



Fitch Affirms Dominican Republic IDRs at 'B'; Outlook Positive

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Fitch Ratings-New York-30 August 2007: Fitch Ratings has today affirmed the Dominican Republic's foreign currency and local currency Issuer Default Ratings (IDRs) at 'B', with a Positive Outlook. Fitch also affirmed the country ceiling at 'B+' and the short-term foreign currency IDR at 'B'.

According to Theresa Paiz Fredel, a Senior Director on the Fitch Ratings sovereign team, 'The Dominican Republic's ratings are supported by the strength of the economic recovery, progress on the structural reform front, as well as a manageable debt service profile.' Nevertheless, in spite of achieving macroeconomic stability, a still fragile liquidity position that can be exacerbated by a less benign external environment or a loss of confidence and ensuing capital flight constrains the ratings to current levels at this time. As the IMF stand-by arrangement expires in January 2008, Fitch is also concerned that without the program as an anchor, it may be more challenging for the government to complete its structural reform agenda and prudently manage public finances, particularly in an election year, which could have implications for maintaining confidence.

The government has faced delays implementing its structural reform agenda as required by the stand-by arrangement with the IMF. However, as expected, notable progress with respect to the fiscal and financial sectors has occurred since the government gained the majority in Congress last year. Structural reform efforts have targeted fiscal sustainability, the institutionalization of the budgetary process and improvements in the efficiency of expenditures. The financial system's supervisory and regulatory framework has been strengthened. Passage of the electricity sector law was also secured this month. Additionally, the authorities finally implemented a plan to recapitalize the central bank and address the quasi-fiscal deficit problem earlier this year.

The vigorous pace of economic growth continued in the first half of 2007, reaching 7.9%, while inflation has remained in single digits. Fiscal consolidation is back on track, reflecting better than anticipated revenue growth and expenditure restraint. Unlike prior years, the authorities should easily meet, if not surpass, the targeted non-financial fiscal surplus of 0.5% of GDP this year. A favorable balance of payments performance, underpinned by remittances, tourism receipts, as well as strong FDI flows, continues to support a steady recuperation of foreign reserves and an improvement in the country's liquidity position. The country's liquidity ratio has increased to 145% this year from a low of 36% in 2003. However, this ratio remains significantly below the 'B' median of 210%, and when adjusting the liquidity ratio to include banks' resident foreign currency deposits, it declines to 76%, highlighting the vulnerabilities associated with high dollarization. Furthermore, Fitch estimates that the country's overall external financing needs as a proportion of international reserves are 92% this year, more than twice the 'B' median of 38%. Scheduled amortizations for the non-financial public sector, however, are almost entirely with official creditors this year and are covered by commitments from multilateral and bilateral sources as well as treasury deposits.

Looking ahead, future ratings upgrades could be underpinned by a further strengthening of international liquidity and/or an appropriate policy response to a more challenging external environment. Continued fiscal restraint amid an economic slowdown and an election year would also be viewed positively. Additionally, fulfillment of the structural performance criteria required by the IMF program could bolster the government's efforts to improve the country's institutional framework in order to avoid the recurrence of the type of crisis that occurred in 2003.

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