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SOVEREIGN ANALYSIS

COSTA RICA

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Sovereign Bond Analysis: Costa Rica

Investment Thesis

In summary, we have assigned a **MARKETWEIGHT** recommendation for Costa Rica ("CR") **2026s** and **2027s** notes and an **UNDERWEIGHT** recommendation for the **2029s,** and **2045s**. We believe these bonds offer the potential investor exposure to a relatively fast growing increasingly industrialized economy that has recently shown signs of a pivot to fiscal conservatism. We note that Costa Rica (CR) measures above its peer group in several economic indicators and has been making improvements in the indicators for which it is lagging. A drawback to this, however, is that these improvements have not gone unnoticed, and as such the bonds trade at relatively tight spreads compared to their peers. This, therefore, dampens the potential future gains from spread compression that investors might be able to capture. Despite this, we believe a market weight rating on the shorter duration bonds is appropriate given the country's trajectory while offsetting risks associated with duration and uncertain external debt funding. In the same vein, we currently do not favor the risk-reward profile for their longer-duration bonds despite having a favorable view of the fundamentals of the country.

Other potential risk factors to watch out for include, the possibility of further acts of God, which currently might present tangible risks such as an active hurricane season, as well as fears of drought and other shocks that may negatively impact growth and which we have seen occur quite frequently in the past. Lastly, there is a potential risk to the external balance, particularly as the Country is expected to shift to a looser monetary policy relative to the Fed in the short term. This occurs as the country aims to bolster its reserve position, particularly when faced with significant debt maturities in the short to medium term, coupled with the need for legislative approval to raise external debt.

Credit Rating

Currently, Costa Rica has a credit rating from all the major credit rating agencies. The table below summarizes the ratings from all the major agencies. The country is rated B2 (stable) by Moody's, BB- (stable) by Fitch, and B+ (stable) by S&P. To start our analysis, we looked briefly at the credit rating and sensitivities for CR by S&P. On the 23rd of February 2023, S&P Global revised the rating on the CR to B+ 'stable' from B 'Stable'.

Table Cr.1 Latest credit reports

Agent	Rating	Date
S&P	B+	23 February 2023
Fitch	BB-	02 March 2023
Moody's	B2	13 December 2022

The reasons given for this change in outlook included the impressive fiscal consolidation efforts of the government leading to the first primary fiscal surplus in 2022 in more than a decade with the help of robust revenue growth and spending constraint introduced in the 2018 tax reform. They also noted that their stable outlook incorporates the expectation of continued strong fiscal performance over the next year, albeit with the expectations of a slightly larger deficit and slowing growth. They, however, believe that access to official funding including disbursements under the extended fund facility of the International Monetary

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Fund and the newly created Resilience and Sustainability (RSF) fund will boost the flexibility of funding and confidence in the local and global capital markets. Further to this S&P outlined different scenarios that may warrant either a downgrade or upgrade of the country's credit rating in the next 12 months which we further outline below:

- Downside Scenario

  S&P Global stated that in the next 12 months, the rating could be revised downward if policy changes or setbacks in fiscal implementation threaten debt management. Despite declining, financing needs remain high and whether it succeeds in tapping global capital markets on favorable terms this year is likely to depend on signs of continued fiscal commitment and compliance with IMF reviews. If policy reversals occur, recourse to the central bank or other unconventional financings could lead S&P to consider the country's institutional framework and ability to support public finances as less favorable, despite widespread checks and balances and a strong democratic tradition, and lead to a downgrade.
- Upside Scenario

  They noted that the rating on the bond could be increased if in 12-18 months the Government and the Legislative Assembly maintain the fiscal measures that have supported deficit reduction. The public employment reform that will come into effect this year is expected to play a role. These steps are likely to strengthen investor confidence and maintain access to the local market and external borrowing (official and from the capital market). They also noted that further strong foreign direct investment (FDI) and exports, associated with special trade zones and tourism, could reduce the country's external vulnerability, supporting growth and fiscal performance.

Note: Throughout this document, we keep in mind these rating sensitives and highlight points that we think are positive for the sensitivities in green and ones that are negative in red.

Economic Overview[1] (note that throughout all dollar figures represent Costa Rican Colon unless stated otherwise)

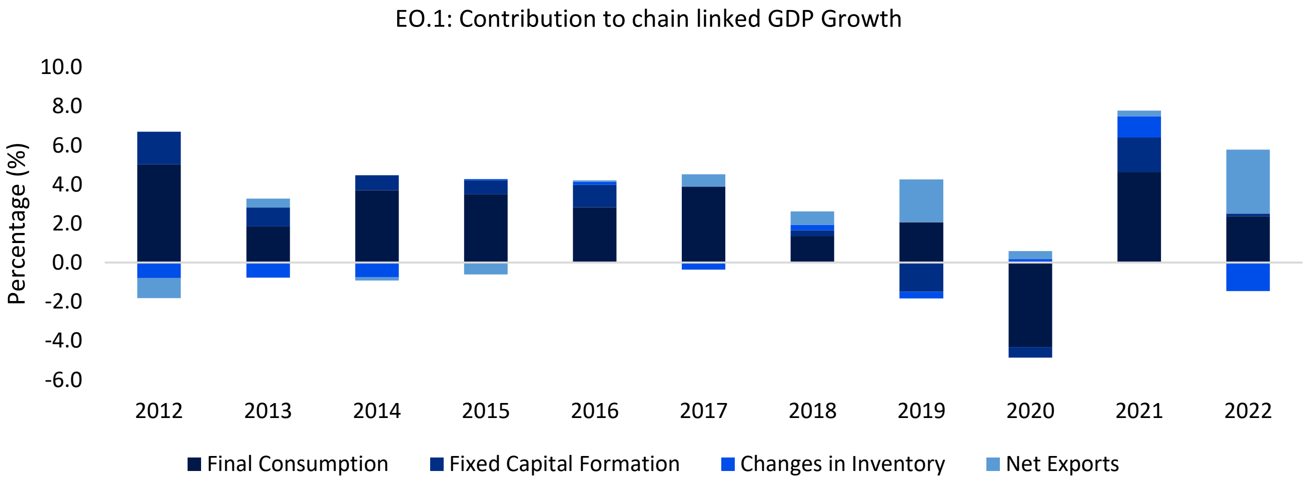
	2017	2018	2019	2020	2021	2022
Real GDP	4.2	2.6	2.4	-4.3	7.8	3.3*
CPI	1.6	2.2	2.1	0.7	1.7	8.9
Unemployment Rate	9.3	12	12.4	20	13.7	12
Consolidated public sector debt(%)	47.1	51.4	56.4	67.2	68.2	67.6**
Revenues and grants (% GDP)	7.2	14.6	15	14.4	15.8	15**
Interest expenditure	3.2	3.6	4.1	4.7	4.9	5.2**
Policy interest rate 1/	4.75	5.25	2.75	0.75	1.25	9

* Q3 2022, ** Forecasted year-end IMF

[1] Source: CIA Factbook

The Costa Rican economy has historically grown at an average real rate of 4.0% for the last 2 decades (1999-2019) albeit this pace of growth slowed down noticeably in the later years leading up to the pandemic (2018 – 2019). This compares to the average growth in the LATAM (Latin America and Caribbean region) of 2.4% over the 1999–2019 time frame. Much like the rest of the world, CR was impacted by the pandemic and suffered a decline of 4.1% in real GDP in 2020. This is however compared to the 7.0% experienced by the region overall and has subsequently recovered at a faster pace than their regional peers. This was due to some degree of expenditure switching, that is, while consumer demand and general domestic absorption declined, there was also some amount of offsetting declines in imports.

Despite the shock in consumer confidence in 2018 due to widespread protest against fiscal reforms, as well as a tropical storm and drought which have impacted production, and tighter domestic financing conditions pre-pandemic; **post-pandemic however, growth has exceeded projections. IMF projected in their 2021 article 4 consultations 2.6% and 3.3% for 2021 and 2022 respectively compared to actual outturns of 7.8% and 3.8%. This was led by a strong rebound in consumer spending and exports, owing to the rebound seen in tourism and transportation since the easing of lockdown restrictions globally as well as continued growth in trade through the country's free trade zones.** There are however signs that this growth surge, partly due to the rebound from the pandemic decline, has slowed somewhat in the latter part of the year. This is evidenced by the monthly index of economic activity seeing a fairly large slowdown in its growth rate over the last 3 months of 2022, with the index up 4.5% point-to-point in December 2022 vs `double-digit/near double-digit growth at the start and middle of the year. This coincides with the pace of growth based on actual quarterly GDP numbers declining over the later part of 2022.



Outlook

Currently, the expectation both by the Costa Rican Central Bank and the IMF is for slightly above or at trend growth in the short to medium-term (with trend growth being at approximately the 3.0% level). We believe this above-average growth is possible given a recovery in consumer confidence which was damaged by reform policies pre-pandemic. In addition to this, there remains

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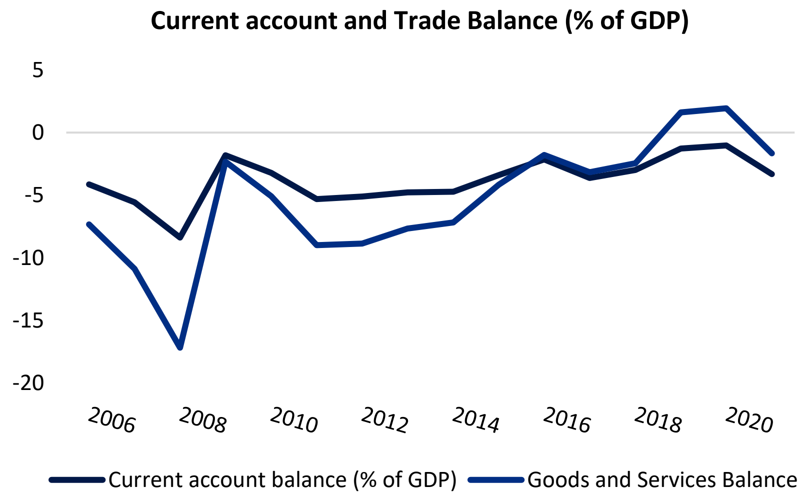
a possible benefit to be gained from the continued shift to nearshoring/friend shoring which is likely to benefit CR greatly given their proximity to the US market. These projections however reflect a tapering of the explosive growth that CR has seen as they initially recovered from the covid pandemic. However, we do note that there exist possible headwinds to growth, including the ongoing war in Ukraine and possible ramifications to commodity prices, the impact of domestic monetary policy as the central bank has elected to raise rates aggressively to tame inflation as well as the expectation of a continuation of contractionary monetary policy. Given these factors, we believe marginally below-potential GDP growth in the short to medium-term remains the base case assumption, barring more growth inducive policy action. Notwithstanding, CR is still well positioned relative to other emerging market credits. Firstly, the country has a marginally higher level of potential growth when compared to the average for the Latin America and Caribbean region. This will provide some cushion in terms of its relative growth in the face of common macroeconomic issues. Secondly, the country has not only been shown to be able to attract FDI but also has a resilient export and tourism sector that drives growth and is one of CR's main strengths as it relates to its external balance/Foreign exchange generation.

External Sector

Current Account

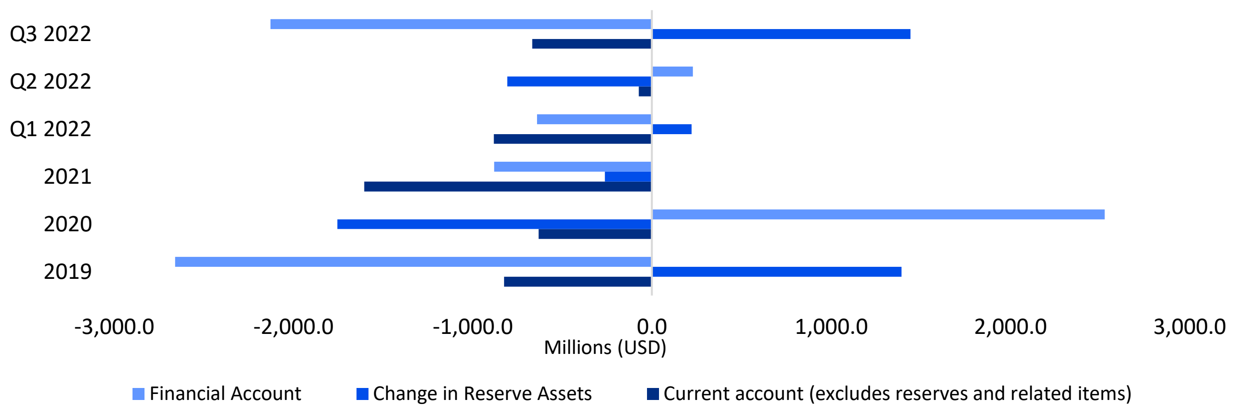
Historically, the country has run a persistent but moderate current account deficit (which isn't necessarily concerning given the above-average rate of growth seen domestically, which might necessitate a deficit). At the end of 2021, the country's current account deficit stood at 3.3%, which is slightly below the average of the last 10 years of 3.9%. Historically, this deficit had primarily been a result of a negative balance in the trade of goods and a historical deficit in the net primary income balance which are typically only partially offset by a positive services trade balance. The negative goods trade balance reflects the country's dependence on commodity imports such as refined petroleum and manufactured goods such as capital equipment. The country, however, has a fairly diverse export product offering with its main export being electronic components and medical equipment (Costa Rica is a popular destination for electronics manufacturing and development) coupled with traditional exports such as bananas and coffee. The service sub-account mainly reflects the impact of tourism while the persistently negative primary income reflects payments to foreign investors for their ownership of production factors.



Financial Account

The country's constant current account deficit has primarily been financed through foreign direct investments through the financial account. To place that in perspective over the last 20 years, net foreign direct investment in CR has represented over 6% of GDP. In fact, in 2022 Investment Monitor noted that CR was the top destination globally for FDI when controlled for economic size, receiving over 13x the FDI inflow that would be expected for a country its size. They also stated that the 3 major sectors that attract the most FDI inflows tend to be the technology, business, and professional services sector which in 2021 attracted a total of 63% of Costa Rica's total inbound greenfield FDI. It is also noteworthy that Costa Rica tends to attract heavy investment from US base technology or technology-enabling businesses.

This ability to attract foreign investments to fund the current account deficit has allowed the country to grow its reserve assets throughout the years. Net Reserve assets, for example, stood at US$1.3 billion in 2000 and have since risen to over US$8.5 billion as of March 2023. While the country has funded deficits with FDI flows, they have also moderately utilized multilateral/exceptional funding. This reflects items such as loan forgiveness, IMF credit, Debt for Equity swaps, etc. and in the case of CR likely reflects borrowing for balance of payment support. **In summary, the ability of the CR to continue attracting foreign flows has enabled the country to fund its deficit with only moderate use of exceptional financing. While they have had to draw down reserves in the peak of the pandemic, the central bank has been able to rebuild reserves through later purchases on the open market and borrowing from the Latin American Reserve Fund**



Outlook

Looking at the most recent data which spans the first 3 quarters of 2022, the current account deficit stood at US$1.6 billion which is much higher than each of the last 3 years with the deficit for the comparable period in 2021 being US$566.3 million. This deficit was mainly driven by continued primary income deficits particularly as the stock of foreign investment domestically continues to grow. This was however adequately funded by foreign direct investment which has allowed for the further bolstering of the country's reserve assets with minor aid from IMF credits and exceptional financing.

Currently, the IMF is projecting that in the short to medium-term CR will continue to run a sizeable (but manageable) current account deficit which is however expected to improve relative to the 2022 projected outturn. That is, the current account deficit is projected to fall to the 3% level in the medium term. The IMF assessed that this would partly reflect the impact of a recovery in tourism and an expectation of a softening of global commodity prices which had driven the larger deficit in recent years. Hence in their assessment the external accounts remain broadly in line with fundamentals and remain sustainable.

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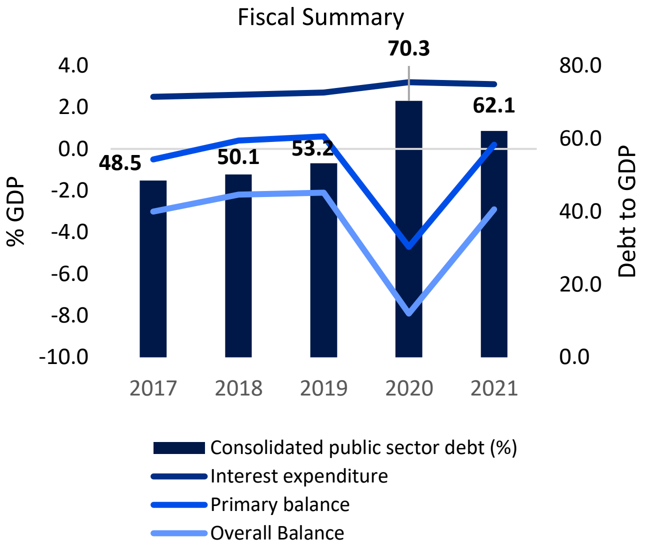
Several signs point in a positive direction for the external balance of the CR. Firstly, as we had mentioned prior, the resilience of the manufacturing export sector and free trade zones, which is likely to be complemented by a tourism sector that continues to recover from the pandemic fallout. Secondly, the resilience of the country's Foreign direct investment flow will also allow for the efficient funding of a moderate current account deficit going forward. As it relates to the deficit, we are expecting that barring other major terms of trade shock such as the one that was represented by the covid pandemic, there will be a normalization to a moderate deficit funded with non-exceptional financing items. Lastly, more fiscal conservatism means that the primary and fiscal deficit is likely to narrow. This will have a direct impact on the current account deficit since government savings and investment is one-half of the equation for the current account deficit/ balance (the other being private savings and investment).

Fiscal Position

Part of the reason for the decline in growth pre-pandemic was the ramifications of a fiscal reform package that the government had undertaken. This led to some degree of unrest from the public sector and lowered the government's contribution to growth. These reforms include the 2018 fiscal law to strengthen public finance. **This was essentially a fiscal rule that came into effect in 2020 which limits nominal expenditure growth for current and total expenditures which is linked to past nominal GDP growth and debt levels (includes provisions for extraordinary events).**



This policy has allowed for some anchoring of fiscal policy and has also already begun to bear fruit. This is evidenced by the country recording a primary surplus to the tune of 2.1 % of GDP in 2022. The highest primary surplus since 2008 and the first surplus in over a decade. The fiscal deficit likewise narrowed to 2.5% of GDP lower than the 5.0% of GDP seen in 2021. This, therefore, highlights the shift in the fiscal policy stance of the Government. Regarding the composition of revenue and expenses, we note that tax revenue represents 13.9% of GDP while interest expenditure currently represents approximately 5.0% of GDP and has been growing over the last 4 years from 4.1% of GDP in 2019. The improvement in the primary balance, however, despite the higher interest expense which is projected to fall in the medium to long term was a combination of improved tax collection and expenditure controls.

The improved tax revenue was partly aided by recently enacted tax reforms which included a VAT replacing general sales tax. Globalization of capital income and gains tax at 15% and increasingly progressive personal income tax with additional brackets of 20 and 25% for employment income. Further to this, the general rebound in the domestic economy and inflation also aided tax revenue. The IMF in their 3rd review under the extended fund facility with Costa Rica noted that the tax policy reforms were expected to yield benefits of up to 0.4% of GDP on the revenue side through 2023. On the other hand, expense growth was

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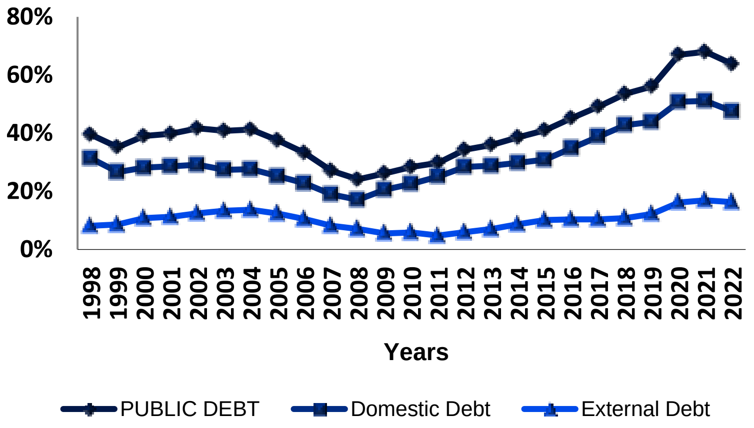
fairly restrained by the fiscal policy rule (due to debt-to-GDP exceeding 60% in 2020 and 2021) which necessitated and will continue to necessitate stricter fiscal spending through 2025. The government also acknowledged the sizeable and growing portion of debt expenditure and has noted that they expect their debt management efforts to help to contain interest expenditure going forward.

Debt Profile

In line with the newfound adherence to fiscal conservatism, as evidenced by the fiscal policy rules and the recent primary surplus, the debt-to-GDP ratio at the end of December 2022 stood at 63.8%. This compares to the debt-to-GDP ratio of 68.2% at the end of 2021. This was aided by the continued growth in the domestic economy, coupled with the primary surplus recorded in the year. Of note, this halts the general upward trend in the ratio between 2009-2020.



Looking at the composition of the total debt stock as of December 2022 of $28.2 trillion, approximately 74.5% was domestic debt while 25.5% was external debt. External debt refers to debt held by non-residents while internal debt is held by domestic residents. Further to this, an overwhelming majority of the debt is denominated in domestic currency (63.1%) with 33.4% being denominated in US dollars. Hence the country has relatively low exposure to foreign currency risk while interest rate risks are reduced due to the majority of the debt being fixed rate. **On the other hand, notably close to 50% of the debt is maturing in under 5 years which represents a fairly large refinancing risk.** This is particularly important in the case of external debt given that the country's ministry of finance requires congressional approval to raise external debt. However, we note that Costa Rican Lawmakers in November 2022 approved foreign debt issuance of up to US$5.0 billion over the next 3 years. Of note, the allowable issuances are staggered and conditional on meeting certain fiscal requirements and compared to the little under $13.9 billion in US$ debt due within the next 3 years. On a positive note, however, the country has met all of its fiscal targets under the IMF's Extended fund facility and has gained access to RSF funding which further reduces financing pressures. The progression of external debt, specifically the capacity to fund it, remains an area to pay keen attention to.

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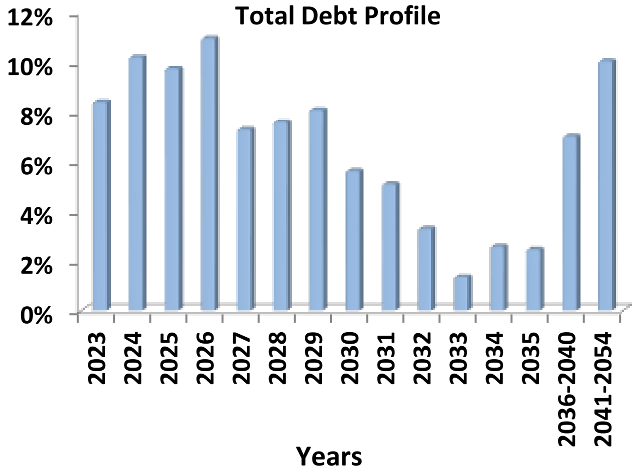

Outlook

Going forward, with continued growth, we expect government revenue collection to continue to be strong. This is particularly true if the yields from the 2018 tax reforms continue to bolster government collections going forward. There is also further implementation of the new tax laws expected to come into the fore in 2023, namely the phasing in of rules for corporate taxation and a phasing out of reduced VAT rates for tourism and construction which is further expected to boost revenues. Coupled with this, continued implementation of the fiscal rules is likely to restrain government expenditure and hence set the stage for an improved fiscal balance and lower debt in the medium to long term.

Notwithstanding, the country does remain susceptible to shocks that may provide headwinds to the country's fiscal balance/ debt targets. These shocks may include susceptibility to extreme weather events such as tropical storms as well as droughts, situations that we have seen occur right before the pandemic. As such, there will need to be appropriate fiscal buffers and contingency policies in place for these scenarios, particularly given the political limit on the amount of external financing that government can legally take on. **This fact is even more important given the high concentration of maturities within the next 5 years. Hence a further bolstering of external reserves and greater access to multilateral funding will play a pivotal role in the development of the country's debt strategy over the ensuing years.**

Monetary Sector

Much like most countries globally in 2021/2022 Costa Rica faced rising inflation. The 12-month point-to-point inflation as of January 2023 was 7.65%, coming down from a peak of over 12% in August of 2022. The Costa Rican central bank is also an inflation targeter with a target of a 3% midpoint with a 1% band either way. Hence inflation remains well above the upper target bound of 4%. In response to this, the central bank increased its policy interest rate from 0.75% in December of 2021 to the current rate of 9.00%. The bank's monetary policy rate is defined as the reference interest rate for a day-term facility in the central bank's integrated liquidity market and is therefore used to guide short-term interest rates and eventually impact long-term rates throughout the economy.

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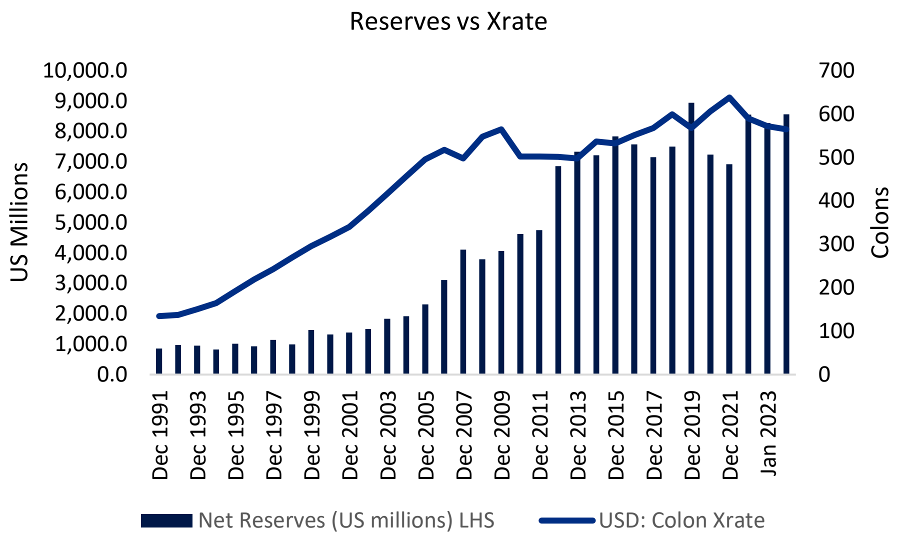

Other monetary policy actions that the central bank has taken include the increase in the minimum legal reserve requirement for deposits and other obligations in national currency from 12% to 15% in July 2022. This has facilitated an increase in the monetary base (through increased reserve holdings) but has facilitated an overall decrease in the money supply as the central bank aims to control domestic demand and stabilize the exchange rate. This is evidenced by the M1 money supply point-to-point growth as of February 2023 representing a decline of 12.6%. For reference, this compares to the 12.5% point-to-point growth seen in February 2022. Lastly, the central bank has aimed to ensure stability in the foreign exchange market by targeted intervention while still allowing some flexibility in the exchange rate. This resulted in the country's stock of gross foreign reserves falling to US$6.2 billion in the first half of 2022 which was only 75% of the IMF's reserve adequacy metric due to higher-than-expected demand from the non-financial public sector (namely the oil company). There has however been some recovery with gross reserves currently standing at US$8.5 billion.

This recent contractionary monetary policy is in contrast to the relatively accommodative stance that was seen slightly before covid, with the first-rate cut being 25 basis points in March of 2019 to 5.0% which was further exacerbated by the pandemic that warranted further cuts to as low as 0.75% in June 2021. In addition to this, the central bank provided additional liquidity by purchasing sovereign securities in the secondary market. It is estimated that the neutral rate of interest, that is the rate that is neither accommodative nor contractionary is estimated to be 1.0% in real terms. Hence the current monetary policy stance is contractionary.

Outlook

Like most countries globally, CR is currently faced with an inflation issue. The central bank has however shown its resolve to build credibility and fight inflation by quickly changing its stance. The central bank in its last 2 policy meetings however held the rate unchanged a 9.0%. In doing so, they stated they believe that inflation had peaked and would return to target by Q4 2023, earlier than projected in their prior meeting of a return to target by the first half of 2024. In the latest policy brief, they also note that they don't foresee further tightening absent any materialization of upside risks to inflation. Notably, this was before the latest reading of 5.6% in February 2023. The tightening monetary stance was also aided by the appreciation in the Costa Rican Colon which is currently at its highest point since 2017 buoyed by the improving trade balance, the prior monetary tightening, and lastly the declining inflation rate.

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Given the above factors, the likelihood of a continued pause before eventual cuts in 2024 remains high. This is also being reiterated by bank officials who remain on the side of no more hikes unless upside inflation risks materialize. Also, since the neutral rate is currently estimated at 1.0% in real terms in the event of inflation declining, bringing policy back to neutral territory (assuming inflation returns to the 3% target level by 2024) would necessitate a decrease in the policy rate to approximately the 4-5% level which we would see as more of a long-term target rate for interest rates. On a side note, the likelihood of the central bank easing while the fed increases introduces the possibility of a tapering of the strength of the CR colon.

Relative Economic Factors

To wrap up the macroeconomic review of Costa Rica, we compare how the Country matches up on key macroeconomic variables relative to peers within the same rating bucket as assigned by S&P Global. The metrics utilized in the table are forecasted figures for 2023 by S&P, with Costa Rica's percentile rank relative to peers being in the rightmost column. The percentile score coincides with Costa Rica's rank from a list of its peers, i.e., the 90th percentile means that they ranked above 90% of their peers on that given metric key.

Category	Measure	Percentile
Economic	GDP Per Capita	86.1
	Real GDP growth (%)	30.5
	Real Investment growth (%)	33.3
Government	GG Balance/GDP	50
	Primary GG Balance/GDP (%)	77.7
	GG Revenue/GDP (%)	55.5
	GG Int Exp/ Rev (%)	77.7
	Gross GG Debt/GDP(%)	52.7
External	Net External Liab/ Car (%)	44.4
	Narrow net ext. debt/ CAR	25
	Current Account Bal/GDP (%)	44.4
	Usable Reserves/ CAPs (Months)	34.2
	Gross ext. fin needs/(CAR+ use.res) (%)	40

Costa Rica is growing faster than its peers and is much "richer" than other "B" rated countries based on real GDP per capita. However, the S&P's projection of real GDP growth and real investment growth places CR under the 50th percentile in terms of the ranking of these projected 2023 numbers. While this is below average, this might be due to CR on average being richer than peers in the bracket as well as suffering a relatively smaller decline in GDP during the pandemic which might lead to lower "rebound growth". Regarding the fiscal accounts, the projected general government balance ranks in the middle of the pact for peers while the country ranks in the 77th percentile for primary balance. On the other hand, the country has a relatively high-interest expense compared to revenue, an issue that we highlighted prior and one which the government is actively trying to rectify. However, these factors are slightly offset by favorable debt compositions relative to peers with CR having relatively little foreign currency debt.

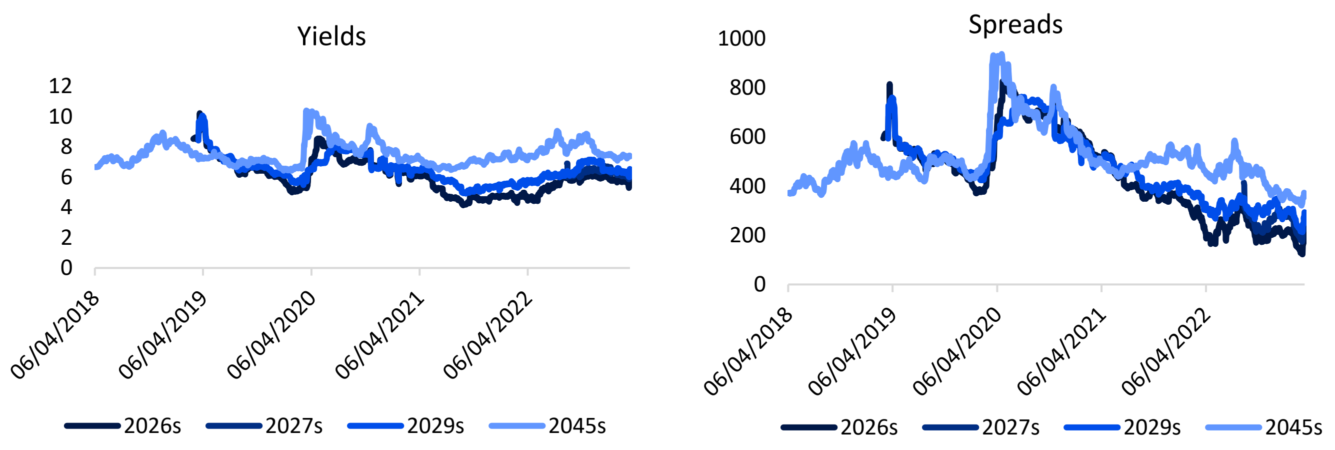
Given its heightened importance due to the current macroeconomic climate, we also pay keen attention to CR's external position, particularly relative to its peers. CR ranks below the median for measures such as reserve coverage (usable reserves as a portion of current account payments) while being slightly below the median for S&P's forecast of the Current account balance. Effectively, this means that CR has a smaller current account balance relative to peers while also having fewer reserves to cover current account payments. On the other hand, this negative is partially alleviated by the aforementioned fact that CR is a very strong destination for FDI flows which helps to fund the current account deficit, while also being able to potentially aid the Country in rebuilding reserves. The IMF has also stated the need for the country to bolster its reserve balance as it stood below the reserve adequacy ratio of 100% in 2022 but they expect the reserve to meet the ratio by the end of 2023.

Relative Analysis

Historical

Currently, CR has several global bonds outstanding. The ones that we will be covering for this analysis will be 2026, 2027s, 2029s, and 2045s global bonds. Further to this, we look at the historical price performance of each of the bonds in fig RA.1 below. From this, we see that, unlike the general fixed income (particularly emerging market) asset class as a whole, CR bonds have been relatively stable during the 2022 hiking cycle, with yields climbing only marginally higher. This is partly explained by the credit spread on each bond noticeably compressing over this same period. This has coincided with the improving fundamentals of the country which eventually culminated in a rating upgrade from several credit rating agencies in early 2023. Hence given this trajectory, all bonds are trading above their 1-year average yield given the general rise in interest rates except the 2027s, which trades very close to its average 1-year yield, yet all the bonds still trade at historically low spreads reflecting the declining credit risk of the sovereign. (Note that all 4 bonds currently trade at below pre-pandemic spreads). Given that the bonds currently trade relatively tight based on historical norms, the question is then how tight is this spread relative to similarly rated credits generally and other LATAM spreads and potentially if there is likely to be further spread compression.

Fig RA.1: Yield History Selected CR Bonds



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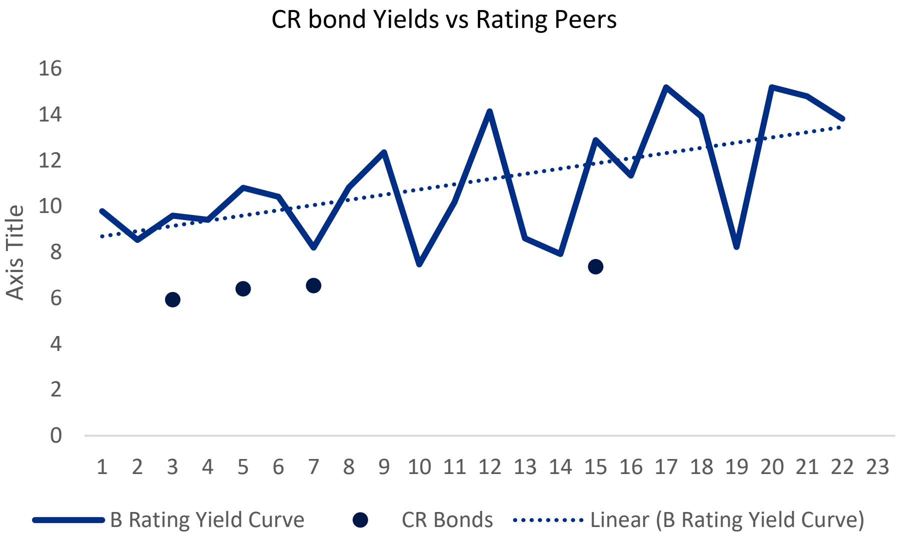
Peer Comparisons (Global B band)



To compare the current trading price of the CR bonds to similar sovereigns, we developed two relative value curves. The first compares the yield and spread of CR bonds to ones that are of a similar rating. Other filters on the sovereigns included in this index are bonds with a similar Bloomberg composite rating, above US$500 million principal outstanding, and only bullet maturities. Bonds of a specific tenor were given the same weight regardless of the tenor. From this, we see that relative to similarly rated peers, all Costa Rican bonds trade at relatively lower yields. This might be reflective of the expected trend improvement in the country's fundamentals. This is somewhat evidenced by the bond also trading at much tighter G-Spreads than its peers.

Peer Comparisons (Regional Multiple rating Bands)

The second relative value index compares CR to countries within the same region, that is Latin America and the Caribbean. The bonds are compared across credit ratings and time to maturity. The only other inclusion criteria that were selected for this comparison were that there must be at least US$500 million in principal outstanding for any particular bond included, the maturity type must be a bullet payment, and the currency must be USD (i.e. only global bonds) and the issuer must have a Bloomberg composite rating of between AAA and CC- (of note, the principal outstanding filter mainly served the purpose of removing very small issues, to remove the outsized impact of these issuers given that an unweighted average yield was utilized for the remainder).

From this pricing matrix, with the maturity and credit rating of similar issues to the four Costa Rican bond issues that we are contemplating, we note several observations. Firstly, each of the four bonds is priced at relatively expensive levels for their tenor. Hence, each of the four bonds analyzed trade more closely to BB-rated securities, reflecting how debt holders view the quality of the credit.

- Issuers between the B- to B+ rating for the 2–4-year tenor had average yields ranging from 9.72% to 9.86% compared to the yield on the 2026s of 5.92%.
- Issuers between the B- to B+ rating for the 3–5-year tenor had average yields ranging from 9.72% to 10.63% compared to the yield on the 2027s of 6.40%.
- Issuers between the B- to B+ rating for the 5–7-year tenor had average yields ranging from 9.60% to 10.75% compared to the yield on the 2029s of 6.54%.

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- While there is a dearth of comparable tenor bonds in the same rating bucket to compare to the 2045s we look at similar tenors in a slightly higher rating bucket BB- to BB+ which for the 21-23 year tenor the yields range between 6.39% to 7.92%.

Given the above, we again note that CR bonds trade a notch higher in the BB rating buckets based both on yields and spreads. This might be associated with CR being relatively richer concerning GDP, while also showing an improving fiscal position relative to peers as we have seen in the "relative economic factors" section, despite having vast room for improvements on their external accounts metrics. Hence, we believe the market is currently pricing in heavily the improving fiscal conditions of the country while not discounting too heavily its external position, which is further exacerbated by frequent funding uncertainty given the limitations placed on external borrowing which requires congressional approval. While we agree with the assessment of the improving fundamentals of the country, we believe the greater improvement in terms of access to multilateral funding and the build-up of external reserves would be required to justify entering at current spreads which are historically tight, given the overall macro environment. Given this we assign a **MARKETWEIGHT** rating to the 2026s and 2027s, reflecting our preference for a shorter duration, and our favorable view of the trajectory of the sovereign but limited to market due to already tight spreads that are already trading close to BB-rated issues. We then assigned an **UNDERWEIGHT** rating to the 2029s and 2045s mainly due to an unfavorable view of longer duration and external funding uncertainties that remain particularly in the medium term where the country has sizeable maturities. This is then further compounded by the aforementioned tight spreads that all the current issues trade at relative to peers.

Recommendation Sensitivity and Risks

Changes in fundamental factors that may warrant a review of our recommendations on these issues include clear signs of a reversal in the upward trajectory in reserve accumulation and coverage, particularly when contextualized with US monetary policy (i.e., is the US tightening and the impact it could/is having on the external accounts) and overall external balance stability. Failing to meet stipulated fiscal landmarks which will allow the country access to further funding from external sources (i.e external bond market or through multilateral organizations such as IMF). Any contrary signs that suggest any of the above are becoming less of a concern would further cement/improve our outlook, all else being equal.

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