Costa Rica

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First Citizens Research & Analytics

Real GDP growth (%) 2015	2.8%
Real GDP growth (%) 2016	4.20%
Exchange Rate (USD/XCD)	1/533.03
FX Direction	Free Float
INFLATION	
Target Rate	3.00%±1 p.p
Current Month (Dec - 15)	-0.81%
Forecast 2016	<3.00%
FISCAL	
Budget Deficit (%) 2016	6.2%
Deficit Trend	Increasing
Debt/GDP	63.2%
Debt Direction	Increasing

Rating	
S & P Foreign Currency	BB- (Negative)
Fitch Foreign Currency	BB+ (Negative)
Moody's Foreign Currency	Ba1 (Negative)

Last Election	April 2014
Next Election	April 2018
Term	1
Current	Luis Guillermo Solís / PAC

Economy	Agriculture: 6% Industry: 22% Services: 72%
Export Partners:	US, EU, China, Canada,Panama,Mexico,Colombia
Major Exports:	Agriculture: 6% Industry: 22% Services: 72%
Tourism Mkts	US, EU, Central America
Reserve Direction	
Import Cover	
Direction	

ECONOMIC OUTLOOK

The Costa Rican economy measured growth of 2.8% in 2015 (3.5% - 2014) mainly driven by domestic demand and the services industries. The construction industry grew by 4.5% (3.1% - 2014) due to strong growth in 1H15 stemming from the commencement of the Moin Container Terminal and various infrastructure and power generation projects. There was no manufacturing growth in 2015 (2.4% - 2014) as the sector continues to feel the repercussions of Intel's exit in 2014. Production of medical equipment and supplies and plastic and metal products are now the major contributors in the manufacturing sector and have been somewhat offsetting the void left by Intel. The agricultural sector contracted by 4.1% in 2015 (+3.7% in 2014) due to the effects of the El Nino phenomenon and reduced production of flowers and foliage. Pineapple and banana production fell by 8.5% and 8.0% respectively while the EU's decision to restrict entry of Costa Rican plants negatively affected ornamental flower exports. Positively coffee production increased by 3.8% in the latter half of 2015. Domestic demand grew 7.3% in 2015 (2.4% - 2014) driven by private consumption expenditure (4.6%) and credit expansion. Economic growth has been projected at 4.2% and 4.5% in 2016 and 2017 respectively by the Central Bank of Costa Rica.

**INFLATION
MONETARY POLICY**

Inflation continued its downward trend as of December 2014 and is estimated to have ended 2015 between -1.0% and -0.5%. The decline was due to the drop in global energy prices, falling rates for utilities and certain agricultural goods. The Central Bank of Costa Rica's (BCCR) 2016 inflation target is 3% ± 1 though low inflation is expected to persist in 2016. The BCCR reduced the Monetary Policy Rate by 50 basis points to 1.75% in January 2016.

TRADE BALANCE/ BOP

The Costa Rican trade deficit shrank 2.7% to USD6.19 billion in 2015. The decrease was driven by an 8.5% decline to USD15.7 billion in imports and a 14.6% fall in exports to USD9.51 billion. Import of oil fell by 41.5% to USD1.23 billion while lower exports of electronic and microprocessor components from free zone companies and lower agricultural output contributed significantly to the fall in exports. The surplus in the services account continued to partially offset the negative trade gap and increased by 5.8% to USD5.4 billion due to growth in computer services, data processing and inbound tourism.
The Capital and Financial account increased by 24.6% to USD2.77 billion in 2015. The public sector and private sector increased by 42.8% and 4.6% to USD1.65 billion and USD1.12 billion respectively. Foreign direct investment (FDI) increased to USD2.2 billion for 2015 compared to USD2.18 billion in 1H14. Foreign savings inflows were sufficient to finance the current account deficit and increase the Net International Reserves by USD645 million to USD7.83 billion equivalent to 6.7 months of import cover and 14.9% of GDP (14.6% in 2014).
The current account deficit fell to 4% of GDP in 2015 from 4.7% of GDP in 2014 and is forecasted around 4% of GDP for 2016-2017 provided downward pressures persist on the oil price and the U.S recovery continues.

FISCAL ACCOUNTS

The general government deficit (including deficits of central government and state owned agencies and central bank losses) is estimated at 5.9% of GDP in 2015, compared to 5.7% of GDP in 2014. As at November tax revenue rose by 9.0% mainly due to improved tax collection (6.6%) and sales tax (2.2%) while current expenditures (excluding interest) grew by 7.3%. The rise in expenditures was underpinned by higher wages and salaries (6.9%), current transfers to the public sector (7.7%), and capital expenditures (7.2%). Total debt continued its upward trend and is estimated to have reached 63.2% in 2015 from 58.6% in 2014.

Credit Rating & Political Climate

Luis Guillermo Solís was elected President unopposed on the Costa Rica's runoff election on April 6 2014. However the result is the most fragmented legislative assembly in the country's history with nine parties represented in the 57 seats. Solis's PAC party has 13 of the 57 seats in the Legislative Assembly and the obstructive powers guaranteed to minority parties by Costa Rica's legislative rules has the potential to make passing legislation a difficult affair.

On 20th January 2016, Fitch Ratings affirmed its BB+ (Negative) credit rating outlook on Costa Rica According to the ratings agency there has been no fundamental changes to Costa Rica's fiscal position and the negative outlook continues to be driven by: 1) Continued widening of Costa Rica's budget deficit and difficulty in the passage of tax reform bills. 2) Deteriorating debt dynamics and financing conditions. 3) Deceleration of growth.
On 25 February 2016, Standard & Poor's lowered its rating on Costa Rica from BB to BB- with a negative outlook. According to S&P, the downgrade was triggered by the country's continued deterioration of its fiscal accounts due to increasing expenditure pressures and the lack of tax reform to address it.

OUTLOOK

Costa Rican growth slowed to 2.8% in 2015 as the loss of high value foreign companies such as Intel continue to weigh on the country's manufacturing sector in addition to a slowdown in agriculture due to adverse weather conditions and trade restrictions by the EU. Positively the tourism industry grew by 9% in 2015; there was a record 2.6 million visitors mainly due to growth from the U.S market and the addition of new airlines which translated to approximately USD2.8 billion in revenue during 2015. There were increases in tourists from the U.S (1,077,044 persons), U.K (400,000 persons) and China of 40%, 20% and 29% respectively. Private consumption and government spending are expected to provide support for the economy in 2016.
Efforts for China to purchase USD1 billion of Costa Rican debt bonds failed in Jan 2016 and the government has stated that it will focus on projects to combat tax evasion, reduce tax exemptions, focus on the management of the State General Fund, resurrect the tax on legal entities and the public discussion as means of controlling the fiscal deficit. A large ₡221,771,800,000.00 bond was also launched in January which will help the government to makes it payments. The fiscal deficit is expected to continue growing and is projected at 6.2% and 7.0% for 2016 and 2017 respectively. The rapid depreciation of other Latin American currencies has also negatively affected Costa Rica as its currency has remained resilient and therefore decreased Costa Rica's trade competitiveness.
Economic growth has been projected at 4.2% in 2016 by the Central Bank of Costa Rica and the IMF while the BMI is more conservative with a forecast of 3.3%.

First Citizens Research & Analytics holds a negative view on Costa Rica noting the prospects of slowing growth and urgent need for the administration to pass fiscal reform legislation. Government has expressed its intention to proceed with fiscal reforms in 2016 but the fragmented nature of the assembly can easily lead to a repeat of the past where legislation was unable to be passed. There is a high likelihood that failure to reign in the fiscal deficit will result in a downward revision of its ratings by the rating agencies in 2016. There was already a downgrade in Feb 2015 by S&P, however as the government approaches its last full year in office in 2017 it is unlikely the President Solis will be unable to push through any meaningful changes in the fiscal regime or make any significant cuts in expenditure. The prospect of further downgrades remains high.