Costa Rica—Concluding Statement of the 2016 Article IV mission

A Concluding Statement describes the preliminary findings of IMF staff at the end of an official staff visit (or 'mission'), in most cases to a member country. Missions are undertaken as part of regular (usually annual) consultations under Article IV of the IMF's Articles of Agreement, in the context of a request to use IMF resources (borrow from the IMF), as part of discussions of staff monitored programs, or as part of other staff monitoring of economic developments.

The authorities have consented to the publication of this statement. The views expressed in this statement are those of the IMF staff and do not necessarily represent the views of the IMF's Executive Board. Based on the preliminary findings of this mission, staff will prepare a report that, subject to management approval, will be presented to the IMF Executive Board for discussion and decision.

This note summarizes preliminary findings and recommendations of the IMF mission that visited Costa Rica during February 23 – March 7 to conduct the 2016 Article IV consultation. The mission is grateful for the high quality and openness of the discussions and for the cooperation and hospitality of the Costa Rican authorities and private sector.

I. Recent Developments

1. **Growth picked up but stayed below potential in 2015, further widening the negative output gap, while inflation declined sharply, turning negative in the second semester.**

- Activity rose by 3¾ percent in 2015, ¾ percent higher than in 2014, as domestic demand was boosted by the improved terms of trade (from lower import commodity prices) and higher investment, more than offsetting the impact of the withdrawal of Intel's manufacturing and adverse weather conditions for the main agricultural export crops. Both private and public investment recovered significantly, the latter supported by construction of a new port terminal and public water systems. A third year of growth below the estimated trend rate of 4 percent, however, lifted the output gap about 1 percent below potential GDP (that is, the actual GDP was 1 percent below the level that the economy could sustain without generating inflationary pressures).

- Having ended 2014 at over 5 percent, inflation dove into negative territory in the second half of 2015 following the sharp decline in imported oil prices and the widening output gap. Inflation is expected to remain below the target range until the end of 2016.

2. **The colón was stable and reserve accumulation resumed strongly in 2015.** After the early-2014 bout of volatility amid growing expectations of U.S. monetary policy normalization, the colón has been stable. Stability has set in despite the early-2015 removal of the exchange rate band in line with Fund advice to strengthen the inflation-targeting framework. A lower current account deficit—4 percent of GDP in 2015, driven by lower oil prices—as well as the $1 bn Eurobond issuance, resilient FDI flows, and increased net foreign bank liabilities led to a major increase in reserves, bringing them further above the IMF adequacy metric. Nonetheless, in late 2015 and early 2016, reserves declined somewhat, as the private and public sectors, including

financial intermediaries, increased their demand for FX and the central bank accommodated it resulting in a stable exchange rate. The external position is estimated to be broadly in equilibrium, with no significant over- or undervaluation of the real exchange rate.

3. **The fiscal deficit remains elevated and the public debt-to-GDP ratio continues to increase.** Despite buoyant revenues, not least stemming from efforts by the authorities to improve tax administration, rising transfers to decentralized government entities kept the primary deficit at around 3 percent of GDP in 2015. With the interest bill broadly stable, aided by lower domestic financing costs, the overall central government deficit remained around 6 percent of GDP in 2014–15 and debt exceeded 42 percent of GDP.

4. **The authorities responded to the decline in inflation and the widening negative output gap by cutting substantially the monetary policy rate.** It has been reduced by 350 basis points to 1¾ percent. Real lending rates, however, haveincreased since mid-2014, as the fall in inflation expectations more than offset the so far limited transmission of the large policy rate cuts to lending rates. In addition, the REER has appreciated and credit growth has moderated. Thus, overall, financial conditions have tightened but this is likely to change as the recent policy rates cuts complete, or at least extend, their pass-through. On the other hand, high dollarization and anticipation of forthcoming upward pressures on domestic interest rates from large budgetary financing needs have already slowed down, and may also ultimately constrain, the transmission process.

5. **The financial system appears sound, though dollarization continues to be a source of vulnerability**. Capital is well above regulatory requirements and liquidity indicators are robust. While non-performing loans have remained low, profitability remains below that of regional peers. Reliance on foreign funding continued, but rollover risks appear manageable. Credit is expanding at a rate consistent with healthy financial deepening and there is little evidence of financial sector risk buildup. However, credit growth has again tilted toward credit in FX, including to sectors without natural FX hedges, in the recent period of exchange rate stability.

II. OUTLOOK AND RISKS

6. **GDP is projected to expand faster and inflation to revert to the BCCR target range in 2016, with activity returning to potential over the medium-term.** Growth is expected to exceed slightly its potential of 4 percent in 2016, supported by four factors: (i) continued U.S. recovery, (ii) dissipation of the one-off effects of Intel withdrawal, (iii) domestic monetary stimulus, and (iv) sustained real credit expansion. The output gap is anticipated to shrink somewhat in 2016, and then mostly close over the medium term. Inflation is forecasted to return to the target range by end-2016 and hover around its center in the medium-term. The current account deficit will widen marginally to 4¼ percent of GDP over the medium-term amid gradual recovery of international commodity prices.

7. **External and domestic risks weigh on the outlook.** The mission views external risk related to the normalization of U.S. monetary policy as moderately on the upside. Faster U.S.

growth would have a larger positive impact given strong trade ties than the negative impact of tighter global financial conditions. However, extreme bouts of market volatility could inflict serious damage. Additional downside risks include deeper-than-expected slowdowns in advanced and emerging markets, and currency depreciation, which, if substantial, could trigger an increase in NPLs given high credit dollarization of the banking system. On the domestic front, persistently large fiscal deficits and rising public debt make the economy vulnerable to sudden changes in financial market conditions. In addition, large government gross financing requirements could lift domestic interest rates, weighing on private investment and growth, and limiting the transmission of the monetary stimulus to lending rates.

III. Policy Discussions

8. **The key challenge is to reduce longer-term economic vulnerabilities while maintaining a policy mix that is appropriate for current cyclical conditions.** It will be critical to start restoring long-term fiscal sustainability as soon as possible to buttress macroeconomic stability. The monetary policy framework and financial system supervision and regulation should also be strengthened. Additionally, reforms are needed to boost potential and inclusive growth.

A. Near-term Policy Mix

9. **Current economic conditions call for a policy mix characterized by the start of fiscal tightening and continuation of a supportive monetary policy.** The authorities appropriately intend to begin gradual fiscal adjustment this year. Measures submitted to Congress could result in a deficit reduction of about ¾ percent of GDP in 2016 relative to overall and primary deficits of 6½ and 3¼ percent of GDP respectively that would prevail in the absence of policy action. With output below potential and zero inflation, a continued accommodative monetary policy stance consistent with bringing inflation back to the target range will help offset the short-term impact of the tighter budgetary stance. At the same time, if signs emerge that price pressures threaten to drive inflation above the mid-point of the new BCCR target range and jeopardize the still-very-recent anchoring of inflation expectations, and taking into account also the lags in monetary policy transmission, the BCCR ought to start reversing the easing cycle.. This consideration is reinforced by the prospective upward normalization of global interest rates, which could induce depreciation pressures.

B. Safeguarding Fiscal Sustainability

10. **Current fiscal trends remain unsustainable in the long term.** Without policy action, the central government deficit would exceed 9 percent of GDP and debt rise to almost 70 percent by 2021. The mission confirms its previous estimate that total fiscal adjustment of 3¾ percent of GDP is needed over the medium-term to stabilize the central government debt ratio at a safe level. Parametric adjustments will also be needed over a somewhat longer horizon to bring the extra-budgetary pension systems to actuarial equilibrium, including larger contributions, lower replacement rates, and higher retirement age.

11. **The pace of adjustment should strike a balance between lowering the sustainability gap and limiting the adverse impact on growth.** An appropriately front-loaded fiscal consolidation as planned by the authorities, with somewhat less than two-thirds of the total adjustment in 2016-17- and smaller corrections in subsequent years, would have only moderate output cost over the forecast period. Postponing the adjustment would not only result in larger future tightening needs to stabilize debt-to-GDP (for example, some 1 to 1½ percent of GDP additional adjustment in 2018), but also increase the risk of an abrupt shift in investor sentiment and, as a consequence, of a forced disorderly adjustment.

12. **In this connection, the mission welcomes the authorities' medium-term fiscal consolidation plan, accompanied by steps to contain long-term expenditure growth.**

- The government's strategy to strengthen public finances by about 2½ percent of GDP with tax-raising measures is appropriate, given Costa Rica's low revenue effort compared to other upper-middle-income countries. Furthermore, the authorities have already identified spending cuts through legislative changes and administrative measures that would yield the 1¼ percent of GDP also required to fully close the sustainability gap.

- The mission underscores that only an adjustment of the size identified by the mission and the authorities (3¾ percent of GDP) as needed to stabilize the public-debt-to-GDP ratio would be adequate from a macro-economic perspective. Indeed, a partial fiscal adjustment scenario—if tax reform proposals currently in Congress are watered down and efforts to contain spending are insufficient—would result in continued large fiscal deficits driven mainly by a mounting interest bill, and significant additional debt accumulation. This would further raise vulnerabilities and potentially erode the underpinnings of macroeconomic stability.

- On the contrary, full fiscal adjustment would yield a much more favorable outlook. This would require congressional approval of all submitted tax measures, coupled with a reduction in the growth of current spending —mostly transfers and public sector wages— to keep it throughout the medium term below the expansion of nominal GDP,. The tighter fiscal stance would allow for a more balanced macro policy mix, allowing a monetary policy stance less tight than that needed with only partial fiscal consolidation to maintain the new inflation target, thereby helping to close the output gap over the medium term. It would also help mitigate increases in market rates associated with the normalization of U.S. monetary policy and tend to reduce the current account deficit. Therefore, it is urgent to approve this year and in their entirety the fiscal adjustment proposals submitted by the government to Congress.

- It is important that the authorities show durable commitment to contain expenditures in the longer run, not least to facilitate political and social support for the adjustment package. In this regard, the mission welcomes legislative proposals currently under discussion to reform public employment conditions, thus preventing excessive automatic

increases in current outlays, and a fiscal rule aimed at the preservation of government debt sustainability. The mission stresses the need for adequate enforcement mechanisms to ensure that the new rule is effectively binding.

C. Upgrading the Monetary and Exchange Rate Policy Framework

13. **The mission commends the authorities for their achievements in lowering inflation and endorses their decision to further lower the target range.** The central bank has succeeded in preventing persistent deviations from the target range since 2009 and anchoring inflation expectations to the center of the 3-5 percent target range introduced in 2014. Based on this, the mission supports the central bank's decision to take advantage of the recent sharp decline in inflation to revise the target range to 2-4 percent, in line with average inflation of trading partners. At the same time, we emphasize the need for this move to be accompanied by fiscal consolidation to prevent the risk that an excessively tight monetary policy might be needed to contain inflation within the target range.

14. **Progress towards full-fledged inflation targeting should continue.** The removal of the exchange rate band in early 2015 was an important milestone in this direction. The mission nevertheless considers that some additional steps may be useful. To begin with, the authorities could gradually allow greater exchange rate flexibility in both directions. Currently, the authorities continue to manage the colón to avert excessive volatility and counter unwarranted deviations from medium-term fundamentals, which is understandable in light of the large financial dollarization. However, we believe that a gradual, contained increase in the flexibility of the exchange rate, in line with the intended policies of the central bank, would enhance the role of the exchange rate as a shock absorber and make market participants more cognizant of two-way risks in exchange markets. The mission is also concerned that lack of publicity about the triggers of FX intervention may, under circumstances less favorable than those presently prevailing, undermine confidence in the inflation target as the undisputed anchor of monetary policy. The central bank should improve its communication about FX intervention, especially as its efforts to deepen the FX market take effect. In addition, the authorities should foster development of the secondary market for government securities with a larger local investor base to reinforce the effectiveness of monetary policy and enhance resilience to external financial shocks.

D. Financial Stability

15. **Private sector currency mismatches, high net foreign liabilities of banks, and growing household leverage pose key risks to financial stability.** Our stress test results, confirm the resilience of the banking system. However, three vulnerabilities need to be closely monitored. First, large dollarization of bank loans is a serious and intensifying concern. Notwithstanding the overall long FX position of the banking system, a large depreciation of the colón may impact asset quality, given substantial unhedged FX liabilities in the private sector, and weigh severely down on growth. Second, large bank borrowing abroad, incurred to fund the rapid FX growth to residents, raises rollover risks. Third, fast rising household leverage could

endanger asset quality. Moreover, though starting from a low level before the global crisis, continuing accumulation of government debt by banks could weaken their balance sheets through bond repricing as interest rates would increase in the absence of fiscal adjustment. This is especially true in a global environment where monetary conditions are likely to tighten over the medium term.

16. **The authorities are taking positive steps to alleviate these concerns.** Risk-weightings on FX loans to un-hedged borrowers were recently increased and reserve requirements were extended to medium- and long-term foreign bank borrowing. Furthermore, counter-cyclical provisioning and stricter provisioning on FX loans to un-hedged borrowers as well as higher risk-weightings for household mortgages are expected to be introduced this year. It is not possible yet to determine whether these measures will be sufficient to reduce significantly vulnerabilities. The mission recommends that further tightening of provisioning on FX bank lending and of reserve requirements on FX bank borrowing (the latter requiring Congressional action) should be considered, if there is no evidence of a reduction in the share of FX loans already this year. Additionally, the coverage of the credit bureau should be extended to loans to households granted by non-bank entities.

17. **The mission urges implementation of pending 2008 FSAP recommendations.** Key points include empowering the Superintendence of Financial Institutions to conduct consolidated supervision, providing legal protection to bank supervisors in line with international best practice, strengthening bank resolution procedures, and broadening the supervisory perimeter to non-bank financial institutions, all of which require new legislation. The mission supports recently enacted measures to advance towards full implementation of risk-based supervision.

18. **The mission calls for gradual adoption of Basel III standards and additional improvements in cross-country supervision**. In this respect, we welcome the recent enactment of the Basel III Liquidity Coverage Ratio, which will buttress the ability of the banking sector to absorb shocks. The regulatory and risk management frameworks would greatly benefit from introducing Basel III definitions of capital, a capital conservation buffer, and a leverage ratio. Our analysis shows that this could be accomplished without significant detrimental effects on growth. We also consider important enhancing transnational monitoring. Finally, significant gaps in the definition of financial group as well as narrow supervisory and enforcement perimeter remain as pending issues.

E. Structural Reforms

19. **Structural reforms are needed to boost potential growth and competitiveness.** Specifically**,** the mission counsels that private sector participation in the energy sector be increased and tariff-setting reviewed to help reduce the industrial cost of electricity. Moreover, infrastructure bottlenecks need to be addressed, and business regulations streamlined to help strengthen competitiveness and accelerate potential growth. We also stress that lifting the efficiency of social and education spending will protect vulnerable groups and improve program

outcomes without jeopardizing the budget. Concerning the financial sector, the mission recommends fostering capital market development, stepping up competition among banks, refining loan-provisioning rules to avoid high collateral requirements being used as a substitute for proper credit-risk analysis, and further ameliorating the judicial enforcement of secured and unsecured claims. These actions should permanently lower interest rate spreads and borrowing costs, thereby facilitating financial inclusion and deepening.

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

Population (2014, millions)	4.8	Human Development Index Rank (2013)	68 (out of 187)
Per capita GDP (2014, U.S. dollars)	10,425	Life expectancy (2013, years)	80.0
Unemployment (2014, percent of labor force)	9.7	Literacy rate (2014, percent of people ages > 15)	98.0
Poverty (2014, percent of population)	22.0	Ratio of girls to boys in primary and secondary	
Income share held by highest 10 percent of households	39.4	education (2013, percent)	103.0
Income share held by lowest 10 percent of households	1.7	Gini coefficient (2012)	48.6

			Est.		Proj.	
	2013	2014	2015	2016	2017	2018
	(Annual percentage change, unless otherwise indicated)					
Output and Prices						
Real GDP growth	1.8	3.0	3.7	4.2	4.3	4.4
Output gap (percent of potential GDP)	0.4	-0.8	-1.1	-0.9	-0.6	-0.3
GDP deflator	4.2	4.7	2.2	3.6	3.2	3.5
Consumer prices (end of period)	3.7	5.1	-0.8	3.0	3.0	3.0
Money and Credit						
Monetary base	10.2	10.4	9.2	9.8	9.1	9.1
Broad money	7.7	15.4	7.1	8.8	8.3	9.2
Credit to private sector	12.2	17.5	11.6	12.0	12.0	11.4
Monetary policy rate (percent; end of period)	3.8	5.3	2.3	...	...	...
	(In percent of GDP, unless otherwise indicated)					
Savings and Investment						
Gross domestic investment	18.8	19.6	19.1	19.1	19.4	19.3
Gross domestic savings	13.8	14.9	15.1	14.8	15.1	15.0
External Sector						
Current account balance	-5.0	-4.7	-4.0	-4.2	-4.3	-4.3
Of which: Trade balance	-11.3	-10.5	-10.2	-10.2	-10.4	-10.8
Financial and capital account balance	6.4	4.6	6.2	5.1	5.1	4.3
Of which: Foreign direct investment	4.8	4.0	4.1	4.3	4.3	4.3
Change in net international reserves (increase -)	-461	113	-622	-500	-500	0
Net international reserves (millions of U.S. dollars)	7,331	7,211	7,834	8,334	8,834	8,834
Public Finances						
Central government primary balance	-2.8	-3.1	-3.0	-2.4	-1.5	-1.2
Central government overall balance	-5.6	-6.0	-5.8	-5.8	-5.5	-5.5
Central government debt	36.0	39.3	42.4	45.0	47.3	49.3
Consolidated public sector overall balance 2/	-5.4	-5.6	-5.6	-5.9	-5.4	-5.3
Consolidated public sector debt 3/	42.0	43.2	45.8	47.6	49.1	50.2
Of which: External public debt	8.9	10.5	11.7	12.2	12.7	12.9
Memorandum Item:						
GDP (US$ billions)	49.6	49.6	52.9	57.0	60.9	65.2

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

1/ Includes cuts in transfers of about 0.3 percent of GDP, another 0.2 percent of GDP of expenditure cuts in a 2016 supplementary budget, broadening of the VAT base and higher taxes on sales of vehicles and real estate from the last quarter of 2016, increase in marginal income tax rates on higher-income brackets from 2017, as well as further amendments to the corporate income tax and moderate gains from improved tax administration.

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

Population (2014, millions)	4.8	Human Development Index Rank (2013)	68 (out of 187)
Per capita GDP (2014, U.S. dollars)	10,425	Life expectancy (2013, years)	80.0
Unemployment (2014, percent of labor force)	9.7	Literacy rate (2014, percent of people ages > 15)	98.0
Poverty (2014, percent of population)	22.0	Ratio of girls to boys in primary and secondary	
Income share held by highest 10 percent of households	39.4	education (2013, percent)	103.0
Income share held by lowest 10 percent of households	1.7	Gini coefficient (2012)	48.6

			Est.		Proj.	
	2013	2014	2015	2016	2017	2018
	(Annual percentage change, unless otherwise indicated)					
Output and Prices						
Real GDP growth	1.8	3.0	3.7	4.2	4.2	4.6
Output gap (percent of potential GDP)	0.4	-0.8	-1.1	-0.9	-0.7	-0.2
GDP deflator	4.2	4.7	2.2	3.6	3.1	4.2
Consumer prices (end of period)	3.7	5.1	-0.8	3.0	3.0	3.0
Money and Credit						
Monetary base	10.2	10.4	9.2	9.9	9.0	9.1
Broad money	7.7	15.4	7.1	8.9	8.2	9.2
Credit to private sector	12.2	17.5	11.6	12.4	12.9	12.9
Monetary policy rate (percent; end of period)	3.8	5.3	2.3	...	...	...
	(In percent of GDP, unless otherwise indicated)					
Savings and Investment						
Gross domestic investment	18.8	19.6	19.1	19.1	19.3	20.0
Gross domestic savings	13.8	14.9	15.1	14.8	15.1	15.9
External Sector						
Current account balance	-5.0	-4.7	-4.0	-4.2	-4.2	-4.1
Of which: Trade balance	-11.3	-10.5	-10.2	-10.2	-10.3	-10.5
Financial and capital account balance	6.4	4.6	6.2	5.1	5.0	4.1
Of which: Foreign direct investment	4.8	4.0	4.1	4.3	4.3	4.3
Change in net international reserves (increase -)	-461	113	-622	-500	-500	0
Net international reserves (millions of U.S. dollars)	7,331	7,211	7,834	8,334	8,834	8,834
Public Finances						
Central government primary balance	-2.8	-3.1	-3.0	-2.4	-0.9	0.0
Central government overall balance	-5.6	-6.0	-5.8	-5.7	-4.4	-3.6
Central government debt	36.0	39.3	42.4	44.9	46.1	46.0
Consolidated public sector overall balance 2/	-5.4	-5.6	-5.6	-5.8	-4.4	-3.6
Consolidated public sector debt 3/	42.0	43.2	45.8	47.5	48.0	47.1
Of which: External public debt	8.9	10.5	11.7	12.2	12.7	12.8
Memorandum Item:						
GDP (US$ billions)	49.6	49.6	52.9	57.0	60.8	65.6

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

1/ Includes measures as in the baseline partial adjustment scenario, as well as administratively-determined measures to contain growth in the wage bill, and increases in the VAT rate from 2017.

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 3. Costa Rica: Central Government Balance, Baseline Scenario (Partial Adjustment) 1/

			Est.	Projection					
	2013	2014	2015	2016	2017	2018	2019	2020	2021
	(In billions of colones)								
Revenue	**3,380**	**3,625**	**3,994**	**4,439**	**5,102**	**5,639**	**6,113**	**6,601**	**7,117**
Tax revenue	3,292	3,522	3,862	4,296	4,948	5,473	5,933	6,406	6,906
Nontax revenue 2/	87	103	132	143	154	166	180	195	210
Expenditure	**4,765**	**5,230**	**5,643**	**6,220**	**6,895**	**7,584**	**8,235**	**8,904**	**9,559**
Current noninterest	3,684	3,990	4,330	4,567	4,901	5,299	5,739	6,204	6,700
Wages	1,817	1,969	2,113	2,278	2,462	2,668	2,889	3,123	3,373
Goods and services	158	180	194	194	209	225	244	264	285
Transfers	1,708	1,842	2,023	2,095	2,230	2,406	2,605	2,816	3,041
Interest 3/	681	775	787	1,044	1,311	1,523	1,671	1,809	1,897
Capital	400	465	526	609	683	762	825	892	963
Primary balance	**-704**	**-830**	**-862**	**-736**	**-482**	**-421**	**-451**	**-494**	**-546**
Overall Balance	**-1,386**	**-1,604**	**-1,649**	**-1,781**	**-1,793**	**-1,945**	**-2,122**	**-2,304**	**-2,443**
Total Financing	1,386	1,604	1,652	1,781	1,793	1,945	2,122	2,304	2,443
External (net)	401	490	598	412	417	372	379	247	385
Domestic (net)	984	1,115	1,212	1,368	1,376	1,573	1,743	2,057	2,058
Central government debt	**8,932**	**10,484**	**11,984**	**13,752**	**15,562**	**17,533**	**19,689**	**21,859**	**24,278**
External	1,763	2,366	2,944	3,337	3,756	4,138	4,532	4,645	5,006
Domestic	7,169	8,118	9,040	10,415	11,806	13,395	15,158	17,215	19,272
	(In percent of GDP)								
Revenue	**13.6**	**13.6**	**14.1**	**14.5**	**15.5**	**15.9**	**15.9**	**15.9**	**15.8**
Tax revenue	13.3	13.2	13.7	14.1	15.0	15.4	15.4	15.4	15.4
Nontax revenue 2/	0.4	0.4	0.5	0.5	0.5	0.5	0.5	0.5	0.5
Expenditure	**19.2**	**19.6**	**20.0**	**20.4**	**21.0**	**21.3**	**21.4**	**21.4**	**21.3**
Current noninterest	14.9	14.9	15.3	14.9	14.9	14.9	14.9	14.9	14.9
Wages	7.3	7.4	7.5	7.5	7.5	7.5	7.5	7.5	7.5
Goods and services	0.6	0.7	0.7	0.6	0.6	0.6	0.6	0.6	0.6
Transfers	6.9	6.9	7.2	6.9	6.8	6.8	6.8	6.8	6.8
Interest 3/	2.7	2.9	2.8	3.4	4.0	4.3	4.3	4.3	4.2
Capital	1.6	1.7	1.9	2.0	2.1	2.1	2.1	2.1	2.1
Primary balance	**-2.8**	**-3.1**	**-3.0**	**-2.4**	**-1.5**	**-1.2**	**-1.2**	**-1.2**	**-1.2**
Overall Balance	**-5.6**	**-6.0**	**-5.8**	**-5.8**	**-5.5**	**-5.5**	**-5.5**	**-5.5**	**-5.4**
Total Financing	5.6	6.0	5.8	5.8	5.5	5.5	5.5	5.5	5.4
External (net)	1.6	1.8	2.1	1.3	1.3	1.0	1.0	0.6	0.9
Domestic (net)	4.0	4.2	4.3	4.5	4.2	4.4	4.5	4.9	4.6
Central government debt	**36.0**	**39.3**	**42.4**	**45.0**	**47.3**	**49.3**	**51.2**	**52.5**	**54.0**
External	7.1	8.9	10.4	10.9	11.4	11.6	11.8	11.2	11.1
Domestic	28.9	30.4	32.0	34.1	35.9	37.7	39.4	41.4	42.9
Memorandum items:									
Non-interest expenditure growth (percent)									
in nominal terms	12.0	9.1	9.0	6.6	7.9	8.5	8.3	8.1	8.0
in real terms	6.4	4.4	8.1	5.4	4.7	5.4	5.1	4.9	4.8
Nominal GDP	24,781	26,703	28,279	30,547	32,878	35,543	38,493	41,609	44,936
CPI Inflation (period average)	5.2	4.5	0.8	1.1	3.0	3.0	3.0	3.0	3.0

Sources: Ministry of Finance and Fund staff estimates.

1/ Includes cuts in transfers of about 0.3 percent of GDP, another 0.2 percent of GDP of expenditure cuts in a 2016 supplementary budget, broadening of the VAT base and higher taxes on sales of vehicles and real estate from the last quarter of 2016, increase in marginal income tax rates on higher-income brackets from 2017, as well as further amendments to the corporate income tax and moderate gains from improved tax administration.

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

			Est.	Projection					
	2013	2014	2015	2016	2017	2018	2019	2020	2021
	(In billions of colones)								
Revenue	**3,380**	**3,625**	**3,994**	**4,445**	**5,210**	**5,920**	**6,432**	**6,929**	**7,454**
Tax revenue	3,292	3,522	3,862	4,301	5,056	5,753	6,251	6,733	7,244
Nontax revenue 2/	87	103	132	143	154	166	181	195	210
Expenditure	**4,765**	**5,230**	**5,643**	**6,176**	**6,640**	**7,218**	**7,830**	**8,331**	**8,908**
Current noninterest	3,684	3,990	4,330	4,574	4,832	5,156	5,566	5,962	6,378
Wages	1,817	1,969	2,113	2,281	2,413	2,561	2,745	2,919	3,100
Goods and services	158	180	194	194	189	190	206	223	240
Transfers	1,708	1,842	2,023	2,098	2,230	2,405	2,615	2,820	3,038
Interest 3/	681	775	787	992	1,126	1,301	1,435	1,476	1,568
Capital	400	465	526	610	683	761	828	893	962
Primary balance	**-704**	**-830**	**-862**	**-739**	**-305**	**3**	**37**	**73**	**114**
Overall Balance	**-1,386**	**-1,604**	**-1,649**	**-1,731**	**-1,431**	**-1,298**	**-1,398**	**-1,403**	**-1,454**
Total Financing	1,386	1,604	1,652	1,731	1,431	1,298	1,398	1,403	1,454
External (net)	401	490	598	412	417	372	379	247	385
Domestic (net)	984	1,115	1,212	1,319	1,013	926	1,019	1,156	1,069
Central government debt	**8,932**	**10,484**	**11,984**	**13,702**	**15,149**	**16,473**	**17,903**	**19,173**	**20,603**
External	1,763	2,366	2,944	3,337	3,756	4,138	4,532	4,645	5,006
Domestic	7,169	8,118	9,040	10,365	11,393	12,335	13,372	14,528	15,597
	(In percent of GDP)								
Revenue	**13.6**	**13.6**	**14.1**	**14.5**	**15.9**	**16.5**	**16.5**	**16.5**	**16.5**
Tax revenue	13.3	13.2	13.7	14.1	15.4	16.1	16.1	16.1	16.0
Nontax revenue 2/	0.4	0.4	0.5	0.5	0.5	0.5	0.5	0.5	0.5
Expenditure	**19.2**	**19.6**	**20.0**	**20.2**	**20.2**	**20.2**	**20.1**	**19.9**	**19.7**
Current noninterest	14.9	14.9	15.3	15.0	14.7	14.4	14.3	14.2	14.1
Wages	7.3	7.4	7.5	7.5	7.4	7.2	7.1	7.0	6.9
Goods and services	0.6	0.7	0.7	0.6	0.6	0.5	0.5	0.5	0.5
Transfers	6.9	6.9	7.2	6.9	6.8	6.7	6.7	6.7	6.7
Interest 3/	2.7	2.9	2.8	3.2	3.4	3.6	3.7	3.5	3.5
Capital	1.6	1.7	1.9	2.0	2.1	2.1	2.1	2.1	2.1
Primary balance	**-2.8**	**-3.1**	**-3.0**	**-2.4**	**-0.9**	**0.0**	**0.1**	**0.2**	**0.3**
Overall Balance	**-5.6**	**-6.0**	**-5.8**	**-5.7**	**-4.4**	**-3.6**	**-3.6**	**-3.3**	**-3.2**
Total Financing	**5.6**	**6.0**	**5.8**	**5.7**	**4.4**	**3.6**	**3.6**	**3.3**	**3.2**
External (net)	1.6	1.8	2.1	1.3	1.3	1.0	1.0	0.6	0.9
Domestic (net)	4.0	4.2	4.3	4.3	3.1	2.6	2.6	2.8	2.4
Central government debt	**36.0**	**39.3**	**42.4**	**44.9**	**46.1**	**46.0**	**46.0**	**45.7**	**45.6**
External	7.1	8.9	10.4	10.9	11.4	11.6	11.7	11.1	11.1
Domestic	28.9	30.4	32.0	33.9	34.7	34.5	34.4	34.6	34.5
Memorandum items:									
Non-interest expenditure growth (percent)									
in nominal terms	12.0	9.1	9.0	6.7	6.4	7.3	8.1	7.2	7.1
in real terms	6.4	4.4	8.1	5.6	3.3	4.2	4.9	4.1	4.0
Nominal GDP	24,781	26,703	28,279	30,549	32,832	35,780	38,892	41,941	45,177
CPI Inflation (period average)	5.2	4.5	0.8	1.1	3.0	3.0	3.0	3.0	3.0

Sources: Ministry of Finance and Fund staff estimates.

1/ Includes measures as in the baseline partial adjustment scenario, as well as administratively-determined measures to contain growth in the wage bill, and increases in the VAT rate from 2017.

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.