9	18.2	18.1	18.7
Interest	2.1	2.0	2.1	2.0	2.5	2.6	2.7	2.8	3.1
Capital expenditure	1.7	2.3	1.4	1.4	1.6	1.7	1.8	1.8	2.0
Primary balance	-1.2	-3.0	-1.9	-2.3	-2.8	-3.1	-3.0	-2.4	-3.1
Overall balance	-3.6	-5.0	-4.0	-4.3	-5.4	-5.6	-5.7	-5.3	-6.2
Central government public debt	26.2	28.4	29.9	34.3	35.9	38.5	41.0	45.0	49.2
Domestic	20.6	22.6	25.1	28.4	28.8	29.8	30.9	34.7	38.9
External	5.5	5.8	4.8	5.9	7.1	8.7	10.1	10.3	10.3
Money and credit	**Percentages of GDP, end-of-year stocks**								
Domestic credit	44.2	39.9	41.1	39.6	43.1	45.9	46.0	45.5	43.8
To the public sector	8.8	10.1	11.8	11.4	14.1	15.5	6.7	7.1	20.0
To the private sector	48.8	45.7	47.1	49.1	52.0	56.3	58.6	61.2	63.7
Others	-8.7	-9.6	-10.7	-12.3	-13.3	-15.9	-19.4	-22.7	-27.7
Monetary base	6.9	6.9	7.0	7.5	7.8	7.8	8.0	8.0	8.4
Money (M1)	14.6	15.6	16.0	16.5	17.5	17.4	18.8	19.4	18.4
M2	33.3	32.8	32.2	34.2	36.8	37.5	37.0	35.7	33.5
Foreign-currency deposits	23.9	18.8	17.7	16.0	14.9	16.4	15.2	15.1	15.4

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/ 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

	2016				2017				2018	
	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/	4.2	4.3	3.5	4.6	3.6	3.4	2.7	3.1	2.5	…
Gross international reserves (millions of dollars)	7 794	7 816	7 889	7 624	7 417	6 982	6 877	6 945	7 537	8 089
Real effective exchange rate (index: 2005=100) c/	72.9	75.0	76.0	76.3	76.7	79.4	81.2	80.2	79.8	78.9
Consumer prices (12-month percentage variation)	-1.1	-0.9	0.4	0.8	1.6	1.8	1.6	2.6	2.6	2.1
Wholesale prices (12-month percentage variation)	-1.5	-1.7	-0.7	0.3	1.1	2.5	3.1	3.1	3.6	3.1
Average nominal exchange rate (colones per dollar)	536.8	540.3	551.4	554.2	559.5	570.1	574.8	569.0	569.3	566.6
Nominal interest rates (average annualized percentages)										
Deposit rate d/	3.5	3.5	3.5	3.5	3.5	3.8	5.0	5.0	5.1	5.3
Lending rate e/	15.4	14.7	14.2	14.3	14.2	14.2	14.8	14.8	15.1	15.4
Interbank rate	1.7	1.6	1.7	1.9	1.9	3.7	5.2	4.6	5.0	5.0
Monetary policy rates	1.8	1.8	1.8	1.8	1.8	3.1	4.5	4.7	4.9	5.0
International bond issues (millions of dollars)	-	500	-	-	-	300	-	-	0	0
Stock price index (national index to end of period, 31 December 2005 = 100)	207	212	259	250	253	…	…	…	…	…
Domestic credit (variation from same quarter of preceding year)	7.9	8.2	7.0	5.4	5.8	7.4	6.3	3.1	-1.9	-3.8 f/
Non-performing loans as a percentage of total credit	1.7	1.6	1.6	1.6	1.6	1.7	1.9	2.0	2.0	2.3

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/ Quarterly average, weighted by the value of goods exports and imports.
d/ Average local-currency deposit rate in the financial system.
e/ Average local-currency lending rate in the financial system.
f/ Figures as of April.