Capital Market Dynamics

Foreign Exchange ► The Dominican Republic (DR) enjoys a stable exchange rate environment (the peso depreciated only 2.1% versus the US dollar over the past 12 months) due to positive capital flows and favourable external market conditions. The country’s terms of trade received a positive boost from a sharp decline in crude oil prices, a recovery in gold prices, an increase in tourist arrivals and solid remittances due to positive employment conditions in the USA. The central bank conducts an interventionist policy through the use of the exchange rate as an anchor to contain inflationary pressures. Net international reserves total US$5 billion as of April 2016.

Sovereign Debt & Credit Ratings ► The country’s sovereign credit profile remains healthy with the following ratings: B1 (Moody’s), BB– (Standard and Poor’s), and B+ (Fitch). Fitch upgraded the country’s outlook to “positive” on the back of solid growth and successful fiscal consolidation. However, some observers view recent external debt issuance as an issue of concern. The global perception of DR’s credit risk, as measured by the bond yield debt spread versus US Treasury bonds, has been low and stable over the past six months. The prepayment of debt obligations owed to Venezuela’s Petro Caribe at a sizable discount is a key structural enhancement to the country’s sovereign debt profile and a major factor leading to an improved fiscal performance in recent months.

Economic Outlook

Growth ► The DR remains the best performing economy in the Western Hemisphere. Real GDP grew by 7% y/y in 2015, supported by favourable credit conditions boosting local consumption, high tourism and remittances flows (courtesy of the US business cycle), a fiscal impulse to upgrade infrastructure, and persistently low inflation (triggered by oil price deflation). Year to date, the economy remains strong growing by 7.1% y/y in the first four months of 2016. The construction sector remains a source of strength, expanding by 17% y/y in the January-April period. Looking ahead, the post-election fiscal adjustment coupled with US monetary policy shifts will moderate the pace of local economic activity towards the potential growth rate of 5-5.5% by 2017. The project to develop a coal-fired facility will help improve the energy matrix and reduce structural costs for business and households.

Inflation & Monetary Context ► Price stability remains the norm. Supported by the exchange rate anchor, favourable terms of trade, a reduction in the oil import bill of nearly US$1 billion, and stable labour costs, consumer prices have remained well contained below the 4% ± 1% target. The likelihood of post-election tax adjustments, coupled with temporary weather-related shocks to food prices and normalization in crude oil markets, may fuel modest upward price pressures. Headline inflation, which was 1.7% y/y in May, will likely close the year at 2.7% before accelerating to the center of the target range by the end of 2017. The central bank kept its policy-setting interest rate at 5% last May, yet monetary tightening cannot be ruled out early in the new year.

Fiscal & Current Account Balance ► The fiscal situation may present modest challenges. The non-financial public sector debt-to-GDP ratio will close the year at around 35% of GDP, yet the inclusion of the electricity subsidy and debt securities issued by the central bank might increase total public sector debt to near 50% of GDP. A fiscal adjustment through higher taxes in selected goods and services together with lower public sector investments appears to be the likely scenario for the second half of 2016. High labour informality (unofficially estimated to be around 50% of the total workforce) and persistent structural rigidities in the electricity sector remain key impediments to fiscal consolidation. The central bank estimates the fiscal deficit to close the year at 2.3% of GDP (versus 3.4% estimated by the IMF). The current account deficit will end the year below 2% of GDP.

Institutional Framework & Political Environment

Governance ► Presidential elections took place in May 2016. President Danilo Medina, from the Partido de la Liberación Dominicana, was re-elected for a four-year term. A socially inclusive policy framework will remain in place. Relations with the US remain sound given strong political and economic (tourism and remittances) ties. The crisis in Haiti remains an issue affecting the Hispaniola island, and a frequent source of bilateral diplomatic tensions due to the risk of disorderly human migration. The re-establishment of diplomatic relations between the US and Cuba is both a threat (diversion of tourism flows) and business opportunity for the Dominican economy.

Financial Sector ► The banking sector remains systemically sound and adequately capitalized (solventy ratio at 15%). Asset quality of deposit-taking firms (NPL ratio at 1.5%) remains healthy. Domestic credit grew at an annualized rate of 13.8% last May, with an estimated annual expansion of 12% for 2016 as a whole. Growth-sensitive sectors retain comfortable access to local credit. Securitization of banks’ balance sheets is increasing. Local banks and pension funds remain the primary holders of debt issued by the central bank and the Treasury.