COSTA RICA

Table 1	2020
Population, million	5.1
GDP, current US$ billion	61.8
GDP per capita, current US$	12127.6
International poverty rate ($1.9)[a]	1.0
Lower middle-income poverty rate ($3.2)[a]	3.2
Upper middle-income poverty rate ($5.5)[a]	10.6
Gini index[a]	48.2
School enrollment, primary (% gross)[b]	116.2
Life expectancy at birth, years[b]	80.1

Source: WDI, Macro Poverty Outlook, and official data.
Notes:
(a) Most recent value (2019), 2011 PPPs.
(b) WDI for School enrollment (2019); Life expectancy (2018).

The COVID-19 crisis interrupted Costa Rica's incipient economic recovery and fiscal consolidation, with GDP contracting 4.6 percent in 2020. Job and income losses among the vulnerable resulted in higher poverty and inequality, despite adequate policy response. Growth is expected to recover in 2021 and 2022 led by stronger external demand, including tourism, and a rebound in investment, as structural reforms and fiscal consolidation efforts rebuild market confidence. Poverty reduction hinges on deepening the equity lens of reforms.

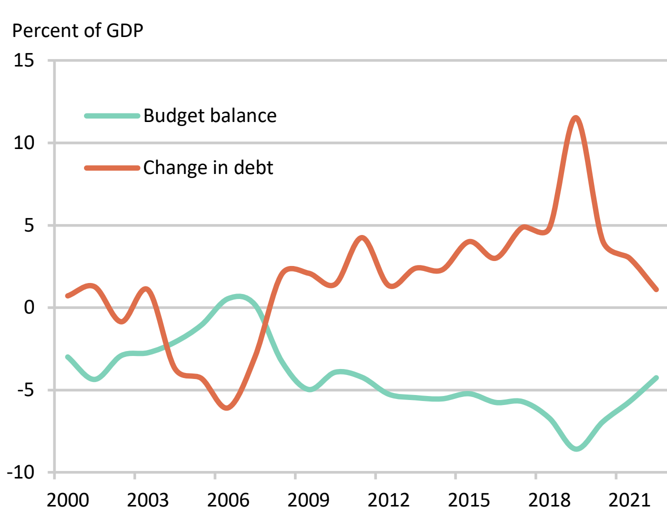
Key conditions and challenges

Costa Rica stands out in the region for its good governance and solid institutions, which are key elements of its successful outward-oriented growth model. Trade openness and foreign investment, together with significant investment in human capital and institutions, have allowed the country to double its income per capita in the last two decades. Costa Rica has also been at the forefront of efforts to promote the sustainable use of natural resources and of the fight against climate change, key elements of the country's long-term development plan. After averaging 4 percent per year between 2010 and 2016, GDP growth slowed in the following years as external shocks negatively affected the agricultural sector and further worsened an already weak fiscal situation. The approval of a major fiscal reform, which introduced a VAT, increased income tax, and introduced spending ceilings through a sound fiscal rule, alleviated fiscal sustainability concerns and reduced economic uncertainty, accelerating growth in 2019 and early 2020. The recent accession to the OECD has underpinned reforms that further reinforce growth prospects.
However, the COVID-19 outbreak temporarily interrupted fiscal consolidation efforts as revenues decreased, pandemic-related government expenditures expanded, and the public debt increased further pressuring the country's expensive interest bill. Even though Costa Rica's strong health system and timely response helped mitigate social impacts, poverty increased. A new IMF Extended Fund Facility (EFF) for three years, with expected approval in the first half of 2021, is projected to catalyze multilateral financing, mitigating concerns about Costa Rica's return to fiscal consolidation and providing cushion to downside risks, such as associated with more prolonged Covid-19 crisis that delays the economic recovery until the second half of 2021. Further delays in economic growth could also reduce households' income and employment opportunities, particularly for informal workers, self-employed, and small businesses, with lingering poverty and inequality impacts.

Recent developments

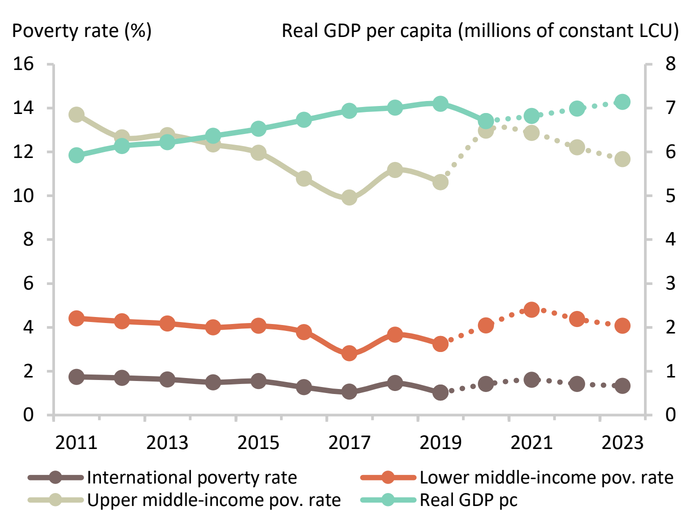
Despite the government's proactive response, the COVID-19 pandemic had a heavy toll on Costa Rica's economy. GDP is estimated to have contracted 4.6 percent in 2020, the largest drop in four decades, driven by sharp declines in investment (-4.8 percent) and private consumption (-4.4 percent). Amid increased global economic uncertainty, private investment contracted. Reduced consumption reflects the severe deterioration of labor markets and family incomes. One out of five workers were unemployed by Q4 2020, with youth, women, and individuals with incomplete secondary education affected the most. Despite strong mitigation-efforts, an estimated 124,000 people fell into poverty

FIGURE 1 Costa Rica / Budget balance and change in debt



Source: World bank.

FIGURE 2 Costa Rica / Actual and projected poverty rates and real private consumption per capita



Source: World Bank. Notes: see Table 2.

($5.5/day PPP), leading Costa Rica's poverty rate to rise to 13 percent in 2020 from 10.8 percent in 2019.

The country's response to the crisis was timely and adequate but deteriorated the country's already weak fiscal position. The economic slowdown and tax deferrals decreased revenues, while health-related spending and social transfers pressured expenditures, despite efforts to contain non-priority spending through wage freezes and budgetary reallocations. The fiscal deficit in 2020 expanded to 8.6 percent of GDP, pushing government debt to 67.9 percent of GDP and the interest bill to 4.7 percent.

The effects of the COVID-19 pandemic on the country's external position were reflected in a slight increase in the current account deficit to 2.5 percent of GDP in 2020, as exports deteriorated more than imports. With increased net portfolio outflows and lower FDI, external borrowing helped finance the current account deficit, maintaining reserves at around 7,2 billion (11.8 percent of GDP). The relatively resilient goods exports (led by medical equipment and implements, and food industry) helped mitigate the impact of a sharp drop in services exports, which decreased more than 25 percent y-o-y driven by tourism (estimated declined of 60% y-o-y).

Outlook

GDP is projected to recover by 2.6 percent in 2021, supported by an improvement in foreign demand and less stringent credit conditions. This would support a gradual recovery of the confidence of economic agents and resume investment. As the vaccination campaign rolls out worldwide and tourism recovers, growth is projected to accelerate to 3.3 percent in 2022. The impact of new waves of the COVID-19 on economic activity is expected to be more moderate, as countries have learned how to operate in the new constrained physical-distancing setting. With Costa Rica's main trading partners already recovering, total exports are expected to increase by 8 percent in 2021. Over time, these improvements would positively affect sectors like hotels, restaurants, and transport. Poverty is expected to decrease slowly but would not reach pre-pandemic levels during the forecast period. The heterogenous impact of the COVID-19 would push inequality to its highest in a decade. Social and economic support measures can help contain these effects but are limited by fiscal space.

The government is anticipated to resume its fiscal consolidation plan in 2021, primary spending is expected to decline 3.1 percent of GDP over the 2021-23 period, supported by the fiscal rule and the public employment reform. These efforts, combined with revenue improvements, are projected to yield a primary surplus of 1 percent of GDP in 2023. Public debt is expected to peak at 76.1 percent of GDP in 2023 and gradually decline thereafter.

Extended impacts of the COVID-19 would delay economic recovery and lead to greater fiscal stress, possibly increasing public debt above 80 percent of GDP. Difficulties in reaching consensus around key reforms, including those supported by the IMF program are also a risk. Costa Rica's diversified productive structure, a good level of international reserves and stable financial system, work as mitigating factors.

TABLE 2 Costa Rica / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2018	2019	2020 e	2021 f	2022 f	2023 f
Real GDP growth, at constant market prices	2.1	2.2	-4.6	2.6	3.3	3.1
Private Consumption	1.6	1.6	-4.4	2.5	2.6	2.8
Government Consumption	0.5	5.3	1.0	-0.9	-0.8	-0.6
Gross Fixed Capital Investment	0.8	-5.4	-4.8	5.1	4.4	4.6
Exports, Goods and Services	4.7	3.0	-11.0	8.0	8.4	6.6
Imports, Goods and Services	0.2	-0.5	-9.7	7.7	5.8	5.4
Real GDP growth, at constant factor prices	2.2	2.2	-4.4	2.4	3.3	3.0
Agriculture	2.0	-1.2	-0.9	2.6	2.6	2.1
Industry	1.9	-0.8	-1.4	3.9	4.7	5.0
Services	2.3	3.3	-5.4	2.0	2.9	2.5
Inflation (Consumer Price Index)	2.2	1.5	0.7	1.5	2.0	1.8
Current Account Balance (% of GDP)	-3.0	-2.3	-2.5	-3.2	-3.0	-2.9
Net Foreign Direct Investment (% of GDP)	3.5	3.9	2.9	3.2	3.8	4.3
Fiscal Balance (% of GDP)	-5.7	-6.7	-8.6	-6.9	-5.7	-4.2
Debt (% of GDP)	51.7	56.5	67.9	72.0	75.0	76.1
Primary Balance (% of GDP)	-2.3	-2.6	-3.9	-1.7	-0.3	1.0
International poverty rate ($1.9 in 2011 PPP)[a,b]	1.5	1.0	1.4	1.6	1.4	1.3
Lower middle-income poverty rate ($3.2 in 2011 PPP)[a,b]	3.7	3.2	4.1	4.8	4.4	4.1
Upper middle-income poverty rate ($5.5 in 2011 PPP)[a,b]	11.2	10.6	13.0	12.9	12.2	11.7

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.
Notes: e = estimate. f = forecast.

(a) Calculations based on SEDLAC harmonization, using 2019-ENAHO.Actual data: 2019. Nowcast: 2020. Forecast are from 2021to 2023.

(b) Projection using microsimulation model.