Euler Hermes Economic Research

Country Report

Costa Rica

Taking stock as the storm blows over

General Information

GDP	USD49.553bn (World ranking 82, World Bank 2014)
Population	4.94mn (World ranking 118, World Bank 2014)
Form of state	Democratic Republic
Head of government	Luis Guillermo Solís Rivera
Next elections	2018, presidential and legislative

Strengths

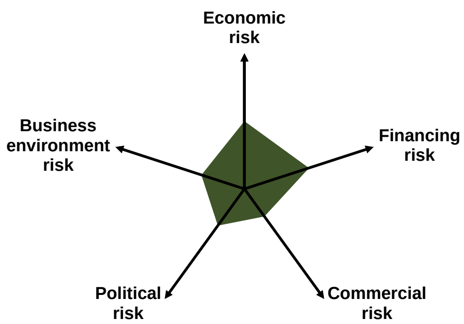
- Stable, enduring democratic framework
- Dynamic tourism sector
- Moderate public and external debt
- Large FDI inflows
- Large foreign reserves, covering more than 5 months of imports

Weaknesses

- High dependency on US (foreign investment in a few large companies, export demand and tourism)
- Large fiscal deficit which requires tax reform to raise the low structural revenue base
- Declining exports

Country Rating

BB1



Source: Euler Hermes

Trade Structure

By destination/origin (% of total)

Exports		Rank		Imports
United States	33%	1	50%	United States
China	11%	2	7%	China
Netherlands	10%	3	7%	Mexico
Mexico	8%	4	5%	Japan
United Kingdom	4%	5	3%	Brazil

By product (% of total)

Exports		Rank		Imports
Electrical machinery	48%	1	16%	Electrical machinery
Vegetables and fruits	14%	2	13%	Petroleum products
Office machines	9%	3	6%	Road vehicles
Scientific instruments	5%	4	4%	Iron and steel
Manufactured articles	3%	5	4%	Manufactured articles

Source: ITC, Chelem

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Economic Overview

Low oil prices support domestic demand

Real GDP expanded by +3.5% in 2014, a similar rate as in 2013, since the fall in exports (-0.9%) caused by Intel's (microchips) withdrawal from the country was offset by a larger fall in imports (-2.1%) and a speeding up of private consumption (+2.5%). The latter continued to be dynamic over H1-2015, supported by falling oil prices leading to very low inflation rates (CPI even contracted by -0.3% y/yin July against +5.4% in late-2014). Against this backdrop, the Central Bank has cut its key rate by 175bps since February to keep up aggregate demand. Euler Hermes expects growth to keep that pace in 2015 and 2016, supported by private consumption and resumption in investment and exports, while inflation should remain below the target on the back of low oil prices.

Sound macro environment despite fiscal fragilities

The macroeconomic environment is generally sound, with political stability and an overall business-friendly framework. The country remains a place of choice for business, performing above the regional average in terms of ease of doing business, regulatory quality, rule of law, and control of corruption. The monetary policy is framed for inflation targeting, currently for 3% (+/-1pp). The exchange rate policy was changed in last February from a band system in place since 2006 to a managed float. This shift has had a minor impact on the local currency movement, since the Colon had been in a de facto float since mid-2014.

Despite a persistent current account deficit (that is nevertheless narrowing), external vulnerability is under control with above 80% of the deficit being covered by FDI inflows. FX reserves are also at comfortable levels and cover above 6 months of imports. The external debt is low and Costa Rica enjoys easy access to capital markets in case of financing needs. Exports within free trade zones (mainly electronics) account for approximately 50% of total exports while the share of traditional agricultural commodities, albeit declining, still accounts for 18% of total exports. The United States weighs heavily on the economic performance, absorbing 33% of exports and providing 61% of total FDI. Moreover, the economy is highly dependent on tourism receipts and the electronic sector, the latter being dominated by a few large companies.

The main weakness comes from fragile fiscal accounts, with fiscal deficit expected to widen to -6.8% of GDP in 2016. While President Solís is facing political difficulties with his tax reform proposal to be adopted (which includes an increase in VAT, personal income tax and capital taxes), the government struggles with the containment of public spending due to automatic wage adjustments in the public sector and statutory transfers to education, social development and social security funds. Although the public debt level remains manageable, it is rising rapidly and should be close to 45% of GDP by 2016.

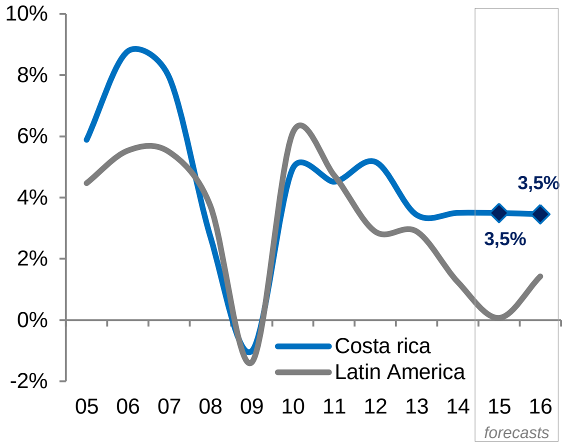
Key economic forecasts

	2013	2014	2015	2016
GDP growth (% change)	3.4	3.5	3.5	3.5
Inflation (%, yearly average)	5.2	4.5	1.4	2.4
Fiscal balance* (% of GDP)	-5.6	-6.0	-6.3	-6.8
Public debt* (% of GDP)	36.3	39.8	42.7	44.9
Current account (% of GDP)	-5.0	-4.8	-3.8	-4.2
External debt (% of GDP)	35.0	35.9	36.6	37.1

**Includes Local Government; Non-financial Public Corporations; Social Security Funds; State Governments*

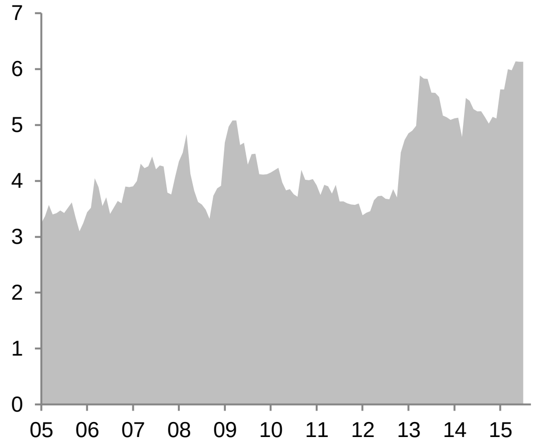
Sources: National statistics, IMF-WEO, IHS, Euler Hermes

Real GDP growth (%)



Sources: National sources, IMF-WEO, IHS, Euler Hermes

FX import cover (months)



Sources: National sources, IMF-WEO, IHS, Euler Hermes

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