

REPORT ON THE ECONOMY OF THE DOMINICAN REPUBLIC
JANUARY-JUNE, 2010
EXECUTIVE SUMMARY

The Dominican economy showed a strong recovery by growing 7.5% during the first half of the year, after having expanded at just 1.4% in January-June last year. Almost all productive activities recorded an annualized increase as a result of economic policy measures adopted by the monetary authorities in the context of the crisis affecting the international economy. These measures helped facilitate a greater flow of resources toward the economy in an environment characterized by exchange rate stability and low inflation.

The most active sector in the January-June period was Construction, which increased by 15.2%; followed by Commerce, 14.3%; and Energy and Water, 10.6%. Other activities registering positive results were: Financial Intermediation and Insurance, 9.7%; Local Manufacturing, 9.3%; Agriculture and Livestock, 7.8%; Communications, 7.8%; Education, 6.8%; Transportation, 5.8%; Health, 5.1%; Other Services, 4.1%; Rental Housing, 3.3%; Hospitality Sector, 2.2%; and Public Administration, 1.8%.

When considering the expenditure approach in measuring economic activity, the recovery of domestic demand stands out, growing by 9.3% in January-June 2010, compared to an increase of only 0.1% during the same period last year. Two factors that contributed to the expansion in domestic demand are final consumption and gross capital formation, which grew by 7.1% and 21.3%, respectively. The improvement in economic activity contributed to a decline in the expanded unemployment rate, from 14.9% in October 2009 to 14.4% in April 2010.

During the first half of the year, it is noteworthy that in an environment of high economic growth, inflation remained at low levels, consistent with Monetary Program targets. Accumulated inflation, as measured by the variance in the Consumer Price Index (CPI), for month-end June was 2.87%. This is lower than the 3.19% rate observed for the same prior-year period. In annualized terms, inflation was 5.44%, which is below the 6.0% -7.0% range established in the Monetary Program.

In the external sector, preliminary figures indicate an overall deficit of US\$410.1 million in the balance of payments and a current account deficit of US\$1.93 billion during the first half of the year. Among the main factors influencing this balance is an increase of 40.4% in fuel prices in the international markets. The financing of the current account deficit was achieved through an increase in foreign capital inflows, particularly in the form of portfolio investments, foreign direct investment and external borrowing.

At the end of June this year, Central Bank Net International Reserves (NIR) showed a decrease compared to year-end 2009. This had been contemplated in the design of the present year's Monetary Program. Despite this reduction, NIR stood at US\$2.51 billion, while consolidated NIR, (Central Bank NIR plus the Government's IMF obligations) reached US\$2.18 billion. This comfortably exceeds the target of US\$1.76 million established under the Stand-By Agreement.

In the fiscal sector, at the end of the first half of the year, the Central Government balance on an accrual basis had registered a deficit of RD\$29.74 billion, which is below the fiscal target of

RD\$30.4 billion stipulated in the IMF Agreement. This deficit was the result of a significant increase in government spending, particularly in public investment. Growth in income and spending in January-June 2010 compared to the same prior-year period was consistent with the greater economic activity that was registered during the period in question.

In the meantime, monetary policy continued to support the economic recovery that began in 2009 by meeting the goals of currency issuance and maintaining policy rates unaltered; the latter are at historically low levels. During the first half of the year, liquidity management was conducted through the placement of Central Bank securities through competitive bidding and by the use of international reserves, as set out in the Monetary Program. In the last week of June, the weighted average rate in the bidding for Central Bank securities was 4.96%, which represents an increase of 0.19 percentage points over December 2009.

As at June 30, 2010, the financial sector reflected a favorable performance when compared to the same date in 2009. This was driven by the principal variables, which were influenced by solid loan and deposit growth during the first half of the year, as well good results from the financial and management indicators. For June 2010, total sector assets and liabilities registered increases of 15.5% and 17.0%, respectively. In regulatory matters, at the request of the financial intermediaries the authorities introduced some amendments to the Regulation on Operational Risk, which was published for consultation with stakeholders.

In the second quarter of 2010, the lending rates of financial intermediaries continued the downward trend that has been observed for several consecutive periods, while deposit rates show a slight increase over March 2010. Multiple service banks' weighted average lending and deposit rates stood at 11.72% and 4.55% respectively. Lending rates decreased by 0.54 percentage points and deposit rates increased 0.31 percentage points compared to the results for March 2010.

The figures corresponding to the first half of the year show a significant recovery for the Dominican economy, in an environment of macroeconomic stability. Economic policy continues to be implemented according to the guidelines presented in the country's Letter of Intent, sent to the IMF last year. Following these guidelines, it is expected that by the end of the present year inflation should remain between 6% and 7% in an environment of macroeconomic stability. The monetary authorities are committed to meeting the inflation target and to creating the conditions for maintaining exchange rate and price stability, in an environment of sustained growth.