

**Report on the Dominican Economy**  
**January – June, 2007**  
**Executive Summary**

During the first half of 2007, the Dominican economy grew by 7.9%, driven mainly by the following sectors: financial intermediation (48.0%), communications (18.6%), commerce (14.0%), energy and water (9.8%), hospitality (6.6%), transportation (6.3%) and other service activities (6.7%). In the most active sector, financial intermediation, the decisive factor was the multiple service banks' private sector loan portfolio. At month-end June, in absolute terms, this portfolio had increased by RD\$ 46.53 billion, more than half of which corresponded to loans for production.

On the expense side, the principal determinants of real GDP during the first half were final consumption and gross capital formation. Final consumption rose by 13.6% and gross capital formation by 10.2% when compared to the same prior-year period. Within final consumption, the fastest growth took place in private consumption, which grew by 14.2% during the period in question. Gross capital formation's performance was the result, among other factors, of a 42.6% increase in capital goods imports valued in dollars.

The principal indicators for the Dominican labor market, as per the National Labor Force Survey for April 2007, suggest that the broad unemployment rate continued on a downward trend, standing at 15.6% for April. This is a drop equal to 0.4 percentage point compared to the 16.0% figure for October 2006, and represented the creation of 59,141 new jobs, consistent with economic growth for the period. It should be noted that this new employment, together with the cumulative increase of 286,636 jobs registered between October 2004 and October 2006, results in a total 345,777 new jobs for the period between October 2004 and April 2006.

Domestic prices were kept within the limits established in the Monetary Program. Inflation for the first half of the year, according to the Consumer Price Index (CPI) stood at 4.38%, principally due to increases in the world oil market. Accordingly, if the oil factor is excluded from the CPI, inflation would equal only 1.97%. In annualized terms, the inflation rate was 5.91%.

In the external sector, the balance of payments global result for the Dominican economy was US\$ 441.2 million for the period in question. This is consistent with an increase in Central Bank international reserves for the period. The balance of payments current account registered a deficit of US\$ 802.3 million, which was funded by foreign capital inflows. The current account deficit was largely due to an increase in total imports of 18.2% compared to the same prior-year period.

With regard to the components of the commercial balance, national exports excluding industrial free zones grew by US\$ 472.8 million or 51.9%. This performance was favored by a rise of 131.3%, worth US\$ 358.3 million, in ferronickel exports, due to higher prices in the international markets. Domestic imports rose by 26.5% during the period, mainly because of the "other imports" category, which increased by 55.2%. Capital goods imports grew by 42.6% and consumer goods by 33.0%.

The balance of payments capital and financial account finished the period with a surplus of US\$ 643.4 million, which is 33% higher than the same prior-year period. Foreign direct investment for the period stood at US\$ 592.8 million, lower by US\$ 23.4 million than the figure for 2006. Foreign capital inflows allowed the Central Bank to continue the process of building up reserves initiated in 2004. During the first half of 2007, Net International Reserves grew by US\$ 454.3 million.

Preliminary results indicate that the Central Government fiscal accounts, on an accrual basis, registered a surplus of RD\$ 10.33 billion, which is equal to 1.8% of GDP. This is in contrast to the deficit figure for the same prior-year period of RD\$ 6.53 billion. The Non-Financial Public Sector had a surplus of RD\$ 13.31 billion. This figure more than complied with the IMF Stand-by Agreement's quantitative target for fiscal performance. This improved fiscal performance for the first half of the year is the result of a program that includes enhancements in customs administration, tax compliance, public spending, and government debt.

As to the monetary sector, Central Bank policy focused on meeting the Monetary Program's inflation objective for the first quarter 2007. Annualized inflation as of June was 5.91%, which was within the program target figure, despite sharp increases in the international oil market. As in earlier periods, the principal monetary policy instrument was applied through open market operations. Thus, the monetary base indicative target, as defined in the IMF Stand-by Agreement, was amply met. During the period under analysis, important steps were taken toward a definitive solution for the quasi-fiscal situation, as the National Congress approved the Central Bank Recapitalization Law.

In the second quarter of 2007, the financial sector witnessed greater activity among assets and liabilities than in the prior quarter. Accordingly, total assets and liabilities more than quadrupled the growth registered during the first quarter of 2007, favored by an expansion in the loan portfolio. On the other hand, net worth grew by 3.2% as of June 2007. With regard to the financial regulatory environment, the Regulation on Corporate Governance received definitive ratification. This constitutes one of the most important pillars of the framework of standards that apply to financial intermediation institutions.