Emerging Insight

Dominican Republic: The five positive and negative aspects about the economy

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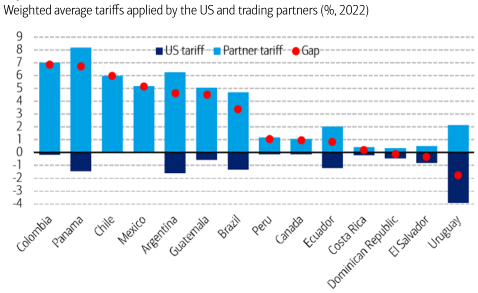
Key takeaways

- In our view, these are the five +ve aspects: growth prospects, governance, reform efforts, geopolitics, and new fiscal rule.
- Five -ve: foreign currency debt, sensitivity to FX, exposure of banks to public debt, lack of tax reform, Haiti border.
- External debt strategy: Marketweight as valuations already reflect fundamentals.

By Alexander Müller, Pedro Diaz, and Lucas Martin

Chart of the Day: LatAm exposure to US reciprocal tariffs. DomRep is among the least exposed
Weighted average tariffs applied by the US and trading partners (%, 2022)



Source: BofA Global Research, World Bank WITS.

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DomRep: Positive aspects outweigh the negative

Putting everything into the balance, we believe the Dominican Republic embodies one of the best macroeconomic stories in Latin America. In this report we analyze the main strengths of the economy (growth prospects, governance, reform efforts, geopolitics, and the new fiscal rule); as well as give a commentary of the main vulnerabilities (mostly related to fiscal matters and sensitivity to exchange rate fluctuations).

The five positive aspects

1) Strong growth prospects: half the battle

The potential growth of the Dominican economy is in the vicinity of 5%, which is what GDP expanded last year (more than twice as fast than the LatAm region, 2.1%). Growing robustly is half the battle for an emerging market. It makes a lot of things easier: the middle class expands, high returns attract foreign investment, tax revenues rise, social and political conditions tend to stability, among other features of a virtuous circle. Nevertheless, we are revising down our GDP growth forecasts for 2024 (to 4%, from 5.1%) and 2025 (to 4.5%, from 5%) because of three reasons: i) downward revision in BofA's US GDP growth forecasts; ii) tighter credit in the construction sector; and iii) disappointing data in the beginning of 2025.

2) Strong governance: capacity to deliver

President Luis Abinader has the third highest approval rate among LatAm's heads of state (only below El Salvador's Nayib Bukele and Mexico's Claudia Sheinbaum) and super majorities in Congress (more than two thirds in both the Senate and the Lower House). This empowers the government with a strong mandate to maintain political stability and deliver economic reforms.

3) Structural reform efforts: tax reform is not everything

Often, LatAm countries suffer from scarcity of structural reforms that are beneficial for productivity and macroeconomic strength. DomRep is an exception on this matter. Granted, the tax reform (critical for aspiration to become investment-grade) was cancelled. But there are at least six other reforms, either being implemented or debated: electricity (approved in 2021), fiscal rule (approved in 2024), anti-corruption & governance, labor, and mining,

4) New fiscal rule: mitigates one of the key vulnerabilities

The fiscal rule law, enacted last year, should be conducive to lowering the public debt ratio over time. Complementing it with a tax reform would have been more powerful. DomRep aspires to become an investment-grade country, but its public debt ratio is significantly higher than the countries in this category (once quasi-fiscal debt is considered). The fiscal rule caps the growth rate of primary expenditures at CPI inflation plus 3%. Assuming the CPI and the GDP deflator grow at a similar pace (a reasonable assumption), this means that primary expenditures will shrink (as a percent of GDP) whenever GDP grows more than 3% in real terms.

5) Strong geopolitical relation with US: reduces exposure

We believe DomRep's strong geopolitical relations with the Trump administration reduces the country's exposure to changes in US economic policies. At the beginning of the year, the Trump administration froze foreign aid worldwide, with very few exceptions. One of those exceptions where funds for security at the border between DomRep and Haiti. When US Secretary of State Marco Rubio travelled to DomRep in February, he spoke about DomRep as a reliable ally. Moreover, we note DomRep's exposure to US reciprocal import tariffs is among the lowest in the region (see Chart of the Day).

The five negative aspects

1) Highest share of foreign currency in public debt

DomRep has the highest share of foreign currency in public debt across Latam. The Abinader has made progress in tackling the issue, reducing it to 66.9% in 2024 (from over 70% in previous years). But it's still pretty high, which means a sharp exchange rate depreciation can cause a large increase in the public debt ratio. We think this is one of the main reasons that explains why the Central Bank (BCRD) is sensitive about the exchange rate.

2) Sensitivity to exchange rate and suboptimal decisions

The Central Bank (BCRD) seems highly sensitive to exchange rate, which sometimes may lead to suboptimal monetary policy decisions (e.g., not cutting rates when inflation is low and activity is weakening). This happened in 2019 when a tourism shock hit the economy, and perhaps one could argue it's happening in 2025 (although in 2019 it was more evident). We tested this hypothesis in a report published in 2023 (see "The Role of the Exchange Rate in the Central Bank's Reaction Function" (https://rsch.baml.com/r?q=XidzuJDoL5kbjqIGlyTPkA)).

3) Banks own large amounts of public sector securities

DomRep's high foreign currency share of public debt is related to this issue. The banking sector is heavily invested in public sector securities (accounting for 25% of total assets, only lower than Argentina), limiting the space for the government to borrow funds in the domestic market. That may be why almost every year the government taps the international market with multi-billion, dollar denominated, bond issuances.

4) Cancellation of tax reform means no investment-grade

We believe the chances of DomRep achieving investment-grade credit rating status are low without a tax reform. The reform was ready, proposing socially-viable and efficient measures (like eliminating tax exemptions on the tourism sector and the domestic sales of Free Trade Zones, among other measures). However, the authorities decided to withdraw it from Congress. It was a big disappointment for markets.

5) Haiti border poses threats

Haiti is the poorest country in the Western Hemisphere and is undergoing an economic crisis. If migration flows keep rising that could burden the Dominican government with higher fiscal costs on security, health, education, and housing. The pollution of the environment is another issue.

Exhibit 1: BofA's macroeconomic forecasts for the Dominican Republic
We expect the Dominican economy to continue outperforming the LatAm region on economic growth in the coming years

	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025F	2026F
Nominal GDP (US$ billions)	75.7	80.0	85.5	88.9	78.9	94.3	113.6	121.4	123.8	124.6	132.6
GDP growth (% year-over-year)	6.7	4.7	7.0	5.0	-6.7	0.0	4.9	2.3	5.0	4.0	4.5
CPI inflation (year-over-year, end-of-period)	1.7	4.2	1.2	3.7	5.6	8.5	7.8	3.6	3.3	4.1	3.9
Current account balance (% of GDP)	-1.1	-0.2	-1.5	-1.3	-1.7	-2.8	-5.8	-3.6	-3.4	-2.6	-2.9
Net international reserves (US$ billions)	6.0	6.8	7.6	8.8	10.8	13.0	14.4	15.5	13.4	14.6	15.7
Nominal exchange rate (USDDOP, end-of-period)	46.7	48.2	50.4	53.1	58.2	57.3	56.2	58.1	61.1	64.0	66.0
Monetary policy rate (%, end-of-period)	5.50	5.25	5.50	4.50	3.00	4.50	8.50	7.00	5.75	5.75	5.75
Gross Non-Financial Public Sector debt (% of GDP)	35.4	36.9	37.6	40.4	56.6	50.6	45.6	45.2	46.5	47.6	47.7
Non-Financial Public Sector primary balance (% of GDP)	-0.1	-0.2	0.3	0.4	-4.3	0.6	0.2	0.1	0.2	0.3	0.4
Non-Financial Public Sector overall balance (% of GDP)	-2.7	-2.8	-2.3	-2.3	-7.6	-2.5	-2.7	-3.1	-3.2	-3.0	-2.7

Source: BofA Global Research, Central Bank (BCRD), Ministry of Finance (Hacienda), Bloomberg

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EXD Strategy: Marketweight as valuations already reflect fundamentals

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We keep our Marketweight (MW) recommendation on DomRep's external debt (EXD). Despite recent revisions to our growth and fiscal forecasts, we still see DomRep as having strong fundamentals. Bond valuations already price in around 2 notches of credit rating upgrades. We think these upgrades are feasible, but in the absence of an unlikely fiscal reform, they should take a long time to materialize.

News and Views

Brazil: inflation expectations are stabilizing

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According to the Brazilian Central Bank's (BCB) weekly readout (Focus survey), inflation forecasts were constant for 2027 and 2028 at 4.00 and 3.78, respectively. For 2025 they decreased from 5.66 to 5.65, and for 2026 they increased from 4.48 to 4.50. GDP growth expectations decreased for 2025 and for 2027, from 1.99 to 1.98; and from 2.00 to 1.99, respectively. For 2026 and for 2028 they were constant at 1.60 and 2.00, respectively. With respect to FX, forecasts were unchanged for all years, except 2025, at 6.00; 5.90; and 5.90, respectively. For 2025, they decreased from 5.98 to 5.95. Selic rates expectations were unchanged for all years, at 15.00; 12.50; 10.50; and 10.00, respectively.

- **To follow:** Last week, we updated our inflation, GDP growth and Selic rate expectations. We now see inflation at 5.4 for 2025 (below consensus), and at 4.5 for 2026 (in line with consensus). We expect GDP to grow 2.0 in 2025 (in line with consensus) and 1.6 in 2026 (in line with consensus). We see the BRL at 5.75 by 25YE, (stronger than consensus) and at 6.00 by 26YE (in line with consensus). We forecast selic at 14.25 for 2025 (below consensus) and at 11.25 for 2026 (below consensus).

Mexico: Biweekly headline inflation fell to 3.67% yoy in 1H March

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Biweekly headline inflation was below expectations in 1H March at 0.14% (E. 0.17%, BofA 0.17%). Core inflation was below expectations as well at 0.24% (E. 0.25%, BofA 0.29%). Core was driven to the downside by non-food merchandise at 0.15% (skin cream). Non-core was driven to the downside by energy prices at -0.71% (low octane gasoline) and by fruits and vegetables at -0.12% (onion). In annual terms, headline inflation is now at 3.67% yoy, down from 3.81% yoy, while core inflation is now at 3.56%, down from 3.66% yoy a fortnight ago. Services inflation fell to 4.25% yoy from 4.65% yoy.

- **To follow**: Inflation continues to fall, which will allow Banxico to continue cutting at 50bp clips. We expect a 50bp cut on March 24, with unanimous support and unchanged forward guidance (https://rsch.baml.com/r?q=xfhaUuUU3wjhQNhUwpm6bw) (see report).

Mexico: Monthly GDP fell -0.16% mom sa in January

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Monthly GDP (IGAE) growth in January was weak, although slightly above expectations, at -0.16% mom sa in real terms (E. -0.20%, BofA -0.60%), up from -1.08% mom sa in December (revised to the downside from -1.05%). By components, industry fell by -0.38% mom sa (vs. -1.44% in December), services were flat (vs. -0.85% in December) and agriculture grew 3.13% mom sa (vs. 0.90 in December). Annually, IGAE fell -0.08% yoy nsa.

To follow: We believe the Mexican economy is in a technical recession (https://rsch.baml.com/r?q=!6WfbPW!SRY-DtGEmi96TA) (see report).

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Valuation & Risk

Dominican Rep (DOMREP)

We have a Marketweight recommendation on DomRep's external bonds given good fundamentals, but relatively tight valuations.

Upside risks for bonds are approval of structural reforms (including fiscal rule, higher revenues, electricity reform), strong growth, and credit rating upgrades.

Downside risks for bonds are slow growth, larger subsidies, and wider deficit.

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Credit opinion history

Dominican Republic / DOMREP

Sovereign	Date[R1]	Action	Recommendation
Dominican Republic / DOMREP	28-Feb-2022		Overweight
	08-Mar-2022	Downgrade	Marketweight
	10-Aug-2023	Downgrade	Underweight
	12-Feb-2024	Upgrade	Marketweight

Table reflects credit opinion history as of previous business day's close. ^First date of recommendation within last 36 months. The investment opinion system is contained at the end of the report under the heading "BofA Global Research Credit Opinion Key."[R1]

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Sovereign Investment Rating Distribution: Global Group (as of 31 Dec 2024)

Coverage Universe	Count	Percent	Inv. Banking Relationships [R2]	Count	Percent
Buy	14	25.45%	Buy	7	50.00%
Hold	34	61.82%	Hold	14	41.18%
Sell	7	12.73%	Sell	2	28.57%

[R2] Issuers that were investment banking clients of BofA Securities or one of its affiliates within the past 12 months. For purposes of this Investment Rating Distribution, the coverage universe includes only Sovereign issuer recommendations. A Sovereign issuer rated Overweight is included as a Buy, a Sovereign issuer rated Marketweight is included as a Hold, and a Sovereign issuer rated Underweight is included as a Sell.

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