Research Update:

Dominican Republic Outlook Revised To Negative On Increased External And Debt Risks; 'BB-/B' Ratings Affirmed

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Overview

- The impact of the COVID-19 pandemic will weaken the Dominican Republic's fiscal and external profiles through lower internal demand and weaker tourism and remittances inflows.
- The decline in government revenues and increased spending pressures would further accelerate the already rapid borrowing, significantly reducing the government's flexibility to take on new debt and potentially weakening its fiscal buffers.
- We are revising our outlook on the long-term ratings on the Dominican Republic to negative from stable and affirming our 'BB-/B' sovereign credit ratings.
- The negative outlook indicates that the severe external shock could be even deeper or more prolonged than expected, which could lead to further deterioration in the sovereign's external and debt profiles.

Rating Action

On April 16, 2020, S&P Global Ratings revised its outlook on the long-term ratings on the Dominican Republic to negative from stable. At the same time, we affirmed our 'BB-/B' long- and short-term foreign and local currency sovereign credit ratings. The transfer and convertibility (T&C) assessment is unchanged at 'BB+'.

Outlook

The negative outlook reflects our view that there is at least a one-in-three chance that we could lower the ratings on the Dominican Republic over the next 12-18 months, given the potential impact of the COVID-19 pandemic, and associated containment measures, on the sovereign's vulnerable fiscal and external profiles. A more severe economic decline through both tourism and other material economic sectors, or a more prolonged impact from the pandemic, could limit the expected recovery in 2021. This could push the government to borrow more to implement a larger fiscal package, which could lead to materially worse debt and external profiles.

Downside scenario

We could lower the ratings over the next 12-18 months if the economic recovery that we currently expect in 2021 is weaker, or if the crisis is more prolonged than our base case, because of a deeper impact of COVID-19 containment measures and longer border closures. If such a scenario results in a more structural deterioration of the government's external and debt profiles, we could lower the ratings.

Upside scenario

We could revise the outlook to stable over the same time frame if risks of a more severe or prolonged crisis subside and pressures on fiscal performance and debt buildup ease. We would also expect a potential new government to take steps to improve structural fiscal trends, such as through fiscal and energy-sector reforms or tackling the quasi-fiscal deficit of the central bank. Lower fiscal deficits, coupled with sustained improvement in external liquidity ratios, could also stabilize the outlook over the next 12-18 months.

Rationale

Our ratings on the Dominican Republic reflect its dynamic economy, which is vulnerable to external shocks but has quickly adjusted in the aftermaths and has posted higher long-term growth rates than peers. The fast economic growth has downplayed some of the Dominican Republic's structural problems in the past.

Our ratings are constrained by the country's institutional weaknesses, reflected in its inability to pass meaningful reforms, and its rapid buildup in debt, which has gradually worsened its external profile and limits the space for further fiscal corrections.

Institutional and economic profile: Economic growth should come to a halt in 2020 due to the severe external shock but recover in the following years

- The Dominican Republic's economy will suffer a severe hit in 2020, although we consider its flexibility will enable it to resume growth over the next three years, more rapidly than several of its peers.
- We do not expect progress on structural reforms given the presidential election this year and the more urgent challenges the incoming administration will face.
- Continued delays in advancing structural reforms diminish the sovereign's capacity to maintain sustainable public finances in the long term.

The global spread of COVID-19 will have unprecedented implications for tourism-dependent sovereigns in the Caribbean and North Atlantic. In addition to the human costs, we expect the pandemic, together with travel restrictions, will have a significant impact on GDP, fiscal accounts, and foreign exchange inflows in 2020. Our base case for tourism to the Caribbean and North Atlantic in 2020 assumes a decline of 60%-70% in the last three quarters of the year compared with 2019, followed by a rebound in tourism in 2021.

The Dominican Republic is more diversified than other tourism-dependent sovereigns in the Caribbean and North Atlantic. However, we consider that the combination of a halt in domestic demand and a sudden stop in tourism inflows, and the likely spillovers to several sectors of the economy, will contribute to a significant deceleration of the Dominican Republic's GDP in 2020. We expect the economy to contract 2% in 2020 and per capita GDP to fall to about $8,100. This forecast is subject to significant downside risks, given the uncertainty about both the extent of the COVID-19 pandemic and its economic implications.

Nonetheless, our base case assumes the impact of COVID-19 will be a temporary hit, and we expect a sustained recovery in 2021. We forecast that the Dominican Republic's real GDP growth will converge to about 5% over the next three years, comparing positively with its regional peers with a similar level of economic development. If the economic impact is more severe than expected, or if the recovery is more prolonged, the fiscal, institutional, and social challenges would promptly become more evident. The negative outlook highlights these uncertainties.

Elections in 2020 will set the stage for a new president to take office in August. However, we expect the severe economic shock, social discontent, and alleged corruption to limit the government's ability to pass key structural reforms to improve fiscal consolidation by increasing revenues or curbing expenditures.

The ongoing delays and failure to advance reform in key sectors of the economy reflect, in our view, a still limited capacity to maintain sustainable public finances and promote balanced economic growth over the longer term.

Flexibility and performance profile: External debt is likely to continue increasing as new borrowings finance fiscal deficits

- We expect the current account deficit (CAD) to widen to about 5% of GDP in 2020 because of the sudden stop of tourism inflows and fewer remittances.
- The Dominican Republic's fiscal deficits should spike in 2020, as the government implements its fiscal package, and average 4% of GDP over the next three years.
- Extraordinary fiscal measures and external needs would be partially covered with new borrowings, which would weigh on the sovereign's external and debt profiles.

We expect the pandemic to have a significant impact on the government's revenues and expenditures this year, through a severe drawdown in tax collection and direct subsidies aimed to the most vulnerable. However, our base-case scenario assumes that the economic recovery would help ease fiscal pressures, and we are projecting the general government deficit to average 4% of GDP over the next three years, of which around 2% corresponds to the central bank quasi-fiscal deficit. (Our definition of general government includes the central government, the central bank quasi-fiscal deficit, and the nonfinancial public sector.)

The government will likely finance its fiscal package through lending from multilateral institutions and new borrowings, including lending from the central bank up to the limit allowed by law. We expect the change in net general government debt to spike to about 8% of GDP in 2020 and to converge to 5% in 2021-2023.

This would increase the sovereign's net debt to around 57% of GDP in 2020, up from 49% of GDP in 2019 and 33% of GDP in 2011. The rapid buildup in debt exacerbates fiscal weaknesses, and diminishes structural buffers to deal with potential future external shocks. The net debt stock includes central bank certificates (13% of GDP in 2019) and excludes the bonds that the central government issued to capitalize the central bank (3% of GDP in 2019) following the 2003-2004 bailout of the banking sector.

The sovereign has improved its reputation as a frequent issuer, and we think it could get new financing as international markets reopen. That said, local capital markets remain comparably shallow, and foreign currency debt of about 55% of total debt underscores the vulnerability to Dominican peso depreciation.

Higher debt will keep interest payments high, at an average of 22% of general government revenues over the next three years. This figure reflects the Dominican Republic's very low tax burden. However, it 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.

On the external side, the CAD is likely to widen markedly in 2020, to about 5% of GDP, as a result of the sudden stop in tourism inflows and a drop in remittances, which together account for half of the Dominican Republic's current account receipts (CARs). This would only be partially compensated by lower oil prices--the Dominican Republic is a net oil importer. For 2021-2023, we expect the CAD to gradually narrow and average 2% of GDP, following the recovery of the tourism sector and U.S. real wages. We expect the CAD to continue being fully financed by foreign direct investment (FDI), which we project to drop and remain below 3% of GDP, on average, over the same period.

According to our base case, the pickup in external indebtedness, especially driven by the central government's worse fiscal outcomes and lower CARs, should result in narrow net external debt spiking toward 115% of CARs and a correction to about 90% of CAR in 2021-2023. Given the Dominican Republic's tight links with the U.S. economy, we continue to consider the Dominican Republic as vulnerable to sudden changes in FDI flows--net external liabilities, which include the high stock of FDI in the country, account for about 230% of CARs. With FDI fully financing the CAD and the government issuing external debt, the central bank has been increasing usable reserves, which accounted for about 11% of GDP in 2019. As a result, we expect the country's gross external financing needs to be slightly above 100% of CAR plus usable reserves during 2020-2023.

Since 2012, when the central bank became operationally independent, inflation has remained below its target range (4% plus/minus 1%). We expect inflationary pressures to remain subdued, given the weak economic activity in 2020. Still, we consider monetary policy to be somewhat constrained by quasi-fiscal losses, a low level of domestic credit (below 30% of GDP), and shallow domestic debt and capital markets. A new memorandum of understanding signed by the Finance Ministry and the central bank could allow for a gradual recapitalization of the latter, over the next seven years. This could ease the central government's interest burden and strengthen the central bank's tools. However, it is still uncertain how the new agreement would work and how commitments could become enforceable.

We consider banking sector contingent liabilities limited, given that the sector is relatively small, with total assets estimated at about 40% of GDP. The financial sector is concentrated in a few large banks, which we consider to be systemic and have relatively stronger capital and liquidity ratios. Nonetheless, the severe external shock could rapidly erode the financial sector strengths, especially for smaller banks, and entities that are more exposed to tourism, remittances, and sharp increases in unemployment.

Environment, social and governance (ESG) factors relevant to the rating action:

- Health and safety

Key Statistics

Table 1

Dominican Republic--Selected Indicators

	2013	2014	2015	2016	2017	2018	2019	2020f	2021f	2022f	2023f
Economic indicators (%)											
Nominal GDP (bil. LC)	2,619.77	2,925.67	3,205.66	3,487.29	3,802.66	4,235.85	4,562.24	4,605.12	5,076.68	5,543.74	6,053.76
Nominal GDP (bil. $)	62.68	67.18	71.16	75.70	80.00	85.56	88.94	84.92	89.67	94.16	98.87
GDP per capita ($000s)	6.4	6.8	7.1	7.5	7.9	8.3	8.6	8.1	8.5	8.9	9.2
Real GDP growth	4.9	7.1	6.9	6.7	4.7	7.0	5.1	(2.0)	6.0	5.0	5.0
Real GDP per capita growth	3.8	6.0	5.9	5.7	3.7	6.0	4.1	(2.8)	5.1	4.1	4.1
Real investment growth	(2.5)	9.3	18.9	12.3	(0.3)	13.3	8.1	0.9	10.2	9.2	9.2
Investment/GDP	22.7	23.1	23.4	23.0	22.5	25.8	26.0	26.8	26.8	26.8	26.8
Savings/GDP	18.6	19.9	21.6	21.9	22.3	24.4	24.6	21.6	24.2	25.0	25.3
Exports/GDP	25.2	25.2	23.8	23.9	23.7	23.6	23.1	17.0	21.8	22.6	22.8
Real exports growth	9.0	8.7	3.1	7.5	4.9	6.1	1.5	(27.8)	35.8	8.8	6.0
Unemployment rate	15.0	14.5	14.0	13.3	10.0	10.3	15.0	15.0	15.0	15.0	16.0
External indicators (%)											
Current account balance/GDP	(4.1)	(3.2)	(1.8)	(1.1)	(0.2)	(1.4)	(1.4)	(5.2)	(2.5)	(1.8)	(1.5)
Current account balance/CARs	(12.0)	(9.6)	(5.5)	(3.3)	(0.5)	(4.2)	(4.2)	(20.1)	(7.9)	(5.6)	(4.7)
CARs/GDP	34.0	33.8	32.5	32.5	32.7	32.6	32.6	25.9	31.8	32.5	32.7
Trade balance/GDP	(11.8)	(11.0)	(10.5)	(10.0)	(9.5)	(10.9)	(10.2)	(9.2)	(10.1)	(10.7)	(10.9)
Net FDI/GDP	3.2	3.3	3.1	3.2	4.5	3.0	3.4	1.4	2.7	3.1	3.1
Net portfolio equity inflow/GDP	2.9	2.2	4.9	2.3	2.2	3.2	2.5	1.0	2.0	2.2	2.2
Gross external financing needs/CARs plus usable reserves	115.2	111.9	116.8	104.7	100.0	101.0	98.6	105.0	102.3	100.3	103.7
Narrow net external debt/CARs	79.4	87.0	81.1	80.4	80.9	75.4	76.5	114.9	91.4	88.3	84.0
Narrow net external debt/CAPs	70.9	79.4	76.8	77.8	80.5	72.4	73.5	95.6	84.7	83.7	80.3

Table 1

Dominican Republic--Selected Indicators (cont.)

	2013	2014	2015	2016	2017	2018	2019	2020f	2021f	2022f	2023f
Net external liabilities/CARs	171.5	182.3	184.8	186.2	194.8	185.5	189.9	268.7	217.4	214.1	211.1
Net external liabilities/CAPs	153.1	166.4	175.1	180.3	193.8	178.1	182.4	223.7	201.4	202.8	201.7
Short-term external debt by remaining maturity/CARs	17.5	20.3	30.3	18.7	18.2	16.9	15.7	19.4	18.9	17.0	20.6
Usable reserves/CAPs (months)	1.3	1.8	1.9	1.9	2.2	2.3	2.5	3.3	2.7	2.5	2.4
Usable reserves (mil. $)	3,644	3,777	4,061	4,875	5,552	6,246	7,244	6,863	6,783	6,711	6,639
Fiscal indicators (general government; %)											
Balance/GDP	(5.4)	(5.0)	(4.5)	(4.0)	(4.3)	(3.7)	(3.4)	(6.9)	(4.9)	(3.9)	(3.9)
Change in net debt/GDP	6.8	4.0	3.3	5.4	5.8	5.4	6.6	8.2	6.0	5.0	5.0
Primary balance/GDP	(3.1)	(2.7)	(2.2)	(1.5)	(1.8)	(1.1)	(0.7)	(3.8)	(1.8)	(0.8)	(0.8)
Revenue/GDP	14.2	14.2	13.7	13.9	14.0	14.2	14.4	12.4	13.4	13.9	13.9
Expenditures/GDP	19.6	19.3	18.2	17.9	18.4	17.9	17.8	19.3	18.3	17.8	17.8
Interest/revenues	15.9	16.5	16.8	18.3	18.2	18.3	19.1	25.4	23.7	22.9	22.9
Debt/GDP	44.0	42.7	42.2	44.5	46.7	48.1	51.6	59.3	59.8	59.8	59.8
Debt/revenues	309.4	299.9	307.1	320.6	333.1	339.8	358.7	478.6	446.6	430.5	430.5
Net debt/GDP	41.7	41.3	41.0	43.1	45.3	46.1	49.4	57.1	57.8	58.0	58.1
Liquid assets/GDP	2.3	1.4	1.2	1.4	1.3	2.0	2.2	2.2	2.0	1.8	1.7
Monetary indicators (%)											
CPI growth	3.9	1.6	2.3	1.7	4.2	1.2	3.7	3.0	4.0	4.0	4.0
GDP deflator growth	4.7	4.3	2.5	2.0	4.2	4.1	2.5	3.0	4.0	4.0	4.0
Exchange rate, year-end (LC/$)	42.79	44.36	45.55	46.71	48.30	50.28	52.96	55.50	57.72	60.03	62.43
Banks' claims on resident non-gov't sector growth	14.9	19.9	17.9	12.0	11.5	10.4	9.8	0.9	10.2	9.2	9.2
Banks' claims on resident non-gov't sector/GDP	23.0	24.7	26.5	27.3	27.9	27.7	28.2	28.2	28.2	28.2	28.2
Foreign currency share of claims by banks on residents	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Foreign currency share of residents' bank deposits	39.2	40.8	40.2	39.7	35.2	36.9	34.2	34.2	34.2	34.2	34.2

Table 1

Dominican Republic--Selected Indicators (cont.)

	2013	2014	2015	2016	2017	2018	2019	2020f	2021f	2022f	2023f
Real effective exchange rate growth	(2.9)	(2.0)	2.8	(0.5)	(3.1)	(3.3)	(1.2)	(100)	N/A	N/A	N/A

Sources: Central Bank of Dominican Republic (economic indicators), Central Bank of Dominican Republic (external indicators), Ministry of Finance and Central Bank of Dominican Republic (fiscal indicators), and International Monetary Fund (monetary indicators).
Adjustments: Our GG debt data includes debt issued by the Central Bank, and excludes recapitalization bonds issued by Ministry of Finance. Our fiscal data includes the quasi-fiscal deficit from the Central Bank.
Definitions: 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.
N/A--Not applicable. LC--Local currency. CARs--Current account receipts. FDI--Foreign direct investment. CAPs--Current account payments. e--Estimate.
f--Forecast. 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.

Ratings Score Snapshot

Table 2

Dominican Republic--Ratings Score Snapshot

Key rating factor	Score	Explanation
Institutional assessment	5	Policy choices led to delays in the approval of structural reforms, which may weaken support for sustainable public finances and balanced economic growth.
Economic assessment	3	Based on GDP per capita and growth trends, per selected indicators in table 1.
		Weighted average real GDP per capita trend growth over a 10-year period is above sovereigns in the same GDP category.
External assessment	5	Based on narrow net external debt and gross external financing needs/(current account receipts plus usable reserves), per selected indicators in table 1.
		There is a risk of marked deterioration in the cost of or access to external financing, given that net external liabilities are significantly higher than narrow net external debt. The net external liability position is worse than the narrow net external debt position by over 100% of current account receipts, per selected indicators in table 1.
Fiscal assessment: flexibility and performance	5	Based on the change in net general government debt (% of GDP), per selected indicators in table 1.
Fiscal assessment: debt burden	5	Based on net general government debt (% of GDP) and general government interest expenditures (% of general government revenues), per selected indicators in table 1.
		Over 50% of gross government debt is denominated in foreign currency.
Monetary assessment	4	The exchange rate regime is a crawling peg, with the central bank intervening intermittently in foreign exchange markets.
		The central bank has a short track record of operational independence and uses market-based monetary instruments, such as open market operations. CPI as per selected indicators in table 1. The central bank has the ability to act as lender of last resort for the financial system.

Table 2

Dominican Republic--Ratings Score Snapshot (cont.)

Key rating factor	Score	Explanation
Indicative rating	bb-	
Notches of supplemental adjustments and flexibility	0	
Final rating		
Foreign currency	BB-	
Notches of uplift	0	Default risks do not apply differently to foreign- and local-currency debt
Local currency	BB-	

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, April 7, 2020
- Sovereign Ratings List, April 7, 2020
- Sovereign Ratings Score Snapshot, April 1, 2020
- The Escalating Coronavirus Shock Is Pushing 2020 Global Growth Toward Zero, March 30, 2020
- Stress Scenario: The Sovereigns Most Vulnerable To A COVID-19-Related Slowdown In Tourism, March 17, 2020
- S&P Global Ratings Cuts WTI And Brent Crude Oil Price Assumptions Amid Continued Near-Term Pressure, March 19, 2020
- Sovereign Debt 2020: Global Borrowing To Increase To $8.1 Trillion Amid Favorable Financing Conditions, Feb. 20, 2020
- Global Sovereign Rating Trends 2020: Sovereign Debt Buildup Continues, Jan. 29, 2020
- Dominican Republic's US$2.5 Billion Notes Rated 'BB-', Jan. 27, 2020
- Sovereign Risk Indicators. An interactive version is also available at http://www.spratings.com/sri

- Summary: Dominican Republic, April 16, 2019
- 2018 Annual Sovereign Default And Rating Transition Study, March 15, 2019

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; Outlook Action

	To	From
Dominican Republic		
Sovereign Credit Rating	BB-/Negative/B	BB-/Stable/B
Ratings Affirmed		
Dominican Republic		
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 S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.