

# Fitch: President Arias' Narrow Victory Could Affect the Pace of Reforms

9 de marzo de 2006

Fitch Ratings-New York-08 March 2006: Fitch Ratings today said that while the victory of Oscar Arias in Costa Rica's recent presidential elections bodes well for reforms, the narrow victory margin could affect the pace of reforms. Contrary to pre-election polls in which Mr. Arias was leading by several percentage points, he won only by a very narrow margin. President Arias is viewed to be in favor of the U.S.-Central American Free Trade Agreement (CAFTA) and is pro-fiscal reform and pro-private enterprise, but a weaker election mandate could undermine his ability to spearhead reforms. 'As the PLN (the party of President Arias) has failed to obtain a simple majority in Congress, it remains to be seen how quickly the new administration will be able to garner sufficient support in a divided Congress to enact crucial reforms,' said Shelly Shetty, Senior Director in Fitch's Sovereign Group in New York. Fitch believes that the newly-elected Arias administration needs to make headway in CAFTA and fiscal reforms in order to place the country on a higher growth trajectory. Fitch rates Costa Rica's foreign and local currency issuer default ratings 'BB' and 'BB+', respectively. The Rating Outlook is Negative. Although the fiscal reform has passed the first vote in the legislative assembly, it is unclear whether it would be passed before the next administration takes over in May. Fiscal reform entailing revenue-raising measures is necessary to improve the medium-term outlook for the Costa Rican public finances. Although Fitch recognizes the recent reduction in Costa Rica's fiscal deficit, it believes that a permanent reduction in the general government deficit would require a revenue-enhancing reform. Inflation in Costa Rica ended at 14% last year, which is among the highest in the Latin American region. Additional tax revenues are needed to recapitalize the central bank in order to improve the effectiveness of monetary policy. The central bank's much lauded goal of moving toward a more flexible exchange rate regime and reversing the widespread financial dollarization could only be achieved after a fiscal reform is passed. Fitch also notes that Costa Rica is the only Central American country that has not yet approved CAFTA in its Congress. 'Approval of CAFTA is critical to further strengthen Costa Rica's position as a leading destination for foreign direct investment flows in the Central American region. It is hoped that the new government uses its political honeymoon period to seek a speedy approval of CAFTA,' said Shetty. Although the Pacheco government submitted CAFTA in Congress last year, the approval of this crucial trade pact has not been easy to obtain because of opposition from the unions and some political parties. The treaty will not only provide Costa Rica with the opportunity to gain permanent access to the U.S. market, but it will also indirectly benefit private businesses in Costa Rica, as the treaty requires the liberalization of state-dominated telecom and insurance sectors. Costa Rica's economy has experienced relatively high growth in the past few years. Benefiting from a favorable external backdrop and robust tourism flows, the economy is estimated to have grown at 4% in 2005; however, the approval of CAFTA along with fiscal reforms could make higher growth more sustainable. In the coming months, Fitch will assess the ability of the Arias administration to push through reforms in Congress. Continued fiscal restraint, passage of a tax-enhancing package and/or implementation of CAFTA could help in stabilizing Costa Rica's ratings. Contact: Shelly Shetty +1-212-908-0324 or Roger M. Scher +1-212-908-0240, New York. Media Relations: Christopher Kimble, New York, Tel: +1 212-908-0226. Fitch's rating definitions and the terms of use of such ratings are available on the agency's public site, '[www.fitchratings.com](http://www.fitchratings.com)'. Published ratings, criteria and methodologies are available from this site, at all times. Fitch's code of conduct, confidentiality, conflicts of interest, affiliate firewall, compliance and other relevant policies and procedures are also available from the 'Code of Conduct' section of this site.