

External Trade And Investment - Costa Rica - Q4 2017

15 Sep 2017 Costa Rica Balance of Payments

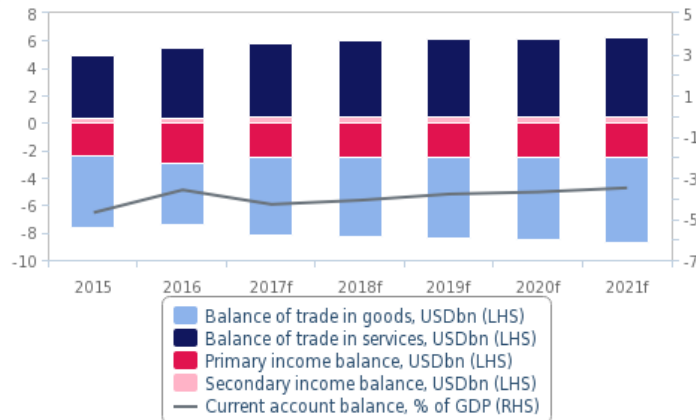
Export Growth Will Narrow Deficit, Though Debt Burden Could Risk Inbound Investment

BMI View: Costa Rica's strong goods exports will drive a modest narrowing of the current account deficit over the coming years. However persistent current account shortfalls and the increasing cost of government financing will raise risks to the external account's stability over time.

Strong goods exports will modestly narrow Costa Rica's current account shortfall over the coming years, however we expect the trade balance to remain in deficit, as rising fuel costs and high consumer demand for foreign products bolster goods imports (see 'Deficit To Modestly Narrow In Years Ahead', February 24). Solid US growth will be a major catalyst for strong goods exports from Costa Rica (see 'Chart Pack: Q2 Rebound Shows Full-Year Forecast On Track', July 28). The US is the destination for some 37.0% of Costa Rican exports and will continue to provide a market for manufactured products such as electronics and medical equipment leading to average goods export growth of 4.8% over the next five years. Additionally, the US is the primary place of origin for tourists, who support the county's services surplus and drive remittance flows. In all, we forecast a current account deficit of 3.8% of GDP in 2017 and 3.7% in 2018.

Shortfall To Persist

Costa Rica - Current Account Breakdown



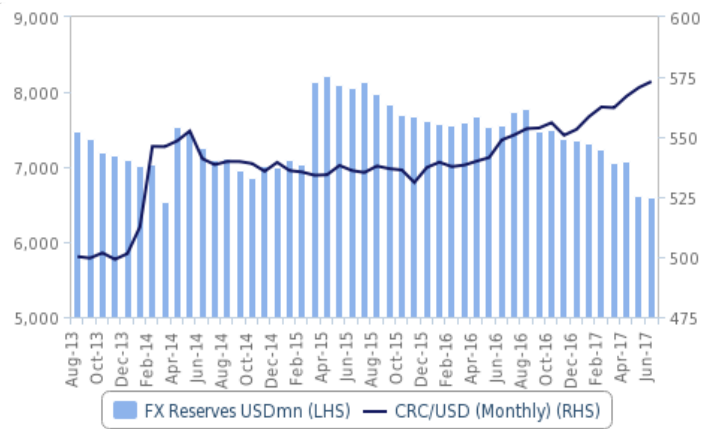
f = BMI forecast. Source: BCCR, BMI

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A substantial debt burden could begin to weigh on investor sentiment, raising Costa Rica's financing costs at a time when its borrowing costs are already rising. Over the past several years, mandated public spending and high interest payments have driven a fiscal deficit that we expect to equal 5.3% of GDP in 2017, while total government debt surpassed 60.0% of GDP in 2016. Lack of substantive fiscal reform has led to sovereign credit rating downgrades from **Moody's** and **Fitch Ratings** this year, placing the country two levels below investment grade (see 'Revenue Gains To Fade While Fiscal Reforms Stall', April 11). The weak fiscal position could trigger a loss of foreign investor confidence, risking inflows into the country's infrastructure pipeline and making it difficult to finance persistent current account shortfalls (see 'Consumption And Investment To Drive Strong Growth', July 10).

Falling Reserves Risk Currency Stability

Costa Rica - Foreign Exchange Reserves And Exchange Rate



Source: Bloomberg, BMI

In light of the low prospect for policymaking amid heightened political gridlock and looming elections (see *'Electoral Field Takes Shape Amid Government Standstill', June 1*), officials will pursue short-term solutions to lure foreign capital in the coming months. In addition to financing its persistent current account shortfalls, the government relies on foreign currency to ensure the managed depreciation of the colón. We expect the administration of President Guillermo Solís to bolster its business-friendly reputation by waiving a longstanding law that discourages the entry of foreign capital. However, the restrictions particularly target foreign traders who wish to hold local securities and their removal could lead to an influx of portfolio flows, which could just as rapidly be divested. Additionally, the government's application to the Fondo Latinoamericano de Reservas for a USD1.0bn loan to boost foreign reserves will likely be temporary solution, as an increasing amount of the government's funds go toward debt repayment.