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Research Update:

Dominican Republic 'BB-/B' Ratings Affirmed; Outlook Remains Stable

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Table Of Contents

Overview

Rating Action

Rationale

Outlook

Key Statistics

Ratings Score Snapshot

Related Criteria And Research

Ratings List

Research Update:

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Overview

- Growth in the Dominican Republic has remained above that of its peers, and its current account deficit and external debt have declined given low oil prices and robust tourism inflows.
- However, we expect net general government debt to rise during 2016-2018 absent efforts to bolster fiscal revenues.
- We are affirming our 'BB-/B' long- and short-term sovereign credit ratings on the Dominican Republic.
- The stable outlook reflects our opinion that over the coming year, economic growth will be higher than peers and fiscal and external vulnerabilities will remain in check.

Rating Action

On May 3, 2016, S&P Global Ratings affirmed its 'BB-/B' long- and short-term sovereign credit ratings on the Dominican Republic. The outlook remains stable. The transfer and convertibility (T&C) assessment is unchanged at 'BB+'.

Rationale

The ratings on the Dominican Republic reflect its relatively diversified economy, which has sustained economic growth above its peers, as well as its fairly stable external debt and liquidity indicators. The country's monetary policy has also gained more flexibility, particularly since 2012, under inflation targeting and a somewhat more freely floating peso; though it's still constrained by the central bank quasi-deficit and the low level of domestic credit. Various institutional weaknesses and a still-evolving system of checks and balances that have not consistently supported policy predictability across administrations constrain the ratings. In addition, we expect the government debt burden to trend higher and become more costly given reduced PetroCaribe concessional financing.

On May 15, the Dominican Republic will elect a new president, who will take office in August 2016. The leading contenders are President Danilo Medina, representing the Partido de la Liberación Dominicana, and Luis Abinader from the Partido Revolucionario Moderno. Should there be a second round of voting, it would occur on June 12.

The Dominican Republic's institutions have not consistently supported policy

predictability across administrations. For example, the constitution was changed to abolish consecutive reelection in 2010, but there was a 2015 constitutional reform to permit consecutive presidential terms, driven by President Medina's high popularity. Although a second term for President Medina would likely bring policy continuity, the reform exemplifies the changing nature of institutions in the Dominican Republic.

In addition, policymakers across party lines have failed 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. Our rating assumes this remains the case under the next government, be it a second Medina Administration or a new Abinader Administration.

S&P Global Ratings estimates per capita GDP of about US$7,000 in 2016. Real per capita GDP growth averaged 3.8% over the past five years. Coupled with our projections, per capita GDP growth in the Dominican Republic is, on average, above that of its peers at a similar level of economic development. We project real GDP to expand by 5% in 2016-2018, following growth of 7.3% in 2014 and 7% in 2015, which were the highest in the region. We expect tourism, mining, construction, and remittances from Dominican Republicans living in the U.S. to drive growth.

We do not see the greater opening of the Cuban market to American arrivals significantly hurting the Dominican Republic's tourism offering over the next three to four years. This reflects the diversity of origin of the Dominican Republic's tourists, the strength of the Dominican Republic's hospitality sector (which is also active in Cuba), and the competitiveness of its tourism.

In 2015, the general government deficit was 4.6% of GDP, compared with 4.7% in 2014. The 2015 central government deficit was just below 3% of GDP. Lower tax revenues, given Barrick Gold production below expected targets and a decline in oil tax related revenues (given low oil prices), reduced the Dominican Republic's fiscal revenues to 14.6% of GDP from 15.1% the previous year. Lower oil prices, however, also helped to contain growth in current expenditures because of lower subsidies. Relatively low oil prices and a control of expenditure should ensure general government deficits during 2016-2018 at around 4.5% of GDP.

The high general government deficit reflects several structural deficiencies in the Dominican Republic's fiscal performance. Interest payments on the recapitalization bonds plus the quasi-deficit of the central bank still represent 2% of GDP. Energy-sector losses only decreased to 1.1% of GDP (considering the electricity company losses and the current transfers made by the central government) in 2015, from the 2% average of 2012-2014, given lower oil prices. Even though this government (and prior governments as well) is fully aware of the reforms needed, it hasn't been able to address these structural fiscal shortcomings.

We expect net general government debt to continue to increase toward 48% of GDP during 2016-2018. Some increase in debt and less concessional funding contribute to our projections for a higher general government interest burden of 19% of general government revenues, although this ratio is distorted by the interest payments on the recapitalization bonds.

Debt-management practices continue to improve. Beginning in 2015, Congress approves an overall debt issuance limit annually, facilitating more agile debt management, instead of separate limits on external versus domestic financing and then having to approve individual external bond issuances. The government's debt management strategy is to reduce dependence on foreign currency debt (currently at 75% of total debt) by developing domestic markets to meet general government financing needs in the next couple of years.

We consider the Dominican Republic's contingent liabilities to be limited. This takes into account Banco de la Reservas' one-third market share of the Dominican Republic's financial system, its relatively small size (gross assets of the banking sector were about 48% of GDP in 2015), and the debt of government-related entities at about 6% of GDP.

The Dominican Republic's current account deficit (CAD) declined to under 2% of GDP in 2015 given lower oil prices and continued strong tourism and remittances receipts. This compares with 3.3% in 2014 and the historical peak of 9.5% in 2008. Relatively low oil prices and the solid tourism outlook should keep the CAD around the same level as 2015 in 2016-2018. Foreign direct investment (FDI) flows exceeded the CAD, resulting in an increase of international foreign reserves to $5.2 billion by the end of 2015. Stable CAD and FDI flows should keep the gross external financing needs around 100% of current account receipts (CAR) and usable reserves in 2016-2017. We expect it to be closer to 70% of CAR in 2016-2018.

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 lower range target. Inflation during the first quarter of 2016 was -0.6%. The central bank has allowed the Dominican Republic's peso to float more freely, although, like many central banks, it still intervenes to smooth seasonal market volatility. The monetary transmission mechanisms are still constrained by the central bank quasi-deficit and the low level of domestic credit (below 30% of GDP in 2015).

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 34% of GDP, as well as the fairly unrestrictive nature of the Dominican Republic's foreign-exchange regime.

Outlook

The stable outlook is premised on our assumption that the government will contain fiscal slippage and that economic growth will remain higher than peers, both contributing to keeping the Dominican Republic's fiscal debt burden and external vulnerabilities in check over the coming year.

A more substantial rise in the general government deficit and debt burden than in our base-case scenario would likely exacerbate the Dominican Republic's external vulnerability and could lead us to lower the rating, especially absent political action to reverse the slippage. We also assume that growth remains supported by policies pursued by the new Administration.

We could raise the ratings in the coming years if the government is able to implement measures to address fiscal structural deficiencies, which should help reduce fiscal and external indebtedness.

Key Statistics

Table 1

Selected Indicators										
	2009	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016f**	**2017f**	**2018f**
ECONOMIC INDICATORS (%)										
Nominal GDP (bil. LC)	1,729.47	1,978.85	2,218.43	2,377.50	2,558.59	2,786.23	3,023.12	3,253.18	3,484.15	3,750.17
Nominal GDP (bil. $)	47.89	53.04	58.03	60.44	61.20	63.97	66.32	70.55	74.08	77.78
GDP per capita (000s $)	5.1	5.6	6.1	6.2	6.3	6.5	6.6	7.0	7.3	7.6
Real GDP growth	0.9	8.3	2.8	2.6	4.8	7.3	7.0	5.5	5.0	4.5
Real GDP per capita growth	(0.1)	7.2	1.7	1.6	3.7	6.3	5.9	4.5	4.0	3.5
Real investment growth	(16.6)	19.7	(8.1)	(5.5)	1.2	13.5	23.7	6.0	6.0	6.0
Investment/GDP	23.9	26.7	25.1	23.1	21.8	21.5	21.6	21.8	22.2	22.5
Savings/GDP	19.1	19.1	17.6	16.5	17.7	18.2	19.6	19.9	20.1	20.3
Exports/GDP	21.1	21.9	23.7	24.4	25.4	25.7	24.6	24.8	25.2	25.3
Real exports growth	(8.4)	11.4	13.0	8.1	8.6	7.8	2.2	3.0	3.0	3.0
Unemployment rate	14.9	14.3	14.6	14.7	15.0	14.5	14.0	14.0	15.0	15.0
EXTERNAL INDICATORS (%)										
Current account balance/GDP	(4.9)	(7.6)	(7.5)	(6.6)	(4.1)	(3.3)	(2.0)	(1.9)	(2.1)	(2.2)
Current account balance/CARs	(16.7)	(23.6)	(23.3)	(20.2)	(12.2)	(9.8)	(5.9)	(5.7)	(6.4)	(6.7)
Trade balance/GDP	(14.2)	(15.8)	(15.4)	(14.5)	(12.1)	(11.5)	(11.1)	(10.8)	(11.0)	(11.0)
Net FDI/GDP	2.6	3.0	3.7	6.1	2.0	3.5	3.4	2.8	2.7	2.6
Net portfolio equity inflow/GDP	(0.9)	1.4	1.3	(0.7)	2.9	2.3	2.1	0.0	0.0	0.0

Table 1

Selected Indicators (cont.)

	2009	2010	2011	2012	2013	2014	2015	2016f	2017f	2018f
Gross external financing needs/CARs plus usable reserves	114.7	114.6	116.7	112.3	111.7	107.4	101.6	103.7	101.7	98.7
Narrow net external debt/CARs	47.7	71.9	73.8	83.1	82.7	84.6	73.4	71.1	68.7	67.1
Net external liabilities/CARs	144.6	152.2	158.2	173.2	177.7	185.2	180.2	175.3	170.4	166.2
Short-term external debt by remaining maturity/CARs	15.7	11.2	13.2	11.7	13.8	15.5	13.0	16.2	15.2	14.2
Reserves/CAPs (months)	1.6	1.7	1.6	1.7	1.4	1.8	1.9	2.0	2.2	2.5
FISCAL INDICATORS (%, General government)										
Balance/GDP	(4.4)	(4.0)	(4.3)	(8.0)	(5.3)	(4.6)	(4.6)	(4.9)	(4.5)	(4.5)
Change in debt/GDP	5.3	4.0	3.4	6.0	10.3	3.5	2.9	4.9	4.5	4.5
Primary balance/GDP	(2.5)	(2.2)	(2.2)	(5.6)	(2.9)	(2.1)	(2.0)	(2.2)	(1.6)	(1.6)
Revenue/GDP	13.3	13.1	12.8	13.6	14.5	15.1	14.7	14.7	14.7	14.7
Expenditures/GDP	17.7	17.1	17.1	21.6	19.8	19.7	19.4	19.7	19.2	19.2
Interest /revenues	13.9	13.8	15.7	17.4	15.9	16.7	18.0	18.7	19.3	19.8
Debt/GDP	34.1	33.8	33.6	37.3	44.9	44.8	44.1	45.9	47.4	48.5
Debt/Revenue	256.4	258.2	261.1	274.0	309.4	296.5	299.2	311.6	321.3	328.9
Net debt/GDP	31.7	31.2	31.1	35.5	42.5	43.3	42.9	44.8	46.3	47.5
Liquid assets/GDP	2.4	2.6	2.4	1.7	2.4	1.4	1.3	1.2	1.1	1.0
MONETARY INDICATORS (%)										
CPI growth	1.4	6.3	8.5	3.7	4.8	3.0	0.8	1.5	2.0	3.0
GDP deflator growth	3.4	5.6	9.0	4.4	2.7	1.4	1.4	2.0	2.0	3.0
Exchange rate, year-end (LC/$)	36.38	37.93	38.79	40.37	42.85	44.39	45.66	46.57	47.50	48.93
Banks' claims on resident non-gov't sector growth	7.2	20.4	12.8	5.6	14.9	20.0	17.9	7.3	6.8	7.5
Banks' claims on resident non-gov't sector/GDP	21.1	22.2	22.3	22.0	23.5	25.9	28.1	28.1	28.0	28.0
Foreign currency share of residents' bank deposits	32.8	37.8	36.9	34.1	39.2	40.8	40.3	40.3	40.3	40.3

Table 1

Selected Indicators (cont.)										
	2009	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016f**	**2017f**	**2018f**
Real effective exchange rate growth	(0.4)	0.0	0.7	0.2	(2.4)	(2.1)	3.7	N/A	N/A	N/A

Savings is defined as investment plus the current account surplus (deficit). Investment is defined as expenditure on capital goods, including plant, equipment, and housing, plus the change in inventories. Banks are other depository 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. LC--Local currency. CARs--Current account receipts. FDI--Foreign direct investment. CAPs--Current account payments. The data and ratios above result from S&P Global Ratings' own calculations, drawing on national as well as international sources, reflecting S&P Global Ratings' independent view on the timeliness, coverage, accuracy, credibility, and usability of available information. f--Forecast. N/A--Not applicable.

Ratings Score Snapshot

Table 2

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

S&P Global Ratings' 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 S&P Global Ratings' "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 S&P Global Ratings' 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

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 "economic assessment" had improved and that the "debt assessment" had deteriorated. 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

Ratings Affirmed

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

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at www.spcapitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings public website at www.standardandpoors.com. Use the Ratings search box located in the left column.

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