CENTRAL BANK OF THE DOMINICAN REPUBLIC

Executive Summary of the 2013 Central Bank Monetary Program

(December 2012)

1. INTRODUCTION

Since 2012, the Central Bank of the Dominican Republic (CBDR) has been implementing its monetary policy according to an Inflation Targeting Framework (ITF). Accordingly, policy decisions are designed to minimize future inflation deviations from the announced targets. Within this framework the main instrument is the monetary policy rate (MPR), which aims to influence the interbank rate and possibly other market rates in order to affect the decisions related to consumption, savings, and investment among private agents.

Under this monetary policy framework, the performance of the monetary base and of other monetary aggregates become indicative variables, rather than intermediate or control variables, as was the case under the old monetary targeting framework (MTF).

Under the ITF, the elaboration of the Monetary Program is based on a macroeconomic consistency model that takes into account the forecasts for the main variables of the monetary, fiscal, real and external sectors. These forecasts are conditioned by the implementation of monetary policy measures designed to accomplish the inflation target within the stipulated time horizon.

The Central Bank Monetary Program for 2014 is based on the provisions contained in Article 26 of the Monetary and Financial Law Number 183-02, and the Monetary Program and Monetary Policy Instruments Regulation derived from that law. Under this regulatory framework, price stability is the main objective of monetary policy in the Dominican Republic.

b. Inflation will converge to the goal in the first half of the year

During 2012, the Dominican economy has been characterized by a moderate rate of economic growth and a gradual reduction of external and internal inflationary pressures. The Gross Domestic Product (GDP) should grow by about 4.0% this year, which is still below its potential. Annual inflation, on the other hand, could be around 3.5% -4.0% by December which is below the lower limit of the target range of 5.5% ± 1.0%.

The international outlook for 2013 is driven by a slower global growth as a result of recessionary conditions in the Euro Area (EA), sluggish growth in the United States (U.S.) and a slowdown in the major emerging economies.

On a local level, aggregate demand will be conditioned by the impact on consumption and private investment of the tax reform, as well as by the slowdown in public spending. In this context, the most recent forecasts indicate that real GDP growth will be more moderate in 2013, at about 3.0%, and should improve in 2014, reaching 4.5%. In the meantime, inflation could be affected by the direct impact of the tax adjustment, which would be offset by lower demand pressures because of the negative output gap. Forecast models indicate that inflation for 2013 and 2014 would be slightly above the target centers of 5.0% ± 1.0% and 4.5% ± 1.0%, respectively.

PRELIMINARY MACROECONOMIC RESULTS - 2012

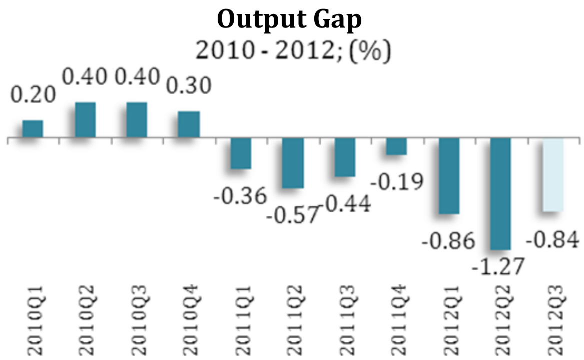
In 2012, the world's leading economies continued to show lower growth rates than expected. While the U.S. has continued to grow moderately, the EA was in a recession during the third quarter. In fact, year-on-year growth in the U.S. reached 2.7% in September, thus helping to reduce the unemployment rate, which stood at 7.7% in November. However, real GDP for the EA recorded two consecutive quarters of negative growth, which is technically considered as a recession. At the end of the third quarter, the EA had registered a y-o-y growth of -0.6%.

Given the weak economic performance, central banks in the advanced economies have maintained an expansionary policy stance. The Federal Reserve has extended its program of quantitative easing, while the European Central Bank (ECB) has expanded its bond-buying program, and reduced its MPR once. Moreover, emerging economies have also begun to show signs of a slowdown in activity. According to the International Monetary Fund (IMF), these economies could grow at around 5.2% in 2012, less than the 6.3% registered in 2011.

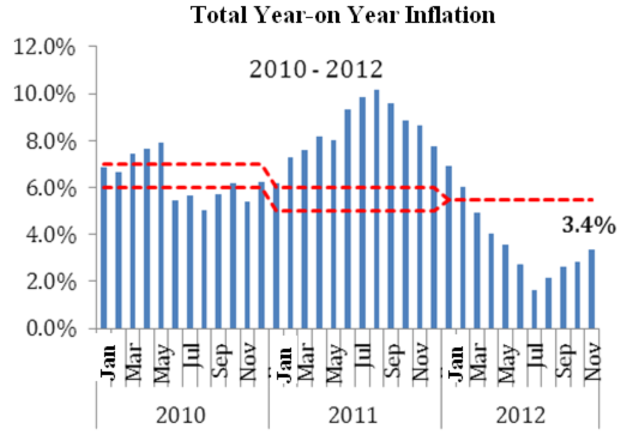
Oil prices had shown a rising trend earlier in 2012, due to geopolitical tensions in the Middle East, but that trend has been reversed as a result of slower global economic growth. In this context, external inflationary pressures have remained low during the year, resulting in an inflation rate of about 3.0% for 2012.

The absence of a final solution to the debt crisis in the EA, as well as the potential effects of the "fiscal cliff" in the U.S., increases the uncertainty of the performance of the international economy in the short term.

Locally, the Dominican economy grew at 3.9% in the first three quarters of 2012, below the growth rate recorded a year earlier. This result, combined with the effects of a decline in consumption and private investment, kept the economy operating below its potential. During the first three quarters of the year, domestic demand grew at an average rate of 3.0%.



As a result of a negative output gap and lower external inflationary pressures, annual inflation for most of 2012 has remained below the target of 5.5% ± 1.0%. In November 2012, inflation reached 3.4% and is calculated to be around 4.0% at the end of the year. Similarly, core inflation, which measures monetary inflation pressures, has declined, dropping to 3.6% in November. This is below its average level for the past five years.



During the first three quarters of 2012, the current account of the balance of payments recorded a deficit of US$3,014.5 million, US$122.7 million lower than the deficit for the same period the prior-year. Total imports, particularly oil and oil by-products, rose by only 3.7% in the first three quarters of 2012, compared to an increase of 32.3% during the comparable period in 2011. This result contributed to a moderate decline in the current account deficit.

For year-end 2012, it is expected that the current account balance will stand at US$4,041.9 million, which is a decrease of US$457.1 million compared to the deficit observed in 2011. In relative terms, the current account deficit should decrease by 1 percentage point of GDP, from 7.9% in 2011 to 6.9% in 2012. This deficit will be financed mainly by foreign direct investment, which is estimated to reach around US$3,175.5 million at year-end.

On the other hand, the fiscal outlook deteriorated significantly in 2012. At month-end November, tax revenue was RD$25.0 billion lower than the budgeted revenue, while total year-on-year expenditures grew by more than 45.0%. Accordingly, for the end of the year it is expected that the non-financial public sector (NFPS) deficit will reach a ratio between 7.0% and 7.2% of GDP.

Because of the increase in the deficit, and in an effort to improve the sustainability of public finances, a tax reform package was approved with the objective of increasing revenues by 1.8% of GDP. Additionally, the Public Revenue and Expenditure Bill include spending cuts estimated at 1.8% of GDP. With these fiscal measures, the NFPS deficit for 2013 would fall to levels around -2.7% to -3.0% of GDP.

Moreover, during the first months of the year, financial sector interest rates remained high, leading to a slowdown in private sector lending. Given these circumstances and with the aim of easing monetary conditions, the CBDR began a reduction process of the MPR and the Lombard rate at its May policy meeting. Initially the MPR and the Lombard rate were reduced by 75 and 100 b.p., respectively. Subsequently, they were both reduced by 50 b.p. during the July and August month-end meetings leaving the MPR at 5.0% and the Lombard rate at 7.0%.

Financial sector interest rates reacted to these expansionary monetary policy measures, falling from the high levels observed earlier in the year. In fact, between June and November, the lending rate (weighted average) decreased by approximately 263 b.p., to 13.6% annually. During the same period, the deposit rate (weighted average) fell by 420 b.p., and by November stood at 4.4% annually.

As market interest rates have continued to decrease, the slowdown in the growth rate of domestic currency loans to the private sector has been halted. At the end of November, year-on-year growth for these loans stood at 3.9%, due mainly to an increase in consumer and home loans.

Additionally, beginning in June 2012 the monetary aggregates grew more vigorously, which is consistent with the more flexible posture. At the end of November 2012, currency in circulation (M1) grew at a year-on-year rate of 9.9%, while the money supply (M2) and broad money (M3) exhibited y-o-y rates of 10.8% and 12.8 %, respectively.

OUTLOOK ON THE INTERNATIONAL ENVIRONMENT

Current prospects for the world economy point to further moderation in the pace of economic expansion, to the extent that there is still uncertainty regarding fiscal problems in the EA, sluggish growth of the U.S., and the slowdown in activity in the emerging economies.

The IMF and other international and private observers have revised their growth forecasts downward for next year. For example, in its most recent report, Consensus Forecasts (CF) estimates a global economic growth of 2.7% for 2013.

The U.S. economy, whose growth is positive but slow, would register a 2.2% growth rate for 2012. For 2013, CF forecasts growth around 1.9%. However, this forecast is surrounded by uncertainty, , particularly with regard to the impact of the "fiscal cliff" to take effect automatically in early 2013 unless a political consensus is achieved that could involve many combinations of tax hikes and spending cuts.

Growth forecasts for the EA are more pessimistic. In fact, CF estimates zero growth for that region for 2013. The lack of an effective solution to the fiscal and debt problems of the weaker economies exacerbates the slowdown in Germany, creating more doubts about the performance of the region in the short run.

For Latin America, forecasts for year-end 2012 suggest a growth rate of 2.9%. In 2013, this region should record growth at about 3.7%, with improved results for Chile and Argentina and a continuing strong performance in Peru.

Some moderation is expected for commodity prices in 2013. Our current forecast assumes no significant changes in the IMF oil basket, down from US$106.1 in 2012 to US$105.1 in 2013. This scenario is consistent with the expectations of a weakening global economy next year. As for gold, the forecasts for next year show that the average price should remain near US$1,700 per troy ounce.

Perspectives for External Variables

Variables	2011	2012	2013
GDP - World Economy (Growth)	3.1%	2.5%	2.7%
Real GDP - USA (Growth)	1.8%	2.2%	1.9%
GDP - Eurozone (Growth)	1.5%	-0.5%	0.0%
GDP - Latin American (Growth)	4.2%	2.9%	3.7%
Price of Oil (US$/bbl.)*	104.0	106.1	105.1

*Source: Consensus Forecast./*IMF*

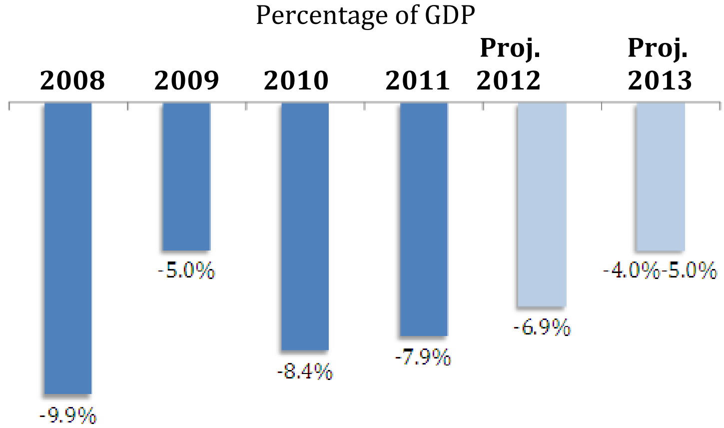
MACROECONOMIC OUTLOOK ON THE DOMINICAN REPUBLIC

The monetary easing implemented at mid-year 2012 induced a reduction in market interest rates. Given the monetary policy transmission channels, the lower rates have led to increased activity in monetary aggregates and private sector loans. Recent forecasts indicate that private sector loans in local currency will continue to recover in 2013, with a y-o-y growth of about 8.1%.

The current account deficit should reach around 6.9% of GDP at year-end 2012. For 2013, it is expected that the gradual reduction of the deficit will continue and that it will close at around 4.0% to 5.0% of GDP. This improvement in the external accounts would be driven by a higher growth of total exports (16.0%), due largely to the commencement of gold production and to increases in tourism revenue (6.1%) and remittances (5.1 %).

Current Account Balance

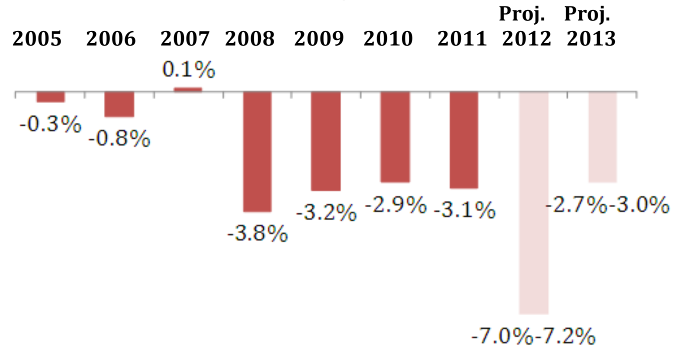
Percentage of GDP



Source: CBDR

Additionally, the implementation of tax reform measures along with the planned cuts in public spending, in accordance with the 2013 Government Budget, should have a favorable impact on the fiscal balance. As a result of this contractive fiscal policy, the NFPS deficit for 2013 should be in the range of -2.7% to -3.0% of GDP. Moreover, the CBDR's quasi-fiscal deficit is forecast for next year at around 1.4% of GDP. Thus, the consolidated public sector would be ending 2013 with a deficit of around 4.4% of GDP, down by approximately 4 percentage points of GDP, compared to the deficit recorded in 2012.

NFPS Balance
Percentage of GDP



Source: CBDR

Aggregate demand will be affected by the slowdown in public spending and the impact of the taxation adjustment on consumption and private investment. In this regard, our baseline scenario forecasts indicate that real GDP growth for 2013 should be around 3.0%, increasing to 4.5% in 2014. Considering this behavior of the economy, it is estimated that the output gap will remain in negative territory on the policy horizon, closing by early 2015.

The risks with respect to economic activity forecasts are tilted downward, due primarily to the effects of fiscal consolidation. In this sense, a slower than expected recovery for consumption and private investment, and/or a greater than expected impact as a result of public spending cuts, could reduce GDP growth below the 3.0% forecast.

Moreover, for 2013 there is the potential risk driven by a slower than expected recovery of the U.S. economy, as well as the possibility that the recession will persist in the EA. A slowdown in global growth could be transmitted to the Dominican economy, mainly through reductions in exports, remittances, tourism and foreign investment.

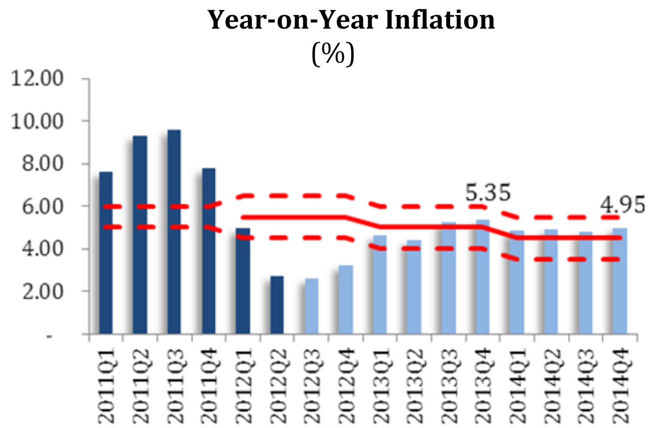
Perspectives for Domestic Variables

Variables	2011	2012	2013
Real GDP (Growth)	4.5%	4.0%	3.0%
Inflation as of December	7.8%	4.0%	5.0%±1.0%
Current Account (% of GDP)	-7.9%	-6.9%	-4.0%-5.0%
Fiscal Balance (% of GDP)	-3.1%	-7.0%-7.2%	-2.7%-3.0%

Source: CBDR

INFLATION FORECASTS AND EXPECTATIONS

By the end of 2012, inflation is projected to be close to 4.0%. The forecast models indicate that the impact of the tax adjustment on the price level would be a one-time increase, and that this effect would be partially offset by a more negative output gap. Accordingly, the estimates suggest that inflation would be slightly above the center range of the targets of 5.0% ± 1.0% and 4.5% ± 1.0%, for 2013 and 2014, respectively.



Core inflation has remained moderate for most of the year, and it is expected to close at around 3.6% by the end of 2012. The CBRD does not expect any significant fluctuations in core inflation within the policy horizon and has forecast it to remain at around 4.0%.

The balance of inflation risks in the forecast is biased upward. The most recent forecasts envisage that overall inflation would be at the upper range of the target within the policy horizon, reflecting the impact of the tax reform adjustment. Additionally, another risk related to domestic inflationary pressures is associated with higher prices of regulated goods and services. Externally, the possibility of higher than expected international oil prices and/or prices for other commodities could represent an upside inflation risk.

MONETARY POLICY FRAMEWORK: GOALS, INSTRUMENTS AND INDICATORS

Considering that the CBDR operates under an inflation targeting scheme in which monetary aggregates are taken into account as indicative variables, the expected future path for these variables is shown below. By 2013, projections indicate that growth for the Narrow Money Base (NMB), consistent with an inflation target of 5.0% ± 1.0%, would be around 8.6%, which is slightly higher than the forecast for nominal GDP growth. M1, M2 and M3 monetary aggregates would behave similarly to the NMB, expanding by 9.7%, 8.8% and 9.0%, respectively.

The estimate of the NMB is conditioned by an increase in net international reserves (NIR) of US$338 million during 2013, totaling US$3,338 million. This accumulation of foreign currency would allow Gross International Reserves to cover 2.1 months of imports, and eventually, up to 3 months of imports in the medium term.

Consequently, net domestic assets, which measure the difference between the narrow money base and net foreign assets, would fluctuate in a range between RD$56.0 and RD$61.0 billion.

Variables	2013			
	Mar.	Jun.	Sep.	Dec.
Narrow Money Base (MM RD$)	163,074.1	165,698.0	171,439.7	182,831.9
Y-O-Y (%)	*8.9%*	*9.7%*	*12.1%*	*8.6%*
Net International Reserves (MM US$)	2,961.7	3,067.0	3,191.7	3,337.8
Y-O-Y (MM US$)	*-69.2*	*-152.2*	*189.3*	*337.8*
Net Domestic Assets (MM RD$)	60,517.1	57,611.7	56,244.2	58,948.9
Local Currency Private Sector Loans (MM RD$)	414,774.6	416,338.4	438,240.9	451,368.2
Y-O-Y (%)	*2.1%*	*5.9%*	*8.5%*	*8.1%*

This baseline scenario assumes revenue resulting from the CBDR's Recapitalization Plan equivalent to 0.7% of nominal GDP as estimated for 2013. Considering this revenue, as well as interest payments on open market operations and other items, the quasi-fiscal deficit would amount to 1.4% of GDP by year-end 2013.

SUMMARY - MAIN MACROECONOMIC INDICATORS
2012 PRELIMINARY FIGURES - 2013 FORECAST

Below is a summary of the main macroeconomic indicators.

CENTRAL BANK OF THE DOMINICAN REPUBLIC
MONETARY PROGRAMMING AND ECONOMIC RESEARCH DEPARTMENT

MAIN MACROECONOMIC INDICATORS - MONETARY PROGRAM 2013

Variables	Forecast 2012	Forecast 2013
Real Sector:		
Real GDP Growth	4.0%	3.0%
Inflation Rate, End of Period	4.0%	5.1%
Inflation Rate, Annual Average	3.8%	5.0%
Growth of the Implicit GDP Deflactor	4.5%	5.0%
Fiscal Sector:		
Tax Burden	13.5%	14.7%
% Var. Central Government Total Revenues	12.7%	20.3%
% Var. Central Government Tax Revenues	13.6%	17.6%
% Var. Central Government Total Spending	38.9%	-4.0%
NFPS Balance as % of GDP	-7.0%-7.2%	-2.7%-3.0%
Quasi-Fiscal Balance as % of GDP	-1.1%	-1.4%
Consolidated Public Sector Balance as % of GDP	-8.1%-8.3%	-4.1%-4.4%
External Sector:		
Balance of Payments Current Account (MM of US$)	-4,041.9	-2,975.0
Balance of Payments Current Account (% of GDP)	-6.9%	-4.0%-5.0%
% Var. – Total Exports	6.3%	16.1%
% Var. – Total Imports	1.8%	4.1%
Oil Imports (MM of US$)	4,684.9	4,758.1
Foreign Direct Investment (MM of US$)	3,175.5	2,041.4
Overall Balance of Payments Deficit	-335.8	505.1
Monetary Sector:		
Net International Reserves (MM of US$)	3,000.0	3,337.8
% Var. – Narrow Money Base	8.5%	8.6%
% Var. – Local Currency Loans to Private Sector	2.4%	8.1%
% Var. – Currency in Circulation (M1)	10.0%	9.7%
% Var. – Money Supply (M2)	10.4%	8.8%
% Var. – Broad Money (M3)	10.6%	9.0%