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ISSUER COMMENT
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Government of Costa Rica

Policy response to mitigate coronavirus' negative economic effect will weigh on government finances

On 19 March, Costa Rica's (B2 stable) Legislative Assembly unanimously passed a fiscal stimulus package to mitigate the negative economic effects of the coronavirus. The government's policy response will mitigate the effects of the economic downturn but will negatively pressure the sovereign's fiscal profile.

The measures include a three-month moratorium on tax payments, a phased reduction of corporate social benefit contributions, and extended credit lines to the companies most affected by the economic downturn. Although there are no official estimates of the size of the fiscal stimulus, it comes while the sovereign's credit profile is already under significant pressure.

Additionally, the government closed its borders to tourists through 12 April to prevent contagion, which will weigh on economic activity given that the tourism sector comprised nearly 13% of total employment, more than 13% of GDP and around 4% of total investment in 2018. The Costa Rican Tourism Institute expects a meaningful reduction in tourism activity over the next three months, but believes it is too early to establish the magnitude of the effect. Hotels reported that more than 8,000 nights of bookings have been canceled, mostly throughout the second quarter, leading the Costa Rican Chamber of Hotels and Hospitality to estimate a fall in sales of 5%-50% depending on the region.

Costa Rica is in the midst of a fiscal consolidation program to reduce its debt burden, which more than doubled to 58% of GDP in 2019 from 24% in 2008. The most important corrective fiscal measures included in the government's fiscal consolidation efforts have been spread over time with most of the deficit reduction based on limiting the growth of current expenditures. We expect full implementation to run into public opposition as additional savings will require reductions to the government wage bill and social transfers, which will prove particularly difficult amid the coronavirus-induced economic downturn.

We expect lower growth to decrease government revenue, complicating the implementation of previously planned revenue measures. As of February, the government projected 2020 tax savings of around 1.6% of GDP, of which it expected 0.7% from the value-added tax, 0.7% from income taxes and 0.2% from other taxes. We believe 2020 tax savings will lower, at around 1.0% of GDP and expect Costa Rica's fiscal deficit to be higher than our February forecast 6% of GDP, with government debt more than 63% of GDP by the end of the year.

In addition to the government's fiscal response, the Central Bank of Costa Rica cut its key policy rate by 100 basis points to 1.25% to ease domestic credit conditions amid the government's coronavirus containment strategy. We maintain our expectation that inflation will remain at the lower end of the central bank's 3% (plus or minus 1%) target, as it has over the past five years given the deflationary effects of the coronavirus.

Moody's related publications

- **Issuer In-Depth**: Government of Costa Rica – B2 stable: Annual credit analysis, 25 February 2020
- **Credit Opinion:** Government of Costa Rica – B2 stable: Update following downgrade to B2, outlook stable, 10 February 2020
- **Rating Action**: Moody's downgrades Costa Rica's rating to B2; changes outlook to stable, 10 February 2020
- **Outlook**: Sovereigns – Latin America & Caribbean: 2020 outlook negative as rising social discontent weighs on policies, fiscal outturns and growth, 7 January 2020
- **Rating Methodology**: Sovereign Ratings Methodology, 25 November 2019

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