COSTA RICA

A proven track record

Laura Chinchilla, the first woman president of Costa Rica, is expected to continue many of the policies of Oscar Arias, but with her own nuances. Given the country's strong new economic team, growing FDI inflows, the dynamism and diversification of the export sector, and responsible anti-cyclical fiscal and monetary policy, we recommend overweighting Costa Rica in the short part of the curve.

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A strong new economic team

President Chinchilla will be supported by Vice President Luis Liberman, who holds a Ph.D. in Economics from the University of Illinois, is a former banker, and will be in charge of coordinating policies with the economic team. The team also includes new Central Bank President Rodrigo Bolaños, who has served as president of the Latin American Reserve Fund, was president of the central bank in the mid-1990s, and holds a Ph.D. in Economics from the University of Chicago. Minister of Finance Fernando Herrero is also experienced, having occupied the post previously under José María Figueres.

Responsible counter-cyclical economic policy

Herrero has said that foreign debt is likely to increase in order to finance the fiscal deficit, which is expected to be around 5.0% of GDP because of the need to fulfill election promises and to cover the costs necessary to stimulate the economy; however, we expect a lower fiscal deficit of 3.7%. Herrero also indicated that the country will request a loan from the World Bank for US$500mn, already approved by the assembly, and authorities are awaiting approval for another loan of an equal amount requested from the IDB. Since Costa Rica has the lowest public external debt as a percentage of GDP (11.4%) among the Central American and Caribbean countries, we believe that it is appropriate during this contraction period to finance a countercyclical fiscal policy using external debt.

We expect Costa Rica to grow at 4.2% in 2010

The monthly index of economic activity (IMAE) published by the central bank shows growth of 6.1% y/y in the first quarter of the year and 5.9% m/m in March, confirming the upward trend that has been in place since September 2009. The increase has been driven primarily by the manufacturing sector, which grew 13.6% y/y. We have updated our growth outlook to 4.2% y/y in 2010 and 4.7 y/y in 2011.

Another good sign is that Costa Rica is increasing its capital inflows, as evidenced by the strong currency appreciation of 13.2% since September 2009. In this regard, total FDI inflows have grown an average of 10.2% since 2000, currently at USD1.3bn, or 4.5% of GDP. For this year, we expect FDI to finance 100% of the current account deficit. On the other hand, exports continue to grow significantly, up 13.5% y/y so far in 2010. Since 2001, exports have grown at an average annual rate of 8%, representing one-third of GDP, with strong diversification of exported products and destinations (Costa Rica exports 4,080 different products to 153 destination countries). The key to success is the country's qualified workforce; Costa Rica's educational system ranked twenty-sixth worldwide, the highest in Latin America according to the World Economic Forum.

We do not think that the market has priced in these positive developments and recommend that investors overweight the credit. We do not expect new issuance, since it would require Congressional approval and the government does not have a majority, but the finance ministry has indicated the possibility of a swap to exchange bonds maturing in 2011, 2012, 2013, and 2014—with prices ranging from 106 to 114—into one bond with a possible maturity in 2021. Given that the other Costa Rican bond with a maturity in 2020 traded with a large premium (above 136%), we believe that it is a better to express our bullish view in the shorter part of the curve and wait for a possible swap instead of paying a large premium.

Figure 1: Costa Rica: Macroeconomic forecast

	2006	2007	2008	2009F	2010F	2011F
Activity						
Real GDP (% y/y)	8.8	7.8	2.9	-1.4	4.2	4.7
Consumption (% y/y)	5.5	6.8	4.3	2.2	6.5	7.2
Fixed Capital Investment (% y/y)	10.8	18.0	12.6	-14.0	25.9	29.0
Exports (% y/y)	10.3	10.0	-0.9	-7.7	18.4	22.1
Imports (% y/y)	7.9	4.5	2.7	-19.3	27.8	31.2
GDP (USD bn)	22.5	26.3	29.8	29.9	35.6	38.5
External Sector						
Current Account (USD bn)	-1.0	-1.6	-2.7	-1.1	-1.7	-1.9
CA (% GDP)	-4.5	-6.3	-8.9	-3.8	-4.7	-4.8
Trade Balance (USD bn)	-2.7	-3.0	-5.9	-2.7	-3.4	-3.9
Gross External Debt (USD bn)	7.0	8.3	9.2	8.0	8.4	8.8
International Reserves (USD bn)	3.1	4.1	3.8	4.1	4.6	5.1
Public Sector						
Public Sector Balance (% GDP)	-1.1	0.6	0.7	-3.0	-3.7	-2.5
Primary Balance (% GDP)	2.7	3.7	2.8	-0.7	-1.3	-0.2
Prices						
CPI (% Dec/Dec)	9.4	10.8	13.9	4.0	7.2	5.9
CPI (% Average)	11.5	9.4	13.4	9.5	5.7	3.4

Source: Costa Rican Central Bank, Barclays Capital

Analyst Certification(s)

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