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SOVEREIGN ANALYSIS

DOMINICAN REPUBLIC

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Sovereign Bond Analysis: Dominican Republic

Investment Thesis

In summary, we have assigned a **MARKETWEIGHT** recommendation for the Dominican Republic ("DR") **2025** and **2030** notes and an **OVERWEIGHT** recommendation for the **2026s** and **2027s**, We believe these bonds offer the potential investor to gain exposure to one of the fastest growing "blue chip" Caribbean economies with a relatively modest fiscal stance and improving external position. While we note that the DR measures above its peer group in several economic indicators and has been making improvements in the indicators for which it is lagging, we believe its bonds are attractively priced. More specifically we believe the 4-6 year tenor bonds on a relative basis to its regional peers and similarly rated countries globally trade at an attractive price while offering more room for spread compression. On the other hand, while we see the 2025s and 20230s as more fairly priced, we do believe that it still allows exposure to the DR and represents a good option for those investors who are still more skeptical of longer-duration strategies.

However, potential risk factors to watch out for include, the possibility of further acts of God, which right now might present tangible risks such as the potential for an active hurricane season, as well as fears over a possible spread of "monkey Pox" which can cause a negative shock to country's tourist industry. Other risk factors that should be monitored are the current inflationary pressures and the subsequent possibilities for social unrest which might impact growth and deterioration of public finance (due to government subsidies), though we believe these risks are currently not elevated. Lastly, other risks include the potential for capital flight and external shocks, particularly in today's context of Fed monetary policy. Hence essential to the holding and monitoring of this position is to keep abreast of the external position of the DR which at this time we feel risks are not elevated but given the nature of capital and FDI flows is subject to change.

Credit Rating

Currently, the Dominican Republic has a credit rating from all the major credit rating agencies. The table below shows the rating history of the DR from all the major agencies. The country is rated Ba3 (stable) by Moody's, BB- by Fitch, and BB- (stable) by S&P. To start our analysis, we looked briefly at the credit rating and sensitivities for the DR by S&P. On the 2nd of December 2021, S&P Global revised the outlook on the DR to 'stable' from 'Negative' with its BB- rating being reaffirmed.

Table Cr.1 Latest credit reports

	Rating	Date	Action
Fitch	BB- (Stable)	Dec 8th, 2021	Affirmed, outlook changed to stable
Moody's	Ba3	Mar 26, 2021	Affirmed
S&P	BB- (Stable)	Dec 2nd, 2021	Affirmed, outlook changed to stable

The reasons given for this change in outlook included the impressive economic recovery from the covid pandemic, strong GDP growth, and also strong revenue collection. These positives were balanced by S&P's view that the country is hampered by weak public finances and shortcomings in its institutional assessment (ability to pass laws and reforms that strengthen the sovereignty of the state) which was shown through the repeated delays in passing meaningful tax reforms. They, however, expressed their

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view that the stable outlook remains anchored on strong growth and policy continuity which they expect to carry on for the next 12-18 months which would stabilize the debt burden despite no tax reform.

- Downside Scenario

  S&P Global stated that if in the next 12-18 months, the positive trends outlined above were to lose momentum, particularly in the sense of structurally weaker economic growth or a deteriorating external position leading to higher fiscal deficits and a worsening debt burden, this could constitute a cause for a downgrade.

- Upside Scenario

  They noted that the rating on the bond could be increased if in 12-18 months the government was able to demonstrate the capacity to implement fiscal and other reforms to bolster the sovereign's institutionality. The rating could also be raised if a combination of good GDP growth and improved fiscal performance, results in a structurally smaller fiscal deficit that reduces the DR's debt and interest burden.

Note: Throughout this document, we keep in mind these rating sensitives and highlight points that we think are positive for the sensitivities in green and ones that are negative in red.

Economic Overview[1] (note that throughout all dollar figures represent PESOs unless stated otherwise)

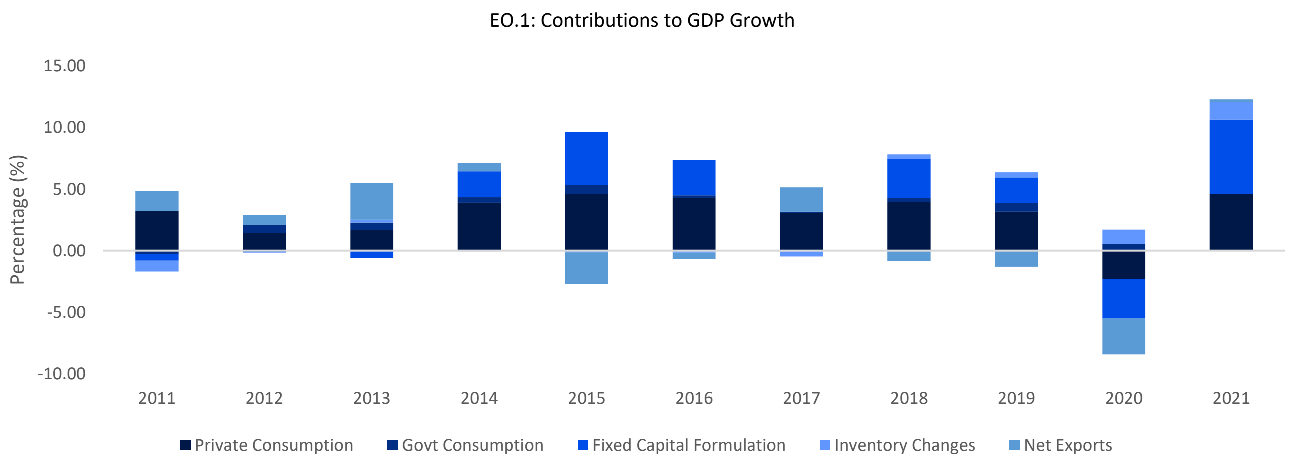
	2017	2018	2019	2020	2021
Real GDP	4.7%	7.0%	5.1%	-6.7%	12.3%
CPI	4.2%	1.2%	3.7%	5.6%	8.5%
Unemployment Rate	5.4%	6.1%	6.0%	7.5%	7.3%
Consolidated public sector debt (%)	48.5	50.1	53.2	70.3	62.1
Revenues and grants (% GDP)	14.0	14.2	14.4	14.2	15.6
Interest expenditure	2.5	2.6	2.7	3.2	3.1
Policy interest rate 1/	5.3%	5.5%	4.5%	3.0%	3.5%

Sources: Dominican Republic statistics Office and Central Bank, IMF article IV 2022

The Dominican Republic is one of the fastest-growing countries in the Caribbean as exemplified by its 5.3% average annual growth rate in the 2011-2019 period (pre-global pandemic), compared to the **1.8%** average for the Latin America and Caribbean region. The DR economy is also sufficiently diverse: at the end of 2021, its main economic sectors included agriculture (5.7% of total value added), the industries sector (31.3% of total value added), which is inclusive of manufacturing, and the services sector (56.0%). In terms of subsectors, the largest contribution to GDP includes the construction sector (14.3% of GDP), the commercial services sector (10.9%), and transportation and storage (8.5%). Like most other countries the DR also suffered a sharp decline in economic activity in 2020 due to the covid pandemic, with GDP in 2020 declining by 6.7%. The country has however recovered well, with GDP rebounding 12.3% in 2021. **Of note, while the decline in the DR was in line with the average decline in the region, they have recovered at a much faster rate, with the**

[1] Source: CIA Factbook

average growth in the LATAM space for 2021 coming in at only 6.8% (by the end of 2021 the DR economy was already about 5% above pre-pandemic levels).



Looking at the structure of the DR's economy we note that historically, the country has seen relatively strong consumption-led growth over the review period, while investment and net export growth has been comparatively more volatile. Of this consumption fuelled growth, a large majority was via private consumption. Notably, the pandemic in 2020 led to broad-based declines in all major components of GDP, with the largest hit being to net exports which contributed -2.9% growth to the decline of -6.7%. Of this decline, an over 30.3% decline in exports year-over-year (YoY) (and hence a contribution of -7% to 2020 growth) outweighed the decline in imports during this period. In 2021 however, the robust economic recovery in the DR was led by above-trend investment growth (7.46% contribution) followed by an improvement in the net export position, combined with a return to trend consumption growth, buoyed by a return to strong private consumption growth (as government consumptions growth contributed negligibly to the 2021 recovery). **The fast-paced recovery has been greatly aided by the swift rebound in the tourism sector which as of June 2022, year-to-date, is only 0.8% below the comparable period in 2019 (Particularly, in June the country had a record number of visitors at 644 thousand, 9.8% above 2019 levels) and up over 86.9% over 2021, thereby pointing to the resilience of the sector.**

Outlook

Currently, the expectation is for above-average growth to continue into 2023 but converge to the long-run trend growth of approximately 5% in potential output. This is evidenced by the IMF projecting growth for both 2022 and 2023 to come in at around 5% of GDP. Initial forecasts for the Dominican Republic were for growth of approximately 5.5% in 2022 before being downgraded to 5%. This highlights the core concerns that remain for the DR (albeit these concerns are global) primarily as it relates to weakening global demand, the impact of inflation on consumer demand, the subsequent shift to more restrictive monetary policy due to those inflationary pressures, and lastly, uncertainties due to world events such as the War in Ukraine.

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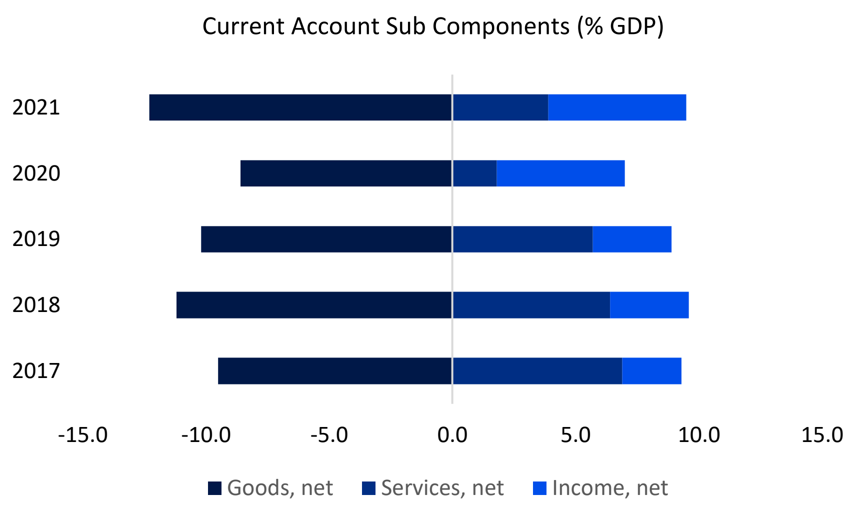
However, we do note that the DR is still well positioned relative to other emerging market credits. Firstly, the country has a demonstrably higher level of potential growth when compared to the average for the Caribbean region. This will provide some cushion in terms of its relative growth in the face of common macroeconomic issues. Secondly, the country has not only been shown to be able to attract FDI but also has a resilient tourism sector that drives growth and is one of the DR's main strengths as it relates to its external balance/Foreign exchange generation. Thirdly, while the decline in global demand has concrete negative impacts on growth, it does come with a silver lining in the form of softening commodity prices, given that the country is a net importer of petroleum products (the country would have imported US$3.7 billion in petroleum and petroleum products in 2021 compared to total imports of US$24.1 billion in total).

The most recent GDP growth result for the first quarter of 2022 came in at 6.1%. While this represents above-average trend/potential growth, it falls in line with the expectation of a quick deceleration to trend (as evidenced by Q3 and Q4 2021 coming in at approximately 11.4% and 11.1% respectively, pointing to the growth deceleration). The country also produces an activity index which attempts to provide a timelier measure of economic activity than quarterly GDP. Looking at the seasonally adjusted production index, we note that it indicates that economic activity during Q1 of 2022 remains vibrant, with a 5.8% YoY increase in the index for June 2022. The reading on the index month-over-month (MoM) for June however, has seen an annualized growth of 3%, down from the 15% and 11% in April and May 2022, respectively.

External Sector

Current Account

Historically, the country has run a persistent but moderate current account deficit (which isn't necessarily concerning given the above-average rate of growth seen domestically, which might necessitate a deficit) primarily due to a deficit in goods trade while the country has historically been a net exporter of services. The country's historic goods deficit is primarily driven by the fact that the DR is a large net importer of fuels, while its services surplus reflects the country's strong dependence on tourism both as an economic sector and as a foreign exchange earner. As it relates to the income sub-account of the current account (CA), the DR typically runs a surplus. While the country has a negative net foreign asset balance (basically foreigners own more resources domestically than Dominican residents own abroad), and a subsequent negative primary income sub-account (as these foreigners get paid on their assets deployed domestically, i.e., think profit repatriation), this is largely outweighed by the country's positive secondary income balance attributable to its relatively high remittances inflows.



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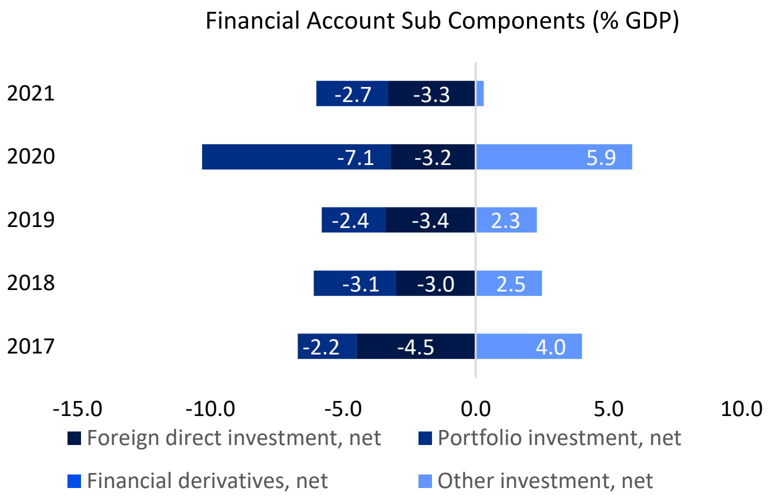
The initial shock of the pandemic resulted in a lower services balance as the tourism sector faltered due to the global restriction on travel, reducing the service balance to 1.8% of GDP from 5.7% in 2019. However, this decline was cushioned by higher-than-average remittance inflows, which bolstered the income sub-account, representing inflows of 5.2% of GDP compared to 3.2% the year prior. This improvement in remittances was buoyed by the improvements that were seen in the US economy at the time as well as, and more importantly, the high level of fiscal stimulus that bolstered US disposable income (of note as of the end of December 2021 83.2% of all remittances to the DR came from the US).

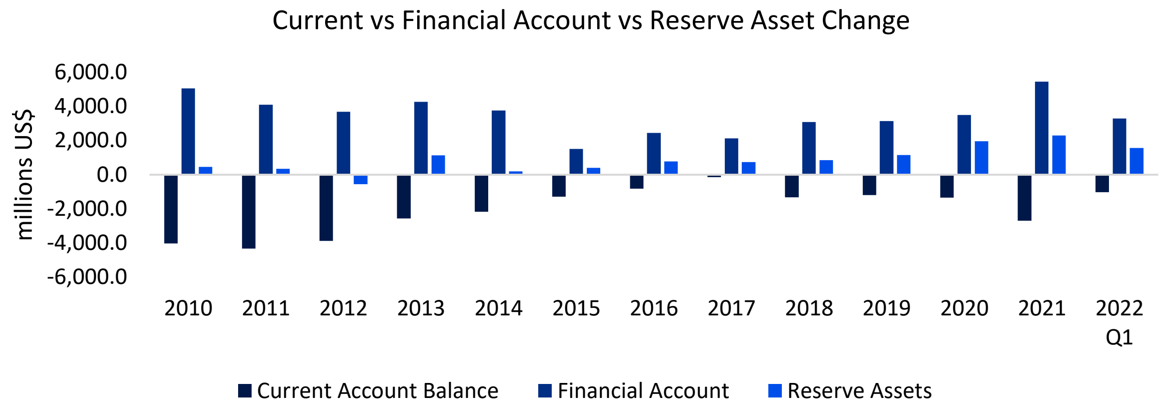
While we noted that in terms of real growth, the net trade in goods and services improved and contributed positively to the recovery in 2021, however, with the rising global inflation filtering through to import prices, the country's current account (CA) balance worsened in 2021. This is driven by an increase in global commodity prices, leading to a deterioration in the goods account, while the services account has still not recovered to pre-pandemic levels with a surplus of 3.9%, compared to 5.7% and 6.4% in 2019 and 2018 respectively. This worsening of the CA was however tempered slightly by continued strength in the income sub-account, continuing with the strength seen during the pandemic hit 2020.

Financial Account

The growth in the NIR, despite the persistent (albeit moderate) current account deficit, has primarily been enabled by the country's being able to attract sustained foreign direct investment flows. As can be seen from the figure on the right, the FDI sub-component of the financial account has averaged an inflow of approximately 3.5% of GDP (in the table an inflow is shown with a negative sign for the financial account), with these inflows remaining relatively strong even during the pandemic. The country has been funding its current account deficit through further net inflows from portfolio investments. The DR is one of the main recipients in the Caribbean and Central America of FDI flows with the government having several incentive plans, particularly to promote investments in tourism and infrastructure[2]. Notably, reinvestment into the mining and hotel sector has been largely seen as the main factor contributing to the resilience of FDI during pandemic-hit periods. **Note: For the first 3 months of 2022 the country attracted US$1.0 billion in FDI flows. This compares to US$896.4 million in 2020 (a 14.6% increase) and US$967.8 million in 2019** and **represented a record level of FDI inflows.**



[2] The sectors which benefit the most from FDI are the tourism, real estate, telecommunications, free trade zones, mining, and financial sectors



Despite the current account deficit being above the pre-pandemic level and having been a structural feature of the DR economy, the country's external position as measured by its reserve balances has been improving over the years. As of the end of July 2022, the country's net international reserves stood at US$14.5 billion. Over the 2011-2021 period the NIR has grown at a CAGR of 13.6%, and notably grew during the pandemic-induced terms of trade shock in 2020/2021 as the monetary authorities allowed the currency to float freely. This can be seen in the chart above that the balance on the CA has mainly been financed by the financial account (excluding reserve asset changes) and hence the use of "exceptional financing" such as loan forgiveness, IMF credit, Debt for Equity swaps, etc. was relatively limited (except for the BOP support loan that was given for added security "just-in-case" during the heights of the pandemic).

In summary, the ability of the DR to continue attracting foreign flows has enabled the country to fund its deficit without the use of exceptional financing or drawing down on its stock of foreign reserves.

Outlook

As of the first quarter of 2022, we have seen the trend continue with a moderate current account deficit of approximately US$1.0 billion, much larger than the surplus of US$276 million in 2019, US$81.1 million in 2020, and the deficit of $378.0 million in 2021. This is linked both to the above trend growth in domestic demand combined with the increased cost of fuel imports. This deficit continued to be supported by record direct investment flows as well as portfolio flows from the financial account. Hence, for Q1 2022, the use of exceptional funding was limited as reserve assets increased by $1.6 billion over the quarter (the largest Q1 accumulation of reserves over the entire 2010-2022 period). **This points to the positive momentum in terms of external stability and that the improving reserve cover is continuing.**

Several signs point in a positive direction for the external balance of the DR. Firstly, as we had mentioned prior, the resilience of the tourism sector, which as recently as June, has seen a record number of arrivals. Secondly, the resilience of the country's Foreign direct investment flow will also allow for the efficient funding of a moderate current account deficit going forward. As it relates to the deficit itself we are expecting that barring other major terms of trade shock such as the one that was represented by the covid pandemic, there will be a normalization to a moderate deficit funded with non-exceptional financing items. This is based on our expectation of continued strength in the tourism sector and the expectation in the short to medium term of a

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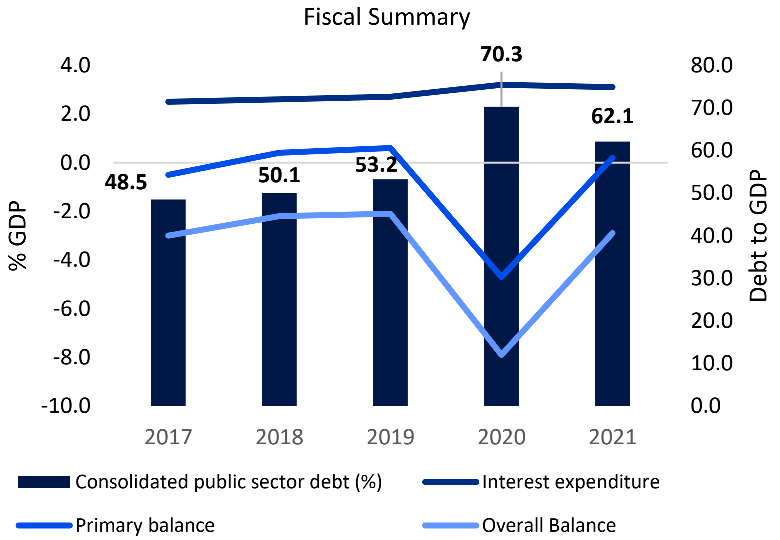
softening in global crude oil prices relative to the levels seen in late 2021, and early 2022. We do however expect headwinds from weaker global growth and normalization of remittances that were elevated during the pandemic, combined with higher factor income outflow from the increased external debt.

Currently, the IMF is projecting that the DR will continue to run a moderate current account deficit in the medium term to the tune of 3.4% and 2.4% in 2022 and 2023, respectively. This forecast is driven by a larger goods deficit and a reduction in the net income flow, both of which will marginally outweigh an improvement in the service trade flow. However, the IMF did express their view that the trajectory of the current account, external debt, and reserves remain in line with fundamentals but do also note their recommendation for continued reserve accumulation, as the reserve balances stood at 83% of the assessing reserve adequacy (ARA) metric[3].

Fiscal Position

In line with the high growth that we have seen in the domestic economy, the central Govt of the DR has run a fiscal deficit over the past 5 years. In the 3 years before the pandemic, the fiscal deficit averaged 2.5% of GDP. However, when we abstract interest payment on the debt, the DR before the pandemic was running a primary surplus. During the pandemic, the government ran a larger deficit (both primary and fiscal) due to the government's initiatives to lessen the blow of the pandemic to the population. Elements of their pandemic response include increased health care spending and transfers to low-income families and the unemployed along with tax relief (a lot of the new social spending programs that were introduced temporarily were rolled into a new social spending program). **Hence, a part of the reason for the quick recovery from the pandemic for the DR was the fiscal flexibility that was available, given the relatively conservative fiscal stance in the years right before the pandemic, which afforded fiscal room for a targeted response to the pandemic fallout.**



(In a brief Segway, we note that in terms of institutionalizing fiscal conservatism, the DR according to the IMF fiscal council database as of 2021 has no recognized fiscal council or fiscal rules which would be able to keep tabs on government debt. The country does however presents an annual debt management framework. While in the latest article IV, the country's authorities

[3] Assessing Reserve Adequacy or risk-weighted metrics developed by the IMF for emerging Markets. define the required level of foreign exchange reserves on the basis of the weighted average of four indicators: (1) short-term external debt, (2) portfolio liabilities and other long-term external debt, (3) monetary aggregate, (4) exports. The weights change for different countries based on exchange rate regimes.

have stated their intention to implement policy reforms including a fiscal responsibility law, there has been no further evidence of this agenda document elsewhere)

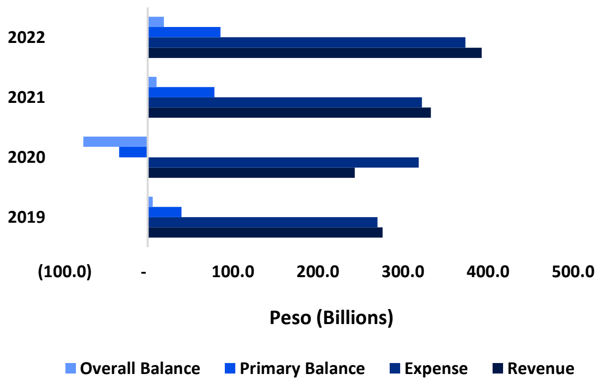
Most of the DR's tax revenue comes from direct consumption taxes i.e., value-added taxes on goods and services. The country's tax revenue and grants as a percentage of GDP have averaged 14.2% in the 3 years pre-pandemic. According to the 2022 Revenue Statistics publication by the Organisation for Economic Co-operation and Development (OECD), the DR as of 2020 was amongst the three countries with the lowest Tax-to-GDP ratio in Latin America and Caribbean Region[4]. In terms of expenses, we note that interest expense as a portion of GDP for the DR has been in a constant uptrend, up from 2.5% in 2017 to 3.1% in 2021. To better see the consequence of the higher interest expense when combined with the relatively smaller tax base in the DR, we note that based on world bank data for 2020, the DR spent a much larger portion of tax revenues on interest expenses in 2020 (the world bank data suggests approximately 22%) compared to the average in the Latin America and Caribbean region of 11.9%. This, therefore, reduces the ability of the Government to invest in important infrastructure and social programs.

Latest Update 2022

For the current year to date, the government generated approximately $392 billion in revenue for the first five (5) months of 2022. This is markedly higher than the revenue collection even during the pre-pandemic period when the country collected $276.0 million for the first five months of 2019. This large improvement in revenue is mainly driven by increased general consumption taxes on goods and services, which is up over 25% compared to 2021, and 43% over pre-pandemic 2019. Notably, the country has seen a greater level of inflation over the period, in line with the global trend, however, even on an inflation-adjusted basis, revenue generation for the YTD has improved.

Total Expenses likewise increased over the period totaling $373.5 billion for the first 5 months of 2022 (compared to $322 billion in 2021, an increase of $51.1 billion). This expense figure was 17% higher than the corresponding period in 2021 and 28% higher than that of 2019. The main driver of this increased expenditure was higher wages and salaries for Government workers (up more than $14.6 billion over 2021) as well as increased subsidies which jumped by $27.4 billion (these jumps in subsidies reflect the continued support for the energy sector as well as the recent government initiative to subsidize fuel costs). Overall, for the first 5 months of 2022, both the overall balance and the primary balance have improved dramatically compared to the comparable period over the last 3 years. This is evidenced by chart FP.1 showing a fiscal/overall balance of $19.2 billion and a primary balance of $85.5 billion.

Figure FP 1: May YTD Fiscal Summary



4 https://read.oecd.org/10.1787/58a2dc35-en-es

Outlook

Going forward, in the face of continued growth, we expect government revenue collection to continue to be strong, albeit with possible headwinds being the possible downward pressure on growth in the medium term due to tightening monetary policy and the global inflationary pressures. While the swift return to fiscal prudence and the subsequent expectation of a return to a primary surplus (as further evidenced by the YTD fiscal performance) augurs well for the fiscal position going forward, **in the long-term concerns remain regarding the low tax base and the increasing portion of revenues that currently has to be allocated to interest expenditure.**

Another potential headwind despite the better-than-expected YTD performance of the fiscal accounts is the continued pressure on the energy sector, which is heavily subsidized by the Government and typically serves as a strain on government finances. This is then coupled with the explicit fuel subsidy policy in place by the government, which may reduce the primary surplus in the event of growth slowing, and by extension would reduce government revenue. The government has however attempted to make sweeping reforms in the electricity sector to reduce its burden on the state (for reference in 2021 the state-owned energy distributors made a total operating loss of US$867.6 million)[5]. **This process has already been underway with the signing of the electricity pact in February 2021, with broad agreements on the way forward for the sector including Reforming governance, Opening the sector to private sector participation, pricing reforms, and also plans on improving the operational efficiency of the sector.**

In summary, while the DR has shown a track record of relative prudence and the current YTD performance suggests that this will continue in the near term, we do note the structural concerns. Hence, while we are positive about the outlook for the government accounts and note that they have sufficient fiscal room to adapt in the case of shocks, we would still monitor closely the macro environment as it directly impacts both the need/length of the current subsidy on fuel by the government, but also indirectly, tax revenue. Notably, while we have not seen massive improvements in the operating performance of the state-owned electricity distribution company operating performance, we do however await the potential benefits of the signing of the energy pact in 2021.

[5] In the DR there are three energy distributors, two of which are owned by government and the other is partly owned (50% government ownership) The industry historically has suffered from great operating deficiencies and there exists government paid electricity subsidies to some households

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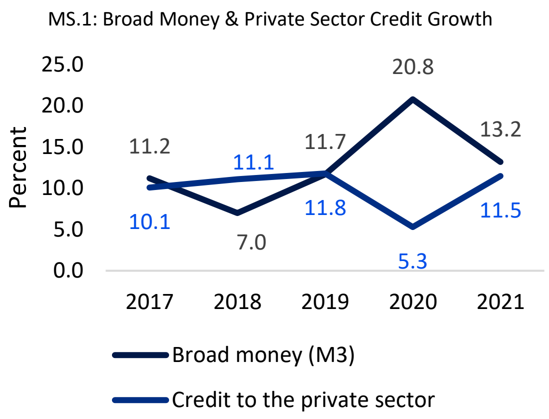
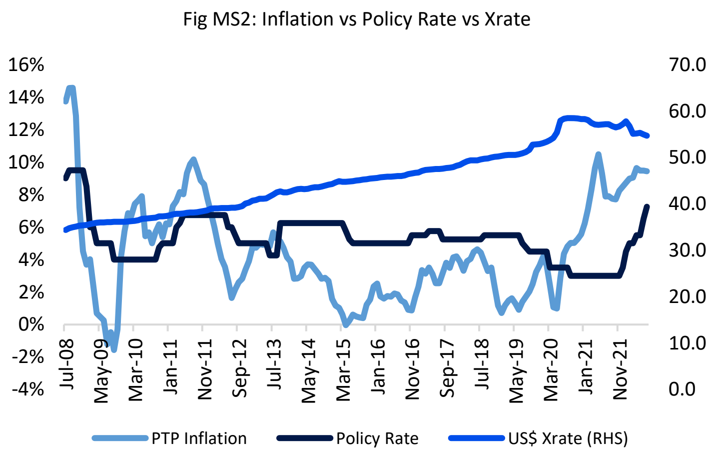
Monetary Sector

The Central Bank of the Dominican Republic is amongst the world's Central Banks that adopt an explicit inflation-targeting regime. The bank currently has an inflation target band of between 3 to 5% with 4% being the optimal target within a 24-month horizon. The Bank's main policy rate is an indicative rate meant to influence short-term interbank rates and eventually longer-term rates throughout the domestic economy. The Central Bank incrementally decreased the policy rate throughout 2019 going into 2020 to facilitate continued domestic growth with the M3 monetary base growing at an average of 10.0% through the 2017-2019 period pre-pandemic.



During the pandemic, figure MS 1 above illustrates the role monetary policy played in aiding the pandemic recovery efforts. During this period, the policy rate was cut to 3.0%, its lowest level on record. This was augmented with several emergency methods by the Central Bank to increase domestic currency liquidity. Some of these measures include the provision of short-term repo funding, a decrease in reserve requirements (to expand private credit) as well as financing facilities for vulnerable businesses and households. These emergency methods are estimated to have provided liquidity to the tune of $215 billion or 5% of GDP. These measures facilitated the expansion in the Central Bank balance sheet (with central bank domestic assets increasing by 27.1% to $812.8 billion at the end of December 2021, from $639.4 billion as of December 2020 on the back of a $131.5 billion increase in credit to deposit-taking institutions) and by extension, the M3 monetary base, which grew by over 20.3% in 2020. Of note, while the central bank did intervene by buying and selling currency in the market, the currency still depreciated by over 10% during the heights of the pandemic as they still generally allow the exchange rate to float to a reasonable degree, allowing it to play its role as an automatic stabilizer.

While these policies buoyed liquidity and facilitated further credit expansion, especially through their impact on reducing the average lending rate of deposit-taking institutions, monetary policy has quickly normalized with base money growth slowing back to historically average levels. However as can be seen from graph MS 2, while the focus during the pandemic was on driving growth, like many other Central Banks the DR has shifted its focus to stemming the current tide of inflation, which on a monthly point-to-point basis has breached the Central Bank's upper bound every month since January 2021. Hence to combat this inflationary



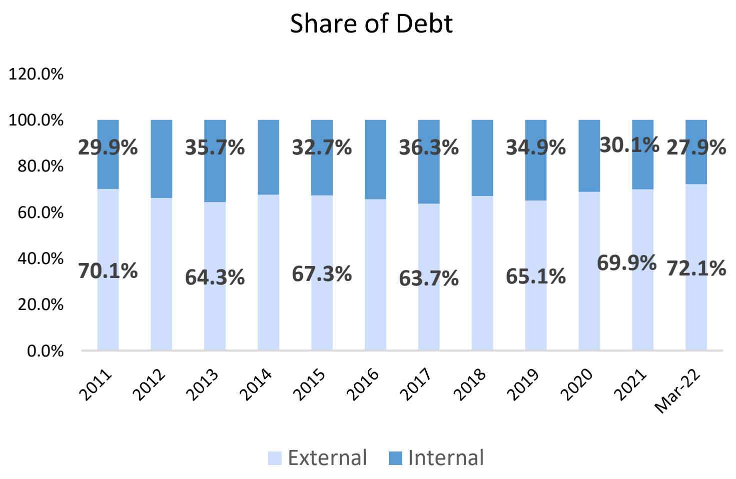
surge the central bank has quickly pivoted to a less accommodative monetary policy, increasing its policy interest rate from the low of 3.0% to 7.25% as of July 2022.

Outlook

Like most countries globally the DR is currently faced with an inflation issue. The central bank has however shown its resolve to build credibility and fight inflation by quickly changing its stance. We also note that while the bank would not have had a significant track record as an inflation targeter (given their switch to IT in 2012) in the past, before the current bout of inflation, had been able to keep the inflation range bound. Currently, it is the expectation that inflation will revert to the Central Bank target range by Q4 2022 (Based on the Central Bank's projections). There has however been some reprieve with the latest monthly inflation readings for the first 7 months showing a trend decline month over month with the reading in July coming in a .50% compared to 1.18% in January.

Debt Profile

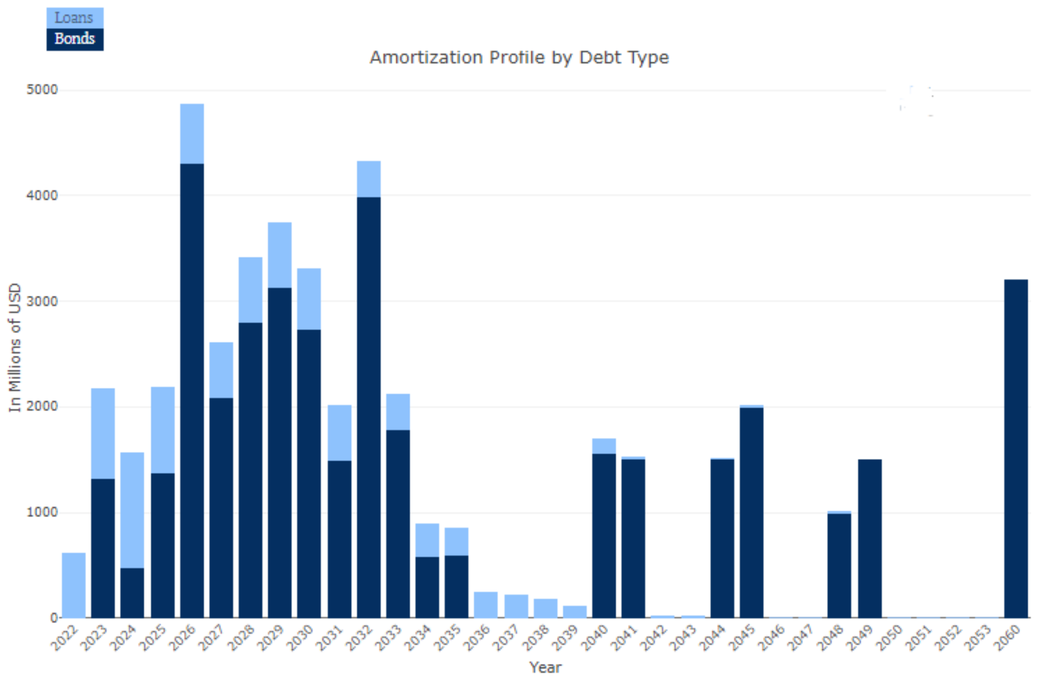
As of March 2022, the DR had total non-financial public sector debt of US$50.5 billion (and the total debt including the financial sector of US$64.5 billion, with the additional debt being that of the Central Bank). Of the total debt, approximately US$36.4 billion was external **(72.1%),** while internal debt totaled US$14.1 billion **(27.9%)**. External debt refers to debt held by non-residents while internal debt is held by domestic residents. Of the country's external debt, the majority represented private debt global bonds which represented approximately US$27.7 billion of all outstanding central government debt. Domestic bond issues on the other hand represented US$10.6 billion of the over US$50 billion in total debt.



We note that the DR is heavily exposed to foreign currency risk. This is evidenced by 74.4% of the total debt stock being denominated in US dollar currency. This compares to 72.4% in 2012, and hence the proportion of foreign to domestic debt has been relatively stable over the years. The DR publishes periodic medium-term debt management strategy documents where they outline their objectives for the debt stock. Of note, they explicitly target reducing FX exposure in their 2016-2020 MTDMS (latest available document), however, the shock of covid led to the government tapping the international market for capital and led to a slight uptick in the portion of a foreign currency debt. Their goal however remains to reduce the reliance on foreign-denominated debt.

In terms of interest rate and duration risk, we note that the share of variable rate debt in the country's total debt stock has trended downwards since 2012. In 2012 over 33% of the debt was floating rate debt, with this ratio falling to 12.4% as of

2022. The weighted average interest rate on the outstanding debt was 6.4% in 2022, compared to 5.8% in 2009. The country has also relatively low refinancing risk in the short term with only 3.5% of current debt maturing in under a year. Likewise, the average time to maturity of the country's stock of debt has trended upwards moving from an average of 9.4 years in 2017 to 12.3 years in 2021 (just for comparison, in the 2016-2020 debt management plan, the government was aiming for under 12% short term debt and an average time to maturity of 6-9 years by 2020). The following chart illustrates the current maturity profile of the central government debt:



In summary, the DR is still fairly well exposed to exchange rate risks based on the composition of their debt. This is however slightly alleviated by their demonstratable ability to gain access to foreign markets and to attract FDI flows from which to generate foreign exchange. Other risk metrics such as the ratio of fixed vs variable, and average time to maturity have trended in favorable directions. **The expectation is that the government will continue its attempt to reduce the portion of the foreign-denominated debt through the deepening of domestic financial markets. An action plan for the development of the government securities market domestically has already been prepared and the equivalent of a US$2 billion domestic peso bond issued in 2021, was an insight into how the government wants to develop the local markets and manage debt going forward.**

Relative Economic Factors

To wrap up the macroeconomic review of the DR we compare how the country matches up on key macroeconomic variables relative to peers in the same rating bucket as assigned by S&P Global. The metrics utilized in the table are the forecasted figures for 2022 by S&P with the DR's percentile rank relative to peers being in the rightmost column. The ranking for certain measures has been altered so that a higher percentile rank represents a positive, with measures above the 50th percentile being color-coded in green (percentile score coincides with the DR's rank from a list of peers, i.e 90th percentile means that they rank above 90% of their peers on that given metric.

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Key positives which we have made stand out in a peer comparison. Namely, the DR is growing at a fast pace compared to its peers and is also much "richer" than the average BB-rated country based on real GDP per capita. In terms of the financial sector, the country is expected to run a relatively large primary balance relative to peers placing it in the 70th percentile for this measure. However, the country is set back by high-interest payments and relatively low tax revenue as a percentage of GDP. Also, the country ranks below the median of its peer group for its General Government Debt-to-GDP ratio. This, however, is somewhat expected given the above-average historical growth shown by the DR relative to its peers and the expectation is for this above-average growth to extend into the future. The DR also has a relatively high portion of its debt denominated in foreign currency, with it being ranked in the 35th percentile for this measure (the adjustments we made to the percentile ranking mean a higher ratio of foreign currency debt equals a lower percentile rank).

Peer Ranking ON Select Measures (S&P 2022 Forecast)

Category	Measure	Percentile Rank
Economic	GDP per capita	88.2
	Real GDP growth (%)	82.3
	Real investment growth (%)	64.7
Government	GG balance/GDP (%)	41.2
	Primary GG balance/GDP (%)	70.5
	GG Revenues/GDP (%)	11.7
	GG interest expenditure/revenues (%)	5.9
	Gross GG debt/GDP (%)	35.3
External	Net External Liab/Car %	17.7
	Narrow net ext. debt/CARs (%)	23.6
	Current account balance/GDP (%)	64.7
	Usable reserves/CAPs (months)	23.5
	Gross ext. fin. needs/(CAR + use. res.) (%)	58.9
Debt	Foreign Currency Debt %	35.3

External Sector

Given its heightened importance due to the current macroeconomic climate, we also pay keen attention to DR's external position, particularly relative to its peers. We note the DR ranks below the median for measures such as reserve coverage (usable reserves as a portion of current account payments) and the net external debt/current account receipts coverage ratio. The DR's relatively low ranking on the narrow net reserves as a portion of current account receipts also points to the fact that the country is still exposed to foreign currency risks, particularly if there were to be a shock to foreign currency inflows or a reversion of capital flows **(we do take solace in the fact that they would have been able to survive and adequately recovered their external balance in the face of the covid pandemic, however, we do note that an external crisis is something that we should be mindful of in the current economic environment)**.

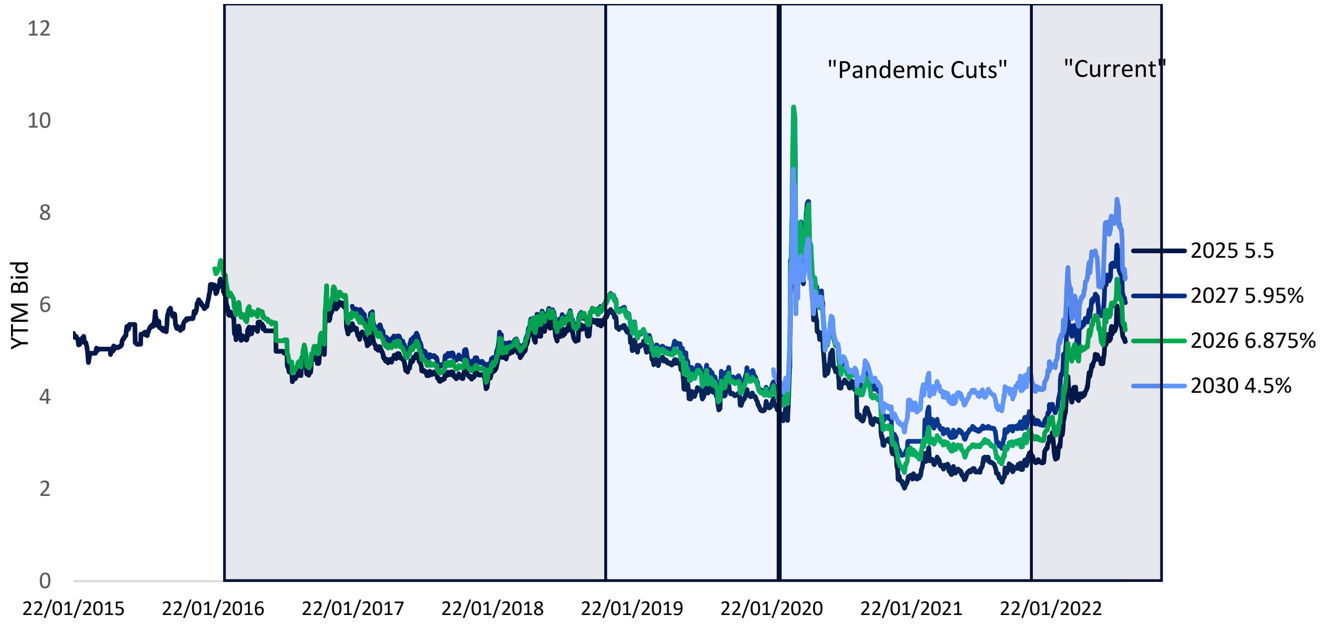
However, the country's ability to tap the international markets and attract capital flows through FDI has allowed it to continue growing reserves which if continued, will bode well for the reserve coverage metric. **Notwithstanding, this points to the importance of continued growth and shock-free evolution of the country's external accounts going forward to improve its external balance metrics.** We also note that in terms of more traditional measures, the DR in 2021 had an import coverage ratio of 4.6x, which while below the LATAM region average of 8.3x, still represents more than 3 months of import cover, which is the recommended benchmark (for perspective Jamaica in the last few years has typically hovered at a coverage ratio of 5-6x).

Relative Analysis

Historical

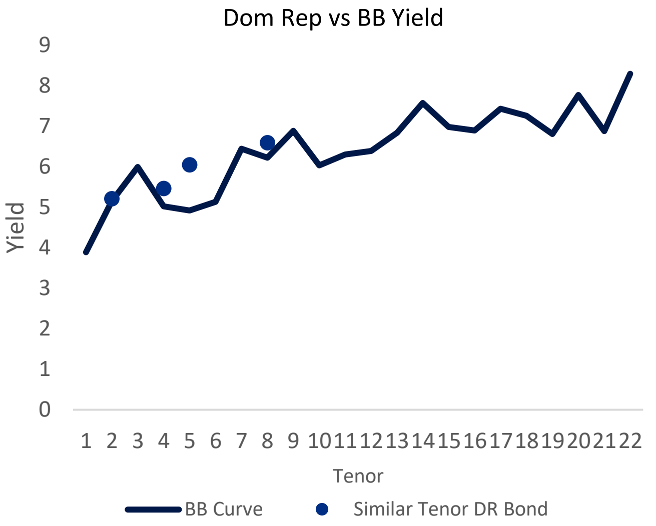
Currently, the DR has several global bonds outstanding. The ones that we will be covering for this analysis will be 2025, 2026s, 2027s, and 2030s global bonds. Further to this, we look at the historical price performance of each of the bonds in fig RA.1 below (light grey represents hiking cycles while light blue represents Federal Reserve cutting cycles). From this, we see that like the fixed income (particularly emerging market) asset class as a whole there has been a sell as the market has been in a risk-off mode since the start of the current hiking cycle. While all four bonds subsequently fell from their highs following the pandemic sell-off, we note that they all remain above their pre-pandemic levels. This is particularly true for the higher duration bonds (expected given their higher sensitivity to interest rates) with the 2030s currently trading at 87.8 which is 12.8% lower than pre-pandemic levels (we use the last day of February 2020 as the pre-pandemic pricing date. 2027, 2026, and 2025 are trading 6.7%, 8.7%, and 9.4% lower than pre-pandemic levels respectively.

Fig RA.1: Yield History Selected DR Bonds



Further to this we also looked at the current G-spreads (that is the premium above similar-interpolated tenors of a US treasury security) relative to the historical spreads for each of the four bonds. Unsurprisingly, in line with the overall macro theme of greater credit spreads across the general fixed income market, each of the bonds experienced a spread blowout in March of 2020. However, all the bonds except 2030 are currently trading at a spread below their pre-pandemic levels. That is, the spread for all the bonds except the 2030s declined compared to Feb 2020 spreads. This has been aided by the generally positive momentum that is currently seen for DR bonds for the month-to-date given its "blue chip Caribbean" status, making it the first destination for flows when EM's rally with most spreads declining over this period by over 50 basis points.

Peer Comparisons (Global BB band)



To compare the current trading price of the DR bonds to similar sovereigns we developed two relative value curves. The first compares the yield and spread of the DR bonds to ones that are of a similar rating. Other filters on the sovereigns included in this index are bonds with a similar Bloomberg composite rating, above US$500 million outstanding, and only bullet maturities. Bonds of a specific tenor were given the same weight regardless of the tenor. From this, we see that relative to similarly rated peers, only the 2025s seem to be trading at fair value, while based on this metric all the other longer maturity bonds are currently trading at a discount to peers, with the largest discount being in the mid tenors, 2026s and 2027s (**the 2030s are trading at a discount albeit marginally**).

Peer Comparisons (Regional Multiple rating Bands)

The second relative value index compares DR to countries within the same region, that is Latin America and the Caribbean. The bonds are compared across credit ratings and time to maturity. The only other inclusion criteria that were selected for this comparison were that there must be at least US$500 million outstanding for any particular bond included, the maturity type must be a bullet payment, and the currency must be USD (i.e. only global bonds) and the issuer must have a Bloomberg composite rating of between AAA and CC- (of note, the amount outstanding filter mainly served the purpose of removing very small issues, to remove the outsized impact of these issuers given that an unweighted average yield was utilized for the remainder).

From this pricing matrix, with the maturity and credit rating of similar issues to the three Dom Rep bond issues that we are contemplating, we note several observations. Firstly, each of the four bonds is priced at relatively attractive levels for their tenor. In the +/- 1 tenor range of the four DR bonds that we are looking at, such as the BB+ peer group analysis above, we note that the 3 longer tenor bonds, on a relative basis, are fairly attractive while the 2025s tend to be closer to fair value (but still undervalued relative to the LATAM peers).

- Issuers between the BB to BB+ rating for the 2–4-year tenor had average yields ranging from 3.64% to 4.83% compared to the yield on the 2025s of 5.21%
- Issuers between the BB to BB+ rating for the 3–5-year tenor had average yields ranging from 3.64% to 5.15% compared to the yield on the 2026s of 5.46%
- Issuers between the BB to BB+ rating for the 4–6-year tenor had average yields ranging from 4.08% to 5.63% compared to the yield on the 2027s of 6.05%
- Issuers between the BB to BB+ rating for the 7–9-year tenor had average yields ranging from 5.01% to 5.59% compared to the yield in the 2030s of 6.59%

Given the above and our overall macro view, it is more favorable to slightly increase exposures to duration (3-6 year sweet spot at the moment). We have assigned an **OVERWEIGHT** rating on the 2026s and the 2027s while we have assigned a **MARKETWEIGHT** rating on the 2025s and 2030s. The overweight rating reflects our slightly favorable view on duration (closer to the 6 year duration), as well as our belief that these bonds provide better relative pricing. Our overweight recommendation also shows that we are particularly keen on the middle of the curve. The market weight rating on the 2030s however reflects our view of preferring to compromise on duration (given the environment and possibility of further hikes) and sticking closer to the 3–6-year maturity coupled with the fact that the 2030s duration is further extended by the relatively low coupon. Hence for us to be more favorable toward the 2030s we would require a more attractive price/spread as it is only marginally discounted/relatively close to fair on a peer comparison basis. As it relates to the market weight rating on the 2025s, we note that it represents less of a bargain based on relative terms, with signs of crowding out based on strong demand. Despite this, we still believe the bond offers an adequate yield and little short-term refinancing risk and would be a suitable option for the relatively more risk-averse individual who would rather opt to stay on the shorter end of the curve at this point.

Recommendation Sensitivity and Risks

Changes in fundamental factors that may warrant a review of our recommendations on these issues include a clear indication of increased risks due to natural events. This includes the possible impact of further disease outbreaks such as monkeypox and the like which may impact travel and consequently the DR's current account (other events such as an active hurricane season which would fall under risk considerations are also important to watch). Other factors include clear signs of growing fiscal strain of the energy distribution company's operating losses on the country's fiscal balance, dramatic slowdown in the structural long-run growth, and clear signs of a reversal in the upward trajectory in reserve accumulation and coverage, particularly when contextualized with US monetary policy (i.e., is the US tightening and the impact it could/is having on the external accounts) and overall external balance stability. Any contrary signs that suggest any of the above are becoming less of concern would further cement/improve our outlook, all else being equal.

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Appendix: Carib Bond Yield Matrix

	Rating									
Tenor	A	A-	BBB	BBB-	BB+	BB	BB-	B+	B	CCC
1					3.85		3.75	23.63	8.41	
2	3.70			3.63	4.69		3.70			42.45
3	3.89		4.17	4.51			3.64		5.20	
4				4.04	4.83	4.08	4.29	9.81		34.09
5	3.18		4.04	3.90	5.15	4.14	4.58			
6	3.40				5.63		4.85			
7	3.38			4.49	5.01			17.53		32.19
8			4.37				5.24			
9	3.40			5.06	5.22		5.59			
10				4.14	7.38					27.30
11			5.10	4.75			6.30	11.21		
12				5.17						
13										25.70
14							6.39		5.60	
15					7.61					
16								9.46		
17				5.76						
18					7.74		7.05			
19										24.40
20	4.93									
21									7.78	
22				5.76		6.24	6.73		8.09	
23				5.78					7.62	
24				5.78						
25		4.79					6.86			
26				5.81		6.33				
28			4.98							
88				6.39						

Included: Anguilla or Antigua and Barbuda or Aruba or Bahamas or Barbados or Bermuda or Bonaire, Saint Eustatius and Saba or the British Virgin Islands or the Cayman Islands or Cuba or Curacao or Dominica or Grenada or Guadeloupe or Haiti or Jamaica or Martinique or Montserrat or Netherlands Antilles or Puerto Rico or Saint Kitts and Nevis or Saint Lucia or Saint Vincent and the Grenadines or Sint Maarten or Trinidad and Tobago or Turks and Caicos Island or United States Virgin Islands or Costa Rica or El Salvador or Guatemala or Honduras or Mexico or Nicaragua or Panama or Argentina or Bolivia or Brazil or Chile or Colombia or Ecuador or Paraguay or Peru or Uruguay or Venezuela

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