Euler Hermes Economic Research

Country Report

Dominican Republic

Public and external financing needs remain important

General Information

GDP	USD58.951bn (World ranking 70, World Bank 2012)
Population	10.28 million (World ranking 83, World Bank 2012)
Form of state	Democratic Republic
Head of government	Danilo MEDINA Sanchez
Next elections	2016, presidential

Strengths

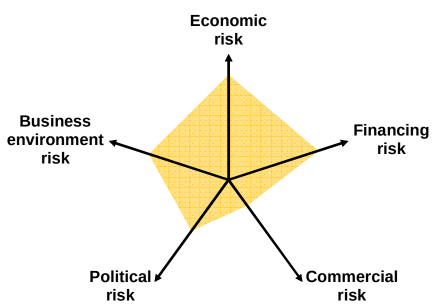
- Resilient economic growth
- Political stability
- Well-developed tourist infrastructure
- Free trade zones (50% of total exports)
- Business environment above regional average
- Belongs to the Petrocaribe alliance (which allows the purchases of Venezuelan oil at preferred rates)

Weaknesses

- Continued fiscal consolidation
- Large external financing requirements
- Weak democratic institutions and fragile rule of law
- Inefficient energy sector with risks of cuts and blackouts
- Red tape and corruption undermine investment environment
- Wide income inequality and poverty maintain risk of wide social unrest

Country Rating

C2



Source: Euler Hermes

Trade Structure

By destination / origin (% of total)

Exports		Rank		Imports
China	24%	1	20%	United States
Japan	11%	2	17%	China
United States	10%	3	9%	Brazil
Brazil	6%	4	7%	Argentina
South Korea	5%	5	4%	Germany

By product (% of total)

Exports		Rank		Imports
Apparel & clothing	11%	1	22%	Petroleum products
Scientific instruments	10%	2	6%	Textile yarn products
Manufactured articles	8%	3	6%	Electrical machinery
Electrical machinery	7%	4	5%	Manufactured articles
Vegetables and fruits	7%	5	5%	Road vehicles

Sources: Chelem, UNCTAD (2012)

Economic Overview

Favorable outlook for growth in 2014 and 2015

Fiscal reforms adopted in late-2012 sharply hit the real economy, which slowed in the first half of 2013 to +1.6% y/y, against an average growth of circa +4% since 2010. Notably, private consumption fell by -0.7% y/y in H1-2013 following the rise in ITBIS (similar to VAT) implemented in November 2012, while investment dropped by -9% y/y. Against this background, the authorities decided to implement a more supportive fiscal policy as of May 2013, primarily through more public spending in investment (especially in roads and construction). The monetary policy also loosed. The key interest rate was cut by 75bps in May to 4.25%, and the legal reserves requirement for commercial banks was reduced. As a result, credit to private sector accelerated significantly (+15% y/y in August against +6.7% y/y in January), despite the abrupt adjustment in monetary policy in late August, when the Central Bank boost the key rate to 6.25%. This hike was necessary to ease the downward pressures on the exchange rate generated by concerns surrounding the path of Fed's tapering. However the credit to the private sector remained buoyant all through 2013 (+13% y/y in December).

Real GDP picked-up to +6.4% in H2-2013. All in all, the Dominican economy expanded by +4.1% in 2013, after +3.9% in 2012. Available data for 2014 suggest that economic growth remains strong (+5.5% y/y in Q1-2014), mainly driven by mining, construction and agriculture.

Euler Hermes expects the economy to slightly accelerate to +4.2% in 2014 and to +4.3% in 2015, largely outperforming the regional average, on the back of still supportive fiscal policy, continued growth of credit, dynamic exports and superior tourist revenues.

Inflation to remain under control

The increase in inflation in early-2013 caused by the rise in the ITBIS was partly offset throughout the year by the moderation of raw material and energy prices (mainly fuel). After a peak of +5.7% y/y in July, the inflation rate slowed to +4.1% y/y in December. On average, consumer prices increased by +3.9% in 2013, thus staying within the target established by the Central Bank for the year (5% +/- 1ppt). For 2014, the inflation target range was adjusted on the downside to 4.5% +/-1ppt. The inflation rate has been below this target since the beginning of the year (+3.1% y/y in August). Euler Hermes expects consumer prices to increase on average by +3.2% in 2014, and by +3.8% in 2015.

Despite a welcomed first step towards fiscal consolidation, there is still a long way to go

Late 2012 saw fiscal reforms aimed at tackling the chronic public deficit. Namely, the tax on transfer of industrialized goods and services (ITBIS, similar to VAT) was increased by 2ppt to 18% in January 2013, with the basket of taxable goods increased. The reduced VAT applied to basic goods was also raised to 11% (from 8%) in early-2014. Consequently, the revenues of the national government rebounded by more than +15% y/y in 2013, while tax revenues reached 14% of GDP against 13% in 2012. On the expenditure side, public spending fell by -1.2% y/y in 2013. This was driven by a reduction in capital spending (-35% y/y), with current spending rebounding by +14% as a consequence of the supportive measures implemented in May 2013. Overall, according to IMF data, the public sector deficit narrowed to -3.6% of GDP against -6.8% in 2012. Public debt continued to grow and reached 34% of GDP in 2013.

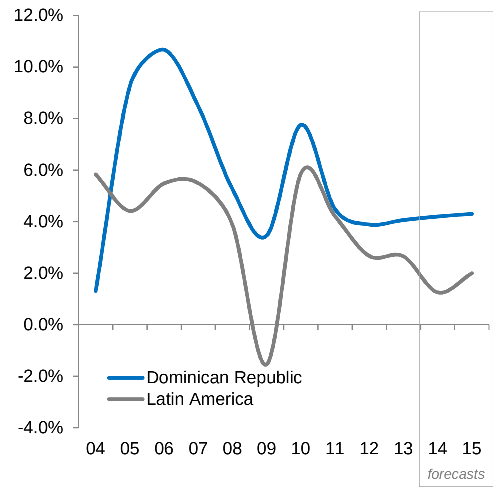
Key economic forecasts

	2012	2013	2014f	2015f
GDP growth (% change)	3.9	4.1	4.2	4.3
Inflation (%, yearly average)	3.7	4.8	3.2	3.8
Fiscal balance* (% of GDP)	-6.8	-3.6	-3.0	-3.0
Public debt* (% of GDP)	30.2	33.8	35.9	36.9
Current account (% of GDP)	-6.8	-4.2	-4.3	-4.3
External debt (% of GDP)	28.6	30.8	31.3	32.0

*Includes Central Government; Local Government; Social Security Funds; State Government

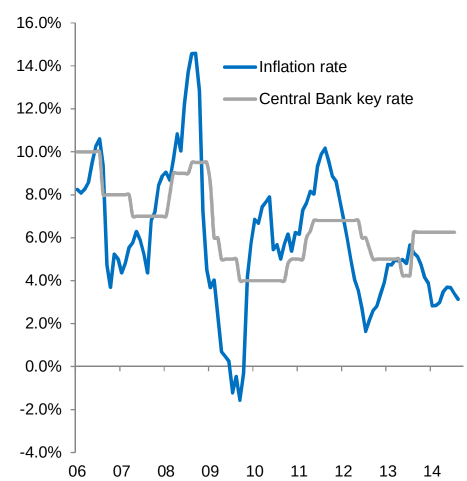
Sources: National sources, IHS, IMF, Euler Hermes

GDP growth (%)



Sources: National sources, IHS, Euler Hermes

Inflation rate and Monetary policy rate (%)



Sources: National sources, IHS, Euler Hermes

Euler Hermes expects the fiscal deficit to narrow again in 2014 to -3% of GDP and to stabilize at this level in 2015. The public debt is expected to grow up to 37% of GDP by 2015. Further reforms would be welcomed to reinforce the soundness of public finances and the public debt sustainability. At present electricity subsidies weight heavily on the budget (about 10% of total current expenditures).

External financing needs remain important

The trade deficit narrowed slightly in 2013 to -USD7.2 bn (against -USD8.7 bn in 2012) as imports fell by -4.9% while exports grew by +6.9%. Notably, the start of operations in the mine Pueblo Viejo allowed exports of gold to bounce more than +500%, fully offsetting the decline in other exports (namely sugar and coffee). Exports from the free trade zones increased at a slower pace (+1.8%), this has seen their share of total exports drop to 52% against 80% ten years ago. Tourist revenues (+8%) boosted the surplus in Services, while the rebound in worker remittances (+5% after a decline of -1% in 2012) drove a rise in the income balance surplus. In the coming years we expect the current account to stabilize at around -4.2% of GDP, after -6.8% in 2012.

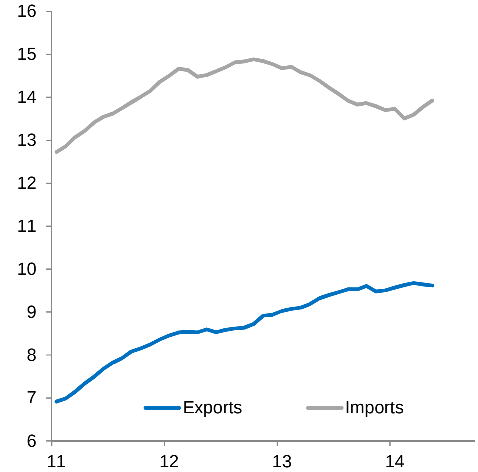
The current account deficit was mainly financed by a rebound of net portfolio inflows, which reached 3% of GDP while net inflows of FDI decreased to 2% of GDP (against 3.3% in 2012) following the completion of several investment projects. Importantly the Petrocaribe alliance framework, which allows the purchase of Venezuelan crude oil at preferential rates, eases some of external constraints. The outlook of this bilateral cooperation raises some concerns given the actual political and economic situation of Venezuela.

In the first 5 months of 2014, exports have increased by +2% y/y while imports have rebounded by +4% y/y. Euler Hermes expects a deterioration of the trade balance this year, with the current account deficit should slightly deteriorate to -4.3% of GDP, and should hold at this level in 2015.

Despite these large financing needs, external vulnerability should remain broadly under control in the short-term thanks to larger net capital inflows and government bond issuance. International reserves (excluding gold) amounted to USD5 bn as of June 2014, which represents about 3 months of import cover (of goods and services).

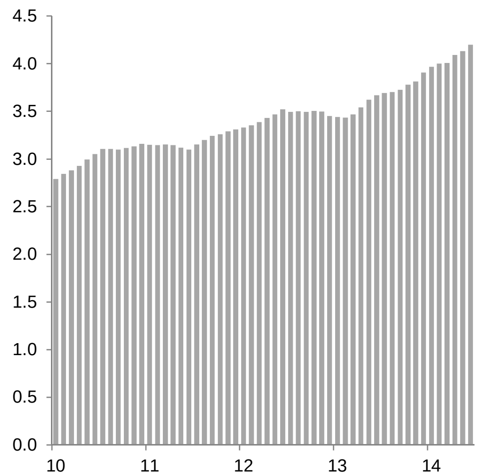
The external debt is relatively low at 30.8% of GDP in 2013. Even with the slight increase anticipated by Euler Hermes, it should stay at manageable levels.

Exports and imports of goods (over 12 months, USD bn)



Sources: National sources, IHS, Euler Hermes

International reserves minus gold (USD bn)



Sources: National sources, IHS, Euler Hermes

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