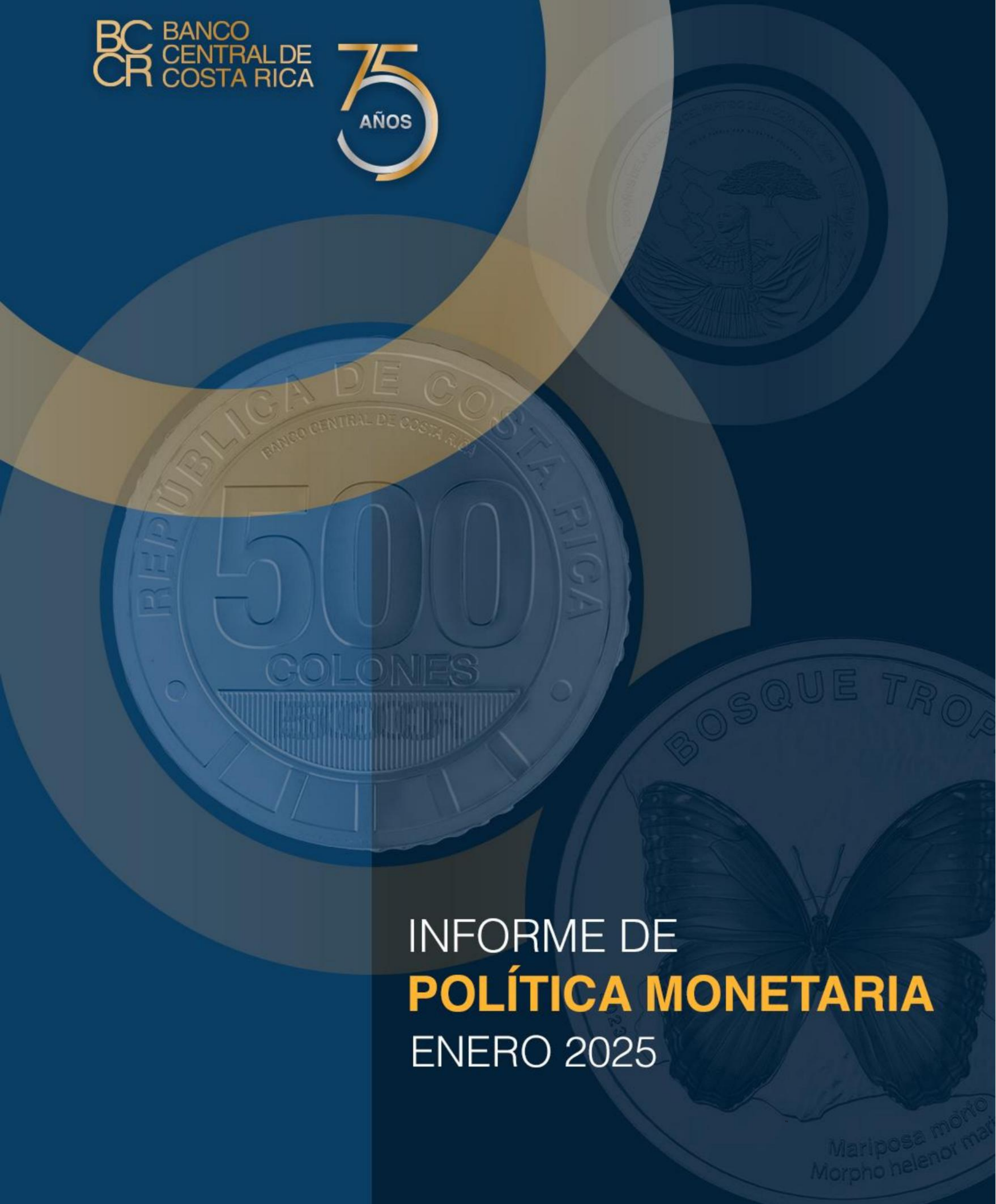
BANCO CENTRAL DE COSTA RICA

75 AÑOS



INFORME DE POLÍTICA MONETARIA

ENERO 2025

Approved by the Board of Directors of the Central Bank of Costa Rica in article 4 of session 6235-2025 of January 28, 2025.

Content

Chart Index

Table of Contents

Table of Contents

ABBREVIATIONS

BCCR	Central Bank of Costa Rica
BEM	Monetary stabilization bonds
BM	World Bank
Cocaví	National Road Council
CSP	Credit to the private sector
COVID-19	Disease caused by the SARS CoV-2 virus
EMBI	Emerging market bonds indicator
ENOS	Atmospheric phenomenon El Niño Southern Oscillation
FLAR	Latin American Reserve Fund
IMF	International Monetary Fund
ICE	Costa Rican Institute of Electricity
CPI	Consumer Price Index
IPM	Monetary Policy Report
THOUSAND	Integrated liquidity market
Monex	Foreign currency market
OECD	Organization for Economic Cooperation and Development
GDP	Gross domestic product
RINS	Net international reserves
SFN	National financial system
SPNB	Non-banking public sector
TPM	Monetary policy rate
UCR	University of Costa Rica
USD	United States dollars

Informe de Política Monetaria

Enero 2025

"El Banco Central de Costa Rica, constituido en la forma dicha, será una institución autónoma de derecho público".

Artículo 2, Ley Constitutiva del Banco Central de Costa Rica.

"El Banco Central de Costa Rica es una institución autónoma de derecho público, con personalidad jurídica y patrimonio propios, que forma parte del Sistema Bancario Nacional".

Artículo 1, Ley Orgánica del Banco Central de Costa Rica N.° 7558.

BCCR BANCO CENTRAL DE COSTA RICA 75 AÑOS

THE MONETARY POLICY REGIME OF THE BCCR

Monetary policy comprises the set of actions taken by a central bank to influence the amount of money available in the economy and, therefore, interest rates, in order to promote price stability.

In the case of Costa Rica, monetary policy provisions are governed by the provisions of Law 7558, Organic Law of the Central Bank of Costa Rica (BCCR).
Specifically, according to its Article 2, the Central Bank directs its actions towards achieving low and stable inflation as its main objective. In January 2018, the BCCR officially adopted the explicit inflation targeting scheme for the conduct of its monetary policy[1] ; however, it had been implementing this monetary scheme for years before.

Such a framework is characterized by the public announcement of the central bank's commitment to achieve a quantitative objective (usually with a tolerance range around the target) for inflation over a given time horizon, and is accompanied by the recognition that its main objective is to keep inflation low and stable.

It also highlights the importance of accountability and explanation of the motivations behind the monetary authority's decision-making in the process of forming inflationary expectations.

In accordance with the above, the Board of Directors of the Central Bank of Costa Rica defined the explicit inflation target at 3%, with a tolerance margin of ± 1 percentage point, over a 24-month horizon.

This means that the BCCR's monetary policy is prospective. That is, since monetary policy measures require time to be transmitted to other economic variables and have the expected effect on inflation, they are based on the projected evolution of inflation and its determinants. The main instrument for indicating the tone of monetary policy is the Monetary Policy Rate (TPM), which is revised in accordance with a schedule approved by the Board of Directors, which is made public in advance[2] . Thus, the TPM and monetary policy in general will be adjusted in such a way that projected inflation is oriented towards the 3% target.

The analyses carried out by the BCCR to make its monetary policy decisions are reported to society through press releases and analytical documents. Among them is the Monetary Policy Report, which is published four times a year, at the end of January, April, July and October. This report analyzes the macroeconomic situation, details the monetary policy actions applied by the Central Bank and presents the entity's projections for inflation and production.

1 Further details of the BCCR's monetary policy framework are presented in Chapter 2 of the Report on Monetary Policy of April 2020.

2 Starting in March 2024, the BCCR holds a press conference after each monetary policy decision, the purpose of which is to communicate its decision and the reasons behind it.

PRESENTATION

On behalf of the Board of Directors of the Central Bank of Costa Rica (BCCR), I present the Monetary Policy Report (IPM) for January 2025. This document makes explicit the BCCR's analysis of the national and international economic situation, reviews the projections for a set of macroeconomic variables and details the policy actions applied and the direction of those to be executed to meet the objectives established in its Organic Law.

In 2024, global inflation continued to decline; however, in the fourth quarter there were slight increases in some countries, due to the increase in service prices and adverse weather events. In addition, global production grew at a moderate pace, with differences between the main economies. Given this reality, central banks showed caution in their monetary policy decisions.

At the local level, the main macroeconomic indicators showed a performance in 2024 that can be characterized by relatively high economic growth, low inflation, a tendency to improve labor indicators, strengthening of external accounts and the continuation of efforts to place public finances on the path of sustainability.

General inflation showed an upward trend, although it registered negative values year-on-year, for much of the year, while core inflation posted positive but low rates. In particular, at the end of the year, headline inflation stood at 0.8% and core inflation at 0.9%, both below the lower limit of the range that contains the inflation target (3.0% ± 1 pp). Prospectively, the Central Bank estimates that the probability of year-on-year inflation returning to negative values is low.

Economic activity maintained a growth rate of over 4.0% in the year, driven mainly by domestic demand, particularly private consumption and investment. Its growth is estimated at 4.3% for the year, 0.2 percentage points (pp) higher than that forecast in last October's report and also higher than the historical average recorded in the period 2010-2019 (3.8%), prior to the pandemic, and the growth in production of the country's main trading partners in 2023 and 2024 (estimated at 2.8% and 2.5%, respectively).

In line with the performance of economic activity, labor market indicators showed an improvement in 2024. The unemployment rate decreased throughout the year, albeit with ups and downs, and stabilized in the quarter ending in November at 7.3%, accompanied by increased employment and labor force participation.

With these results, in the second half of the year employment reached the level observed at the beginning of 2020, prior to the pandemic, which allows us to infer that there has been a significant increase in labor productivity. It is expected that this improvement in productivity will have a favorable impact on the long-term growth capacity of the economy and on workers' income.

The central government generated primary surpluses in the year, which supports efforts to achieve fiscal consolidation in the medium term and contributed to its debt-to-GDP ratio falling below 60% by the end of 2024, according to estimates by the Ministry of Finance.

The country's operations with the rest of the world generated a current account deficit of the balance of payments equivalent to 1.4% of GDP. The country received net external financing for an amount equivalent to 2.3% of GDP, sufficient to finance this deficit and accumulate reserve assets.

Finally, credit to the private sector grew in line with the evolution of economic activity and it is estimated that the trend behavior of monetary aggregates will not generate inflationary pressures in the next 24 months.

Given the behavior of inflation, as well as the analysis of the trajectory of inflation forecasts, its macroeconomic determinants and the risks that would condition its projection, between January 2024 and the same month of this year, the Board of Directors of the BCCR reduced the level of the Monetary Policy Rate (TPM) by a cumulative 200 bp, which are added to the 300 bp applied in 2023. These decisions allowed the TPM to be placed in the estimated zone of monetary policy neutrality.

This report projects an average growth in production in the biennium 2025-2026 of 4.0%, a rate that, although it means a slowdown compared to 2024, is relatively high compared to the average growth estimated for trading partners (2.4% in 2025). As in 2024, national production would be driven mainly by domestic demand.

The current account deficit of the balance of payments would be, on average, around 1.5% of GDP during that biennium. As in previous years, this gap would be more than covered by long-term external savings, particularly direct investment.

The BCCR expects that both general and underlying inflation will return to the tolerance range around the target in the third quarter of 2025. However, the assessment of risks regarding the trajectory of this variable in the programming horizon is tilted downwards.

As it has done so far, the BCCR will maintain a prudent monetary policy, based on a prospective analysis of inflation and its determinants, as well as the risks, the materialization of which could divert inflation from its central path.

In the foreign exchange market, it will participate to meet the requirements of the non-banking public sector, as well as to mitigate violent fluctuations in the exchange rate and, to the extent possible, further strengthen the country's financial protection, in accordance with the criteria and parameters established by its Board of Directors.

It will also continue its efforts to improve communication with the general public, and markets in particular, through, among others, documents such as the one presented on this occasion.

Finally, in this year in which the BCCR celebrates the 75th anniversary of its birth to legal life, citizens are invited to reflect on the importance of this entity enjoying full autonomy, constitutionally guaranteed, as set forth in bill 24,480 *(Addition of a Final Paragraph to Article 188 of the Political Constitution to Grant Administrative and Government Autonomy to the Central Bank of Costa Rica),* submitted for consideration by the Legislative Assembly.

In this regard, it is appropriate to recall the words of Mr. Juan Trejos Quirós, deputy of the Constituent Assembly of 1949, who, in reference to the future existence of a central bank, at that time highlighted the need for ***"the proper functioning of this body, since it constitutes the main economic guarantee that the people need"[3] .***

Roger Madrigal Lopez

Róger Madrigal L.

[3] https://www.asamblea.go.cr/sd/actas_constituciónntes/Actas%20Asamblea%20Nacional%20Constituente%201949%20Volume%20III.pdf

SUMMARY

Economic situation

In the international environment, inflation continued to decline in 2024, due to the reduction in raw material prices and restrictive monetary policy. However, in the last quarter there were slight increases in some countries, associated with the increase in service prices and adverse weather events.

In line with the above, central banks in most economies continued with the process of easing monetary policy, although some paused the process and others even reversed it due to increases in inflation.

Under these conditions, economic activity in the main economies grew at a moderate pace in 2024. In particular, in the third quarter of the year, economic growth in the United States was 2.7% and in the euro area it showed an improvement, but remained relatively low (0.9%). Meanwhile, in China, economic activity accelerated in the fourth quarter (5.4%), driven by the stimulus measures applied at the end of September to improve consumer and investor confidence. Based on the above, the International Monetary Fund (IMF) estimated that the world economy would have grown 3.2% in 2024 (3.3% in 2023).

In Costa Rica, in the fourth quarter of 2024, the annual headline inflation was 0.0% on average, similar to that of the previous quarter, while the underlying inflation remained positive, although low.

The return of general inflation to values around 0.0%, after remaining at negative rates for several months, was mainly due to the slower pace of decline in external prices, the increase in maritime transport costs and the effects of the less restrictive stance of monetary policy. Particularly noteworthy are the effects on inflation in services.

At the end of the year, headline inflation, measured by the year-on-year variation of the Consumer Price Index, stood at 0.8% and core inflation at 0.9%. These levels remain below the lower limit of the range around the inflation target (3.0% ± 1 pp).

Economic activity continued to perform well in the fourth quarter, with a year-on-year variation of 4.3%, driven by domestic demand. With this result, it is estimated that in 2024 GDP would have grown by 4.3%, a rate 0.2 pp higher than that forecast in last October's report.

Linked to the evolution of economic activity, the unemployment rate remained relatively stable in the last months of 2024 (7.3% in the quarter ending in November), in which a growing trend in employment and participation in the labor market was simultaneously observed. Likewise, real income moderated its growth rate and showed heterogeneity both by the type of employer (public and private sector) and by the qualification level of workers.

As regards public finances, the generation of primary surpluses throughout the year contributed to the Central Government's debt to GDP ratio being located at below 60% by the end of 2024, according to estimates by the Ministry of Finance. This performance supports the path towards fiscal consolidation in the medium term.

In the country's operations with the rest of the world, in the fourth quarter of 2024 the current account deficit of the balance of payments amounted to 0.5% of GDP, which means that for the year it stood at 1.4% of GDP, 0.3 pp lower than expected in the October report. During the year, the country received net external financing for an amount equivalent to 2.3% of GDP, sufficient to finance the current account deficit and increase reserve assets by the equivalent of 1.0% of GDP. The continuity of direct investment flows (5.4% of GDP) was highlighted, channeled mainly towards special foreign trade regimes.

Finally, credit to the private sector grew in line with the evolution of economic activity and it is estimated that the trend behavior of monetary aggregates will not generate inflationary pressures in the next 24 months.

BCCR policy actions

In 2024, the BCCR Board of Directors reduced the TPM on five occasions, for a cumulative 200 basis points (bp), as part of the gradual and orderly process of easing its monetary policy, which began on March 15, 2023. Between this last date and October 2024, the cumulative decrease in the TPM was 500 bp, to place it at 4.0% annually.

Specifically, at the meeting held on December 19, 2024, the Board of Directors, among other reasons, considered that, given the uncertainty surrounding the evolution of inflation and its macroeconomic determinants, it was prudent to pause the process of reducing the TPM. Then, on January 23, 2025, it stated that, due to the lags in the transmission of monetary policy, it was advisable to maintain the level of the TPM; this in order to give space for the active interest rates of some activities to finish incorporating the recent reductions in that indicator.

With the reductions applied to the TPM and given the behavior of inflationary expectations, the Bank estimates that this indicator is contained within the monetary policy neutrality zone.

Monetary policy actions also consider short-term liquidity conditions. In 2024, the national financial system maintained a broad condition of
Liquidity, which continued in January of this year, has decreased. This is largely due to the cancellation of a significant part of the special credit granted
by the BCCR to financial intermediaries to address the adverse economic effects of the COVID-19 pandemic.

In addition to the above, the behavior of liquidity in the period under review was explained, mainly, by the monetary effect resulting from the net purchase of foreign currency by the BCCR in the exchange market, purchases that have occurred in a situation of relative abundance of foreign currency.

The BCCR's participation as a net demander in the Foreign Currency Market (Monex) allowed it to meet the requirements of the Non-Banking Public Sector (NBPS) and increase the balance of the BCCR's net international reserves (NIR) by *USD* 952 million in 2024, reaching *USD* 14,171 million. This balance is equivalent to 14.9% of GDP and 147% of the minimum adequate level defined by the Board of Directors.

Despite the active participation of the BCCR in the foreign exchange market, its surplus conditions led to a nominal appreciation of the colon of 2.4% in 2024.

Future projections and actions of monetary policy

International financial organizations estimate that the world economy will grow at modest rates similar to those in 2024. In particular, the International Monetary Fund considers that in the 2025-2026 biennium, the world economy would grow by 3.3%, 0.1 pp higher than that forecast for 2024 and 2025 in the IPM of October 2024. This in a context of declining inflation and gradual monetary easing.

The national economy will grow by an average of 4.0% during the 2025-2026 biennium, a rate that, although it means a slowdown compared to 2024, is relatively high compared to the average growth estimated for trading partners (2.4% in 2025). National production would be driven mainly by domestic demand.

Both headline and core inflation are expected to return to the tolerance range around the target in the third quarter of 2025. These projections incorporate a monetary policy stance aimed at ensuring that inflation converges in the medium term to the target defined by the BCCR Board of Directors (3% ± 1 pp).

As regards the current account deficit of the balance of payments, in the two-year period it would be on average around 1.5% of GDP, similar to that of the previous year. As in previous years, this current account gap would be more than covered by long-term external savings, particularly direct investment, and would allow the ratio of reserve assets to GDP to reach an average level of 14.9% and the reserve indicator to reach an average value close to 150.0%.

Preliminary information provided by the Ministry of Finance indicates that primary surpluses consistent with the fiscal consolidation process would be generated in the two-year period in question. The primary and financial results, as a proportion of GDP, would be 1.5% and -3.1% in 2025, in that order, and 1.7% and -2.7% in 2026 (1.3% and -3.5% in 2024). Thus, the Central Government debt to GDP ratio would remain below 60% (59.8% estimated by the Ministry of Finance for 2024).

The review of the projections of the main macroeconomic variables presented in this exercise incorporates the information available as of January 2025, but is subject to upward or downward risks that, if materialized, could deviate inflation from the macroeconomic scenario incorporated in this report.

Among the downside risks, the permanence of international interest rates stands out higher for longer. This situation could reduce the growth of the country's main trading partners and, therefore, negatively affect the country's external demand, with a consequent downward impact on local economic growth and inflation.

Upside risks include potential trade restrictions due to tensions between G7 countries and China, as well as an escalation of current geopolitical conflicts. This would lead to additional disruptions in supply chains and increased volatility in commodity prices, putting upward pressure on production costs. In addition, extreme weather conditions could not be expected to continue.

not only cause supply shocks, but also generate higher costs in supply chains and, thereby, increase inflationary pressures.

In this context, the Board of Directors of the BCCR reaffirms its commitment to price stability, a condition that favors macroeconomic stability and has a positive impact on economic growth, job creation and the well-being of the population. Therefore, it maintains the inflation target at 3% ± 1 pp.

As it has done so far, its monetary policy will be based on a prospective analysis of inflation and its macroeconomic determinants, as well as on the identification, at any given time, of risks whose materialization could divert inflation from its central path.

Based on this analysis, the required adjustments will be made to the TPM so that, within the macroeconomic programming horizon, inflation returns to values close to this target.
To this end, it will also manage the liquidity of the financial system to reduce monetary excesses and prevent their persistence from generating additional inflationary pressures.

In terms of foreign exchange, in accordance with the provisions of its Organic Law, the BCCR will participate in the foreign exchange market in order to meet its own requirements and those of the non-banking public sector, as well as to mitigate violent fluctuations in the exchange rate.
To the extent that exchange market conditions permit, the Bank will seek to further strengthen the country's financial protection, in accordance with the parameters and guidelines defined by its Board of Directors.

Finally, improving communication with the public will continue to be a priority, in order to facilitate a better understanding of the macroeconomic situation and the elements that support the BCCR's decisions on monetary and foreign exchange matters and issues related to the stability and efficiency of the financial system.

Capítulo 1

Coyuntura económica

"Si el sistema bancario se pone en manos de una institución autónoma, responsable, integrada por personas capacitadas y honestas, al margen completamente de los vaivenes de la política, al cabo de algunos años el sistema bancario nacional será tan fuerte y respetable, como lo es hoy el Banco de Seguros".

Rodrigo Facio, Acta 130, p. 85 del Tomo III de las Actas de la Asamblea Nacional Constituyente.

BANCO CENTRAL DE COSTA RICA

75 AÑOS

CHAPTER 1. ECONOMIC SITUATION

The main facts of the external and national macroeconomic situation that determine the framework in which the Central Bank of Costa Rica applies its monetary policy are presented below.

In the external environment, global inflation continued to decline, although in some countries There were slight increases during the last quarter of the year, driven by high service prices and adverse weather events. This led to prudent monetary policy easing decisions in both advanced and emerging economies.

Economic activity in the main countries grew at a moderate pace during the same period; however, more recently, the possible implementation of protectionist trade policies increased uncertainty about the performance of the world economy, the process of disinflation and the relaxation of monetary policy.

In Costa Rica, the interannual general inflation was 0.8% at the end of 2024 and 0.0% in the fourth quarter of the year (0.1% in the previous quarter), while core inflation remained positive, although below 1.0%. Both indicators remained below the lower limit of the tolerance range around the inflation target.

Domestic production accelerated in the fourth quarter of 2024, leading to an estimated 4.3% GDP growth for the year, 0.2 pp higher than forecast in last October's report.

The labor market showed a behavior consistent with the results of the economic activity, which was reflected, among other things, in an unemployment rate below the historical average and rising employment and participation rates.

In the fourth quarter of 2024, the current account deficit of the balance of payments amounted to 0.5% of GDP and placed the annual gap at 1.4%, 0.3 pp of GDP lower than estimated.

The BCCR considers that the behavior of monetary and credit aggregates in 2024 did not generate inflationary pressures that exceed the inflation target in the next 24 months.

1.1 International economy

In 2024, global inflation[4] continued to decline, partly reflecting falling commodity prices and the lagged effects of tight monetary policy. However, towards the end of the year, the disinflationary process lost momentum in some countries and even reversed in others (Chart 1).

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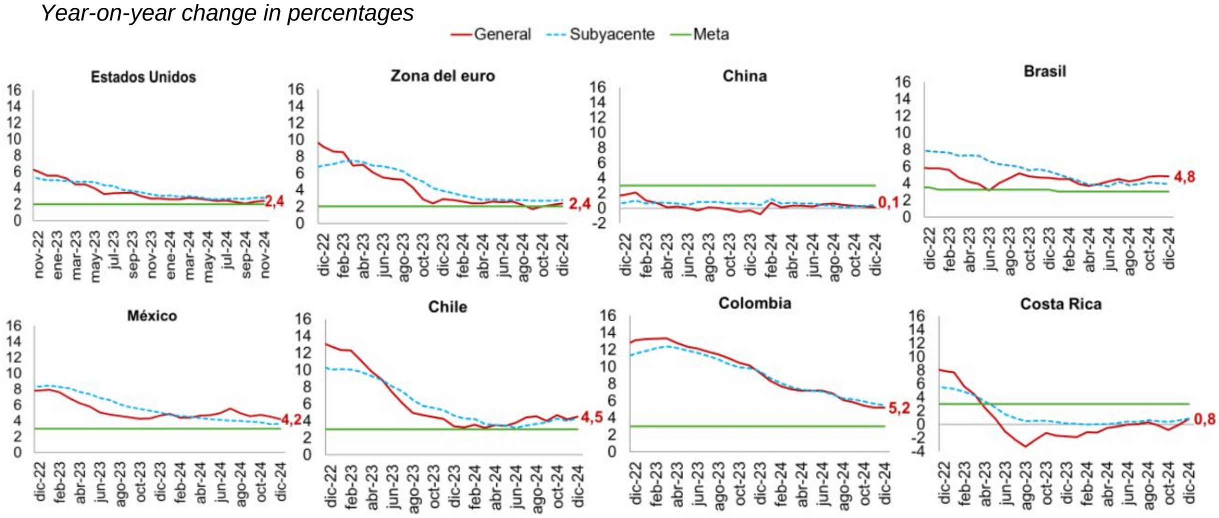
4 The data included in this section refer to year-on-year inflation.

In the United States5 , In November, headline inflation6 rose for the second consecutive month, reaching 2.4% (2.3% in October), although core inflation remained at 2.8%. This performance was driven by the downward rigidity in
service prices, which have seen high rates of change in recent months.

Gráfico 1. Inflation indicators

Year-on-year change in percentages



Source: Central Bank of Costa Rica, with information from Bloomberg as of January 29, 2025.

In the euro area, headline inflation rose in December for the third consecutive month, reaching 2.4% (2.2% in November), the highest level since last July (2.6%), but the underlying indicator (2.7%) remained unchanged. As in the United States, the rise in inflation in the euro area was mainly due to service prices, which recorded a year-on-year change of 4.0% in the month in question.
and accounted for 74% of year-on-year inflation.

In emerging and developing economies, inflation has behaved differently. For example, in China, consumer prices have remained low and stable throughout 2024, and in December, headline inflation stood at 0.1% (0.2% in November), while core inflation was 0.4% (0.3% the previous month).

In some Latin American countries, general inflation showed increases throughout the year, explained in some cases by adverse weather events (floods and droughts), which pushed up food prices, while in others factors such as increases in energy prices7 and in services (housing and others) influenced the increase. In particular, in December general inflation slowed in Brazil

and Mexico8, but grew in Chile (to 4.5% from 4.2% in the previous month) and remained stable in Colombia.

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5 In December, according to the US consumer price index, headline inflation rose to 2.9% (2.7% in November), while core inflation fell to 3.2% (3.3% in the previous month).

6 Measured by the Personal Consumption Expenditures (PCE) Price Index.

7 In the case of Chile, the increase in energy prices was influenced by the elimination of the freeze on electricity rates applied at the end of 2019, which were extended until mid-2024.

8 To stand at 4.8% and 4.2% respectively (4.9% and 4.6% in November).

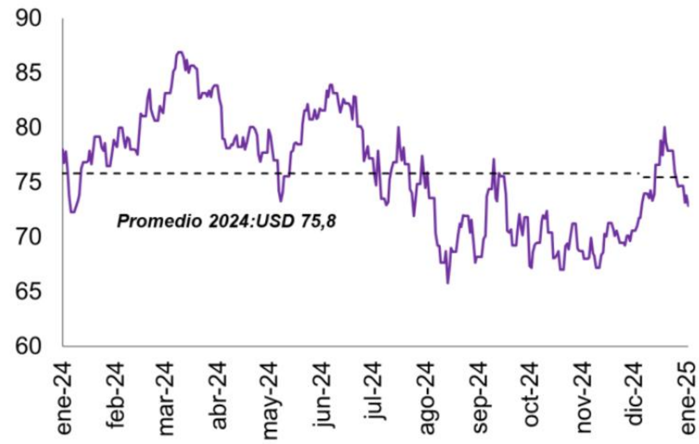
The price of oil has shown a downward trend since the beginning of the second quarter of 2024, explained by the prospects of lower demand, in particular from China, reaching a minimum on September 10 (*USD* 65.7 per barrel of WTI).

After relative stability, these prices showed an upward trend starting on December 9, influenced, among others, by the decision of the Organization of Petroleum Exporting Countries and its allies (OPEC+) to postpone the start of the increase in oil production in its member countries for 3 more months9, monetary and fiscal policies implemented by China to stimulate demand, the decline in commercial crude oil reserves in the United States10, US and UK sanctions on the Russian oil industry, as well as improved prospects for global oil demand in 202511 . More recently, this

The behavior was reversed and the price showed a downward trend, determined among other factors by: the increase in commercial oil reserves in the United States12, the resumption of exports from Libya and the possible imposition of tariffs on imports from Canada and Mexico by the United States.13

As of January 29, the average price per barrel of WTI oil was *USD* 75.4, which meant an increase of 8.3% compared to the average price in December 2024.
(*USD* 69.6) (Chart 2).

Gráfico 2. WTI oil price
USD per barrel



Source: Central Bank of Costa Rica, with information from Bloomberg as of January 29, 2025.

9 With this decision, the gradual increase in production would begin in April 2025 and conclude in October 2026.

10 Due to the severe winter in the northern hemisphere, which boosted demand for heating fuel.

11 In January of this year, the International Energy Agency (IEA) predicted an acceleration of consumption for 2025 and revised upwards its demand forecast for the last quarter of 2024. The OPEC+ maintained its forecast for global crude oil consumption to increase in 2025 (Oil Market Report - January 2025 and OPEC Monthly Market Report, January 15, 2025).

12 According to the Energy Information Administration, in the week ending January 24, these reserves grew by 3.5 million barrels (mb) and the expectation was approximately 2.2 mb.

13 Announced by the President of the United States at the Annual Meeting of the World Economic Forum, January 2025.

Central banks in most advanced economies continued to ease monetary policy. A similar pattern was observed in emerging economies, although some paused the process and others reversed it.

(Chart 3).

The US Federal Reserve System cut its benchmark interest rate by 25 basis points (bp) at its November and December 2024 meetings, respectively, until placing it in a range of [4.25% - 4.50%] 14 . In addition, at the last of these meetings he indicated that in 2025 there would be two cuts in that indicator, instead of the four he had planned in September of last year. This decision was supported on the strength of the labor market, as well as higher-than-expected inflation and an upward revision in economic growth for 202515 . Notably, at its meeting on January 29, 2025, the Federal Reserve maintained the reference interest rates within the indicated range, as expected by the financial market16 .

Similarly, at its December meeting, the European Central Bank cut its benchmark interest rate17 by 25 bp to 3.0%; this was the third consecutive reduction in this indicator during 2024.

In contrast, the Bank of Japan raised its policy rate in March 2024 from -0.1% to a range of 0-0.1%, the first increase in many years18; in August of that year and in January 2025, it raised the benchmark rate again to 0.50%.

In emerging economies, the People's Bank of China cut its benchmark interest rate (prime rate for 1-year loans) twice in 2024 (10 bp in July and 25 bp in October), bringing it to 3.1%. These cuts were part of efforts by the country's authorities to boost credit demand, consumption and investment growth, and economic activity.

14 The cumulative decrease in this indicator between September 2024, when the cuts began, and December of that year, was 100 bp.

15 Federal Reserve Minutes, December 2024.

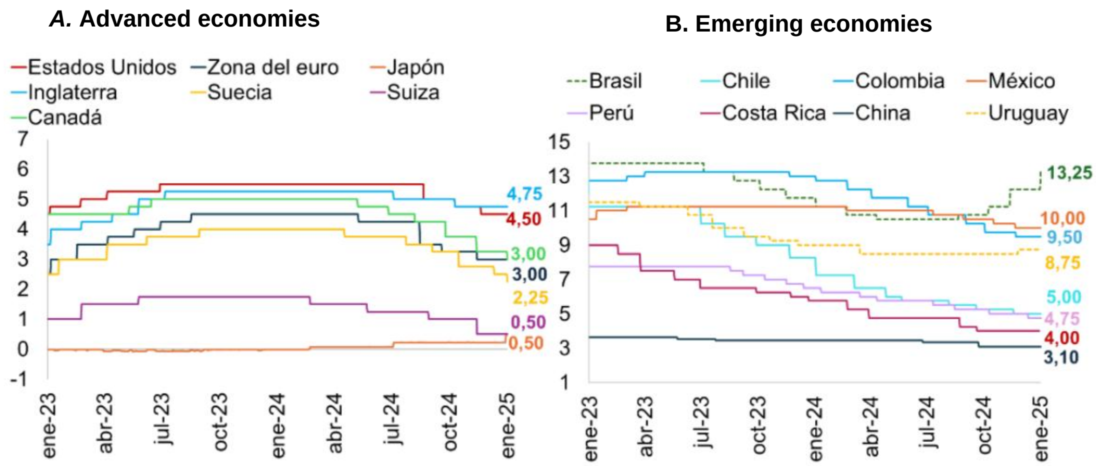
[16] The Federal Reserve's decision was unanimous. In the press release of January 29, 2025, it noted that economic activity is growing at a solid pace, labor market conditions are robust and inflation remains somewhat high.

From 18 September 2024, the European Central Bank will use the deposit facility rate as a guide for its monetary policy.

18 The Bank of Japan kept interest rates at negative levels for a prolonged period in order to stimulate an economy characterized by low growth and persistently falling prices. In March 2024, it raised the interest rate in response to inflation above the 2.0% target and to rising economic growth forecasts, given the recovery in domestic demand.

Gráfico 3. **Monetary policy rates in selected economies**

In percentages



Source: Central Bank of Costa Rica, with information from Bloomberg as of January 29, 2025.

In several major Latin American economies, the process of monetary policy easing continued, although in some the direction of policy changed. Mexico, Chile, Colombia, Peru and Costa Rica continued to cut their policy rates, with temporary pauses in the tightening process.

Brazil, on the other hand, increased its reference rate starting in September 2024 by a cumulative 275 bp to 13.25%[19] . The Central Bank of Brazil attributed these increases to several factors, including the unanchoring of inflation expectations, higher inflation projections, higher-than-expected economic growth, and a widening of the output gap.

Similarly, in December (for the first time in 2024) the Central Bank of Uruguay raised its reference interest rate by 25 bp, to 8.75%, due to uncertainty about the international context and its effect on inflationary expectations.

International financial markets showed a positive performance in 2024, although the upward trend has recently reversed. Since mid-year, they have shown episodes of increased volatility (Chart 4).

The upward trend was observed for most of 2024, but was tempered on several occasions by specific events such as uncertainty about the evolution of technology stocks; the unexpected increase in the monetary policy interest rate in Japan, which affected rate arbitrage operations; the intensification of geopolitical tensions in the Middle East and expectations of a slower pace of reduction in the reference rate of the Federal Reserve System of the United States.

In line with the aforementioned trend, the main stock indices of
The United States ended 2024 with growth rates similar to those recorded a year ago: the Dow Jones Industrial Average increased 12.9%, the S&P 500 grew 23.3%

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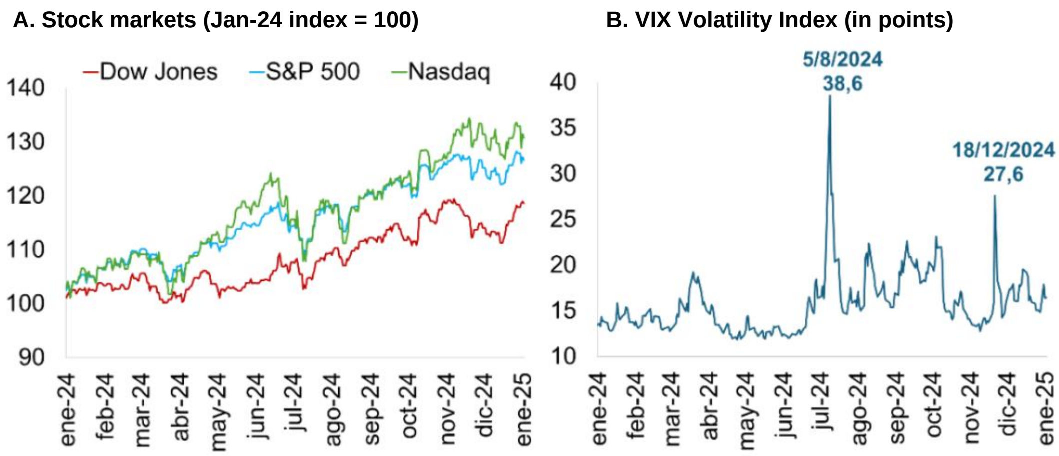
19 In the statement of January 29, 2025, the Central Bank indicated that the current scenario required of a more contractionary monetary policy due to the de-anchoring of inflation expectations, the increase in inflation projections, the resilience of economic activity and pressures on the labour market. The increase in the reference rate was 100 bp

and the Nasdaq Composite 28.6%. In January of this year, the stock indices showed a recovery

Gráfico 4. International financial markets



Source: Central Bank of Costa Rica, with information from Bloomberg as of January 29, 2025.

The positive performance of financial markets in the first part of 2024 occurred in a low volatility environment, which was reflected in the VIX20 index. In the second half of the year, this indicator increased and even temporarily exceeded 30 points (a level associated with high volatility), as a result of the increase in the Japanese reference rate (on August 5) and the expectations generated by the decision of the Federal Reserve System to reduce the adjustments in its reference rate scheduled for 2025 compared to what was projected in September 2024 (on December 18).

The economic activity of the main economies maintained a moderate growth rate in the third quarter of 2024, with which the International Monetary Fund21 estimates that the world economy would have grown 3.2% in that year, slightly below 2023 (3.3%) (Chart 5).

US economic growth moderated in the third quarter of 2024, compared to the previous two quarters, but maintained a good pace due to the strength of the private consumption22 , the strength of the labour market and improved consumer confidence.

In the euro area, economic growth improved in the third quarter but remained relatively low. This was due, among other factors, to the weak dynamics of the manufacturing industry, low business and consumer confidence and the persistence of the effect of higher energy prices23 on economic activity, elements that contributed to the cooling of the two largest economies in the region (Germany and France).

20 Indicator that measures the expected volatility in financial markets in the next 30 days.

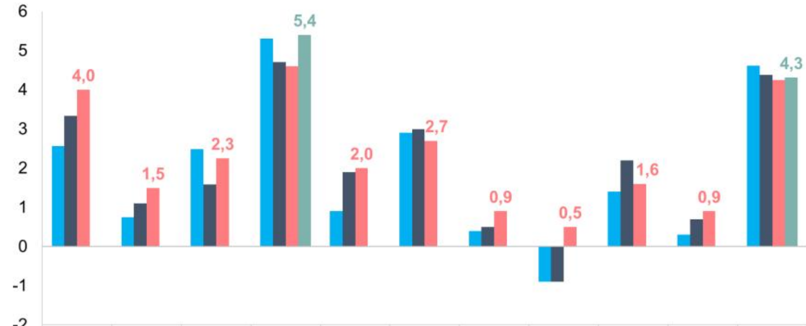
21 World Economic Outlook, January 2025.

22 This item represents more than two-thirds of the country's gross domestic product, Bureau of Economic Analysis, December 19, 2024.

23 "One cycle ends and another begins, amid growing disparity " IMF, January 17, 2025.

Gráfico 5. Quarterly GDP of selected countries and regions

Year-on-year change in percentage



	Brasil	Canadá	Chile	China	Colombia	Estados Unidos	Zona del euro	Japón	México	Reino Unido	Costa Rica
I -24	2,6	0,8	2,5	5,3	0,9	2,9	0,4	-0,9	1,4	0,3	4,6
II -24	3,3	1,1	1,6	4,7	1,9	3,0	0,5	-0,9	2,2	0,7	4,4
III -24	4,0	1,5	2,3	4,6	2,0	2,7	0,9	0,5	1,6	0,9	4,2
IV -24				5,4							4,3

1For Costa Rica, the T (1.4) of the cycle trend is used.
Source: Central Bank of Costa Rica, with information from central banks, statistical institutes and Bloomberg as of January 17, 2025.

Economic activity in China accelerated in the fourth quarter of 2024, driven by stimulus measures implemented at the end of September to generate confidence in consumers and investors and, in this way, try to achieve annual growth of around 5.0%24. A summary of these measures is presented below.

Stimulus measures implemented by China in 2024

According to their nature, the actions were classified as macroeconomic, real estate market and capital market. The first ones include: a) the reduction in the interest rate of different financial instruments25 , b) the decrease of the mandatory reserve ratio (the liquidity injection was approximately 1 trillion yuan) and c) the increase of the borrowing quota (debt ceiling) of local governments to issue special bonds worth 10 billion yuan.

To strengthen the housing market, the interest rate on existing mortgages was lowered to reduce the gap with interest rates on new mortgages (the gap encouraged early loan repayments over the past 2 years) and the down payment for the purchase of a second home was reduced.

As regards the capital market, the measures consisted of: a) a *"swap"* line for 500 billion yuan, which allows securities firms, fund management companies and insurance companies to pledge their assets as collateral in exchange for financing to acquire highly liquid assets and b) a 300 billion yuan refinancing line to guide banks to support share buybacks and purchases of listed companies.

24 China's economy was still facing the consequences of the health restrictions applied in the 2020-2022 period (fall in internal and external demand and deflationary pressures), and the prolonged real estate crisis.

25 On the 7- and 20-day reverse repurchase, the loan facility for financial institutions for one-year terms and the preferential rate for 1- and 5-year loans (reference for business loans).

In the main Latin American economies, production accelerated in the third quarter of 2024, with the exception of Mexico. The case of Brazil stood out, with a growth of 4.0% in that period, explained by the greater household consumption26 , driven in turn by government programs and improvements in the labor market, as well as the increase in investment (greater formation of capital goods).

With these results, the IMF estimates that in 2024 the gross domestic product (GDP) of the United States, the Eurozone, China and Latin America would have grown by 2.8%, 0.8%, 4.8% and 2.4% (3.7% in Brazil), respectively.

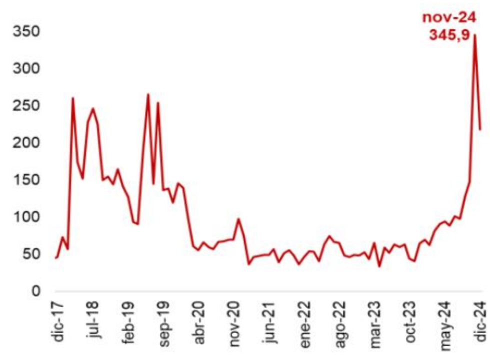
Uncertainty has increased over the possible impact on global trade of any measures taken by the new US administration.

The incoming US government announced several measures related to the country's trade, tax and immigration policy27. Additionally, it expressed its interest in making decisions on issues such as territorial expansion28 , climate change29 , the oil and gas market30 , war conflicts and artificial intelligence31, among others.

In particular, the eventual imposition of tariffs led to a significant increase in the global uncertainty about international trade, as evidenced by the Trade Policy Uncertainty Index (TPU), which last November reached its highest level since the trade conflicts of 2018 (Chart 6).

Gráfico 6. Indicator of uncertainty associated with trade policies

In points



Source: Central Bank of Costa Rica, with information from https://www.matteoiacoviello.com/gpr.htm as of January 2025.

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26 This item represents more than two-thirds of Brazil's GDP, according to the Institute of Geography and Statistics.

27 In terms of trade, the measures would focus on the imposition of tariffs and the review of trade agreements. In particular, the new administration expressed its intention to impose a tax on imports from China (60%), Canada and Mexico (25%) and the rest of the world (10%-20%). Regarding the immigration issue, on January 20, 2025, a decree was issued to declare a state of emergency on the southern border and two days later orders were signed to deploy the army on the southern border, carry out mass deportations and realign the admission of refugees to the United States.

28 Regain control over the Panama Canal and increase its territorial expansion through the purchase from Greenland.

On January 20, 2025 , several decrees were signed, including: a) the withdrawal of the United States from the Paris Agreement (2015) and, b) the declaration of a national energy emergency and the use of Alaska as an energy reservoir.

30 Search for new areas for oil and gas exploration.

On January 23 , 2025, an executive order on artificial intelligence was signed aimed at promoting the United States' global leadership in this activity.

1.2 Local economy

1.2.1 Inflation

At the end of 2024, headline inflation (year-on-year) stood at 0.8%, bringing the average for the fourth quarter to 0.0% (0.1% in the previous quarter). Core inflation32 remained positive during the last quarter of that year, although below 1.0%. Both indicators remained below the lower limit of the range defined around the inflation target.

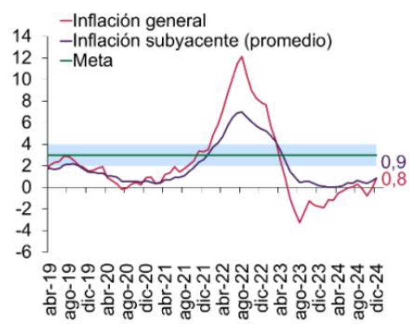
During the last quarter of 2024, headline inflation, measured by the year-on-year variation of the Consumer Price Index (CPI), showed dissimilar rates ranging from -0.8% in October to 0.8% in December (Chart 7.A), for an average of 0.0% (0.1% in the previous quarter). For its part, core inflation continued to show positive values and stood at 0.9% at the end of the year (0.6% on average in the fourth quarter).
With these results, inflation continued below the lower limit of the range around the inflation target (3.0% ± 1 pp).

As in the previous quarter33, in the fourth quarter of 2024 the average contribution of the services price sub-index to year-on-year inflation was positive (1.15 pp on average) while that of the goods price sub-index was negative to the same extent34 , so the variation for the quarter was 0.0%.

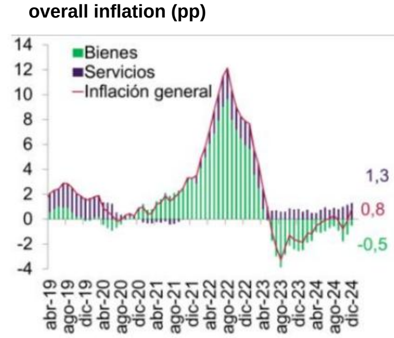
Gráfico 7. Inflation indicators

Year-on-year change in percentages and percentage points

A. General and underlying inflation (percentages)



B. Contribution of goods and services inflation to overall inflation (pp)



Source: Central Bank of Costa Rica and National Institute of Statistics and Census.

32 Core inflation captures to a greater extent the effect of internal demand factors on inflation. which monetary policy has an effect; that is, it better approaches the inflationary phenomenon, understood as a generalized and sustained change in the price level caused by monetary phenomena. For more details, see the technical note "Costa Rica Core Inflation Indices (IIS2021)".

33 In the third quarter of 2024, the slightly positive result of average general inflation (0.1%) was determined by the evolution of the services price subindex, which contributed 0.8 pp, offsetting the negative contribution of 0.7 pp from the goods subindex.

34 The weighting of goods and services in the CPI basket is 53% and 47%, respectively (base December 2020). In the fourth quarter of 2024, the average year-on-year changes were -2.2% and 2.6% in the order indicated.

In particular, in December the positive year-on-year result (0.8%) was determined by the services price subindex. This subindex increased by 3.0% year-on-year (the goods subindex decreased by 1.0%35) and, given its relative weighting in the CPI basket, its positive contribution more than offset the negative contribution of goods to the year-on-year inflation result for that month (Chart 7.B).

In services, the largest positive contributions came from fixed telephony, electricity and housing rentals, with 0.3 pp each, tourist packages abroad (0.2 pp) and airfare (0.1 pp), partially offset by telecommunications services in packages (-0.2 pp). In goods, the negative contributions of fuels (-0.6 pp), oil (-0.2 pp), new cars and meats stood out with -0.1 pp each, the above compensated to a greater extent by agricultural goods (0.7 pp).

When breaking down the CPI into its components, regulated and non-regulated, the average year-on-year variation of the former in the fourth quarter of 2024 was -2.7% and 0.5% in the latter (-1.2% and 0.3% in the previous quarter, respectively). Given its respective weights in the CPI36 basket , Their contributions to the average year-on-year inflation for the quarter under review were offset.

Specifically, at the end of 2024, regulated goods and services reached a year-on-year variation of -2.3% while that of non-regulated goods and services was 1.4%; the positive contribution of the latter more than offset the negative contribution of regulated goods and services. In the regulated goods and services, the main negative contribution came from fuels (-0.6 pp) and the positive one from electricity (0.3 pp). In the non-regulated component, the positive contributions were highlighted by potatoes (0.4 pp), mobile telephony (0.3 pp), tourist packages abroad, housing rentals and papaya with 0.2 pp each, and airline tickets (0.1 pp), partially offset by telecommunications services in packages and oil, with -0.2 pp each, and new cars (-0.1 pp).

The return of general inflation to values around 0.0%, starting in the second quarter of 2024, was mainly due to the slower pace of decline in external prices, the increase in maritime transport costs and the effects of the less restrictive stance of monetary policy.

The slower pace of decline in external prices has been reflected internally in the imported raw material price index, which recorded an average reduction of 6.7% in 2024, lower than the 12.3% drop in 2023 (Chart 8.A).

However, it is important to mention that in the fourth quarter, the index of imported raw materials registered an average year-on-year decrease of 10.7%, higher than the fall of the two previous quarters (3.2% and 9.0% in the second and third, respectively), explained by the 10.0% decrease in the price of WTI crude oil in the last quarter of the year (-7.3% in the previous quarter). The impact of this reduction on the

35 In the prices of goods, the year-on-year variation was -3.3% in October, -2.3% in November and -1.0% in December 2024. The lower negative rate in the last two months is largely the result of a supply shock due to significant increases in the price of some agricultural goods due to adverse weather conditions. In fact, fruits showed variation rates of 10%, 11.6% and 35% in the order indicated, while the subgroup of vegetables, tubers and legumes showed -5.4%, 6.9% and 12% in the same order.

36 The weighting of the regulated and non-regulated components in the CPI basket is 14% and 86% respectively (base December 2020).

The index was partly offset by the smaller decrease in the price of basic grains37 and by the high increase in the world price of maritime transport38 .

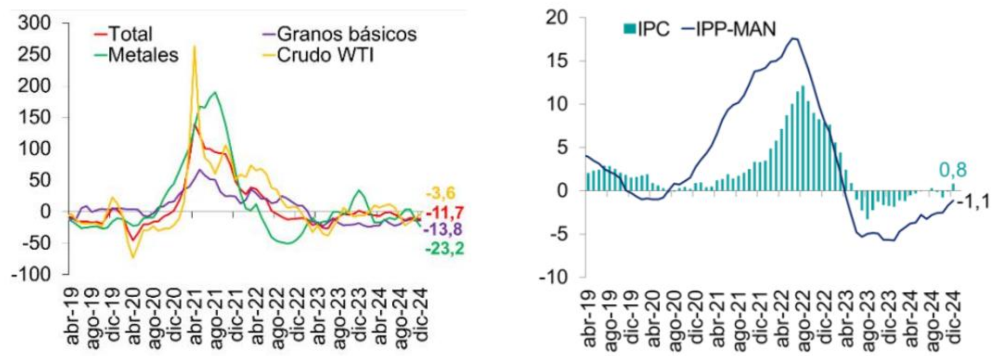
The slower pace of decline in external prices and the increase in the price of maritime transport have influenced the Manufacturing Producer Price Index (PPI-MAN), an indicator that, although it has maintained negative year-on-year variations since April 2023, has been increasingly less negative. Particularly, in the fourth quarter of 2024 its average year-on-year variation was -1.8% (-2.9% in the previous quarter)39

(Chart 8.B).

Gráfico 8. Raw material and producer prices for manufacturing

Year-on-year change, in percentages

A. Price of imported raw materials [1] **B. IPP-MAN and IPC**



1Grains include: wheat, corn, soybeans and rice. Metals: iron, steel, aluminum, zinc and copper.
Source: Central Bank of Costa Rica and National Institute of Statistics and Census.

Domestic factors also contributed to inflation returning to around zero in the fourth quarter. These include the less restrictive monetary policy40 applied from March 2023 and the lower appreciation of the local currency in 2024.

Inflation expectations, both those obtained from the survey carried out by the BCCR
As estimated from the negotiation of public securities in the Costa Rican financial market (market expectations), they remain within the tolerance range defined for inflation; however, their values have tended towards the lower limit of said range.

37 Basic grains in the fourth quarter fell 13.4% (-18.8% in the previous quarter).

38Although the global reference price for container transport fell by 30.0% on average between the third and fourth quarters of 2024 (from *USD* 5,071 to *USD* 3,561), the increase was very significant compared to the average price for 2023 *(USD* 1,488), for an increase of 139%. This behaviour was due, among others, to geopolitical tensions in the Red Sea and the effects of climate change on this activity.

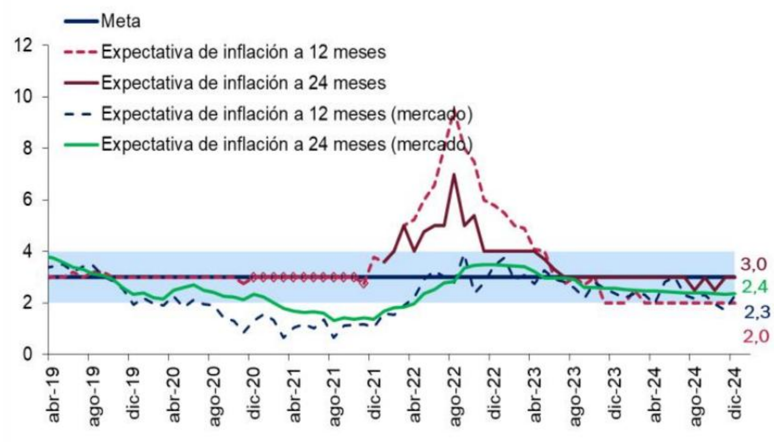
39 When broken down by type of good, the final consumer goods price subindex, which could have a greater impact on the CPI in the short term, showed an average year-on-year variation of 0.6% in the fourth quarter of 2024 (-0.3% on average in the previous quarter); in December it was 1.3%.

40 Between December 2021 and October 2022, the TPM increased by 825 bp, which led to a restrictive monetary policy stance since November 2022, which contributed to moderating aggregate demand pressures and facilitated the containment of second-round inflationary effects.

At the end of the fourth quarter of 2024, the first of these measurements placed the median of inflation expectations at 12 and 24 months at 2.0% and 3.0% respectively, while market expectations stood at 2.3% and 2.4% at those terms 41
(Chart 9).

Gráfico 9. Inflation expectations at 12 and 24 months according to the BCCR survey (median)1 and market

Year-on-year change, in percentages



1The data correspond to the expected year-on-year inflation from month t+12 to month t+24, where t is the month of the consultation. In the series of 12-month inflation expectations of the survey for the period December 2020 - November 2021 (suspension period), an inference obtained through the functional time series technique is used.
See: Functional time series in the analysis of inflation expectations surveys in Costa Rica.
Source: Central Bank of Costa Rica.

If inflation remains below the lower bound for a prolonged period, it may raise valid questions about whether the inflation target should be lowered. However, as discussed in Box 1, the revision of the inflation target does not necessarily depend on the value of the variable in a given period, but is a process that is periodically carried out by some central banks with inflation targeting regimes as part of their functions. Such a revision will not always lead to a change in the target, but it is valuable because it contributes to accountability and to the participation of society in this important issue.

41 Market expectations for 36- and 60-month year-on-year inflation stabilized at around 2.3% during 2024.

Box 1. Elements to consider in determining the inflation target

The Central Bank of Costa Rica (BCCR) officially adopted the explicit inflation targeting scheme for the conduct of its monetary policy in January 2018 42, although in practice this policy framework was applied gradually, with tangible reforms since October 2006.

This scheme is characterized by the public announcement of the central bank's commitment to achieve a quantitative inflation target over a given time horizon and is accompanied by the recognition that its main objective is to keep inflation low and stable. It also highlights the importance of accountability and explanation of the motivations behind the monetary authority's decision-making in the process of forming inflationary expectations.

In the process of transition to this regime, the BCCR took several measures43 with the characteristics mentioned in the previous paragraph. Among them, the following stand out: a) the commitment to a numerical target for inflation in the medium term, b) the adoption of a more flexible exchange rate regime, c) the definition of the Monetary Policy Rate (TPM) as the main instrument of monetary policy, d) the creation of a liquidity market in which the price of liquidity was linked to the level of the TPM, e) the strengthening of communication channels and transparency with the public, and f) the improvement of the tools to forecast inflation, all accompanied by an administrative reform and a reinforcement of human capital and its capabilities in order to take on the new tasks that the change in monetary (and exchange) regime demanded.

This box focuses on the first of the measures mentioned above, namely the commitment to a numerical inflation target. In particular, the importance of such a commitment and the theoretical aspects that must be considered in defining the target are first discussed.
The procedure followed by the BCCR when setting the current inflation target is then reviewed and information is presented on some countries that apply this monetary policy regime.

Importance of commitment to an inflation target

The first countries to implement an inflation targeting regime were New Zealand (1990), Canada (1991), the United Kingdom (1992) and Sweden (1993). According to King (2024), rather than developing a new theory of inflation, the interest of these countries in adopting this scheme was to create institutions (set of rules) that would shape the way monetary policy was established in a world of increasing financial liberalization and absence of exchange controls. In line with this purpose, in 1989 New Zealand included in the Reserve Bank Act (central bank) the objective of ensuring price stability, a commitment that was assumed by other central banks that opted for this monetary policy framework in later years.

The above shows that, from the beginning, the inflation targeting approach recognized the importance of monetary policy actions being aimed at achieving price stability. Low and stable inflation contributes to the efficiency of production processes and to the well-being of the population because it reduces the adverse redistributive effects associated with inflation.

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42 Article 5 Session 5813-2018. With the adoption of this scheme, the transition process initiated in 2005 was completed, when the Board of Directors approved the strategic project “Explicit inflation target scheme for Costa Rica” (article 11, session 5229 of January 5, 2005), the objective of which was to design a strategy aimed at preparing the conditions for migrating to an inflation targeting regime.

43 Further details of these measures are presented in Chapter 3 of the December Inflation Report. of 2017.

inflation[44]. In addition, it promotes the stability of other macro-prices (interest rates, exchange rates and wages), which allows savings, investment and consumption decisions to be taken under conditions of lower coordination costs and greater certainty[45]. This favours the efficient allocation of productive resources, with positive implications for economic growth, well-being and employment.

While central banks could direct their policy actions towards achieving price stability without communicating to the public the desired inflation level, in the inflation targeting approach central banks make explicit their commitment to the objective of achieving a certain level of inflation for the medium term. Such an announcement contributes to transparency in monetary policy actions and increases the credibility of central banks.
It also helps to guide the expectations of economic agents and, consequently, helps to consolidate the inflation target as the economy's anchor for the price formation process.

How to define the inflation target?

When setting an inflation target, the first, and perhaps most important, step is to define what low and stable inflation is. Price stability, in its most rigorous expression, means that the price level does not vary; that is, inflation is equal to zero. However, the literature indicates that a zero inflation target is not optimal.

In this regard, Mishkin and Bernanke (1997) argue that there are reasons why this target should be greater than zero. One of these reasons is the tendency of official inflation figures (measured by the Consumer Price Index, CPI) to exaggerate true inflation due to substitution bias[46] in fixed-weighted indices[47] and the lack of adequate accounting for the change in quality in the items included in the basket of goods and services on which inflation is calculated. They also indicate that, even if an inflation indicator is available that corrects this measurement error, the risks related to a very low inflation target must be considered. One of them is that there would be a greater probability of the economy falling into deflation; another is that it would not allow real wages to adjust to balance the labor market in the event that nominal wages were rigid downwards.

On the same topic, Jongrim Ha, M. Ayhan Kose, and Franziska Ohnsorge (2019) argued that while low and stable inflation has positive effects for the economy, in terms of output, employment, and financial stability, extremely low inflation, such as that which prevailed in many advanced economies after the 2008 financial crisis, may make it difficult for central banks to reduce short-term real interest rates sufficiently to provide the necessary stimulus to demand, given the near-zero value of nominal interest rates. It may therefore limit the scope for action of conventional monetary policy and lead central banks to use unconventional measures.[48]

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including large-scale purchases of financial assets, to reduce interest rates to

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[44] In particular, low- and fixed-income groups have fewer mechanisms to protect themselves against inflation and, in addition, spend a larger proportion of their income on the consumption of goods and services.

45 Frequent price fluctuations make long-term planning difficult for households and businesses, as these changes affect input costs, interest rates, wages and risk in financial markets.

46 This bias occurs when a product in the basket used in calculating inflation is replaced by another that has different specifications or quality and an adequate adjustment is not made to prices for changes in product quality.

47 It should be noted that, in Costa Rica, the CPI is calculated based on a Lowe-type Laspeyres index.

48 Such measures could entail higher costs for central banks and make it more difficult for the public to understand the message they wish to send (compared to changes in the level of the reference interest rate).

long term. These difficulties in implementing an expansionary monetary policy, in turn, increase the risk of falling into a period of self-reinforcing deflation that raises the debt burden and further depresses economic activity.49 Furthermore, they agree that extremely low inflation can also hamper the adjustment of absolute and relative real wages, due to the general downward rigidity of nominal wages.

Given the above arguments, the question is what is the optimal inflation rate? According to the last cited authors, theoretical models offer a wide range of optimal inflation rates, negative and positive, in accordance with the assumptions used. Those that recommend inflation targets equal to or less than zero usually assume perfect price flexibility, while those that assume sticky prices suggest an optimal inflation rate of zero. On the other hand, in models that incorporate a greater variety of additional rigidities and restrictions, such as sticky wages, a zero lower bound for nominal interest rates, and financial frictions and price indexation, the optimal inflation rate is positive.

As with theoretical models, the empirical literature suggests that optimal inflation rates lie within a wide range. “Too high” inflation and deflation are associated with output losses, while “too low” inflation carries the risk of deflation and eventually recession. The benchmark for considering inflation “too high” varies widely depending on country characteristics, while the minimum value for judging inflation “too low” depends on the magnitude and frequency of adverse shocks, the flexibility of fiscal policy, and the effectiveness of monetary policy transmission.

Jongrim et al. (2018) noted that, given the above risks, some economists50 recommended raising central banks’ inflation targets to 4%, twice the average target of inflation-targeting central banks in advanced economies, but others51 disagreed with that recommendation.

Specifically, for the case of the United States of America, Mishkin (2018) argued, once the reasons for and against raising the inflation target had been evaluated, that it was preferable to keep it at 2%. Among other arguments, he pointed out that one of the successes of central banks in recent years was the anchoring of inflation expectations around 2%, so if the inflation target were to increase to 4%, the success achieved in establishing a strong nominal anchor would be jeopardized.

In contrast, Summers (2018), referring to the specific case of the United States, argued that while in the mid-nineties, when the Federal Reserve System set the inflation target at 2%, this objective might have been appropriate, in 2018 it may no longer be so. This was because this value was intended to balance the costs of inflation with the benefits of avoiding deflation; however, there were reasons to believe that the risks of deflation had increased, which is why he considered it appropriate to increase the target. Similarly, Wessel (2018) suggested that the 2% objective was no longer appropriate because the neutral real interest rate52 was at that time lower than it used to be, which

49 An example of the above is the prolonged deflation that Japan faced from the second half of the nineties.

50 Blanchard, Dell'Arricia, and Mauro (2010), Ball (2014), Krugman (2014), Kiley and Roberts (2017), and Andrade et al. (2018).

51 Coibon and Gorodnichenko (2012), Coibon, Gorodnichenko and Wieland (2012), Mishkin (2018) Dorich et al. (2018), Schmitt-Grohe and Uribe (2010).

52 The neutral real interest rate is defined as the medium-term real interest rate that is consistent with an economy in full employment of the factors of production and inflation approaching the target.

which increased the risk that nominal interest rates would be constrained by the zero lower bound.53

In practice, most advanced countries with inflation targeting schemes have a target of 2% with a symmetric tolerance range (Table 1.1) and have maintained this target for a long period of time. This stability of the target may be due to the inherent costs of changing it, especially if it were to be increased.

Table 1.1 Some countries with inflation targets: inflation target and indicator used

Country	Date of adoption of the inflation targeting regime	Rate of inflation goal	Inflation indicator
Australia	1993	2.0-3.0	CPI
Brazil	1999	3.0± 1.5	IPCA [1]
Canada	1991	2.0± 1	CPI
Chili	2000	3.0	CPI
Colombia	1999	3.0 ±	CPI
Costa Rica	2018	1 3.0±	CPI
USA	2012	1	PCE [2]
Philippines	2002	2.0	CPI
Guatemala	2005	2.0-4.0	CPI
India	2012	4.0± 1	CPI
Israel	1997	4.0± 2	CPI
Japan	2013		CPI
Kenya	2013	2.0± 1	CPI
Mexico	2001	2.0	CPI
New Zealand	1990		CPI
Peru	2002	2.5-7.5	CPI
United Kingdom	1992	3.0	CPI
Czech Republic	1997	2.0	CPI
Dominican Republic	2012	2.0± 1	CPI
Sweden	1993	2.0	CPIF [3]
Uruguay	1991	2.0 4.0± 1 2.0 3.0-6.0	CPI

1/ Broad consumer price index.
2/ Personal consumption expenditure (PCE) price index.
3/ Consumer Price Index with a Fixed Interest Rate (CPIF).
Source: Central Bank of Costa Rica, with information from the International Monetary Fund.

Canada is an illustrative case, where a formal and transparent process of reviewing the inflation target is applied every five years (starting in 2001). This process has allowed for continuous improvement based on accumulated experience and knowledge, especially in the operational aspects of the application of the inflation targeting regime. The review does not imply that the objective will change; in fact, in the six reviews carried out in this country, the inflation target has been maintained54 .

53 The underlying argument is that when financial markets anticipate higher inflation, nominal interest rates are generally higher, which gives more room to cut them at times when the economy slows too much or heads into a recession.
54 John Murray (2018), who was Deputy Governor of the Bank of Canada from 2008 to 2014, explains that the main reason why the target has not changed is that the economy appears to have performed exceptionally well under the 2% inflation target. Furthermore, periodic reviews, even if they do not modify the target, are a fundamental part of central bank accountability, dispel unnecessary uncertainty and concerns of economic agents, and are a deliberate and transparent mechanism that engages stakeholders. He also states,

Another important consideration when choosing an inflation target is deciding which inflation indicator to use, since there are different measures. The selected indicator is generally considered to be accurate, well-known, timely, and easily understandable to the public. However, it is also crucial that it excludes one-off price shocks that do not affect the inflation trend, since monetary policy seeks to influence the latter. While the Consumer Price Index (CPI) meets the first four conditions, it does not satisfy the last one, thus requiring the use of a core inflation indicator. This type of indicator, although technically more suitable for approximating the long-term inflation trend, is more difficult to explain to the public, which is why most countries have chosen to use the CPI to define the inflation target (Table 1).

Additionally, it must be defined whether the target will be expressed as a point value or as a range. King (2024) points out that, in the beginning, countries that adopted the inflation targeting regime defined the objective in terms of price stability, rather than a specific value for inflation. The common practice was to establish ranges and declare that the monetary authority's goal would be to be located at the lower end of the range within a defined time horizon. This approach was adopted because setting a precise numerical target after a period of high inflation and volatility could be ambitious. Over time, success in reducing inflation led some countries to opt for point targets, while others preferred to establish symmetrical ranges around a central value.

Targets are clearer to the public and make it easier to assess whether they are being met. However, the use of target ranges gives central banks flexibility to respond to temporary shocks that affect the price level without affecting their credibility and generating unnecessary costs in terms of output. This flexibility is also supported by the fact that the inflation target is specified for a medium-term period (usually 2 years).

The literature on inflation targeting is usually focused on advanced economies, but is scarce for emerging economies such as Costa Rica. From the information collected for some selected Latin American countries, it can be seen that the criteria for choosing the inflation target differ. For example, at the Central Bank of Chile, the 3% target was derived from an analysis of the advantages and disadvantages of other possible levels of inflation, including the need to facilitate the adjustment of relative prices and maintain a sufficient distance from the zero limit on the nominal interest rate. 55 At the Central Reserve Bank of Peru, the choice of the inflation target sought to anchor inflationary expectations at a level similar to that of developed economies and thereby establish a permanent commitment to currency stability. In Colombia, the Bank of the Republic announced in 2001 that the long-term target for inflation would be 3.0%, arguing that this was consistent with the constitutional objective of ensuring the currency's purchasing power was maintained, in coordination with general economic policy.

The Bank of Canada is very careful to set out the issues it proposes to address in each review, as well as the changes that might be considered, and to solicit comments from the public, government and academics. It concludes that although the main features of the framework have remained unchanged after six reviews, something new and valuable has been learned on each occasion.

[55] According to information provided by the Central Bank of Chile, the medium-term inflation targeting scheme was adopted in 2000, with a target of 3% over two years, with the intention that most of the time inflation would be in a range of 2% to 4%. In 2020, the tolerance range was eliminated, although the target remained at 3%.

56 Peru implemented the inflation targeting regime for the first time in 2002 with a range of 1.5%-3.5%. Subsequently, in 2007, it set the inflation target at 2% with a tolerance range of ±1 pp.

Procedure followed by the BCCR in setting the current inflation target

In accordance with the provisions of Article 2 of its Organic Law57, in the macroeconomic programming of January 2008, the BCCR communicated to Costa Rican society, for the first time, a central value for the inflation target with a tolerance margin of ± 1 pp, measured with the interannual variation of the Consumer Price Index (CPI).

It started with a central value of 8%, but in July 2009 the international situation allowed this parameter to be revised downwards to 5%, a value at which it remained for the following four years, until in January 2014 it was reduced by 1 pp and since January 2016 it has been at 3%.

This last value for the inflation target was not determined arbitrarily. Given that the Costa Rican economy is small, open and imports raw materials, particularly hydrocarbons, it is reasonable to aspire to maintain a level of inflation similar to that of its main trading partners. Therefore, in 2012 the Central Bank estimated that the long-term inflation of these countries was around 3%58. Based on this, the Central Bank's Program

Macroeconomic 2016-2017 the Bank informed society of its intention to maintain the inflation at 3% with a tolerance range of ±1 pp59, an objective that has been maintained until now date.

After four years of maintaining the inflation target at 3%±1 pp, in the Macroeconomic Program 2020-2021 of January 2020, the Board of Directors of the BCCR indicated that, during that year, it would begin a process of analysis and consultations to explore the convenience and opportunity of revising the inflation target. However, the COVID-19 pandemic forced that discussion to be paused.

The issue of the revision of the inflation target was taken up again in the BCCR Strategic Plan 2025-203060. Specifically, strategic axis number one called “Low and stable inflation” provided for 2026, “to evaluate the parameters from which the inflation target is defined, in accordance with the characteristics of a small and open economy such as Costa Rica, and international experience in this matter.”

As previously discussed and in line with the economic literature on determining the inflation target, in the case of the Costa Rican economy, the current inflation target is a specific value with a symmetrical range around that value. Furthermore, said value is set based on the interannual variation of the CPI and not on an underlying inflation indicator.

Final comments

This box contributes to the beginning of the discussion on the minimum critical considerations for revising the current inflation target. In future analyses, it will be necessary to delve deeper into the specificity of emerging economies, with special attention to the case of Costa Rica.

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57 This article establishes that the main objective of the BCCR is to maintain the internal and external stability of the national currency and ensure its conversion into other currencies. Internal stability is interpreted as the achievement of low and stable inflation.

58 Álvarez and León. “Inflation of trading partners as a reference for the inflation target in Costa Rica”. Working Paper 022|2012. Economic Research Department. BCCR. The update of the inflation of trading partners indicated the following: for the subperiods 1992-2024, 2000-2024 and 2010-2024 the average was 3.50%, 2.86% and 2.72% respectively.

59 For more details, see Box 4 “The long-term inflation target” in the Macroeconomic Program 2016-2017. 60

Approved by the Board of Directors in article 11 of the minutes of session 6200-2024, held on July 23, 2024.

It is important to note the illustrative case of the Central Bank of Canada, which has carried out a review every 5 years since 2001 and has ratified the target level in force since that year in each of them.

The process of revising the inflation target is important because it contributes in particular to the central bank's accountability to citizens. To this end, it is advisable that in addition to BCCR officials, organizations and academics outside the entity participate in this process.

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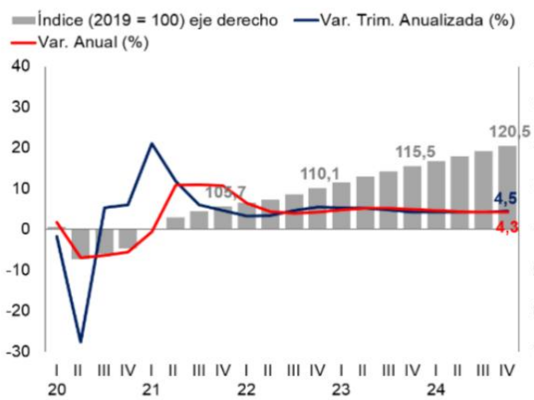
1.2.2 Economic activity, labour market, balance of payments and public finances

Production showed an acceleration in the fourth quarter of 2024 which, although modest, reversed the downward trend recorded since the second half of 2023. With this result, it is estimated that GDP would have grown 4.3% in the year, 0.2 pp higher than expected in the report last October.

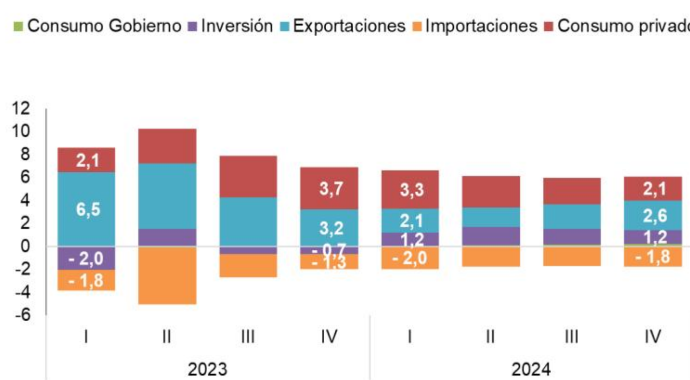
In the fourth quarter of 2024, GDP grew 4.3% year-on-year and its annualized quarterly change was 4.5%, higher than the 4.3% recorded in the previous quarter (Chart 10.A). This performance was influenced, on the expenditure side, by domestic demand, particularly private consumption and investment (Chart 10.B). By activity, construction, manufacturing and transportation services mainly influenced this result.

Gráfico 10. Quarterly GDP in volume, total variation and by expenditure components (cycle trend)

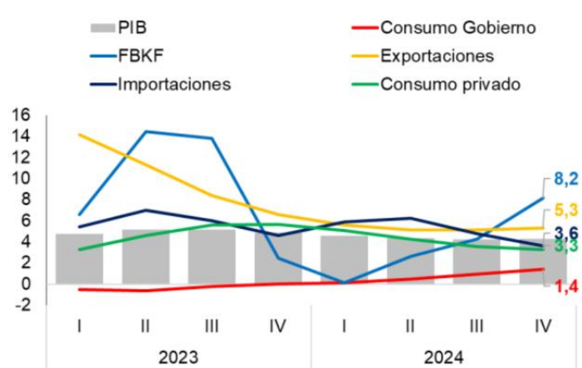
A. Total variation



B. Contribution to the interannual variation rate



C. Variation by expenditure components



Source: Central Bank of Costa Rica.

Private consumption showed a moderation in the last quarter of the year, in contrast with the acceleration in the growth of public consumption and gross capital formation (Chart 10.C).

In the fourth quarter of 2024, private consumption grew by 3.3% (5.7% a year ago), which is consistent with the reduction observed throughout the year in its growth rate. This behavior was influenced by the moderation in real disposable household income, given the dynamics of economic activity.

By type of good and service, this result corresponds to a higher consumption of clothing, footwear, educational services, housing rental services, financial services and insurance, transportation services, food products and vehicle purchases, as well as a lower consumption of furniture, paper products and health services.

In contrast to the moderation of private consumption, public consumption showed an acceleration in its growth rate throughout the year. In the fourth quarter, it recorded an interannual rate of change of 1.4%, from a value of zero a year ago. This result is linked to the greater purchases of goods and services by the public administration and health[61] .

Gross capital formation continued to rise and grew in the fourth quarter of 2024 8.2% (2.4% a year ago). This increase is explained by the greater investment in new construction (both private and public) as well as in investment in machinery and equipment by the private sector (transport equipment, parts and machinery for specialized use in the medical industry and equipment for cooling chambers).

Exports of goods and services increased by 5.3% in the fourth quarter of 2024, while imports grew by 3.6% in that period.

Exports of goods increased 11% year-on-year, a value similar to that recorded a year ago (10.6%), driven mainly by sales of companies under the special regime (medical supplies) and manufactured products under the definitive regime (sugar, meat, dairy products, copper wires, and steel sheets).

The growth rate of services exports moderated throughout the year, from 3.0% in the first quarter to 0.6% in the fourth quarter. This was due to a greater demand for IT and business services from productive units and companies under the special regime, which was offset by the slowdown in the influx of tourists[62] . In aggregate terms, exports of goods and services increased 5.3% in the fourth quarter (6.6% in the same period in 2023).

In line with the behavior of domestic demand (consumption and investment), imports of goods grew 4.3% in the fourth quarter of 2024 (0.9% a year ago). The increase in imports was driven by the purchase of vehicles, food products, transportation equipment (for people and goods), and equipment related to the medical industry and for cooling chambers. He highlighted,

61 The contracted positions showed a variation rate close to zero due to the combined effect of a slight increase in the hiring of positions in public administration and education (given the application of the fiscal rule) and the reduction in the hiring of new health personnel.

62 In the fourth quarter of 2024, tourist arrivals decreased by 3.4%, while in the same period of 2023 they had grown by 14.4%, both in year-on-year terms.

In addition, the growth in purchases by companies under the special regime after five quarters of negative results63 .

Imports of services increased by 8.6% mainly due to the greater flow of Costa Ricans to the rest of the world64 and the increase in transportation services. In aggregate terms, imports of goods and services increased by 3.6%, which meant 1.0 pp less compared to the same period in 2023.

By economic activity (Chart 11), agriculture and hotels and restaurants slowed down in the fourth quarter of the year, both affected by adverse weather conditions.

Agricultural activity registered a growth of 0.8%, lower than that observed both in the previous quarter (2.0%) and a year ago (3.4%). This increase is related to the greater exportable production of pineapple and the boost in domestic demand for meat, chicken, milk and eggs, effects partially offset by due to the contraction in the production of goods such as coffee, onions, bananas and vegetables65 .

Weather conditions also affected the production of hotel and restaurant services, forcing the closure of airports (due to their effect on the runway), with the consequent reduction of flights to the country. However, there was a constant influx of tourists, mainly in coastal areas and some mountain areas, as well as an increase in domestic demand for restaurant services66

, The growth of this activity in the fourth quarter (1.0%) was considerably lower compared to a year ago (7.2%).

Manufacturing and construction accelerated their growth, driven, respectively, by the production of companies under the special regime and works for private purposes.

Manufacturing grew 6.2% in the last quarter, higher than the rates of previous quarters. This is related to the continued boost in production by companies under the special regime67, and to the increase in factory production by companies under the definitive regime, particularly of food products (chicken, meat, bakery products, sugar and dairy products), batteries, copper wires and cleaning products.

Construction activity showed little dynamism during the first three quarters of the year, with growth rates below 3.0%. However, in the fourth quarter, its variation (8.6%), although it moderated with respect to a year ago, showed a significant improvement, due to the performance of construction for private purposes and the recovery of construction for public purposes.

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63 This improvement was observed in the purchases of inputs for the metallurgical, metalworking, chemical and pharmaceutical industries, as well as construction materials.

64 In the fourth quarter of 2024, outbound tourism increased by 8.9% (25.7% in the same period in 2023).

65 The decline was due to adverse weather conditions that affected crop productivity.

66 Fast food chains, specialized food services for corporate groups and business events in hotel facilities.

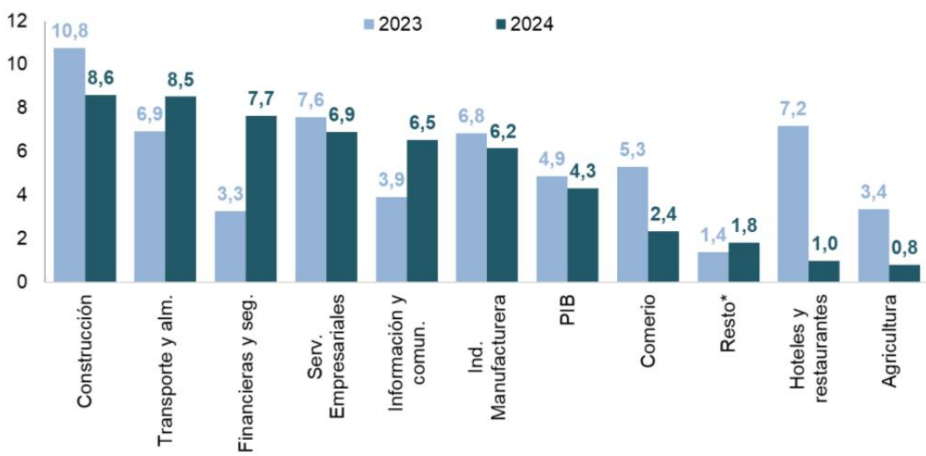
67 In the fourth quarter of 2024, production under the special and definitive regimes increased by 11.9% and 1.9% respectively (13.1% and 1.6% in the same period in 2023).

In the case of works for private purposes, the highest execution of housing projects for middle and high incomes stood out, followed by growth in the construction of residential and non-residential buildings (industrial warehouses, commercial premises and shopping malls).

Public works have had three quarters with positive results and reached their highest value in the fourth quarter. This was influenced by the greater execution of road infrastructure works by the National Roads Council (CONAVI) and the Ministry of Public Works and Transport (MOPT), as well as progress in electricity generation projects68 and municipal projects.

Gráfico 11. Quarterly GDP in volume by economic activities in the fourth quarter quarter of 2024 (cycle trend)

Year-on-year change in percentages



*Includes mining and quarrying activities, electricity and water, real estate, public administration, health and education, artistic and entertainment activities and households as employers.
Source: Central Bank of Costa Rica.

Trade slowed down in line with the slowdown in some activities, while transport accelerated.

Trade activity registered a lower growth compared to a year ago (2.4% from 5.3%), in line with the evolution of activities such as agriculture and hotels, restaurants, as well as with the moderation of growth in household income. By type of goods, the moderation was reflected in sales of hardware, electrical, food and fuel products, mainly.

Transport activity also accelerated during the year, increasing by 8.5% in the fourth quarter (6.9% a year ago). In particular, there was a notable increase in transport support activities, taxi transport services and freight transport services.

[68] Borinquen Geothermal Project in Guanacaste.

Information and communication activities and professional services, as well as financial services, showed greater growth compared to the previous year. former.

The acceleration of information and communications activity is explained by the external demand for IT services from companies under the special regime (specifically, technical support, program development and IT consulting), movie theater services, cable and conventional television, as well as mobile telephone and Internet services.

The growth of professional services responded both to the demand for activities under the definitive regime (advertising services, architecture, engineering, vehicle rental and private security) and to the external demand for support services.
companies under the special regime. In contrast, there was lower demand for technical design and research and development services.

Finally, financial and insurance services activity increased by 7.7% (3.3% a year ago), explained by: a) financial intermediation services, mainly due to the growth of current account deposits and savings at sight; b) commissions, especially for the use of credit and debit cards; and c) income from insurance services.

Given the performance of economic activity in the fourth quarter of 2024, it is estimated that GDP grew 4.3% in the year, which means an upward revision of 0.2 pp compared to what was forecast in last October's report (Table 1).

The estimated growth for 2024 is higher than the historical average recorded in the period 2010-2019 (3.8%), prior to the pandemic, and that of the country's trading partners in 2023 and 2024 (estimated at 2.8% and 2.5%, respectively).

The upward revision with respect to the October report considers a greater external demand for manufactured products, both under the final and special regime, as well as a slightly greater growth in final consumption expenditure. By economic activity, the improvement noted was concentrated in construction and manufacturing activities. In the first case, it was linked to the execution in the last quarter of the year of construction projects for private use, while in manufacturing, the performance in external sales of medical supplies and manufactured products under the final regime had an impact.

Table 1. GDP in volume according to expenditure components and economic activities.

Annual variation in percentages and differences in pp

	Estimate	Differences with Regarding IPM October 2024 in pp	Contribution (pp)
	2024	2024	2024
Gross domestic product	**4.3**	**0.2**	**4.3**
Household consumption	4.0	0.3	2.6
Government consumption	0.7	0.2	0.1
Gross fixed capital formation	4.3	-0.1	0.7
Change in inventories (% of GDP)	-0.2	-0.2	0.7
Exports	**5.8**	**0.9**	**2.2**
Estate	8.0	1.2	1.7
Services	2.9	0.3	0.5
Imports	***6.0***	***0.2***	**-2.0**
Estate	4.9	-0.3	-1.2
Services	9.6	2.1	-0.8
Real gross disposable income	4.3	0.3	
Real gross disposable personal income	4.1	0.3	

	Estimate	Differences with Regarding IPM October 2024 in pp	Contribution (pp)
	2024	2024	2024
Gross domestic product	**4.3**	**0.2**	**4.3**
Agriculture	2.0	0.2	0.1
Manufacture	5.5	0.3	0.8
Construction	3.5	3.7	0.1
Private destination	3.5	4.2	0.1
Public destination	2.7	-2.4	0.0
Trade	3.9	0.0	0.4
Transport and storage	7.8	0.1	0.3
Hotels and Restaurants	5.0	-0.5	0.1
Business Services	6.7	0.2	0.9
Rest [1/]	3.3	0.1	1.6

[1]Includes mines and quarries, electricity and water, information and communications, real estate activities, financial intermediation and insurance, public administration, education and health, other services and taxes on imports and products.
Source: Central Bank of Costa Rica.

The outlook for the economy's performance, both among consumers and businesses, is optimistic.

In the fourth quarter of 2024, the Consumer Confidence Index (ICC) prepared by the University of Costa Rica stood at 52.6, 0.9 points higher than the previous quarter, which shows an optimistic and relatively stable perception of consumer confidence (Chart 12).

The ICC is divided into two sub-indexes, which measure consumers' perception of the current and future economic environment. This time there was no significant change in opinion about the future, but perception did improve.
related to the current environment69 .

In contrast, the Economic Agent Confidence Index calculated by the BCCR70 stood at 56.9 points (3.8 points less than in the previous quarter), which interrupts the trend of six consecutive quarters on the rise, although it remains in the area that corresponds to optimistic perceptions.

Finally, for the first quarter of 2025, the UCR global business expectations index rose 3.1 points compared to the previous quarter and accumulated 14
consecutive quarters with values above 50 points, which reflects that the
optimism on the part of businessmen remains.

Gráfico 12. Consumer and business confidence indices1

1Values above 50 denote optimism and below that level reflect pessimism.
Source: Central Bank of Costa Rica and University of Costa Rica.

The unemployment rate remained relatively stable in the last months of 2024, in a context of greater employment and participation in the labor market.

In November, the unemployment rate71 was 7.3%, 0.3 pp and 0.1 pp higher than the previous month and a year ago, respectively. Despite the increase in this variable, it is still below the historical average72. The underemployment rate stood at 3.4% and continued to decline (Chart 13.A).

Employment continued to rise and reached 2.2 million workers, a figure 160 thousand people higher than the level recorded in the same period of the previous year, which meant a

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69 According to the ICC Report for the fourth quarter of 2024, more people indicated that it was a good time to purchase durable goods for the home. There were no significant changes in the opinion on the economic condition of households compared to a year ago.

70 Respondents are academics linked to the economic area, economic and financial analysts, and businesspeople.

71This indicator relates the unemployed population to the labor force. The unemployed population is made up of the labor force that was not employed in the reference week, although it was available to participate in the production of goods and services, and sought employment. The labor force is the set of persons aged 15 years or older who during the reference period participated in the production of goods and services or were willing to do so; it is made up of the employed and unemployed populations.

72 Between 2010 and 2019 (the year before the pandemic), the average unemployment rate was 9.9%.

year-on-year increase of 7.8%. This means that the level of total employment was practically the same as that recorded at the beginning of 2020. The employment rate stood at 52.6%, 3.2 pp higher than that recorded the previous year (Chart 13.B).

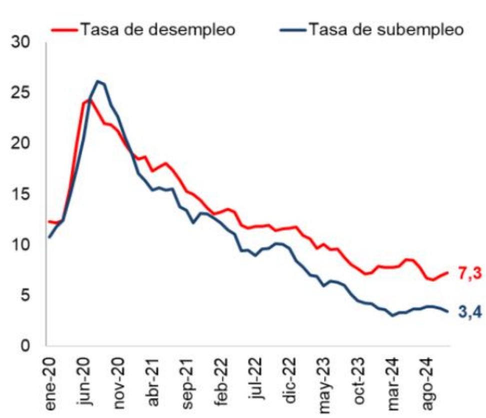
Formal employment (Chart 13.C) performed better, with a year-on-year increase of 5.7%, which placed its level 15.4 pp above that recorded in the pre-pandemic period. In contrast, informal employment remained far from the level recorded in February 2020 (17.9 pp less), although its year-on-year growth accelerated during the second half of 2024 (11.2% in November). Informal employment accounted for 39.0% of the total (46.3% in 2019).

According to qualification level (Chart 13.D), high-qualification employment was 14.4 pp higher than the value recorded in February 2020, while medium- and low-qualification employment also tended to rise, but without returning to the level of that period (3.2 pp and 4.8 pp respectively).

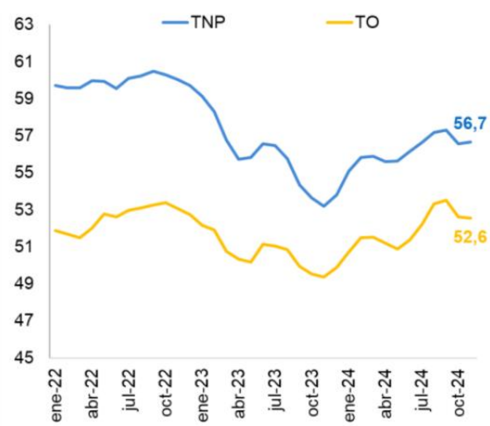
Gráfico 13. Labor market indicators

In percentages.

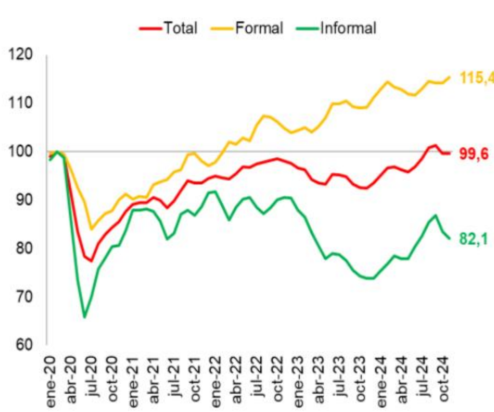
A. Unemployment and underemployment rate



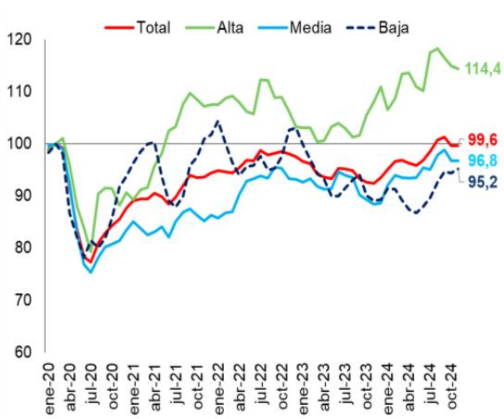
B. Net participation and employment rate



C. Employed by formality (Feb-20=100)



D. Employed by qualification (Feb-20=100)



Source: Central Bank of Costa Rica with information from the National Institute of Statistics and Census.

Labor force participation also continued to grow in 2024, as in November it stood at 56.7%, 3.5 percentage points higher than in the same month last year. This trend is consistent with the trajectory of economic activity, which could have influenced workers' expectations about the possibility of finding employment in the short term. In addition, the recovery of real wages in recent months encourages greater participation in the labor market.

Real labour income moderated its growth rate and showed heterogeneity by type of employer (public and private sector) and by the qualification level of workers.

The moderation in the pace of income growth was observed both in real and nominal terms and was consistent with the results of economic activity (Chart 14.A).

Income growth continued to be uneven across employer sectors (Chart 14.B). The increase in real income in the private sector (10 pp higher than the pre-pandemic level) contrasts with the fall in public sector income (around 11 pp less than in the pre-pandemic period). This indicates, on the one hand, the good performance of the economy, which allowed an acceleration in the growth rate of income (from work) in the private sector and, on the other, the effects of spending restraint on the dynamics of public sector workers' wages.

There are also differences in income depending on the level of qualification. The income of medium- and low-skilled workers in the private sector rose (7.8 pp and 13.9 pp more than in February 2020), while the income of high-skilled workers in the same sector, although they registered an increase in their real income, has tended to moderate.

The real earnings of low- and medium-skilled public sector workers remained below the level recorded before the pandemic, although they tend to converge towards that level from 2023 onwards. In contrast, the earnings of high-skilled public sector workers stagnated at 15 percentage points below what was recorded in February 2020.

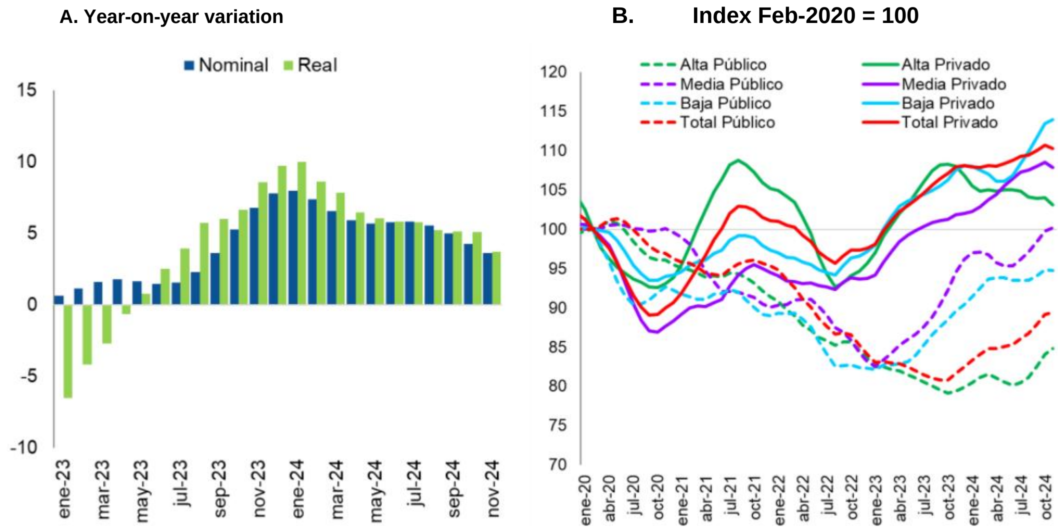
The evolution of income by qualification is consistent with what has been observed in economic growth and the level of employment. The pandemic caused a reduction in the labor supply (lower participation), which had a greater impact on informal jobs.
This behavior has been gradually, but not completely, reversed.

Informal employment, whose recovery is less, is associated, to a greater extent, with low- and medium-skilled jobs, which contrasts with an economy that, due to its growth rate, increases labor demand. As a consequence, this dynamic possibly explains the greater growth in wages in these groups.

In summary, the recent performance of the labour market is consistent with the results discussed for economic activity and is reflected in unemployment rates below the historical average (9.9% between 2010 and 2019) and rising employment and participation rates. At the same time, real incomes show a recovery, associated with both economic growth and the containment of the inflationary shock, although in the case of the public sector they are still below the pre-pandemic level.

Finally, in the period between 2020 and 2024, the level of production increased by more than 20%, while employment, after falling as a result of the economic effects of the pandemic, reached the level of early 2020 in the second half of 2024. This allows us to infer that there has been a significant increase in labor productivity73. This has a favorable impact on the economy's growth capacity in the long term and improves workers' income.

Gráfico 14. Real income1 in main occupation by qualification and institutional sector *Year-on-year change in percentages and Feb-20 index = 100.*



1Calculations from the trend series of actual income.
Source: Central Bank of Costa Rica with information from the National Institute of Statistics and Census.

In the fourth quarter of 2024, the current account deficit of the balance of payments amounted to 0.5% of GDP, which at the end of the year reached the equivalent of 1.4% of GDP. The latter meant a downward revision of 0.3 pp of GDP compared to the estimate in October (Table 2).

The narrower current account gap than expected in October was mainly due to the result in the goods account, whose deficit was lower than estimated at 0.7 pp of GDP. This performance combined the effect of an increase in exports and a reduction in imports compared to the forecasts of 0.5 pp and 0.2 pp of GDP, respectively.

The higher exports of goods were determined, to a large extent, by the performance of foreign sales of companies under the special regime, particularly those of medical supplies. Additionally, the preliminary figures for exports under the definitive regime show a slightly higher than estimated growth, both for agricultural goods and manufactured products.

The slower pace of import growth compared to what was expected for 2024 was concentrated primarily in purchases of raw materials and goods.

73 The average number of effective hours worked per week in the period 2010-2019 was 42.6, while in the period 2020-2024 it was 40.6. Therefore, the improvement in productivity per hour worked increased.

of capital under the special regime. In the definitive regime, a slight downward adjustment was observed, explained by the hydrocarbons item, while in the rest of this regime an increase in external purchases was recorded, driven to a greater extent by the acquisition of goods intended for consumption.

Table 2. Balance of payments of Costa Rica
In millions of USD, as a percentage of GDP and in percentage points (pp)

	Estimate IV Quarter 2024		Estimated 2024		Differences Regarding the IPM October 2024
	USD	% of GDP	*USD*	% of GDP	In pp
I Current account	**-487**	**-0.5**	**-1 335**	**-1.4**	**-0.3**
A. Goods	-1 001	-1.0	-4,000	-4.2	-0.7
Exports FOB Imports CIF	5 397	5.7	20,616	21.6	0.5
Hydrocarbons	6 398	6.7	24,616	25.8	-0.2
	451	0.5	2,287	2.4	-0.1
B. Services	2 358	2.5	10,272	10.8	-0.1
Travel	683	0.7	3,553	3.7	0.0
C. Primary income	-1 950	-2.0	-8 170	-8.6	0.3
Interest on external public debt Rest of primary	-309	-0.3	-1 336	-1.4	0.0
income D. Secondary income **II**	-1 640	-1.8	-6 835	-7.2	0.3
Capital account	106	0.0	563	0.6	0.0
	5	**0.0**	24	0.0	0.0
Net lending (+) / Net borrowing (-)	**-482**	**-0.5**	**-1 311**	**-1.4**	**-0.3**
III Financial account	**-554**	**-0.6**	**-2 231**	**-2.3**	**-0.6**
Public sector	99	0.1	-273	-0.3	-0.3
Private sector	-653	-0.7	-1 958	-2.1	-0.3
Direct investment liabilities	-1 226	-1.3	-5 123	-5.4	0.3
IV Reserve assets	**72**	**0.1**	**920**	**1.0**	**-0.3**
Reserve asset balance	**14 177**	**14.9**	**14 177**	**14.9**	**-0.3**

Source: Central Bank of Costa Rica.

In particular, the oil bill in 2024 was *USD* 2,286.6 million *(USD* 451.1 million in the fourth quarter), 0.1 pp of GDP lower than forecast last October. This difference combined the effect of a lower average price for the hydrocarbon mix (1.8%) and a lower quantity of imported barrels (2.5%).

The surplus in the services account in 2024 is estimated at *USD* 10,272.0 million, equivalent to 10.8% of GDP (10.9% estimated in the previous report). This downward revision was mainly the result of manufacturing services (according to preliminary figures for the October-November two-month period).

The travel account result was in line with expectations, despite the temporary closure of the Daniel Oduber Quirós International Airport in Guanacaste in November due to deterioration of the runway.

Net expenditures on remuneration of productive factors (primary income) amounted to 8.6% of GDP in 2024 (2.0% in the fourth quarter). This figure represented an upward adjustment of 0.3 pp in relation to the estimate in the previous report, due to the increase in income from direct investment in the fourth quarter, since the interest on external public debt was similar to that expected.

At the end of 2024, the country required net external financing for an amount equivalent to 2.3% of GDP, a ratio lower by 0.6 pp of GDP than estimated in October and consistent with the lower current account deficit. These inflows made it possible to finance this deficit. and promote a 1.0% increase in GDP in reserve assets.

The lower access to external savings compared to what was projected in the previous report was mainly due to the greater net outflow of resources from the rest of private capital (which excludes direct investment) and the lower financing received by public banks. Direct investment was equivalent to 5.4% of GDP, 0.3 pp higher than the estimate from last October and, as usual, it was mostly channeled to the manufacturing industry, specifically to medical supplies and electronic components companies (mainly semiconductors).

External savings allowed the joint negative gap in the current and capital accounts to be financed, reserve assets to be accumulated at around 1.0% of GDP and a balance of *USD* 14,177.3 million at the end of December, equivalent to 14.9% of GDP (15.2% forecast in October). In this context, the net international reserves (NI) monitoring indicator stood at 144.6% of the minimum adequate level defined by the BCCR Board of Directors.

In terms of other indicators, this amount of reserves is equivalent to 8.5 months of imports of goods under the definitive regime and 2.2 times the balance of the country's total short-term external debt.

In the period January-November 2024, public finances maintained a performance consistent with the objective of medium-term fiscal consolidation, despite the deterioration recorded in financial results compared to the same period in 2023.

At the end of November, the Central Government presented a primary surplus equivalent to 1.2% of GDP and a financial deficit of 3.2% of GDP; although these results are less favorable than those observed a year ago (1.8% and -2.5%, in the respective order), it continues with positive primary results, which, in itself, is consistent with the search for fiscal sustainability (Charts 15.A).

Tax revenues accumulated through November grew by 2.0% (2.6% a year ago) and represented 11.9% of GDP[74]. On the one hand, customs revenues recovered (they grew by 8.9% in contrast to the fall of 7.5% twelve months ago) and the single tax on fuels grew by 8.9%; these effects were partially offset by:

a. The drop in revenue from income and profits tax, specifically that corresponding to legal entities in the private sector, which decreased by around 0.3 pp of GDP in 2024 compared to the previous year.

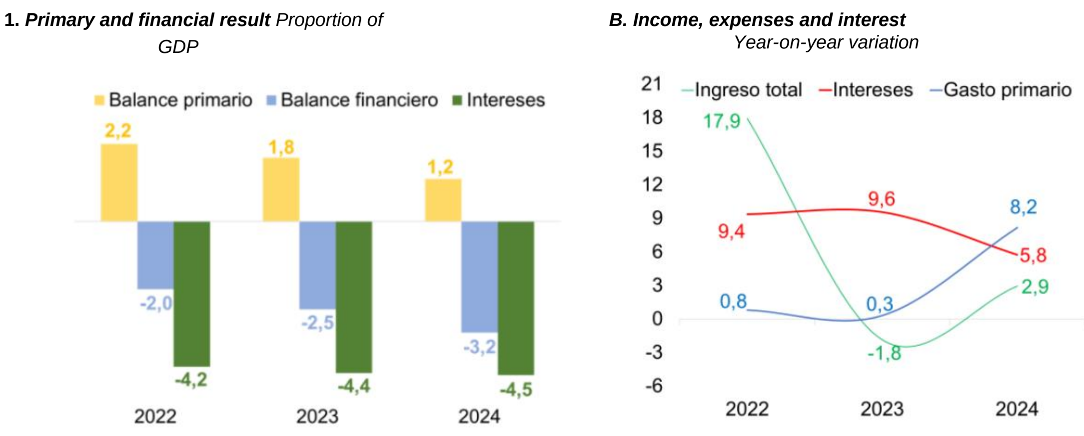
   According to the Ministry of Finance (MH), this behavior responded to the lower liquidation made by companies in March 2024.

74 Tax revenue in terms of GDP in the same period of 2022 and 2023 reached 12.4% and 12.1%, in that order. The lower relative weight in 2024 could be associated, in part, with the differentiated evolution of economic growth according to the trade regime. The tax scheme introduces tax incentives (exemption from some taxes) for companies covered by special trade regimes, whose production in the last five years grew at an average rate of 13.2% (4.7% for the definitive regime); this increased their contribution to economic growth (from 10.1% in 2019 to 13.6% in 2024). Given this differentiated performance of economic activity, the unequal tax treatment introduces challenges
for the revenues of the Ministry of Finance and, in the medium term, risks to fiscal sustainability.

corresponding to the fiscal period 2023, which focused on private legal units in the financial, transportation and agricultural sectors75 .

b. The reduction in property tax collection, particularly vehicle property tax, which decreased by ¢37.8 billion (0.1% of GDP in 2024) compared to the same period in 2023.

Gráfico 15. Central Government: financial and primary results and interests.
Figures as of November of each year



Source: Central Bank of Costa Rica with figures from the Ministry of Finance.

Total and primary spending showed growth of 7.5% and 8.2%, respectively, as of November 2024, above the 2.7% and 0.3% of the same period in 2023 (Charts 15.B).
This behavior was due to:

a. Salary expenses, which grew by 6.5% (1.7% in 2023), as a result of the commitment made by the Ministry of Finance to pay the retroactive payment corresponding to the general increase in the base, pending since 2020 (approximately ÿ92,000 million).

b. The increase in current and capital transfers, of 6.1% and 25%, respectively (-0.6% and -0.2% twelve months ago, in that order), especially due to the greater resources transferred to the Costa Rican Social Security Fund (CCSS), the Special Higher Education Fund (FEES), the Housing Mortgage Bank (Banhvi), the Education Boards and the National Emergency Commission (CNE).

c. The payment of interest on the debt, which amounted to ÿ2.2 trillion (4.5% of GDP) and This meant an increase of 5.8% year-on-year, lower compared to the same period in 2023 and 2022 (9.6% and 9.4%, in that order).

75 In the financial sector, the greatest impact occurred in three commercial banks; in the transport sector, in companies supporting air transport and maritime trade, particularly freight and cargo handling; and in the agricultural sector, it was associated with the liquidation of domestic sales and exports (particularly pineapple).

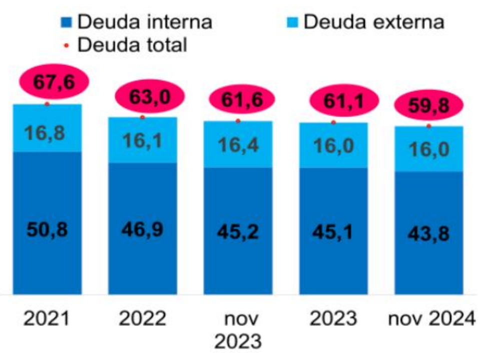
The generation of a primary surplus in the last three years reduced the Government's financing requirements and allowed the debt to grow at a slower rate than nominal GDP and, as of November 2024, the debt/GDP ratio decreased by 1.8 pp compared to the same month of the previous year and stood at 59.8%76 (Chart 16.A).

The debt balance grew by 1.3%, a rate lower than the growth of a year earlier (2.2%) and average for the five-year period 2019-2023 (9.4%) (Chart 16.B).

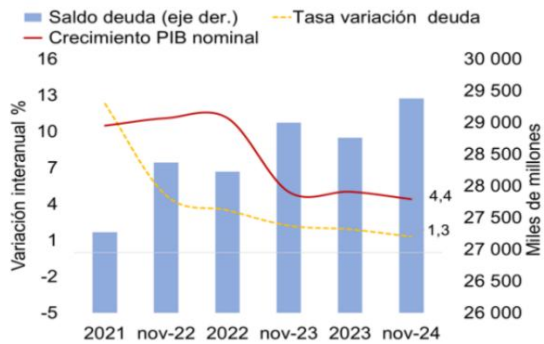
Gráfico 16. Central Government: total debt balance.

As a proportion of GDP, in millions of colones and variation rates

A. Central Government Debt



B. Total debt balance and growth

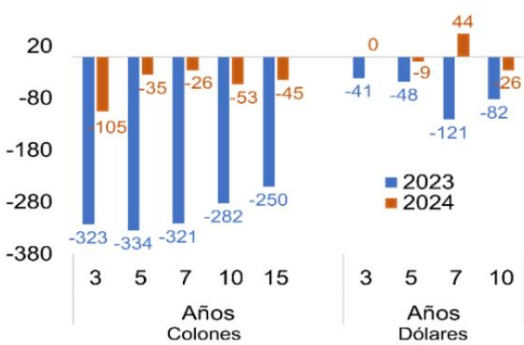


Source: Central Bank of Costa Rica with figures from the Ministry of Finance.

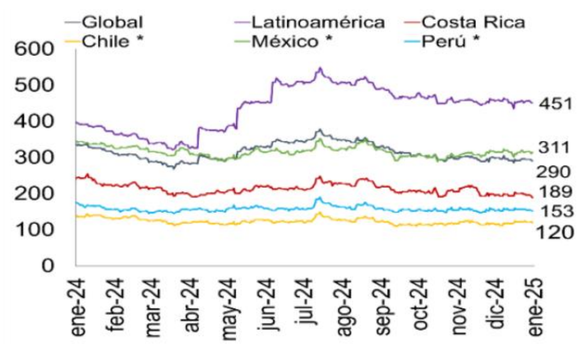
Gráfico 17. Adjustment in the interest rates of domestic debt securities Central Government and Emerging Markets Bond Indicator (EMBI)

In basis points

A. ***Adjustment in interest rates***



B. EMBI (22/1/25)



*Investment grade economies.
Source: Central Bank of Costa Rica with information from the Ministry of Finance.

76 According to preliminary data provided by the Ministry of Finance, the debt-to-GDP ratio at the end of 2024 stood at 59.76%, which would allow the fiscal rule to be applied in 2026 to current expenditure rather than total expenditure. In addition, the percentage to be applied would be 75% of the average nominal GDP growth. However, given the proximity of this result to 60%, there is a risk that measures that have a negative impact on the primary result in 2025 or adverse financial conditions could undermine the sustainability of debt at values below 60% of GDP.

Fiscal consolidation contributed to improving the confidence of economic agents in the Central Government's ability to meet its obligations, which was reflected in a reduction in the interest rates assigned in the primary debt market during 2024[77] (Chart 17.A). Similarly, the perception of sovereign risk not only decreased throughout the year but is also better than the Latin American average and some economies in the region with higher credit ratings, as can be seen in the emerging market bond indicator, EMBI (Chart 17.B).

1.2.3 Monetary conditions

The Central Bank estimates that the behavior of monetary aggregates at the end of December 2024 will not generate inflationary pressures that exceed the inflation target in the next 24 months.

At the end of 2024[78], the monetary base increased by 8.7%, an expansion determined mainly by the monetary effect of the net purchase of dollars by the BCCR in the foreign exchange market, the payment of interest on deposit instruments in national currency and the drop in the balance of electronic term deposits. These movements were partially offset by the net placement of monetary stabilization bonds and the increase in both the balance of the Government's general fund in colones and deposits in the Integrated Liquidity Market (MIL).

Financial savings, approximated by broad monetary aggregates, during 2024
showed variation rates consistent with the growth of economic activity and the inflation target, which is why it is considered that its behavior does not incubate inflationary pressures above said target.

Total liquidity and financial wealth grew, on average, at an interannual rate at the end of the year of around 6.5%, while the broad currency (M1) accelerated, from 6.8% in December 2023 to 11.3% a year later, which highlighted the

Greater preference of savers for highly liquid deposits in colones (Chart 18.A). This behavior is related to the lower opportunity cost of holding instruments with low or no yield, given the reduction in passive interest rates in colones[79] and the low levels of inflation observed since the second half of 2023.

The decrease in passive interest rates in colones, together with the behavior of passive rates in dollars and expectations of variation in the exchange rate (according to the market), placed the reward for saving in national currency at negative values throughout the year (Chart 18.B).

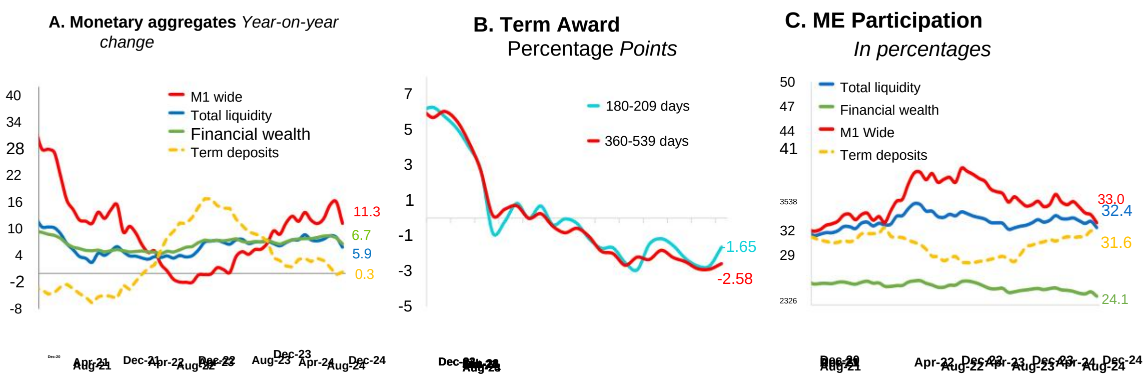
77 The downward adjustment in interest rates was between 26 and 105 bp for all terms in colones and between 9 and 26 bp in foreign currency, if the yields assigned between December 2023 and December 2024 are taken as a reference.

78 Considers information from the BCCR and financial intermediaries (preliminary) as of December 31 2024. The growth rates of monetary aggregates and credit to the private sector exclude the effect of changes in the exchange rate.

79 The reductions in the TPM from March 2023 to December 31, 2024 (500 bp) have been transferred mainly to passive interest rates.

The negative values of the bonus for saving in colones80 have influenced the dollarization of term savings. Thus, at the end of December of the previous year, term deposits in foreign currency registered an annual growth of 5.6% while in colones it contracted by 2.0%; thus, the relative share of the foreign currency component of said deposits increased by 1.6 pp in the year81 and 0.4 pp in the last quarter of 2024 (Chart 18.C).

Gráfico 18. Monetary aggregates, reward for saving in national currency and relative share of foreign currency (FC)



Source: Central Bank of Costa Rica.

Total private sector credit (PSC) evolved in line with the level of transactions in the economy and the inflation target. Although the preference for operations in foreign currency was evident, this showed a slowdown in the last months of the year.

The CSP showed an annual growth of 7.5% at the end of 2024 (6.4% in 2023), similar to the compound growth of economic activity and the inflation target82. Growth was observed in both national and foreign currency, but was higher in the latter.
(Chart 19.A). However, foreign currency financing showed a slowdown in its growth rate since September.

Ignoring the exchange rate risk, the increased demand for dollar credit was encouraged due to the relative increase in the cost of financing in colones. The behavior of the active rates in colones and in dollars and the evolution of the expectations of exchange rate variation (market) led to the excess cost of borrowing in colones being positive and standing at 163 bp on average for 2024.

As a result of the greater dynamism of credit in foreign currency, its relative participation within the total rose to 32.5% at the end of 2024, 0.7 pp above what observed a year ago (Chart 19.B), which increases the exposure of the financial system to exchange risk, especially if credit is granted to people with

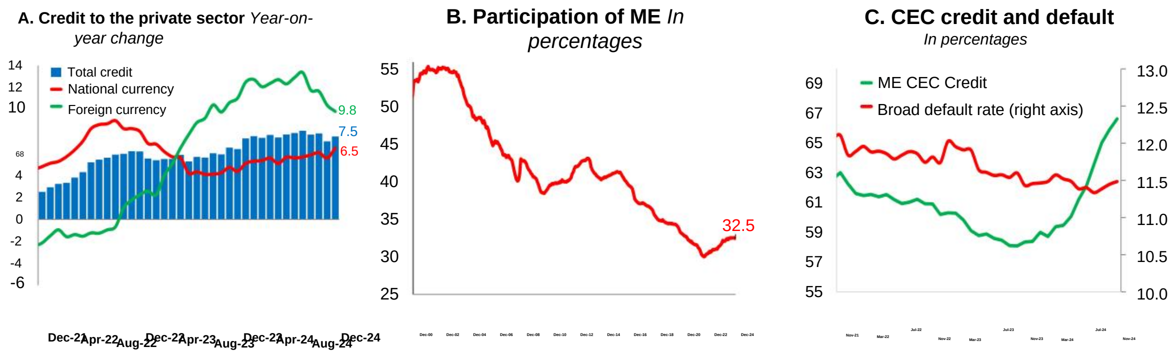
80 Mainly due to the behavior of exchange rate variation expectations, since in 2024 nominal interest rates in colones were, on average, higher than the corresponding ones in dollars by about 138 bp.

81 There is no evidence of a dollarization process in broad monetary aggregates. The relative share of the foreign currency component in total liquidity and total financial wealth decreased by around 0.6 pp in 2024.

82 The gradual increase in financial deepening leads to the financial aggregate tending to grow at a faster rate than the growth of nominal GDP.

foreign exchange exposure (CEC)83. In this regard, it is worth mentioning that the proportion of foreign currency credit granted to debtors with foreign exchange exposure increased by 8.3 pp in the twelve months ended in November 202484 (Chart 19.C).

Gráfico 19. Financial system credit (total and by currency)1 , relative share of foreign currency (FC), relative share of FC credit with foreign exchange exposure (CEC) and broad non-performing loan ratio



[1] Figures without exchange rate effect.

Source: Central Bank of Costa Rica and Sugef.

According to the sources and uses of resources, in 2024 the credit in foreign currency was covered by funds from public deposits and the reduction of external assets, while in colones, although the main source was the increase in deposits, the reduction in the holding of fiscal securities by financial intermediaries also contributed. By economic activity, nearly 86%85 of credit was concentrated in consumption, housing, services and commerce, a fact that increases the exposure of the financial system and limits financing for other activities.

As of November 2024, the delinquency rate of the National Financial System's credit portfolio increased compared to the same month of the previous year. The indicator for delinquency of more than 90 days and in judicial collection stood at 2.1% (1.9% in November 2023). However, the broad delinquency indicator of the National Banking System (which includes regulatory delinquency, liquidated credits and recovered assets) remained relatively stable in 2024, standing at an average of 11.5% (Chart 19.C)86 .

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83 According to the Regulation on Comprehensive Risk Management (Sugef Agreement 2-10), as of January 2023, the debtor of a loan in foreign currency qualifies as “without exposure to exchange rate risk” if it has a natural or financial hedge against that risk, which must cover at least 100% of the loan service. Natural hedge occurs when the debtor has a regular flow of income in the same currency of the operation(s), while financial hedge occurs if it has a financial derivative to cover it.

84 This proportion went from 58.4% in November 2023 to 66.6% in the same month in 2024.

85 In October 2024, credit in colones was concentrated in consumer activities (43.5%) and housing (28.8%), while in dollars it was in services (27.0%), housing (24.0%) and commerce (13.8%).

86 The broad default indicator stood at 11.3% in February 2020 (the month prior to the declaration of the pandemic in Costa Rica).

Capítulo 2

Acciones de política del BCCR

"El buen funcionamiento de ese organismo, pues, constituye la principal garantía económica que necesita el pueblo. Por eso, el primer artículo de mi moción dice así: "Habrá un organismo técnico encargado de la regulación del numerario con ajuste a la ley de la moneda. Me parece que esta institución debe figurar separadamente en la Carta".

Diputado Juan Trejos Quirós, página 3 del Acta 131.

BANCO CENTRAL DE COSTA RICA 75 AÑOS

CHAPTER 2. BCCR POLICY ACTIONS

Between January 2024 and January of this year, the BCCR Board of Directors reduced the TPM level on five occasions, for a cumulative 200 bp to place it at 4.0% as of October 18. These decisions, which were based on the analysis of the recent behavior of inflation and the trajectory of inflation forecasts and their macroeconomic determinants, as well as the assessment of the risks that would condition the inflation projection, allowed the TPM to be placed within the range of monetary policy neutrality.

In 2024 and so far this year, the national financial system has presented a comfortable liquidity condition. These excesses have been contained in BCCR instruments, mostly in very short-term operations in the Integrated Liquidity Market (MIL) and have decreased significantly over the course of this year, due to the expected cancellation of a large part of the credit,
granted by the BCCR to the financial system, to mitigate the effects of the pandemic.

This liquidity has largely been caused by the expansionary effect associated with the purchase of foreign currency by the BCCR, which occurred in a context of a private exchange market with a greater surplus.

2.1. Monetary policy rate

The Central Bank implements its monetary policy on the basis of an inflation targeting scheme, in which it uses the TPM as the main instrument to control inflation.

By changing the level of the TPM, it establishes its policy stance and seeks to influence the behavior of inflation expectations, while seeking to control aggregate demand pressures.

Between January 18, 2024, and January 23, 2025,[87] the Board of Directors reduced the TPM on five occasions, for a cumulative amount of 200 bp: 25 at the monetary policy meeting of January 18, 2024, 50 at the meetings of March 21 and April 25, 50 at the meeting of September 19, and 25 bp at the meeting of October 17.

These reductions were part of a gradual and orderly downward adjustment process in this indicator that began on March 15, 2023 and has placed the TPM in the range of monetary policy neutrality. Between this last date and January 2025, the
The cumulative decrease in the TPM was 500 bp, which meant that it stood at 4.0% annually.

At the meetings held in December and January of this year[88], the Board of Directors of the BCCR considered that, given the delays in the transmission of monetary policy, it was prudent to give space for the active interest rates for some activities to finish incorporating the recent reductions in the TPM, and therefore decided to keep the level of the TPM unchanged (4.0%). These decisions were based on the analysis of the

87 During this period there were 9 monetary policy meetings.

88 Monetary policy meetings of December 19, 2024 and January 23, 2025.

local and international economic situation and the prospective behaviour of inflation and its determinants, as well as the effect on these variables of the increase in uncertainty.

Particularly, the arguments that supported the last decision include the following:

1. Estimated global economic growth for the 2025-2026 biennium (3.3% annually) similar to that of the previous year, accompanied by a slower disinflationary process and relaxation of monetary policy than expected months ago, for which reason international interest rates would remain high for longer.

2. High growth in national economic activity (4.5% year-on-year according to the Monthly Index of Economic Activity for November 2024, and an annual average of 4.3%). Consistent with the above, the labor market shows unemployment rates below the historical average, rising employment and participation rates, and real wage growth.

3. Overall inflation in December (0.8%) was the highest year-on-year rate in the past 19 months, and it is unlikely that overall inflation will return to negative values. On the other hand, core inflation in that month was 0.9%, which indicates the absence of inflationary pressures from aggregate demand, below the target.

4. Inflation expectations at 12 and 24 months remain within the range defined around the inflation target and the BCCR projection models suggest that general and core inflation will enter the tolerance range by the third quarter of 2025.

Given the 500 bp reduction in the TPM between March 2023 and October 2024, as well As with the behavior of inflation expectations, it is estimated that the TPM has been located within the range of monetary policy neutrality.

The above, together with the lags that exist in the transmission of monetary policy, led the Board of Directors to consider that it was prudent to give the necessary space for the active interest rates for some activities to fully incorporate the aforementioned reductions in the TPM. In this regard, it should be noted that, according to the study carried out by the BCCR in Barquero-Romero, J. (2024)89 , on the transmission of changes in the TPM to the interest rates of the financial system shows that the transfer is incomplete and heterogeneous between economic activities (Box 2).

Based on the prospective analysis carried out, the Board of Directors decided to maintain the TPM level at 4.0% per year and reiterated its commitment to low and stable inflation, so that it will make the necessary changes to the TPM, in a timely manner and in the appropriate direction, when macroeconomic conditions and risk assessment require it.

[89] Barquero-Romero, J. (2024). The transmission of the monetary policy rate in Costa Rica, 2018 to 2024. Research Document Technical Note 06-2014 Economic Research Department, Central Bank of Costa Rica.

Finally, it is important to note that the BCCR considers it relevant to maintain permanent communication with citizens, in order to present its position on the evolution of the national economy and, especially, to make public the monetary policy strategy used to try to place inflation at a level consistent with the target. Along these lines, throughout 2024 and so far this year, the Bank has held press conferences to explain its monetary policy decisions and to present the Monetary Policy Report. In addition, it has actively participated in social media and recently enabled a podcast called Enfoque Central that can be consulted on the *Spotify platform.*

Box 2. Transmission of the monetary policy rate to lending rates in Costa Rica, 2018-2024

In the context of the inflation targeting scheme90 , the Monetary Policy Rate (TPM) is the main instrument used by the Central Bank of Costa Rica (BCCR) to conduct its monetary policy. Therefore, it is necessary that the modifications in this indicator are transmitted to the rest of the interest rates of the economy, which are those that affect the consumption, savings and investment decisions of economic agents. An increase in the TPM would reduce aggregate demand and, ultimately, decrease inflation, the target variable of this policy, while a decrease would have the opposite effect (it stimulates aggregate demand, which would eventually push inflation upwards).

This box summarizes and updates some of the results of the analysis carried out by the BCCR in 2024 on the intensity and speed with which changes in the TPM are transmitted to other interest rates in the economy.91 For the estimation, error correction vector models (VECM) were used, in which each lending interest rate is explained only as a function of the TPM. When two or more variables have a stable long-term relationship, the VECM makes it possible to estimate this relationship and analyze how the variables adjust to it when they deviate in the short term.

Additionally, this model is used to approximate the time required for the estimated transfer to be completed92 .

To estimate the model, weekly data on active interest rates in local currency (those actually applied to loans) were used from the first week of 201893 to the first week of December 202494. These rates are calculated by the BCCR from data provided by financial institutions supervised by Sugef, and it is possible to group them both by economic activity and by type of entity:

cooperatives, financial institutions, mutual funds and banks, whether public or private, which together make up Other Depository Institutions (OSD). This box will refer to the shift to the lending rates of OSD in general and to that of banks (public or private) in particular.

It is important to emphasize that the analysis is framed in a period in which the BCCR used the TPM very actively. Since the end of 2019, the BCCR began a process of relaxing monetary policy that deepened during 2020, in order to counteract the negative effects of lower economic activity, until reaching the lowest historical level of the TPM. Subsequently, from the last months of 2021 and during 2022, the BCCR increased the TPM in an accelerated manner to counteract the effect of inflationary shocks associated with, among others, the rapid increase in demand following the pandemic, the

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90 Officially adopted in January 2018.

91 Barquero (2024). The transmission of the monetary policy rate in Costa Rica, 2018-2024. This study covered the period from the first week of January 2018 to the last week of September 2024. 92

Hendry, D. (1995) Dynamic Econometrics. Oxford University Press, United Kingdom. pp. 211-217, 286-288.

93 The Negotiated Active Rate and Negotiated Passive Rate indicators have been calculated and published by the BCCR since January 2018.

94 The methodology for calculating negotiated active rates consists of a weighted average of the active interest rates of all credit transactions formalized during the week, between debtors and the different groups of financial intermediaries that make up the other depository corporations (OSD, which are resident financial corporations and quasi-corporations, except for the Central Bank, whose main activity is financial intermediation). The weighting is based on the amount of each transaction according to the corresponding economic activity.

war between Russia and Ukraine and the increase in international transport costs maritime. Finally, from March 2023 to the present, the BCCR has moved its monetary policy towards increasingly less restrictive conditions, given that inflation has decreased and since May 2023 it has been below the tolerance range around the target.

Previous studies on the transmission of monetary policy for the case of Costa Rica95 They found that the pass-through is not unitary for most interest rates, but that the speed of the pass-through has increased over time. In addition, they found that there are differences in the pass-through depending on the nature of the bank (public or private) and the type of interest rate (active or passive).

Results

Table 2.1 shows the coefficient of transfer of the TPM to the active rates of the OSD and towards the basic passive rate (TBP96). The coefficient is the measure, in basis points (bp), in which an interest rate responds to a 100 bp change in the TPM.

From the results shown, it can be concluded that the range of the pass-through in the active rates oscillates between 12 bp (real estate activities) and 52 bp (construction) for every 100 bp of variation in the TPM. The estimated coefficients are statistically significant for most of the rates (TBP, agriculture, industry, construction, real estate activities, trade, transport, tourism services, other activities and negotiated assets).

The same table shows the time, in weeks, that it takes to complete this pass-through. For example, in the case of the TBP the estimated pass-through coefficient is 40 bp, so the time presented corresponds to the number of weeks it takes to complete the 40 bp change in the TBP. This indicator is known as the speed of pass-through. This analysis shows that the pass-through time varies between 13 weeks (approximately 3 months) for the TBP and trade, and up to 26 weeks (6 months) for the rate of other activities.

Table 2.1 Other depository institutions. Transmission coefficient of the TPM to lending rates and speed of adjustment1/
Period 2018-2024

Activities	Transfer (in percentage points)		Speed (in weeks)
TBP	0.40	***	13
Agriculture	0.44	***	15
Industry	0.51	***	10
Construction	0.52	***	25
Real estate activities	0.12	***	20
Trade	0.30	***	13
Transport	0.46	***	22
Tourism services	0.37	***	16
Other activities	0.31	***	26
Traded Active (TAN)	0.49	***	16

95 These studies covered a period of increasing exchange rate flexibility; that is, the transition from an exchange rate band regime to managed floating. A compilation of these investigations is presented in Barquero (2024).

96 The basic passive rate (BPR) is included in the analysis because, despite being an indicator of the cost of deposits, it is used as a reference for a significant percentage of variable rate loans in the financial system (Barquero and Orane, 2015). Thus, while the BPR captures the effect of movements in the TPM on the interest rate of current loans (approved in previous periods), the negotiated active rate (TAN) reflects the behavior of the interest rates of new loans.

1Level of significance: 0.01%=***. Results for consumption rates, with and without a card, are not shown, since they are not significant at 10%.
Source: Prepared by the authors using data from the Central Bank of Costa Rica.

Table 2.2 presents estimates by ownership structure for public and private banks. In most activities, the pass-through is stronger in private banks than in public banks, with the exception of interest rates for construction and other activities.

Table 2.2 Public and private banks. TPM transmission coefficient to active rates1 Period 2018-2024

Activities	Public Banks	Private Banks
Agriculture	0.32 ***	0.68 ***
Industry	0.32 ***	0.68 ***
Construction	0.33 ***	0.17 ***
Real estate activities	0.16 ***	-0.07
Trade	0.22 ***	0.61 ***
Transport	0.39 ***	0.71 ***
Tourism services	0.31 ***	0.46 ***
Other activities	0.76 ***	0.28 **
Traded Active (TAN)	0.27 ***	0.79 ***

1Level of significance: 0.01%=***, 0.05=**. Not significant at 10%= -. Results for consumption rates, with and without a card, are not shown, since they are not significant at 10%.
Source: Prepared by the authors using data from the Central Bank of Costa Rica.

An additional result that emerges from this analysis is that, when examining the coefficients of pass-through to rates related to consumption, with and without credit cards, these are not statistically significant. Therefore, it cannot be stated that there is transmission of the TPM to these rates. Given that the consumer portfolio represents, on average, 25% of the total portfolio of the banking system and 33% of that of the financial system, and a large part is denominated in national currency. The above limits the transmission of monetary policy

and therefore constitutes a challenge to its effectiveness.

Table 2.3 presents the long-term pass-through coefficients of the TPM to the interest rates of the different economic activities for two specific time intervals.

The first interval corresponds to the period between December 2021 and February 2023 in which, in response to the rapid increase in the local price level and inflation expectations, the TPM was strongly adjusted upwards in a timely manner.

The second period covers from December 2022 to the first week of December 2024, a period in which, due to the reduction in inflation indicators, monetary policy became less restrictive, with gradual decreases in the TPM. This division of periods is based on the direction of changes in the TPM and allows for a simple assessment of whether market interest rates react differently, in terms of the magnitude and speed of the transfer, to reductions and increases in the TPM97 .

97 There is a pause period in TPM increases before the first reductions between December 2022 and February 2023. This period is included in both samples since the direction of future changes was not clear at that time. Additionally, estimates are made with different samples, whether they include or exclude that period, and the results are not statistically different.

Table 2.3 Other depository corporations. Estimates of the transfer ratio for selected periods1

Activities	From 12/2021 to 02/2023		From 12/2022 to 12/2024	
	Coefficient	Speed	Coefficient	Speed
TBP	0.44	13	0.54	14
Agriculture	0.60	12	0.52	18
Industry	0.78	7	0.55	12
Construction	0.51	25	0.18	26
Real Estate Activities	0.32	17	0.26	22
Trade	0.62	12	0.47	13
Transport	0.44	21	0.41	22
Tourism Services	0.57	14	0.32	17
Other Activities	0.77	26	0.34	26
Active Negotiated (TAN)	0.52	14	0.14	17

[1] Note: All coefficients are significant at 1%.
Source: Central Bank of Costa Rica.

The results show that, in general, the transmission of the TPM to the active rates of the group of intermediaries that make up the OSD is lower in the face of reductions in the TPM (period from 12/2022 to 12/2024) than in the face of increases (period from 12/2021 to 02/2023), while in the case of the TBP the opposite occurs98 . In addition, the speed of transmission is higher in the face of increases in the TPM than in the face of reductions.

This result coincides with that shown by previous studies (Barquero-Romero, Loaiza-Marín and Mendoza-Fernández, 2021), which indicate that, with increases in the TPM, the transmission is greater towards active rates and with reductions in that indicator, the transmission is greater towards passive rates, movements that would tend to increase the financial intermediation margin.

Conclusions

This box presents the results of the transfer of the TPM to the lending rates offered by Other Depository Institutions (OSD) in general, and by public and private banks in particular. In this study, the main novelty is that weekly data on the interest rates actually granted by financial intermediaries to their clients, which have been available since January 2018, were used.

In general, it is concluded that the transfer of the TPM to the OSD's active interest rates is incomplete and heterogeneous across economic activities. On average, the transmission is around 50 bp for every 100 bp of change in the TPM, and is reached after 16 weeks, approximately 4 months. Compared with the results of studies that used information prior to 2018 (Barquero and Cendra, 2020), the speed of transmission is now higher99 .

98 For their part, the TAN and the consumption rate do not show significant results.

99 In this case, the information used corresponded to announced rates, with monthly periodicity and aggregated according to type of bank (public or private).

Furthermore, another characteristic of the MPR transmission process is asymmetry. In periods of upward adjustments in the MPR, the transmission of the policy signal is greater and manifests itself more quickly than during periods of reductions in this indicator.

When this phenomenon is analysed by group of banks, it can be seen that the transmission of the TPM to the active rates is greater in private banks than in public banks.

Finally, no statistically significant evidence was found to support the claim that changes in the TPM are transmitted to consumer interest rates (with or without credit cards).
This result is important for the BCCR, as it represents a limitation in the effectiveness of the TPM (its main policy instrument) for controlling inflation, since the signal it sends does not reach a high percentage of the credit market.

The results on the process of transmission of the TPM to the active rates in Costa Rica discussed above are a reflection of some of the characteristics of the industrial organization in the Costa Rican financial system, which limit a more competitive process of price formation, in this case, interest rates.

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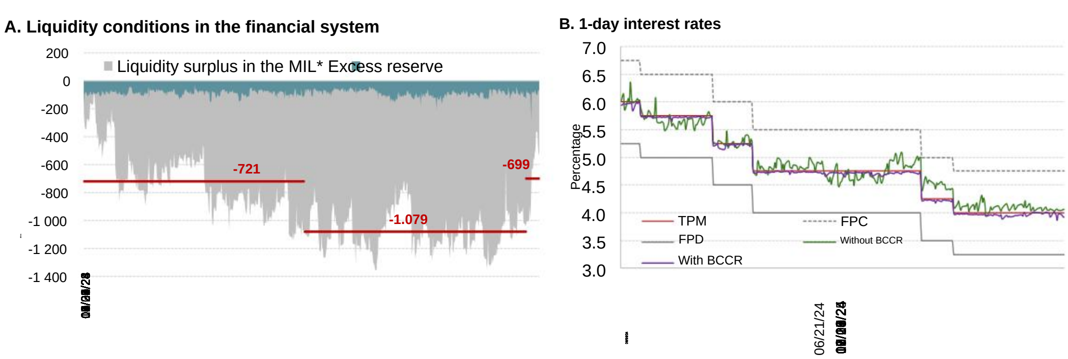
2.2 Managing the liquidity of the economy

The average daily surplus of liquidity in the financial system, measured based on the net collection of the BCCR in the Integrated Liquidity Market (MIL), amounted during 2024 to ÿ1,079.0 billion (ÿ720.8 billion a year ago) and, particularly in the first 22 days of January of this year, that average was ÿ699.0 billion (Chart 20.A).

The behavior of liquidity in 2024 and so far in 2025 was largely determined by the monetary effect resulting from the net purchase of foreign currency by the BCCR (equivalent to ÿ1,012.6 billion) and the payment of interest on its debt (around ÿ300 billion100). These effects were largely sterilized by the placement of monetary stabilization bonds, the balance of which as of January 22 increased by ÿ937.7 billion compared to the end of 2023, and the cancellation of the credit facility granted by the BCCR in response to the economic effects of the pandemic101, concentrated in January of this year.

The MIL overnight interest rates have adjusted to the decreases in the TPM. As of January 22 of this year, the interest rate indicator that includes BCCR operations registered a gap with respect to the TPM of 3 bp, while the gap associated with the indicator that excludes them was 12 bp (Chart 20.B). This latter gap widened from the second half of August mainly due to changes in the net position of some public and private banks that put upward pressure on interest rates; however, in January the same entities contributed to reducing the gap again.

Gráfico 20. **MIL indicators in colones**



* It is estimated by the net participation of the BCCR in the MIL; if it is a net debtor, it indicates that there is a surplus of liquidity and vice versa.

Source: Central Bank of Costa Rica.

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100 Of which ¢248.0 billion corresponded to monetary stabilization bonds.

101 In September 2020, the BCCR authorized a special and temporary credit facility for financial intermediaries, so that they could channel resources to mitigate the economic effects of the pandemic on households and businesses. The credit was granted at a rate of 0.8% and for terms of 2 and 4 years (concentrated on the latter term) and amounted to ÿ826,355 million. At the end of 2024, its balance was ÿ528,272 million and by January 2025, contractual payments are ÿ420,327 million.

Additionally, the following stand out in terms of liquidity behavior in 2024 and so far this year:

1. The increase in the average balance of Government deposits in the BCCR (ÿ170.0 billion from the end of 2023 to January 22). This account registers significant changes due to debt movements, tax collection and, more recently, the gradual implementation of the Efficient Liquidity Management Law.

2. The provision taken by the Board of Directors of the BCCR (article 8 of agreement 6121-2023 of May 25, 2023) that obliges financial entities subject to the liquidity reserve requirement to constitute it in deposits in the MIL for a term of 28 days or more102 (effective as of January 2024) and which also establishes that supervised savings and credit cooperatives must comply with the minimum legal reserve requirement103 (as of April 2024).

   Therefore, from the end of 2023 to January 22, 2025, the balance of deposits in the MIL for the liquidity reserve increased by ÿ138,546 million104 and that of the cooperative fund accounts in the BCCR by ÿ55,640 million.

3. From the second half of November 2024 onwards, the reduction of The excess liquidity was influenced, in addition to movements in government deposits, by the increase in demand for cash due to seasonal effects (in November, December and January) 105 and by the maturities of the special credit facility.

   Specifically, in the first 22 days of January, the balance of this credit facility fell by ÿ397,609 million. Current operations will expire in the remainder of the first quarter of this year, which will imply a contraction additional liquidity of ÿ130,664 million.

On September 9, 2024, the BCCR again enabled auctions in the MIL at 7-day terms and, starting October 7, those at 14-day terms. As of January 22 of this year, the balance of these two instruments was ÿ49.2 billion and ÿ51.88 billion, at 7 and 14 days respectively.

Chart 21 shows the daily amounts called for and the percentage of allocation (on average 41.7% at 7 days and 45.7% at 14 days). In general, these instruments have had good acceptance by financial institutions.

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102 According to the provisions of article 117 of Law 7558, solidarity associations and savings and credit cooperatives that the BCCR exempts from the reserve requirement must comply with a liquidity reserve, in a percentage equal to that applied for the reserve requirement and under the conditions defined by the Board of Directors of the BCCR.

103 The BCCR decided to increase the EML percentage gradually; in April 2024, 1.5% of EML was applied and six months later, 3.0%.

104 Of which, 69.4% corresponded to solidarity associations and the rest to savings and credit cooperatives.

105 Demand for cash at the end of December increased by ÿ189,309 million compared to October 31 (13.3%) and a good part of that increase, being seasonal, was reversed in January 2025 (fall of ÿ151,457 million in the first 22 days of the month, that is, 9.4% compared to last December).

Finally, both in 2024 and so far this year, the BCCR did not participate in the securities repurchase markets managed by the National Stock Exchange and
In the secondary market, it bought its own shares for *USD* 49 million.

Gráfico 21. **ODL auctions contracting over 1 day**

Source: Central Bank of Costa Rica.

2.3. BCCR participation in the foreign exchange market

In 2024, the BCCR maintained its participation as a net demander in the Foreign Currency Market (Monex). Despite this, market conditions led to a nominal appreciation of the colon of 2.38%.

In 2024, the surplus from private exchange market operations (known as "windows")106 was *USD* 6,887.3 million107 , *USD* 475.4 million lower than the previous year. This result allowed the BCCR to make net purchases in Monex for *USD* 5.709 million108 , which were used to increase the country's financial protection by *USD* 2,305.3 million (own operations), cover the contemporary net requirements of the Non-Banking Public Sector (SPNB) for *USD* 3,193.3 million and *USD* 220.0 million to meet future requirements (for this purpose it had accumulated *USD* 160.0 million in 2023). The BCCR also sold USD 9.9 million for stabilization.

As a result of market conditions, the national currency registered a nominal appreciation of 2.38%. At the end of the year, the weighted average exchange rate of Monex was ÿ 511.27, lower than that observed at the end of 2023 (ÿ 523.46). The largest drop in the exchange rate occurred in the first quarter, an effect that was partially reversed in the second quarter. Subsequently, this indicator resumed its downward trend, but more moderately than at the beginning of the year (Chart 22).

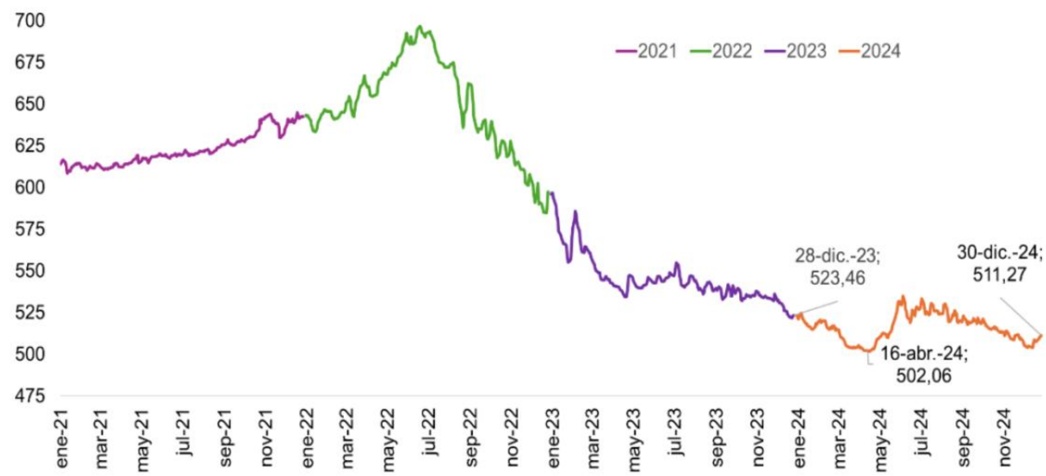
[106] Public transactions with foreign exchange intermediaries.

107 According to information provided by foreign exchange intermediaries, in the period April-December 2024, the most important foreign exchange movements, both in demand and supply, were channeled by the production units of the definitive regime with 67.9% and 51.6% of the total, respectively. However, the special regime (free zone and active processing) accounted for 93.6% of the surplus. In the supply of foreign exchange, by economic activity, professional, scientific, technical, administrative and support activities stood out, while in demand, trade and vehicle repair stood out.

108 During 2024, trades were carried out on Monex for an amount of *USD* 9,579 million. The BCCR's net demand share represented 60% of the total traded in said market.

Gráfico 22. Monex Weighted Average Exchange Rate

Colones per USD



Source: Central Bank of Costa Rica.

The participation of the BCCR in the foreign exchange market, together with the interest income from the assets that constitute the NIR *(USD* 526.5 million) and the increase in deposits from financial institutions109 *(USD* 274.5 million) explained, for the most part, the *USD* 952 million increase in the balance of the BCCR's net international reserves compared to 2023.

At the end of December 2024, the balance of net international reserves amounted to *USD* 14,171 million, which represented 144.6% of the minimum adequate level defined by the Board of Directors and an equivalent of 14.9% of the GDP estimated in the report of last October. In terms of other statistical indicators, it is equivalent to 8.5 months of imports of goods under the final regime of 2024 and 1.5 times the monetary base in the broad sense.

[109] Includes depository companies other than BCCR, stock exchanges and other financial entities

Capítulo 3

Proyecciones y acciones de política

"En ningún caso recurrirá el Estado a efectuar negociación alguna capaz de perturbar la regulación del numerario y de alterar el valor de la moneda establecido por la ley".

Artículo propuesto por Juan Trejos Quirós, página 4 del Acta 131.

CHAPTER 3. POLICY PROJECTIONS AND ACTIONS

Below are the macroeconomic projections for the period 2025-2026[110] and the risks, the materialization of which would determine its implementation.

International financial organizations estimate that in the 2025-2026 biennium the world economy would register moderate growth, practically equal to that forecast in the IPM of October 2024. In addition, they foresee that global inflation would continue its downward path and would converge to the objectives set by central banks, more quickly in advanced economies.

The national economy is expected to grow by 4.0% on average during the 2025-2026 biennium (4.1% in the first of these years and 4.0% in the second). While this represents a moderation with respect to the growth estimated for 2024 (4.3%), these rates are high in relation to those forecast for the country's main trading partners. The increase in production would be driven mainly by domestic demand.

The current account deficit would average 1.5% of GDP in the 2025-2026 biennium, similar to the result for 2024, but in particular for 2025 it would be 0.2 pp lower than forecast in last October's report. As in previous years, this deficit would be more than covered by long-term external savings.

Fiscal projections for the 2025-2026 biennium assume better results (higher primary surplus and lower financial deficit) compared to 2024, which maintains the fiscal authorities' commitment to achieving sustainability of central government debt.

The projections presented in this report are subject to risks that, if realized, would deviate inflation from the central path. On this occasion, the risks are skewed to the downside.

3.1 Projections for the international economy

The estimated global economic growth for 2025-2026, while similar to that of the previous year, is considered modest by international organizations. This growth would occur in an environment of greater uncertainty and a process of disinflation that has slowed down; therefore, the forecasts contemplate higher international interest rates than those anticipated in the IPM of last October.

In their January 2025 publications, international organizations generally maintained their economic growth estimates for the 2025-2026 biennium.
2026 (Chart 23 and Table 3) compared to what was published in its previous reports. The IMF projected an average growth for the biennium of 3.3%, while the World Bank placed it at around 2.7%, in a context in which inflation is approaching the central banks' targets and gradual monetary easing supports economic activity, both in advanced and in emerging and developing economies.

110 This report incorporates the revision of the projections for 2025 with respect to what was forecast for that year in last October's report and includes, for the first time, estimates for 2026.

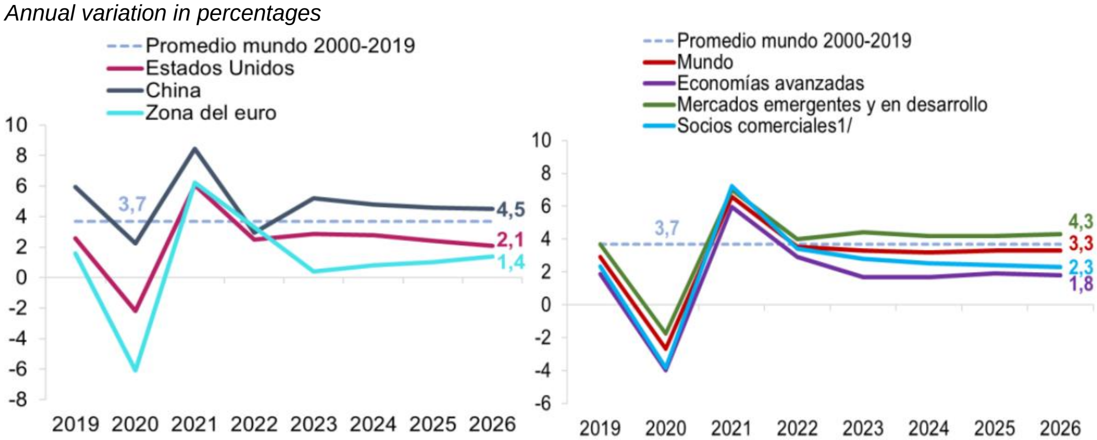
For the United States, Costa Rica's main trading partner, the aforementioned organizations have adjusted their growth outlook for 2025 upwards, given the evolution of consumer spending and a "stronger" labor market than expected in 2024; for 2026 the rate would moderate and the level of economic activity would be around its potential level.

The IMF predicts that the country will grow by 2.7% this year and 2.1% next year, while the World Bank predicts that the growth rates will be 2.3% and 2.0% in the same order.

These projections, while showing a similar behavior to that estimated by members of the United States Federal Reserve System, differ in magnitude; in its report last December, the Federal Reserve contemplated a growth of 2.2% for 2025 and 2.0% for the following year[111] .

Gráfico 23. IMF: Global growth projections 2025-2026

Annual variation in percentages



1Economic growth of a sample of the country's 15 main partners representing 85% of total exports, weighted by the value of accumulated exports to August 2024.
Source: Central Bank of Costa Rica, with information from the Federal Reserve System (December 2024), World Bank and IMF (January 2025).

For the euro area, both organisations have revised their estimates for 2025 downwards and expect growth of 1.0%. This downward revision is driven by a weaker-than-expected activity in late 2024, particularly in the manufacturing sector, as well as increasing uncertainty about the political outlook and the effects of a tariff war.

For 2026, they estimate a slight acceleration, which they justify by a greater strength of domestic demand, as financial conditions relax, confidence improves and uncertainty dissipates.

In contrast, for China both the IMF and the World Bank adjusted their forecasts for 2025 upwards, to 4.6% and 4.5%, (from 4.5% and 4.1%), respectively. This is due to the boost that the recent support measures announced by the authorities, discussed in Chapter 1 of this report, would give to economic activity and the high export growth at the end of last year. However, they expect the

111 For 2025, the value corresponds to the upper limit of the central tendency, while for 2026 it is the median. The values come from the estimates of each participant of the Federal Open Market Committee (FOMC).

Consumption is expected to remain weak given the fragility of both the labour market and consumer confidence, and the loss of wealth associated with falling property prices.

A slight slowdown is expected for 2026. Among the risks associated with these growth prospects, those related to trade relations with the United States stand out.

For Latin America and the Caribbean, despite the expected slowdown in the region's main economies, both organizations estimate that growth would accelerate slightly to 2.5% in 2025 and 2.7% in 2026, as macroeconomic performance in Argentina improves (economic recovery and reduction in inflation). Commodity prices112 would encourage the region's export efforts.

Table 3. International organizations: economic growth projections 2025-2026

Year-on-year change in percentages

	International Monetary Fund International			World Bank			Reserve System Federal		
	2024	2025	2026	2024	2025	2026	2024	2025	2026
World	3.2	3.3	3.3	2.7	2.7	2.7	---	---	---
Advanced economies	1.7	1.9	1.8	1.7	1.7	1.8	---	---	---
USA	2.8	2.7	2.1	2.8	2.3	2.0	2.5	2.2	2.0
Eurozone	0.8	1.0	1.4	0.7	1.0	1.2	---	---	---
Germany	-0.2	0.3	1.1	---	---	---	---	---	---
France	1.1	0.8	1.1	---	---	---	---	---	---
Japan	-0.2	1.1	0.8	0.0	1,2	0.9	---	---	---
United Kingdom	0.9	1.6	1.5	---	---	---	---	---	---
Emerging and developing countries	4.2	4.2	4.3	4.1	4.1	4.0	---	---	---
China	4.8	4.6	4.5	4.9	4.5	4.0	---	---	---
Latin America and the Caribbean	2.4	2.5	2.7	2.2	2.5	2.6	---	---	---
Brazil	3.7	2.2	2.2	3.2	2.2	23	---	---	---

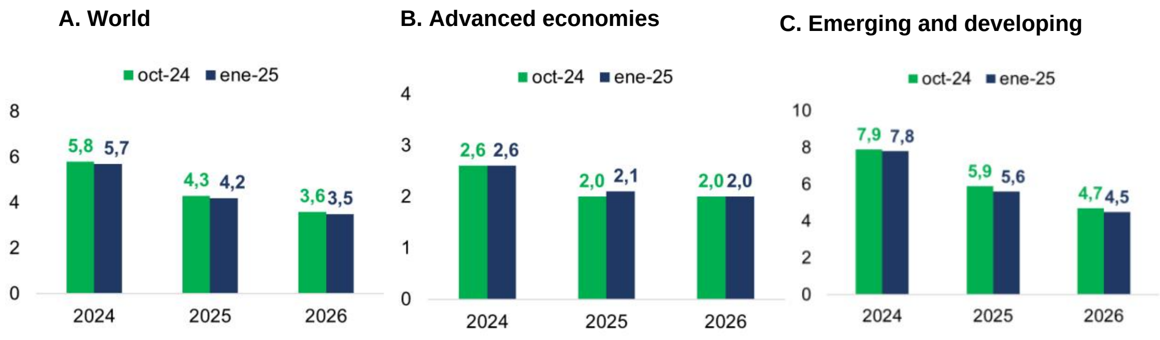
Source: Central Bank of Costa Rica, with information from the World Bank and IMF (January 2025) and the Federal Reserve System (December 2024).

As for global inflation, the IMF expects it to continue to decline, supported by the decline in energy prices and the effect on demand of the gradual cooling of labor markets. Consumer prices are expected to grow from 5.7% in 2024 to 4.2% in 2025 and 3.5% in 2026 (Chart 24). It also expects inflation to converge toward the central banks' target sooner in advanced economies than in emerging and developing economies.

112 Specifically, the World Bank, in its "Global Economic Outlook" report, predicts that metal prices will remain stable, at levels well above those before the pandemic, which would support investments in particular in metals linked to the green transition. This would benefit countries such as Chile and Peru. The rebound in investment would be less favorable in energy exporters.

Gráfico 24. IMF: inflation projections 2025-2026

In percentages



Source: Central Bank of Costa Rica, based on the IMF's "World Economic Outlook" report, October 2024 and January 2025.

Regarding the international price of raw materials, this report estimates a 2.2% increase in the price of a barrel of oil and a 1.3% drop in the price of basic grains by 2025 (Table 4), a behavior that is in accordance with what has been stated by the Organization of Petroleum Exporting Countries (OPEC) and the Food and Agriculture Organization of the United Nations (FAO).

The first entity113 estimates that in the year in question the net demand for oil would increase by 300,000 barrels per day compared to 2024114, which would put upward pressure on its price. Similarly, for 2026 it projects an increase in net demand, but by a smaller amount (200,000 barrels per day).

FAO115 slightly lowered its estimate of global cereal production for the 2024/2025 period, due to downward revisions in maize (lower than expected yields in the United States and the European Union) and wheat (lower yields in the European Union due to excessively wet conditions). However, this would be the second highest production on record and would allow the price decline recorded in 2024 to extend into 2025.

For 2026, FAO estimates a slight increase in grain prices, which would be explained by the lower expansion of sowing areas in the period due to the expected price reduction for 2025.

The main assumptions regarding the external environment are calculated based on the information available as of January 2025 and, although they take into account the high uncertainty surrounding the measures announced by the new US government administration, they do not incorporate any assumptions regarding their specific implications, or possible changes in these, on the variables included.

113 "OPEC Monthly Oil Market Report", January 2025.

114 This is due to increased demand for transport (air and road travel) and the boost in industrial, agricultural and construction activities in non-OECD countries.

115 FAO Cereal Supply and Demand Brief, December 2024

Table 4. Main assumptions of the external environment1
Year-on-year change in percentages

	Estimate	Projections		Differences from IPM projections October 2024 (in pp and *USD*)	
	2024	2025	2026	2024	2025
Global growth	3.2	3.3	3.3	0.0	0.1
United States Growth	2.8	2.4	2.1	0.7	0.4
Growth in trading partners, average	2.5	2.4	2.3	0.4	0.2
World inflation (average)	5.7	4.2	3.5	-0.1	-0.1
Inflation in advanced economies (average)	2.6	2.1	2.0	0.0	0.1
Inflation in emerging economies (average)	7.8	5.6	4.5	-0.1	-0.3
Trade partners inflation, average	2.4	2.2	2.3	0.0	0.0
Hydrocarbon price *(USD)2*	90.9	93.0	84.8	-3.1	0.6
% variation	*-9.3*	*2.2*	*-8.7*	-3.1	4.0
Grain price index, % change	*-18.5*	*-1.3*	*1.0*	-0.3	-1.9
Terms of trade3 , variation %	1.5	0.2	0.5	0.5	-0.2
SOFR (as of December)4	4.4	4.1	4.0	0.6	1.0

1Figures for 2024 are estimates, while those for 2025 and 2026 are projected.
2In the case of hydrocarbon prices, the differences are presented in *USD.*
3The 2025 projection was incorrectly stated in the document published on January 30, 2025; therefore, the value of 0.0% was replaced by 0.2%
4For 2024, it corresponds to the SOFR Overnight rate as of 12/31/2024, for 2025 and 2026 it corresponds to the projection for the SOFR Overnight rate, with information from Bloomberg.
Source: Central Bank of Costa Rica with information from Bloomberg and economic growth outlook from the Federal Reserve System (December 2024) and the IMF (October 2024 and January 2025).

3.2 Projections for the national economy

The national economy will grow by an average of 4.0% during the 2025-2026 biennium, driven mainly by domestic demand.

Economic projections indicate a moderation in GDP growth compared to 2024, with a 4.1% increase in 2025 and a 4.0% increase in the following year. Despite the slowdown, the economy is expected to continue with relatively high growth rates, driven by strong domestic demand and the continued flow of direct investment. However, factors such as geopolitical tensions, global trade disputes and extreme weather events could affect these projections.

The estimated growth rate for 2025 assumes a 4.2% increase in domestic demand, slightly lower than that estimated for 2024, but higher than the 4.0% proposed in the report of October of the previous year. This increase is due to a greater expansion of household consumption and private investment. Exports will maintain significant growth, although at a slower pace due to the economic slowdown of the main trading partners.

Despite the moderation in some sectors, within the OECD member countries, Costa Rica is expected to have one of the highest economic growth rates in 2025. For 2026, a slight deceleration in the GDP growth rate is expected, with private spending as the main driver of economic activity, followed by increased investment.

According to the expenditure components, consumption would be the main driver of the growth estimated for the biennium. In addition, the acceleration in gross fixed capital formation and the moderate growth of government consumption would influence this result. External demand and imports would slow down compared to 2024.

According to expenditure components, the following stands out (Table 5):

1. **Consumption.** Growth is expected to be 3.9% in 2025 and 4.0% in 2026, driven by rising real disposable personal income.116 The largest contribution to consumption growth is expected from services, followed by non-durable goods. Containment is expected for durable goods such as vehicles, especially in the first year, due to the extraordinary demand recorded during the 2023-2024 period.

2. **Government consumption.** It would grow by 0.8% in 2025. Although public entities dedicated to the activities of Administration and Public Education would continue to be subject to the spending containment policy, both in remuneration and in the purchase of goods and services, in accordance with the provisions of the National Budget, there would be greater hiring in the Judiciary, the Supreme Electoral Tribunal and the Ministry of Security, which would contribute to the upward revision of public spending by 0.1% with respect to the previous report.

   By 2026, all public entities are expected to apply the directive on wage restraint and the purchase of goods and services. In particular, a slight slowdown in the hiring of new positions is estimated compared to what was estimated for 2025, which would imply a growth of 0.7% in this variable.

3. **Gross fixed capital formation.** The growth rate is expected to accelerate in relation to 2024 (from 4.3% to 6.8% in 2025 and 7.0% in 2026), mainly related to the increase in private investment in imported machinery and equipment, aimed at manufacturing and service activities. On the other hand, new private constructions117 would show a slower growth rate, but public constructions118 would show greater momentum.

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116 In the two-year period, projections contemplate an average growth of real disposable personal income of 3.9%, explained by the growth of economic activity and an average gain of 0.3% in the terms of trade.

117 According to the evolution of building permits, a moderate rate is projected compared to the previous year (3.5% in 2024, 2.6% and 2.9% in the following years). This behavior responds to a contained growth in the construction of housing for middle- and high-income households, slightly offset by the increase in the construction of the non-residential segment 118. Investment in public works would grow 4.8% and 4.1% in 2025 and 2026, respectively (2.2% in 2024). In 2025, it would be determined by the works of the Emergency Program for the Comprehensive and Resilient Reconstruction of Infrastructure, the continuation of the Expansion of National Route 32, electricity generation works (in particular Borinquen, the geothermal energy project in the Guanacaste Mountain Range) and road projects (Road Infrastructure Program and Promotion of Public-Private Partnerships, Stage II of the Cantonal Road Network Program CCLIP, Road Infrastructure and Urban Mobility Program Resilient Connectivity).

The lower rate for 2026 would be influenced by the completion of the Expansion of National Route 32 and the Border Integration Program, an effect partially offset by investment in road projects associated with the Road Infrastructure and Urban Mobility Program Resilient Connectivity, Stage II of the Cantonal Road Network Program CCLIP, Transportation Infrastructure Program, the start of the Water Supply Project for the Middle Basin of the Tempisque River and Coastal Communities, the continuation of electricity generation works and municipal projects.

4. External demand. The growth of goods exports during the two-year period would be more moderate than in 2024, in line with the expected slowdown of the main trading partners. This behavior would also be influenced by the base effect of sales of companies under the special regime, which registered an increase of close to 14.2% between 2022 and 2024, as well as by the outstanding performance of pineapple exports, which reached an average export value of *USD* 112 million in 2024, higher than the average of the previous five years *(USD*

86.2 million).

For services exports, a downward revision was made to growth in 2025, due to the moderation in tourism-related services, professional and IT services, compared to the estimates in the previous report. However, the performance of this sector during the biennium is expected to exceed the estimate for 2024, driven mainly by professional services and support to foreign companies.

5. Imports. An acceleration in the growth of imports of goods is projected for the biennium, driven by the recovery in purchases of raw materials, greater investment in capital goods by companies under the special regime, and consumption. As for imports of services, their growth would be lower than in 2024 and would be related, mainly, to the fall in the import of professional, support and information services in 2025, coupled with the lower increase in outbound tourism in both years.

Table 5. GDP in volume by expenditure components
Annual variation in percentages

	Estimate	Projections		Differences with respect to IPM October 2024 in pp	Contribution (pp)		
	2024	2025	2026	2025	2024	2025	2026
Gross domestic product	**4.3**	**4.1**	**4.0**	**0.2**	**4.3**	**4.1**	**4.0**
Household consumption	4.0	3.9	4.0	0.1	2.6	2.5	2.5
Government consumption	0.7	0.8	0.7	0.1	0.1	0.1	0.1
Gross fixed capital formation	4.3	6.8	7.0	0.8	0.7	1.1	1.1
Change in inventories (% of GDP)	-0.2	0.1	0.5	-0.1	0.7	0.3	0.3
Exports	**5.8**	**5.0**	**4.7**	**-0.8**	**2.2**	**1.9**	**1.9**
Estate	8.0	5.8	6.2	-0.9	1.7	1.3	1.4
Services	2.9	3.9	2.7	-0.7	0.5	0.6	0.5
Imports	***6.0***	***5.5***	***5.7***	***-0.8***	**-2.0**	**-1.8**	**-1.9**
Estate	4.9	6.4	6.1	-0.8	-1.2	-1.6	-1.5
Services	9.6	2.8	4.5	-0.8	-0.8	-0.2	-0.4
Real gross disposable income	4.3	4.0	4.1	-0.2			
Real gross disposable personal income	4.1	3.9	4.0	0.1			

Source: Central Bank of Costa Rica.

The activities that, due to their relative importance, would contribute most to increasing the GDP would be business services, manufacturing, trade, transportation and hospitality and restaurants.

By economic activity (Table 6) we have the following:

1. Business services. Average growth is estimated for 2025-2026 of 5.6%, favoured by the activities of financial management consultancy, support for companies that offer services to the external market, as well as advertising services and legal services of companies under the definitive regime that supply internal demand.

2. **Manufacturing.** In the two-year period, the growth of this activity would moderate with respect to 2024 by around 1.3 pp, mainly due to the expected evolution of the external demand for manufactured goods under the special regime and, to a lesser extent, the demand for companies under the definitive regime that produce for the domestic market.

3. **Trade.** It is estimated that commercial activity will grow at a level slightly lower than in 2024 during the two-year period, a trend that corresponds to the expected evolution of the import of consumer goods[119], as well as to the performance of agricultural activities, hotels, restaurants and construction.

4. **Transport.** For the 2025-2026 biennium, an average growth of 7.6% is estimated. This performance is in line with the growth forecast for foreign trade in goods, freight transport, and transport support activities including toll services, airports and ports. In addition, stability is expected in the land transport service for people, particularly in the taxi and bus segments.

5. **Hotels and restaurants.** Growth in the two-year period would be driven especially by growth in hotel services located in coastal areas and some mountain areas, the positive performance of restaurants in the Greater Metropolitan Area, especially fast food chains, and the increase in specialized food services for corporate groups.

6. **Construction.** In the two-year period it would grow by an average of 2.9%. As mentioned Previously, in addition to the slowdown in the growth rate of private construction, a greater boost in public investment is expected due to the continued construction of roads, highways and bridges, as well as works to provide basic electricity and water services.

7. **Agriculture.** An average rate of 1.8% is estimated for the biennium, which implies a moderate growth in the exportable production of pineapple and banana, as well as beef. The latter would benefit from the elimination of tariffs on dairy products for their entry into the United States market. Despite this, the risk of impact remains due to possible adverse weather conditions resulting from the ENSO climate phenomenon in its La Niña phase[120], present since the second half of 2024 and which could affect yield per hectare.

of activities oriented towards the local market.

119 Purchases of imported consumer goods, such as vehicles, food products, pharmaceuticals and textiles, registered an increase of close to 12.6% in 2024. For the biennium 2025-2026, By 2026, an increase of around 8% is expected.

120 The neutral phase of ENSO is still present; if the possible establishment of the La Niña phase were to occur, it would be in the first quarter of 2025. In addition, the Caribbean Sea and North Atlantic continue to be warm and this condition will continue at least until March of this year. *Seasonal Forecast January–March 2025, p. 1, National Meteorological Institute.*

Table 6. GDP in volume by economic activity *Annual variation in percentages*

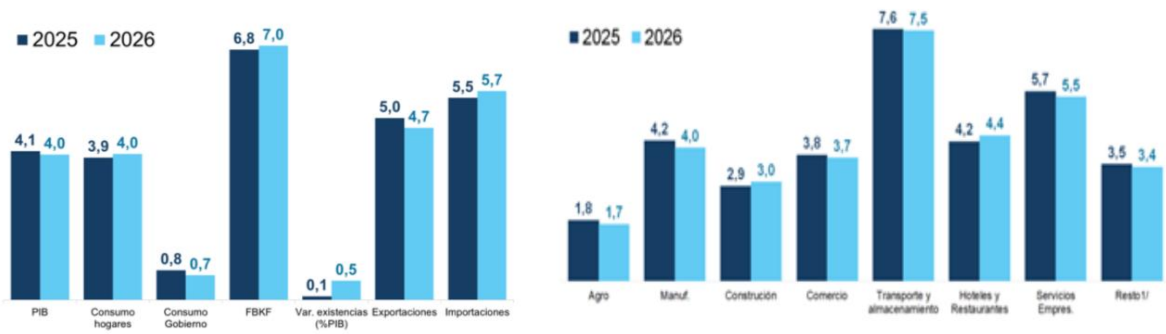
	Estimate	Projections		Differences with respect to IPM October 2024 in pp	Contribution (pp)		
	2024	2025	2026	2025	2024	2025	2026
Gross domestic product	**4.3**	**4.1**	**4.0**	**0.2**	**4.3**	**4.1**	**4.0**
Agriculture	2.0	1.8	1.7	0.2	0.1	0.1	0.1
Manufacture	5.5	4.2	4.0	0.3	0.8	0.6	0.5
Construction	3.5	2.9	3.0	0.9	0.1	0.1	0.1
Private destination	3.5	2.6	2.9	1.0	0.1	0.1	0.1
Public destination	2.7	5.3	3.8	0.1	0.0	0.0	0.0
Trade	3.9	3.8	3.7	0.5	0.4	0.4	0.3
Transport and storage	7.8	7.6	7.5	0.1	0.3	0.3	0.4
Hotels and Restaurants	5.0	4.2	4.4	-0.4	0.1	0.1	0.1
Business Services	6.7	5.7	5.5	0.2	0.9	0.8	0.8
Rest 1/	3.3	3.5	3.4	0.1	1.6	1.7	1.7

[1]Includes mines and quarries, electricity and water, information and communications, real estate activities, financial intermediation and insurance, public administration, education and health, other services and taxes on imports and products.
Source: Central Bank of Costa Rica.

Chart 25 summarizes the estimated GDP growth in this report for the years 2025 and 2026, both by expenditure components and by economic activity.

Gráfico 25. GDP in volume by expenditure components and economic activity
Annual variation in percentages (correct format)

A. Components of expenditure *B. Economic activity*



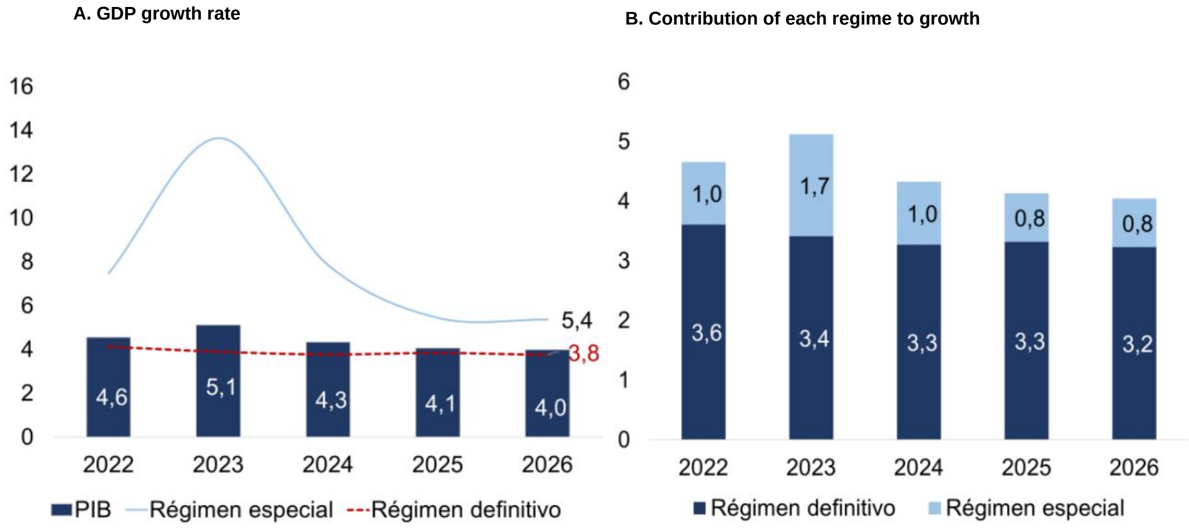
[1] Mines and quarries, electricity and water, information and communications, public administration, education and health, other services and taxes on imports and products. Source: Central Bank of Costa Rica.

By trade regime, the slowdown in economic activity is explained by the behavior of the special regime.

The production of the final regime, which represents around 86% of GDP, showed a relatively stable growth in the period 2022-2024, close to 3.8%, which is estimated to continue in the biennium 2025-2026. For its part, the activity of the special regime, which constitutes the remaining 14%, registered an increase of more than two digits in 2023 and then began to decelerate, which is why it is estimated that in the biennium it would register an increase of around 5.4% (Chart 26.A).

The expected behavior of the special regime explains the projected slowdown of GDP in the two-year period compared to 2024. As can be seen in Chart 26.B, in the two-year period the contribution to growth of the definitive regime is similar to that of 2024, while that of the special regime is lower.

Gráfico 26. GDP growth rate according to trade regime and contribution of each regime



Source: Central Bank of Costa Rica.

In the 2025-2026 biennium, the current account deficit would average 1.5% of GDP, similar to the result in 2024. This gap would be more than covered by long-term external savings, as has been characteristic of the last two decades.

The goods account deficit would reach an average ratio of 4.4% to GDP in that biennium, slightly higher than in 2024 (Table 7). However, the estimates for 2025 were revised downwards by 0.6 pp compared to what was indicated in the previous report, given the recent performance of foreign trade figures, which showed higher exports and lower imports121 .

Export growth is believed to be led by companies under special regimes, with an average variation of 8.9% over the two-year period. This rate is moderate compared to what was observed in previous years, characterized by the extraordinary increase in sales of these companies (19.5% on average for the period 2021-2024).

Exports under the definitive regime would show rates similar to those of 2024, on average 5.0% for agricultural goods and 4.0% for manufactured goods.

121 This revision incorporates the increase in the growth prospects of the country's main trading partners (from 2.2% to 2.4% by 2025) as well as the expected slowdown in growth.
of domestic economy.

Table 7. Balance of payments of Costa Rica 1

In millions of USD, as a percentage of GDP and in percentage points (pp)

	Estimate	Projections		Differences regarding to the IPM October 2024
	2024	2025	2026	2025
I Current account	**-1,335**	**-1,497**	**-1,567**	**-178**
A. Goods	-4,000	-4,472	-4,787	-614
Exports FOB Imports CIF	20,616	22,240	23,876	430
Of which: hydrocarbons	24,616	26,712	28,663	-184
	2,287	2,213	2,067	92
B. Services	10,272	10,915.0	11,478.2	-131
Travel	3,553	3,879	4,159	-97
C. Primary income D.	-8,170	-8,513	-8,810	284
Secondary income **II Capital**	563	574	551	-22
account Net lending (+) /	24	23	24	1
Net borrowing (-)	**-1,359**	**-1,520**	**-1,591**	**-177**
III Financial account	**-2,231**	**-2,357**	**-2,567**	**-29**
Public sector	-273	-102	-679	-428
Private sector Of	-1,958	-2,254	-1,888	399
which: Direct investment liabilities	-5,123	-5,279	-5,466	200
IV Reserve Assets	**920**	**883**	**1,023**	**150**
GDP ratios				
Net indebtedness	-1.4	-1.5	-1.5	-0.1
Current account deficit	-1.4	-1.5	-1.5	-0.2
Deficit in goods	-4.2	-4.4	-4.4	-0.6
Surplus in services	10.8	10.7	10.6	-0.2
Primary income deficit	-8.6	-8.4	-8.2	0.2
Financial account	-2.3	-2.3	-2.4	-0.1
Direct investment liabilities	-5.4	-5.2	-5.1	0.2
Reserve asset balance	14.9	14.8	14.9	-0.2
Reserve asset balance (millions of USD)	**14,177**	**15,060**	**16,084**	**-88**

[1] Estimated figures for 2024 and projections for 2025 and 2026.
Source: Central Bank of Costa Rica

Even though import growth was revised downwards compared to what was indicated in October, this rate maintains the acceleration compared to 2024, mainly due to the boost in purchases by companies under the special trade regime, whose average annual rate (11.7%) contrasts with the 5.3% drop in 2024.

As regards the final regime without considering hydrocarbons, an average annual growth of external purchases of 8.4% is assumed (10.7% in 2024), determined mainly by consumer and capital goods.

Specifically, for the purchase of hydrocarbons, it is expected that the contraction observed since 2023 will continue in the two-year period, after the exceptional growth shown in 2022 due to the increase in international prices of the product. This result combines the effect of an average reduction in the prices of the finished product mix (2.2% on average for the two-year period compared to the price of 2024) and the quantity of barrels (1.0%).

The average annual surplus in the services account would amount to *USD* 11,196.6 million (10.7% of GDP, similar to the 2024 ratio). As usual, the travel account and business support services, telecommunications, computer science and information services stand out. The estimates for this biennium were adjusted downwards in relation to what was assumed last October, particularly in the tourist income category122 and in manufacturing services.

[122] According to data from the Costa Rican Tourism Institute (ICT) available last December.

The remuneration of production factors owned by non-residents is estimated to grow at an average rate of 3.8%, reaching 8.3% of GDP (8.6% in 2024). This moderation is associated with the expected decrease in international interest rates.

In the 2025-2026 biennium, net external savings would reach, on average, the equivalent of 2.3% of GDP, close to what was observed in 2024 and which would allow the ratio of reserve assets to GDP to be maintained at around 14.9%.

External financing would be directed, to a greater extent, to the private sector, which on average would receive the equivalent of 1.9% of GDP, while for the public sector the average income would reach 0.4% of GDP, destined mainly to the Central Government.

Net external savings to the private sector are classified in this report as direct investment (DI) flows and other financial flows. In the first case, they are expected to be, on average, 5.1% of GDP, a ratio similar to the average of the previous five years[123]. For the rest of the financial flows, the projection contemplates an outflow of resources equivalent to 3.1% of GDP, on average, similar to what was observed in 2024 and which would largely be associated with movements in the Costa Rican financial sector.

The estimated external financing for the two-year period, together with the current account deficit forecasts, would allow the accumulation of reserve assets until reaching an average balance equivalent to 14.9% of GDP. In this context, the reserve monitoring indicator would present an average value of 149.5% of the minimum adequate level defined by the Board of Directors of the BCCR.

Fiscal projections for the 2025-2026 biennium assume better results (higher primary surplus and lower financial deficit) compared to 2024, thus maintaining the medium-term consolidation process.

According to MH[124] estimates , the primary and financial balances as a proportion of GDP in 2025 would be 1.5% and -3.1%, respectively, and 1.7% and -2.7% a year later (1.3% and -3.5% in 2024) [125] These results will allow the downward trend in the government debt to GDP ratio to continue (Table 8).

The projections incorporate the following assumptions:

a. Total and tax revenues would grow at an average rate of 5.5% and 6.7% in 2025 and 2026[126], respectively, above the average growth of

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123 For 2025, the projection was revised upwards compared to what was forecast in the October report, given the recent evolution of ID and the expected growth in exports of companies covered by special regimes.

124 This corresponds to a preliminary review of the fiscal projections prepared by the Ministry of Finance in December of last year and which will be maintained until the full results for 2024 are available. The Ministry of Finance is in the process of reviewing the 2025-2030 projections for its Medium-Term Fiscal Framework, which will be published in March of this year.

125 Data estimated by the MH in December 2024.

126 The income yields provided for by Law 9,635 were fully achieved, so, as of these years, no additional resources are contemplated.

Nominal GDP. Given the above, the average tax burden would be equivalent to 13.2% of GDP (13.4% in 2024)127 .

b. Total and primary expenditure would increase by 3.7% and 4.2%, on average, during the two-year period, which would place their average ratio with respect to GDP at 17.7% and 13.2%128 , in the order mentioned; these rates are lower than those forecast in the IPM of last October.

Spending restraint would be reflected in current and capital transfers, and in the payment of interest on the debt. This is despite the fact that in fiscal year 2025 control over total spending will be maintained, while in 2026 control would be applied to current spending.129 , This is because in 2024 the central government debt as a proportion of GDP did not exceed 60%.

The projections for the evolution of the Central Government's debt in relation to GDP foresee a ratio of 59.8% for 2025, similar to that estimated by the Ministry of Finance for 2024, and a fall of 1.0 pp in 2026 (58.8%).

c. Interest payments would begin to decline in 2025. They would register an average growth of 2.3% over the two-year period and as a proportion of GDP would be 4.6% in 2025 and 4.4% in 2026. This reduction is due to the generation of primary surpluses and lower interest rates for the placement of its debt, given the improvements in the credit rating.

Table 8. Main fiscal variables as a proportion of GDP

	Estimate Ministry of Hacienda1	Projections IPM Jan 25		Differences from Oct 2024 projections (in GDP percentages)
	2024	2025	2026 14.8	2025
Total income	15.0	14.8	13.2 13.2	-0.1
Tax revenue	13.4			-0.1
Total expenditure	18.6	17.9	17.4	-0.2
Primary expenditure	13.7	13.3	13.0	-0.1
Interests	4.8	4.6	4.4	-0.1
Primary balance	1.3	1.5	1.7	0.0
Financial deficit	-3.5	-3.1	-2.7	0.1
Financing needs	8.6	8.1	7.6	-0.2
Central Government Debt	59.8	59.8	58.8	-1.3

[1] Corresponds to an MH estimate submitted in December 2024.
Source: Prepared by the authors with information from the MH.

127 The downward adjustments contemplated, especially for 2025, are recorded in the income and profits tax and, to a lesser extent, in the value-added tax.

128 The expenditure to GDP ratio would be below the values recorded in the 2017-2019 period, before the approval of Law 9,635, when its average value was 20% in total expenditure and 16.5% in primary expenditure.

129 According to Article 11 of Chapter II of Title IV of Law 9635, the growth in total expenditure due to the application of the fiscal rule in 2025 will be 65% of the average growth of nominal GDP (equivalent to a rate of 3.75%). By 2026, the proportion would increase from 65% to 75% and would apply to current expenditure, which would allow more room for capital expenditure.

According to the projected fiscal performance, which includes the generation of primary surpluses and a lower interest burden, the gross financing requirement of the Central Government would decrease in terms of GDP (8.1% in 2025 and 7.6% in 2026), which will reduce the pressures of the MH on the local market for loanable funds. When disaggregating the debt by its source of financing, the domestic component will continue to be the main source, especially through the issuance of securities[130] .

Both headline and core inflation are expected to return to the target range in the third quarter of 2025.

In this report, the forecast horizon relevant to monetary policy covers the first quarter of 2025 to the fourth quarter of 2026, and the projections incorporate a monetary policy stance whose objective is for inflation to converge in the medium term to the target defined by the Board of Directors of the BCCR (3% ± 1 pp).

The Central Bank's projection models indicate that, in year-on-year terms, both headline and core inflation will accelerate, especially during the first months of 2025, to converge to values consistent with the range contained in the target in the third quarter of 2025.

Risk assessment remains tilted downwards, meaning there is a higher probability that overall and underlying inflation will fall below the central value.
projected[131] . However, compared to what was estimated last October, that probability is now lower.

The headline inflation in year-on-year terms for the fourth quarter of 2024 (-0.01% on average) was lower than estimated in the IPM for October 2024. This result was offset by two effects: a decrease in the international price of some raw materials, especially oil, and an increase in the price of food, mainly locally produced agricultural products, due to weather factors. As for core inflation, the result observed in the fourth quarter of 2024 (0.7%) was lower than estimated last October[132] .

Inflation expectations, one of the macroeconomic determinants of inflation, would tend to be around 2.5% on average over the projection horizon. The output gap, another of the variables that explain inflation in the short and medium term, is expected to be around 2.5%.

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130 However, the MH foresees a new debt issue in external markets for *USD* 1,000 million in each year for both 2025 and 2026, as contemplated in Bill 24,462 (Amendment of Law No. 10,332, authorization to issue securities in the international market), a proposal that is under discussion in the Legislative Assembly. Additionally, the MH foresees the entry of budget support disbursements for *USD* 843 and *USD* 503 million in 2025 and 2026, in that order. If these assumptions are not met, it will have to turn to the domestic market, which could put upward pressure on local interest rates.

131 The trajectories are generated from the BCCR macroeconomic model, with information as of January 2025 on projections of international commodity prices, interest rates, growth and inflation of Costa Rica's main trading partners, among others, and take into account the response of the TPM, modeled using a Taylor-type rule. The 8-quarter horizon allows for consideration of the lags with which monetary policy operates.

132 In the Monetary Policy Report of October 2024, it was estimated that in the fourth quarter of 2024 General inflation would average 0.1% and underlying inflation 1%.

term, would remain at slightly positive values, but without representing excesses of aggregate demand that would divert inflation from its target.

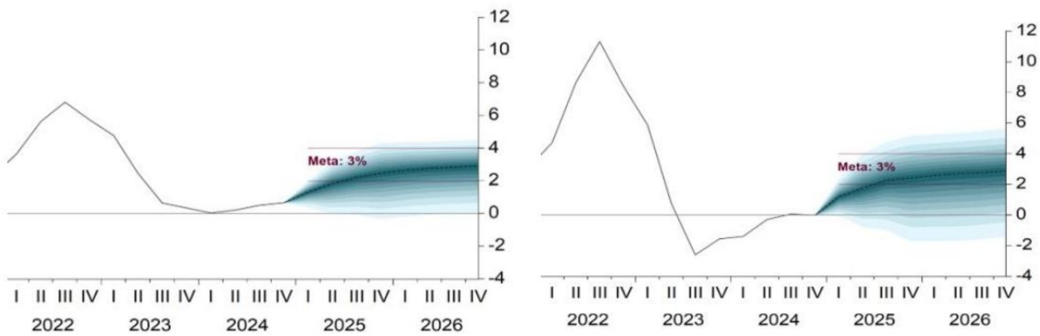
The aforementioned behaviour of the main macroeconomic determinants of inflation would lead to both headline and core inflation being at an average of 2.3% over the entire projection horizon on an interannual basis.

(Chart 27.A and 27.B).

Gráfico 27. Inflation projection

Year-on-year change in percentages [1]

A. Core inflation **B. General inflation**



[1] The charts show the forecast bands for core inflation and headline inflation, as measured by the Consumer Price Index, over the projection horizon. They are conditional projections; that is, they take into account possible monetary policy reactions that could occur over the said horizon.
horizon. The darkest band around the central value concentrates the 10% probability of occurrence. Each pair of bands with successively lighter shades accumulates an additional 10%, until reaching 90% probability.

Source: Central Bank of Costa Rica.

Financial savings and credit to the private sector would increase in line with the expected real growth of economic activity and the inflation target.

Given the inflation target, as well as the expected behavior of the production accounts, total liquidity would grow at an annual rate of 7.2% in 2025 and 7.1% in 2026, which would allow for an annual growth of credit to the private sector of 7.0% and 7.1% in those years, in that order.

The increase in credit would occur in both national and foreign currency; however, a lower growth in credit in dollars is assumed in the biennium (6.5% and 6.0% in 2025 and 2026, respectively) compared to 2024 (9.9%), which would slow down the relative dollarization process of credit observed since 2023. This lower expected growth in credit in foreign currency would be the result of the expected reduction in the active interest rates in colones of the financial system (behavior induced by the reductions applied to the TPM in the previous biennium), which would lead to a greater relative growth of credit in national currency compared to the dynamics of operations in dollars.

Table 9 presents a summary of the projections of the main macroeconomic variables included in this report.

Table 9. Main macroeconomic variables

	Estimate	Projections		Differences from October 2024 projections (in pp)
	2024	2025	2026	2025
GDP (billions of colones)	49 115.9	52 499.9 56 237.2		
GDP real growth	4.3	4.1 4.0 1.5 1.5 14.8		0.2
BP current account deficit (% of GDP)	1.4	15.0 148 150		-0.2
Reserve asset balance (% of GDP)	14.9			-0.2
Booking Tracking Indicator (IR)	145			-2.0
Central Government (% of GDP)				
Financial deficit [1]	3.5	3.1	2.7	-0.1
Primary surplus [1]	1.3	1.5	1.7	-0.1
Year-on-year change in CPI [2]	0.8	2.4	2.9	-0.2
Monetary aggregates and credit (% change) [3]				
Total liquidity (M3)	5.9	7.2	7.1	0.1
Credit to the private sector	7.6	7.0	7.1	0.1
National currency	6.5	7.2	7.6	0.9
Foreign currency	9.9	6.5	6.0	-1.5

1The figures for 2024 are preliminary and those for 2025-2026 correspond to estimates from the Ministry of Finance.
2For the period 2025-2026, it corresponds to the interannual rate of the fourth quarter of each year.
3The valuation of foreign currency does not consider the exchange rate effect.
Source: Central Bank of Costa Rica.

3.3 Risk balance of the macroeconomic forecast

The update of the projections of the main macroeconomic variables for the forecast horizon was carried out with the information available as of January 2025. As is usual in all macroeconomic projections, there are risks inherent to both the external and internal context that could deviate from the central macroeconomic scenario contemplated in this report. If these risks materialize, inflation could deviate both downwards (downside risks) and upwards (upside risks) with respect to the projected central value.

Downside risks

1. A scenario in which international interest rates remain higher for longer could lead to lower growth in the global economy than projected in this exercise, particularly in the main trading partners.
of the country, with the consequent negative effect on external demand. This would slow down local economic growth and reduce inflationary pressures.

2. A smaller and slower pass-through of reductions in the TPM to some of the financial system's active interest rates, compared to what has been historically observed in Costa Rica, would negatively affect economic activity, which would reduce the pressures of domestic demand on prices.

Upside risks

1. Possible trade restrictions in the face of tensions between G7 countries and China or an escalation of current geopolitical conflicts could increase the fragmentation of global trade. This would generate additional disruptions in supply chains and increase the volatility of commodity prices.

raw materials, especially oil and food, which, as in other similar episodes, would translate into higher production costs and inflationary pressures.

2. Extreme weather conditions, such as the development of the ENSO phenomenon in its La Niña phase between February and April 2025, would have a negative impact on agricultural production and other climate-dependent activities, both locally and internationally. This would not only reduce the supply of certain commodities, thereby raising their prices, but would also generate higher costs in the agricultural and energy supply chain, thereby amplifying inflationary pressures.

3.4. Future monetary policy actions and functioning of the foreign exchange market

The BCCR Board of Directors reaffirms its commitment to price stability, a condition that promotes macroeconomic stability and has a positive impact on the economic growth and job creation. For this reason, the inflation target is maintained at 3%± 1 pp

The BCCR will make the required adjustments to the TPM so that inflation returns to values consistent with that target. This is based on the assessment of recent behavior and the trajectory of inflation forecasts and its macroeconomic determinants (output gap and inflation expectations), as well as the risks associated with the inflation projection.

It will also manage the liquidity of the financial system in order to reduce monetary excesses and prevent their persistence from generating additional inflationary pressures.
It should be noted that monetary pressures are not anticipated, given that the expiration of the credit facility granted by the BCCR in response to the economic effects of the pandemic has managed to significantly reduce monetary excesses.

In addition, it will seek to improve communication with the public, in order to facilitate a better understanding of the macroeconomic situation and the elements that support the BCCR's decisions on monetary and exchange matters and issues related to the stability and efficiency of the financial system. The aim is to contribute to an informed process of building economic expectations, which will facilitate the convergence of inflation to the target defined by the BCCR.

In terms of foreign exchange, in accordance with the provisions of its Organic Law, the BCCR will participate in the foreign exchange market in order to meet its own requirements and those of the non-banking public sector, as well as to mitigate violent fluctuations in the exchange rate.
To the extent that exchange market conditions allow, it will seek to further strengthen the country's financial protection. In addition, similar to what it does in the debt and liquidity markets, it will continue to analyze possible operational changes that seek the better functioning of that market and thereby contribute to an orderly process of price formation.