

DOMINICAN REPUBLIC – ECONOMIC PERFORMANCE
JANUARY-SEPTEMBER, 2006
EXECUTIVE SUMMARY

The Dominican economy, as measured by the Gross Domestic Product (GDP), base 1991, registered a growth rate of 11.3% from January to September of 2006. This notable expansion was greatly determined by the increasing activity of sectors such as construction (29.8%), communications (26.0%), agriculture and livestock (14.9%), commerce (10.7%), domestic manufacture (9.5%), and hospitality (8.4%). In contrast with the production increases in these sectors, free trade zones decreased by 5.4 per cent.

An important event related to the economy's growth is that, during the period between July and September of the present year, GDP increased 10.6%, achieving for the first time in history, double digit growth for five consecutive quarters. Prior to this, the longest period of double digit growth for the Dominican economy occurred during the four quarters from October-December of 1999, to July-September 2000.

At current prices, during the January-September period of this year, GDP grew 17.5%, which reflects a GDP implicit deflator of 5.5%, in accordance with the 3.46% growth of the Consumer Price Index during this period.

The increase in economic activity during the period of January-September was influenced by two factors that historically have been highly correlated with GDP. First, the private sector loan portfolio of multiple service banks increased by RD\$11.57 billion during the first three quarters of the year. Secondly, domestic goods imports grew 16.0% during that period, driven mainly by a rise of 25.0% in raw materials imports, which is consistent with increasing activity shown by the principal manufacturing sectors.

On the expenditure side, in real terms, public as well as private investment were the main factors that most influenced the expansion of economic activity. In general terms, Gross Fixed Capital Formation expanded by 26.3%. The main component of this growth was investment in the construction sector, which grew by 29.8% from January to September. This in turn, generated a multiplier effect with regard to economic activity and job creation.

With regard to consumption, there was a slowdown in the growth of Private Consumer spending, which, while expanding by 14.1% in the same prior year period, during the first three quarters of in 2006, grew 8.2 per cent. In contrast to this, public consumption during this period increased by 14.4%, a much improved performance compared to the 5.7% growth registered in the same prior year period. These figures show that GDP expansion during the first three quarters of the year was based on higher levels of investments, contrary to what occurred in 2005, when private consumption was the main factor determining GDP growth.

In consonance with strong economic activity during the period in question, inflationary pressures were kept under control during the first three quarters of the year. **Cumulative inflation** was 3.46% for the period in question, which marks a slight reduction with respect to the 3.49% registered at the end of the first half of the year. This reduction came as a result of a decrease in international oil prices during the third quarter of the year, which offset somewhat the effect of price increases for some food products and seasonal increases produced in educational services each year.

Cumulative inflation performance during the first three quarters of the year indicates easy compliance with the inflation goals established in the Central Bank's Monetary Program. The handling of monetary policy made an important contribution to compliance with the goals, and essentially was focused on controlling the expansion of monetary aggregates, seeking consistency with economic growth.

The placing of securities issues continued to be the main **monetary policy** tool. The total amount outstanding of Central Bank certificates amounted to RD\$153.47 billion as of September 2006, which is 14.3% higher with respect to the same prior year period. Despite this increase, total monthly interest payments on certificates fell from RD\$3.00 billion in 2004, to RD\$2.10 billion in January-September 2006.

Similarly, the Central Bank reduced the Lombard discount window interest rate during the third quarter from 25% to 18% and the rate on interest bearing overnight deposits from 10% to 8%. The greater rate of reduction in the Lombard rate compared to overnight deposits is in accordance with the Central Bank's efforts to establish a rate band that will improve transmission of policy signals to the market.

In the external sector, the balance of payments current account registered a deficit of US\$436.4 million during the first three quarters of 2006, equal to -1.6% of the GDP. This is higher than the -0.9% of GDP for January-September 2005, and was due mainly to higher oil imports as well as greater demand for imported goods.

The 16.0% growth in domestic imports during the period in question was largely responsible for an increase of US\$685.5 million in the commercial deficit with respect to the same prior year period. The oil imports equaled US\$2.10 billion, for a total increase of 16.8% with respect to last year, resulting from increases in the average price of oil and its by-products. It should be noted that this deficit was offset by a significant growth of 35.4% in exports of domestic products.

In the **fiscal sector**, preliminary results show that the Central Government generated an accrued deficit of RD\$11.28 billion (1.3% of GDP) during the first three quarters of the year. This deficit was financed with both internal and external resources. After considering disbursements, bond issuances, maturities, payments, arrears and restructures and debt cancellation for the period, net external financing amounted to RD\$20.90 billion.

Total Central Government revenues increased 15.3% in January-September with respect to the same prior year period, in consonance with current GDP growth. Spending rose by 33.1% during this period. Of total Central Government spending, 74.6% represented current expenditures, a slight reduction with respect to January-September 2005, when the figure was 76 percent.

Total **financial sector** assets and liabilities grew 13.1% and 9.8% respectively, between September 2005 and September 2006. Total assets for the sector equaled RD\$489.70 billion, while liabilities reached RD\$397.47 billion. During this period, paid-in capital increased 20.0%. Additionally, new regulations for financial system operations were introduced during the year.

Notable among these are modifications to the calculation of multiple service banks' legal reserve requirement. The publication of the Draft Regulation on Risk Exposure (*Proyecto del Reglamento de Concentración de Riesgos*) was approved, and so were the standards that regulate the issuance of mortgage bonds.

Finally, as a result of the economy's performance this year, GDP projections were revised, showing an expected growth of 10.1% for year-end 2006; in other words, continued double digit growth.