Costa Rica

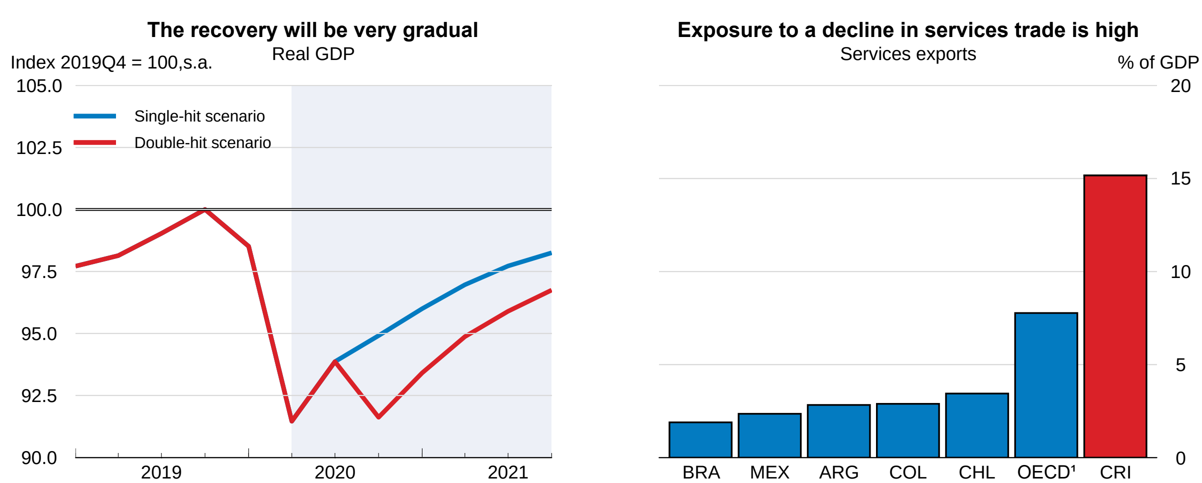
Economic activity is projected to contract by around 5% in 2020, before rebounding by 1½ per cent in 2021, if there is a second COVID-19 outbreak in the autumn of 2020. The protracted recovery will hinge on the delayed normalisation of tourism, with the affected sectors likely to be subject to near complete shutdowns until the last quarter of 2020. If the pandemic subsides soon, GDP will shrink by about 4% in 2020 and expand by around 2¾ per cent in 2021, due to a stronger recovery in domestic demand and exports. Headline inflation will initially decline more than core inflation due to subdued energy prices. The surge in unemployment will depress private consumption.

Prior to the pandemic, Costa Rica was determined to reduce the high budget deficit and apply a fiscal rule that restrains public spending growth. Even if the authorities have appropriately increased health and social protection spending, they aim to return to a deficit-reduction path once the crisis moderates. Ensuring that support programmes reach out primarily those who have lost their job or part of their wages, both in the formal and informal sector, is key to preserve incomes. Continuing with the implementation of the wide array of reforms linked to the OECD accession process would support the recovery and help reduce social inequalities.

The health system has proved to be resilient

Costa Rica has been less severely hit by the pandemic than other countries thanks to the swift reaction of the authorities. The spread of the CODIV-19 virus still required a set of lockdown measures, including the closing of borders to tourism, which is a crucial source of income and jobs. The propagation of the virus started in early March and accelerated in April. Following a slowdown in early May, the number of cases slightly increased in late May.

Costa Rica



1. OECD refers to a GDP-weighted average.
Source: OECD Economic Outlook 107 database; and World Bank World Development Indicators.

StatLink https://doi.org/10.1787/888934139214

Costa Rica: Demand, output and prices (double-hit scenario)

Costa Rica: double-hit scenario	2016	2017	2018	2019	2020	2021
	Current prices CRC trillion	Percentage changes, volume (2012 prices)				
GDP at market prices	31.1	3.9	2.7	2.1	-4.9	1.5
Private consumption	20.0	3.6	2.0	1.6	-2.0	1.3
Government consumption	5.4	3.1	0.5	4.9	1.4	0.3
Gross fixed capital formation	5.7	-2.5	3.0	-6.4	-11.2	3.0
Final domestic demand	31.0	2.4	1.9	0.7	-2.9	1.4
Stockbuilding[1]	0.0	1.5	-0.7	0.6	-0.4	0.0
Total domestic demand	31.1	3.8	1.1	1.2	-3.4	1.4
Exports of goods and services	10.0	4.0	4.7	2.7	-12.2	0.8
Imports of goods and services	9.9	3.7	0.1	0.2	-7.6	0.6
Net exports[1]	0.1	0.0	1.6	0.9	-1.5	0.0
Memorandum items						
GDP deflator	_	2.6	2.5	1.7	1.2	1.6
Consumer price index	_	1.6	2.2	2.1	1.0	1.7
Core inflation index[2]	_	1.2	2.1	2.4	1.2	1.5
Unemployment rate (% of labour force)	_	9.1	10.3	11.8	17.0	15.5
Current account balance (% of GDP)	_	-3.3	-3.3	-2.5	-4.8	-4.1

1. Contributions to changes in real GDP, actual amount in the first column.
2. Consumer price index excluding food and energy.
Source: OECD Economic Outlook 107 database.

StatLink https://doi.org/10.1787/888934137561

The government declared a national state of emergency in mid-March. The authorities closed borders to foreign entry, suspended the cruise season and imposed restrictions on foreign residents when leaving the country. Schools, recreational areas and businesses that involve social gatherings were closed and private vehicle traffic was restricted. During confinement, establishments with operating permits were allowed to remain functional, but only at 50% capacity. Health authorities transformed an existing hospital into a specialised care centre, increased the supply of diagnostic tests, protective equipment and essential medicines, and provided free COVID-19 testing and treatment. The authorities aim to have reserved 2 thousand beds for COVID-19 patients and expect to have increased the ventilator capacity before late June. The government also provided delivery of food and home care for 15 thousand senior citizens. The authorities announced in mid-May an exit strategy that aims to gradually phase out confinement measures until August, assuming that the pandemic will subside by then.

The contagion has taken a toll on growth and employment and raised sovereign credit risk

The estimated initial output loss from the confinement measures in the first half of the year could reach 22%. The global growth slowdown has additionally hit foreign demand, hampering GDP and employment growth. This is particularly due to the economic importance of services exports, which is higher than in other countries in the region and the OECD area, and the significant contribution of tourism to employment. Around 7100 companies, employing more than 8% of all workers, have applied to the temporary work scheme introduced by the government, which allows distressed firms to proportionally reduce working hours and salaries. The government temporarily invoked the emergency escape clause embedded in the fiscal rule only for health-related institutions, and intends to reinstate the fiscal rule by 2021. Sovereign risk premia have increased by around 300 basis points, given the high fiscal deficit and public debt. The authorities have recently secured four credit lines at below-market interest rates from multilateral institutions, exceeding 2% of GDP.

Costa Rica: Demand, output and prices (single-hit scenario)

Costa Rica: single-hit scenario	2016	2017	2018	2019	2020	2021
	Current prices CRC trillion	Percentage changes, volume (2012 prices)				
GDP at market prices	31.1	3.9	2.7	2.1	-4.1	2.7
Private consumption	20.0	3.6	2.0	1.6	-1.3	2.6
Government consumption	5.4	3.1	0.5	4.9	1.0	0.4
Gross fixed capital formation	5.7	-2.5	3.0	-6.4	-9.2	4.8
Final domestic demand	31.0	2.4	1.9	0.7	-2.2	2.5
Stockbuilding[1]	0.0	1.5	-0.7	0.6	-0.4	0.0
Total domestic demand	31.1	3.8	1.1	1.2	-2.7	2.4
Exports of goods and services	10.0	4.0	4.7	2.7	-10.4	1.6
Imports of goods and services	9.9	3.7	0.1	0.2	-6.3	0.9
Net exports[1]	0.1	0.0	1.6	0.9	-1.3	0.2
Memorandum items						
GDP deflator	_	2.6	2.5	1.7	1.4	1.9
Consumer price index	_	1.6	2.2	2.1	1.3	2.0
Core inflation index[2]	_	1.2	2.1	2.4	1.4	1.9
Unemployment rate (% of labour force)	_	9.1	10.3	11.8	15.9	13.9
Current account balance (% of GDP)	_	-3.3	-3.3	-2.5	-4.4	-3.8

1. Contributions to changes in real GDP, actual amount in the first column.
2. Consumer price index excluding food and energy.
Source: OECD Economic Outlook 107 database.

StatLink https://doi.org/10.1787/888934137580

Both monetary and fiscal policies have reacted

The central bank has reduced the policy interest rate by 100 basis points to 1.25% and eased liquidity conditions. Financial supervisors temporarily reduced counter-cyclical buffer provisions and modified prudential regulations to create space for the re-profiling of credit repayments of distressed borrowers. Fiscal authorities declared a 3-month moratorium on customs duties as well as value–added, income, and tourism taxes, and a deferral of payments of social security contributions. The authorities introduced a loan programme for firms, providing start-up and working capital finance and a direct cash transfer programme targeted at individuals who lost their job or faced reduced working hours, including those in the informal sector. Monetary and macro-prudential measures will ease credit and liquidity conditions. Cash transfers will support private consumption and mitigate poverty in the short term.

The economy will suffer a recession and the recovery will be gradual

In the double-hit scenario, the services sector, and particularly tourism firms, will operate below capacity until the end of 2020, decreasing employment. The domestic demand and export outlook will deteriorate in the fourth quarter of 2020 due to the second outbreak of the pandemic. Tourism is projected to recover gradually in 2021. The limited support measures and the disruption in global supply chains will weigh on private consumption and investment. Inflation will decline in the near term, given the reduction in domestic demand and lower oil prices, which will partly offset the negative effects on net exports. Fiscal spending will be allocated more to transfers than purchases of goods. In the single-hit scenario, the recovery in 2021 will be stronger, helped by carryover effects from a gradual resumption of tourism and exports in the second half of 2020. The economic contraction will lead to a significant loss of revenues and widen the central government fiscal deficit to near 9% of GDP in 2020, with central government debt reaching around 70% of GDP in both scenarios. Key downside risks are a drop in confidence due to a failure to proceed with fiscal consolidation, which would hamper public debt sustainability, and additional episodes of financial volatility in emerging economies. Imperfect implementation of the temporary work scheme might increase informality and unemployment rapidly. On the upside, a faster–than–expected normalisation in the global tourism outlook would accelerate the recovery of exports.

The fiscal response should be temporary

Income support payments should be maintained as long as confinement measures weigh on jobs and household earnings. However, it is vital to ensure that the fiscal responses to the COVID-19 shock are temporary and well targeted. Expenditure items that are typically hard to reverse, such as public hiring or subsidies without explicit sunset clauses, should be avoided. Additional but limited interest rate cuts will further ease domestic financial conditions. Creating incentives to invest in export diversification in sectors that are less reliant on social interactions and international passenger travels would provide insurance against future foreign demand shocks and could offer an opportunity to move towards higher-productivity activities.

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