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International

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Costa Rica downgraded by Fitch to BB

- On 19 January 2017, Fitch Rating Agency lowered its long-term foreign currency rating on Costa Rica from BB+ to BB with a stable outlook.
 - According to Fitch, the downgrade was triggered by the country's continued deterioration of its debt dynamics due to growing fiscal deficits and the lack of political consensus to address the issue.
 - The fragmented nature of Costa Rica's congress has made it very difficult for President Luis Guillermo Solis's administration to pass the important VAT and income tax reforms (estimated 2% of GDP in additional revenues) required. With congressional and presidential elections approaching in February 2018, the likelihood of these reforms passing through parliament is diminishing.
 - Costa Rica's central government fiscal deficit improved by 0.6% to 5.1% of GDP in 2016 mainly due to administrative measures. However, Fitch forecasts further widening over the next two years due to a higher interest burden and spending rigidities.
 - These fiscal imbalances has contributed to Costa Rica's debt burden doubling to an estimated 41% of GDP in 2016 over the past 8 years.
 - In the absence of tax reform the debt burden is expected to reach over 60% of GDP within the next decade.
 - Several factors result in Costa Rica's stable outlook including the country's strong growth and financing flexibility in the captive local market. GDP growth is estimated to have reached 4.2% in 2016 as the economy was supported by its dynamic and diversified export base
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and the strong performance of its tourism sector. In 2016, Costa Rica was largely able to meet its financing needs in the local market by tapping sizeable liquidity among various public-sector entities, after congressional authorization for external bond issuance ended in 2015.

- Low oil prices have also been beneficial to the country by helping to reduce the current account deficit to 3.5% of GDP in 2016 from 4.5% in 2015 and boosting tourism receipts. However low prices have also contributed to low inflation averaging 0.7% in 2016, well below the central bank's target of 3%+/-1pp. This has resulted in a hold on the central bank's policy rate after a cumulative 350 basis point cut in 2015 – Jan 2016.
- Inflation is expected to converge towards the central bank's target in 2017 and GDP growth is forecasted above 4% for 2017 and 2018.
- Costa Rica is rated BB- (Negative) by S&P and Ba1 (Negative) by Moody's.



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