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FEATURED Q&A

What Does a Rating Downgrade Mean for Costa Rica?

Q Moody's Investors Service cut the rating on Costa Rica's government bonds to junk status in mid-September citing poor fiscal and debt metrics and political obstacles to fiscal reform. The move followed a budget submitted by President Luis Guillermo Solís to Congress that included a deficit of 6.6 percent of GDP for next year. What does the downgrade mean for investor confidence in the country? What is the outlook for improving Costa Rica's fiscal situation?

A Munish Manchanda, member of the board of directors at the Costa Rican-American Chamber of Commerce: "Costa Rica continues to be a strong investment destination in Latin America even though Moody's has downgraded the credit rating to a 'junk' status. The news of this downgrade has caused concern to businesses as it will create a medium- to long-term impact on the borrowing costs of corporates and a huge impact on the borrowing costs of the government. The private sector is worried about the government's proposal of increasing the budget spending for 2015 and recommends a thorough and much-needed examination of government costs to reduce the projected deficit of 6.6 percent. Regarding the outlook of our fiscal situation, the country is on a tough journey, and the government will have to take a lot of strong measures and look at implementing a fiscal reform sooner rather than later, which will require a lot of strong will. However, we are delighted to share that President Solís has heard the voice of AmCham and has agreed to create a competiveness council allowing Costa Rica's private sector to directly work with his government, which gives us a light of hope. It is also important to mention that Costa Rica is ranked 51st on the annual Global Competiveness Report, and we need to make big strides and progress in infrastructure and the energy sector in order to maintain and improve our rank."

Continued on page 3

Mexican Congressman Found Dead Following Kidnapping

Gabriel Gómez Michel, a member of Mexico's Chamber of Deputies, and his driver were found dead in Zacatecas state, authorities said Thursday. Gómez, 49 and a member of the PRI, had been abducted on Monday south of Guadalajara. See brief on page 2.

File Photo: Mexican Government.

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NEWS BRIEFS

Body of Mexican Congressman Found in Zacatecas State

Mexican authorities said they have identified two burned bodies found in a car in the state of Zacatecas as Congressman Gabriel Gómez Michel and his driver Heriberto Núñez Ramos, BBC News reported Thursday. Gómez, a member of the ruling PRI party who represented Jalisco's 18th district in the Chamber of Deputies, was abducted Monday south of city of Guadalajara in Jalisco state. PRI politicians said they suspect criminal gangs were responsible for the killing.

Fourteen Feared Dead After Paraguay Boat Capsizes

Fourteen people are feared to be dead after a boat capsized on the River Paraguay on the Paraguay-Brazil border, BBC News reported Thursday. In all, the Paraguayan vessel was carrying 16 Brazilian tourists and 11 Paraguayan crew members when it sank during a storm. Thirteen people were able to swim ashore, three bodies were retrieved, and the 11 others are missing and presumed dead.

Telecom Italia Investors Want to Maintain Stake in Argentina Unit

A small group of investors in **Telecom Italia** that represents investors with a 1 percent stake said today that the company should maintain its 22.7 percent controlling state in **Telecom Argentina**, which the Italian company agreed to sell to investor **Fintech** for $960 million almost a year ago, Reuters reported. The comments from the Asati investor group came as Telecom Italia's board is set to hold a meeting on the deal today.

Political News

One Killed as Homemade Bomb Explodes in Santiago

A man was killed early Thursday when a homemade bomb he was handling exploded in Santiago. The man, Sergio Landskron, 29, became covered in flames when the bomb exploded in the Yungay neighborhood near the center of the Chilean capital, Agence France-Presse reported. Horrified witnesses yelled for water as Landskron became engulfed in flames. The man sustained burns on 40 percent of his body, lost his right hand and suffered a fractured skull. He died a short time later at a nearby hospital. "There wasn't much we could do," Dr. Mario Hernández, who attended Landskron, told reporters, *The Wall Street Journal* reported. "The patient was so badly injured when he arrived and he died a few minutes later." It was unclear whether the man had been placing the bomb when it went off or if he was a bystander said local prosecutor, Claudio Orellana. No group claimed responsibility for the explosion. President Michelle Bachelet said the explosion was an isolated event. "These are isolated acts of terrorism," she said. "Chile continues to be a safe and stable country." The deadly blast came just weeks after a bomb exploded Sept. 8 in a trash can at a fast-food restaurant in Santiago's busy Escuela Militar subway station. That blast injured 14 people and was the most serious bombing in the South American country since 1990. Authorities last week arrested three alleged members of an anarchist group in connection with the subway station explosion. Investigators said that they were looking into whether the man killed in Thursday's explosion was linked to the three people arrested following the Sept. 8 blast. However, Landskron's family denied he was involved in any wrongdoing. "He is a victim," said his brother Andrés, AFP reported. The family added in a statement that Landskron had been living on the streets and was a drug addict. Over the past five years, there have been approximately 200 unsolved bombings across Chile. Most target banks, restaurants and other public areas, but have rarely caused injuries or major damage. [Editor's note: See Q&A on security in Chile in Tuesday's *Advisor*.]

> "Chile continues to be a safe and stable country."
>
> — ***Michelle Bachelet***

Eight Members of Mexico's Military Detained in Shooting Deaths

Mexico's military has detained seven soldiers and an officer in connection with the fatal shootings of 22 suspected drug gang members in June, Agence France-Presse reported Thursday. The arrests happened a week after *Esquire* magazine's Latin America edition reported that a witness, whose 15-year-old daughter was among those killed, said the soldiers opened fire after the suspects had surrendered. The incident happened June 30 in the village of San Pedro Limón in the municipality of Tlatlaya, approximately 150 miles south-southwest of Mexico City, BBC News reported. The military had said that the suspected members of the La Familia Michoacana drug cartel were killed in a shootout with soldiers. However, suspicions were raised after only one soldier was killed. Some of the bodies had bullet wounds at chest level, suggesting that they were not killed in a shootout, BBC News reported. The woman who purportedly witnessed the shooting said that only one man had been killed in a shootout and the others were lined up and executed. Hours before officials announced the arrests of the military personnel, Mexican Defense Minister Salvador Cienfuegos, an army general, said at a seminar that the military is committed to fundamental rights and that

Cienfuegos

File Photo: Mexican Government.

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"any behavior that distances itself from this principle must be taken to the corresponding judicial courts."

Venezuela's Maduro Calls for U.N.'s 'Refounding'

In his speech to the United Nations General Assembly, Venezuelan President Nicolás Maduro called late Wednesday for the body's "refounding," the Associated Press reported. In his first speech to the General Assembly, Maduro said the United Nations should take on a significant transformation, recognizing that the world is multipolar. "The U.N. charter is one of the most beautiful poems you can read, but it's turned into a document that has been thrown aside and is trampled permanently," said the socialist president, the *Miami Herald* reported. "The countries of the world are clamoring for their voice to be heard." Venezuela has strong backing from Latin America to be awarded a temporary seat on the U.N. Security Council in a vote expected in October. Maduro used part of his speech to denounce the U.S. embargo against Cuba and also praised Syrian President Bashar al-Assad for helping to fight Islamic militants, the AP reported. Maduro also blasted U.S. "imperial forces" that "have tried again and again to undermine democracy."

Economic News

Brazil Bank Workers Vote for Strike Starting Sept. 30

Bank employees in Brazil late Thursday voted to strike for the 11th consecutive year after rejecting a 7 percent pay raise from the country's bank federation, Fenaban, Bloomberg News reported. Contraf-Cut, the union representing some 500,000 workers, scheduled the strike to begin on Tuesday. Bank workers want a pay increase of 12.5 percent, which they say is needed in part because of Brazil's annual inflation rate, which reached 6.35 percent in August. Workers have set a meeting for Monday to either plan for the work stoppage or to take another vote if Fenaban counters with a new pay hike proposal.

Featured Q&A

Continued from page 1

Adriana Rodríguez, head of investment strategy at Aldesa: "The rating downgrade from Moody's was widely expected in the country, and the international market had already incorporated the country's downgrade since for months our sovereign bonds were trading at a premium more in line with the one paid by the junk category than with the one paid by bonds rated as investment grade. Nevertheless, for investors, the Moody's downgrade and the statement that accompanied it added a new and more concrete dimension to our problem. The factor cited by Moody's as 'institutional weakness' is, in our opinion, the most critical one because it is derived from elements of our civil society that are difficult to change, especially in the time needed for the fiscal deficit not to compromise economic growth any more in the upcoming years. Our 'institutional weakness' and the enormous difficulty in achieving consensus on every main decision has become a main obstacle for growth and competitiveness. However, on the positive side, the downgrade and the realization of its consequences, particularly in the face of an another external debt issuance next year, seem to have convinced those who did not believe in the urgency of the fiscal problem, and the relevance of controlling growth in public spending, that it is time to deal with the problem instead of minimizing it and has put a renewed sense of urgency in changing the sales tax to a value-added tax, in addition to introducing a global income tax early next year. Both changes, although small ones, are steps in the right direction. Both measures were regarded as suspicious or unnecessary by some people even a week ago."

> "For investors, the Moody's downgrade and the statement that accompanied it added a new and more concrete dimension to our problem."
>
> *— Adriana Rodríguez*

César Arias, associate director of Latin American Sovereigns at Fitch Ratings: "The outlook for Costa Rica's BB+ ratings will largely hinge on ability of the Solís administration to rein in fiscal deficits to improve the trend of government debt and maintain the country's competitive advantage of attracting foreign investment into high-value-added manufacturing and services industries for sustaining reasonable growth rates. Solís first proposed budget projects that the fiscal deficit will widen to an estimated 6 percent of GDP in 2014 and 6.7 percent in 2015, the highest level since 1980. The government is pressing ahead with revenue-enhancing and cost-containment measures aimed at reducing the budget gap to 5 percent of GDP and containing the debt ratio at 50 percent of GDP by 2019. Overcoming long-standing political challenges and budgetary rigidities is key for the successful implementation of these reforms. Legislation to tackle tax evasion, migrate from a sales tax to value-added tax system and broaden the income-tax base could be diluted or blocked, as the ruling party only holds 13 of the 57 congressional seats. Similarly, there is uncertainty on the savings that could emerge from announced caps on public sector pensions and hiring freezes. Nearly 95 percent of budget spending is legally earmarked or allocated to wages, mandatory transfers and debt service. Costa Rica currently enjoys good financing flexibility, supported by a captive domestic investor base and continued access to global markets. However, higher global interest rates and uncertainty related to the deteriorating fiscal situation could have a detrimental impact on borrowing costs, market confidence, capital inflows and currency volatility."

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Featured Q&A

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Risa Grais-Targow, senior analyst, and Maria Jose Hernandez, associate, both at Eurasia Group: "President Luis Guillermo Solís is unlikely to respond to the rating downgrade with more urgency surrounding needed fiscal reforms. Solís argues that the downgrade is due to fiscal problems inherited from his predecessors, while in fact, his 2015 budget aims to increase spending by 19.7 percent compared to 2014 and raise the deficit to 6.7 percent of GDP, up from 6 percent in 2014. Moreover, the government remains overly optimistic that improved tax administration will significantly improve its fiscal balance. Solís remains committed to delaying more fundamental tax reform until the second half of his four-year term. This means that even if approved, the VAT and global income tax that the government announced last week would only come into effect in 2016. Moreover, a divided Congress and deep political polarization will ensure that negotiations around fiscal reform will be difficult. The ruling PAC holds just 13 of the 57 seats in Congress, and the PAC itself is a fractured party that Solís does not necessarily control. Ultimately, some sort of fiscal reform will likely be approved, though it could be significantly watered down, and further delays will only complicate negotiations. In the meantime, limited external debt authorization means the government will be forced to borrow locally at higher rates, undermining investor confidence and potentially economic growth."

> "A divided Congress and deep political polarization will ensure that negotiations around fiscal reform will be difficult."
>
> *— Risa Grais-Targow & Maria Jose Hernandez*

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Photo: Matthew Petroff

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