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Research Update:

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

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Overview

- The ratings on the Dominican Republic reflect the sovereign's persistent fiscal and external deficits and weak political institutions, offset by a diversified economic structure that supports medium-term growth (despite the recent deceleration in GDP growth rates).
- We are affirming our 'B+/B' sovereign credit ratings on the Dominican Republic.
- The stable outlook reflects our view that the Dominican Republic will only gradually reduce its fiscal deficit, which will prove inadequate to significantly lower its fiscal and monetary vulnerabilities.

(Watch the related CreditMatters TV segment titled, "What’s Behind Standard & Poor’s Rating On The Dominican Republic," dated June 4, 2014.)

Rating Action

On May 30, 2014, Standard & Poor's Ratings Services affirmed its 'B+/B' long- and short-term sovereign credit ratings on the Dominican Republic. The outlook remains stable. We also affirmed our transfer and convertibility assessment of 'BB'.

Rationale

The ratings on the Dominican Republic reflect the combination of its persistent fiscal and external deficits and weak political institutions, offset by its diversified economic structure that supports medium-term growth (despite the recent deceleration in GDP growth rates). We project real GDP will expand by 4.5% in 2014-2015. Weaknesses in monetary policy (low domestic credit with significant dollarization and quasi-fiscal deficits of the central bank) are another key constraint on the ratings.

Nevertheless, President Danilo Medina (elected in 2012) successfully reduced the general government fiscal deficit to 5% of GDP in 2013 while keeping his campaign promise to increase social expenditure. The fiscal outcome in 2012 was significantly worse than previous years (the general government deficit reached 8.2% of GDP), partly because of accelerated spending on public works before the presidential election. With a large majority in Congress, the new Administration passed a significant tax reform after taking office in 2012, boosting revenues in 2013. At the same time, the government capital expenditure fell to more historical levels with the completion of the Santo

Domingo metro and major road works.

We expect the fiscal deficit to only gradually diminish, to about 4.5% of GDP in 2014 (including the deficit of the central bank) and to decrease marginally in 2015 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 45% of GDP in 2013 to about 48% in 2016 (including central bank certificates and excluding recapitalization bonds).

The Dominican Republic's US$1.25 billion (2% of GDP) international bond issuance in April 2014 met a substantial portion of fiscal and external financing 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 Venezuela's Petrocaribe program, and one-third from the growing domestic debt market. While Petrocaribe has already committed external financing for 2014, future financing will increasingly depend on political developments in Venezuela.

From 2014 onward, the Dominican Republic will benefit from the exports of 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 marginally to close to 4.0% in 2014 from 4.3% of GDP in 2013. We estimate gross external financing needs at 110% of current account receipts and usable reserves, on average, for 2013-2016. Narrow net external debt was 53% of current account receipts in 2013, well below the net external liability position of 151%, primarily because of the importance of foreign direct investment.

Financial intermediation is low in the Dominican Republic. Private-sector domestic credit is only 25% of GDP and has grown little in real terms for a decade. State-owned Banco de la Reservas has a nearly 40% market share of deposits and is one of the largest external debtors outside of the central government. (It is also an important fiscal agent of the government.)

Outlook

The Dominican Republic continues to face significant fiscal and external vulnerabilities. Efforts to mitigate these vulnerabilities would likely lead to improved creditworthiness. A faster pace of fiscal adjustment that stabilizes and gradually reduces the government's debt burden, as well as improvements in the country's external liquidity through a further accumulation of international reserves, could lead to an upgrade of the Dominican Republic. Addressing the structural deficiencies in the electricity sector and at the central bank would also help to improve the country's fiscal position (and monetary policy effectiveness) and, in turn, boost 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.

Key Statistics

Dominican Republic--Selected Indicators											
	2007	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014f**	**2015f**	**2016f**	**2017f**
Nominal GDP (bil. US$)	41.0	45.2	46.5	51.0	55.4	58.9	59.3	62.9	65.9	68.9	72.1
GDP per capita (US$)	4,296	4,676	4,744	5,135	5,512	5,776	5,739	6,004	6,196	6,394	6,599
Real GDP growth (%)	8.5	5.3	3.5	7.8	4.5	3.9	4.1	4.0	4.5	4.5	4.5
Real GDP per capita growth (%)	6.9	3.8	2.1	6.3	3.1	2.5	2.6	2.6	3.1	3.1	3.1
Change in general government debt/GDP (%)	2.2	5.3	5.4	4.2	3.6	6.1	10.3	4.5	4.0	5.4	5.1
General government balance/GDP (%)	(1.7)	(4.4)	(4.5)	(4.1)	(4.5)	(8.2)	(5.0)	(4.5)	(4.0)	(5.4)	(5.1)
General government debt/GDP (%)	30.4	31.6	35.1	35.2	35.1	38.3	45.3	46.2	46.4	48.0	49.1
Net general government debt/GDP (%)	28.5	29.4	32.7	32.5	32.6	36.5	42.9	44.8	45.1	46.7	48.0
General government interest expenditure/revenues (%)	9.1	10.4	13.9	13.8	15.7	17.4	16.0	16.2	16.2	16.6	16.9
Other dc claims on resident nongovernment sector/GDP (%)	21.9	21.6	21.7	23.1	23.5	22.6	24.8	25.1	25.4	25.6	25.8
CPI growth (%)	6.1	10.6	1.4	6.3	8.5	3.7	5.0	4.5	4.5	4.5	4.5
Gross external financing needs/CARs plus usable reserves (%)	113.7	121.5	115.1	119.3	118.2	113.1	113.6	109.9	109.8	109.8	109.7
Current account balance/GDP (%)	(5.3)	(10.0)	(5.0)	(8.5)	(7.9)	(6.8)	(4.3)	(4.0)	(3.6)	(3.5)	(3.4)
Current account balance/CARs (%)	(13.4)	(28.3)	(16.7)	(27.9)	(24.6)	(21.4)	(12.9)	(11.8)	(10.8)	(10.4)	(10.2)
Narrow net external debt/CARs (%)	30.9	41.9	48.9	56.0	54.1	60.3	53.1	60.2	61.8	63.3	64.8
Net external liabilities/CARs (%)	87.4	111.4	145.9	167.0	165.7	182.4	151.1	153.7	153.7	154.0	154.2

Note: Other depository corporations (dc) are financial corporations (other than the central bank) whose liabilities are included in the national definition of broad money. Gross external financing needs are defined as current account payments plus short-term external debt at the end of the prior year plus nonresident deposits at the end of the prior year plus long-term external debt maturing within the year. Narrow net external debt is defined as the stock of foreign and local currency public- and private-sector borrowings from nonresidents minus official reserves minus public-sector liquid assets held by nonresidents minus financial sector loans to, deposits with, or investments in nonresident entities. A negative number indicates net external lending. The data and ratios above result from Standard & Poor’s own calculations, drawing on national as well as international sources, reflecting Standard & Poor’s independent view on the timeliness, coverage, accuracy, credibility, and usability of available information. CARs--Current account receipts. f--Forecast.

Related Criteria And Research

Related Criteria

- Sovereign Government Rating Methodology And Assumptions, June 24, 2013
- Methodology For Linking Short-Term And Long-Term Ratings For Corporate, Insurance, And Sovereign Issuers, May 7, 2013
- Criteria For Determining Transfer And Convertibility Assessments, May 18, 2009

In accordance with our relevant policies and procedures, the Rating Committee was composed of analysts that are qualified to vote in the committee, with sufficient experience to convey the appropriate level of knowledge and understanding of the methodology applicable (see 'Related Criteria And Research'). At the onset of the committee, the chair confirmed that the information provided to the Rating Committee by the primary analyst had been distributed in a timely manner and was sufficient for Committee members to make an informed decision.

After the primary analyst gave opening remarks and explained the recommendation, the Committee discussed key rating factors and critical issues in accordance with the relevant criteria. Qualitative and quantitative risk factors were considered and discussed, looking at track-record and forecasts. The chair ensured every voting member was given the opportunity to articulate his/her opinion. The chair or designee reviewed the draft report to ensure consistency with the Committee decision. The views and the decision of the rating committee are summarized in the above rationale and outlook.

Ratings List

Ratings Affirmed

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

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