July 2011
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Costa Rica: 2011 Article IV Consultation — Staff Report; Informational Annex; Public Information Notice, Press Release, and Statement by the Executive Director

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 2011 Article IV consultation with Costa Rica, the following documents have been released and are included in this package:

- The staff report for the 2011 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on April 12, 2011, 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 11, 2011. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- Informational Annex to the Staff Report of May 11, 2011.

- The Public Information Notice

- The Press Release

- A Buff statement by the Executive Director

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

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INTERNATIONAL MONETARY FUND

COSTA RICA

STAFF REPORT FOR THE 2011 ARTICLE IV CONSULTATION

May 11, 2011

KEY ISSUES

Near-term challenges: The rise in commodity prices and abundant global liquidity pose risks for the inflation outlook and for macroeconomic policy more generally. Maintaining the exchange rate band with the nominal rate at the most appreciated end is complicating further macroeconomic management. A well coordinated policy response comprising a tightening of the fiscal stance, greater exchange rate flexibility and watchful monitoring of inflation pressures is warranted.

Fiscal sustainability: Under staff projections, the authorities' fiscal plans would result in a gradual decline in the fiscal deficit and a moderate but steady rise in the public debt ratio (to 46 percent of GDP by 2016). The strategy is anchored on an important tax reform proposal under consideration by the Legislative Assembly. Although borrowing constraints are not likely to be binding in the near term, this strategy entails risks over the medium term. More ambitious fiscal consolidation targets centered on strict expenditure restraint would be advisable.

Monetary policy framework: The authorities have made progress in monetary control recently, and reiterated their commitment to transition to an inflation targeting regime. Delays in eliminating the exchange rate band could undermine the credibility of the process.

Financial system: The financial system remains sound, although there is scope to further strengthen supervision and regulation. Seeking approval of legislation enhancing consolidated supervision, establishing a deposit insurance system and strengthening the resolution framework should receive higher priority.

Approved By
Miguel Savastano (WHD) and Dominique Desruelle (SPR)

Discussions took place in San José during March 28 – April 12, 2011. The staff team comprised Messrs. Piñón (head), Morra, Ms. Ustyugova (all WHD), Mr. Llaudes (SPR) and Mr. Delgado (Regional Resident Representative). Messrs. Pérez Verdía and Gramajo (both OED), participated in the policy discussions.

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BACKGROUND

1. Costa Rica weathered the global crisis well, but its fiscal position weakened considerably. The authorities' response to the crisis consisted of a supportive fiscal stance and increased recourse to external resources, (including through a 15-month precautionary Stand-By arrangement with the Fund that expired in July 2010). In the event, the output loss was moderate, the balance of payments adjustment was orderly, and the financial system remained sound. The fiscal position, however, deteriorated significantly as a result of much lower-than-expected revenues and higher-than-envisaged increases in current expenditure.

2. The administration that took office in May 2010 has proposed a tax reform to reduce the fiscal deficit. President Laura Chinchilla is committed to improve law enforcement, education, and infrastructure. In January 2011, the administration submitted a tax reform proposal to the Legislative Assembly. The government has also taken steps to improve tax administration.

3. Exchange system and statistics. Costa Rica has accepted the obligations of Article VIII, sections 2, 3, and 4. Its exchange system is free of restrictions on the making of payments and transfers for current international transactions. Data provision is broadly adequate for surveillance.

RECENT ECONOMIC DEVELOPMENTS

4. Economic growth resumed in 2010, while inflation remained subdued (Figure 1). Following a 1.3 percent decline in 2009, real GDP grew by 4.2 percent in 2010, initially led by a recovery in inventories and public consumption and later by private consumption. Annual inflation increased from 4 percent in 2009 to 4.6 percent at end-March 2011 (within the 4-6 percent official target range). Core inflation also increased moderately (to 4 percent). More recently, the rise in international food and fuel prices has pushed inflation expectations further above the ceiling of the inflation target range.

5. The external current account deficit widened in 2010, but private capital inflows recovered (Figure 2). Following a sharp contraction of trade, export growth rebounded in 2010 (6.5 percent) but was outpaced by the growth rate of imports (19.6 percent), raising the external current account deficit to 3.6 percent of GDP (2 percent in 2009). The surplus in the capital account also increased significantly, as the private sector deleveraging observed in 2009 ended, and net public sector inflows increased (including a US$500 million loan from the World Bank). As a result, the overall balance of payments recorded a surplus of over US$550 million (1½ percent of GDP) during the year.

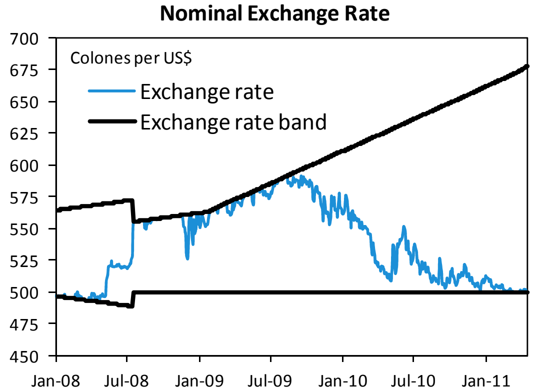
Private Capital Account
(In millions of U.S. dollars)

	2009	2010	Change
Private capital account	**291**	**1,681**	**1,390**
FDI	**1,347**	**1,450**	**103**
Non-FDI flows	**-1,056**	**231**	**1,287**
Of which : Banking sector	-727	136	863
Of which : Nonfinancial private sector	-329	95	423

Source: Fund staff based on Central Bank of Costa Rica.

6. The exchange rate appreciated and reached the bottom of the band in late 2010. From mid-2009 to April 2011, the colón appreciated by some 15 percent vis-à-vis the U.S. dollar (14 percent in real effective terms). The colón reached the appreciated end of the exchange rate band in December 2010, and has remained within 2 percent of the floor since then. The appreciation pressures stemmed from higher private capital inflows, and were supported by some portfolio rebalancing toward colón-denominated assets.

Nominal Exchange Rate

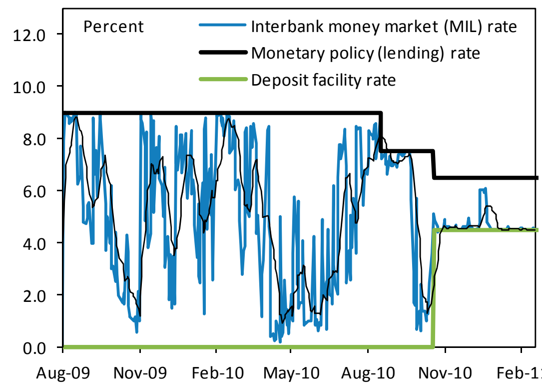


Source: Central Bank

7. The central bank adopted measures to contain the appreciation pressures. Starting in August 2010, it has lowered the policy interest rate by a total of 250 basis points (to 6.5 percent); and in September 2010 it launched a 16-month program of foreign exchange purchases for a total of US$600 million (Figure 3). The cumulative purchases under the program reached the announced US$600 million target in April 2011.

8. The authorities kept the inflation target range for 2011 unchanged at 4–6 percent, and adopted measures to enhance monetary control. The increased inflation risks led the central bank to postpone a planned reduction in the inflation target to 3–5 percent. The authorities also established a deposit facility for banks that, combined with a previously existing lending facility, created a corridor for short-term interest rates, and introduced new instruments to mop up excess liquidity. These measures have stabilized short-term interest rates at the bottom of the corridor.

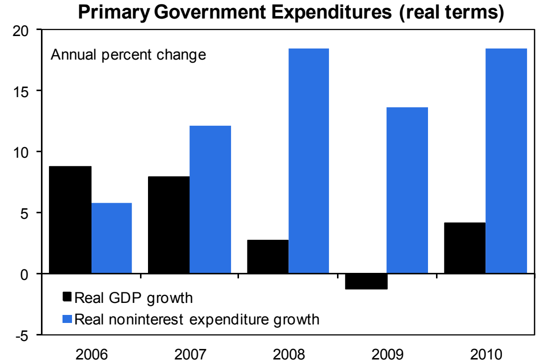
Interest Rate Corridor



Source: Fund staff based on Central Bank.

9. The fiscal deficit continued to widen (Figure 4). Government spending continued to increase in 2010, including in wages and current transfers; and the consolidated public sector deficit rose to 5½ percent of GDP (4 percent in 2009). Public sector debt at end-2010 reached 39.4 percent of GDP, up from 36 percent in 2008.

Primary Government Expenditures (real terms)



Sources: Ministry of Finance; and Fund staff estimates.

10. The banking sector remained resilient. Although banks' profitability declined (the return on equity fell from 14.3 percent in December 2008 to 8.3 percent in December 2010), the change was largely attributable to the economic slowdown and other transitory effects. Moreover, capitalization and liquidity levels remain adequate. Nonperforming loans have stabilized below 2 percent of total loans (Figure 5). Credit growth to the private sector remained subdued in 2010, but has started to pick up in 2011. The share of bank loans and deposits denominated in U.S. dollars continued to decline, although the latter remains above pre-crisis levels. (Figure 6).

Effective Capital Adequacy Ratio

	2008	2009	2010
CAPDR 1/	14.4	15.5	16.1
Costa Rica	15.1	15.9	16.4

Source: Surpervisory authorities, and Fund staff estimates.

Notes:

1/ Regional unweighted average.

MACROECONOMIC OUTLOOK AND RISKS

11. The economic outlook is generally positive. Supported by the global recovery and strong inflows of foreign direct investment (FDI), real GDP is projected to grow by 4.3 percent in 2011 and stabilize at 4½ percent over the medium term (somewhat below pre-crisis rates). Higher global food and fuel prices and the one-off impact of the tax reform (expected to be approved in the second half of 2011) would push inflation above 7 percent in 2011; thereafter inflation is projected to fall gradually to about 4 percent. The external current account deficit is expected to increase to 4.8 percent of GDP in 2011 and stabilize at about 5.2 percent over the medium term, and be fully financed by strong FDI and other capital flows.

12. Risks to the medium-term outlook are somewhat tilted to the downside.

- *Risks to the growth outlook appear balanced*. Concerns about the strength of the global recovery are subsiding, while lax global financial conditions may induce further capital inflows and fuel domestic demand and activity growth.

- *Higher global commodity prices pose risks for the inflation outlook*. Continued global price pressures could push headline inflation further above the official target range, which in the absence of corrective policies could ignite second round effects and keep inflation above the target range for a prolonged period of time.

- *Fiscal policy's capacity to respond to adverse shocks will be limited*. The government's fiscal strategy may result in a moderate increase in the public debt to GDP ratio, even after taking into account the revenues from the tax reform. There are also risks that the increase in public debt is higher than envisaged.

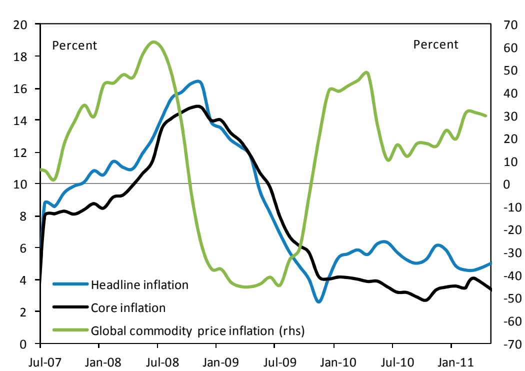
POLICY DISCUSSIONS

13. Focus of the consultation. Discussions with the authorities centered on the appropriate policy mix at the current stage of the economic cycle; and medium-term reforms to: (i) ensure fiscal sustainability; (ii) improve the effectiveness of monetary policy; and (iii) increase the resilience of the financial system.

A. Near-term Policy Mix

14. There was broad agreement that containing second round effects from higher global food and fuel prices is a key policy challenge. Although inflation has remained subdued, staff highlighted the upward risks to the inflation outlook stemming from lags in the transmission mechanism and entrenched backward-looking indexation, including for public sector wages. Those factors contributed to a large pass-through to inflation in Costa Rica during the global price shock of 2007–08. The authorities were of the view that inflation risks would be lower this time around because the surge in commodity prices is taking place when there is still slack in the economy.

World Commodity Prices and Domestic Inflation



Source: Central Bank, and Fund staff estimates.

15. Continued capital inflows also present risks to the inflation outlook. Lax global financial conditions will remain a push factor for capital flows to emerging economies. Staff noted that, as long as the exchange rate band remains in place, those inflows would put pressure on the Central Bank's sterilization capacity and, in the end, result in higher inflation and a real appreciation of the colón.

16. Staff encouraged the authorities to take prompt action to preserve the significant gains on the inflation front attained in recent years. Concretely, staff recommended:

- *Restraining domestic demand growth through further fiscal effort*. Staff noted that the fiscal outturn projected for 2011 (a consolidated public sector deficit of about 5½ percent of GDP) was too expansionary given the rebound in private domestic demand. The authorities agreed, in principle, and noted that a recent presidential directive freezing employment levels in the central administration and reducing operational expenditures below the levels contemplated in the budget would generate some savings. However, additional expenditure reducing measures were not regarded as viable.

- *Standing ready to raise interest rates before core inflation increases*. Staff underscored that, if fiscal policy remains loose, efforts to attain the inflation target would place a considerable burden on monetary policy. The authorities indicated their intentions to evaluate the monetary policy stance at the first signs of second-round effects on inflation. However, they were of the view that those inflationary pressures are not likely to materialize for a while.

- *Allowing the nominal exchange rate to appreciate*. The authorities indicated they remained committed to a more flexible exchange arrangement, but considered that conditions were not propitious for the elimination of the exchange rate band, as it could result in a large appreciation of the colón. They argued that given current loose global financial conditions, macroeconomic policy tools may be insufficient to fend off a large undershooting. Staff noted that the risk of a large or prolonged undershooting of the nominal exchange rate following the termination of the band could be mitigated through a tighter fiscal stance and sterilized intervention. The authorities indicated their preference for waiting until temporary appreciation pressures subside rather than doing away with the bands.

17. **Staff encouraged the authorities to develop a strategy to reduce backward-looking indexation practices.** In particular, it recommended to start using forward-looking measures of inflation (such as the mid-point of the official inflation target) to adjust prices and wages set by the government (including the minimum wage). The authorities agreed that forward-looking measures would be preferable but noted that any changes to current practices would require building consensus and, in some cases, changing legislation, both of which were likely to take some time.

B. Safeguarding Fiscal Sustainability

18. **The mission developed a scenario incorporating the government's fiscal plans.** The scenario envisages an increase in government revenues of 3 percentage points of GDP in the next five years (mainly as a result of the proposed tax reform and improvements in tax administration, Box 1) and an increase in expenditures of about 1 percent of GDP (reflecting planned spending in the areas of security, education and infrastructure [1]). With these assumptions, the consolidated public sector deficit (central government deficit) would decline to about 4¼ percent of GDP (3¾ percent of GDP) by 2016, while the public debt to GDP ratio would rise to about 46 percent of GDP. The authorities thought that the scenario made too conservative assumptions regarding the gains from the tax reform and were of the view that the fiscal deficit would decline more rapidly to debt stabilizing levels.

19. **The mission encouraged the authorities to adopt more ambitious fiscal consolidation targets.** It noted that Costa Rica had been able to respond effectively to the global crisis in large part because of the significant fiscal consolidation it had undertaken in the years prior to the crisis. Staff argued that a priority of fiscal policy should be to regain the capacity to respond in a similar way to future adverse shocks by placing the public debt to GDP ratio on a downward path, and bringing the ratio below 35 percent of GDP over the medium term. The authorities indicated that reducing the public debt ratio to pre-crisis levels would be challenging, but stressed that they will make

1 The Legislative Assembly is expected to approve a constitutional amendment mandating an increase in education spending to 8 percent of GDP by 2014 (about 1 percent of GDP above the current level).

every effort to keep the public debt at prudent levels, including through expenditure restraint.

Box 1 Revenue Mobilization Strategy

The Costa Rican government has developed a strategy to increase tax revenues over the medium term. The strategy comprises a tax reform and tax administration efforts, which the authorities expect to yield 2½ percent of GDP and about 1 percent of GDP, respectively.

A comprehensive tax reform proposal was submitted to the National Assembly in January 2011. The main measures contemplated in the bill include: replacing the 13 percent sales tax for a 14 percent full-fledged value-added tax (VAT); a significant broadening of the VAT base to include key services that are currently exempt (e.g. private education and health); reducing the basic consumption basket that will be exempt from the VAT; the introduction of a 15 percent tax rate on capital gains; increasing the tax rate on dividends (from 5 to 15 percent) and on interest received on exchange-traded securities, bank deposits and public debt securities (from 8 to 15 percent); introducing a 15 percent tax rate on external payments made to top-tier banks and other institutions; and raising selective taxes on vehicles and property transfer taxes. The authorities' estimates of the yield of the components of the proposed reform are shown in the table.

Tax reform proposal

Measures	Expected yield * (in percent of GDP)
Total	**2.5**
Value added tax	**1.7**
Broadening of tax base	1.4
Of which: Reduction of basic consumption basket	*0.7*
Of which: Taxation of services	*0.8*
Increase in tax rate (from 13 to 14 percent)	0.3
Income tax	**0.6**
Broadening of tax base	0.6
Increases in tax rates	0.1
Excise taxes and other	**0.2**

Source: Fund staff based on Ministry of Finance.
* Estimated by the Ministry of Finance.

The proposed tax reform would improve the efficiency and equity of Costa Rica's tax system. Adoption of the proposed measures would require modernizing the method to determine the VAT liability, bringing it in line with international practices. It would also increase the equity of the system by eliminating exemptions currently benefiting the higher income segments of the population. The authorities estimate that 60 percent of the additional revenue would be generated from households in the top 20 percent income bracket.

The government's strategy also contains measures to reduce tax evasion. Planned actions include increasing tax compliance controls by 20 percent, fostering the use of debit and credit card transactions, establishing reference values for a set of imported products, and broadening the tax regime for small contributors.

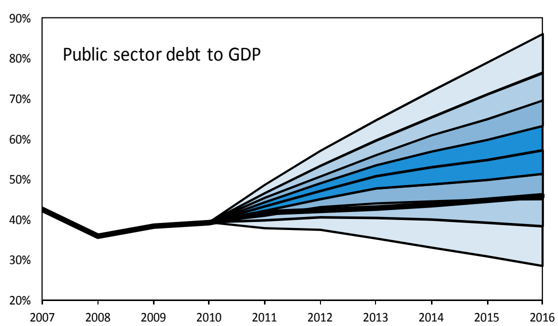
Box 2 Risks to Fiscal Sustainability

Following an important decline through 2008, Costa Rica's public debt to GDP ratio rose in the aftermath of the global crisis. From end-2008 to end-2010, the public debt to GDP ratio increased by about 4 percentage points, to near 40 percent.

The policies envisaged by the current government would not stabilize the public debt to GDP ratio. The staff's scenario discussed with the authorities, which assumes that the tax reform is approved in the second-half of 2011, would result in an increase in the public debt to GDP ratio of more than 6 percentage points between 2010 and 2016. Even though the scenario assumes significant increases in tax collection, the expenditure path would leave the fiscal deficit above debt-stabilizing levels.[2]

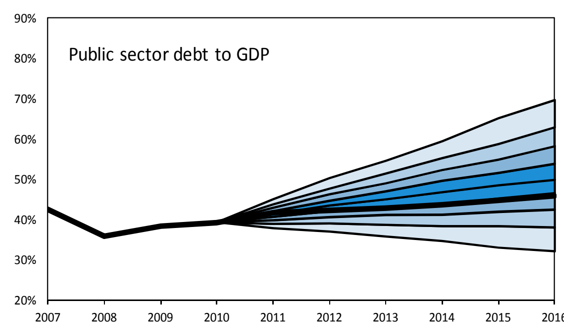
The risks that the public debt to GDP ratio rises faster than in the baseline scenario are high. Results from a stochastic public debt sustainability exercise, based on an estimated fiscal reaction function, show that, by end-2016, the median public debt ratio could be in the range between 50 percent of GDP (panel estimates) and 57 percent (time series estimates). These results illustrate the challenges that the authorities will confront to maintain the public debt close to the deterministic trajectory of the baseline scenario under their planned fiscal policies.

Stochastic public debt analysis (time series)



Source: Fund staff estimates

Stochastic public debt analysis (panel data)

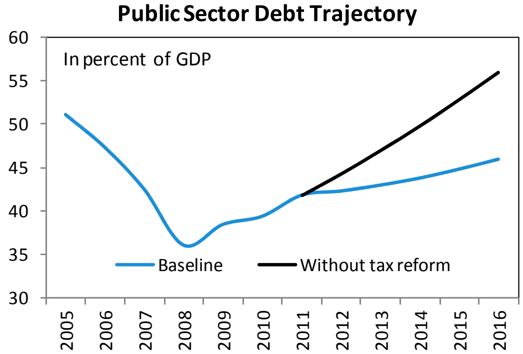


Source: Fund staff estimates

[2] The authorities' estimate of the revenue yield of the tax reform is higher than staff's (see Box 1), reducing the deficit to debt-stabilizing levels.

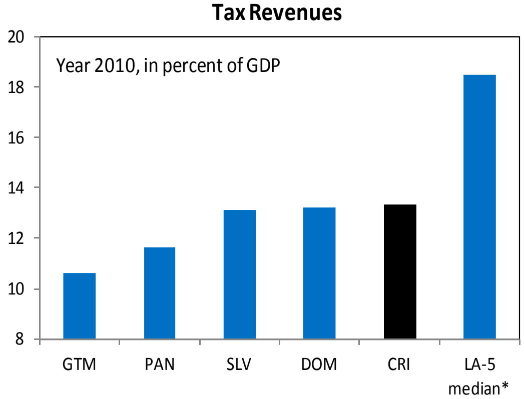
20. There was agreement that the approval of the proposed tax reform was critical for fiscal sustainability. A significant increase in government revenues is necessary to contain debt dynamics, given the planned expenditure path (Box 2). Staff noted that the revenue-enhancing emphasis of the proposed reform was appropriate given Costa Rica's relatively low revenue-to-GDP ratio. The expected broadening of the tax base and the emphasis placed on improving the equity of the tax system also are commendable. While the tax reform is facing some opposition in the Legislative Assembly, the authorities expressed confidence about its approval, highlighting that the private sector and political parties are cognizant of the need to increase public revenues.

Public Sector Debt Trajectory



Source: Fund staff estimates.

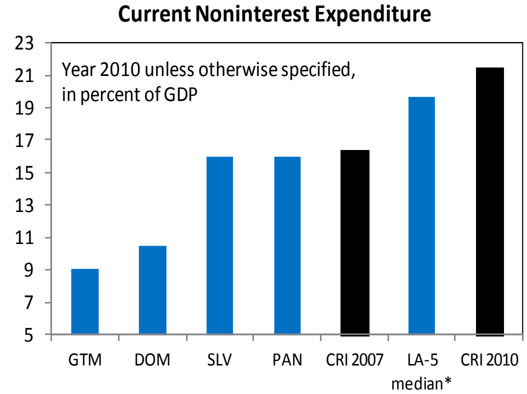
Tax Revenues



Source: National authorities. * Includes Brazil, Chile, Colombia, Mexico and Peru.

21. A strategy to reduce government expenditures in percent of GDP over the medium term is necessary. Although capital expenditure has remained broadly stable as a share of GDP in recent years, current government expenditures, including the wage bill, have increased sharply, and have reached levels that are high compared to countries of similar level of income and government revenues. The mission noted that the recent directive to freeze vacancies and reduce operational expenditures (vis-à-vis the budget) in 2011 was an important first step, but stressed that it would not be sufficient to reduce current expenditures' share in GDP. Staff argued that a medium-term expenditure framework that keeps current expenditure growth below the (projected) growth rate of nominal GDP for several years was necessary to lower the share of current expenditures to GDP and regain fiscal space.

Current Noninterest Expenditure



Source: National authorities. * Includes Brazil, Chile, Colombia, Mexico and Peru.

22. The mission welcomed the planned improvements in tax administration. Staff and the authorities concurred that there is substantial scope to strengthen tax administration and reduce tax evasion, and that the improvements in these areas would contribute importantly to the fiscal consolidation strategy. In this connection, staff welcomed the adoption of a new information system by the tax administration agency, which would help increase information crosschecks and tax compliance controls. Staff estimated that improved tax administration would generate additional revenues of about ½ percent of GDP over the next five years. The authorities, however, considered that the gains would be significantly larger.

23. **Other reforms to strengthen the fiscal frameworks also were discussed.** There was broad agreement that, once fiscal consolidation was firmly underway, it would be desirable to develop fiscal rules with countercyclical elements. Reforms aimed at lessening budget rigidities, such as revenue-earmarking, would also be desirable.

C. Monetary and Exchange Rate Policies

24. **The mission encouraged the authorities to speed up the transition to an inflation targeting framework.** The mission acknowledged the important steps taken in recent years to modernize the monetary policy framework (including the announcement of an official inflation target and the widening of the exchange rate band). However, it noted that a prolonged transition process risks losing credibility. To accelerate the transition, staff recommended:

- *Increasing exchange rate flexibility*. Staff underscored that moving toward a more flexible exchange rate regime, preferably by eliminating the band, would clarify the primacy of the inflation objective, help anchor inflation expectations, and enhance the transmission mechanism between policy rates and market rates. The authorities restated their intention to eliminate the exchange rate band before the adoption of full-fledged inflation targeting, but considered that the present juncture was not appropriate to take such step (¶15).

- *Phasing out the interest rate corridor*. There was agreement that the interest rate corridor established in October 2010 had enhanced monetary control, and that it would be advisable to deepen the reform by adopting a single policy rate. In line with this, the authorities indicated that they plan to narrow the corridor for short-term interest rates and establish the mid-point of such corridor as the benchmark policy rate.

- *Recapitalizing the central bank*. Staff argued that a stronger capital base for the central bank would help insulate monetary policy decisions from balance sheet considerations. The authorities indicated that they were examining options to recapitalize the central bank but considered that fiscal space in the short run was too tight to make significant progress in this area.

25. **Notwithstanding the recent appreciation, the exchange rate seems broadly in line with medium-term fundamentals.** Exchange rate assessments based on the standard methodologies suggest an overvaluation of the colón in the order of 2–6 percent, well within the margin of error. Favorable prospects for foreign direct investment, which are expected to cover the non-interest current account deficit over the medium term, are key for this result. Nonetheless, staff underscored that a fiscal consolidation strategy centered on

expenditure restraint would help mitigate the risks of an excessive appreciation of the colón. In addition, there was agreement that continued efforts to reduce the costs of doing business and increase efficiency would be beneficial for competitiveness.

Real Exchange Rate Assessment

(Percent deviation from estimated equilibrium)
(+ = overvaluation)

Macrobalance approach	6
ERER approach	6
External stability approach	2

Source: Fund staff estimates

D. Financial Sector

26. While acknowledging that the financial system had weathered the crisis well, the mission discussed enhancements to banking sector supervision and regulation. It noted that the legal framework remained weak and that progress in implementing the recommendations from the 2008 FSAP had been slow (Box 3). The mission stressed the importance of seeking congressional approval of the legislation submitted in 2004 and 2010 to enhance consolidated supervision, establish a deposit insurance system and strengthen the bank resolution framework. It noted that, while the financial system is sound, the measures were necessary to reduce risks to financial stability, as they would equip the regulatory and supervisory authorities with the tools and legal protections to take appropriate actions on a timely basis if a financial institution faces difficulties. The authorities reiterated their commitment to seek approval of the legislation, but indicated that the tax reform had the highest priority.

27. The mission welcomed progress to introduce risk-based supervision. It encouraged the authorities to supplement those efforts with enhancements of the regulatory framework (e.g., issuing norms on liquidity, operational, country and market risks) and further strengthen soundness classification. It also suggested that the authorities undertake periodic stress tests of financial institutions. The mission welcomed the plans to monitor systemic risk and introduce Basel III capital and liquidity buffers.

Supervisory Practices (Scale from 0 to 10, 10 = Best International Practices)

	CRI	DOM	SLV	GTM	HND	NIC	PAN	AVGE
Risk-Based Supervision	4.8	5.7	4.2	5.4	4.5	3.8	4.7	4.7
Consolidated Supervision	6.4	4.2	6.2	8.3	7.1	7.4	7.8	6.8
Supervisory perimeter	6.6	4.3	1.8	3.7	3.1	3.9	4.5	4.0
TOTAL	6.0	4.8	4.1	5.8	4.9	5.0	5.7	5.2

Source: Fund staff based on supervisory authorities' responses to questionnaires.

COLOR CODE:
Less than 10 percent above or below the regional avge
Above regional average
Below regional average

28. The authorities were encouraged to explore ways to level the playing field between public and private banks. Staff noted that long-standing regulatory distortions of the Costa Rican financial system have allowed public banks to benefit from state guarantees on all liabilities, and be exempt from taxation on their dollar-denominated deposits and from contributions to the development finance system. In addition, the appointment of their directors falls outside the purview of the Superintendency of Financial Institutions (SUGEF).

Box 3 Main Recommendations of the 2008 FSAP Update - Status

Principal Recommendations (By area, excluding financial sector development issues)	Status 1/
A. Prudential Supervision and Regulation	
Amend the legal framework in order to provide protection for supervisors while performing their responsibilities in good faith.	NI
Introduce pertinent laws for the Superintendency of Banks (SUGEF) to be able to supervise banking groups (including offshore structures) on a consolidated basis. Upon the approval of such laws the SUGEF should issue without delay operational regulations to ensure its rapid implementation by the banking system. 2/	PL
Increase supervisory focus on banks' own risk management systems, in part through incentives for banks to classify and provision correctly their loans. 3/	FI
Broaden the base of reserve requirements to include short term lines of credit.	FI
Apply higher risk weight ratios to unhedged borrowers for capital adequacy purposes.	NI
The SUGEF should issue a new regulation enhancing the complementarities of the work of bank supervisors and external auditors.	FI
The National Council of Financial Sector Supervision (CONASSIF) should take into account IFRS when issuing new regulations. 4/	FI
Modify the funding arrangements for supervision, in line with international best practices.	NI
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.	PL
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.	PI
Improve the early warning system, to allow the adoption of remedial actions in a timely manner.	PI
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. 5/	NI
Establish a deposit insurance scheme, in line with international best practices.	PL
Amend the bank resolution legal framework to include purchase and assumption type techniques.	PL
Enable voluntary, extra-judicial corporate restructuring agreements.	FI

1/ FI: fully implemented; PI: partially implemented; PL: pending legislation; NI: Not implemented.
2/ The draft law on consolidated supervision was submitted to the Legislative Assembly in 2004. The Superintendency of banks has issued several regulations.
3/ Regulation on overall risk management (approved on June 25, 2010).
4/ Regulation on information of entities and financial conglomerates (last updated on June 15, 2010).
5/ The BCCR strengthened its emergency liquidity toolbox during the crisis by introducing high-access liquidity lines and improving the design of repo operations. However, the emergency lender of last resort window has not been discontinued and repo operations are not linked to prudential limits in terms of regulatory capital.

STAFF APPRAISAL

29. Costa Rica's recovery is firmly underway and its economic outlook is favorable. Real GDP is expected to grow by more than 4 percent in 2011 and by about 4½ percent over the medium term, supported by sizable and stable flows of foreign direct investment. However, a key challenge is to adopt more flexible and forward-looking macroeconomic policies.

30. The rise in world food and fuel prices and lax global financial conditions will present challenges. Higher commodity prices will put upward pressures on inflation and impact more severely the poorer segments of the population, while abundant global liquidity will continue to induce private capital inflows. A coordinated policy response to mitigate the risks posed by these external factors would be advisable. Such response should comprise a tighter fiscal stance than the one contemplated in the 2011 budget, the elimination of the exchange rate band, and readiness to tighten monetary policy before second round effects of the price shock materialize. Introducing forward-looking inflation measures in the indexation mechanisms controlled by the government also would be helpful.

31. Given the external environment, the fiscal stance envisaged for 2011 is too expansionary. Even assuming that the tax reform is approved and starts yielding revenues in 2011, the consolidated public sector deficit is projected to close the year at about 5½ percent of GDP, broadly the same as in 2010. The sustained recovery of private domestic demand and the sizable increase in public debt since 2008 would have called for a significant withdrawal of fiscal stimulus, as was recommended previously.

32. The proposed tax reform is sound and, if approved, will be key to safeguard fiscal sustainability. Broadening the tax base and improving the equity of the tax system are strong elements of the proposed reform. Planned efforts to strengthen tax administration also are appropriate and should be supplemented with mechanisms to make them permanent.

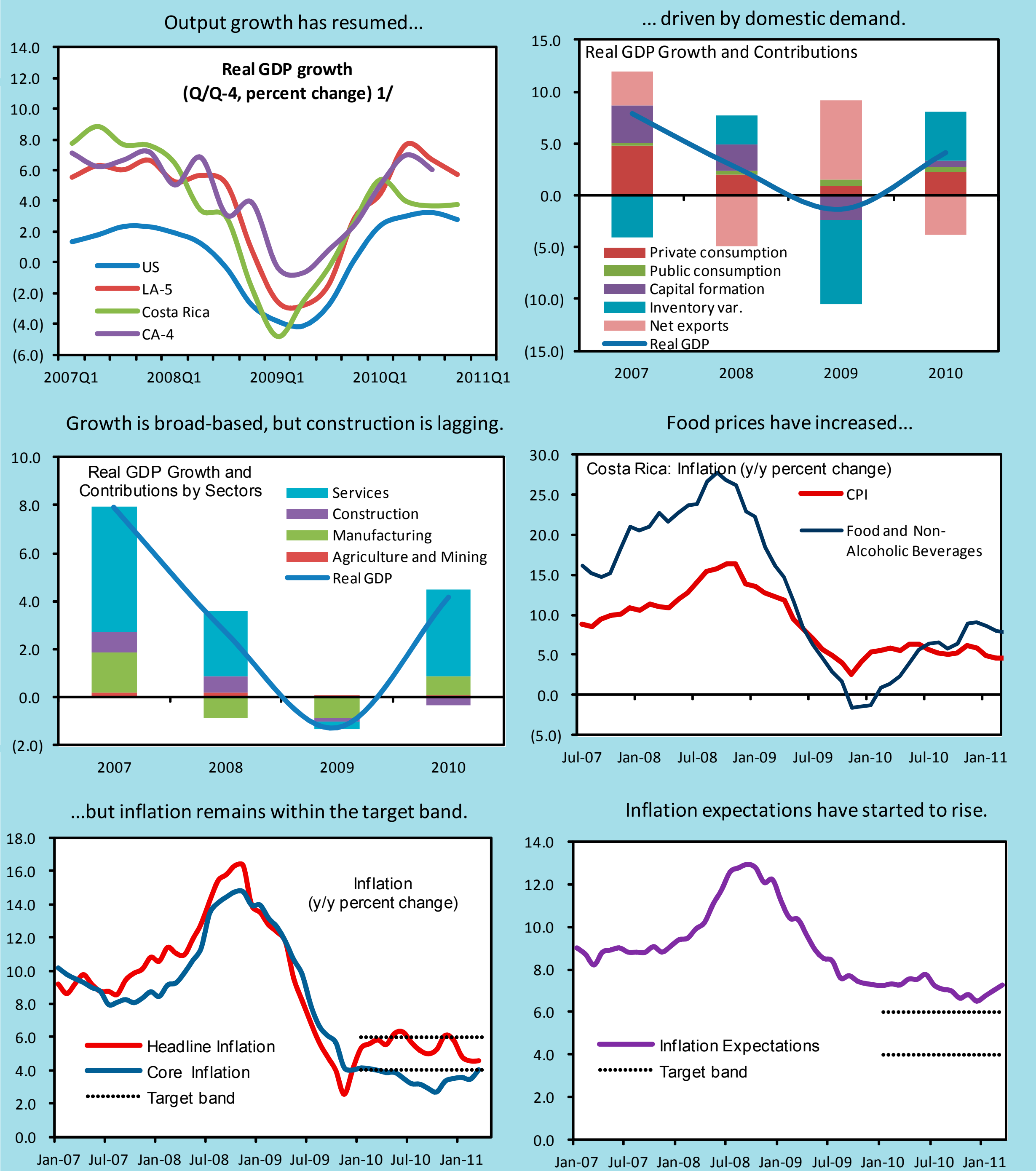
33. It would be advisable to set more ambitious targets for fiscal consolidation centered on expenditure restraint. The government's fiscal program may result in a gradual rise in the public debt ratio and carries risks. The authorities are encouraged to reconsider their fiscal program and set targets aimed at rebuilding the fiscal space used in recent years. These efforts should be anchored on a path that lowers the share of government expenditures (including the wage bill) on GDP.

34. The upgrading of the monetary policy framework should receive higher priority. Costa Rica's transition to an inflation targeting framework is taking too long and may compromise the central bank's credibility. Maintaining the exchange rate close to the appreciated end of the exchange rate band despite continued capital inflows could raise doubts about the primary objective of monetary policy and the authorities' commitment to transition to inflation targeting. The authorities are encouraged to consider an opportune time to abandon the exchange rate band and deploy an effective communication strategy to establish the primacy of the inflation target. Plans to narrow the corridor for short-term interest rates and establish the mid-point of such corridor as the policy rate are welcome.

35. Although the Costa Rican banking system remains sound, legislation to further strengthen supervision and prudential regulations has not yet been approved. The authorities are encouraged to seek support for the approval of the bills submitted in recent years to enhance consolidated supervision, establish a deposit insurance system and strengthen the resolution framework. In addition, the authorities should explore ways to level the playing field between public and private banks.

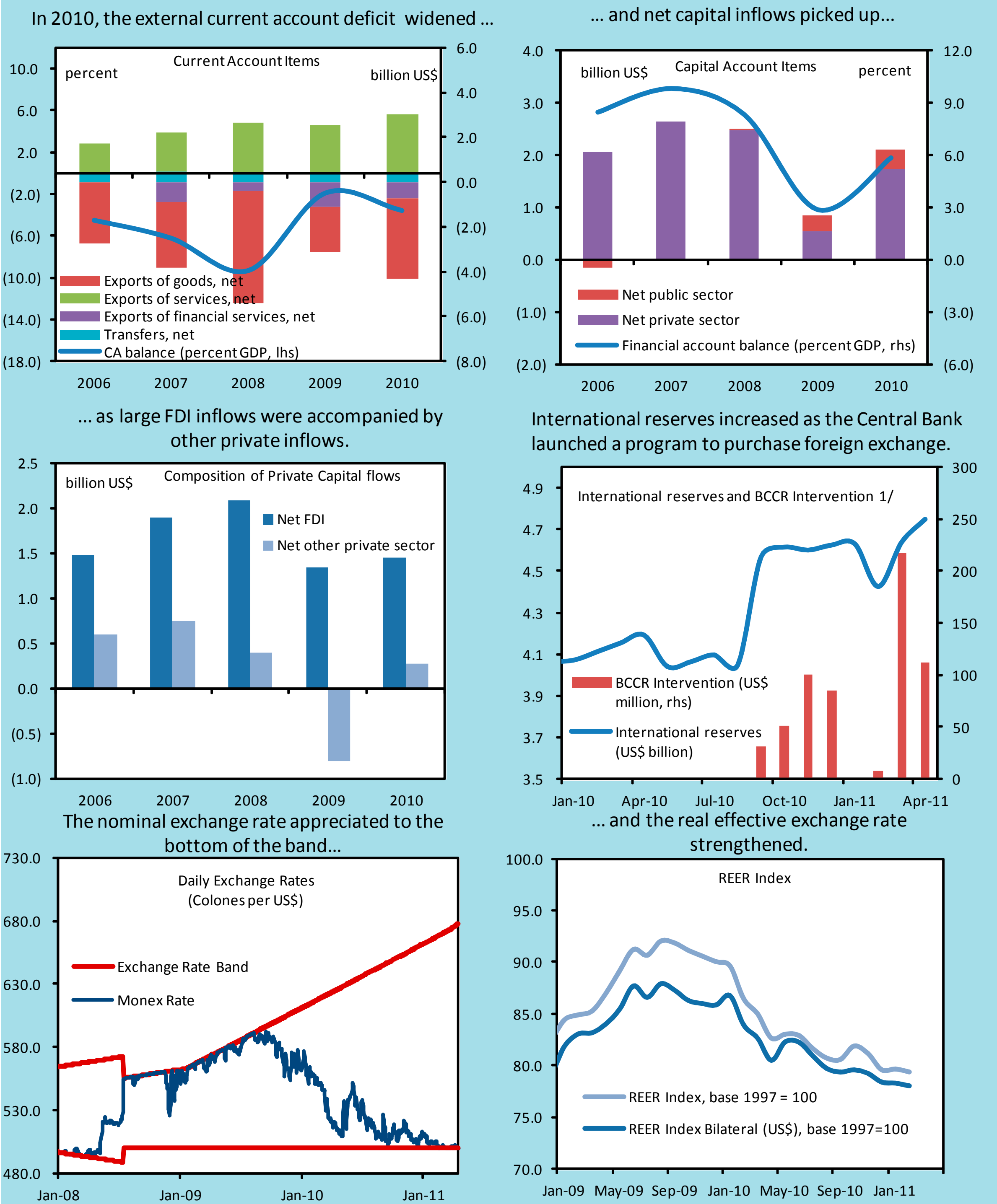
36. It is recommended that the next Article IV consultation take place on the standard 12-month cycle.

Figure 1. Costa Rica: Recent Economic Developments



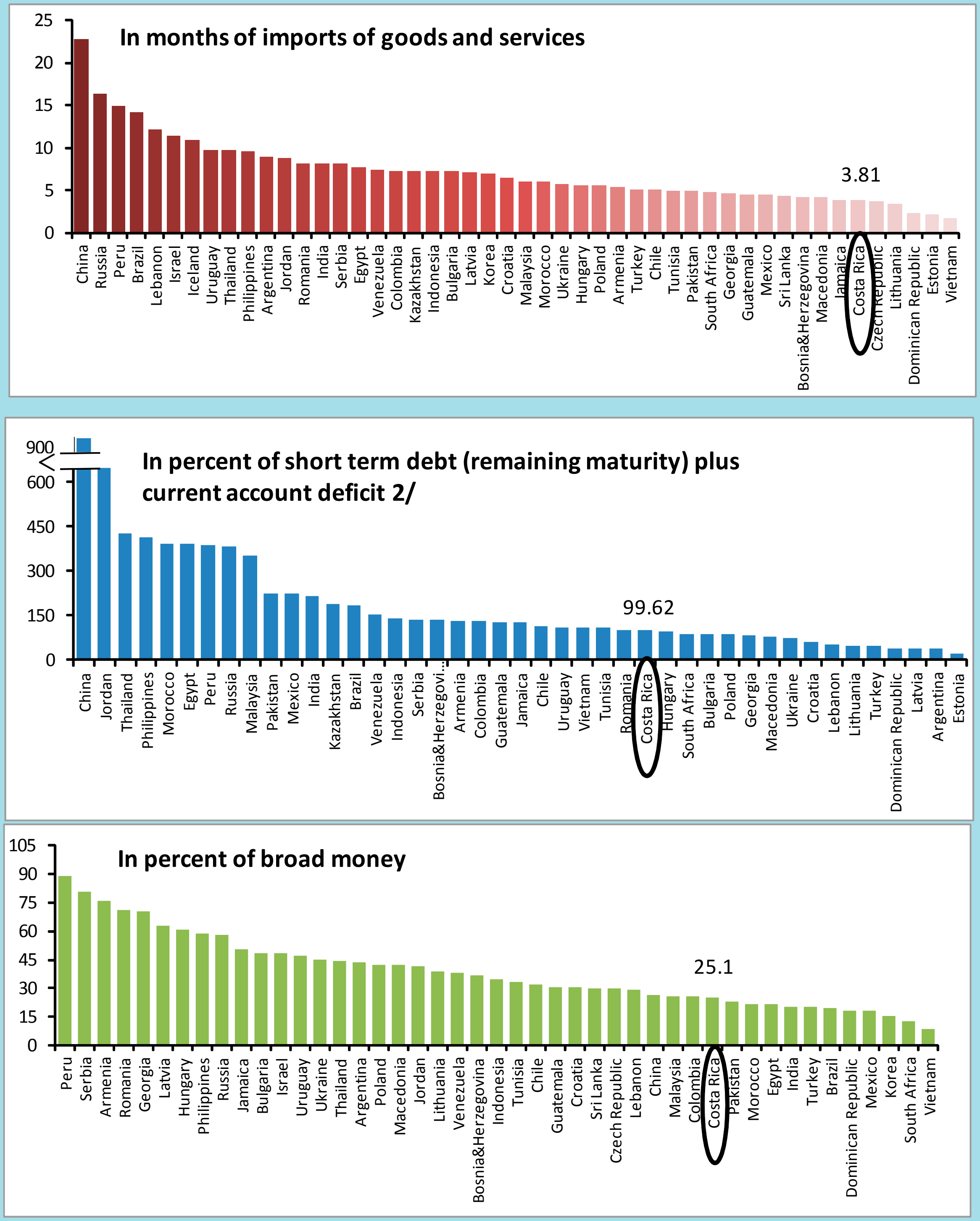
Sources: Country authorities; and Fund staff calculations.
1/ CA-4 includes median growth rates of Guatemala, Honduras, El Salvador and Nicaragua. LA-5 includes median growth rates of Brazil, Chile, Colombia, Mexico and Peru.

Figure 2. Costa Rica: External Developments

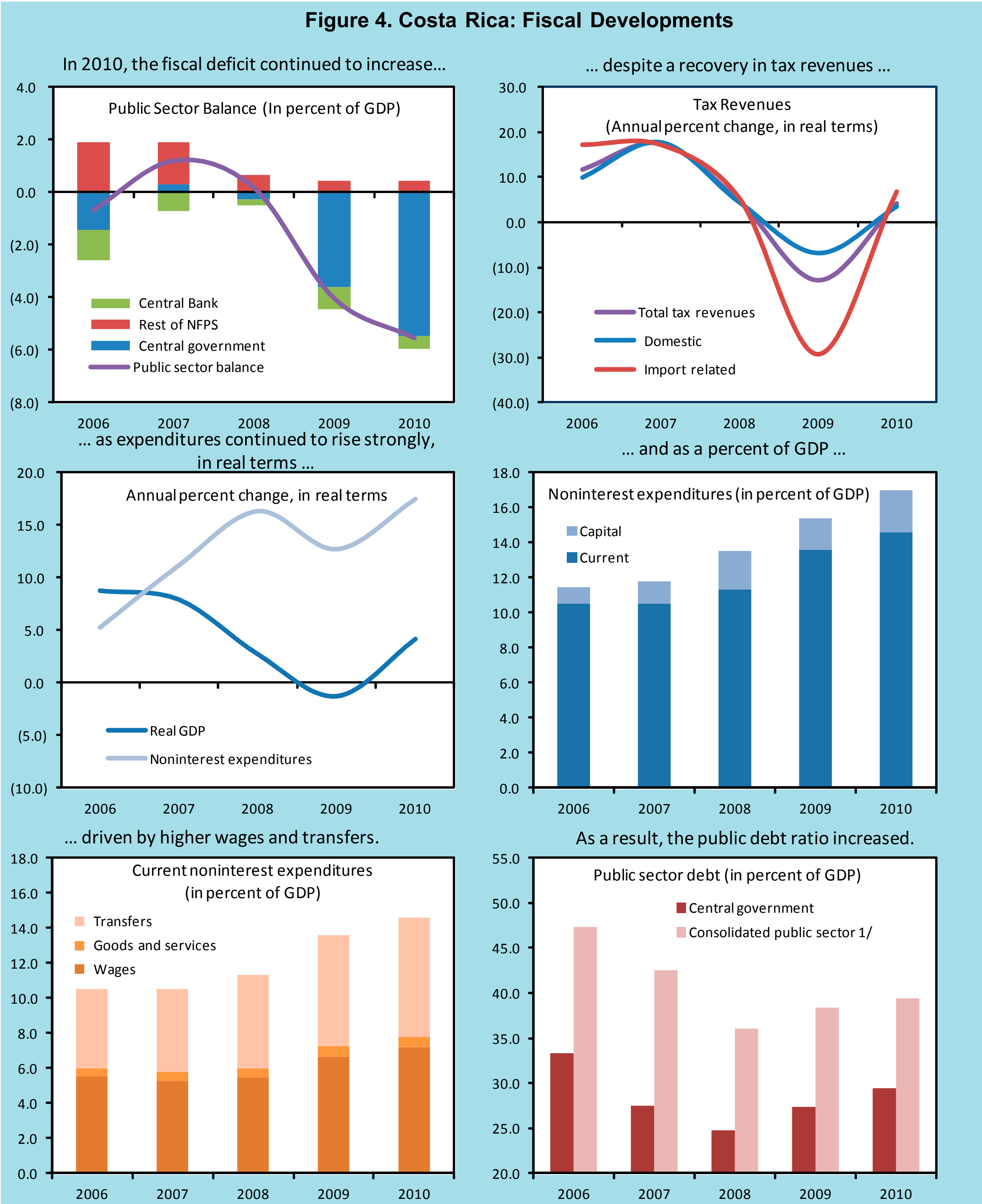


Sources: Country authorities; and Fund staff calculations.
1/ The increase in international reserves of September 2010 reflects a US$500 million disbursement from the World Bank. The decrease in international reserves of February 2011 reflects the amortization of a US$250 million bond.

Figure 3: Costa Rica: Reserve Coverage in International Perspective[1]

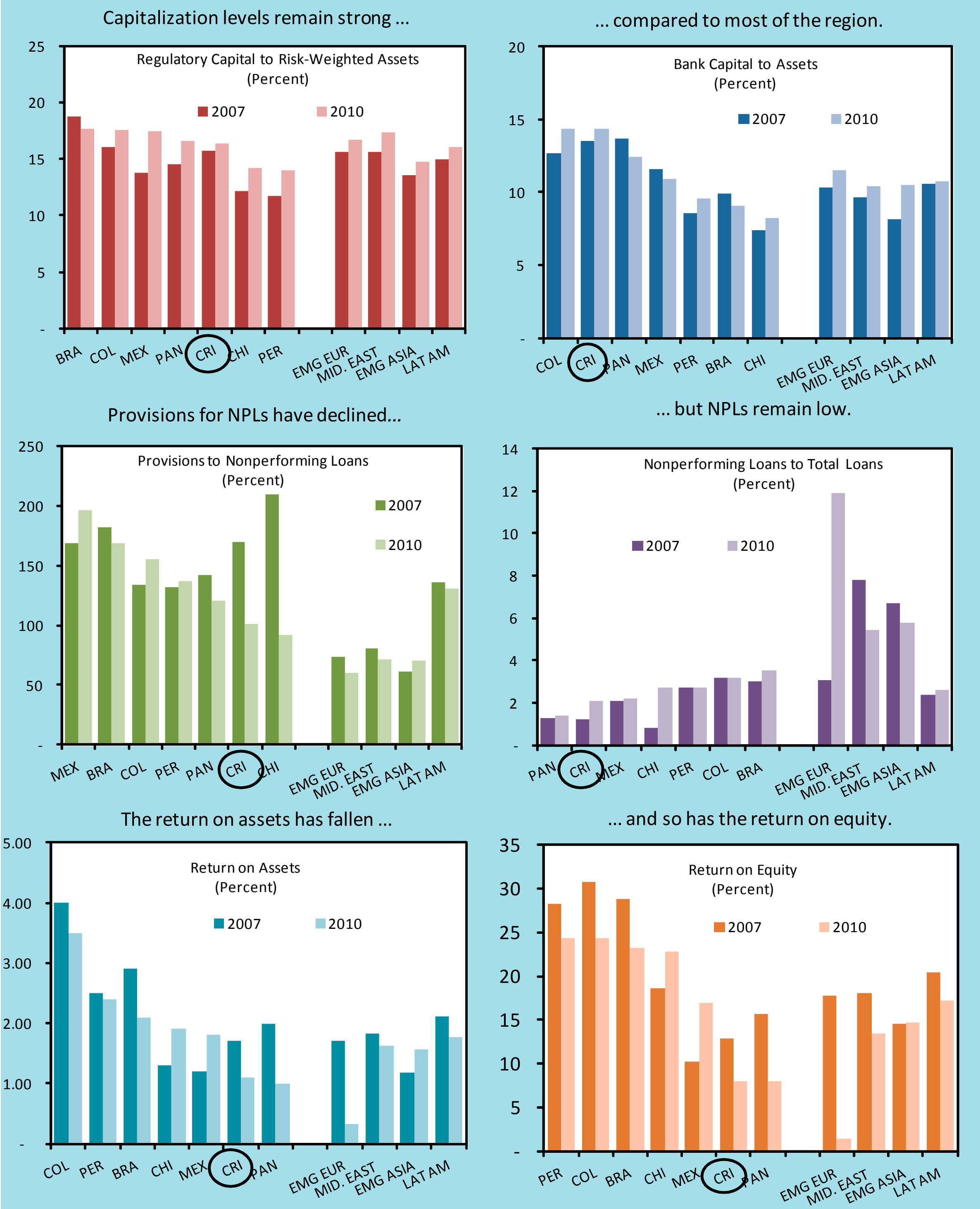


Source: Fund staff estimates.
1/ End-2010 staff estimates for gross international reserves.
2/ Gross international reserves at end 2010 in percent of external debt at remaining maturity in 2010, plus the current account deficit projected for 2011.



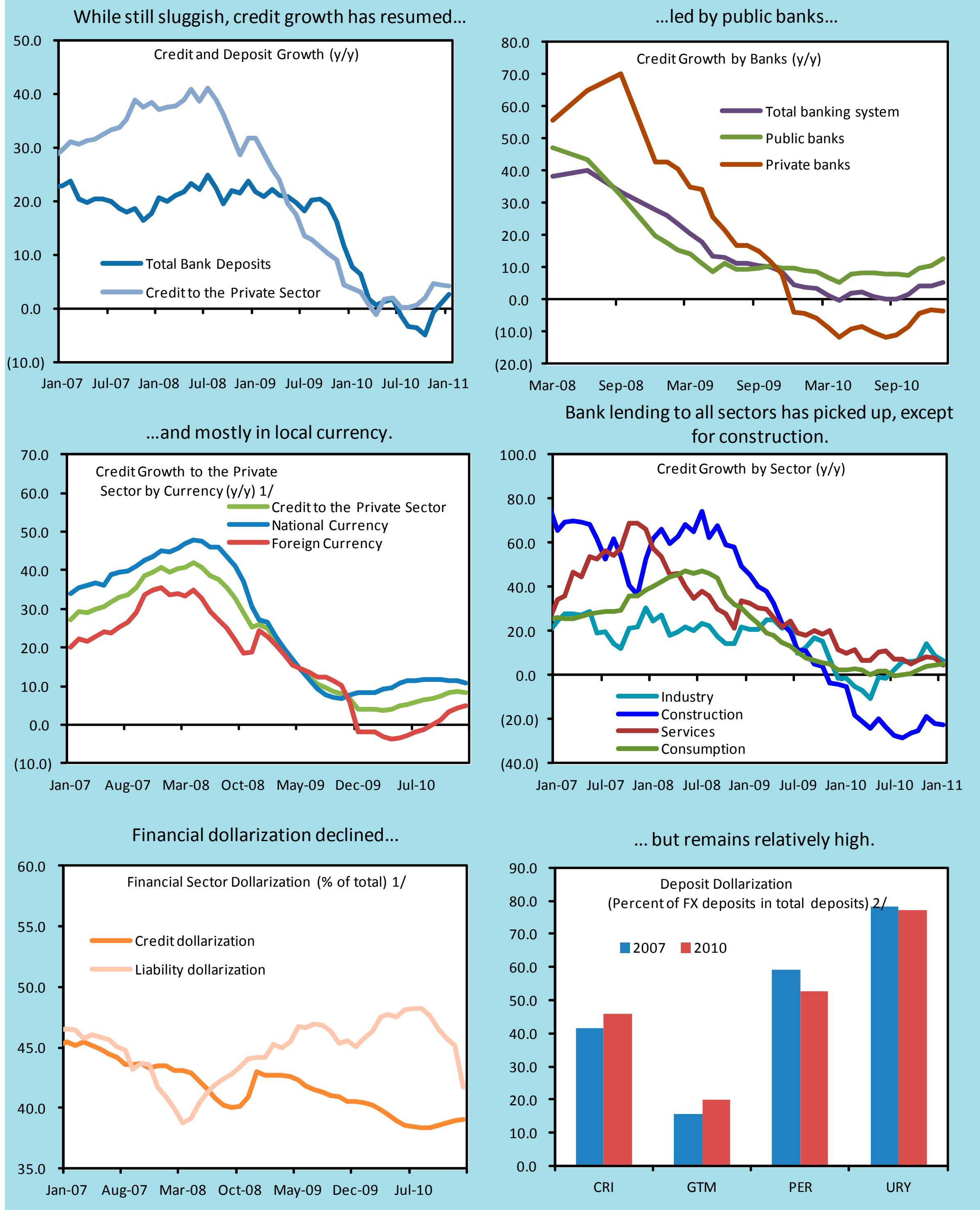
Sources: Ministry of Finance and Fund staff estimates.
1/ Excluding the electricity company.

Figure 5. Costa Rica: Comparative Financial Soundness Indicators



Sources: Country authorities; and Fund staff calculations.

Figure 6. Costa Rica: Bank Deposits and Credit



Sources: Country authorities; and Fund staff calculations.
1/ Adjusted by exchange rate.
2/ December 2007 and latest available data for 2010.

Table 1. Costa Rica: Selected Economic Indicators

Per capita GDP (2010, U.S. dollars)	7,843	Unemployment (2010, percent of labor force)	7.3
Population (July 2010, millions)	4.6	Poverty (2009, percent of households)	18.5
Life expectancy (2009, years)	79.1	Extreme poverty (2009, percent of households)	4.2

				Est.	Projections	
	2007	2008	2009	2010	2011	2012
	(Annual percentage change, unless otherwise indicated)					
National Income and Prices						
Real GDP growth	7.9	2.7	-1.3	4.2	4.3	4.4
GDP deflator	9.4	12.4	8.2	7.8	5.8	7.2
Consumer prices (end of period) 1/	10.8	13.9	4.0	5.8	7.5	6.5
External Sector						
Terms of trade (deterioration -)	-2.8	-1.1	4.9	0.8	-3.1	-0.2
Real effective exchange rate (eop; depreciation -)	1.5	3.8	2.1	12.3	…	…
Money and Credit						
Monetary base	33.0	11.9	5.1	11.2	9.7	11.5
Broad money	17.9	16.1	9.6	1.3	12.6	11.4
Bank credit to private sector	38.3	31.8	4.5	4.4	11.7	11.6
	(In percent of GDP)					
Public Finances						
Combined public sector primary balance 2/	5.0	2.8	-0.9	-2.7	-2.5	-0.5
Combined public sector overall balance 2/	1.2	0.2	-4.0	-5.6	-5.6	-3.9
Central government	0.3	-0.3	-3.6	-5.6	-5.6	-4.0
Decentralized government entities	1.3	0.6	0.4	0.5	0.5	0.6
Public enterprises (excluding ICE)	0.3	0.0	0.0	0.2	0.0	0.0
Central Bank	-0.7	-0.2	-0.8	-0.6	-0.5	-0.4
Combined public sector debt (excluding ICE) 2/	42.5	36.0	38.4	39.4	42.0	42.8
Of which: External public debt	9.7	8.6	7.2	7.1	6.8	7.0
Combined public sector debt (including ICE) 3/	45.3	39.5	42.5	42.8	45.4	46.1
Savings and Investment						
Gross domestic investment	24.7	27.6	15.9	20.0	20.2	20.8
Gross national savings	18.4	18.2	13.9	16.3	15.4	15.8
External Sector						
Trade balance	-11.3	-16.8	-7.0	-10.0	-11.6	-12.2
Current account balance	-6.3	-9.3	-2.0	-3.6	-4.8	-5.0
Foreign direct investment	6.2	6.9	4.6	4.1	4.6	4.5
	(In millions of U.S. dollars, unless otherwise indicated)					
Change in net international reserves (increase -)	-999	315	-268	-561	-400	-300
Net international reserves	4,114	3,799	4,066	4,627	5,027	5,327
In months of nonmaquila imports of G&S	3.8	4.7	4.0	4.2	4.1	4.1
Gross domestic product	26,322	29,838	29,241	35,780	40,167	43,112

Sources: Central Bank of Costa Rica; Ministry of Finance; and Fund staff projections.

1/ The projection for 2011 includes a one-off impact from the tax reform (assumed to be approved later in 2011).
2/ Combined public sector = central government + central bank + decentralized government entities + public enterprises, excluding the Instituto de Electricidad (ICE).
3/ Includes debt by the Instituto de Electricidad (ICE) guaranteed by the government.

Table 2. Costa Rica: Balance of Payments

(In millions of U.S. dollars, unless otherwise indicated)

				Est.	Projection					
	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Current Account	-1,646	-2,787	-574	-1,299	-1,936	-2,156	-2,331	-2,490	-2,625	-2,757
Trade balance	-2,985	-5,013	-2,037	-3,588	-4,642	-5,259	-5,957	-6,485	-6,808	-7,230
Export of goods (f.o.b.)	9,299	9,555	8,838	9,417	10,382	11,220	11,897	12,704	13,579	14,417
Import of goods (f.o.b.)	12,285	14,569	10,875	13,004	15,024	16,479	17,854	19,189	20,387	21,647
Services	1,734	2,201	2,188	2,661	3,075	3,448	3,847	4,244	4,558	4,923
Income	-865	-417	-1,084	-740	-751	-851	-817	-913	-1,108	-1,253
Current transfers	470	442	359	368	382	507	596	664	733	802
Financial and Capital Account	2,273	2,513	643	2,097	2,336	2,456	2,631	2,765	2,875	3,007
Foreign direct investment	1,634	2,072	1,339	1,450	1,841	1,936	1,994	2,128	2,199	2,347
Non-FDI flows	618	433	-754	597	495	520	637	637	676	661
Public sector	0	11	302	366	69	234	365	385	435	435
Disbursements	236	737	596	776	569	771	816	836	636	636
Amortization	-237	-726	-295	-410	-500	-537	-451	-451	-201	-201
Private sector	618	422	-1,056	231	425	286	272	252	241	226
Errors and Omissions	213	-41	-10	-237	0	0	0	0	0	0
Change in Net Reserves (increase -)	-839	315	-59	-561	-400	-300	-300	-275	-250	-250
	(Annual percentage change)									
Exports of goods (f.o.b.)										
Value	14.8	2.8	-7.5	6.5	10.3	8.1	6.0	6.8	6.9	6.2
Volume	9.2	-4.4	-4.6	3.6	5.0	4.7	5.3	5.7	5.8	5.5
Imports of goods (c.i.f.)										
Value	12.7	18.2	-25.4	19.6	15.6	9.7	8.3	7.5	6.2	6.2
Volume	3.7	8.6	-21.0	14.3	6.0	6.5	6.7	6.9	6.2	6.2
Of which: oil										
Value	15.6	44.7	-40.7	35.3	40.5	6.3	2.6	3.5	4.5	5.0
Volume	4.6	2.6	-3.7	6.4	6.0	5.5	5.0	4.5	4.0	4.0
	(In percent of GDP)									
Current account	-6.3	-9.3	-2.0	-3.6	-4.8	-5.0	-5.1	-5.2	-5.2	-5.2
Non-oil current account	-0.8	-2.3	2.3	1.1	1.0	0.8	0.5	0.4	0.3	0.3
Export of goods (f.o.b.)	35.3	32.0	30.2	26.3	25.8	26.0	26.0	26.4	26.9	27.3
Import of goods (f.o.b.)	46.7	48.8	37.2	36.3	37.4	38.2	39.1	39.8	40.4	40.9
Non-oil goods imports (f.o.b.)	41.2	41.8	33.0	31.7	31.5	32.4	33.4	34.3	34.9	35.4
Income	-3.3	-1.4	-3.7	-2.1	-1.9	-2.0	-1.8	-1.9	-2.2	-2.4
Direct investment	6.2	6.9	4.6	4.1	4.6	4.5	4.4	4.4	4.4	4.4
Memorandum Items:										
Net international reserves (US$ million) 1/	4,114	3,799	4,066	4,627	5,027	5,327	5,627	5,902	6,152	6,402
In months of non-maquila imports	3.8	4.7	4.0	4.2	4.1	4.1	4.1	4.0	4.0	4.0
In percent short-term debt 2/	96.7	88.4	133.7	138.3	133.4	129.4	122.0	139.5	126.5	129.0

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

1/ Includes valuation adjustments of US$160 million in 2007 for reclassification of capital contribution to FLAR and US$209 million in 2009 for the SDR allocation.

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

Table 3. Costa Rica: Central Government Balance

(In billions of colones)

	2007	2008	2009	Est. 2010	Projections 2011	2012
Revenues	**2,105**	**2,490**	**2,363**	**2,617**	**2,997**	**3,756**
Tax revenues 1/	2,029	2,409	2,262	2,492	2,862	3,605
Direct taxes	584	758	765	846	932	1,166
Sales tax	798	937	831	920	1,110	1,480
Excise, customs, and others	647	714	666	726	820	959
Nontax revenues 2/	76	81	101	125	135	151
Expenditure	**2,062**	**2,536**	**2,970**	**3,649**	**4,069**	**4,615**
Current non-interest	1,427	1,776	2,275	2,748	3,130	3,502
Wages	713	857	1,115	1,349	1,588	1,779
Goods and services	73	88	106	121	167	171
Transfers 2/	641	832	1,054	1,278	1,375	1,551
Of which : social security	324	372	445	506	598	667
Interest	454	415	393	452	550	650
Of which : adjustment for TUDES 3/	35	75	33	50	75	71
Capital	180	279	302	449	389	464
Primary balance	**497**	**370**	**-213**	**-580**	**-522**	**-210**
Overall balance	**43**	**-46**	**-606**	**-1,032**	**-1,072**	**-859**
Total financing	-43	46	606	1,032	1,072	859
External (net)	-21	-49	-186	247	22	131
Domestic (net)	-22	95	793	785	1,050	728
Central government debt	**3,747**	**3,891**	**4,587**	**5,551**	**6,664**	**7,586**
Domestic	2,612	2,753	3,611	4,420	5,470	6,198
External	1,135	1,138	976	1,131	1,194	1,387
Memorandum items:						
Non-interest expenditure nominal growth (percent)	21.5	27.9	25.3	24.1	10.1	12.7
Of which : current	17.7	24.4	28.1	20.8	13.9	11.9
Non-interest expenditure real growth (percent)	11.1	12.7	16.2	17.4	3.8	5.3
Of which : current	7.7	9.7	18.8	14.3	7.4	4.6
Nominal GDP (in billions of colones)	13,598	15,702	16,764	18,819	20,740	23,147

Sources: Ministry of Finance and IMF staff.

1/ Assumes that the tax reform submitted to the National Assembly becomes effective in the second-half of 2011.
2/ Transfers to the Social Development and Family Transfers Fund (FODESAF) are accounted for in net terms.
3/ TUDES is an inflation-indexed bond whose value is adjusted monthly in line with inflation and that pays a fixed rate coupon twice a year, calculated over the adjusted value of the bond. The inflation adjustment of the principal is not reflected as interest expenditure in the official fiscal accounts, but is added in the Fund presentation of the fiscal balance.

Table 4. Costa Rica: Central Government Balance

(In percent of GDP)

	2007	2008	2009	Est. 2010	Projections 2011	2012
Revenues	**15.5**	**15.9**	**14.1**	**13.9**	**14.4**	**16.2**
Tax revenues 1/	14.9	15.3	13.5	13.2	13.8	15.6
Direct taxes	4.3	4.8	4.6	4.5	4.5	5.0
Sales tax	5.9	6.0	5.0	4.9	5.4	6.4
Excise, customs, and others	4.8	4.5	4.0	3.9	4.0	4.1
Non-tax revenues 2/	0.6	0.5	0.6	0.7	0.7	0.7
Expenditure	**15.2**	**16.1**	**17.7**	**19.4**	**19.6**	**19.9**
Current non-interest	10.5	11.3	13.6	14.6	15.1	15.1
Wages	5.2	5.5	6.7	7.2	7.7	7.7
Goods and services	0.5	0.6	0.6	0.6	0.8	0.7
Transfers 2/	4.7	5.3	6.3	6.8	6.6	6.7
Interest	3.3	2.6	2.3	2.4	2.7	2.8
of which: adjustment for TUDES 3/	0.3	0.5	0.2	0.3	0.4	0.3
Capital	1.3	1.8	1.8	2.4	1.9	2.0
Primary balance	**3.7**	**2.4**	**-1.3**	**-3.1**	**-2.5**	**-0.9**
Overall balance	**0.3**	**-0.3**	**-3.6**	**-5.5**	**-5.2**	**-3.7**
Total financing	**-0.3**	**0.3**	**3.6**	**5.5**	**5.2**	**3.7**
External (net)	-0.2	-0.3	-1.1	1.3	0.1	0.6
Domestic (net)	-0.2	0.6	4.7	4.2	5.1	3.1
Central government debt	**27.6**	**24.8**	**27.4**	**29.5**	**32.1**	**32.8**
Domestic	19.2	17.5	21.5	23.5	26.4	26.8
External	8.3	7.3	5.8	6.0	5.8	6.0
Memorandum items:						
Non-interest expenditure nominal growth (percent)	21.5	27.9	25.3	24.1	10.1	12.7
Of which : current	17.7	24.4	28.1	20.8	13.9	11.9
Non-interest expenditure real growth (percent)	11.1	12.7	16.2	17.4	3.8	5.3
Of which : current	7.7	9.7	18.8	14.3	7.4	4.6
Nominal GDP (in billions of colones)	13,598	15,702	16,764	18,819	20,740	23,147

Sources: Ministry of Finance and IMF staff.

1/ Assumes that the tax reform submitted to the National Assembly becomes effective in the second-half of 2011.

2/ Transfers to the Social Development and Family Transfers Fund (FODESAF) are accounted for in net terms.

3/ TUDES is an inflation-indexed bond whose value is adjusted monthly in line with inflation and that pays a fixed rate coupon twice a year, calculated over the adjusted value of the bond. The inflation adjustment of the principal is not reflected as interest expenditure in the official fiscal accounts, but is added in the Fund presentation of the fiscal balance.

Table 5. Costa Rica: Combined Public Sector Operations 1/

(In billions of colones)

	2007	2008	2009	Est. 2010	Projections 2011	Projections 2012
Non-financial public sector:						
Revenues	**3,187**	**3,700**	**3,768**	**4,179**	**4,672**	**5,625**
Tax revenues 2/	2,055	2,437	2,289	2,520	2,893	3,640
Nontax revenues	172	161	218	245	270	301
Social security contributions	871	1,057	1,186	1,332	1,468	1,638
Operating balance of public enterprises	89	46	75	83	41	46
Expenditure	**2,926**	**3,640**	**4,302**	**5,130**	**5,739**	**6,476**
Current non-interest	2,221	2,755	3,428	4,047	4,582	5,127
Wages	977	1,201	1,545	1,839	2,148	2,404
Goods and services	288	355	387	441	520	569
Transfers	956	1,199	1,497	1,767	1,914	2,153
Interest	418	383	381	446	561	662
Of which : adjustment for TUDES 3/	-3	41	18	28	41	39
Capital	286	503	493	637	596	687
Of which : central government	180	279	302	449	389	464
Of which : rest of non-financial public sector	106	224	192	188	207	224
Nonfinancial public sector primary balance	**679**	**443**	**-154**	**-504**	**-506**	**-189**
Nonfinancial public sector overall balance	**261**	**60**	**-535**	**-951**	**-1,067**	**-851**
Central government	43	-46	-606	-1,032	-1,072	-859
Decentralized government entities	172	101	73	50	5	8
Public enterprises (excluding ICE)	46	4	-2	31	0	0
Total financing	**-261**	**-60**	**535**	**951**	**1,067**	**851**
External	-17	-54	-188	247	5	108
Domestic	-244	-6	723	704	1,063	743
Central Bank balance	**-96**	**-29**	**-138**	**-88**	**-104**	**-116**
Combined public sector balance (includes Central Bank)	**165**	**31**	**-673**	**-1,039**	**-1,171**	**-967**
Public sector debt (excluding ICE)	**5,777**	**5,659**	**6,443**	**7,411**	**8,673**	**9,790**
Domestic	4,457	4,306	5,236	6,076	7,290	8,233
External	1,320	1,353	1,207	1,335	1,383	1,557
Memorandum items:						
Public sector debt (including ICE)	6,158	6,199	7,127	8,051	9,388	10,573
Non-interest expenditure nominal growth (percent)	21.4	29.9	20.4	19.4	10.6	12.3
Of which : current	19.9	24.0	24.4	18.0	13.2	11.9
Non-interest expenditure real growth (percent)	11.0	14.6	11.6	13.0	4.3	4.9
Of which : current	9.7	9.3	15.4	11.7	6.8	4.6
Nominal GDP (in billions of colones)	13,598	15,702	16,764	18,819	20,740	23,147
CPI Inflation (period average)	9.4	13.4	7.8	5.7	6.0	7.0

Sources: Ministry of Finance and IMF staff estimates.

1/ Combined public sector = central government + central bank + decentralized government entities + public enterprises, excluding the Instituto de Electricidad (ICE).

2/ Assumes that the tax reform submitted to the National Assembly becomes effective in the second half of 2011.

3/ TUDES is an inflation-indexed bond whose value is adjusted monthly in line with inflation and that pays a fixed rate coupon twice a year, calculated over the adjusted value of the bond. The inflation adjustment of the principal is not reflected as interest expenditure in the official fiscal accounts, but is added in the Fund presentation of the fiscal balance.

Table 6. Costa Rica: Combined Public Sector Operations 1/
(In percent of GDP)

				Est.	Projections	
	2007	2008	2009	2010	2011	2012
Revenues	**23.4**	**23.6**	**22.5**	**22.2**	**22.5**	**24.3**
Tax revenues 2/	15.1	15.5	13.7	13.4	13.9	15.7
Non-tax revenues	1.3	1.0	1.3	1.3	1.3	1.3
Social security contributions	6.4	6.7	7.1	7.1	7.1	7.1
Operating balance of public enterprises	0.7	0.3	0.4	0.4	0.2	0.2
Expenditure	**21.5**	**23.2**	**25.7**	**27.3**	**27.7**	**28.0**
Current non-interest	16.3	17.5	20.5	21.5	22.1	22.1
Wages	7.2	7.6	9.2	9.8	10.4	10.4
Goods and services	2.1	2.3	2.3	2.3	2.5	2.5
Transfers	7.0	7.6	8.9	9.4	9.2	9.3
Interest	3.1	2.4	2.3	2.4	2.7	2.9
of which: adjustment for TUDES 3/	0.0	0.3	0.1	0.1	0.2	0.2
Capital	2.1	3.2	2.9	3.4	2.9	3.0
of which: central government	1.3	1.8	1.8	2.4	1.9	2.0
of which: rest of non-financial public sector	0.8	1.4	1.1	1.0	1.0	1.0
Nonfinancial public sector primary balance	**5.0**	**2.8**	**-0.9**	**-2.7**	**-2.4**	**-0.8**
Nonfinancial public sector overall balance	**1.9**	**0.4**	**-3.2**	**-5.1**	**-5.1**	**-3.7**
Central government	0.3	-0.3	-3.6	-5.5	-5.2	-3.7
Decentralized government entities	1.3	0.6	0.4	0.3	0.0	0.0
Public enterprises (excluding ICE)	0.3	0.0	0.0	0.2	0.0	0.0
Total financing	**-1.9**	**-0.4**	**3.2**	**5.1**	**5.1**	**3.7**
External	-0.1	-0.3	-1.1	1.3	0.0	0.5
Domestic	-1.8	0.0	4.3	3.7	5.1	3.2
Central Bank balance	**-0.7**	**-0.2**	**-0.8**	**-0.5**	**-0.5**	**-0.5**
Combined public sector balance (includes Central Bank)	**1.2**	**0.2**	**-4.0**	**-5.5**	**-5.6**	**-4.2**
Public sector debt (excluding ICE)	**42.5**	**36.0**	**38.4**	**39.4**	**41.8**	**42.3**
Domestic	32.8	27.4	31.2	32.3	35.1	35.6
External	9.7	8.6	7.2	7.1	6.7	6.7
Memorandum items:						
Public sector debt (including ICE)	45.3	39.5	42.5	42.8	45.3	45.7
Non-interest expenditure nominal growth (percent)	21.4	29.9	20.4	19.4	10.6	12.3
of which: current	19.9	24.0	24.4	18.0	13.2	11.9
Non-interest expenditure real growth (percent)	11.0	14.6	11.6	13.0	4.3	4.9
of which: current	9.7	9.3	15.4	11.7	6.8	4.6
Nominal GDP (in billions of colones)	13,598	15,702	16,764	18,819	20,740	23,147

Sources: Ministry of Finance and IMF staff estimates.
1/ Combined public sector = central government + central bank + decentralized government entities + public enterprises, excluding the Instituto de Electricidad (ICE).
2/ Assumes that the tax reform submitted to the National Assembly becomes effective in the second half of 2011.
3/ TUDES is an inflation-indexed bond whose value is adjusted monthly in line with inflation and that pays a fixed rate coupon twice a year, calculated over the adjusted value of the bond. The inflation adjustment of the principal is not reflected as interest expenditure in the official fiscal accounts, but is added in the Fund presentation of the fiscal balance.

Table 7. Costa Rica: Monetary Survey

(In billions of colones, unless otherwise indicated)

	2007	2008	2009	Est. 2010	Proj. 2011
Central Bank					
Net foreign assets	2,125	2,186	2,420	2,492	2,764
Net international reserves	2,037	2,090	2,272	2,350	2,608
(In millions of US$)	4,114	3,799	4,066	4,627	5,027
Net Medium-Term Foreign Assets	107	116	140	140	140
Net domestic assets	-1,097	-1,035	-1,210	-1,147	-1,288
Net domestic credit	-429	-547	-792	-926	-1,000
Capital account (-)	1,182	1,219	1,266	1,346	1,471
Other items net (-)	-5	-193	-270	-159	-122
Monetary stabilization bonds (-)	-1,845	-1,513	-1,414	-1,407	-1,637
Monetary base	1,028	1,151	1,210	1,345	1,476
Currency	546	575	613	665	724
Required reserves	482	576	597	680	752
Other Depository Institutions					
Net foreign assets	-313	-420	-20	-87	-250
Net domestic assets	6,175	7,674	8,128	8,183	9,368
Net domestic credit	8,097	10,064	11,087	11,776	13,694
Credit to nonfinancial public sector (net)	338	316	586	872	1,572
Credit to the private sector	6,013	7,925	8,281	8,645	9,657
Credit to financial corporations (net)	1,745	1,823	2,221	2,260	2,465
Capital account	1,237	1,597	1,829	2,036	2,362
Other items (net)	-685	-793	-1,129	-1,557	-1,964
Liabilities	5,862	7,254	8,108	8,096	9,118
National currency	3,481	3,940	4,299	4,731	5,092
Foreign currency	2,381	3,314	3,809	3,364	4,026
Financial System					
Net foreign assets	1,812	1,766	2,400	2,405	2,514
Net domestic assets	5,640	6,885	7,078	7,194	8,294
Net domestic credit	6,291	8,221	8,816	9,228	11,001
Capital account	55	378	564	690	891
Other items (net)	-595	-957	-1,174	-1,344	-1,816
Broad money (M4)	7,453	8,651	9,478	9,599	10,808
Memorandum Items:					
			(Percent changes)		
Monetary base	33.0	11.9	5.1	11.2	9.7
Broad money (M4)	17.9	16.1	9.6	1.3	12.6
Credit to the private sector (National Currency)	45.2	27.1	8.3	11.4	13.8
Credit to the private sector (Foreign Currency) 1/	30.0	38.2	-0.3	-5.2	8.3
			(In percent of GDP)		
Monetary base	7.6	7.3	7.2	7.1	7.1
Broad money (M4)	54.8	55.1	56.5	51.0	52.0
Credit to the private sector (National Currency)	25.5	28.0	28.4	28.2	29.1
Credit to the private sector (Foreign Currency)	18.8	22.4	21.0	17.7	17.4

Sources: Central Bank; and Fund staff estimates.
1/ Measured in U.S. dollar terms.

Table 8. Costa Rica: Indicators of External Vulnerability

	2007	2008	2009	2010	Projection 2011	2012
Merchandise exports (percent change)	14.8	2.8	-7.5	6.5	10.3	8.1
Merchandise imports (percent change)	12.7	18.2	-25.4	19.6	15.6	9.7
Terms of trade (percent change)	-2.8	-1.1	4.9	0.8	-3.1	-0.2
Current account balance (in percent of GDP)	-6.3	-9.3	-2.0	-3.6	-4.8	-5.0
Central bank net international reserves (in US$ millions)	4,114	3,799	4,066	4,627	5,027	5,327
In months of next year's imports of nonmaquila goods and services	3.8	4.7	4.0	4.2	4.1	4.1
In months of next year's imports of nonmaquila goods and services	199.3	183.3	189.9	174.7	179.2	181.2
In percent of M4	27.5	24.4	24.2	24.5	24.5	24.4
In percent of deposits in foreign currency	86.1	63.7	60.3	69.8	65.7	66.7
In percent of short-term external debt 1/	96.7	88.4	133.7	138.3	133.4	129.4
Public external debt service (in percent of GDP)	1.6	3.0	1.6	1.7	1.7	1.4
External debt (in percent of GDP)	32.1	30.5	28.0	25.2	24.0	24.2
External debt (in percent of exports)	65.7	66.8	65.8	67.3	63.7	63.2
REER appreciation (+)	1.5	3.8	2.1	12.3	…	…

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

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

Table 9. Costa Rica: Medium-Term Framework

(Annual percentage change; unless otherwise indicated)

	2007	2008	2009	2010	Projection 2011	2012	2013	2014	2015	2016
Real GDP	7.9	2.7	-1.3	4.2	4.3	4.4	4.5	4.5	4.5	4.5
Consumption	6.9	3.3	2.1	3.7	3.8	3.8	3.9	3.8	3.8	3.8
Private consumption	7.5	3.2	1.5	3.4	3.7	3.7	3.8	3.8	3.8	3.8
Government consumption	2.3	4.4	6.7	5.9	4.6	4.9	4.6	3.4	4.0	4.0
Gross domestic investment	-1.2	22.2	-36.7	29.1	5.9	7.7	7.8	7.4	6.3	6.9
Fixed capital formation	18.1	11.0	-9.8	2.6	4.6	7.1	8.0	7.4	6.6	7.1
Exports of goods and nonfactor services	9.9	-2.6	-6.0	4.8	5.1	5.6	5.7	6.1	5.9	5.5
Imports of goods and nonfactor services	4.3	6.5	-19.9	14.2	5.2	6.4	6.5	6.6	5.9	5.8
Consumption (contribution to growth)	4.9	2.4	1.5	2.7	2.8	2.8	2.8	2.7	2.7	2.7
Investment (contribution to growth)	3.7	2.5	-2.4	0.6	1.0	1.6	1.8	1.7	1.6	1.7
Inventories (contribution to growth)	-4.0	2.8	-8.1	4.7	0.4	0.2	0.1	0.1	0.0	0.0
Net exports (contribution to growth)	3.3	-5.0	7.7	-3.8	0.1	-0.2	-0.2	-0.1	0.1	0.0
Investment and savings (in percent of GDP)										
Savings	24.7	27.6	15.9	20.0	20.2	20.8	21.5	22.0	22.4	22.9
National savings	18.4	18.2	13.9	16.3	15.4	15.8	16.4	16.9	17.2	17.7
External savings 1/	6.3	9.3	2.0	3.6	4.8	5.0	5.1	5.2	5.2	5.2
Gross domestic investment	24.7	27.6	15.9	20.0	20.2	20.8	21.5	22.0	22.4	22.9
Private sector	18.6	19.6	18.5	15.5	16.3	16.7	17.4	17.8	18.2	18.6
Public sector	3.2	4.0	3.6	4.2	3.6	3.7	3.7	3.8	3.8	3.9
Inventory changes	2.9	4.0	-6.3	0.2	0.3	0.4	0.4	0.4	0.4	0.4
Balance of payments (in percent of GDP)										
Current account balance	-6.3	-9.3	-2.0	-3.6	-4.8	-5.0	-5.1	-5.2	-5.2	-5.2
Trade balance	-11.3	-16.8	-7.0	-10.0	-11.6	-12.2	-13.0	-13.5	-13.5	-13.7
Services	6.6	7.4	7.5	7.4	7.7	8.0	8.4	8.8	9.0	9.3
Income	-3.3	-1.4	-3.7	-2.1	-1.9	-2.0	-1.8	-1.9	-2.2	-2.4
Current transfers	1.8	1.5	1.2	1.0	1.0	1.2	1.3	1.4	1.5	1.5
Financial and capital account	8.6	8.4	2.2	6.4	5.8	5.7	5.8	5.7	5.7	5.7
Direct investment	6.2	6.9	4.6	4.1	4.6	4.5	4.4	4.4	4.4	4.4
Capital flows	2.3	1.5	-2.6	2.3	1.2	1.2	1.4	1.3	1.3	1.2
Public sector	0.0	0.0	1.0	1.0	0.2	0.5	0.8	0.8	0.9	0.8
Private net capital	2.3	1.4	-3.6	1.3	1.1	0.7	0.6	0.5	0.5	0.4
Errors and omissions	0.8	-0.1	0.0	-0.7	0.0	0.0	0.0	0.0	0.0	0.0
Change in net reserves (increase -)	-3.2	1.1	-0.2	-1.6	-1.0	-0.7	-0.7	-0.6	-0.5	-0.5
Memorandum items:										
GDP deflator	9.4	12.4	8.2	7.8	5.8	7.2	6.0	5.1	4.5	4.3
CPI (avg)	9.4	13.4	7.8	5.7	6.0	7.0	6.0	5.0	4.2	4.0
CPI (eop)	10.8	13.9	4.0	5.8	7.5	6.5	5.5	4.5	4.0	4.0
Net international reserves (millions of US$)	4,114	3,799	4,066	4,627	5,027	5,327	5,627	5,902	6,152	6,402

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

1/ External current account deficit.

Table 10. Costa Rica: Banking Sector Indicators

(In percent)

	2008				2009				2010				2011	
	Mar	Jun	Sep	Dec	Mar	Jun	Sep	Dec	Mar	Jun	Sep	Dec	Jan	Feb
Capitalization														
Risk-adjusted capital ratio	15.5	14.7	14.5	15.1	15.2	15.4	15.4	16.0	16.5	16.4	16.8	17.3	17.2	17.5
Capital-to-assets ratio	12.8	12.8	12.8	13.3	13.3	13.5	13.7	13.9	14.3	14.5	14.9	14.8	14.7	14.9
Asset quality														
Nonperforming loans to total loans	1.2	1.1	1.2	1.5	1.8	2.0	2.1	2.0	3.1	2.2	2.0	1.8	1.9	1.8
Non-income generating assets to total assets	16.6	17.0	18.1	18.2	19.1	18.9	19.0	18.6	19.6	18.7	18.3	17.4	17.5	17.3
Foreclosed assets to total assets	0.2	0.2	0.2	0.3	0.4	0.4	0.5	0.6	0.6	0.7	0.8	0.8	0.8	0.8
Loan loss provisions to total loans	1.8	1.7	1.7	1.8	1.9	1.9	2.0	1.9	2.1	2.1	1.9	1.8	1.8	1.8
Management														
Administrative expenses to total assets	4.8	4.6	4.5	4.4	4.3	4.3	4.2	4.1	4.1	4.1	4.2	4.3	4.3	4.3
Noninterest expenses to gross income	77.2	79.6	82.2	79.3	78.9	77.4	75.7	76.8	81.6	85.9	86.9	85.0	84.3	84.3
Total expenses to total revenues	90.6	91.0	91.7	92.5	93.0	93.5	93.7	95.2	96.5	97.2	97.2	96.2	95.9	95.8
Profitability														
Return on assets (ROA)	1.5	1.6	1.7	1.8	1.7	1.6	1.5	1.1	1.0	1.0	1.0	1.2	1.2	1.2
Return on equity (ROE)	11.8	12.2	13.4	14.3	14.3	12.4	11.5	8.7	7.6	7.2	7.2	8.3	8.8	8.9
Interest margin to gross income	34.0	29.4	25.6	20.8	20.4	20.8	21.7	20.7	17.5	14.4	14.4	16.6	17.5	17.6
Liquidity														
Liquid assets to total short-term liabilities	87.5	84.6	80.1	83.0	94.9	101.2	99.6	93.4	93.2	91.1	93.6	90.1	90.8	90.8
Liquid assets to total assets	32.5	29.7	27.4	27.7	30.0	31.1	30.7	30.6	31.4	30.6	30.6	30.7	31.0	31.1
Loans to deposits	103.1	107.3	109.8	109.7	101.9	98.6	98.4	98.9	97.1	95.8	97.2	97.8	96.9	96.6
Liquid assets to deposits	48.5	44.6	41.0	42.1	43.7	44.8	43.7	43.9	44.8	42.6	43.3	43.8	44.1	44.2
Sensitivity to market risk														
Net open FX position to capital	19.0	21.7	19.5	20.4	22.8	22.9	26.4	25.4	22.2	21.7	17.3	18.8	18.2	17.3
Other														
Financial margin 1/	7.8	7.6	7.7	7.9	8.0	8.3	7.9	7.7	7.8	8.0	8.1	8.2	8.2	8.3
Credit growth (over a year ago)	38.3	40.0	33.5	27.8	20.6	13.1	10.4	4.5	1.3	2.5	0.2	4.2	5.4	5.2
Deposit growth (over a year ago)	22.4	23.8	21.3	25.4	21.9	23.1	24.6	15.9	6.3	5.4	0.3	5.4	7.5	7.7

Source: Superintendency of Banks.
1/ Difference between implicit loan and deposit rates.

Table 11. Costa Rica: External Debt Sustainability Framework, 2006-2016

(In percent of GDP, unless otherwise indicated)

	Actual				Est.			Projections						Debt-stabilizing Non-interest
	2006	2007	2008	2009	2010			2011	2012	2013	2014	2015	2016	Current Account 6/
Baseline: External debt	**31.9**	**32.1**	**30.5**	**28.0**	**25.2**			**24.0**	**24.2**	**25.0**	**25.9**	**26.9**	**27.9**	**-3.9**
Change in external debt	-2.0	0.2	-1.6	-2.6	-2.7			-1.3	0.2	0.8	0.9	1.0	1.0	
Identified external debt-creating flows (4+8+9+10)	-5.8	-5.5	-1.4	-2.0	-5.5			-1.2	-0.2	0.1	0.2	0.3	0.2	
Current account deficit, excluding interest payments	3.4	4.6	8.2	0.9	2.9			4.2	4.4	4.5	4.3	3.8	3.5	
Deficit in balance of goods and services	6.1	4.8	9.4	-0.5	3.3			3.9	4.2	4.6	4.7	4.5	4.4	
Exports	49.2	48.8	45.7	42.5	37.5			37.7	38.2	38.6	39.2	39.9	40.5	
Imports	55.3	53.6	55.1	42.0	40.8			41.6	42.4	43.2	43.9	44.4	44.9	
Private sector debt creating flows	-0.4	1.2	0.1	-3.2	-1.8			-0.5	0.2	0.4	0.5	0.6	0.6	
Net non-debt creating capital inflows (negative)	-6.5	-7.2	-7.0	-4.6	-4.1			-4.6	-4.5	-4.4	-4.4	-4.4	-4.4	
Automatic debt dynamics 1/	-2.7	-3.0	-2.6	1.7	-4.4			-0.3	-0.4	-0.4	-0.2	0.3	0.6	
Contribution from nominal interest rate	1.2	1.6	1.2	1.0	0.7			0.6	0.6	0.6	0.9	1.4	1.8	
Contribution from real GDP growth	-2.6	-2.2	-0.8	0.4	-1.0			-1.0	-1.0	-1.0	-1.1	-1.1	-1.2	
Contribution from price and exchange rate changes 2/	-1.2	-2.4	-3.0	0.2	-4.2			...	...	...	...	...	...	
Residual, incl. change in gross foreign assets 3/	3.9	5.7	-0.2	-0.5	2.8			-0.1	0.5	0.6	0.7	0.7	0.7	
External debt-to-exports ratio (in percent)	64.9	65.7	66.8	65.8	67.3			63.6	63.4	64.7	65.9	67.4	68.8	
Gross external financing need (in billions of US dollars) 4/	5.8	6.9	10.3	8.5	6.6			7.7	8.7	9.6	10.8	11.8	13.2	
In percent of GDP	25.9	26.1	34.4	29.2	18.4			19.2	20.2	21.1	22.4	23.4	24.9	
Scenario with key variables at their historical averages 5/								**24.4**	**23.4**	**22.2**	**21.0**	**19.7**	**18.5**	**-5.5**
Key Macroeconomic Assumptions Underlying Baseline						10-Year Historical Average	10-Year Standard Deviation							
Real GDP growth (in percent)	8.8	7.9	2.7	-1.3	4.2	4.3	3.1	4.3	4.4	4.5	4.5	4.5	4.5	
GDP deflator in U.S. dollars (change in percent)	3.7	8.3	10.4	-0.7	17.5	4.2	6.1	7.6	2.8	1.5	0.9	0.3	0.3	
Nominal external interest rate (in percent)	3.9	5.9	4.1	3.3	3.1	4.4	0.9	2.8	2.5	2.8	3.7	5.7	6.7	
Growth of exports (US dollar terms, in percent)	13.9	16.1	6.1	-8.9	7.9	6.1	9.6	12.9	8.7	7.1	7.2	6.7	6.3	
Growth of imports (US dollar terms, in percent)	15.7	13.3	16.6	-25.4	18.8	8.1	13.6	14.5	9.3	8.0	7.1	6.0	5.9	
Current account balance, excluding interest payments	-3.4	-4.6	-8.2	-0.9	-2.9	-3.6	1.9	-4.2	-4.4	-4.5	-4.3	-3.8	-3.5	
Net non-debt creating capital inflows	6.5	7.2	7.0	4.6	4.1	4.8	1.5	4.6	4.5	4.4	4.4	4.4	4.4	

1/ Derived as $[r - g - \rho(1+g) + \varepsilon\alpha(1+r)]/(1+g+\rho+g\rho)$ times previous period debt stock, with r = nominal effective interest rate on external debt; ρ = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, ε = nominal appreciation (increase in dollar value of domestic currency), and α = share of domestic-currency denominated debt in total external debt.

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

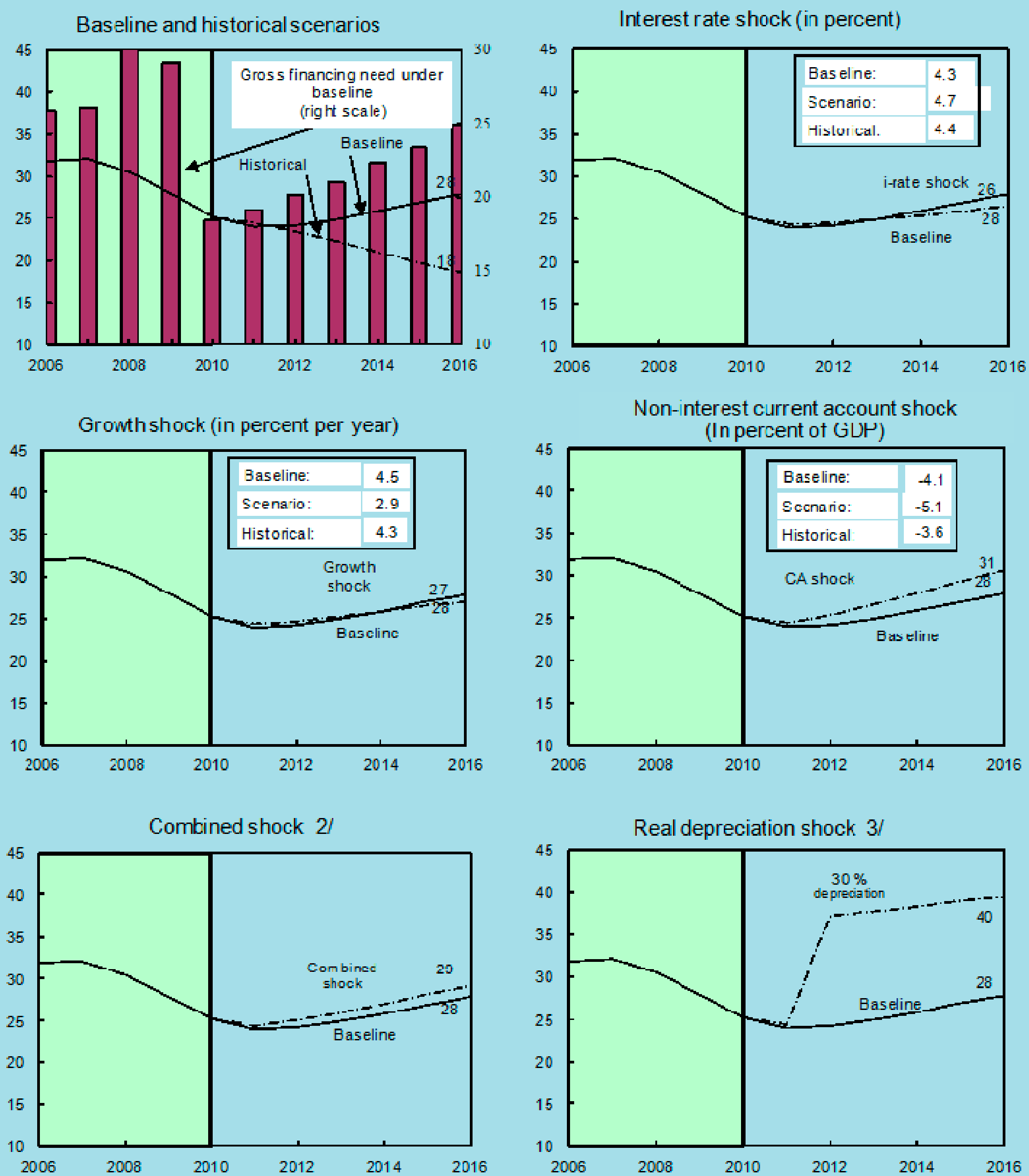
3/ For projection, line includes the impact of price and exchange rate changes.

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

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

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

Figure 7. Costa Rica: External Debt Sustainability: Bound Tests 1/
(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/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
3/ One-time real depreciation of 30 percent occurs in 2010.

Table 12. Costa Rica: Combined Public Sector Debt Sustainability Framework, 2006-2016

(In percent of GDP, unless otherwise indicated)

	Actual				Est.			Projections						Debt-Stabilizing Primary Balance 9/
	2006	2007	2008	2009	2010			2011	2012	2013	2014	2015	2016	
Baseline: Public sector debt 1/	**47.3**	**42.5**	**36.0**	**38.4**	**39.4**			**41.8**	**42.3**	**43.0**	**43.8**	**44.8**	**46.0**	**-0.2**
Of which: foreign-currency denominated	18.3	13.5	11.9	11.7	11.3			11.5	11.7	11.5	11.3	11.1	11.0	
Change in public sector debt	-3.8	-4.8	-6.4	2.4	0.9			2.4	0.5	0.7	0.8	1.0	1.1	
Identified debt-creating flows (4+7+12)	-7.3	-9.1	-4.5	1.9	1.3			2.0	-0.2	0.2	0.3	0.6	0.7	
Primary deficit	-3.2	-4.3	-2.6	1.7	3.1			2.9	1.3	1.3	1.3	1.3	1.3	
Revenue and grants	22.3	23.4	23.6	22.5	22.2			22.5	24.3	24.5	24.7	24.9	25.0	
Primary (noninterest) expenditure	19.1	19.1	20.9	24.2	25.4			25.5	25.6	25.9	26.0	26.1	26.2	
Automatic debt dynamics 2/	-4.1	-4.8	-1.8	0.2	-1.8			-0.9	-1.5	-1.2	-1.0	-0.7	-0.6	
Contribution from interest rate/growth differential 3/	-4.9	-4.2	-3.3	0.0	-1.8			-0.9	-1.5	-1.2	-1.0	-0.7	-0.6	
Of which: contribution from real interest rate	-1.2	-1.0	-2.3	-0.4	-0.4			0.6	0.2	0.6	0.8	1.2	1.3	
Of which: contribution from real GDP growth	-3.7	-3.2	-1.0	0.4	-1.4			-1.5	-1.6	-1.7	-1.8	-1.8	-1.9	
Contribution from exchange rate depreciation 4/	0.8	-0.6	1.4	0.2	-1.1			...	...	...	...	...	...	
Other identified debt-creating flows	0.0	0.0	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0	
Privatization receipts (negative)	0.0	0.0	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes 5/	3.5	4.2	-2.0	0.5	-0.4			0.4	0.6	0.5	0.5	0.4	0.4	
Public sector debt-to-revenue ratio 1/	212.3	181.3	152.9	171.0	177.3			185.6	174.0	175.3	177.2	180.3	184.0	
Gross financing need 6/	0.7	-1.2	-0.2	4.0	5.5			5.6	4.2	4.1	4.1	4.2	4.3	
In billions of U.S. dollars	0.2	-0.3	-0.1	1.2	2.0			2.3	1.8	1.9	2.0	2.1	2.3	
Scenario with key variables at their historical averages 7/								**35.6**	**32.3**	**28.9**	**25.6**	**22.4**	**19.4**	**-1.0**
Scenario with no policy change (constant primary balance) in 2010-2016								**41.6**	**43.9**	**46.4**	**49.0**	**51.9**	**54.9**	**-0.3**
Key Macroeconomic and Fiscal Assumptions Underlying Baseline						10-Year Historical Average	10-Year Standard Deviation							
Real GDP growth (in percent)	8.8	7.9	2.7	-1.3	4.2	4.3	3.1	4.3	4.4	4.5	4.5	4.5	4.5	
Average nominal interest rate on public debt (in percent) 8/	9.2	7.7	6.6	6.7	6.9	8.3	1.2	7.6	7.6	7.3	7.3	7.4	7.4	
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	-1.8	-1.7	-5.8	-1.4	-0.8	-1.5	1.9	1.9	0.7	1.7	2.3	3.1	3.3	
Nominal appreciation (increase in US dollar value of local currency, in percent)	-4.1	4.0	-10.3	-1.7	11.3	-4.3	7.1	...	...	...	...	...	...	
Inflation rate (GDP deflator, in percent)	11.0	9.4	12.4	8.2	7.8	9.7	1.6	5.7	6.9	5.6	5.0	4.3	4.1	
Growth in real primary spending of combined public sector (in percent)	5.7	11.0	14.6	11.6	13.0	8.2	4.6	4.3	4.9	5.1	5.1	5.0	5.1	

1/ The public sector comprises the central government, decentralized entities, public enterprises (excluding ICE), and the central bank.

2/ Derived as $[(r - \pi(1+g) - g + \alpha\varepsilon(1+r)]/(1+g+\pi+g\pi))$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; α = share of foreign-currency denominated debt; and ε = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

3/ The real interest rate contribution is derived from the denominator in footnote 2/ as $r - \pi(1+g)$ and the real growth contribution as $-g$.

4/ The exchange rate contribution is derived from the numerator in footnote 2/ as $\alpha\varepsilon(1+r)$.

5/ For projections, this line includes exchange rate changes.

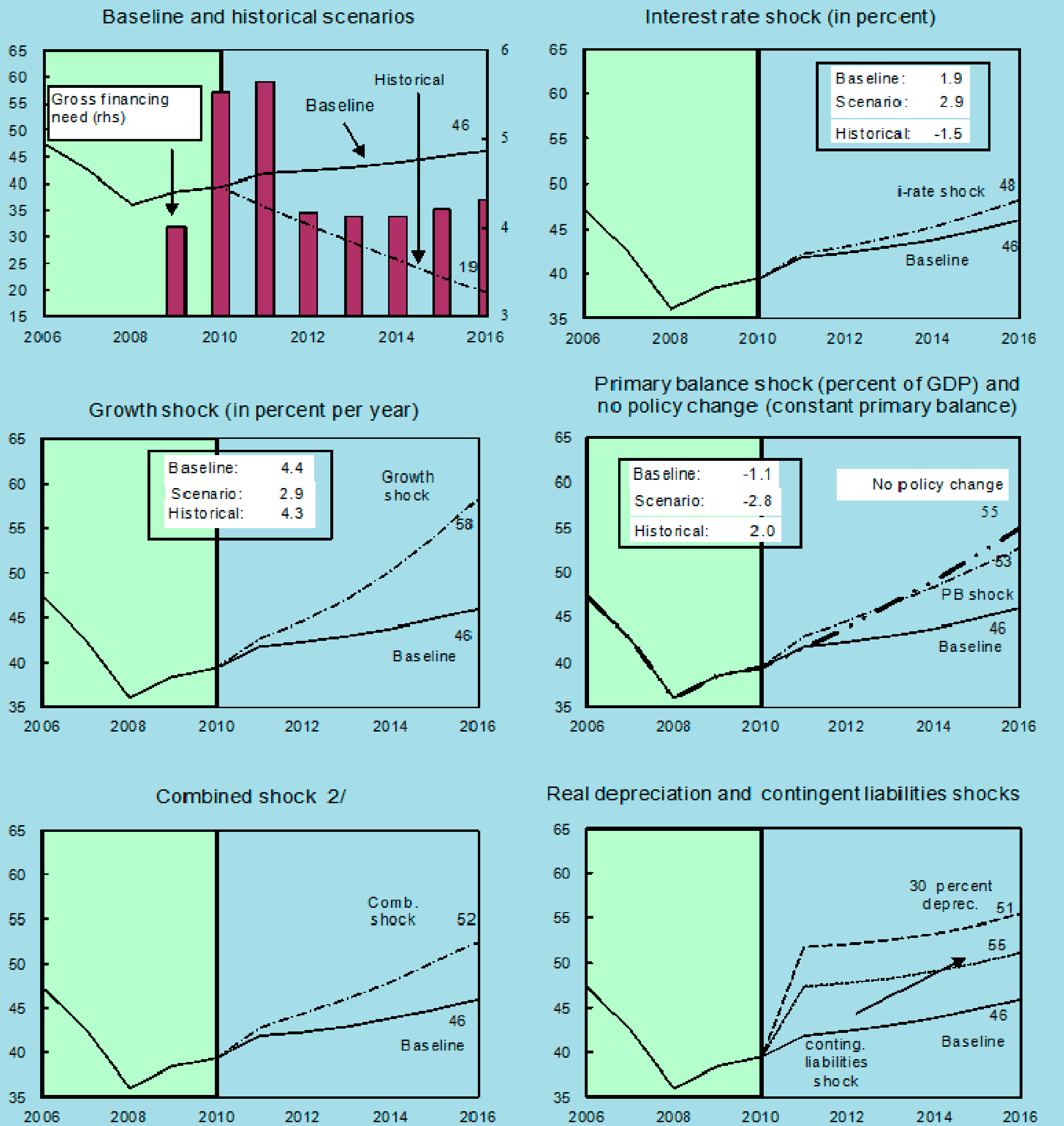
6/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.

7/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.

8/ Derived as nominal interest expenditure divided by previous period debt stock.

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.

Figure 8. Costa Rica: Public Debt Sustainability: Bound Tests 1/
(Public 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/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and primary balance.
3/ One-time real depreciation of 30 percent and 10 percent of GDP shock to contingent liabilities occur in 2009, with real depreciation defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

INTERNATIONAL MONETARY FUND

COSTA RICA

2011 Article IV Consultation—Informational Annex

Prepared by the Western Hemisphere Department
(In consultation with other departments)

May 11, 2011

Contents Page

I. Relations with the Fund

As of March 31, 2011

I. Membership Status: Joined: January 08, 1946, Article VIII.

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

III. SDR Department:	**SDR Million**	**%Allocation**
Net cumulative allocation	156.53	100.00
Holdings	132.58	84.70

IV. Outstanding Purchases and Loans: None

V. Latest Financial Arrangements:

Type	Approval date	Expiration date	Amount approved (SDR million)
Stand-By	Apr 11, 2009	Jul 10, 2010	492.30
Stand-By	Nov 29, 1995	Feb 28, 1997	52.00
Stand-By	Apr 19, 1993	Feb 18, 1994	21.04

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

	Overdue	Forthcoming				
		2011	2012	2013	2014	2015
Principal	0.00	0.00	0.00	0.00	0.00	0.00
Charges/Interest	0.00	0.08	0.11	0.11	0.11	0.11
Total	0.00	0.08	0.11	0.11	0.11	0.11

VII Exchange Rate Arrangement: Costa Rica's current exchange arrangement is classified as *other managed arrangement*. Since October 2006, the de jure exchange rate arrangement has been a crawling band with an increasing width. The ceiling and floor of the band have been adjusted several times, most recently in January 2009, when the crawl rate of the band's ceiling has been set at 0.20 colones (previously 0.06 colones) per business day. The floor of the band has been flat since July 2008. As of May 11, 2011, the intervention buying and selling exchange rates were 500.00 and 679.65 colones per

U.S. dollar respectively. Costa Rica maintains an exchange system free of restrictions on the making of payments and transfers for current international transactions.

VIII. Last Article IV Consultation: Concluded on September 23, 2009 (Country Report No. 09/303). The next Article IV consultation will take place in accordance with the July 15, 2002 decision on consultation cycles.

IX. FSAP Participation and ROSCs Assessments: The FSAP took place in October and December 2001, and was updated in February 2008. A data ROSC took place in July 2001 with a reassessment in April 2009. A fiscal ROSC took place in April 2006.

X. Recent Technical Assistance:

Department	Dates	Purpose
STA, CAPTAC	February 2011 September 2010 February 2010 December 2009	Regional Project on Harmonization of External Sector Statistics, specifically, Statistics of the BOP, International Investment Position, International Reserves, Foreign Currency Liquidity, and Foreign Debt
	January 2011 October 2010	Government Finance Statistics
	February 2008	Monetary and Financial Statistics
MCM, CAPTAC	April 2011 December 2010 March 2010	Financial Regulation and Supervision
	November 2010 August 2010	Monetary Policy Implementation: Liquidity and Foreign Exchange Management
	December 2008 November 2008 August 2008	Reorganization of SUGEF and Modernization of Supervisory Practices
	October 2008	Supervision of Foreign Exchange Risk and Foreign Exchange Operations
	September 2008	Central Bank FX Intervention
FAD, CAPTAC	November 2010 May 2010 February 2010 September 2009	Tax and Customs Administration
	October 2009	Public Finance Management
LEG	August 2010	AML/CFT Legal and Supervisory Framework

XI. Resident Representative: Fernando L. Delgado is the regional resident representative in Central America, Panama and the Dominican Republic.

II. Relations with the World Bank and Bank-Fund Collaboration under the JMAP

1. **The IMF's Costa Rica team led by Mr. Piñón (mission chief) has met on various occasions with the World Bank's Costa Rica team led by Mr. Lopez (lead economist and PREM sector leader)** to discuss macroeconomic challenges, identify macrocritical structural reforms, and coordinate the two teams' work for the period March 2011–February 2012.

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

3. **The teams have also discussed the risks to Costa Rica's inflation outlook stemming from higher global commodity prices, and the appropriate policy mix to contain second round effects.**

4. **Based on the shared assessment of macroeconomic challenges, the teams have identified 4 structural reform areas as macrocritical:**

- Fiscal consolidation. Costa Rica's fiscal position deteriorated due to larger than expected revenue losses during the global crisis and higher-than-anticipated increases in current spending. The priority now is to roll back the fiscal expansion of recent years and limit the risks to fiscal sustainability. Approval of a tax reform is critical, but there is also a need for a strategy to reduce current spending as a percent 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 recently and limit currency appreciation pressures.

- 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.

- Competitiveness. 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 position Costa Rica as a knowledge economy. There is also a high level commitment to improving the business environment and removing burdensome red tape. Given the sizable investments required to upgrade infrastructure and a 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). The government has already begun to open the insurance, electricity and telecommunication sectors to private investments.

5. The teams agreed the following division of labor:

- Fiscal consolidation. The Fund will continue to provide policy recommendations on macro-fiscal issues, including the overall strategy of fiscal consolidation and the tax reform. The government has also requested World Bank technical assistance to support the use of public-private partnerships as a vehicle to finance key infrastructure projects.

- 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.

- Competitiveness. The Bank will continue to work with the government on policy recommendations in key areas. In terms of lending, the government has requested a project in higher education that is currently under preparation. The government has also requested technical assistance from IFC Advisory services to improve the investment climate.

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

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

- The Bank team requests to be kept informed of the Fund's assessments of macroeconomic policies and prospects.

7. The attached table lists the teams' separate and joint work programs during March 2011–February 2012.

World Bank and IMF Planned Activities in Macro-Critical Structural Reform Areas, March 2011–February 2012

Title	Products	Provisional Timing of Missions	Expected Delivery Date
World Bank Work Program	Country Partnership Strategy International Investors Conference with the Council of the Americas	Preparatory work is ongoing June 30, 2011	Board Discussion is expected in July 2011 June 30, 2011
IMF Work Program	Staff visit Technical Assistance: Tax revenue and Customs Administration Strengthening Medium-term Expenditure Framework Risk-based policies and procedures for AML/CFT supervision Liquidity management, macro forecasting models and exchange rate market (CAPTAC) Improvements in National Accounts Improvement in PPI and import/export price indexes Migration to the GFSM 2001 analytical framework Improvement in monetary and financing statistics as part of regional project Improvement in external sector statistics as part of regional project	October 2011 2011-2012	

III. Relations with the Inter-American Development Bank

1. **Recent activities**. The IBD´s loan portfolio in Costa Rica has 8 sovereign guaranteed operations in execution, with an approved amount of US$798.6 million. The available amount for disbursements is US$697.3 million (87.3% of the approved), and is concentrated in the areas of Transportation (49.0%), Energy (33.6%) and Water and Sanitation (11.7%). The average age of the operations is 4.9 years. The IDB still has three operations pending legislative ratification: a program for water and sanitation, a cantonal road network program, and a sustainable tourism program. Disbursements of sovereign guaranteed operations during 2011 are expected to reach around US$102.5 million, concentrated in the areas of Energy (57.1%), Transportation (24.4%) and Reform and Modernization of the State (18.0%). Currently, there is one operation expected to be approved by the IDB during 2011, which is the program of Citizen Security (US$132.4 million).

2. **Future plans**. The IDB is currently preparing the Country Strategy 2011–14, which is expected to be approved by June 2011. During the strategy period, the IDB intends to be involved mainly in the areas of Transportation, Energy, Citizen Security, Social Protection and Innovation.

Sovereign Guaranteed Operations (as of April 19, 2011)
(In millions of U.S. dollars)

	Approved	**Disbursed**	**Obligated**	**Available**
Loans in execution	**798.6**	**101.3**	**0.0**	**697.3**
Tourism Program in Protected Areas	19.0	0.0	0.0	19.0
First Electric Power Sector Development Program 2008-2011	250.0	15.8	0.0	234.2
First Road Infrastructure Program	300.0	18.1	0.0	281.9
Cantonal Road Network Program	60.0	0.0	0.0	60.0
Water and Sanitation Program	73.0	0.0	0.0	73.0
Cadaster and Registry Regularization	65.0	45.3	0.0	19.7
Judiciary Modernization Program II	22.4	21.8	0.0	0.6
Sustainable Development of the Binational Watershed Rio Sixaola	9.2	0.3	0.0	8.9
Nonreimbursable Technical Cooperations	**34.8**	**7.1**	**0.1**	**27.6**
Total	**833.4**	**108.4**	**0.1**	**724.9**

Loan Disbursements (Sovereign Guaranteed Operations)

(In millions of U.S. dollars)

	2003	2004	2005	2006	2007	2008	2009	2010	2011*
Disbursements	88.4	100.2	41.6	22.5	12.9	18.0	40.6	55.7	102.4
Amortization	93.1	110.2	208.8	78.4	81.4	289.3**	46.0	45.3	64.2
Interest and charges	42.3	41.8	40.2	26.3	23.6	24.1	13.8	11.9	28.0
Net cash flow	-47.0	-51.8	-207.4	-82.2	-92.1	-295.4	-19.2	-1.5	10.2

* Projections (January 2011).
**Includes an anticipated repayment of US$200 million

Lending Program for 2011 (Tentative)

(In millions of U.S. dollars)

Project	Amount
Program of Citizen Security	132.4

IV. STATISTICAL ISSUES[1]

As of May 9, 2011

I. Assessment of Data Adequacy for Surveillance
General: Data provision is broadly adequate for surveillance, although it has some shortcomings in the areas of national accounts, price, government finance and balance of payments statistics.
National Accounts: National accounts are compiled generally in accordance with the System of National Accounts 1993 (SNA 1993). However, the reference year for the series at constant prices (1991) is outdated. Estimation of rentals for owner occupied dwellings should be improved. Accounting depreciation is used instead of estimating consumption of fixed capital. Double deflation method is not applied. Changes in inventories are obtained as residuals and the Chow Lin (without indicator) method is applied for benchmarking quarterly value added of activities, comprising a third of GDP. Non-observed/informal activities are not properly covered.
Price Statistics: The compilation of the consumer price index (CPI), in general, employs concepts and definitions from the 1993 SNA and the international CPI manual. However, the CPI lacks a market basket component to measure the cost of owner-occupied housing. Also, the index only covers urban households located in greater San Jose, which comprises approximately 46 percent of the total population and 72 percent of the urban population of Costa Rica. Individual price index data are not generally verified against similar data from other databases such as the producer price index (PPI) and agricultural price indices. Nevertheless, atypical movements in the data are investigated and corrected when necessary. Except for being compiled only by product aggregations and not by economic activity as well, the PPI is compiled based on concepts and definitions from the 1993 SNA and the international PPI Manual. However, the weights, the establishment sample, and the product sample for the PPI that were introduced in 2000 are based on 1997 sales data. Therefore, the index needs updating. A comprehensive assessment of the source data is being carried out, and is guiding the production of new source data to update the PPI and the national accounts. It is expected that the index will be updated in 2011.
Government Finance Statistics: The concepts and definitions used in compiling GFS generally follow the guidelines of the GFSM 1986. However, financing data and government debt, which use national concepts that combine instruments and holders, are not in accordance with international standards. A migration path to the GFSM 2001 has been adopted in the context of the GFS harmonization project for Central America, Panama, and the Dominican Republic. Monthly fiscal statistics are only compiled and

[1] Incorporates the assessment of Costa Rica's macroeconomic statistics provided by the Report on the Observance of Standards and Codes (ROSC) published in February 2010.

disseminated for budgetary central government, while annual statistics are compiled and disseminated for the entire public sector and its subsectors. The place of issue (Costa Rica or abroad) criterion is followed to classify domestic and foreign debt, instead of the internationally recommended residency criterion. Fiscal data discrepancies among national compilers on particular items are not regularly reconciled, although large fluctuations or discrepancies are investigated. Fiscal statistics are not regularly reconciled with monetary statistics, or other macroeconomic statistics.
Monetary Statistics: Costa Rica's monetary statistics are broadly in line with the methodology of the MFSM. Classification/sectorization follows the MFSM with some exceptions. The social security system accounts are not presented within the central government, but aggregated with other public sector accounts. Some financial assets and liabilities are not disaggregated by economic sector. Accrued interest is not classified together with its underlying instrument.
Balance of Payments: The balance of payments statistics broadly follow the concepts and definitions in the BPM5. While generally adequate and derived from sound collection programs, source data are incomplete to compile some services in the current account, financial transactions of the nonfinancial private sector, and remuneration of employees. Foreign direct investment transactions and positions are valued on a cash basis instead of the recommended accrual basis. Services are recorded at the time the service is provided. While other income transactions are recorded on an accrual basis, interest on public external debt is recorded on the due date; no adjustment is made to convert interest to accrued values. Transfer prices in some cases are not converted to market prices.

II. 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.

Table of Common Indicators Required for Surveillance
(As of April 19, 2011)

	Date of latest observation	Date received	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of Publication	Memo Items:	
						Data Quality – Methodological soundness[7]	Data Quality – Accuracy and reliability[8]
Exchange Rates	Apr 11	Apr 11	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	Apr 11	Apr 11	D	D	D		
Reserve/Base Money	Mar 11	Apr 11	D	D	D	O, LO, LO, LO	O, O, O, LO, O
Broad Money	Mar 11	Apr 11	M	M	M		
Central Bank Balance Sheet	Feb 11	Mar 11	M	M	M		
Consolidated Balance Sheet of the Banking System	Jan 11	Mar 11	M	M	M		
Interest Rates[2]	Apr 11	Apr 11	D	D	D		
Consumer Price Index	Mar 11	Apr 11	M	M	M	O, LO, O, O	LO, O, LO, LO,O
Revenue, Expenditure, Balance, and Composition of Financing[3] – General Government[4]	Dec 09	Jul 10	A	A	A	LO, LNO, LO, LO	LO, O, O, LO, O
Revenue, Expenditure, Balance, and Composition of Financing[3]– Central Government	Mar 11	Apr 11	M	M	M		
Stocks of Central Government and Central Government-Guaranteed Debt[5]	Jan 11	Mar 11	M	M	M		
External Current Account Balance	Dec 10	Mar 11	Q	Q	Q	O, LO, O, LO	LO, O, LO, O, LNO
Exports and Imports of Goods and Services	Dec 10	Mar 11	Q	Q	Q		
GDP/GNP	Dec 10	Mar 11	Q	Q	Q	O, LO, LNO, O	LO, O, LNO, O, LO
Gross External Debt	Dec 10	Mar 11	Q	Q	Q		
International Investment Position	Dec 10	Mar 11	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 The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
5 Including currency and maturity composition.
6 Daily (D); weekly (W); monthly (M); quarterly (Q); annually (A); irregular (I); and not available (NA).
7 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, 2009, for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O); largely observed (LO); largely not observed (LNO); not observed (NO); and not available (NA).
8 Same as footnote 7, except referring to international standards concerning source data, assessment of source data, statistical techniques, assessment and validation of intermediate data and statistical outputs, and revision studies.

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 11/69
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May 31, 2011

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

IMF Executive Board Concludes 2011 Article IV Consultation with Costa Rica and Ex-Post Evaluation of Exceptional Access under the 2009 Stand-By Arrangement

On May 25, 2011, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation and Ex-Post Evaluation of Exceptional Access under the 2009 Stand-By Arrangement with Costa Rica.[1]

Background

Costa Rica's economy weathered the global crisis well and its recovery is firmly underway. Following a 1.3 percent decline in 2009, real Gross Domestic Product (GDP) grew by 4.2 percent in 2010, initially led by a recovery in inventories and public consumption and later by private consumption. Annual inflation increased from 4 percent in 2009 to 4.6 percent at end-March 2011 (well within the 4-6 percent official target range).

Although the external current account deficit widened in 2010, the surplus in the capital account increased by more, as the private sector deleveraging observed in 2009 ended and net public sector inflows increased. As a result, the overall balance of payments recorded a surplus of 1.5 percent of GDP during the year. This surplus, together with some portfolio rebalancing toward local currency-denominated assets, pushed the colón to the appreciated end of the

[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. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

exchange rate band in late 2010. In response, the central bank lowered the policy interest rate and launched a program of foreign exchange purchases.

The fiscal deficit continued to widen during 2010. Tax revenues did not recover the levels observed prior to the crisis, and government spending, especially wages and current transfers, continued to increase. As a result, the consolidated public sector deficit rose to 5.5 percent of GDP, from 4 percent in 2009. Public sector debt at end-2010 reached 39.4 percent of GDP.

Financial sector indicators are strong, with adequate levels of liquidity and capitalization. Credit to the private sector remained sluggish in 2010 but began to pick up in 2011. Financial dollarization has resumed a declining trend.

Supported by the global economic recovery and strong inflows of foreign direct investment (FDI), real GDP is projected to grow by 4.3 percent in 2011 and stabilize at 4.5 percent over the medium term. Inflation is projected to rise above 7 percent in 2011 pushed by higher world commodity prices and a one-off impact from the tax reform (assumed to be approved in the second half of 2011), but is expected to fall gradually thereafter. The external current account deficit would increase to 4.8 percent of GDP in 2011 and stabilize at about 5.2 percent of GDP over the medium term, and is expected to be fully financed by FDI and other capital flows.

While the economic outlook is generally positive, some downside risks remain. These stem from the rise in commodity prices and abundant global liquidity, which pose risks for the inflation outlook and for macroeconomic policy more generally, particularly if the exchange rate band is maintained. Risks to the outlook could also arise from a weaker fiscal position, as the authorities' fiscal program would result in a gradual decline in the fiscal deficit and a moderate but steady rise in the public debt ratio.

Executive Board Assessment

Executive Directors welcomed Costa Rica's economic recovery and its favorable outlook, and stressed the importance of gearing macroeconomic policies toward containing domestic demand pressures. Given the challenges presented by high world commodity prices and significant capital inflows, Directors encouraged the authorities to tighten fiscal policy, move toward a more flexible exchange rate, and pursue a vigilant monetary policy.

Directors stressed the importance of safeguarding fiscal sustainability. They welcomed the tax reform proposal submitted to the Legislative Assembly, underscoring that its approval will be key. Directors supported the authorities' efforts to broaden the tax base and improve the equity of the tax system, as well as the planned actions to strengthen tax administration. Looking ahead, they advised the authorities to pursue a more ambitious medium-term fiscal consolidation strategy to help rebuild fiscal buffers. Directors pointed out that the authorities' fiscal program could result in a gradual rise in the public debt ratio, and stressed the need to exercise further expenditure restraint, particularly on current spending.

Directors noted the staff's assessment that the exchange rate appears to be broadly in line with fundamentals. They considered that upgrading the monetary policy framework and completing the transition to an inflation targeting regime should be key priorities. They welcomed the authorities' plans to narrow the corridor for short-term interest rates, and encouraged them to develop an effective communications strategy to address a move away from the exchange rate band and make the inflation target the centerpiece of the monetary policy framework. Directors agreed that recapitalizing the Central Bank is essential to bolstering its credibility.

Directors concurred that the banking system remains sound, and encouraged the authorities to continue strengthening supervision and prudential regulations. They stressed the importance of securing approval of the legislation to enhance consolidated supervision, establish a deposit insurance system, and strengthen the resolution framework. Directors encouraged the authorities to press ahead with implementing the remaining Financial Sector Assessment Program recommendations.

Directors welcomed that the authorities' economic program, supported by the precautionary Stand-By Arrangement of 2009-10, had successfully met its immediate objective of supporting macroeconomic stability at a time of global financial turmoil. At the same time, they noted that the fiscal position had deteriorated, particularly through the enactment of permanent, rather than temporary measures, and that progress in advancing structural reforms was slow during the program period.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case.

Costa Rica: Selected Economic Indicators

Per capita GDP (2010, U.S. dollars)	7,843	Unemployment (2010, percent of labor force)	7.3
Population (July 2010, millions)	4.6	Poverty (2009, percent of households)	18.5
Life expectancy (2009, years)	79.1	Extreme poverty (2009, percent of households)	4.2

	2006	2007	2008	2009	Est. 2010	Proj. 2011
	(Annual percentage change, unless otherwise indicated)					
National Income and Prices						
Real GDP growth	8.8	7.9	2.7	-1.3	4.2	4.3
GDP deflator	11.0	9.4	12.4	8.2	7.8	5.8
Consumer prices (end of period) 1/	9.4	10.8	13.9	4.0	5.8	7.5
External Sector						
Terms of trade (deterioration -)	-3.1	-2.8	-1.1	4.9	0.8	-3.1
Real effective exchange rate (eop; depreciation -)	0.8	1.5	3.8	2.1	12.3	…
Money and Credit						
Monetary base	26.9	33.0	11.9	5.1	11.2	9.7
Broad money	23.2	17.9	16.1	9.6	1.3	12.6
Bank credit to private sector	28.5	38.3	31.8	4.5	4.4	11.7
	(In percent of GDP)					
Public Finances						
Combined public sector primary balance 2/	4.4	5.0	2.8	-0.9	-2.7	-2.4
Combined public sector overall balance 2/	-0.7	1.2	0.2	-4.0	-5.5	-5.6
Central government	-1.4	0.3	-0.3	-3.6	-5.5	-5.2
Decentralized government entities	2.1	1.3	0.6	0.4	0.3	0.0
Public enterprises (excluding ICE)	-0.1	0.3	0.0	0.0	0.2	0.0
Central Bank	-1.1	-0.7	-0.2	-0.8	-0.5	-0.5
Combined public sector debt (excluding ICE) 2/	47.3	42.5	36.0	38.4	39.4	41.8
Of which: External public debt	12.0	9.7	8.6	7.2	7.1	6.7
Combined public sector debt (including ICE) 3/	50.7	45.3	39.5	42.5	42.8	45.3
Savings and Investment						
Gross domestic investment	26.4	24.7	27.6	15.9	20.0	20.2
Gross national savings	21.9	18.4	18.2	13.9	16.3	15.4
External Sector						
Trade balance	-12.1	-11.3	-16.8	-7.0	-10.0	-11.6
Current account balance	-4.5	-6.3	-9.3	-2.0	-3.6	-4.8
Foreign direct investment	6.1	6.2	6.9	4.6	4.1	4.6
	(In millions of U.S. dollars, unless otherwise indicated)					
Change in net international reserves (increase -)	-802	-999	315	-268	-561	-400
Net international reserves	3,115	4,114	3,799	4,066	4,627	5,027
In months of nonmaquila imports of G&S	3.5	3.8	4.7	4.0	4.2	4.1
Gross domestic product	22,526	26,322	29,838	29,241	35,780	40,167

Sources: Central Bank of Costa Rica; Ministry of Finance; and IMF staff projections.
1/ The projection for 2011 includes a one-off impact from the tax reform (assumed to be approved later in 2011).
2/Combined public sector comprises: the central government, the central bank, decentralized government entities, public enterprises, excluding the Instituto de Electricidad (ICE).
3/ Includes the debt by the Instituto de Electricidad (ICE) guaranteed by the government.

INTERNATIONAL MONETARY FUND
EXTERNAL RELATIONS DEPARTMENT

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Washington, D.C. 20431 USA

Staff Statement at the Conclusion of an IMF Mission to Costa Rica

An IMF mission visited San José during March 28-April 12 as part of the 2011 Article IV consultation discussions with Costa Rica. The mission met with Vice President Luis Liberman, Minister of Finance Fernando Herrero, Central Bank President Rodrigo Bolaños, other senior officials, members of congress, academics and representatives of the private sector. At the end of the visit, Marco Piñón, chief of the IMF mission, issued the following statement:

"Economic activity in Costa Rica recovered in 2010 led by private consumption, while inflation remained within the official target range. With the normalization of external trade, the current account deficit widened, but was comfortably financed by large foreign direct investment (FDI) and other private capital inflows. Reflecting this, the exchange rate appreciated and moved to the limit of the exchange rate band, despite significant foreign exchange intervention. In addition, the deficit of the combined public sector increased to 5.5 percent of Gross Domestic Product (GDP), owing to subdued tax revenues and higher government expenditures.

"The medium-term economic outlook for Costa Rica is broadly positive, underpinned by the global recovery and robust FDI inflows. Real GDP growth is expected to hover around 4–4.5 percent in 2011 and over the medium term, while inflation is projected to increase in 2011, pushed by higher global food and fuel prices, but to decline in subsequent years. FDI and other private capital flows are likely to remain strong.

"Near term risks are mainly related to a higher than expected impact of international food and fuel prices on inflation. In the medium and long term, the key challenge is to lower the fiscal deficit significantly. In this regard the mission considers that the draft tax reform recently sent to Congress is key to secure a higher revenue base that increases the country's capacity to respond to adverse shocks. However, efforts on the revenue side will need to be supplemented by prudent expenditure policies, including through a medium-term framework to help reduce the share of current government spending over GDP.

"The mission encouraged the authorities to continue strengthening the monetary policy and financial supervision frameworks. Approval of bills before Congress aimed at enhancing consolidated supervision, establishing a deposit insurance system, and strengthening the banking resolution framework would help bring Costa Rica's financial regulation in line with best international practices, and to protect the stability of the financial system.

"The IMF will continue its close policy dialogue with the authorities of Costa Rica. Upon its return to Washington, staff will prepare a report to the IMF's Executive Board, which will serve as a basis for a Board discussion in late May."

Statement by Mr. Perez-Verdia and Mr. Gramajo-Marroquin on Costa Rica
Executive Board Meeting
May 25, 2011

We would like to thank staff for their comprehensive set of papers and for the constructive dialogue with our authorities. We broadly agree with staff's assessment and recommendations.

Ex Post Evaluation of Exceptional Access Under the 2009 Stand-By Arrangement.

1. Although we cannot evaluate outcomes had a program not been in place, we can ascertain that the program was successful in helping the country maintain confidence in the government´s response to the crisis by increasing existing liquidity buffers. In this context, we believe the program helped Costa Rica take advantage of its strong fundamentals to mitigate the adverse effects stemming from the global crisis and preserve financial stability.

2. The policy mix during the crisis was adequate. A tighter monetary stance and an expansionary fiscal policy (using fiscal spaces created before the crisis) helped Costa Rica face the economic slowdown while safeguarding confidence. As a result, external risks did not materialize and the economy began to recover quickly after the crisis. We reiterate our view that IMF support during program discussions and the length of the SBA was instrumental to face this period successfully.

3. Ex post evaluation of the quality of the stimulus package is always likely to reveal weaknesses, but the nature and size of the stimulus package, like in other countries, reflected operational constraints given the very immediate nature of the challenge. Fiscal deterioration at the time was mainly driven by lower-than-envisaged tax collections. We believe that the greatest uncertainty during this period was about the duration and severity of the crisis and whether the drop in tax collections was permanent or temporary.

4. Our authorities made efforts to improve monetary policy effectiveness, although the transition toward inflation targeting did not accelerate. In particular, as staff rightly pointed out, the single rate crawling peg was replaced by a crawling band, open market operations were streamlined, the Central Bank established an overnight lending facility (which was recently complemented with a deposit facility), and a draft law to recapitalize the BCCR was submitted to Congress.

5. We think that streamlined conditionality in HAPAs allows member countries to achieve short-term goals more effectively. We have no doubt that Costa Rica's 2009 SBA helped withstand the crisis better than a traditional SBA by providing substantial liquidity buffers thereby effectively insuring the country against external risks. Moreover, there is evidence of the success of the program: the SBA remained precautionary and on track and the financial system stayed strong with ample liquidity throughout.

6. In sum, taking into account the high level of uncertainty during the crisis, we believe that the modality, design and implementation of the program, were adequate to guarantee its success.

2011 Article IV Consultation

Recent Developments

After a 1.3 percent decline in 2009, Costa Rica's economy grew 4.2 percent in 2010 and is expected to grow 4.3 percent in 2011.

Inflation increased to 5.8 percent in 2010, within the 4-6 target range. Although inflation decreased to 4.7 percent at end-April 2011, significant risks stem from increases in international food and fuel prices, which have recently increased inflation expectations and put at risk the Central Bank's 2011 inflation target.

As staff pointed out, domestic currency appreciation pressures continue due mainly to higher private capital inflows and some portfolio rebalancing toward domestic currency denominated assets.

The current account deficit was 3.6 percent of GDP in 2010, which was more than compensated by the surplus in the capital account due to private capital inflows. Hence, the overall balance of payments showed a surplus of more than 1.5 percent of GDP.

The banking sector remains liquid and well capitalized, and nonperforming loans have stabilized below 2 percent of total loans.

Fiscal Policy

The consolidated public sector deficit for 2011 is projected at 5.6 percent (similar to fiscal outturn for 2010: 5.5 percent). According to staff's view, fiscal outturn is still expansionary, given the strong domestic demand. Our authorities are taking measures this year, such as freezing employment levels in central administration and reducing operational expenditures below margins contemplated in the budget, which should generate some savings. Nevertheless, room for further current expenditure reductions is limited, given existing rigidities of public expenditures.

Our authorities understand the importance of stabilizing public sector debt at prudent levels. They presented in January their National Fiscal Sustainability Policy, a comprehensive strategy with the aim of increasing tax revenues and controlling current spending over the medium term. It contemplates a comprehensive tax reform and tax administration measures, which authorities expect will yield 2.5 percent of GDP and 1 percent of GDP, respectively. Our authorities believe that there is significant room to improve tax administration, in particular by reducing tax evasion. In this sense, they are in the process of adopting a new information system that would enhance information crosschecks and tax compliance controls. They are also taking measures to control current expenditure in the short and medium terms.

We believe that the proposed tax reform, submitted in January, will increase efficiency and enhance equity by eliminating current distortions in the tax system. It modernizes the sales tax, bringing it more in line with international VAT practices and broadening its base to include services. While broadening the VAT base, our authorities have protected the most vulnerable by exempting from the VAT a small consumption basket, basic electricity and water consumption, as well as some private schools. On income taxes, the tax reform levels the playing field on capital income by proposing a single tax rate of 15 percent on dividends, capital gains, and interest income.

Our authorities are aware that achieving their ambitious fiscal strategy is challenging, but remain confident that it will bring about significant fiscal consolidation with the stabilization of Costa Rica´s public debt. In the short term, the strategy is expected to reduce the deficit by about 0.5 percent of GDP in 2011 due to the combination of tax administration improvements and expenditure cuts. Furthermore, our authorities stand ready to make further efforts on the expenditure side should it become necessary.

Monetary and Exchange Rate Policies

Our authorities remain committed to maintaining low and stable inflation. They kept the 4-6 percent target range for 2011 and have adopted measures to enhance monetary management, including the establishment of a deposit facility that, jointly with the lending facility, generated a corridor for short-term interest rates, and introduced new instruments to neutralize excess liquidity.

Increases in international food and fuel prices and relaxed global financial conditions pose significant risks to inflation in 2011. In this context, our authorities are willing to tighten the monetary policy stance as soon as signs of second-round effects are evident.

In line with their inflation objective, authorities share the view that a more flexible exchange rate would help anchor inflation expectations, and they convey their intention to eliminate the exchange rate band before the adoption of a full-fledged inflation targeting regime. However, they consider the current economic environment inappropriate for such shift in the exchange rate regime. In particular, currently high global liquidity and a significant shift in the portfolio of Costa Rican residents toward local currency—denominated assets are seen as temporary factors pressing the exchange rate against the most appreciated side of the band. A more flexible exchange rate regime would lead to further appreciation—on top of a 14 percent real appreciation already observed since April 2009—that might very well revert once liquidity conditions normalize in advanced countries.

Financial Sector

The financial system weathered the global crisis well, but we acknowledge that further progress on improving financial legislation is warranted, particularly to enhance consolidated supervision and strengthen the bank resolution framework. In this context, our authorities are committed to seek approval from the National Assembly of the related draft laws. Meanwhile, they are working to introduce risk-base supervision and are planning to monitor system risk and introduce Base III capital and liquidity buffers. Our authorities are of the view that advances in the adoption of main recommendations of the 2008 FSAP update are greater than reported by the staff (Box 3).