

CENTRAL BANK OF THE DOMINICAN REPUBLIC

Economic Note

The Central Bank of the Dominican Republic, following its firm commitment to the maintenance of macroeconomic stability and control over inflation as its basic function, and in the interest of orienting economic agents and the general public, wishes to inform with regard to the effects of its recent monetary policy decisions and the prospects for the local economy for the second half of 2008, considering the impact of international events.

Recently, volatility in international markets is showing signs of moderation, particularly oil and food prices; this reduces the expectations for imported inflation. As a result, the central banks in the United States, the European Union, and the United Kingdom have simultaneously decided to maintain unaltered their monetary policy interest rates. In similar fashion, international oil prices may be reflecting a correction in the speculative component of their performance, in accordance with the reduction in demand pressures given the global economic slowdown.

Internally, the restrictive monetary policy implemented by the Central Bank has been effective in reducing the growth rate of private credit, in order to lessen the pressure on internal demand. In fact, interannual growth in local currency commercial bank credit to the private sector has fallen from 33.2% in December 2007 to 18.5% in July 2008. Evidence of this is the nearly RD\$ 4,500 million reduction in private sector commercial credit in domestic currency, compared to June 2008.

Additionally, the Government transferred RD\$ 4,007 million to the Central Bank for interest payments on bonds and recapitalization instruments issued by the Finance Ministry at the beginning of the year and corresponding to the first quarter. This is an important source of contraction, which contributes to meet the money supply target set in the 2008 Central Bank's Monetary Program.

It should be noted that the accumulation of international reserves by the Central Bank have strengthened the country's external position. They increased by US\$ 133 million from June to the present. It is expected that a robust foreign direct investment performance, which could surpass US\$2,500 million towards the end of the year, will contribute to the international reserves to the levels registered at the beginning of 2008. This could even allow us to surpass those levels for year-end 2008, which would be consistent with the Monetary Program.

Furthermore, the fiscal policy measures recently announced by President Fernandez should lead to a decrease of the real interannual growth rate in public spending for the second half of the current year. This will allow to slow down internal demand, thus contributing to a moderation of domestic inflationary pressures and the current account deficit in the coming months.

According to IMF and Central Bank estimations, a US\$10 reduction in the per-barrel price of oil, the national expenditure for this commodity drops by US\$400 million. Thus, it is expected that if oil price trends down below US\$ 120/bbl, this should lead to a notable improvement in the current account balance.

The Central Bank will continue to closely monitor international events and developments in internal markets, as well as their implications for mid and long-term inflation expectations.