

**Report on the Economy of the Dominican Republic**  
**January – December, 2008**  
**Executive Summary**

The year 2008 was marked by a progressive worsening of international financial conditions resulting from the collapse of the U.S. real estate market, particularly with regard to subprime mortgages. Inadequate risk analysis, combined with financial innovations in the context of an increasingly unregulated environment, led to the growing impact of this crisis throughout the U.S. financial sector and among the leading financial institutions worldwide. Consequently, this provoked a severe liquidity crisis and limited access to credit, and thus a global slowdown in economic activity. Accordingly, the elevated price levels for oil, food, and metals evident during much of the year exacerbated the uncertainties that characterized the handling of economic policy, particularly with regard to emerging economies such as the Dominican Republic.

In this context, the Real Gross Domestic Product (GDP) for the Dominican Republic grew by 5.3% in 2008. This was due to expansion in the following sectors: Communications (19.9%); Financial Intermediation and Insurance (13.7%); Water and Energy (10.3%); Commerce (5.0%); Other Service Activities (4.8%); Transportation (4.2%); and Hospitality (3.4%). On the other hand, the following sectors registered negative growth compared to their share of GDP for 2007: Mining (-30.3%); Agriculture and Livestock (-3.4%); Industrial Free Zones (-1.1%); and Construction (-0.4%).

According to preliminary reports, within the Central American region, the Dominican Republic's economic growth is in second place after Panama (9.2%). Spending growth in the Dominican economy was fueled primarily by internal demand. End consumption increased by 7.1% and gross capital formation by 9.2%. Both indices were under performance levels for 2007.

At the same time, inflationary pressures in the Dominican Republic varied widely during the course of 2008. During the first half of the year, the Dominican economy faced strong inflationary pressures due to unprecedented price levels for oil and other commodities in the international market, as well as an overheated public and private internal demand. However, in the second half of the year the international financial crisis worsened, giving way to a sustained slowdown and stabilizing oil prices. This eventually led to lower domestic inflation during the fourth quarter.

In order to preserve macroeconomic stability, the monetary authorities adopted a series of constraints geared to reducing inflation by means of lower internal demand. The constraints included three increases applied to the monetary policy (overnight) rate, important changes to the composition and calculation of the legal reserve requirement, and sales of international reserves. These constraints helped to close the year with an inflation rate of 4.52%. This came after an average of 10.76% for the first three quarters and 8.88% for 2007. In addition to achieving control over inflation, the Dominican foreign exchange market was kept relatively stable. This is reflected in the fact that the exchange rate depreciated a mere 3.46%. This is the second lowest level of depreciation in Latin America after Guatemala.

In the external sector, the balance of payments current account registered a deficit of US\$4.44 billion in 2008, equal to 9.7% of GDP. This was due primarily to the oil and food price increases, as 53.6% of the increase in the deficit from 2007 to 2008 may be explained by this fact. Regarding national exports, these fell by US\$231.0 million, or 8.8%, mainly as a result of a drop of US\$606.4 million in ferronickel exports. The greater part of the current account deficit was financed by the capital and financial account, in particular by higher inflows of foreign direct investment. FDI flows reached the unprecedented figure of US\$2.88 billion during the period in question.

In the fiscal area, the Non-Financial Public Sector balance reflected a deficit equal to 3.4% of GDP. This result derives from increases to the subsidies for LPG, electricity, and food in the first half of the year, in order to offset international price increases, as well as spending to alleviate the effects of four large storms that affected the country in 2008. Meantime, the Central Bank quasi-fiscal deficit stood at 1.3% of GDP, which is below the expected level as projected in the Monetary Program for the year.

During 2008, the financial sector maintained a favorable performance, albeit with a certain degree of slackening as of the third quarter. The sector held its own in terms of strength and stability, backed up by the country's consistent macroeconomic performance despite the overseas turmoil. Total financial sector assets and liabilities grew by 11.0% and 11.7%, respectively, compared to December 2007. Asset growth was driven by an expansion in the loan portfolio, while the higher levels of liabilities resulted from rising external financing and growth in deposit taking and outstanding securities in the hands of the public

The credit portfolio remains the caption representing the greatest weight and growth rate among total sector assets, expanding by 17.7% in 2008. Regarding liabilities, the increase at year-end 2008 can be explained by a 31.4% rise in outstanding paper, and by the fact that other borrowings rose from RD\$4.92 billion in December 2007 to RD\$16.51 billion as of December 2008. As of that date, the sector's equity had increased by 10.1%, thus reinforcing the trend toward a stronger capital base that has been noted in recent years.