

## **REPORT ON THE DOMINICAN ECONOMY, JANUARY-JUNE 2009 EXECUTIVE SUMMARY**

The Gross Domestic Product (GDP) of the Dominican Republic grew by 1.4% in real terms during the first half of 2009. This result reflects a slowing of economic growth as a consequence of the global crisis and its impact on the Dominican economy. In the second quarter, however, economic activity was up by 1.8%, higher than that observed in the first quarter when the economy grew by just 1.0 percent. The greater growth in the second quarter reflects, in large measure, the effects of the monetary measures that were implemented earlier this year.

Economic sectors registering the best performance in the first half of the year were: Communications, 19.4%; Agriculture and Livestock, 12.7%; Financial Intermediation and Insurance, 7.8%; Other Services, 6.5%; Health, 3.9%; Education, 3.2%; Rental Housing, 3.1%; Public Administration, 2.2%; and Energy and Water, 2.1%. These activities together accounted for 45.1% of GDP. In contrast to the positive performance in these sectors, activities related to external demand continued to show the negative effects of the global crisis on the Dominican economy. In this regard, the following sectors registered negative growth: Mining (-76.1%); Industrial Free Zones (-19.8%); and Hospitality (-7.3%). Other sectors that had negative results for the period were Construction (-19.2%); Trade (-5.5%); Local Manufacturing (-2.4%); and Transportation (-1.8%).

On the demand side, private consumption, whose share in GDP is 90%, in real terms grew by 6.5% during the first half of the year. This expansion in private consumption contributed to a growth rate of 6.1% for final consumption during the period in question. In contrast, public consumption fell by 5.2 percent. Gross Capital Formation was another component of GDP on the expenditure side that underwent a significant decline. This variable, which represents 17.0% of the country's GDP, dropped by 19.8%; in the first half of 2009, compared to the same period last year when it increased by 16.3 percent.

Despite the crisis situation that has affected the world economy and its impact on the Dominican economy, inflation remained low during the first half of the year. In cumulative terms, the change in the Consumer Price Index (CPI) in the first two quarters of the year was 3.19%, markedly less than the 7.57% registered during the same prior-year period. The CPI components that exhibited the highest increases in this period were fuel prices (2.58%) and electricity (0.47%), which together contributed 3.05 percentage points to the inflation index in the first half of the year. It should be noted that inflation stood at just 0.26% at the close of June 2009, indicating a significant drop in the growth rate of price levels during this period. Due to this result, the Dominican Republic is in second place among Latin American economies with the lowest annualized inflation rates.

With regard to the external sector, the impact of the crisis gave rise to a deficit of US\$803.4 million in the balance of payments current account. However, the deficit was lower than in the same prior-year period, at which time it stood at US\$1.44 billion. This reduction in the deficit is explained by, among other things, the significant decline in the price of oil and of some imports of foods and commodities, as well as a reduction in demand for imported goods. The current account balance was financed by the capital and financial account, the balance of which was positive at US\$375.6 million due to foreign capital inflows, mainly as FDI amounting to about US\$1.56 billion.

Regarding the main components of the current account, national exports excluding industrial free zones went down by US\$480.2 million (35.9%). Similarly, industrial free zone exports declined by US\$483.9 million (21.9%) for reasons related to the global economic crisis. On the import side, the slowdown in economic growth and a reduction in international commodities prices in the first half of the year resulted in lower demand for imported goods. In this regard, imports for the first half equaled US\$5.58 billion, which represents a reduction of close to US\$2.60 billion (31.7%) compared to the previous year. That decline included a sharp drop in the oil bill, which, at US\$1.10 billion, was 53.2% lower than the amount for the same prior-year period.

In the fiscal sector, Central Government accounts were affected by the impact of the global crisis on revenues, which fell below projected levels. As a result of this reduction, and also due to a sharp decline in public investment, the Central Government deficit (using the accrual method) reached RD\$11.22 billion. Accordingly, the Non-Financial Public Sector (NFPS) registered a deficit of RD\$9.92 billion during the same period. The Central Government's total revenue in the January-June period amounted to RD \$ 112.85 billion. This represents a percentage decline of 12.5%; compared to the same period of 2008. In similar fashion, total expenditure slowed to RD\$119.34 billion. This is an absolute reduction of RD\$26.15 billion from the comparable period of 2008, and is equivalent to a percentage decline of 18.0%.

In the meantime, monetary policy was actively applied in the first half of the year, when measures were taken to reduce interest rates and foster private local currency credit. Monetary policy actions were initiated earlier this year with reductions in interest rates on overnight deposits and the Lombard window. Moreover, for the purpose of maximizing the scope of the overnight and Lombard rate cuts, the Central Bank decided to revise downward the rates for direct over-the-counter securities. Other measures to enhance the effectiveness of the monetary policy transmission mechanism include: a reduction in legal reserve requirements, the funds liberated to be used for credits to productive sectors; and the adoption of an expansionary stance in the management of central bank bill maturities.

As a result of the monetary measures applied, in the second quarter of 2009 interest rates began trending downward. The month of June closed with weighted average lending rates of 17.71% and deposit rates around 7.01% per annum. These rates were lower by 3.01 and 3.62 percentage points, respectively, compared to March 2009 levels. The loan portfolio experienced an upswing of 2.9% over December 2008, but if the drop of 1.3% registered in March 2009 is taken into account, this represents an effective increase of 4.2%. The measures applied by the authorities, as outlined above, led to greater channeling of bank credit to the productive sectors of the economy, albeit with some lag.

Overall, macroeconomic stability has been maintained despite the difficult environment for the Dominican economy in the context of the global crisis. The first signs of a possible recovery seem to be appearing on the international scene, which would allow the Dominican economy to benefit from a less adverse global context. The Central Bank, as the entity responsible for ensuring price stability, will be alert to any changes in economic conditions, so as to apply measures ensuring macroeconomic stability and creating an enabling environment for increasing investment levels and economic activity in the Dominican Republic.