

**RATING ACTION COMMENTARY****Fitch Revises Costa Rica's Outlook to Positive; Affirms IDR at 'BB'**

Tue 25 Feb, 2025 - 14:15 ET

Fitch Ratings - New York - 25 Feb 2025: Fitch Ratings has affirmed Costa Rica's Long-Term Foreign-Currency Issuer Default Rating (IDR) at 'BB'. The Rating Outlook has been revised to Positive from Stable.

A full list of rating actions is at the end of this rating action commentary.

**KEY RATING DRIVERS**

**Positive Outlook:** The Positive Outlook reflects robust growth, improvements in Costa Rica's external position, gradually declining debt trajectory, and continuation of primary surpluses, despite some easing of fiscal gains. Costa Rica's rating is supported by structural strengths relative to the 'BB' category, including high per-capita income relative to peers. This is counterbalanced by still high interest payments that are a source of fiscal rigidity and a track record of political gridlock hindering reforms and financing flexibility despite strong governance indicators.

**Strong Growth:** Real GDP grew 4.3% in 2024, down from 5.1% in 2023 but still above estimates of potential growth (3%-4%), driven by consumption and a dynamic export sector. The 'dual economy' continues to be a feature of Costa Rica's growth profile, with stronger economic activity in the free trade zones (FTZs) than in the broader economy. Fitch expects growth to slow to 3.8% in 2025 and to 3.5% over the medium-term.

**Inflation Still Below Target:** Inflation has remained among the lowest in the region, averaging -0.4% in 2024. A strong exchange rate (26% appreciation since mid-2022) contributed to negative inflation in 2023 and 1H24. Fitch expects average inflation to reach 1.7% in 2025, gradually converging with the lower end of the 3% +/- 1 target range, in line with recent trends. The central bank has kept the policy rate at 4% since October 2024,

following 500 bps of cuts starting in early 2023, and Fitch does not expect more cuts due to the recent pickup in inflation.

**Fiscal Momentum Slows:** Revenue growth has begun to decelerate, with tax revenue growing only 2.4% in 2024. Total expenditure growth (6.3%) exceeded overall revenue growth (3.2%) in 2024, in part due to some one-off expenses (i.e., a retroactive salary increase). Current primary spending grew 5.7% (driven by 6.5% increase in wages) and capex by 17%, while interest expenditure growth slowed to 5%, as domestic interest rates have fallen.

As a result, the central government primary surplus fell to 1.1% of GDP in 2024, down from 1.6% in 2023. The overall central government deficit grew in line with this deterioration, rising to 3.8% of GDP in 2024 from 3.3% in 2023, as the high interest burden remained flat at 4.8% of GDP.

**Gradual Fiscal Consolidation:** Fitch expects the central government to reach a 3.1% overall deficit in 2025 (primary surplus of 1.5%) supported by a reversal of one-off effects and lower interest burden. Medium term fiscal consolidation is likely to come from a slow reduction in the wage bill and a declining interest burden, as domestic debt is rolled over at lower rates. Primary surpluses are then likely to stabilize at around these levels, absent new tax measures, as the impact of the 2018 tax reform seems to have run its course and flexibilization of spending limits under the fiscal rule from 2026 could put some upward pressure on spending.

Central government debt fell below the 60% threshold (59.8%) at end 2024, down from 61.1% in 2023, in part due to support from a strong exchange rate and a drawdown of deposits. This means a less stringent version of the fiscal rule will apply to the 2026 budget, with capex not subject to the strict spending growth cap. Fitch estimates consolidated general government debt fell to 55% in 2024, down from 55.3% in 2023.

**External Borrowing Authorization:** Lower than expected primary surpluses led the government to propose revisions to the targets in the Eurobond law, which provides multi-year external borrowing authorization. Proposed revisions to the law would extend the additional annual USD1 billion Eurobond issuance authorization by one year (to 2025 and 2026). The revisions are still being discussed in Congress, but Fitch expects them to be approved. A proposed constitutional amendment, that would provide the government more flexibility in external borrowing on a more permanent basis, is likely to face greater challenges, particularly in the run-up to elections in February 2026.

**Deep Local Market, Lower Cost Financing:** The 2024 deficit was financed through multilateral financing and the domestic market. Fitch expects a similar funding mix in 2025, with the potential addition of USD1 billion in Eurobond issuance if the external borrowing authorization extension is approved, although Fitch expects the government to be able to comfortably finance deficits absent this authorization.

Local interest rates have fallen, and the government has taken advantage of lower rates to conduct liability management operations to lower costs and extend maturities, with average maturity of domestic debt increasing to seven years in 2024 from 5.7 years in 2021. Lower interest rates will help lower the high interest to revenue ratio (32% at central government level) over the medium term, although it remains the highest in the 'BB' category and well above the 'BB' median (10%).

**Stronger External Position:** Fitch estimates the current account deficit reached 1.4% in 2024, in line with 2023 and well below its 2010-2019 average (3.7%) and 'BB' median (2.3%). Strong export performance and tourism sector have led to robust foreign exchange inflows. Costa Rica seems to be a beneficiary of nearshoring trends, with strong FTZ export performance and FDI inflows (USD2.6 bn through Q3 2024, on track to match the record set in 2023).

International reserves grew to USD14.2 billion at end 2024, up from USD13.2 billion at end 2023. Reserves at end 2024 reflected 146% of the IMF's ARA metric and 4.3 months of CXP (up from 3.1 months in 2022 and approaching BB median of 4.8 months). Greater reserve accumulation has put Costa Rica in a slight net sovereign external creditor position as of 2024 (+1%).

**Elections in 2026:** Congressional and presidential elections will take place in February 2026. The beginning of the electoral cycle may mean that any further reforms are hard to advance ahead of elections, including the constitutional amendment related to external financing. There is still uncertainty over the potential candidates this far ahead of elections given Costa Rica's many political parties and fragmented system. The president's current popularity remains high, with key voter concerns related to rising crime and violence.

**ESG Governance:** Costa Rica has an ESG Relevance Score of '5' for Political Stability and Rights and '5' [+] for the Rule of Law, Institutional and Regulatory Quality and Control of Corruption. These scores reflect the high weight that the World Bank Governance Indicators (WBGI) have in our proprietary Sovereign Rating Model. Costa Rica has a high WBGI ranking at 71, reflecting its long track record of stable and peaceful political

transitions, well established rights for participation in the political process, strong institutional capacity, effective rule of law and a low level of corruption.

## RATING SENSITIVITIES

### Factors that Could, Individually or Collectively, Lead to Negative Rating

#### Action/Downgrade

--Public Finances: Fiscal policy reversal that results in an upward debt trajectory in a context of fiscal rigidity;

--External Finances: Evidence of external liquidity stress; for example, a sharp decline of international reserves.

### Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

--Public Finances: Sustained decline in central government's debt/GDP ratio and interest to revenue ratio;

--Structural Factors: Evidence of reduced political gridlock that supports progress on reforms and ensures financing flexibility.

## SOVEREIGN RATING MODEL (SRM) AND QUALITATIVE OVERLAY (QO)

Fitch's proprietary sovereign rating model (SRM) assigns Costa Rica a score equivalent to a rating of 'BBB' on the Long-Term Foreign-Currency IDR scale.

Fitch's sovereign rating committee adjusted the output from the SRM score to arrive at the final Long-Term Foreign-Currency IDR by applying its qualitative overlay (QO), relative to SRM data and output, as follows:

Structural: -2 notches; reflects a long track record of institutional gridlock that has hindered timely progress on necessary reforms and access to external financing, which is not fully captured in the high governance scores that feed into the SRM.

Public Finances: -1 notch; reflects an adverse fiscal structure due to a high central government interest to revenue ratio. Central government fiscal metrics are much weaker than the general government metrics that feed into the SRM, signaling greater fiscal financing and rigidity challenges.

Fitch's SRM is the agency's proprietary multiple regression rating model that employs 18 variables based on three-year centered averages, including one year of forecasts, to

produce a score equivalent to a Long-Term Foreign-Currency IDR. Fitch's QO is a forward-looking qualitative framework designed to allow for adjustment to the SRM output to assign the final rating, reflecting factors within Fitch's criteria that are not fully quantifiable and/or not fully reflected in the SRM.

## COUNTRY CEILING

The Country Ceiling for Costa Rica is 'BBB-', two notches above the Long-Term Foreign-Currency IDR. This reflects strong constraints and incentives, relative to the IDR, against capital or exchange controls being imposed that would prevent or significantly impede the private sector from converting local currency into foreign currency and transferring the proceeds to non-resident creditors to service debt payments.

The BCCR has allowed for greater currency flexibility in recent years, prompting the IMF to change its classification of the exchange-rate regime from "crawl-like arrangement" to "floating", and helping the score in Fitch's CCM.

Fitch's CCM produced a starting point uplift of +2 notches above the IDR. Fitch's rating committee did not apply a qualitative adjustment to the model result.

## REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

## ESG CONSIDERATIONS

Costa Rica has an ESG Relevance Score of '5' for Political Stability and Rights, as WBGI have the highest weight in Fitch's SRM and are therefore highly relevant to the rating and a key rating driver with a high weight. As Costa Rica has a percentile rank above 50 for the respective governance indicator but has a track record of political gridlock that is highly relevant to a -2 QO notch adjustment, this has a negative impact on the credit profile.

Costa Rica has an ESG Relevance Score of '5' [+] for Rule of Law, Institutional & Regulatory Quality and Control of Corruption as WBGI have the highest weight in Fitch's SRM and are therefore highly relevant to the rating and are a key rating driver with a high weight. As Costa Rica has a percentile rank above 50 for the respective governance indicators, this has a positive impact on the credit profile.

Costa Rica has an ESG Relevance Score of '4' [+] for Human Rights and Political Freedoms as the Voice and Accountability pillar of the WBGI is relevant to the rating and a rating driver. As Costa Rica has a percentile rank above 50 for the respective governance indicator, this has a positive impact on the credit profile.

Costa Rica has an ESG Relevance Score of '4' [+] for Creditor Rights as willingness to service and repay debt is relevant to the rating and is a rating driver for Costa Rica, as for all sovereigns. As Costa Rica has record of 20+ years without a restructuring of public debt, which is captured in Fitch's SRM variable, this has a positive impact on the credit profile.

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit

<https://www.fitchratings.com/topics/esg/products#esg-relevance-scores>.

## RATING ACTIONS

ENTITY / DEBT	RATING	PRIOR
Costa Rica	LT IDR    BB Rating Outlook Positive Affirmed	BB Rating Outlook Stable
	ST IDR    B    Affirmed	B
	LC LT IDR    BB Rating Outlook Positive Affirmed	BB Rating Outlook Stable
	LC ST IDR    B    Affirmed	B

Country Ceiling	BBB-	Affirmed	BBB-
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senior unsecured	LT	BB	Affirmed	BB
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#### **[VIEW ADDITIONAL RATING DETAILS](#)**

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## APPLICABLE CRITERIA

[Country Ceiling Criteria \(pub. 24 Jul 2023\)](#)

[Sovereign Rating Criteria - Effective from 24 October 2024 to 15 September 2025 \(pub. 24 Oct 2024\) \(including rating assumption sensitivity\)](#)

## APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Country Ceiling Model, v2.0.3 ([1](#))

Debt Dynamics Model, v1.3.2 ([1](#))

Macro-Prudential Indicator Model, v1.5.0 ([1](#))

Sovereign Rating Model, v3.14.2 ([1](#))

## ADDITIONAL DISCLOSURES

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Costa Rica

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