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COSTA RICA

February 2015

2014 ARTICLE IV CONSULTATION—STAFF REPORT; PRESS RELEASE; STAFF STATEMENT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR COSTA RICA

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2014 Article IV consultation with Costa Rica, the following documents have been released and are included in this package:

- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on January 30, 2015, following discussions that ended on November 10, 2014, with the officials of Costa Rica on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on January 9, 2015.
- An **Informational Annex** prepared by the IMF.
- A **Staff Statement** of January 27, 2015 updating information on recent developments.
- A **Press Release** summarizing the views of the Executive Board as expressed during its January 30, 2015 consideration of the staff report that concluded the Article IV consultation with Costa Rica.
- A **Statement by the Executive Director** for Costa Rica.

The document listed below has been or will be separately released.

Selected Issues Paper

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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International Monetary Fund
Washington, D.C.

COSTA RICA

STAFF REPORT FOR THE 2014 ARTICLE IV CONSULTATION

January 9, 2015

KEY ISSUES

Context. The economy recovered quickly from the global crisis of 2008–09, with healthy growth and low inflation. Growth has, however, slowed recently and is expected to remain subdued in the short run, since gains from recovery in the U.S. will be offset by the closure of the Intel manufacturing plant. Inflation is elevated, owing primarily to exchange rate (XR) depreciation triggered by global repricing of emerging market assets in early 2014. Risks to the outlook are tilted to the downside. Absent consolidation, large fiscal deficits would make public debt dynamics unsustainable in the long-run.

The short-term policy mix should envision a lower budget deficit and vigilance over inflation. A tighter fiscal stance would mitigate risks of inflation, external imbalances, and start restoring long-run sustainability. The authorities should also stand ready to increase interest rates and allow greater exchange rate flexibility if inflationary pressures persist, especially in the absence of fiscal adjustment.

Steady fiscal consolidation is required over the medium term. The threat of unsustainable public debt dynamics calls for corrective action, as postponing budgetary retrenchment could seriously endanger macroeconomic stability. The authorities' fiscal plan, which contemplates somewhat front-loaded followed by gradual adjustment, is appropriate to bring public debt on a sustainable footing, while maintaining robust growth. Full specification and swift adoption of supporting measures will be critical to achieve these objectives.

It is important to strengthen the monetary policy framework. Increasing XR flexibility and completing the transition to inflation targeting are key. This would permit consolidating gains in lowering inflation made in recent years.

Further improvements in financial system regulation and supervision, as well as structural reforms to stimulate inclusive growth, are desirable. Deepening consolidated, risk-based, and cross-border supervision as well as gradually adopting Basel III capital and liquidity standards would further buttress financial stability. Efficiency-enhancing measures to fuel competition, improve the education system, and eliminate red-tape would help boost trend growth, reduce unemployment, and bolster external competitiveness.

Approved By
K. Srinivisan (WHD) and Masato Miyazaki (SPR)

Discussions took place in San José during October 28–November 10, 2014. The mission comprised L. Figliuoli (Head), A. Ivanova, J. Puig, L. Erickson, J. Wong (all WHD), J. Restrepo (ICD), and M. Garza (Regional Resident Representative). K. Srinivasan (WHD) and Juan Carlos Pacheco (OED) participated in the closing meeting.

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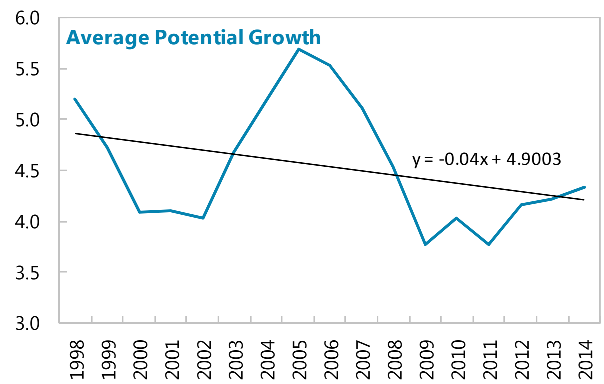
OVERVIEW

1. **Costa Rica bounced back quickly from the 2008–09 global crisis, but momentum is now slowing and macro vulnerabilities, mainly from the weak fiscal position, are rising.** After falling modestly in 2009, real GDP surged in 2010–12. Since then, however, growth has moderated below potential, with the latter also on a declining trend. Hence, structural impediments must be removed to maintain sustained rates of economic expansion. The counter-cyclical budgetary stimulus imparted in 2009 pushed the deficit above 5 percent of GDP in 2010 (mainly through a rise in wages and transfers). The deficit has been creeping up further since then, placing the public-debt-to-GDP ratio on an unsustainable upward trajectory, which is fast approaching levels shown to increase risks of disorderly adjustment for emerging economies. A fairly inflexible XR has contributed to exacerbate vulnerabilities associated with dollarization in the financial sector, rendering even more important further improvements in regulation and supervision.

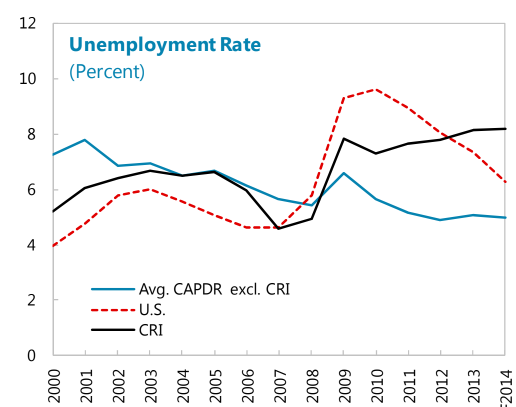


Source: Fund staff estimates.

RECENT ECONOMIC DEVELOPMENTS AND OUTLOOK

A. Recent Developments

2. **Growth decelerated in 2013 and has remained stable in 2014, opening a small output gap**. After expanding by about 5 percent in 2012, activity rose by 3½ percent in 2013, largely on account of weaker domestic consumption (Figure 1) and net exports, the latter mirroring slower growth in the U.S.—Costa Rica's major export market (Analytical Note (AN) 2, Figure 6). Growth is reckoned to have stayed the same in 2014, as activity was dampened by closure of Intel manufacturing, announced in April. With growth below its trend rate of 4¼ percent (AN 1), output has now fallen slightly short of potential. The unemployment rate has been elevated since the global crisis and increased further in early 2014, reflecting new and returning entrants into the labor force.



Sources: WEO and Fund staff estimates.

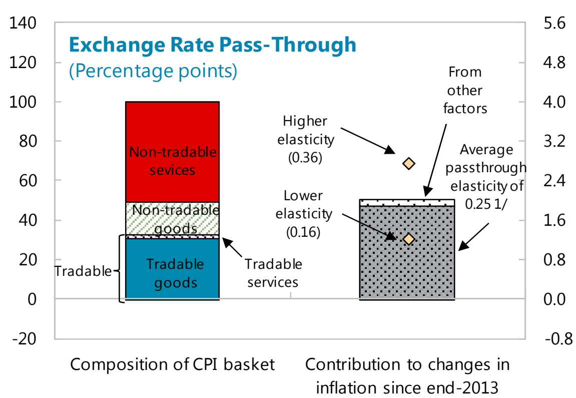
Potential GDP Growth Rate

	Potential GDP growth rate 1999-2008	2009-13	2014	Output Gap 2013	2014
Production Function Approach	4.8	3.8	4.1	0.1	-0.2
Cycle Extraction Filters	***Potential GDP growth rate*** **1999-2008**	**2009-13**	**2014**	***Output Gap*** **2013**	**2014**
Hodrick-Prescott	4.8	3.8	4.1	0.1	-0.2
Butterworth	4.8	3.7	4.1	0.2	-0.1
Christiano-Fitzgerald	4.9	3.3	4.5	1.2	0.5
Baxter-King	4.9	3.8	4.1	-0.1	-0.4
Univariate Kalman Filters	***Potential GDP growth rate*** **1999-2008**	**2009-13**	**2014**	***Output Gap*** **2013**	**2014**
Deterministic Drift	4.5	4.5	4.5	1.9	1.1
Mean Reversion	4.9	4.9	4.9	-4.3	-4.6
Multivariate Filters	***Potential GDP growth rate*** **2001-08**	**2009-13**	**2014**	***Output Gap*** **2013**	**2014**
With inflation	4.5	4.2	4.2	-0.2	-1.0
With inflation and financial vars.	4.8	3.7	4.1*	-2.0	--
Average of All Models	**4.7**	**4.0**	**4.3**	**-0.3**	**-0.6**

Source: Fund staff estimates.

**/ Estimate for 2013.*

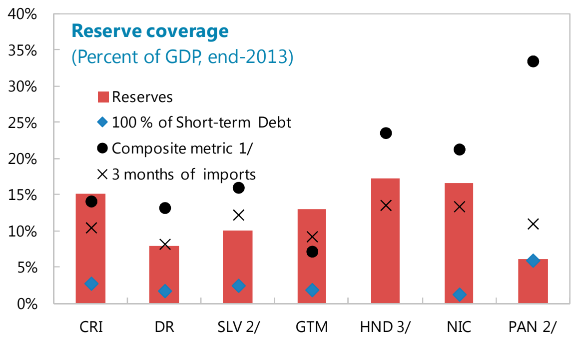
3. **Inflation remained within the target range in 2013, but rose sharply and breached its new upper limit in 2014.** Inflation at end-2013 was 3.7 percent. To signal commitment to lower inflation, the central bank (BCCR) lowered its target range from 4–6 percent to 3–5 percent in early 2014. However, owing mainly to the pass-through to domestic prices from XR depreciation (AN 5) and sticky inflation expectations which persist above the target range, inflation reached 5.7 percent in October 2014 and is anticipated to have finished 2014 above the upper limit of the target range. To contain the second-round effects from depreciation, the authorities have raised monetary policy rates twice since the beginning of the year (to 5.25 percent in May), undoing the reductions effected in the second half of 2013.



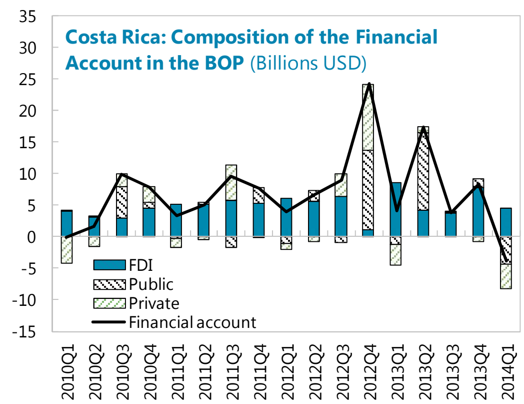
Sources: National authorities and Fund staff estimates.
1/ Average elasticity from three specifications, ranging from 0.16 to 0.36.

4. **The private capital inflows of 2012 have reversed and the exchange rate depreciated markedly in early 2014.** The current account deficit declined slightly to 5 percent of GDP in 2013 and is expected to remain broadly stable in 2014. Private capital inflows combined with government tapping of international capital markets in 2012–13 kept the XR at the bottom of the band, with strong accumulation of reserves by the BCCR (Figure 2). However, in the wake of U.S. monetary

policy (USMP) normalization, the colón lost 10 percent of its value between January and March 2014, as private inflows and government use of its FX deposits ceased, while domestic residents adjusted their portfolios toward FX assets. It has since recovered somewhat, with year-to-date depreciation standing at 7 percent in mid-November. The BCCR intervened in an attempt to smooth excessive XR fluctuations, selling about 6 percent of its end-2013 NIR stock, but reserves were boosted by government Eurobond issuance in April and resumed purchases by the BCCR towards year-end. Thus, reserves remained well within the IMF adequacy metric at end-2014 (Box 1).



Sources: National authorities and Fund staff estimates.
1/ Composite Metric (floating exchange rate) = 5% × Exports + 5% × Broad Money + 30% × Short-term Debt + 10% × Other Liabilities
Composite Metric (fixed exchange rate) = 10% × Exports + 10% × Broad Money + 30% × Short-term Debt + 15% × Other Liabilities
2/ El Salvador and Panama are dollarized economies. Panama does not have a Central Bank. Hence the interpretation of reserve adequacy might be different for these countries.
3/ 3 months of imports refers to the following year's imports of non-maquila goods. The composite metric was calculated based on Dabla-Norris, Kim, and Shirono (2011), "'Optimal Precautionary Reserves for Low-Income Countries: A Cost-Benefit Analysis," IMF Working Paper 11/249.



Sources: National authorities and Fund staff estimates.

5. **Competitiveness has improved as a result of colón devaluation.** The real effective exchange rate (REER) rose by over 30 percent between 2005 and 2013, largely due to high inflation differentials (Figure 3). Some of this appreciation was undone in 2014, as the REER declined by 4 percent with nominal depreciation outpacing a growing inflation differential. However, multilaterally consistent estimates under the EBA and CGER approaches (Box 1) suggest that Costa Rica's current account and REER are broadly in line with fundamentals. Nonetheless, there are some signs of competitiveness problems (Box 1) suggesting that productivity-enhancing reforms (¶29) and wage restraint would help Costa Rica maintain a competitive edge. This is especially important in light of Intel's exit which may generate negative "signaling effects", although its direct impact on Costa Rica's competitiveness is likely small. Fiscal consolidation (¶18) would also support long-term external stability.

Box 1. Costa Rica: External Stability Assessment

Costa Rica's real effective exchange rate (REER) is generally in line with medium-term fundamentals. Staff used various approaches to assess the external balance and exchange rate. These included changes in the CPI-based REER, regression-based methods to evaluate the appropriateness of the current account balance, and stability conditions for net foreign assets.

A large nominal depreciation in 2014 combined with only a modest inflation increase partially reversed the REER appreciation of the last 10 years. The 30 percent appreciation in the CPI-based REER since 2003 has been mostly driven by inflation differential with the main trading partner, the U.S. With year-to-date depreciation at 7 percent in mid-November and outpacing inflation (below 6 percent in October), the REER has declined by 4 percent.

Nonetheless the current account deficit has remained broadly stable and the market share has improved. The current account deficit has hovered close to 5 percent of GDP, as a strong positive services balance partly offsets a negative non-oil trade balance. Costa Rica has gained export market share during the same period in contrast to other emerging markets (Figure 3).

The financing structure of the current account and relatively low external liabilities mitigate risks. The current account is mostly financed by FDI inflows, which have hovered at around 5 percent of GDP. As a result, while the IIP is negative at over 35 percent of GDP, FDI comprises more than 60 percent of total liabilities. The external debt profile presents no sustainability concerns, with the external debt-to-GDP ratio set to decline into the medium term, and with a low share of short-term debt. Net international reserves stood at 5.6 months of non-maquila imports of goods and services at end-2013 and are within the Fund's composite reserve adequacy metric.

Costa Rica: Implied undervaluation ("+" = Overvaluation)

	CA norm	CA projected/ cyclically-	REER deviation (updated)	REER deviation (2012 AIV)
CGER-like methodologies				
Macroeconomic balance	-5.5	-5.3	-0.8	7.9
External sustainability	-2.0	-5.3	13.2	8.5
ES (NFA exlud. FDI)	-6.8	-5.3	-5.9	NA
EBA				
Macroeconomic balance	-5.4	-4.2	-4.7	6.7
WHD staff model 1/	-5.7	-5.3	-1.6	NA
Average			0.0	7.7

Source: Fund staff estimates.
1/ For details see "Current Account Imbalances: Can Structural Policies Make a Difference?" by Anna Ivanova, https://www.imf.org/external/pubs/cat/longres.aspx?sk=25750.0

IMF's multilaterally consistent estimates suggest that Costa Rica's REER is broadly in line with fundamentals both in the short term and relative to medium-term benchmarks.

- The macro balance approach in the External Balance Assessment (EBA) is estimated on the basis of existing fundamentals and desirable policies. It points to a sustainable cyclically-adjusted current account deficit of 5.4 percent of GDP, which is about 1¼ percentage point larger than the actual cyclically-adjusted deficit of 4.2 percent, implying and undervaluation of 4¾ percent. Identified policy gaps are a significant contributor to Costa Rica's relatively large estimated current account norm, in particular health expenditures which are higher than the world average.
- The macro balance approach in the CGER methodologies (which rely on medium term fundamentals) points to an estimated REER undervaluation of barely less than 1 percent.
- The CGER benchmark external sustainability approach, on the other hand, finds a moderate overvaluation of 13¼ percent. However, in order to interpret appropriately these estimates, the

Box 1. Costa Rica: External Stability Assessment (concluded)

significant proportion of FDI in Costa Rica's total external liabilities should be taken into account. Thus, if FDI is excluded from NFA, an undervaluation of little less than 6 percent is assessed.

- The WHD staff model is based on a current account regression that is similar to the CGER macro balance approach, but includes an additional variable capturing the speed of aging, the youth dependency ratio instead of population growth, changes in oil price for oil producers instead of the oil balance, and a measure of trade openness. This method suggests the REER is broadly in line with fundamentals, with an undervaluation of about 1½ percent, in line with EBA estimates.

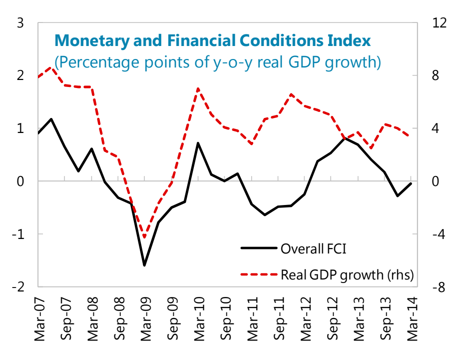
In staff's view, the macro-balance-type approaches—which all point to a small undervaluation—are most reliable, while a simple average across the different reliable methodologies implies virtually no over- or under- valuation. Given model uncertainty and standard errors, staff concludes that Costa Rica's REER is broadly in line with fundamentals.

Nevertheless, there are some signs of competitiveness problems. In contrast to the other countries in the region, Costa Rica has gained market share over the past decade. Nonetheless, further steps to improve competiveness may be needed. Costa Rica lost five positions in the 2015 Doing Business Survey partly driven by a dteterioration in the "starting a business" category where the country lost ten positions. Moreover, according to the Global Competitiveness Index, inadequate infrastructure, difficulty in accessing finance, and concerns over inefficient government spending weigh on the country's competitiveness.

6. **The achievements in containing public spending of 2011 came to a halt in 2012–2013, with public debt continuing to climb** (Figure 4)**.** The efforts to restrain government outlays, mainly through capital expenditure cuts in 2011, were undermined by the rising transfers and interest bill in 2012–2013. While expenditures continued climbing, revenues stagnated. As a result, the central government (CG) deficit increased by 1¼ percentage points of GDP in 2012–13 to 5½ percent of GDP and debt reached 36 percent of GDP in 2013.

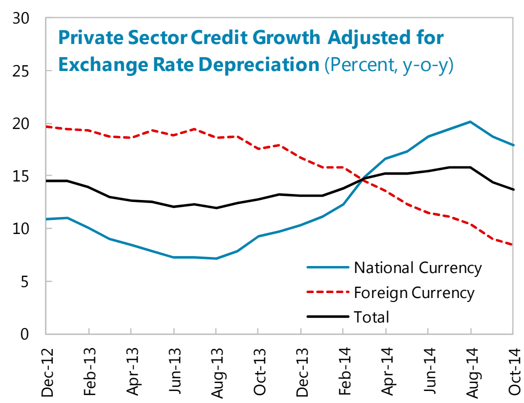
7. **The new government acknowledges the need for fiscal consolidation and is developing a strategy focused on strengthening revenue.** After nullification of the 2012 tax reform by the Supreme Court due to procedural irregularities, the previous administration prepared a roadmap with measures yielding a potential adjustment of about 3½ percent of GDP over five years, broadly in line with previous staff recommendations to ensure long-term sustainability. However, no action was taken before the elections. The new administration, which took office in May 2014, has formulated a consolidation proposal of its own, initially focused on reducing tax evasion and a few exemptions. In this connection, a new draft anti-tax evasion law, which includes measures to reduce income tax expenditures as well as strengthen tax control, was submitted to Congress but the potential impact on revenues from its administrative provisions remains unclear. Since then, a more comprehensive plan has been developed (¶21).

8. **Domestic monetary and financial conditions are broadly neutral.** Following a substantial increase in domestic interest rates, driven by large government borrowing and buoyant private sector credit demand in 2012, financial conditions eased in early 2013 as the government reduced reliance on domestic financing with Eurobond placements (Figure 5). However, interest rates started rising again in the

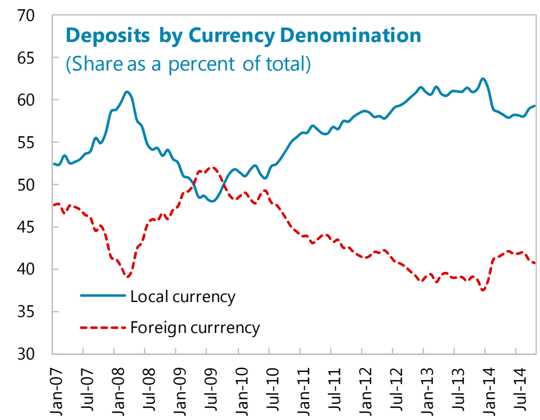


Sources: National authorities and Fund staff estimates.

second half of 2013, as global financial conditions tightened. A broad-based index (FCI) developed by staff (featuring the influence on economic activity of interest rates, REER, house prices, equity prices, VIX, U.S. interest rate) suggests that financial conditions were neither propelling nor dragging GDP growth earlier in 2014, even before the latest policy rate raise (AN 5). At the same time, growth of credit to the private sector, excluding the impact on the stock of FX credit from the devaluation of the colón, has moderated somewhat in H2. Nonetheless, credit growth, supported by a generally healthy financial system (¶9), remains robust and consistent with continued benign financial deepening. Credit composition shifted away from foreign currency loans, while, conversely, deposits moved towards foreign currency in the wake of XR depreciation.

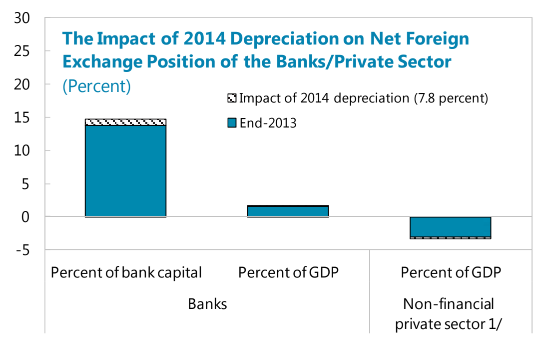


Sources: National authorities and Fund staff estimates.



Sources: National authorities and Fund staff estimates.

9. **The financial system appears sound, though dollarization continues to be a source of vulnerability.** Capital is well above regulatory requirements (Figure 5). Liquidity indicators are generally robust, albeit the loan-to-deposit ratio has been rising since mid-2013 and exceeds 100 percent. Non-performing loans have remained manageable. Profitability declined slightly and remains below that of regional peers. Reliance on foreign funding has increased in the past few years (Figure 5), though banks continue to have a long FX position. Staff estimates suggest that intensification of sovereign and banking strains in advanced countries would not have a large direct impact on credit in Costa Rica (Figure 5 and AN 2). Stress test exercises conducted by bank supervisors yield similar results. Nevertheless, a large depreciation of the colón may impact asset quality, given unhedged liability dollarization of households and corporations. Staff analysis indicates, however, that risks from currency and maturity mismatches are limited and concentrated in the non-financial public and financial sectors (AN 7).



Sources: National authorities and Fund staff estimates.
1/ For non-financial private sector, includes FX bank credit and deposits of non-financial corporations and households.

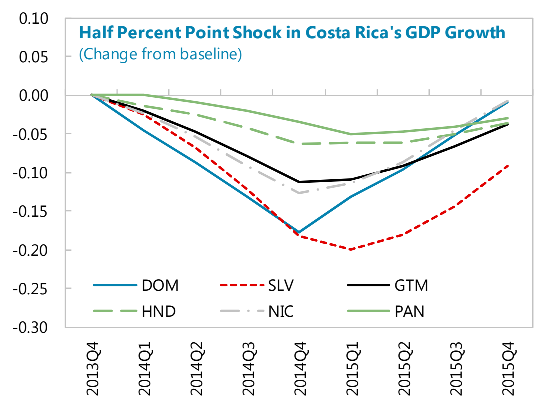
Financial Soundness Indicators (in percent) 1/

	Costa Rica	Guatemala	El Salvador	Honduras	Dominican Republic	Nicaragua 2/	Panama	CAPDR 3/	LA6 4/
Regulatory Capital to Risk-Weighted Assets	16.6	14.8	17.7	14.8	16.7	12.9	15.1*	15.5	15.0***
Capital to Assets Ratio	13.0	9.1*	14.3	11.1	14.5	8.5	10.2*	11.5	10.1
Nonperforming Loans to Total Loans Ratio	1.7	1.2	2.3	3.4	2.3	2.6	1.8*	2.2	2.6
Return on Assets	1.2	1.5	1.6	2.1	1.9	2.3	2.3**	1.8	1.9
Return on Equity	7.9	16.0	11.6	20.3	16.8	22.0	21.9*	16.7	18.4
Net Open Position in Foreign Exchange to Capital	20.8	N/A	0.0	15.7	N/A	113.5	0.0	N/A	4.6

Source: FSI Tables, April 2014, IMF, http://fsi.imf.org
1/ As of December 2013, unless noted otherwise
* As of June 2013; ** As of October 2013; *** Chile is as of November 2013; N/A, not available
2/ Nicaragua data are from national authorities.
3/ Comprises Costa Rica, Guatemala, El Salvador, Honduras, Dominican Republic, Nicaragua, and Panama.
4/ Comprises Brazil, Chile, Colombia, Mexico, Peru, and Uruguay

B. Macroeconomic Outlook and Risks

10. **The authorities agreed that the outlook for 2015 and the medium term will remain subdued amid deteriorating fundamentals.** Growth in 2015 is expected to remain virtually unchanged as the negative impact of a gradual Intel withdrawal offsets again the positive impact of U.S. recovery (¶12 and Figure 6). The Intel closure is estimated to reduce GDP by about ½ to ¾ percentage points in 2014–15 (Figure 1 and AN 1), with temporary negative effects on the level and growth rate of potential GDP (½ and less than ¼ percentage points, respectively), and with no pronounced regional implications (AN 2).[1] The baseline scenario contemplates fiscal consolidation of 2¼ percent of GDP over the medium term, thus incorporating the measures at a more advanced state of elaboration in the authorities' stated plans (¶21).



Source: Fund staff estimates.

The output gap is projected to widen through 2016, then mostly closing over the medium term, with growth also converging to potential. The CG fiscal deficit would stay at about 5¾ percent of GDP and the public debt ratio would approach 51 percent of GDP by 2019. Thanks to continued prudent monetary policy, inflation is projected to hover around 4 percent after returning within the band in early 2015, while the current account deficit rises to 5¼ percent of GDP by 2019.

[1] The closure is not expected to have significant impact on fiscal revenue as Intel operated in the free trade zone.

Costa Rica: Baseline Scenario 1/

(In percent of GDP, unless otherwise indicated)

	2013	2014	2015	2016	2017	2018	2019
Real GDP growth (percent)	3.5	3.6	3.4	4.2	4.5	4.4	4.3
Output gap (percent of potential GDP)	0.0	-0.4	-0.9	-0.9	-0.6	-0.5	-0.4
CPI (percent, end-of-period)	3.7	5.6	4.5	4.0	4.0	4.0	4.0
Current account balance	-4.9	-5.0	-4.7	-4.7	-4.9	-5.0	-5.2
Central government fiscal balance	-5.6	-6.2	-6.0	-5.5	-5.3	-5.5	-5.7
Structural primary balance	-2.8	-3.0	-2.3	-1.8	-1.4	-1.4	-1.4
Structural overall balance	-5.6	-6.1	-5.8	-5.3	-5.2	-5.4	-5.7
Central government debt	36.0	39.4	42.3	44.6	46.5	48.5	50.6

Source: Fund staff estimates.

1/ The baseline scenario includes fiscal consolidation measures of about 2¼ percent of GDP, partly offset by a projected underlying deterioration in the primary balance mainly driven by the constitutionally mandated increase in education expenditure.

11. **The authorities also concurred that an alternative scenario incorporating the fiscal adjustment necessary to restore debt sustainability would yield a stronger outlook.** According to staff analysis, a total adjustment of about 3¾ percent of GDP would achieve the objective of stabilizing debt with only moderate short-term output costs (¶19). A tighter fiscal stance consistent with restoring debt sustainability would mitigate increases in market rates, allow for a more balanced macro policy mix to achieve the inflation target, and reduce the current account deficit.

Costa Rica: Full Fiscal Adjustment Scenario 1/

(In percent of GDP, unless otherwise indicated)

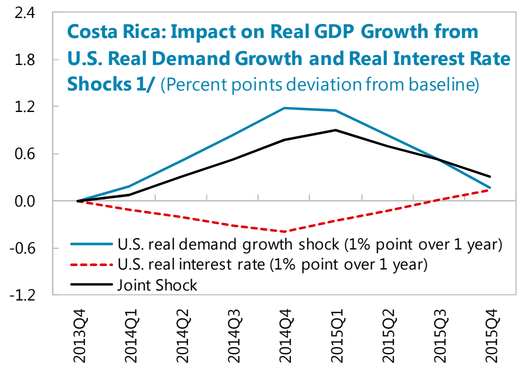
	2013	2014	2015	2016	2017	2018	2019
Real GDP growth (percent)	3.5	3.6	3.3	4.1	4.7	4.5	4.4
Output gap (percent of potential GDP)	0.0	-0.4	-1.0	-1.1	-0.6	-0.3	-0.2
CPI (percent, end-of-period)	3.7	5.6	4.4	3.9	4.0	4.0	4.0
Current account balance	-4.9	-5.0	-4.6	-4.5	-4.5	-4.4	-4.7
Central government fiscal balance	-5.6	-6.2	-5.6	-4.5	-3.8	-3.6	-3.4
Structural primary balance	-2.8	-3.0	-2.1	-1.0	-0.1	0.2	0.3
Structural overall balance	-5.6	-6.1	-5.4	-4.3	-3.7	-3.5	-3.4
Central government debt	36.0	39.4	41.9	43.2	43.5	43.7	43.8

Source: Fund staff estimates.

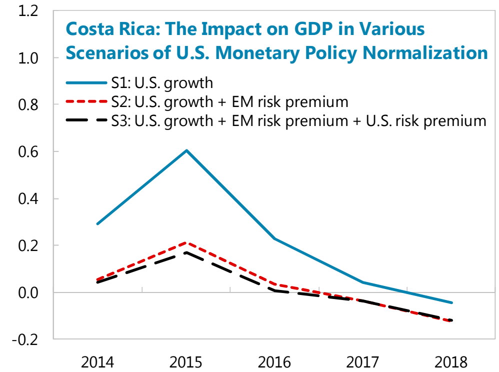
1/ Includes measures as in the baseline scenario and additional measures of 1½ percent of GDP.

12. **Risks to the outlook are tilted to the downside.** Downside risks stem from both global uncertainties and weaknesses in domestic fundamentals (as detailed in the Risk Assessment Matrix):

- **External risks.** Concerning faster *USMP normalization* slightly upside risks prevail, absent pronounced increases in market volatility (Figure 6). Under these conditions, higher U.S. growth would have a positive impact on Costa Rican GDP given its strong trade ties with the U.S. more than offsetting the negative impact of tighter global financial conditions in the short run (AN 2). However, *extreme bouts of market volatility* could inflict serious damage, especially given Costa Rica's weak fiscal position, as interest rates may rise abruptly (Figure 6 and Figure 4). Moreover, if USMP normalization leads to substantial exchange rate depreciation in Costa Rica and reduction in the availability of foreign funding, bank and private sector balance sheets could be negatively affected, with adverse implications for growth, inflation, and the balance of payments. In addition, *deeper-than-expected slowdowns in advanced and emerging markets* could hamper Costa Rica's growth. The effects of global factors may be amplified by strong linkages with the U.S. (AN 2). On the other hand, further sustained declines in energy prices, triggered by deceleration of global demand and coming-on-stream of excess capacity, could have a modest positive impact on Costa Rica.



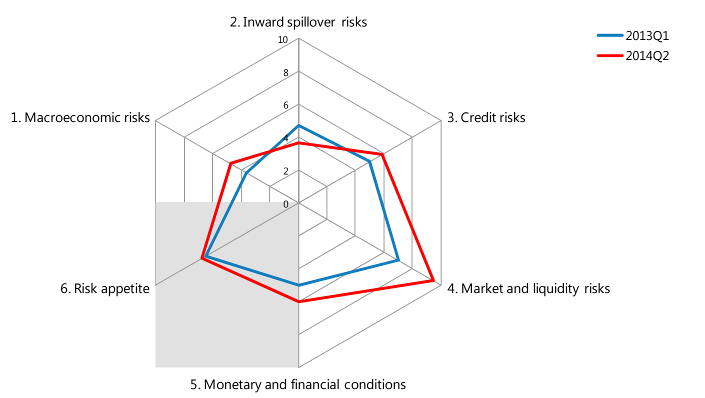
Source: Fund staff estimates.
1/ U.S. real interest rate used in VAR estimation is U.S. real 10 year government bond yield.



Source: Fund staff estimates.

- Domestic risks. The persistence of a large fiscal deficit (for instance, owing to political difficulties in implementing tax reform (¶22)), and the ensuing rise in the public debt ratio, could render the economy vulnerable to sudden changes in financial market conditions. Also, large government gross financing requirements could lift domestic interest rates, weighing on private investment and growth. In addition, a slowdown in FDI due to the "signaling effect" from Intel exit could reduce growth more than expected in the short run.

Costa Rica: Financial Stability Map 1/



Source; Fund staff estimates.
Note: Away from center signifies higher risks, easier monetary and financial conditions, or higher risk appetite.
1/ The variables used for each category are the following. 1) Macroeconomic risks: output gap, inflation rate, unemployment rate, budget balance (percent of GDP), government debt (percent of GDP), current account balance (percent of GDP), domestic credit from banks (deviation from trend and its change as percent of GDP), real investment growth, growth in trade (imports plus exports). 2) Inward spillover risks: exports (percent of GDP), gross foreign assets of banking sector (percent of GDP), LIBOR OIS spreads, Implied volatilities, gross international reserves (in percent of short-term debt, imports and broad money), foreign exchange market pressure index. 3) Credit risks: growth in domestic credit from banks, change in the ratio of domestic credit from banks to GDP, stock market return, unemployment rate, public debt (percent of GDP). 4) Market and liquidity risks: ratio of private domestic credit to resident's deposits, gross foreign liabilities of banking sector (percent of GDP). 5) Monetary and financial conditions: real broad money growth and growth in domestic credit from banks. 6) Risk appetite: volatility of month-to-month stock market returns over past 12 months, volatility of month-to-month exchange rate movements over past 12 months, gross portfolio inflows (percent of GDP) and gross FDI inflows (percent of GDP).

Costa Rica: Risk Assessment Matrix[1]

Source of Risks	Overall Level of Concern (Scale—high, medium, or low)	
	Relative Likelihood[2]	**Impact if Realized**
1. Protracted period of slower growth in advanced and emerging economies.	**High** • Protracted period of slower growth in advanced and emerging economies would reduce growth in Costa Rica, in particular, if growth in the U.S. is negatively affected.	**High** • Weaker-than-expected U.S. growth would lower export demand and significantly weigh on activity and tax revenues. A shock could have a more severe impact than in 2008-09, as fiscal buffers have been drawn down.
2. Surges in global financial market volatility, triggered by geopolitical tensions or revised market expectations on UMP exit/emerging market fundamentals.	**High** • Surges in global financial market volatility would reduce capital flows to Costa Rica, lead to an increase in cost of government financing, as well as potentially an increase in cost of funding for the private sector.	**High** • The direct trade impact would be modest. The indirect impact would depend on how much the shock affects U.S. growth. • A decline in capital flows to emerging could disrupt foreign credit lines and reduce banking sector liquidity. • If markets reassess fiscal risks in Costa Rica, the cost of external government and private sector financing could increase sharply, negatively affecting public debt dynamics and growth.
3. Sustained decline in energy prices.	**Medium** • The recent fall in oil prices could persist and deepen, triggered by deceleration of global demand and coming-on-stream of excess capacity.	**Low** • Persistently low oil prices would improve Costa Rica's terms of trade and counterbalance inflationary pressures, potentially yielding a modest boost to growth prospects.
4. Worse-than-anticipated impact from persistently high fiscal deficits, or higher deficits than projected in the baseline scenario.	**High** • Lack of fiscal consolidation prospects may hurt confidence. • Continued expenditure pressure and lack of tax reform could increase the fiscal deficit and public debt more than projected in the baseline scenario, which already envisages a rapid build up of public debt.	**High** • Lower confidence or a higher government financing requirement could raise domestic interest rates further and reduce investment and growth. • Lower growth or a higher fiscal deficit would exacerbate fiscal sustainability risks, increasing the economy's vulnerability and reducing the government's ability to respond to adverse shocks. • Alternatively, even if confidence remained strong and financing were available, a looser fiscal stance could result in overheating.
5. Sudden unraveling of balance-sheet foreign exchange imbalances.	**Medium** • Balance sheets of corporate and households are exposed to a depreciation of the local currency, given their negative foreign exchange positions. • While the banking sector holds a large open position in foreign currencies, banks' reliance on foreign funding has been rapidly growing, which makes then vulnerable to funding shocks. Moreover, banks are also exposed to foreign exchange risk through its loan portfolio.	**Medium** • Bank loan availability would be curtailed, impacting economic activity and worsening the fiscal position. • Depending on the magnitude of the depreciation, balance sheet deterioration may affect some financial institutions.
6. Larger than anticipated impact from INTEL withdrawal	**Low** • INTEL's withdrawal and external competition weighs down on FDI and leads to an increase in unemployment and a reduction in productivity growth as the enterprises with a more sophisticated export base close. An unsustainable fiscal position may exacerbate these risks.	**Low/Medium** • Depending on the size of the reduction in FDI flows, there may be low to moderate impact on short-term growth, due to lower capital accumulation and productivity growth. The impact on potential growth, however, is likely to be limited since Costa Rica has strong institutions and a well-educated workforce.

[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path discussed in this report (which is the scenario most likely to materialize in the view of the staff). The RAM reflects staff's views on the source of risks and overall level of concerns as of the time of discussions with the authorities. The relative likelihood of risks listed is the staff's subjective assessment of the risks surrounding this baseline.
[2] In case the baseline does not materialize.

POLICY DISCUSSIONS

13. **Discussions centered on the policy mix appropriate for current cyclical conditions and mitigation of longer-term economic vulnerabilities.** In particular, the latter focused on how to: (i) restore fiscal sustainability; (ii) improve the monetary policy framework; (iii) further enhance financial system supervision and regulation; and (iv) boost potential and inclusive growth.

A. Near-term Policy Mix

14. **The authorities appropriately intend to begin fiscal adjustment in 2015, thereby buttressing macro-economic stability and making a head start towards long-term sustainability.** There was agreement that budgetary adjustment in 2015 would contribute to mitigate risks of higher inflation, widening external imbalances, and possible adverse financial market reactions. It would also represent a first critical step to reduce the sustainability gap (¶18). Although the 2015 budget passed by Parliament envisages, in the absence of measures, a further increase in the CG deficit to about 7 percent of GDP, the government plans a correction of about 1¼ percent of GDP in 2015 (as noted, most of the supporting measures, including VAT reform and cuts in transfers (¶21) are at an advanced stage of elaboration and are included in the baseline). In staff's view, this correction would be suitable (¶19 and AN 3), taking into consideration inflation and fiscal sustainability concerns as well as the cyclical position of the economy. It will be critical, though, to implement on a timely basis the planned measures, including speedy adoption of the VAT reform and freeze in real salaries (¶21).

15. **There was agreement that the monetary stance is adequate but policy should remain nimble to guard against the risk of higher-than-anticipated inflation** (¶3)**.** At 5.25 percent, the monetary policy rate is close to the estimated neutral rate of 5.0–5.1 percent, implying a broadly appropriate stance, given output close to potential. This conclusion is also supported by indications of neutral domestic financial conditions (¶8), and, as the authorities emphasized, by moderating credit growth generally consistent with benign financial deepening. However, staff argued that higher inflation risks prevail due to: (i) higher-than-estimated pass-through and second round effects from currency depreciation; (ii) possibly faster U.S. growth; (iii) bigger-than-assumed regulated price hikes, though these are now more unlikely given recent declines in oil prices. These risks are not expected to be outweighed by larger-than-anticipated oil price drop or slowdown due to Intel withdrawal. Accordingly, staff urged the BCCR to stand ready to raise rates if inflation does not decline as anticipated, particularly if it persists above the upper limit of the target range. The authorities reiterated their readiness to adjust the policy rate depending on inflation developments.

Costa Rica: Neutral Interest Rate

		Expected Inflation Mar-2015	5.00
		Actual Monetary Policy Rate	5.25

Method 1/	Neutral Real Interest Rate (NRIR)	Neutral Nominal Interest Rate (NNIR)	Nominal Monetary Policy GAP (bps) 2/
Uncovered Interest Parity	0.2	5.2	-6
Expected-Inflation Augmented Taylor Rule			
2006-2014 sample	-0.8	4.2	-106
2008-2014 sample	-0.7	4.3	-98
General Equilibrium Model			
2006-2014 sample	1.0	6.0	76
2008-2014 sample	0.6	5.6	36
Average			
2006-2014 sample	0.1	5.1	-12
2008-2014 sample	0.0	5.0	-22

Sources: National authorities and Fund staff estimates.
Notes: 1/ All units expressed as percent points unless otherwise stated. 2/ (bps): Basis points

B. Safeguarding Fiscal Sustainability

16. **The authorities recognized that current fiscal trends are unsustainable in the long term.** Without policy action, the CG deficit would be above 9 percent of GDP and debt rise above 60 percent by 2019. Even in the baseline scenario, which incorporates a fiscal adjustment of 2¼ percent of GDP, the CG deficit would persist at about 5¾ percent of GDP by 2019, owing to a mounting interest bill and constitutionally-mandated education spending. Correspondingly, CG debt would grow to 51 percent of GDP by 2019 (from 36 percent of GDP at end-2013), further raising vulnerabilities and potentially eroding the underpinnings of macroeconomic stability.

Costa Rica: Passive Scenario Without Measures 1/

(In percent of GDP, unless otherwise indicated)

	2013	2014	2015	2016	2017	2018	2019
Real GDP growth (percent)	3.5	3.6	3.4	4.2	4.1	4.0	3.9
Output gap (percent of potential GDP)	0.0	-0.4	-0.9	-0.9	-1.0	-1.2	-1.5
CPI (percent, end-of-period)	3.7	5.6	4.7	4.6	4.5	4.5	4.5
Current account balance	-4.9	-4.9	-4.9	-5.5	-6.4	-6.8	-7.4
Central government fiscal balance	-5.6	-6.2	-7.2	-7.4	-8.0	-8.7	-9.4
Structural primary balance	-2.8	-3.0	-3.4	-3.5	-3.5	-3.4	-3.3
Structural overall balance	-5.6	-6.1	-7.0	-7.2	-7.8	-8.5	-9.1
Central government debt	36.0	39.4	43.5	47.7	52.3	57.2	62.6

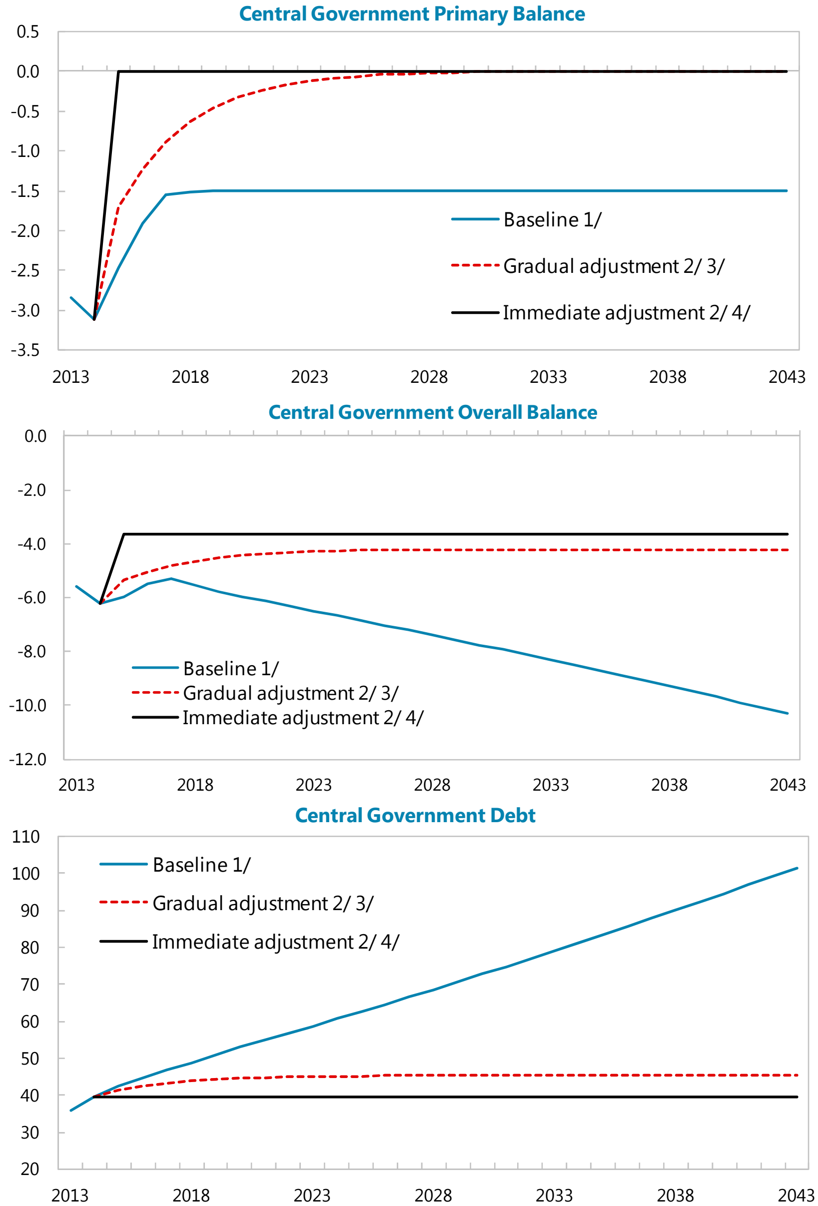
Source: Fund staff estimates.
1/ This scenario does not include any fiscal adjustment measures, while reflecting the underlying deterioration in the primary balance mainly driven by the constitutionally mandated increase in education expenditure.

17. **The authorities also acknowledged that the pension system's financial position has to be strengthened in the long run.** The pension plan run by the Social Security agency (CCSS) and those of the judiciary and the teachers are actuarially imbalanced. They are projected to turn a cash deficit over the long term due to system maturation and population aging (AN 3). Preliminary projections suggest that an adjustment equivalent to about 1½ percent of GDP would be required to ensure actuarial equilibrium of all pension systems for the next 100 years. The authorities indicated that a joint study (by the CCSS and the Superintendence of Pensions) to be released in 2015 would determine the size the imbalance.

18. **There was agreement on the amount of fiscal adjustment needed to stabilize the public debt ratio.** In staff's estimates, fiscal retrenchment amounting to about 3¾ percent of GDP over the medium-term would suffice to stabilize the public debt ratio below levels which are shown to pose risks for macro stability in emerging markets (Annex II). The authorities concurred and intend to consolidate public finances by about 4 percent of GDP over the medium term. The authorities also acknowledged that in the longer run further parametric adjustment would be needed to remedy the actuarial imbalance of the pension system (¶17)—including larger contributions, lower replacement rates, and higher retirement age.

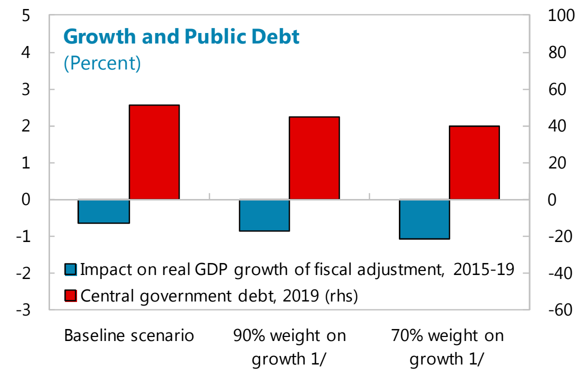
Figure 1. Costa Rica: Long-Term Fiscal Sustainability

(Percent of GDP)



Source: Fund staff estimates and projections.
1/ This path is the baseline through 2019, with a constant primary balance thereafter.
2/ The immediate and gradual adjustment scenarios aim at closing the same initial sustainability gap with consolidation starting in 2015 in both scenarios. The debt stabilizing primary balance is calculated based on medium-term baseline projections of real interest and growth rates that are maintained constant over the projection period in line with the requirements of the optimization model (AN 3). The gap is then measured relative to the 2014 projected fiscal outturn.
3/ The gradual scenario assumes that the authorities place 90 percent weight on the growth objective. Impact of growth is based on fiscal multiplier of 0.3, with a self-correction parameter for the output gap of 0.5, implying that the effect on the output gap of a fiscal adjustment of 1 percent of GDP almost dissipates—is less than 0.1 percent of GDP—in the second year following the adjustment.
4/ The immediate adjustment scenario assumes that the full fiscal adjustment takes place in 2015 and has no impact on growth.

19. **The pace of fiscal consolidation should strike a balance between lowering the sustainability gap and limiting any adverse impact on growth.** The authorities concurred that it would be appropriate to undertake about one third of the fiscal adjustment in 2015 followed by smaller steps in subsequent years. The proposed deficit reduction path would have only moderate output cost over the forecast period, even if fiscal consolidation were simultaneously undertaken by trading partners (AN 2). Staff cautioned against further postponing fiscal retrenchment, stressing that the longer the delay, the larger will be the improvement in the primary balance required to stabilize the public debt ratio. Officials were aware that failing to deliver on the fiscal consolidation plan would also increase the risk of an abrupt shift in investor sentiment and of acute financial market tensions, thus forcing a disorderly adjustment.



Sources: National authorities and Fund staff estimates.
1/ Gradual adjustment scenarios based on model of fiscal adjustment based on authorities' preferences for growth and fiscal objectives.

Fiscal Contribution to Growth Under the Recommended Fiscal Path

	2015				2016			
	Change in the Fiscal Balance	Total Growth Impact	Of which: Domestic Effect	Of which: Spillover Effect	Change in the Fiscal Balance	Total Growth Impact	Of which: Domestic Effect	Of which: Spillover Effect
Costa Rica	**1.0**	**-0.4**	**-0.2**	**-0.1**	**1.0**	**-0.7**	**-0.5**	**-0.2**
of which:								
- current year		-0.5	-0.4	-0.2		-0.4	-0.3	-0.1
- carry over prev. year		0.2	0.1	0.1		-0.3	-0.2	-0.1
PPP weighted average	0.6	-0.2	-0.2	-0.1	0.4	-0.4	-0.3	-0.1

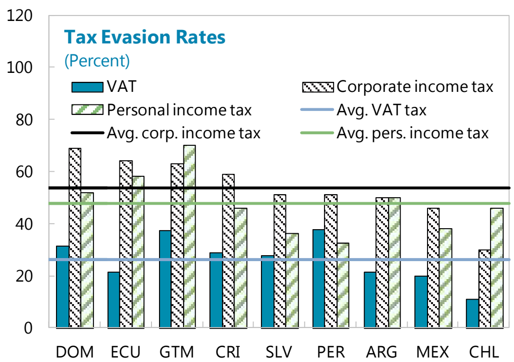
Source: Fund staff estimates.

20. **A common stance was also reached on the broad composition of fiscal adjustment.** The authorities agreed that about two-thirds of the needed adjustment (or 2½ percent of GDP) had to rely on revenue increases. The emphasis on revenue enhancement was considered appropriate given Costa Rica's low revenue effort compared to other upper-middle-income countries.

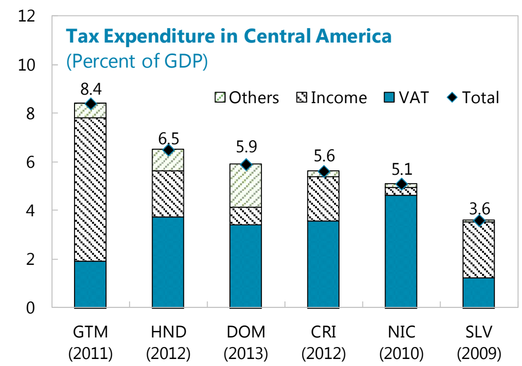
21. **Moreover, the supporting measures identified by the government are advisable, though some important steps still need to be fleshed out.**

- The authorities have readied a legislative proposal to broaden the base of the VAT to include services and basic goods (the latter at a reduced rate), but the bill to reform the income tax (by eliminating some exemptions and moving from schedular to global determination of the tax liability) has not been finalized yet. Most of the measures for reducing expenditures also have to be fully articulated.

- Staff acknowledged that major revenue gains may be accrued by reducing tax exemptions and other special treatments (e.g. to enlarge the base of the VAT), but stressed that the substantial budget consolidation required will also demand increases in tax rates over the medium term. Specifically, staff recommended raising the VAT rate from 13 to 15 percent gradually and increasing marginal rates on higher-income brackets. The latter could also compensate for any regressive impact of hiking VAT rates. The authorities confirmed their willingness to raise the VAT rate in steps starting in 2016, consistent with the consolidation recommended by the staff.



Sources: Corbacho, Fretes Cibils, and Lora (2013); CAF (2012); Cardoza (2012); Jiménez, Gómez Sabaini and Podestá (2010); Pecho, Peláez and Sánchez (2012); and Salim (2011).



Sources: WGTC; Sabatini, Pecho, Moran: 'Los gastos tributarios en Honduras, 2013; national authorities and Fund staff estimates.

- The authorities also considered important actions to strengthen tax compliance, including the draft anti-tax evasion law recently submitted to parliament. Staff agreed with the need to strengthen tax administration, but cautioned that yields from such initiatives are generally uncertain and far from immediate.

- The authorities expressed their commitment to expenditure tightening. In particular, they concurred that efforts should start in 2015 and concentrate on containing growth of current spending, especially of the wage bill and transfers, through modifying indexation to prevent automatic real salary increases and improving efficiency of the civil service, including through a partial employment freeze. This would also support desirable increases in growth-friendly capital spending, in line with authorities' efforts to improve project execution. In this connection, staff cautioned on the need to contain risks of contingent liabilities and additional pressures on domestic financing resulting from new off-budget investment vehicles contemplated by the authorities.

- Staff estimates that the proposals at a more advanced stage of elaboration are likely to yield some 2¼ percent of GDP, as included in the baseline scenario (¶10). The remaining measures needed to generate the required total adjustment of 3¾ percent of GDP ought to be defined urgently, not least to obtain more reliable estimates of their impact.

Costa Rica: Fiscal Consolidation Measures

(In percent of GDP)

	Baseline scenario. Partial fiscal adjustment		Full fiscal adjustment scenario	
	Authorities' plans	Staff assessment 1/	Additional adjustment 2/	Total adjustment
Total adjustment	**4.0**	**2.2**	**1.5**	**3.8**
Revenue	3.1	1.5	1.0	2.5
Administrative measures 3/	0.6	0.2	-	0.2
Exemptions law 4/	0.5	0.3	-	0.3
VAT 5/	1.0	0.7	0.8	1.5
Income tax 6/	1.0	0.4	0.2	0.6
Expenditure	-0.9	-0.7	-0.6	-1.3
Wages 7/	-0.1	-0.1	-0.5	-0.6
Transfers 8/	-0.8	-0.6	-0.1	-0.7

Source: Fund staff estimates.

1/ The baseline scenario incorporates staff's assessment of measures in the authorities' fiscal plan that are at a more advanced stage of elaboration. Includes expenditure cuts equivalent to 0.3 percent of GDP, other cuts in transfers, a partial hiring freeze, broadening of the VAT base from the second half of 2015, a move towards global income tax, miscellaneous cuts in exemptions, and moderate gains from improvements in tax evasion.

2/ The full adjustment scenario includes additional measures in the authorities' plan that were at a less advanced stage of elaboration at the time of the Article IV mission. Includes measures as in the baseline scenario as well as measures to contain growth in the wage bill, and increases in the VAT rate and marginal income tax rates in outer years.

3/ Includes mainly effects of 2014 anti-tax evasion law.

4/ Includes measures envisaged in draft law that would reduce exemptions on income tax for cooperatives and public entities, as well as reinstate an excise on lottery sales.

5/ Baseline projection includes extending VAT coverage to services sector, with basic goods and private education and health taxed at preferential rate of 2 percent. Additional measures include gradual increase from 13 to 15 percent tax rate.

6/ Baseline projection includes move from schedular to global basis for income tax. Additional adjustment measures include gradual increase in marginal rates on higher income brackets.

7/ Baseline projection includes partial hiring freeze. Additional adjustment measures include freezing salaries in real terms.

8/ Baseline projection includes cuts in transfers in the 2015 budget. Additional measures include enforcement of the legal cap on pensions paid out of the budget.

Costa Rica: Fiscal Consolidation Path

(In percent of GDP)

	2015	2016	2017	2018	2019	Total
Total Adjustment	1.3	1.2	0.9	0.2	0.1	3.8
Baseline	1.1	0.8	0.3	-	-	2.2
Revenue	0.4	0.8	0.3	-	-	1.5
Expenditure	0.7	-	-	-	-	0.7
Additional adjustment	0.2	0.5	0.6	0.2	0.1	1.5
Revenue	-	0.4	0.5	0.1	-	1.0
Expenditure	0.2	0.1	0.1	0.1	0.1	0.6

Source: Fund staff estimates.

22. **In addition, most deficit-reducing measures require parliamentary approval, which is made difficult by a complex political situation.** The new administration should take advantage of its high political capital to push forward reforms early in its mandate, not least to persuade the powerful public sector unions to accept sacrifices (the containment of wage growth in the public sector does not require parliamentary approval). Nevertheless, the government noted that it only has a minority representation in Congress, hence passage of several budget consolidation measures requires the cooperation of opposition parties. Lingering resentments from the bitter presidential campaign raise concerns about legislative approval of adjustment measures, notably the reforms of the VAT and income taxes. Nonetheless, there appears to be broad consensus across the political spectrum and society at large that fiscal retrenchment is needed. Thus, there may be scope for leveraging containment of public sector wages to bargain for revenue increases.

C. Improving the Monetary and Exchange Rate Policy Framework

23. **Discussions identified areas to strengthen further the monetary policy framework.** Staff commended the authorities' achievements in lowering inflation since the global crisis. Having posted double-digit inflation for almost 30 years, Costa Rica has maintained it within the BCCR target range of 4–6 percent since 2009 (the range was further reduced to 3–5 percent in 2014). However, the recent depreciation episode illustrated that inflation expectations are not well-anchored. Moreover, perceived exchange rate stability in the past few years has encouraged dollarization, building up vulnerabilities in the balance sheets of banks and the private sector. The FX intervention rule, which aims both to avert excessive volatility and counter excessive deviations from medium-term fundamentals, remains undisclosed. Staff noted that lack of transparency may undermine confidence in the subordination of XR management objectives to the inflation target.

24. **The authorities aim to move towards full-fledged inflation targeting, while maintaining a significant role for active XR management.** Staff argued that allowing more XR flexibility would help establish inflation as the undisputed monetary anchor and lower XR pass-through to inflation. In particular, since appreciation pressures have now subsided, it is an opportune time for abandoning the XR band. More flexibility would enhance the role of the XR as a shock absorber and make market participants more cognizant of two-way risks in exchange markets, promoting the development and use of hedging facilities and the reduction of foreign currency mismatches, while more generally discouraging dollarization. The elimination of the band would not preclude the BCCR from engaging in FX market interventions to smooth out short-term sharp XR fluctuations and strengthen the NIR position as long as interventions do not jeopardize the inflation target. The authorities agreed in principle, but stressed the need to remain vigilant about the impact of XR movements on financial stability and inflation expectations given the high levels of dollarization and unhedged FX borrowing. Specifically, officials noted that other "inflation-targeting" central banks intervene frequently to stem excessive XR volatility and they are likely to follow this mold. The authorities were also cautious about making the intervention rule public due to the fear of facilitating speculation.

Table 1. Costa Rica: Extent of Preparedness for Transitioning to Greater Exchange Rate Flexibility[1]

	Orderly Exits			Exits Under Pressure			Degree of preparedness
	Chile (1984–99)[1]	Israel (1985–2005)[1]	Poland (1990–2000)[1]	Brazil (1999)[1]	Czech Rep. (1996–97)[1]	Uruguay (2002)[1]	Costa Rica (2014)
Ingredients of a Floating Regime							
I. FX Market Development							
Spots Markets	✓	✓	✓	✓	✓	✓	✓[8]
Derivative Markets/Hedging Instruments	✓	✓	✓[2]	✓ (futures)	✓[2]	X	X[9]
Complementary Markets							
Interbank Money Market	✓	✓[3]	✓	✓	✓	X	✓[10]
Securities Market	✓	✓[3]	✓	✓	✓	✓[4]	✓[11]
II. FX Risk Management Capacity	✓	✓	✓	X[5]	✓	X	✓[12]
III. Alternative Monetary Policy Framework	✓	✓	✓	X	X	X	✓
Monetary Policy Implementation Capacity	✓	✓	✓	✓	✓	X	✓[13]
IV. Intervention Strategy for a Floating Regime	With the float	✓	With the float	With the float	✓	With the float	Discretionary intervention
Overall Preparedness	Well prepared	Well prepared	Well prepared	Reasonably well prepared	Reasonably well prepared	Not well prepared	Reasonably well prepared
Memo: Capital Account Liberalization							
Short-term Capital Inflows Liberalized	✓[6]	✓	✓[7]	✓[6]	✓[7]	✓	✓[14]
Capital Ouflows Liberalized	✓[6]	✓	✓[7]	✓	✓[7]	✓	✓
Derivative Transactions Liberalized	✓	✓	✓[7]	✓	✓[7]	✓	✓

Source: Otker-Robe and others (2007) and staff analysis

Note: FX = foreign exchange.

[1] The years in parentheses refer to the period of transition to a full float

[2] Major boom one year before the float.

[3] Lagged behind compared to the foreign exchange markets.

[4] For maturities less than 270 days.

[5] The prudential framework was not in place to control the overall risk exposure of banks, with identified shortcomings mainly regarding the prudential regulation of banks' exposure to FX risk. Corporates in general (and banks) were making active use of the futures markets to hedge their exposures or to take speculative positions. Market participants were not accustomed to assessing, as a matter of routine, the FX risks posed by regular market volatility.

[6] For Chile, all controls were removed shortly before or with the float. For Brazil, controls were liberalized gradually during the 1990s (inflow controls of 1993-96 liberalized by 1999), with further liberalization for nonresident investments after the float.

[7] In the Czech Republic, most inflows and outflows had been liberalized by 1997, but certain inflow transactions (including financial derivatives) were liberalized in early 1999, following a transition period to phase out the remaining controls under the agreement with the Organization for Economic Cooperation and Development (OECD), with full liberalization taking place in 2002, until which time certain transactions (including some selective derivatives operations and short-term portfolio and deposit transactions) had remained controlled.

[8] Spot market is relatively shallow and the central bank does not comprehensively collect information on spot transactions on regular basis.

[9] Derivatives market is unregulated. Hence, while there are no restrictions on derivatives transactions, it is not clear how the associated risks are assessed by the supervisor and how the derivatives market functions in practice.

[10] The interbank market is underdeveloped with low degree of market depth.

[11] The securities market is largely limited to primary market in government securities, secondary market in repos of government securities, and a very thin stock market.

[12] While the prudential framework to control the overall FX risk exposure of the banks as well as the measures to reduce FX risks is in place, it is somewhat obsolete. The private sector does not use derivatives to hedge their exposures on routine basis and market participants in general are not accustomed to assessing the FX risks posed by regular market volatility. After the depreciation episode in 2014, the CB introduced some measures to smooth volatility in the FX market, including new requisitions for the buying/selling of FX by public sector entities. Specifically, before June 2014, the CB participated in the FX market in order to replenish NIR that was withdrawn by the public sector. Now, the CB can decide discretionally when and how to do this replenishment.

[13] While monetary framework is largely in place, the transmission mechnism from policy rates to the market rates is rather weak.

[14] While there are no capital controls currently in place, a recently adopted law empowers the executive, upon consultation with the Central Bank, to impose temporary restrictions on inflows of short-term capital through taxation and compulsory deposits with the Central Bank.

25. **Steady progress has been made to create a favorable environment for inflation targeting, but more may be needed.** The experience of countries that successfully transitioned to more flexible XR regimes (AN 6) suggests the importance of strengthening effective systems for reviewing and managing the exposure to XR risk. In this regard, staff welcomed bank supervision stipulations adopted in 2013, aimed at a more thorough assessment of credit risks related to XR exposures and associated need for higher provisions. The authorities concurred that fostering further development of the secondary market for government securities is also desirable. Finally, staff counseled to resist pressures to expand the BCCR's mandate to include growth, which could generate confusion as to the main target of monetary policy. Additional steps to buttress BCCR credibility further, including by fortifying its balance sheet, could also be useful (AN 4).

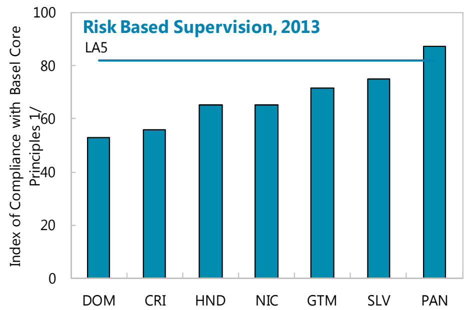
D. Financial Stability

26. **Officials acknowledged that limited progress has been made in implementing pending recommendations from the 2008 FSAP update** (Annex 1)**.** Advances have been slow, largely due to a crowded legislative agenda. In particular, legislation aimed at empowering the Superintendence of Financial Institutions to conduct consolidated supervision, providing adequate protection to bank supervisors, and strengthening bank resolution procedures has been stalled in Congress for 8 years. The authorities are preparing new proposals to replace the old draft laws but the time-frame for their completion and the degree of alignment of the new laws with the 2008 FSAP update recommendations is not clear. The authorities noted, in particular, that introduction of further legal protection for bank supervisors faces strong opposition and may run into court challenges. Staff endorsed progress made towards full implementation of risk-based supervision, but encouraged stepping up efforts to bring it up to best practices.

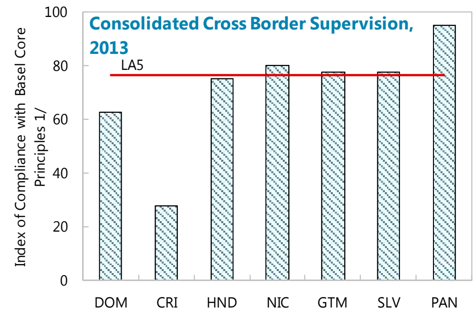
27. **The authorities concurred that gradual adoption of Basel III standards would further improve resilience of the financial system.** The authorities believe that the regulatory and risk management frameworks would benefit from gradually firming up capital quality and increasing liquidity and capital requirements in line with Basel III standards. In particular, moving towards the introduction of Basel III definitions of capital, a capital conservation buffer, and a leverage ratio as well as incorporating market and operational risk capital requirements should be immediate priorities. Staff assessment suggests that only a few banks are not yet in full compliance with Basel III standards (AN 7) and that adopting Basel III capital requirements would have negligible growth impact in Costa Rica.

28. **Regional initiatives to upgrade cross-border consolidated supervision are important, but additional improvements are needed to alleviate lingering spillover risks.** Effective supervision of cross-border financial operations is critical for stability, in particular because financial linkages within the region are not fully understood, owing in part to data limitations but also to legal restrictions on information sharing. Enhancing transnational monitoring is especially important for Costa Rica since its large conglomerate BCT operates in Panama. In this regard, officials emphasized the existence of a data sharing agreement with Panama, but staff underscored that cross-border consolidated supervision seems overall less advanced in Costa Rica compared to other countries in the region. Specifically, though it welcomed Costa Rica's participation in the system of multilateral

MoUs and in the newly created Central American Council of Banking Supervisors, staff urged speedier implementation of actions recommended in the 2008 FSAP (¶26).



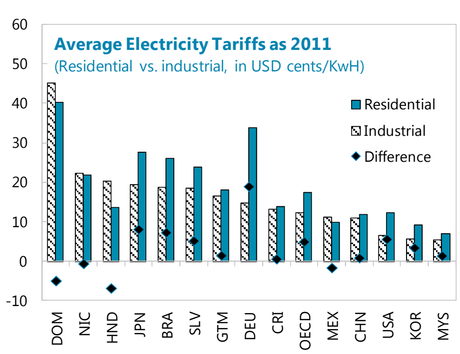
Source: Fund staff estimates based on country assessments.
1/Scale: 100 = compliant; 75 = largely compliant;
25 = materially non-compliant; 0 = non-compliant.



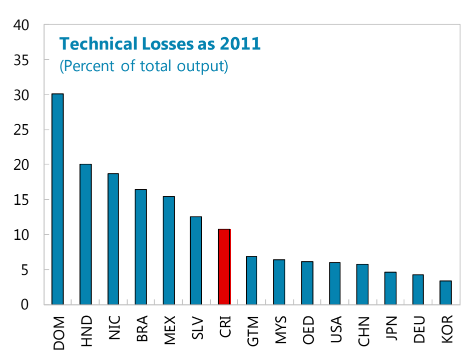
Source: Fund staff estimates based on country assessments.
1/Scale: 100 = compliant; 75 = largely compliant;
25 = materially non-compliant; 0 = non-compliant.

E. Structural Reforms

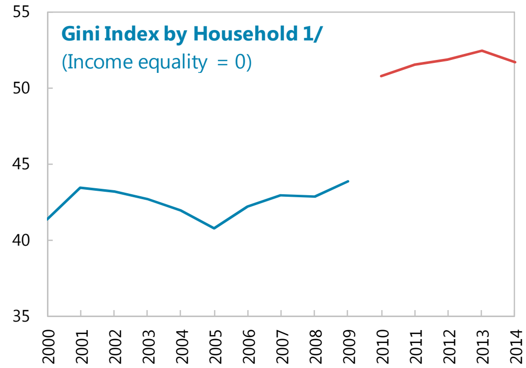
29. **The authorities support structural reforms to buttress Costa Rica's competitiveness and promote inclusive growth.** While Costa Rica has been the regional leader in attracting foreign direct investment, the recent withdrawal of Intel suggests that further steps are needed to maintain the country's competitive edge. Within the region, the country is relatively well-positioned in the electricity market—more than 80 percent of electricity comes from renewable sources, technical losses are relatively low, and industrial tariffs are the lowest in the region. Nevertheless, the cost of electricity is high compared to Asian competitors, which are generally more efficient at electricity production. Staff recommended increasing private sector participation in the energy sector and reviewing tariff setting procedures to enhance cost discipline. While Costa Rica ranks highly on women's educational attainment compared to other countries in the region, it lags in terms of economic participation and opportunity for women, reflected in low female labor force participation and the gender wage gap (Figure 7). With regards to human capital, the authorities agreed that improving the quality of public education spending with emphasis on quality child care and early childhood education could facilitate female return to the labor force, foster productivity improvements, and lower inequality, which has been recently on the rise. Officials also concurred that stimulating competition in the banking sector, fostering the development of the domestic capital market, addressing infrastructure bottlenecks, and streamlining business regulations could accelerate potential growth and improve financial inclusion. According to staff estimates, efficiency gains from these measures could increase trend growth by up to 2 percentage points, while reducing unemployment by 3 percent over the long run (Figure 7).



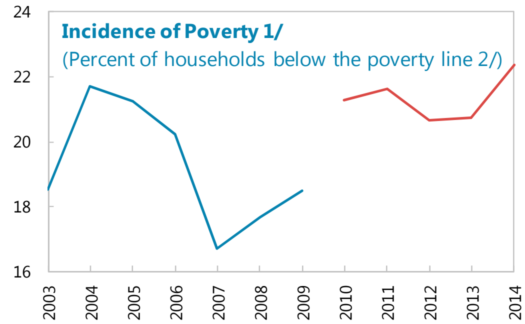
Sources: OLADE and Fund staff estimates.



Sources: OLADE and Fund staff estimates.



Sources: INEC and Fund staff estimates.
1/ The line break in 2010 reflects a methodological change in the measurement of the Gini Index.



Sources: INEC and Fund staff estimates.
1/ The line break in 2010 reflects a methodological change in the measurement of the poverty.
2/ The poverty line is calculated according to the cost of the essential goods and services to afford minimal standards of living.

STAFF APPRAISAL

30. **Costa Rica must address existing vulnerabilities and attain long-term fiscal sustainability, while upgrading productivity and safeguarding financial stability.** In the near term, a tighter fiscal policy stance and vigilance over inflation would buttress macroeconomic stability. At the same time, public finances should be placed on a sustainable path, the monetary policy framework strengthened, and banking sector supervision and regulation further enhanced. Reforms to foster competition, increase efficiency, and promote external competitiveness would accelerate long-run inclusive growth.

31. **With long-term fiscal trends unsustainable, ambitious fiscal consolidation is needed, though it can be implemented at a measured pace.** Excluding the pension system actuarial deficit, a permanent improvement in the fiscal primary balance of 3¾ percent of GDP is required to stabilize the public debt ratio after 2019 at a prudent level and safeguard macroeconomic stability. Given that output is close to potential, the rapid growth of public debt calls for significant upfront fiscal tightening, with about a third of the overall budget adjustment in 2015 followed by smaller steps in subsequent years. Postponing consolidation would result in larger tightening needs to stabilize debt-to-GDP and increase the probability of disorderly adjustment in the event of an adverse turn in investor sentiment. While the social security actuarial deficit could be addressed at a later stage, the longer the correction is delayed, the larger it will be.

32. **Thus, the authorities' fiscal adjustment plan of about 4 percent of GDP is suitable, but supporting measures still need to be fully developed and implemented.** The plan's emphasis on revenue enhancement is well-founded, given Costa Rica's low revenue effort compared to other upper-middle-income countries. However, the proposals at a more advanced phase of elaboration are likely to yield only some 2¼ percent of GDP. Other measures still need to be fleshed out and virtually all have to be enacted. On the revenue side, it is advisable to broaden the VAT base and raise the VAT rate from 13 to 15 percent, as well as to increase marginal tax rates on higher income brackets as part of the introduction of a global income tax, thereby addressing also distributional concerns. Efforts to contain growth of current outlays, particularly the wage bill and transfers, should be stepped up, thus creating space for much needed infrastructural spending. Although recent

actions to strengthen tax compliance are positive, associated revenue gains are likely to materialize only in the longer term.

33. **The monetary stance is broadly appropriate, but the authorities should complete the transition to inflation targeting.** Current monetary policy is expected to support the reentry of inflation within the target band, though vigilance is warranted in case inflation does not decline in line with projections. Elimination of the XR band and concurrent adoption of a more transparent intervention rule would establish the inflation target as the undisputed bearing of monetary policy, while still allowing for smoothing out exchange rate volatility. At the same time, higher XR flexibility would help lower the XR pass-through to inflation and force market participants to internalize currency risks, discouraging dollarization. It is important to foster development of the tools necessary to underpin greater XR flexibility, including hedging instruments and a deeper secondary market for government securities. The authorities should also avoid expanding the BCCR's mandate to include growth, which could generate confusion as to the true target of monetary policy.

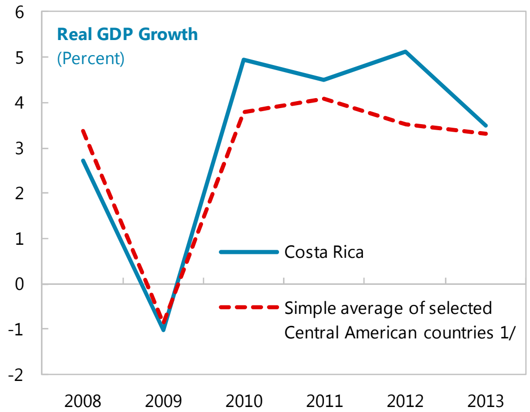
34. **Enactment of the pending FSAP recommendations, a gradual move towards Basel III standards, and strengthening cross-border supervision are important.** In particular, greater urgency is required in empowering the Superintendence of Financial Institutions to conduct consolidated and transnational supervision, providing adequate protection to bank supervisors, and enhancing bank resolution procedures. Progress made towards the full implementation of risk-based supervision is welcome, but more efforts are needed to bring it in line with best practices. The regulatory and risk management frameworks would greatly benefit from introducing gradually Basel III standards.

35. **Structural reforms offer the opportunity to boost productivity and foster long-run inclusive growth.** It would be desirable to step up private sector participation in the energy sector and review tariff setting procedures to strengthen cost controls. Ameliorating efficiency and efficacy of education spending, with the focus on early childhood, could raise women's labor force participation, stimulate productivity, and reduce inequality in the long term. Promoting competition in the banking sector, facilitating capital market development, alleviating infrastructure bottlenecks, and simplifying the regulatory environment would also buttress competitiveness and accelerate potential growth.

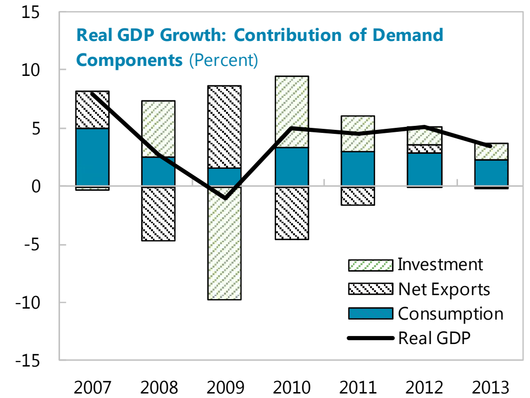
36. **It is recommended that the next Article IV consultation be held on the standard 12-month cycle.**

Figure 2. Costa Rica: Recent Developments and Prospects, Real Sector

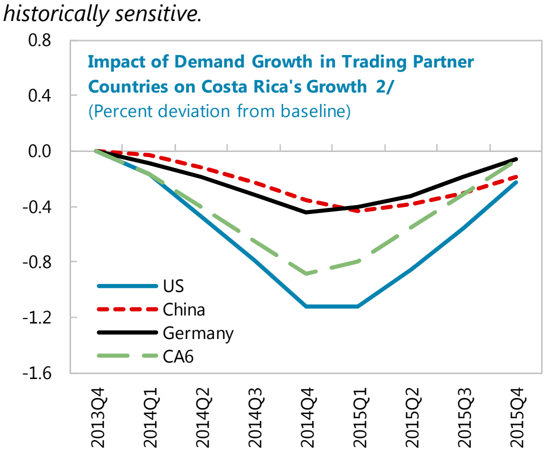
Real GDP growth declined in 2013 in line with the trend in other CAPDR countries...



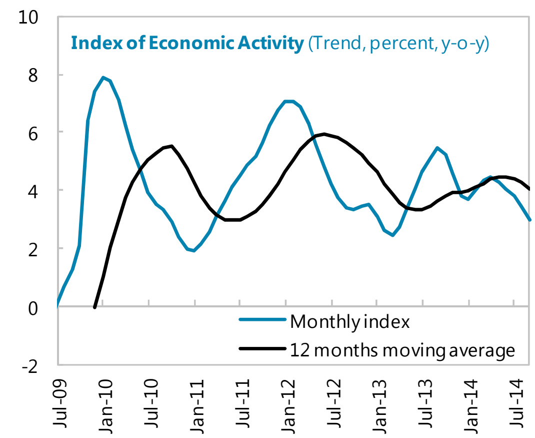
...largely on account of weaker net exports and domestic consumption...



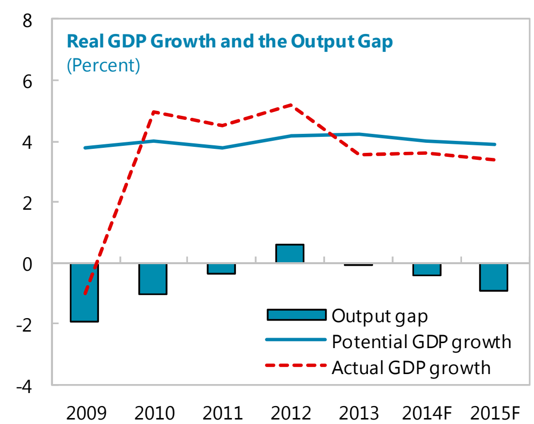
...and, in part, driven by weaker U.S .growth (about 1 percentage point), to which Costa Rica growth has been historically sensitive.



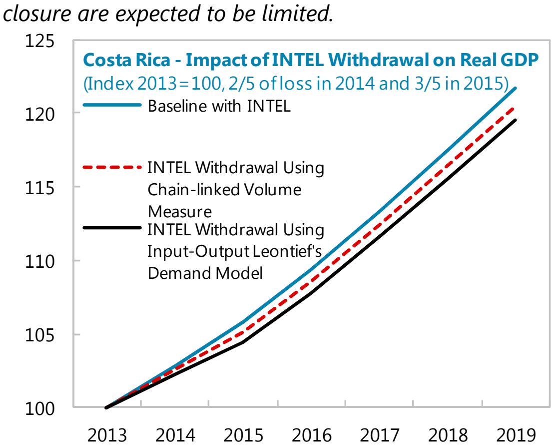
Growth is showing some signs of deceleration...



...and is expected to remain subdued in 2014–15, largely due to the INTEL withdrawal...



...though longer-term consequences of the INTEL plant closure are expected to be limited.



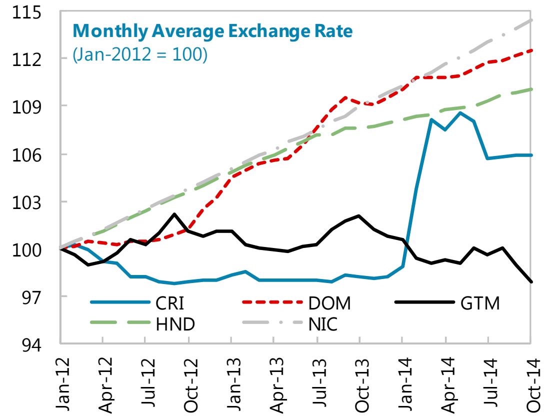
Sources: National authorities and Fund staff estimates.

1/ Selected Central American countries include Costa Rica, Honduras, Nicaragua, El Salvador and the Dominican Republic.

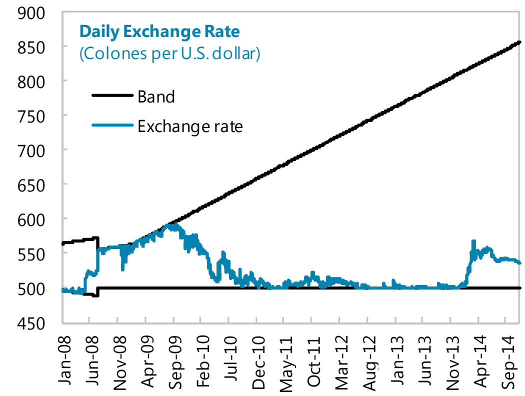
2/ The impact of a one percent point of domestic demand growth shock in trading partner countries on growth in Costa Rica.

Figure 3. Costa Rica: Recent Developments, Nominal Exchange Rate and Inflation

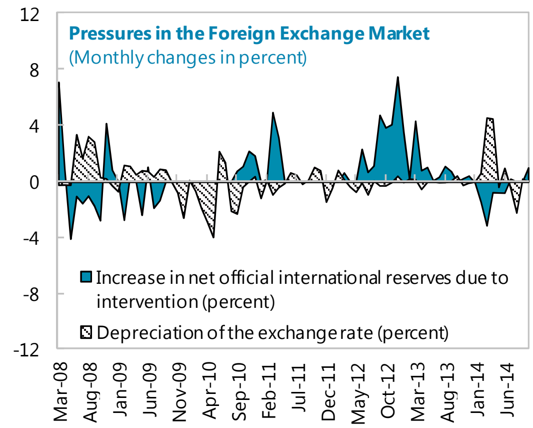
In the wake of U.S. monetary policy announcements, the nominal XR depreciated sharply by regional standards in early 2014…



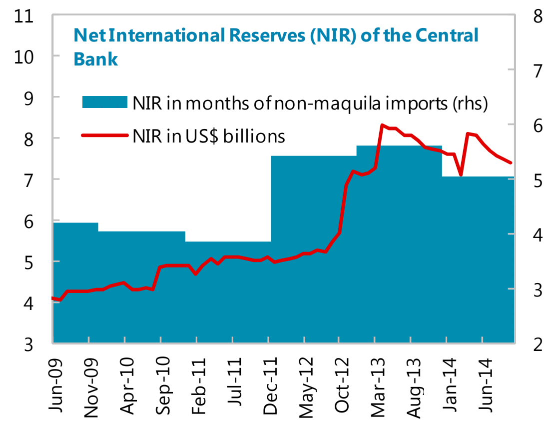
…lifting the XR from the bottom of the band where it was "stuck" since late 2010 but leaving it way below the upper bound.



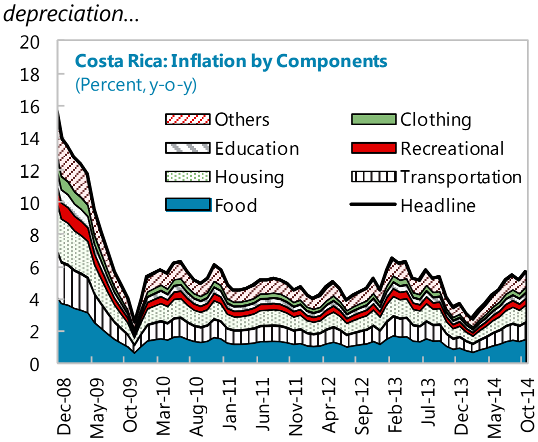
The Central Bank intervened in an attempt to smooth daily fluctuations….



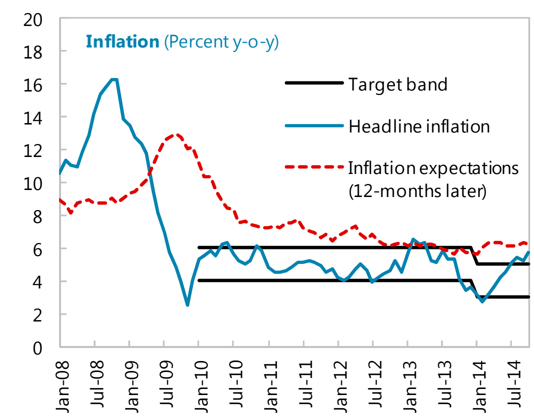
…but reserves, which were boosted by the April 2014 government Eurobond issuance, remain adequate.



A broad-based increase in inflation followed the XR depreciation…



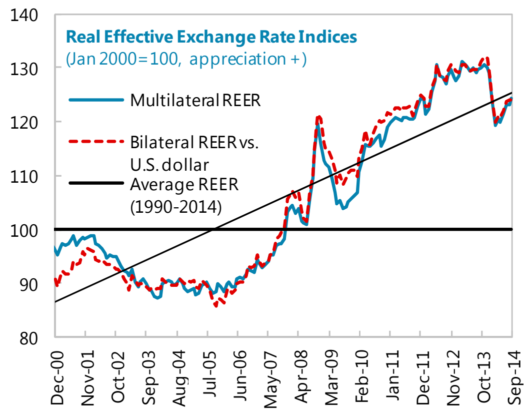
…boosting inflation expectations above the upper bound.



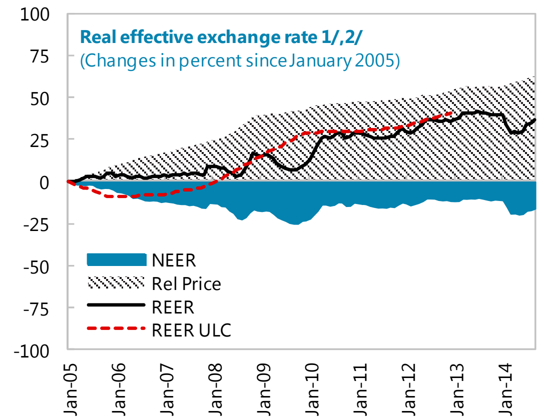
Sources: Bloomberg, Haver Analytics, national authorities and Fund staff estimates and projections.

Figure 4. Costa Rica: Recent Developments, External Sector

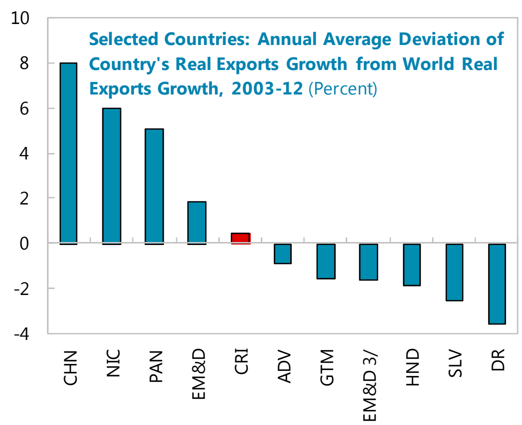
Large nominal XR depreciation in 2014, combined with only modest increase in inflation, led to a real depreciation, pushing the XR closer to equilibrium.



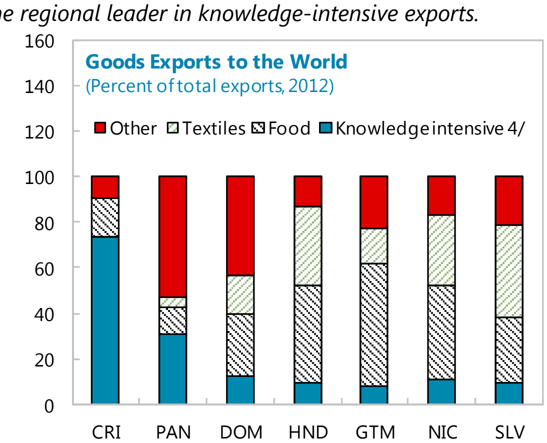
Despite substantial real effective XR appreciation over the past decade, driven largely by inflation differentials…



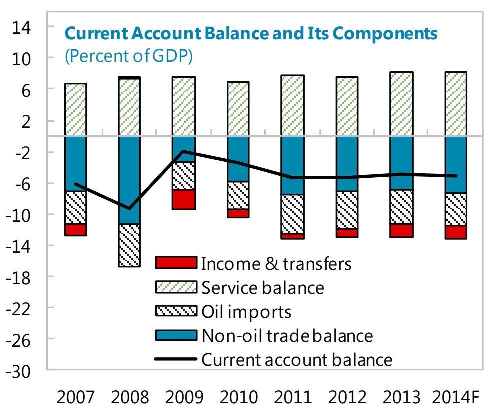
…and in contrast to other countries in the region, Costa Rica retained and even gained the market share…



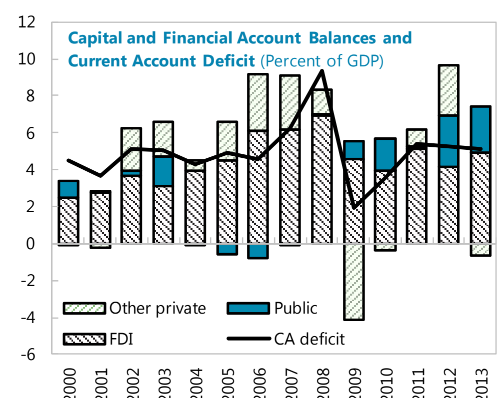
…reaping the benefits of export sophistication as it remains the regional leader in knowledge-intensive exports.



As a result, the current account has been broadly stable…



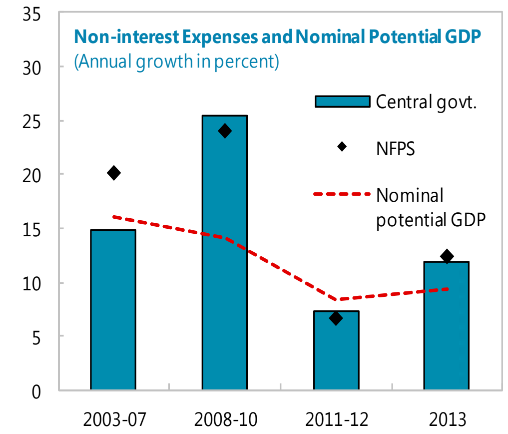
…and has been largely financed by FDI.



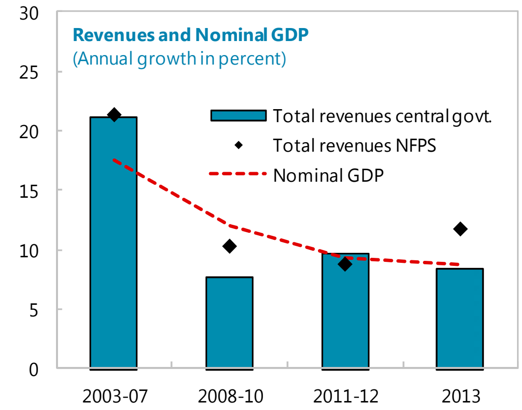
Sources: WITS, UN Comtrade, national authorities and Fund staff estimates.
1/ Increase implies appreciation.
2/ The REER based on ULC was calculated with data for 73 percent of the trading partners.
3/ Excludes China and Asian Tigers (Hong-Kong, Singapore, Korea, Taiwan, Indonesia, Malasia, Philippines, and Thailand.
4/ Knowledge intensive products include transport electrical equipment machinery and chemicals.

Figure 5. Costa Rica: Recent Developments and Prospects, Fiscal Sector

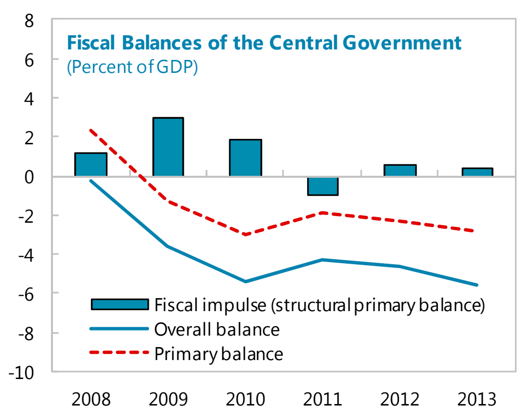
Public expenditures in 2013 continued growing at a rapid pace...



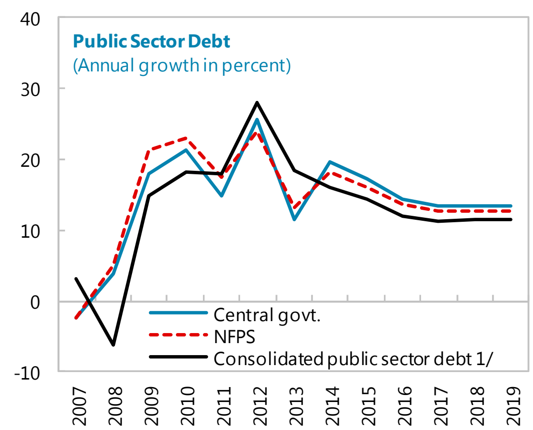
...while revenues just caught up with income...



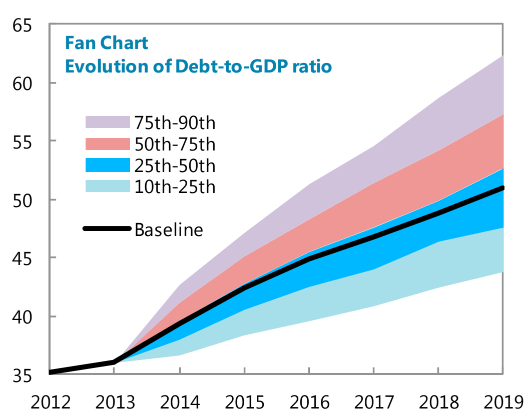
...resulting in further deterioration of the fiscal balance.



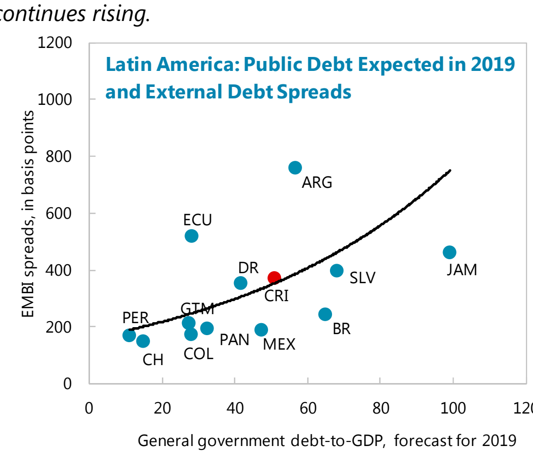
Public debt has grown substantially since the onset of the global financial crisis and is expected to continue its rapid ascent in the medium term...



...with risks tilted to the upside...



...and an increasing likelihood of a debt spiral with potentially non-linear increase in financing costs as debt continues rising.

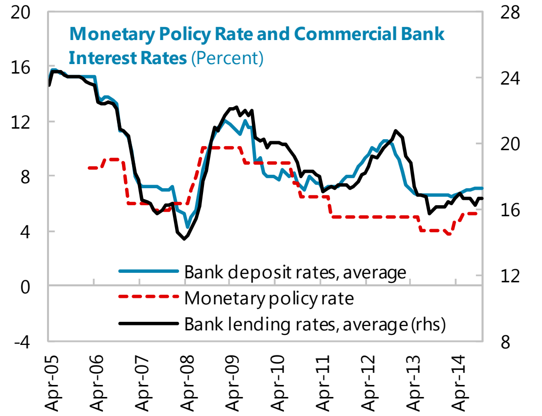


Sources: National authorities and Fund staff estimates.

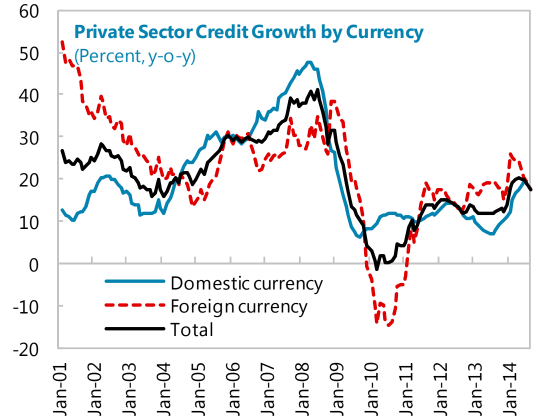
1/ The consolidated public sector balance comprises the central government, decentralized government entities, public enterprises, and the Central Bank, but excludes the Instituto Costarricense de Electricidad (ICE).

Figure 6. Costa Rica: Recent Developments, Financial Sector

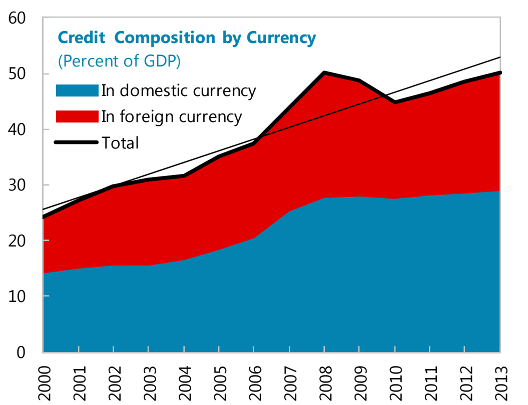
In the wake of XR depreciation in early 2014, monetary policy was tightened and domestic lending rates have started climbing up...



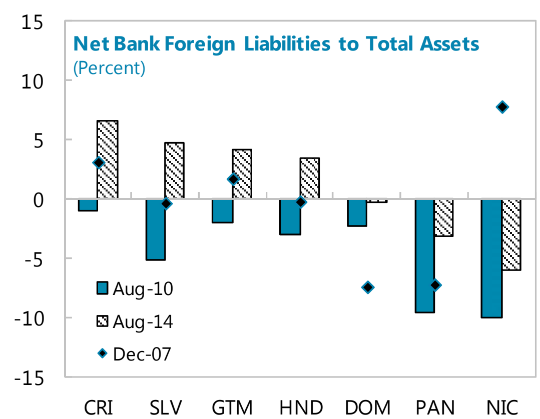
...the credit portfolio shifted away from foreign currency with overall credit growth adjusted for depreciation continuing to outpace the pace of nominal GDP growth.



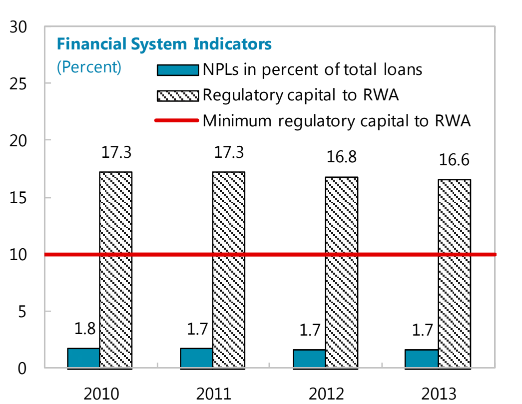
Foreign currency credit, which comprises a large share of the total credit, makes the financial system vulnerable to XR shocks...



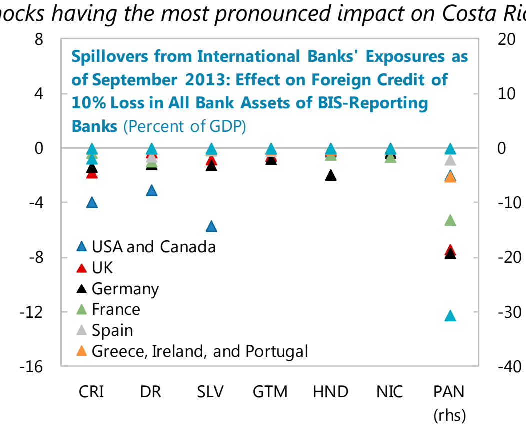
...while increased reliance on foreign financing makes the banks more susceptible to external financing shocks.



Nonetheless, banks meet minimum regulatory capital norms, non-performing loans are low...



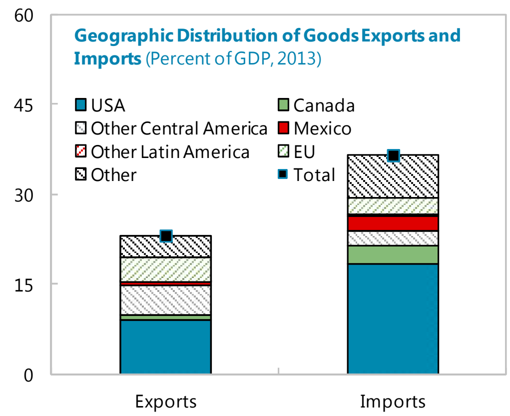
...and the financial system is generally robust to spillovers from asset quality shocks in advanced countries with U.S. shocks having the most pronounced impact on Costa Rica.



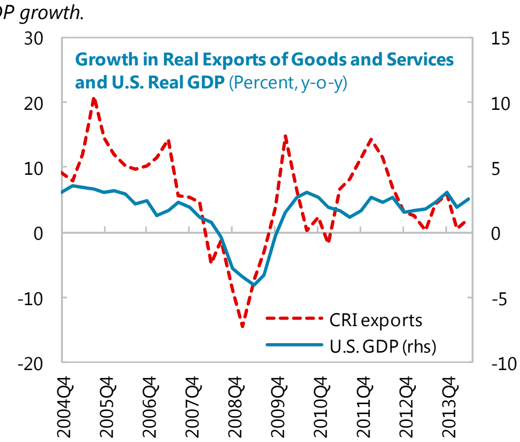
Sources: National authorities and Fund staff estimates.

Figure 7. The Impact of U.S. Monetary Policy Normalization

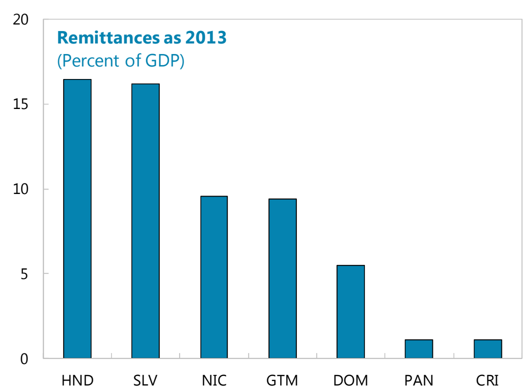
Costa Rica has strong trade ties with U.S....



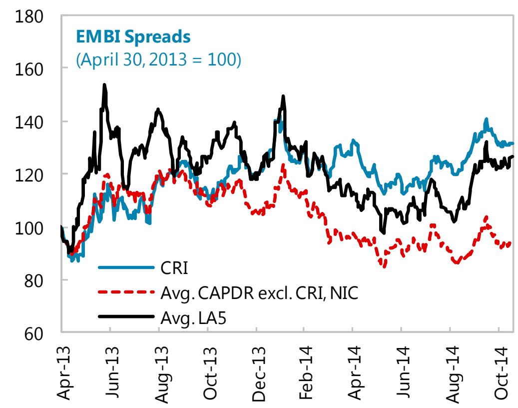
...and its real exports growth is strongly correlated with U.S. real GDP growth.



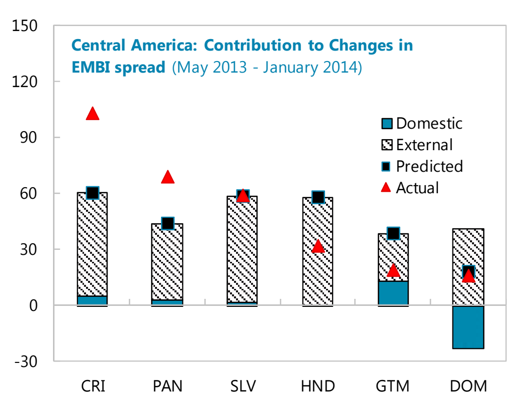
Remittances, in contrast, do not play a significant role.



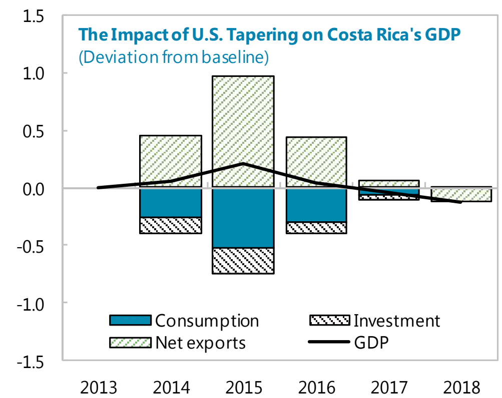
Market perception of risk in Costa Rica has increased significantly since the "tapering talk" started in mid-2013 and remains elevated.



Costa Rica's domestic vulnerabilities could magnify the U.S. monetary policy shock in an adverse scenario. 1/



However, in the absence of substantial market volatility, the positive impact from faster U.S. growth is likely to outweigh tighter global financial conditions, resulting in a positive impact on Costa Rica GDP in the short run. 2/



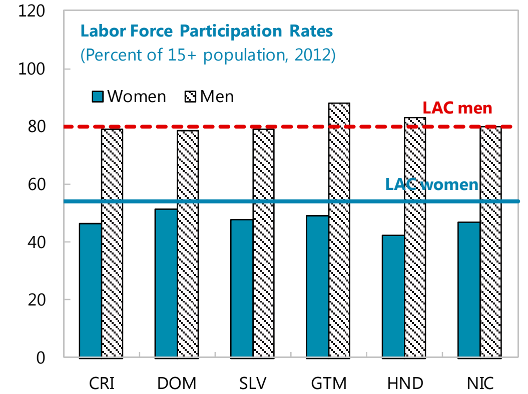
Sources: Bloomberg, national authorities and Fund staff estimates.

1/ Based on panel regression of EMBI spreads on U.S. real interest rate, a measure of domestic fundamentals, and the interaction of U.S. real rate with domestic fundamentals.

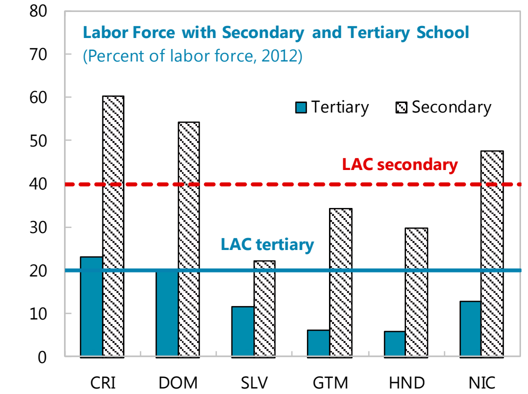
2/ The simulation entails positive U.S. real GDP growth surprise of about 1 percent relative to the baseline through 2015, triggering an earlier-than-expected tightening of Fed policy. Market interest rates rise due to an increase in risk premium outside the U.S. equal to one standard deviation in each Latin American country (for Costa Rica = 100 basis points).

Figure 8. Costa Rica: Labor Market Structure and Growth Potential

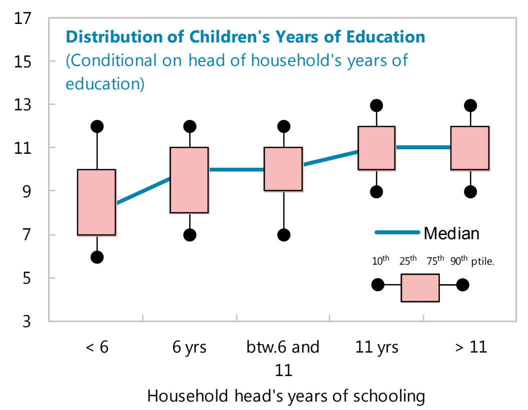
Labor force participation for men is at the regional level, albeit somewhat low for women...



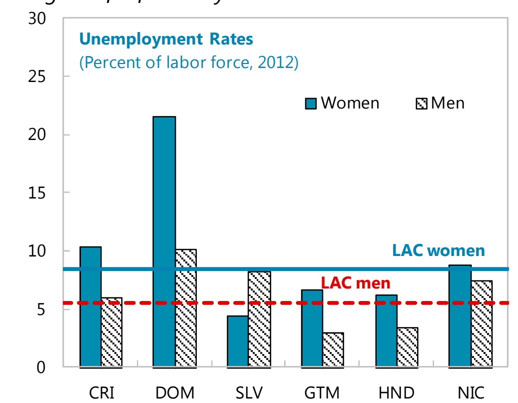
...with relatively high levels of education....



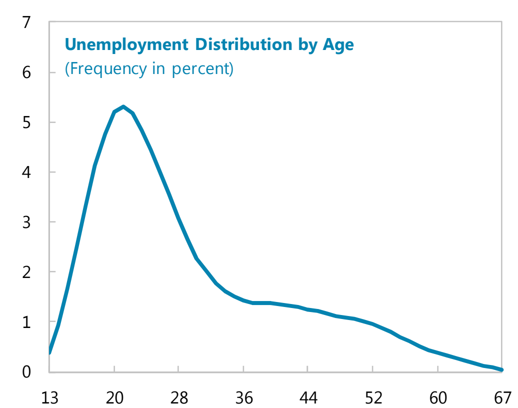
...but some signs of persisting intergenerational inequality.



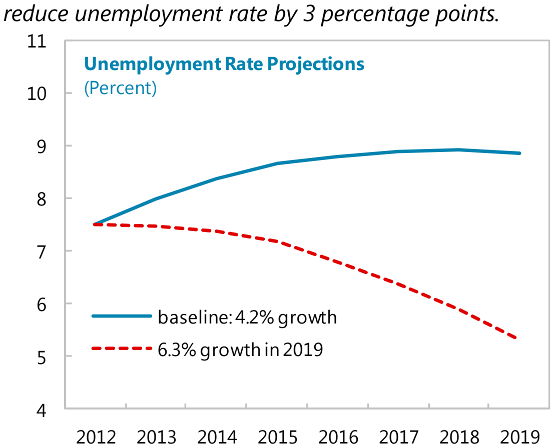
Unemployment rates are high by regional standards though these indicators could be distorted by differences In the degree of informality across countries...



...disproportionately affecting the youth.



Structural reforms estimated to raise potential growth by 2 percentage points over the medium term could help reduce unemployment rate by 3 percentage points.



Sources: WDI Household Surveys and Fund staff estimates.

Table 2a. Costa Rica: Selected Social and Economic Indicators, Baseline Scenario, Partial Fiscal Adjustment 1/

Population (2011, millions)		Human Development Index Rank (2011)	70 (out of 187)
Per capita GDP (2013, U.S. dollars)		Life expectancy (2009, years)	79.1
Unemployment (2011, percent of labor force)		Literacy rate (2009, percent of people ages > 15)	96.0
Poverty (2010, percent of population)		Ratio of girls to boys in primary and secondary education (2010, percent)	102.0
Income share held by highest 10 percent of households			
Income share held by lowest 10 percent of households		Gini coefficient (2009)	51.0

	2010	2011	2012	2013	Proj. 2014	Proj. 2015
	(Annual percentage change, unless otherwise indicated)					
Output and Prices						
Real GDP growth	5.0	4.5	5.2	3.5	3.6	3.4
Output gap (percent of potential GDP)	-1.0	-0.3	0.6	0.0	-0.4	-0.9
GDP deflator	8.0	4.5	4.1	5.0	5.5	5.5
Consumer prices (end of period)	5.8	4.7	4.6	3.7	5.6	4.5
Money and Credit						
Monetary base	11.2	11.6	16.9	10.2	9.3	11.0
Broad money	-0.2	5.5	10.7	7.7	12.8	9.2
Credit to private sector	4.4	13.7	13.4	12.2	14.9	11.2
Monetary policy rate (percent; end of period)	...	5.0	5.0	4.0	...	...
	(In percent of GDP, unless otherwise indicated)					
Savings and Investment						
Gross domestic investment	20.6	21.9	21.7	21.3	21.1	20.2
Gross domestic savings	17.1	16.4	16.4	16.4	16.0	15.6
External Sector						
Current account balance	-3.5	-5.4	-5.3	-4.9	-5.0	-4.7
Of which: Trade balance	-9.5	-12.5	-11.9	-11.3	-11.6	-11.4
Financial and capital account balance	5.5	6.3	9.7	6.5	4.1	5.3
Of which: Foreign direct investment	4.0	5.1	4.2	4.9	4.2	4.0
Change in net international reserves (increase -)	-561	-132	-2,110	-461	466	-345
Net international reserves (millions of U.S. dollars)	4,627	4,756	6,857	7,331	6,865	7,210
Public Finances						
Central government primary balance	-3.0	-1.9	-2.3	-2.8	-3.1	-2.5
Central government overall balance	-5.4	-4.3	-4.6	-5.6	-6.2	-6.0
Central government debt	29.1	30.6	35.1	36.0	39.4	42.3
Consolidated public sector overall balance 2/	-5.4	-4.3	-4.6	-5.4	-6.4	-6.2
Consolidated public sector debt 3/	30.5	32.9	38.5	41.9	44.5	46.6
Of which: External public debt	7.1	6.4	7.5	8.9	11.0	12.8
Memorandum Item:						
GDP (millions of U.S. dollars)	36,298	41,237	45,375	49,621	50,213	54,053

Sources: Central Bank of Costa Rica, Ministry of Finance, and Fund staff estimates.

1/ Includes expenditure cuts equivalent to 0.3 percent of GDP, other cuts in transfers, a partial hiring freeze, broadening of the VAT base from the second half of 2015, a move towards global income tax, miscellaneous cuts in exemptions, and moderate gains from improvements in tax evasion.

2/ The consolidated public sector balance comprises the central government, decentralized government entities, public enterprises, and the central bank, but excludes the Instituto Costarricense de Electricidad (ICE).

3/ The consolidated public debt nets out central government and central bank debt held by the Caja Costarricense del Seguro Social (social security agency) and other entities of the nonfinancial public sector.

Table 2b. Costa Rica: Selected Social and Economic Indicators, Full Fiscal Adjustment Scenario 1/ 2/

Population (2011, millions)	4.7	Human Development Index Rank (2011)	70 (out of 187)
Per capita GDP (2013, U.S. dollars)	10,558	Life expectancy (2009, years)	79.1
Unemployment (2011, percent of labor force)	7.7	Literacy rate (2009, percent of people ages > 15)	96.0
Poverty (2010, percent of population)	24.2	Ratio of girls to boys in primary and secondary education (2010, percent)	102.0
Income share held by highest 10 percent of households	39.4		
Income share held by lowest 10 percent of households	1.7	Gini coefficient (2009)	51.0

	2008	2009	2010	2011	2012	2013	Proj. 2014	Proj. 2015
	(Annual percentage change, unless otherwise indicated)							
Output and Prices								
Real GDP growth	2.7	-1.0	5.0	4.5	5.2	3.5	3.6	3.3
Output gap (percent of potential GDP)	2.8	-1.9	-1.0	-0.3	0.6	0.0	-0.4	-1.0
GDP deflator	12.4	8.4	8.0	4.5	4.1	5.0	5.5	6.0
Consumer prices (end of period)	13.9	4.0	5.8	4.7	4.6	3.7	5.6	4.4
Money and Credit								
Monetary base	11.9	5.1	11.2	11.6	16.9	10.2	9.3	11.2
Broad money	15.8	10.0	-0.2	5.5	10.7	7.7	12.8	9.5
Credit to private sector	31.8	4.5	4.4	13.7	13.4	12.2	14.9	11.7
Monetary policy rate (percent; end of period)	…	…	…	5.0	5.0	4.0	…	…
	(In percent of GDP, unless otherwise indicated)							
Savings and Investment								
Gross domestic investment	27.6	16.3	20.6	21.9	21.7	21.3	21.1	20.3
Gross domestic savings	18.2	14.3	17.1	16.4	16.4	16.4	16.0	15.7
External Sector								
Current account balance	-9.3	-2.0	-3.5	-5.4	-5.3	-4.9	-5.0	-4.6
Of which: Trade balance	-16.8	-6.9	-9.5	-12.5	-11.9	-11.3	-11.6	-11.3
Financial and capital account balance	8.3	1.7	5.5	6.3	9.7	6.5	4.1	5.3
Of which: Foreign direct investment	6.9	4.6	4.0	5.1	4.2	4.9	4.2	4.0
Change in net international reserves (increase -)	348	-51	-561	-132	-2,110	-461	466	-345
Net international reserves (millions of U.S. dollars)	3,799	4,066	4,627	4,756	6,857	7,331	6,865	7,210
Public Finances								
Central government primary balance	2.4	-1.3	-3.0	-1.9	-2.3	-2.8	-3.1	-2.2
Central government overall balance 2/	-0.3	-3.6	-5.4	-4.3	-4.6	-5.6	-6.2	-5.6
Central government debt	24.8	27.2	29.1	30.6	35.1	36.0	39.4	41.9
Consolidated public sector overall balance 3/	0.2	-4.0	-5.4	-4.3	-4.6	-5.4	-6.3	-5.8
Consolidated public sector debt 4/	27.3	29.2	30.5	32.9	38.5	41.9	44.5	46.2
Of which: External public debt	8.6	7.2	7.1	6.4	7.5	8.9	11.0	12.9
Memorandum Item:								
GDP (millions of U.S. dollars)	29,838	29,383	36,298	41,237	45,375	49,621	50,213	54,077

Sources: Central Bank of Costa Rica, Ministry of Finance, and Fund staff estimates.

1/ Includes measures as in the baseline partial adjustment scenario (table 1.1) as well as measures to contain growth in the wage bill, and increases in the VAT rate and marginal income tax rates in outer years.

2/ The inflation adjustment of the principal of TUDES (inflation indexed bonds) was recorded as interest expenditure. In 2014, such inflation adjustment was equivalent to 0.3 percent of GDP.

3/ The consolidated public sector balance comprises the central government, decentralized government entities, public enterprises, and the central bank, but excludes the Instituto Costarricense de Electricidad (ICE).

4/ The consolidated public debt nets out central government and central bank debt held by the Caja Costarricense del Seguro Social (social security agency) and other entities of the nonfinancial public sector.

Table 3. Costa Rica: Balance of Payments, Baseline Scenario, Partial Fiscal Adjustment 1/

						Projection					
	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
					(In millions of U.S. dollars)						
Current Account	-576	-1,281	-2,228	-2,422	-2,452	-2,525	-2,533	-2,720	-3,033	-3,276	-3,605
Trade balance	-2,039	-3,440	-5,144	-5,382	-5,623	-5,808	-6,167	-6,720	-7,532	-8,299	-9,139
Export of goods (f.o.b.)	8,838	9,516	10,426	11,454	11,554	11,078	10,423	10,980	11,652	12,367	13,090
Import of goods (f.o.b.)	10,877	12,956	15,570	16,836	17,178	16,886	16,590	17,700	19,184	20,667	22,229
Services	2,188	2,537	3,182	3,428	4,030	4,138	4,551	4,945	5,422	5,942	6,486
Of which: Travel	1,448	1,575	1,747	1,868	2,225	2,277	2,370	2,509	2,738	3,011	3,310
Income	-1,084	-745	-589	-801	-1,152	-1,169	-1,244	-1,279	-1,311	-1,338	-1,406
Current transfers	359	366	323	333	294	315	327	334	388	420	454
Financial and Capital Account	498	1,986	2,579	4,414	3,231	2,059	2,878	2,720	3,033	3,276	3,605
Public sector	302	615	68	1,239	1,242	1,052	1,203	578	752	785	791
Private sector	196	1,371	2,511	3,175	1,989	1,007	1,675	2,142	2,281	2,491	2,815
Foreign direct investment	1,339	1,441	2,121	1,904	2,424	2,100	2,173	2,282	2,476	2,681	2,898
Other private sector flows	-1,143	-70	391	1,271	-435	-1,093	-498	-140	-195	-191	-83
Errors and Omissions	129	-144	-218	118	-319	0	0	0	0	0	0
Change in International Reserves (increase -)	-51	-561	-132	-2,110	-461	466	-345	0	0	0	0
					(In percent of GDP)						
Current Account	-2.0	-3.5	-5.4	-5.3	-4.9	-5.0	-4.7	-4.7	-4.9	-5.0	-5.2
Trade balance	-6.9	-9.5	-12.5	-11.9	-11.3	-11.6	-11.4	-11.7	-12.3	-12.7	-13.1
Export of goods (f.o.b.)	30.1	26.2	25.3	25.2	23.3	22.1	19.3	19.1	19.0	18.9	18.7
Import of goods (f.o.b.)	37.0	35.7	37.8	37.1	34.6	33.6	30.7	30.8	31.2	31.5	31.8
Of which: Oil and fuels	3.5	3.6	4.9	4.8	4.4	4.3	3.6	3.5	3.5	3.4	3.3
Services	7.4	7.0	7.7	7.6	8.1	8.2	8.4	8.6	8.8	9.1	9.3
Income	-3.7	-2.1	-1.4	-1.8	-2.3	-2.3	-2.3	-2.2	-2.1	-2.0	-2.0
Current transfers	1.2	1.0	0.8	0.7	0.6	0.6	0.6	0.6	0.6	0.6	0.6
Financial and Capital account	1.7	5.5	6.3	9.7	6.5	4.1	5.3	4.7	4.9	5.0	5.2
Of which: Foreign direct investment	4.6	4.0	5.1	4.2	4.9	4.2	4.0	4.0	4.0	4.1	4.1
Change in International Reserves (increase -)	-0.2	-1.5	-0.3	-4.6	-0.9	0.9	-0.6	0.0	0.0	0.0	0.0
Memorandum Items:											
Non-oil current account (percent of GDP)	1.5	0.1	-0.5	-0.5	-0.5	-0.7	-1.1	-1.2	-1.5	-1.6	-1.9
Terms of trade (annual percentage change)	4.9	-0.3	-3.1	-0.8	0.0	0.5	0.7	0.7	0.7	0.7	0.0
Net international reserves (millions of U.S. dollars)	4,066	4,627	4,756	6,857	7,331	6,865	7,210	7,210	7,210	7,210	7,210
-in months of non-maquila imports	4.2	4.0	3.9	5.4	5.6	5.1	5.0	4.5	4.2	3.9	3.9
-in percent short-term debt 2/	138.2	137.6	117.6	156.9	197.4	380.8	570.2	685.7	1087.0	1463.7	1784.0
External debt (percent of GDP) 3/	28.0	25.3	26.5	32.0	35.2	29.6	26.6	25.1	23.5	22.2	21.5

Sources: Central Bank of Costa Rica and Fund staff estimates.

1/ Includes expenditure cuts equivalent to 0.3 percent of GDP, other cuts in transfers, a partial hiring freeze, broadening of the VAT base from the second half of 2015, a move towards global income tax, miscellaneous cuts in exemptions, and moderate gains from improvements in tax evasion.

2/ Public and private sector external debt on remaining maturity. Includes trade credit.

3/ Includes public and private sector debt.

Table 4a. Costa Rica: Central Government Balance, Baseline Scenario, Partial Fiscal Adjustment 1/

							Projection					
	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
	(In billions of colones)											
Revenue	**2,490**	**2,363**	**2,591**	**2,869**	**3,118**	**3,380**	**3,667**	**4,101**	**4,697**	**5,249**	**5,725**	**6,237**
Tax revenue	2,409	2,262	2,492	2,769	3,008	3,292	3,580	4,007	4,595	5,138	5,604	6,105
Nontax revenue 2/	81	101	100	100	110	87	86	94	102	111	121	132
Expenditure	**2,536**	**2,970**	**3,623**	**3,762**	**4,178**	**4,765**	**5,348**	**5,863**	**6,458**	**7,086**	**7,819**	**8,606**
Current noninterest	1,776	2,275	2,723	2,962	3,316	3,684	4,057	4,312	4,723	5,142	5,599	6,090
Wages	857	1,115	1,349	1,514	1,647	1,817	2,006	2,218	2,430	2,647	2,883	3,137
Goods and services	88	106	121	136	143	158	188	220	238	259	282	307
Transfers	832	1,054	1,252	1,313	1,526	1,708	1,863	1,874	2,055	2,236	2,434	2,646
Interest 3/	415	393	452	497	530	681	840	1,030	1,148	1,306	1,525	1,761
Capital	344	302	449	304	332	400	451	521	587	638	695	755
Primary balance	**370**	**-213**	**-580**	**-396**	**-529**	**-704**	**-841**	**-732**	**-612**	**-531**	**-569**	**-608**
Overall Balance	**-46**	**-606**	**-1,032**	**-893**	**-1,059**	**-1,386**	**-1,681**	**-1,762**	**-1,761**	**-1,836**	**-2,094**	**-2,369**
Total Financing	46	606	1,032	893	1,059	1,386	1,681	1,762	1,761	1,836	2,094	2,369
External (net)	0	-186	247	-112	356	401	592	749	348	379	406	417
Domestic (net)	46	793	785	1,005	704	984	1,089	1,013	1,412	1,458	1,688	1,952
Central government debt	**3,891**	**4,587**	**5,562**	**6,382**	**8,015**	**8,932**	**10,676**	**12,512**	**14,320**	**16,235**	**18,425**	**20,906**
External	1,138	976	1,142	1,027	1,383	1,763	2,494	3,288	3,660	4,087	4,554	5,043
Domestic	2,753	3,611	4,420	5,355	6,632	7,169	8,182	9,224	10,660	12,148	13,871	15,864
	(In percent of GDP)											
Revenue	**15.9**	**14.0**	**13.6**	**13.8**	**13.7**	**13.6**	**13.5**	**13.9**	**14.6**	**15.0**	**15.1**	**15.1**
Tax revenue	15.3	13.4	13.1	13.3	13.2	13.3	13.2	13.5	14.3	14.7	14.7	14.8
Nontax revenue 3/	0.5	0.6	0.5	0.5	0.5	0.4	0.3	0.3	0.3	0.3	0.3	0.3
Expenditure	**16.1**	**17.6**	**19.0**	**18.0**	**18.3**	**19.2**	**19.7**	**19.8**	**20.1**	**20.3**	**20.6**	**20.8**
Current noninterest	11.3	13.5	14.3	14.2	14.5	14.9	15.0	14.6	14.7	14.7	14.7	14.7
Wages	5.5	6.6	7.1	7.3	7.2	7.3	7.4	7.5	7.6	7.6	7.6	7.6
Goods and services	0.6	0.6	0.6	0.7	0.6	0.6	0.7	0.7	0.7	0.7	0.7	0.7
Transfers	5.3	6.3	6.6	6.3	6.7	6.9	6.9	6.3	6.4	6.4	6.4	6.4
Interest 2/	2.6	2.3	2.4	2.4	2.3	2.7	3.1	3.5	3.6	3.7	4.0	4.3
Capital	2.2	1.8	2.4	1.5	1.5	1.6	1.7	1.8	1.8	1.8	1.8	1.8
Primary balance	**2.4**	**-1.3**	**-3.0**	**-1.9**	**-2.3**	**-2.8**	**-3.1**	**-2.5**	**-1.9**	**-1.5**	**-1.5**	**-1.5**
Overall Balance	**-0.3**	**-3.6**	**-5.4**	**-4.3**	**-4.6**	**-5.6**	**-6.2**	**-6.0**	**-5.5**	**-5.3**	**-5.5**	**-5.7**
Total Financing	**0.3**	**3.6**	**5.4**	**4.3**	**4.6**	**5.6**	**6.2**	**6.0**	**5.5**	**5.3**	**5.5**	**5.7**
External (net)	0.0	-1.1	1.3	-0.5	1.6	1.6	2.2	2.5	1.1	1.1	1.1	1.0
Domestic (net)	0.3	4.7	4.1	4.8	3.1	4.0	4.0	3.4	4.4	4.2	4.4	4.7
Central government debt	**24.8**	**27.2**	**29.1**	**30.6**	**35.1**	**36.0**	**39.4**	**42.3**	**44.6**	**46.5**	**48.5**	**50.6**
External	7.3	5.8	6.0	4.9	6.1	7.1	9.2	11.1	11.4	11.7	12.0	12.2
Domestic	17.5	21.4	23.2	25.7	29.1	28.9	30.2	31.2	33.2	34.8	36.5	38.4
Memorandum items:												
Non-interest expenditure growth (percent)												
in nominal terms	31.9	21.5	23.1	3.0	11.7	12.0	10.4	7.2	9.9	8.9	8.9	8.8
in real terms	16.3	12.7	16.5	-1.8	6.9	6.4	6.7	2.1	5.4	4.7	4.7	4.6
Nominal GDP	15,702	16,845	19,087	20,852	22,819	24,799	27,115	29,583	32,091	34,919	38,008	41,322
CPI Inflation (period average)	13.4	7.8	5.7	4.9	4.5	5.2	3.4	5.0	4.2	4.0	4.0	4.0

Sources: Ministry of Finance and Fund staff estimates.
1/ Includes expenditure cuts equivalent to 0.3 percent of GDP, other cuts in transfers, a partial hiring freeze, broadening of the VAT base from the second half of 2015, a move towards global income tax, miscellaneous cuts in exemptions, and moderate gains from improvements in tax evasion.
2/ Transfers to the Social development and Family Transfers Fund (FODESAF) are recorded in net terms.
3/ The inflation adjustment of the principal of TUDES (inflation indexed bonds) was recorded as interest expenditure.

Table 4b. Costa Rica: Central Government Balance, Full Fiscal Adjustment Scenario 1/

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
							Projection					
					(In billions of colones)							
Revenue	**2,490**	**2,363**	**2,591**	**2,869**	**3,118**	**3,380**	**3,667**	**4,119**	**4,875**	**5,667**	**6,265**	**6,889**
Tax revenue	2,409	2,262	2,492	2,769	3,008	3,292	3,580	4,024	4,772	5,554	6,142	6,755
Nontax revenue 2/	81	101	100	100	110	87	86	95	103	113	123	134
Expenditure	**2,536**	**2,970**	**3,623**	**3,762**	**4,178**	**4,765**	**5,348**	**5,780**	**6,329**	**7,002**	**7,643**	**8,315**
Current noninterest	1,776	2,275	2,723	2,962	3,316	3,684	4,057	4,262	4,659	5,074	5,522	6,000
Wages	857	1,115	1,349	1,514	1,647	1,817	2,006	2,191	2,383	2,583	2,800	3,031
Goods and services	88	106	121	136	143	158	188	220	239	261	286	312
Transfers	832	1,054	1,252	1,313	1,526	1,708	1,863	1,851	2,037	2,229	2,436	2,658
Interest 3/	415	393	452	497	530	681	840	995	1,079	1,282	1,415	1,543
Capital	344	302	449	304	332	400	451	523	591	646	707	771
Primary balance	**370**	**-213**	**-580**	**-396**	**-529**	**-704**	**-841**	**-666**	**-375**	**-53**	**37**	**118**
Overall Balance	**-46**	**-606**	**-1,032**	**-893**	**-1,059**	**-1,386**	**-1,681**	**-1,661**	**-1,454**	**-1,336**	**-1,378**	**-1,426**
Total Financing	46	606	1,032	893	1,059	1,386	1,681	1,661	1,454	1,336	1,378	1,426
External (net)	0	-186	247	-112	356	401	592	751	352	384	413	426
Domestic (net)	46	793	785	1,005	704	984	1,089	910	1,102	951	965	1,000
Central government debt	**3,891**	**4,587**	**5,562**	**6,382**	**8,015**	**8,932**	**10,676**	**12,436**	**13,969**	**15,399**	**16,892**	**18,453**
External	1,138	976	1,142	1,027	1,383	1,763	2,494	3,308	3,707	4,152	4,643	5,163
Domestic	2,753	3,611	4,420	5,355	6,632	7,169	8,182	9,128	10,262	11,247	12,249	13,290
					(In percent of GDP)							
Revenue	**15.9**	**14.0**	**13.6**	**13.8**	**13.7**	**13.6**	**13.5**	**13.9**	**15.1**	**16.0**	**16.2**	**16.3**
Tax revenue	15.3	13.4	13.1	13.3	13.2	13.3	13.2	13.6	14.8	15.7	15.9	16.0
Nontax revenue 2/	0.5	0.6	0.5	0.5	0.5	0.4	0.3	0.3	0.3	0.3	0.3	0.3
Expenditure	**16.1**	**17.6**	**19.0**	**18.0**	**18.3**	**19.2**	**19.7**	**19.5**	**19.6**	**19.8**	**19.8**	**19.7**
Current noninterest	11.3	13.5	14.3	14.2	14.5	14.9	15.0	14.4	14.4	14.3	14.3	14.2
Wages	5.5	6.6	7.1	7.3	7.2	7.3	7.4	7.4	7.4	7.3	7.2	7.2
Goods and services	0.6	0.6	0.6	0.7	0.6	0.6	0.7	0.7	0.7	0.7	0.7	0.7
Transfers	5.3	6.3	6.6	6.3	6.7	6.9	6.9	6.2	6.3	6.3	6.3	6.3
Interest 3/	2.6	2.3	2.4	2.4	2.3	2.7	3.1	3.4	3.3	3.6	3.7	3.7
Capital	2.2	1.8	2.4	1.5	1.5	1.6	1.7	1.8	1.8	1.8	1.8	1.8
Primary balance	**2.4**	**-1.3**	**-3.0**	**-1.9**	**-2.3**	**-2.8**	**-3.1**	**-2.2**	**-1.2**	**-0.2**	**0.1**	**0.3**
Overall Balance	**-0.3**	**-3.6**	**-5.4**	**-4.3**	**-4.6**	**-5.6**	**-6.2**	**-5.6**	**-4.5**	**-3.8**	**-3.6**	**-3.4**
Total Financing	**0.3**	**3.6**	**5.4**	**4.3**	**4.6**	**5.6**	**6.2**	**5.6**	**4.5**	**3.8**	**3.6**	**3.4**
External (net)	0.0	-1.1	1.3	-0.5	1.6	1.6	2.2	2.5	1.1	1.1	1.1	1.0
Domestic (net)	0.3	4.7	4.1	4.8	3.1	4.0	4.0	3.1	3.4	2.7	2.5	2.4
Central government debt	**24.8**	**27.2**	**29.1**	**30.6**	**35.1**	**36.0**	**39.4**	**41.9**	**43.2**	**43.5**	**43.7**	**43.8**
External	7.3	5.8	6.0	4.9	6.1	7.1	9.2	11.1	11.5	11.7	12.0	12.2
Domestic	17.5	21.4	23.2	25.7	29.1	28.9	30.2	30.7	31.8	31.8	31.7	31.5
Memorandum items:												
Non-interest expenditure growth (percent)												
in nominal terms	31.9	21.5	23.1	3.0	11.7	12.0	10.4	6.1	9.7	9.0	8.9	8.7
in real terms	16.3	12.7	16.5	-1.8	6.9	6.4	6.7	1.1	5.4	4.8	4.7	4.5
Nominal GDP	15,702	16,845	19,087	20,852	22,819	24,799	27,115	29,687	32,321	35,361	38,649	42,169
CPI Inflation (period average)	13.4	7.8	5.7	4.9	4.5	5.2	3.4	5.0	4.1	4.0	4.0	4.0

Sources: Ministry of Finance and Fund staff estimates.

1/ Includes measures as in the baseline partial adjustment scenario (table 3.1) as well as measures to contain growth in the wage bill, and increases in the VAT rate and marginal income tax rates in outer years.

2/ Transfers to the Social development and Family Transfers Fund (FODESAF) are recorded in net terms.

3/ The inflation adjustment of the principal of TUDES (inflation indexed bonds) was recorded as interest expenditure. In 2014, such inflation adjustment was equivalent to 0.3 percent of GDP

Table 5a. Costa Rica: Summary Operations of the Central Government, GFSM 2001 Classification, Baseline Scenario, Partial Fiscal Adjustment 1/

							Projection					
	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
						(In billions of colones)						
Revenue	**2,490**	**2,363**	**2,591**	**2,869**	**3,118**	**3,380**	**3,667**	**4,101**	**4,697**	**5,249**	**5,725**	**6,237**
Taxes	2,409	2,262	2,492	2,769	3,008	3,292	3,580	4,007	4,595	5,138	5,604	6,105
Other revenue 1/	81	101	100	100	110	87	86	94	102	111	121	132
Expenditure	**2,536**	**2,970**	**3,623**	**3,762**	**4,178**	**4,765**	**5,348**	**5,863**	**6,458**	**7,086**	**7,819**	**8,606**
Expense	**2,191**	**2,668**	**3,174**	**3,459**	**3,846**	**4,365**	**4,897**	**5,342**	**5,871**	**6,447**	**7,124**	**7,850**
Compensation of employees	857	1,115	1,349	1,514	1,647	1,817	2,006	2,218	2,430	2,647	2,883	3,137
Purchases of goods and services	88	106	121	136	143	158	188	220	238	259	282	307
Interest 2/	415	393	452	497	530	681	840	1,030	1,148	1,306	1,525	1,761
Of which: Adjustment for TUDES	75	33	50	47	58	50	86	74	74	85	97	111
Social benefits	372	445	506	552	594	616	672	733	795	865	942	1,024
Other expense 3/	460	609	747	761	932	1,092	1,191	1,142	1,260	1,371	1,492	1,622
Net acquisition of nonfinancial assets	**344**	**302**	**449**	**304**	**332**	**400**	**451**	**521**	**587**	**638**	**695**	**755**
Gross operating balance	**299**	**-305**	**-583**	**-589**	**-728**	**-985**	**-1,231**	**-1,241**	**-1,174**	**-1,198**	**-1,399**	**-1,614**
Net lending/borrowing	**-46**	**-606**	**-1,032**	**-893**	**-1,059**	**-1,386**	**-1,681**	**-1,762**	**-1,761**	**-1,836**	**-2,094**	**-2,369**
Net financial transactions	**46**	**606**	**1,032**	**893**	**1,059**	**1,386**	**1,681**	**1,762**	**1,761**	**1,836**	**2,094**	**2,369**
						(In percent of GDP)						
Revenue	**15.9**	**14.0**	**13.6**	**13.8**	**13.7**	**13.6**	**13.5**	**13.9**	**14.6**	**15.0**	**15.1**	**15.1**
Tax revenue	15.3	13.4	13.1	13.3	13.2	13.3	13.2	13.5	14.3	14.7	14.7	14.8
Nontax revenue 2/	0.5	0.6	0.5	0.5	0.5	0.4	0.3	0.3	0.3	0.3	0.3	0.3
Expenditure	**16.1**	**17.6**	**19.0**	**18.0**	**18.3**	**19.2**	**19.7**	**19.8**	**20.1**	**20.3**	**20.6**	**20.8**
Expense	**14.0**	**15.8**	**16.6**	**16.6**	**16.9**	**17.6**	**18.1**	**18.1**	**18.3**	**18.5**	**18.7**	**19.0**
Compensation of employees	5.5	6.6	7.1	7.3	7.2	7.3	7.4	7.5	7.6	7.6	7.6	7.6
Purchases of goods and services	0.6	0.6	0.6	0.7	0.6	0.6	0.7	0.7	0.7	0.7	0.7	0.7
Interest 3/	2.6	2.3	2.4	2.4	2.3	2.7	3.1	3.5	3.6	3.7	4.0	4.3
Of which: Adjustment for TUDES	0.5	0.2	0.3	0.2	0.3	0.2	0.3	0.2	0.2	0.2	0.3	0.3
Social benefits	2.4	2.6	2.7	2.6	2.6	2.5	2.5	2.5	2.5	2.5	2.5	2.5
Other expense 4/	2.9	3.6	3.9	3.6	4.1	4.4	4.4	3.9	3.9	3.9	3.9	3.9
Net acquisition of nonfinancial assets	2.2	1.8	2.4	1.5	1.5	1.6	1.7	1.8	1.8	1.8	1.8	1.8
Gross operating balance	**1.9**	**-1.8**	**-3.1**	**-2.8**	**-3.2**	**-4.0**	**-4.5**	**-4.2**	**-3.7**	**-3.4**	**-3.7**	**-3.9**
Net lending/borrowing	**-0.3**	**-3.6**	**-5.4**	**-4.3**	**-4.6**	**-5.6**	**-6.2**	**-6.0**	**-5.5**	**-5.3**	**-5.5**	**-5.7**
Net financial transactions	**0.3**	**3.6**	**5.4**	**4.3**	**4.6**	**5.6**	**6.2**	**6.0**	**5.5**	**5.3**	**5.5**	**5.7**
Memorandum items:												
Non-interest expenditure growth (percent)												
in nominal terms	31.9	21.5	23.1	3.0	11.7	12.0	10.4	7.2	9.9	8.9	8.9	8.8
in real terms	16.3	12.7	16.5	-1.8	6.9	6.4	6.7	2.1	5.4	4.7	4.7	4.6
Primary balance												
in billions of colones	370	-213	-580	-396	-529	-704	-841	-732	-612	-531	-569	-608
in percent of GDP	2.4	-1.3	-3.0	-1.9	-2.3	-2.8	-3.1	-2.5	-1.9	-1.5	-1.5	-1.5
Cyclically-adjusted primary balance (percent of GDP)	2.0	-1.0	-2.9	-1.8	-2.4	-2.8	-3.0	-2.3	-1.8	-1.4	-1.4	-1.4
Fiscal impulse (percent of GDP)	1.1	2.9	1.9	-1.0	0.6	0.4	0.2	-0.7	-0.6	-0.3	0.0	0.0
Nominal GDP	15,702	16,845	19,087	20,852	22,819	24,799	27,115	29,583	32,091	34,919	38,008	41,322
CPI Inflation (period average)	13.4	7.8	5.7	4.9	4.5	5.2	3.4	5.0	4.2	4.0	4.0	4.0

Sources: Ministry of Finance and Fund staff estimates.

1/ Includes expenditure cuts equivalent to 0.3 percent of GDP, other cuts in transfers, a partial hiring freeze, broadening of the VAT base from the second half of 2015, a move towards global income tax, miscellaneous cuts in exemptions, and moderate gains from improvements in tax evasion.

2/ Transfers to the Social development and Family Transfers Fund (FODESAF) are recorded in net terms.

3/ The inflation adjustment of the principal of TUDES (inflation indexed bonds) was recorded as interest expenditure.

4/ Includes subsidies, transfers and other expense.

Table 5b. Costa Rica: Summary Operations of the Central Government, GFSM 2001 Classification, Full Fiscal Adjustment Scenario 1/

							Projection					
	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
	(In billions of colones)											
Revenue	**2,490**	**2,363**	**2,591**	**2,869**	**3,118**	**3,380**	**3,667**	**4,119**	**4,875**	**5,667**	**6,265**	**6,889**
Taxes	2,409	2,262	2,492	2,769	3,008	3,292	3,580	4,024	4,772	5,554	6,142	6,755
Other revenue 2/	81	101	100	100	110	87	86	95	103	113	123	134
Expenditure	**2,536**	**2,970**	**3,623**	**3,762**	**4,178**	**4,765**	**5,348**	**5,780**	**6,329**	**7,002**	**7,643**	**8,315**
Expense	**2,191**	**2,668**	**3,174**	**3,459**	**3,846**	**4,365**	**4,897**	**5,257**	**5,739**	**6,356**	**6,936**	**7,544**
Compensation of employees	857	1,115	1,349	1,514	1,647	1,817	2,006	2,191	2,383	2,583	2,800	3,031
Purchases of goods and services	88	106	121	136	143	158	188	220	239	261	286	312
Interest 3/	415	393	452	497	530	681	840	995	1,079	1,282	1,415	1,543
Of which: Adjustment for TUDES	75	33	50	47	58	50	86	72	71	82	90	98
Social benefits	372	445	506	552	594	616	672	735	801	876	957	1,045
Other expense 4/	460	609	747	761	932	1,092	1,191	1,116	1,236	1,353	1,479	1,613
Net acquisition of nonfinancial assets	**344**	**302**	**449**	**304**	**332**	**400**	**451**	**523**	**591**	**646**	**707**	**771**
Gross operating balance	**299**	**-305**	**-583**	**-589**	**-728**	**-985**	**-1,231**	**-1,138**	**-863**	**-689**	**-671**	**-655**
Net lending/borrowing	**-46**	**-606**	**-1,032**	**-893**	**-1,059**	**-1,386**	**-1,681**	**-1,661**	**-1,454**	**-1,336**	**-1,378**	**-1,426**
Net financial transactions	**46**	**606**	**1,032**	**893**	**1,059**	**1,386**	**1,681**	**1,661**	**1,454**	**1,336**	**1,378**	**1,426**
	(In percent of GDP)											
Revenue	**15.9**	**14.0**	**13.6**	**13.8**	**13.7**	**13.6**	**13.5**	**13.9**	**15.1**	**16.0**	**16.2**	**16.3**
Tax revenue	15.3	13.4	13.1	13.3	13.2	13.3	13.2	13.6	14.8	15.7	15.9	16.0
Nontax revenue 2/	0.5	0.6	0.5	0.5	0.5	0.4	0.3	0.3	0.3	0.3	0.3	0.3
Expenditure	**16.1**	**17.6**	**19.0**	**18.0**	**18.3**	**19.2**	**19.7**	**19.5**	**19.6**	**19.8**	**19.8**	**19.7**
Expense	**14.0**	**15.8**	**16.6**	**16.6**	**16.9**	**17.6**	**18.1**	**17.7**	**17.8**	**18.0**	**17.9**	**17.9**
Compensation of employees	5.5	6.6	7.1	7.3	7.2	7.3	7.4	7.4	7.4	7.3	7.2	7.2
Purchases of goods and services	0.6	0.6	0.6	0.7	0.6	0.6	0.7	0.7	0.7	0.7	0.7	0.7
Interest 3/	2.6	2.3	2.4	2.4	2.3	2.7	3.1	3.4	3.3	3.6	3.7	3.7
Of which: Adjustment for TUDES	0.5	0.2	0.3	0.2	0.3	0.2	0.3	0.2	0.2	0.2	0.2	0.2
Social benefits	2.4	2.6	2.7	2.6	2.6	2.5	2.5	2.5	2.5	2.5	2.5	2.5
Other expense 4/	2.9	3.6	3.9	3.6	4.1	4.4	4.4	3.8	3.8	3.8	3.8	3.8
Net acquisition of nonfinancial assets	2.2	1.8	2.4	1.5	1.5	1.6	1.7	1.8	1.8	1.8	1.8	1.8
Gross operating balance	**1.9**	**-1.8**	**-3.1**	**-2.8**	**-3.2**	**-4.0**	**-4.5**	**-3.8**	**-2.7**	**-1.9**	**-1.7**	**-1.6**
Net lending/borrowing	**-0.3**	**-3.6**	**-5.4**	**-4.3**	**-4.6**	**-5.6**	**-6.2**	**-5.6**	**-4.5**	**-3.8**	**-3.6**	**-3.4**
Net financial transactions	**0.3**	**3.6**	**5.4**	**4.3**	**4.6**	**5.6**	**6.2**	**5.6**	**4.5**	**3.8**	**3.6**	**3.4**
Memorandum items:												
Non-interest expenditure growth (percent)												
in nominal terms	31.9	21.5	23.1	3.0	11.7	12.0	10.4	6.1	9.7	9.0	8.9	8.7
in real terms	16.3	12.7	16.5	-1.8	6.9	6.4	6.7	1.1	5.4	4.8	4.7	4.5
Primary balance												
in billions of colones	370	-213	-580	-396	-529	-704	-841	-666	-375	-53	37	118
in percent of GDP	2.4	-1.3	-3.0	-1.9	-2.3	-2.8	-3.1	-2.2	-1.2	-0.2	0.1	0.3
Cyclically-adjusted primary balance (percent of GDP)	2.0	-1.0	-2.9	-1.8	-2.4	-2.8	-3.0	-2.1	-1.0	-0.1	0.2	0.3
Fiscal impulse (percent of GDP)	1.1	2.9	1.9	-1.0	0.6	0.4	0.2	-0.9	-1.1	-0.9	-0.2	-0.2
Nominal GDP	15,702	16,845	19,087	20,852	22,819	24,799	27,115	29,687	32,321	35,361	38,649	42,169
CPI Inflation (period average)	13.4	7.8	5.7	4.9	4.5	5.2	3.4	5.0	4.1	4.0	4.0	4.0

Sources: Ministry of Finance and Fund staff estimates.

1/ Includes measures as in the baseline partial adjustment scenario (table 4.1) as well as measures to contain growth in the wage bill, and increases in the VAT rate and marginal income tax rates in outer years.

2/ Transfers to the Social development and Family Transfers Fund (FODESAF) are recorded in net terms.

3/ The inflation adjustment of the principal of TUDES (inflation indexed bonds) was recorded as interest expenditure.

4/ Includes subsidies, transfers and other expense.

Table 6a. Costa Rica: Consolidated Public Sector Operations, Baseline Scenario, Partial Fiscal Adjustment 1/ 2/

							Projections					
	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
						(In billions of colones)						
Nonfinancial public sector:												
Revenue	**3,700**	**3,808**	**4,258**	**4,715**	**5,036**	**5,627**	**6,133**	**6,703**	**7,520**	**8,321**	**9,068**	**9,872**
Tax revenue	2,437	2,289	2,526	2,807	3,049	3,342	3,635	4,067	4,659	5,208	5,681	6,188
Nontax revenue	161	218	185	225	182	257	281	218	237	258	280	305
Social security contributions	1,057	1,227	1,412	1,584	1,743	1,884	2,060	2,247	2,438	2,652	2,887	3,139
Operating balance of public enterprises	46	75	134	99	62	144	157	171	186	202	220	239
Expenditure 3/	**3,640**	**4,343**	**5,209**	**5,482**	**5,941**	**6,770**	**7,600**	**8,289**	**9,062**	**9,888**	**10,858**	**11,888**
Current noninterest	2,755	3,469	4,138	4,525	4,884	5,465	6,005	6,526	7,124	7,755	8,444	9,182
Wages	1,201	1,545	1,885	2,076	2,228	2,437	2,684	2,957	3,232	3,519	3,833	4,170
Goods and services	355	387	414	482	514	554	621	691	750	816	888	966
Transfers	1,199	1,537	1,840	1,966	2,142	2,474	2,701	2,878	3,143	3,420	3,722	4,047
Interest 3/	383	381	432	478	506	660	854	1,032	1,139	1,287	1,490	1,707
Of which: Adjustment for TUDES 4/	41	18	28	26	32	27	46	40	41	47	53	61
Capital	503	493	638	480	551	644	741	731	799	846	925	999
Primary balance	**443**	**-154**	**-519**	**-289**	**-399**	**-483**	**-613**	**-553**	**-404**	**-280**	**-300**	**-309**
Overall Balance	**60**	**-535**	**-951**	**-767**	**-905**	**-1,143**	**-1,467**	**-1,585**	**-1,542**	**-1,567**	**-1,790**	**-2,016**
Central government	-46	-606	-1,032	-893	-1,059	-1,386	-1,681	-1,762	-1,761	-1,836	-2,094	-2,369
Decentralized government entities	101	73	50	130	193	207	180	142	184	235	270	319
Public enterprises	4	-2	31	-4	-39	34	34	34	34	34	34	34
Total Financing	**-60**	**535**	**951**	**767**	**905**	**1,143**	**1,467**	**1,585**	**1,542**	**1,567**	**1,790**	**2,016**
External	-54	-188	243	-129	341	403	607	764	364	397	425	436
Domestic	-6	723	708	896	565	740	860	821	1,178	1,170	1,366	1,580
Consolidated public sector:												
Central Bank balance	-29	-138	-88	-126	-144	-195	-255	-253	-274	-300	-326	-353
Consolidated public sector balance 2/	**31**	**-673**	**-1,039**	**-893**	**-1,049**	**-1,339**	**-1,722**	**-1,838**	**-1,816**	**-1,867**	**-2,117**	**-2,369**
Consolidated public sector debt 2/	**4,292**	**4,925**	**5,824**	**6,862**	**8,787**	**10,398**	**12,057**	**13,793**	**15,458**	**17,184**	**19,150**	**21,360**
						(In percent of GDP)						
Nonfinancial public sector:												
Revenue	**23.6**	**22.6**	**22.3**	**22.6**	**22.1**	**22.7**	**22.6**	**22.7**	**23.4**	**23.8**	**23.9**	**23.9**
Tax revenue	15.5	13.6	13.2	13.5	13.4	13.5	13.4	13.7	14.5	14.9	14.9	15.0
Nontax revenue	1.0	1.3	1.0	1.1	0.8	1.0	1.0	0.7	0.7	0.7	0.7	0.7
Social security contributions	6.7	7.3	7.4	7.6	7.6	7.6	7.6	7.6	7.6	7.6	7.6	7.6
Operating balance of public enterprises	0.3	0.4	0.7	0.5	0.3	0.6	0.6	0.6	0.6	0.6	0.6	0.6
Expenditure 2/	**23.2**	**25.8**	**27.3**	**26.3**	**26.0**	**27.3**	**28.0**	**28.0**	**28.2**	**28.3**	**28.6**	**28.8**
Current noninterest	17.5	20.6	21.7	21.7	21.4	22.0	22.1	22.1	22.2	22.2	22.2	22.2
Wages	7.6	9.2	9.9	10.0	9.8	9.8	9.9	10.0	10.1	10.1	10.1	10.1
Goods and services	2.3	2.3	2.2	2.3	2.3	2.2	2.3	2.3	2.3	2.3	2.3	2.3
Transfers	7.6	9.1	9.6	9.4	9.4	10.0	10.0	9.7	9.8	9.8	9.8	9.8
Interest 3/	2.4	2.3	2.3	2.3	2.2	2.7	3.1	3.5	3.5	3.7	3.9	4.1
Of which: Adjustment for TUDES 4/	0.3	0.1	0.1	0.1	0.1	0.1	0.2	0.1	0.1	0.1	0.1	0.1
Capital	3.2	2.9	3.3	2.3	2.4	2.6	2.7	2.5	2.5	2.4	2.4	2.4
Primary balance	**2.8**	**-0.9**	**-2.7**	**-1.4**	**-1.7**	**-1.9**	**-2.3**	**-1.9**	**-1.3**	**-0.8**	**-0.8**	**-0.7**
Overall Balance	**0.4**	**-3.2**	**-5.0**	**-3.7**	**-4.0**	**-4.6**	**-5.4**	**-5.4**	**-4.8**	**-4.5**	**-4.7**	**-4.9**
Central government	-0.3	-3.6	-5.4	-4.3	-4.6	-5.6	-6.2	-6.0	-5.5	-5.3	-5.5	-5.7
Decentralized government entities	0.6	0.4	0.3	0.6	0.8	0.8	0.7	0.5	0.6	0.7	0.7	0.8
Public enterprises	0.0	0.0	0.2	0.0	-0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Total Financing	**-0.4**	**3.2**	**5.0**	**3.7**	**4.0**	**4.6**	**5.4**	**5.4**	**4.8**	**4.5**	**4.7**	**4.9**
External	-0.3	-1.1	1.3	-0.6	1.5	1.6	2.2	2.6	1.1	1.1	1.1	1.1
Domestic	0.0	4.3	3.7	4.3	2.5	3.0	3.2	2.8	3.7	3.3	3.6	3.8
Consolidated public sector:												
Central Bank balance	-0.2	-0.8	-0.5	-0.6	-0.6	-0.8	-0.9	-0.9	-0.9	-0.9	-0.9	-0.9
Consolidated public sector balance 2/	**0.2**	**-4.0**	**-5.4**	**-4.3**	**-4.6**	**-5.4**	**-6.4**	**-6.2**	**-5.7**	**-5.3**	**-5.6**	**-5.7**
Consolidated public sector debt 2/	**27.3**	**29.2**	**30.5**	**32.9**	**38.5**	**41.9**	**44.5**	**46.6**	**48.2**	**49.2**	**50.4**	**51.7**
Consolidated public sector debt, including ICE	30.8	33.3	33.9	36.3	41.7	45.1	48.0	50.2	51.9	52.6	53.5	54.6
Nominal GDP	15,702	16,845	19,087	20,852	22,819	24,799	27,115	29,583	32,091	34,919	38,008	41,322
CPI Inflation (period average)	13.4	7.8	5.7	4.9	4.5	5.2	3.4	5.0	4.2	4.0	4.0	4.0

Sources: Ministry of Finance and Fund staff estimates.

1/ Includes expenditure cuts equivalent to 0.3 percent of GDP, other cuts in transfers, a partial hiring freeze, broadening of the VAT base from the second half of 2015, a move towards global income tax, miscellaneous cuts in exemptions, and moderate gains from improvements in tax evasion.

2/ The consolidated public sector balance comprises the central government, decentralized government entities, public enterprises and the Central Bank, but excludes the Instituto Costarricense de Electricidad (ICE).

3/ Expenditure was adjusted downward in 2010 and upward in 2011 by ½ percent of GDP to reflect a capital project recorded in 2010 but undertaken in 2011.

4/ The inflation adjustment of the principal of TUDES (inflation indexed bonds) was recorded as interest expenditure.

Table 6b. Costa Rica: Consolidated Public Sector Operations, Full Fiscal Adjustment Scenario 1/ 2/

							Projections					
	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
	(In billions of colones)											
<u>**Nonfinancial public sector:**</u>												
Revenue	**3,700**	**3,808**	**4,258**	**4,715**	**5,036**	**5,627**	**6,133**	**6,730**	**7,718**	**8,777**	**9,665**	**10,598**
Tax revenue	2,437	2,289	2,526	2,807	3,049	3,342	3,635	4,084	4,838	5,625	6,220	6,839
Nontax revenue	161	218	185	225	182	257	281	219	239	261	285	311
Social security contributions	1,057	1,227	1,412	1,584	1,743	1,884	2,060	2,255	2,455	2,686	2,936	3,203
Operating balance of public enterprises	46	75	134	99	62	144	157	172	187	205	224	244
Expenditure 3/	**3,640**	**4,343**	**5,209**	**5,482**	**5,941**	**6,770**	**7,600**	**8,211**	**8,956**	**9,844**	**10,748**	**11,692**
Current noninterest	2,755	3,469	4,138	4,525	4,884	5,465	6,005	6,484	7,078	7,720	8,414	9,156
Wages	1,201	1,545	1,885	2,076	2,228	2,437	2,684	2,933	3,190	3,467	3,765	4,084
Goods and services	355	387	414	482	514	554	621	693	754	825	902	984
Transfers	1,199	1,537	1,840	1,966	2,142	2,474	2,701	2,858	3,133	3,428	3,747	4,088
Interest 4/	383	381	432	478	506	660	854	993	1,073	1,266	1,393	1,516
Of which: Adjustment for TUDES 4/	41	18	28	26	32	27	46	40	39	45	49	54
Capital	503	493	638	480	551	644	741	734	805	858	941	1,020
Primary balance	**443**	**-154**	**-519**	**-289**	**-399**	**-483**	**-613**	**-488**	**-165**	**200**	**310**	**422**
Overall Balance	**60**	**-535**	**-951**	**-767**	**-905**	**-1,143**	**-1,467**	**-1,481**	**-1,237**	**-1,067**	**-1,083**	**-1,094**
Central government	-46	-606	-1,032	-893	-1,059	-1,386	-1,681	-1,661	-1,454	-1,336	-1,378	-1,426
Decentralized government entities	101	73	50	130	193	207	180	146	183	235	260	298
Public enterprises	4	-2	31	-4	-39	34	34	34	34	34	34	34
Total Financing	**-60**	**535**	**951**	**767**	**905**	**1,143**	**1,467**	**1,481**	**1,237**	**1,067**	**1,083**	**1,094**
External	-54	-188	243	-129	341	403	607	766	367	403	432	446
Domestic	-6	723	708	896	565	740	860	714	870	663	651	648
<u>**Consolidated public sector:**</u>												
Central Bank balance	-29	-138	-88	-126	-144	-195	-237	-253	-277	-303	-329	-361
Consolidated public sector balance 2/	**31**	**-673**	**-1,039**	**-893**	**-1,049**	**-1,339**	**-1,703**	**-1,734**	**-1,514**	**-1,370**	**-1,412**	**-1,454**
Consolidated public sector debt 2/	**4,292**	**4,925**	**5,824**	**6,862**	**8,787**	**10,398**	**12,057**	**13,712**	**15,101**	**16,335**	**17,606**	**18,908**
	(In percent of GDP)											
<u>**Nonfinancial public sector:**</u>												
Revenue	**23.6**	**22.6**	**22.3**	**22.6**	**22.1**	**22.7**	**22.6**	**22.7**	**23.9**	**24.8**	**25.0**	**25.1**
Tax revenue	15.5	13.6	13.2	13.5	13.4	13.5	13.4	13.8	15.0	15.9	16.1	16.2
Nontax revenue	1.0	1.3	1.0	1.1	0.8	1.0	1.0	0.7	0.7	0.7	0.7	0.7
Social security contributions	6.7	7.3	7.4	7.6	7.6	7.6	7.6	7.6	7.6	7.6	7.6	7.6
Operating balance of public enterprises	0.3	0.4	0.7	0.5	0.3	0.6	0.6	0.6	0.6	0.6	0.6	0.6
Expenditure 3/	**23.2**	**25.8**	**27.3**	**26.3**	**26.0**	**27.3**	**28.0**	**27.7**	**27.7**	**27.8**	**27.8**	**27.7**
Current noninterest	17.5	20.6	21.7	21.7	21.4	22.0	22.1	21.8	21.9	21.8	21.8	21.7
Wages	7.6	9.2	9.9	10.0	9.8	9.8	9.9	9.9	9.9	9.8	9.7	9.7
Goods and services	2.3	2.3	2.2	2.3	2.3	2.2	2.3	2.3	2.3	2.3	2.3	2.3
Transfers	7.6	9.1	9.6	9.4	9.4	10.0	10.0	9.6	9.7	9.7	9.7	9.7
Interest 4/	2.4	2.3	2.3	2.3	2.2	2.7	3.1	3.3	3.3	3.6	3.6	3.6
Of which: Adjustment for TUDES 4/	0.3	0.1	0.1	0.1	0.1	0.1	0.2	0.1	0.1	0.1	0.1	0.1
Capital	3.2	2.9	3.3	2.3	2.4	2.6	2.7	2.5	2.5	2.4	2.4	2.4
Primary balance	**2.8**	**-0.9**	**-2.7**	**-1.4**	**-1.7**	**-1.9**	**-2.3**	**-1.6**	**-0.5**	**0.6**	**0.8**	**1.0**
Overall Balance	**0.4**	**-3.2**	**-5.0**	**-3.7**	**-4.0**	**-4.6**	**-5.4**	**-5.0**	**-3.8**	**-3.0**	**-2.8**	**-2.6**
Central government	-0.3	-3.6	-5.4	-4.3	-4.6	-5.6	-6.2	-5.6	-4.5	-3.8	-3.6	-3.4
Decentralized government entities	0.6	0.4	0.3	0.6	0.8	0.8	0.7	0.5	0.6	0.7	0.7	0.7
Public enterprises	0.0	0.0	0.2	0.0	-0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Total Financing	**-0.4**	**3.2**	**5.0**	**3.7**	**4.0**	**4.6**	**5.4**	**5.0**	**3.8**	**3.0**	**2.8**	**2.6**
External	-0.3	-1.1	1.3	-0.6	1.5	1.6	2.2	2.6	1.1	1.1	1.1	1.1
Domestic	0.0	4.3	3.7	4.3	2.5	3.0	3.2	2.4	2.7	1.9	1.7	1.5
<u>**Consolidated public sector:**</u>												
Central Bank balance	-0.2	-0.8	-0.5	-0.6	-0.6	-0.8	-0.9	-0.9	-0.9	-0.9	-0.9	-0.9
Consolidated public sector balance 2/	**0.2**	**-4.0**	**-5.4**	**-4.3**	**-4.6**	**-5.4**	**-6.3**	**-5.8**	**-4.7**	**-3.9**	**-3.7**	**-3.4**
Consolidated public sector debt 2/	**27.3**	**29.2**	**30.5**	**32.9**	**38.5**	**41.9**	**44.5**	**46.2**	**46.7**	**46.2**	**45.6**	**44.8**
Consolidated public sector debt, including ICE	30.8	33.3	33.9	36.3	41.7	45.1	48.0	49.8	50.4	49.6	48.7	47.7
Nominal GDP	15,702	16,845	19,087	20,852	22,819	24,799	27,115	29,687	32,321	35,361	38,649	42,169
CPI Inflation (period average)	13.4	7.8	5.7	4.9	4.5	5.2	3.4	5.0	4.1	4.0	4.0	4.0

Sources: Ministry of Finance and Fund staff estimates.

1/ Includes measures as in the baseline partial adjustment scenario (table 5.1) as well as measures to contain growth in the wage bill, and increases in the VAT rate and marginal income tax rates in outer years.

2/ The consolidated public sector balance comprises the central government, decentralized government entities, public enterprises and the Central Bank, but excludes the Instituto Costarricense de Electricidad (ICE).

3/ Expenditure was adjusted downward in 2010 and upward in 2011 by ½ percent of GDP to reflect a capital project recorded in 2010 but undertaken in 2011.

4/ The inflation adjustment of the principal of TUDES (inflation indexed bonds) was recorded as interest expenditure.

Table 7a. Costa Rica: Summary Operations of the Consolidated Public Sector, GFSM 2001 Classification, Baseline Scenario, Partial Fiscal Adjustment 1/ 2/

							Projection					
	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
						(In billions of colones)						
Nonfinancial public sector:												
Revenue	**3,700**	**3,808**	**4,258**	**4,715**	**5,036**	**5,627**	**6,133**	**6,703**	**7,520**	**8,321**	**9,068**	**9,872**
Taxes	2,437	2,289	2,526	2,807	3,049	3,342	3,635	4,067	4,659	5,208	5,681	6,188
Social contributions	1,057	1,227	1,412	1,584	1,743	1,884	2,060	2,247	2,438	2,652	2,887	3,139
Operating balance of public enterprises	46	75	134	99	62	144	157	171	186	202	220	239
Other revenue	161	218	185	225	182	257	281	218	237	258	280	305
Expenditure	**3,640**	**4,343**	**5,209**	**5,482**	**5,941**	**6,770**	**7,600**	**8,289**	**9,062**	**9,888**	**10,858**	**11,888**
Expense	**3,138**	**3,850**	**4,571**	**5,002**	**5,390**	**6,126**	**6,859**	**7,558**	**8,263**	**9,041**	**9,933**	**10,889**
Compensation of employees	1,201	1,545	1,885	2,076	2,228	2,437	2,684	2,957	3,232	3,519	3,833	4,170
Purchases of goods and services	355	387	414	482	514	554	621	691	750	816	888	966
Interest 3/	383	381	432	478	506	660	854	1,032	1,139	1,287	1,490	1,707
Of which: Adjustment for TUDES	41	18	28	26	32	27	46	40	41	47	53	61
Other expense 4/	1,199	1,537	1,840	1,966	2,142	2,474	2,701	2,878	3,143	3,420	3,722	4,047
Net acquisition of nonfinancial assets	**503**	**493**	**638**	**480**	**551**	**644**	**741**	**731**	**799**	**846**	**925**	**999**
Gross operating balance	**563**	**-42**	**-313**	**-287**	**-354**	**-499**	**-726**	**-854**	**-743**	**-721**	**-865**	**-1,017**
Net lending/borrowing (NFPS)	**60**	**-535**	**-951**	**-767**	**-905**	**-1,143**	**-1,467**	**-1,585**	**-1,542**	**-1,567**	**-1,790**	**-2,016**
Net financial transactions (NFPS)	**-60**	**535**	**951**	**767**	**905**	**1,143**	**1,467**	**1,585**	**1,542**	**1,567**	**1,790**	**2,016**
Consolidated public sector: 2/												
Central Bank balance	-29	-138	-88	-126	-144	-195	-255	-253	-274	-300	-326	-353
Net lending/borrowing (consolidated public sector)	**31**	**-673**	**-1,039**	**-893**	**-1,049**	**-1,339**	**-1,722**	**-1,838**	**-1,816**	**-1,867**	**-2,117**	**-2,369**
						(In percent of GDP)						
Nonfinancial public sector:												
Revenue	**23.6**	**22.6**	**22.3**	**22.6**	**22.1**	**22.7**	**22.6**	**22.7**	**23.4**	**23.8**	**23.9**	**23.9**
Taxes	15.5	13.6	13.2	13.5	13.4	13.5	13.4	13.7	14.5	14.9	14.9	15.0
Social contributions	6.7	7.3	7.4	7.6	7.6	7.6	7.6	7.6	7.6	7.6	7.6	7.6
Operating balance of public enterprises	0.3	0.4	0.7	0.5	0.3	0.6	0.6	0.6	0.6	0.6	0.6	0.6
Other revenue	1.0	1.3	1.0	1.1	0.8	1.0	1.0	0.7	0.7	0.7	0.7	0.7
Expenditure	**23.2**	**25.8**	**27.3**	**26.3**	**26.0**	**27.3**	**28.0**	**28.0**	**28.2**	**28.3**	**28.6**	**28.8**
Expense	**20.0**	**22.9**	**23.9**	**24.0**	**23.6**	**24.7**	**25.3**	**25.5**	**25.7**	**25.9**	**26.1**	**26.4**
Compensation of employees	7.6	9.2	9.9	10.0	9.8	9.8	9.9	10.0	10.1	10.1	10.1	10.1
Purchases of goods and services	2.3	2.3	2.2	2.3	2.3	2.2	2.3	2.3	2.3	2.3	2.3	2.3
Interest 2/	2.4	2.3	2.3	2.3	2.2	2.7	3.1	3.5	3.5	3.7	3.9	4.1
Other expense 3/	7.6	9.1	9.6	9.4	9.4	10.0	10.0	9.7	9.8	9.8	9.8	9.8
Net acquisition of nonfinancial assets	**3.2**	**2.9**	**3.3**	**2.3**	**2.4**	**2.6**	**2.7**	**2.5**	**2.5**	**2.4**	**2.4**	**2.4**
Gross operating balance	**3.6**	**-0.2**	**-1.6**	**-1.4**	**-1.6**	**-2.0**	**-2.7**	**-2.9**	**-2.3**	**-2.1**	**-2.3**	**-2.5**
Net lending/borrowing (NFPS)	**0.4**	**-3.2**	**-5.0**	**-3.7**	**-4.0**	**-4.6**	**-5.4**	**-5.4**	**-4.8**	**-4.5**	**-4.7**	**-4.9**
Net financial transactions (NFPS)	**-0.4**	**3.2**	**5.0**	**3.7**	**4.0**	**4.6**	**5.4**	**5.4**	**4.8**	**4.5**	**4.7**	**4.9**
Consolidated public sector: 2/												
Central Bank balance	-0.2	-0.8	-0.5	-0.6	-0.6	-0.8	-0.9	-0.9	-0.9	-0.9	-0.9	-0.9
Net lending/borrowing (consolidated public sector)	**0.2**	**-4.0**	**-5.4**	**-4.3**	**-4.6**	**-5.4**	**-6.4**	**-6.2**	**-5.7**	**-5.3**	**-5.6**	**-5.7**
Memorandum items:												
NFPS non-interest expenditure growth (percent)												
in nominal terms	29.9	21.6	20.6	4.8	8.6	12.4	10.4	7.6	9.2	8.6	8.9	8.7
in real terms	14.6	12.8	14.1	-0.1	3.9	6.8	6.8	2.4	4.7	4.4	4.7	4.5
NFPS primary balance												
in billions of colones	443	-154	-519	-289	-399	-483	-613	-553	-404	-280	-300	-309
in percent of GDP	2.8	-0.9	-2.7	-1.4	-1.7	-1.9	-2.3	-1.9	-1.3	-0.8	-0.8	-0.7

Sources: Ministry of Finance and Fund staff estimates.

1/ Includes expenditure cuts equivalent to 0.3 percent of GDP, other cuts in transfers, a partial hiring freeze, broadening of the VAT base from the second half of 2015, a move towards global income tax, miscellaneous cuts in exemptions, and moderate gains from improvements in tax evasion.

2/ The consolidated public sector balance comprises the central government, decentralized government entities, public enterprises and the Central Bank, but excludes the Instituto Costarricense de Electricidad (ICE).

3/ The inflation adjustment of the principal of TUDES (inflation indexed bonds) was recorded as interest expenditure.

4/ Includes subsidies, transfers and other expense.

Table 7b. Costa Rica: Summary Operations of the Consolidated Public Sector, GFSM 2001 Classification, Full Fiscal Adjustment Scenario 1/ 2/

							Projection					
	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
						(In billions of colones)						
Nonfinancial public sector:												
Revenue	**3,700**	**3,808**	**4,258**	**4,715**	**5,036**	**5,627**	**6,133**	**6,730**	**7,718**	**8,777**	**9,665**	**10,598**
Taxes	2,437	2,289	2,526	2,807	3,049	3,342	3,635	4,084	4,838	5,625	6,220	6,839
Social contributions	1,057	1,227	1,412	1,584	1,743	1,884	2,060	2,255	2,455	2,686	2,936	3,203
Operating balance of public enterprises	46	75	134	99	62	144	157	172	187	205	224	244
Other revenue	161	218	185	225	182	257	281	219	239	261	285	311
Expenditure	**3,640**	**4,343**	**5,209**	**5,482**	**5,941**	**6,770**	**7,600**	**8,211**	**8,956**	**9,844**	**10,748**	**11,692**
Expense	**3,138**	**3,850**	**4,571**	**5,002**	**5,390**	**6,126**	**6,859**	**7,477**	**8,151**	**8,986**	**9,807**	**10,672**
Compensation of employees	1,201	1,545	1,885	2,076	2,228	2,437	2,684	2,933	3,190	3,467	3,765	4,084
Purchases of goods and services	355	387	414	482	514	554	621	693	754	825	902	984
Interest 3/	383	381	432	478	506	660	854	993	1,073	1,266	1,393	1,516
Of which: Adjustment for TUDES	41	18	28	26	32	27	46	40	39	45	49	54
Other expense 4/	1,199	1,537	1,840	1,966	2,142	2,474	2,701	2,858	3,133	3,428	3,747	4,088
Net acquisition of nonfinancial assets	**503**	**493**	**638**	**480**	**551**	**644**	**741**	**734**	**805**	**858**	**941**	**1,020**
Gross operating balance	**563**	**-42**	**-313**	**-287**	**-354**	**-499**	**-726**	**-747**	**-432**	**-209**	**-142**	**-74**
Net lending/borrowing (NFPS)	**60**	**-535**	**-951**	**-767**	**-905**	**-1,143**	**-1,467**	**-1,481**	**-1,237**	**-1,067**	**-1,083**	**-1,094**
Net financial transactions (NFPS)	**-60**	**535**	**951**	**767**	**905**	**1,143**	**1,467**	**1,481**	**1,237**	**1,067**	**1,083**	**1,094**
Consolidated public sector: 2/												
Central Bank balance	-29	-138	-88	-126	-144	-195	-237	-253	-277	-303	-329	-361
Net lending/borrowing (consolidated public sector)	**31**	**-673**	**-1,039**	**-893**	**-1,049**	**-1,339**	**-1,703**	**-1,734**	**-1,514**	**-1,370**	**-1,412**	**-1,454**
						(In percent of GDP)						
Nonfinancial public sector:												
Revenue	**23.6**	**22.6**	**22.3**	**22.6**	**22.1**	**22.7**	**22.6**	**22.7**	**23.9**	**24.8**	**25.0**	**25.1**
Taxes	15.5	13.6	13.2	13.5	13.4	13.5	13.4	13.8	15.0	15.9	16.1	16.2
Social contributions	6.7	7.3	7.4	7.6	7.6	7.6	7.6	7.6	7.6	7.6	7.6	7.6
Operating balance of public enterprises	0.3	0.4	0.7	0.5	0.3	0.6	0.6	0.6	0.6	0.6	0.6	0.6
Other revenue	1.0	1.3	1.0	1.1	0.8	1.0	1.0	0.7	0.7	0.7	0.7	0.7
Expenditure	**23.2**	**25.8**	**27.3**	**26.3**	**26.0**	**27.3**	**28.0**	**27.7**	**27.7**	**27.8**	**27.8**	**27.7**
Expense	**20.0**	**22.9**	**23.9**	**24.0**	**23.6**	**24.7**	**25.3**	**25.2**	**25.2**	**25.4**	**25.4**	**25.3**
Compensation of employees	7.6	9.2	9.9	10.0	9.8	9.8	9.9	9.9	9.9	9.8	9.7	9.7
Purchases of goods and services	2.3	2.3	2.2	2.3	2.3	2.2	2.3	2.3	2.3	2.3	2.3	2.3
Interest 3/	2.4	2.3	2.3	2.3	2.2	2.7	3.1	3.3	3.3	3.6	3.6	3.6
Other expense 4/	7.6	9.1	9.6	9.4	9.4	10.0	10.0	9.6	9.7	9.7	9.7	9.7
Net acquisition of nonfinancial assets	**3.2**	**2.9**	**3.3**	**2.3**	**2.4**	**2.6**	**2.7**	**2.5**	**2.5**	**2.4**	**2.4**	**2.4**
Gross operating balance	**3.6**	**-0.2**	**-1.6**	**-1.4**	**-1.6**	**-2.0**	**-2.7**	**-2.5**	**-1.3**	**-0.6**	**-0.4**	**-0.2**
Net lending/borrowing (NFPS)	**0.4**	**-3.2**	**-5.0**	**-3.7**	**-4.0**	**-4.6**	**-5.4**	**-5.0**	**-3.8**	**-3.0**	**-2.8**	**-2.6**
Net financial transactions (NFPS)	**-0.4**	**3.2**	**5.0**	**3.7**	**4.0**	**4.6**	**5.4**	**5.0**	**3.8**	**3.0**	**2.8**	**2.6**
Consolidated public sector: 2/												
Central Bank balance	-0.2	-0.8	-0.5	-0.6	-0.6	-0.8	-0.9	-0.9	-0.9	-0.9	-0.9	-0.9
Net lending/borrowing (consolidated public sector)	**0.2**	**-4.0**	**-5.4**	**-4.3**	**-4.6**	**-5.4**	**-6.3**	**-5.8**	**-4.7**	**-3.9**	**-3.7**	**-3.4**
Memorandum items:												
NFPS non-interest expenditure growth (percent)												
in nominal terms	29.9	21.6	20.6	4.8	8.6	12.4	10.4	7.0	9.2	8.8	9.1	8.8
in real terms	14.6	12.8	14.1	-0.1	3.9	6.8	6.8	1.9	4.9	4.7	4.9	4.6
NFPS primary balance												
in billions of colones	443	-154	-519	-289	-399	-483	-613	-488	-165	200	310	422
in percent of GDP	2.8	-0.9	-2.7	-1.4	-1.7	-1.9	-2.3	-1.6	-0.5	0.6	0.8	1.0

Sources: Ministry of Finance and Fund staff estimates.

1/ Includes measures as in the baseline partial adjustment scenario (table 6.1) as well as measures to contain growth in the wage bill, and increases in the VAT rate and marginal income tax rates in outer years.

2/ The consolidated public sector balance comprises the central government, decentralized government entities, public enterprises and the Central Bank, but excludes the Instituto Costarricense de Electricidad (ICE).

3/ The inflation adjustment of the principal of TUDES (inflation indexed bonds) was recorded as interest expenditure.

4/ Includes subsidies, transfers and other expense.

Table 8. Costa Rica: Public Sector Debt, Baseline Scenario, Partial Fiscal Adjustment 1/

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
							Projections					
						(In billions of colones)						
Debt issued by:												
NFPS & Central Bank (I) 2/	**5,659**	**6,443**	**7,574**	**8,961**	**11,043**	**12,774**	**14,634**	**16,543**	**18,421**	**20,415**	**22,685**	**25,247**
Nonfinancial public sector (NFPS) 2/	4,137	5,018	6,168	7,248	8,976	10,154	11,996	13,909	15,791	17,786	20,056	22,618
Central government	3,891	4,587	5,562	6,382	8,015	8,932	10,676	12,512	14,320	16,235	18,425	20,906
Rest of nonfinancial public sector 2/	246	431	605	866	961	1,222	1,320	1,397	1,471	1,550	1,630	1,711
Central Bank	1,522	1,425	1,406	1,713	2,067	2,620	2,638	2,634	2,629	2,629	2,629	2,629
Intra-public sector debt holdings (II)	**1,367**	**1,519**	**1,750**	**2,099**	**2,256**	**2,377**	**2,577**	**2,750**	**2,963**	**3,231**	**3,535**	**3,887**
CCSS 3/	889	987	1,130	1,330	1,398	1,444	1,558	1,637	1,756	1,918	2,106	2,333
Other entities of the nonfinancial public sector	458	514	604	756	848	921	1,007	1,099	1,192	1,297	1,412	1,535
Central Bank	20	18	15	13	10	11	12	13	15	16	17	19
Consolidated public sector debt (I-II)	**4,292**	**4,925**	**5,824**	**6,862**	**8,787**	**10,398**	**12,057**	**13,793**	**15,458**	**17,184**	**19,150**	**21,360**
External	1,353	1,207	1,363	1,330	1,711	2,201	2,976	3,792	4,185	4,641	5,137	5,657
Domestic	2,939	3,717	4,461	5,532	7,076	8,196	9,081	10,001	11,273	12,544	14,013	15,703
						(In percent of GDP)						
Debt issued by:												
NFPS & Central Bank (I) 2/	**36.0**	**38.3**	**39.7**	**43.0**	**48.4**	**51.5**	**54.0**	**55.9**	**57.4**	**58.5**	**59.7**	**61.1**
Nonfinancial public sector (NFPS) 2/	26.3	29.8	32.3	34.8	39.3	40.9	44.2	47.0	49.2	50.9	52.8	54.7
Central government	24.8	27.2	29.1	30.6	35.1	36.0	39.4	42.3	44.6	46.5	48.5	50.6
Rest of nonfinancial public sector 2/	1.6	2.6	3.2	4.2	4.2	4.9	4.9	4.7	4.6	4.4	4.3	4.1
Central Bank	9.7	8.5	7.4	8.2	9.1	10.6	9.7	8.9	8.2	7.5	6.9	6.4
Intra-public sector debt holdings (II)	**8.7**	**9.0**	**9.2**	**10.1**	**9.9**	**9.6**	**9.5**	**9.3**	**9.2**	**9.3**	**9.3**	**9.4**
CCSS	5.7	5.9	5.9	6.4	6.1	5.8	5.7	5.5	5.5	5.5	5.5	5.6
Other entities of the nonfinancial public sector	2.9	3.1	3.2	3.6	3.7	3.7	3.7	3.7	3.7	3.7	3.7	3.7
Central Bank	0.1	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Consolidated public sector debt (I-II)	**27.3**	**29.2**	**30.5**	**32.9**	**38.5**	**41.9**	**44.5**	**46.6**	**48.2**	**49.2**	**50.4**	**51.7**
External	8.6	7.2	7.1	6.4	7.5	8.9	11.0	12.8	13.0	13.3	13.5	13.7
Domestic	18.7	22.1	23.4	26.5	31.0	33.1	33.5	33.8	35.1	35.9	36.9	38.0
Memorandum items:												
Debt issued by ICE	3.4	4.1	3.4	3.3	3.2	3.2	3.5	3.6	3.7	3.4	3.1	2.9
Consolidated public sector debt including ICE	30.8	33.3	33.9	36.3	41.7	45.1	48.0	50.2	51.9	52.6	53.5	54.6
Nominal GDP	15,702	16,845	19,087	20,852	22,819	24,799	27,115	29,583	32,091	34,919	38,008	41,322

Sources: Ministry of Finance and Fund staff estimates.

1/ Includes expenditure cuts equivalent to 0.3 percent of GDP, other cuts in transfers, a partial hiring freeze, broadening of the VAT base from the second half of 2015, a move towards global income tax, miscellaneous cuts in exemptions, and moderate gains from improvements in tax evasion.

2/ Excludes the debt issued by the Instituto Costarricense de Electricidad (ICE).

3/ Caja Costarricense del Seguro Social (social security agency).

Table 9. Costa Rica: Monetary Survey, Baseline Scenario, Partial Fiscal Adjustment 1/

							Projection	
	2008	2009	2010	2011	2012	2013	2014	2015
				(In billions of colones, unless otherwise indicated)				
Net foreign assets	2,178	2,413	2,485	2,567	3,612	3,799	3,883	4,166
Net international reserves	2,090	2,272	2,350	2,403	3,443	3,629	3,712	3,994
(In millions of U.S. dollars)	3,799	4,066	4,627	4,756	6,857	7,331	6,865	7,210
Net medium-term foreign assets	89	141	135	164	170	171	171	0
Net domestic assets	-1,027	-1,203	-1,140	-1,067	-1,858	-1,865	-1,769	-1,819
Net domestic credit	-547	-790	-926	-729	-1,303	-935	-1,065	-1,149
Credit to nonfinancial public sector	-20	-50	-288	-87	-561	-201	-216	-216
Credit to other depository corporations (net)	-525	-734	-625	-633	-733	-722	-839	-923
Credit to other financial corporations (net)	0	-4	-9	-7	-7	-9	-10	-9
Credit to the private sector (net)	-2	-2	-3	-2	-2	-2	0	0
Monetary stabilization instruments (-)	-1,316	-1,130	-1,252	-1,588	-1,787	-2,492	-2,629	-2,629
Other items (net)	-392	-551	-303	-140	-441	-325	-216	-435
Capital account (-)	1,228	1,268	1,341	1,390	1,673	1,886	2,141	2,394
Monetary base	1,151	1,210	1,345	1,500	1,754	1,934	2,115	2,347
Currency	575	613	665	743	845	921	1,013	1,106
Required reserves	576	597	680	757	909	1,013	1,102	1,241
Net foreign assets	-420	-20	-87	-580	-1,018	-1,534	-2,034	-2,012
Net domestic assets	7,840	8,325	8,389	9,287	10,565	11,797	13,701	14,554
Net domestic credit	10,157	11,189	11,891	13,175	15,265	17,241	19,816	21,945
Credit to nonfinancial public sector (net)	412	693	980	1,001	1,148	1,225	1,451	1,664
Credit to nonfinancial private sector	7,925	8,281	8,645	9,832	11,145	12,507	14,372	15,984
Credit to financial corporations (net)	1,820	2,216	2,267	2,342	2,973	3,508	3,994	4,298
Other items (net)	-720	-1,034	-1,466	-1,595	-2,097	-2,526	-3,078	-4,137
Capital account	1,597	1,829	2,036	2,294	2,602	2,918	3,037	3,254
Liabilities to nonfinancial private sector	7,420	8,305	8,301	8,707	9,547	10,263	11,667	12,543
In national currency	4,080	4,461	4,911	5,171	6,045	6,912	7,832	8,476
In foreign currency	3,341	3,844	3,390	3,536	3,503	3,409	3,898	4,066
Of which: Deposits	7,255	8,111	8,096	8,470	9,300	9,984	11,362	12,548
Net foreign assets	1,758	2,393	2,398	1,988	2,594	2,265	1,850	2,154
Net domestic assets	7,235	7,499	7,478	8,427	8,937	10,158	12,163	13,146
Net domestic credit	8,317	8,923	9,336	10,746	11,731	13,532	15,606	17,431
Other items (net)	-712	-863	-1,163	-1,415	-1,865	-2,342	-2,548	-3,425
Capital account	369	561	695	904	930	1,032	896	860
Broad money	8,994	9,892	9,875	10,415	11,530	12,424	14,012	15,301
Memorandum Items:				(Annual percentage change)				
Monetary base	11.9	5.1	11.2	11.6	16.9	10.2	9.3	11.0
Broad money	15.8	10.0	-0.2	5.5	10.7	7.7	12.8	9.2
Credit to the private sector	31.8	4.5	4.4	13.7	13.4	12.2	14.9	11.2
Adjusted by changes in the exchange rate	25.7	3.9	8.6	13.8	13.7	12.9	11.4	10.2
				(In percent of GDP)				
Monetary base	7.3	7.2	7.0	7.2	7.7	7.8	7.8	7.9
Broad money	57.3	58.7	51.7	49.9	50.5	50.1	51.7	51.7
Of which: Deposits denominated in foreign currency	21.3	22.8	17.8	17.0	15.4	13.7	14.4	14.4
Credit to the private sector	50.5	49.2	45.3	47.2	48.8	50.4	53.0	54.0
Of which: In foreign currency	22.4	20.9	17.5	18.6	20.0	21.2	21.5	21.5
Central bank balance	-0.3	-0.2	-0.4	-0.2	-1.2	-0.9	-0.9	-0.9

Sources: Central Bank of Costa Rica and Fund staff estimates.

1/ Includes expenditure cuts equivalent to 0.3 percent of GDP, other cuts in transfers, a partial hiring freeze, broadening of the VAT base from the second half of 2015, a move towards global income tax, miscellaneous cuts in exemptions, and moderate gains from improvements in tax evasion.

Table 10a. Costa Rica: Medium-Term Framework, Baseline Scenario, Partial Fiscal Adjustment 1/

									Projection					
	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
	(Annual percentage change)													
Real GDP	8.8	7.9	2.7	-1.0	5.0	4.5	5.2	3.5	3.6	3.4	4.2	4.5	4.4	4.3
Domestic demand	7.6	4.7	7.7	-8.1	10.3	6.2	4.5	3.8	4.5	4.3	4.2	4.9	4.5	4.5
Consumption	5.4	6.9	3.5	2.3	4.5	4.1	3.9	3.2	4.0	4.0	3.9	4.2	4.1	4.0
Gross fixed capital formation	10.8	18.1	11.0	-11.1	5.5	8.9	7.8	12.4	1.7	1.0	7.1	6.7	7.1	7.0
Exports of goods and nonfactor services	10.3	9.9	-2.0	-6.0	5.5	5.4	9.5	3.6	-2.9	-3.6	5.3	5.6	5.5	5.2
Imports of goods and nonfactor services	8.1	4.3	6.5	-18.9	16.5	8.8	8.4	4.1	-1.4	-2.0	5.2	6.3	5.7	5.6
	(Contributions to real GDP growth)													
Domestic demand	7.5	4.7	7.4	-8.1	9.5	6.1	4.5	3.7	4.4	4.2	4.2	4.9	4.5	4.5
Consumption	3.9	4.9	2.5	1.6	3.4	3.0	2.9	2.3	2.9	2.9	2.9	3.0	3.0	2.9
Gross fixed capital formation	2.2	3.7	2.5	-2.7	1.2	2.0	1.8	2.9	0.4	0.3	1.7	1.7	1.8	1.8
Inventory changes	1.3	-4.1	2.3	-7.0	4.9	1.0	-0.2	-1.5	1.1	1.0	-0.4	0.2	-0.3	-0.2
Net exports	1.3	3.3	-4.6	7.1	-4.6	-1.5	0.7	-0.2	-0.8	-0.8	0.0	-0.4	-0.1	-0.2
	(In percent of GDP)													
Savings and Investment														
Savings	26.4	24.7	27.6	16.3	20.6	21.9	21.7	21.3	21.1	20.2	20.3	20.5	20.5	20.6
Domestic savings	21.9	18.4	18.2	14.3	17.1	16.4	16.4	16.4	16.0	15.6	15.5	15.5	15.5	15.5
Private sector	19.6	14.4	14.7	14.6	18.8	17.8	17.9	18.4	18.7	18.5	17.9	17.6	17.8	18.0
Public sector	2.3	4.0	3.6	-0.3	-1.6	-1.4	-1.6	-2.0	-2.7	-2.9	-2.3	-2.1	-2.3	-2.5
External savings 2/	4.5	6.3	9.3	2.0	3.5	5.4	5.3	4.9	5.0	4.7	4.7	4.9	5.0	5.2
Gross domestic investment	26.4	24.7	27.6	16.3	20.6	21.9	21.7	21.3	21.1	20.2	20.3	20.5	20.5	20.6
Private sector	16.8	18.6	19.6	18.4	16.3	16.8	17.1	17.8	17.2	16.5	16.7	17.0	17.2	17.5
Public sector	3.1	3.2	4.0	3.6	3.5	3.1	3.3	3.2	3.0	2.5	2.5	2.5	2.5	2.5
Inventory changes	6.5	2.9	4.0	-5.8	0.8	1.9	1.3	0.3	0.8	1.3	1.0	1.0	0.8	0.7
Balance of payments														
Current account balance	-4.5	-6.3	-9.3	-2.0	-3.5	-5.4	-5.3	-4.9	-5.0	-4.7	-4.7	-4.9	-5.0	-5.2
Trade balance	-12.1	-11.3	-16.8	-6.9	-9.5	-12.5	-11.9	-11.3	-11.6	-11.4	-11.7	-12.3	-12.7	-13.1
Services	6.0	6.6	7.4	7.4	7.0	7.7	7.6	8.1	8.2	8.4	8.6	8.8	9.1	9.3
Income	0.0	-3.3	-1.4	-3.7	-2.1	-1.4	-1.8	-2.3	-2.3	-2.3	-2.2	-2.1	-2.0	-2.0
Current transfers	1.6	1.8	1.5	1.2	1.0	0.8	0.7	0.6	0.6	0.6	0.6	0.6	0.6	0.6
Financial and capital account	8.5	9.2	8.3	1.7	5.5	6.3	9.7	6.5	4.1	5.3	4.7	4.9	5.0	0.0
Public sector	-0.7	0.0	0.0	1.0	1.7	0.2	2.7	2.5	2.1	2.2	1.0	1.2	1.2	1.1
Private sector	9.2	9.2	8.3	0.7	3.8	6.1	7.0	4.0	2.0	3.1	3.7	3.7	3.8	-1.1
Foreign direct investment	6.1	6.2	6.9	4.6	4.0	5.1	4.2	4.9	4.2	4.0	4.0	4.0	4.1	4.1
Other net private flows	3.1	3.0	1.4	-3.9	-0.2	0.9	2.8	-0.9	-2.2	-0.9	-0.2	-0.3	-0.3	-0.1
Errors and omissions	0.7	0.8	-0.2	0.4	-0.4	-0.5	0.3	-0.6	0.0	0.0	0.0	0.0	0.0	0.0
Change in net international reserves (increase -)	-4.6	-3.8	1.2	-0.2	-1.5	-0.3	-4.6	-0.9	0.9	-0.6	0.0	0.0	0.0	0.0
Memorandum items:														
Nominal GDP (billions of colones)	11,518	13,598	15,702	16,845	19,087	20,852	22,819	24,799	27,115	29,583	32,091	34,919	38,008	41,322
GDP deflator (percent change)	11.0	9.4	12.4	8.4	8.0	4.5	4.1	5.0	5.5	5.5	4.1	4.1	4.3	4.2
Consumer prices (percent change; period average)	11.5	9.4	13.4	7.8	5.7	4.9	4.5	5.2	3.4	5.0	4.2	4.0	4.0	4.0
Consumer prices (percent change; end of period)	9.4	10.8	13.9	4.0	5.8	4.7	4.6	3.7	5.6	4.5	4.0	4.0	4.0	4.0
Net international reserves (millions of U.S. dollars)	3,115	4,114	3,799	4,066	4,627	4,756	6,857	7,331	6,865	7,210	7,210	7,210	7,210	7,210

Sources: Central Bank of Costa Rica and Fund staff estimates.

1/ Includes expenditure cuts equivalent to 0.3 percent of GDP, other cuts in transfers, a partial hiring freeze, broadening of the VAT base from the second half of 2015, a move towards global income tax, miscellaneous cuts in exemptions, and moderate gains from improvements in tax evasion.

2/ External current account deficit.

Table 10b. Costa Rica: Medium-Term Framework, Full Fiscal Adjustment Scenario 1/

	2006	2007	2008	2009	2010	2011	2012	2013	Projection 2014	2015	2016	2017	2018	2019
	(Annual percentage change)													
Real GDP	8.8	7.9	2.7	-1.0	5.0	4.5	5.2	3.5	3.6	3.3	4.1	4.7	4.5	4.4
Domestic demand	7.6	4.7	7.7	-8.1	10.3	6.2	4.5	3.8	4.5	4.2	3.8	4.7	4.4	4.8
Consumption	5.4	6.9	3.5	2.3	4.5	4.1	3.9	3.2	4.0	3.6	3.6	4.1	3.9	3.8
Gross fixed capital formation	10.8	18.1	11.0	-11.1	5.5	8.9	7.8	12.4	1.7	1.0	7.1	6.7	7.1	7.0
Exports of goods and nonfactor services	10.3	9.9	-2.0	-6.0	5.5	5.4	9.5	3.6	-2.9	-3.6	5.3	5.8	5.7	5.4
Imports of goods and nonfactor services	8.1	4.3	6.5	-18.9	16.5	8.8	8.4	4.1	-1.4	-2.0	4.7	5.9	5.5	6.2
	(Contributions to real GDP growth)													
Domestic demand	7.5	4.7	7.4	-8.1	9.5	6.1	4.5	3.7	4.4	4.2	3.8	4.7	4.4	4.8
Consumption	3.9	4.9	2.5	1.6	3.4	3.0	2.9	2.3	2.9	2.7	2.6	3.0	2.8	2.8
Gross fixed capital formation	2.2	3.7	2.5	-2.7	1.2	2.0	1.8	2.9	0.4	0.3	1.7	1.7	1.8	1.8
Inventory changes	1.3	-4.1	2.3	-7.0	4.9	1.0	-0.2	-1.5	1.1	1.3	-0.5	0.0	-0.3	0.2
Net exports	1.3	3.3	-4.6	7.1	-4.6	-1.5	0.7	-0.2	-0.8	-0.8	0.3	0.0	0.1	-0.4
	(In percent of GDP)													
Savings and Investment														
Savings	26.4	24.7	27.6	16.3	20.6	21.9	21.7	21.3	21.1	20.3	20.3	20.4	20.4	20.7
Domestic savings	21.9	18.4	18.2	14.3	17.1	16.4	16.4	16.4	16.0	15.7	15.8	15.9	16.0	16.0
Private sector	19.6	14.4	14.7	14.6	18.8	17.8	17.9	18.4	18.7	18.2	17.2	16.5	16.4	16.2
Public sector	2.3	4.0	3.6	-0.3	-1.6	-1.4	-1.6	-2.0	-2.7	-2.5	-1.4	-0.6	-0.4	-0.2
External savings 2/	4.5	6.3	9.3	2.0	3.5	5.4	5.3	4.9	5.0	4.6	4.5	4.5	4.4	4.7
Gross domestic investment	26.4	24.7	27.6	16.3	20.6	21.9	21.7	21.3	21.1	20.3	20.3	20.4	20.4	20.7
Private sector	16.8	18.6	19.6	18.4	16.3	16.8	17.1	17.8	17.2	16.4	16.7	16.9	17.1	17.3
Public sector	3.1	3.2	4.0	3.6	3.5	3.1	3.3	3.2	3.0	2.5	2.5	2.5	2.5	2.5
Inventory changes	6.5	2.9	4.0	-5.8	0.8	1.9	1.3	0.3	0.8	1.4	1.0	1.0	0.8	0.8
Balance of payments														
Current account balance	-4.5	-6.3	-9.3	-2.0	-3.5	-5.4	-5.3	-4.9	-5.0	-4.6	-4.5	-4.5	-4.4	-4.7
Trade balance	-12.1	-11.3	-16.8	-6.9	-9.5	-12.5	-11.9	-11.3	-11.6	-11.3	-11.5	-11.8	-12.1	-12.7
Services	6.0	6.6	7.4	7.4	7.0	7.7	7.6	8.1	8.2	8.4	8.6	8.9	9.1	9.3
Income	0.0	-3.3	-1.4	-3.7	-2.1	-1.4	-1.8	-2.3	-2.3	-2.3	-2.2	-2.1	-2.0	-1.9
Current transfers	1.6	1.8	1.5	1.2	1.0	0.8	0.7	0.6	0.6	0.6	0.6	0.6	0.6	0.6
Financial and capital account	8.5	9.2	8.3	1.7	5.5	6.3	9.7	6.5	4.1	5.3	4.5	4.5	4.4	0.0
Public sector	-0.7	0.0	0.0	1.0	1.7	0.2	2.7	2.5	2.1	2.2	1.0	1.2	1.2	1.1
Private sector	9.2	9.2	8.3	0.7	3.8	6.1	7.0	4.0	2.0	3.0	3.5	3.3	3.2	-1.1
Foreign direct investment	6.1	6.2	6.9	4.6	4.0	5.1	4.2	4.9	4.2	4.0	4.0	4.1	4.2	4.4
Other net private flows	3.1	3.0	1.4	-3.9	-0.2	0.9	2.8	-0.9	-2.2	-1.0	-0.5	-0.9	-1.0	-0.8
Errors and omissions	0.7	0.8	-0.2	0.4	-0.4	-0.5	0.3	-0.6	0.0	0.0	0.0	0.0	0.0	0.0
Change in net international reserves (increase -)	-4.6	-3.8	1.2	-0.2	-1.5	-0.3	-4.6	-0.9	0.9	-0.6	0.0	0.0	0.0	0.0
Memorandum items:														
Nominal GDP (billions of colones)	11,518	13,598	15,702	16,845	19,087	20,852	22,819	24,799	27,115	29,687	32,321	35,361	38,649	42,169
GDP deflator (percent change)	11.0	9.4	12.4	8.4	8.0	4.5	4.1	5.0	5.5	6.0	4.6	4.5	4.6	4.5
Consumer prices (percent change; period average)	11.5	9.4	13.4	7.8	5.7	4.9	4.5	5.2	3.4	5.0	4.1	4.0	4.0	4.0
Consumer prices (percent change; end of period)	9.4	10.8	13.9	4.0	5.8	4.7	4.6	3.7	5.6	4.4	3.9	4.0	4.0	4.0
Net international reserves (millions of U.S. dollars)	3,115	4,114	3,799	4,066	4,627	4,756	6,857	7,331	6,865	7,210	7,210	7,210	7,210	7,210

Sources: Central Bank of Costa Rica and Fund staff estimates.

1/ Includes measures as in the baseline partial adjustment scenario (table 9.1) as well as measures to contain growth in the wage bill, and increases in the VAT rate and marginal income tax rates in outer years.

2/ External current account deficit.

Table 11. Costa Rica: Banking Sector Indicators

	2008	2009	2010	2011	2012	2013	2014				
	Dec	Dec	Dec	Dec	Dec	Dec	Jan	Feb	Mar	Apr	May
			(In percent)								
Capitalization											
Risk-adjusted capital ratio	15.1	16.0	17.3	17.3	16.8	16.6	16.7	16.2	16.1	16.0	16.1
Capital-to-assets ratio	13.3	13.9	14.8	15.0	14.8	14.5	14.4	14.0	14.1	14.1	14.0
Asset quality											
Nonperforming loans to total loans	1.5	2.0	1.8	1.7	1.7	1.7	1.7	1.6	1.6	1.5	1.6
Non-income generating assets to total assets	18.2	18.6	17.4	17.7	16.8	17.1	17.1	17.4	17.3	17.4	17.6
Foreclosed assets to total assets	0.3	0.6	0.8	0.8	1.0	1.0	1.0	0.9	1.0	0.9	1.0
Loan loss provisions to total loans	1.8	1.9	1.8	1.8	1.7	1.6	1.6	1.7	1.6	1.6	1.6
Management											
Administrative expenses to total assets	4.4	4.1	4.3	4.2	4.2	3.9	3.9	3.9	3.9	3.8	3.8
Noninterest expenses to gross income	79.3	76.8	85.0	76.5	67.4	68.1	69.0	74.3	75.7	76.9	77.5
Total expenses to total revenues	92.5	95.2	96.2	93.1	90.7	92.5	92.5	93.7	93.9	94.2	94.2
Profitability											
Return on assets (ROA)	1.8	1.1	1.2	1.3	1.5	1.2	1.2	1.2	1.2	1.2	1.2
Return on equity (ROE)	14.3	8.7	8.3	9.1	10.3	8.2	8.7	8.6	8.7	8.5	8.6
Interest margin to gross income	20.8	20.7	16.6	27.2	32.1	30.5	29.8	24.9	23.6	22.7	22.4
Liquidity											
Liquid assets to total short-term liabilities	83.0	93.4	90.1	85.1	92.6	101.2	98.6	100.6	99.5	97.6	101.1
Liquid assets to total assets	27.7	30.6	30.7	28.8	29.2	30.4	30.3	30.8	30.2	29.8	30.0
Loans to deposits	109.7	98.9	97.8	105.2	106.3	106.6	106.7	106.2	107.1	107.4	107.6
Liquid assets to deposits	42.1	43.9	43.8	42.7	44.0	47.0	46.7	47.4	46.2	45.6	46.1
Sensitivity to market risk											
Net open FX position to capital	20.4	25.4	18.8	18.8	19.1	17.8	17.2	18.7	18.9	19.3	19.7
Other											
Financial margin 1/	7.9	7.7	8.2	8.1	7.7	6.8	6.8	6.9	6.9	6.9	7.0

Source: Superintendency of Banks (SUGEF).

1/ Difference between implicit loan and deposit rates.

Annex I. Costa Rica. Financial System Assessment Program (FSAP) Main Pending Recommendations (2008)

Recommendations	Comments
A. Prudential Supervision and Regulation	
Amend the legal framework in order to provide protection for supervisors while performing their responsibilities in good faith.	Art. 28 of Insurance Law 8653 of August 7, 2008, provides legal protection to insurance supervisors. The reform to provide protection for bank supervisors was originally included in a draft reform of the BCCR law but subsequently dismissed. Currently, there is only legal protection for auditors.
Introduce pertinent laws for the Superintendency of Banks (SUGEF) to be able to supervise banking groups (including offshore structures) on a consolidated basis. Upon the approval of such laws the SUGEF should issue without delay operational regulations to ensure its rapid implementation by the banking system.	This reform was originally included in a draft reform of the BCCR law but subsequently dismissed.
Apply higher risk weight ratios to unhedged borrowers for capital adequacy purposes.	Amendment to capital adequacy regulation took effect in August 2013. This implemented gradual increases in the percentages over 18 months, to reach final levels of 125% for unhedged borrowers and 62.5% for those with residential mortgages by March 2015.[1]
Modify the funding arrangements for supervision, in line with international best practices.	A draft legislation to recapitalize the central bank also addresses the increase in the financing share of the industry.
B. Crisis Management and Bank Crisis Resolution Framework	
Amend article 155 of the Central Bank law in order to grant the SUGEF an appropriate range of supervisory tools to require a bank to take prompt remedial action and to impose penalties in accordance with the gravity of a situation.	This reform was originally included in a draft reform of the BCCR law but subsequently dismissed.
Amend the rating system for prompt corrective actions, to include new directives that allow the SUGEF to take an appropriate range of remedial actions and supervisory decisions.	The authorities intend to amend the rating system once risk-based supervision is fully in place (currently expected in 2017, with major reforms to be conducted in 2015 and 2016).[1]
Improve the early warning system, to allow the adoption of remedial actions in a timely manner.	The authorities will review the possibility of taking a broader range of remedial actions within the scope of the existing law.
Eliminate the emergency loan window and improve the design and operational arrangements of the ordinary rediscount window, including by establishing prudential limits in terms of regulatory capital.	The emergency line introduced during the 2008-09 crisis was discontinued and two high-access rediscount windows were created in 2011: (i) using bonds already included in the money market collateral pool; and (ii) using commercial credit portfolio as collateral (with strict rules on quality and haircuts). Both lines are available in US dollars and in colones. However, the rediscount windows are activated only when a central bank committee considers that there is a systemic risk; operational procedures need to be further streamlined; and repo operations are still to be linked to prudential limits in terms of regulatory capital.
Establish a deposit insurance scheme, in line with international best practices.	
Amend the bank resolution legal framework to include purchase and assumption type techniques.	
Enable voluntary, extra-judicial corporate restructuring agreements.	Approval of the Law on Execution on October 2007 did not address the weaknesses of the current procedural rules.

1/ Staff's preliminary assessment based on updated information provided by the authorities.
Source: Superintendence of Financial Institutions.

Annex II. Costa Rica: Public Debt Sustainability Analysis (Higher Scrutiny Case)

The DSA highlights Costa Rica's unsustainable debt dynamics. The debt stock is projected to rise to 51 percent of GDP by 2019 under the baseline scenario, driven mostly by high fiscal deficits. There are substantial upside risks to the projected debt path from plausible macro shocks. Risks from relatively high financing needs are somewhat mitigated by the existence of a stable domestic investor base.

Key Assumptions

Debt definition. The public debt sustainability analysis focuses on the central government level where the worsening of the fiscal situation has taken place in recent years. The rest of the consolidated public sector has been broadly in balance in recent years as the cash surplus of the social security system broadly offset the small central bank deficit—resulting from its liquidity management operations—while public enterprises are broadly in balance.[1] The additional adjustment needed—about 1½ percent of GDP—to close the actuarial deficit that opens up over the medium and long-term is estimated separately.

Growth and fiscal policy assumptions. The baseline reflects the estimated growth potential of 4.3 percent. The baseline scenario assumes fiscal adjustment of about 2¼ of GDP based on the staff's assessment of measures at a more advanced stage of elaboration in the medium-term adjustment plan announced by the authorities. The improvement in the primary balance is smaller due to the projected deterioration in the fiscal position under a passive scenario, driven mostly by increases in expenditure on education to reach expenditure targets defined under the constitution.

Debt target. In theory it is difficult to justify a unique threshold for debt-to-GDP ratio as the government is deemed solvent if it can generate future primary surpluses sufficient to service its outstanding debt, hence, protracted large budget deficits are not necessarily inconsistent with sustainability, provided that primary surpluses can be generated in the future. In practice, however, such an approach may require large future adjustments, which may not be feasible or desirable, economically and politically. A more operational definition of public debt sustainability offered in the 2003 WEO suggests that a given public debt level is sustainable if it implies that the government's budget constraint (in NPV terms) is satisfied without unrealistically large future corrections in the primary balance. It also emphasizes the importance of liquidity conditions, because even if a government satisfies its present value budget constraint, it may not have sufficient assets and financing available to meet or roll over its maturing liabilities. As practical guidance, empirical evidence indicates that, for emerging market economies, sustaining a debt-to-GDP ratio above 50 percent of GDP may be difficult. For example, the WEO (2003) finds that the median public

[1] The basics output table for the DSA at the consolidated public sector level shows that the estimated sustainability gap in 2019 is lower than at the central government level, given lower actual and projected primary deficits and average interest rates at the consolidated level.

debt-to-GDP ratio for emerging markets in the year before a default was about 50 percent of GDP. This study also concludes that, on average, the conduct of fiscal policy in emerging market economies is not consistent with ensuring sustainability once public debt exceeds a threshold of 50 percent of GDP. Moreover, WEO (2003) argues that a sustainable debt level may be lower for countries that have relatively low revenue-to-GDP ratio, high volatility of the revenue-to-GDP, as well as a weak track record of fiscal consolidations. Given that Costa Rica has low and fairly volatile revenue-to-GDP ratio, compared to other emerging markets, and has not demonstrated the ability to achieve substantial expenditure consolidation in the past decade, the debt threshold for Costa Rica should be significantly lower than 50 percent of GDP to provide a safety margin against the risk of default or at least severe budget funding problems. This is why targeting an upper bound to the public debt ratio of 40 to 45 percent of GDP appears justifiable in the case of Costa Rica.

Results and Assessment

Results. In the baseline, the headline deficit remains close to 6 percent of GDP in 2019, as the higher interest bill from rising public debt—which reaches 51 percent of GDP in 2019 and stays on an upward trajectory thereafter—largely offsets the improvement in the primary balance. The gross financing needs would average almost 10 percent of GDP in 2014–19. In the adjustment scenario, additional measures of 1½ of GDP, as part of a gradual but frontloaded consolidation plan, suffice to stabilize debt by 2019 at a level below 45 percent of GDP. This outcome assumes significant tightening in credit spreads driven by favorable market reaction to a frontloaded adjustment plan with credible measures.

Assessment. While most standard debt profile characteristics are not at "danger" levels (see heat-map), the debt and gross financing needs approach the debt burden benchmarks under stressed scenarios. In particular, debt rises above 60 percent of GDP under the combined macro-fiscal shock, with particularly high sensitivity to growth and fiscal shocks. Debt profile indicators also highlight risks from relatively high spreads on external bonds, elevated financing needs, and significant external and FX debt. The recent loss of the sovereign's only investment grade rating and warnings of potential downgrades by other main agencies highlight the risk that credit risk perceptions could intensify.

Mitigating factors. A stable investor base is an important mitigating factor. Notwithstanding the moderate risk ratings for external and FX debt in the debt profile indicators heat map, the share of these types of debt are at the low end of the reference range for moderate risk countries—external and FX debt represent about 20 and 30 percent of total debt, respectively, compared to benchmark ranges of 15 to 45 for external debt and 20 to 60 for FX debt. Moreover, about 60 percent of domestic debt is held by captive local institutional investors, including the social security system, nonfinancial public sector institutions, and banks.

Table A2.1. Costa Rica: Central Government Debt Sustainability Analysis (DSA) – Baseline Scenario

(in percent of GDP unless otherwise indicated)

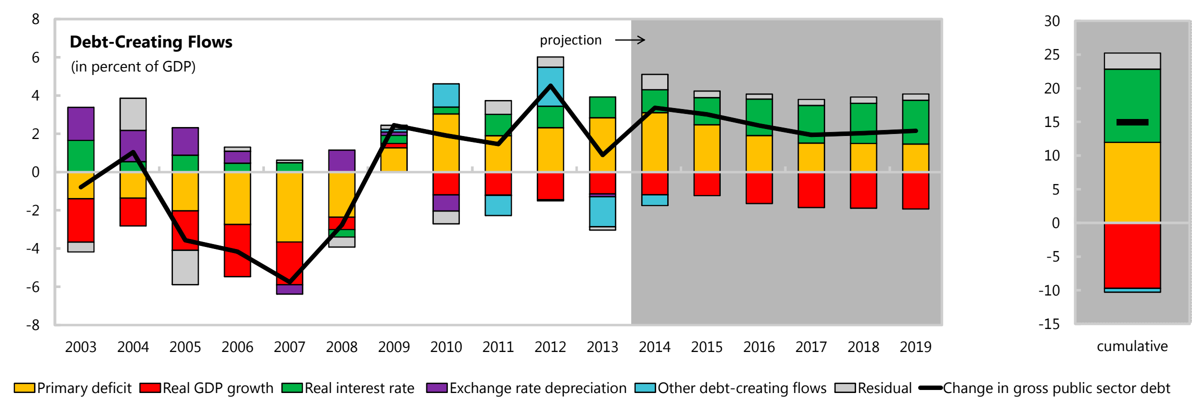
Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2003-2011 [2/]	2012	2013	2014	2015	2016	2017	2018	2019
Nominal gross public debt	32.3	35.1	36.0	39.4	42.4	44.8	46.8	48.8	51.0
Public gross financing needs	11.0	14.0	11.1	10.4	12.2	10.3	8.6	8.6	7.9
Real GDP growth (in percent)	4.9	5.2	3.5	3.6	3.4	4.2	4.5	4.4	4.3
Inflation (GDP deflator, in percent)	9.4	4.1	5.0	5.5	5.5	4.1	4.1	4.3	4.2
Nominal GDP growth (in percent)	14.8	9.4	8.7	9.3	9.1	8.5	8.8	8.8	8.7
Effective interest rate (in percent) [4/]	11.8	8.3	8.5	9.4	9.6	9.2	9.1	9.3	9.5

As of November 13, 2014		
Sovereign Spreads		
EMBIG (bp) 3/		362
5Y CDS (bp)		270
Ratings	Foreign	Local
Moody's	Ba1	Ba1
S&Ps	BB	BB
Fitch	BB+	BB+

Contribution to Changes in Public Debt

	Actual			Projections							
	2003-2011	2012	2013	2014	2015	2016	2017	2018	2019	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	-1.1	4.5	0.9	3.4	3.0	2.4	1.9	2.0	2.2	14.9	
Identified debt-creating flows	-1.1	4.0	1.1	2.6	2.7	2.2	1.6	1.7	1.8	12.6	
Primary deficit	-0.8	2.3	2.8	3.1	2.5	1.9	1.5	1.5	1.5	12.0	0.3
Primary (noninterest) revenue and grants	14.3	13.7	13.6	13.5	13.9	14.6	15.0	15.1	15.1	87.2	
Primary (noninterest) expenditure	13.4	16.0	16.5	16.6	16.3	16.5	16.6	16.6	16.6	99.2	
Automatic debt dynamics [5/]	-0.3	-0.4	-0.2	0.0	0.2	0.3	0.1	0.2	0.3	1.2	
Interest rate/growth differential [6/]	-0.9	-0.3	-0.1	0.0	0.2	0.3	0.1	0.2	0.3	1.2	
Of which: real interest rate	0.6	1.1	1.1	1.2	1.4	1.9	2.0	2.1	2.3	10.9	
Of which: real GDP growth	-1.5	-1.4	-1.1	-1.2	-1.2	-1.6	-1.9	-1.9	-1.9	-9.7	
Exchange rate depreciation [7/]	0.6	-0.1	-0.1	…	…	…	…	…	…	…	
Other identified debt-creating flows	0.0	2.0	-1.6	-0.6	0.0	0.0	0.0	0.0	0.0	-0.6	
Please specify (1) (e.g., drawdown of deposits) (negative)	0.0	2.0	-1.6	-0.6	0.0	0.0	0.0	0.0	0.0	-0.6	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Please specify (2) (e.g., ESM and Euroarea loans)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes [8/]	-0.1	0.5	-0.2	0.8	0.3	0.3	0.3	0.3	0.3	2.4	

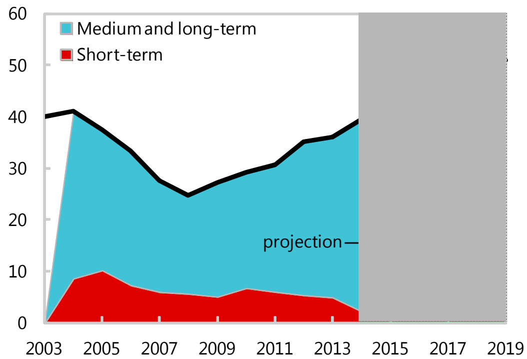


Source: Fund staff estimates and projections.
1/ Public sector is defined as central government.
2/ Based on available data.
3/ EMBIG.
4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.
5/ Derived as [(r - π(1+g) - g + ae(1+r)]/(1+g+π+gπ)) times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate;
a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).
6/ The real interest rate contribution is derived from the numerator in footnote 5 as r - π (1+g) and the real growth contribution as -g.
7/ The exchange rate contribution is derived from the numerator in footnote 5 as ae(1+r).
8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

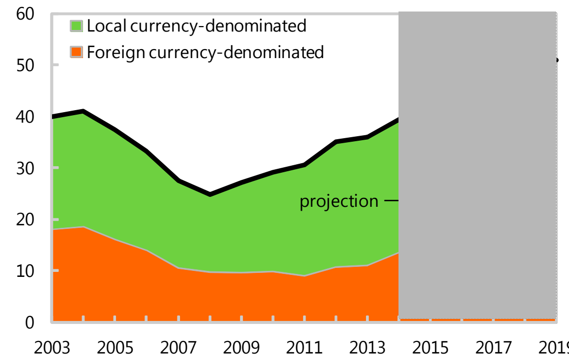
Table A2.2. Costa Rica: Central Government DSA – Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

By Maturity
(in percent of GDP)



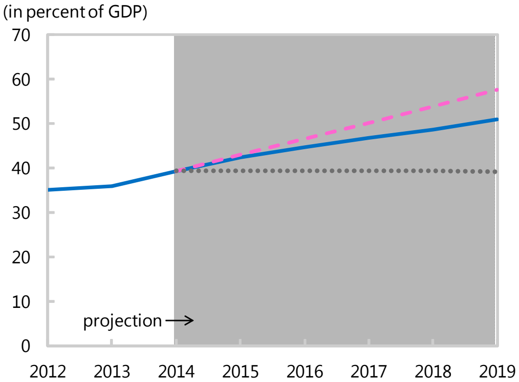
By Currency
(in percent of GDP)



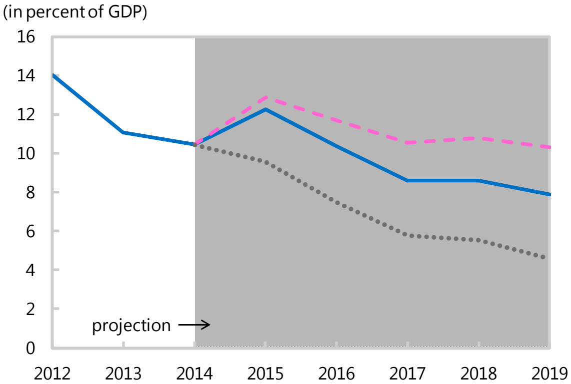
Alternative Scenarios

Baseline   Historical   Constant Primary Balance

Gross Nominal Public Debt
(in percent of GDP)



Public Gross Financing Needs
(in percent of GDP)



Underlying Assumptions
(in percent)

Baseline Scenario	2014	2015	2016	2017	2018	2019
Real GDP growth	3.6	3.4	4.2	4.5	4.4	4.3
Inflation	5.5	5.5	4.1	4.1	4.3	4.2
Primary Balance	-3.1	-2.5	-1.9	-1.5	-1.5	-1.5
Effective interest rate	9.4	9.6	9.2	9.1	9.3	9.5
Constant Primary Balance Scenario						
Real GDP growth	3.6	3.4	4.2	4.5	4.4	4.3
Inflation	5.5	5.5	4.1	4.1	4.3	4.2
Primary Balance	-3.1	-3.1	-3.1	-3.1	-3.1	-3.1
Effective interest rate	9.4	9.6	9.1	9.1	9.3	9.5

Historical Scenario	2014	2015	2016	2017	2018	2019
Real GDP growth	3.6	4.7	4.7	4.7	4.7	4.7
Inflation	5.5	5.5	4.1	4.1	4.3	4.2
Primary Balance	-3.1	0.1	0.1	0.1	0.1	0.1
Effective interest rate	9.4	9.6	8.8	8.4	8.4	8.4

Source: Fund staff estimates and projections.

Table A2.3. Costa Rica: Central Government DSA – Realism of Baseline Assumptions

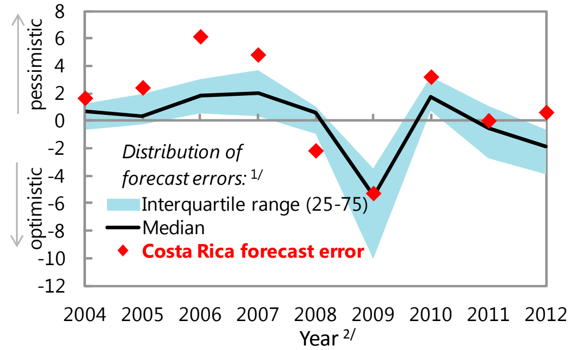
Forecast Track Record, versus program countries

Real GDP Growth

(in percent, actual-projection)

Costa Rica median forecast error, 2004-2012: **1.64**

Has a percentile rank of: **82%**

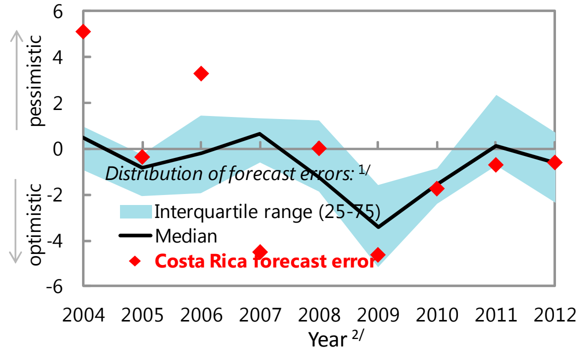


Primary Balance

(in percent of GDP, actual-projection)

Costa Rica median forecast error, 2004-2012: **-0.60**

Has a percentile rank of: **39%**

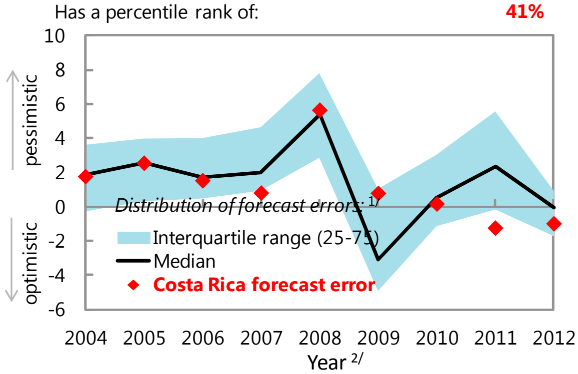


Inflation (Deflator)

(in percent, actual-projection)

Costa Rica median forecast error, 2004-2012: **0.80**

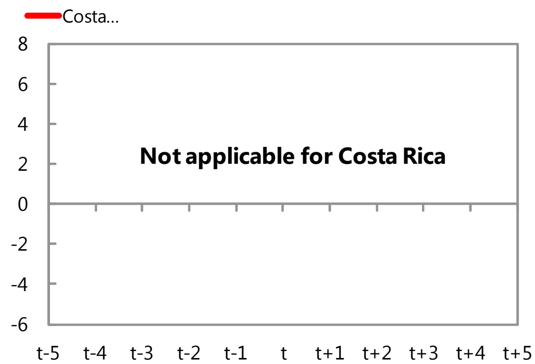
Has a percentile rank of: **41%**



Boom-Bust Analysis 3/

Real GDP growth

(in percent)



Source: Fund staff estimates and projections.

1/ Plotted distribution includes program countries, percentile rank refers to all countries

2/ Projections made in the spring WEO vintage of the preceding year

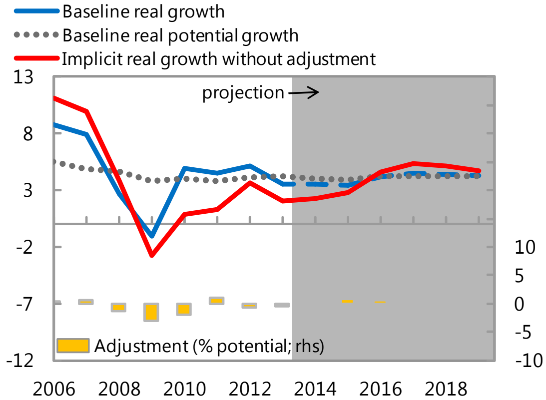
3/ Not applicable for Costa Rica, as it meets neither the positive output gap criterion nor the private credit growth criterion.

Table A2.3. Costa Rica: Central Government DSA – Realism of Baseline Assumptions (continued)

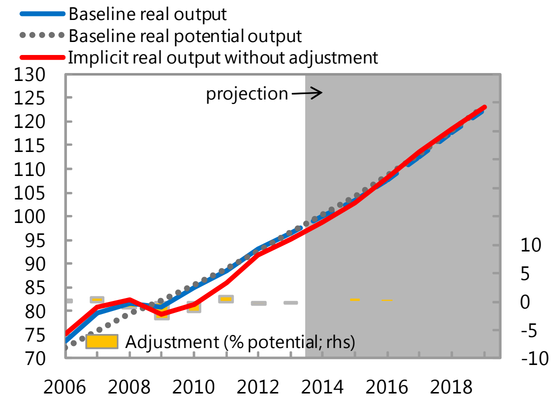
Growth and Level of Output in Absence of Fiscal Adjustment

Assumed multiplier of 1, persistence of 0.6

Real GDP Growth
(in percent)

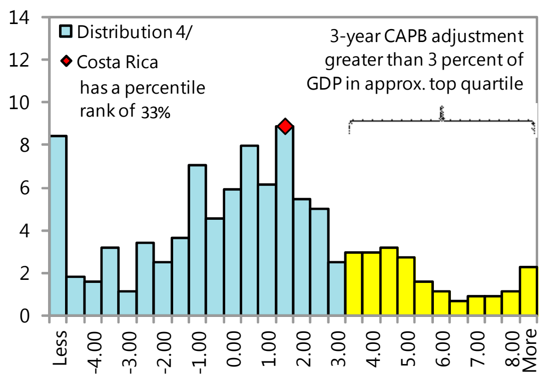


Real Output Level
(Baseline real output in 2014=100)

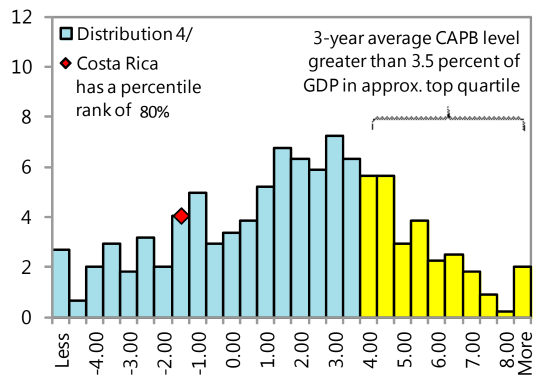


Assessing the Realism of Projected Fiscal Adjustment

3-Year Adjustment in Cyclically-Adjusted Primary Balance (CAPB)
(Percent of GDP)



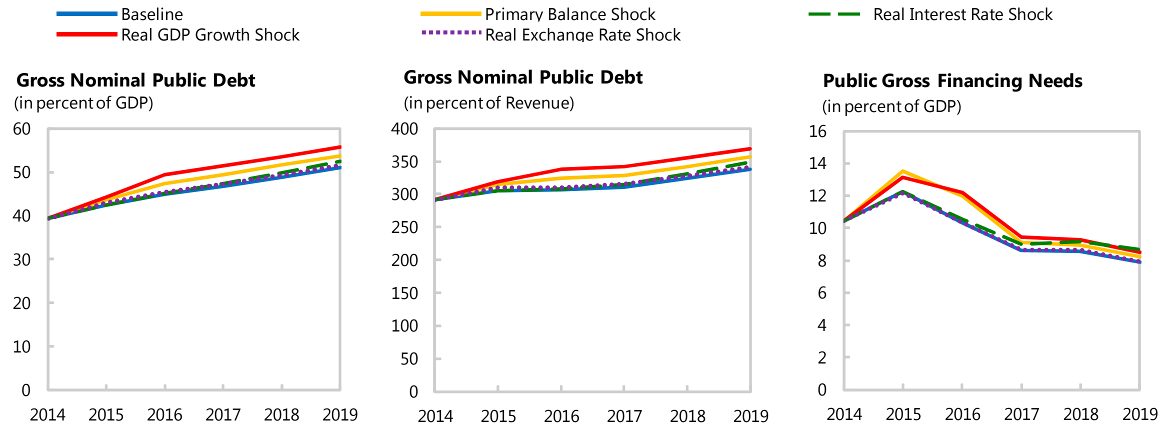
3-Year Average Level of Cyclically-Adjusted Primary Balance (CAPB)
(Percent of GDP)



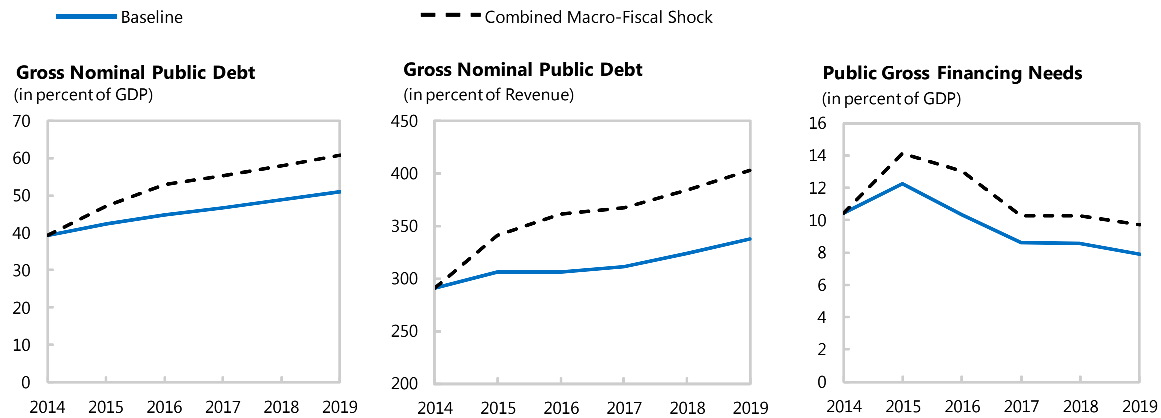
Source: Fund staff estimates and projections.
4/ Data cover annual obervations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

Table A2.4. Costa Rica: Central Government DSA – Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions

(in percent)

Primary Balance Shock	2014	2015	2016	2017	2018	2019
Real GDP growth	3.6	3.4	4.2	4.5	4.4	4.3
Inflation	5.5	5.5	4.1	4.1	4.3	4.2
Primary balance	-3.1	-3.8	-3.2	-1.5	-1.5	-1.5
Effective interest rate	9.4	9.6	9.2	9.2	9.4	9.6
Real Interest Rate Shock						
Real GDP growth	3.6	3.4	4.2	4.5	4.4	4.3
Inflation	5.5	5.5	4.1	4.1	4.3	4.2
Primary balance	-3.1	-2.5	-1.9	-1.5	-1.5	-1.5
Effective interest rate	9.4	9.6	9.7	9.9	10.4	10.7
Combined Shock						
Real GDP growth	3.6	0.7	1.5	4.5	4.4	4.3
Inflation	5.5	4.8	3.4	4.1	4.3	4.2
Primary balance	-3.1	-3.8	-3.2	-1.5	-1.5	-1.5
Effective interest rate	9.4	10.0	9.6	9.8	10.3	10.7

Real GDP Growth Shock	2014	2015	2016	2017	2018	2019
Real GDP growth	3.6	0.7	1.5	4.5	4.4	4.3
Inflation	5.5	4.8	3.4	4.1	4.3	4.2
Primary balance	-3.1	-3.0	-3.0	-1.5	-1.5	-1.5
Effective interest rate	9.4	9.6	9.2	9.2	9.4	9.6
Real Exchange Rate Shock						
Real GDP growth	3.6	3.4	4.2	4.5	4.4	4.3
Inflation	5.5	9.4	4.1	4.1	4.3	4.2
Primary balance	-3.1	-2.5	-1.9	-1.5	-1.5	-1.5
Effective interest rate	9.4	10.0	9.0	9.0	9.3	9.4

Source: Fund staff estimates and projections.

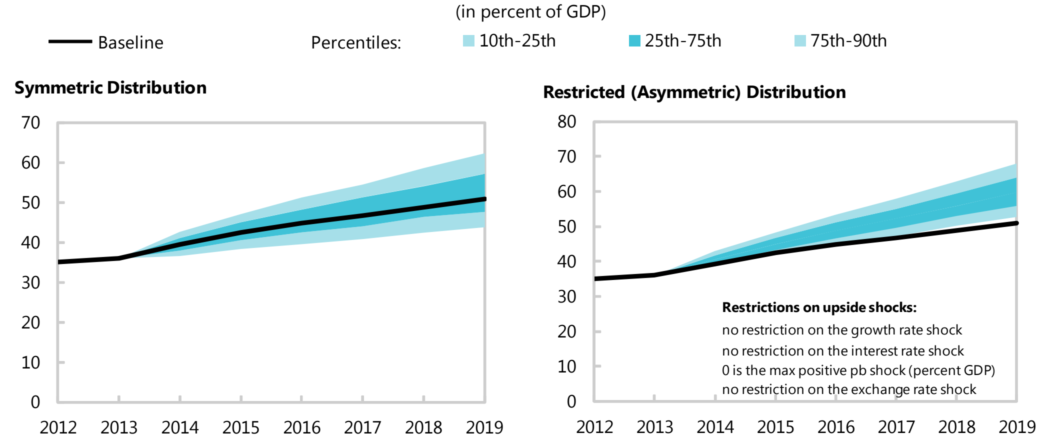
Table A2.5. Costa Rica: Central Government DSA – Risk Assessment

Heat Map

Debt level 1/	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability shock
Gross financing needs 2/	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability Shock
Debt profile 3/	Market Perception	External Financing Requirements	Change in the Share of Short-Term Debt	Public Debt Held by Non-Residents	Foreign Currency Debt

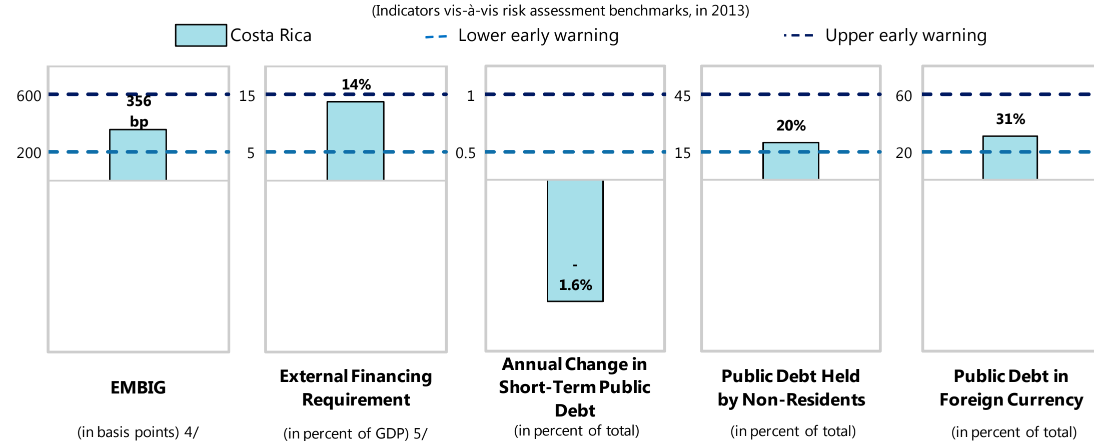
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2013)



Source: Fund staff estimates and projections.

1/ The cell is highlighted in green if debt burden benchmark of 70% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

2/ The cell is highlighted in green if gross financing needs benchmark of 15% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

3/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant, cell is white.
Lower and upper risk-assessment benchmarks are:

200 and 600 basis points for bond spreads; 5 and 15 percent of GDP for external financing requirement; 0.5 and 1 percent for change in the share of short-term debt; 15 and 45 percent for the public debt held by non-residents; and 20 and 60 percent for the share of foreign-currency denominated debt.

4/ EMBIG, an average over the last 3 months, 15-Aug-14 through 13-Nov-14.

5/ External financing requirement is defined as the sum of current account deficit, amortization of medium and long-term total external debt, and short-term total external debt at the end of previous period.

Table A2.6. Costa Rica: Central Government DSA – Adjustment Scenario

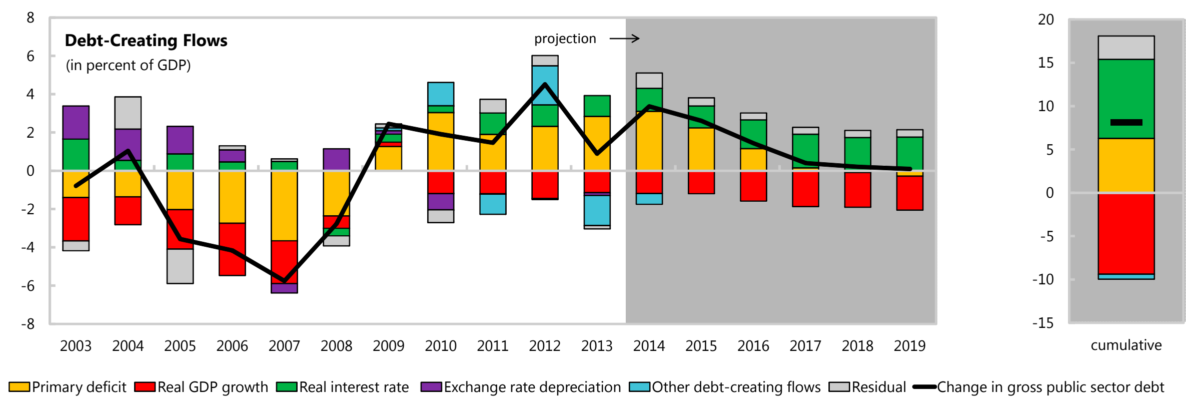
(in percent of GDP unless otherwise indicated)

Debt, Economic and Market Indicators [1/]

	Actual			Projections						As of December 31, 2013		
	2003-2011 [2/]	2012	2013	2014	2015	2016	2017	2018	2019	Sovereign Spreads		
Nominal gross public debt	32.3	35.1	36.0	39.4	42.0	43.4	43.8	44.0	44.1	EMBIG (bp) 3/		329
Public gross financing needs	11.0	14.0	11.1	10.4	11.9	9.3	6.9	6.3	5.1	5Y CDS (bp)		264
Real GDP growth (in percent)	4.9	5.2	3.5	3.6	3.3	4.1	4.7	4.5	4.4	Ratings	Foreign	Local
Inflation (GDP deflator, in percent)	9.4	4.1	5.0	5.5	6.0	4.6	4.5	4.6	4.5	Moody's	Ba1	Ba1
Nominal GDP growth (in percent)	14.8	9.4	8.7	9.3	9.5	8.9	9.4	9.3	9.1	S&Ps	BB	BB
Effective interest rate (in percent) [4/]	11.8	8.3	8.5	9.4	9.3	8.7	9.1	9.1	9.1	Fitch	BB+	BB+

Contribution to Changes in Public Debt

	Actual			Projections							
	2003-2011	2012	2013	2014	2015	2016	2017	2018	2019	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	-1.1	4.5	0.9	3.4	2.6	1.4	0.4	0.2	0.1	8.1	
Identified debt-creating flows	-1.1	4.0	1.1	2.6	2.2	1.1	0.0	-0.2	-0.3	5.4	
Primary deficit	-0.8	2.3	2.8	3.1	2.2	1.2	0.2	-0.1	-0.3	6.3	0.0
Primary (noninterest) revenue and grants	14.3	13.7	13.6	13.5	13.9	15.1	16.0	16.2	16.3	91.1	
Primary (noninterest) expenditure	13.4	16.0	16.5	16.6	16.1	16.2	16.2	16.1	16.1	97.3	
Automatic debt dynamics [5/]	-0.3	-0.4	-0.2	0.0	-0.1	-0.1	-0.1	-0.1	0.0	-0.3	
Interest rate/growth differential [6/]	-0.9	-0.3	-0.1	0.0	-0.1	-0.1	-0.1	-0.1	0.0	-0.3	
Of which: real interest rate	0.6	1.1	1.1	1.2	1.1	1.5	1.8	1.7	1.8	9.1	
Of which: real GDP growth	-1.5	-1.4	-1.1	-1.2	-1.2	-1.6	-1.9	-1.8	-1.8	-9.4	
Exchange rate depreciation [7/]	0.6	-0.1	-0.1	…	…	…	…	…	…	…	
Other identified debt-creating flows	0.0	2.0	-1.6	-0.6	0.0	0.0	0.0	0.0	0.0	-0.6	
Please specify (1) (e.g., drawdown of deposits) (negative)	0.0	2.0	-1.6	-0.6	0.0	0.0	0.0	0.0	0.0	-0.6	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Please specify (2) (e.g., ESM and Euroarea loans)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes [8/]	-0.1	0.5	-0.2	0.8	0.4	0.4	0.4	0.4	0.4	2.7	



Source: Fund staff estimates and projections.
1/ Public sector is defined as central government.
2/ Based on available data.
3/ EMBIG.
4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.
5/ Derived as [(r - π(1+g) - g + ae(1+r)]/(1+g+π+gπ)) times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).
6/ The real interest rate contribution is derived from the numerator in footnote 5 as r - π (1+g) and the real growth contribution as -g.
7/ The exchange rate contribution is derived from the numerator in footnote 5 as ae(1+r).
8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Table A2.7. Costa Rica: Consolidated Public Sector DSA – Baseline Scenario

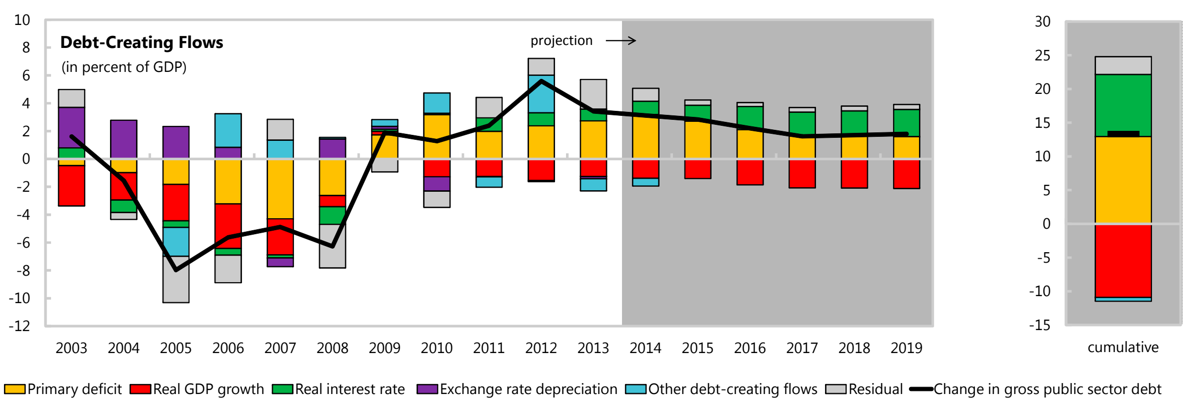
(in percent of GDP unless otherwise indicated)

Debt, Economic and Market Indicators [1/]

	Actual			Projections						As of November 13, 2014		
	2003-2011 [2/]	2012	2013	2014	2015	2016	2017	2018	2019	Sovereign Spreads		
Nominal gross public debt	38.0	38.5	41.9	45.1	47.9	50.1	51.7	53.4	55.2	EMBIG (bp) 3/		362
Public gross financing needs	3.8	10.5	10.9	10.6	12.6	10.6	8.7	8.7	7.9	5Y CDS (bp)		270
Real GDP growth (in percent)	4.9	5.2	3.5	3.6	3.4	4.2	4.5	4.4	4.3	Ratings	Foreign	Local
Inflation (GDP deflator, in percent)	9.4	4.1	5.0	5.5	5.5	4.1	4.1	4.3	4.2	Moody's	Ba1	Ba1
Nominal GDP growth (in percent)	14.8	9.4	8.7	9.3	9.1	8.5	8.8	8.8	8.7	S&Ps	BB	BB
Effective interest rate (in percent) [4/]	9.5	7.4	7.5	8.2	8.4	8.0	8.0	8.2	8.4	Fitch	BB+	BB+

Contribution to Changes in Public Debt

	Actual			Projections							
	2003-2011	2012	2013	2014	2015	2016	2017	2018	2019	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	-2.1	5.6	3.4	3.1	2.8	2.2	1.6	1.7	1.8	13.3	
Identified debt-creating flows	-1.4	4.4	1.3	2.2	2.5	1.9	1.3	1.4	1.4	10.7	
Primary deficit	-0.7	2.4	2.7	3.2	2.7	2.1	1.7	1.6	1.6	13.0	-0.2
Primary (noninterest) revenue and grants	22.1	22.1	22.7	22.6	22.7	23.4	23.8	23.9	23.9	140.3	
Primary (noninterest) expenditure	21.3	24.5	25.4	25.8	25.4	25.5	25.5	25.5	25.5	153.2	
Automatic debt dynamics [5/]	-1.0	-0.7	-0.6	-0.4	-0.3	-0.2	-0.4	-0.3	-0.2	-1.7	
Interest rate/growth differential [6/]	-2.0	-0.6	-0.4	-0.4	-0.3	-0.2	-0.4	-0.3	-0.2	-1.7	
Of which: real interest rate	-0.1	0.9	0.8	0.9	1.1	1.7	1.7	1.8	2.0	9.2	
Of which: real GDP growth	-1.8	-1.5	-1.3	-1.4	-1.4	-1.9	-2.1	-2.1	-2.1	-10.9	
Exchange rate depreciation [7/]	1.0	-0.1	-0.2	…	…	…	…	…	…	…	
Other identified debt-creating flows	0.3	2.7	-0.9	-0.6	0.0	0.0	0.0	0.0	0.0	-0.6	
Please specify (1) (e.g., drawdown of deposits) (negative)	0.3	2.7	-0.9	-0.6	0.0	0.0	0.0	0.0	0.0	-0.6	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Please specify (2) (e.g., ESM and Euroarea loans)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes [8/]	-0.8	1.2	2.1	0.9	0.4	0.3	0.3	0.3	0.4	2.6	



Source: Fund staff estimates and projections.

1/ Public sector is defined as consolidated public sector.

2/ Based on available data.

3/ EMBIG.

4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

5/ Derived as [(r - π(1+g) - g + ae(1+r)]/(1+g+π+gπ)) times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

6/ The real interest rate contribution is derived from the numerator in footnote 5 as r - π (1+g) and the real growth contribution as -g.

7/ The exchange rate contribution is derived from the numerator in footnote 5 as ae(1+r).

8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Annex III. Costa Rica: External Debt Sustainability Assessment

Table A3.1. Costa Rica: External Debt Sustainability Framework, 2011–19

(In percent of GDP, unless otherwise indicated)

	Actual		Est.	Projections						
	2011	2012	2013	2014	2015	2016	2017	2018	2019	**Debt-stabilizing non-interest current account 6/**
Baseline: External debt	26.5	32.0	35.2	**29.6**	**26.6**	**25.1**	**23.5**	**22.2**	**21.5**	**-4.8**
Change in external debt	1.2	5.5	3.2	-5.5	-3.0	-1.5	-1.6	-1.2	-0.7	
Identified external debt-creating flows (4+8+9)	-2.9	-2.2	-3.3	-0.1	-2.0	-1.3	-1.2	-1.0	-0.8	
Current account deficit, excluding interest payments	4.8	4.5	4.1	4.0	3.7	3.9	4.2	4.3	4.5	
Deficit in balance of goods and services	4.8	4.3	3.2	3.3	3.0	3.1	3.4	3.6	3.8	
Exports	37.4	37.3	35.5	34.4	31.5	31.5	31.6	31.8	31.9	
Imports	42.1	41.6	38.7	37.7	34.5	34.6	35.1	35.4	35.7	
Net non-debt creating capital inflows (negative)	-5.3	-5.1	-5.5	-4.8	-4.6	-4.5	-4.5	-4.5	-4.6	
Automatic debt dynamics 1/	-2.4	-1.6	-1.9	0.6	-1.1	-0.7	-0.9	-0.8	-0.7	
Contribution from nominal interest rate	0.6	0.9	0.8	1.1	1.0	0.9	0.7	0.7	0.7	
Contribution from real GDP growth	-1.0	-1.2	-1.0	-1.3	-0.9	-1.1	-1.1	-1.0	-0.9	
Contribution from price and exchange rate changes 2/	-2.0	-1.2	-1.7	...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	4.1	7.7	6.4	-5.4	-1.0	-0.2	-0.4	-0.2	0.1	
External debt-to-exports ratio (in percent)	70.8	85.8	99.1	86.2	84.3	79.4	74.2	70.0	67.6	
Gross external financing need (in billions of US dollars) 4/	0.0	6.5	6.8	6.2	4.8	4.3	4.2	4.2	4.3	
in percent of GDP	0.0	14.2	13.7	12.4	8.9	7.4	6.9	6.4	6.1	
Scenario with key variables at their historical averages 5/				**29.6**	**25.3**	**22.0**	**18.8**	**16.0**	**13.6**	**-6.3**
Key Macroeconomic Assumptions Underlying Baseline										
Real GDP growth (in percent)	4.5	5.2	3.5	3.6	3.4	4.2	4.5	4.4	4.3	
GDP deflator in US dollars (change in percent)	8.7	4.6	5.6	-2.3	4.1	2.0	2.3	2.3	2.2	
Nominal external interest rate (in percent)	2.9	3.5	2.9	3.1	3.7	3.4	3.2	3.2	3.3	
Growth of exports (US dollar terms, in percent)	11.4	9.8	4.0	-2.0	-1.2	6.3	7.2	7.2	6.9	
Growth of imports (US dollar terms, in percent)	17.9	8.6	1.7	-1.4	-1.4	6.6	8.2	7.6	7.5	
Current account balance, excluding interest payments	-4.8	-4.5	-4.1	-4.0	-3.7	-3.9	-4.2	-4.3	-4.5	
Net non-debt creating capital inflows	5.3	5.1	5.5	4.8	4.6	4.5	4.5	4.5	4.6	

Source: National authorities and Fund staff estimates.

1/ Derived as [r - g - r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as [-r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock. r increases with an appreciating domestic currency (e > 0) and rising inflation (based on GDP deflator).

3/ For projection, line includes the impact of price and exchange rate changes.

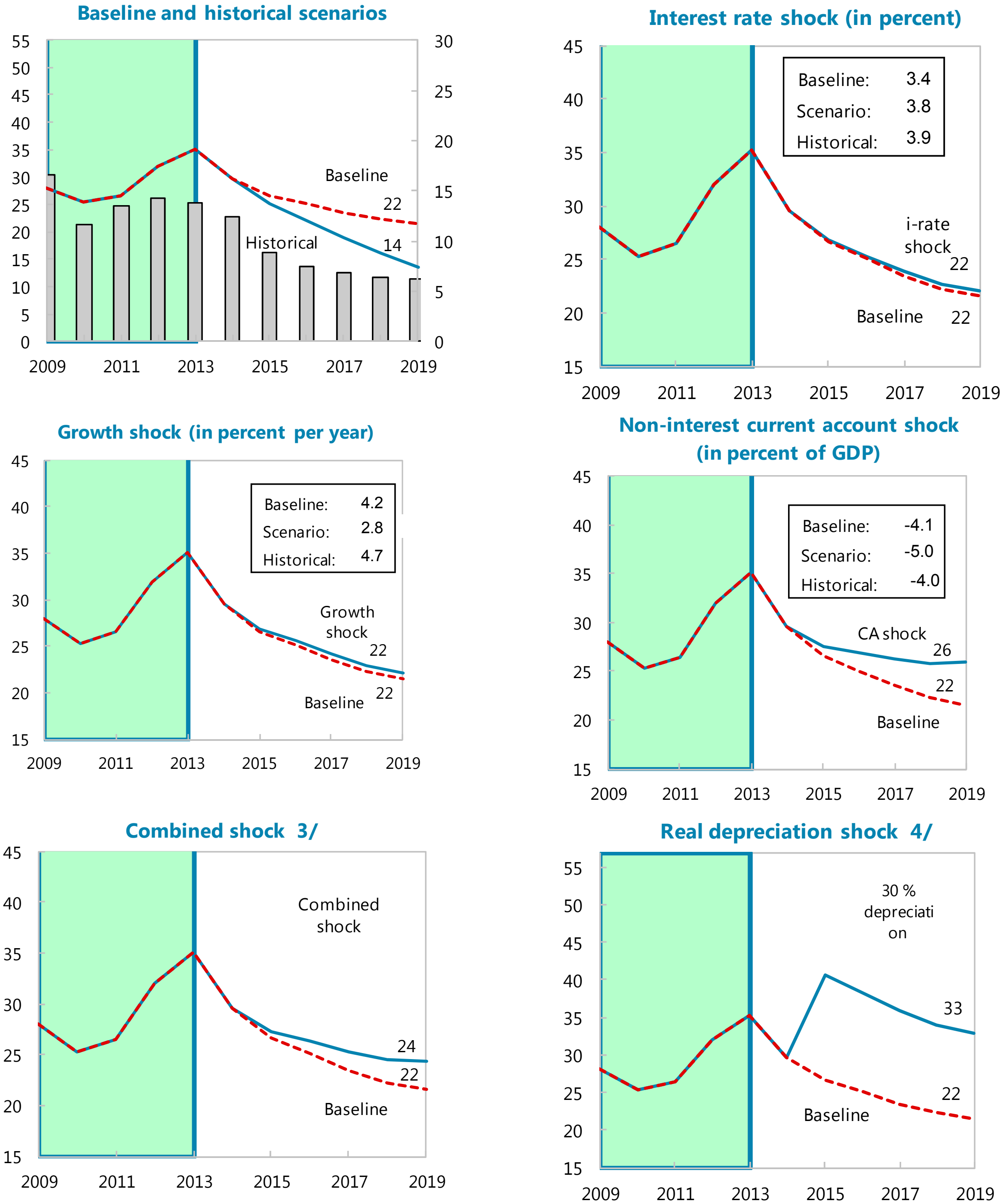
4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Figure A3.1. Costa Rica: External Debt Sustainability: Bound Tests 1/ 2/

(External debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and Fund staff estimates.

1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.

2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.

3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.

4/ One-time real depreciation of 30 percent occurs in 2010.

INTERNATIONAL MONETARY FUND

COSTA RICA

January 9, 2015

STAFF REPORT FOR THE 2014 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By: The Western Hemisphere Department

CONTENTS

FUND RELATIONS

(As of October 31, 2014)

Membership Status: Joined: January 8, 1946

General Resources Account:	**SDR Million**	**% Quota**
Quota	164.10	100.00
Fund holdings of currency	144.09	87.81
Reserve Tranche Position	20.02	12.20

SDR Department:	**SDR Million**	**% Allocation**
Net cumulative allocation	156.53	100.00
Holdings	132.50	84.65

Outstanding Purchases and Loans:

None

Latest Financial Arrangements:

Type	**Date of Arrangement**	**Expiration Date**	**Amount Approved (SDR Million)**	**Amount Drawn (SDR Million)**
Stand-By	04/11/2009	07/10/2010	492.30	0.00
Stand-By	11/29/1995	02/28/1997	52.00	0.00
Stand-By	04/19/1993	02/18/1994	21.04	0.00

Projected Payments to Fund
(SDR Million; based on existing use of resources and present holdings of SDRs):

	Overdue	**Forthcoming**			
		2015	2016	2017	2018
Principal	0.00	0.00	0.00	0.00	0.00
Charges/Interest	0.00	0.01	0.01	0.01	0.01
Total	**0.00**	**0.01**	**0.01**	**0.01**	**0.01**

Exchange Rate Arrangement. Costa Rica's de jure exchange rate arrangement is classified as a "crawling band," while the de facto exchange rate arrangement is classified as "stabilized." Since October 2006, the de jure exchange rate arrangement has been a crawling band with an increasing width. The ceiling and floor of the band have been adjusted several times, most recently in January 2009, when the crawl rate of the band's ceiling has been set at 0.20 colones (previously 0.06 colones) a business day. The floor of the band has been flat since July 2008. As of December 3, 2014, the intervention buying and selling exchange rates were 500 and 858.25 colones per U.S. dollar respectively. Costa Rica maintains an exchange system free of restrictions on the making of payments and transfers for current international transactions.

Article IV Consultation. The last Article IV consultation was concluded on February 22, 2013 (Country Report No. 13/79). The 2014 consultation was delayed to accommodate the Costa Rican presidential elections, which were concluded in April 2014.

FSAP participation and ROSCs. The FSAP took place in 2001, and was updated in 2008. A data ROSC took place in 2001 with a reassessment in 2009. A fiscal ROSC took place in 2006.

Technical Assistance.

Department	Time of Delivery	Purpose
STA, CAPTAC-DR	February 2013	Volume indices
Real Sector	2013 and 2014	Quarterly national accounts / agricultural work-in-progress
	April 2013	2008 System of National Accounts (SNA)
	September 2013	Flow of funds table / agricultural work-in-progress
	2013 and 2014	Source data: construction
	April 2014	Producer Price Index
	July 2014	Input-output tables
	September 2014	Non-observed economy: employment matrix
	October 2014	Economic Study to Enterprises / Source data: construction
External Sector		
	February 2013	Balance of Payments and International Investment Position
	August 2013	Topics of the Current Account
	February 2014	Balance of Payments and International Investment Position
	March 2014	Coordinated Direct Investment and Portfolio Surveys
	October 2014	Topics of the Secondary Income Account
MCM, CAPTAC-DR	2013 and 2014	Improving institutional capacity for Macroeconomic Policy analysis and modeling
	March 2014	Review and Analysis of the Central Bank's Lender of Last Resort Facilities
	2013 and 2014	Adoption of International Financial Reporting Standards
	2013 and 2014	Methodology and information system for cross-border and consolidated supervision
	January 2013	Operational risk management and supervision
	2013 and 2014	Regulations for market risk management
	2013 and 2014	Road map for the adoption of international regulatory practices focused on Basel III
FAD, CAPTAC-DR	April 2013	Methodology to draft Conceptual model for a new IFMIS
	May 2013	Implementing a medium-term expenditure framework
	September 2013	Introducing change in systems to consider IPSAS implementation
	2012 and 2013	Customs Procedures and System
	2013- 2014	Post Clearance Audit
	October 2014	Strategic Planning
	November 2014	Customs Risk Management
	2013	Checking integrity of the taxpayer base, taxpayers' filling obligations, massive control process, audit and collection.
	2013	Electronic invoice regime and new audit approach's definition.
	2013-2014	IT standards' definition.
	2013-2014	Reform plan and organizational arrangements.
LEG	2011 - 2014	Structures and tools for the SML/CFT Supervisory Framework
	2014 - 2015	National AML/CFT Strategy

Resident Representative: Mario Garza (based in Guatemala) is the regional resident representative for Central America, Panama and the Dominican Republic.

PAST FUND STAFF RECOMMENDATIONS AND IMPLEMENTATION

2012 Article IV Staff Recommendation	Implementation
Fiscal Policy	
• Rebuild fiscal buffers that were used to contain the impact of the global crisis. Moreover, fiscal consolidation is needed to safeguard fiscal sustainability over the medium and long term. • The consolidation strategy should center on both revenue enhancing measures and expenditure restraint. An early fiscal correction of about 1-1½ percent of GDP would be appropriate, with greater consolidation necessary into the medium term.	• Containment of public spending was short lived, with primary expenditures and debt rising again in 2012–13. Efforts to restrain outlays, mainly through capital expenditure cuts in 2011, were undermined by larger transfers and interest costs in 2012–13. As a result, both the central government deficit and public debt increased in relation to GDP.
Monetary and Foreign Exchange Policy	
• Continued adherence to the exchange rate band system may imperil the low inflation achieved in recent years, in light of the strong appreciating pressures exacerbated by the large capital inflows. • To protect macroeconomic stability, the authorities should phase out the exchange rate band and establish the inflation target as the sole nominal anchor of the economy. Foreign exchange market interventions by the central bank to smooth out exchange rate fluctuations and strengthen the NIR position would still be possible insofar as these do not undermine the inflation target.	• Private capital inflows and government external bond issuance kept the XR at the bottom of the band in 2012–13, with strong reserve accumulation. However, the colón lost 8 percent of its value in 2014 as private inflows dried up and domestic residents adjusted their portfolios toward FX assets. The central bank intervened to reduce volatility and the XR has stabilized. • After ending 2013 at 3.7 percent, inflation climbed to 5.5 percent—above the 3-5 percent central bank target range—in August 2014. This reflected mainly pass-through to domestic prices from the exchange rate depreciation. To contain second-round effects from devaluation, the authorities raised the monetary policy rate twice this year. • The authorities are considering a move to a more flexible exchange rate system, although the band system is still in place, and are intervening in the foreign exchange market by following an undisclosed rule.
Financial Sector	
• Implementation of the 2008 FSAP recommendations should be accelerated. • The authorities should strive to introduce risk-based supervision. Existing capital quality should be firmed up and liquidity and capital requirements increased in line with Basel III standards.	• Progress on introducing FSAP recommendations has been mixed. Critical legislation to enhance consolidated supervision and strengthen bank resolution remains to be approved. • Measures have been enacted to move towards full implementation of risk-based supervision.

RELATIONS WITH THE WORLD BANK AND BANK-FUND COLLABORATION UNDER THE JOINT MANAGEMENT ACTION PLAN (JMAP)

1. **In November 2014, the IMF's Costa Rica team led by Mr. Figliuoli (mission chief) met with the World Bank's Costa Rica team led by Mr. Calvo-Gonzalez (lead economist and PREM sector leader) to discuss macroeconomic challenges, identify macro-critical structural reforms, and coordinate the two teams' work.**

2. **The teams agreed that Costa Rica's main macroeconomic challenges are to safeguard fiscal sustainability, increase the effectiveness of monetary policy, maintain financial sector stability and enhance competitiveness.**

3. **The teams also discussed potential strategies to foster inclusive growth in the context of growing inequality.**

4. **Based on the shared assessment of macroeconomic challenges, the teams identified four structural reform areas as macro-critical:**

- Fiscal consolidation. The fiscal consolidation strategy should comprise both revenue and expenditure components, with a slant towards revenue enhancement. The adjustment plan laid out by the authorities is appropriate, though critical elements need further elaboration. Key elements for a successful adjustment plan include broadening the base for the VAT, increasing VAT rates, raising marginal tax rates on high earners and containing growth of the public sector wage bill.

- Monetary policy framework. The transition to inflation targeting and greater exchange rate flexibility should be accelerated in order to lock in low inflation achieved in recently years.

- Financial sector stability. Progress has been made in adopting risk-based financial supervision. Looking ahead, approval of legislation on consolidated supervision, deposit insurance and banking resolution will be critical to bring the regulatory framework up to international best practices.

- Productivity. The country is making progress in addressing issues of universal coverage and quality in secondary education, and is seeking to develop its scientific and technological capabilities, which would help maintain Costa Rica's growth of knowledge-intensive exports. There is also strong commitment to improving the business environment and removing burdensome red tape. Given the sizable investments required to upgrade infrastructure and the tight fiscal situation, the government is seeking to create the institutional conditions to engage the private sector in financing, construction and management of infrastructure projects (public-private partnerships), though these will require vigilance to avoid undue contingent liabilities.

5. **The teams agreed the following division of labor:**

- Fiscal consolidation. The IMF (the Fund) will continue to provide policy recommendations on macro-fiscal issues, including the overall strategy of fiscal consolidation and the tax reform. The World Bank (the Bank) will provide technical assistance to support the use of public-private partnerships as a vehicle to finance key infrastructure projects. The government also requested assistance to improve financial management, service delivery, and sustainability of its social security system.

- Monetary policy framework. The Fund will continue to provide policy recommendations regarding the transition to inflation targeting and a more flexible exchange rate regime.

- Financial sector stability. The Bank and the Fund will cooperate as necessary in assisting the country in implementing the FSAP recommendations.

- Productivity. The Bank will continue to provide policy recommendations in key areas. In terms of lending, the government is being supported by a project in higher education (approved in September 2012) and a catastrophe draw down deferred option (approved in March 2009). The government has also requested technical assistance from IFC Advisory services to improve the investment climate.

6. **The teams have the following requests for information from their counterparts:**

- The Fund team requests to be kept informed of progress in the above macro-critical structural reform areas. Timing: when milestones are reached (and at least semi-annually).

- The Bank team requests to be kept informed of the Fund's assessments of macroeconomic policies and prospects. Timing: when milestones are reached (and at least semi-annually).

7. **The table below lists the teams' separate and joint work programs for 2015.**

Table 1. World Bank and IMF Planned Activities in Macro-Critical Structural Reform Areas

Title	Products	Provisional Timing of Missions	Expected Delivery Date
World Bank Work Program	Costa Rica Integration into Global Value Chains	September 2014	Final Delivery December 2014
	Costa Rica health (technical assistance)	February, 2013	Final delivery December 2014
	Recognition of Foreign Degrees	October 2014	Final Delivery March 2015
	Analytical Framework for Financial Risk	December 2014	Final Delivery January 2015
IMF Work Program	Staff visit	May, 2015	May, 2015
	Regional Conference	July, 2015	July, 2015
	Technical assistance:	2015	
	National Accounts		
	Banking Supervision and Regulation		
	Fiscal Revenue and Expenditure Management		

8. **The attached table summarizes the financial relations between Costa Rica and the World Bank (in million U.S. dollars).**

Table 2. Costa Rica and the World Bank: Financial Relations

Project Name	Total loan	Undisbursed through FY14	Projected disbursements in FY15
Higher Education Improvement Project	200	191	15
Catastrophe Deferred Draw Down Option	65	31	0

RELATIONS WITH THE INTER-AMERICAN DEVELOPMENT BANK

1. **Recent activities**. The IBD´s loan portfolio in Costa Rica has 11 sovereign guaranteed operations in execution, with an approved amount of US$1,360.7 million. The available amount for disbursements is US$1,069.8 million (80.1% of the approved), and is concentrated in the areas of Energy (32.5%), Transportation (26.3%), Education (15.6%) and Reform and Modernization of the State (12.9 %). The average age of the operations is 4 years. The IDB still has three operations pending legislative ratification: Water and Sanitation Program, an Innovation and Human Capital for Competitiveness Program and an Education Infrastructure Construction and Equipment Program. Disbursements of sovereign guaranteed operations during 2012 are expected to reach around US$94.2 million, concentrated in the areas of Energy (69.7%), Reform and Modernization of the State (15.0%) and Transportation (12.8%).

2. **Future plans**. During the 2013 the IDB expects to continue the implementation of its 2011–2014 Country Strategy for Costa Rica, focused on the areas of Transportation, Energy, Citizen Security, Early Childhood Development, Health and Innovation. In 2013 the IDB expects to approve two Sovereign Guarantee loans for a total amount of US$338.0 million on Transportation and Logistics/Regional Integration.

Loan Disbursements (Sovereign Guaranteed Operations)

(In millions of U.S. dollars)

	2007	2008	2009	2010	2011	2012*
Disbursements	12.9	18	40.6	55.7	121.0	94.2
Amortization	81.4	289.3**	46.0	45.3	47.0	61.4
Interest and charges	23.6	24.1	13.8	11.4	10.4	17.1
Net cash flow	-92.1	-295.4	-19.2	-1.0	61.5	14.3

* Projections (December 2012).
**Includes an anticipated repayment of US$200 million

Lending Program for 2013 (tentative)

(In millions of U.S. dollars)

Projects	**Amount**
Border Crossing	40.0
Second Road Infrastructure Program	298.0
Total	338.0

Sovereign Guaranteed Operations (as of December 03, 2012)
(In millions of U.S. dollars)

	Approved	Disbursed	Obligated	Available
Loans in execution	**1360.7**	**270.1**	**20.7**	**1069.8**
Cadaster and Registry Regularization	65.0	59.1	0.0	5.9
Sustainable Development of the Binational Watershed Rio Sixaola	9.2	0.9	0.0	8.3
Tourism Program in Protected Areas	19.0	0.0	0.0	19.0
First Electric Power Sector Development Program 2008-2011	250.0	131.6	20.7	97.7
First Road Infraestructure Program	300.0	66.6	0.0	233.4
Cantonal Road Network Program	60.0	12.0	0.0	48.0
Water and Sanitation Program	73.0	0.0	0.0	73.0
Violence Prevention and Social Inclusion Promotion Program	132.4	0.0	0.0	132.4
Innovation and Human Capital for Competitiveness Program	35.0	0.0	0.0	35.0
Power Sector Development Program 2012-16 (Reventazon Hydroelectric Project)	250.0	0.0	0.0	250.0
Education Infrastructure Construction and Equipment Program	167.0	0.0	0.0	167.0
Nonreimbursable Technical Cooperations	**15.5**	**6.5**	**0.5**	**8.6**
Total	**1376.2**	**276.6**	**21.2**	**1078.4**

STATISTICAL ISSUES

(As of December, 2014)

General: Data provision is broadly adequate for surveillance. The quality of macroeconomic data has continued to improve in recent years. This was confirmed by a reassessment of the Data Module Report on the Observance of Standards and Codes (ROSC) that was published in February 2010. Further statistical improvements are being pursued, including in the real, monetary, fiscal and balance of payments sectors. The Central Bank, the Ministry of Finance, and the National Institute of Statistics and Census make data available to the public through regular official publications on their websites (www.bccr.fi.cr, www.hacienda.go.cr, and www.inec.go.cr).

National accounts: National accounts are compiled generally in accordance with the System of National Accounts 1993 (SNA 1993). However, the reference year 1991 for the series at constant prices is outdated, an issue of significant recent importance for estimating the effect of the Intel withdrawal on estimates of real GDP. Estimation of rentals for owner occupied dwellings should be improved. Accounting depreciation is used instead of estimating consumption of fixed capital. Double deflation method is not applied. Changes in inventories are obtained as residuals and the Chow Lin (without indicator) method is applied for benchmarking quarterly value added of activities, comprising a third of GDP. Non-observed/informal activities are not properly covered. The Central Bank is currently in the process of changing the base year to 2012 and implementing the recommendations of the System of National Accounts 2008 (2008 SNA) that are relevant for the Costa Rican economy. The project is scheduled for completion by December, 2015.

Price statistics: The compilation of the consumer price index (CPI), in general, employs concepts and definitions from the 1993 SNA and the international CPI manual. However, the CPI lacks a market basket component to measure the cost of owner-occupied housing. Also, the index only covers urban households located in greater San Jose, which comprise approximately 46 percent of the total population and 72 percent of the urban population of Costa Rica. Individual price index data are not generally verified against similar data from other databases such as the producer price index (PPI) and agricultural price indices. Nevertheless, atypical movements in the data are investigated and corrected when necessary.

Except for being compiled only by product aggregations and not by economic activity as well, the PPI is compiled based on concepts and definitions from the 1993 SNA and the international PPI Manual. However, the weights, the establishment sample, and the product sample for the PPI that were introduced in 2000 are based on 1997 sales data. Therefore, the index needs updating. A comprehensive assessment of the source data is being carried out, and this is guiding the production of new source data to update the PPI and the national accounts. The export and import and import price indices as well as the PPI are currently being updated.

Government finance statistics: The concepts and definitions used in compiling GFS generally follow the guidelines of the GFSM 1986. However, financing data and government debt, which use national concepts that combine instruments and holders, are not in accordance with international standards. A migration path to the GFSM 2001 has been adopted in the context of the GFS harmonization project for Central America, Panama, and the Dominican Republic. Monthly fiscal statistics are only compiled and disseminated for budgetary central government, while annual statistics are compiled and disseminated for the entire public sector and its subsectors. The place of issue (Costa Rica or abroad) criterion is followed to classify domestic and foreign debt, instead of the internationally recommended residency criterion. Fiscal data discrepancies among national compilers on particular items are not regularly reconciled, although large fluctuations or discrepancies are investigated. Fiscal statistics are not regularly reconciled with monetary statistics, or other macroeconomic statistics.

Monetary Statistics: Costa Rica's monetary statistics are broadly in line with the methodology of the MFSM. Classification/sectorization follows the MFSM with some exceptions. The social security system accounts are not presented within the central government, but aggregated with other public sector accounts. Some financial assets and liabilities are not disaggregated by economic sector. Accrued interest is not classified together with its underlying instrument.

Balance of Payments: The balance of payments statistics broadly follow the concepts and definitions in the BPM5. While generally adequate and derived from sound collection programs, source data are incomplete to compile some services in the current account, financial transactions of the nonfinancial private sector, and remuneration of employees. Foreign direct investment transactions and positions are valued on a cash basis instead of the recommended accrual basis. Services are recorded at the time the service is provided. While other income transactions are recorded on an accrual basis, interest on public external debt is recorded on the due date; no adjustment is made to convert interest to accrued values. Transfer prices in some cases are not converted to market prices.

Data Standards and Quality: Costa Rica is in observance with the Special Data Dissemination Standards (SDDS). Data Module Report on the Observance of Standards and Codes (ROSC) was published in February 2010.

Costa Rica: Table of Common Indicators Required for Surveillance

(As of December 1, 2014)

	Date of latest observation	Date received	Frequency of Data[5]	Frequency of Reporting[5]	Frequency of Publication	Memo Items:	
						Data Quality – Methodological soundness[6]	Data Quality – Accuracy and reliability[7]
Exchange Rates	Dec 14	Dec 14	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	Dec 14	Dec 14	D	D	D		
Reserve/Base Money	Dec 14	Dec 14	D	D	D	O, LO, LO, LO	O, O, O, LO, O
Broad Money	Nov 14	Nov 14	M	M	M		
Central Bank Balance Sheet	Nov 14	Nov 14	M	M	M		
Consolidated Balance Sheet of the Banking System	Oct 14	Dec 14	M	M	M		
Interest Rates[2]	Dec 14	Dec 14	D	D	D		
Consumer Price Index	Oct 14	Dec 14	M	M	M	O, LO, O, O	LO, O, LO, LO,O
Revenue, Expenditure, Balance, and Composition of Financing[3] – Central Government	Oct 14	Dec 14	M	M	M	LO, LNO, LO, LO	LO, O, O, LO, O
Stocks of Central Government and Central Government-Guaranteed Debt[4]	Oct 14	Dec 14	M	M	M		
External Current Account Balance	Jun 14	Oct 14	Q	Q	Q	O, LO, O, LO	LO, O, LO, O, LNO
Exports and Imports of Goods and Services	Jun 14	Oct 14	Q	Q	Q		
GDP/GNP	Jun 14	Oct 14	Q	Q	Q	O, LO, LNO, O	LO, O, LNO, O, LO
Gross External Debt	Jun 14	Oct 14	Q	Q	Q		
International Investment Position	Jun 14	Oct 14	Q	Q	Q		

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[2] Both market-based and officially-determined, including discounts rates, money market rates, rates on treasury bills, notes, and bonds.
[3] Foreign, domestic bank, and domestic nonbank financing.
[4] Including currency and maturity composition.
[5] Daily (D); weekly (W); monthly (M); quarterly (Q); annually (A); irregular (I); and not available (NA).
[6] Reflects the assessment provided in the data ROSC, published in February, 2010 and based on the findings of the mission that took place in April, 2012, for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O); largely observed (LO); largely not observed (LNO); not observed (NO); and not available (NA).
[7] Same as footnote 7, except referring to international standards concerning source data, assessment of source data, statistical techniques, assessment and validation of intermediate data and statistical outputs, and revision studies.

Statement by the Staff Representative on Costa Rica
Executive Board Meeting
January 30, 2014

1. **This statement provides additional information that has become available since the staff report was issued.** It does not alter the thrust of the staff appraisal.

2. **Headline economic indicators remain broadly in line with the baseline scenario in the staff report.**

- Economic activity slowed down in late 2014, especially in the free trade zone—reflecting faster than expected winding-down of operations at the Intel assembly plant—and in the agriculture sector owing to weather factors. As a result, GDP growth for 2014 as a whole is now estimated at 3.5 percent, marginally lower than the 3.6 percent in the staff report. On the other hand, GDP in 2015 is now projected to expand somewhat faster (3.7 percent) than in the staff report reflecting both lower international oil prices and higher U.S. growth projections.[1]

- End-2014 inflation was lower than projected—5.1 versus 5.6 percent—mainly the effect of lower oil prices. Second round effects from lower oil prices should bring inflation closer to the center of the 3–5 percent target band earlier than expected in the staff report. End-2015 inflation is currently anticipated at 4.4 percent (versus 4.5 percent), with significant potential for further downward revisions

- The decline in international reserves over 2014 was lower than anticipated—about US$0.1 bn, versus expected US$0.5 bn—as the central bank stepped up FX purchases in the latter part of the year in response to stronger demand for colones. The exchange rate has remained stable at around 540 colones per dollar. The current account deficit for 2015 is now expected to be significantly lower than in the staff report after recent downward revisions in international oil price projections. However, staff's assessment that the external position is adequate remains unchanged.

3. **The authorities have publicly reiterated their commitment to fiscal adjustment in line with Fund advice.** A VAT law aimed at broadening the tax base to include the services sector and at gradually raising the tax rate from 13 to 15 percent has been drafted by the Ministry of Finance and is expected to be submitted to Congress shortly, together with the reform of the income tax law. The minister of finance has also publicly committed to other adjustment measures, including base public salary increases below inflation and cuts in transfers.

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[1] The WEO oil price forecast has been revised from US$73.4 per barrel to US$56.7 per barrel for 2015.

Table 1. Costa Rica: Selected Social and Economic Indicators, Baseline Scenario (Partial Adjustment) 1/

Population (2011, millions)	4.7	Human Development Index Rank (2011)	70 (out of 187)
Per capita GDP (2013, U.S. dollars)	10,558	Life expectancy (2009, years)	79.1
Unemployment (2011, percent of labor force)	7.7	Literacy rate (2009, percent of people ages > 15)	96.0
Poverty (2010, percent of population)	24.2	Ratio of girls to boys in primary and secondary education (2010, percent)	102.0
Income share held by highest 10 percent of households	39.4		
Income share held by lowest 10 percent of households	1.7	Gini coefficient (2009)	51.0

					Estim.	Proj.
	2010	2011	2012	2013	2014	2015
	(Annual percentage change, unless otherwise indicated)					
Output and Prices						
Real GDP growth	5.0	4.5	5.2	3.5	3.5	3.7
Output gap (percent of potential GDP)	-1.0	-0.3	0.6	0.0	-0.5	-0.7
GDP deflator	8.0	4.5	4.1	5.0	5.4	5.7
Consumer prices (end of period)	5.8	4.7	4.6	3.7	5.1	4.4
Money and Credit						
Monetary base	11.2	11.6	16.9	10.2	9.3	11.2
Broad money	-0.2	5.5	10.7	7.7	14.1	9.4
Credit to private sector	4.4	13.7	13.4	12.2	13.9	11.8
Monetary policy rate (percent; end of period)	…	5.0	5.0	4.0	…	…
	(In percent of GDP, unless otherwise indicated)					
Savings and Investment						
Gross domestic investment	20.6	21.9	21.7	21.3	21.0	19.6
Gross domestic savings	17.1	16.4	16.4	16.4	16.2	16.2
External Sector						
Current account balance	-3.5	-5.4	-5.3	-4.9	-4.8	-3.4
Of which: Trade balance	-9.5	-12.5	-11.9	-11.3	-11.5	-10.1
Financial and capital account balance	5.5	6.3	9.7	6.5	4.5	4.0
Of which: Foreign direct investment	4.0	5.1	4.2	4.9	4.3	4.1
Change in net international reserves (increase -)	-561	-132	-2,110	-461	119	-345
Net international reserves (millions of U.S. dollars)	4,627	4,756	6,857	7,331	7,211	7,556
Public Finances						
Central government primary balance	-3.0	-1.9	-2.3	-2.8	-3.1	-2.6
Central government overall balance	-5.4	-4.3	-4.6	-5.6	-6.2	-6.1
Central government debt	29.1	30.6	35.1	36.0	39.4	42.3
Consolidated public sector overall balance 2/	-5.4	-4.3	-4.6	-5.4	-6.4	-6.5
Consolidated public sector debt 3/	30.5	32.9	38.5	41.9	45.5	47.6
Of which: External public debt	7.1	6.4	7.5	8.9	11.0	12.7
Memorandum Item:						
GDP (millions of U.S. dollars)	36,298	41,237	45,375	49,621	49,610	54,363

Sources: Central Bank of Costa Rica, Ministry of Finance, and Fund staff estimates.

1/ Includes expenditure cuts equivalent to 0.3 percent of GDP, other cuts in transfers, a partial hiring freeze, broadening of the VAT base from the second half of 2015, a move towards global income tax, miscellaneous cuts in exemptions, and moderate gains from improvements in tax evasion.

2/ The consolidated public sector balance comprises the central government, decentralized government entities, public enterprises, and the central bank, but excludes the Instituto Costarricense de Electricidad (ICE).

3/ The consolidated public debt nets out central government and central bank debt held by the Caja Costarricense del Seguro Social (social security agency) and other entities of the nonfinancial public sector.

INTERNATIONAL MONETARY FUND
COMMUNICATIONS DEPARTMENT

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International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2014 Article IV Consultation with Costa Rica

January 30, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Costa Rica.

Costa Rica bounced back quickly from the 2008–09 global crisis, but growth momentum is now slowing and macro vulnerabilities, mainly from the weak fiscal position, are rising. After falling modestly in 2009, real GDP surged in 2010–12. Since then, however, growth has moderated below potential, with the latter also on a declining trend. The counter-cyclical budgetary stimulus imparted in 2009 pushed the deficit above 5 percent of GDP in 2010 (mainly through a rise in wages and transfers). The deficit has been creeping up further since then, placing the public-debt-to-GDP ratio on an unsustainable upward trajectory, which is fast approaching levels shown to increase risks of disorderly adjustment for emerging economies. A fairly inflexible exchange rate has contributed to vulnerabilities associated with dollarization in the financial sector.

The outlook for 2015 and beyond remains subdued amid deteriorating fundamentals. Growth in 2015 is expected to stay virtually unchanged, as the positive influence of U.S. recovery offsets the negative impact of a gradual Intel withdrawal. The output gap is projected to widen through 2016, then mostly closing over the medium term, with growth also converging to potential. The baseline scenario contemplates fiscal consolidation of 2.2percent of GDP over the medium term. In this case, the central government fiscal deficit would stay at about 5.75 percent of GDP, and the public debt ratio would approach 51 percent of GDP by 2019. Thanks to continued prudent monetary policy, inflation is projected to hover around 4 percent after returning within the Central Bank's announced band in early 2015, while the current account deficit rises to 5.25percent of GDP by 2019.

Risks to the outlook are tilted to the downside. Concerning external factors, in the case of faster U.S. monetary policy normalization, slightly upside risks prevail, with a positive impact of

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

higher U.S. growth more than offsetting the negative influence of tighter global financial conditions in the short run. However, extreme bouts of market volatility could inflict serious damage, especially given Costa Rica's weak fiscal position, as interest rates may rise abruptly. On the other hand, further sustained declines in energy prices could have a modest positive effect on Costa Rica. On the domestic side, the persistence of a large fiscal deficit and the ensuing rise in the public debt ratio could render the economy vulnerable to sudden changes in financial market conditions.

Executive Board Assessment

While commending Costa Rica's resilience in the aftermath of the global financial crisis, Executive Directors called for reinvigorated efforts to preserve macroeconomic stability in the wake of waning growth and rising unemployment and vulnerabilities. They recommended an ambitious but phased budget consolidation to arrest the deterioration in the fiscal accounts and put the public debt on a sustainable trajectory, along with a strengthening of the monetary policy framework and structural reforms to boost competitiveness and inclusive growth.

Directors welcomed the authorities' intention to implement a total fiscal adjustment of about 4 percent of GDP, with a front-loaded adjustment in 2015 followed by more incremental steps in subsequent years. Noting Costa Rica's low revenue effort relative to peer countries, they supported the emphasis on boosting revenue mobilization through a mix of administrative and policy reforms—including broadening the tax base, and raising the VAT rate and marginal rates on higher-income brackets. Directors also encouraged efforts to contain the growth of current outlays, particularly the wage bill and transfers, thus creating space for much-needed infrastructure spending. They looked forward to Parliamentary approval of outstanding legislative reforms and encouraged consensus building for a comprehensive package of measures to underpin deficit reduction. Over the longer run, measures are also needed to address the social security actuarial deficit.

Directors considered the current monetary policy stance to be appropriate, while calling on the Banco Central de Costa Rica (BCCR) to stand ready to increase its policy rate should inflationary pressure persist. They recommended strengthening the monetary policy framework, including further steps towards inflation targeting and enhanced exchange rate flexibility. In this regard, most Directors supported the elimination of the exchange rate band. Directors also recommended the development of tools to underpin greater exchange rate flexibility, including hedging instruments.

Directors encouraged implementation of pending FSAP recommendations, to help strengthen financial sector supervision and resilience. They advised a gradual move towards Basel III standards, and strengthening cross-border supervision. Priority should also be given to empowering the Financial Institutions Superintendence to conduct consolidated and transnational supervision, providing adequate protection to supervisors, and enhancing bank resolution procedures.

Directors called for continued progress in structural reforms to boost productivity, enhance external competitiveness, and foster long-run inclusive growth. Efforts are needed to streamline the regulatory environment, increase private sector participation in the energy sector, alleviate infrastructure bottlenecks, and promote capital market development. Directors also recommended ameliorating the efficiency of education spending, with a view to increasing women's labor force participation, stimulating productivity, and reducing inequality in the long term.

Costa Rica: Selected Social and Economic Indicators, Baseline Scenario (Partial Adjustment) 1/

Population (2011, millions)		Human Development Index Rank (2011)	70 (out of 187)
Per capita GDP (2013, U.S. dollars)		Life expectancy (2009, years)	79.1
Unemployment (2011, percent of labor force)		Literacy rate (2009, percent of people ages > 15)	96.0
Poverty (2010, percent of population)		Ratio of girls to boys in primary and	102.0
Income share held by highest 10 percent of households		secondary education (2010, percent)	
Income share held by lowest 10 percent of households		Gini coefficient (2009)	51.0

					Proj.	Proj.
	2010	2011	2012	2013	2014	2015
	(Annual percentage change, unless otherwise indicated)					
Output and Prices						
Real GDP growth	5.0	4.5	5.2	3.5	3.6	3.4
Output gap (percent of potential GDP)	-1.0	-0.3	0.6	0.0	-0.4	-0.9
GDP deflator	8.0	4.5	4.1	5.0	5.5	5.5
Consumer prices (end of period)	5.8	4.7	4.6	3.7	5.6	4.5
Money and Credit						
Monetary base	11.2	11.6	16.9	10.2	9.3	11.0
Broad money	-0.2	5.5	10.7	7.7	12.8	9.2
Credit to private sector	4.4	13.7	13.4	12.2	14.9	11.2
Monetary policy rate (percent; end of period)	…	5.0	5.0	4.0	…	…
	(In percent of GDP, unless otherwise indicated)					
Savings and Investment						
Gross domestic investment	20.6	21.9	21.7	21.3	21.1	20.2
Gross domestic savings	17.1	16.4	16.4	16.4	16.0	15.6
External Sector						
Current account balance	-3.5	-5.4	-5.3	-4.9	-5.0	-4.7
Of which: Trade balance	-9.5	-12.5	-11.9	-11.3	-11.6	-11.4
Financial and capital account balance	5.5	6.3	9.7	6.5	4.1	5.3
Of which: Foreign direct investment	4.0	5.1	4.2	4.9	4.2	4.0
Change in net international reserves (increase -)	-561	-132	-2,110	-461	466	-345
Net international reserves (millions of U.S. dollars)	4,627	4,756	6,857	7,331	6,865	7,210
Public Finances						
Central government primary balance	-3.0	-1.9	-2.3	-2.8	-3.1	-2.5
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Consolidated public sector debt 3/	30.5	32.9	38.5	41.9	44.5	46.6
Of which: External public debt	7.1	6.4	7.5	8.9	11.0	12.8
Memorandum Item:						
GDP (millions of U.S. dollars)	36,298	41,237	45,375	49,621	50,213	54,053

Sources: Central Bank of Costa Rica, Ministry of Finance, and Fund staff estimates.

1/ Includes expenditure cuts equivalent to 0.3 percent of GDP, other cuts in transfers, a partial hiring freeze, broadening of the VAT base from the second half of 2015, a move towards global income tax, miscellaneous cuts in exemptions, and moderate gains from improvements in tax evasion.

2/ The consolidated public sector balance comprises the central government, decentralized government entities, public enterprises, and the central bank, but excludes the Instituto Costarricense de Electricidad (ICE).

3/ The consolidated public debt nets out central government and central bank debt held by the Caja Costarricense del Seguro Social (social security agency) and other entities of the nonfinancial public sector.

Statement by Mr. Jimenez Latorre and Mr. Pacheco on Costa Rica
Executive Board Meeting
January 27, 2015

The Costa Rican authorities thank staff for a very constructive dialogue during the Article IV consultation and concur with the report´s main findings and recommendations.

A new government took office last May after a second round presidential election, marking a first time win for the Citizens' Action Party. The government plans to boost economic growth and reduce unemployment by addressing infrastructure bottlenecks, supporting SME, fighting red tape and other reforms. The authorities´ agenda also contemplates reduction of poverty and income inequality, both high for the country's standards. Since its inception the government has been dealing with a high fiscal deficit and has put in place many measures to tackle it.

Recent Developments

Thanks to the authorities´ efforts the fiscal deficit, previously projected at 6.3 percent of GDP, closed 2014 at 5.6 percent. Upon enactment of a decree to freeze 85 percent of vacancies in July 2014 and other measures, the government has managed to reduce the growth of spending from 14 percent in 2013 to 9.3 percent in 2014. Moreover, as capital spending grew at 16 percent, the burden of the adjustment fell on current spending that grew at 8.7[1] percent compare with 13.4 percent in 2013.

As stated in the report, authorities and staff concur on the size, pace and composition of the fiscal adjustment. The Finance Minister has presented a 3.8 percent of GDP fiscal consolidation plan that includes reform of current taxes, rates[2] and spending measures, as well as a freeze on real salaries.

[1] This is the lowest current spending growth rate in 6 years.

[2] Gradually from 2016 onwards.

The macroeconomic context is positive. Inflation, at 5.1 percent, closed near its target range even after a considerable depreciation during the first semester. Growth would be only partially affected by the proposed fiscal consolidation and is expected to return to potential in the medium term. Stronger growth in the U.S., Cost Rica's main trade partner, and prolonged lower oil prices would improve growth prospects.

Despite the closure of Intel manufacturing plant, external accounts are healthy and FDI remains high. Reserves are within IMF adequacy metric.

Fiscal Policy

Revenues

Tax avoidance and tax evasion accounted for 7.75 percent of GDP[3] while exemptions account for 6 percent of GDP. Together they exceed the current tax revenue. Since May 2014, the government has put in place a number of administrative initiatives to fight tax evasion and tax avoidance, one of the most relevant being the obligation by every firm to withhold 2 percent of each sale as a corporate income tax presumption[4]. The electronic invoice is expected to become mandatory this year and will join the set of tools to fight evasion.

These measures are being complemented by two law initiatives already under congress review, the anti-tax evasion law and the anti-smuggling law[5]. While the former strengthens tax controls and enforces collection, the latter fights smuggling by overhauling the legal framework and increasing sanctions and penalties.

The authorities are aware that all these measures account for a small portion of the needed fiscal consolidation. The broad part of the adjustment is expected to come from the reform to the VAT and income tax. In the current VAT setup, services, the most dynamic sector of the economy, are exempted. The reform will include them into the taxable base exempting basic goods[6], education and health services.

In the case of income tax, the government is working to change the current schedular system for a global determination of the tax liability. At the time of the Article IV mission in November, the VAT reform and the income tax reform were to be sent for Congress approval

[3] 2012 estimations.

[4] This measure was initially appealed in the administrative court but it has been recently affirmed.

[5] These law initiatives were sent to congress in July and November 2014 respectively.

[6] In the case of basic goods the authorities plan to eliminate the exoneration as soon as the subsidy system works. They will subsidize the first 3 deciles.

in December 2014 and February 2015, respectively. However, to compensate some of the regressive effects of the VAT reform some members of Congress opted to approve both reforms together. This makes March the new date to present both initiatives.

During the first semester of 2015, the authorities plan to present another exemptions related reform. It will streamline the current setup, incorporate sanctions and regulate the creation of exemptions, for instance by setting an expiration date.

Expenditure and Financing

On the expenditure side, the government cut the 2015 budget in 0.4 percent of GDP and will maintain the partial hiring freeze. Salaries are going to be frozen in real terms. Those are tangible actions that will impact the 2015 expenditure invoice. A number of law initiatives will be also sent to congress during 2015 and will have a permanent effect on the fiscal accounts, such as a cap on pensions paid out of the budget and a strengthening of the system, a cap on high salaries and the public employment law.

While fiscal measures begin to yield, the government will use external financing in order to avoid crowding out domestic market and pressure interest rates. It is expected to place one billion dollars in international markets during 2015 and contingent credit lines with World Bank and IADB for 2016 are being negotiated.

Monetary and Exchange Rate Policy

Inflation ended 2014 close to the target range despite an important depreciation of the Colon during the first semester. The authorities agree with the importance of allowing for more XR flexibility and concur that the elimination of the band could be the next step. However, we would like to provide more details regarding the FX market in Costa Rica and the Central Bank´s (BCCR) rational behind maintaining veiled some aspects of the intervention rule. As the report states, the main objective of the rules is to avoid excessive short-term fluctuations without interfering with the medium-term trends. BCCR intervention is framed into a robust set of regulations approved by the Board of Directors and a special committee[7]. Daily when market closes BCCR publishes the balance negotiated in the market as well as the amount of the intervention, if any. The intervention trigger, the amounts allowed and other elements were approved by the Board based on technical advice. BCCR´s staff is in charge of the execution with no discretion allowed and under the constant scrutiny of the audit department. The BCCR's Board of directors has decided to maintain specific intervention criteria private since Costa Rica FX market is small and dominated by few banks, thus disclosure of those specific details would facilitate speculation against small agents. The system works in a very transparent way.

[7] The Financial Stability Committee is formed by the central bank´s president, manager and relevant directors.

Financial system

The financial system is sound and as the report recognizes "…only a few banks are not yet in full compliance with Basel III standards…" The pending reforms have been delayed by an overwhelming fiscal and trade agenda in congress over the last years. Notwithstanding, the authorities have requested the IMF for TA on conglomerate supervision in order to expedite the reform process.

Structural reforms

We concur competitiveness needs to be improved. The country ranks 51th (third in Latin-American region) in the Global Competitiveness Index 2014-2015. Infrastructure bottlenecks, excessive regulatory environment, ease of doing business and concerns on the efficiency and efficacy of education spending are among the diagnosed problems being addressed by the authorities. The government has secured more than USD 1.5 billion coming from multilateral and bilateral sources to overhaul road infrastructure and a comprehensive strategy has been put into place to launch execution. The environmental agency has just granted final approval to begin the construction of a USD 1 billion mega-port in the Caribbean coast by APM Terminals[8].

With regard to electricity tariffs, they are relatively well-positioned against different benchmarks, more so taking into account that 80 percent of the electricity comes from renewable sources.

The recent withdrawal of Intel, more than signaling competitiveness problems in Costa Rica, was the result of changes in the personal computers global market. Due to this fact the company is closing or downsizing microprocessor chip manufacturing lines, also in other markets. But it is not exiting the country; an important division of R&D is going to be upgraded.

Thanks to its well- educated work force, the country continues attracting foreign corporations from the technology and services sectors. In fact, FDI was in line with the authorities' projection, totaling USD 2.2 billion in 2014. The medical sector, mainly manufacturing technological devices, is booming with 63 firms already operating and new investments in the pipeline. This technology industry is less sensitive to economic downturns than other sectors.

With regard to trade integration, Costa Rica began the process of joining the Pacific Alliance[9] on February 10, 2014. This bloc not only will boost trade among members but also may serve

[8] APM Terminals is part of the MAERSK Group.

[9] The founding members are Chile, Colombia, Peru and Mexico. If counted as a single country this group of

as a platform toward the Asia-Pacific region. The authorities are also fully committed with the action plan to become a member of OECD.

nations would be the sixth largest economy in the world