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FOR
AGENDA

EBS/83/127
Correction 1

CONFIDENTIAL

July 14, 1983

To: Members of the Executive Board

From: The Secretary

Subject: Costa Rica - Staff Report for the 1983 Article IV Consultation
and Review Under the Stand-By Arrangement

The following corrections have been made in EBS/83/127 (6/20/83):

Page 11, Table 3, "Liabilities to private sector," line 34, columns 1, 2,
4, and 5: for "35.8," "33.4," "31.6," and "34.6"
read "36.3," "35.0," "32.2," and "35.3"

Footnote 8, lines 2 and 3: for "banking market rate"
read "accounting rate"

Page 25, line 20: for "33.4 1/" read "35.0 1/"

Page 27, "GDP deflator," line 3, column 3: for "86.5" read "86.3"

line 19, "(depreciation -)," column 2:
for "59.9" read "-59.9"

line 31, "Velocity (GDP relative to M_3) 3/,"
columns 3 and 5: for "3.0" and "2.9"
read "2.9" and "2.8"

Corrected pages are attached.

Att: (3)

Table 3. Costa Rica: Summary Operations of the Banking System

	US\$1 = ₡ 50.00					Revised
	US\$1 = ₡ 40.00		Stand-By Program		Actual	Projection
	1981	1982	1982	1983	1982	1983
(In millions of colones)						
I. Banking System						
Net international reserves 1/	-34,940	-47,794	-65,435	-65,435	-59,745	-59,745
Net domestic assets	85,956	114,515	141,405	163,755	134,842	149,880
Net credit to public sector	9,294 2/	11,166 2/	13,171	15,171	11,092 2/	13,090 2/
Central Government 3/	(7,370)	(6,596)	(...)	(...)	(6,581)	(...)
Rest of public sector 3/	(1,924)	(4,570)	(...)	(...)	(4,511)	(...)
Credit to private sector 4/	13,241	18,094	18,420	27,345	18,231	24,590
Valuation adjustment	32,319	32,319	41,839	41,839	42,032	42,032
Other	5,430	8,816	9,125	20,550	8,337	17,968
Counterpart arrears	25,672	44,120	58,850	58,850	55,150	52,200
Counterpart unrequited foreign exchange	1,140	1,140	1,425	1,425	1,425	1,425
Long-term foreign liabilities	22,556	25,028	31,445	40,545	31,290	37,940
Liabilities to private sector 5/	27,320 2/	40,553 2/	43,100	56,350	42,382 2/	50,770 2/
II. Central Bank						
Net international reserves 1/	-35,420	-48,295	-66,035	-66,035	-60,370	-60,370
Official reserves	-9,748	-4,175	-7,185	-7,185	-5,220	-6,170
Payments arrears	-25,672	-44,120	-58,850	--	-55,150	--
Rescheduling	--	--	--	-58,850	--	-52,200
Net domestic assets	39,846	55,232	73,995	76,935	67,309	68,970
Net credit to public sector 3/	9,651 2/	11,872 2/	13,151	15,151	11,857 2/	13,857 2/
Net position with banks	-8,117	-11,120	-11,154	-8,412	-12,908	-11,335
Stabilization bonds	-1,542	-4,755	-5,450	-9,750	-4,755	-6,394
Long-term foreign liabilities 6/	-20,336	-22,414	-28,670	-37,820	-28,020	-34,670
Valuation adjustment	30,267	30,267	39,026	39,026	39,217	39,217
Other	4,251	7,262	8,242	19,890	6,766	16,095
Counterpart arrears	25,672	44,120	58,350	58,850	55,150	52,200
Currency issue	4,426	6,937	7,960	10,900	6,937	8,600
(In per cent change)						
Banking system						
Net domestic assets 7/	62.9	104.5		51.9		35.5
Net credit to public sector	21.2	20.1		15.2		18.0
Credit to private sector	9.8	36.7		48.5		34.9
Liabilities to private sector 5/	27.3	48.4		30.7		19.8
(As per cent of GDP)						
Net credit to public sector	16.6	11.5		9.8		9.9
Credit to private sector	22.8	18.6		17.7		18.7
Liabilities to private sector 8/	36.3	35.0		32.2		35.3
(In millions of colones)						
Memorandum items						
Exchange subsidies to public sector (cumulative)	886	2,257		3,066		2,887
Central Government	(360)	(453)		(450)		(453)
Rest of public sector	(526)	(1,804)		(2,616)		(2,434)
Consumer price (change in per cent)	65.1	81.7		40.0		19.3

Sources: Central Bank of Costa Rica; and Fund staff estimates.

1/ Includes payments arrears.

2/ Adjusted for reclassification of public sector deposits in the commercial banks previously classified as private sector deposits.

3/ Includes exchange subsidies.

4/ Includes credit to nonbank financial intermediaries.

5/ Includes liabilities to nonbank financial intermediaries.

6/ Includes SDR allocation and gold revaluation.

7/ In relation to liabilities to the private sector, including liabilities to nonbank financial intermediaries, at the beginning of the period.

8/ Ratio of two-year average of liabilities to the private sector, including liabilities to nonbank financial intermediaries, in relation to GDP. Foreign currency deposits are valued at the average accounting rate of each year.

The authorities reaffirmed their intention to continue to observe the limits on banking system credit to the public sector and of assuring an adequate availability of financing to the private sector. The Costa Rican representatives pointed out that they were contemplating a reduction of domestic interest rates by a small amount, and contended that such a move would be within the spirit of their commitment to maintain a flexible interest rate policy, the ultimate objective of which is the establishment of rates that are positive in real terms. The authorities pointed out that, in view of the reduction which has already taken place in domestic inflation, interest rates were now positive in real terms. Taking this into account, as well as the expected rate of inflation for the year as a whole and the drop in interest rates abroad, they considered that a small reduction in interest rates was justifiable at this time.

The mission believed that such a measure would be acceptable in the light of recent developments in domestic inflation and interest rates abroad, but emphasized that the authorities should be prepared to raise interest rates promptly if inflation accelerated in the future and expressed concern about the likely resistance to do so if such a need were to arise. The mission also pointed out that a reduction of interest rates, however small, may result in pressures on the free market exchange rate, in which case the authorities have to be prepared to increase the banking exchange rate to keep within the permissible spread between the two exchange rates. The Costa Rican authorities shared the staff's views on this issue and indicated that by deciding to reduce interest rates they were taking a calculated risk and were aware that they should be ready to reverse their action if it was necessary because inflation accelerated or if deposit and/or credit developments so warranted.

After the mission, on May 17, 1983 the Board of Directors of the Central Bank approved a reduction in the basic interest rate on six-month deposits, to which most deposit and loan rates are related, from 25 per cent to 22 per cent. The lending rates applied to commercial agriculture and to manufacturing will continue to be the same as the basic deposit rate and 3-1/2 percentage points higher than the basic rate, respectively, while the one applied to cattle raising was adjusted downward to 4 percentage points below the basic deposit rate. The rate applied to all other loans will remain unchanged at 30 per cent.

3. Incomes and price policies

The authorities confirmed their intention to adjust public sector salaries and minimum wages in absolute amounts on the basis of the changing cost of a basic basket of goods and services, composed mainly of food products, transportation, water and electricity. It is estimated that this mechanism of wage adjustments will result in salary increases below the expected rate of inflation. Real wages for both public and private sector employees have declined considerably in the last two

COSTA RICA

Area and population

Area	50,900 sq. kilometers
Population (mid-1982)	2.3 million
Annual rate of population increase (1978-82)	2.5 per cent

GNP per capita (1982) SDR 993.7

<u>Origin of GDP (1982 est.)</u>	<u>1982</u> (Per cent)
Agriculture	19.9
Manufacturing	22.5
Commercial services	13.0
Construction	3.8
Other	40.8

Ratios to GDP (1982)

Exports of goods and services	45.1
Imports of goods and services	56.1
Central government revenue	13.2
Central government expenditure	16.3
External public debt (end of year)	118.0
National savings	8.4
Investment	18.0
Money and quasi-money (end of year)	35.0 <u>1/</u>

Annual changes in selected economic indicators

	<u>1980</u>	<u>1981</u>	<u>1982</u>
	(In per cent)		
Real GDP per capita	-1.7	-7.1	-11.3
Real GDP	0.8	-4.6	-8.8
GDP at current prices	19.7	38.1	69.8
Domestic expenditures (at current prices)	19.2	30.1	55.4
Investment	(25.7)	(9.6)	(44.8)
Consumption	(17.2)	(36.6)	(58.1)
GDP deflator	18.8	44.7	86.3
Consumer prices (annual averages)	18.1	37.1	90.1
Wholesale prices (annual averages)	23.7	65.3	108.2
Central government revenues	17.6	47.2	74.4
Central government expenditures	24.9	24.8	52.7
Money and quasi-money	15.1	27.3	48.4
Money	(16.8)	(46.7)	(59.9)
Quasi-money	(13.8)	(14.6)	(41.2)
Net domestic assets of the banking system <u>2/</u>	51.5	62.9	104.5
Credit to public sector (net) <u>2/</u>	(16.7)	(9.1)	(6.8)
Credit to private sector <u>2/</u>	(10.0)	(6.4)	(17.8)
Counterpart arrears and others <u>2/</u>	(24.8)	(47.4)	(79.9)
Merchandise exports (f.o.b.)	6.2	0.2	-12.6
Merchandise imports (c.i.f.)	9.3	-20.6	-29.1

<u>Central government finances</u>			
	1980	1981	1982
	(millions of colones)		
Revenue	4,982	7,333	12,792
Expenditure	8,282	10,332	15,775
Current account surplus or deficit (-)	-1,370	-893	-906
Overall deficit (-)	-3,300	-2,999	-2,983
External financing (net) ^{3/}	678	1,487	2,457
Internal financing (net)	2,622	1,512	526
<u>Balance of payments</u>			
	(millions of U.S. dollars)		
Merchandise exports, f.o.b.	1,001	1,003	876
Merchandise imports, c.i.f.	-1,528	-1,213	-860
Factor services (net)	-216	-319	-404
Other services and transfers (net)	79	104	146
Current and transfer account balance	-664	-425	-242
Official capital (net)	227	67	-14
Private capital (net) ^{4/}	-181	-64	-16
Financial intermediaries (net)	162	-43	-54
Accumulations of arrears	283	359	461
Change in net official international reserves (increase -)	173	106	-139
<u>International reserve position</u>			
	(millions of U.S. dollars)		
Central Bank (gross)	228	147	263
Central Bank (net)	-137	-244	-104
Rest of banking system (net)	--	12	13
<u>IMF data (as of April 30, 1983)</u>			
<u>Article VIII status</u>			
Intervention currency and rate	U.S. dollar at ¢ 40.00 per US\$		
Quota	SDR 61.5 million		
Fund holdings of colones	SDR 158.6 million		
From Fund resources			
Credit tranche purchases (including SBA)	SDR 17.9 million		
EFF purchases	SDR 11.3 million		
CFF purchases	SDR 45.5 million		
Oil facility purchases	SDR 0.4 million		
From Supplementary and Enlarged Access resources			
Stand-by purchases	SDR 10.75 million		
EFF purchases	SDR 11.25 million		
Fund holdings under Enlarged Access Policy ^{5/}	83.3 per cent of quota		
Total Fund holdings	157.9 per cent of quota		
Stand-by arrangement (December 22, 1982-December 21, 1983)	SDR 92.3 million		
Purchases thereunder	SDR 18.5 million		
Status of drawing rights thereunder	Intact		
Special Drawing Rights Department			
Cumulative SDR allocation	SDR 23.7 million		
Net acquisition or utilization (-) of SDRs	SDR 20.7 million		
Holdings of SDRs	12.7 per cent of allocation		
Share of profits from gold sales	US\$5.1 million		

^{1/} Average of outstanding balance at the end of 1982 and 1981 in relation to GDP.

^{2/} Against the stock of liabilities to the private sector, including liabilities to nonbank financial intermediaries, at the beginning of the period.

^{3/} Includes accumulation of interests in arrears.

^{4/} Includes errors and omissions.

^{5/} Refers to Fund's holdings related to credit tranche (including SBA) and EFF purchases from Fund resources, plus purchases from Supplementary and Enlarged Access resources.

Costa Rica: Selected Economic and Financial Indicators

	Actual		Prel. SBA Program		Est.
	1980	1981	1982	1983	1983
(Annual per cent changes, unless otherwise specified)					
<u>National income and prices</u>					
GDP at constant prices	0.8	-4.6	-8.8	--	--
GDP deflator	18.8	44.7	86.3	48.4	35.8
Consumer prices (end of period)	17.8	65.1	81.8	40.0	19.3
(average)	18.1	37.1	90.1	55.0	37.9
<u>External sector (on the basis of U.S. dollars)</u>					
Exports, f.o.b.	6.3	0.2	-12.6	7.4	2.7
Imports, c.i.f.	9.4	-20.6	-29.1	4.4	4.7
Non-oil imports, c.i.f.	8.0	-22.4	-33.0	3.2	10.6
Export volume	-5.8	7.8	-11.9	4.0	2.5
Import volume	-3.6	-25.7	-34.4	--	1.6
Terms of trade (deterioration -)	-0.5	-13.0	-8.1	-1.1	-2.8
Nominal effective exchange rate					
(depreciation -)	0.4	-139.0	-64.0
Nominal effective exchange rate					
(depreciation -)	0.4	-139.0	-64.0
Real effective exchange rate					
(depreciation -)	8.1	-59.9	22.9
<u>Government budget</u>					
Revenue and grants	17.6	47.2	74.4	59.9	49.3
Total expenditure	24.9	24.7	52.7	47.2	43.7
<u>Money and credit (banking system)</u>					
Net domestic assets <u>1/4/</u>	51.5	62.9	104.5	51.9	35.5
Public sector <u>1/</u>	(16.7)	(9.1)	(6.9)	(4.6)	(4.7)
Private sector <u>1/</u>	(10.0)	(6.4)	(17.8)	(20.7)	(15.0)
Counterpart arrears and others <u>1/</u>	(24.8)	(47.4)	(79.9)	(26.6)	(15.8)
Medium- and long-term foreign liabilities <u>1/</u>	6.3	2.2	9.0	21.1	15.7
Liabilities to private sector (M ₃) <u>2/</u>	15.1	27.3	48.4	30.7	19.8
Velocity (GDP relative to M ₃) <u>3/</u>	2.7	2.8	2.9	3.1	2.8
Interest rate (annual rate, six-month time deposit)	19.8	21.5	25.0	...	22.0
(In per cent of GDP)					
Overall public sector deficit <u>4/</u>	11.2	13.9	9.1	4.4	4.0
Central government savings	-3.3	-1.6	-0.9	0.2	-0.4
Central government budget deficit <u>4/</u>	8.0	5.2	3.1	2.3	2.7
Domestic financing	(6.3)	(2.6)	(0.6)	(0.8)	(1.7)
Foreign financing <u>4/</u>	(1.7)	(2.6)	(2.5)	(1.5)	(1.0)
Gross domestic investment	26.6	21.1	18.0	18.1	20.5
Gross national savings	12.2	9.3	8.4	10.1	10.8
Current account balance (deficit -)	-14.4	-11.7	-9.6	-8.0	-9.7
Trade balance (deficit -)	-11.4	-5.8	0.7	3.8	--
External debt inclusive of use of Fund credit and short term	56.3	77.7	118.0	114.2	127.8
(In per cent of exports of goods and services)					
Debt service ratio <u>7/</u>	33.4	51.7 <u>5/</u>	57.2 <u>5/</u>	58.0	47.5 <u>6/</u>
Interest payments <u>7/</u>	14.6	25.6 <u>5/</u>	34.8 <u>5/</u>	40.5	38.6 <u>6/</u>
(In millions of U.S. dollars)					
Change in net official foreign reserves	-173	-106	139	...	59
Gross official reserves (months of imports)	1.8	1.5	3.7	3.3	4.0
External payments arrears (decrease -) <u>8/</u>	283.0	358.8	461.2	-1,117.0 <u>9/</u>	-1,103.0 <u>9/</u>

Sources: Central Bank of Costa Rica; Ministry of Finance; and Fund staff estimates.

1/ Against the stock of liabilities to the private sector, including liabilities to nonbank financial intermediaries, at the beginning of the period.2/ Includes liabilities to nonbank financial intermediaries.3/ GDP of year_t relative to the average M₃ of year_{t-1} plus year_t.4/ Includes accumulation of interests in arrears.5/ Includes unpaid interest and amortization.6/ After rescheduling of arrears and certain current payments.7/ Inclusive of Fund charges and repurchases as well as interest on short term.8/ Excludes arrears on short-term foreign liabilities of the Central Bank.9/ Assumes rescheduling of payments arrears.