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RESEARCH UPDATE

Dominican Republic Ratings Raised To 'B+/B' From 'B/B'; Outlook Stable

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Overview

- The Dominican Republic has made progress improving its debt management and growth prospects as well as in advancing structural reforms.
- As a result, we have raised the local- and foreign-currency sovereign credit ratings on the republic to 'B+/B' from 'B/B'.
- The stable outlook balances the country's stronger growth prospects with its lack of progress in addressing economic, fiscal, and institutional rigidities.

Rating Action

On June 13, 2011, Standard & Poor's Ratings Services raised its local- and foreign-currency sovereign credit ratings on the Dominican Republic to 'B+/B' from 'B'/B'. The outlook is stable. At the same time, Standard & Poor's raised its transfer and convertibility assessment on the Dominican Republic to 'BB' from 'BB-'. The recovery rating remains at '3'.

Rationale

The upgrade reflects the country's progress in gradually improving its debt structure and debt management; its stronger growth and export prospects; its advancements in structural reforms, especially in the financial sector; and a general improvement in policymaking transparency and predictability. Nevertheless, many structural and institutional inefficiencies remain unaddressed, and the execution risks related to weak institutions and the politization of decision-making persist.

The Dominican Republic's economy remains resilient. Real GDP growth—at 7.8% in 2010 and averaging 6.6% since the last crisis of 2003—reflects expansion in all major economic sectors. Higher exports, including the rebound in the maquila industry, as well as

solid investment and consumption growth propelled the economy. The reopening of the Falconbridge nickel mine in 2010 and the expectation of the largest (more than US$3 billion) foreign investment project in the country, Barrick Gold, coming on stream in 2012 should meaningfully strengthen the country's external accounts and growth prospects.

We expect the Dominican Republic's real GDP to be 5.5% this year, and medium-term growth of 4%-5% is feasible. In the electricity sector, reform challenges persist, but managerial changes—together with specific quantitative benchmarks set as part of the International Monetary Fund (IMF) stand-by program—are bearing positive results. Meaningful advancement in this sector will only be gradual because it depends on the depolitization of decision-making, the improvement of payment culture, and the strengthening of the institutional framework.

Despite buoyant economic growth, fiscal challenges persist, as revenue collection lags behind the economic expansion. The Dominican Republic's tax system needs a reform to generate higher revenue collection, which could support the country's large spending needs, especially in the social and capital infrastructure areas. Following the countercyclical policy effected in 2009 and the first half of 2010, the government is facing a challenge to consolidate its fiscal accounts this year. As of both Dec. 31, 2010, and March 31, 2011, the government had not met several performance criteria of the 28-month US$1.7 billion stand-by arrangement approved in November 2009, particularly those related to the electricity sector. However, it has implemented most structural measures. Nevertheless, the government and the IMF agreed on the key measures for the rest of 2011. The final assessment of the fifth and sixth reviews is forthcoming.

To comply with the fiscal-consolidation goal, the government raised electricity tariffs (by 8% effective June 2011, after an 11% increase in late 2010) and committed to cut nonsocial spending by 12% starting in April 2011. In addition, at the end of May 2011, the president sent to Congress a number of tax measures to reverse the declining trend in tax collections. We expect the general government deficit to be 3% of GDP this year (including 0.8% of recapitalization costs). Net general government debt is expected to be 36% of GDP during the forecast period.

The Dominican Republic's fiscal performance in 2012 will be influenced by the election dynamic. Presidential elections are due in May 2012. We do not expect drastic shifts in policymaking regardless of the election outcome, but fiscal slippage is likely (general government deficit is forecasted at 3.3% of GDP that year). Also, more divided decision-making is possible if the PRD (Partido Revolucionario Dominicano) candidate, Hipolito Mejia, wins the presidency, in which case he would have to work with the Partido de la Liberación Dominicana (PLD)-dominated legislature.

The Dominican Republic's external profile remains weak but has improved substantially over the years because of the build-up in international reserves. Useable reserves cover 1.5 months of current account payments in 2011, and we expect the liquidity ratio to come down to 124%. The external profile should strengthen going forward as gold and ferronickel exports from the country's two major mining projects come on stream in 2011-2012.

Outlook

The stable outlook balances the Dominican Republic's solid growth and export prospects, which should help with further fiscal consolidation and strengthening of the country's currently weak liquidity profile, on one hand against the weak institutions, lack of progress in addressing structural rigidities in the economy, fiscal accounts, and on the monetary front on the other hand. An advance in addressing

the structural deficiencies in the electricity sector, improving tax-system efficiency, and improving the external profile would bolster the sovereign's creditworthiness. On the other hand, fiscal slippage, which would likely exacerbate the external vulnerability, would be a negative and could put pressure on the rating, especially if the political willingness to reverse the slippage is lacking.

Related Criteria And Research

- Sovereign Credit Ratings: A Primer, May 29, 2008.

Ratings List

Upgraded

	To	From
Dominican Republic		
Sovereign Credit Rating	B+/Stable/B	B/Positive/B
Senior Unsecured	B+	B
Recovery Rating	3	3
Transfer & Convertibility Assessment	BB	BB-

Complete ratings information is available to subscribers of RatingsDirect, Standard & Poor's Web-based credit analysis system, at www.ratingsdirect.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com; under Credit Ratings in the left navigation area, select Find a Rating, then Credit Ratings Search.

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