

Research Update:

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

December 2, 2020

Overview

- The severe shock from the COVID-19 pandemic has exacerbated the Dominican Republic's fiscal, external, and debt risks, reducing the government's flexibility in responding to potential further external shocks.
- The new administration's strong mandate in Congress could allow for some progress on key structural reforms.
- We are affirming our 'BB-/B' sovereign credit ratings on the Dominican Republic.
- The negative outlook indicates our view that in the context of severe economic downturns, the long-standing inability to pass meaningful reforms could exacerbate external and fiscal weaknesses, as well as weaken economic recovery.

Rating Action

On Dec. 2, 2020, S&P Global Ratings affirmed its 'BB-' long-term foreign and local currency sovereign credit ratings on the Dominican Republic. The outlook remains negative. We also affirmed our 'B' short-term sovereign credit ratings. The transfer and convertibility (T&C) assessment remains 'BB+'.

Outlook

The negative outlook reflects our view that we could lower the ratings on the Dominican Republic over the next six to 18 months, given the severe impact of the COVID-19 pandemic on the sovereign's already vulnerable fiscal and external profiles, as well as the potential for a weaker-than-expected economic recovery.

Downside scenario

We could lower the ratings if the government is unable to pass reforms to curb the fiscal deficit,

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Research Update: Dominican Republic 'BB-/B' Ratings Affirmed; Outlook Remains Negative

which otherwise could lead to a substantial increase in external debt. We could also lower the ratings if the expected economic recovery is weaker, due to further external shocks, or if the COVID-19 pandemic and its related containment measures lower the country's potential economic growth.

Upside scenario

We could revise the outlook to stable over the next six to 18 months if risks of a more severe or prolonged crisis subside, the government is able to implement measures to ensure a structurally smaller fiscal deficit, and economic activity rebounds. We would also look for a longer record of demonstrated capacity to pass long-standing economic reforms.

Rationale

Our 'BB-' long-term ratings on the Dominican Republic reflect its fast-growing and resilient economy, which is vulnerable to external shocks. The country's sustained economic dynamism over the past decade has offset some of the sovereign's structural weaknesses. The ratings also reflect the Dominican Republic's likely better potential to return to high economic growth and alleviate recent external weaknesses compared with most rating peers.

Our ratings are constrained by the country's historical political challenges in passing structural reforms to contain large fiscal deficits. Weak debt and external profiles also constrain the ratings.

Institutional and economic profile: Reform outlook could improve under the new administration's strong mandate

- The new administration's strong mandate in Congress and high popularity could unlock some of the delayed reforms.
- The country's institutional assessment reflects its vibrant democracy and its historical challenges in passing timely reforms to contain fiscal and external vulnerabilities.
- Following a severe contraction in 2020, the country's economic diversification should sustain an economic rebound in 2021 and strong growth thereafter.

President Luis Abinader (Partido Revolucionario Moderno, or PRM) took office in August 2020 for a four-year term. His strong mandate could bode well for the reform outlook. The PRM has strong majorities in Congress and the Senate and holds most of the municipalities in the country. The president ran on a platform to improve transparency and anti-corruption policies, coupled with maintaining pro-business economic policies. While the government's immediate priority has been dealing with the health emergency, following his campaign promises, the president appointed an independent prosecutor, and his government has taken important steps to dismantle the highly inefficient energy utilities conglomerate Dominican Corporation of State Electrical Companies.

That said, the difficulties prior governments have had in passing reforms have translated into a deterioration of the country's fiscal and external profiles over the last decade. In the past, high economic growth lowered the sense of urgency for passing reforms. However, the recent severe recession has highlighted the country's fiscal and external vulnerabilities. The new administration faces the challenge of addressing the impact of the economic shock in 2020, as well as the social discontent that stems from alleged corruption and public-sector inefficiencies over the years.

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The global spread of COVID-19 is having unprecedented implications for the Dominican Republic's economy, particularly in tourism. In addition to the human costs, the pandemic will reduce GDP by 6.5% in 2020 and lower per capita GDP to about \$7,600.

The Dominican Republic's growth prospects continue to compare positively with its peers with a similar level of economic development. Our base case assumes the impact of COVID-19 will be transitory, with the economy bouncing back to growth of 5% in 2021-2023. The recovery will likely be helped by the country's economic diversification. Tourism, one of the economic pillars of the country, will most likely lag behind other sectors in the recovery, fully recovering only when COVID-19 vaccines become generally available. The ongoing recovery in construction, manufacturing, mining, and exports from free-trade zones could allow for a faster reactivation in coming years. However, our forecasts are subject to downside risks, given the uncertainty about both the extent of the COVID-19 pandemic and its economic implications.

To contain the spread of the virus, the country imposed mandatory quarantines and curfews, temporarily closing borders during the second quarter. The government is currently implementing protocols to allow for a broader economic reactivation, including bolstering the health system and keeping high testing rates.

Flexibility and performance profile: A rapid buildup in external debt is narrowing fiscal flexibility ahead of further potential external shocks

- The fiscal deficit and debt have spiked in 2020 as the government implemented a fiscal package to mitigate the impact of the pandemic.
- Sizable external borrowings are weakening the sovereign's external profile and limiting the fiscal policy flexibility ahead of further external shocks.
- We expect only a marginal deterioration of the current account deficit (CAD) as the sharp fall in tourism receipts is being compensated by high remittances and a significant correction in imports.

The government's fiscal response to the pandemic has focused on subsidies to suspended formal employees, direct money transfers aimed at the large share of informal workers, and various tax relief measures. We estimate the cost of the countercyclical measures at 4% of GDP. In our view, higher spending, along with revenue losses due to the recession, will likely boost the general government deficit in 2020, approaching 11% of GDP. Our definition of general government includes the central government and the central bank quasi-fiscal deficit.

We expect the government to narrow its fiscal deficits only gradually as it rolls back the COVID-19-related programs deployed this year, revenue recovers with higher economic activity, and the government reduces losses in the energy sector. We project general government deficits to fall toward 5% of GDP over 2021-2023, of which around 1% of GDP corresponds to the central bank quasi-fiscal deficit. The government has acknowledged the need for a fiscal reform and plans to introduce it in 2021. A successful reform would likely be an upside for fiscal consolidation.

The government will continue to finance its fiscal deficits largely through external borrowings, mainly in the debt market but some from multilateral institutions. Despite some deepening in recent years, shallow domestic markets limit its capacity to raise debt internally.

We expect the change in net general government debt to spike to about 12.5% of GDP in 2020 and to decline to 5% in 2022-2023. The sovereign's net debt (which includes the central bank's debt) is expected to reach over 60% of GDP in 2021, up from 49% of GDP in 2019 and 32% of GDP in 2010.

Research Update: Dominican Republic 'BB-/B' Ratings Affirmed; Outlook Remains Negative

In our view, the rapid buildup in debt, a result of fiscal weaknesses, diminishes the sovereign's buffers to deal with potential external shocks. The net debt stock includes central bank certificates (14% of GDP) and excludes the bonds that the central government issued to capitalize the central bank (3% of GDP) following the 2003-2004 bailout of the banking sector. Higher debt will keep interest payments high, at an average of 25% of general government revenue over the next three years, also reflecting the country's low tax burden. This ratio captures the interest paid to the central bank (2.5% of general government revenue) as a result of its quasi deficit.

The sovereign has tapped international markets at favorable rates to cover its borrowing needs. It has issued US\$6.3 billion this year at a comparable rate to its prior issuances. That said, the historical reliance on international markets results in vulnerability to currency depreciation, given foreign currency denominated debt is about 60% of total debt.

The rise in external debt, combined with a sharp decline in current account receipts (CARs), has worsened the country's external profile. We project narrow net external debt to spike toward 115% of CARs, from 82% in 2019, and remain above 100% over the next three years. Furthermore, the Dominican Republic could be vulnerable to sudden changes in foreign direct investment (FDI) flows, since net external liabilities, which include the high stock of FDI in the country, account for about 230% of CARs. FDI inflows are likely to drop modestly in 2020 but still fully fund the CAD. On the other hand, external liquidity has remained relatively strong during the current recession, and the central bank has been increasing usable reserves, which currently account for about 12% of GDP. As a result, we expect the country's gross external financing needs to remain about 87% of CARs plus usable reserves during 2020-2023.

Despite the sharp fall in tourism inflows in 2020, the country has benefited from substantially higher remittances and a sizable correction in imports. The CAD is likely to increase marginally in 2020, to about 2.5% of GDP, and gradually narrow in coming years as manufacturing exports from free-trade zones and tourism recover. The significant share of Dominicans living and working abroad, coupled with the fiscal packages deployed in the U.S., have led to a substantial increase in remittances, which we expect to hike about 15% in 2020. Gold exports, which historically accounted for 6% of total CARs, are also helping to mitigate the impact on lost tourism. Furthermore, lower oil prices, coupled with a significant fall in other imports, have contained the external deficit. We expect the CAD to continue being fully financed by FDI, which we project at 3.5% of GDP in 2020-2023.

The central bank has eased monetary conditions and implemented a monetary package of 4% of GDP. Among other measures, it cut monetary policy rates, reduced reserve requirements, and provided liquidity lines to banks. Since 2012, when the central bank became operationally independent, inflation has remained below its target range (4% plus or minus 1%). We expect inflation to temporarily increase due to short-term pressures, but to remain within the target in the coming years. Still, we consider monetary policy to be constrained by the central bank's quasi-fiscal losses, a low level of domestic credit (about 30% of GDP), and shallow domestic debt and capital markets. A memorandum of understanding signed by the Finance Ministry and the central bank could allow for a gradual recapitalization of the bank over the next seven years, easing the central government's interest burden and strengthening its policy tools.

We consider banking-sector contingent liabilities to be limited, given the sector's total assets are estimated at less than 50% of GDP. The financial sector is concentrated in a few large banks, which we consider to be systemic and have stronger capital and liquidity ratios. Since the last banking crisis in 2003, the central bank has improved regulation and financial sector oversight.

Key Statistics

Table 1

Dominican Republic--Selected Indicators

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
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	4,423.52	4,876.93	5,351.21	5,843.52
Nominal GDP (bil. \$)	62.68	67.18	71.16	75.70	80.00	85.56	88.94	79.02	80.64	84.48	88.49
GDP per capita (000s \$)	6.4	6.8	7.1	7.5	7.9	8.3	8.6	7.6	7.7	7.9	8.3
Real GDP growth	4.9	7.1	6.9	6.7	4.7	7.0	5.1	(6.5)	5.0	5.0	5.0
Real GDP per capita growth	3.8	6.0	5.9	5.7	3.7	6.0	4.1	(7.3)	4.1	4.1	4.1
Real investment growth	(2.5)	9.3	18.9	12.3	(0.3)	13.3	8.1	(12.7)	10.3	9.7	9.2
Investment/GDP	22.7	23.1	23.4	23.0	22.5	25.8	26.0	24.1	24.1	24.1	24.1
Savings/GDP	18.6	19.9	21.6	21.9	22.3	24.4	24.6	21.6	21.6	22.4	22.6
Exports/GDP	25.2	25.2	23.8	23.9	23.7	23.6	23.1	16.9	21.3	23.5	23.7
Real exports growth	9.0	8.7	3.1	7.5	4.9	6.1	1.5	(31.6)	32.7	15.5	6.2
Unemployment rate	15.0	14.5	15.2	14.1	12.7	11.2	10.8	15.0	14.0	13.0	12.0
External indicators (%)											
Current account balance/GDP	(4.1)	(3.2)	(1.8)	(1.1)	(0.2)	(1.4)	(1.4)	(2.5)	(2.5)	(1.7)	(1.5)
Current account balance/CARs	(12.0)	(9.6)	(5.5)	(3.3)	(0.5)	(4.2)	(4.2)	(8.7)	(7.7)	(5.1)	(4.4)
CARs/GDP	34.0	33.8	32.5	32.5	32.7	32.6	32.6	29.0	32.3	34.2	34.3
Trade balance/GDP	(11.8)	(11.0)	(10.5)	(10.0)	(9.5)	(10.9)	(10.2)	(8.2)	(10.3)	(11.0)	(11.1)
Net FDI/GDP	3.2	3.3	3.1	3.2	4.5	3.0	3.4	3.5	3.5	3.5	3.5
Net portfolio equity inflow/GDP	(0.0)	(0.0)	(0.1)	0.3	0.0	(0.5)	(0.3)	0.0	0.0	0.0	0.0
Gross external financing needs/CARs plus usable reserves	105.4	103.0	103.5	92.7	88.2	90.2	89.6	87.1	87.5	86.5	88.8
Narrow net external debt/CARs	92.3	90.0	84.1	83.3	83.5	77.9	81.9	112.8	102.7	100.3	101.5
Narrow net external debt/CAPs	82.4	82.2	79.7	80.6	83.1	74.8	78.6	103.7	95.4	95.5	97.2

Research Update: Dominican Republic 'BB-/B' Ratings Affirmed; Outlook Remains Negative

Table 1

Dominican Republic--Selected Indicators (cont.)

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Net external liabilities/CARs	184.3	185.3	187.8	189.1	197.4	187.9	193.0	265.2	247.5	240.9	245.8
Net external liabilities/CAPs	164.5	169.2	178.0	183.0	196.4	180.4	185.3	243.9	229.9	229.3	235.4
Short-term external debt by remaining maturity/CARs	6.5	9.9	14.9	4.7	4.1	4.0	4.8	5.9	4.9	3.9	6.1
Usable reserves/CAPs (months)	1.3	1.8	1.9	1.9	2.2	2.3	2.5	3.5	3.2	3.0	2.8
Usable reserves (mil. \$)	3,644	3,777	4,061	4,875	5,552	6,246	7,244	7,470	7,517	7,420	7,319
Fiscal indicators (general government; %)											
Balance/GDP	(6.8)	(4.9)	(4.4)	(3.9)	(4.2)	(3.6)	(3.4)	(10.9)	(6.4)	(4.4)	(3.4)
Change in net debt/GDP	6.7	4.0	3.3	5.4	5.8	5.4	6.6	12.5	9.6	5.8	4.7
Primary balance/GDP	(4.5)	(2.6)	(2.1)	(1.3)	(1.7)	(1.0)	(0.7)	(7.4)	(2.8)	(0.8)	0.2
Revenue/GDP	14.1	14.2	13.7	13.9	14.0	14.2	14.4	13.4	13.9	14.4	14.9
Expenditures/GDP	20.8	19.2	18.1	17.7	18.2	17.7	17.8	24.3	20.3	18.8	18.3
Interest/revenues	16.1	16.5	16.8	18.3	18.2	18.3	19.1	26.7	26.4	25.3	24.1
Debt/GDP	44.0	42.7	42.2	44.5	46.7	48.1	51.6	67.2	68.9	68.6	67.5
Debt/revenues	312.6	299.9	307.1	320.6	333.1	339.8	358.7	501.6	495.8	476.7	453.2
Net debt/GDP	41.7	41.3	41.0	43.1	45.3	46.1	49.4	63.5	67.2	67.0	66.1
Liquid assets/GDP	2.3	1.4	1.2	1.4	1.3	2.0	2.2	3.7	1.7	1.6	1.5
Monetary indicators (%)											
CPI growth	4.8	3.0	0.8	1.6	3.3	3.6	1.8	3.7	5.0	4.5	4.0
GDP deflator growth	4.7	4.3	2.5	2.0	4.2	4.1	2.5	3.7	5.0	4.5	4.0
Exchange rate, year-end (LC/\$)	42.79	44.36	45.55	46.71	48.30	50.28	52.96	59.00	61.95	64.74	67.33
Banks' claims on resident non-gov't sector growth	14.9	19.9	17.9	12.0	11.5	10.4	9.9	4.5	10.3	9.7	9.2
Banks' claims on resident non-gov't sector/GDP	23.0	24.7	26.5	27.3	27.9	27.7	28.3	30.5	30.5	30.5	30.5
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	36.3	41.2	41.2	41.2	41.2

Research Update: Dominican Republic 'BB-/B' Ratings Affirmed; Outlook Remains Negative

Table 1

Dominican Republic--Selected Indicators (cont.)

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Real effective exchange rate growth	(2.9)	(2.0)	2.8	(0.5)	(3.1)	(3.3)	(1.2)	(100.0)	N/A	N/A	N/A

Adjustments: Our GG debt data includes debt issued by the central bank and excludes recapitalization bonds issued by the 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 claims on 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. 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. Sources: Central Bank of Dominican Republic (economic indicators, external indicators), Ministry of Finance and Central Bank of Dominican Republic (fiscal indicators), and International Monetary Fund (monetary indicators).

Ratings Score Snapshot

Table 2

Dominican Republic--Ratings Score Snapshot

Key rating factors	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	6	Based on net general government debt (% of GDP) and general government interest expenditure (% of general government revenue), 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 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 a lender of last resort for the financial system.
Indicative rating	b+	

Table 2

Dominican Republic--Ratings Score Snapshot (cont.)

Key rating factors	Score	Explanation
Notches of supplemental adjustments and flexibility	1	We consider the external shock to be transitory, and it could be reverted over the medium term. Furthermore, the insititutional assessment could be in a positive transition, given the current reform outlook.
Final rating		
Foreign currency	BB-	
Notches of uplift	0	Default risks do not apply differently to foreign currency 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: Principles Of Credit Ratings, Feb. 16, 2011
- General Criteria: Methodology: Criteria For Determining Transfer And Convertibility Assessments, May 18, 2009

Related Research

- Sovereign Ratings History, Nov. 9, 2020
- Sovereign Ratings List, Nov. 9, 2020
- Sovereign Ratings Score Snapshot, Nov. 2, 2020
- Dominican Republic's US\$3.8 Billion Notes Rated 'BB-', Sept. 21, 2020
- 2019 Annual Sovereign Default And Rating Transition Study, May 18, 2020
- Dominican Republic Outlook Revised To Negative On Increased External And Debt Risks; 'BB-/B' Ratings Affirmed, April 16, 2020
- Stress Scenario: The Sovereigns Most Vulnerable To A COVID-19-Related Slowdown In Tourism, March 17, 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

Research Update: Dominican Republic 'BB-/B' Ratings Affirmed; Outlook Remains Negative

- Sovereign Risk Indicators. An interactive version is also available at <http://www.spratings.com/sri>

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-/Negative/B
Transfer & Convertibility Assessment	
Local Currency	BB+

Dominican Republic

Senior Unsecured	BB-
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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.

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