

**CENTRAL BANK OF THE DOMINICAN REPUBLIC**  
**Executive Summary – Central Bank Monetary Program - 2011**

The Central Bank of the Dominican Republic, in compliance with the provisions of Monetary and Financial Law No.183-02 and its implementing Regulation, and the First Resolution of the Monetary Board dated December 9, 2010, hereby makes available to the general public the Executive Summary of the Monetary Program for 2011.

The implementation of expansionary policies in both the fiscal and monetary areas in the first half of 2010 has accelerated economic growth, allowing for the possibility that the Dominican economy could have expanded by about 6.5-7.0% by year end. This performance would be considered even more remarkable if one takes into account the uncertainty that has affected international markets as a result of the debt problems in Europe and a slower than expected recovery in the United States. Beginning in the second half of the year, the fiscal stimulus has been phased out and a more neutral monetary policy stance has been assumed. This has created the conditions for assuring that these higher levels of economic growth do not jeopardize the inflation target of 6.0-7.0%, as established in the 2010 Monetary Program.

For 2011, it is expected that the global economy will continue its recovery, but at a slower pace than had been previously anticipated. On the domestic front, a Monetary Program has been designed that provides a more neutral monetary policy and greater fiscal consolidation, which would allow growth in the range of 5.5-6.0% without major inflationary pressures, and that would be in line with the Stand-By Agreement with the International Monetary Fund (IMF).

**Preliminary Macroeconomic Results for 2010**

The implementation of fiscal and monetary flexibility measures during the first half of the year brought about strong growth in domestic demand, leading to an increase in real gross domestic product (GDP) of 7.6% in the January-September period. The performance of the economy during this period was driven by the construction, commerce, communications and financial intermediation sectors, all of which benefited from an increased flow of funds from the financial sector, as low domestic interest rates were maintained. According to current projections, the economy should have grown in the range of 6.5-7.0% for year-end.

In 2010, inflationary pressures remained subdued despite faster growth. At the end of November, annual inflation reached 5.4%, which is in line with the projected Monetary Program target of 6.0-7.0% for 2010. It should be noted that inflation should remain within this range, despite the adjustments made to fuel prices and electricity rates in the last quarter of the year. Taking these changes into consideration, inflation would stand at an annualized rate of 6.3% by the end of December.

In 2010, the balance of payments current account registered higher deficits than those observed in 2009. This deterioration was mainly due to rapid growth in imports of goods and services, and was particularly affected by the oil bill, as a result of greater domestic economic activity. For year-end 2010, we expect a final result for the current account deficit of 7.5% of GDP and an

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overall balance of payments deficit of US\$476.6 million. Tourism should have grown 4.6% due to the recovery of the developed economies and, in particular, as a by-product of strong growth in the South American economies, whose nationals represent an increasingly significant share of tourist arrivals. In terms of remittances, we expect the final figure for 2010 to show a falloff of 2.8% compared to the previous year.

During the first half of the year, the Government implemented an expansionary fiscal policy, specifically through a significant increase in public spending. Starting in the third quarter, a gradual moderation began to be applied to spending. This, along with the recovery of tax revenues associated with increased economic activity, contributed to a fiscal deficit position equal to approximately 2.4% of GDP at the end of September. It is expected that in the fourth quarter the trend of slower growth in public spending has been maintained, and would continue the strengthening of tax revenues as the economy maintains its momentum. Thus, the projections are for a Central government fiscal deficit of about 2.3% of GDP, which is lower than the 3.5 percent rate registered in 2009.

In the realm of monetary policy, the Central Bank is undergoing a transition process toward a monetary policy regime based on inflation targeting. Under this scheme, the Central Bank would use a benchmark interest rate as a mechanism to signal its policy stance. Variances in the benchmark interest rate or monetary policy rate would be transferred to the rest of the financial system rate structure and would fulfill the ultimate goal of affecting real economic variables, including inflation, through the transmission mechanisms for monetary policy.

In an environment of low inflationary pressure and a slower than expected global economic recovery, the Central Bank applied a monetary policy based on low interest rates during the first nine months of the year, thus boosting private credit and contributing sensibly to the revitalization of domestic economic activity. In January-September, the interest rate band, consisting of the monetary policy (overnight) rate and the Lombard rate, remained unchanged at 4.0% and 9.5%, respectively.

However, starting in October, the Central Bank changed its policy stance when it began gradually withdrawing the monetary stimulus that it had been offering since early 2009. In this regard, the Central Bank during the course of its policy meetings decided to raise its monetary policy interest rate by 0.75 and 0.25 percentage points for September and October, respectively. These measures are aimed to prevent the inflation rate from deviating from its target range for 2011, given the lag effect inherent in the transmission mechanisms for monetary policy.

For the end of 2010, it was expected that the Monetary Program inflation target would be met, somewhere in the range of 6.0-7.0 percent. Estimates for December 2010 indicate that the restricted monetary base would be near the lower limit of the Monetary Program range for that month. M2 and M3 monetary aggregates (on a harmonized basis) would grow at rates of around 8.0%, while domestic currency private sector loans would expand by 18.5% by the end of 2010.

**International Environment for 2011<sup>1</sup>**

The world economy underwent a modest recovery in 2010, to reach a projected growth of 4.8% according to IMF estimates. The emerging and developing economies have performed better than the advanced countries, with a projected growth of 7.1% compared with 2.7% for the latter. The U.S. would grow by 2.6% in 2010 according to the IMF, while the European Union will have expanded by 1.7% during the year. Latin America, meanwhile, closed the year with a growth of 5.7%. Thus, the recovery of the global economy continues to depend on emerging economies, while advanced economies would continue to grow at a moderate pace.

As a result of the expansion in global output, international trade, which had contracted by 11% in 2009, should have grown by 11.4% in 2010, while global inflation as measured by average consumer prices should have reached 2.7, compared to -3.2% in 2009.

Despite the ongoing recovery of global output, the lag effects of the economic crisis are still sharply evident in some countries, especially the advanced economies. This is reflected in a negative output gap, and, as a result, relatively high unemployment and low inflation rates. In order to try to improve the economic situation, both developed and developing countries have implemented policies aimed at fiscal stimulus and monetary easing, that have sought to restore consumer confidence and stimulate investment activities.

In this regard, the interventions of the Federal Reserve Bank of the United States and the European Central Bank have been relevant. These agencies have maintained low interest rates and provided liquidity to financial markets for extended periods, which is reflected in the depreciation of currencies such as the U.S. dollar against the currencies of several emerging and developing economies.

On the other hand, commodity prices, especially oil, metals and food, have reacted to both the global economic recovery, which has improved the prospects for demand growth, and the depreciation of the dollar, the invoicing currency for which most of these goods. With regard to this, the IMF energy price index increased by 21.9% in 2010, while prices for food and metals increased by 7.4% and 31.4% respectively.

For 2011, a global GDP expansion of 4.2 percent is foreseen. The output of the emerging economies would grow at 6.4%, while for the developed economies growth would be around 2.2 percent. Low inflation levels are anticipated and downside risks predominate with regard to this outlook, although the possibility of a new recession has been ruled out.

In some economies, both advanced and emerging, there are some adjustments that have yet to take place, such as the stabilization and reduction of high levels of public debt, and financial system restructuring and reform. Monetary policy will remain flexible in most developed economies, and the use of further unconventional measures is recommended if policy rates continue to be as close to zero as they are.

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<sup>1</sup> This section is based on "World Economic Outlook," International Monetary Fund, October 2010.

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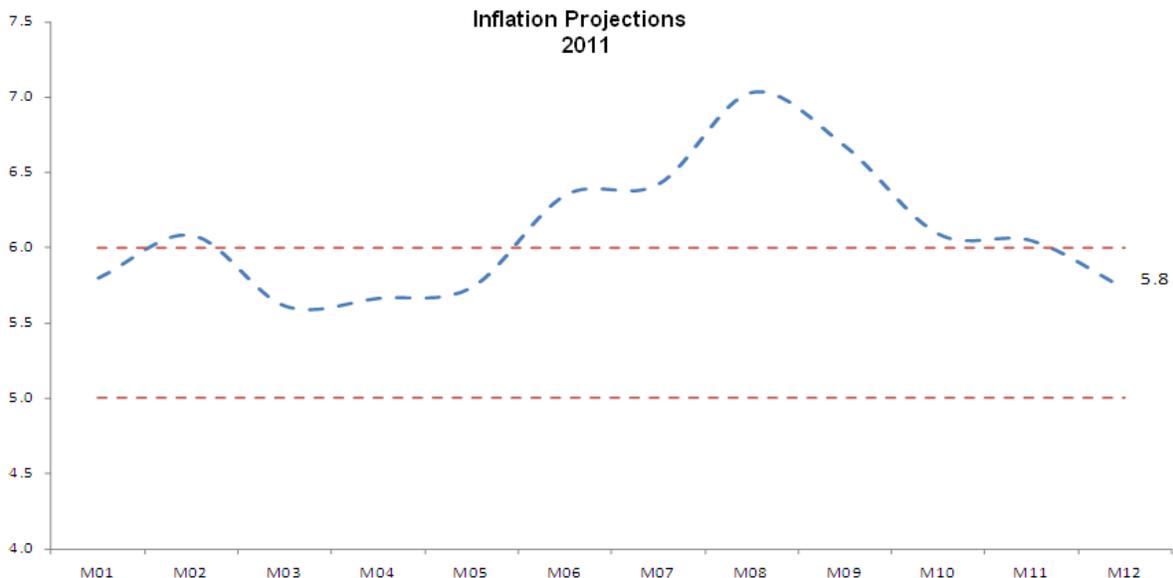
The U.S. economy seems to be recovering, in particular due to unprecedented stimulus initiatives to be applied through macroeconomic policies, and thus growth of 2.3% is forecast for 2011. In Europe, 2010 has been dominated by the sovereign debt crisis, while the application of liquidity support and the creation of new financing instruments have halted financial turbulence. The IMF estimates that GDP in the advanced European economies will grow at a rate of 1.6% in 2011.

In general, Latin America has enjoyed a faster pace than expected in its recovery, due to favorable external financing conditions and high income levels derived from the export of raw materials, especially for the countries of South America. It is expected that the region's growth will stand at 4.0% in 2011.

### Macroeconomic Prospects for the Dominican Republic in 2011

From the economic point of view, this year is seen as one of adjustment and fiscal consolidation at the domestic level in the Dominican Republic, and moderate growth for the international economy. Locally, we expect the phasing out of fiscal and monetary stimulus measures that the economy enjoyed until the third quarter of 2010. At the international level, we predict higher oil prices as the process of global economic recovery continues.

The Monetary Program for 2011 has been designed taking these factors into account, as well as the ongoing agreement with the IMF, which includes an inflation target within the range of 5.0-6.0% for year-end. The inflation target is consistent with the continuing process of price reduction, which is in line with the eventual transition to a policy strategy based on an inflation targeting framework.



While the economy would grow by 5.5-6.0% in 2011, a level close to potential, it is expected that the implementation of fiscal and monetary policies of a more neutral nature will help contain any suggestion of inflationary pressure. In this regard, the major source of inflationary pressure could

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originate in the external environment, since higher oil prices are expected as the recovery in global economic activity continues.

In accordance with the 2011 Monetary Program, the current account deficit would close 2011 at 6.3% of GDP, a sharp reduction compared to the 7.5% of GDP expected for year-end 2010. This narrowing of the current account deficit would be achieved by means of slower growth in imports than that of the previous year, combined with greater activity in the export sector. An expansion of tourism is also expected, as well as a rebound in foreign direct investment, which would stand at around US\$1.90 billion by year-end 2011.

In the fiscal area, we expect revenue growth of about 12.2% that when coupled with a slowdown in spending growth to near 7.6%, would result in a reduction of the Central Government deficit to 1.6% of GDP.

The fulfillment of these expectations is subject to the developments in international oil prices, since higher than expected increases in this commodity could generate inflationary pressures. Meeting these targets is also linked to the performance of the U.S. economy, since any reduction in that country's growth rate would have a negative impact on the outlook for the Dominican Republic.

### Objectives and Targets of the Monetary Program

An inflation rate within the target range of 5.0-6.0% is a principal monetary policy objective of the 2011 Monetary Program. This is consistent with a growth rate of 5.5 - 6.0 % for the Dominican economy. To achieve this, the policy will be designed to transition to an inflation targeting regime in the context of the IMF Agreement, setting quarterly targets for consolidated net international reserves and net domestic assets. These targets are to be determined through estimates for the relevant monetary aggregates, and are shown below.

Variable	Mar 2011	Jun 2011	Sep 2011	Dec 2011
Inflation Target, y-o-y	5.9%	6.8%	6.8%	5.9%

#### ▪ Central Bank Net International Reserves (NIR)

By definition, net international reserves exclude current liabilities of gross reserves. Estimates for 2011 contemplate a pattern of reserve accumulation that allow for an increase above the figure for 2010 of \$ 555.5 million in total net international reserves, bringing the balance of this caption to US\$3.28 billion.

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Figures in millions of US\$

Variable	Mar 2011	Jun 2011	Sep 2011	Dec 2011
NIR Accumulation Model	-286	164	164	515
NIR Level	2,436	2,600	2,764	3,278
Annual Cumulative Target				556

### ▪ Consolidated Net International Reserves

The consolidated net international reserves include Central Bank gross international reserves minus reserve liabilities, including the Ministry of Finance debt with the IMF. By December 2011, these reserves must equal at least US\$2.32 billion, implying a buildup to US\$300.0 million above the 2010 year-end target.

Figures in millions of US\$

Variable	Mar 2011	Jun 2011	Sep 2011	Dec 2011
NIR Accumulation Model	-350	100	100	450
NIRC* Level	1,666	1,766	1,866	2,316
Annual Cumulative Target				300

\*According to the definition in the IMF Agreement.

### ▪ Net Domestic Assets

The net domestic assets of the Central Bank express the differential between the restricted monetary base and the consolidated net international reserves in Dominican pesos. During the year, net domestic assets will be capped on a quarterly basis for the full year at RD\$80.0 billion, beginning in the fourth quarter of 2010.

### ▪ Restricted Monetary Base

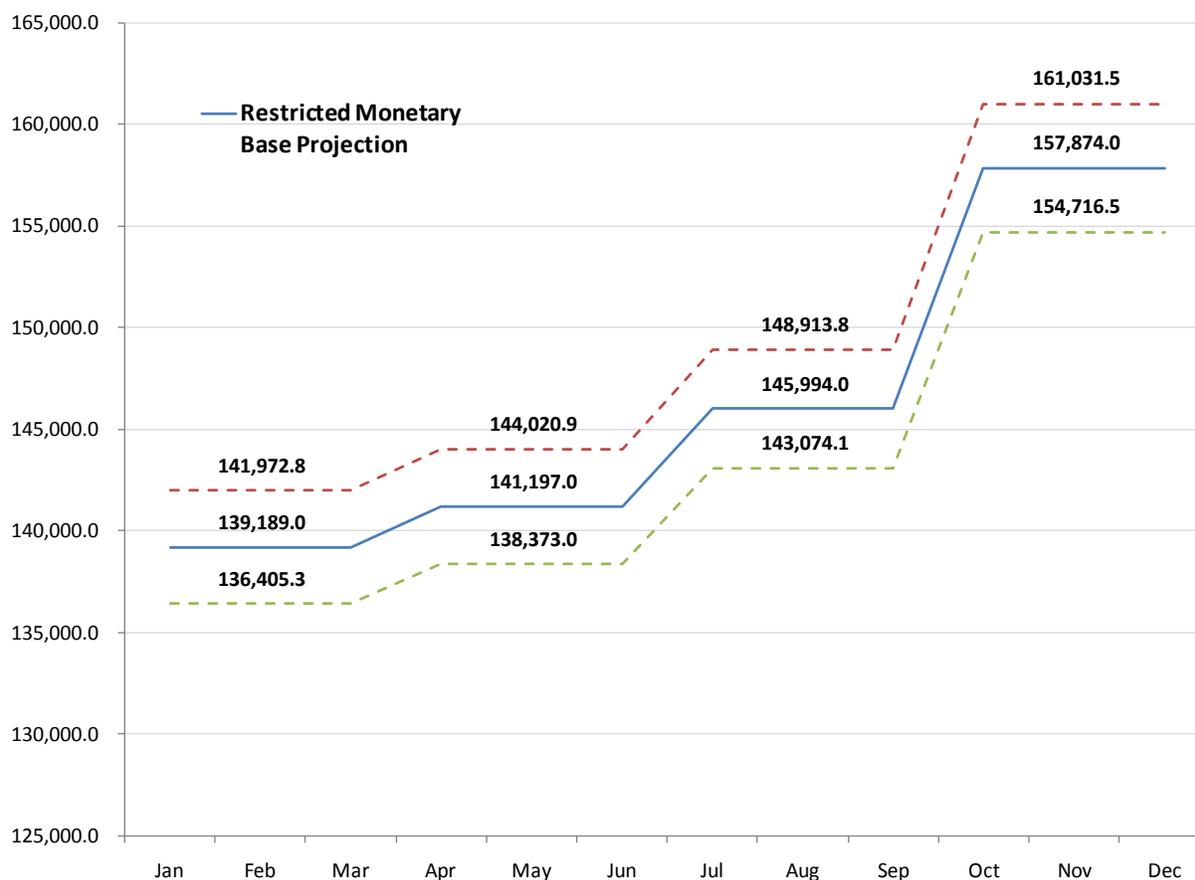
The restricted monetary base is considered an indicative target in the 2011 Monetary Program. It consists of banknotes issued and bank sight deposits in national currency at the Central Bank. During 2011, the accumulation of international reserves and interest payments on security issues are seen as major expansion factors. Moreover, the placement of participation certificates will be the most important contraction factor. The expected changes in the sources and uses of the restricted monetary base as analyzed in the Program are presented below.

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Figures in millions of  
RD\$

Variable	Mar 2011	Jun 2011	Sep 2011	Dec 2011
<b>Sources of the Restricted Monetary Base</b>	<b>139,189</b>	<b>141,197</b>	<b>145,994</b>	<b>157,874</b>
Net International Reserves (In RD\$)	94,075	101,324	108,603	129,464
Net Domestic Assets	45,115	39,873	37,392	28,410
<b>Uses of the Restricted Monetary Base</b>	<b>139,189</b>	<b>141,197</b>	<b>145,994</b>	<b>157,874</b>
Currency Issued	68,742	70,559	72,819	80,348
Currency in Circulation	55,212	56,242	57,828	65,296
Cash and Due from Banks	13,530	14,317	14,991	15,052
Bank Sight Deposits in RD\$	70,448	70,638	73,175	77,525

**Monetary Base Target and Tolerance Range of +/- 2%**



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### Summary - Principal Macroeconomic Indicators 2010 Preliminary Figures – 2011 Forecast

Variables	2010 Estimates	2011 Forecast
<b><u>Real Sector</u></b>		
Real GDP Growth	6.5-7.0%	5.5-6.0%
Inflation Rate, end of period	6.0-7.0%	5.0-6.0%
Inflation Rate, average	6.42%	6.37%
GDP Deflator Growth	6.4%	5.4%
<b><u>Fiscal Sector</u></b>		
Var. % Total Income, Central Government	14.0%	12.2%
Var. % Fiscal Revenues, Central Government	12.7%	11.8%
Var. % Total Expenditure, Central Government	7.1%	7.6%
Var. % Current Expenditure, Central Government	4.2%	8.5%
Var. % Capital Expenditure, Central Government	17.8%	4.7%
Non-Financial Public Sector Balance	-2.5% of GDP	-1.6% of GDP
Consolidated Public Sector Balance	-3.8% of GDP	-3.0% of GDP
<b><u>External Sector</u></b>		
Balance of Payments Current Account Deficit	-7.5% of GDP	-6.3% of GDP
Var. % Domestic Exports	52.5%	31.4%
Var. % Domestic Imports	24.5%	7.3%
Var. % Other Imports	33.1%	9.1%
Oil Invoice (US\$ Bn)	US\$3.46	US\$3.80
Foreign Direct Investment (US\$ Bn)	US\$1.53	US\$1.90
<b><u>International Reserves</u></b>		
Gross International Reserves (US\$ Bn)	US\$3.14	US\$3.92
Net International Reserves (US\$ Bn)	US\$2.72	US\$3.28
Consolidated Net International Reserves (US\$ Bn)	US\$2.02	US\$2.32
<b><u>Monetary Sector</u></b>		
Growth - Monetary Base	6.8%	7.1%
Growth - Banknotes Issued	7.0%	7.2%
Growth - Sight Deposits in RD\$	6.7%	7.0%
Growth - Private Sector Credit in RD\$	19.4%	11.8%
Growth - Private Sector Loans in RD\$ (Harmonized)	18.5%	11.8%
Central Bank Quasi-fiscal Deficit	-1.2% of GDP	-1.4% of GDP