IMF Country Report No. 17/156

COSTA RICA

2017 ARTICLE IV CONSULTATION—PRESS RELEASE; AND STAFF REPORT

June 2017

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 2017 Article IV consultation with Costa Rica, the following documents have been released and are included in this package:

- A **Press Release**.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on a lapse of time basis, following discussions that ended on May 16, 2017, 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 May 31, 2017.
- An **Informational Annex** prepared by the IMF staff.

The documents listed below have been or will be separately released.

Selected Issues

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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FOR IMMEDIATE RELEASE
June 27, 2017

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

IMF Executive Board Concludes 2017 Article IV Consultation with Costa Rica

The Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Costa Rica on June 14, 2017, and considered and endorsed the staff appraisal without a meeting on a lapse-of-time basis.[2]

Costa Rica's economy is growing at its estimated trend rate of about 4¼ percent and the output gap is essentially closed. Headline inflation turned positive again in the second half of 2016 and is rising moderately, with both headline and core indicators still below the 2-4 percent target range. The colón has been depreciating moderately since mid-2016, while reserves have declined despite the narrowing in the current account deficit. Considering that inflation is returning to desired levels and that output is at potential, the central bank increased its policy rate by 225 basis points since April 2017, to 4 percent. Financial conditions are now broadly neutral, having gradually eased in 2016, the financial system appears sound, and credit growth continues to be consistent with healthy financial deepening and macroeconomic trends. The fiscal deficit remains high and public debt continues to rise rapidly despite the authorities' deepened consolidation efforts in 2016. Recent advances in fiscal consolidation have been partly reversed and political consensus on a comprehensive fiscal package remains elusive.

With approval of a fiscal package unlikely due to the political cycle, economic activity will ease slightly, while inflation will revert to the target range. In 2017, growth is anticipated to slow marginally to 4 percent, driven by weaker terms-of-trade and more stringent financial conditions. Past monetary stimulus, fading base effects from past oil price declines, and the continuing moderate depreciation since mid-2016, are expected to bring inflation back to the middle of the target range by end-2017. Financial conditions are anticipated to gradually tighten amid the incipient monetary policy normalization, persistently high public sector financial needs, and

[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.

[2] The Executive Board takes decisions under its lapse-of-time procedure when the Board agrees that a proposal can be considered without convening formal discussions.

rising international rates. Consequently, potential growth will also decelerate because rising interest rates weigh on private investment. The current account deficit will widen marginally to about 4 percent of GDP as oil prices recover and despite a modest positive effect of the recent depreciation on exports. Key downside risks relate to persistently high fiscal deficits and rising public debt, the heavy dollarization of bank assets and liabilities, and a less favorable external environment, including tighter-than-expected global financial conditions, a retreat in cross-border integration, and weaker-than-projected global growth.

Executive Board Assessment

In concluding the 2017 Article IV Consultation with Costa Rica, Executive Directors endorsed staff's appraisal as follows:

Risks to the outlook are rising, underscoring the increasing urgency of addressing mounting macro vulnerabilities. The economy is growing at trend, inflation is returning to target, and the external current account deficit has narrowed. The exchange rate depreciated moderately and international reserves declined due to reduced external budget and bank financing, as well as domestic portfolio switches into FX deposits. The external position continues to be close to equilibrium. However, weakening domestic fundamentals stemming from large fiscal deficits make the country particularly vulnerable to the projected tightening in global financial conditions and other external risks. While growth is anticipated to slow only marginally in 2017, potential growth would be eroded over the medium term reflecting higher risk premia and greater need for monetary tightening in a baseline scenario without additional fiscal reforms. If fiscal vulnerabilities are not addressed, competitiveness and the external position could also be negatively affected.

Current economic conditions call for continuation of fiscal consolidation and monetary policy normalization. With the output virtually at potential and a still sizeable fiscal sustainability gap, the near-term policy mix should be characterized by gradual budgetary adjustment and unwinding of monetary easing. Hence, it is important to administratively contain expenditure and mobilize revenue to minimize the short-term deterioration from recent constitutional court rulings expanding revenue earmarking. The central bank should keep tightening the monetary stance to maintain inflation around the mid-point of the target range and prevent jeopardizing the incipient anchoring of inflation expectations to the target band.

A comprehensive reform strategy is needed to achieve long-term fiscal sustainability. The authorities' main proposal consisting of broadening the bases of the VAT and income tax as well as hikes in their rates, accompanied by sustained administrative steps to contain the wage bill, would be sufficient to stabilize public debt within safe levels in the medium term. Congressional approval before the elections of a balanced package, including the aforementioned tax reforms but also public employment and fiscal responsibility laws, would be important. Parametric reforms are also needed to shore up the pension system over the long term.

Greater exchange rate flexibility would strengthen the credibility of the IT framework, enhance resilience to external shocks. Moreover, enhanced transparency of the triggers for the FX-intervention rule would firm confidence in the full subordination of exchange rate management to the inflation objectives. Greater exchange rate flexibility would also reinforce the role of the exchange rate as a shock absorber while easing pressure on international reserves, and help internalize exchange rate risks, thus reducing FX mismatches and discouraging dollarization.

The introduction of micro- and macro-prudential tools to contain systemic financial risks is welcomed, but more may be needed. Further tightening of regulatory requirements should be considered if there is no evidence of a reduction in banks' FX exposures, or if the deceleration of FX credit proves temporary. Additional measures could include higher reserve and liquidity requirements on FX liabilities, complemented by increases in capital buffers and provisioning, and stricter controls on FX loans. In addition, implementation of pending 2008 FSAP recommendations and adoption of Basel III standards would improve resilience of the financial system.

Structural reforms are required to maintain the country's competitive position. Addressing weaknesses in transport infrastructure, education expenditure efficiency, and taking steps to support financial deepening would be critical to help accelerate potential growth and make it more inclusive. The successful implementation of environmental policies has buttressed the economy's structural transformation towards higher growth services. The authorities also need to build on this by providing a legal and regulatory environment that stimulates those sectors that are more resilient to climate change.

Table 1. Costa Rica: Selected Social and Economic Indicators, Baseline Scenario 1/

Population (2016, millions)	4.9	Human Development Index Rank (2016)	66 (out of 188)
Per capita GDP (2016, U.S. dollars)	11,888	Life expectancy (2015, years)	79.6
Unemployment (2016, percent of labor force)	9.5	Literacy rate (2015, percent of people ages > 15)	97.6
Poverty (2016, percent of population)	20.5	Ratio of girls to boys in primary and secondary education (2014, percent)	102.0
Income share held by highest 10 percent of households	36.9		
Income share held by lowest 10 percent of households	1.5	Gini coefficient (2014)	48.5

					Proj.	
	2013	2014	2015	2016	2017	2018
	(Annual percentage change, unless otherwise indicated)					
Output and Prices						
Real GDP growth	2.3	3.7	4.7	4.3	4.0	4.0
Output gap (percent of potential GDP)	-0.4	-0.6	0.0	0.1	0.0	-0.1
GDP deflator	4.0	5.8	2.7	2.3	1.5	3.2
Consumer prices (end of period)	3.7	5.1	-0.8	0.8	3.0	3.0
Money and Credit						
Monetary base	10.2	10.4	9.2	6.4	2.8	6.5
Broad money	7.7	15.4	4.0	2.3	6.3	7.5
Credit to private sector	12.2	17.5	11.8	12.8	11.1	10.9
Monetary policy rate (percent; end of period) 4/	3.8	5.3	2.3	1.8	4.0	…
	(In percent of GDP, unless otherwise indicated)					
Savings and Investment						
Gross domestic investment	19.0	18.8	20.2	19.7	19.6	19.5
Gross domestic savings	14.1	13.9	15.9	16.5	15.6	15.6
External Sector						
Current account balance	-4.8	-4.9	-4.3	-3.2	-4.0	-4.0
Of which: Trade balance	-11.0	-10.4	-9.0	-7.8	-8.5	-8.5
Financial and capital account balance	-6.1	-6.0	-4.9	-3.7	-3.7	-3.7
Of which: Foreign direct investment	-4.8	-5.6	-4.8	-4.6	-4.6	-4.5
Change in net international reserves (increase +)	474	-119	622	-260	-325	0
Net international reserves (millions of U.S. dollars)	7,331	7,211	7,834	7,574	7,249	7,249
Public Finances						
Central government primary balance	-2.8	-3.0	-3.0	-2.4	-2.8	-2.8
Central government overall balance	-5.6	-5.9	-5.6	-5.3	-6.1	-6.5
Central government debt	35.8	38.3	40.8	44.7	48.4	51.7
Consolidated public sector overall balance 2/	-5.4	-5.5	-5.8	-4.6	-5.6	-6.1
Consolidated public sector debt 3/	41.8	42.8	45.4	49.2	51.9	54.1
Of which: External public debt	8.7	10.2	11.3	11.3	11.1	10.6
Memorandum Item:						
GDP (US$ billions)	50.3	51.3	55.5	58.1	60.0	63.7

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

1/ The baseline scenario includes additional consolidation deriving from already adopted legislative measures, mainly to combat tax evasion and curtail unspent budgetary allocations of decentralized government entities. It includes increases in education and social expenditures broadly consistent with constitutional mandates, as well as limited increases in investments.

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.

4/ The 2017 data is as of May 2017.

INTERNATIONAL MONETARY FUND

COSTA RICA

STAFF REPORT FOR THE 2017 ARTICLE IV CONSULTATION

May 31, 2017

KEY ISSUES

Context: Growth is robust, inflation low, and the current account deficit has narrowed amid favorable external conditions. The budget deficit is being reduced through improvements in tax administration, expenditure under-execution, and recently passed legislation, but it remains high. With the external environment turning less favorable, the urgency of addressing elevated macro vulnerabilities has increased.

Main Policy Advice

- With the output gap closed, inflation rebounding, and a still sizeable fiscal sustainability gap, the short-term policy mix should be characterized by fiscal consolidation and the start of monetary policy normalization.
- Continued budget consolidation is required over the medium term. Without additional policy action, fiscal trends remain unsustainable. An ambitious strategy with VAT and income tax rate hikes and strict expenditure containment measures remains critical to achieve this objective. Parametric reforms are also needed to tackle imbalances in the pension system.
- Greater exchange rate (XR) flexibility would strengthen the credibility of the IT framework, enhance resilience to external shocks, and discourage dollarization. Fostering the secondary bond market would also help.
- Additional efforts should be considered to reduce dollarization, improve cross-border supervision, strengthen the AML/CFT framework, implement pending 2008 FSAP recommendations, and fully adopt Basel III standards.
- Structural reforms to boost potential growth include upgrading infrastructure and public expenditure efficiency, especially in education, and taking measures to support financial deepening and environmental resilience.

Approved By
K. Srinivasan (WHD) and Y. Sun (SPR)

Discussions took place in San Jose during May 2-16, 2017. The staff team comprised Lorenzo Figliuoli (head), Valentina Flamini, Dmitry Plotnikov, Jaume Puig Forne, and Victoria Valente (all WHD). Gerardo Peraza, Regional Resident Representative, also participated in the meetings.

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OVERVIEW

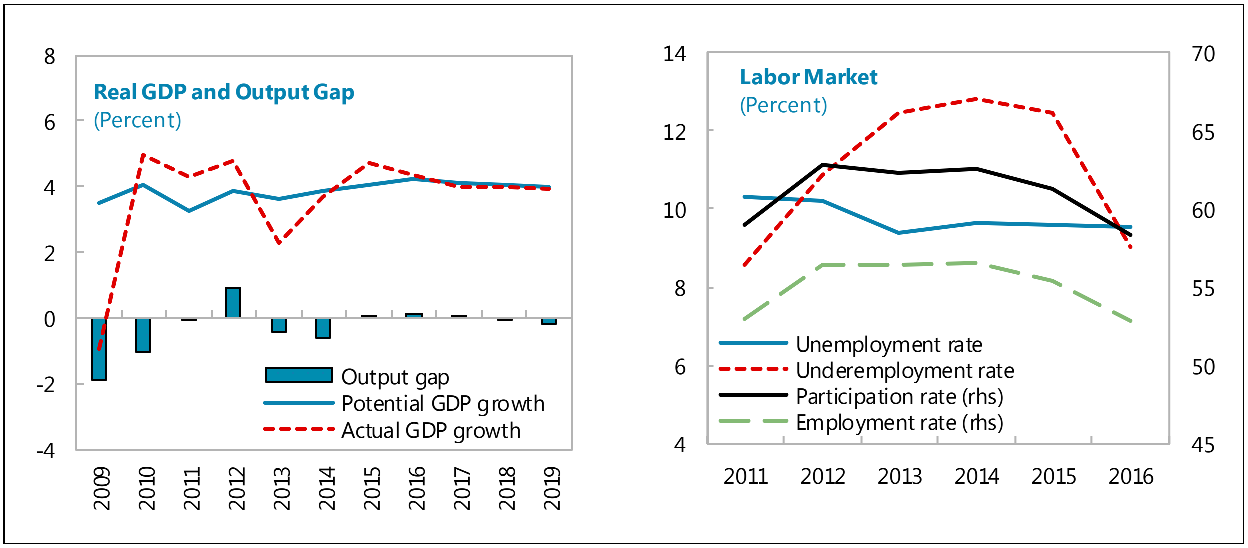
1. **The economy is growing robustly boosted by favorable external conditions, but macro vulnerabilities, mainly from the weak fiscal position, remain elevated.** The good economic performance in 2015-16 has been aided by propitious global conditions, notably continuing low commodity prices and ample liquidity in financial markets. Nonetheless, the persistence of large fiscal deficits and continued increases in the public-debt-to-GDP ratio make Costa Rica vulnerable to adverse changes in financial markets sentiment, the likelihood of which have risen recently (¶13). Inflation and the current account deficit have declined significantly on the back of lower oil prices, but inflation is expected to return to target this year, while the current account is anticipated to widen slightly over the medium-term as international commodity prices recover (¶11). Despite decelerating recently, FX lending remains the key financial sector vulnerability (¶25).

2. **Policy actions have been broadly consistent with past Fund advice.** The authorities have made progress toward reducing the fiscal sustainability gap through administrative and legislative measures adopted last year (¶7 and 8). They also submitted to Congress comprehensive fiscal measures in line with staff advice that would be sufficient to fully close the gap, but key tax provisions in the package have thus far failed to obtain parliamentary approval (¶8). The authorities made progress in passing measures to deepen the FX market that should facilitate greater XR flexibility to complete the transition to full-fledged inflation targeting (¶24). The central bank has appropriately started reversing the monetary easing cycle, with inflation expected to return to target this year (¶4 and 11). The authorities' have taken additional prudential measures to contain systemic risks in the financial sector (¶27). Their decision to participate in a Fund-conducted Financial Sector Stability Review is a welcome additional step toward full implementation of the 2008 FSAP recommendations and gradual adoption of Basel III standards (¶28).

RECENT ECONOMIC DEVELOPMENTS AND OUTLOOK

A. Recent Developments

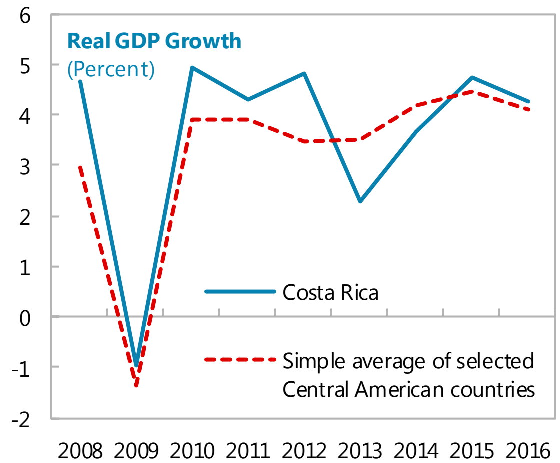
3. **The economy is growing at trend and the output gap is essentially closed.** Activity fell below potential during 2013-14, owing to both weakening domestic demand and sluggish exports in line with the slow U.S. recovery. The slack was largely plugged in 2015, when GDP expanded by 4¾ percent, with a boost to domestic demand from improved terms of trade and large investment schemes, notably for a new port terminal. This more than offset the impact of Intel's manufacturing withdrawal, adverse weather conditions for the main agricultural export crops, and slightly contractionary financial conditions. In 2016, strong export performance, further terms-of-trade gain from the additional decline in oil prices (¶5), and supportive financial conditions (¶9) helped maintain growth at potential, at around 4¼ percent, despite the drag from the normalization in investment and moderate fiscal consolidation (¶7). The unemployment rate remained elevated, though underemployment decreased substantially, while labor force participation and employment continued to decline.



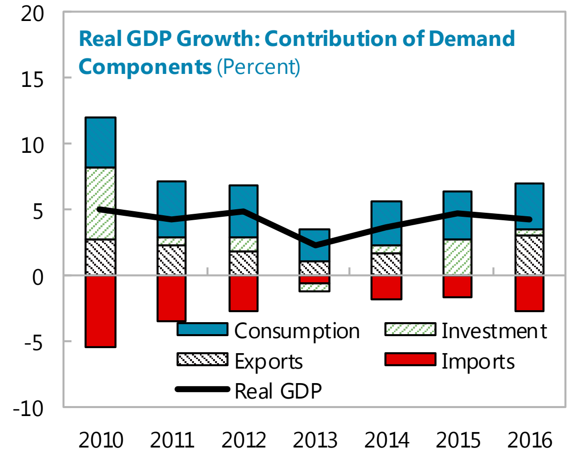
	Potential GDP growth rate			Output Gap	
	2000-2009	**2010-2015**	**2016**	**2015**	**2016**
Cycle Extraction Filters					
Hodrick-Prescott	4.46	3.80	4.21	-0.07	-0.03
Butterworth	4.43	3.73	4.25	0.04	0.04
Christiano-Fitzgerald	4.23	3.79	4.23	0.42	0.44
Baxter-King	4.70	3.78	4.19	-0.19	-0.19
Average of All Models	**4.45**	**3.78**	**4.22**	**0.05**	**0.07**

Figure 1. Costa Rica: Recent Developments, Real Sector

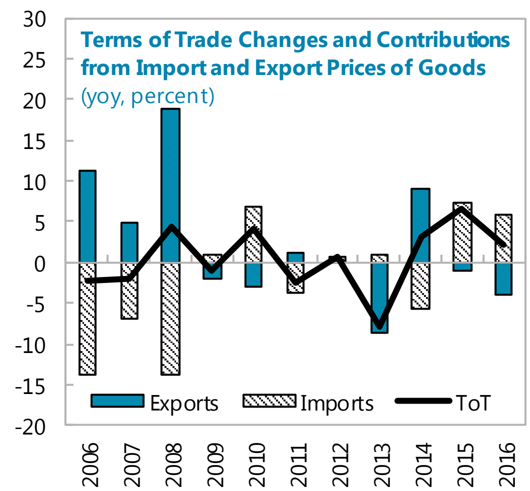
After picking up during 2014-15, real GDP growth is now in line with other CAPRD countries...



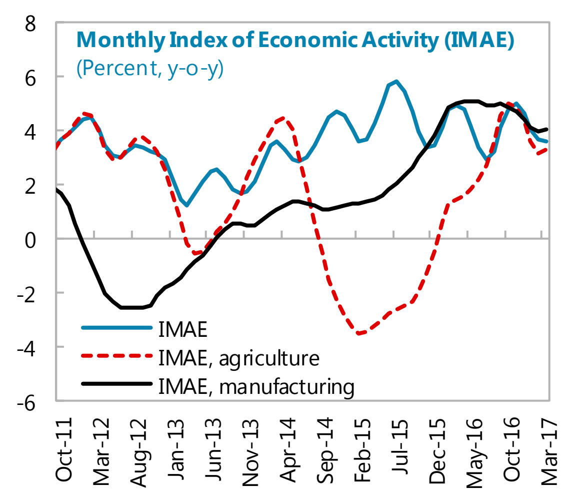
...supported by strong domestic demand and exports. These benefitted from...



...some further terms-of-trade gains from the additional decline in oil prices...

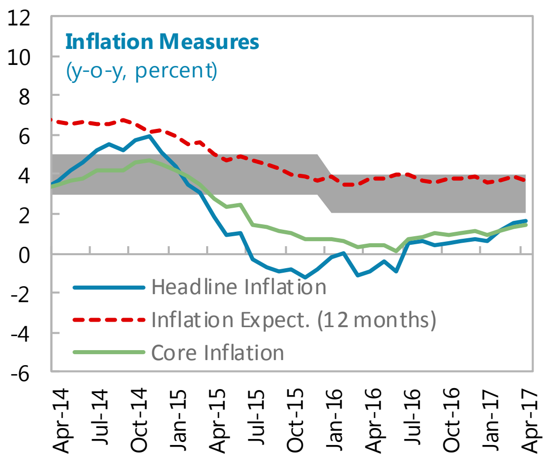


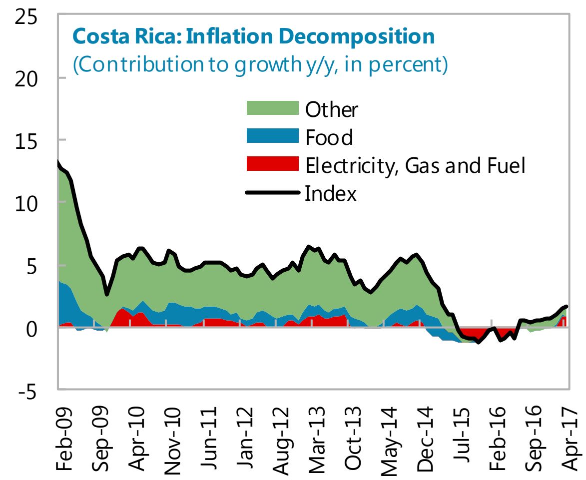
...and a rebound in the agricultural sector following adverse weather conditions in 2015.



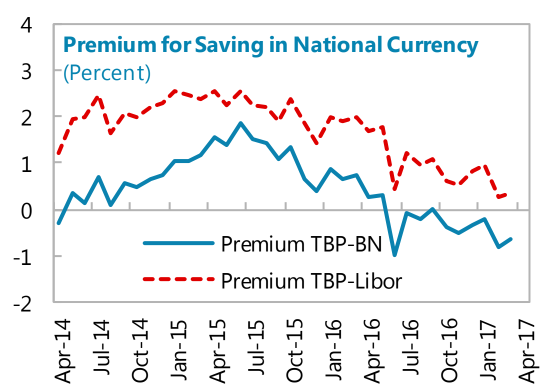
Sources: National authorities, WEO Database and Fund staff estimates.

4. **During the last two years, headline and core inflation have stayed below the BCCR target range, anchoring inflation expectations within it.** The sharp decline in imported oil prices drove headline inflation into negative territory in the second half of 2015, with core inflation also falling close to zero by mid-2016 despite a broadly closed output gap. The aggressive response of the central bank—with the policy rate set at 1¾ percent since early 2016 after cumulative cuts of 350 basis points—together with the gradual fading of the effect of lower oil prices turned headline inflation positive again in the second half of 2016, though both headline and core indicators are still below the 2-4 percent target range. Thus, inflation expectations have also converged inside that range, though hovering near its top. In light of the ongoing normalization of inflation and the closed output gap, the BCCR increased its policy rate by 225 basis points since April 2017, to 4 percent.

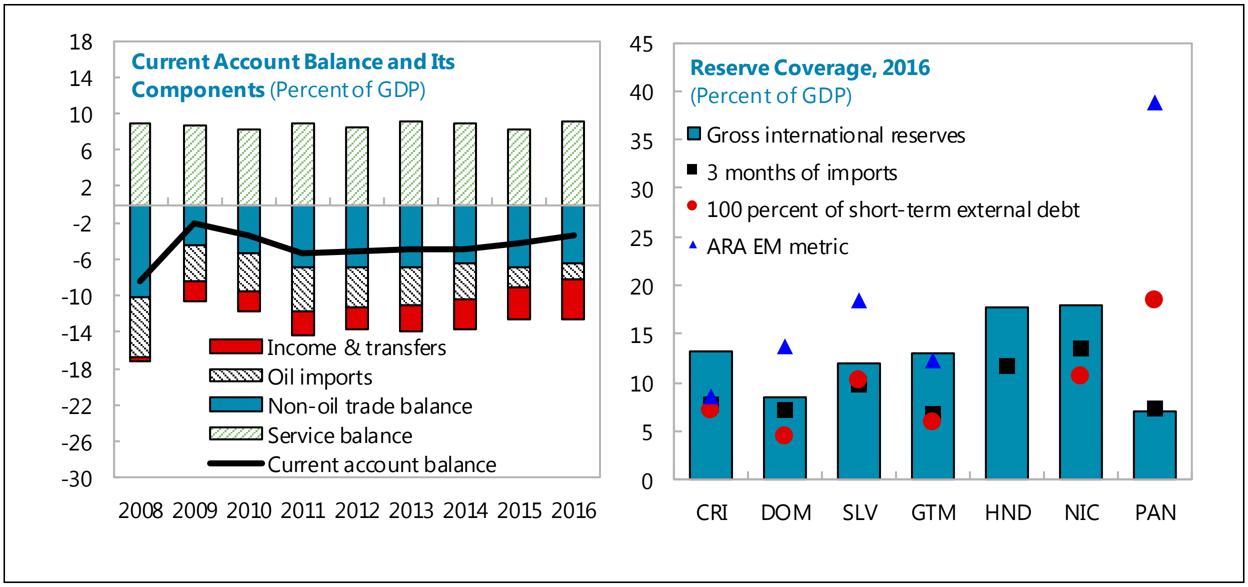




5. **Reserves declined and the XR depreciated moderately despite the improvement in the current account.** The current account deficit fell further to 3¼ percent of GDP in 2016, from 4¼ percent of GDP in 2015, amid still low oil prices and strong growth in exports—particularly of medical devices, corporate services, and agricultural products. Notwithstanding sustained strong FDI of about 4½ percent of GDP, international reserves experienced the largest drop since 2008, falling about US$260 million to US$7.6 bln—though still well above the Fund's adequacy metric. Lower net FX supply—which was only partially accommodated by the central bank, with the colón depreciating about 3 percent—reflected the decrease in external budget financing, reduced premia on savings in local currency that prompted portfolio switches into dollar deposits, and expectations of a decoupling from the U.S. dollar that led banks to decrease foreign funding and increase deposits abroad in FX. These trends intensified in early 2017, with additional reserve loss of about US$430 mln and colón depreciation of about 6½ percent.



Source: BCCR; and staff calculations. Note: difference between the interest rate on deposits in COL and USD, adjusted for the expected ER change.



6. **The external position continues to be close to equilibrium, with signs of improvement in competitiveness**. With average headline inflation near zero and the nominal XR allowed to devalue somewhat, the CPI-based REER depreciated 1½ percent in 2016. This, together with a more appreciated equilibrium REER, largely reflecting the decline in external budget financing and continued productivity growth—according to the Fund's multilaterally consistent estimates and other methodologies—suggests that Costa Rica gained some competitiveness in 2016 (Annex I). The improvement is confirmed also by the persistent strength of exports and FDI. Overall, the conclusion is that the external position remains broadly in equilibrium. Nevertheless, continuing large fiscal deficits pose risk to external stability, while inadequate infrastructure, public spending inefficiencies (¶30) and excessive regulatory costs continue to weigh on Costa Rica's competitiveness.

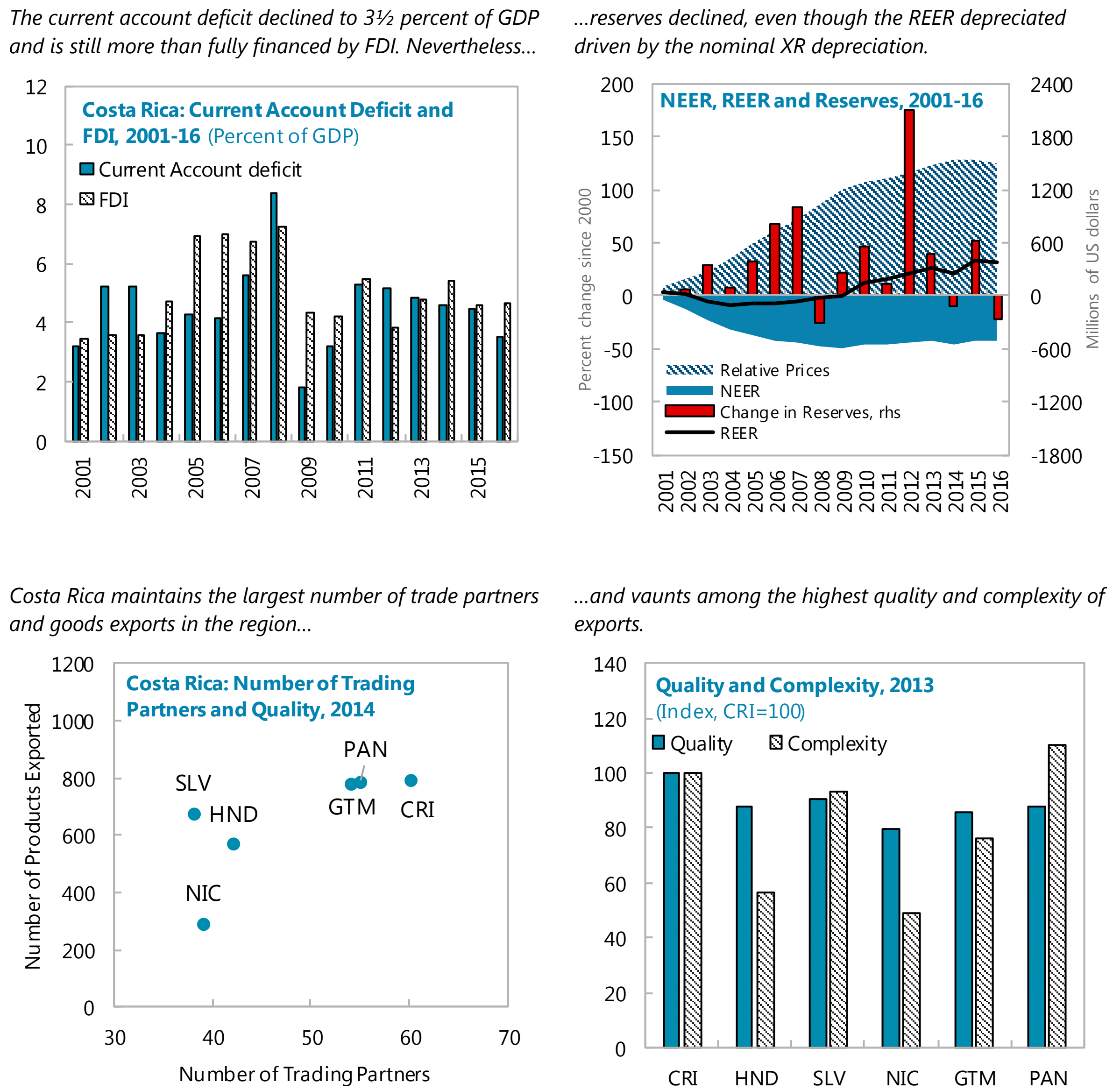
Costa Rica: Implied Undervaluation ("+" = Overvaluation)

	Current account (CA) norm	CA projected/ cyclically-adjusted	REER gap (updated)	REER gap (2016 AIV)	REER gap (2014 AIV)
External sustainability (ES)	-3.0	-4.0	2.3	6.8	13.2
ES (NFA exclud. FDI)	-7.3	-4.0	-7.9	-7.1	-5.9
EBA-Lite					
Macroeconomic Balance	-5.3	-3.2	-4.7	-3.5	NA
Equilibrium REER	NA	NA	15.0	22.0	NA
EBA					
Macroeconomic Balance	-4.8	-3.2	-3.8	-2.1	-4.7
Average 1/			0.2	3.2	0.9

Source: Fund Estimates

1/ The average in this report is taken over a different set of models than in previous reports

Figure 2. Costa Rica: Recent Developments, External Sector



Sources: National authorities, Atlas of Economic Complexity, WITS, and Fund staff estimates.

7. **The fiscal deficit remains high and public debt continues to rise rapidly despite the authorities' deepened consolidation efforts in 2016.** Having maintained a broadly unchanged non-interest balance in the first two years of the administration, the government's determination to contain wage bill growth and lower personal income tax evasion allowed a reduction in the primary deficit of about ½ percent of GDP to 2½ percent of GDP last year, imparting an equivalent negative fiscal impulse. With interest payments broadly stable as a share of GDP notwithstanding the constant rise in debt, the overall deficit also dropped to 5¼ percent of GDP, while debt reached 45 percent of GDP at end-2016. The decline in the cost of domestic financing despite no new

Eurobond issuance was made possible by pass-through of policy rate cuts to domestic market rates, but also by greater reliance on floating rate and dollar-denominated bonds. Such funding shift has allowed an extension of average debt maturity, but increased medium-term vulnerabilities of the government balance sheet. External bond spreads remained among the highest in Central America, while the sovereign rating fell deeper into sub-investment grade.

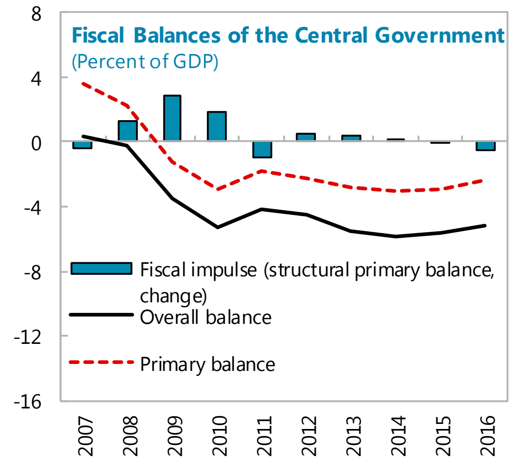
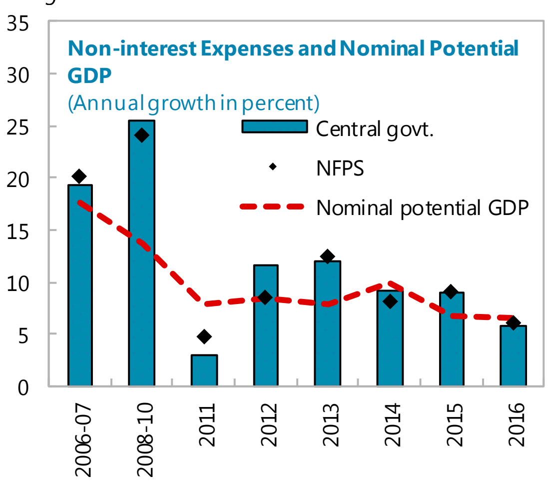
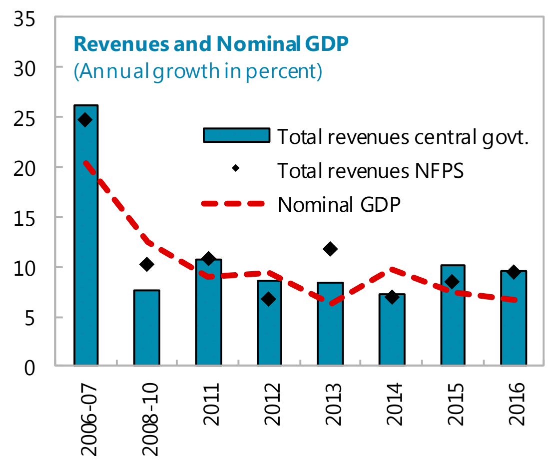


Figure 3. Costa Rica: Recent Developments, Fiscal Sector

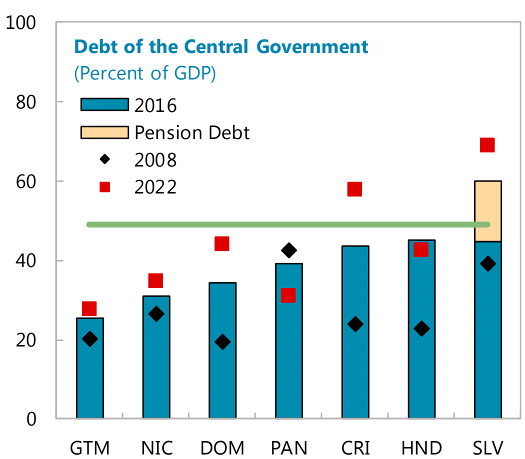
Revenue growth from anti-tax-evasion efforts remained strong in 2016...



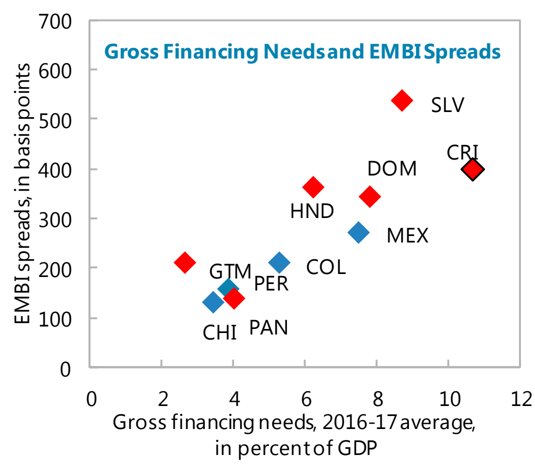
... and expenditure growth was more contained than in 2015.



However, public debt will continue rising under the baseline scenario, with increasing risks of a debt spiral...



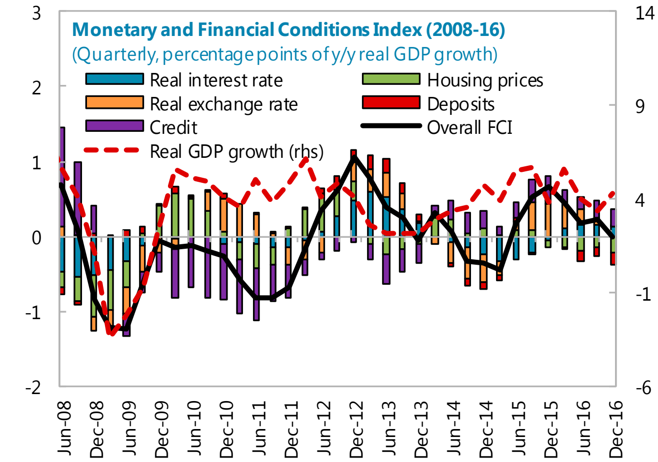
... if changes in the external environment lead to higher international interest rates and emerging market external spreads.

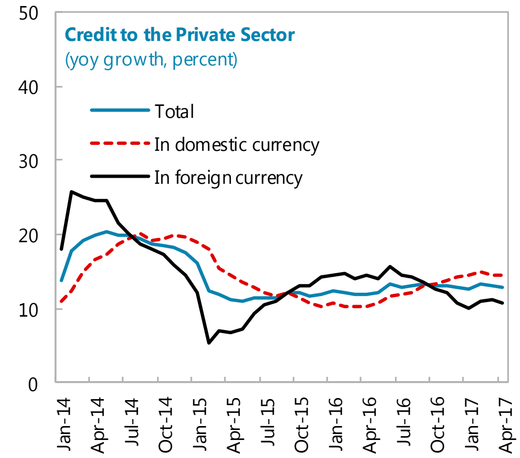


Sources: National authorities, WEO Database and Fund staff estimates.

8. **Recent advances in fiscal consolidation have been partly reversed and political consensus on a comprehensive fiscal package remains elusive.** Measures enacted by Congress in 2016, mainly to fight tax evasion and contain transfers to decentralized institutions and in pensions paid out of the budget would yield additional budget consolidation of about ½ percent of GDP in 2017-18. However, these gains will be largely offset by the recent Constitutional court rulings mandating stricter enforcement of earmarking provisions for social and education expenditure. The government also submitted to parliament at the beginning of this year a fiscal package that would have delivered the adjustment needed to close the sustainability gap (¶19-20) before the pronouncements of the Constitutional court. Inclusion in the measures of the public employment law prompted trade union calls for a general strike, while key opposition figures also made conflicting statements about the feasibility of adopting proposed broad tax reforms before the early-2018 elections. The government reacted by sounding out political forces on an alternative plan focused mainly on tax base widening that it considered could better garner Congressional approval in 2017, but it has also expressed its continued commitment to seek parliamentary support for the original proposal before the end of the current administration (¶20).

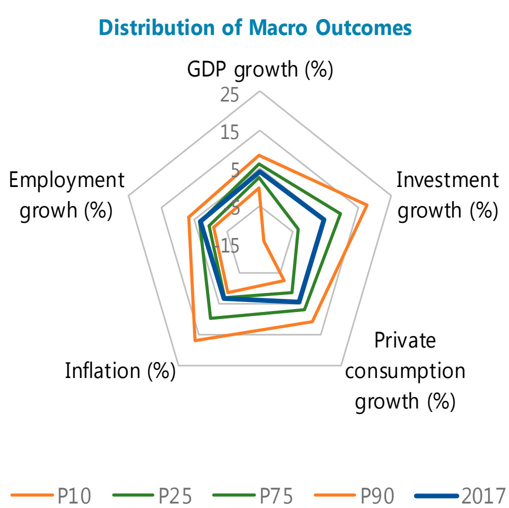
9. **Financial conditions are now broadly neutral, having gradually eased in 2016.** Real lending rates started falling in 2016, as pass-through from policy rate cuts quickened and inflation expectations stabilized within the new target range. Both bank funding and lending rates have been stable since late 2016. Overall, two-thirds of the 350 basis points cuts in the policy rate to 1¾ percent were mirrored in lower lending rates before the recent start of the tightening cycle in April that has brought the policy rate back to 4 percent. At the same time, the REER depreciated slightly (¶6), and credit started to decelerate in late 2016 steered by slowing FX loans, reflecting increased XR volatility, reduced gap between domestic and FX lending rates, as well new macro-prudential measures lifting the cost of FX lending to unhedged borrowers (¶27). Slower FX credit growth also reduced the need for banks' foreign funding (¶5). A broad-based index (FCI)—featuring the influence on economic activity of credit, deposits, real interest rates, REER, and house prices—suggests that financial conditions were expansionary in 2016 and turned neutral toward the end of the year.

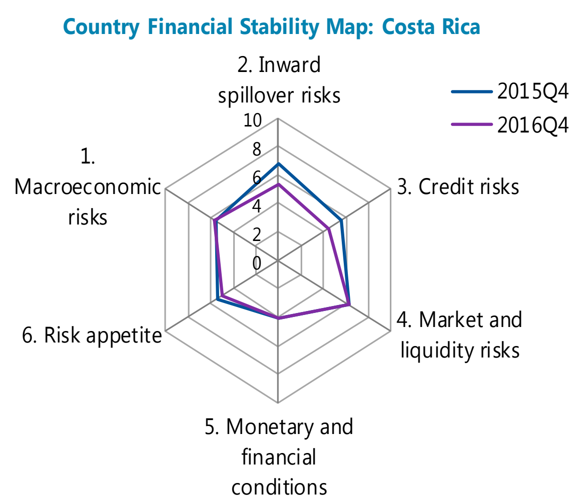




Sources: Country authorities and Fund staff estimates.

10. **Credit risks are manageable and banks have adequate capital buffers, but high dollarization remains a source of financial sector vulnerability.** Credit growth continues to be consistent with healthy financial deepening and macroeconomic trends. The banking sector has enough buffers to face negative shocks, although profitability continues to be low by regional standards. Compared to end-2015, there is no evidence of financial risk buildup; indeed, credit and inward spillover risks have eased somewhat. However, the high dollarization of both credit and bank liabilities create XR-related credit and funding risks, although buffers are large enough to withstand shocks of plausible magnitude without raising solvency and liquidity concerns. More recently, over-reliance on non-deposit liabilities, has heightened vulnerability to market volatility and loss of confidence from foreign lenders, to which Costa Rica is particularly exposed given its high perceived sovereign risk.





Note: Away from center signifies higher risks, easier monetary and financial conditions, or higher risk appetite.

Costa Rica: Banking Sector Financial Soundness Indicators, December 2016

	All Banks	State Owned	Domestic Private	Foreign
Selected Banking Sector Ratios (Percent)				
Capital Adequacy				
Total capital / RWA (CAR)	18.7	20.5	14.0	16.2
Asset Quality				
NPLs/ total loans	1.6	2.1	1.0	0.9
FX loans/total loans	63.6	48.4	99.6	84.9
Funding				
Deposits/total liabilities	87.5	86.8	89.2	88.7
Deposits/total loans	129.2	132.8	126.3	123.7
Profitability				
ROA (after-tax)	1.0	1.0	1.0	1.0
ROE (after-tax)	8.0	7.5	9.3	9.1
Liquidity				
Liquid assets/total assets	27.6	28.6	24.9	26.0
Liquid assets/short-term liabilities	82.6	77.6	98.5	93.1
Sensitivity to Market Risk				
Net FX exposure / capital	24.5	5.4	86.7	58.9

Source: SUGEF; and IMF staff calculations.

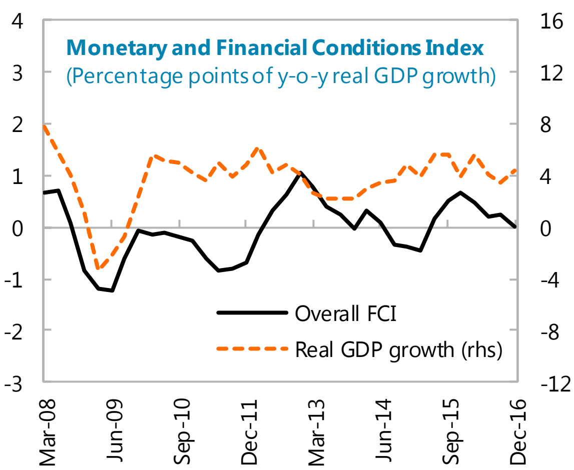
Costa Rica: Financial Soundness Indicator Map

Costa Rica	2015Q1	2015Q2	2015Q3	2015Q4	2016Q1	2016Q2	2016Q3	2016Q4
Overall Financial Sector Rating	M	M	M	M	M	M	M	M
Credit cycle	L	L	L	L	L	L	L	L
Change in credit / GDP ratio (pp, annual)	1.6	1.4	2.0	2.1	2.3	2.6	2.6	2.4
Growth of credit / GDP (%, annual)	3.0	2.8	3.8	4.1	4.3	4.8	4.9	4.3
Credit-to-GDP gap (st. dev)	-1.0	-1.5	-1.5	-1.1	-1.6	-1.3	-0.9	-0.7
Balance Sheet Soundness	M	M	M	M	M	M	M	M
Balance Sheet Structural Risk	M	M	M	M	M	M	M	M
Deposit-to-loan ratio	100.8	104.8	98.4	96.6	96.6	90.4	89.3	85.7
FX liabilities % (of total liabilities)	34.6	35.1	33.7	33.5	33.9	33.1	33.7	33.5
FX loans % (of total loans)	41.0	41.2	41.4	41.8	41.8	42.1	41.5	41.0
Balance Sheet Buffers	L	L	L	L	L	L	L	L
Leverage	L	L	L	L	L	L	L	L
Leverage ratio (%)	10.0	9.7	9.9	9.7	9.9	9.7	9.5	9.3
Profitability	L	L	L	L	L	L	L	L
ROA	1.1	1.0	1.0	1.1	1.2	1.2	0.6	0.6
ROE	8.0	7.4	7.3	7.3	8.3	8.7	4.3	4.3
Asset quality	L	L	L	M	L	L	L	L
NPL ratio	1.6	1.6	1.7	1.7	1.7	1.6	1.6	1.6
NPL ratio change (%, annual)	-2.0	0.7	1.6	7.2	4.7	1.4	-4.8	-4.8

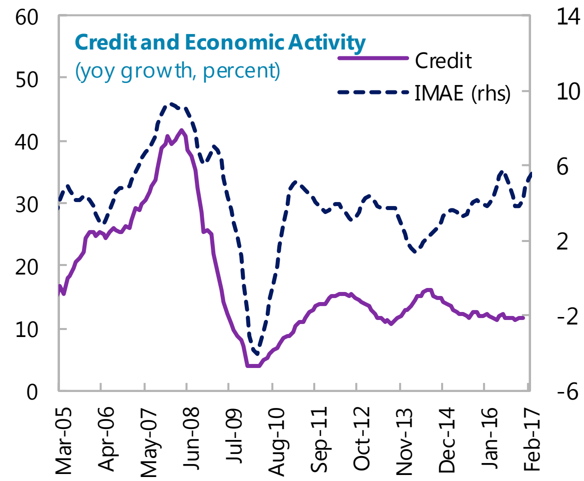
Note: An indicator is marked as red (policies needed) if the upper range of the threshold is breached; as yellow (on alert) if the indicator is between the lower and the upper thresholds; and green (no policies) if the indicator is below the lower threshold. The thresholds are based on analyses in the September 2011 GFSR Chapter 3, Dell'Ariccia and others (2012), Key Aspects of Macroprudential Policies (2013), Staff Guidance Notes on Macroprudential Policies (2014), and Basel III leverage ratio; and informed by MCM's experiences in FSAPs.

Figure 4. Costa Rica: Recent Developments, Financial Sector

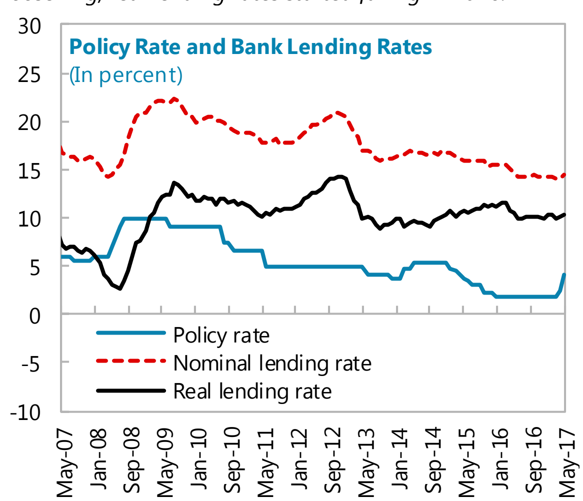
Financial conditions have gradually eased in 2016 and are now broadly neutral.



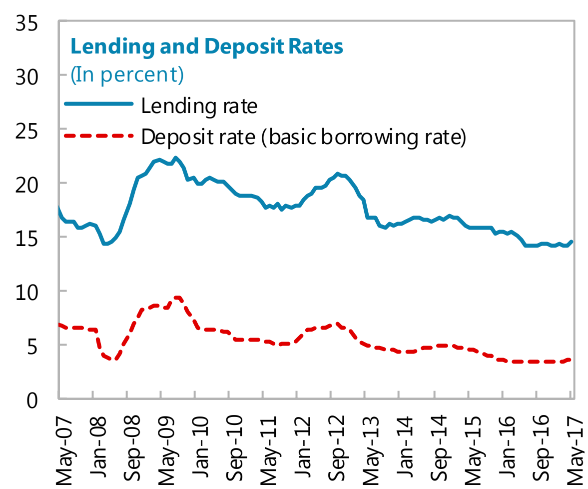
Credit decelerated somewhat despite sustained economic activity, steered by lower FX loans.



After hedging up through 2015 despite large monetary loosening, real lending rates started falling in 2016.



About 2/3 of the policy rate cuts were mirrored in lower lending rates, but bank spreads remain high.



Sources: National authorities, WEO Database and Fund staff estimates.

B. Macroeconomic Outlook and Risks

11. **With approval of a fiscal package unlikely, baseline projections envisage that economic activity will ease somewhat, while inflation reverts to the target range.**

- The prevailing view of analysts and stakeholders is that it will be difficult for the reform proposals presented by the government to be enacted before the elections. Therefore, the baseline scenario does not incorporate fiscal adjustment provisions beyond those already sanctioned, leading to stable primary fiscal deficit of almost 3 percent of GDP over the medium term.

- In 2017, growth is anticipated to slow marginally to 4 percent, with continued substitution of external sources of expansion for domestic demand. The latter is expected to decelerate somewhat due to weaker terms-of-trade, as oil prices continue to normalize. Financial conditions should gradually tighten amid incipient monetary policy normalization, persistently high public sector financing needs, and rising international rates. Export performance, bolstered also by the recent real depreciation, would remain robust, as global and especially U.S. growth accelerate. Past monetary stimulus, fading base effects from past oil price declines, and recent moderate depreciation, are expected to bring inflation back to the middle of the target range by end-2017.

- Over the medium-term, potential growth would be visibly eroded, reflecting mainly the strain on private investment of higher interest rates ensuing from the tighter monetary stance needed to keep inflation close to target and costlier risk premia in the continuation of large budget deficits. Credit is projected to expand modestly faster than nominal GDP, consistent with further healthy financial deepening. The current account deficit will widen slightly to 4 percent of GDP, amid gradual recovery of commodity prices. Without additional significant consolidation steps, public debt will rise close to 65 percent of GDP by 2022, driven mainly by a mounting interest bill (¶18).

Costa Rica: Baseline Scenario 1/

(In percent of GDP, unless otherwise indicated)

	2016	2017	2018	2019	2020	2021	2022
Real GDP growth (percent)	4.3	4.0	4.0	3.9	3.9	3.8	3.8
Potential GDP growth (percent)	4.2	4.1	4.1	4.0	3.9	3.8	3.8
Output gap (percent of potential GDP)	0.1	0.0	-0.1	-0.2	-0.2	-0.2	-0.2
CPI (percent, end-of-period)	0.8	3.0	3.0	3.0	3.0	3.0	3.0
Credit growth (percent)	12.8	11.1	10.9	10.0	9.2	8.6	8.1
Current account balance	-3.2	-4.0	-4.0	-4.0	-4.0	-4.0	-4.0
Central government fiscal balance	-5.3	-6.1	-6.5	-6.9	-7.3	-7.7	-8.2
Structural primary balance	-2.4	-2.8	-2.8	-2.8	-2.7	-2.7	-2.7
Structural overall balance	-5.3	-6.1	-6.5	-6.9	-7.3	-7.7	-8.2
Central government debt	44.7	48.4	51.7	55.2	58.4	62.1	66.0

Source: Fund staff estimates.
1/ Includes additional consolidation deriving from already adopted legislative measures. It includes increases in education and social expenditures broadly consistent with constitutional mandates, as well as limited increases in investment.

12. **An alternative scenario incorporating the fiscal adjustment necessary to restore debt sustainability would yield a more favorable outlook.** According to staff analysis, an additional correction of about 3 percent of GDP would stabilize public debt in the medium term within safe levels (¶19), with only moderate short-term output costs. Growth would be higher in outer years than in the baseline, reflecting confidence effects and a more balanced policy mix, with the

restoration of fiscal sustainability allowing a more accommodative monetary stance. This would also mitigate increases in market rates associated with the normalization of U.S. monetary policy.

Costa Rica: Adjustment Scenario 1/

(In percent of GDP, unless otherwise indicated)

	2016	2017	2018	2019	2020	2021	2022
Real GDP growth (percent)	4.3	4.0	4.1	3.8	4.4	4.4	4.2
Potential GDP growth (percent)	4.2	4.2	4.2	4.2	4.2	4.2	4.2
Output gap (percent of potential GDP)	0.1	0.0	-0.1	-0.4	-0.2	0.0	0.0
CPI (percent, end-of-period)	0.8	3.0	3.0	3.0	3.0	3.0	3.0
Credit growth (in percent)	12.8	11.0	11.0	11.2	11.3	11.7	10.9
Current account balance	-3.2	-3.8	-3.7	-3.0	-2.9	-2.8	-2.7
Central government fiscal balance	-5.3	-5.7	-5.6	-4.1	-3.5	-3.2	-3.2
Structural primary balance	-2.4	-2.5	-2.3	-0.5	0.2	0.2	0.3
Structural overall balance	-5.3	-5.7	-5.6	-4.0	-3.4	-3.2	-3.2
Central government debt	44.7	48.0	50.3	51.0	50.6	50.1	49.7

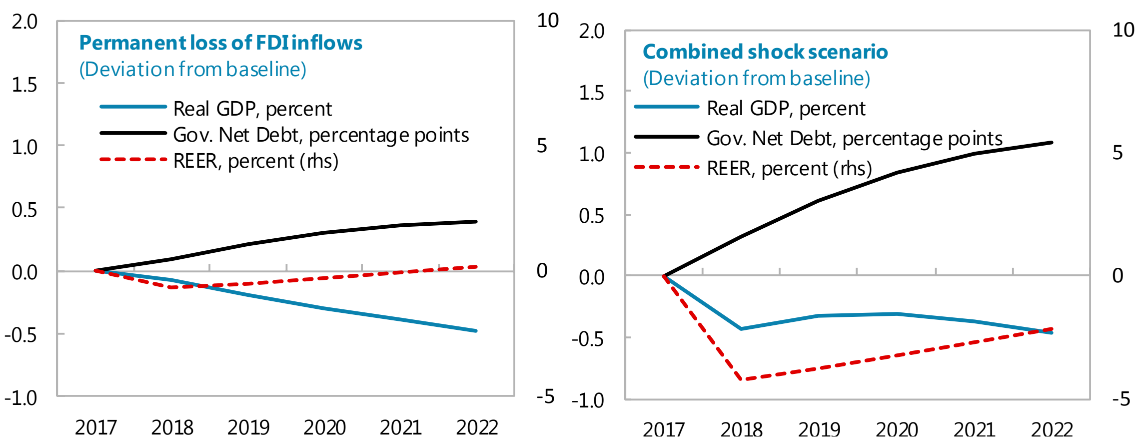
Source: Fund staff estimates.

1/ Includes measures of 3 percent of GDP needed to stabilize debt at a safe level over the medium term. Consistent with the literature, growth projections are based on assumed "underlying" low multiplier of 0.2 for additional adjustment measures focused mainly on revenue side, with additional substantial confidence effects from restoration of fiscal sustainability. Faster credit growth from reduced crowding out and easier monetary stance amid reduced inflationary pressures with respect to the baseline scenario also supports growth. Current account projections assume improvements in competitiveness resulting mainly from lower risk premia, higher investment in export sectors, and some contention of growth in public sector wages with spillovers to the private sector.

13. **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.** Markedly *tighter global financial conditions* driven by substantial further strengthening of the U.S. dollar, more rapid monetary policy normalization, or rising risk premia from a weaker fiscal position in the U.S. could inflict significant damage on Costa Rica, given its weak budgetary situation, bank reliance on foreign funding, and high credit dollarization. Costa Rica's open economy would also be particularly vulnerable to a *retreat in cross-border integration* if increased protectionism and economic isolationism takes hold in key advanced economies. FDI could suffer from sizable reductions in the U.S. effective corporate tax rate, although the impact is likely to be contained, given the importance of other pull factors, including an educated workforce, security, rule of law, and geographical location. Still, model simulations suggest that a more adverse scenario with changes in U.S. policies also affecting trade and term premia could decrease GDP growth by ½ percent over the medium term (AN I). *Weaker-than-expected global growth*, especially from structurally lower expansion in key economies would also be detrimental to Costa Rica's medium-term growth prospects. While Costa Rica seems less vulnerable to the *loss of correspondent banking relationships (CBR)* given the absence of a significant offshore sector like other countries in the Central America-

Caribbean region, intensification of thus far comparatively limited AML-compliance concerns could exacerbate this risk (¶29).

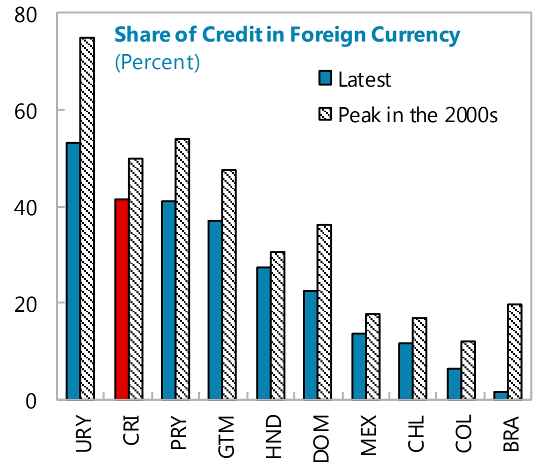


Source: IMF/RES WHDMOD simulations. Note: The FDI scenario assumes a 20% decline in FDI from the US, implying a permanent reduction in investment of 0.55% of GDP from 2018. The combined shock scenario assumes a combination of: (i) the FDI scenario; (ii) an increase in tariffs to the WTO MFN; and (iii) a temporary yet persistent 50 bps increase in the US term premium with spillovers to global commodities.

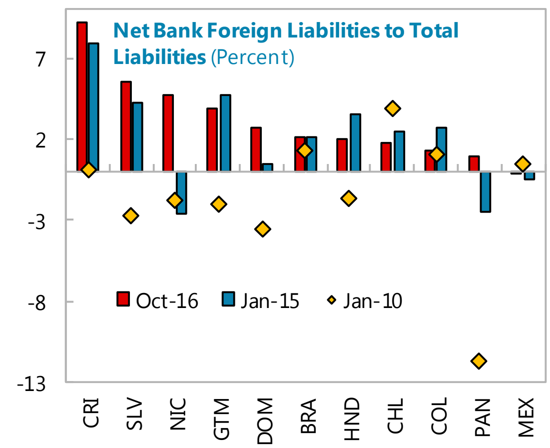
- **Domestic risks.** The *persistence of large fiscal deficits* and associated large gross financing requirements render the economy particularly vulnerable to hikes in domestic interest rates and adverse changes in global financial market sentiment, notwithstanding the existence of a large stable base of domestic institutional investors. Containing the cost of domestic budget financing through greater reliance on floating rate and dollar-denominated bonds could exacerbate these risks (¶7). Competitiveness and the external position could also be negatively affected if fiscal vulnerabilities are not addressed. Moreover, given *low profitability and heavy dollarization of the banking system,* financial stability could be jeopardized by substantial currency depreciation, mainly through higher NPLs (¶25).

Figure 5. Costa Rica: Financial Sector Risks and Vulnerabilities

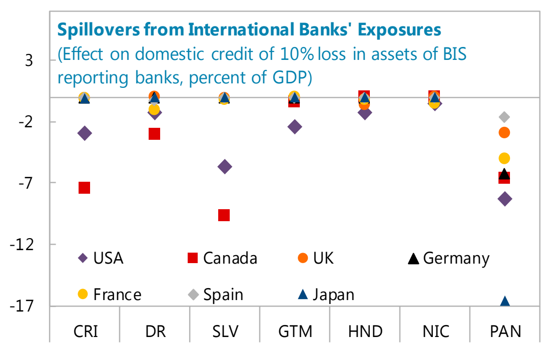
Costa Rica is one of the countries with the highest credit dollarization in the region...



...and among the most reliant on foreign funding...

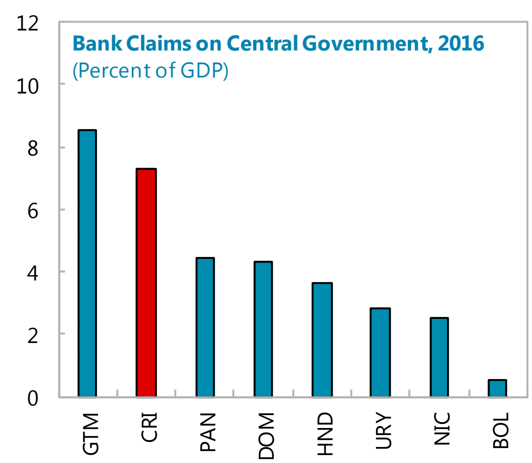


...although associated rollover risks appear manageable.

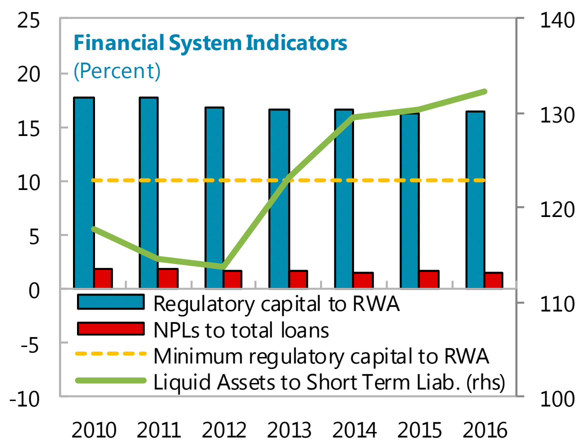


Source: IMF/RES Bank Contagion Module, based on BIS data as ofr June 2016. Note: In Panama, the loss of credit includes credit by banks in the off-shore center with minimal links to the domestic economy.

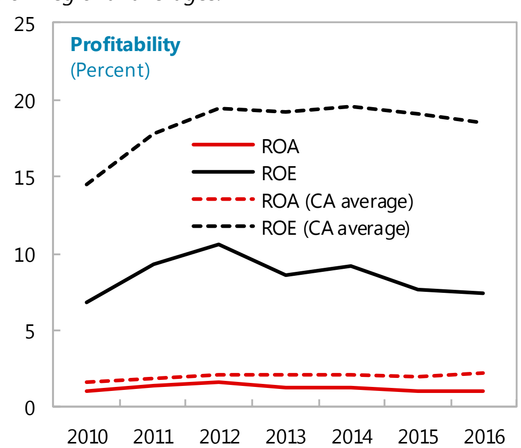
Exposure to a sovereign with high and rising public debt is another area of concern.



However, banks are adequately capitalized and liquid, and NPLs remain low...



...although profitability has been declining and remains below regional averages.



Sources: BIS, IFS, WEO Database and Fund staff estimates.

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. Tighter global financial conditions.	**High/Medium** • Significant further strengthening of the US dollar and/or higher rates as investors reassess policy fundamentals leading to higher risk premia, or if there is a more rapid Fed normalization (High). • Reduced financial services by global/regional banks, including loss of correspondent bank accounts (Medium).	**High/Medium** • Changes in the U.S. policy mix leading to stronger U.S. growth in tandem with higher international rates could on net be beneficial for Costa Rica. However, significantly higher international rates and stronger US dollar under more disorderly scenarios could disrupt external bank funding and increase credit risks from unhedged FX borrowers. If markets reassessed fiscal risks in Costa Rica, the cost of external government and private sector financing could increase sharply, negatively affecting public debt dynamics and growth (High). • If exchange rate flexibility vis-à-vis the dollar were to be restricted by the central bank out of concerns over balance sheet effects, the NEER would appreciate, negatively affecting competitiveness vis-à-vis the rest of the world. Possible significant loss of reserves would also increase the economy's external vulnerabilities (Medium). • Significant losses of correspondent accounts could curtail cross-border payments, trade finance, and remittances (Medium).
2. Retreat in cross-border integration.	**High** • Fraying consensus about the benefits of globalization could lead to protectionism and economic isolationism, leading to reduced global and regional policy collaboration with negative consequences for trade, capital and labor flows, investors' sentiment, and growth.	**High/Medium** • Costa Rica's open economy would be particularly vulnerable to significant changes in trade policies in key trading partners. Notwithstanding the importance of other pull factors, such as the educated labor force, rule of law and geographical location, FDI flows would also be significantly affected by changes in advanced country policies aimed at discouraging investments abroad.
3. Slower growth in advanced and/or emerging economies.	**Medium/High** • Sharper-than-expected global slowdown in the short-term, triggered by significant China slowdown (Low in the short-term, Medium thereafter), or turning credit cycle in EMs (Medium). • Protracted period of structurally weaker growth in advanced (High) and emerging economies (Medium).	**Medium/High** • Impact of weaker emerging markets growth in the short- or long-term would be moderate, as long as U.S. growth were relatively unaffected (Medium). • Protracted period of weaker-than-expected growth in the U.S. 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 used up (High).
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 budget 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.

[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

14. **The consultation focused on the policy mix appropriate for current cyclical conditions and on mitigation of longer-term economic vulnerabilities.** In particular, the latter covered 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

15. **The mission recommended a policy mix characterized by additional fiscal tightening and continued monetary policy normalization.** With output essentially at potential, inflation recovering, and a still sizeable fiscal sustainability gap, the authorities should deepen their budgetary consolidation efforts and keep withdrawing monetary stimulus.

16. **Staff advised continued fiscal consolidation in 2017 as part of a gradual path toward fiscal sustainability.** The primary deficit is expected to widen to 2¾ percent of GDP this year under the baseline scenario, owing to recent Constitutional court rulings (¶8).[1] Staff nonetheless stressed the importance of intensifying the authorities' administrative efforts to curtail expenditure and mobilize revenue to minimize or even prevent the fiscal deterioration. The mission moreover strongly supported the authorities' intention to seek Congressional approval of additional legislative measures (¶8) in the last year of the Solis administration to make additional gains toward closing the sustainability gap over the medium term (¶19-21).

17. **The mission recommended that the central bank ought to continue reversing the easing cycle.** Since both headline and core inflation remain well below the target range, the monetary stance has remained appropriately expansionary—with a policy rate of 4 percent, still below the estimated neutral rate of 5 percent. At the same time, inflation expectations sit stubbornly near the upper bound of the target range and headline inflation is projected to return to the center of the range by the end of this year. Thus, with the output gap virtually closed, and considering the lags in monetary policy transmission, staff advised that the central bank should consider further tightening the monetary stance during the second half of 2017, especially if price pressures threaten to drive inflation above the mid-point of the target range and jeopardize the still-very-recent anchoring of inflation expectations. This argument is reinforced by prospective Fed normalization and associated U.S. dollar strengthening, which could prompt colón depreciation thereby stoking inflation.

[1] The 2017 original budget envisioned primary and overall fiscal deficits of 3¼ and 6½ percent of GDP, without the impact from legislative measures or the gains from administrative measures in 2016. A supplementary budget presented in April included additional expenditures of ¼ percent of GDP to comply with recent Constitutional court rulings on earmarking of social expenditures.[2] OECD recommendations—as part of the accession process—to enhance competition include giving the competition commission more independence, eliminating anti-trust exemptions, improving corporate governance of SOEs, and reducing barriers to entrepreneurship.

Costa Rica: Neutral Interest Rate Estimates, May 2017

		Expected Inflation Dec-2017	3.00
		Actual Monetary Policy Rate	4.00

Method 1/	Neutral Real Interest Rate (NRIR)	Neutral Nominal Interest Rate (NNIR)	Monetary Policy GAP (bps) 2/
Uncovered Interest Parity	2.8	5.8	183
Expected-Inflation Augmented Taylor Rule			
2006-2016	1.6	4.6	60
General Equilibrium Model			
2006-2016	1.6	4.6	63
Forward Looking Monetary Model			
1994-2016	1.8	4.8	76
Quarterly Projection Model			
1996-2016	2.0	5.0	105
Average	2.0	5.0	97

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

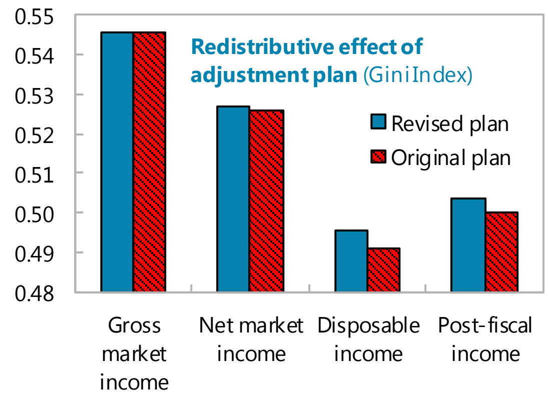
18. **Staff observed that, despite recent progress in budgetary consolidation, fiscal trends remain unsustainable in the long term.** In the baseline, without additional policy action, the Central Government primary deficit would return to around 3 percent of GDP over the medium term. The overall deficit would rise over 8 percent of GDP and debt reach 65 percent of GDP by 2022 (steadily growing thereafter), from 45 percent at end-2016, owing to a mounting interest bill and constitutionally-mandated education spending.

19. **Hence, the mission recommended further budget adjustment of 3 percent of GDP to stabilize the public debt ratio.** This would maintain the share of public debt to GDP below levels which tend to weaken macro stability in emerging markets, while accommodating desirable increases in growth-friendly capital spending (Annex IV). Reflecting advances already made (¶7), the fiscal sustainability gap has declined by ¾ percent of GDP since the last Article IV.

20. **Staff underscored that only the authorities' main plan can provide the adjustment needed to close the sustainability gap.** The authorities' full-fledged tax reforms (¶8), accompanied by sustained administrative steps to contain the wage bill, would deliver the needed residual adjustment of 3 percent of GDP. Maintaining the balance between revenue and expenditure measures, including the public employment and fiscal responsibility laws with additional consolidation benefits over the long-term, will remain critical to shore up parliamentary support for the package. In contrast, the mission noted that the alternative legislative package, even if enacted by Congress before the elections, would yield at most 1½ percent of GDP. The shortfall is mainly

due to the removal of the VAT rate increases, partly offset by less generous compensation to lower-income families for the VAT hike and taxation of previously exempt education and health services at a reduced rate.

21. **The alternative adjustment scenario** (¶12) **assumes full implementation of the Fund-endorsed fiscal consolidation package.** This envisages Congressional approval of VAT and income tax reforms along the lines of the government's main proposal, giving 2¼ percent of GDP. Staff estimates indicate that their distributional impact would be positive, given increased progressivity of the income tax and VAT transfers to low-income households which more than offset the regressive impact of the VAT reform (AN II.A). The adjustment could take place with approval this year of certain provisions of the revised package and of the remaining elements under the next administration, or entirely under the purview of the next government. The scenario includes about ¾ percent of GDP in spending reductions—effected administratively, mostly through a partial hiring freeze and holding base salary increases below inflation. Implementation of these measures would ensure that total adjustment since the start of fiscal retrenchment in 2016 consists for about two-thirds of additional revenues—consistent with staff advice, given Costa Rica's low collection effort compared to other upper-middle-income countries. However, the delays associated with the political cycle and the cost of prolonging them further mean that consolidation would have to be less gradual than previously proposed by staff to modulate better the adverse impact on growth.



Note: Gross market income is part of the baseline and is not modified by reforms. Net market income accounts for the impact of changes in PIT. The disposable income shows the combined effect of the PIT and the VAT refund, and the post-fiscal income summarizes the impact of the three interventions (PIT, VAT and partial refund of VAT).

22. **Staff also pointed out that radical reforms are needed to ensure financial sustainability of the pension system over the long term.** An independent actuarial report found that only major parametric changes will resolve imbalances of the main pay-as-you-go scheme subject to long-term pressures from system maturation and population aging. The main recommendations are to raise gradually the retirement age to 70 years, cut the replacement rate by one fifth, and lift the contribution rate up to 26 percent by 2055. A stylized exercise conducted by staff reaches similar conclusions (AN II.C). The Social Security responded by announcing a 1 percent increase in the employee's contribution rate, bringing the total contribution rate to 9.5 percent from June 2017, as well as the start of a national dialogue to discuss additional reforms needed to meaningfully close the actuarial gap. The mission also argued that reforming the actuarially imbalanced special regime for the judiciary, which could require budgetary support already in the near future, would be especially urgent.

Costa Rica. Fiscal consolidation measures

(Percent of GDP)

	Main plan	Alternative plan
Legislative measures	2.3	1.5
VAT	1.5	0.9
Base widening (services)	0.5	0.5
Tax rate hike (13 to 15 percent)	0.8	-
Vehicle and real estate sales	0.2	-
Other 1/		0.4
Income tax 2/	0.8	0.6
Administrative expenditure measures	0.7	-
Residual gap	-	1.5
Total sustainability gap	3.0	

1/ Includes: impact of limiting VAT refund to 3 poorer deciles of the population (vs. 4 in the main proposal); taxation at reduced rate of previously exempted health and education services; and 1 percentage point increase in excise tax on selected products.

2/ The alternative plan would envisage a new marginal tax rate of 20 percent on higher income brackets (compared to 20 and 25 percent in the main plan), uniform taxation of income from investments at 12 percent (compared to 15 percent in the main plan). Both plans include reduction in exemptions on income from capital and more limited deductability of interest payments.

Costa Rica: Full Adjustment Scenario. Fiscal Consolidation Path

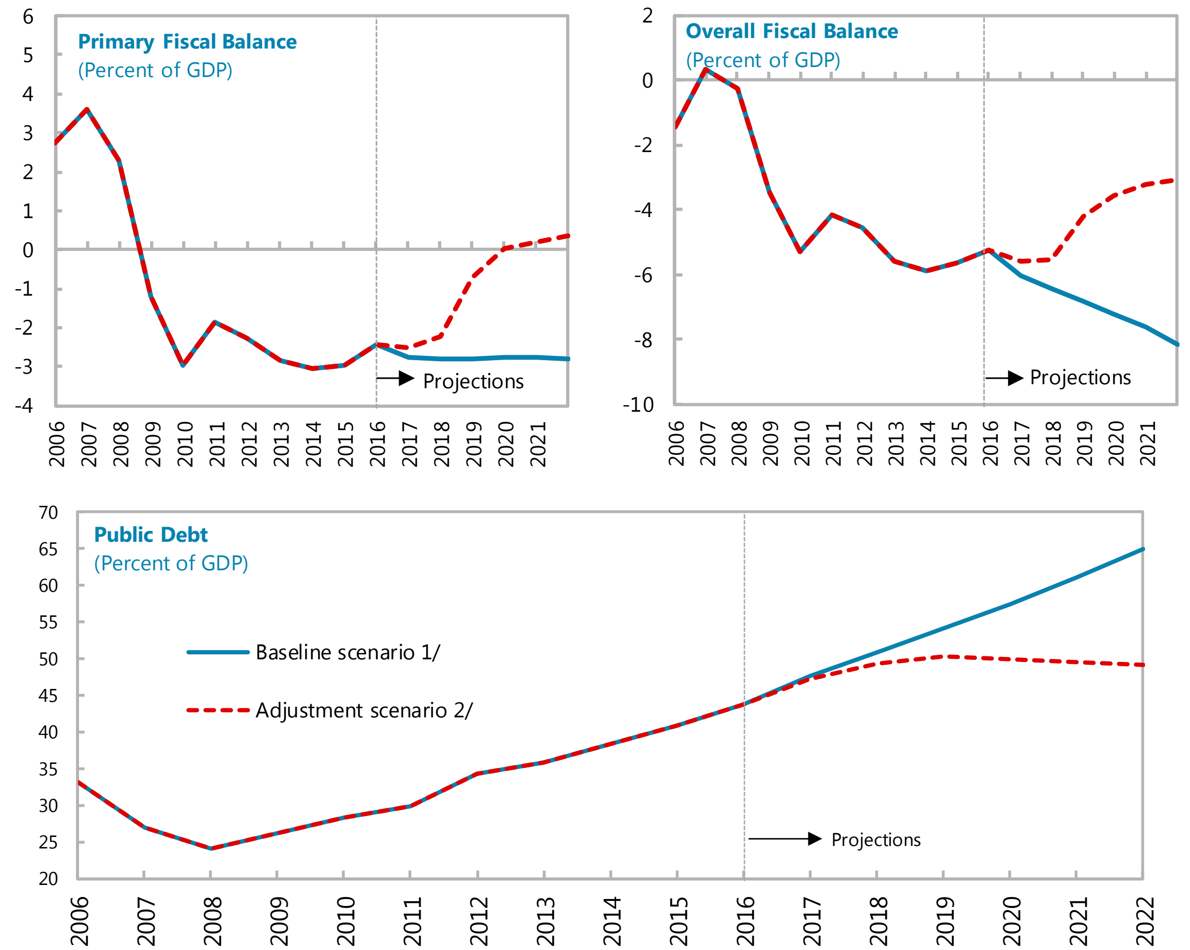
(Percent of GDP)

	2017	2018	2019	2020	2021	2022	Total
Total Adjustment	0.1	0.5	1.6	0.6	0.1	0.1	3.0
Revenue	-	0.3	1.5	0.5	-	-	2.3
VAT	-	0.3	0.7	0.5	-	-	1.5
Base widening (services)	-	0.2	0.2	0.1	-	-	0.5
Tax rate (13 to 15 percent)	-	-	0.4	0.4	-	-	0.8
Vehicle and real estate sales	-	0.1	0.1	-	-	-	0.2
Income tax	-	-	0.8	-	-	-	0.8
Expenditure	0.1	0.1	0.1	0.1	0.1	0.1	0.7
Wage bill 1/	0.1	0.1	0.1	0.1	0.1	0.1	0.7

Source: Fund staff estimates.

1/ Includes impact combination of hiring freeze outside education and sustained increases in base salary 1 percent below inflation.

Figure 6. Costa Rica: Baseline and Adjustment Scenarios



1/ Includes consolidation deriving from already adopted legislative measures and continued limited increases in expenditure on education. 2/ Includes further measures of 3 percent of GDP needed to stabilize debt at a safe level over the medium term.

C. Improving the Monetary and Exchange Rate Policy Framework

23. **The mission acknowledged the authorities' steady progress toward full-fledged inflation targeting and laid out the need for additional steps.** Monetary policy has succeeded in substantially lowering inflation expectations and keeping them within the new 2-4 percent target introduced in January 2016. At the same time, the BCCR has accommodated a contained increase in XR flexibility in 2016 (¶5) and intends to maintain a similar stance this year. Commending this, the mission argued for more XR flexibility and enhanced transparency about the triggers of the FX-intervention rule. Such moves would strengthen further credibility of the inflation-targeting framework, by reinforcing confidence in the full subordination of XR management to the inflation objectives. Greater XR flexibility would also buttress the role of the XR as a shock absorber while limiting further loss of reserves, and help internalize XR risks, thus reducing FX mismatches and discouraging dollarization. Fostering the underdeveloped secondary market for government

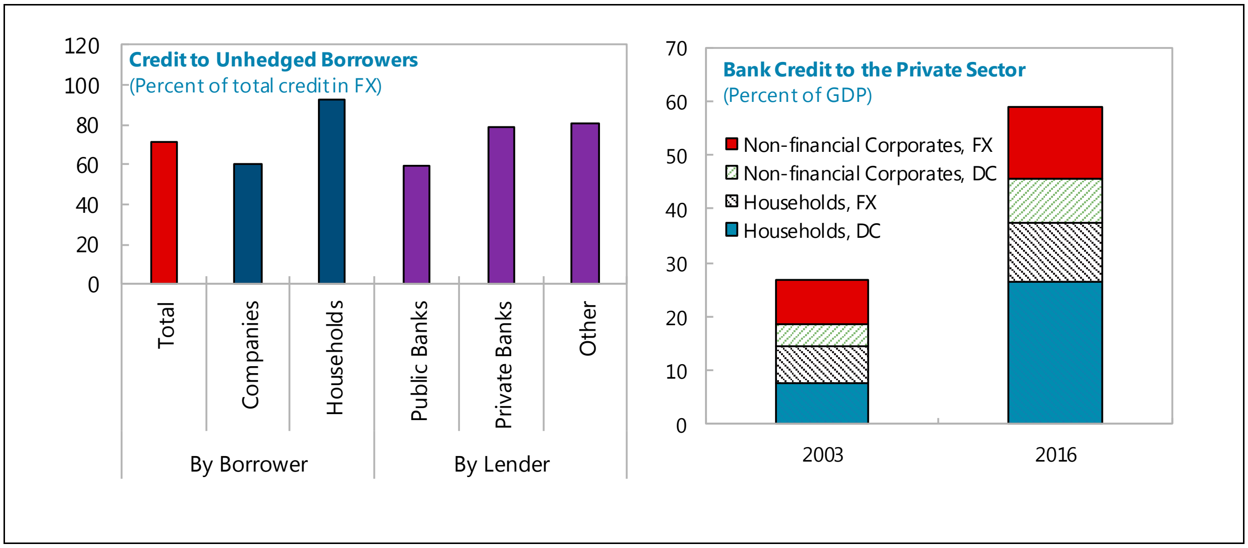
securities, including through use of standardized simple instruments with conventional maturities, would also boost effectiveness of monetary policy and resilience to external financial shocks.

24. **The central bank is appropriately taking further measures to deepen the FX market, thereby propitiating more tolerance for XR flexibility.** The authorities will introduce in July 2017 a single-price FX auction among authorized intermediaries before the beginning of each trading session in the continuous market (Monex). The auction is meant to facilitate the consolidation of FX demand and supply, thus reducing search costs and provide a reference price for the continuous FX market. This is expected to improve liquidity and price discovery, lower uncertainty and volatility at the beginning of the Monex trading session, and reduce market concentration, thereby making the XR less dependent on the operations of a few large entities and prone to speculative moves. In April 2017, the BCCR also proposed a new regulation to requires that commercial banks fix their net open FX position as a share of capital at the level consistent with their business model, with any deviation subject to its authorization. This regulation is being complemented by prudential measures proposed by the Superintendence of Banks (SUGEF) to protect banks' capital adequacy against losses from XR movements and reduce incentives for FX speculation (¶27). The mission noted that, if successful in reducing the market power of major banks, and thus in strengthening the operation of the FX market, the BCCR would find it easier to reduce further its FX interventions.

D. Financial Stability

25. **Staff reiterated that large dollarization of lending to unhedged borrowers, rising household leverage, and sovereign exposure linger as the key financial sector vulnerabilities.**

- About 40 percent of credit to the non-financial private sector in Costa Rica is denominated in foreign currency, and over 70 percent of such credit is extended to unhedged borrowers, exposing the system to credit risk through XR risk. At the same time, the brisk increase in households' leverage in later years, with a high incidence of credit by non-bank commercial entities, may also endanger banks' asset quality, particularly in the absence of shared information on borrowers' aggregate debt. Finally, continuing accumulation of government debt holdings subjects banks to sovereign risk and mounting mark-to-market losses on sovereign exposures, especially in an environment of increasing interest rates (¶13).



- Staff explained that, according to its stress test (AN III.B), despite the overall long FX position of the banking system, a large depreciation of the colón would indirectly affect capital adequacy through credit risk, given large unhedged foreign liabilities in the private sector. Moreover, though a significant spike in interest rates would not result in bank "flow" losses, the stock effect from repricing of domestic government bonds would compound capital losses. Overall, however, banks appear sufficiently capitalized to absorb these shocks and there is no need for additional buffers.

- The smallest public bank required a restructuring plan after prolonged losses; staff urged the authorities to implement it decisively to minimize contingent liabilities.

Costa Rica: Summary of Stress Test Results

	All Banks	State Owned	Domestic Private	Foreign
Asset Quality				
Non performing loans (NPLs, Percent of Total Loans))	1.6	2.1	0.9	0.9
Capital adequacy ratio (CAR) pre-shock	18.7	20.5	14.0	16.2
Credit Risk Stress Test 1/				
1. "Proportional increase in NPLs"				
Post-shock CAR (Percent)	16.8	18.7	12.2	14.3
CAR change (Pct Points)	-1.9	-1.8	-1.8	-2.0
2. "Sectoral shocks to NPLs"				
Post-shock CAR (Percent)	17.7	20.0	13.4	14.3
CAR change (Pct Points)	-1.1	-0.6	-0.6	-2.0
Interest Rate Risk Stress Test 2/				
1. Net interest income impact				
Post-shock CAR (Percent)	19.5	21.1	15.2	17.3
CAR change (Pct Points)	0.8	0.6	1.2	1.1
2. Repricing impact				
Post-shock CAR (Percent)	18.6	20.1	14.1	16.7
CAR change (Pct Points)	-0.9	-1.0	-1.1	-0.7
Overall change in CAR (NII and Repricing)	-0.1	-0.4	0.1	0.4
FX Risk Stress Test 3/				
1. Direct Foreign Exchange Risk				
Post-shock CAR (Percent)	17.5	19.0	13.1	15.6
CAR change (Pct Points)	-1.2	-1.5	-0.9	-0.6
2. Indirect Foreign Exchange Risk				
Post-shock CAR (Percent)	16.1	18.1	11.2	13.2
CAR change (Pct Points)	-1.5	-1.0	-1.9	-2.4
Overall change in CAR (Direct and Indirect)	-2.7	-2.5	-2.8	-3.0
Interbank Stress Test				
CAR (after the macroshocks)	14.7	16.6	10.0	12.2
CAR after the first iteration	14.7	16.6	10.0	12.2
Liquidity Stress Test (# of liquid banks after 5 days) 4/				
Simple liquidity test (run on all banks, fire-sale of assets)	16	4	2	10

Source: SUGEF, and IMF staff estimates.

Notes: : The sample includes a total of 16 banks, of which 4 state owned, 2 private and 10 foreign.

1/ *The proportional increase in NPLs* assumes 9 percent (average NPLs over the last 10 years plus 3 s.d.) of outstanding performing loans to become non-performing; and the *Sectoral Shock* assumes 7 and 11 percent (average sectoral NPLs over the last 10 years plus 3 s.d.) of outstanding loans in the construction and trade sectors (which account together for about 62 percent of total loans) becoming non-performing.

2/ The *Interest Rat*e Shock assumes a 3.5 percentage points nominal interest rate increase.

4/ The *Liquidity Shock* assumes a 10 and 8 percent per day withdrawal of demand deposits in domestic and foreign currency respectively; and a 5 and 3 percent per day withdrawal of time deposits in domestic and foreign currency respectively.

Costa Rica: Summary of Stress Test Results

Source: SUGEF, and IMF staff estimates.

Notes: The sample includes a total of 16 banks, of which 4 state owned, 2 private and 10 foreign. *The System-Wide Credit Risk* Shock assumes 9 percent (3 s.d. over average NPLs during the last 10 years) of outstanding performing loans to become non-performing; and the *Sectoral Shock* assumes 7 and 11 percent (3 s.d. over average sectoral NPLs during the last 10 years) of outstanding loans in the construction and trade sectors (which account together for about 62 percent of total loans) becoming non-performing. The *Interest Rate* Shock assumes a 3.5 percentage points nominal interest rate increase. The *FX Shock* assumes a 18 percent depreciation of the FX rate, leading to 11 percent of FX loans becoming NPL. The *Liquidity Shock* assumes a 10 and 8 percent per day withdrawal of demand deposits in domestic and foreign currency respectively; and a 5 and 3 percent per day withdrawal of time deposits in domestic and foreign currency respectively.

26. **The mission also cautioned that high net foreign liabilities expose banks to rollover risk.** About 35 percent of Costa Rica's bank liabilities are in foreign currency, putting liquidity at risk in case, for example, of tighter global financial conditions or withdrawal of CBR. However, staff analysis suggests that currently banks' high liquidity provides sufficient cushion in the event of a short-term generalized drain as well as a more protracted shock to FX liquidity, and most banks would be able to withstand a substantial loss of foreign funding (AN III.B).

27. **The authorities have introduced various micro- and macro-prudential tools to contain these systemic risks, though staff warned that more may be necessary.** Besides those adopted before 2016, last year several new regulations were introduced: (i) higher risk-weightings on household mortgages with high loan-to-value ratios, with further penalization for mortgages in FX to unhedged borrowers; (ii) additional generic provisioning of 1.5 percent on FX loans to unhedged borrowers; and (iii) countercyclical provisional buffers. In April 2017, the SUGEF also proposed a revision of minimum capital requirements for market risk to protect banks' capital adequacy against losses from XR movements, in line with Basel III guidelines (¶24). The mission argued that, though FX credit slowed down during 2016 (¶9), further tightening of prudential requirements should be considered if there is no evidence of a reduction in banks' FX exposures within a reasonable time, or if the deceleration of FX credit proves temporary. Additional measures could include higher reserve and liquidity requirements on FX liabilities, complemented by increases in capital buffers and provisioning, or stricter requirements—such as more stringent loans-to-values ratios—on FX loans.

28. **The mission repeated that implementation of pending 2008 FSAP recommendations and adoption of Basel III standards would improve resilience of the financial system.** Albeit substantial progress has been made in adopting risk-based supervision, advances towards the implementation of other key FSAP recommendations, notably crisis management and the bank resolution framework, have been slow due to the crowded legislative agenda, as most of them require new legislation, including, in some instances, constitutional reform (Annex II). Staff argued that the regulatory and risk management frameworks would also benefit from gradually introducing Basel III capital requirements and liquidity standards. In this respect, the mission welcomed the authorities' plan to introduce in 2018 a Net Stable Funding Ratio in addition to the Liquidity Coverage Ratio enacted in 2015. At the same time, the credit gap proves to be a robust early warning indicator of future financial distress and the activation of countercyclical capital buffers based on it would strengthen the resilience of banks through the financial cycle, although their implementation would likely entail non-negligible challenges (AN III.A). Progress toward past FSAP advice and the implementation of Basel III standards will be assessed, among other topics, by an imminent Financial Sector Stability Review.

29. **The mission urged reinforcement of the AML/CFT regime and the national framework for cross-border consolidated supervision.** Costa Rica needs to implement recently adopted legislative measures aimed at remedying deficiencies in its AML/CFT regime identified by the GAFILAT. Inclusion in the list of jurisdictions with strategic weaknesses in this area would hinder access of domestic financial institutions to the international financial system and increase the risk of losing correspondent banking relationships. National implementation of the recommendations in the

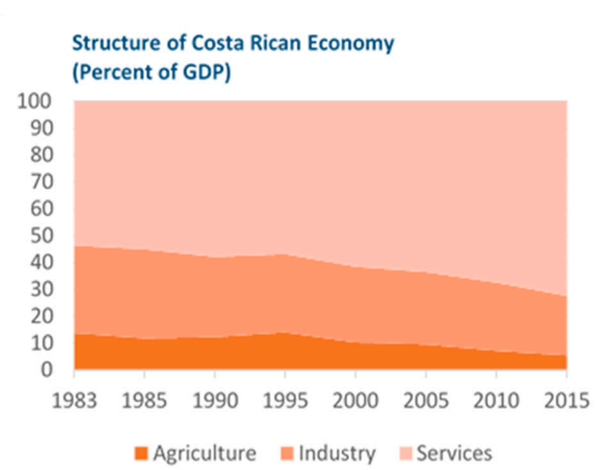
WHD Cluster Surveillance Report on Financial Integration in CAPDR would support cross-border harmonization of prudential norms, thus promoting regulatory and supervisory coordination (Annex III).

E. Structural Reforms

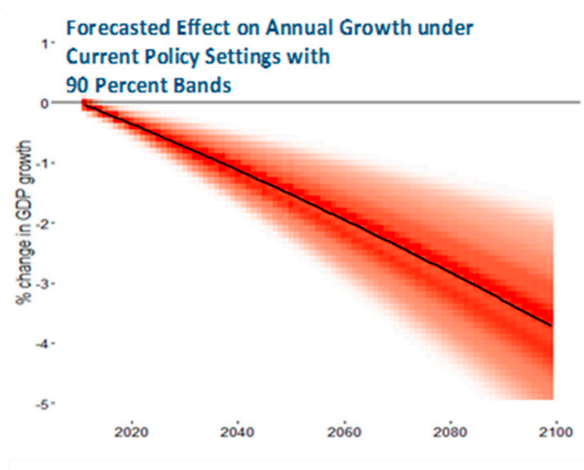
30. **Structural reforms are needed to further improve competitiveness and foster inclusive growth.** Costa Rica ranks favorably in many business indicators and remains a regional leader in attracting foreign direct investment. However, additional steps are needed to maintain the country's competitive position and further mitigate vulnerabilities to possible adverse changes in international conditions (¶6 and 13, Annex I). Addressing weaknesses in transport infrastructure, public expenditure efficiency—especially in education—and competition policies[2] would boost potential growth and make it more inclusive (ANs II.B and IV). Amendments to the electricity regulatory framework, including price-setting procedures to enhance cost discipline and reduce tariffs, as well as expanded child-care provision to promote female labor force participation would also be supportive of growth. The country has successfully implemented environmental policies that have buttressed the economy's structural transformation towards high growth services, primarily tourism. Going forward, it will be important to ensure that the legal and regulatory framework stimulate the growth of those sectors that are more resilient to climate change (AN V).

Figure 7. Costa Rica: Environmental Policy and Climate Change

In the past environmental policy helped transform the economy toward high-value services



Further structural transformation of the economy should alleviate estimated negative impact of the global warming



[2] OECD recommendations—as part of the accession process—to enhance competition include giving the competition commission more independence, eliminating anti-trust exemptions, improving corporate governance of SOEs, and reducing barriers to entrepreneurship.

31. **Efforts are needed to support continued healthy financial deepening.** Measures to increase competition in the banking sector would help reduce comparatively high interest rate spreads, thereby boosting credit, investment and growth. Financial development would also be supported by more market-friendly public debt management and issuance strategies that promote larger secondary markets for government securities, refined loan-provisioning rules that prevent high collateral requirements from being used as a substitute for proper credit-risk analysis, and better protection of investor rights.

F. Authorities' Views

32. **The authorities generally agreed with the outlook and risks highlighted by staff.** They concurred that a baseline scenario without additional adjustment would be detrimental to growth, given associated high financing costs and crowding out of private investment, while the alternative adjustment scenario would yield a more favorable outlook. The authorities also broadly shared staff's assessment of downside risks, emphasizing the importance of non-tax pull factors for FDI as a key mitigator of the country's vulnerability to possible changes in U.S. fiscal policies. They expressed however greater concern about possible indirect effects on growth through other trading partners in the region that would be more affected by possible changes in U.S. immigration and trade policies.

33. **Authorities broadly concurred with the staff's policy recommendations, while stressing graduality in extending XR flexibility and prudential requirements.**

- They agreed on the need for administrative efforts to minimize the fiscal deterioration from recent Constitutional court rulings mandating stricter enforcement of revenue earmarking provisions. The authorities also reiterated their readiness to continue increasing the monetary policy rate as needed to prevent the emergence of inflationary pressures. In addition to the direct interest rate channel, they also viewed gradual restoration of the premium on savings in colones as important to contain depreciation pressures with possible second-round effects on inflation.

- The authorities concurred that full implementation of fiscal reforms broadly in line with staff advice would be critical to place public debt on a sustainable trajectory over the medium term. They reiterated their commitment to seek parliamentary approval of a comprehensive fiscal package along these lines before the elections.

- The central bank supported in principle a contained increase in the flexibility of the XR and more transparency regarding its intervention rule to strengthen the monetary policy framework, but stressed the need to ensure that recent measures were successful in deepening the FX market and making it more resilient against speculation.

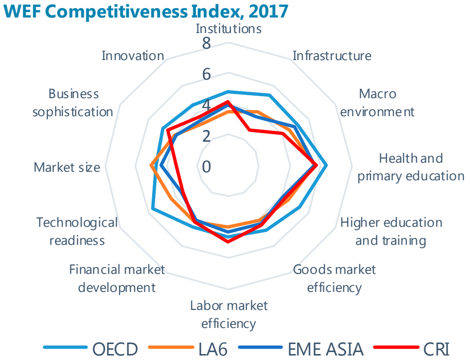
- Bank supervisors recognized that large dollarization, currency mismatches in the private sector, and growing household leverage represent financial sector vulnerabilities, and underscore the benefits of recent prudential measures to contain associated risks. They emphasized, however, that any additional regulations should be introduced cautiously, given their impact on already low profitability in the banking sector. The authorities also reiterated their support for a gradual adoption of Basel III standards, implementation of pending FSAP recommendations, and further improvements in cross-border supervision, noting also that the upcoming FSSR will help identify and fill regulatory gaps in these areas.

- Regarding the efficiency of expenditure on education, the authorities underscored the high costs associated with their primary goal of maximizing coverage as a key tool to tackle poverty.

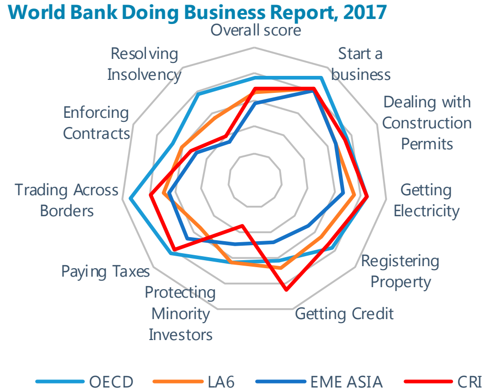
Figure 8. Costa Rica: Competitiveness and Structural Reforms

Costa Rica's competitiveness indicators compare relatively well with emerging economies but lag the OECD, particularly, regarding the quality of infrastructure.

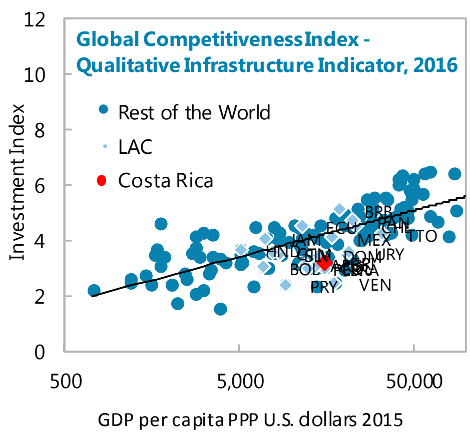
WEF Competitiveness Index, 2017

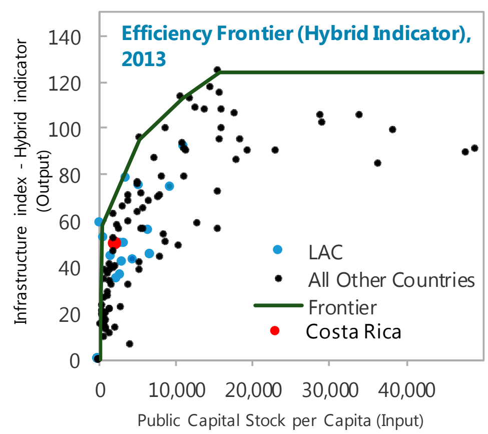


World Bank Doing Business Report, 2017



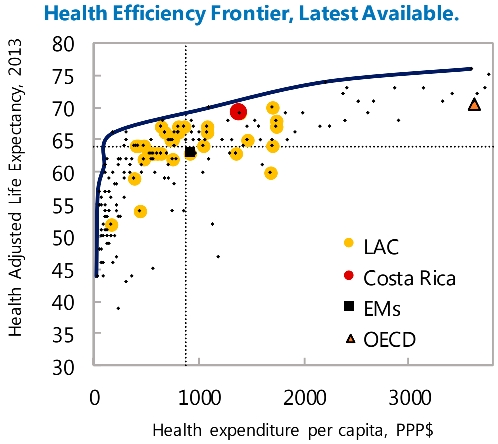
This in part because of insufficient level of infrastructure investment given Costa Rica's income level, with a substantial margin for improving the efficiency of public capital spending.



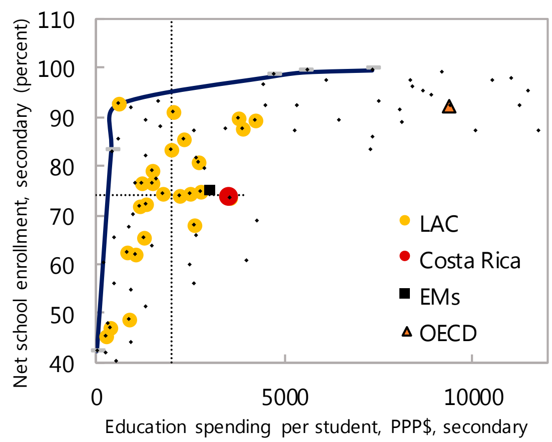


Costa Rica has made substantial progress in improving living standards, including almost universal health care, but there is ample scope for increasing the return of education spending.

Health Efficiency Frontier, Latest Available.



Education Spending Frontier, Secondary, Latest Value Available



Sources: World Economic Forum; World Bank Doing Business Indicators, Cerra et al 2016, IMF EAT, and Fund staff estimates.

STAFF APPRAISAL

34. **Risks to the outlook are rising, underscoring the increasing urgency of addressing mounting macro vulnerabilities**. The economy is growing at trend, inflation is returning to target, and the external current account deficit has narrowed. The exchange rate depreciated moderately and international reserves declined due to reduced external budget and bank financing, as well as domestic portfolio switches into FX deposits. The external position continues to be close to equilibrium. However, weakening domestic fundamentals stemming from large fiscal deficits make the country particularly vulnerable to the projected tightening in global financial conditions and other external risks. While growth is anticipated to slow only marginally in 2017, potential growth would be eroded over the medium term reflecting higher risk premia and greater need for monetary tightening in a baseline scenario without additional fiscal reforms. If fiscal vulnerabilities are not addressed, competitiveness and the external position could also be negatively affected.

35. **Current economic conditions call for continuation of fiscal consolidation and monetary policy normalization.** With the output virtually at potential and a still sizeable fiscal sustainability gap, the near-term policy mix should be characterized by gradual budgetary adjustment and unwinding of monetary easing. Hence, it is important to administratively contain expenditure and mobilize revenue to minimize the short-term deterioration from recent constitutional court rulings expanding revenue earmarking. The central bank should keep tightening the monetary stance to maintain inflation around the mid-point of the target range and prevent jeopardizing the incipient anchoring of inflation expectations to the target band.

36. **A comprehensive reform strategy is needed to achieve long-term fiscal sustainability.** The authorities' main proposal consisting of broadening the bases of the VAT and income tax as well as hikes in their rates, accompanied by sustained administrative steps to contain the wage bill, would be sufficient to stabilize public debt within safe levels in the medium term. Congressional approval before the elections of a balanced package, including the aforementioned tax reforms but also public employment and fiscal responsibility laws, would be important. Parametric reforms are also needed to shore up the pension system over the long term.

37. **Greater exchange rate flexibility would strengthen the credibility of the IT framework, enhance resilience to external shocks.** Moreover, enhanced transparency of the triggers for the FX-intervention rule would firm confidence in the full subordination of XR management to the inflation objectives. Greater XR flexibility would also reinforce the role of the XR as a shock absorber while easing pressure on international reserves, and help internalize XR risks, thus reducing FX mismatches and discouraging dollarization.

38. **The introduction of micro- and macro-prudential tools to contain systemic financial risks is welcomed, but more may be needed.** Further tightening of regulatory requirements should be considered if there is no evidence of a reduction in banks' FX exposures, or if the deceleration of FX credit proves temporary. Additional measures could include higher reserve and

liquidity requirements on FX liabilities, complemented by increases in capital buffers and provisioning, and stricter controls on FX loans. In addition, implementation of pending 2008 FSAP recommendations and adoption of Basel III standards would improve resilience of the financial system.

39. **Structural reforms are required to maintain the country's competitive position**. Addressing weaknesses in transport infrastructure, education expenditure efficiency, and taking steps to support financial deepening would be critical to help accelerate potential growth and make it more inclusive. The successful implementation of environmental policies has buttressed the economy's structural transformation towards higher growth services. The authorities also need to build on this by providing a legal and regulatory environment that stimulates those sectors that are more resilient to climate change.

40. **It is recommended that Costa Rica remain on the standard 12-month consultation cycle.**

Table 1. Costa Rica: Selected Social and Economic Indicators, Baseline Scenario 1/

Population (2016, millions)	4.9	Human Development Index Rank (2016)	66 (out of 188)
Per capita GDP (2016, U.S. dollars)	11,888	Life expectancy (2015, years)	79.6
Unemployment (2016, percent of labor force)	9.5	Literacy rate (2015, percent of people ages > 15)	97.6
Poverty (2016, percent of population)	20.5	Ratio of girls to boys in primary and secondary	
Income share held by highest 10 percent of households	36.9	education (2014, percent)	102.0
Income share held by lowest 10 percent of households	1.5	Gini coefficient (2014)	48.5

					Proj.	
	2013	2014	2015	2016	2017	2018
	(Annual percentage change, unless otherwise indicated)					
Output and Prices						
Real GDP growth	2.3	3.7	4.7	4.3	4.0	4.0
Output gap (percent of potential GDP)	-0.4	-0.6	0.0	0.1	0.0	-0.1
GDP deflator	4.0	5.8	2.7	2.3	1.5	3.2
Consumer prices (end of period)	3.7	5.1	-0.8	0.8	3.0	3.0
Money and Credit						
Monetary base	10.2	10.4	9.2	6.4	2.8	6.5
Broad money	7.7	15.4	4.0	2.3	6.3	7.5
Credit to private sector	12.2	17.5	11.8	12.8	11.1	10.9
Monetary policy rate (percent; end of period) 4/	3.8	5.3	2.3	1.8	4.0	…
	(In percent of GDP, unless otherwise indicated)					
Savings and Investment						
Gross domestic investment	19.0	18.8	20.2	19.7	19.6	19.5
Gross domestic savings	14.1	13.9	15.9	16.5	15.6	15.6
External Sector						
Current account balance	-4.8	-4.9	-4.3	-3.2	-4.0	-4.0
Of which: Trade balance	-11.0	-10.4	-9.0	-7.8	-8.5	-8.5
Financial and capital account balance	-6.1	-6.0	-4.9	-3.7	-3.7	-3.7
Of which: Foreign direct investment	-4.8	-5.6	-4.8	-4.6	-4.6	-4.5
Change in net international reserves (increase +)	474	-119	622	-260	-325	0
Net international reserves (millions of U.S. dollars)	7,331	7,211	7,834	7,574	7,249	7,249
Public Finances						
Central government primary balance	-2.8	-3.0	-3.0	-2.4	-2.8	-2.8
Central government overall balance	-5.6	-5.9	-5.6	-5.3	-6.1	-6.5
Central government debt	35.8	38.3	40.8	44.7	48.4	51.7
Consolidated public sector overall balance 2/	-5.4	-5.5	-5.8	-4.6	-5.6	-6.1
Consolidated public sector debt 3/	41.8	42.8	45.4	49.2	51.9	54.1
Of which: External public debt	8.7	10.2	11.3	11.3	11.1	10.6
Memorandum Item:						
GDP (US$ billions)	50.3	51.3	55.5	58.1	60.0	63.7

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

1/ The baseline scenario includes additional consolidation deriving from already adopted legislative measures, mainly to combat tax evasion and curtail unspent budgetary allocations of decentralized government entities. It includes increases in education and social expenditures broadly consistent with constitutional mandates, as well as limited increases in investments.

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.

4/ The 2017 data is as of May 2017.

Table 2. Costa Rica: Balance of Payments, Baseline Scenario

								Projections					
	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
					(In millions of U.S. dollars)								
Current Account	-1,214	-2,265	-2,411	-2,431	-2,489	-2,384	-1,880	-2,402	-2,539	-2,688	-2,870	-3,119	-3,324
Goods and services balance	-416	-1,195	-1,364	-995	-789	-361	574	494	573	644	654	575	601
Trade balance	-3,548	-5,027	-5,348	-5,559	-5,329	-4,977	-4,508	-5,103	-5,408	-5,713	-6,001	-6,420	-6,858
Export of goods (f.o.b.)	7,493	8,301	8,923	8,866	9,456	9,445	10,148	10,819	11,563	12,356	13,177	14,064	15,027
Import of goods (f.o.b.)	11,040	13,329	14,271	14,425	14,784	14,422	14,656	15,922	16,971	18,069	19,179	20,484	21,885
Services balance	3,132	3,833	3,984	4,564	4,539	4,615	5,081	5,597	5,982	6,358	6,655	6,994	7,458
Of which: Travel balance	1,828	2,023	2,107	2,503	2,546	2,732	3,063	3,315	3,466	3,616	3,750	3,966	4,296
Exports of services	5,021	5,782	6,209	6,949	7,106	7,453	8,288	8,991	9,678	10,352	10,996	11,745	12,659
Imports of services	1,889	1,949	2,224	2,386	2,567	2,838	3,207	3,394	3,696	3,995	4,341	4,750	5,201
Primary Income	-1,186	-1,418	-1,456	-1,828	-2,150	-2,484	-2,926	-3,388	-3,616	-3,842	-4,033	-4,197	-4,418
Secondary Income	388	348	408	392	450	461	472	492	504	510	509	504	494
Net lending (+) / Borrowing (-)	-1160	-2243	-2365	-2423	-2514	-2352	-1794	-2316	-2453	-2602	-2784	-3033	-3238
Financial Account	-1,642	-2,873	-2,034	-3,084	-3,042	-2,751	-2,234	-2,316	-2,453	-2,602	-2,784	-3,033	-3,238
Public sector	-615	-68	-1,239	-1,243	-1,034	-1,989	-523	-458	-317	-326	64	-335	-336
Private sector	-1,027	-2,805	-796	-1,840	-2,009	-762	-1,711	-1,858	-2,136	-2,276	-2,848	-2,699	-2,902
Foreign direct investment	-1,589	-2,328	-1,803	-2,401	-2,851	-2,686	-2,684	-2,743	-2,858	-2,975	-3,101	-3,238	-3,374
Other private sector flows	562	-477	1,007	561	842	1,924	973	885	722	700	254	539	472
Errors and Omissions	-482	-629	331	-660	-528	-399	-440	0	0	0	0	0	0
Change in International Reserves (increase +)	561	129	2,101	474	-119	622	-260	-325	0	0	0	0	0
					(In percent of GDP)								
Current Account	-3.2	-5.3	-5.1	-4.8	-4.9	-4.3	-3.2	-4.0	-4.0	-4.0	-4.0	-4.0	-4.0
Goods and services balance	-1.1	-2.8	-2.9	-2.0	-1.5	-0.7	1.0	0.8	0.9	1.0	0.9	0.7	0.7
Trade balance	-9.4	-11.8	-11.4	-11.0	-10.4	-9.0	-7.8	-8.5	-8.5	-8.4	-8.3	-8.3	-8.2
Export of goods (f.o.b.)	19.9	19.4	19.0	17.6	18.4	17.0	17.5	18.0	18.1	18.3	18.2	18.2	18.1
Import of goods (f.o.b.)	29.3	31.2	30.4	28.7	28.8	26.0	25.2	26.6	26.6	26.7	26.6	26.4	26.3
Services balance	8.3	9.0	8.5	9.1	8.9	8.3	8.7	9.3	9.4	9.4	9.2	9.0	9.0
Of which: Travel balance	4.9	4.7	4.5	5.0	5.0	4.9	5.3	5.5	5.4	5.3	5.2	5.1	5.2
Exports of services	13.3	13.5	13.2	13.8	13.9	13.4	14.3	15.0	15.2	15.3	15.2	15.2	15.2
Imports of services	5.0	4.6	4.7	4.7	5.0	5.1	5.5	5.7	5.8	5.9	6.0	6.1	6.3
Primary Income	-3.2	-3.3	-3.1	-3.6	-4.2	-4.5	-5.0	-5.6	-5.7	-5.7	-5.6	-5.4	-5.3
Secondary Income	1.0	0.8	0.9	0.8	0.9	0.8	0.8	0.8	0.8	0.8	0.7	0.7	0.6
Net lending (+) / Borrowing (-)	-3.1	-5.3	-5.0	-4.8	-4.9	-4.2	-3.1	-3.9	-3.9	-3.8	-3.9	-3.9	-3.9
Financial Account	-4.4	-6.7	-4.3	-6.1	-5.9	-5.0	-3.8	-3.9	-3.9	-3.8	-3.9	-3.9	-3.9
Of which: Foreign direct investment	-4.2	-5.5	-3.8	-4.8	-5.6	-4.8	-4.6	-4.6	-4.5	-4.4	-4.3	-4.2	-4.1
Change in International Reserves (increase +)	1.5	0.3	4.5	0.9	-0.2	1.1	-0.4	-0.5	0.0	0.0	0.0	0.0	0.0
Memorandum Items:													
Non-oil current account (percent of GDP)	0.9	-0.5	-0.7	-0.7	-0.9	-2.2	-1.5	-1.7	-1.7	-1.8	-1.8	-1.9	-1.9
Terms of trade (annual percentage change)	-0.3	-2.4	0.6	-7.8	3.1	4.8	0.6	-1.7	0.0	0.1	0.0	-0.1	-0.2
Net international reserves (millions of U.S. dollars)	4,627	4,756	6,857	7,331	7,211	7,834	7,574	7,249	7,249	7,249	7,249	7,249	7,249
-in months of non-maquila imports	4.3	4.1	5.8	5.5	5.1	5.4	4.8	4.3	4.1	3.8	3.5	3.3	3.2
-in percent short-term debt 1/	133.6	110.5	148.9	154.7	189.4	200.7	179.0	172.8	201.7	215.5	319.3	339.3	357.9
External debt (percent of GDP) 2/	25.3	26.4	32.7	39.0	42.4	43.3	45.5	39.7	36.6	33.8	31.1	28.6	26.5

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

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

2/ Includes public and private sector debt.

Table 3. Costa Rica: Central Government Balance, Baseline Scenario

							Est.	Projection					
	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
						(In billions of colones)							
Revenue	**2,591**	**2,869**	**3,118**	**3,380**	**3,625**	**3,994**	**4,379**	**4,634**	**5,010**	**5,415**	**5,800**	**6,215**	**6,662**
Tax revenue	2,492	2,769	3,008	3,292	3,522	3,862	4,168	4,484	4,849	5,243	5,615	6,017	6,450
Nontax revenue 1/	100	100	110	87	103	132	212	150	161	172	185	198	213
Expenditure	**3,623**	**3,762**	**4,178**	**4,765**	**5,231**	**5,647**	**6,024**	**6,638**	**7,315**	**8,037**	**8,773**	**9,581**	**10,526**
Current noninterest	2,723	2,962	3,316	3,684	3,990	4,330	4,563	4,873	5,255	5,658	6,047	6,472	6,944
Wages	1,349	1,514	1,647	1,817	1,969	2,113	2,178	2,299	2,496	2,697	2,892	3,102	3,328
Goods and services	121	136	143	158	180	194	198	209	224	240	258	276	296
Transfers	1,252	1,313	1,526	1,708	1,842	2,023	2,187	2,366	2,536	2,721	2,897	3,094	3,320
Interest 2/	452	497	530	681	775	787	886	1,096	1,312	1,558	1,846	2,164	2,569
Capital	449	304	332	400	466	530	575	669	748	821	880	944	1,013
Primary balance	**-580**	**-396**	**-529**	**-704**	**-831**	**-866**	**-758**	**-909**	**-993**	**-1,064**	**-1,127**	**-1,201**	**-1,295**
Overall Balance	**-1,032**	**-893**	**-1,059**	**-1,386**	**-1,606**	**-1,653**	**-1,644**	**-2,005**	**-2,305**	**-2,622**	**-2,973**	**-3,366**	**-3,864**
Total Financing	1,032	893	1,059	1,386	1,606	1,653	1,644	2,005	2,305	2,622	2,973	3,366	3,864
External (net)	247	-112	356	401	490	598	160	129	78	82	-55	86	86
Domestic (net)	785	1,005	704	984	1,116	1,055	1,484	1,876	2,227	2,540	3,028	3,280	3,777
Central government debt	**5,551**	**6,369**	**7,998**	**8,909**	**10,457**	**11,970**	**13,988**	**16,004**	**18,330**	**20,979**	**23,806**	**27,138**	**30,968**
External	1,131	1,014	1,366	1,741	2,339	2,930	3,178	3,296	3,369	3,448	3,247	3,299	3,351
Domestic	4,420	5,355	6,632	7,169	8,118	9,040	10,810	12,708	14,961	17,531	20,559	23,839	27,616
						(In percent of GDP)							
Revenue	**13.2**	**13.4**	**13.3**	**13.6**	**13.3**	**13.6**	**14.0**	**14.0**	**14.1**	**14.2**	**14.2**	**14.2**	**14.2**
Tax revenue	12.7	13.0	12.9	13.2	12.9	13.2	13.3	13.6	13.7	13.8	13.8	13.8	13.7
Nontax revenue 1/	0.5	0.5	0.5	0.4	0.4	0.4	0.7	0.5	0.5	0.5	0.5	0.5	0.5
Expenditure	**18.5**	**17.6**	**17.9**	**19.2**	**19.2**	**19.3**	**19.3**	**20.1**	**20.6**	**21.1**	**21.5**	**21.9**	**22.4**
Current noninterest	13.9	13.9	14.2	14.8	14.6	14.8	14.6	14.8	14.8	14.9	14.8	14.8	14.8
Wages	6.9	7.1	7.0	7.3	7.2	7.2	7.0	7.0	7.0	7.1	7.1	7.1	7.1
Goods and services	0.6	0.6	0.6	0.6	0.7	0.7	0.6	0.6	0.6	0.6	0.6	0.6	0.6
Transfers	6.4	6.1	6.5	6.9	6.8	6.9	7.0	7.2	7.2	7.2	7.1	7.1	7.1
Interest 2/	2.3	2.3	2.3	2.7	2.8	2.7	2.8	3.3	3.7	4.1	4.5	4.9	5.5
Capital	2.3	1.4	1.4	1.6	1.7	1.8	1.8	2.0	2.1	2.2	2.2	2.2	2.2
Primary balance	**-3.0**	**-1.9**	**-2.3**	**-2.8**	**-3.0**	**-3.0**	**-2.4**	**-2.8**	**-2.8**	**-2.8**	**-2.8**	**-2.7**	**-2.8**
Overall Balance	**-5.3**	**-4.2**	**-4.5**	**-5.6**	**-5.9**	**-5.6**	**-5.3**	**-6.1**	**-6.5**	**-6.9**	**-7.3**	**-7.7**	**-8.2**
Total Financing	**5.3**	**4.2**	**4.5**	**5.6**	**5.9**	**5.6**	**5.3**	**6.1**	**6.5**	**6.9**	**7.3**	**7.7**	**8.2**
External (net)	1.3	-0.5	1.5	1.6	1.8	2.0	0.5	0.4	0.2	0.2	-0.1	0.2	0.2
Domestic (net)	4.0	4.7	3.0	4.0	4.1	3.6	4.7	5.7	6.3	6.7	7.4	7.5	8.1
Central government debt	**28.3**	**29.8**	**34.2**	**35.8**	**38.3**	**40.8**	**44.7**	**48.4**	**51.7**	**55.2**	**58.4**	**62.1**	**66.0**
External	5.8	4.7	5.8	7.0	8.6	10.0	10.2	10.0	9.5	9.1	8.0	7.5	7.1
Domestic	22.6	25.1	28.4	28.8	29.8	30.8	34.5	38.5	42.2	46.1	50.4	54.5	58.9
Memorandum items:													
Non-interest expenditure growth (percent)													
in nominal terms	23.1	3.0	11.7	12.0	9.1	9.1	5.7	7.9	8.3	7.9	6.9	7.1	7.3
in real terms	16.5	-1.8	6.9	6.4	4.4	8.2	5.7	5.9	5.2	4.8	3.8	3.9	4.2
Nominal GDP	19,597	21,371	23,371	24,861	27,269	29,316	31,287	33,033	35,439	38,027	40,774	43,732	46,921
CPI Inflation (period average)	5.7	4.9	4.5	5.2	4.5	0.8	0.0	1.9	3.0	3.0	3.0	3.0	3.0

Sources: Ministry of Finance and Fund staff estimates.

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

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

Table 4. Costa Rica: Summary Operations of the Central Government, GFSM 2001 Classification, Baseline Scenario

								Projections					
	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
				(In billions of colones)									
Revenue	**2,591**	**2,869**	**3,118**	**3,380**	**3,625**	**3,994**	**4,379**	**4,634**	**5,010**	**5,415**	**5,800**	**6,215**	**6,662**
Taxes	2,492	2,769	3,008	3,292	3,522	3,862	4,168	4,484	4,849	5,243	5,615	6,017	6,450
Other revenue 1/	100	100	110	87	103	132	212	150	161	172	185	198	213
Expenditure	**3,623**	**3,762**	**4,178**	**4,765**	**5,231**	**5,647**	**6,024**	**6,638**	**7,315**	**8,037**	**8,773**	**9,581**	**10,526**
Expense	**3,174**	**3,459**	**3,846**	**4,365**	**4,765**	**5,117**	**5,448**	**5,969**	**6,567**	**7,216**	**7,892**	**8,636**	**9,513**
Compensation of employees	1,349	1,514	1,647	1,817	1,969	2,113	2,178	2,299	2,496	2,697	2,892	3,102	3,328
Purchases of goods and services	121	136	143	158	180	194	198	209	224	240	258	276	296
Interest 2/	452	497	530	681	775	787	886	1,096	1,312	1,558	1,846	2,164	2,569
Of which: Adjustment for TUDES	50	48	58	50	79	-13	11	37	44	52	61	71	83
Social benefits	506	552	594	616	661	710	681	719	771	827	887	951	1,021
Other expense 3/	747	761	932	1,092	1,181	1,313	1,507	1,647	1,764	1,893	2,010	2,142	2,299
Net acquisition of nonfinancial assets	**449**	**304**	**332**	**400**	**466**	**530**	**575**	**669**	**748**	**821**	**880**	**944**	**1,013**
Gross operating balance	**-583**	**-589**	**-728**	**-985**	**-1,140**	**-1,124**	**-1,069**	**-1,335**	**-1,558**	**-1,801**	**-2,093**	**-2,421**	**-2,851**
Net lending/borrowing	**-1,032**	**-893**	**-1,059**	**-1,386**	**-1,606**	**-1,653**	**-1,644**	**-2,005**	**-2,305**	**-2,622**	**-2,973**	**-3,366**	**-3,864**
Net financial transactions	**1,032**	**893**	**1,059**	**1,386**	**1,606**	**1,653**	**1,644**	**2,005**	**2,305**	**2,622**	**2,973**	**3,366**	**3,864**
				(In percent of GDP)									
Revenue	**13.2**	**13.4**	**13.3**	**13.6**	**13.3**	**13.6**	**14.0**	**14.0**	**14.1**	**14.2**	**14.2**	**14.2**	**14.2**
Tax revenue	12.7	13.0	12.9	13.2	12.9	13.2	13.3	13.6	13.7	13.8	13.8	13.8	13.7
Nontax revenue 1/	0.5	0.5	0.5	0.4	0.4	0.4	0.7	0.5	0.5	0.5	0.5	0.5	0.5
Expenditure	**18.5**	**17.6**	**17.9**	**19.2**	**19.2**	**19.3**	**19.3**	**20.1**	**20.6**	**21.1**	**21.5**	**21.9**	**22.4**
Expense	**16.2**	**16.2**	**16.5**	**17.6**	**17.5**	**17.5**	**17.4**	**18.1**	**18.5**	**19.0**	**19.4**	**19.7**	**20.3**
Compensation of employees	6.9	7.1	7.0	7.3	7.2	7.2	7.0	7.0	7.0	7.1	7.1	7.1	7.1
Purchases of goods and services	0.6	0.6	0.6	0.6	0.7	0.7	0.6	0.6	0.6	0.6	0.6	0.6	0.6
Interest 2/	2.3	2.3	2.3	2.7	2.8	2.7	2.8	3.3	3.7	4.1	4.5	4.9	5.5
Of which: Adjustment for TUDES	0.3	0.2	0.2	0.2	0.3	0.0	0.0	0.1	0.1	0.1	0.1	0.2	0.2
Social benefits	2.6	2.6	2.5	2.5	2.4	2.4	2.2	2.2	2.2	2.2	2.2	2.2	2.2
Other expense 3/	3.8	3.6	4.0	4.4	4.3	4.5	4.8	5.0	5.0	5.0	4.9	4.9	4.9
Net acquisition of nonfinancial assets	2.3	1.4	1.4	1.6	1.7	1.8	1.8	2.0	2.1	2.2	2.2	2.2	2.2
Gross operating balance	**-3.0**	**-2.8**	**-3.1**	**-4.0**	**-4.2**	**-3.8**	**-3.4**	**-4.0**	**-4.4**	**-4.7**	**-5.1**	**-5.5**	**-6.1**
Net lending/borrowing	**-5.3**	**-4.2**	**-4.5**	**-5.6**	**-5.9**	**-5.6**	**-5.3**	**-6.1**	**-6.5**	**-6.9**	**-7.3**	**-7.7**	**-8.2**
Net financial transactions	**5.3**	**4.2**	**4.5**	**5.6**	**5.9**	**5.6**	**5.3**	**6.1**	**6.5**	**6.9**	**7.3**	**7.7**	**8.2**
Memorandum items:													
Non-interest expenditure growth (percent)													
in nominal terms	23.1	3.0	11.7	12.0	9.1	9.1	5.7	7.9	8.3	7.9	6.9	7.1	7.3
in real terms	16.5	-1.8	6.9	6.4	4.4	8.2	5.7	5.9	5.2	4.8	3.8	3.9	4.2
Primary balance													
in billions of colones	-580	-396	-529	-704	-831	-866	-758	-909	-993	-1,064	-1,127	-1,201	-1,295
in percent of GDP	-3.0	-1.9	-2.3	-2.8	-3.0	-3.0	-2.4	-2.8	-2.8	-2.8	-2.8	-2.7	-2.8
Cyclically-adjusted primary balance (percent of GDP)	-2.8	-1.9	-2.4	-2.8	-3.0	-3.0	-2.4	-2.8	-2.8	-2.8	-2.7	-2.7	-2.7
Fiscal impulse (percent of GDP)	1.9	-1.0	0.5	0.4	0.2	0.0	-0.5	0.3	0.0	0.0	0.0	0.0	0.0
Nominal GDP	19,597	21,371	23,371	24,861	27,269	29,316	31,287	33,033	35,439	38,027	40,774	43,732	46,921
CPI Inflation (period average)	5.7	4.9	4.5	5.2	4.5	0.8	0.0	1.9	3.0	3.0	3.0	3.0	3.0

Sources: Ministry of Finance and Fund staff estimates.
1/ Transfers to the Social development and Family Transfers Fund (FODESAF) are recorded in net terms.
2/ The inflation adjustment of the principal of TUDES (inflation indexed bonds) was recorded as interest expenditure.
3/ Includes subsidies, transfers and other expense.

Table 5. Costa Rica: Consolidated Public Sector Operations, Baseline Scenario 1/

							Est.	Projections					
	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
						(In billions of colones)							
Nonfinancial public sector:													
Revenue	**4,258**	**4,715**	**5,036**	**5,627**	**6,021**	**6,529**	**7,141**	**7,607**	**8,182**	**8,800**	**9,384**	**10,025**	**10,713**
Tax revenue	2,526	2,807	3,049	3,342	3,575	3,917	4,227	4,546	4,916	5,314	5,692	6,099	6,538
Nontax revenue	185	225	182	257	259	309	315	316	321	325	337	361	387
Social security contributions	1,412	1,584	1,743	1,884	2,055	2,225	2,517	2,657	2,851	3,059	3,247	3,448	3,662
Operating balance of public enterprises	134	99	62	144	132	78	84	88	95	102	109	117	125
Expenditure 2/	**5,209**	**5,482**	**5,941**	**6,770**	**7,344**	**8,001**	**8,496**	**9,280**	**10,128**	**11,031**	**11,952**	**12,954**	**14,101**
Current noninterest	4,138	4,525	4,884	5,465	5,899	6,424	6,812	7,265	7,839	8,449	9,052	9,695	10,402
Wages	1,885	2,076	2,228	2,437	2,620	2,791	2,901	3,063	3,315	3,576	3,835	4,113	4,413
Goods and services	414	482	514	554	594	643	677	715	767	823	882	946	1,016
Transfers	1,840	1,966	2,142	2,474	2,685	2,990	3,234	3,487	3,757	4,050	4,334	4,636	4,974
Interest	432	478	506	660	740	795	855	1,089	1,284	1,503	1,757	2,032	2,383
Of which: Adjustment for TUDES 3/	28	26	32	27	42	-7	6	20	24	28	33	39	46
Capital	638	480	551	644	705	783	830	926	1,005	1,078	1,144	1,227	1,316
Primary balance	**-519**	**-289**	**-399**	**-483**	**-583**	**-677**	**-501**	**-583**	**-662**	**-728**	**-811**	**-897**	**-1,006**
Overall Balance	**-951**	**-767**	**-905**	**-1,143**	**-1,323**	**-1,472**	**-1,355**	**-1,672**	**-1,946**	**-2,230**	**-2,568**	**-2,929**	**-3,388**
Central government	-1,032	-893	-1,059	-1,386	-1,606	-1,653	-1,644	-2,005	-2,305	-2,622	-2,973	-3,366	-3,864
Decentralized government entities	50	130	193	207	259	224	363	318	346	378	391	423	462
Public enterprises	31	-4	-39	34	24	-42	14	14	14	14	14	14	14
Total Financing	**951**	**767**	**905**	**1,143**	**1,323**	**1,472**	**1,355**	**1,672**	**1,946**	**2,230**	**2,568**	**2,929**	**3,388**
External	243	-126	340	407	507	614	198	147	97	101	-18	123	123
Domestic	708	893	566	736	816	858	1,157	1,525	1,849	2,130	2,586	2,806	3,265
Consolidated public sector:													
Central Bank balance	-88	-126	-144	-195	-186	-219	-179	-189	-202	-217	-233	-250	-268
Consolidated public sector balance	**-1,039**	**-893**	**-1,049**	**-1,339**	**-1,509**	**-1,691**	**-1,446**	**-1,861**	**-2,148**	**-2,448**	**-2,801**	**-3,179**	**-3,656**
Consolidated public sector debt	**5,810**	**6,846**	**8,766**	**10,389**	**11,664**	**13,295**	**15,407**	**17,153**	**19,171**	**21,481**	**23,953**	**26,897**	**30,301**
						(In percent of GDP)							
Nonfinancial public sector:													
Revenue	**21.7**	**22.1**	**21.5**	**22.6**	**22.1**	**22.3**	**22.8**	**23.0**	**23.1**	**23.1**	**23.0**	**22.9**	**22.8**
Tax revenue	12.9	13.1	13.0	13.4	13.1	13.4	13.5	13.8	13.9	14.0	14.0	13.9	13.9
Nontax revenue	0.9	1.1	0.8	1.0	0.9	1.1	1.0	1.0	0.9	0.9	0.8	0.8	0.8
Social security contributions	7.2	7.4	7.5	7.6	7.5	7.6	8.0	8.0	8.0	8.0	8.0	7.9	7.8
Operating balance of public enterprises	0.7	0.5	0.3	0.6	0.5	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Expenditure 2/	**26.6**	**25.7**	**25.4**	**27.2**	**26.9**	**27.3**	**27.2**	**28.1**	**28.6**	**29.0**	**29.3**	**29.6**	**30.1**
Current noninterest	21.1	21.2	20.9	22.0	21.6	21.9	21.8	22.0	22.1	22.2	22.2	22.2	22.2
Wages	9.6	9.7	9.5	9.8	9.6	9.5	9.3	9.3	9.4	9.4	9.4	9.4	9.4
Goods and services	2.1	2.3	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
Transfers	9.4	9.2	9.2	10.0	9.8	10.2	10.3	10.6	10.6	10.7	10.6	10.6	10.6
Interest	2.2	2.2	2.2	2.7	2.7	2.7	2.7	3.3	3.6	4.0	4.3	4.6	5.1
Of which: Adjustment for TUDES 3/	0.1	0.1	0.1	0.1	0.2	0.0	0.0	0.1	0.1	0.1	0.1	0.1	0.1
Capital	3.3	2.2	2.4	2.6	2.6	2.7	2.7	2.8	2.8	2.8	2.8	2.8	2.8
Primary balance	**-2.6**	**-1.4**	**-1.7**	**-1.9**	**-2.1**	**-2.3**	**-1.6**	**-1.8**	**-1.9**	**-1.9**	**-2.0**	**-2.1**	**-2.1**
Overall Balance	**-4.9**	**-3.6**	**-3.9**	**-4.6**	**-4.9**	**-5.0**	**-4.3**	**-5.1**	**-5.5**	**-5.9**	**-6.3**	**-6.7**	**-7.2**
Central government	-5.3	-4.2	-4.5	-5.6	-5.9	-5.6	-5.3	-6.1	-6.5	-6.9	-7.3	-7.7	-8.2
Decentralized government entities	0.3	0.6	0.8	0.8	0.9	0.8	1.2	1.0	1.0	1.0	1.0	1.0	1.0
Public enterprises	0.2	0.0	-0.2	0.1	0.1	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total Financing	**4.9**	**3.6**	**3.9**	**4.6**	**4.9**	**5.0**	**4.3**	**5.1**	**5.5**	**5.9**	**6.3**	**6.7**	**7.2**
External	1.2	-0.6	1.5	1.6	1.9	2.1	0.6	0.4	0.3	0.3	0.0	0.3	0.3
Domestic	3.6	4.2	2.4	3.0	3.0	2.9	3.7	4.6	5.2	5.6	6.3	6.4	7.0
Consolidated public sector:													
Central Bank balance	-0.4	-0.6	-0.6	-0.8	-0.7	-0.7	-0.6	-0.6	-0.6	-0.6	-0.6	-0.6	-0.6
Consolidated public sector balance	**-5.3**	**-4.2**	**-4.5**	**-5.4**	**-5.5**	**-5.8**	**-4.6**	**-5.6**	**-6.1**	**-6.4**	**-6.9**	**-7.3**	**-7.8**
Consolidated public sector debt	**29.6**	**32.0**	**37.5**	**41.8**	**42.8**	**45.4**	**49.2**	**51.9**	**54.1**	**56.5**	**58.7**	**61.5**	**64.6**
Consolidated public sector debt, including ICE	32.9	35.3	40.6	45.0	46.2	48.9	52.9	55.4	57.3	59.5	61.5	64.0	66.9
Nominal GDP	19,597	21,371	23,371	24,861	27,269	29,316	31,287	33,033	35,439	38,027	40,774	43,732	46,921
CPI Inflation (period average)	5.7	4.9	4.5	5.2	4.5	0.8	0.0	1.9	3.0	3.0	3.0	3.0	3.0

Sources: Ministry of Finance 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).

2/ 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.

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

Table 6. Costa Rica: Summary Operations of the Consolidated Public Sector, GFSM 2001 Classification, Baseline Scenario 1/

							Est.	Projections					
	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
						(In billions of colones)							
Nonfinancial public sector:													
Revenue	**4,258**	**4,715**	**5,036**	**5,627**	**6,021**	**6,529**	**7,141**	**7,607**	**8,182**	**8,800**	**9,384**	**10,025**	**10,713**
Taxes	2,526	2,807	3,049	3,342	3,575	3,917	4,227	4,546	4,916	5,314	5,692	6,099	6,538
Social contributions	1,412	1,584	1,743	1,884	2,055	2,225	2,517	2,657	2,851	3,059	3,247	3,448	3,662
Operating balance of public enterprises	134	99	62	144	132	78	84	88	95	102	109	117	125
Other revenue	185	225	182	257	259	309	315	316	321	325	337	361	387
Expenditure	**5,209**	**5,482**	**5,941**	**6,770**	**7,344**	**8,001**	**8,496**	**9,280**	**10,128**	**11,031**	**11,952**	**12,954**	**14,101**
Expense	**4,571**	**5,002**	**5,390**	**6,126**	**6,639**	**7,218**	**7,667**	**8,354**	**9,123**	**9,952**	**10,809**	**11,727**	**12,785**
Compensation of employees	1,885	2,076	2,228	2,437	2,620	2,791	2,901	3,063	3,315	3,576	3,835	4,113	4,413
Purchases of goods and services	414	482	514	554	594	643	677	715	767	823	882	946	1,016
Interest 2/	432	478	506	660	740	795	855	1,089	1,284	1,503	1,757	2,032	2,383
Of which: Adjustment for TUDES	28	26	32	27	42	-7	6	20	24	28	33	39	46
Other expense 3/	1,840	1,966	2,142	2,474	2,685	2,990	3,234	3,487	3,757	4,050	4,334	4,636	4,974
Net acquisition of nonfinancial assets	**638**	**480**	**551**	**644**	**705**	**783**	**830**	**926**	**1,005**	**1,078**	**1,144**	**1,227**	**1,316**
Gross operating balance	**-313**	**-287**	**-354**	**-499**	**-618**	**-689**	**-525**	**-747**	**-941**	**-1,152**	**-1,424**	**-1,702**	**-2,072**
Net lending/borrowing (NFPS)	**-951**	**-767**	**-905**	**-1,143**	**-1,323**	**-1,472**	**-1,355**	**-1,672**	**-1,946**	**-2,230**	**-2,568**	**-2,929**	**-3,388**
Net financial transactions (NFPS)	**951**	**767**	**905**	**1,143**	**1,323**	**1,472**	**1,355**	**1,672**	**1,946**	**2,230**	**2,568**	**2,929**	**3,388**
Consolidated public sector:													
Central Bank balance	-88	-126	-144	-195	-186	-219	-179	-189	-202	-217	-233	-250	-268
Net lending/borrowing (consolidated public sector)	**-1,039**	**-893**	**-1,049**	**-1,339**	**-1,509**	**-1,691**	**-1,446**	**-1,861**	**-2,148**	**-2,448**	**-2,801**	**-3,179**	**-3,656**
						(In percent of GDP)							
Nonfinancial public sector:													
Revenue	**21.7**	**22.1**	**21.5**	**22.6**	**22.1**	**22.3**	**22.8**	**23.0**	**23.1**	**23.1**	**23.0**	**22.9**	**22.8**
Taxes	12.9	13.1	13.0	13.4	13.1	13.4	13.5	13.8	13.9	14.0	14.0	13.9	13.9
Social contributions	7.2	7.4	7.5	7.6	7.5	7.6	8.0	8.0	8.0	8.0	8.0	7.9	7.8
Operating balance of public enterprises	0.7	0.5	0.3	0.6	0.5	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Other revenue	0.9	1.1	0.8	1.0	0.9	1.1	1.0	1.0	0.9	0.9	0.8	0.8	0.8
Expenditure	**26.6**	**25.7**	**25.4**	**27.2**	**26.9**	**27.3**	**27.2**	**28.1**	**28.6**	**29.0**	**29.3**	**29.6**	**30.1**
Expense	**23.3**	**23.4**	**23.1**	**24.6**	**24.3**	**24.6**	**24.5**	**25.3**	**25.7**	**26.2**	**26.5**	**26.8**	**27.2**
Compensation of employees	9.6	9.7	9.5	9.8	9.6	9.5	9.3	9.3	9.4	9.4	9.4	9.4	9.4
Purchases of goods and services	2.1	2.3	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
Interest 2/	2.2	2.2	2.2	2.7	2.7	2.7	2.7	3.3	3.6	4.0	4.3	4.6	5.1
Other expense 3/	9.4	9.2	9.2	10.0	9.8	10.2	10.3	10.6	10.6	10.7	10.6	10.6	10.6
Net acquisition of nonfinancial assets	**3.3**	**2.2**	**2.4**	**2.6**	**2.6**	**2.7**	**2.7**	**2.8**	**2.8**	**2.8**	**2.8**	**2.8**	**2.8**
Gross operating balance	**-1.6**	**-1.3**	**-1.5**	**-2.0**	**-2.3**	**-2.4**	**-1.7**	**-2.3**	**-2.7**	**-3.0**	**-3.5**	**-3.9**	**-4.4**
Net lending/borrowing (NFPS)	**-4.9**	**-3.6**	**-3.9**	**-4.6**	**-4.9**	**-5.0**	**-4.3**	**-5.1**	**-5.5**	**-5.9**	**-6.3**	**-6.7**	**-7.2**
Net financial transactions (NFPS)	**4.9**	**3.6**	**3.9**	**4.6**	**4.9**	**5.0**	**4.3**	**5.1**	**5.5**	**5.9**	**6.3**	**6.7**	**7.2**
Consolidated public sector:													
Central Bank balance	-0.4	-0.6	-0.6	-0.8	-0.7	-0.7	-0.6	-0.6	-0.6	-0.6	-0.6	-0.6	-0.6
Net lending/borrowing (consolidated public sector)	**-5.3**	**-4.2**	**-4.5**	**-5.4**	**-5.5**	**-5.8**	**-4.6**	**-5.6**	**-6.1**	**-6.4**	**-6.9**	**-7.3**	**-7.8**
Memorandum items:													
NFPS non-interest expenditure growth (percent)													
in nominal terms	20.6	4.8	8.6	12.4	8.1	9.1	6.0	7.2	8.0	7.7	7.0	7.1	7.3
in real terms	14.1	-0.1	3.9	6.8	3.4	8.3	6.1	5.2	4.8	4.6	3.9	4.0	4.2
NFPS primary balance													
in billions of colones	-519	-289	-399	-483	-583	-677	-501	-583	-662	-728	-811	-897	-1,006
in percent of GDP	-2.6	-1.4	-1.7	-1.9	-2.1	-2.3	-1.6	-1.8	-1.9	-1.9	-2.0	-2.1	-2.1

Sources: Ministry of Finance 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).

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

3/ Includes subsidies, transfers and other expense.

Table 7. Costa Rica: Public Sector Debt, Baseline Scenario

					Est.	Projections					
	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
	(In billions of colones)										
Debt issued by:											
NFPS & Central Bank (I) 1/	**11,022**	**12,746**	**14,127**	**15,872**	**18,383**	**20,462**	**22,859**	**25,581**	**28,477**	**31,877**	**35,775**
Nonfinancial public sector (NFPS) 1/	8,955	10,126	11,779	13,343	15,920	18,007	20,405	23,127	26,023	29,422	33,321
Central government	7,998	8,909	10,457	11,970	13,988	16,004	18,330	20,979	23,806	27,138	30,968
Rest of nonfinancial public sector 1/	957	1,217	1,322	1,374	1,932	2,004	2,075	2,148	2,216	2,285	2,353
Central Bank	2,067	2,620	2,348	2,528	2,463	2,454	2,454	2,454	2,454	2,454	2,454
Intra-public sector debt holdings (II)	**2,256**	**2,357**	**2,463**	**2,577**	**2,976**	**3,309**	**3,688**	**4,100**	**4,523**	**4,979**	**5,474**
CCSS 2/	1,398	1,444	1,462	1,501	1,827	2,096	2,387	2,703	3,026	3,374	3,751
Other entities of the nonfinancial public sector	848	902	989	1,063	1,135	1,198	1,285	1,379	1,479	1,586	1,702
Central Bank	10	11	12	13	14	15	16	17	18	19	21
Consolidated public sector debt (I-II)	**8,766**	**10,389**	**11,664**	**13,295**	**15,407**	**17,153**	**19,171**	**21,481**	**23,953**	**26,897**	**30,301**
External	1,690	2,173	2,780	3,303	3,525	3,664	3,759	3,860	3,678	3,748	3,819
Domestic	7,076	8,216	8,884	9,992	11,882	13,489	15,413	17,621	20,275	23,150	26,483
	(In percent of GDP)										
Debt issued by:											
NFPS & Central Bank (I) 1/	**47.2**	**51.3**	**51.8**	**54.1**	**58.8**	**61.9**	**64.5**	**67.3**	**69.8**	**72.9**	**76.2**
Nonfinancial public sector (NFPS) 1/	38.3	40.7	43.2	45.5	50.9	54.5	57.6	60.8	63.8	67.3	71.0
Central government	34.2	35.8	38.3	40.8	44.7	48.4	51.7	55.2	58.4	62.1	66.0
Rest of nonfinancial public sector 1/	4.1	4.9	4.8	4.7	6.2	6.1	5.9	5.6	5.4	5.2	5.0
Central Bank	8.8	10.5	8.6	8.6	7.9	7.4	6.9	6.5	6.0	5.6	5.2
Intra-public sector debt holdings (II)	**9.7**	**9.5**	**9.0**	**8.8**	**9.5**	**10.0**	**10.4**	**10.8**	**11.1**	**11.4**	**11.7**
CCSS 2/	6.0	5.8	5.4	5.1	5.8	6.3	6.7	7.1	7.4	7.7	8.0
Other entities of the nonfinancial public sector	3.6	3.6	3.6	3.6	3.6	3.6	3.6	3.6	3.6	3.6	3.6
Central Bank	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Consolidated public sector debt (I-II)	**37.5**	**41.8**	**42.8**	**45.4**	**49.2**	**51.9**	**54.1**	**56.5**	**58.7**	**61.5**	**64.6**
External	7.2	8.7	10.2	11.3	11.3	11.1	10.6	10.2	9.0	8.6	8.1
Domestic	30.3	33.0	32.6	34.1	38.0	40.8	43.5	46.3	49.7	52.9	56.4
Memorandum items:											
Nominal GDP	23,371	24,861	27,269	29,316	31,287	33,033	35,439	38,027	40,774	43,732	46,921

Sources: Ministry of Finance; and Fund staff estimates.

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

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

Table 8. Costa Rica: Monetary Survey, Baseline Scenario

						Est.	Proj.	
	2011	2012	2013	2014	2015	2016	2017	2018
	(In billions of colones, unless otherwise indicated)							
Net foreign assets	2,567	3,612	3,799	4,038	4,413	4,445	4,362	4,469
Net international reserves	2,403	3,443	3,629	3,846	4,167	4,152	4,013	4,052
(In millions of U.S. dollars)	4,756	6,857	7,331	7,211	7,834	7,574	7,249	7,249
Net medium-term foreign assets	164	170	171	192	0	0	0	0
Net domestic assets	-1,067	-1,858	-1,865	-1,902	-2,081	-1,963	-1,811	-1,751
Net domestic credit	-729	-1,303	-935	-1,019	-1,193	-1,442	-1,575	-1,733
Credit to nonfinancial public sector	-87	-561	-201	-65	-123	-238	-238	-238
Credit to other depository corporations (net)	-633	-733	-722	-936	-1,044	-1,181	-1,313	-1,471
Credit to other financial corporations (net)	-7	-7	-9	-16	-25	-22	-22	-22
Credit to the private sector (net)	-2	-2	-2	-2	-1	-1	-1	-1
Monetary stabilization instruments (-)	-1,588	-1,787	-2,492	-2,313	-2,491	-2,445	-2,445	-2,445
Other items (net)	-235	-423	-326	-421	-478	-246	128	412
Capital account (-)	1,485	1,655	1,887	1,850	2,081	2,171	2,081	2,015
Monetary base	1,500	1,754	1,934	2,136	2,332	2,482	2,552	2,718
Currency	743	845	921	988	1,051	1,109	1,170	1,236
Required reserves	757	909	1,013	1,147	1,281	1,373	1,381	1,482
Net foreign assets	-580	-1,018	-1,534	-1,716	-2,475	-2,712	-2,963	-3,285
Net domestic assets	9,287	10,565	11,797	13,505	14,591	15,457	16,419	17,721
Net domestic credit	13,175	15,265	17,241	20,072	22,673	24,981	27,352	30,125
Credit to nonfinancial public sector (net)	1,001	1,148	1,225	1,493	1,983	2,313	2,450	2,663
Credit to nonfinancial private sector	9,832	11,145	12,507	14,701	16,440	18,541	20,598	22,834
Credit to financial corporations (net)	2,342	2,973	3,508	3,877	4,250	4,127	4,304	4,627
Other items (net)	-1,595	-2,097	-2,526	-3,316	-4,454	-5,522	-6,474	-7,513
Capital account	2,294	2,602	2,918	3,251	3,628	4,001	4,459	4,891
Liabilities to nonfinancial private sector	8,707	9,547	10,263	11,789	12,115	12,745	13,456	14,436
In national currency	5,171	6,045	6,855	7,721	8,053	8,471	8,943	9,595
In foreign currency	3,536	3,503	3,409	4,068	4,063	4,275	4,513	4,842
Of which: Deposits	8,470	9,300	9,984	11,486	11,780	12,348	13,226	14,359
Net foreign assets	1,988	2,594	2,265	2,322	1,938	1,733	1,400	1,184
Net domestic assets	8,427	8,937	10,158	12,012	12,973	13,518	14,811	16,238
Net domestic credit	10,746	11,731	13,532	16,129	18,300	20,616	22,810	25,260
Other items (net)	-1,510	-1,847	-2,343	-2,716	-3,780	-5,267	-5,620	-6,146
Capital account	809	947	1,030	1,401	1,547	1,830	2,378	2,875
Broad money	10,415	11,530	12,424	14,334	14,911	15,251	16,211	17,422
Memorandum Items:	(Annual percentage change)							
Monetary base	11.6	16.9	10.2	10.4	9.2	6.4	2.8	6.5
Broad money	5.5	10.7	7.7	15.4	4.0	2.3	6.3	7.5
Credit to the private sector	13.7	13.4	12.2	17.5	11.8	12.8	11.1	10.9
Adjusted by changes in the exchange rate	13.8	13.7	12.9	14.1	11.9	11.5	11.3	10.6
	(In percent of GDP)							
Monetary base	7.0	7.5	7.8	7.8	8.0	7.9	7.7	7.7
Broad money	48.7	49.3	50.0	52.6	50.9	48.7	49.1	49.2
Of which: Deposits denominated in foreign currency	16.5	15.0	13.7	14.9	13.9	13.7	14.2	14.7
Credit to the private sector	46.0	47.7	50.3	53.9	56.1	59.3	62.4	64.4
Of which: In foreign currency	18.1	19.5	21.1	22.1	23.4	24.3	24.8	24.8
Central bank balance	-0.6	-0.7	-0.9	0.1	-0.8	-0.3	0.3	0.2

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

Table 9. Costa Rica: Medium-Term Framework, Baseline Scenario

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
							Projections					
						(Annual percentage change)						
Real GDP	4.3	4.8	2.3	3.7	4.7	4.3	4.0	4.0	3.9	3.9	3.8	3.8
Domestic demand	4.8	4.9	1.8	3.8	6.1	3.8	3.3	4.2	4.2	4.2	4.4	4.2
Consumption	5.1	4.9	3.0	4.0	4.3	4.1	3.9	4.2	4.5	4.4	4.4	4.4
Gross fixed capital formation	3.2	9.9	-0.3	3.3	8.8	-1.5	6.0	5.1	4.9	4.8	5.0	5.1
Exports of goods and nonfactor services	7.1	5.5	3.3	5.2	0.0	9.5	3.4	4.7	4.5	4.2	4.4	5.0
Imports of goods and nonfactor services	10.7	7.8	1.7	5.0	4.6	7.5	1.8	5.3	5.2	5.1	5.8	6.0
						(Contributions to real GDP growth)						
Domestic demand	4.9	5.1	1.9	4.0	6.3	3.9	3.5	4.3	4.4	4.4	4.6	4.4
Consumption	4.2	4.1	2.5	3.3	3.6	3.5	3.3	3.5	3.8	3.7	3.7	3.8
Gross fixed capital formation	0.6	1.9	-0.1	0.7	1.8	-0.3	1.2	1.0	1.0	1.0	1.0	1.1
Inventory changes	0.1	-0.9	-0.6	0.0	1.0	0.8	-0.9	-0.2	-0.4	-0.3	-0.2	-0.4
Net exports	-1.3	-1.0	0.5	-0.1	-1.7	0.3	0.4	-0.4	-0.4	-0.5	-0.7	-0.6
						(In percent of GDP)						
Savings and Investment												
Savings	19.9	20.5	19.0	18.8	20.2	19.7	19.6	19.5	19.2	19.0	19.0	18.8
Domestic savings	14.6	15.3	14.1	13.9	15.9	16.5	15.6	15.6	15.3	15.0	14.9	14.8
Private sector	15.9	16.9	16.2	16.2	18.3	18.2	17.9	18.2	18.3	18.6	18.9	19.2
Public sector	-1.3	-1.5	-2.0	-2.3	-2.4	-1.7	-2.3	-2.7	-3.1	-3.5	-3.9	-4.4
External savings 1/	5.3	5.1	4.8	4.9	4.3	3.2	4.0	4.0	4.0	4.0	4.0	4.0
Gross domestic investment	19.9	20.5	19.0	18.8	20.2	19.7	19.6	19.5	19.2	19.0	19.0	18.8
Private sector	16.6	17.4	16.3	16.3	16.6	15.1	16.0	16.1	16.2	16.2	16.2	16.1
Public sector	3.1	3.2	3.2	3.2	3.3	3.3	3.5	3.5	3.5	3.5	3.5	3.5
Inventory changes	0.2	-0.1	-0.5	-0.7	0.3	1.3	0.1	-0.1	-0.5	-0.6	-0.7	-0.8
Balance of payments												
Current account balance	-5.3	-5.1	-4.8	-4.9	-4.3	-3.2	-4.0	-4.0	-4.0	-4.0	-4.0	-4.0
Trade balance	-11.8	-11.4	-11.0	-10.4	-9.0	-7.8	-8.5	-8.5	-8.4	-8.3	-8.3	-8.2
Services	9.0	8.5	9.1	8.9	8.3	8.7	9.3	9.4	9.4	9.2	9.0	9.0
Income	-3.3	-3.1	-3.6	-4.2	-4.5	-5.0	-5.6	-5.7	-5.7	-5.6	-5.4	-5.3
Current transfers	0.8	0.9	0.8	0.9	0.8	0.8	0.8	0.8	0.8	0.7	0.7	0.6
Financial and capital account	-6.7	-4.2	-6.1	-6.0	-4.9	-3.7	-3.7	-3.7	-3.7	-3.7	-3.8	-3.8
Public sector	-0.2	-2.6	-2.5	-2.0	-3.6	-0.9	-0.8	-0.5	-0.5	0.1	-0.4	-0.4
Private sector	-6.5	-1.6	-3.6	-4.0	-1.3	-2.8	-3.0	-3.2	-3.2	-3.8	-3.4	-3.4
Foreign direct investment	-5.5	-3.8	-4.8	-5.6	-4.8	-4.6	-4.6	-4.5	-4.4	-4.3	-4.2	-4.1
Other net private flows	0.9	2.7	-0.9	-1.5	0.7	1.8	1.6	1.3	1.2	0.5	0.8	0.7
Errors and omissions	-1.5	0.7	-1.3	-1.0	-0.7	-0.8	0.0	0.0	0.0	0.0	0.0	0.0
Change in net international reserves (increase -)	0.3	4.5	0.9	-0.2	1.1	-0.4	-0.5	0.0	0.0	0.0	0.0	0.0
Memorandum items:												
Nominal GDP (billions of colones)	21,371	23,371	24,861	27,269	29,316	31,287	33,033	35,439	38,027	40,774	43,732	46,921
GDP deflator (percent change)	4.5	4.4	4.0	5.8	2.7	2.3	1.5	3.2	3.3	3.2	3.3	3.4
Consumer prices (percent change; period average)	4.9	4.5	5.2	4.5	0.8	0.0	1.9	3.0	3.0	3.0	3.0	3.0
Consumer prices (percent change; end of period)	4.7	4.6	3.7	5.1	-0.8	0.8	3.0	3.0	3.0	3.0	3.0	3.0
Credit to the private sector (percent change)	13.7	13.4	12.2	17.5	11.8	12.8	11.1	10.9	10.0	9.2	8.6	8.1
Net international reserves (millions of U.S. dollars)	4,756	6,857	7,331	7,211	7,834	7,574	7,249	7,249	7,249	7,249	7,249	7,249

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

1/ External current account deficit.

Table 10. Costa Rica: Banking Sector Indicators

	2010	2011	2012	2013	2014	2015	2016	2017
	Dec	Dec	Dec	Dec	Dec	Dec	Dec	Jan
	(In percent)							
Capitalization								
Risk-adjusted capital ratio	17.3	17.3	16.8	16.6	16.7	16.2	16.4	16.4
Capital-to-assets ratio	14.8	15.0	14.8	14.5	14.1	14.1	14.1	14.1
Asset quality								
Nonperforming loans to total loans	1.8	1.7	1.7	1.7	1.5	1.6	1.5	1.6
Non-income generating assets to total assets	17.4	17.7	16.8	17.1	16.3	15.6	15.7	15.6
Foreclosed assets to total assets	0.8	0.8	1.0	1.0	1.0	0.9	0.8	0.8
Loan loss provisions to total loans	1.8	1.8	1.7	1.6	1.6	1.9	2.2	2.3
Management								
Administrative expenses to total assets	4.3	4.2	4.2	3.9	3.6	3.5	3.3	3.3
Noninterest expenses to gross income	85.0	76.5	67.4	68.1	77.7	67.6	67.6	67.3
Total expenses to total revenues	96.2	93.1	90.7	92.5	94.2	92.7	91.3	91.3
Profitability								
Return on assets (ROA)	1.2	1.3	1.5	1.2	1.2	1.0	1.2	1.2
Return on equity (ROE)	8.3	9.1	10.3	8.2	8.5	7.3	8.8	9.2
Interest margin to gross income	16.6	27.2	32.1	30.5	22.8	33.5	32.4	32.6
Liquidity								
Liquid assets to total short-term liabilities	90.1	85.1	92.6	101.2	98.7	97.8	95.9	97.1
Liquid assets to total assets	30.7	28.8	29.2	30.4	29.1	28.9	28.2	28.6
Loans to deposits	97.8	105.2	106.3	106.6	109.5	115.5	115.8	113.9
Liquid assets to deposits	43.8	42.7	44.0	47.0	45.1	46.6	45.0	45.3
Sensitivity to market risk								
Net open FX position to capital	18.8	18.8	19.1	17.8	17.4	19.9	21.4	20.8
Other								
Financial margin 1/	8.2	8.1	7.7	6.8	7.1	7.0	6.9	6.9

Source: Superintendency of Banks (SUGEF).

1/ Difference between implicit loan and deposit rates.

Annex I. External Stability Assessment

The external position of Costa Rica is broadly in line with medium-term fundamentals and desirable policies. Staff used various approaches to assess the external balance and the exchange rate position. These include quantitative indicators, regression-based methods to estimate the distance of the current account (CA) balance from its equilibrium value and stability conditions for net foreign assets.

In 2016 the REER depreciated moderately in contrast with the previous year. As the headline inflation was close to zero throughout 2016 and the nominal exchange rate against the U.S. dollar depreciated about 3 percent, the REER depreciated about 1½ percent in 2016. This is in contrast with 2015 when the colon was stable and the REER appreciated almost 10 percent. Even though the 2016 REER level is about 30 percent above the 2009 level, staff estimates that such dynamics are consistent with the relative productivity improvement (the Balassa-Samuelson effect). To see this, the chart below shows REER adjusted for the labor productivity differential between Costa Rica and the U.S., the main trading partner. According to the chart the total appreciation since 2009 reflects changes in the equilibrium value, rather than unsustainable developments.

At the same time the CA deficit has declined and the exports market share has continued to increase. As another indication of a competitiveness gain, the CA deficit has improved further reaching 3¼ percent of GDP in 2016 on the back of still low fuel prices and strong exports growth of more than 9 percent, specifically tourism, which expanded more than 12 percent. This more than compensated Intel's manufacturing exit in 2014 and boosted Costa Rican exports share in world markets further by more than 6 percent relative to 2015, faster than total LAC exports of services and manufacturing goods (see chart below).

The financing structure of the CA and somewhat low external liabilities mitigate risks. The CA continues to be largely financed by FDI inflows. While the net International Investment Position (IIP) is negative at more than 45 percent of GDP, FDI comprises more than 65 percent of total liabilities. While, the U.S. continues to be the largest source of FDI (25 percent of the total in 2013-15), its importance declined over time (the U.S. accounted for about 50 percent of FDI in 2005-12). The sectors that attracted high amount of FDI in 2015 are mostly export-oriented and include real estate, manufacturing, commerce and agriculture. The external debt profile presents no significant 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. Even though international reserves declined by US$260 mln in 2016, the resulting stock is still at 4.9 months of non-maquila imports of goods and services at end-2016 and within the relevant Fund's composite reserve adequacy metric.[1]

[1] Staff believes that the ARA float metric (almost 150 percent coverage) is the more relevant one for Costa Rica in 2016 due to observed XR dynamics in 2016 and commitments of the central bank to allow more flexibility to complete transition to a fully-fledged inflation targeting regime.

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

	Current account (CA) norm	CA projected/ cyclically-adjusted	REER gap (updated)	REER gap (2016 AIV)	REER gap (2014 AIV)
External sustainability (ES)	-3.2	-3.4	0.7	6.8	13.2
ES (NFA exclud. FDI)	-7.9	-3.4	-11.1	-7.1	-5.9
EBA-Lite					
Macroeconomic Balance	-5.3	-3.6	-2.0	-3.5	NA
Equilibrium REER	NA	NA	15.0	22.0	NA
EBA					
Macroeconomic Balance	-4.8	-3.6	-3.0	-2.1	-4.7
Average 1/			-0.1	3.2	0.9

Source: Fund Estimates

1/ The average in this report is taken over a different set of models than in previous reports

Fund's multilaterally consistent estimates suggest that Costa Rica's REER has gained competitiveness and is broadly in line with fundamentals.

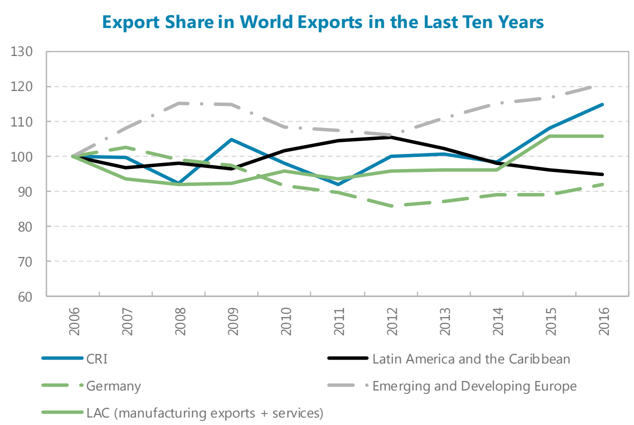
- The macro balance approach in the External Balance Assessment (EBA) is estimated on the basis of existing fundamentals and desirable policies. It points to a sustainable current account norm deficit of 4.8 percent of GDP in 2016, which is about 1.6 percent of GDP larger than the actual cyclically-adjusted deficit of 3.2 percent in 2016, implying a REER undervaluation of 3.8 percent. Overall identified policy gaps in Costa Rica are small and negative at -0.2 percent. Health expenditures, which are significantly higher than the world average, as well as the country's fiscal policy gap were offset by the relative credit gap. The latter arises from faster than optimal credit growth in the rest of the world, with credit growth in Costa Rica in line with desired financial deepening.

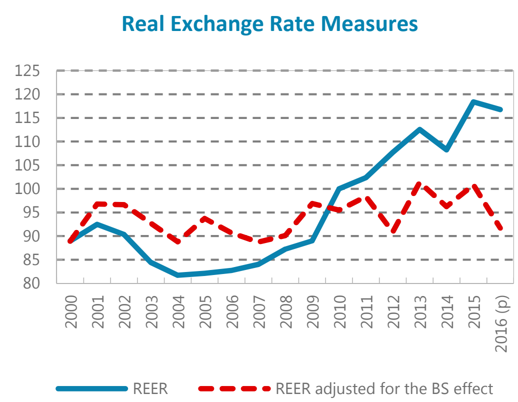
- The complementary macro balance approach in the EBA-lite assessment that includes a larger number of countries estimates REER undervaluation of 4.7 percent. High labor productivity and a relatively slow population aging speed more than compensated already high dependency ratio and resulted in a sustainable CA norm of about 5¼ percent of GDP. The implied policy gap is small and positive at 0.2 percent, as the fiscal policy gap was more than offset by the relative credit gap, similarly to the EBA approach. The REER gap implied by the equilibrium REER approach is significant (15 percent), but lower than it was in 2016 (22 percent). However, the model has been historically a poor fit as indicated by large residuals and misaligned trends in the fitted and actual REER series. The REER gaps implied by these approaches for the 2016 Article IV were calculated retroactively and are not included in the corresponding report. relative

- The external sustainability (ES) approach, which seeks a CA that stabilizes IIP as a share of GDP finds slight overvaluation of 2 percent. Taking into account the financial structure of external liabilities of Costa Rica by excluding FDI from the stock of total liabilities implies a moderate undervaluation of 7.9 percent.

Staff views the results based on the macro balance approaches, which both find external competitiveness gains as the most reliable. The simple average across the different methodologies implies no over or undervaluation. Given uncertainty about the estimated norms, staff concludes that Costa Rica's REER is broadly line with fundamentals.

According to assessments by other international institutions, the competitiveness of Costa Rica has remained broadly the same. Costa Rica maintained its 2016 score in 2017 Doing Business Survey by the World Bank in almost all categories. High cost of starting a business, weak contract enforcement and poor protection of minority investors persist as main concerns. According to the 2017 Global Competitiveness Report by the World Economic Forum, Costa Rica's assessment has remained at the same level as the last year. Overall, Costa Rica continues to perform better than most of the Latin American countries outpaced only by Chile and Panama. Inefficient government bureaucracy and still inadequate, but slightly improved, infrastructure quality continues to be the main drags on competitiveness.





Annex II. 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. A draft bank resolution law contemplates protection for bank supervisors participating in the resolution process. A constitutional reform is necessary to establish legal protection for bank supervisors. CONASSIF has issued agreements to provide legal assistance to SUGEF senior personnel in case of judicial inquiries arising from the exercise of their functions.
Introduce pertinent laws for the Superintendence 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 their rapid implementation by the banking system.	The draft law that was submitted in the past has been archived by Congress. SUGEF is in the process of re-drafting a new reform bill. The strategic orientations of this bill have been defined in 2015.
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] A normative reform that increases the generic provision for un-hedged borrowers from 0.5 to 1.5 percent has been approved in May 2016.
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.	With the IMF's help, SUGEF is in the process of drafting a new reform bill. The strategic orientations of this project have been defined in 2015.
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 conducted in 2015 and 2016).[1] SUGEF has been carrying pilot visits to various financial entities which will allow defining the focus of the rating system in the context of risk-based supervision.
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

Recommendations	Comments
	portfolio as collateral (with strict rules on quality and haircuts). Both lines are available in U.S. 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.	SUGEF is working on a draft law with the assistance of the IMF's TA.
Amend the bank resolution legal framework to include purchase and assumption type techniques.	Improvements to the bank resolution framework are being developed as a complement to the deposit guarantee scheme.
Enable voluntary, extra-judicial corporate restructuring agreements.	Approval of the Law on Execution in 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 III. Summary of Recommendations in the WHD Cluster Surveillance Report on Financial Integration in CAPDR

Micro-prudential Regulation	
Regulatory Perimeter	• Designate a Lead Supervisor in each country. • Adopt a broad definition of financial conglomerate and economic group. • Develop and periodically update a map of existing financial conglomerates. Empower supervisors to regulate holding corporations. • Agree on a common scope of supervision to minimize regulatory arbitrage.
Capital Adequacy	• Bridge existing different capital definitions across countries. • Adopt common definition of capital consistent with international best practice. • Harmonize the calculation of financial conglomerates' capital on a consolidated basis. • Adopt common loan classification criteria, at least applicable to regional entities.
Corporate Governance	• Regulate the organization structure of conglomerates to facilitate their supervision. • Reinforce legal authorities for the identification of ultimate ownership of financial conglomerates and economic groups. • Harmonize regulations on market entry and participation. • Establish minimum regional standards on risk management systems.
Credit Limits	• Adopt common thresholds on credit concentration and exposures to related parties. • Empower supervisors to inquire about ultimate owners' identities beyond financial corporations that are part of the financial conglomerates. • Grant sufficient legal protection to supervisors.
Macro-financial Regulation and Instruments	
Regional Supervision	• Implement a Regional Financial Stability Council with a broad mandate for regional financial stability, building from existing forums and Ministries of Finance. • Extend responsibility of supervising regional conglomerates to principal supervisors. • Harmonize financial data exchange in line with international accounting standards.
Macro-prudential Regulation	• Ensure full integration of systemic risk in the regulatory and supervisory frameworks. • Develop national and regional frameworks to identify SIFIs. • Calibrate micro-financial regulatory instruments to address macro-prudential risk. • Agree on a common set of macro-prudential instruments to be used to induce a reduction of systemic risk from financial conglomerates. • Reinforce regional macro-prudential surveillance, including by regional authorities.
Lender of Last Resort	• Adopt minimum country requirements on LOLR facilities. • Re-examine regulation for ring-fencing to ensure it addresses liquidity pressures transmitted across borders through financial conglomerates. • Develop macro-prudential metrics for liquidity in foreign exchange. • Reassess national frameworks on reserve requirements for foreign currency liabilities.
Remedial Actions and Resolution	• Extend legal regimes for corrective and remedial actions to non-bank financial institutions, and also specifically for SIFIs and financial conglomerates. • Adapt resolution frameworks to take into account regional implications.
Deposit Insurance	• Harmonize deposit insurance facilities. • Establish explicit coverage of deposits in off-shore banks with a specific regime.

Annex IV. Public Debt Sustainability Analysis (Higher Scrutiny Case)

The DSA highlights Costa Rica's unsustainable public debt dynamics. The debt stock is projected to rise over 65 percent of GDP by 2022 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.

A. Key Assumptions

Debt definition. The public debt sustainability analysis focuses on the central government 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 and other decentralized government entities broadly offset the small central bank deficit—resulting from its liquidity management operations—while public enterprises are broadly in balance.

Growth and fiscal policy assumptions. The baseline anticipates a slowdown in potential growth from an estimated 4.3 percent in 2016 to 3.8 percent by 2022, reflecting mainly the strain on private investment of higher interest rates amid costlier risk premia from continued large budget deficits and related tighter monetary stance needed to keep inflation close to target. The baseline scenario only assumes additional fiscal adjustment of about ¾ percent of GDP based on the staff's assessment of already approved legislative measures. The primary balance is nevertheless projected to deteriorate by almost ½ percent of GDP, driven mostly by projected increases in expenditure arising from recent Constitutional Court rulings and other planned small increases in public investment.

Debt target. In theory, it is difficult to justify a unique threshold for the 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 worsen risks significantly. For example, the WEO (2003) finds that the median public debt-to-GDP ratio for emerging markets in the year before a default was about 50 percent of GDP. Therefore, targeting an upper bound to the public debt ratio below 50 percent of GDP or so appears justifiable in the case of Costa Rica.

B. Results and Assessment

Results. In the baseline, the headline deficit exceeds 8 percent of GDP in 2022, as the higher interest bill from rising public debt—which exceeds 65 percent of GDP in 2022 and stays on an upward trajectory thereafter—more than offsets the small projected improvement in the primary balance. The average gross financing needs would be 12 percent of GDP in 2017-22. In the adjustment scenario, additional measures of 3 of GDP as part of a gradual but frontloaded consolidation plan suffice to stabilize debt by 2022 at a level just below 50 percent of GDP. This outcome assumes tightening in credit spreads driven by favorable market reaction to a frontloaded adjustment plan with credible measures.

Assessment. While most standard indicators are not at "danger" levels (see heat-map), the debt and gross financing needs approach the benchmarks for medium-risk assessment under stressed scenarios, while market perception indicators are approaching the high-risk assessment. In particular:

- In addition to the medium-risk assessments under the growth and contingent liability shocks in the heat map, debt levels are just 2-4 percentage points of GDP short of the 70 percent debt threshold for medium-risk assessment under all other specific shocks. Moreover, debt levels have particularly high sensitivity to growth shocks which may be particularly prominent under heightened external risks of greater protectionism and economic isolationism in advanced economies identified in the risk assessment matrix.

- In addition to the medium-risk assessment under the contingent liability shock,[1] gross financing needs are just 2-3 percentage points of GDP below the 15 percent threshold for medium-risk under all other specific shocks.

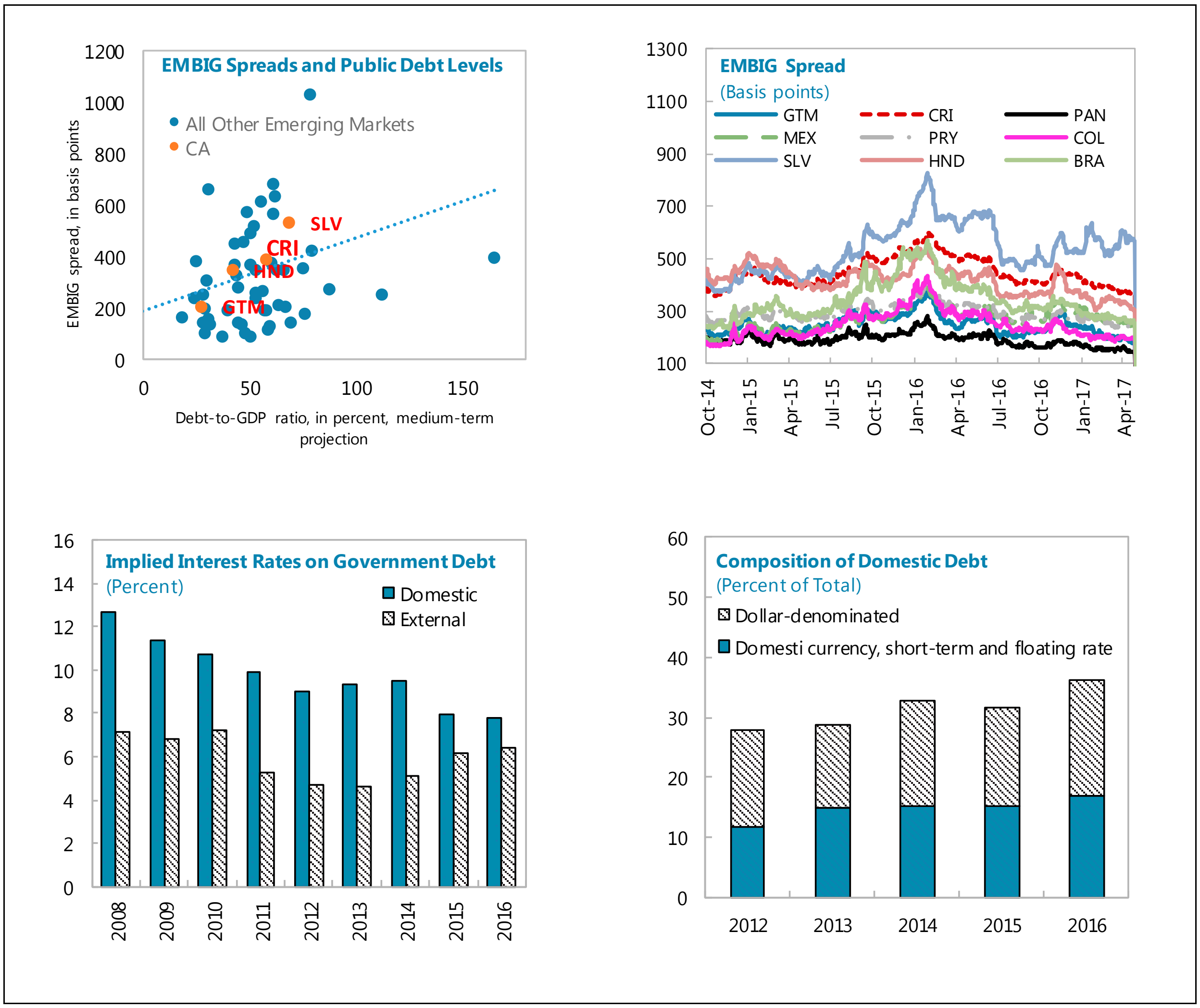
- In addition to the current medium-risk assessment under most debt profile indicators, market perception indicators have at times been above the benchmark for the high-risk assessment, and vulnerabilities to interest rate and exchange rate shocks are increasing.

    - An international comparison of spreads on external bonds shows that Costa Rica's spreads are broadly consistent with market average perceptions of countries in a similar fiscal situation—measured by projected debt-to-GDP ratios in the medium-term. While Costa Rica's external financing costs have benefited from recent favorable external financing conditions for emerging markets and are currently around 400 basis points, they briefly exceeded the 600 basis points threshold for high-risk assessment during the period of heightened concerns about emerging market fundamentals in late 2015-early 2016. Given

[1] The standard contingent liability shock in the DSA template is calibrated as a 10 percent loss in the value of banking system assets excluding claims on government. The size of this shock is of similar magnitude to maximum possible direct losses from complete write-down of bank exposures to sovereign debt and associated need for bank recapitalization to restore capital adequacy ratios, though actual losses would likely be larger under such an extreme scenario of full-blown sovereign debt and economic crisis.

the relatively unchanged fiscal situation, the country could easily return to or surpass those levels under high risk scenarios identified in the risk assessment matrix involving tighter global financial conditions from more rapid monetary policy normalization or rising concerns about a weaker fiscal position in the U.S.

- Domestic financing costs declined last year despite the lack of external bond financing, as they benefitted from the pass-through of policy rate cuts to domestic market rates, but also from greater reliance on floating rate and dollar-denominated bonds that increase the vulnerability of public debt to possible future interest rate and exchange rate shocks.



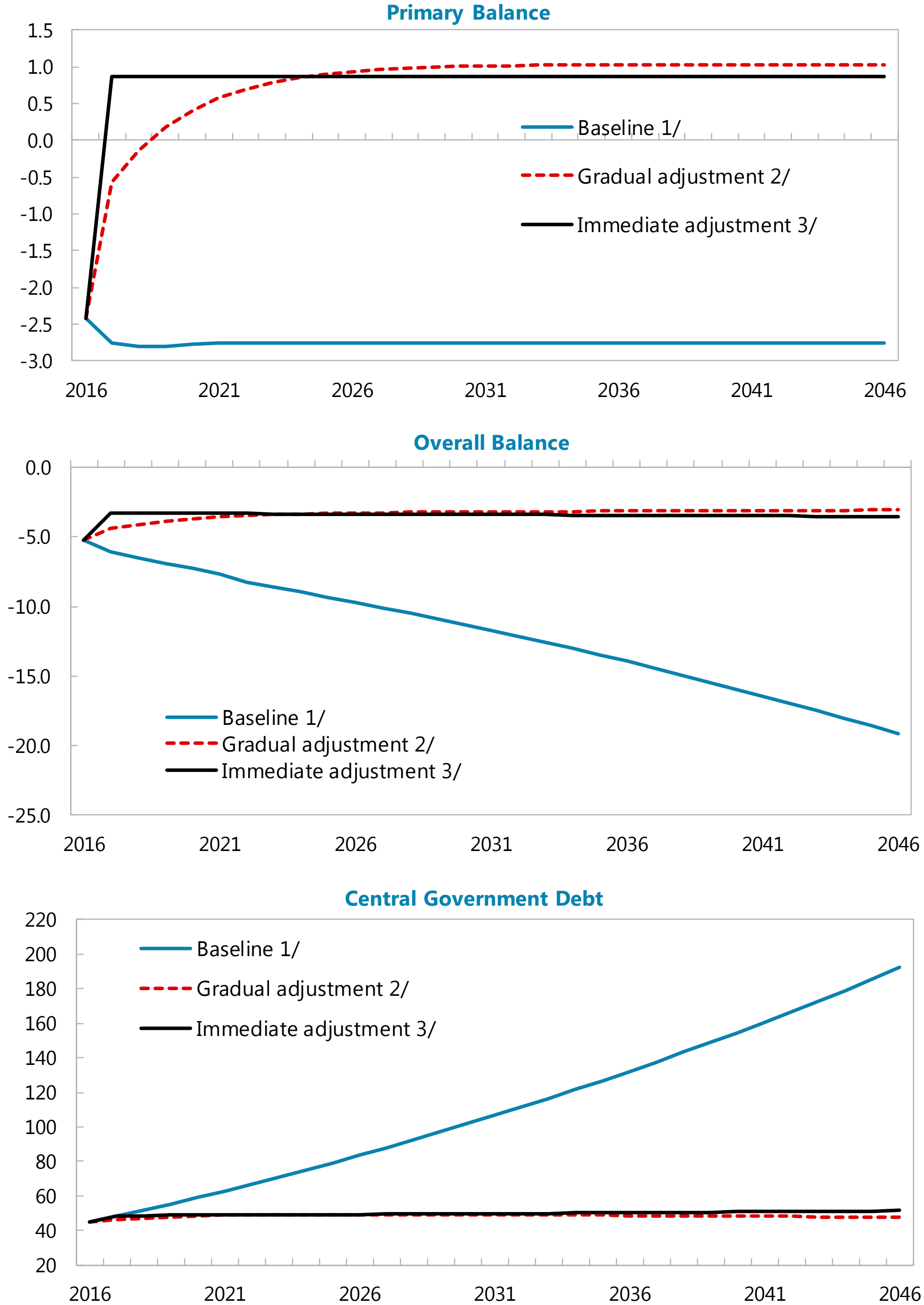
Mitigating factors. A stable investor base is an important mitigating factor. Notwithstanding the medium risk ratings for external and FX debt in the debt profile indicators heat map, with external and FX debt representing 23 and 38 percent of total debt respectively, about 60 percent of total domestic debt is held by captive local institutional investors, including the social security system, nonfinancial public sector institutions, and banks.

Recommended adjustment path. Gradual but frontloaded fiscal consolidation would strike an appropriate balance between lowering the sustainability gap and limiting the adverse impact on growth. To gauge the optimal fiscal consolidation path, we resort to a model of quadratic preferences in which the authorities' relative preferences for closing the fiscal sustainability gap and the output gap are taken into account.[2] Relative to the model results obtained in the 2016 Article IV, the optimal fiscal consolidation path is more frontloaded reflecting current estimates that the output gap is now essentially closed, while the fiscal sustainability gap is still sizeable.

[2] Quadratic preferences imply that the pressure to act to reduce the output and sustainability gaps increases in a nonlinear fashion with the size of the gap.

Costa Rica: Long-Term Fiscal Sustainability

(Percent of GDP)



1/ This path is the baseline through 2022, with a constant primary balance thereafter.

2/ Adjustment begins in 2017. Assumes a long-run real interest rate greater than the potential growth rate for the whole period.

3/ Assumes that the full fiscal adjustment takes place in 2017 and has no impact on growth.

Costa Rica Central Government Debt Sustainability Analysis (DSA) - Baseline Scenario

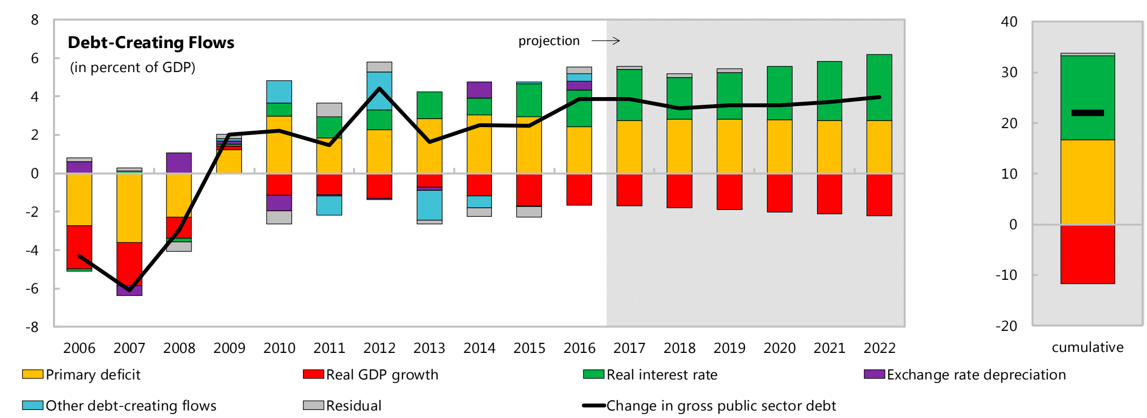
(in percent of GDP unless otherwise indicated)

Debt, Economic and Market Indicators [1]

	Actual			Projections						As of May 12, 2017		
	2006-2014 [2]	2015	2016	2017	2018	2019	2020	2021	2022	Sovereign Spreads		
Nominal gross public debt	30.8	40.8	44.7	48.6	52.0	55.5	59.0	62.7	66.7	EMBIG (bp) 3/		368
Public gross financing needs	12.0	11.3	10.6	11.1	12.7	12.3	11.9	11.8	12.5	5Y CDS (bp)		368
Real GDP growth (in percent)	4.3	4.7	4.3	4.0	4.0	3.9	3.9	3.8	3.8	Ratings	Foreign	Local
Inflation (GDP deflator, in percent)	7.8	2.7	2.3	1.5	3.2	3.3	3.2	3.3	3.4	Moody's	Ba2	Ba2
Nominal GDP growth (in percent)	12.5	7.5	6.7	5.6	7.3	7.3	7.2	7.3	7.3	S&Ps	BB-	BB-
Effective interest rate (in percent) [4]	10.1	7.5	7.4	7.8	8.2	8.5	8.7	9.0	9.4	Fitch	BB	BB

Contribution to Changes in Public Debt

	Actual			Projections							
	2006-2014	2015	2016	2017	2018	2019	2020	2021	2022	cumulative	debt-stabilizing
Change in gross public sector debt	0.1	2.5	3.9	3.9	3.4	3.5	3.6	3.7	4.0	22.0	primary
Identified debt-creating flows	0.1	3.0	3.5	3.7	3.2	3.4	3.6	3.7	4.0	21.5	balance [9]
Primary deficit	0.6	3.0	2.4	2.8	2.8	2.8	2.8	2.7	2.8	16.6	1.2
Primary (noninterest) revenue and grants	13.9	13.6	14.0	14.0	14.1	14.2	14.2	14.2	14.2	85.0	
Primary (noninterest) expenditure	14.5	16.6	16.4	16.8	16.9	17.0	17.0	17.0	17.0	101.7	
Automatic debt dynamics [5]	-0.5	0.0	0.7	1.0	0.4	0.6	0.8	1.0	1.2	4.9	
Interest rate/growth differential [6]	-0.7	0.0	0.3	1.0	0.4	0.6	0.8	1.0	1.2	4.9	
Of which: real interest rate	0.6	1.7	1.9	2.6	2.2	2.5	2.8	3.1	3.4	16.6	
Of which: real GDP growth	-1.2	-1.7	-1.7	-1.7	-1.8	-1.9	-2.0	-2.1	-2.2	-11.7	
Exchange rate depreciation [7]	0.1	0.0	0.5	…	…	…	…	…	…	…	
Other identified debt-creating flows	0.0	0.1	0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Please specify (1) (e.g., drawdown of deposits) (negative)	0.0	0.1	0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
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]	0.0	-0.6	0.3	0.2	0.2	0.2	0.0	0.0	0.0	0.5	

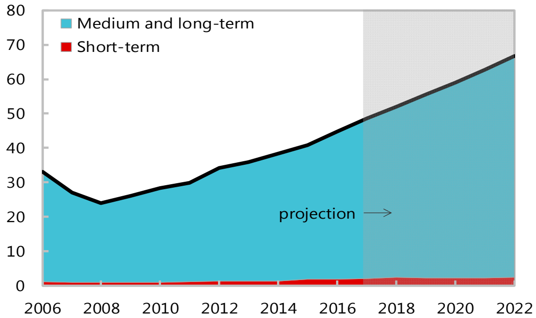


Source: Fund staff estimates and projections.
1/ Public sector is defined as central government.
2/ Based on available data.
3/ EMBIG.
4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.
5/ Derived as [(r - π(1+g) - g + ae(1+r)]/(1+g+π+gπ)) times 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.

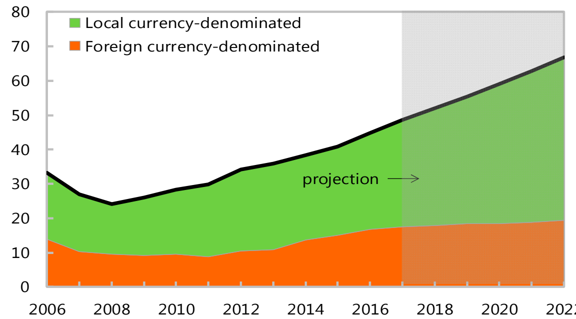
Costa Rica Central Government DSA - Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

By Maturity
(in percent of GDP)



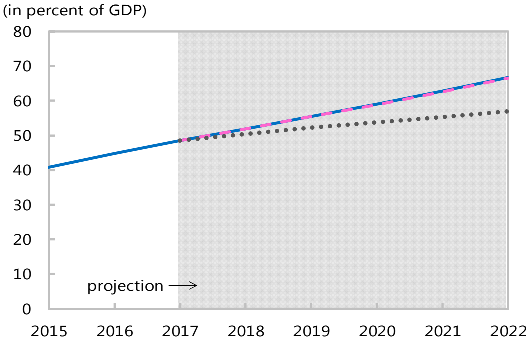
By Currency
(in percent of GDP)



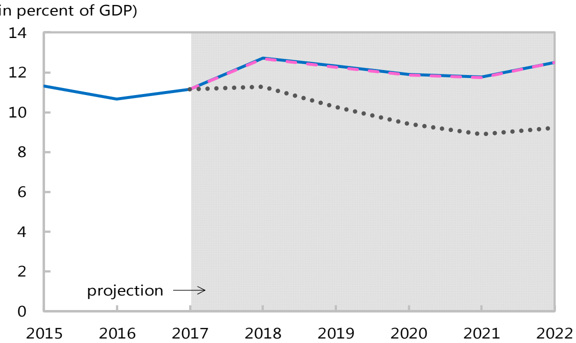
Alternative Scenarios

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	2017	2018	2019	2020	2021	2022
Real GDP growth	4.0	4.0	3.9	3.9	3.8	3.8
Inflation	1.5	3.2	3.3	3.2	3.3	3.4
Primary Balance	-2.8	-2.8	-2.8	-2.8	-2.7	-2.8
Effective interest rate	7.8	8.2	8.5	8.7	9.0	9.4
Constant Primary Balance Scenario						
Real GDP growth	4.0	4.0	3.9	3.9	3.8	3.8
Inflation	1.5	3.2	3.3	3.2	3.3	3.4
Primary Balance	-2.8	-2.8	-2.8	-2.8	-2.8	-2.8
Effective interest rate	7.8	8.2	8.5	8.7	9.0	9.4

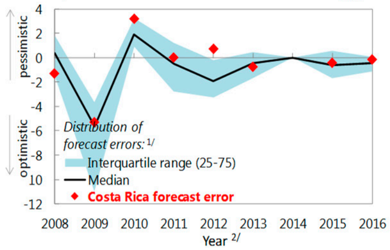
Historical Scenario	2017	2018	2019	2020	2021	2022
Real GDP growth	4.0	4.1	4.1	4.1	4.1	4.1
Inflation	1.5	3.2	3.3	3.2	3.3	3.4
Primary Balance	-2.8	-1.4	-1.4	-1.4	-1.4	-1.4
Effective interest rate	7.8	8.2	8.0	7.9	7.9	8.0

Source: Fund staff estimates and projections.

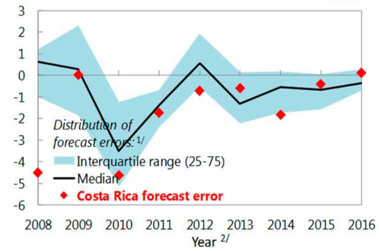
Costa Rica Central Government DSA – Realism of Baseline Assumptions

Forecast Track Record, versus program countries

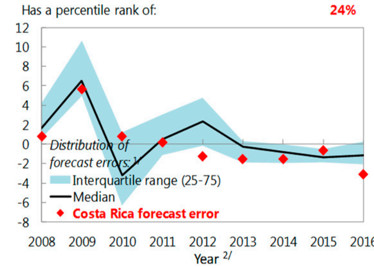
Real GDP Growth
(in percent, actual-projection)
Costa Rica median forecast error, 2008-2016: **-0.29**
Has a percentile rank of: **66%**



Primary Balance
(in percent of GDP, actual-projection)
Costa Rica median forecast error, 2008-2016: **-0.70**
Has a percentile rank of: **47%**

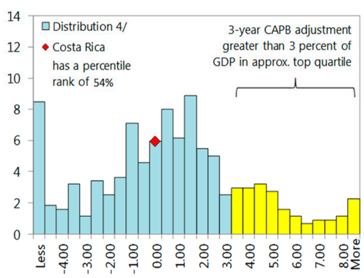


Inflation (Deflator)
(in percent, actual-projection)
Costa Rica median forecast error, 2008-2016: **-0.63**
Has a percentile rank of: **24%**

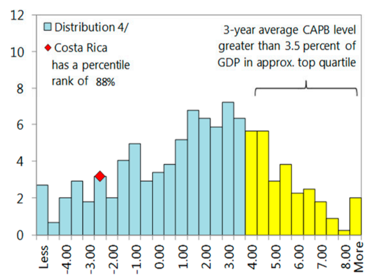


Assessing the Realism of Projected Fiscal Adjustment

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

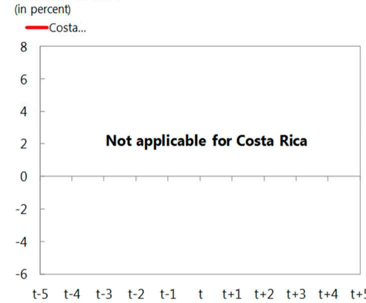


3-Year Average Level of Cyclically-Adjusted Primary Balance (CAPB)
(Percent of GDP)



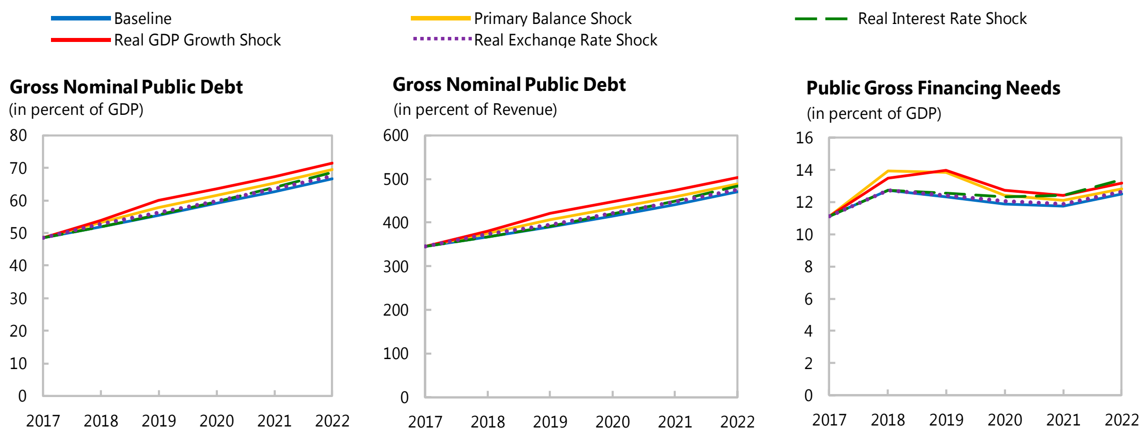
Boom-Bust Analysis 3/

Real GDP growth
(in percent)

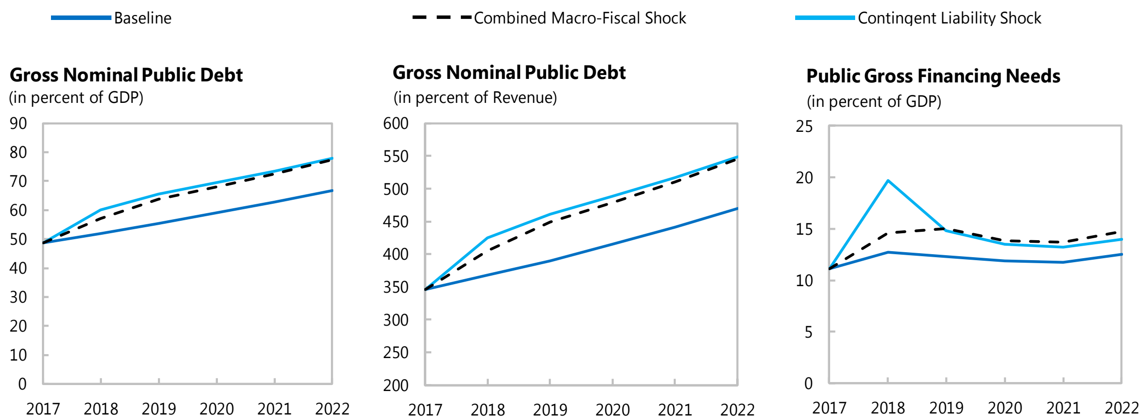


Source : IMF Staff.
1/ Plotted distribution includes program countries, percentile rank refers to all countries.
2/ Projections made in the spring WEO vintage of the preceding year.
3/ Not applicable for Costa Rica, as it meets neither the positive output gap criterion nor the private credit growth criterion.
4/ Data cover annual observations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions

(in percent)

	2017	2018	2019	2020	2021	2022
Primary Balance Shock						
Real GDP growth	4.0	4.0	3.9	3.9	3.8	3.8
Inflation	1.5	3.2	3.3	3.2	3.3	3.4
Primary balance	-2.8	-4.0	-4.0	-2.8	-2.7	-2.8
Effective interest rate	7.8	8.2	8.5	8.8	9.1	9.4
Real Interest Rate Shock						
Real GDP growth	4.0	4.0	3.9	3.9	3.8	3.8
Inflation	1.5	3.2	3.3	3.2	3.3	3.4
Primary balance	-2.8	-2.8	-2.8	-2.8	-2.7	-2.8
Effective interest rate	7.8	8.2	8.9	9.5	10.0	10.5
Combined Shock						
Real GDP growth	4.0	1.7	1.6	3.9	3.8	3.8
Inflation	1.5	2.6	2.7	3.2	3.3	3.4
Primary balance	-2.8	-4.0	-4.0	-2.8	-2.7	-2.8
Effective interest rate	7.8	8.6	8.9	9.5	10.0	10.5

	2017	2018	2019	2020	2021	2022
Real GDP Growth Shock						
Real GDP growth	4.0	1.7	1.6	3.9	3.8	3.8
Inflation	1.5	2.6	2.7	3.2	3.3	3.4
Primary balance	-2.8	-3.3	-3.8	-2.8	-2.7	-2.8
Effective interest rate	7.8	8.2	8.5	8.8	9.0	9.4
Real Exchange Rate Shock						
Real GDP growth	4.0	4.0	3.9	3.9	3.8	3.8
Inflation	1.5	6.9	3.3	3.2	3.3	3.4
Primary balance	-2.8	-2.8	-2.8	-2.8	-2.7	-2.8
Effective interest rate	7.8	8.6	8.4	8.7	9.0	9.3
Contingent Liability Shock						
Real GDP growth	4.0	1.7	1.6	3.9	3.8	3.8
Inflation	1.5	2.6	2.7	3.2	3.3	3.4
Primary balance	-2.8	-9.1	-2.8	-2.8	-2.7	-2.8
Effective interest rate	7.8	9.1	8.8	9.1	9.3	9.6

Source: Fund staff estimates and projections.

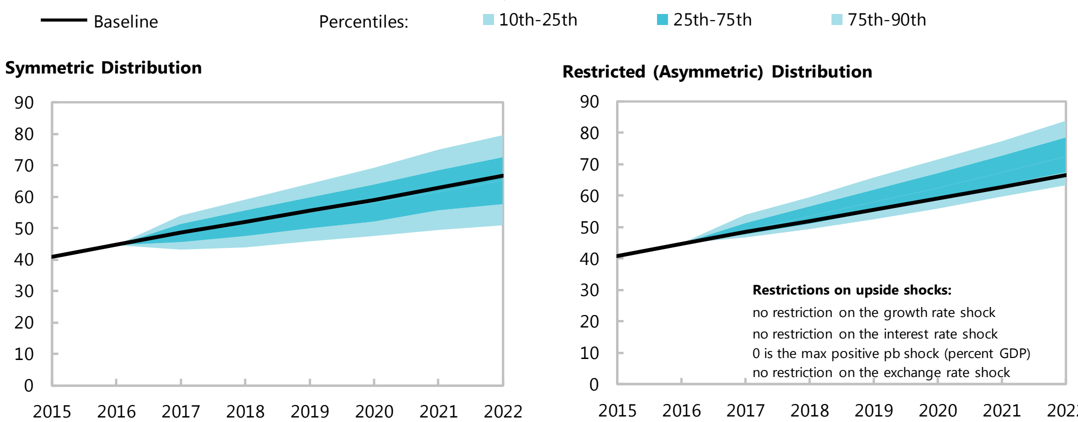
Costa Rica Central Government DSA Risk Assessment

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

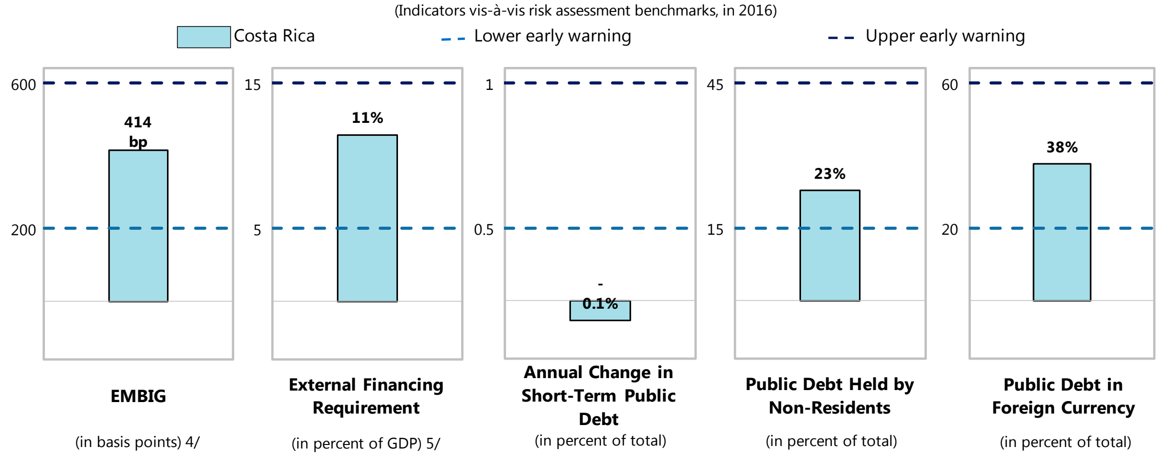
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2016)



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:

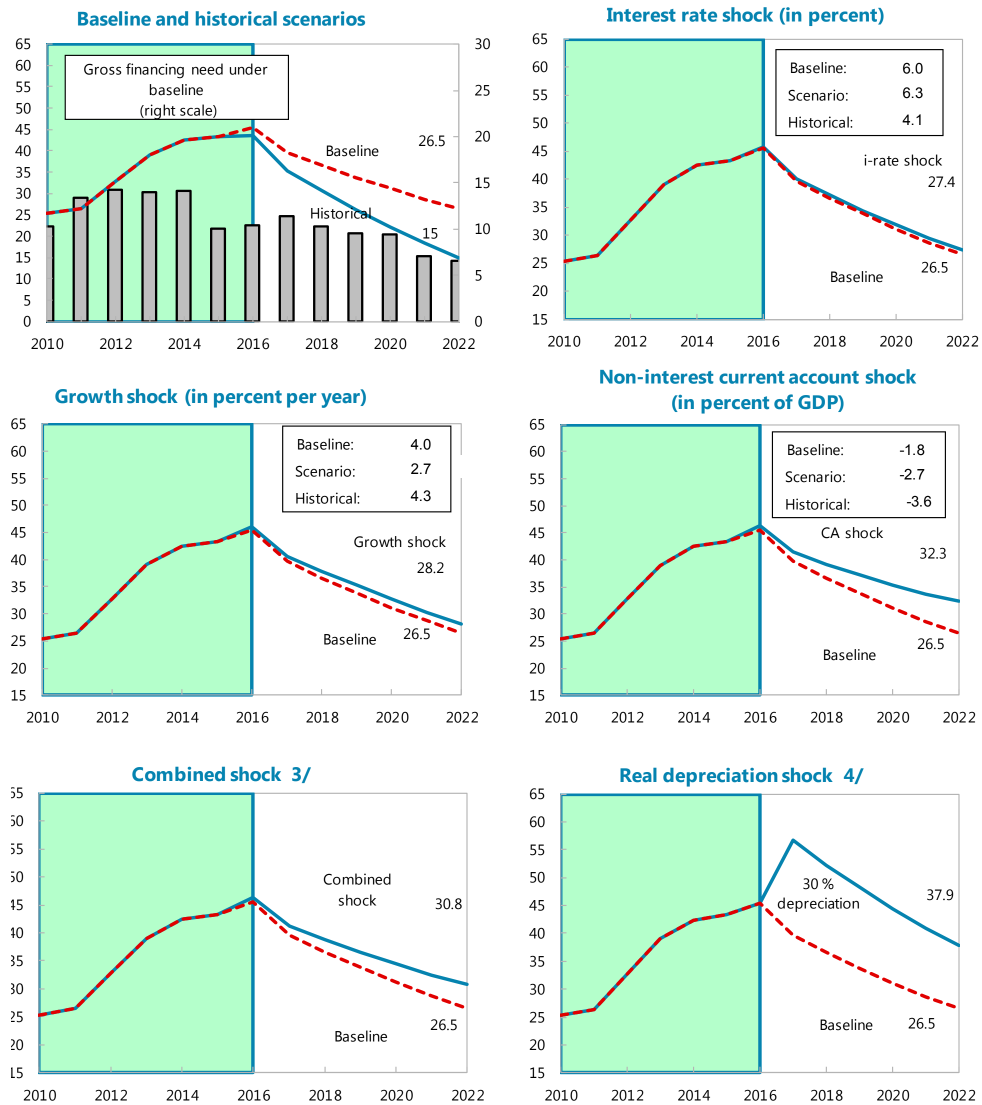
200 and 600 basis points for bond spreads; 5 and 15 percent of GDP for external financing requirement; 0.5 and 1 percent for change in the share of short-term debt; 15 and 45 percent for the public debt held by non-residents; and 20 and 60 percent for the share of foreign-currency denominated debt.

4/ EMBIG, an average over the last 3 months, 11-Feb-17 through 12-May-17.

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.

Annex V. Costa Rica: External Debt Sustainability Assessment

Costa Rica: External Debt Sustainability: Bound Tests 1/ 2/
(External debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and 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 2016.

INTERNATIONAL MONETARY FUND

COSTA RICA

STAFF REPORT FOR THE 2017 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

May 31, 2017

Prepared By: The Western Hemisphere Department

CONTENTS

FUND RELATIONS

(As of March 31, 2017)

Membership Status: Joined: January 8, 1946; Article VIII

General Resources Account:	**SDR Million**	**% Quota**
Quota	369.40	100.00
Fund holdings of currency	298.07	80.69
Reserve Tranche Position	71.34	19.31

SDR Department:	**SDR Million**	**% Allocation**
Net cumulative allocation	156.53	100.00
Holdings	85.07	54.35

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**			
		2017	2018	2019	2020
Principal	0.00	0.00	0.00	0.00	0.00
Charges/Interest	0.00	0.22	0.30	0.30	0.30
Total	**0.00**	**0.22**	**0.30**	**0.30**	**0.30**

Exchange Rate Arrangement. Costa Rica’s de jure current exchange rate arrangement classification is “managed float,” (previously classified as a crawling band arrangement) while the de facto current exchange rate arrangement is classified as “crawl-like” (previously classified as “stabilized.”) The former was established on February 2, 2015. The central bank committed to allow the exchange rate to be freely determined by foreign currency supply and demand, but reserved the right to participate in the market to meet its own foreign currency requirements and those of the nonbank public sector and, at its discretion, to prevent sharp fluctuations in the exchange rate. Starting from June 8, 2016, the exchange rate stayed within a 2 percent band of a 3½ depreciation trend against the U.S. dollar, mostly because the Central Bank maintained active, although less significant, role in exchange rate management to avert excessive volatility in light of the large financial dollarization of the financial system. 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 May 23, 2016 (Country Report No. 16/131).

FSAP participation and ROSCs. The FSAP took place in 2001, and was updated in 2007. A data ROSC took place in 2002 with a reassessment in 2010. A fiscal ROSC took place in 2007.

Technical Assistance.

Department	Time of Delivery	Purpose
STA, CAPTAC-DR Real Sector	May 2016 May 2016 May 2016 February 2017 April 2017	Quarterly Construction Survey Retropolization Quarterly Accounts / IMAE Quarterly Construction Survey Monthly Indicators / IMAE
MCM, CAPTAC-DR	January 2016 February 2016 February 2016 March 2016 April 2016 July 2016 November 2016 November 2016 November 2016	Strengthening the capacity of financial stability analysis Capacity building projection and macroeconomic analysis to the BCCR Macroprudential policies in the region Credit risk regulation and supervision Stress testing Consolidated supervision IFRS training Market risk supervision Credit risk supervision
FAD, CAPTAC-DR	February 2016 March 2016 April 2016 April 2016 May 2016 July 2016 August 2016 August 2016 October 2016 October 2016 October 2016 November 2016 November 2016	Customs administration Tax Administration Customs administration Fiscal Risks - Specific risks Customs administration Strengthen the audit area Customs administration process management Tax Administration Customs administration process management Customs administration integrated containers control model Set the taxpayer risk matrix Accounting - Business Intelligence Model Budget – Costing

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

PAST FUND STAFF RECOMMENDATIONS AND IMPLEMENTATION

2016 Article IV Staff Recommendation	Implementation
Fiscal Policy	
• Fiscal adjustment of 3¾ percent of GDP is needed to stabilize the debt-to-GDP ratio over the medium term below levels which are shown to pose risks for macro stability in emerging markets. • Start gradual fiscal adjustment in 2016 to start closing the sustainability gap while minimizing the impact on growth, and also mitigating risks of higher inflation, widening external imbalances and possible adverse financial market reactions. • In the longer-term, parametric adjustments would also be needed to remedy the actuarial imbalance of the pension system.	• The government achieved a reduction of ½ percent of GDP in the primary surplus in 2016 through administrative measures to contain wage bill growth and reduce personal income tax evasion. The government also obtained Congressional approval of legislative measures—including on anti-tax evasion, transfers to decentralized institutions, and pensions paid out of the budget—expected to deliver about ½ percent of GDP of additional adjustment. However, recent Constitutional Court rulings mandating stricter enforcement of earmarking provisions for social and education expenditure offset some of these gains (¶7 and 8). • The authorities announced in early 2017 the start of Congressional discussions of a fiscal reform package that would have largely closed the remaining fiscal sustainability gap estimated at 3 percent of GDP. This included VAT reform aimed at broadening the base and increasing rates, income tax reform introducing additional marginal rates on higher-income brackets, and a law to reform public employment. Inclusion in the measures of the public employment law prompted trade union calls for a general strike. The government reacted by sounding out political forces on an alternative plan focused mainly on tax base widening that it considered could better garner Congressional approval in 2017, but it has also expressed its continued commitment to seek parliamentary support for the original proposal before the end of the current administration (¶18, 19, and 20). • The pension system's administrator (CCSS) and the Superintendence commissioned an independent actuarial report on the country's main pay-as-you-go (PAYG) system. Following the report's findings that radical parametric reforms are needed to close the actuarial gap, the CCSS announced a 1 percent increase in the employee's contribution rate, effective from June 2017, as well as the start of a national dialogue to discuss additional reforms (¶22).

Monetary and Foreign Exchange Policy	
• Maintain the current expansionary monetary stance, but stand ready to raise rates if price pressures threaten to drive inflation above the mid-point of the new target range. • Allow more XR flexibility to help establish inflation as the undisputed monetary anchor, as well as to discourage dollarization.	• In light of the ongoing normalization of inflation and the closed output gap, the BCCR increased its policy rate by 225 basis points since April 2017, to 4 percent (¶4), still below the estimated neutral rate of 5 percent (¶17). • The authorities have made progress in passing measures to deepen the FX market that should facilitate greater XR flexibility to complete the transition to full-fledged inflation targeting (¶23 and 24).
Financial Sector	
• Implementation of the pending 2008 FSAP recommendations should be accelerated. • Reduce vulnerabilities stemming from currency mismatches in the private sector and high bank net foreign liabilities.	• Progress on introducing FSAP recommendations remains slow. However, the authorities' decision to participate in a Fund-conducted Financial Sector Stability Review is a welcome step toward full implementation of the 2008 FSAP recommendations (¶28). • The authorities' have taken additional prudential tools to contain systemic risks in the financial sector (¶27). Besides those adopted before 2016, last year several new regulations were introduced: (i) higher risk-weightings on household mortgages with high loan-to-value ratios, with further penalization for mortgages in FX to unhedged borrowers; (ii) additional generic provisioning of 1.5 percent on FX loans to unhedged borrowers; and (iii) countercyclical provisions. In April 2017, the SUGEF also proposed a revision of minimum capital requirements for market risk to protect banks' capital adequacy against losses from XR movements, in line with Basel III guidelines.

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

1. **The IMF's Costa Rica team is in coordination with the World Bank's Costa Rica team** to identify macroeconomic challenges and macro-critical structural reforms, and coordinate the two teams' work.

2. **The teams agree 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. **Based on the shared assessment of macroeconomic challenges, the teams identify 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 main adjustment plan laid out by the authorities is appropriate, but full implementation is critical. Key elements include raising revenues through fiscal reforms already submitted to Congress that adequately focus on broadening the base for the VAT, increasing VAT rates and marginal income tax rates on high earners, with an additional sizeable contribution from mostly administratively-determined measures aimed at gradually reducing expenditures as a share of GDP.

- *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.

4. **The teams are in agreement on 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 seek opportunities to 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. The authorities have requested an FSAP update for next fiscal year.

- 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), a catastrophe draw down deferred option (approved in March 2009) and a health operation (approved in March 2016). The government has also requested technical assistance from IFC Advisory services to improve the investment climate.

5. **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).

6. **The table below lists the teams' separate and joint work programs for 2017-18.**

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	Public Expenditure Review		March 2018
IMF Work Program	Staff visit	October, 2017	October, 2017
	Regional Conference	July, 2018	July, 2018
	Technical assistance:	2017	
	National Accounts and Price Statistics		
	Monetary and FX Operations		
	Banking Supervision and Regulation		
	Fiscal Revenue and Expenditure Management		

7. **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 FY17	Projected disbursements in
Higher Education Improvement Project	200	109	60
Catastrophe Deferred Draw Down Option	65	31	0
Strengthening Universal Health Insurance	420	315	100

8. **Other analytical or advisory services:**

Task Name	Delivery
PMR MRP Implementation Costa Rica	28-Mar-2019
PMR Domestic C-Market Infrastructure	28-Mar-2019
PMR Costa Rica: carbon offset demand	29-Mar-2019
PMR: carbon offset supply (P3)	29-Mar-2019
Hydropower Sustainability Support	23-Jul-2018
Regional Financial Integration Approach	30-May-2018

RELATIONS WITH THE INTER-AMERICAN DEVELOPMENT BANK

Recent activities. The IBD´s loan portfolio in Costa Rica has 9 sovereign guaranteed operations in execution and two programs pending ratification, with an approved amount of US$1,.787.0 million. The available amount for disbursements is US$1,139.1 million (64% of the approved), and is concentrated in the areas of Transportation (49.2%), Energy (27.4%), Education (12.4%) and Water and Sanitation (6.0%). The average age of the operations is 2.1 years. Disbursements of sovereign guaranteed operations during 2017 are expected to reach US$135.7 million, concentrated in the areas of Education (25.8%), Transportation (22.6%), Reform and Modernization of the State (22.5%), and Energy (17.3%).

IDB Disbursements, amortization and net flows
Sovereign Guaranteed Operations
(In millions of U.S. dollars)

	2009	2010	2011	2012	2013	2014	2015	2016	2017*
Disbursements	41.3	55.7	121.0	86.9	131.3	209.9	173.4	154.4	135.7
Amortization	46.0	45.3	47.0	45.2	36.9	32.5	39.1	53.8	56.9
Interest and charges	12.2	11.9	10.9	9.9	10.3	10.7	13.2	22.2	26.6
Net cash flow	18.9	1.5	-60.9	-29.9	-82.6	-164.6	-119.5	-76.7	-50.4

* Projections (March 2017)

Sovereign Guaranteed Operations (as of April 21, 2017)
(In millions of U.S. dollars)

	Approved	Disbursed	Committed	Available
Loans in execution	**1,787.0**	**641.5**	**6.4**	**1,139.1**
Tourism Program in Protected Areas	19.0	19.0	0.0	0.0
First Road Infrastructure Program	300.0	300.0	0.0	0.0
Cantonal Road Network Program	60.0	44.3	0.0	15.7
Water and Sanitation Program	73.0	5.1	0.0	67.9
Violence Prevention and Social Inclusion Promotion Program	132.4	101.9	0.0	30.5
Power Sector Development Program 2012-16 (Reventazón Hydroelectric Project)	250.0	131.3	6.4	112.3
Building and Equipping of Education Infrastructure	167.5	25.9	0.0	141.6
Innovation and Human Capital for Competitiveness Program	35.0	9.0	0.0	26.0
Infrastructure Transport Program (PIT)	450.0	5.0	0.0	445.0
Border Integration Program of Costa Rica*	100.0	0.0	0.0	100.0
First Renewable Energy, Transmission and Distribution of Electricity Program*	200.0	0.0	0.0	200.0
Non-reimbursable Technical Cooperations	**11.5**	**6.2**	**1.7**	**3.6**
Total	**1,799.8**	**647.6**	**6.4**	**1,145.8**

*Pending ratification

STATISTICAL ISSUES

(As of May 2017)

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 2008 (SNA 2008). The Central Bank disseminated the annual national accounts data for the years 1991-2016, with 2012 as the new base year of the system. Estimation of real estate housing including owner-occupied housing has been improved: the housing stock of the base year (2012) has been estimated at the most detailed level according to the 2011 Census, at national, provincial, canton and district level. To calculate subsequent years, the rental item of the CPI is used as the price indicator, and the volume is extrapolated from the statistics of houses built with residential purposes obtained from the construction industry. Accounting depreciation is used instead of estimating consumption of fixed capital. In the new system, double deflation method is applied to obtain annual value added in constant prices; whereas single extrapolation is used for quarterly volume estimates using output volume indicators. Appropriate price indices are used to derive current value estimates. Changes in inventories are obtained following the 2008 SNA recommendations for those products for which enough information is available. This includes the most important agricultural and livestock products. The proportional Denton method is applied for benchmarking quarterly national accounts series to their annual counterpart. The informal activity of households as producers of goods and services is included in GDP level (but not separately estimated) thanks to the elaboration of employment and remuneration matrices.

Price statistics: The compilation of the consumer price index (CPI) employs concepts and definitions from the last international CPI manual. Its structure, scope, and coverage have been recently updated. The CPI weights are based on the 2012/2013 Income and Expenditure Survey, and the index covers the national urban and mixed households, which comprise approximately 73 percent of the total population and 82 percent of the total consumption expenditures of Costa Rica. Atypical movements in the data are investigated and corrected when necessary.

The PPI is compiled based on concepts and definitions from the 1993 SNA and the international PPI Manual, and is calculated both by product and economic activity (manufacture and services activities). The base year of the PPI for domestic manufacture, transportation, tourism services and professional services is 2012, whereas PPI for electricity and sales hydrocarbons, and the export and import price index (that is not yet available) are calculated following a moving-base approach.

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. 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. Annual data for the *GFS Yearbook* are reported on a regular basis, most recently for 2015.[1] 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 and Financial Statistics: Central Bank of Costa Rica (CBCR) reports the Standardized Report Forms (SRFs) 1SR for CBCR, 2SR for the other depository corporations (ODCs), and 5SR for monetary aggregates for publication in the IMF's *International Financial Statistics (IFS)* on a monthly basis with a lag of two months. The reported monetary statistics are broadly in line with the methodology of the *Monetary and Financial Statistics Manual* (*MFSM*). The classification of financial instruments and economic sectors follows the *MFSM* with some exceptions. Accrued interest is not classified together with underlying instruments, as recommended the *MFSM*. The CBCR is working for expanding the coverage of the monetary statistics including short term funds as ODCs and investment funds and pension funds as other financial corporations, in line with IMF technical assistance.

Financial sector surveillance: Costa Rica reports all core financial soundness indicators (FSIs) and one of the 13 encouraged FSIs for deposit takers on a monthly basis for posting on the IMF's FSI website with less than one quarter lag. The authorities are planning to expand the reported FSIs of the encouraged set for deposit takers.

External sector statistics: The Central Bank of Costa Rica (BCCR) compiles and disseminates quarterly balance of payments and international investment position (IIP) statistics, which are produced on a sixth edition of the Balance of Payments and International Investment Position Manual (BPM6) basis. Source data are generally adequate and derived from sound collection programs and work is still ongoing to improve the coverage of financial transactions of the nonfinancial private sector (such as those related to trade credit and advances), and remuneration of employees. Transfer prices in some cases are not converted to market prices.

[1] Costa Rica regularly reports to STA GFS division annual data in the format of GFSM 2014. The institutional coverage for Revenues and Expenses is General Government, but for Transactions and Stocks of assets and liabilities is Budgetary Central Government plus Social Security Fund. The last year reported was 2015.

The BCCR also monthly compiles and disseminates the Data Template on International Reserves and Foreign Currency Liquidity, reports semi-annual data to the Coordinated Portfolio Investment Survey (CPIS) and annual data to the Coordinated Direct Investment Survey (CDIS), and submits quarterly external debt statistics to the Quarterly External Debt Statistics (QEDS) database.

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 March 24, 2016)

	Date of latest observation	Date received	Frequency of Data[5]	Frequency of Reporting[5]	Frequency of Publication	Memo Items: Data Quality – Methodological soundness[6]	Memo Items: Data Quality – Accuracy and reliability[7]
Exchange Rates	Apr 17	Apr 17	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	Apr 17	Apr 17	D	D	D		
Reserve/Base Money	Apr 17	Apr 17	D	D	D	O, LO, LO, LO	O, O, O, LO, O
Broad Money	Apr 17	May 17	M	M	M		
Central Bank Balance Sheet	Apr 17	May 17	M	M	M		
Consolidated Balance Sheet of the Banking System	Apr 17	May 17	M	M	M		
Interest Rates[2]	Apr 17	May 17	D	D	D		
Consumer Price Index	Mar 17	Apr 17	M	M	M	O, LO, O, O	LO, O, LO, LO,O
Revenue, Expenditure, Balance, and Composition of Financing[3]– Central Government	Apr 17	May 17	M	M	M	LO, LNO, LO, LO	LO, O, O, LO, O
Stocks of Central Government and Central Government-Guaranteed Debt[4]	Apr 17	May 17	M	M	M		
External Current Account Balance	Dec 16	Mar 17	Q	Q	Q	O, LO, O, LO	LO, O, LO, O, LNO
Exports and Imports of Goods and Services	Dec 16	Mar 17	Q	Q	Q		
GDP/GNP	Dec 16	Mar 17	Q	Q	Q	O, LO, LNO, O	LO, O, LNO, O, LO
Gross External Debt	Dec 16	Mar 17	Q	Q	Q		
International Investment Position	Dec 16	Mar 17	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 i row. The assessment indicates whether international standards concerning concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O); largely observed (largely not observed (LNO); not observed (NO); and not available (NA).
[7] Same as footnote 6, 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.