Costa Rica

GDP will grow by 2.3% in 2023 and 3.7% in 2024. High inflation and a tight monetary policy stance will hold back private consumption in 2023, and fiscal restraint will contain public spending. Exports will be hampered by weaker global growth in 2023 but gain strength in 2024. Annual inflation peaked at 12% recently but is set to decline to 4.2% in year-average terms by 2024, still above the 3% target.

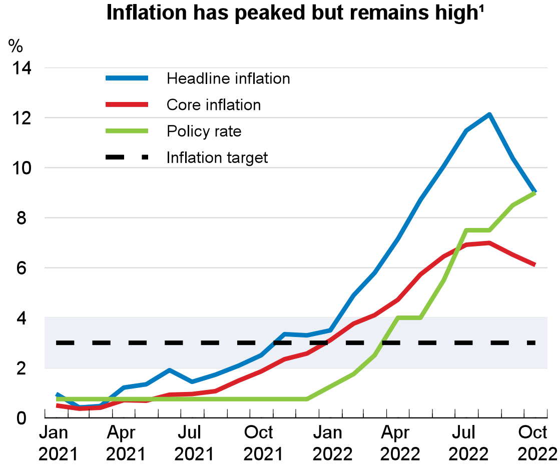
The fiscal outlook has improved due to the full implementation of the fiscal rule and better-than-expected revenues. However, with public debt at 70% of GDP and large interest payments, the fiscal stance will need to remain prudent. The monetary policy tightening that started in December 2021 to contain inflationary pressures and prevent the de-anchoring of inflation expectations is expected to continue until the end of 2022. Improving the quality and efficiency of education, by providing more targeted support to students with learning gaps and increasing the number of science graduates, would support higher growth and equity.

Exports have been driving growth amid high inflation

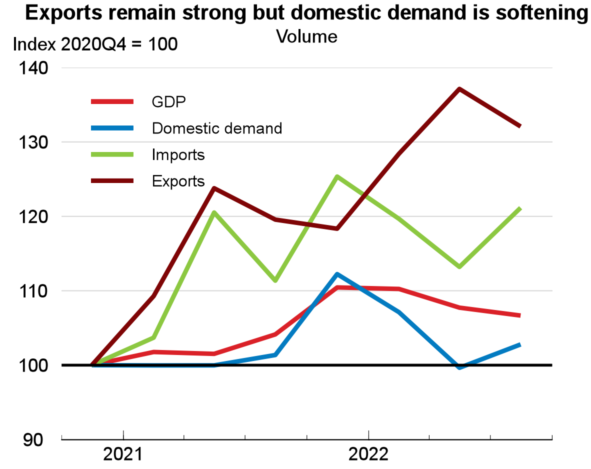
Domestic demand softened in the first three quarters of 2022, despite buoyant ICT activity, as high inflation and monetary policy tightening weighed on private consumption and public investment remained low. Exports continue to support GDP growth, demand for manufacturing output remains solid and tourism activity is approaching pre-pandemic levels.

Costa Rica

Inflation has peaked but remains high[1]



Exports remain strong but domestic demand is softening



1. The horizontal dashed black line indicates the target inflation rate of monetary policy. The shaded area reports the tolerance band around the inflation target (+2% to +4%). Headline and core inflation indicate, respectively, the headline consumer price inflation rate and the core consumer price inflation rate, which excludes food and energy.
Source: Banco Central de Costa Rica.

StatLink https://stat.link/fb5a8q

Costa Rica: Demand, output and prices

Costa Rica	2019	2020	2021	2022	2023	2024
	Current prices CRC trillion	Percentage changes, volume (2017 prices)				
GDP at market prices	37.8	-4.3	7.8	4.3	2.3	3.7
Private consumption	24.3	-6.9	7.0	3.6	2.3	2.7
Government consumption	6.3	0.8	1.7	2.1	0.1	0.8
Gross fixed capital formation	6.1	-3.4	11.0	1.6	-0.5	5.5
Final domestic demand	36.8	-5.0	6.6	3.0	1.4	2.9
Stockbuilding[1]	- 0.1	0.2	1.1	-0.8	0.6	0.0
Total domestic demand	36.7	-4.8	7.8	1.8	1.7	2.8
Exports of goods and services	13.0	-10.6	15.9	12.2	8.8	9.1
Imports of goods and services	11.9	-12.9	16.9	5.5	8.5	7.5
Net exports[1]	1.1	0.4	0.3	2.5	0.6	1.1
Memorandum items						
GDP deflator	_	0.8	2.0	7.8	6.4	4.2
Consumer price index	_	0.7	1.7	8.8	6.9	4.2
Core inflation index[2]	_	1.3	0.9	4.5	5.8	4.2
Unemployment rate (% of labour force)	_	19.5	16.4	12.2	11.4	11.1
Current account balance (% of GDP)	_	-1.1	-3.3	-4.4	-3.8	-2.7

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 112 database.

StatLink https://stat.link/4kszil

Headline and core inflation stood at 9% (year-on-year) and 6.1%, respectively, in October, above the 3% inflation target but below the peak recorded in August. Domestic cost pressures remain contained and real wages decreased by 3.8% in August with respect to December 2021. Median two-year ahead household inflation expectations rose to 5.4% in October, from 5% a month earlier, and remain above the upper end of the inflation tolerance band of 2-4%. To mitigate the impact of the increase in energy and food prices the fuel tax was frozen for six months in July (with an estimated cost of 0.05% of 2021 GDP) and a monthly subsidy of around USD 90 for poor households, renewable for up to three months, was established in November (with an estimated cost of 0.05% of 2021 GDP).

Fiscal prudence and tight monetary policy will continue

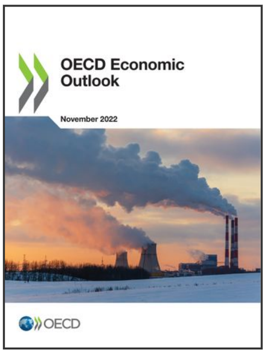
Adherence to the fiscal rule is assumed to keep public spending in check, making it possible to meet the government's fiscal targets over the projection horizon. Central government net lending is projected to fall to 4% in 2022, 2.6% in 2023 and 2.2% in 2024. Under these assumptions, public debt will peak at around 70% in 2022 before starting to decline. Monetary policy tightening is assumed to continue until the end of 2022 with the policy rate reaching 9%. Monetary policy is assumed to start easing in late 2023 with the inflation rate nearing the upper bound of the 2-4% inflation tolerance band. The policy rate is expected to be cut by 50 basis points in 2023Q4 and 2024Q1, and by 25 basis points in each of the following three quarters, reaching 7.25% by 2024Q4.

Growth will gradually strengthen after slowing in 2023

Growth will slow to 2.3% in 2023 before strengthening to 3.7% in 2024 as the global economy recovers. High and persistent inflation and a tight monetary policy stance will hit household real disposable incomes, softening private consumption in the second half of 2022 and in 2023, and limiting the positive impact of the assumed full recovery of tourism on economic activity and employment. Export growth will slow in 2023, but gain traction in 2024 as global demand strengthens. Foreign direct investment inflows are assumed to continue over the projection period, while public investment will remain weak. Inflation is projected to fall to 6.9% in 2023 and to 4.2% in 2024, as external inflationary pressures wear off and domestic cost pressures are contained by a tight monetary policy stance. The high degree of dollarisation of Costa Rica’s economy exposes the country to external funding and exchange rate risks. On the upside, the renewed efforts to deepen trade integration could bring stronger exports.

Pushing ahead with structural reform would increase growth and equity

Continuing to implement structural reforms initiated during the OECD accession process would increase growth and economic resilience and reduce income inequalities. Establishing virtual one-stop shops could reduce the high administrative burden to start a company. Improving the quality and efficiency of education, by providing more targeted support to students with learning gaps and increasing the number of science graduates, would support higher growth and equity. To achieve net carbon neutrality by 2050, Costa Rica should reduce emissions in the transport sector by strengthening the public transport network and expanding the fleet of zero-emission vehicles, as well as maintaining the 100% share of electricity produced from renewable sources.



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