Costa Rica

ECLAC estimates that the Costa Rican economy will experience real growth of 3.9% in 2017, down from 4.5% in 2016, as a result of slowing private consumption and adverse climate phenomena. External demand has also been less buoyant, especially for services exports. Inflation will converge towards the central bank's target range (3% plus or minus one percentage point) and the year-on-year rate will be around 2.5% in December, owing to rising international commodity prices. The current account deficit will grow to 4% of GDP (up from 3% in 2016), as a result of a decline in the terms of trade and an increase in the income account deficit. The nationwide unemployment rate averaged 9% in the first three quarters of 2017, compared to 9.5% in the same period of the previous year.

The fiscal deficit recorded an uptick due to higher interest payments and rising current expenditures, and will therefore close the year at around 6% of GDP (up from 5.2% in 2016). The constitutional mandate of the current government is coming to an end, and presidential and legislative elections will be held in February 2018. As yet no agreement has been reached in the Assembly to approve the main fiscal reform bills, which are intended to reduce the deficit and, in particular, would introduce a value added tax and make changes to the income tax.

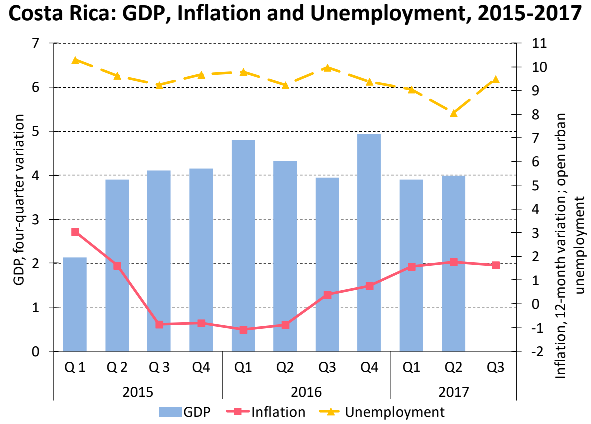
Total central government revenues recorded year-on-year real growth of 4.4% in the first nine months of 2017 (compared with growth of 9.9% over the same period of 2016). This slowing is primarily the result of lower revenues from taxes on imports (down by 5.3% in real terms) and on consumption (down by 4.6% in real terms), reflecting lower sales of automobiles and other imported durable consumer goods following the devaluation of the colon in May.

Total central government spending recorded a real year-on-year increase of 8.8% in the first three quarters of 2017 (compared to 2.9% for the same period of 2016). There was an especially sharp increase in interest payments (21.2% in real terms), as a result of higher interest rates. Current spending rose by 7.3% in real terms.

The public debt of the central government reached 15.56 trillion colones at the end of September 2017 (equivalent to US$ 27.197 million), for a real increase of 9.4% over December 2016. It is expected to close the year 2017 at around 48% of GDP (compared to 44.7% in 2016). The government continued to rely for its financing on the domestic market, primarily on institutional clients of the public sector.

Monetary policy has maintained a restrictive stance in 2017, contrasting with an expansionary fiscal policy that demands an increasing flow of resources to finance the deficit. The monetary policy interest rate was raised on six occasions by a total of 300 basis points in the first 11 months of 2017, to stand at 4.75%. These increases took place amid rising demand for dollars on the part of the Costa Rican financial system, which exerted upward pressure on the exchange rate, especially in the month of May when it peaked

Costa Rica: GDP, Inflation and Unemployment, 2015-2017



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

at 595 colones to the dollar. The increase in the premium for savings in colones, as well as the availability of up to US$ 1 billion in international reserves on the part of the central bank, served to moderate pressure on the exchange rate. As a result, at the end of October the exchange rate stood at 570 colones to the dollar, a nominal depreciation of 2.5% from the level recorded at the end of 2016.

In this context, the central bank's international reserves amounted to US$ 6.898 billion at the end of September 2017, down by US$ 785 million from the same month of the previous year. At the beginning of October, the Latin American Reserve Fund (FLAR) approved the central bank's request for a loan of US$ 1 billion, intended to strengthen the country's reserve position.

The hike in the benchmark interest rate is beginning to make its effects felt in the rest of the financial system. The basic interest rate on deposits stood at 5.84% in September of 2017 (4.1% in real terms), compared to 4.78% in the same month of 2016 (4.4% in real terms). The average lending rate in the financial system was 12.9% (down from 13.7% in September 2016). These increases have as yet had no significant impact on the pace of lending to the private sector, which in June showed year-on-year growth of 12.2% (10.4% in real terms).

Costa Rica: main economic indicators, 2015-2017

	2015	2016	2017 [a]
	Annual growth rate		
Gross domestic product	3.6	4.5	3.9
Per capita gross domestic product	2.5	3.5	2.9
Consumer prices	-0.8	0.8	2.3 [b]
Real average wage [c]	4.1	3.9	1.4 [d]
Money (M1)	9.6	17.8	3.5 [d]
Real effective exchange rate [e]	-5.0	2.0	5.7 [f]
Terms of trade	0.3	-0.3	-1.5
	Annual average percentage		
Open urban unemployment rate [e]	9.7	9.6	8.9 [f]
Central government			
Overall balance / GDP	-5.7	-5.2	-6.1
Nominal deposit rate [g]	4.4	3.5	4.1 [f]
Nominal lending rate [h]	15.9	14.7	14.4 [f]
	Millions of dollars		
Exports of goods and services	17 125	18 814	19 916
Imports of goods and services	17 144	18 120	19 352
Current account balance	-1 942	-1 698	-2 106
Capital and financial balance [i]	2 586	1 463	1 356
Overall balance	644	-235	-750

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
a/ Estimates.
b/ Figures as of October.
c/ Average wage declared by workers covered by social security.
d/ Figures as of August.
e/ A negative rate indicates an appreciation of the currency in real terms. Refers to the global real effective exchange rate.
f/ Figures as of September
g/ Average deposit rates in local currency.
h/ Average lending rate in local currency.
i/ Includes errors and omissions.

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 ministers of foreign trade of the member countries are expected to sign the agremeent in December and send it to their legislative assemblies for approval. 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).

The deficit on the merchandise trade balance was partly offset by the growing surplus in services. Goods exports recorded year-on-year growth of 7.7% to September (compared to 7.5% for the same period in 2016). Exports of medical equipment and devices remained particularly strong. Goods imports rose by less (3.7%, compared to 3.1% in 2016), and the terms of trade deteriorated by 2%.

Exports of services slowed in the first half of 2017 to a year-on-year growth rate of 5.3% (well down from the 15.3% recorded in the prior-year period), owing to weaker earnings from tourism and business services. The deficit on the income account, meanwhile, expanded by 9.9% year-on-year. Foreign direct investment (FDI) flows in the first half of the year amounted to US$ 1.654 billion, slightly exceeding the flows received in the same period of 2016 (US$ 1.597 billion).

In the first half of 2017, the economy received a significant boost from services, especially professional and business support services as well as financial intermediation and insurance, while construction saw a notable downturn. For the second half, services and manufacturing are expected to contribute strongly to GDP, while agricultural activity will be adversely affected by climate events.

By spending component, during the first half of the year private consumption grew on average by 2.9%, well down from the 5.4% in the year-earlier period, reflecting slower growth in disposable incomes and rising interest rates. Gross fixed capital formation increased by 1.2% (while it declined by 1.5% in 2016), thanks to new private investment. Exports grew by 8% in comparison with the 10.6% recorded in 2016, due to the weaker growth of services exports as noted above.

Year-on-year inflation in October reached 2.3%, and, for the first time in more than two years, was within the central bank's target range. Price indices for health care, beverages and education showed the greatest variations, while those for communications and clothing declined.

The employment rate rose in the first three quarters of 2017, to 54.1% (compared to 52.3% for the same period of 2016). The real minimum wage index showed a year-on-year average change of 0.16% in the first nine months of the year.

For 2018, ECLAC expects the economy to accelerate slightly, with real growth of 4.1%. External demand will be boosted by more robust growth in the country's main trading partners. The investment performance is also expected to improve, thanks to the efforts to repair the damage caused by adverse weather phenomena in 2017. The inflation rate will be within the central bank's target range and the current account deficit will close the year at around 4% of GDP. If the political impasse on the main fiscal reform measures persists, the central government deficit will exceed 6.5% of GDP.