MOODY'S
INVESTORS SERVICE

Rating Action: Moody's changes Costa Rica's outlook to stable, affirms B2 ratings

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New York, December 08, 2021 -- Moody's Investors Service ("Moody's") has today changed the outlook on the Government of Costa Rica's ratings to stable from negative. Concurrently, Moody's has affirmed Costa Rica's B2 long-term issuer and senior unsecured bond ratings.

The change to a stable outlook reflects:

• Gradual deficit reduction and lower funding needs resulting from a recovering economy

• Expectations that the current International Monetary Fund (IMF) program will support structural policy changes by the next administration

The affirmation of Costa Rica's B2 ratings considers the sovereign's relative wealth levels and a dynamic economy balanced by the decade-long rise in the government's main debt metrics.

Costa Rica's local and foreign currency country ceilings remain unchanged. The Ba1 LC ceiling, four notches higher than the sovereign rating, reflects limited government intervention in the economy and a history of respect for the rule of law. The Ba3 FC ceiling, two notches below the LC ceiling, reflects the risk of potential transfer and convertibility controls in the event of a default given the high level of domestic dollarization.

RATINGS RATIONALE

RATIONALE FOR CHANGING THE OUTLOOK TO STABLE FROM NEGATIVE

RECENT DEFICIT REDUCTION AND LOWER FUNDING NEEDS

Moody's forecasts that Costa Rica's fiscal deficit this year will be 5.8% of GDP, a large number albeit lower than both last year's result (8.1% of GDP) and that we forecasted in early 2021 (7% of GDP). The lower deficits are the result of faster economic growth and increased revenues. These trends have supported a reduction in overall government funding needs easing refinancing pressures.

Real GDP growth will be 5% this year and Moody's forecasts 4% growth in 2022, as the economy recovers from the 2020 Covid -induced recession. Costa Rica has a long history of adapting to economic shocks and last year's recession was only the third in over 50 years. Moody's expects that Costa Rica will return to a 3% average growth after 2023.

Faster economic growth will help raise government revenues to 15% of GDP by 2023, about 1% of GDP higher than the pre Covid average and the resulting lower deficits will help reduce funding needs relative to prior years. We estimate that Costa Rica's gross funding needs will drop to close to 11% of GDP in 2021-2022 after averaging over 13% of GDP in 2018 and 2019. Reduced financing pressures will be further assisted by increased borrowing from multilateral lenders, which usually lend at rates lower than market funding. Moody's estimates that close to 40% of 2022 government financing needs could be met by the IMF and other multilateral organizations.

EXPECTATIONS IMF PROGRAM WILL SUPPORT FISCAL CONSOLIDATION UNDER NEXT ADMINISTRATION

In March of this year the IMF's board approved a three-year $1.8 billion (2.8% of GDP) arrangement under the Extended Fund Facility (EFF), a program targeted to countries seeking to correct structural imbalances over an extended period. The EFF program was approved in July by Costa Rica's unicameral legislative Assembly. Approval by the Assembly was an important signal of political support, with 44 of the Assembly's 57 members voting for implementation.

The main goal of the program is gradual fiscal consolidation, aiming for a 1% primary surplus by 2023. While some slippage is likely, and Moody's forecasts a smaller but still positive primary result of 0.7% of GDP, Moody's expects that Costa Rica will continue to gradually reduce its deficits as stated under the program even with a government change. Disbursements under the program, spread out over the life of the agreement, are contingent on meeting the agreed upon targets.

Costa Rica's next presidential elections are due in February 2022 with a new administration assuming office in May 2022. The next government will inherit an existing IMF program, requiring it to meet existing fiscal targets. Regardless of political orientation, Moody's expects that the EFF program will be followed through by the incoming authorities.

RATIONALE FOR AFFIRMING THE RATINGS AT B2

Costa Rica's B2 ratings reflect the balance of a relatively wealthy and dynamic economy and relatively strong institutions with the large increase in the country's main debt metrics since 2010.

The country's long term economic outlook remains strong as the economy continues to transition from simple agricultural exports, to tourism, light manufacturing, and more recently business outsourcing and medical technology exports. Costa Rica's GDP per capita (PPP) at $20,268 in 2020 is more than four times the median of similarly rated countries and its $64 billion economy is also larger than rated peers.

Costa Rica also compares favorably to other sovereigns in the region on measures such as government effectiveness, rule of law and control of corruption. Costa Rica's democracy is the oldest in the region. These features of the country's institutional makeup are supportive of the country's credit risk profile because they speak to institutional continuity and political stability, elements that tend to be correlated with policy predictability.

Costa Rica's B2 ratings also reflect the political difficulties in the last decade to reign in high deficits, which increased debt from 28% of GDP in 2010 to a forecast 70% this year. Costa Rica's debt burden, measured both against GDP and government revenues, is among the highest of all rated peers. And the country's debt affordability is particularly weak, with interest payments representing over 30% of all government revenues, one of the highest levels among rated sovereigns. The high interest burden increases funding risks for the country in the event of a sudden or sharp rise in interest rates.

ENVIRONMENTAL, SOCIAL AND GOVERNANCE CONSIDERATIONS

Costa Rica's ESG Credit Impact Score is moderately negative (CIS-3), reflecting moderate exposure to environmental and social risk, and a moderately negative governance issuer profile score with limited fiscal policy effectiveness.

Costa Rica's exposure to environmental risks is moderately negative (E-3 issuer profile score), related to physical climate change and natural capital erosion. Lower crop yields because of climate events can harm the agricultural export sector, and tourism revenue may be affected by rising sea levels and increased storm severity.

Exposure to social risks is also moderately negative (S-3 issuer profile score). Social considerations historically were not material to Costa Rica's credit profile given its long history of stable governments and democratic institutions but attempts to reduce high fiscal deficits have encountered significant social resistance in recent years. Popular demands to reduce perceived inequalities and high rates of violence will continue to challenge domestic policy choices.

The influence of Governance on Costa Rica's credit profile is moderately negative (G-3 issuer profile) and risks are mainly related to the political inability of several administrations to address a growing fiscal crisis that will require significant fiscal consolidation and structural reforms. Costa Rica has struggled for almost 10 years to reduce high fiscal deficits, and several previous reform attempts were stymied by political differences.

GDP per capita (PPP basis, US$): 20,269 (2020 Actual) (also known as Per Capita Income)

Real GDP growth (% change): -4.5% (2020 Actual) (also known as GDP Growth)

Inflation Rate (CPI, % change Dec/Dec): 0.9% (2020 Actual)

Gen. Gov. Financial Balance/GDP: -8.1% (2020 Actual) (also known as Fiscal Balance)

Current Account Balance/GDP: -2.2% (2020 Actual) (also known as External Balance)

External debt/GDP: 51.7% (2020 Actual)

Economic resiliency: ba1

Default history: No default events (on bonds or loans) have been recorded since 1983.

On 03 December 2021, a rating committee was called to discuss the rating of the Costa Rica, Government of. The main points raised during the discussion were: The issuer's economic fundamentals, including its economic strength, have materially increased. The issuer's fiscal or financial strength, including its debt profile, has materially increased. The issuer has become less susceptible to event risks.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

WHAT COULD CHANGE THE RATINGS UP

Upside rating potential may result from a continued drop in fiscal deficits that supports declining debt metrics. Approval and implementation of long term sustainable fiscal structure that reduces the risk of future increases in debt metrics will also support a positive rating action.

WHAT COULD CHANGE THE RATINGS DOWN

A negative rating action may result from fiscal deterioration that results in higher government debt metrics than we project, market access challenges and higher funding costs. Evidence of stress in the banking system could also strain the rating. Abandonment of the IMF EFF program that leads to a funding crisis due to lack of market funding access could also lead to a negative rating action.

The principal methodology used in these ratings was Sovereign Ratings Methodology published in November 2019 and available at https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1158631 . Alternatively, please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

The weighting of all rating factors is described in the methodology used in this credit rating action, if applicable.

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found at: https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_79004.

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Regulatory disclosures contained in this press release apply to the credit rating and, if applicable, the related rating outlook or rating review.

Moody's general principles for assessing environmental, social and governance (ESG) risks in our credit analysis can be found at http://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1288235 .

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