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Research Update:

Dominican Republic 'B+/B' Ratings Affirmed; Outlook Remains Stable

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Overview

- Tax measures that the government of the Dominican Republic passed in late 2012 and its intention to contain expenditures will likely result in the deficit falling to 5% of GDP in 2013 from 7.8% in 2012, which will moderate the rise in the sovereign's debt burden.
- Higher mining exports will reduce the country's current account deficit, while global markets provide lower-cost financing than in the past, boosting the country's external liquidity.
- As a result, we are affirming our 'B+' long-term foreign and local currency ratings on the Dominican Republic.
- The stable outlook balances the challenges the government will continue to face in reducing fiscal and external deficits against the progress in boosting export potential and improving debt management.

Rating Action

On May 29, 2013, Standard & Poor's Ratings Services affirmed its 'B+' long-term foreign and local currency ratings and its 'B' short-term foreign and local currency ratings on the Dominican Republic. The outlook on the ratings remains stable. The 'BB' transfer and convertibility assessment is unchanged.

Rationale

Our 'B+' rating on the Dominican Republic reflects the combination of persistent fiscal and external deficits and weak political institutions, along with a diversified economic structure that supports medium-term growth, despite the recent deceleration in GDP growth rates. We project real GDP to expand by 3.0% in 2013, rising to 4.0% in 2014.

One of President Danilo Medina's (elected in 2012) challenges is to reduce the fiscal deficit while keeping his campaign promise to increase social expenditure. The 2012 fiscal outcome worsened significantly (the general government deficit reached 7.8% of GDP), partly because of aggressive presidential election-related spending. With a large majority in Congress, the new Administration passed a significant tax reform in 2012. The government expects revenues could increase up to 1.6 percentage points of GDP during 2013, although lower GDP growth rates could moderate the immediate impact of the reform. We expect the fiscal deficit to diminish to about 5% of GDP in 2013 (including the deficit of the central bank) and to decrease marginally

over the next two years before it faces new pressures from the electoral process in 2016. Despite the lower deficits, we expect the net general government debt burden to continue to increase marginally over the next two years from 39% of GDP in 2012 to about 42% in 2015 (including central bank certificates and excluding recapitalization bonds).

Recent disagreements about electricity tariffs (shortfalls that require annual government subsidies of about 2% of GDP) have complicated the renewal of the International Monetary Fund stand-by agreement that expired in 2012. We do not expect a new agreement in the short term. The recent US$1 billion (1.6% of GDP) international bond issuance by the Republic met a substantial portion of fiscal and external needs for the year. The government's financing program for the year totals 5.8% of GDP, with about two-thirds coming from external sources, including 1% of GDP from Petrocaribe, and one-third from the growing domestic debt market. While Petrocaribe has already committed external financing for 2013, future financing will increasingly depend on political developments in Venezuela.

From 2013 onward, the Dominican Republic will benefit from the exports of ferro-nickel and gold after large investments in the sector. We expect gold exports to reach 1.7% of GDP. Despite the heavy dependence on oil imports (representing close to 8% of GDP), we project the current account deficit to narrow from 7.2% of GDP in 2012 to close to 5.0% in 2013. We estimate gross external financing needs at 118% of current account receipts and useable reserves, on average, for 2012-2015. Narrow net external debt was 79% of current account receipts in 2012, well below the net external liability position of 170%, primarily because of the importance of foreign direct investment.

Outlook

The stable outlook reflects the Dominican Republic's relatively solid growth and export prospects and our expectation that the government will continue its efforts to reduce fiscal and external deficits. We balance these strengths against the risk of fiscal and external deterioration if the government does not implement corrective measures in a timely manner. Addressing the structural deficiencies in the electricity sector, improving tax-system efficiency, or strengthening the external profile would benefit the sovereign's creditworthiness.

On the other hand, fiscal slippage, which would likely exacerbate the external vulnerability, would be a negative factor and could lead us to lower the rating, especially if the political willingness to reverse the slippage is lacking.

Related Criteria And Research

- Principles Of Credit Ratings, Feb. 16, 2011
- Sovereigns: Sovereign Government Rating Methodology And Assumptions, June 30, 2011
- Criteria For Determining Transfer And Convertibility Assessments, May 18, 2009

Ratings List

Ratings Affirmed

Dominican Republic	
Sovereign Credit Rating	B+/Stable/B
Transfer & Convertibility Assessment	
Local Currency	BB
Senior Unsecured	B+

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