SOVEREIGN: Dominican Republic

PLEASE SEE IMPORTANT DISCLOSURES IN THE APPENDIX

Ratings: Standard and poor's, BB-/Stable; and Moody's Ba3/Stable

Summary

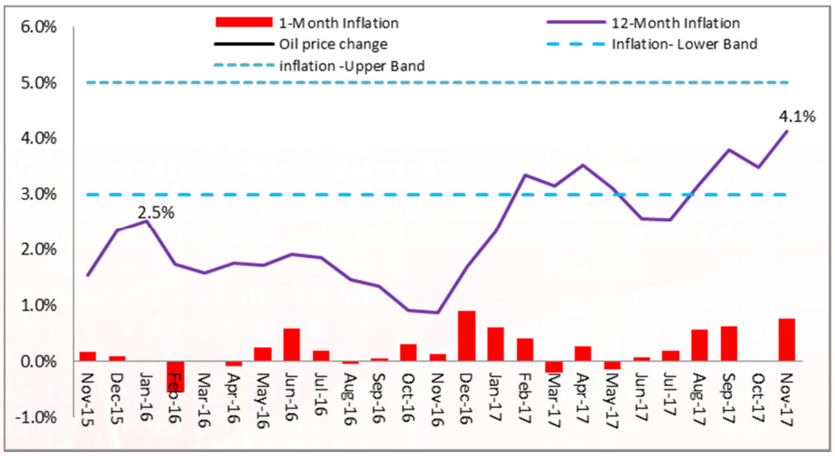
The Dominican Republic remains the fastest growing economy in Latin America and the Caribbean despite an expected slowdown in 2017. The growth momentum is tempered in part by slower Government spending to meet the fiscal target over the medium-term. Tourism and related construction activities remain the main drivers of the growth dynamics with aid from mining and exports from the free zones. Inflation is trending up in part due to an increase in crude oil prices. The domestic economy is heavily dependent on imported fossil fuels for transportation, electricity generation and domestic purposes. Thus a rise in oil prices is transmitted through these conduits to push inflation. The central bank policy rate was reduced in August and remains unchanged throughout Q4:17. However with the prospect of further rate increase in the US the risk is weighted towards upward rate adjustments in 2018. Stability has characterized the foreign currency market since 2012 however relatively low reserves place the economy in a vulnerable position especially with respect to terms of trade shocks, which if they occur could prove disruptive to market activities and lead to accelerated depreciation.

Strengths	**Weaknesses**
• Strong foundation in fiscal and monetary policies have paved the way for high economic growth, exchange rate stability and low inflation • Elevated real output over the years have led to massive welfare improvement and reduction in poverty.	• Underdeveloped electricity infrastructure causes frequent power outages, which is disruptive to smooth productive operation. • Low external reserves relative to imports leave the sovereign vulnerable to external shocks.
Opportunities	**Threats**
• Growing service-oriented economy with ever increasing need for additional players to fill expanding demand. • Enabling business climate facilitated by government policies and	• High dependency on tourism and the US economy leave the local economy vulnerable to a reversal of economic growth in the US. • Corruption allegations levied against the ruling party cast a pale of gloom over the legislative assembly and may negatively impact the legislative process going forward.

Inflation

As at the end of November-2017 headline inflation was at 4.14% which is well within the central bank's targeted range of 3% - 5%. This is higher than the average inflation rate for the calendar year-to-date of 3.2% and 0.9% for the similar period in 2016. The rise in inflation reflects the pass-through effect of increases in crude oil prices, which have risen by 9% and 24% relative to December and November 2016, respectively. Core inflation, which excludes the more volatile food prices, comes in at under 3%.

Figure 6: Inflation and Policy Rate



Source: BCRD and JMMBIR

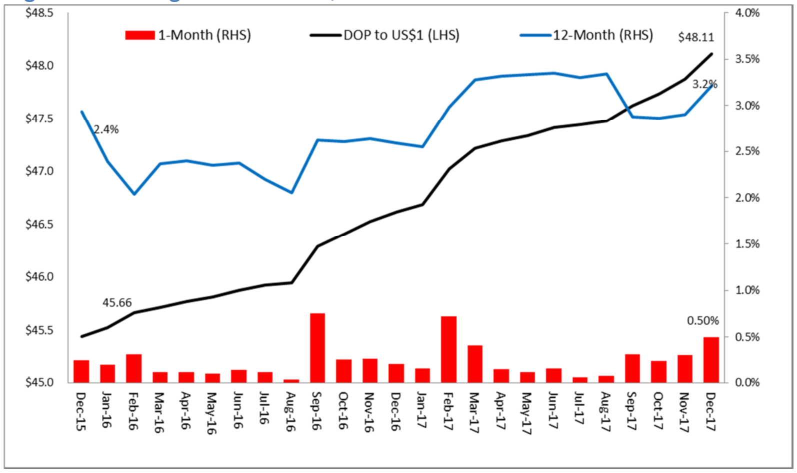
The Dominican Republic being a net oil importer will feel the impact of upward commodity price adjustments and depreciation of the pesos. At the end of November 2017, the spot price for West Texas Intermediary crude oil was 9% higher when compared to end-December 2016.

We are expecting the inflation rate to end the year well within the targeted band articulated by the central bank. Looking ahead, the outlook is that inflation will remain stable throughout 2018 despite the spectre of rising oil prices. We are of the opinion that the central bank will continue to be prudent in its policy intervention to control inflation. Expected adjustments in the policy rates should help to mitigate the impact of commodity price increases on the economy by reigning in core inflation.

Exchange Rate

The DOP traded at 48.11to US$1 at end December-2017 which represents depreciation of 3.2% relative to the similar period in 2016. Maintaining stability in the currency market is one of the central tenets of the BCRD. Against the background of the government containing the fiscal deficit and positive developments in the balance of payment accounts, no mark shift is expected in the depreciation trajectory of the DOP. Accordingly, we expect the depreciation path to remain relatively low over multiple periods. Despite this outlook, sharp increases in commodity prices could negatively affect the current account and which would then be transmitted into the currency market resulting in pressure on the local currency.

Figure 7: Exchange rate DOP: US$1



Source: BCRD and JMMBIR

Interest Rate

At the monetary policy meeting in December the Central Bank of the Dominica Republic (BCRD) maintained the repo rate at 5.25% per annum. This comes against the background of a 25 basis points upward adjustment in interest rates by the US Fed earlier in the month. In its assessment on the local and domestic economies, the Bank noted that while headline inflation has increased, it is well within its targeted range while core inflation remains relatively subdued. The Bank expects the domestic economy to grow by around 5% while the world economy is likely to remain buoyant throughout 2018. Consistent with the outlook on the domestic and international economy the Bank kept the repo rate fixed.

It is our opinion however that further rate adjustments by the Fed will elicit upward rate changes by the BCRD in the near term. No rate action by the central bank could have negative consequences on the balance of payment accounts arising from widening of the interest rate differential between US-dollar and DOP denominated assets. Given the posture of the Fed, consensus forecast suggests three rate increases are on the horizon in 2018. Arising from this outlook and expected action by the BCRD, it is safe to assume that repo rates in the Dominican Republic will increase by at least 25 basis points in 2018.

Outlook

Real GDP growth is expected to decelerate below 5% in 2018 due in part to lower government spending. Despite this outlook, economic growth in the Dominican Republic is likely to remain the highest in the western hemisphere. Robust growth in the US should provide tailwind for expansion in Tourism, the main growth driver over the last decade. Activities in tourism are expected to be complemented by Construction, and to a lesser extent Mining & Quarrying driven by strengthening in precious metal prices.

The inflation momentum is expected to strengthen due to a rise in oil prices. This and anticipated rate increases in the US are expected to force the BCRD to increase the repo rate to temper inflationary impulse while preserving financial portfolio balances. No mark change is expected in the pace of depreciation of the domestic currency despite a likely increase in the current account deficit, as the languishing effect of strong economic policies should help to stymie speculative forces.

Risk factors to the domestic economy are fairly balanced at this time as we are not expecting any disruptions in source economies for the sovereign's exports, nor are we expecting sharp shifts in import prices which could negatively affect the external accounts and put pressure on the local currency. Consistent with the view, we are expecting a stable macroeconomic environment in 2018.

Source:

Bloomberg
Jeffries
Oppenheimer

APPENDIX

IMPORTANT DISCLOSURES

ABSTRACT—As a part of our new Portfolio Strategy we are recommending strict adherence to the following Portfolio Allocation **DEFINITIONS/RECOMMENDATIONS**.

PLEASE NOTE THAT NO INDIVIDUAL ASSET IN YOUR PORTFOLIO SHOULD HAVE A WEIGHTING GREATER THAN 5% UNLESS OTHERWISE RECOMMENDED BY YOUR PORTFOLIO MANAGER OR A SPECIFIC JMMB RESEARCH REPORT. CONSEQUENTLY THE FOLLOWING **DEFINITIONS** ARE PROVIDED FOR CLARITY.

UNDERWEIGHT—REDUCE EXPOSURE IN YOUR PORTFOLIO TO LESS THAN 5% FOR THIS PARTICULAR ASSET

SELL—REDUCE EXPOSURE IN YOUR PORTFOLIO TO ZERO.

HOLD/MARKETWEIGHT—EXPOSURE TO THE ASSET SHOULD BE EQUAL TO 5% OF YOUR TOTAL PORTFOLIO HELD AT JMMB.

OVERWEIGHT/BUY—EXPOSURE TO THIS ASSET SHOULD BE BETWEEN 5% AND 10% OF YOUR TOTAL PORTFOLIO HELD AT JMMB

COPYRIGHT INFRINGEMENT

The investments referred to in this report may not be suitable for you should consult your licensed investment advisor. Nothing in this report constitutes investment, legal, accounting or tax advice or a representation that any investment or strategy is suitable to your individual circumstances or otherwise constitutes a personal recommendation to you.

Disclosure Under The Securities Act

This disclosure is being provided pursuant to section 39 of the Securities Act. This research report is prepared by Jamaica Money Market Brokers Limited (JMMB) and the information and views expressed are those of JMMB. JMMB is a subsidiary of the JMMB Group Limited (JMMBGL). Associated persons of JMMB include JMMBGL and its subsidiaries and affiliated companies, including JMMB Fund Managers Limited, a licensed securities dealer and manager of collective investment schemes.
As at the date of this report, JMMB and its affiliates, directors, officers, employees and other associated persons may from time to time buy or sell, or act as principal or agent in, the securities mentioned in this research report. JMMB or its affiliates, directors, officers and employees have no interest in or interest in the acquisition or disposal of the securities other than expressed above. No part of their compensation is or will be related to the recommendations or opinions in this report.