

Costa Rica

ECLAC estimates that the Costa Rican economy will post real growth of 3.0% in 2018, down from 3.2% in 2017. Domestic demand slowed owing to increased interest rates and a decline in consumer confidence triggered by a deteriorating fiscal deficit projected to reach 7% of GDP (6.2% in 2017). Inflation will end 2018 at 2%, down from 2.6% in 2017, as pressures from increased international commodity prices were mitigated by lower domestic demand. The current account deficit will grow to 3.3% of GDP in 2018 (up from 2.9% in 2017), as a result of a decline in the terms of trade. The unemployment rate is expected to increase slightly to 9.5% (from 9.1% in 2017), owing to slower growth of economic activity.

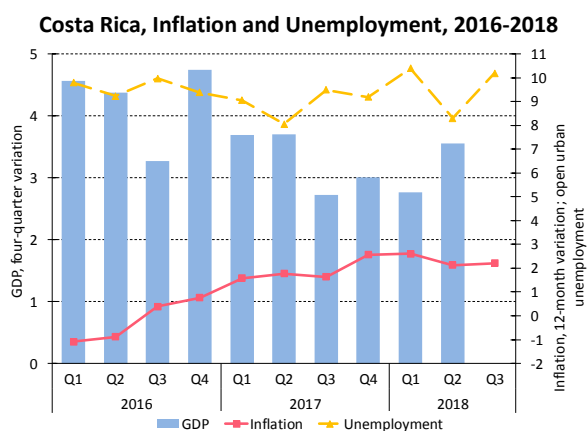
Carlos Alvarado, the candidate of the ruling Acción Ciudadana Party (PAC), took up office as President of the Republic in May 2018. PAC won 10 of the 57 seats in a now highly fragmented Legislative Assembly.

Total central government revenues recorded a year-on-year real decline of 1.1% in the first nine months of 2018, primarily due to lower revenues from taxes on imports (down by 6.6% in real terms). The fiscal burden will close the year at around 13% of GDP (down from 13.6% in 2017). Total central government spending recorded a real year-on-year increase of 3.5% in the first three quarters of 2018 (compared to 8.9% for the same period of 2017). Interest payments on the public debt continued to rise (up 10.7% for the period between January and September), while current transfers increased by 8.2% in real terms. Capital expenditure recorded a year-on-year decline of 14.6%, as a result of current fiscal constraints.

The Public Finance Strengthening Act was finally adopted in December 2018. Noteworthy changes include the conversion of the general sales tax into a 13% value added tax, with lower rates for a select set of goods and services, including those in the basic basket. On the revenue side, the Act establishes an income tax to be levied on the taxpayer's total income. On the expenditure side, the Act establishes ceilings for senior officials' salaries and reins in the growth of extra earnings, while at the same time setting limits on increases in expenditure during crisis periods. Over the long term, the reform will yield a reduction of the deficit by two to three percentage points of GDP, providing temporary fiscal relief for central government.

The public debt of the central government will close 2018 at around 53% of GDP (compared to 49% at the end of 2017). As in previous years, government financing needs were met by placing bonds on the domestic market. To further address government financing needs, in September the central bank purchased Treasury bills in the amount of 498 billion colones (approximately US\$ 830 million). This measure was described as exceptional and it had to be settled within 90 days.

The central bank adjusted its monetary policy interest rate twice in the first 11 months of 2018, to stand at 5.25% in response to upward pressure on the exchange rate and increased



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

inflationary expectations. The higher benchmark rate and increased cost of central government financing exerted moderate pressure on the average lending rate in the financial system, which stood at 15.7% in October 2018 (13.1% in real terms), up from 14.8% in the same month in 2017 (13.3% in 2017). The basic interest rate on deposits stood at 5.8% in October 2018 (3.7% in real terms), compared to 3.5% in the same month of 2017 (4.5% in real terms).

The pace of bank lending to the private sector declined sharply in the first seven months of 2018, showing year-on-year growth of 2.6% (down from 11.3% in the year-earlier period), primarily as a result of greater uncertainty regarding the economic, and especially fiscal, outlook.

In the first seven months of 2018, the exchange rate held steady at around 570 colones to the dollar. In September and October, significant pressure was exerted on the colon. That pressure eased in November and by the end of that month the MONEX exchange rate stood at 602 colones to the dollar. The central bank's international reserves fell by almost US\$ 1.5 billion between March and October 2018 and closed October at US\$ 5.640 billion. That figure includes the US\$ 1 billion loan from the Latin American Reserve Fund (FLAR) approved in October 2017 and posted in the accounts in March 2018.

On the trade policy front, the new government has stated its intention to administer existing treaties, rather than negotiate new agreements. Work continues on preparing Costa Rica's accession to the Organization for Economic Cooperation and Development (OECD).

Goods exports recorded year-on-year growth of 5.6% to October 2018 (compared to 7.8% for the same period in 2017), while goods imports rose by less (5.5%, compared to 4.5% for the prior-year period).

In the first half of 2018, the current account deficit stood at US\$ 934 million (up by 34% over the deficit for first-half 2017). As in previous years, the surplus on the services account (US\$ 2.791 billion) offset the negative balance for goods. Exports of telecommunication, computer and information services were particularly buoyant (16.9%). Foreign direct investment (FDI) flows in the first half of 2018 amounted to US\$ 1.658 billion, similar to the volume received in the same period of 2017.

GDP posted average year-on-year growth of 3.2% in the first half of 2018. Average year-on-year growth of gross fixed capital formation was 10% (while it declined by 11% in the same period of 2017). Private consumption continued to slow (growing by 2.4%, compared to 2.9% in 2017), reflecting rising interest rates and more pervasive uncertainty. Public consumption was also less buoyant (up by 2.9%, compared to 3.2% in 2017).

Costa Rica: main economic indicators, 2016-2018

	2016	2017	2018 ^a
	Annual growth rate		
Gross domestic product	4.2	3.3	3.0
Per capita gross domestic product	3.2	2.3	2.0
Consumer prices	0.8	2.6	2.0 ^b
Real average wage ^c	3.9	1.2	2.1 ^d
Money (M1)	17.8	1.7	2.9 ^d
Real effective exchange rate ^e	2.1	5.8	0.5 ^f
Terms of trade	0.0	0.0	-2.1
	Annual average percentage		
Open urban unemployment rate	9.6	9.0	9.7 ^f
Central government			
Overall balance / GDP	-5.3	-6.2	-7.4
Nominal deposit rate ^g	3.5	4.3	5.4 ^b
Nominal lending rate ^h	14.7	14.5	15.5 ^b
	Millions of dollars		
Exports of goods and services	18 637	19 557	20 763
Imports of goods and services	17 954	18 807	19 721
Current account balance	-1 257	-1 685	-1 971
Capital and financial balance ⁱ	1 022	1 266	1 569
Overall balance	-235	-419	-402

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/ Interannual variation of the period from January to July.

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.

By sector, construction showed average year-on-year growth of 23.4% in the first half of 2018, after contracting in 2017, thanks to the reactivation of commercial and industrial warehouse projects. Financial intermediation and insurance (4.7%) and information and communication services continued to show robust growth, while manufacturing growth was more modest (2.5%).

Year-on-year inflation in the first 10 months of the year remained within the central bank's target range (3%, with a one percentage point plus or minus margin of tolerance). In October year-on-year inflation was 2.0%.

The open unemployment rate averaged 9.7% in the first three quarters of 2018 (0.9 percentage points above that recorded for the year-earlier period). The nominal minimum wage index showed a year-on-year increase of 2.43% (0.4% in real terms) in October.

GDP is expected to grow by 3% in 2019. Most the thrust is expected to derive from the external sector, as domestic demand is likely to continue to show moderate growth. The balance-of-payments deficit will remain at around 3% of GDP, reflecting less marked shifts in international commodity prices. Exchange-rate depreciation will exert inflationary pressure and the inflation rate will be close to the upper limit of the central bank's target range. The full impact of the fiscal reform will take several years to filter through, so that in 2019 the central government deficit is expected to hover between 6% and 7% of GDP.