Standard & Poor's revised its outlook on the Dominican Republic to Positive; confirms rating in 'B'

Summary

- The Dominican Republic's economic performance surpassed expectations in 2009, with the country recording the highest GDP growth rate in Latin and Central America.
- In addition, the 28-month standby agreement with the International Monetary Fund, which the Dominican Republic signed in November 2009, creates an important framework for maintaining fiscal discipline while addressing long-standing structural challenges.
- As a result, we have revised the outlook on the Dominican Republic to positive from stable to reflect the country's solid growth prospects, improvement in debt management, and stronger managerial leadership within the electricity sector.
- We have also affirmed the 'B' long-term and 'B' short-term foreign- and local-currency sovereign credit ratings on the republic.

Rating Action

NEW YORK (Standard & Poor's) May 5, 2010--Standard & Poor's Ratings Services said today that it revised its outlook on the Dominican Republic to positive from stable. Standard & Poor's also said that it affirmed its 'B' long-term and 'B' short-term foreign- and local-currency sovereign credit ratings on the country. The transfer and convertibility assessment remains at 'BB-', and the recovery rating on the Dominican Republic's unsecured debt is unchanged at '3'.

Fundamentals

"The revision of the outlook to positive reflects our expectation that the Dominican Republic's macroeconomic fundamentals will gradually strengthen," explained Standard & Poor's credit analyst Olga Kalinina. "In addition, we expect that the country will have a more transparent economic strategy, including specific policy and implementation benchmarks, and improved decision-making."

So far, the country has achieved the most progress in its domestic debt management. The debt-management office was successful in re-establishing and deepening the government debt market, with maturities extending up to seven years. We consider the broadening of the investor base (which now includes local pension funds) in domestic debt to be a positive credit factor.

In the electricity sector, reform challenges persist, but managerial changes--together with specific quantitative benchmarks set as part of the 28-month 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.

The Dominican Republic's economy remains resilient, with 3.5% growth in 2009. We expect that real GDP will be 4.3% in 2010 and 5% in 2011-2012, based on the recovery in tourism, the ongoing investment by Barrick Gold, and an export boost related to Dominican Republic's assistance in Haiti's reconstruction.

However, the Dominican Republic's fiscal performance in 2009 did not benefit from the economic growth, as collapsed imports and lower incomes hurt tax income. The general government deficit was 4.5% of GDP in 2009, down from 5% in 2008. It reflected financing constraints in the first three quarters of the year and the start of countercyclical fiscal policy in the last quarter. The expansionary policy is designed (according to the IMF agreement) to continue through the first half of 2010, after which the government has committed to start fiscal consolidation. As a result, we expect that the general government deficit will be 3.5% of GDP this year, declining to 2.9% in 2011. Net general government debt will likely have peaked at 35% of GDP in 2009 and now should decline based on strong growth and fiscal consolidation.

Finally, the US$1.66 billion, 28-month agreement with the IMF (equivalent to 500% of the Dominican Republic's quota), with US$422 million already disbursed, is an important anchor for the country's fiscal and structural targets.

Outlook

"The positive outlook reflects our expectation that the Dominican Republic's macroeconomic fundamentals will gradually strengthen because of the combination of strong growth prospects and its commitment to adhere to fiscal and structural benchmarks in the context of the IMF stand-by program," Ms. Kalinina added. Nevertheless, the execution risks related to weak institutions and the politization of decision-making remain. Deviations from the fiscal and structural benchmarks established with the IMF would undermine policy credibility and damage the country's creditworthiness. On the other hand, the gradual improvement in fiscal position--along with progress on the structural reform agenda--could lead us to consider an upgrade. Specifically, improvements in the electricity sector will be an important indicator of the government's willingness and ability to tackle difficult reforms.

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