CENTRAL BANK OF THE DOMINICAN REPUBLIC
Executive Summary of the Central Bank's
Monetary Program for 2012

1. INTRODUCTION

a. A Monetary Program under Inflation Targeting

Beginning in 2012, the Central Bank of the Dominican Republic (CBDR) will formally adopt a monetary policy framework based on inflation targeting (ITF). Under this new framework, the central objective is inflation and the nominal anchor becomes the explicit inflation target announced by the CBDR. In this context, the formation of inflation expectations among the agents is important, taking into consideration in their decision making the CB's commitment to keep inflation at the announced level.

The main instrument of monetary policy to be applied in the ITF is a benchmark interest rate that signals the position of the CBDR to the agents, thus allowing a transfer to the other market rates and, eventually, to real variables and inflation performance. The CBDR has chosen the overnight rate or the short-term interest-bearing deposit rate as its benchmark rate.

Under the ITF, the timely management of monetary policy requires an analysis of forecasts for key macroeconomic variables, considering that the effects of measures taken by the CBDR would, with a time lag, be reflected on their final objective, inflation. This is why the inflation targeting framework tends to be forward looking; i.e., it acts to prevent potential deviations of inflation from its target.

In countries that have adopted the framework of explicit inflation targeting, the evidence indicates that the regime has been effective in achieving a reduction in the level and volatility of inflation, as well as moderating volatility in the growth of GDP. Additionally, there has been some success in anchoring inflation expectations to the announced targets.

In applying an inflation targeting strategy, the monetary program is based on a macroeconomic consistency model that contains the projected performance of the main monetary, fiscal, real and external sectors' variables, based on their compliance with the inflation target. This model allows an assessment of the impact of monetary policy actions on other sectors of the economy, establishing in a comprehensive manner the transmission mechanisms for monetary policy and the time lags involved.

Specifically, in a *monetary program under an inflation targeting framework*, monetary aggregates, rather than being seen as intermediate goals, become indicative or monitoring variables in the decision making process.

b. *Convergence on the inflation target in first quarter 2012*

During 2011, the maintenance of a neutral monetary policy stance has led to success in facing the strong inflationary pressures that had affected the Dominican economy during the year. In this regard, the adjustments made to regulated goods and services, as well as higher oil and food prices worldwide, combined to keep the actual rate above the year-on-year inflation target. However, beginning in September, inflation has been cooling down and it is expected that the final year-end figure should come in at levels close to 8.0%.

For 2012, there is still uncertainty about the course that the global economy will take. On the one hand, developed economies should move slowly forward, as the fiscal consolidation processes deepen and they find their way toward a resolution of the debt problems. The emerging and developing economies, on the other hand, would remain the engine of world economic growth, albeit at a slower pace than that observed in 2011, to the extent that they will be affected by the slow economic recovery in the developed economies.

On the domestic front, projections indicate that economic activity will continue below its potential level throughout 2012, with real GDP growth around 4.5%-5.0%. This, along with the weakening of the impact of electricity tariff increases, the price of oil, and the minimum wage, would augur a continuation of the recent moderation in the inflation trend. In this context, the monetary program envisages that inflation would converge on its target of 5.5% (+/-1.0%) during the first half of 2012.

The Central Bank's Monetary Program for 2012 is based on provisions in Article 26 of the Monetary and Financial Law 183-02 and in its corresponding Regulation covering the Monetary Program and Monetary Policy Instruments. According to this regulatory framework, the main objective of monetary policy in the Dominican Republic is price stability.

PRELIMINARY MACROECONOMIC RESULTS - 2011

The external situation in 2011 has been characterized by sluggish activity, high unemployment, and financial difficulties in the advanced economies, which led to the adoption of a more expansionary monetary policy. This monetary easing has acquired an unorthodox touch, with the expansion of central bank balance sheets (e.g., the Fed's Operation Twist[1]) and the use of unconventional instruments. In contrast, the emerging and developing economies performed remarkably well, with high rates of economic growth, which served to support global activity. In these countries, monetary policy has adopted a neutral stance, in order to face inflationary pressures stemming from the revitalized domestic activity.

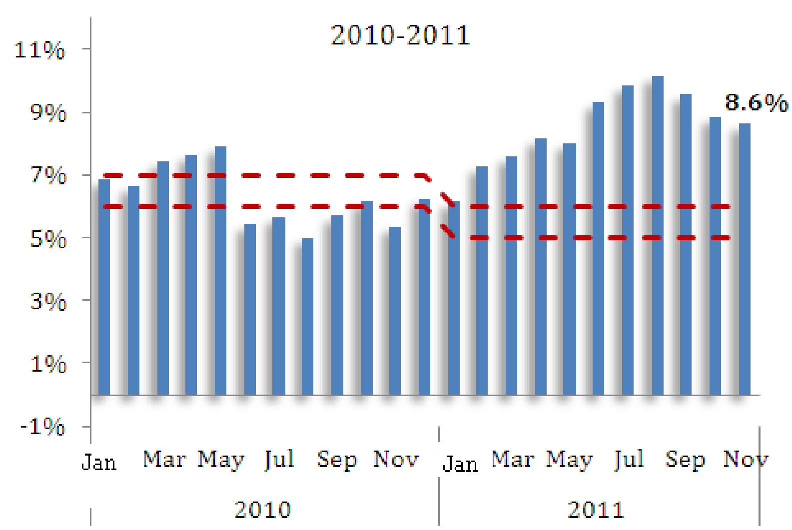
[1] This is a monetary policy maneuver that involves selling shorter-term assets in order to buy more long-term assets.

Greater uncertainty in the financial markets has affected commodity prices, which have been marked by volatile and mostly upward tendencies. In the specific cases of oil and gold, which in addition to their status as basic consumer goods serve as stores of value for investors in times of high volatility, price increases have been more pronounced.

Domestically, in the first three quarters of 2011 the economy expanded by 4.2%, registering greater activity in the third quarter when it grew by 4.5%. However, these growth rates are below the potential capacity of the economy, thus generating a negative shortfall and helping to reduce exogenous inflationary pressures. Indeed, the growth of the economy during 2011 has been below that recorded in 2010 as a result of combining more neutral monetary and fiscal policies.

The slowdown in economic activity was accompanied by strong inflationary pressure throughout the year. In fact, adjustments in the prices of regulated goods and services (fossil fuels, electricity rates, and wages), and the effects of Tropical Storm Irene, coupled with increases in international basic commodity prices (mainly oil and food), maintained inflation high throughout 2011. However, although the year-on-year inflation rate was above the target at all times (8.6% in November), monthly inflation was closely linked to the occurrence of shocks, which ultimately were of a temporary nature, the effects of which are already beginning to dissipate. It is estimated that final year-end inflation will be around 8.0%, while core inflation will stand at 5.5%.

Year-on Year Inflation



Source CBDR

Net exports performed favorably during 2011, supported by a 23.8% increase in exports in January-September and a moderation in non-oil imports. These factors, together with the expected increase in mineral exports (gold and nickel) would allow a decrease in the current account deficit, which would diminish from about 8.0% last year to 5.5% in 2012.

In the earlier quarters of 2011 there was a deepening of the fiscal consolidation process, as a 12.0% cut in non-social public spending was implemented, in addition to a tax adjustment that included the introduction of a tax on the productive assets of financial institutions. Despite the fact that there has been an 8.0% increase in electricity tariffs in June, the higher oil prices during the first half and the damages to power generation caused by Tropical Storm Irene in August have led to a 70.0% year-on-year increase through September in current transfers to the electricity sector.

The CBDR resumed the withdrawal of monetary stimulus with increases in the monetary policy rate conducted between March and May that placed the overnight rate at 6.75%. Between June and November, however, the CBDR left the interest rate corridor unchanged: 6.75% for short-term interest-bearing deposits (overnight) and 9.50% for the Lombard rate.

At the same time, for the purpose of strengthening the transmission mechanisms, the monetary authorities continued to manage financial sector liquidity by conducting open market operations (sales of CBDR securities).

These monetary policy measures led to increases in nominal and real market interest rates, which in turn resulted in a slowdown in the pace of expansion of domestic currency credit to the private sector in. Monetary aggregates also grew more moderately, reflecting tighter monetary conditions.

In November, as part of the strategy of the Recapitalization Plan establishing a gradual reduction in legal reserve requirements, the Central Bank reduced the financial sector reserve requirement, based on the premise that the demand for money associated with the Christmas season would absorb this increase in liquidity. Similarly, in its November Monetary Policy meeting the CBDR reduced the Lombard rate (to be effective in December), in order to continue narrowing the policy rate corridor.

2012 INTERNATIONAL ENVIRONMENT

The external environmental conditions that impact the Dominican Republic are characterized by an increased uncertainty, mainly influenced by a slower than expected recovery in the U.S., the deepening debt crisis in the euro area, and increased volatility in the international markets.

These factors inform a noticeable moderation in global economic activity and the prospect of a more gradual recovery over the medium term. In this regard, we expect an expansion of global economic activity of 4.0%, for both 2011 and 2012. Through trade channels, the slower growth in the developed economies has affected the strong activity that emerging economies had witnessed in 2010. However, these countries continue to be the engine of global growth, expanding at rates above 6.0% in 2011 and 2012.

For the U.S., performance expectations continue to be conservative. Despite having experienced a slight decline in recent months, unemployment remains above 9.0% and, according to the Fed, is expected to continue at levels greater than 8.5% for 2012. GDP would increase by 1.5% in 2011 and 1.8% in 2012, significantly below potential for the U.S.

Additionally, while commodity prices trended upward in early 2011, these have been more moderate in recent months. If this trend continues, it is estimated that oil prices will close 2011 at around US$95.70 and increase slightly in 2012, to around US$101.00 per barrel.

It should be noted that gold prices have remained historically high by acting as a haven for investors, given the uncertain environment. It is expected that this trend should continue until the end of 2012, with a price over US$1,700.00 per troy ounce.

External Variables - Outlook

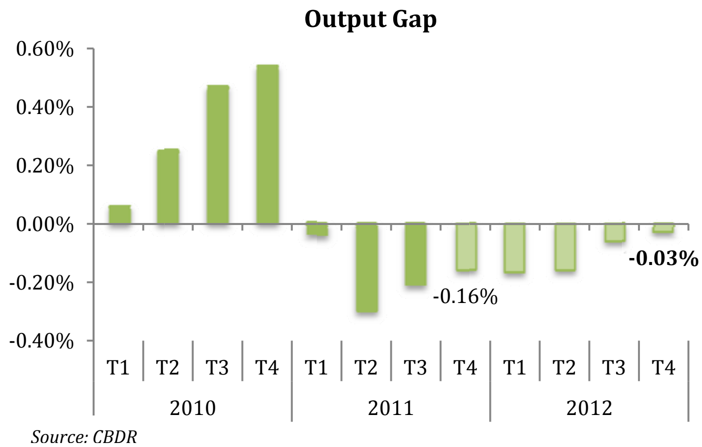
Variables	2010	2011	2012
GDP World Economy (Growth)	5.0%	4.0%	4.0%
Real GDP - USA (Growth)	2.6%	1.5%	1.8%
GDP Euro Zone (Growth)	1.8%	1.6%	1.1%
GDP Latin America (Growth)	6.1%	4.5%	4.0%
Price of Oil (US$/bbl.)	79.0	100.0	100.0
Price of Gold (US$/Troy Ounce)	1,393.0	1,640.0	1,641.2

Source: CBDR

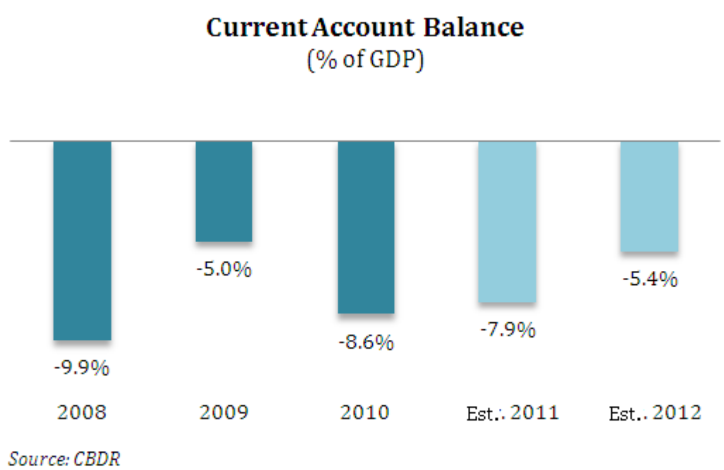
MACROECONOMIC OUTLOOK FOR THE DOMINICAN REPUBLIC IN 2012

The implementation of a more cautious monetary policy has led to an increase in market interest rates. In turn, these higher rates have contributed to the continued moderation in the growth of lending to the private sector and to monetary aggregates growing at more sustainable rates. Should this trend continue, domestic currency lending to the private sector should close 2011 with an expansion in the range 13.0% -15.0% and in 2012 would grow by approximately 10.0% -15.0%. These rates are close to nominal GDP growth.

Less expansionary monetary conditions, together with reductions in non-social public spending, the implementation of fiscal measures, and a distressed international environment have led to a slowdown in economic activity, which has led to a closing of the positive gap in output that had been observed in 2010. The projections point to a growth of 4.5% for year-end 2011, while for 2012 slight improvement in GDP growth is foreseen, in the range of 4.5% -5.0%, which would converge on the level of potential output. This increased economic growth would be underpinned by higher net exports and moderate growth in consumption and investment.



Regarding the indicators for the external sector, the recovery in net exports and the prospects for better terms of trade would allow a reduction equal to approximately 3 percentage points of GDP in the current account deficit, projected at around 5.5% for 2012 from an estimated 8.0% in 2011. Improved performance in net exports will be based on the startup of gold exports and an increase in nickel exports. Additionally, there are good prospects for tourism revenues, which should rise by 3.5% and 5.7% in 2011 and 2012, respectively, while remittances would grow more than 6.0% in both years.



Regarding fiscal policy, the national budget for 2012 contemplates a reduction in the central government deficit, to a level around 0.9% of GDP. Accordingly, the budget for 2012 is projecting total revenues amounting to RD$346.8 billion, while total expenditures would be RD$374.2 billion.

With respect to economic activity, the risks are skewed to the downside. The main risk factor is related to the expected performance of the U.S. economy. Additionally, a further deterioration of economic conditions in Europe would cause greater uncertainty in international markets and the tightening of capital flows to emerging economies. Finally, the prospects for international nickel prices are negative, which could result in a less favorable current account situation.

Internal Variables - Outlook

Variables	2010	2011	2012
Real GDP (Growth)	7.8%	4.5%	4.5-5.0%
Inflation to December	6.2%	8.0-8.5%	5.5% +/- 1.0%
Current Account (% of GDP)	-8.6%	-7.9%	-5.4%
Fiscal Balance (% of GDP)	-2.5%	-2.0-2.2%	-0.9%

Source: CBDR

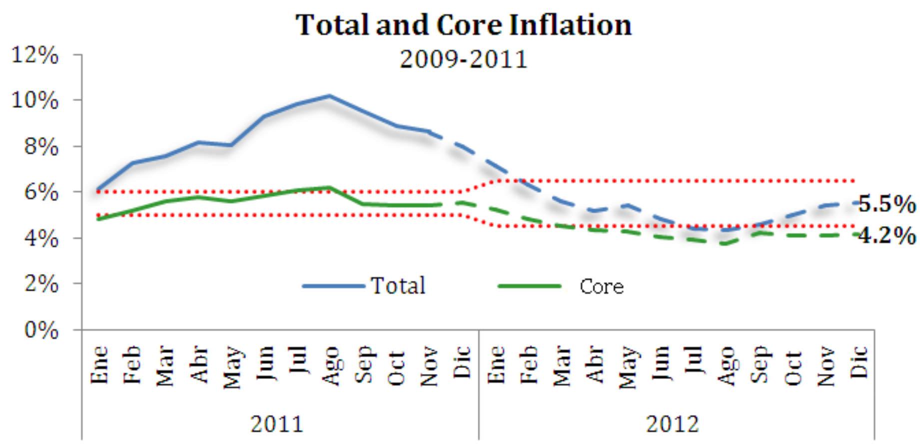
PROJECTIONS AND INFLATION EXPECTATIONS

The projections and expectations of economic agents indicate that inflation would converge on the target in the first months of 2012, providing that external inflationary pressures remain diminished.

The reversal in inflationary pressures that has been observed in recent months will continue in the final months of 2011 and the beginning of 2012, leading to a return to target in the first quarter. The prospect of inflation convergence is based on the supposition that the effect of increases in certain regulated prices will have dissipated and the outlook for international oil and food prices remains moderate. According to the econometric models available to the CBDR, inflation is expected to be closing 2011 in the range of 8.0% -8.5%, while in 2012 it will be located throughout most of the year within the target range of 5.5% (+/-1.0%), to finish near the lower limit of the range.

Similarly, core inflation would maintain its recent downward trend, to the extent that economic activity is growing below its potential. This behavior would allow core inflation to be located slightly above 5.0% in 2011 and about 4.5% by the end of 2012, below its historical average.

Additionally, the expectations of economic agents suggest that the shocks affecting inflation during 2011were temporary. In this sense, the agents expect inflation to be closing 2011 at 8.4%, and converging on the target in the first months of 2012, to close the year at around 6.1%.



Source: CBDR.

Regarding inflation, the balance of risks for 2012 is biased upward. On the one hand, the central scenario assumes oil prices to be slightly higher than those prevailing in 2011. However, were there to be sharper increases in oil prices, this would significantly alter the pattern of inflation, due to a direct impact on the cost of transportation and energy, as well as second-round effects on the prices of other goods. Additionally, being that 2012 is an election year, the conduct of fiscal policy is an element of additional risk, due to the certainty of more public spending activity in the first half of the year.

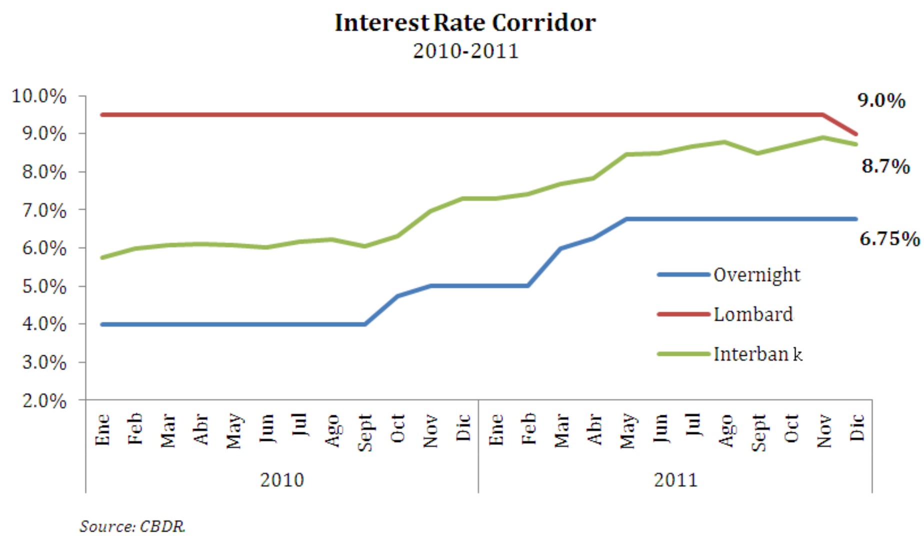
MONETARY POLICY FRAMEWORK: GOALS, INSTRUMENTS, AND INDICATORS

Beginning in 2012, the CBDR is formally adopting a monetary policy framework based on inflation targeting. An inflation-targeting framework (ITF) is a strategy whose centerpiece is the official publication of quantitative inflation targets for a given time horizon. Under this new framework, the central objective is tied to inflation and the nominal anchor becomes the explicit inflation target announced by the CBDR. In this context, the formation of the agents' inflation expectations gains greater importance, since in their decision-making they will take into consideration the CBDR's commitment to keep inflation at the level announced.

The decision to adopt a new monetary policy framework is mainly due to the weakening of the relationship that had been observed between money supply and inflation, resulting from financial innovations and the formation of more efficient and competitive markets.

The main policy instrument in the ITF is a reference interest rate signaling the BCDR's stance to the agents, allowing transmission to other market rates and, eventually, to real variables. In this sense, the ITF is a "forward-looking" framework as opposed to traditional approaches that primarily take into account past history in the decision-making process.

Among its policy instruments, the CBDR has an interest rate corridor that serves as the signaling system for its monetary policy stance. The floor for this corridor is the overnight or short-term interest bearing deposit rate, and the ceiling is the Lombard rate paid by financial institutions for access to the liquidity window.



At the end of each month, the Committee for Open Market Operations (COMA) meets to consider decisions regarding the rate corridor, based on an analysis of relevant macroeconomic variables and their outlook for the medium and long term. Policy decisions are reported to the market by publishing a policy statement on the institution's website.

The decisions to move the rate corridor in a certain direction are intended to influence the behavior of the interbank rate and eventually the rest of the market rates, in order to affect decisions regarding consumption, savings, and investment by private agents.

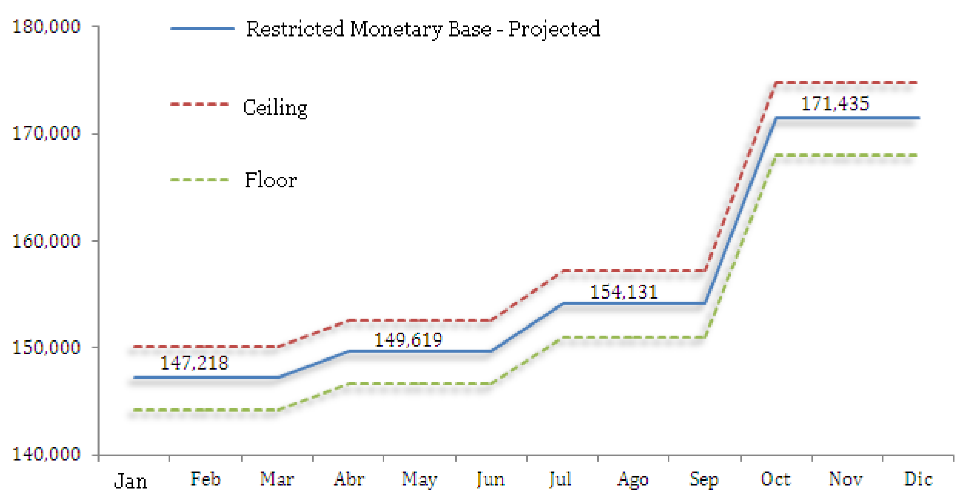
In this monetary policy regime, the movement of monetary aggregates becomes one of the indicative variables, rather than an intermediate or control variable, as they were in the old framework that targeted monetary aggregates.

Taking this into account, the behavior of the restricted monetary base contemplated in the Monetary Program for 2012 and consistent with the inflation target of 5.5% (+/-1.0%) annual growth, is around 11.0%, very similar to projected growth in nominal GDP. The restricted monetary base would show the following characteristics:

Millions of RD$

Variable	Mar 2012	Jun 2012	Sep 2012	Dec 2012
Restricted Monetary Base -Sources	**147,218**	**149,619**	**154,131**	**171,435**
Net Internatonal Reserves (In L/C)	118,238	122,908	127,620	146,624
Net Domestic Assets	28,981	26,711	26,511	24,811
Restricted Monetary Base -Uses	**147,218**	**149,619**	**154,131**	**171,435**
Currency Issued	71,635	73,236	74,332	87,578
Currency in Circulation	59,388	60,624	61,104	71,955
Cash and Due from Banks	12,323	12,688	13,303	15,698
Sight Deposits - Banks in L/C	75,583	76,383	79,799	83,858

Restricted Monetary Base - Projected
2012



Source:CBDR

The behavior of the monetary base is determined by a buildup of US$300.0 million in Consolidated Net International Reserves (CNIR). The buildup provided for in the Monetary Program would be consistent with the following pattern:

Millions of US$

Variable	Mar 2012	Jun 2012	Sep 2012	Dec 2012
Buildup Pattern – CNIR	**-350**	**100**	**100**	**450**
Level - CNIR	**1,965**	**2,065**	**2,165**	**2,615**
Annual Cumulative Target				**300**

Consequently, net domestic assets, which express the difference between the restricted monetary base and international reserves would fluctuate in a range between RD$70.0 and RD$77.0 billion.

On the other hand, for 2012 it is estimated that transfers related to the Recapitalization Plan for the CBDR will total RD$23.8 billion. Taking this into consideration, the quasi-fiscal balance would be closing the year at around 1.1% of GDP.

MAIN MACROECONOMIC INDICATORS - SUMMARY
2011 PRELIMINARY FIGURES - 2012 PROJECTED FIGURES

Below is a summary of the main macroeconomic indicators:

Variable	2011 Estimate	2012 - Projected
Real Sector		
Real GDP Growth	4.0% - 5.0%	4.5% - 5.0%
Inflation – End of Period	7% - 8%	5% - 6%
Inflation – Average	8.48%	5.31%
Growth – GDP Deflator	8.5%	6.0%
Fiscal Sector		
% Var. – Total Revenues (Central Government)	13.4%	19.9%
% Var. – Tax Revenues (CG)	14.1%	18.3%
% Var. – Total Spending (CG)	4.8%	14.5%
% Var. – Current Spending (CG)	6.5%	8.6%
% Var. – Capital Spending (CG)	-0.7%	35.4%
Non-Financial Public Sector Balance	-1.6% of GDP	-0.9% of GDP
Consolidated Public Sector Balance	-2.8% of GDP	-2.1% of GDP
External Sector		
Balance of Payments Current Account Deficit	-7.9% of GDP	-5.4% of GDP
% Var. – National Exports	44.4%	47.0%
% Var. – National Imports	12.8%	5.7%
% Var. – Other Imports	13.3%	9.3%
Oil Bill (Millions of US$)	US$4,594.8	US$4,608.4
Foreign Direct Investment (Millions of US$)	US$2,371.1	US$2,023.1
International Reserves		
Gross International Reserves (Millions of US$)	US$3,982.0	US$4,329.8
Net International Reserves (Millions of US$)	US$3,302.3	US$3,602.3
Consolidated Net International Reserves (Millions of US$)	US$2,315.0	US$2,615.0
Monetary Sector		
Growth – Monetary Base	6.6%	11.0%
Growth – Currency Issued	6.6%	11.1%
Growth – Local Currency Sight Deposits	6.6%	10.9%
Growth – Local Currency Credit to the Private Sector	17.4%	11.6%
Growth – Local Currency Credit to the Private Sector (Harmonized)	13.9%	11.6%
Central Bank Quasi-Fiscal Deficit	-1.2% of GDP	-1.1% of GDP

*Estimates and projections prepared with data available as of November, 2011.