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Research Update:

Dominican Republic Long-Term Ratings Raised To 'BB-' On Improved Monetary And Fiscal Stance; Outlook Is Stable

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Overview

- In our opinion, the Dominican Republic has a growing track record of sound monetary policy execution under an inflation-targeting regime.
- Lower fiscal deficits since 2012 (on tax reform, higher mining revenues, and containment in spending) and cash- and debt-management practices by the Treasury have also strengthened the Dominican Republic's fiscal position.
- We are raising our long-term sovereign credit ratings on the Dominican Republic to 'BB-' from 'B+'.
- The stable outlook is premised on our assumption that the government will contain preelection-related spending--in contrast with the previous presidential election--and that the debate about allowing consecutive presidential terms will not disrupt the economy.

Rating Action

On May 20, 2015, Standard & Poor's Ratings Services raised its long-term sovereign credit ratings on the Dominican Republic (DR) to 'BB-' from 'B+'. The outlook is stable. At the same time, we affirmed the 'B' short-term rating. We also raised our transfer and convertibility (T&C) assessment to 'BB+' from 'BB'.

Rationale

The upgrade stems from our improved assessment of monetary policy in the DR. In 2012, the central bank became operationally independent and moved to an inflation-targeting regime, improving its policy track record. Inflation has averaged 3.1% since then, near the central bank's target. The central bank has allowed the DR peso to float more freely, although like many central banks, it intervenes in the market to smooth volatility. That said, ongoing quasi-deficits of the central bank and the low level of private-sector domestic credit (25% of GDP in 2014) dull the monetary transmission mechanism.

An improved fiscal stance is another reason for our upgrade. The DR's fiscal deficit has declined during the past several years, the increase in debt has slowed, and debt management continues to strengthen. The general government deficit fell to 4.5% of GDP in 2014 from 8% in 2012, which had reflected a run-up in preelection spending. The administration of President Danilo Medina

has been able to reduce the deficit while increasing social expenditure following a tax rate hike in 2013 and higher mining royalties (owing in part to renegotiating its contract with Barrick Gold), as well as cuts in capital expenditure. Increased social spending has focused on its "4% of GDP for education program."

In 2015, we expect the general government deficit to decline toward 4% of GDP given lower oil prices and steady electricity tariffs, which will benefit the electricity sector. In the past, fiscal results have deteriorated during election periods. We expect some modest election-related spending in 2016 to generate a somewhat higher deficit next year, but our upgrade is premised on an assumption that it will be significantly lower than in 2012. Nearly 4% of GDP of our figures for DR's general government fiscal deficit pertains to transfers to the broader public sector or its imputed losses. These include 1.5% of GDP of losses at the central bank (a legacy of bank bailouts in 2003), 0.7% of GDP of interest costs on recapitalization bonds injected into the central bank to reduce these losses, 1.4% of GDP of transfers to the electricity sector, and 0.4% of GDP of losses at nonfinancial public enterprises.

We expect net general government debt to average 43% of GDP during 2015-2016 and the interest burden to remain at 16% of government revenues, of which almost one-third accrues on the recapitalization bonds. Cash- and debt-management practices continue to improve. The recently implemented "cuenta unica" centralizes government accounts at the Treasury and serves to manage cash and control expenditures more efficiently. In addition, for the first time, as part of the 2015 budget, congress approved an overall debt issuance limit facilitating more agile debt management, instead of separate limits on external versus domestic financing, and approving individual external bond issuances. It was under this authority that in January and May 2015 the government issued US$3.5 billion in global bonds due in 2025 and 2045. The government used the proceeds to meet part of its 2015 borrowing requirement. It also used US$1.9 billion of the proceeds to buy back, at a 52% discount from par, US$4 billion of 11.4-year debt owed to PetroCaribe, a bilateral lending vehicle of the Venezuelan government. The buyback provided a small net present value savings to the fiscal and cut the headline net general government debt-to-GDP ratio to 41.7% in 2015 from 44% in 2014.

We expect that the government will turn to its domestic markets for at least a quarter of its financing requirement in 2015 and 2016. We consider the DR's contingent liabilities to be limited, as our criteria define the term. This takes into account Banco de la Reservas' one-third market share of the DR's financial system, its relatively small size (gross assets of the banking sector were about 38% of GDP in 2014), and the debt of government-related entities at about 6% of GDP.

The rest of the DR's sovereign credit profile reflects various institutional weaknesses that are somewhat offset by a diversified economic structure and a track record of solid growth. The DR's institutions have not consistently supported policy predictability across administrations. The current debate

about changing the constitution to permit consecutive presidential terms, which was driven by President Medina's high popularity, is an example. While a second term for President Medina could reinforce policy continuity, the debate exemplifies the changing nature of institutions in the DR. The constitution was only changed to abolish consecutive reelection in 2010. In addition, policymakers remain unable to resolve long-standing deficiencies in the electricity sector despite their pressure on the government's budget. That said, the economy has grown briskly without imbalances, and policymakers have improved monetary and fiscal policy execution during the past several years, underpinning the upgrade.

Standard & Poor's estimates per capita GDP around US$6,400 in 2015. Real per capita GDP growth averaged 4% over the past five years. We project real GDP to expand by 5% in 2015-2016 following growth of 7.3% in 2014, which was the highest in the region. As in 2014, we expect tourism, mining (with gold production reaching peak output), and construction of social housing to drive growth. Lower oil prices will also boost consumption. We do not see the DR's tourism offering being materially hurt in the forecast horizon by the greater opening of the Cuban market to American arrivals, given the diversity of origin of the DR's tourists, the strength of the DR hospitality sector (which is also active in Cuba), and the competitiveness of its tourism.

Assuming that imported oil volume remains stable, oil imports receipts should be reduced by almost 30%. Therefore, we estimate the current account deficit (CAD) closer to 2.4% of GDP in 2015 and 2016, which confirms the improving trend since the CAD peak of 7.5% of GDP in 2011. Growing tourism receipts and gold export volumes also contribute to the lower CAD. An improving CAD and steady foreign direct investment should set gross external financing needs closer to an average 105% of current account receipts (CAR) and usable reserves in 2015-2016. We estimate that external debt net of liquid assets was 84% of CAR in 2014; we expect it to average 81% of CAR in 2015-2016.

Our 'BB-' local currency rating reflects the country's still limited monetary policy transmission mechanism and small capital markets. The T&C assessment of 'BB+' is based on the outward orientation of the Dominican economy, with CAR at 33% of GDP, as well as the fairly unrestrictive nature of the DR's foreign-exchange regime.

Outlook

The stable outlook is premised on our assumption that over the next year, the government will contain any preelection fiscal slippage and the debate about the immediate presidential reelection will not disrupt the economy.

A more substantial rise in the general government deficit and debt burden than in our base-case scenario would likely exacerbate the DR's external vulnerability and could lead us to lower the rating, especially if the political willingness to reverse the slippage is lacking. Negative electoral dynamics that weigh on growth prospects could also put downward pressure on

the rating.

We could raise the ratings in the coming years following a reduction in the government's debt burden and improvements in the country's external liquidity. Addressing the structural deficiencies in the electricity sector would also help improve the country's fiscal position, supporting creditworthiness as well.

Key Statistics

Table 1

Dominican Republic--Selected Indicators											
	2008	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015f**	**2016f**	**2017f**	**2018f**
Nominal GDP (bil. US$)	47.52	47.89	53.04	58.03	60.44	61.20	63.97	67.22	71.43	74.82	78.19
GDP per capita (US$)	5,121	5,105	5,596	6,057	6,243	6,255	6,472	6,733	7,085	7,348	7,602
Real GDP growth (%)	3.1	0.9	8.3	2.8	2.6	4.8	7.3	5.0	5.0	4.5	4.5
Real GDP per capita growth (%)	2.0	(0.1)	7.2	1.7	1.6	3.7	6.3	4.0	4.0	3.5	3.5
Change in general government debt/GDP (%)	5.1	5.3	4.0	3.4	6.0	10.3	4.4	1.1	5.3	4.0	3.6
General government balance/GDP (%)	(4.2)	(4.4)	(4.0)	(4.3)	(8.0)	(5.3)	(4.5)	(4.2)	(5.3)	(4.0)	(3.6)
General government debt/GDP (%)	30.1	34.1	33.8	33.6	37.3	44.9	45.6	43.2	44.9	45.3	45.3
Net general government debt/GDP (%)	28.0	31.7	31.2	31.1	34.9	43.1	44.0	41.7	43.5	44.0	44.1
General government interest expenditure/revenues (%)	10.4	13.9	13.8	15.7	17.4	15.9	16.6	15.7	16.3	16.0	15.6
Other dc claims on resident nongovernment sector/GDP (%)	20.5	21.1	22.2	22.4	22.1	23.6	25.9	26.0	26.0	26.0	26.1
CPI growth (%)	10.6	1.4	6.3	8.5	3.9	3.9	1.6	2.0	3.5	4.0	4.0
Gross external financing needs/CARs plus usable reserves (%)	121.5	115.0	116.2	117.3	112.4	111.7	106.9	102.3	106.7	106.7	103.5
Current account balance/GDP (%)	(9.5)	(4.9)	(7.6)	(7.5)	(6.6)	(4.1)	(3.2)	(2.2)	(2.6)	(3.3)	(3.4)
Current account balance/CARs (%)	(28.3)	(16.7)	(23.6)	(23.3)	(20.2)	(12.2)	(9.3)	(6.4)	(7.9)	(10.1)	(10.4)
Narrow net external debt/CARs (%)	41.9	49.6	72.5	73.9	82.0	80.9	83.8	81.1	80.1	77.7	76.0
Net external liabilities/CARs (%)	111.4	146.6	152.8	158.3	172.1	175.9	181.6	177.3	174.7	170.5	166.8

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.

Ratings Score Snapshot

Table 2

Dominican Republic--Ratings Score Snapshot

Key rating factors	Assessments
Institutional assessment	Weakness
Economic assessment	Neutral
External assessment	Neutral
Fiscal assessment: flexibility and performance	Neutral
Fiscal assessment: debt burden	Neutral
Monetary assessment	Neutral

Note: Standard & Poor's analysis of sovereign creditworthiness rests on its assessment and scoring of five key rating factors: (i) institutional assessment; (ii) economic assessment; (iii) external assessment; (iv) the average of fiscal flexibility and performance, and debt burden; and (v) monetary assessment. Each of the factors is assessed on a continuum spanning from 1 (strongest) to 6 (weakest). Section V.B of Standard & Poor's "Sovereign Rating Methodology," published on Dec. 23, 2014 , summarizes how the various factors are combined to derive the sovereign foreign currency rating, while section V.C details how the scores are derived. The ratings score snapshot summarizes whether we consider that the individual rating factors listed in our methodology constitute a strength or a weakness to the sovereign credit profile, or whether we consider them to be neutral. The concepts of "strength", "neutral", or "weakness" are absolute, rather than in relation to sovereigns in a given rating category. Therefore, highly rated sovereigns will typically display more strengths, and lower rated sovereigns more weaknesses. In accordance with Standard & Poor's sovereign ratings methodology, a change in assessment of the aforementioned factors does not in all cases lead to a change in the rating, nor is a change in the rating necessarily predicated on changes in one or more of the assessments.

Related Criteria And Research

Related Criteria

- Sovereign Rating Methodology, Dec. 23, 2014
- 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

Related Research

- 2014 Annual Sovereign Default Study And Rating Transitions, May 18, 2015
- Sovereign Risk Indicators, March 31, 2015

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 committee agreed that "fiscal assessment: flexibility and performance" and "monetary assessment" had both improved. All other key rating factors were unchanged.

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. The weighting of all rating factors is described in the methodology used in this rating action (see 'Related Criteria And Research').

Ratings List

Upgraded; Ratings Affirmed

	To	From
Dominican Republic		
Sovereign Credit Rating	BB-/Stable/B	B+/Stable/B

Upgraded

	To	From
Dominican Republic		
Transfer & Convertibility Assessment	BB+	BB
Senior Unsecured	BB-	B+

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