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)	1/554.30
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 has performed strongly for 2016 averaging growth of 5.0% as at April 2016 (1.9% as at April 2015). This was due to stronger growth of the service industries as well as the agricultural and manufacturing sector. The manufacturing sector grew by 7.2% (-4.0% - April 2015) due to increased foreign demand by the companies linked to the free trade zones (medical and dental equipment, electronic and optical products and pineapple juice. There was also increased demand for other manufacturers due to increased demand for packaging products, bakery products, malt and malt liquors. The agricultural sector grew by 1.2% (-4.0% in Apr - 2015) due to greater production (sugar, pineapple, banana) related to better weather conditions and increased demand. The service industry continued to show strong growth with the transport, storage and communication sector growing by 5.5% (4.9% - Apr -2015) especially in areas related to telecommunications, road transport, tourism-related services (aviation, car rental and travel agencies) and those linked to the mobilization of products for foreign trade. Business services grew by 10% (7.3% - Apr -2015) mainly due to call centers, cost centers and computer program development. The construction sector grew by 0.4% due to an increase on private construction which offset the drop in public construction. 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. Low inflation has persisted in 2016 averaging 0.01% as at June 2016. The Central Bank of Costa Rica's (BCCR) reduced its inflation targeting band for the first time in two years in 2016, from 4.0 ± 1.0% to 3.0 ± 1.0%. Inflation is forecasted to recover to 3.0% by end of 2016. The BCCR reduced the Monetary Policy Rate by 50 basis points to 1.75% in January 2016. The rate is among the lowest of emerging and frontier economies worldwide. In May 2016 the central bank held the rate due to stable but low macroeconomic determinants.

TRADE BALANCE/ BOP

The Costa Rican trade deficit shrank to 2.9% of GDP for 1Q16 (USD1,624 million) compared to 3.4% of GDP for 1Q15 reflecting a 7.7% and 1.4% increase in sales and purchases. Exports grew by 5.9% while imports fell by 0.1%. Exports increased due to demand for medical supplies and equipment, canned fruits and vegetables, sugar, bananas and pineapple. Contributing to imports were purchases of capital goods (cargo transport vehicles, industrial machinery and tools) and consumer goods (private vehicles). The oil bill fell by 22.9% to USD321.7 million (USD417.1 million – Apr - 2015). In terms of exports, the most dynamic markets were European (medical supplies, canned fruit, bananas and pineapple) showing growth of 17.3% and the group of countries in the Caribbean and Oceania (sugar) with growth of 25.1%. 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 fiscal deficit measured 1.3% of GDP for 1Q16 compared to 1.6% of GDP in 2015. Expenditure grew by 3.1% (11.6% -2015) due to increases in interest payments (19.2%), current transfers (5.9%) and wages (3.2%). There was a slowdown in wages which grew by 11% in the equivalent period in 2015 as well as a sharp drop in capital expenditures (33.8%) and purchases of goods and services (11.6%). Total revenue increased by 7.3% (10.2% - April 2015) due to higher tax collection on income and profits (16.3%), customs (9.3%) and domestic sales (7.6%).
Total debt measured 61.4% of GDP as at April 2016.

CREDIT RATING AND POLITICS

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 26th February 2015, Standard & Poor's affirmed Costa Rica's long and short-term foreign currency credit ratings at 'BB'. The outlook remains stable. According to the ratings agency the affirmation was driven by: 1) The expectation of positive growth prospects and improvement in the country's external position due to lower current account deficits. 2) The stable albeit fragmented political system of the country. 3) Increasing flexibility in the exchange rate resulting in greater ability to absorb external shocks. 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 downgraded 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 cautious view on Costa Rica noting the prospects of decreased trade competitiveness 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. This led to a downgrade in Feb 2015 by S&P, however as the government approaches its last full year in office in 2017 it is unlikely that 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 remain.