Dominican Republic

1. General trends

Thanks to expansionary policies and an upswing in external demand, the Dominican economy grew by 7.8% during 2010 (as against 3.5% in 2009). Strong growth in domestic demand deepened the balance-of-payments current account deficit to 8.6% of GDP (versus 5% in 2009) and in October the central bank embarked on a series of hikes in its reference rate, taking it from the historical low of 4% to 6.75% in May 2011. The cuts introduced during the second half of 2010 helped reduce the central government fiscal deficit to 2.5% of GDP.

The biggest macroeconomic policy challenge for 2011 will be to ensure that rising domestic demand does not cancel out the gains made in controlling inflation, which registered year-on-year change of 6.2% at the end of 2010, as opposed to 5.8% in 2009. A balance will also have to be struck between the need to scale back transfers to the electric power sector and the impact of energy price rises on the population. The public policy stance is therefore expected to become tighter, leading to growth of 5.5%, a current account deficit of 7.5% of GDP and a central government deficit of 1.6% of GDP.

Presidential elections are due to be held in May 2012, meaning that politics in 2011 will be dominated by elections within the main parties and the subsequent campaigns. Significant changes in the country's economic policy are not anticipated, however.

2. Economic policy

(a) Fiscal policy

Reflecting the upturn in economic activity, total central government revenue grew by 6.1% in real terms in 2010 (compared with -9.3% in 2009). However, this was lower than expected, principally because business taxes were calculated using 2009 as a basis. The tax burden shrank, in fact, from 13.1% of GDP in 2009 to 12.8% in 2010.

Although transfers to the electric power sector dropped by 12.4% in real terms, they equated to 1.2% of GDP, double the original target of 0.6% of GDP. This was attributable to delays in targeting consumer subsidies on electricity, related in part to rising international oil prices.

In light of this and with the aim of meeting the target agreed with the International Monetary Fund (IMF) of a central government deficit of 2.4% of GDP, the budget was revised during the second semester, with the result that total expenditure grew in real terms by 3.1%. This moderate figure reflects real growth in current spending of just 0.3%. Capital expenditure grew by 13.3% in real terms (-26.8% in 2009), largely owing to a substantial increase in fixed investment (31.7% in real terms, versus -30.6% in 2009), given that in real terms capital transfers contracted for a second year running (-18.5%), following a drop of 20.2% in 2009.

These measures resulted in a central government deficit equivalent to 2.5% of GDP, one percentage point below that recorded in 2009 but slightly over the target agreed with IMF. The consolidated public sector balance is therefore estimated to be close to the 3.9% of GDP

Table 1
DOMINICAN REPUBLIC: MAIN ECONOMIC INDICATORS

	2002	2003	2004	2005	2006	2007	2008	2009	2010 [a]
					Annual growth rates [b]				
Gross domestic product	5.8	-0.3	1.3	9.3	10.7	8.5	5.3	3.5	7.8
Per capita gross domestic product	4.2	-1.8	-0.2	7.7	9.1	6.9	3.8	2.1	6.3
Gross domestic product, by sector									
Agriculture, livestock, hunting, forestry and fishing	2.5	1.8	-2.5	5.9	8.6	1.2	-3.4	12.5	5.5
Mining and quarrying	7.7	8.8	5.8	-0.1	11.0	-1.4	-30.3	-51.9	2.9
Manufacturing	4.9	0.9	2.4	6.3	3.2	2.4	2.6	-1.2	7.2
Electricity, gas and water	9.7	-6.9	-23.8	4.8	6.3	9.7	10.3	3.0	5.4
Construction	4.6	-17.1	-2.3	9.2	24.6	3.2	-0.4	-3.9	11.0
Wholesale and retail commerce, restaurants and hotels	4.5	-2.3	-1.2	12.5	8.3	9.3	4.3	-3.1	9.9
Transport, storage and communications	15.1	5.7	6.5	18.9	17.8	12.5	15.5	10.6	7.9
Financial institutions, insurance, real estate and business services	7.7	3.9	-1.6	2.0	9.0	11.0	7.3	5.2	7.1
Community, social and personal services [c]	4.1	3.5	2.7	-1.2	5.8	4.5	3.5	5.7	4.1
Gross domestic product, by type of expenditure									
Gasto de consumo final	5.7	-4.9	3.1	15.4	12.0	8.9	7.8	4.9	7.6
Consumo del gobierno	8.0	-12.6	3.8	10.2	11.0	10.0	7.7	-3.4	3.3
Consumo privado	5.6	-4.6	3.1	15.7	12.0	8.9	7.8	5.2	7.7
Gross capital formation	3.5	-28.0	-2.3	13.1	20.8	12.4	9.2	-14.7	17.5
Exports (goods and services)	2.0	10.6	3.6	-1.2	0.7	3.2	-4.0	-7.4	11.6
Imports (goods and services)	1.5	-12.9	5.3	11.3	8.2	6.8	4.7	-9.8	14.4
					Percentages of GDP				
Investment and saving [d]									
Gross capital formation	21.2	15.0	14.9	16.5	18.4	18.9	18.3	14.8	16.5
National saving	18.0	20.1	19.7	15.1	14.8	13.6	8.4	9.8	7.9
External saving	3.2	-5.2	-4.8	1.4	3.6	5.3	9.9	5.0	8.6
					Millions of dollars				
Balance of payments									
Current account balance	-798	1 036	1 041	-473	-1 287	-2 166	-4 519	-2 331	-4 435
Goods balance	-3 673	-2 156	-1 952	-3 725	-5 564	-6 437	-9 245	-6 813	-8 701
Exports, f.o.b.	5 165	5 471	5 936	6 145	6 610	7 160	6 748	5 483	6 598
Imports, f.o.b.	8 838	7 627	7 888	9 869	12 174	13 597	15 993	12 296	15 299
Services trade balance	1 757	2 249	2 291	2 457	2 985	3 053	2 962	2 987	2 936
Income balance	-1 152	-1 393	-1 825	-1 902	-1 853	-2 183	-1 748	-1 721	-1 788
Net current transfers	2 269	2 336	2 528	2 697	3 144	3 401	3 513	3 216	3 118
Capital and financial balance [e]	243	-1 583	-862	1 178	1 482	2 793	4 193	2 737	4 493
Net foreign direct investment	917	613	909	1 123	1 085	1 667	2 870	2 165	1 626
Other capital movements	-674	-2 196	-1 771	55	397	1 125	1 323	572	2 867
Overall balance	-555	-546	179	705	194	627	-326	406	58
Variation in reserve assets [f]	527	358	-542	-1 109	-344	-683	309	-638	-453
Other financing	28	189	363	404	150	56	17	232	395
Other external-sector indicators									
Real effective exchange rate (index: 2000=100) [g]	101.6	135.5	128.9	92.9	98.9	98.0	100.1	102.0	100.0
Terms of trade for goods (index: 2005=100)	106.0	102.2	101.0	100.0	99.0	102.3	97.7	105.7	101.8
Net resource transfer (millions of dollars)	-881	-2.787	-2.324	-321	-221	666	2.462	1.248	3.099
Total gross external debt (millions of dollars) [h]	4.536	5.987	6.380	5.847	6.295	6.556	7.219	8.215	9.947
					Average annual rates				
Employment									
Labour force participation rate [i]	55.1	54.7	56.3	55.9	56.0	56.1	55.6	53.8	55.0
Open unemployment rate [j]	16.1	16.7	18.4	17.9	16.2	15.6	14.1	14.9	14.3
					Annual percentages				
Prices									
Variation in consumer prices (December-December)	10.5	42.7	28.7	7.4	5.0	8.9	4.5	5.8	6.2
Variation in nominal exchange rate (annual average)	9.4	63.7	38.2	-26.9	12.4	-0.3	4.3	4.3	2.5
Variation in real minimum wage	-0.5	-9.2	-15.0	18.7	-7.1	4.8	-6.5	7.0	-0.4
Nominal deposit rate [k]	16.4	20.6	21.1	12.7	9.8	7.0	10.3	7.8	4.9
Nominal lending rate [l]	21.3	27.8	30.3	21.4	15.7	11.7	16.0	12.9	8.3

Table 1 (concluded)

	2002	2003	2004	2005	2006	2007	2008	2009	2010 [a]
					Percentages of GDP				
Central government									
Total revenue [m]	14.6	13.2	14.0	15.7	16.1	17.7	15.9	13.7	13.6
Current revenue	14.3	13.1	13.9	15.4	15.9	17.3	15.7	13.5	13.4
Tax revenue	13.8	12.1	12.9	14.6	14.9	16.0	15.0	13.1	12.8
Capital revenue	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total expenditure	16.2	16.1	16.6	16.8	17.2	17.6	19.5	16.9	16.3
Current expenditure	10.5	10.2	12.5	12.6	13.0	13.0	14.4	13.3	12.5
Interest	1.1	1.6	1.8	1.3	1.4	1.2	1.6	1.9	1.9
Capital expenditure	5.7	5.9	4.1	4.3	4.2	4.6	5.1	3.6	3.8
Primary balance [n]	-0.2	-2.7	-1.6	0.7	0.3	1.4	-1.9	-1.6	-0.6
Overall balance [n]	-1.3	-4.3	-3.4	-0.6	-1.1	0.1	-3.5	-3.5	-2.5
Central-government debt	...	...	...	22.0	20.4	18.4	24.4	28.0	28.2
Domestic	...	...	...	3.3	2.6	2.0	8.2	10.3	9.3
External	...	...	...	18.6	17.7	16.4	16.2	17.7	19.6
Money and credit [o]									
Domestic credit [p]	35.2	38.8	29.4	30.6	26.7	26.2	24.8	25.5	25.0
To the public sector	1.5	1.6	6.2	10.4	17.9	17.4	18.0	19.1	16.8
To the private sector	33.6	37.1	23.1	23.5	19.9	21.7	21.0	21.5	22.9
Others	0.1	0.1	0.2	-3.3	-11.0	-12.9	-14.3	-15.1	-14.6
Liquidity (M3)	35.7	49.8	39.1	37.3	33.8	34.5	31.4	33.4	33.1
Currency outside banks and local-currency deposits (M2)	28.2	40.2	32.5	30.0	27.3	28.0	25.3	27.1	26.2
Foreign-currency deposits	7.5	9.6	6.6	7.3	6.5	6.5	6.1	6.3	6.8

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] Includes gas supply and business services.
[d] Based on figures in local currency expressed in dollars at current prices.
[e] Includes errors and omissions.
[f] A minus sign (-) denotes an increase in reserves.
[g] Annual average, weighted by the value of goods exports and imports.
[h] Up to 2004, includes secured external debt, public and private. As from 2005, corresponds to non-financial public sector external debt, pursuant to the new methodology adopted by the Ministry of Finance.
[i] Economically active population as a percentage of the working-age population; nationwide total.
[j] Percentage of the economically active population; nationwide total. Includes hidden unemployment.
[k] 90-day certificates of deposit.
[l] Average of the benchmark rate.
[m] Includes grants.
[n] Includes residuals.
[o] The monetary figures are end-of-year stocks.
[p] Figures refers to the Harmonized monetary and banking indicators.

envisaged in the agreement. The central government fiscal balance is calculated according to financing needs and therefore includes the impact of unclassified operations, without which the deficit would have amounted to 2.7% of GDP.

The fiscal deficit was financed mainly from external resources, including a US$ 750 million bond issue. Total non-financial public sector debt rose by just 0.3 GDP points to 28.7%, which reflects measures adopted in 2010 to shift the domestic debt portfolio away from bank credit and towards medium-term government securities. As a consequence, domestic debt fell from 10.8% of GDP in 2009 to 9.4% in 2010. External public debt meanwhile rose from 17.6% of GDP in 2009 to 19.3% in 2010. Taking into account the private debt underwritten by the government, external private debt rose from 20.5% to 22% of GDP.

Rising international fuel prices present a challenge for public finances, despite the 11% hike in electricity rates announced in November 2010, and the budget cuts of 12% announced in March 2011 for all government ministries except health and education. Although the 2011 budget submitted to congress envisages a central government deficit of 1.6% of GDP (3% for the consolidated public sector), the government is negotiating for manoeuvring room on some of the fiscal targets agreed with IMF, which led to delays in the fifth review of the stand-by arrangement.

There have also been delays in the adoption of a decree permitting bonds to be issued on both the domestic and international markets, including a US$ 500 million bond the government was planning to issue during the first half of 2011. This is one of the reasons why net international reserves dropped by over US$ 700 million between December 2010 and May 2011.

Table 2
DOMINICAN REPUBLIC: MAIN QUARTERLY INDICATORS

	2009				2010 [a]				2011 [a]	
	I	II	III	IV	I	II	III	IV	I	II [b]
Gross domestic product (variation from same quarter of preceding year) [c]	1.0	1.8	3.4	7.5	7.5	7.5	7.7	8.3	…	…
Goods exports, f.o.b. (millions of dollars)	1 272	1 439	1 406	1 366	1 539	1 723	1 705	1 660	1 779	…
Goods imports, f.o.b. (millions of dollars)	2 162	2 396	2 540	2 848	2 722	3 334	3 347	3 492	3 422	…
Gross international reserves (millions of dollars)	2 542	2 498	2 673	3 307	2 738	2 979	2 722	3 765	2 990	2 953
Real effective exchange rate (index: 2000=100) [d]	100.3	102.5	102.5	102.7	98.9	99.3	100.4	101.3	100.7	101.8
Consumer prices (12-month percentage variation)	2.4	0.3	-1.6	5.7	7.4	5.4	5.7	6.3	7.6	8.0
Average nominal exchange rate (pesos per dollar)	35.60	35.97	36.10	36.15	36.31	36.77	37.03	37.36	37.71	37.95
Nominal interest rates (annualized percentages)										
Deposit rate [e]	12.0	7.8	6.6	4.7	4.4	4.5	4.7	5.7	6.5	7.3
Lending rate [f]	19.4	12.3	10.4	9.4	9.0	7.9	7.7	8.8	9.2	10.1
Interbank rate	11.5	7.6	7.6	5.6	5.9	6.1	6.1	6.9	7.5	8.1
Domestic credit (variation from same quarter of preceding year)	10.2	9.6	10.2	9.5	15.3	14.4	14.9	11.1	6.9	10.8
Non-performing loans as a percentage of total credit	4.2	4.1	4.2	4.0	4.1	3.3	3.4	2.9	3.0	3.0

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Preliminary figures.
[b] Data to May.
[c] Based on figures in local currency at constant 1991 prices.
[d] Quarterly average, weighted by the value of goods exports and imports.
[e] 90-day certificates of deposit.
[f] Average of the benchmark rate.

(b) Monetary and exchange-rate policy

Having maintained a reference rate of 4% for 13 months, in October the central bank began to raise the overnight rate to prevent the economy from overheating, which could hamper efforts to meet the 2011 inflation target of between 5% and 6%.

By May 2011 the reference rate had been raised 275 basis points to 6.75%. Estimates indicate that it will close the year at over 7%. One of the aims of these increases is to slow the pace of growth in private sector credit, whose 12-month nominal expansion fell to 14.2% in early June after peaking at 19.8% at the end of 2010. The other aim is to encourage real deposit rates back into positive territory to encourage saving.

Reflecting healthy capital inflows and central bank interventions in the currency market to prevent major fluctuations, the nominal exchange rate experienced a modest average depreciation of 2.4%. Considering the differential in inflation rates, this corresponds to a 2% appreciation in the real effective exchange rate.

Although the central bank has expressed its intention to do everything in its power to meet the objective set in the monetary programme, fiscal policy may render monetary policy less effective in 2011. The delays surrounding the review of the IMF agreement and the approval of bond issuances have compromised the plan to build up central bank reserves. Unless this situation is swiftly resolved, depreciation may be steeper than expected (approximately 4.5% on average, similar to the average depreciation witnessed in 2007-2008), which, considering exchange rate pass-through, would have an adverse effect on inflation.

In the financial sector, strong credit growth meant a slight fall in the cash ratio from 25.89% in 2009 to 24.29% in 2010. Nevertheless, the quality of the loan portfolio improved and the non-performing loans index decreased by over one percentage point to 3% in 2010, while equity returns climbed from 20.35% in 2009 to 23.25% in 2010. According to estimates by the Superintendence of Banks, financial sector assets are projected to grow by 11%-13% in 2011, with growth in the loan portfolio of between 10% and 12% and an increase in deposits of between 12% and 14%.

Within the context of the regional integration initiative brokered by the Central American Monetary Council, the Dominican Republic central bank was designated institutional manager of the regional interconnected payments system. All these operations will therefore be settled through the Dominican payment system.

3. The main variables

(a) Economic activity

Thanks to the international economic recovery, and driven by expansionary monetary and fiscal policy, the Dominican economy grew in real terms by 7.8% (6.4% per capita) in 2010. Taking into consideration the net impact of terms-of-trade deterioration and the drop in factor payments to the rest of the world and in net current transfers, available gross national income grew by 6.2% in real terms (versus 5.3% in 2009).

This robust performance is attributable to growing private consumption (7.7%), driven by better employment conditions (with increased labour-market participation and a lower unemployment rate), an expansion in personal borrowing and a recovery in investment. Having contracted by 14.7% in 2009, investment grew by 17.5% in 2010, supported by an expansion in private sector lending. Given rising domestic demand, especially on the consumption side, export recovery (11.6%) was not strong enough to offset import growth (14.4%).

By sector, the 2010 performance reflects the buoyancy of services, particularly commerce (13.6%); hotels, bars and restaurants (4.7%); and financial intermediation (12.5%). With the mobile phone penetration rate nearing 100%, growth in the communications sector has slowed to a moderate 8.3%. Manufacturing, which had contracted by 1.2% in 2009 owing to plummeting external demand, grew by 7.2% in 2010 thanks to a shift towards greater value added activities in free trade zones and rising domestic demand. The agricultural sector, which had expanded by 12.5% in 2009 thanks in part to technical and financial support from the Ministry of Agriculture, grew at the more moderate rate of 5.5% in 2010.

External demand is expected to continue to drive both mining and manufacturing, given the budget cut forced by higher oil prices and the increase in the central bank's reference rate, which is intended to curb growth in lending to the private sector and encourage saving. Nevertheless, it is estimated that growth of the Dominican economy will ease back to 5% in 2011.

(b) Prices, wages and employment

In 2010 inflation was determined by food and fuel prices, which began a new cycle of increases in the fourth quarter of 2009, driven by the global recovery. As a consequence, 12-month inflation surged to 7.9% in May 2010. As the global recovery lost momentum, however, international commodity prices began to level off and year-on-year inflation ended 2010 at 6.2% (6.3% average for the year), within the target range of between 6% and 7%.

Owing to the depletion of idle capacity in key sectors of the economy and rising oil prices as a result of the political crisis in the Middle East, inflation picked up in early 2011. This is beginning to affect core inflation, which had climbed to 5.6% by May 2011, by contrast with 3% in early 2010. Although the monetary authorities began raising reference rates in October 2010 and will continue to do so for the rest of the year,[1] monetary policy could be rendered less effective if subsidies to the electricity sector are not sufficiently targeted. In view of this, ECLAC forecasts that year-on-year inflation at the end of 2011 will be around 6%, the ceiling of the target range laid down in the monetary programme.

Thanks to the Dominican economy's rapid response to the global recovery, labour market indicators improved throughout 2010. The participation rate is still below pre-crisis levels (56.3% in the second half of 2007), but ended 2010 at 55%, 1.4 percentage points above the rate for the first half of 2009. Broad unemployment (which includes both those seeking work and those not actively looking but willing to work) stood at 14.9% of the economically active population in 2009, but dropped by 0.8 percentage points to end 2010 at 14.1%. Although employment indicators still show gaps between men and women, these have also narrowed since the second quarter of 2009.

Despite nominal growth of 6.3% in the average hourly wage, in real terms the hourly rate decreased slightly by 0.1% in 2010, in comparison with a real increase of 7.5% in 2009. During the second quarter of 2011 negotiations took place on raising the minimum wage for workers not affiliated to a sectoral trade union, who represent almost 28% of the working population. A nominal increase of 17% was agreed.

Better employment conditions led to the creation of over 160,000 jobs, which helped to advance the fight against poverty. According to estimates from the Ministry of Economic Affairs, Planning and Development, 33.2% of the population were living in poverty in the first half of 2010,

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1 According to the survey of macroeconomic expectations carried out by the central bank in May 2011, the reference rate will close the year at around 7.8%.

a level not seen since before the 2003 crisis. The prospect of lower economic growth, greater inflationary pressures and a narrower fiscal gap in 2011 underlines the importance of shielding investments in health and education so as to leverage social policies. In this regard, the coverage of the conditional transfer programme *Solidaridad* ("Solidarity") is expected to expand by over 10% and reach a total of 590,000 families by the end of 2011.

(c) The external sector

In 2011, the current account deficit expanded by over US$ 2 billion, reaching the equivalent of 8.6% of GDP by the end of the year (5% in 2009). This was mainly the result of a deterioration in the merchandise balance (16.9% of GDP), owing to the rising oil bill and the impact of strong domestic demand on imports, despite the buoyancy of non-traditional exports, in particular organic products, and the nascent recovery of exports from free trade zones.

Fuel prices also ate into the surplus on the services trade account; the recovery in foreign tourist arrivals (up 3.1% in 2010 compared with a drop of 0.9% in 2009) was not enough to compensate for rising transportation costs. The flow of family remittances, which represent approximately 6% of GDP, shrank by 1.4%, an indication of the relatively high levels of unemployment that persist in the United States and Spain (the two main destinations for Dominican migrants).

The current account deficit was comfortably financed by foreign direct investment inflows (amounting to US$ 1.626 billion, or 3.1% of GDP), multilateral financing and a US$ 750 million bond issue. The central bank was thus able to increase its net reserves by approximately US$ 500 million, which took the balance to 3.1 months of merchandise import cover by the end of 2010.

For 2011, ECLAC projects that the resumption of ferronickel exports in the first half of the year and the start-up of gold exports in the fourth quarter, together with strong growth in non-traditional exports and the shift towards activities with greater value added in the free trade zones, will offset higher international fuel and food prices to some extent. Given the impact of fiscal retrenchment on employment and consumption in developed countries, no significant changes in tourism or remittances are expected.

ECLAC therefore forecasts a current account deficit of around 7.5% of GDP for 2011. As in 2010, this will be financed through a combination of foreign direct investment inflows (amounting to approximately US$ 1.9 billion), a US$ 500 million bond issue and multilateral financing. Drawdown of international reserves is a possibility in the event of delays in receipt of loan disbursements from international financing institutions.