COSTA RICA

Table 1	2021
Population, million	5.1
GDP, current US$ billion	64.4
GDP per capita, current US$	12536.2
International poverty rate ($2.15)[a]	2.2
Lower middle-income poverty rate ($3.65)[a]	6.0
Upper middle-income poverty rate ($6.85)[a]	19.8
Gini index[a]	49.3
School enrollment, primary (% gross)[b]	115.0
Life expectancy at birth, years[b]	80.5
Total GHG emissions (mtCO2e)	8.0

Source: WDI, Macro Poverty Outlook, and official data.
a/ Most recent value (2020), 2017 PPPs.
b/ Most recent WDI value (2020).

Costa Rica's strong rebound in 2021 and the recovery in tourism underpinned growth in the first half of 2022. However, weaker external demand, higher inflation, and tighter financing conditions are expected to reduce growth, employment, and real wages going forward. As a result, poverty is expected to remain stable in 2022. Pursuing fiscal consolidation through more efficient taxes and spending, while protecting those most affected by recent shocks is key for sustained growth and social progress.

Key conditions and challenges

An outward-oriented growth model, investment in human capital, and good governance allowed Costa Rica to double its income per capita in the last two decades and to consolidate its green trademark. The country upgraded its exports, increasing resilience to external shocks. Fiscal vulnerabilities, however, built up as spending increased while revenues stayed flat. In the decade before the pandemic, expanded access to education and the internet led to a decline in multidimensional poverty. However, monetary poverty reduction was limited, and inequality increased, as labor market outcomes for women and lower-educated workers did not improve. Poverty rates remained higher for historically disadvantaged groups such as single mothers, Afro-descendants, indigenous populations, and migrants.

The pandemic intensified fiscal and social challenges. Fiscal consolidation efforts, launched in 2018, were interrupted as revenues collapsed amid increasing expenditures as the government sought to mitigate the impact of the pandemic. The debt-to-GDP ratio increased from 56.1 percent in 2019 to 67.1 percent in 2020. Unemployment rates nearly doubled -surpassing 20 percent in mid-2020 - and poverty (US$6.85 poverty line) increased from 13.7 percent of the population in 2019 to 19.8 percent in 2020. Fiscal spending discipline and tax collection recovered in 2021 when GDP grew by 7.8 percent. Unemployment and poverty (US$6.85 poverty line) declined with the economic recovery, but both remained above pre-pandemic levels in 2021 (13.7 and 14.3 percent, respectively).

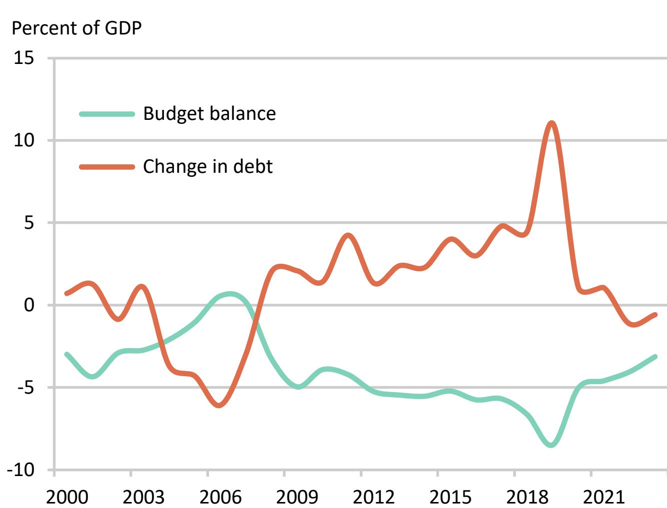
Costa Rica's immediate challenge is to fight inflation and persevere in fiscal consolidation while trying to minimize the impacts on growth and poverty. On growth and shared prosperity, the country needs to sustain reforms to improve education and labor market outcomes to reduce its dual-economy nature, while maintaining its green trademark. In parallel, it is important to ensure that the country's institutional setting is consistent with the implementation of these policy objectives and with a sustainable and effective delivery of social services.

Recent developments

In the first half of 2022, GDP grew 6.9 percent y-o-y. Tourism arrivals increased 62.2 percent by June 2022, boosting the services sector. Agriculture was affected by adverse weather, and the manufacturing and construction sectors started to slow down as adverse external conditions started to curb investment.

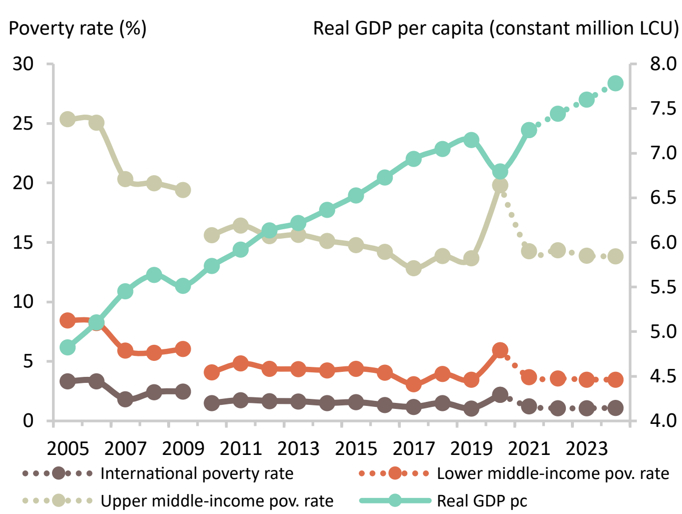
The current account deficit increased from -0.9 percent of GDP in the first half of 2021 to -2.3 percent of GDP in the same period of 2022. While the recovery of tourism increased the surplus of the services account, imports of goods significantly outpaced exports: 17.2 and 12.7 percent y-o-y, driven by

FIGURE 1 Costa Rica / Budget balance and change in bebt



Sources: Central Bank of Costa Rica and World Bank staff calculations.

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



Source: World Bank. Notes: see Table 2.

a sharp deterioration in terms of trade, with pressures from key imported products, such as fuels and fertilizers.

Higher international food and oil prices resulted in the highest inflation rate in 13 years - 10.1 percent (12 months until June 2022), above the inflation target. Those at the bottom of the income distribution were most affected as food and transport make up a higher share of their spending. To contain inflation, the BCCR has gradually increased the policy rate, reaching 7.5 percent in July of 2022 (up from 0.75 in December of 2021).

Public finances improved in the first quarter of 2022 with a primary surplus of 0.85 percent of GDP and a fiscal deficit of -0.2 percent of GDP, supported by increased tax collection, and contained spending. Responses to high prices, including new temporary emergency transfers and possible fuel price controls, have been consistent with the fiscal consolidation so far but should be monitored carefully.

Although the unemployment rate fell, the employment rate has only partially recovered from the pandemic. Primary sector employment remained below its pre-pandemic level, and real wages declined by 4.1 percent compared to February 2020. In the absence of emergency social assistance payments, poverty (US$6.85 threshold) is estimated to remain stable above the pre-pandemic level at 14.4 percent in 2022.

Outlook

Continued inflationary pressures and tighter external conditions will slow down the economy. Higher input prices and depressed external demand are expected to dampen growth in the manufacturing and construction sectors. Uncertainty and the effect of inflation on income will moderate consumption and private investment in 2022-2023. Growth is expected to moderate to 3.3 and 2.9 percent in 2022 and 2023, respectively, before rebounding in 2024 supported by Costa Rica's dynamic exporting sectors. The current account deficit is expected to widen to 4.3 percent of GDP in 2022 as a result of slower growth in Costa Rica's main trading partners and worse terms of trade, but it remains fully covered by net FDI.

As inflation stabilizes and labor market conditions improve driven by growth in the services sector, the poverty rate is expected to decline in 2023 and then stabilize at around 13.8 percent in 2024. Poverty could be further reduced with the implementation of targeted social assistance measures for historically disadvantaged groups and those living under the poverty threshold.

A small, open economy, Costa Rica is highly vulnerable to external shocks, including global inflationary pressures and tighter financing conditions; all of these increase food and energy costs and add financing pressures, increasing uncertainty of the economic outlook both at the macro and household level. Fiscal consolidation is expected to continue over the forecasting period, anchored in the fiscal rule and the IMF-supported program. Additional announced reforms, such as reduction of tax expenditures and reduced fragmentation of social programs, are critical to reinforce fiscal consolidation and create buffers against shocks while protecting the poor. Building consensus around reforms is key but will take time.

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

	2019	2020	2021	2022e	2023f	2024f
Real GDP growth, at constant market prices	2.4	-4.1	7.8	3.3	2.9	3.2
Private Consumption	1.7	-5.0	6.4	2.9	2.6	2.6
Government Consumption	5.9	0.6	1.4	0.7	0.6	0.8
Gross Fixed Capital Investment	-8.2	-1.7	8.7	3.7	3.5	4.9
Exports, Goods and Services	4.3	-10.9	15.9	7.8	4.7	5.9
Imports, Goods and Services	-2.3	-10.2	16.2	6.1	3.3	4.5
Real GDP growth, at constant factor prices	2.4	-4.1	7.8	3.3	2.9	3.2
Agriculture	-1.5	0.5	3.8	2.0	2.2	2.4
Industry	-0.3	1.0	10.2	3.1	2.4	3.0
Services	3.4	-5.7	7.3	3.5	3.2	3.3
Inflation (Consumer Price Index)	1.5	0.7	3.3	9.9	4.9	3.2
Current Account Balance (% of GDP)	-1.2	-1.1	-3.3	-4.3	-3.7	-3.5
Net Foreign Direct Investment Inflow (% of GDP)	4.2	2.6	4.8	3.9	3.9	4.1
Fiscal Balance (% of GDP)	-6.6	-8.5	-5.0	-4.6	-4.0	-3.1
Debt (% of GDP)	56.1	67.1	68.2	69.2	68.1	67.5
Primary Balance (% of GDP)	-2.6	-3.9	-0.3	0.5	0.9	1.3
International poverty rate ($2.15 in 2017 PPP)[a,b]	1.1	2.2	1.2	1.1	1.1	1.1
Lower middle-income poverty rate ($3.65 in 2017 PPP)[a,b]	3.5	6.0	3.7	3.6	3.5	3.5
Upper middle-income poverty rate ($6.85 in 2017 PPP)[a,b]	13.7	19.8	14.3	14.4	13.9	13.8
GHG emissions growth (mtCO2e)	0.0	-8.1	3.1	1.9	1.2	1.1
Energy related GHG emissions (% of total)	91.1	89.1	87.4	84.4	81.8	79.6

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices. Emissions data sourced from CAIT and OECD.
Notes: e = estimate, f = forecast. Poverty lines are expressed in 2017 PPP, resulting in changes from earlier editions that used 2011 PPP. See pip.worldbank.org.
a/ Calculations based on SEDLAC harmonization, using 2020-ENAHO. Actual data: 2020. Nowcast: 2021. Forecasts are from 2022 to 2024.
b/ Projections using microsimulation methodology.