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## Research Update:

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

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## Ratings

Foreign Currency: BB-/Stable/B
Local Currency: BB-/Stable/B
For further details see Ratings List.

## Overview

- We continue to expect the Dominican Republic to grow above peers despite the slowdown in 2017.
- Structural reform momentum has stalled, and we expect limited progress under the remainder of the Medina Administration. Therefore, we expect general government deficits to average 4.2% of GDP and net general government debt to rise to 52% in 2021.
- We are affirming our 'BB-/B' long- and short-term sovereign credit ratings on the Dominican Republic.
- Our stable outlook reflects our expectation that solid growth balances the risks from loose fiscal policy and higher debt.

## Rating Action

On April 19, 2018, 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+'.

## Outlook

Our stable outlook mirrors our expectation that the Dominican Republic will continue to grow at an average of 5% annually during the next two years, which helps mitigate a rise in net general government debt and deficits expected to average 4.2% of GDP during 2018-2021. Our stable outlook also assumes that tourism and remittances will partially offset higher oil prices during the forecast period, with some weakening in the current account deficit (CAD) and external liquidity.

We could raise the ratings if the government takes steps to improve structural fiscal trends, such as through energy sector reform, tackling the quasi-deficit of the central bank, or central government fiscal reform. Lower fiscal deficits, coupled with sustained improvement in external liquidity ratios, could lead to an upgrade during the next two years.

We could lower our ratings if policy decisions or adverse external conditions generate lower potential GDP growth during the next two years or if the Dominican Republic doesn't grow faster than peers with a similar level of economic development, also weighing on the Dominican Republic's fiscal dynamics.

## Rationale

Our ratings on the Dominican Republic reflect our view that despite decelerating over the past couple years, especially in 2017, we expect real GDP growth to average 5% during 2018-2021, still above peers. The ratings also reflect the Dominican Republic's monetary policy framework, which includes inflation targeting, with a growing track record of effectiveness. The ratings are constrained by, in our view, institutional weaknesses, rising net general government debt and interest burdens, and a still relatively weak external profile.

### Institutional and economic profile: A diversified economy with strong growth prospects, mitigated by the institutional capacity to advance structural reforms

- At a projected average of 5% annually, we expect real GDP growth to continue to compare favorably with peers during 2018-2021.
- Strong tourism and demand from the U.S. and stable growth of the financial sector will be the main economic drivers.
- Institutional weakness is reflected by an inability to advance various structural reforms and weaker policy execution across political cycles.

We project the country's GDP per capita at US$7,780 in 2018. The Dominican Republic posted GDP growth of 4.6% in 2017, below the average during 2014-2016 of 7.1%. The slowdown stems from weaker business confidence and uncertainties associated with corruption allegations and social unrest stemming from the company Odebrecht's role in the government's infrastructure projects. In addition, two significant hurricanes caused sizable damage on the northern region of the island. We expect U.S. demand for Dominican goods and tourism to bolster exports of goods and services, and remittances to support private consumption, resulting in average real GDP growth of 5% during 2018-2021. We expect real per capita GDP growth to remain slightly above 4% during the same period, which still compares positively with peers at the same level of economic development.

President Danilo Medina from the Partido de la Liberación Dominicana (PLD) party is halfway through his second four-year mandate and continues to post high, although declining, approval ratings. The PLD has an absolute majority in both legislative chambers and runs a vast majority of the Dominican Republic's municipalities. However, dominance of the PLD has not translated to passage of needed structural reforms.

President Medina's and the PLD's capacity to pass reforms has been constrained by corruption allegations, internal divisions of the PLD between President Medina's and former president Leonel Fernandez's (1996-2000, 2004-2012) factions, and electoral-driven considerations. In our opinion, well-known structural reforms, including the energy, fiscal, labor, and competitiveness reforms, along with the renewal of the central bank recapitalization law, have been on hold since President Medina took power in 2012. Lastly, in our opinion, the absence of action to correct structural deficiencies raises greater uncertainty about the Dominican Republic's capacity to maintain sustainable public finances and promote balanced economic growth over the longer term.

### Flexibility and performance profile: The Dominican Republic is likely to post fiscal deficits and rising debt during the next two years

- The Dominican Republic's fiscal performance is marked by consistent fiscal deficits and rising debt.
- Tourism and remittances should somewhat offset higher oil prices, but we expect CAD and external liquidity indicators to weaken.
- The Dominican Republic moved to an inflation-targeting regime in 2012 and continues to build an adequate track record by maintaining inflation at or below the target range.

The general government (which includes central government results, the central bank quasi-deficit, and the nonfinancial public sector) posted a deficit of 4.4% of GDP in 2017, slightly worse than the 2016 deficit of 4.2%. The benefits of the 2012 fiscal reform waned by 2016. The government was only able to raise marginally higher revenue by administrative measures, while extraordinary reconstruction costs (after the season's hurricanes) underpin higher deficits in 2017.

Administrative measures such as the integration between the tax database and customs database should promote higher tax compliance and yield some revenue gains, but assuming no fiscal reform over the forecast horizon, we would expect general government deficits to average 4.2% of GDP. This includes increased fiscal slippage deviation during the next electoral period in 2020. Absent a new central bank recapitalization law (currently under discussion), our projections still assume the quasi-deficit of the central bank would remain around 2% of GDP (estimate includes the central government transfers to the central bank). The energy pact has been delayed since August 2015; the version currently under discussion among the sector's main players is unlikely to address key system structural issues, such as the 30% physical losses. The Punta Catalina energy plant is expected to start operating at year-end 2018 and reach full capacity sometime in 2019, which should help to reduce the cost of the losses.

We expect the Dominican Republic's change in net general government debt to average 5.1% during 2018-2021, which includes general government deficits and considers some depreciation of the peso. We expect net general government debt to reach 52% of GDP by 2021, significantly higher than the 32% posted a decade earlier. The net debt stock includes central bank certificates (equivalent to 13.3% of GDP in 2017) and excludes the recapitalization bonds that the central government issued to capitalize the central bank (equivalent to 3.7% of GDP) following the 2003-2004 bailout of the banking sector. Higher debt will keep interest payments high, at an average of 21% of general government revenues during 2018-2021. This figure is not fully comparable with peers because almost 25% of the central government's interest bill is paid to the central bank to help recapitalize it.

Due to its still-shallow domestic debt market, the Dominican Republic is highly dependent on external financing. More than 50% of the general government debt is denominated in foreign currency. We assess the contingent liabilities as limited. This considers assets of the deposit-taking financial institutions that are just below 50% of GDP. Non-deposit-taking institutions are not material in size, mainly considering the size of the Dominican pension system funds, which is less than 15% of GDP. Moreover, we incorporate much of the debt of nonfinancial public enterprises into our general government debt figures, as well as the fiscal results of large enterprises (such as energy transmission and distribution public companies) into our calculation of general government deficits.

In 2017, the Dominican Republic posted the lowest CAD of the last of the last 25 years, thanks to growing tourism and remittance receipts. We expect relatively higher oil prices during 2018-2021 to result in still-moderate CAD at an average of 1.7% of GDP. We expect foreign direct investment and the rest of the financial account to fully finance the Dominican Republic's CAD and contribute to the growing international reserves. We expect the country's gross external financing needs at around 100% of current account receipts (CAR) plus usable reserves during 2018-2021, while its narrow net external debt is set to increase toward 80% of CAR from 70% in 2017. We expect net external liabilities to reach 180% during the forecast period. We consider the gap between narrow net external debt and net liabilities to be significant, and it highlights the country's vulnerability to adverse external conditions.

In 2012, the central bank became operationally independent and moved to an inflation-targeting regime, improving its policy track record. Inflation has averaged 2.7% since then, near the lower end of the central bank's target (4% plus/minus 1%). The central bank has allowed the Dominican Republic's peso to float more freely, although it still intervenes in the foreign exchange market. Its monetary transmission mechanism is constrained by quasi-fiscal losses, a low level of domestic credit (below 30% of GDP in 2017), and shallow domestic debt and capital markets. These factors constrain our long-term local currency rating at 'BB-'.

The T&C assessment is 'BB+', two notches higher than the foreign currency sovereign rating. This reflects our opinion that the likelihood of the sovereign restricting access to foreign exchange that Dominican Republic-based nonsovereign issuers need for debt service is moderately lower than the likelihood of the sovereign defaulting on its foreign currency obligations. The distinction is based on the outward orientation of the Dominican economy, especially given the importance of tourism and tourism investment, CARs at 35% of GDP, and the fairly unrestrictive nature of Dominican Republic's foreign-exchange regime.

## Key Statistics

**Table 1**

| Dominican Republic--Selected Indicators | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **(Mil. DOP)** | **2011** | **2012** | **2013** | **2014** | **2015** | **2016** | **2017** | **2018f** | **2019f** | **2020f** | **2021f** |
| **ECONOMIC INDICATORS (%)** | | | | | | | | | | | |
| Nominal GDP (bil. LC) | 2,210.21 | 2,386.02 | 2,619.77 | 2,877.53 | 3,099.65 | 3,333.42 | 3,613.15 | 3,945.56 | 4,308.55 | 4,704.93 | 5,137.79 |
| Nominal GDP (bil. $) | 57.81 | 60.66 | 62.66 | 66.07 | 68.80 | 72.34 | 75.93 | 79.83 | 83.82 | 88.01 | 92.41 |
| GDP per capita (000s $) | 6.0 | 6.3 | 6.4 | 6.7 | 6.9 | 7.2 | 7.5 | 7.8 | 8.1 | 8.4 | 8.8 |
| Real GDP growth | 3.1 | 2.7 | 4.9 | 7.6 | 7.0 | 6.6 | 4.6 | 5.0 | 5.0 | 5.0 | 5.0 |
| Real GDP per capita growth | 2.0 | 1.6 | 3.8 | 6.6 | 6.0 | 5.6 | 3.6 | 4.0 | 4.1 | 4.1 | 4.1 |
| Real investment growth | (2.2) | (0.5) | (2.5) | 12.3 | 20.6 | 11.4 | 0.5 | 6.0 | 6.0 | 6.0 | 6.0 |
| Investment/GDP | 25.0 | 24.3 | 22.7 | 23.0 | 22.6 | 21.9 | 21.8 | 21.8 | 21.8 | 21.7 | 21.7 |
| Savings/GDP | 17.5 | 17.9 | 18.6 | 19.7 | 20.7 | 20.6 | 21.5 | 20.9 | 20.4 | 19.8 | 19.2 |
| Exports/GDP | 24.2 | 24.6 | 25.2 | 25.4 | 24.5 | 24.9 | 24.8 | 24.6 | 24.3 | 24.0 | 23.8 |
| Real exports growth | 7.3 | 5.5 | 9.0 | 7.5 | 2.0 | 6.6 | 4.7 | 3.0 | 3.0 | 3.0 | 3.0 |
| Unemployment rate | 14.6 | 14.7 | 15.0 | 14.5 | 14.0 | 13.3 | 15.0 | 15.0 | 15.0 | 15.0 | 15.0 |
| **EXTERNAL INDICATORS (%)** | | | | | | | | | | | |
| Current account balance/GDP | (7.5) | (6.4) | (4.1) | (3.3) | (1.9) | (1.4) | (0.4) | (0.9) | (1.4) | (2.0) | (2.5) |
| Current account balance/CARs | (22.4) | (19.2) | (12.0) | (9.6) | (5.5) | (4.0) | (1.0) | (2.6) | (4.2) | (5.8) | (7.5) |
| CARs/GDP | 33.4 | 33.3 | 34.1 | 34.4 | 33.6 | 34.1 | 34.1 | 33.9 | 33.7 | 33.6 | 33.4 |
| Trade balance/GDP | (15.5) | (14.4) | (11.8) | (11.2) | (10.8) | (10.5) | (10.2) | (10.9) | (11.6) | (12.3) | (13.0) |
| Net FDI/GDP | 3.9 | 5.2 | 3.2 | 3.3 | 3.2 | 3.3 | 4.7 | 3.3 | 3.2 | 3.2 | 3.2 |
| Net portfolio equity inflow/GDP | 1.3 | 0.6 | 2.9 | 2.2 | 2.1 | 2.4 | 2.2 | 2.0 | 2.0 | 1.9 | 1.8 |
| Gross external financing needs/CARs plus usable reserves | 119.2 | 114.2 | 115.1 | 111.4 | 107.2 | 103.5 | 98.8 | 95.9 | 98.9 | 100.5 | 102.7 |
| Narrow net external debt/CARs | 69.1 | 78.7 | 78.3 | 78.5 | 74.2 | 72.9 | 70.1 | 73.8 | 77.3 | 80.6 | 82.9 |

**Table 1**

| Dominican Republic--Selected Indicators (cont.) | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **(Mil. DOP)** | **2011** | **2012** | **2013** | **2014** | **2015** | **2016** | **2017** | **2018f** | **2019f** | **2020f** | **2021f** |
| Narrow net external debt/CAPs | 56.4 | 66.1 | 69.9 | 71.7 | 70.3 | 70.2 | 69.4 | 72.0 | 74.2 | 76.2 | 77.1 |
| Net external liabilities/CARs | 150.9 | 166.4 | 170.4 | 173.8 | 177.9 | 178.5 | 176.2 | 178.5 | 180.5 | 182.6 | 183.6 |
| Net external liabilities/CAPs | 123.3 | 139.6 | 152.1 | 158.7 | 168.6 | 171.7 | 174.4 | 174.0 | 173.3 | 172.5 | 170.8 |
| Short-term external debt by remaining maturity/CARs | 16.3 | 14.4 | 17.4 | 19.7 | 19.2 | 16.6 | 16.4 | 13.1 | 15.3 | 15.7 | 16.5 |
| Usable reserves/CAPs (months) | 1.6 | 1.7 | 1.3 | 1.8 | 1.9 | 1.9 | 2.2 | 2.4 | 2.4 | 2.4 | 2.3 |
| Usable reserves (mil. $) | 3,423 | 2,658 | 3,644 | 3,777 | 4,061 | 4,875 | 5,552 | 5,876 | 6,204 | 6,428 | 6,848 |
| **FISCAL INDICATORS (%, General government)** | | | | | | | | | | | |
| Balance/GDP | (4.3) | (8.0) | (5.4) | (4.5) | (4.6) | (4.2) | (4.4) | (4.2) | (3.8) | (4.9) | (4.1) |
| Change in net debt/GDP | 3.1 | 8.3 | 6.8 | 4.1 | 3.4 | 5.6 | 6.2 | 5.1 | 4.7 | 5.7 | 4.9 |
| Primary balance/GDP | (2.3) | (5.6) | (3.1) | (2.1) | (2.1) | (1.3) | (1.4) | (1.1) | (0.7) | (1.7) | (0.8) |
| Revenue/GDP | 12.9 | 13.6 | 14.2 | 14.6 | 14.4 | 14.6 | 14.9 | 14.9 | 14.9 | 14.6 | 14.6 |
| Expenditures/GDP | 17.2 | 21.5 | 19.6 | 19.1 | 19.0 | 18.8 | 19.3 | 19.1 | 18.8 | 19.5 | 18.7 |
| Interest /revenues | 15.7 | 17.4 | 15.9 | 16.7 | 18.0 | 19.6 | 20.2 | 20.6 | 20.8 | 21.8 | 22.0 |
| Debt/GDP | 34.8 | 40.1 | 44.0 | 43.5 | 43.7 | 46.5 | 49.2 | 50.2 | 50.7 | 52.1 | 52.6 |
| Debt/Revenue | 270.0 | 295.5 | 309.7 | 298.1 | 304.5 | 318.0 | 330.1 | 336.4 | 339.7 | 356.1 | 359.2 |
| Net debt/GDP | 32.4 | 38.3 | 41.7 | 42.0 | 42.5 | 45.1 | 47.8 | 48.9 | 49.5 | 51.1 | 51.6 |
| Liquid assets/GDP | 2.4 | 1.7 | 2.3 | 1.4 | 1.2 | 1.5 | 1.4 | 1.3 | 1.2 | 1.1 | 1.0 |
| **MONETARY INDICATORS (%)** | | | | | | | | | | | |
| CPI growth | 7.8 | 3.9 | 3.9 | 1.6 | 2.3 | 1.7 | 4.2 | 4.0 | 4.0 | 4.0 | 4.0 |
| GDP deflator growth | 8.1 | 5.1 | 4.7 | 2.0 | 0.6 | 0.9 | 3.7 | 4.0 | 4.0 | 4.0 | 4.0 |
| Exchange rate, year-end (LC/$) | 38.79 | 40.36 | 42.85 | 44.39 | 45.66 | 46.73 | 48.46 | 50.39 | 52.41 | 54.51 | 56.69 |
| Banks' claims on resident non-gov't sector growth | 12.8 | 5.6 | 14.9 | 19.9 | 17.9 | 12.0 | 11.4 | 9.2 | 9.2 | 9.2 | 9.2 |
| Banks' claims on resident non-gov't sector/GDP | 22.4 | 21.9 | 23.0 | 25.1 | 27.5 | 28.6 | 29.4 | 29.4 | 29.4 | 29.4 | 29.4 |
| Foreign currency share of residents' bank deposits | 36.9 | 38.7 | 39.2 | 40.9 | 40.3 | 39.7 | 40.2 | 40.2 | 40.2 | 40.2 | 40.2 |

**Table 1**

| Dominican Republic--Selected Indicators (cont.) | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **(Mil. DOP)** | **2011** | **2012** | **2013** | **2014** | **2015** | **2016** | **2017** | **2018f** | **2019f** | **2020f** | **2021f** |
| Real effective exchange rate growth | 0.7 | 0.2 | (2.4) | (2.1) | 2.3 | (0.8) | (3.7) | N/A | 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**

| Dominican Republic--Ratings Score Snapshot | |
|---|---|
| **Key rating factors** | |
| Institutional assessment | 5 |
| Economic assessment | 3 |
| External assessment | 5 |
| Fiscal assessment: flexibility and performance | 5 |
| Fiscal assessment: debt burden | 5 |
| Monetary assessment | 4 |

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). S&P Global Ratings' "Sovereign Rating Methodology," published on Dec. 18, 2017, details how we derive and combine the scores and then derive the sovereign foreign currency rating. In accordance with S&P Global Ratings' sovereign ratings methodology, a change in score 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 scores. In determining the final rating the committee can make use of the flexibility afforded by §15 and §§126-128 of the rating methodology.

## Related Criteria

- Criteria - Governments - Sovereigns: Sovereign Rating Methodology, Dec. 18, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings , April 7, 2017
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- General Criteria: Methodology: Criteria For Determining Transfer And Convertibility Assessments, May 18, 2009

## Related Research

- Sovereign Ratings History, March 6, 2018
- Sovereign Debt 2018: Global Borrowing To Remain Steady At US$7.4 Trillion, Feb. 22, 2018
- S&P Global Ratings Raises 2018 Brent And WTI Oil Price Assumptions, Jan. 18, 2018
- Latin American And Caribbean Sovereign Rating Trends 2018, Jan. 11, 2018
- Global Sovereign Rating Trends 2018, Jan. 10, 2018
- Sovereign Risk Indicators, also available at www.spratings.com/sri
- Dominican Republic 'BB-/B' Ratings Affirmed; Outlook Remains Stable, April 27, 2017
- 2016 Annual Sovereign Default Study And Rating Transitions, April 3, 2017

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's assessment of the key rating factors is reflected in the Ratings Score Snapshot above.

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.capitaliq.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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