Euler Hermes Economic Research

Country Report

Costa Rica

Robust performance, but mind the fiscal vulnerabilities

General Information

GDP	USD57.4355bn (World ranking 74, World Bank 2016)
Population	4.86mn (World ranking 119, World Bank 2016)
Form of state	Presidential, representative democratic republic
Head of government	Luis Guillermo SOLIS Rivera (PAC, center-left)
Next elections	February 2018, presidential and legislative

Strengths

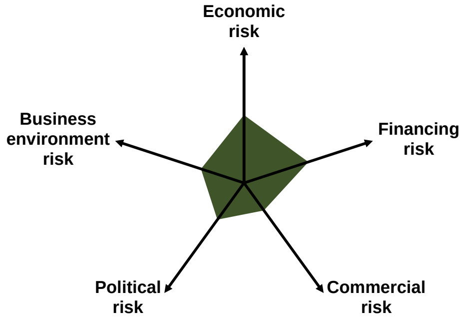
- Stable, enduring democratic framework
- Favorable business and legal conditions compared to the rest of Central and Latin America
- Comfortable foreign reserves, covering between 4 and 5 months of imports and moderate external debt
- Dynamic tourism sector

Weaknesses

- High dependency on US (trade, foreign investment in a few large companies, and tourism)
- Large fiscal deficit which requires tax reform to raise the low structural revenue base. As a result, the public debt-to-GDP ratio rises rapidly

Country Rating

BB1



Source: Euler Hermes

Trade Structure

By destination/origin (% of total)

Exports		Rank		Imports
United States	37%	1	41%	United States
Netherlands	5%	2	13%	China
Belgium	5%	3	7%	Mexico
Guatemala	5%	4	3%	Guatemala
Nicaragua	4%	5	3%	Japan

By product (% of total)

Exports		Rank		Imports
Electrical machinery and appliances	22%	1	12%	Electrical machinery and appliances
Vegetables and fruits	22%	2	9%	Road vehicles
Professional and scientific instruments	11%	3	7%	Petroleum, petroleum products and related materials
Miscellaneous edible products	5%	4	6%	Telecommunication and sound recording apparatus
Miscellaneous manufactured articles	5%	5	5%	Miscellaneous manufactured articles

Source: UNCTAD (2016)

Economic Overview

An attractive investment destination with a positive growth outlook

Costa Rica's GDP growth rate has been among the most dynamic in the Latin American region. The economy expanded by +4.3% in 2016 and should grow by +3.8% in 2017. The output gap is closed by now, as the economy should continue growing at +3.8% in 2018 and +3.9% in 2019. Favorable global and local financial conditions and a positive terms-of-trade shock (low oil prices) have supported activity.

While inflation plummeted with the sharp decline in oil prices, it has swung back to +1.6% in 2017. It should increase to +2.9% in 2018 and stabilize at +3.0% in 2019. This, along with the will to follow the US Fed's momentum, explains the gradual monetary tightening: policy rates rose by 275 bps since April 2017, to 4.5%.

Two factors explain the robust growth outlook. First, the moderate energy import bill supporting private consumption and net exports. Then there is strong external demand. The acceleration of the US economy, Costa Rica's first trade partner, should help offset Intel's withdrawal from the country.

Costa Rica's business environment ranks 5th in Latin America, and 62nd globally, according to the World Bank Doing Business survey. In terms of access to credit, electricity, control of corruption and rule of law, Costa Rica outperforms most of its regional peers. Hence, it is a very attractive destination for foreign investment, notably in the tourism sector, which accounts for 7% of total GDP.

Risks stem from fiscal vulnerabilities

Costa Rica's external position is rather comfortable. Foreign exchange reserves cover around 4 to 5 months of imports. The current account deficit is financed to a large extent (134%) by foreign direct investment flows. It is expected to stabilize at -4.0% going forward. This should allow external debt to gradually decrease back to 2014 levels (around 35% of GDP). While a diversification strategy has been initiated, the country remains exposed to the volatility in commodity prices.

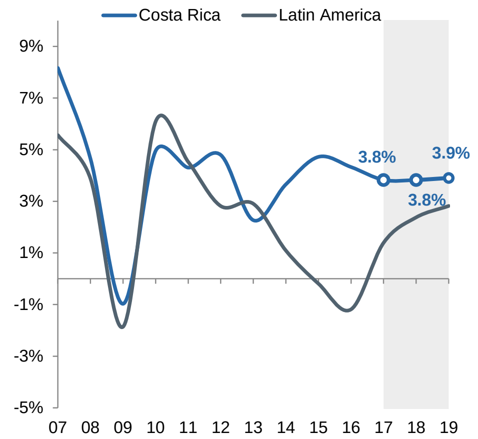
Perceived risks stem from fiscal vulnerabilities. Public debt-to-GDP ratio is on a sharp rise. In 2014, it stood at 38.3%. It could surpass the 50% mark in 2018. The fiscal deficit should exceed -6% in 2017, as attempts to pass a holistic tax reform ran into political opposition. Only minor fiscal adjustments (e.g. to pensions) have partially limited damages. Elections in February 2018 should be a disincentive to further fiscal consolidation.

Key economic forecasts

	2016	2017	2018f	2019f
GDP growth (% change)	4.3	3.8	3.8	3.9
Inflation (%, yearly average)	0.0	1.6	2.9	3.0
Fiscal balance (% of GDP)	-5.3	-6.2	-6.5	-6.9
Public debt (% of GDP)	44.7	49.1	52.4	55.8
Current account (% of GDP)	-3.2	-3.9	-4.0	-4.0
External debt (% of GDP)	41.1	38.8	37.1	35.6

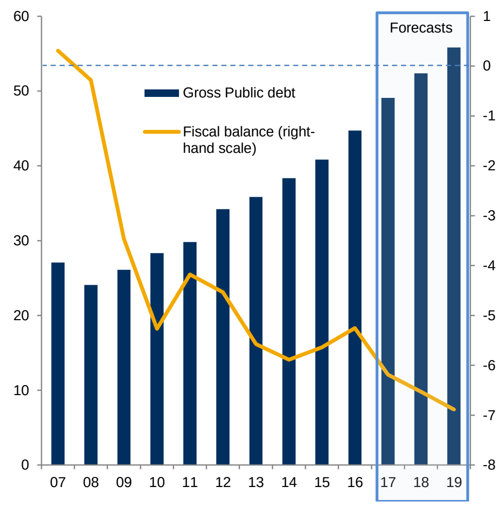
Sources: National statistics, IMF-WEO, Euler Hermes

GDP Growth (%)



Sources: National statistics, IMF-WEO, Euler Hermes

Public debt and fiscal balance (% of GDP)



Sources: National statistics, IMF-WEO, Euler Hermes

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