Costa Rica

In 2009, Costa Rica's economy suffered the effects of the global economic slowdown and, particularly, the recession in the United States. The main channels of transmission were falling external demand and tourist arrivals, as well as weakening flows of foreign direct investment (FDI). As a result, GDP is expected to shrink by about 1.2%, after having grown by 2.6% in 2008. Gross domestic investment and exports declined significantly, though this was partially offset by a moderate increase in consumption. The open unemployment rate rose to 7.8% nationwide. Inflation decreased significantly and is expected to end the year at about 4.5%. The balance-of-payments current account deficit decreased considerably, from 9.2% of GDP in 2008 to 3.3% in 2009, whereas the fiscal deficit rose sharply to 3.8% of GDP.

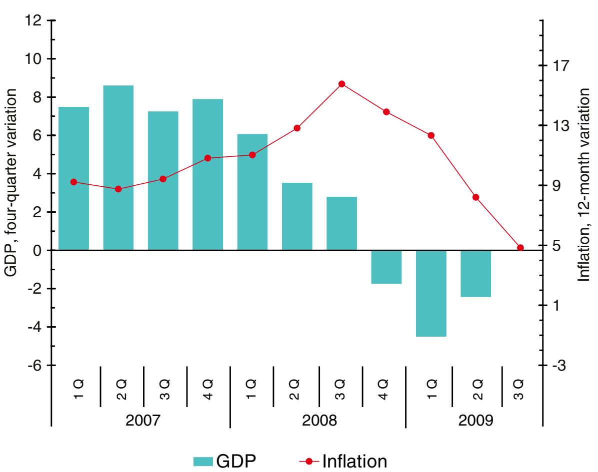
According to ECLAC estimates, GDP will grow by 3.5% in 2010, driven by recovering external demand. Inflation will remain at about 5%, whereas the current account deficit will be similar to that of 2009. The fiscal deficit, as a percentage of GDP, is also expected to be similar to the previous year's figure. In this context, the new government, which will take office in 2010, is expected to engage in fiscal reform efforts.

The balance of the central government deteriorated significantly, which led to several budget adjustments during the year. The administration also sought temporary authorization from the Legislative Assembly to finance current expenditures by borrowing. Fiscal receipts dropped by 9.5% in real terms, because of the downturn in economic activity and in imports. As a result, income taxes and foreign trade suffered the greatest contractions.

In contrast, central government spending increased by 15.6% in real terms. Current expenditures grew the most, as a result of a higher wage bill and countercyclical policies, which included extending social security coverage to workers laid off from their jobs, subsidizing food and transport and raising pensions. The fiscal deficit was financed mainly through the issuance of domestic debt purchased by institutional investors, which posted an annualized growth rate of 28%. External debt came down from 33% of GDP in 2008 to 30% in 2009, as a result of capital payments. Lines of credit with multilateral organizations were hardly used.

In 2009, monetary and exchange-rate policy continued to be directed towards price stability and migration towards a flexible exchange-rate scheme. The central bank found less need to adjust the exchange-rate band than it had in 2008, mainly because there was less turbulence and pressure in the currency market. Since the end of August, the exchange rate has eased back from the upper limit of the band, thanks to a lower current account deficit. In mid-November, the nominal exchange rate was 565 colones

COSTA RICA: GDP AND INFLATION



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

COSTA RICA: MAIN ECONOMIC INDICATORS

	2007	2008	2009 [a]
	Annual percentage growth rates		
Gross domestic product	7.8	2.6	-1.2
Per capita gross domestic product	6.3	1.2	-2.5
Consumer prices	10.8	13.9	4.0 [b]
Average real wage [c]	1.4	-2.0	9.4 [d]
Money (M1)	22.6	1.5	0.6 [e]
Real effective exchange rate [f]	-2.5	-3.4	-1.1 [g]
Terms of trade	-1.0	-3.8	8.0
	Annual average percentages		
Urban unemployment rate	4.8	4.8	7.6
Central government overall balance/GDP	0.6	0.2	-3.8
Nominal deposit rate	7.1	5.4	8.7 [h]
Nominal lending rate	17.3	16.7	21.7 [h]
	Millions of dollars		
	12 852	13 660	12 631
Imports of goods and services	14 103	16 444	13 271
Current account balance	-1 646	-2 732	-1 195
Capital and financial account balance [i]	2 794	2 384	1 462
Overall balance	1 148	-348	267

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Preliminary estimates.
[b] Twelve-month variation to October 2009.
[c] Average wages reported by workers covered by social security.
[d] Estimate based on data from January to September.
[e] Twelve-month variation to November 2009.
[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.
[i] Includes errors and omissions.

per dollar, which represents a depreciation of about 3% compared with the rate at the start of the year. This movement has caused a slight depreciation in the real bilateral exchange rate with the United States, following three years of movement in the opposite direction.

The central bank adopted a tight monetary policy aimed at countering potential inflationary pressures, despite the pullback in economic activity. Until the end of November, the monetary-policy rate had been reduced once, and by only a single percentage point (from 10% to 9%). The financial system's average nominal lending rate closed the year at 24.6%, which translates into a real rate of 17.8%. The average nominal deposit rate ended the year at 10.7%, returning the real rate to positive territory (3.8%) after its negative figures of 2008. Foreign-currency deposits grew by 25%, which reflects the increasing dollarization of the economy.

During 2009, several rounds of talks were held with a view to a free trade agreement with China. Negotiations on the proposed association agreement between Central America and the European Union had to be suspended, pending resolution of the crisis in Honduras. In order to comply with commitments undertaken in the framework of the World Trade Organization (WTO), the government sent a bill to the Legislative Assembly to modify the law on free zones.

The economic downturn was sharper in the first half of 2009 and, since April, the decline in the monthly index of economic activity has eased. The plunge in gross domestic investment (-24.1%) reflected the contraction in construction and machinery purchases and heavy inventory drawdowns. Consumption grew by 1.8% (4.3% in 2008), despite deteriorating economic conditions, driven by rising real wages, increased public spending on remuneration and procurement of goods and services, and the strengthening of social programmes. By sector, manufacturing (-4.9%) and commerce, restaurants and hotels (-4.4%) felt the effect of slumping external demand, whereas agriculture and livestock (-4.7%) were also hurt by adverse weather events and pests.

Inflation, as measured by the consumer price index, dropped significantly in 2009. The year-on-year rate in December is expected to come in at 4.5% (compared with 13.9% in 2008). This decrease is attributable primarily to the economic slowdown and lower international food and fuel prices. Also, the new exchange-rate scheme has helped keep currency fluctuations from being passed through to domestic prices. The nationwide unemployment rate rose sharply (by 2.9 percentage points), following three years of decline. Real wages in the formal sector increased because of the drop in inflation.

The current account deficit narrowed significantly, mainly as a result of goods imports (which were down by around 20%). In the case of durable and capital goods, the fall in imports was due to the contraction of economic activity and, in the case of fuels and lubricants, to lower international prices as well. Exports also contracted, but at a lesser rate of some 7%. In the first half of 2009, exports from free zones fell sharply, but towards the end of the year the pace of the decline had slowed.

Exports of services decreased by about 9%, because of reduced revenues from transport and tourism. Exports of business services are thought to have continued to rise, however, thanks to the arrival of new businesses seeking to lower costs. FDI flows totalled US$ 1.4 billion, compared with US$ 2 billion in 2008, as investment in construction and tourism fell. Though the financial account surplus shrank, it still exceeded the current account deficit in absolute terms, which led to an accumulation of reserves.