The Central Bank’s Macroeconomic Program: An Overview of 2018 and Perspectives for 2019-20

Rodrigo Cubero Brealey
President, Central Bank of Costa Rica

This Program was approved unanimously by the Board of Directors of the BCCR on January 25, 2019.
Content

- 2018: An overview
  - External developments
  - The Costa Rican economy
- Perspectives for 2019-2020
External Developments 2018
External Developments 2018

Global economic activity lost traction in 2018:
- Growth declined to 3.7% (3.8% in 2017).
- Deceleration in China and Euro Area.
- However, US economy accelerated from 2.2% in 2017 to 2.9% in 2018.

Monetary policy normalization in advanced economies:
- Interest rates tend to increase.
- ECB completed asset accumulation program.
World Trade in Goods and Services
(Percent Variation in Volume)

Source: Central Bank of Costa Rica, based on IMF data from October 2018.
Rise in commodity prices, mainly oil.

Trade disputes between USA and China.

Political and social tensions in Nicaragua.
The Costa Rican Economy

2018
Domestic Economy 2018

Economic situation affected by high uncertainty due to...

- Elections during first quarter of the year.
- Worsening fiscal situation.
- Central Government’s financing problems.
- Public servants’ strike against fiscal reform.
Domestic Economy 2018

Uncertainty led to...

Dollarization of savings.

Deceleration in credit to private sector.

Higher risk premia on government debt.

Upward pressure on local interest rates.
Macroeconomic Outcomes

Inflation 2018

2.0% (2.6% in 2017)

Low, stable and within target range (3% ± 1p. p.).

Core inflation: 2.3%

Inflation expectations 3.7%
Inflation
(Y-o-Y Change in Consumer Price Index, %)

Target Range for CPI Inflation

Source: Central Bank Of Costa Rica and National Institute of Statistics and Census
Macroeconomic Outcomes

Economic Growth 2018

2.7% (3.4% in 2017)

Key Factors

Public sector strike

-0.4 p.p.

Tensions in Nicaragua

-0.2 p.p.

Worsening fiscal situation, uncertainty, oil prices, global economic slowdown, rising international interest rates.
<table>
<thead>
<tr>
<th></th>
<th>2017</th>
<th>2018</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current Account Deficit</td>
<td>3.0% GDP</td>
<td>3.1% GDP</td>
</tr>
<tr>
<td>FDI inflows</td>
<td>4.9% GDP</td>
<td>4.5% GDP</td>
</tr>
<tr>
<td>Net international reserves</td>
<td>12.3% GDP</td>
<td>12.5% GDP</td>
</tr>
</tbody>
</table>
### Macroeconomic Outcomes

#### Public Sector 2018

<table>
<thead>
<tr>
<th></th>
<th>2017</th>
<th>2018</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Central Government Deficit</strong></td>
<td>6.1% GDP</td>
<td>6.0% GDP</td>
</tr>
<tr>
<td><strong>Primary Deficit</strong></td>
<td>3.0% GDP</td>
<td>2.4% GDP</td>
</tr>
<tr>
<td><strong>Central Government Debt</strong></td>
<td>48.7% GDP</td>
<td>53.6% GDP</td>
</tr>
</tbody>
</table>
Relative stability during first semester

July to November: volatility, upward pressure on exchange rate.

December: relative FX affluence.
Monex: Weighted Average Exchange Rate
(Colones per USD dollar)

Source: Central Bank of Costa Rica
MACROECONOMIC PROGRAM
Perspectives for
2019-2020
Export markets expected to grow at similar rates as in 2018: **2.5%**

US GDP growth expected to decline:

- **2.9%**
  - 2018
- **2.5%**
  - 2019
- **1.8%**
  - 2020

Continued normalization of monetary policy in advanced economies → international interest rates will continue to rise.
Global GDP Growth (in %)

- **World**: 4.4, 3.3, 2.8, 2.5, 2.6, 2.4
- **Advanced economies**: 4.7, 3.7, 2.3, 2.0, 1.7
- **Emerging market and developing economies**: 4.6, 3.5, 2.6, 2.0, 1.7
- **Trade Partners**: 4.9, 3.6, 2.6, 2.0, 1.7

Trading partners’ inflation to remain at **2.8%** for 2019-2020.

Change in average price of imported fuel:

- **17.7%** in 2019
- **2.3%** in 2020

Nicaraguan economy will continue to face challenges.

Continued geopolitical and trade tensions.
Inflation and Monetary Policy

BCCR’s main objective: low and stable inflation

- Protects purchasing power of income.
- Facilitates economic calculus, reduces uncertainty.
- Stimulates growth.

Inflation target

3% ± 1p.p.
Inflation

Target range

2% to 4%

Consistent with BCCR’s commitment to low and stable inflation.

2018: 2.0%

Demand pressures and inflation expectations consistent with inflation remaining within target range.

Impact of new VAT (Law 9635) on price level: 1.1% (70% of which would materialize between July 2019 and June 2020).

BCCR will remain alert to the evolution of key inflation determinants.
Non-Conditional Inflation Forecast
(YoY change in CPI, in %)

Source: Central Bank of Costa Rica
## Macroeconomic Program 2019-2020

### Policies to achieve inflation target

<table>
<thead>
<tr>
<th>Adjustment in policy rate if analysis identifies deviations between inflation forecast and target.</th>
<th>Exchange rate market intervention for three motives:</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>• Agent for non-financial public sector.</td>
</tr>
<tr>
<td></td>
<td>• Meet own needs.</td>
</tr>
<tr>
<td></td>
<td>• Prevent excessive fluctuations.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Pursue improvements in operations and price formation in key markets (FX, liquidity, and debt).</th>
<th>Proactive management of liquidity control instruments, in coordination with Finance Ministry.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Strengthen communication with the public.</td>
</tr>
</tbody>
</table>
Macroeconomic Program 2019-2020

Costa Rica

GDP Growth

Higher than estimate for 2018 (2.7%), but below Costa Rica’s potential GDP growth rate (3.5%).

Projection 2019: 3.2%

Projection 2020: 3.0%
Government’s consumption expenditure reflects “rebound” from negative effects of the 2018 strike, despite efforts to rein in expenditure.
Without the 2018 strike, economic growth would have been...

2018:
- 3.1% (Instead of 2.7%)

2019:
- 2.8% (Instead of 3.2%)
Household Consumption

Costa Rica

GDP Growth and Disposable Income

Propelled by:
Improvement in terms of trade → boosts disposable income.

Dampened by:
- High household indebtedness (60% disposable income).
- Negative effect of fiscal reform (0.29% in 2019 and 0.61% of GDP in 2020).
Disposable Income and Private Consumption

(Level and % Change)

Level (in constant colones)

% Change

Billion of Colones of 2018


2018 2019 2020 2021 2022 2023

Source: Central Bank of Costa Rica
GDP Growth and Disposable Income

Macroeconomic Program 2019-2020

Costa Rica

Rate of growth 3.7%

Private Investment growth to moderate on less dynamic private construction activity.

Private Investment (% Change)

Source: Central Bank of Costa Rica
Public Investment
a strong recovery in 2019 (mainly road infrastructure programs).

GDP Growth and Disposable Income

Macroeconomic Program 2019-2020
Costa Rica

Rate of growth 7.3%

Public Investment
% Change

Source: Central Bank of Costa Rica
Contribution to GDP Growth by Expenditure Components

(Contribution in p.p.)

<table>
<thead>
<tr>
<th>Year</th>
<th>Net External Demand</th>
<th>Inventories</th>
<th>Household Consumption</th>
<th>Public Investment</th>
<th>Private Investment</th>
<th>General Government Consumption</th>
</tr>
</thead>
<tbody>
<tr>
<td>2018</td>
<td>2.7</td>
<td>0.5</td>
<td>1.4</td>
<td>-0.5</td>
<td>0.3</td>
<td>-0.7</td>
</tr>
<tr>
<td>2019</td>
<td>3.2</td>
<td>0.5</td>
<td>1.6</td>
<td>0.3</td>
<td>0.7</td>
<td>1.5</td>
</tr>
<tr>
<td>2020</td>
<td>3.0</td>
<td>0.2</td>
<td>1.5</td>
<td>0.1</td>
<td>0.4</td>
<td>0.1</td>
</tr>
</tbody>
</table>

Source: Central Bank of Costa Rica
### Effects of Fiscal Reform on Private and Public Consumption (in % of GDP)

<table>
<thead>
<tr>
<th></th>
<th>2019</th>
<th>2020</th>
</tr>
</thead>
<tbody>
<tr>
<td>Households Consumption Expenditure</td>
<td>-0.29%</td>
<td>-0.61%</td>
</tr>
<tr>
<td>General Government Expenditure</td>
<td>-0.26%</td>
<td>-0.71%</td>
</tr>
<tr>
<td>Total Effect</td>
<td>-0.55%</td>
<td>-1.31%</td>
</tr>
</tbody>
</table>
Fiscal Reform Impact over Economic Growth

<table>
<thead>
<tr>
<th>Year</th>
<th>Cumulative Effect</th>
<th>Marginal Effect</th>
</tr>
</thead>
<tbody>
<tr>
<td>2019</td>
<td>-0.11%</td>
<td>-0.11%</td>
</tr>
<tr>
<td>2020</td>
<td>-0.14%</td>
<td>-0.03%</td>
</tr>
<tr>
<td>2021</td>
<td>-1.38%</td>
<td>-1.24%</td>
</tr>
<tr>
<td>2022</td>
<td>-2.30%</td>
<td>-0.92%</td>
</tr>
<tr>
<td>2023</td>
<td>-2.64%</td>
<td>-0.34%</td>
</tr>
</tbody>
</table>

Source: Central Bank of Costa Rica
Macroeconomic Program 2019-2020

Costa Rica

GDP Growth and Disposable Income

Economic Activity by Industry

GDP growth expected to be led by education and health services (recovery effect after public sector strike). Professional and business support services also expected to show more dynamism.


<table>
<thead>
<tr>
<th></th>
<th>2018</th>
<th>2019</th>
<th>2020</th>
</tr>
</thead>
<tbody>
<tr>
<td>PIB</td>
<td>2.7</td>
<td>3.2</td>
<td>3.0</td>
</tr>
<tr>
<td>Agriculture</td>
<td>0.1</td>
<td>0.1</td>
<td>0.1</td>
</tr>
<tr>
<td>Manufacture</td>
<td>0.3</td>
<td>0.4</td>
<td>0.5</td>
</tr>
<tr>
<td>Retail</td>
<td>0.2</td>
<td>0.2</td>
<td>0.2</td>
</tr>
<tr>
<td>Business Services</td>
<td>0.5</td>
<td>0.6</td>
<td>0.5</td>
</tr>
<tr>
<td>Education and Health</td>
<td>0.1</td>
<td>0.7</td>
<td>0.3</td>
</tr>
<tr>
<td>Others</td>
<td>1.5</td>
<td>1.2</td>
<td>1.4</td>
</tr>
</tbody>
</table>
### Balance of Payments

**Costa Rica**

#### Current Account Deficit

<table>
<thead>
<tr>
<th>Year</th>
<th>GDP</th>
<th>2018</th>
<th>2019</th>
<th>2020</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>% of GDP</td>
<td>3.1%</td>
<td>2.9%</td>
<td>2.8%</td>
</tr>
</tbody>
</table>

Lower than 2018 (3.1%), due to higher expected net service exports.

Deficit in goods trade but increasing surplus in services trade.
Costa Rica

Macroeconomic Program 2019-2020

Expected nominal growth

Undated

<table>
<thead>
<tr>
<th>Year</th>
<th>Imports</th>
<th>Exports</th>
</tr>
</thead>
<tbody>
<tr>
<td>2018</td>
<td>4.1%</td>
<td>6.0%</td>
</tr>
<tr>
<td>2019</td>
<td>4.1%</td>
<td>6.0%</td>
</tr>
<tr>
<td>2020</td>
<td>5.7%</td>
<td>6.1%</td>
</tr>
</tbody>
</table>

Increase in capital goods imports related to public infrastructure projects

Continued strength in exports from FTZs
Macroeconomic Program 2019-2020

Costa Rica

Balance of Payments

Foreign Direct Investment

- 2018: 4.5% of GDP
- 2019: 4.4% GDP
- 2020: 4.0% GDP

Net International Reserves

- 2018: 12.5% of GDP
- 2019: 14.2% GDP
- 2020: 12.9% GDP
Assumption that Government will issue debt in international markets:

USD 1.5 billion
in each of 2019 and 2020.

Access to multilateral budget support loans for USD 450 million.

Resources will be fundamental to help meet the Government’s funding needs and reduce pressure on local interest rates.

Net savings for private sector will remain around 1.8% of GDP.
Fiscal Projections

If all its provisions are strictly applied, the fiscal reform approved in December 2018 (Law 9635) will help restore long-term fiscal sustainability.

<table>
<thead>
<tr>
<th>Year</th>
<th>GDP</th>
<th>2018</th>
<th>2019</th>
<th>2020</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>%</td>
<td>6.0%</td>
<td>6.2%</td>
<td>5.8%</td>
</tr>
</tbody>
</table>

Excludes interest payments

<table>
<thead>
<tr>
<th>Year</th>
<th>GDP</th>
<th>2018</th>
<th>2019</th>
<th>2020</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>%</td>
<td>2.4%</td>
<td>2.1%</td>
<td>1.2%</td>
</tr>
</tbody>
</table>

Central Government’s Deficit

2019 6.2% GDP
2020 5.8% GDP

Primary Deficit

2019 2.1% GDP
2020 1.2% GDP
Central Government: Projections for Total Debt and Primary Balance
(in % of GDP)

Source: Central Bank of Costa Rica
### Central Government: Gross Financing Needs

*(in % of GDP)*

<table>
<thead>
<tr>
<th></th>
<th>2017</th>
<th>2018</th>
<th>2019</th>
<th>2020</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Gross Financing Requirements</strong></td>
<td>11,6</td>
<td>12,3</td>
<td>12,7</td>
<td>11,9</td>
</tr>
<tr>
<td><strong>Deficit</strong></td>
<td>6,1</td>
<td>6,0</td>
<td>6,2</td>
<td>5,8</td>
</tr>
<tr>
<td><strong>Debt Amortization</strong></td>
<td>5,5</td>
<td>6,3</td>
<td>6,5</td>
<td>6,1</td>
</tr>
<tr>
<td><strong>Sources</strong></td>
<td>11,6</td>
<td>12,3</td>
<td>12,7</td>
<td>11,9</td>
</tr>
<tr>
<td><strong>Internal Debt</strong></td>
<td>11,1</td>
<td>11,7</td>
<td>8,4</td>
<td>8,2</td>
</tr>
<tr>
<td><strong>External Debt</strong></td>
<td>0,6</td>
<td>0,6</td>
<td>4,3</td>
<td>3,7</td>
</tr>
</tbody>
</table>

Source: Central Bank of Costa Rica and Minister of Finance
<table>
<thead>
<tr>
<th>Year</th>
<th>National Savings (Approximated by financial wealth)</th>
<th>Credit to the Private Sector</th>
</tr>
</thead>
<tbody>
<tr>
<td>2018</td>
<td>7.5%</td>
<td>3.5%</td>
</tr>
<tr>
<td>2019</td>
<td>8.5%</td>
<td>4.9%</td>
</tr>
<tr>
<td>2020</td>
<td>7.4%</td>
<td>5.5%</td>
</tr>
</tbody>
</table>
All projections in this Program are based on the best available information up to January 2019. There exist, however, risks arising from international and domestic factors, which could generate deviations in the projections.
Macroeconomic Program 2019-2020

Risk Analysis

External

Lower global growth
• Trade tensions.
• Financial market volatility.
• Worsening political conflicts in the region.

International volatility in commodity prices:
• Mainly oil prices.
## Risk Analysis
### Domestic

<table>
<thead>
<tr>
<th>Risk Factor</th>
</tr>
</thead>
<tbody>
<tr>
<td>Absence of approval for external funding.</td>
</tr>
<tr>
<td>Supply shocks associated to adverse climatic conditions.</td>
</tr>
<tr>
<td>Social tensions (strikes).</td>
</tr>
</tbody>
</table>
Macroeconomic Program 2019-2020

Macroeconomic implications of lack of authorization to international bonds issuance (Alternative scenario)

- Funding requirements should be met in domestic markets or multilateral loans.
- Uncertainty.
- Upward pressure on domestic interest rates.
- Stress in currency, liquidity and debt markets.
- Private sector crowding out.
- Lower GDP growth and employment generation, higher poverty.
<table>
<thead>
<tr>
<th>Scenario</th>
<th>Base</th>
<th>Alternative</th>
<th>Source</th>
</tr>
</thead>
<tbody>
<tr>
<td>Central Government’s Debt³</td>
<td>59.1%</td>
<td>60.5%</td>
<td>Central Bank of Costa Rica</td>
</tr>
<tr>
<td>Central Government’s Domestic Debt³</td>
<td>45.0%</td>
<td>49.3%</td>
<td></td>
</tr>
<tr>
<td>Interest Payments²</td>
<td>4.4%</td>
<td>5.1%</td>
<td></td>
</tr>
<tr>
<td>Credit to the Private Sector³</td>
<td>5.2%</td>
<td>4.5%</td>
<td></td>
</tr>
<tr>
<td>GDP³</td>
<td>3.1%</td>
<td>2.1%</td>
<td></td>
</tr>
</tbody>
</table>

³ As % of GDP.
² Ratio to GDP.
³ Annual growth rate.
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