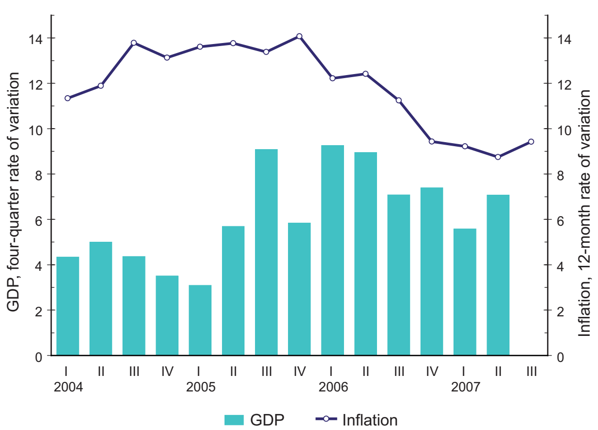
Costa Rica

The expansion of the Costa Rican economy slowed from 8.2% in 2006 to 7.0% in 2007. The growth rate remains high, however, especially in comparison with potential growth, estimated at 4.5%. Exports rose by 9% at constant prices and continued to show the greatest buoyancy. The open unemployment figure fell from 6.0% to 4.6%. Inflation picked up during the last months of 2007 and is expected to reach 10.0% by the end of the year, exceeding the 2006 figure (9.4%) and the target set by the central bank (8%). The central government fiscal deficit edged up somewhat from the equivalent of 1.1% of GDP in 2006 to 1.3% in 2007, while the balance of payments current-account deficit rose slightly to 5.2% of GDP. The central bank has set an inflation target of 6% for 2008. ECLAC estimates forecast real GDP growth of 6.0% and an inflation rate of 7%. The central government fiscal deficit is expected to decline slightly to 1.1% of GDP, while the balance of payments current-account deficit as a percentage of GDP should be similar to the 2007 figure.

Lack of parliamentary support for government initiatives hindered implementation of a number of important economic policy measures, including approval of the tax reform bill. The central government fiscal deficit was up slightly (1.3% of GDP) and current revenue grew thanks to the buoyancy of the economy and improvements in tax administration. The payment of wages and pensions, as well as a sharp rise in “other expenditure”, were the causes of the moderate upturn in the deficit.[1] In order to discourage short-term capital inflows and restrain the fluctuation of the dollar, the central bank kept the floor of the crawling band system unchanged and lowered interest rates. However, mostly owing to the excess of dollars in the national market, which was partly caused by high financial inflows from abroad, the dollar exchange rate

COSTA RICA: GDP AND INFLATION



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

1 “Other expenditure” consists mainly of transfers to municipalities and the “Avancemos” programme, financing provided to the National Highway Council (CONAVI) and spending on school meals and non-contributory pensions.

remained at or close to the floor of the exchange-rate band (520 colones) despite considerable purchases of dollars by the central bank. In August, the year-on-year variation of the nominal exchange rate was 0.3%. Owing to the inflation gap, the Costa Rican currency posted a real appreciation of 5.5% against the dollar. In response, the central bank decided in November that on the basis of an intervention rate of 498.39 colones (buying) and 562.83 (selling), the daily depreciation would be 6 cents.

In the course of the year, the central bank cut the monetary-policy rate from 9.75% to 6.0%.[2] This change was reflected in the interest rate structure of central bank debt instruments and led to widespread cuts in commercial banks' lending and deposit rates. Nonetheless, given the central bank's inflation target of 8%, the upswing in inflation in late 2007 is expected to bring about interest rate rises.

Following the referendum of 7 October which approved the Dominican Republic-Central America-United States Free Trade Agreement (CAFTA-DR), the country's President enacted the agreement as a law of the Republic. The approval by Congress of the implementation programme remained pending, however.

Trade and investment cooperation agreements were signed with China following the establishment of diplomatic relations in July. The accords include an agreement on reciprocal protection of investments and an agreement to explore the possibility of signing a free trade agreement. An agreement was also reached between the Costa Rican Oil Refinery (RECOPE) and the China National Petroleum Corporation. Among other things, the agreement provides for Chinese technical assistance to analyse the possibility of extending the existing refinery operated by RECOPE.

At 7%, the growth of the Costa Rican economy in 2007 was greater than had been forecast (5%) and the national open unemployment rate fell from 6.0% to 4.6%. At the sectoral level, there were notable increases in value added in construction, transport, storage and communications, financial intermediation services, manufacturing —thanks to the output of companies operating in the free trade zones and those which export mostly to Central America— and agriculture. In the last quarter of the year, economic activity was affected by the negative impact of the heavy rainfall that hit the north of the country and the Caribbean coast.

Year-on-year inflation, measured by the yearly variation of the consumer price index (CPI), stood at 9.4% in September, the same as at the end of 2006. According to ECLAC estimates, the inflation figure will be about 10%, given the upward trend in international oil prices, excess demand especially in the private sector, which particularly affected non-tradables, and the concentration of banking resources in high-liquidity financial assets.

In the external sector, the balance-of-payments current account posted a deficit equivalent to 5.2% of GDP. The rising deficit on the income account, caused by increased repatriation of profits and dividends associated with foreign direct investment (FDI), surpassed the net surplus on the services account. The current-account deficit, however, stood at only 57.3% of the surplus on the capital and financial account, mostly owing to the high level of FDI, which rose to more than US$ 1.65 billion, with major investments in the real estate and tourism sectors. This gave a considerable boost (32%) to net international reserves, which stood at US$ 4.115 billion.

COSTA RICA: MAIN ECONOMIC INDICATORS

	2005	2006	2007 [a]
	Annual growth rates		
Gross domestic product	5.9	8.2	7.0
Per capita gross domestic product	4.0	6.3	5.2
Consumer prices	14.1	9.4	10.1 [b]
Average real wage [c]	-1.9	1.6	1.9 [d]
Money (M1)	13.7	21.0	23.3 [e]
Real effective exchange rate [f]	1.4	-0.2	-1.5 [g]
Terms of trade	-3.8	-2.9	-1.0
	Annual average percentages		
Unemployment rate	6.6	6.0	4.6
National administration overall balance / GDP	-2.1	-1.1	-1.3
Nominal deposit rate	12.1	11.3	7.2 [h]
Nominal lending rate	24.0	22.6	17.4 [h]
	Millions of dollars		
Exports of goods and services	9 721	11 023	12 515
Imports of goods and services	10 747	12 426	13 518
Current account	-971	-1 122	-1 346
Capital and financial account	1 364	2 153	2 346
Overall balance	393	1 031	1 000

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 2007.
[c] Average wages reported by workers covered by social sucurity.
[d] Estimate based on data from January to August.
[e] Twelve-month variation to October 2007.
[f] A negative rate indicates an appreciation of the currency in real terms.
[g] Year-on-year average variation, January to October 2007.
[h] Average from January to November, annualized.

2 As of March 2006, the monetary-policy rate was defined as the interest rate of the overnight deposit facility.

Goods exports grew overall by 14.7%. The fastest-growing agricultural products included bananas, pineapples and coffee. Prominent among industrial exports were integrated circuits, electrical microstructures and components for modular circuits, and exports to the Central American Common Market. Import growth of 9.3% was concentrated in raw materials and intermediate goods, largely reflecting the country's rising oil bill, imports of raw materials for construction and, to a lesser extent, foreign purchases by companies operating in its free trade zones.