Costa Rica

1. General trends

Having contracted by 1.3% in 2009, the real GDP of Costa Rica grew by 4.2% in 2010. This upturn is attributable to the strong performance of exports and a moderate expansion in consumption and gross investment. Per capita GDP grew by 2.8%, thus reversing the 2.6% fall sustained in 2009. Inflation stood at 5.8% at the end of the year, which is within the target range announced by the central bank at the beginning of the year. The open unemployment rate improved, standing at 7.3% compared with 8.4% in 2009. The central government balance continued to deteriorate and closed the year at a figure equivalent to 5.2% of GDP, compared with 3.4% in 2009. The balance-of-payments current account deficit widened considerably to 3.6% from 2% in 2009.

In 2010, the Costa Rican economy benefited from the upturn in the international economy, which had a positive influence in the form of stronger external demand for goods and services, an increase in tourism and larger foreign direct investment (FDI) flows. With regard to macroeconomic policy, the executive branch is working on a fiscal reform proposal in response to the widening fiscal deficit; however, up to June 2011, the proposed reform had yet to be adopted by the Legislative Assembly. Substantial inflows of foreign exchange pushed down the nominal exchange rate against the dollar towards the floor of the band, while the central bank accumulated large amounts of reserves.

ECLAC forecasts GDP growth of 3.2% in 2011, as a result of sluggish activity among the country's main trading partners and the as yet moderate rally in domestic demand. Commitments related to transfers and compensation will continue to exert pressure on the fiscal balance, which, barring any significant improvement in fiscal revenues and assuming that spending stabilizes, will once again be a deficit of over 5% of GDP. High fuel and commodity prices will keep the current account deficit at about 4% of GDP.

In 2011 the central bank is facing weighty policy decisions in an international environment characterized by volatility and uncertainty. In early 2011, the exchange rate stayed close to the floor of the band, necessitating a significant intervention to protect the established rate of 500 colones to the dollar. The need to finance a large deficit could place upward pressure on the interest rate, which could also lead to increased inflows of short-term capital. On the other hand, there could be a reversal of capital flows if interest rates rise in developed countries or investor appetite for risk assets wanes.

2. Economic policy

Significantly higher central government spending, coupled with only a modest upturn in tax revenue, resulted in another increase in the fiscal deficit as a proportion of GDP. Monetary and exchange-rate policies in 2010 continued to aim for a transition towards a flexible exchange rate and inflation targeting, while also pursuing the process to keep inflation down that was begun in 2009.

(a) Fiscal policy

The overall performance of the public sector, which includes the non-financial public sector and the central bank, continued to deteriorate in 2010, resulting in a deficit equivalent to 5.4% of GDP, compared with 3.9% in 2009. Between 2007 and 2010, the central government balance went from a slight surplus (0.6%) to the largest fiscal deficit in Latin America as a percentage of GDP. The central bank's deficit was equivalent to 0.5% of GDP, down by 0.3 percentage points from 2009 because of lower interest rates on its investment instruments.

Central government current revenues picked up significantly, growing by 10% in real terms (compared with a 12.1% decline in 2009), owing to the upturn in economic activity, and especially foreign trade. Customs duties rose at an annual rate of 8.4%, while selective taxes on imports mushroomed by 24.7%. Domestic sales tax and income tax expanded by a meagre 2% and 3.5%, respectively. Given the weight of these two taxes as a proportion of total tax revenue, the tax burden diminished from 13.5% of GDP in 2009 to 13.2% in 2010.

Central government current spending expanded by 18.1% in real terms in 2010, compared with 14.8% in 2009. The wage bill shot up by 14.5% in 2010 under a programme to gradually raise salaries that began in 2009 during the economic crisis. Transfers jumped by 27.5% in real terms, as more resources were allocated to social programmes and public universities. Capital expenditure rose by 35.6% in real terms, driven by capital transfers from the central government to the National Highway Council (CONAVI) for the construction and repair of highways. Total central government spending was up by 20% in 2010 (10.7% in 2009), rising in terms of GDP from 15.7% in 2008 to 19.8% in 2010.

The growing fiscal deficit was financed by issuing domestic debt, which thus increased from an amount equivalent to 29.9% of GDP in 2009 to 31.2% in 2010. External debt stood at 11.8% of GDP at the end of the year, which was 0.5 percentage points lower than in 2009. A loan from the World Bank for US$ 500 million was disbursed in September with a view to paying off debts and improving the country's debt profile in terms of maturity and cost. In the same month, Moody's Investors Service upgraded the country's government bond rating from Ba1 to investment grade Baa3. At the end of 2010 total public debt was equivalent to 42.9% of GDP, compared with 42.1% in 2009.

In order to tackle the widening fiscal deficit, the executive branch has been working on a fiscal reform proposal which seeks to increase revenues and rationalize spending.

In the first four months of 2011, tax revenue grew moderately; however, if the trend continues, the deficit could widen even further, making the need for a comprehensive fiscal reform even more urgent.

(b) Monetary and exchange-rate policy

The exchange market was extremely volatile throughout the year, with a tendency towards an appreciation of the colón, which kept it close to the floor of the band (500 colones) during the last five months of the year. At the end of December, the exchange rate reached 512 colones to the dollar, representing an annual nominal appreciation of 8.3%. The bilateral real exchange rate with the United States dollar reflected a 9.5% appreciation in 2010, while in terms of the multilateral real exchange rate, the appreciation was 13.2%. The exchange rate is influenced by the central bank's reduced foreign currency holdings and by inflows of capital, attracted by the positive interest rate spread.

In September the central bank announced a programme to accumulate, as a precautionary measure, international reserves totalling up to US$ 600 million between 2 September 2010 and 31 December 2011; thus, by the end of the last quarter of 2010, it had built up US$ 250 million in reserves. In addition, in December the central bank openly intervened to protect the floor of the band with an operation worth US$ 16 million. As a result, US$ 560 million in international reserves were accumulated during 2010, giving total reserves of US$ 4.627 billion at the end of December.

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. On 21 October it was lowered by a further 100 basis points and closed the year at 6.5%.

With a view to improving the pass-through of the benchmark rate to the rates of the financial system and to increasing its control over liquidity, the central bank created an overnight deposit facility in October, setting the interest rate at 4.5%. This created a band of interest rates in the integrated liquidity market, whose ceiling is the monetary policy rate and whose floor is the overnight rate.

The interest rates in the financial system responded in part to the changes to the benchmark rate. The financial system's net average six-month deposit rate closed the year at 7.8%, compared with 8.8% in 2009. In real terms it fell substantially, from 4.6% in 2009 to 1.8%, because of higher inflation. Lending rates declined, but remain high. The real average rate of the financial system closed the year at 13.9% (18.1% in 2009), much higher than the levels seen before the crisis.

Lending to the private sector expanded by 4.8% in nominal terms, which was more than in 2009 (3.5%), but less than the growth of 30% or higher seen between 2007 and 2008. The decline of real lending rates, the upturn in economic activity and the greater availability of resources in the financial system favoured the expansion of credit. By sector, consumer loans experienced a modest increase of 5.3%, but lending to the construction industry continued to contract, falling by 19.7%.

Currency in circulation rose by 9.9%, slightly below the rate of economic growth in nominal terms. Current account deposits in national currency scaled up significantly (26%), while deposits in foreign currency fell by 3.1%, owing to the appreciation of the colón and low domestic inflation.

In 2011, the exchange rate has remained under pressure, sticking to the floor of the band since mid-February. In the first four months of the year, the central bank purchased more than US$ 350 million to protect the lower limit of the band. In April a legal reserve requirement was established for short-term external capital inflows (less than one year) into the financial system, with a view to reducing the economy's exposure to the volatility of such flows.

(c) Trade policy

In May 2010, the association agreement between Central America and the European Union was signed and the ratification process began. The legal review process is expected to be completed in 2011, and the next stage, involving the approval of the agreement by the legislature, will begin. Free trade agreement negotiations with China and Singapore were concluded in April 2010 and the resulting agreements are expected to be approved by the legislature and come into effect in 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, together with Panama, in 2011. In September, Costa Rica initiated negotiations on a free trade agreement with Peru. El Salvador, Honduras and Panama will also join those negotiations, which are expected to be concluded in 2011.

3. The main variables

(a) Economic activity

External and domestic demand rose by 4.8% and 8.7%, respectively, in real terms, while the significant expansion in imports (14.2%) had a negative impact on GDP growth. The expansion of aggregate demand is attributable mainly to the impetus of gross domestic investment, which climbed by 29.1%, and to a lesser extent to consumption, which rose by 3.7%. The upswing in gross domestic investment was the result of companies' restocking, rather than gross fixed capital formation, which went up by 2.6%. The upturn in private consumption (3.4% compared with 1.5% in 2009) was the outcome of higher real available income, which in turn was associated with buoyant economic activity and the increase in real wages. Government consumption rose by 5.9% in real terms, compared with 6.7% in 2009.

Most productive sectors rallied in 2010. As the areas damaged by adverse weather events in 2009 returned to production, the agriculture and livestock sector grew at an annual rate of 6.5%, after falling by 3.2% in 2009. Having dropped by 3.9% in 2009, manufactures were up by 3.7%, driven by an upturn in external and domestic demand. In the face of continued oversupply and sluggish credit growth, the construction sector shrank once again, this time by 6.7%.

Table 1
COSTA RICA: MAIN ECONOMIC INDICATORS

	2002	2003	2004	2005	2006	2007	2008	2009	2010[a]
					Annual growth rates [b]				
Gross domestic product	2.9	6.4	4.3	5.9	8.8	7.9	2.7	-1.3	4.2
Per capita gross domestic product	0.8	4.3	2.4	4.1	7.1	6.4	1.4	-2.6	2.8
Gross domestic product, by sector									
Agriculture, livestrock, hunting, forestry and fishing	-3.3	7.4	0.7	4.3	12.7	5.6	-3.2	-3.2	6.5
Mining and quarrying	-3.1	4.2	7.7	7.6	25.7	-1.5	-5.6	-14.1	-5.3
Manufacturing	3.4	8.4	4.0	10.8	10.8	7.0	-3.7	-3.9	3.7
Electricity, gas and water	5.3	5.8	4.0	5.9	6.1	2.3	-0.6	3.3	2.8
Construction	-1.5	4.8	6.3	-0.2	18.2	21.3	14.6	-3.0	-6.7
Wholesale and retail commerce, restaurants and hotels	1.6	3.4	3.9	4.0	4.8	6.6	3.4	-6.4	4.4
Transport, storage and communications	12.0	13.7	12.0	9.6	10.5	9.8	7.6	1.9	6.4
Financial institutions, insurance, real estate and business services	4.8	7.1	6.6	5.4	11.1	9.3	8.5	5.6	5.0
Community, social and personal services	3.0	3.0	1.4	3.3	2.3	3.4	4.5	4.7	4.1
Gross domestic product, by type of expenditure									
Final consumption expenditure	3.0	2.8	2.9	3.9	5.4	6.9	3.3	2.1	3.7
Government consumption	2.3	-0.3	1.3	0.2	2.9	2.3	4.4	6.7	5.9
Private consumption	3.1	3.2	3.1	4.4	5.7	7.5	3.2	1.5	3.4
Gross capital formation	9.8	-4.7	10.9	11.3	13.9	-1.2	22.2	-36.7	29.1
Exports (goods and services)	3.6	12.1	8.2	12.8	10.3	9.9	-2.6	-6.0	4.8
Imports (goods and services)	6.9	0.9	9.1	12.4	8.1	4.3	6.5	-19.9	14.2
					Percentages of GDP				
Investment and saving [c]									
Gross capital formation	22.6	20.6	23.1	24.3	26.4	24.7	27.6	15.9	20.0
National saving	17.5	15.6	18.9	19.4	21.9	18.4	18.2	13.9	16.3
External saving	5.1	5.0	4.3	4.9	4.5	6.3	9.3	2.0	3.6
					Millions of dollars				
Balance of payments									
Current account balance	-857	-880	-791	-981	-1 023	-1 646	-2 787	-576	-1 299
Goods balance	-1 278	-1 089	-1 421	-2 159	-2 727	-2 985	-5 013	-2 039	-3 576
Exports, f.o.b.	5 270	6 163	6 370	7 099	8 102	9 299	9 555	8 838	9 375
Imports, f.o.b.	6 548	7 252	7 791	9 258	10 829	12 285	14 569	10 877	12 951
Services trade balance	685	776	857	1 116	1 351	1 734	2 201	2 188	2 635
Income balance	-440	-776	-440	-209	4	-865	-417	-1 084	-717
Net current transfers	175	209	212	270	349	470	442	359	359
Capital and financial balance [d]	1 020	1 219	872	1 374	2 053	2 794	2 439	836	1 860
Net foreign direct investment	625	548	733	904	1 371	1 634	2 072	1 339	1 404
Other capital movements	395	671	139	470	682	1 160	367	-503	456
Overall balance	163	339	80	393	1 031	1 148	-348	260	561
Variation in reserve assets [e]	-163	-339	-80	-393	-1 031	-1 148	348	-260	-561
Other external-sector indicators									
Real effective exchange rate (index: 2000=100) [f]	98.9	104.8	106.5	107.6	106.5	103.9	100.1	99.7	89.0
Terms of trade for goods (index: 2005=100)	109.7	108.1	104.0	100.0	97.1	96.1	92.5	95.6	91.8
Net resource transfer (millions of dollars)	580	443	432	1 166	2 058	1 929	2 022	-247	1 142
Gross external public debt (millions of dollars)	5 310	5 575	5 765	6 763	7 186	8 444	9 105	8 174	8 558
					Average annual rates				
Employment									
Labour force participation rate [g]	55.4	55.5	54.4	56.8	56.6	57.0	56.7	60.4	59.1
Open unemployment rate [h]	16.9	15.3	14.9	12.9	12.6	11.2	11.3	8.5	7.1
Visible underemployment rate [i]	12.3	15.2	14.4	14.6	13.5	11.5	10.5	13.5	11.2
					Annual percentages				
Prices									
Variation in consumer prices (December-December)	9.7	9.9	13.1	14.1	9.4	10.8	13.9	4.0	5.8
Variation in industrial producer prices (December-December)	8.4	11.0	17.7	12.1	13.7	14.6	23.5	-1.2	4.5
Variation in nominal exchange rate (annual average)	9.3	10.8	10.0	9.1	7.0	1.0	1.9	8.9	-8.3
Variation in average real wage	4.1	0.4	-2.6	-1.9	1.6	1.4	-2.0	7.7	2.1
Nominal deposit rate [j]	14.0	12.6	11.5	12.1	11.4	7.1	5.4	8.6	6.1
Nominal lending rate [k]	26.8	26.2	23.4	24.0	22.7	17.3	16.7	21.6	19.4

Table 1 (concluded)

	2002	2003	2004	2005	2006	2007	2008	2009	2010[a]
	Percentages of GDP								
Non-financial public sector									
Total revenue	24.7	25.0	24.4	25.2	25.8	26.6	26.8	26.0	25.8
Current revenue	24.8	24.7	24.4	25.2	25.8	26.6	26.9	26.0	25.7
Tax revenue	19.8	19.9	19.7	20.2	20.7	22.1	22.8	21.3	21.2
Capital revenue	-0.1	0.4	-0.0	-0.0	-0.0	-0.0	-0.1	0.0	0.1
Total expenditure [l]	28.6	27.4	26.4	25.6	24.5	24.8	26.9	30.7	31.2
Current expenditure	23.3	22.8	22.2	21.8	21.0	20.7	21.1	24.2	25.2
Interest	4.3	4.3	4.1	4.2	3.8	3.1	2.2	2.2	2.2
Capital expenditure	5.2	4.5	4.1	3.8	3.5	4.1	5.3	6.5	5.9
Primary balance	0.4	1.9	2.1	3.8	5.2	4.9	2.1	-2.5	-3.2
Overall balance	-3.9	-2.4	-2.0	-0.4	1.3	1.8	-0.1	-4.6	-5.4
Non-financial public sector debt	45.1	45.6	46.9	42.9	38.4	31.8	29.9	34.1	36.2
Domestic	28.7	27.0	27.6	25.5	23.4	19.6	18.1	23.1	25.7
External	16.4	18.6	19.3	17.4	15.0	12.2	11.8	11.1	10.5
Money and credit [m]									
Domestic credit	31.2	33.3	36.1	36.8	36.3	39.6	45.0	45.0	41.9
To the public sector	5.6	6.5	9.0	6.7	4.4	2.2	2.2	3.4	3.2
To the private sector	25.4	26.5	26.7	29.4	31.1	36.5	41.7	40.4	37.8
Other	0.1	0.3	0.4	0.7	0.8	0.9	1.1	1.1	1.0
Liquidity (M3)	36.3	37.1	42.6	44.0	44.3	43.8	46.8	49.6	46.8
Currency outside banks and local-currency deposits (M2)	20.4	20.9	21.0	22.3	23.5	25.6	24.8	25.7	26.0
Foreign-currency deposits	16.0	16.2	21.6	21.7	20.8	18.1	22.0	23.9	20.8

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 1991 prices.
[c] Based on figures in local currency expressed in dollars at current prices.
[d] Includes errors and omissions.
[e] A minus sign (-) denotes an increase in reserves.
[f] Annual average, weighted by the value of goods exports and imports.
[g] Economically active population as a percentage of the working-age population; nationwide total.
[h] Percentage of the economically active population; nationwide total.
[i] Percentage of the working population; nationwide total.
[j] Average deposit rate in the financial system (gross).
[k] Average lending rate in the financial system.
[l] Includes net lending.
[m] The monetary figures are end-of-year stocks.

Services expanded across the board. Transport, storage and communications performed particularly well, with growth of 6.4%, driven by greater demand for services relating to foreign trade and communications. Having dropped by 6.4% in 2009, the commerce, restaurants and hotels sector grew by 4.4%, owing to the upturn in domestic demand and tourism.

The monthly index of economic activity reflected average growth of 3.2% in the first four months of 2011, sustaining the moderate rate of expansion seen in the last quarter of 2010. Services, especially transport, financial intermediation and other business services, performed robustly, while manufacturing picked up only slightly.

(b) Prices, wages and employment

The consumer price index inched up by 1.8 percentage points compared with the previous year because of the increase in prices of agricultural products and regulated services. Inflation stayed within the target range set by the central bank, despite the increase in international fuel and commodity prices, thanks to the appreciation of the colón and moderate growth in domestic demand. Inflation held steady at a single-digit rate for the second year in a row, which had not been seen in recent decades in Costa Rica.

The items that contributed the most to the rise in the consumer price index were: food and non-alcoholic beverages (33.6% of the total cumulative variation at year's end), rentals and housing services (19.8%) and transport (13.9%). Core inflation, which does not take account of variations in controlled prices, rose at a cumulative rate of 3.5%, which was 2.3 percentage points lower than headline inflation.

Although unemployment has declined as the economy has improved, it is still at a much higher level than before the crisis. The national employment rate decreased from 55.4% in 2009 to 54.8% in 2010, as the economy was unable to create enough jobs for the growing labour supply. The real minimum wage increased by 2.4%.

Table 2
COSTA RICA: MAIN QUARTERLY INDICATORS

	2009				2010 [a]				2011 [a]	
	I	II	III	IV	I	II	III	IV	I	II [b]
Gross domestic product (variation from same quarter of preceding year) [c]	-4.8	-2.5	-0.3	2.7	5.4	4.0	3.7	3.7	…	…
Goods exports, f.o.b. (millions of dollars)	2 078	2 240	2 231	2 235	2 404	2 410	2 272	2 299	2 484	1 778
Goods imports, c.i.f. (millions of dollars)	2 531	2 740	2 896	3 228	3 170	3 355	3 498	3 547	3 860	2 578
Gross international reserves (millions of dollars)	4 167	3 936	4 059	4 066	4 155	4 065	4 571	4 627	4 642	4 650
Real effective exchange rate (index: 2000=100) [d]	96.2	99.9	102.2	100.6	93.8	88.7	86.9	86.7	85.5	86.9
Consumer prices (12-month percentage variation)	12.3	8.2	4.8	4.0	5.8	6.3	5.0	5.8	4.6	4.8
Industrial producer prices (12-month percentage variation)	15.0	8.4	-2.3	-1.2	1.7	1.8	1.5	4.5	7.5	9.3
Average nominal exchange rate (colones per dollar)	562	574	585	572	551	526	515	510	503	502
Average real wage (variation from same quarter of preceding year)	13.6	7.8	8.8	11.2	-4.0	3.3	5.7	3.7	15.1	...
Nominal interest rates (annualized percentages)										
Deposit rate [e]	8.5	8.5	9.4	8.0	6.4	6.4	6.1	5.5	5.5	5.4
Lending rate [f]	21.4	22.0	22.1	20.8	19.9	20.0	19.3	18.2	18.1	17.5
Domestic credit (variation from same quarter of preceding year)	26.2	19.7	13.6	6.6	2.9	3.3	-0.8	4.5	12.7	15.0 [g]
Non-performing loans as a percentage of total credit	1.9	2.1	2.2	2.1	2.2	2.2	2.2	1.9	1.9	2.2

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Preliminary figures.
[b] Data to May.
[c] Based on figures in local currency at constant 1991 prices.
[d] Quarterly average, weighted by the value of goods exports and imports.
[e] Average deposit rate in the financial system (gross).
[f] Average lending rate in the financial system.
[g] Data to April.

Year-on-year variation in the consumer price index averaged 4.7% in the first five months of 2011, despite higher international prices for fuels and commodities. However, as long as there are no further significant fluctuations in international oil and commodity prices, achieving the central bank's annual inflation target of 4%, with a margin of tolerance of one percentage point, seems feasible.

(c) The external sector

The balance-of-payments current account deficit widened considerably because of the sharp increase in goods imports (19.2%). Higher international prices for oil, basic grains and commodities in general led the value of imports to skyrocket. Fuel imports were up by 25.6% in relation to 2009, while imports of intermediate goods for mining and industry rose by 20.7%; the latter were associated also with the upturn in the manufacturing industry. Another factor driving up imports was greater demand (consumption and rebuilding of inventories), with the consequent higher imports of consumer goods (21.5%) and capital goods (13.5%).

Goods exports increased by 6.8% with respect to 2009, driven in particular by the higher volumes and prices of agricultural products. Traditional exports went up by 17.8%, with a considerable expansion in exports of coffee (11.7%) and bananas (13.3%). Non-traditional exports rose by 5.6%, with particular increases in exports of pineapples (12.6%) and exports from industries located outside free zones (11.5%). Total exports from free zones slowed towards the end of the year, recording an annual rate of 4.7%, because of a fall in sales of high-tech goods.

As a result of the escalation in international fuel and commodity prices, the terms of trade deteriorated by 3.9%, reversing the improvement seen in 2009 (3.3%).

Exports of services expanded at an annual rate of 20.7%, boosting their share of total exports to 32% (29.3% in 2009). The "other services" sector grew at an annual rate of 29.5%, driven in large part by information technology and information services, which have performed robustly over the last five years. Revenue from travel services picked up significantly (16.3%, compared with a fall of 20.5% in 2009), reflecting the international upturn in tourism.

The deficit on the merchandise trade balance shot up by 75% in relation to the previous year and stood at US$ 3.576 billion. This increase was partially offset by the positive balance of services, which, at US$ 2.635 billion, was 20.4% higher than in 2009. The deficit on the income balance closed at US$ 717 million owing to the repatriation of profits.

Family remittances from abroad totalled US$ 505 million, only 3.5% higher than in the previous year because of the weak recovery of employment in the United States and tougher migration policies. Outward remittances also experienced modest annual growth of 1.4%, to give a total of US$ 227 million, mostly destined for Nicaragua.

The financial account showed a surplus of US$ 2.048 billion, which was higher than the current account deficit (US$ 1.299 billion). FDI totalled US$ 1.404 billion, which was US$ 65 million more than in 2009. These resources were allocated mainly to the manufacturing industry (55%), commerce and services (23%) and real estate (11.6%).

The goods trade deficit is expected to widen in 2011 because of higher international oil and commodity prices and the appreciation of the currency. This will be counterbalanced by the expansion of services exports, especially tourism and business services, and higher FDI flows driven by investment in telecommunications. However, the pattern seen in the first four months of 2011 should be taken as a warning sign: exports grew at a year-on-year rate of only 5.2%, while imports surged by 18.9%.