



The Global Rise in Food Prices and the US Slowdown:

Challenges from the Monetary Policy Perspective

Banco Central de Costa Rica

June 16th, 2008



Macroeconomic Context and Monetary Policy: Challenges in Costa Rica



Macroeconomic Context

- Economic growth, but at decreasing rates (8.8% in 2006, 6.8 in 2007 and 6.5% Q.1-08): Levels and rates higher than potential output
- Improvement in households real income (2007)
- High confidence: Firms and Households
- Increasing Productivity
- Unemployment is at historically low rate as (4.6%)



Macroeconomic Context

- Widening gap in current account (-4.7% in 2006, -5.9 in 2007, -8.5% to -9.0%, projected in 2008)
- Capital inflows (FDI) enough to fund CAD in the recent past and to increase NIR, but not in 2008
- Ratio NIR/GDP $\sim 16\%$
- Fiscal discipline (P.S. Surplus/GDP ≈ -0.4 in 2006, 0.8 in 2007, 0.5 in 2008)



Macroeconomic Context

- Decreasing Ratio Public Debt/GDP (both domestic and foreign debt)
- Monetary policy framework: Transition toward Inflation Targeting
- Exchange Rate Regime: Crawling band (16% width)
- Since October 2006 appreciation of exchange rate (real and nominal terms)



Macroeconomic Context

- Inflation: 9.4% in 2006, 10.8% in 2007, $E(\pi) = 11$ in 2008
- Low interest rates (nominal), negative in real terms for deposits
- Private sector credit grows in the up 30's during last 18 months
- Last 5 weeks depreciation of local currency 5.5%



What to do?

- We have macroeconomic imbalances that should be reduced
- Shocks seem to last more than a few months
- So far, there is no discussion in how to mitigate oil shocks or food shocks.
- Central Bank committed to reduce inflation: tight monetary control (interest rates) and allow exchange rate to adjust



Monetary Policy Options

- Even though in absence of the shocks Costa Rican economy requires to adjust to lower level of expenditure.
- Let the macro prices (interest rate and exchange rate) to adjust.



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