DOMINICAN REPUBLIC

1. General trends

The economy of the Dominican Republic grew 3.9% in 2012 compared with 4.5% in 2011. The slowdown was the result of slumping external demand, the uncertainty that once more clouded international markets and the domestic economy. Bearing in mind the need to rein in the fiscal deficit and lingering uncertainty in international markets, ECLAC estimates that growth in 2013 will be around 3% and inflation could reach the upper limit of the Central Bank's target range of 4% to 6%. The current account balance of payments could near 6% of GDP by the end of the year.

The central government deficit was equivalent to 6.6% of GDP at year-end 2012 (2.6% in 2011). The fiscal imbalance was fuelled by sharply higher capital spending, which almost doubled in 2012 as it grew by 97.5%, and by a substantial expansion of current expenditure, in particular transfers to the power sector.

Monetary policy was relaxed starting in June 2012. However, because of external conditions and the lag effect, year-on-year inflation was 3.9% versus 7.8% in 2011 but with an upward trend that put it at 5% by May 2013. The loosening of monetary policy led to a pick-up of lending to the private sector in the closing months of the year, so that by December it had risen by 11.3% (versus 10.9% in 2011).[1]

The balance of payments current account deficit stood at 7.2% of GDP (7.9% in 2011) owing to a sharp slowdown in imports, which rose by 1.8% in contrast to the prior-year figure of 12.6%. Exports increased by 5.4%.

By March 2013, fiscal policy had turned highly contractionary and the central government posted a surplus fed by a 19% year-on-year jump in revenue and a 15.7% decline in expenditure.

By May 2013 monetary policy had taken hold, with a lowering of the policy rate from 5% to 4.25% and an innovative resolution that lowered the legal reserve requirement in order to free the equivalent of some US$ 500 million for lending to the private sector. At the end of May 2013 year-on-year inflation was 5%.

2. Economic policy

(a) Fiscal policy

Fiscal policy turned clearly expansionary in 2012 during the electoral period. But the increase in expenditure was concentrated in capital investment and, to a lesser extent, in current expenditure. This pushed the central government deficit up to 6.6% of GDP, from 2.6% of GDP at year-end 2011. The 14.3% rise in tax revenue was more than offset by the 97% jump in capital spending and a 21.6% increase in current expenditure.

Rising tax revenues pushed the tax-burden ratio to 13.5% (12.9% in 2011). The main factor was the 37.9% jump in direct tax revenue after the tax reform approved in the second half of 2011 raised the

1 Hamonized figures.

income tax rate for businesses from 25% to 29% and established a 1% tax on net performing financial assets of financial institutions.

Current expenditure rose by 21.6% owing mainly to a 24.2% increase in procurement of goods and services and a 14% jump in salaries and wages. Capital expenditure was up sharply as well (by 97%) as the road network was expanded and some existing roads were repaired.

The need to fund the fiscal deficit drove non-financial public sector debt at year-end 2012 up to US$ 19.24 billion, equivalent to 32.9% of GDP. Of this total, 66.9% is external debt.

The fiscal imbalance calls for a major effort; a new tax reform was approved in late 2012. And a strict austerity plan was launched that entailed a shift towards a highly restrictive fiscal policy for 2013.

The tax reform included, among other measures, raising the goods and services transfer tax (ITBIS) from 16% to 18% effective January 2013 and extending it to some previously-exempted goods. The reform also included amendments to the tax on vehicles and extended the tax on net performing assets of financial institutions through 2013.

These fiscal measures (especially the change in the ITBIS rate) yielded substantially improved fiscal balances for the first quarter of 2013 as tax revenue rose by 19.3% year-on-year and public expenditure fell 15.7%. The first quarter therefore closed with a slight surplus. Substantial cuts in spending (capital expenditure in particular) were a contributing factor, as the slight inertial increase in current expenditure continued because of the wage hike.

The positive outlook for fiscal and macroeconomic improvement made for a successful international placement, in April 2013, of a US$ 1 billion bond issue with a 5.87% interest rate and an average maturity of 10 years. The proceeds will make it possible to fund the 2013 budget without putting pressure on the domestic interest rate.

(b) Monetary policy

In January 2012 the Central Bank of the Dominican Republic formally adopted an inflation-target scheme setting a year-on-year target of 5% with a tolerance band of plus or minus 1%. The central bank started the year with a highly restrictive monetary policy aimed especially at signalling its resolve to meet the inflation target. The pace of inflation eased during the first four months of the year to stand at 1.6% in July because of weak aggregate demand and an international environment with very low inflationary pressures. This trend enabled the central bank to relax its policy in the second half of the year: between the end of June and September it lowered the monetary policy rate from 6.75% to 5% and dropped the Lombard rate from 9% to 7%.[2] The rates held steady at this level through year-end. This monetary policy shift impacted expectations and pushed weighted average bank lending rates down from 16.2% in early January 2012 to 12.86% at year-end. Inflation to December 2012 was 3.9%, still well below the central bank target.

The first few months of 2013 saw inflation tick up from its level in December, but it remained within the central bank's target range for the year. At the end of May, year-on-year inflation reached 5%. But economic actors' expectations and a gloomy outlook for the international economy (in particular in Europe) led to central bank decisions in May 2013 designed to prop up the production sector. The

[2] The Lombard rate is the highest rate that a central bank charges for short-term loans to financial institutions.

Monetary Board lowered its leading interest rate from 5% to 4.25% and added a measure geared towards promoting economic growth by freeing legal reserve funds in order to channel credit to production sectors. The goal is to free up the equivalent of US$ 500 million from legal reserves; the central bank will require that the funding be used especially for supporting production sector and housing loans.

Assuming that the international economic scenario will remain unchanged, and in view of the lag between policy decisions and their monetary impact, ECLAC estimates that inflation at year-end 2013 will near the upper end of the central bank's target range.

3. The main variables

(a) The external sector

The performance of the external sector in the Dominican Republic is shaped by international economic trends, which in 2012 were marked by the deteriorating situation in Europe and crawling growth in the United States. This held total export growth down to 5.4% to stand at US$ 9.079 billion after soaring more than 27% in 2011. Driving this growth was an increase in gold exports after a new mine came on line in November 2012, since traditional exports weakened overall. Owing mainly to falling international prices, sugar exports slid 1.9%, cacao and cacao products were down 8.3% and ferronickel exports dropped 7.9%. In contrast, free trade zone exports edged up by 2.1%, fuelled mainly by exports of tobacco products (19.3%), medical and surgical equipment (5.9%) and footwear (4.5%).

Total imports rose by just 1.8%, compared with 12.6% in 2011. Consumer goods imports grew by a very modest 1.9%, which stands in contrast to the 17.8% surge in imports of capital goods (chiefly, transport equipment and machinery spare parts). As a result, the trade balance was in deficit by US$ 8.67 billion.

Unlike the trade balance, the services balance showed a US$ 3.259 billion surplus thanks to a buoyant tourism sector whose revenue, at US$ 4.549 billion, was 4.5% higher than in 2011. Family remittances were only US$ 3.158 billion (5.3% of GDP) because of rising unemployment in Spain, where a large portion of migrants from the Dominican Republic live.

The current account posted a deficit of US$ 4.240 billion or 72% of GDP, down slightly from 7.9% of GDP in 2011.

The current account deficit was funded in part by the US$ 3.83 billion capital and financial account surplus at year-end 2012, fed mainly by a 58.7% jump in foreign direct investment, which totaled US$ 2.27 billion (3.8% of GDP).

Balance-of-payments operations brought net international reserves down by US$ 428.1 million, to stand at US$ 3.210 billion.

(b) Economic activity

The hallmarks of 2012 were a further slowing of the European economy and a sluggish recovery in the United States. Nonetheless, the economy of the Dominican Republic expanded by 3.9%. The main driver was the sharp increase in public spending, especially capital spending, and, to a lesser extent, current spending. The upturn in capital expenditure was seen in the 4.3% rise in gross capital formation (after falling 2.6% in 2011). Private consumption was up too, but the 1.6% increase was more moderate than the 3.9% rise in 2011. Public consumption climbed 11.5% as central government current expenditure increased. Exports of goods and services rose by 5.4% (8.8% in 2011).

On the production side, the agricultural sector grew 4.1% (compared with 5.5% in 2011). Despite the modest increase in demand for some agricultural products abroad, growth was boosted more by government measures through the Ministry of Agriculture to support growers hit by Hurricanes Isaac and Sandy. In the agriculture subsector, sugar cane production jumped 10.1% after falling 5% in 2011. Other crops posting substantial growth were bananas (7.9%), pigeon peas (12.8%) and squash (9.4%). Accordingly, crop production for domestic consumption increased by 6.6% while export crop output grew by 9.7% .The livestock subsector closed the year up by 1.4% (after climbing 3.9% in 2011), owing to the 10.4% rise in fresh milk production on top of the 7.7% increase in 2011. Beef cattle production rose by 2.4% (versus 2.6% in 2011). Meanwhile, chicken and egg output fell 7.3% and 7.9%, respectively, because of the rising cost of raw materials for poultry feed (maize, soybeans and fats).

Among the traditional key sectors, manufacturing saw a sharp slowdown (growing by just 0.9% in 2012 compared with 6.1% in 2011) as falling demand pushed milling industry output down by 10.7% on the heels of a 3.6% slide in 2011. The drop was partially offset by a 9.3% rise in beverage and tobacco product output in 2012. For the latter, a major factor was the agreement reached by one of the tobacco companies to increase its share of sales of cigarettes abroad. Sugar production rose by 5.1% as sugar industry product output rose overall.

In 2012 free trade-zone value added dropped 0.3%, owing primarily to a fall in textile output as demand in the United States slipped.

The most buoyant economic sector was the service sector, which grew 7.3% after declining 3.6% in 2011, thanks above all to rising energy output. Residential energy consumption increased by 10%, general government consumption rose 4.7% and commercial sector consumption jumped 36.7% on the back of a 4% uptick in commerce that, while slightly below the pace in 2011, reflects the steady rise in sales fuelled by the 13.1% rise in consumer lending in 2012.

Expectations are that the economy will maintain moderate growth in 2013 although, at 3%, the pace will be slower than in 2012 owing in particular to the effort required to bring the fiscal deficit down to a sustainable level. The fiscal balance had already turned positive by the first quarter; with the economy growing by just 0.3%, monetary policy measures deployed in late May were aimed at jump-starting growth and employment while keeping in line with monetary policy targets.

(c) Inflation, wages and employment

With year-on-year inflation closing 2012 at 3.9% (7.8% in 2011), the main driver of domestic prices was a shorter supply of certain agricultural products whose output was affected by Hurricane Sandy. As a result, prices for food and non-alcoholic beverages rose 6.3%, with the sharpest spikes for green plantains (42.3%), tomatoes (77.3%) and onions (22.2%) and more moderate upswings in fresh chicken meat (3.9%), soybean oil (5.3%) and dried milk (6.3%). Other contributing factors were transport (which rose by 3.2% owing to higher fuel prices) and education (which was up 16.3% due above all to a 32.3% jump in the cost of a university education). Restaurant and hotel prices climbed 3.9%.

As for wages, the National Wage Committee (a tripartite Labour Ministry agency) is mandated to review, once every two years, wage rates for all the sectors that make up the country's economy. The national minimum wage for workers is set by binding resolutions and depends on company type and size.

The higher minimum wages that entered into force on 1 June 2011 held throughout 2012. Because of the size of the nominal increases (between 14.5% and 17%, depending on company type and size), the real average increases for the year over the average for 2011 were slight. The open unemployment rate rose from 5.8% in 2011 to 6.5% in 2012.

Table 1

DOMINICAN REPUBLIC: MAIN ECONOMIC INDICATORS

	2004	2005	2006	2007	2008	2009	2010	2011	2012 a/
	Annual growth rates b/								
Gross domestic product	1.3	9.3	10.7	8.5	5.3	3.5	7.8	4.5	3.9
Per capita gross domestic product	-0.2	7.7	9.1	7.0	3.8	2.1	6.3	3.1	2.6
Gross domestic product, by sector									
Agriculture, livestock, hunting, forestry and fishing	-2.5	5.9	8.6	1.2	-3.4	12.5	5.5	5.5	4.1
Mining and quarrying	5.8	-0.1	11.0	-1.4	-30.3	-51.9	2.9	79.7	42.0
Manufacturing	2.4	6.3	3.2	2.4	2.6	-1.2	7.2	6.1	0.9
Electricity, gas and water	-23.8	4.8	6.3	9.7	10.3	3.0	5.4	-3.6	7.3
Construction	-2.3	9.2	24.6	3.2	-0.4	-3.9	11.0	1.4	0.7
Wholesale and retail commerce, restaurants and hotels	-1.2	12.5	8.3	9.3	4.3	-3.1	9.9	4.5	3.6
Transport, storage and communications	6.5	18.9	17.8	12.5	15.5	10.6	7.9	-0.3	3.3
Financial institutions, insurance, real estate and business services	-1.6	2.0	9.0	11.0	7.3	5.2	7.1	3.6	4.9
Community, social and personal services	2.7	-1.2	5.8	4.5	3.5	5.7	4.1	5.1	3.7
Gross domestic product, by type of expenditure									
Final consumption expenditure	3.1	15.4	12.0	8.9	7.8	4.9	7.6	3.8	1.9
Government consumption	3.8	10.2	11.0	10.0	7.7	-3.4	3.3	0.4	11.5
Private consumption	3.1	15.7	12.0	8.9	7.8	5.2	7.7	3.9	1.6
Gross capital formation	-2.3	13.1	20.8	12.4	9.2	-14.7	17.5	-2.6	4.3
Exports (goods and services)	3.6	-1.2	0.7	3.2	-4.0	-7.4	11.6	8.8	5.4
Imports (goods and services)	5.3	11.3	8.2	6.8	4.7	-9.8	14.4	2.9	1.0
Investment and saving c/	**Percentajes of GDP**								
Gross capital formation	14.9	16.5	18.4	18.9	18.3	14.8	16.5	16.4	16.4
National saving	19.7	15.1	14.8	13.6	8.4	9.8	8.1	8.5	9.2
External saving	-4.8	1.4	3.6	5.3	9.9	5.0	8.4	8.0	7.2
Balance of payments	**Millions of dollars**								
Current account balance	1 041	-473	-1 287	-2 166	-4 519	-2 331	-4 330	-4 409	-4 240
Goods balance	-1 952	-3 725	-5 564	-6 437	-9 245	-6 813	-8 736	-8 824	-8 679
Exports, f.o.b.	5 936	6 145	6 610	7 160	6 748	5 483	6 754	8 612	9 079
Imports, f.o.b.	7 888	9 869	12 174	13 597	15 993	12 296	15 489	17 436	17 758
Services trade balance	2 291	2 457	2 985	3 053	2 962	2 987	2 969	3 087	3 259
Income balance	-1 825	-1 902	-1 853	-2 183	-1 748	-1 721	-1 686	-2 089	-2 192
Net current transfers	2 528	2 697	3 144	3 401	3 513	3 216	3 124	3 417	3 371
Capital and financial balance d/	-862	1 178	1 482	2 793	4 193	2 737	4 387	4 563	3 806
Net foreign direct investment	909	1 123	1 085	1 667	2 870	2 165	1 896	2 275	3 610
Other capital movements	-1 771	55	397	1 125	1 323	572	2 491	2 288	196
Overall balance	179	705	194	627	-326	406	58	154	-434
Variation in reserve assets e/	-542	-1 109	-344	-683	309	-638	-453	-331	542
Other financing	363	404	150	56	17	232	395	177	-108
Other external-sector indicators									
Real effective exchange rate (index: 2005=100) f/	139.0	100.0	106.0	106.1	106.3	110.4	108.9	110.4	112.6
Terms of trade for goods (index: 2005=100)	101.0	100.0	99.0	102.3	97.7	105.7	101.8	96.5	95.5
Net resource transfer (millions of dollars)	-2 324	-321	-221	666	2 462	1 248	3 096	2 651	1 506
Gross external public debt (millions of dollars)	6 380	5 847	6 295	6 556	7 219	8 215	9 947	11 625	12 872

Table 1 (concluded)

	2004	2005	2006	2007	2008	2009	2010	2011	2012 a/
Employment	**Average annual rates**								
Labour force participation rate g/	56.3	55.9	56.0	56.1	55.6	53.8	55.0	56.2	56.5
Unemployment rate h/	18.4	17.9	16.2	15.6	14.1	14.9	14.3	14.6	...
Open unemployment rate i/	6.1	6.4	5.5	5.1	4.7	5.3	5.0	5.8	6.5
Prices	**Annual percentages**								
Variation in consumer prices (December-December)	28.7	7.4	5.0	8.9	4.5	5.7	6.3	7.8	3.9
Variation in nominal exchange rate (annual average)	36.6	-27.8	9.7	-0.3	4.1	4.1	2.3	3.3	3.1
Variation in average real wage	-15.0	18.7	-7.1	4.8	-6.5	7.0	-0.4	1.2	...
Nominal deposit rate j/	21.1	12.7	9.8	7.0	10.3	7.8	4.9	7.9	8.0
Nominal lending rate k/	30.3	21.4	15.7	11.7	16.0	12.9	8.3	11.7	12.6
Central government	**Percentajes of GDP**								
Total revenue l/	14.0	15.7	16.1	17.7	15.9	13.7	13.6	13.5	14.0
Tax revenue	12.9	14.6	14.9	16.0	15.0	13.1	12.8	12.9	13.5
Total expenditure	16.6	16.8	17.2	17.6	19.5	16.9	16.4	16.1	19.3
Current expenditure	12.5	12.6	13.0	13.0	14.4	13.3	12.6	12.5	13.6
Interest	1.8	1.3	1.4	1.2	1.6	1.9	1.9	2.1	2.4
Capital expenditure	4.1	4.3	4.2	4.6	5.1	3.6	3.8	3.6	5.8
Primary balance	-1.6	0.7	0.3	1.4	-1.9	-1.6	-0.6	-0.5	-2.9
Overall balance m/	-3.4	-0.6	-1.1	0.1	-3.5	-3.5	-2.5	-2.6	-5.4
Central government public debt	...	22.0	20.2	18.3	24.7	28.2	29.2	30.1	33.3
Domestic	...	3.3	2.6	2.0	8.3	10.4	9.3	8.8	10.9
External	...	18.6	17.6	16.3	16.4	17.8	19.8	21.3	22.4
Money and credit	**Percentages of GDP, end-of-year stocks**								
Domestic credit	38.3	40.8	39.5	39.3	39.1	41.3	40.9	42.3	44.1
To the public sector	5.9	10.4	17.9	17.4	18.0	19.1	19.8	19.8	23.3
To the private sector	23.9	20.5	19.4	21.5	21.2	22.3	23.7	24.0	23.1
Others	8.5	9.3	1.7	-0.7	-1.9	-2.2	-2.5	-1.5	-2.3
Monetary base	8.7	9.1	9.0	8.9	8.5	8.2	7.6	7.3	7.2
Money (M1)	39.0	37.2	33.8	34.4	31.4	33.3	33.0	33.4	33.5
M2	32.5	29.9	27.3	27.9	25.3	27.0	26.2	25.9	25.8
Foreign-currency deposits	6.6	7.3	6.5	6.5	6.1	6.3	6.8	7.5	7.7

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
a/ Preliminary figures.
b/ Based on figures in local currency at constant 1991 prices.
c/ Based on values calculated in national currency and expressed in current dollars.
d/ Includes errors and omissions.
e/ A minus sign (-) indicates an increase in reserve assets.
f/ Annual average, weighted by the value of goods exports and imports.
g/ Nationwide total.
h/ Nationwide total. Includes hidden unemployment.
i/ Nationwide total. Includes an adjustment to the figures for the economically active population for exclusion of hidden unemployment.
j/ 90-day fixed-term certificates of deposit, weighted average..
k/ Prime lending rate.
l/ Includes grants.
m/ The overall balance includes the residue.

Table 2
DOMINICAN REPUBLIC: MAIN QUARTERLY INDICATORS

	2011				2012				2013	
	Q.1	Q.2	Q.3	Q.4	Q.1	Q.2	Q.3	Q.4	Q.1	Q.2 a/
Gross domestic product (variation from same quarter of preceding year) b/	4.3	3.6	4.7	5.2	3.8	3.8	4.1	3.9	0.3	…
Goods exports, f.o.b. (millions of dollars)	1 947	2 355	2 204	2 106	2 110	2 308	2 320	2 342	…	…
Goods imports, c.i.f. (millions of dollars)	3 230	3 788	3 680	3 838	3 515	3 760	3 894	3 796	…	…
Gross international reserves (millions of dollars)	2 990	2 945	3 419	4 098	3 459	3 608	3 369	3 559	3 826	4 392 c/
Real effective exchange rate (index: 2005=100) d/	110.2	111.2	110.0	110.0	112.0	112.4	112.3	113.7	114.0	114.4 c/
Consumer prices (12-month percentage variation)	7.6	9.3	9.6	7.8	4.9	2.7	2.6	3.9	5.0	5.0 c/
Average nominal exchange rate (pesos per dollar)	37.71	38.00	38.12	38.50	39.02	39.08	39.19	39.83	40.85	41.26
Nominal interest rates (annualized percentages)										
Deposit rate e/	6.5	7.6	8.7	8.7	9.1	9.5	6.5	4.9	6.2	5.2
Lending rate f/	9.2	10.6	13.2	13.7	13.7	13.1	11.8	10.1	10.6	10.9
Interbank rate	7.5	8.3	8.7	8.8	8.8	8.5	7.8	7.2	6.5	5.6
Monetary policy rates	5.3	6.6	6.8	6.8	6.8	6.5	5.5	5.0	5.0	5.0
Sovereign bond spread, Embi Global (basis points to end of period) g/	393	393	587	597	506	488	418	343	385	401
International bond issues (millions of dollars)	-	-	500	250	-	-	-	750	300	1 000 c/
Domestic credit (variation from same quarter of preceding year)	10.9	13.9	11.6	13.5	13.5	10.4	14.4	14.2	15.1	11.1 h/
Non-performing loans as a percentage of total credit	3.2	3.0	3.2	2.9	3.3	3.2	3.4	3.4	3.3	3.3 c/

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
a/ Preliminary figures.
b/ Based on figures in local currency at constant 1991 prices.
c/ Figures as of May.
d/ Quarterly average, weighted by the value of goods exports and imports.
e/ 90-day fixed-term certificates of deposit, weighted average..
f/ Prime lending rate.
g/ Measured by J.P.Morgan.
h/ Figures as of April.

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