Research Update:

Dominican Republic Outlook Revised To Stable From Negative; 'BB-' Ratings Affirmed

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Overview

- An impressive economic recovery has reversed the external deterioration from the COVID-19 shock and strengthened the country's external buffers.
- Rapid GDP growth, strong revenue collection, and the inability to fully execute public works have contained fiscal risks.
- We affirmed our 'BB-/B' sovereign credit ratings on the Dominican Republic.
- The stable outlook balances our view of the country's impressive economic dynamism and ability to quickly rebound from external shocks with its weak public finances and shortcomings in its institutional assessment, as shown by repeated delays in passing meaningful tax reforms.

Rating Action

On Dec. 2, 2021, S&P Global Ratings revised its outlook on the Dominican Republic to stable from negative. We also affirmed our 'BB-' long-term foreign and local currency sovereign credit ratings and our 'B' short-term sovereign credit ratings. The transfer and convertibility (T&C) assessment remains 'BB+'.

Outlook

The stable outlook reflects our expectation of continued favorable GDP growth and policy continuity over the next 12 to 18 months that will likely stabilize the government's debt burden, despite lack of progress with broader tax reforms. A rapid economic recovery from the downturn because of the pandemic should mitigate external and fiscal risks.

Downside scenario

We could lower the ratings over the next 12 to 18 months if some of the recent positive trends were to lose momentum, potentially resulting in structurally weaker economic growth or a worsening

external profile. That could result in unexpectedly higher fiscal deficits and a worse debt burden, leading to a downgrade.

Upside scenario

We could raise the ratings over the next 12 to 18 months if there were a forceful track record of demonstrated capacity to implement fiscal and other reforms that bolster the sovereign's institutionality. We could also raise the ratings if a combination of good GDP growth and improved fiscal performance results in a structurally smaller fiscal deficit that reduces the sovereign's debt and interest burden.

Rationale

Our 'BB-' long-term ratings on the Dominican Republic reflect its fast-growing and resilient economy. Despite its vulnerability to external shocks, the country has achieved an impressive economic recovery following the latest unprecedented shock. The recovery has corrected some of the sovereign's external and fiscal weaknesses.

The ratings also incorporate the country's historical political and social challenges in passing structural reforms to contain fiscal deficits and improve public-sector finances, despite recent improvements in the electricity sector. The ratings are constrained by relatively high debt, approaching 60% of GDP; a hefty interest burden at 19% of government revenues; and the country's limited monetary policy flexibility.

Institutional and economic profile: An impressive economic recovery is mitigating the risks of long-standing delays in passing structural reforms

- The Dominican economy is posting an impressive recovery, already surpassing pre-pandemic income and set to resume its long-term trend growth by 2022.
- Economic growth is mainly the result of private investment, construction, manufacturing in free-trade zones, and a strong tourism recovery.
- The government's strong mandate in Congress and high popularity have paved the way for some structural reforms, despite the decision to delay a long-standing tax reform.

The Dominican Republic's economy is posting an impressive economic recovery, following the severe impact of the pandemic. Backed by private-sector investment and a recovery in tourism, GDP is set to grow about 11% in 2021, after contracting 6.7% in 2020. As a result, per capita GDP returned to its pre-pandemic level of about $8,800 by mid-2021. We expect trend GDP growth to be 5% over the next three years.

Tourism, one of the pillars of the economy, is recovering much faster than expected, backed by a strong COVID-19 vaccination campaign. Monthly arrivals already exceed pre-pandemic levels of 2019, suggesting a full recovery by the end of the year. Furthermore, ongoing private investment, construction, domestic consumption (helped by remittances), and manufacturing from free-trade zones are driving economic reactivation.

The rapid recovery highlights the Dominican Republic's economic dynamism, compared with peers with a similar level of development. Our base case assumes GDP will grow 6% in 2022, as tourism fully recovers, and by about 5% afterwards, driven by private-sector investment.

Having said that, S&P Global Ratings believes the new omicron variant is a stark reminder that the COVID-19 pandemic is far from over. Although already declared a variant of concern by the World Health Organization, uncertainty still surrounds its transmissibility, severity, and the effectiveness of existing vaccines against it. Early evidence points toward faster transmissibility, which has led many countries to close their borders with Southern Africa or reimpose international travel restrictions. Over coming weeks, we expect additional evidence and testing will show the extent of the danger it poses to enable us to make a more informed assessment of the risks to credit. Meanwhile, we can expect a precautionary stance in markets, as well as governments to put into place short-term containment measures. Nevertheless, we believe this shows that, once again, more coordinated, and decisive efforts are needed to vaccinate the world's population to prevent the emergence of new, more dangerous variants.

An inability to pass and implement difficult fiscal- and energy-sector reforms contributed to a deterioration in public finances over the past decade, despite better GDP growth than in most countries at a similar level of development. However, the administration of President Luis Abinader of the Partido Revolucionario Moderno (PRM) was able to advance important structural reforms. For example, it secured approval of the Electricity Pact in early 2021 (the pact was initially presented in 2017). The pact has led to the full dismantling of the inefficient energy utility conglomerate and started a gradual increase in electricity tariffs, which were frozen for 10 years. Furthermore, there have been reforms to the judiciary, education, and police force, among others. Nonetheless, the government's recent decision to postpone a long-standing reform aimed at broadening the tax base and increasing revenues demonstrates shortcomings in its ability to undertake forceful and timely measures to strengthen public finances. We expect that the Abinader Administration, which enjoys a working majority in both chambers of Congress and governs most municipalities, will pursue pro-investment policies and minor steps to boost tax revenues and contain spending.

Despite economic recovery, the country's social indicators remain relatively weak and have been affected by the pandemic. Poverty will fall this year and remain around 20%. The rate of informality in the labor market has risen recently to about 60%.

Flexibility and performance profile: External and fiscal buffers have been rebuilt following a severe shock from the COVID-19 pandemic

- Rising foreign currency inflows from tourism, rising exports, record-high remittances, and long-term foreign direct investment have reduced external debt vulnerabilities.
- Higher government revenue collection and an inability to fully execute public works are reducing the fiscal deficit and stabilizing the debt burden.
- The central bank has started monetary policy normalization following a spike in inflation.

The rapid economic recovery has contained external vulnerabilities, which had worsened during the pandemic. We expect current account deficits (CAD) to stabilize around 2% of GDP over the next two years as tourism fully recovers and extraordinarily high remittances normalize. We expect the CAD to continue being fully financed by foreign direct investment (FDI), projected at 3.2% of GDP in 2021-2024.

The improved external profile is due to higher current account receipts (CARs), lower government financing needs, and recent exchange-rate appreciation. We now project narrow net external debt to decrease toward 87% of CARs in 2021-2024, similar to pre-pandemic levels and down from a peak of 116% in 2020. Nonetheless, the Dominican Republic remains exposed to sudden changes

in FDI flows since net external liabilities, which include the high inward stock of FDI, account for about 200% of CARs. External liquidity has remained relatively stable recently as central bank foreign exchange reserves currently exceed 13% of GDP. As a result, we expect the country's gross external financing needs to remain about 85% of CARs plus usable reserves during 2021-2024.

The government has achieved strong fiscal consolidation in 2021, following a steep hike in its fiscal deficit and debt in 2020. Government revenues have recovered rapidly in line with an impressive economic recovery, while expenditures have remained curtailed by the inability to fully execute public works. The government has also shifted its broad-based extraordinary subsidies introduced during the pandemic into targeted transfers to the most vulnerable. We project the general government deficit to narrow to 4.2% of GDP this year (from 9.3% in 2020) and to slightly decrease over the forecast horizon. Our definition of general government includes the central government and the central bank quasi-fiscal deficit, which accounts for 1.0%-1.5% of GDP.

We do not project a substantial increase in government revenues (as a share of GDP) over the coming years, given the decision to postpone a tax reform. However, steps to improve public-sector efficiency, reduce nonessential spending, and to cut energy subsidies to distribution companies through quarterly electricity tariff adjustments could narrow the consolidated fiscal deficit.

We expect the government to continue financing its fiscal deficits largely through external borrowings, mainly in international debt markets but also with official creditors. Despite some deepening in recent years, shallow domestic markets limit the government's capacity to raise debt internally.

As a result of fiscal consolidation efforts and exchange-rate appreciation this year, we expect the change in net general government debt to narrow significantly to 3.4% of GDP in 2021-2024, after having reached 15.1% in 2020. We expect the sovereign's net debt to stabilize just below 60% of GDP over the forecast horizon. The net debt stock includes central bank certificates (15% of GDP) and excludes the bonds that the central government issued to capitalize the central bank (3% of GDP) following the 2003-2004 bailout to the banking sector. Furthermore, the historical reliance on international markets results in vulnerability to currency depreciation, given that central government debt in foreign currency is about 70% of total debt.

We project interest payments to decline to around 19% of general government revenues in 2021-2024, from 23% in 2020, as a result of higher tax collections and active liability management operations to reduce the cost of debt. The government successfully refinanced its domestic and international debt for around $2.4 billion maturing between 2021 and 2027. Our interest payment ratio incorporates the interest paid to the central bank as a result of its quasi-fiscal deficit, which stands around 2% of general government revenue.

The central bank has begun tightening monetary policy as inflation increased due to higher energy and food prices. The bank increased its policy rates to 3.5% in November 2021 after keeping them at 3% throughout the pandemic. It also started reducing the extraordinary liquidity injected to the financial sector to withstand the external shock. We expect inflation to remain within the central bank's target in the coming years (4% plus or minus 1%).

The effectiveness of monetary policy is 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. An ongoing negotiation between the Finance Ministry and the central bank could allow for a gradual recapitalization of the bank over the medium term, easing the central government's interest burden and strengthening its policy tools.

We consider banking-sector contingent liabilities to be limited, given its relatively small size, estimated at 58% of GDP. The financial sector is concentrated in a few large banks, which we

consider to be systemic and have strong 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

	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Economic indicators (%)										
Nominal GDP (bil. LC)	3,205.66	3,487.29	3,802.66	4,235.85	4,562.24	4,456.66	5,342.64	6,002.99	6,555.27	7,158.35
Nominal GDP (bil. $)	71.16	75.70	80.00	85.56	88.94	78.84	92.65	102.25	106.37	111.69
GDP per capita (000s $)	7.1	7.5	7.9	8.3	8.6	7.5	8.8	9.6	9.9	10.3
Real GDP growth	6.9	6.7	4.7	7.0	5.1	(6.7)	11.0	6.0	5.0	5.0
Real GDP per capita growth	5.9	5.7	3.7	6.0	4.1	(7.5)	10.0	5.1	4.1	4.1
Real investment growth	18.9	12.3	(0.3)	13.3	8.1	(12.1)	11.6	6.5	5.5	5.5
Investment/GDP	23.4	23.0	22.5	25.8	26.0	25.4	27.5	27.6	27.8	27.9
Savings/GDP	21.6	21.9	22.3	24.3	24.7	23.4	25.4	25.6	26.2	26.2
Exports/GDP	23.8	23.9	23.7	23.6	23.1	18.3	21.2	21.9	21.7	21.2
Real exports growth	3.1	7.5	4.9	6.1	1.5	(30.3)	28.8	9.6	3.8	2.9
Unemployment rate	15.2	14.1	12.7	11.2	10.8	15.0	14.0	13.0	12.0	12.0
External indicators (%)										
Current account balance/GDP	(1.8)	(1.1)	(0.2)	(1.5)	(1.3)	(2.0)	(2.1)	(2.0)	(1.5)	(1.7)
Current account balance/CARs	(5.5)	(3.3)	(0.5)	(4.7)	(4.1)	(6.5)	(6.1)	(6.2)	(4.8)	(5.3)
CARs/GDP	32.5	32.5	32.7	32.7	32.7	30.1	33.8	32.2	31.9	31.4
Trade balance/GDP	(10.5)	(10.0)	(9.5)	(11.2)	(10.2)	(8.6)	(12.6)	(12.0)	(11.6)	(11.7)
Net FDI/GDP	3.1	3.2	4.5	3.0	3.4	3.2	3.2	3.2	3.2	3.2
Net portfolio equity inflow/GDP	(0.1)	0.3	0.0	(0.5)	(0.4)	(0.8)	0.0	0.0	0.0	0.0
Gross external financing needs/CARs plus usable reserves	103.5	92.7	88.2	90.7	89.6	89.7	86.5	83.8	85.1	86.7
Narrow net external debt/CARs	84.1	83.3	83.5	78.4	84.9	116.5	86.1	84.3	87.5	90.5

Table 1

Dominican Republic--Selected Indicators (cont.)

	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Narrow net external debt/CAPs	79.7	80.6	83.1	74.8	81.6	109.4	81.1	79.3	83.5	85.9
Net external liabilities/CARs	187.8	189.1	197.4	187.9	194.0	250.5	194.0	196.7	206.8	216.3
Net external liabilities/CAPs	178.0	183.0	196.4	179.5	186.4	235.2	182.8	185.2	197.4	205.5
Short-term external debt by remaining maturity/CARs	14.9	4.7	4.1	4.0	4.8	10.6	4.9	3.4	5.5	5.9
Usable reserves/CAPs (months)	1.9	1.9	2.2	2.3	2.5	3.4	3.2	3.5	3.4	3.2
Usable reserves (mil. $)	4,061	4,875	5,552	6,246	7,244	8,863	10,157	10,022	9,902	9,781
Fiscal indicators (general government; %)										
Balance/GDP	(4.4)	(3.9)	(4.2)	(3.6)	(3.4)	(9.3)	(4.2)	(4.6)	(3.8)	(3.7)
Change in net debt/GDP	3.3	5.4	5.8	5.4	6.6	15.1	3.4	6.4	5.0	4.9
Primary balance/GDP	(2.1)	(1.3)	(1.7)	(1.0)	(0.7)	(6.1)	(1.3)	(1.8)	(1.0)	(0.9)
Revenue/GDP	13.7	13.9	14.0	14.2	14.4	14.2	14.9	14.9	15.2	15.2
Expenditures/GDP	18.1	17.7	18.2	17.7	17.8	23.5	19.1	19.5	19.0	18.9
Interest/revenues	16.8	18.3	18.2	18.3	19.1	22.8	19.2	19.1	18.7	18.6
Debt/GDP	42.2	44.5	46.7	48.1	51.6	70.8	62.5	62.0	61.8	61.5
Debt/revenues	307.1	320.6	333.1	339.8	358.7	498.7	419.2	416.3	407.5	405.7
Net debt/GDP	41.0	43.1	45.3	46.1	49.4	65.7	58.2	58.3	58.4	58.4
Liquid assets/GDP	1.2	1.4	1.3	2.0	2.2	5.1	4.2	3.8	3.4	3.1
Monetary indicators (%)										
CPI growth	0.8	1.6	3.3	3.6	1.8	3.8	8.0	6.0	4.0	4.0
GDP deflator growth	2.5	2.0	4.2	4.1	2.5	4.7	8.0	6.0	4.0	4.0
Exchange rate, year-end (LC/$)	45.55	46.71	48.30	50.28	52.96	58.33	57.00	60.42	62.84	65.35
Banks' claims on resident non-gov't sector growth	17.9	12.0	11.5	10.4	9.9	4.5	20.8	13.3	10.2	10.2
Banks' claims on resident non-gov't sector/GDP	26.5	27.3	27.9	27.7	28.3	30.2	30.5	30.7	31.0	31.3
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

Table 1

Dominican Republic--Selected Indicators (cont.)

	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Foreign currency share of residents' bank deposits	40.2	39.7	35.2	36.9	36.3	38.3	38.3	38.3	38.3	38.3
Real effective exchange rate growth	2.8	(0.5)	(3.1)	(3.3)	(1.2)	(6.7)	(100)	N/A	N/A	N/A

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).
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.

Ratings Score Snapshot

Table 2

Dominican Republic--Ratings Score Snapshot

Key rating factors		
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, despite recent improvements.
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	4	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 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 managed float, with the central bank intervening intermittently in foreign exchange markets.

Table 2

Dominican Republic--Ratings Score Snapshot (cont.)

		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	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 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

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- 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

- Economic Outlook Latin America Q1 2022: High Inflation And Labor Market Weakness Will Keep Risks Elevated In 2022, Nov. 29, 2021
- Sovereign Ratings Score Snapshot, Nov. 3, 2021
- Sovereign Ratings History, Nov. 3, 2021
- Sovereign Risk Indicators, Oct. 12, 2021
- Global Sovereign Rating Trends: Third-Quarter 2021, Oct. 7, 2021
- Credit Conditions Emerging Markets Q4 2021: Pandemic Scars Will Linger As New Risks Emerge, Sept. 28, 2021
- Dominican Republic's US$2.5 Billion Notes Rated 'BB-', Jan. 14, 2021

- Dominican Republic 'BB-/B' Ratings Affirmed; Outlook Remains Negative, Dec. 2, 2020

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		
Transfer & Convertibility Assessment		
Local Currency	BB+	
Dominican Republic		
Senior Unsecured	BB-	
Ratings Affirmed; CreditWatch/Outlook Action		
	To	**From**
Dominican Republic		
Sovereign Credit Rating	BB-/Stable/B	BB-/Negative/B

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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