

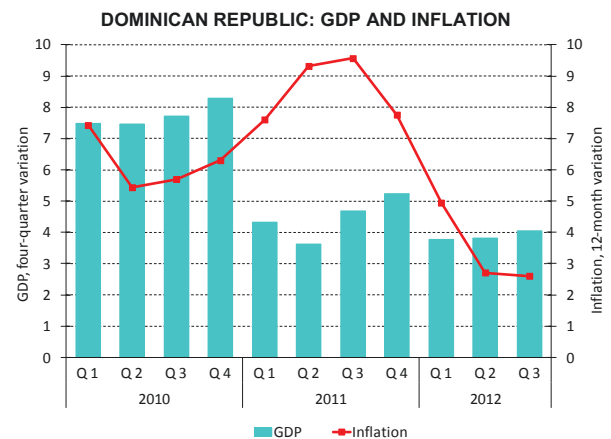
Dominican Republic

Estimates indicate that the Dominican economy grew at a rate of about 3.8% in 2012, down from 4.5% in 2011. This slowdown is due, among other factors, to an unfavourable external environment and the emergence of large fiscal imbalances, which made it difficult to ease monetary policy in a timely fashion. The consolidated public-sector deficit at year-end could be close to 8.5% of GDP, including central bank losses equating to 1.1% of GDP. Inflation may be around 4% (below the central bank's target of 5.5%, with a margin of one percentage point either side); the balance-of-payments current account deficit could stand at close to 7% of GDP, compared with 7.9% in 2011. The new government has taken swift action, approving a tax reform in early November and opening a discussion on a fiscal covenant for trimming public spending. This could prevent a further decline in economic activity and foster growth of at least 3% in 2013.

The president-elect of the Dominican Republic for 2012-2016, Danilo Medina, took office on August 16 against a backdrop of clear fiscal deterioration and international economic uncertainty. Fiscal space has been narrowed by worsening external conditions from 2008 and by falling revenue. The tax burden dropped to 12.9% of GDP in 2011, having reached almost 16% in 2007. This situation was exacerbated by a rise in central government spending during the first half of 2012. Total central government expenditure surged by 30.1% in nominal terms over the same period of 2011, driven by increases in current transfers (to the electricity sector and the private sector, and in the form of social benefits). This rise in spending was not counterbalanced by increased revenue: owing to the economic downturn and the poor results of the 2011 tax reform, revenues grew by only 18.9% in nominal terms, even counting non-recurring income tax receipts. Higher spending during the first half of the year, coupled with its forward inertial effects, could push the consolidated public-sector deficit to around 8.5% of GDP at year-end 2012.

The central bank, despite ongoing operating losses resulting from the 2003 banking crisis that limit its power to act, adopted an inflation-targeting scheme as part of its monetary policy in early 2012. As the

uptrend in international prices eased and the domestic economy slowed, the central bank was able to make successive cuts in the monetary policy rate, taking it from 6.75% in May to 5% in November. Nevertheless, the deteriorating fiscal conditions, the inadequacy of recently adopted tax measures and the persistence of the quasi-fiscal deficit could make further reductions in this rate impossible. Instead, the inflation-targeting scheme could increase the need to continue making room for public consumption, further restricting the



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

potential for spurring private consumption by maintaining or raising the monetary policy rate in the near future.

During the first half of 2012 economic activity slackened and the economy grew by only 3.8%, driven mainly by the manufacture of refined petroleum products (23.2%) and grain mill products (10.4%), mining and quarrying (8.6%) and, to a lesser extent, financial intermediation, insurance and related activities, and energy and water. On the demand side, private consumption (87% of GDP) continued to slow, growing by 2.2% year-on-year to June 2012. Gross capital formation meanwhile climbed 3.2% in the period June 2011 to June 2012, thanks to capital goods imports that will be used to finalize a large number of public works projects.

According to ECLAC estimates, economic growth in the Dominican Republic was 3.8% in 2012. External demand was sluggish due to the unfavourable international climate created by the poor performance of the economies of Europe and the United States and a softening of domestic demand as a result of faltering growth in private consumption and lower public investment in the second half of 2012.

As of October 2012, cumulative inflation stood at 2.6% (versus 7.5% in October 2011) and the inflation rate was 2.8% compared with 8.9% in October last year. This retreat of inflation reflects the delayed impact of the very tight monetary policy measures implemented during the second half of 2011, when the policy rate reached 6.75% and bank interest rates rose following the introduction of a tax on financial institution assets. Inflation is expected to stand at around 4% at the end of 2012 as a result of an easier monetary policy stance since May, which took the policy rate to 5% in October 2012. Open unemployment rose from 5.6% in April 2011 to 5.9% in April 2012 and continues to be twice as high among women as among men. The open unemployment rate in April 2012 was 4.3% for men and 8.7% for women.

With regard to the external sector, demand was moderate but, during the first half of 2012, sales increased by 7.9% in free trade zones and by 1.2% in the case of national exports, while total goods exports expanded by around 4.8%. Imports registered a slowdown, growing by 3.1%. However, capital goods exports performed well (expanding by 20.2%), thanks to public sector imports. Imports of consumer goods were down by 1.5%, and raw materials imports

DOMINICAN REPUBLIC: MAIN ECONOMIC INDICATORS

	2010	2011	2012 ^a
Annual growth rates			
Gross domestic product	7.8	4.5	3.8
Per capita gross domestic product	6.3	3.1	2.5
Consumer prices	6.3	7.8	2.8 ^b
Money (M1)	17.7	4.9	6.5 ^c
Real effective exchange rate ^d	-1.4	1.2	1.6 ^c
Terms of trade	-3.7	-5.3	-1.0
Annual average percentages			
Open urban unemployment rate ^e	14.3	14.6	14.3 ^f
Central government			
overall balance / GDP	-2.5	-2.6	-6.8
Monetary policy rate	4.2	6.4	6.1 ^g
Nominal lending rate ^h	8.3	11.7	12.6 ^g
Millions of dollars			
Exports of goods and services	11 907	13 877	14 750
Imports of goods and services	17 674	19 655	20 088
Current account balance	-4 330	-4 499	-4 417
Capital and financial balance ⁱ	4 387	4 653	2 774
Overall balance	58	154	-1 643

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

^a Estimates.

^b Twelve-month variation to October 2012.

^c Year-on-year average variation, January to October.

^d A negative rate indicates an appreciation of the currency in real terms.

^e Includes hidden unemployment.

^f Figure for April.

^g January-October average.

^h Prime lending rate.

ⁱ Includes errors and omissions.

climbed by only 3.4%. Family remittances recorded a slight drop (0.7%) in the first half of 2012 compared with the year-earlier period. As a result, a current account deficit of around 7% of GDP is expected for year-end 2012. Foreign direct investment more than doubled in the first half of the year, to US\$ 1.886 billion compared with US\$ 894.4 million in the same period of 2011.

In the closing quarter of 2012, a tax reform aimed at boosting tax revenues was discussed and subsequently adopted in early November. While the debate on reducing tax expenditure (including cutting benefits granted to free trade zones) was postponed, the changes made could result in gains of between 1.3% of GDP and 1.5% of GDP next year. The reform may be complemented by a tax amnesty encouraging taxpayers to regularize their tax affairs.

Economic activity could continue to slacken in 2013 due to the risks posed by the external environment, the need for monetary policy to remain tight and the adjustment needed to reduce the deficit through tax reform and cuts in total spending. Economic growth in 2013 may therefore be around 3%.