CENTRAL BANK OF THE DOMINICAN REPUBLIC

Executive Summary of the Central Bank Monetary Program 2016

INTRODUCTION

Since the beginning of 2012, the Central Bank of the Dominican Republic (CBDR) has implemented its monetary policy under an Inflation Targeting framework (IT). In this regard, policy decisions are oriented to assure that future deviations of inflation from the announced targets are held to a minimum. Within this framework, the main instrument is the monetary policy rate (MPR), which aims to influence the interbank rate and, eventually, the rest of the market rates, in order to affect consumer, savings, and investment decisions made by private-sector stakeholders.

In this monetary policy framework, the performances of the monetary base and other monetary aggregates are part of a group of information variables, rather than the intermediate or control variables, as was the case under the previous Monetary Targeting framework (MT).

Under the IT, the development of the Monetary Program is based on a macroeconomic consistency model that combines the perspectives of the main variables of the monetary, fiscal, real and external sectors. These projections are conditioned by the implementation of monetary policy measures that will allow the fulfillment of the inflation target within the stipulated time horizon.

The Central Bank's Monetary Program for 2016 is based on the provisions of Article 26 of the Monetary and Financial Law 183-02 and on the Implementing Regulation for the Monetary Program and Monetary Policy Instruments, which correspond to that law. Under this regulatory framework, the main objective of the Dominican Republic's monetary policy is price stability.

<u>Inflation will converge to the target range in 2016</u>

The prospects for the international environment suggest a moderation in the growth rate of the world economy, which has led to greater uncertainty about future trends in oil prices and in foreign exchange markets. On the one hand, macroeconomic conditions in the United States (USA) allowed the expected normalization of monetary policy by the Federal Reserve (FED) to take place in December 2015, through an increase of 25 basis points in the federal funds rate. On the other hand, the figures for the Euro Zone (EZ) show that it is expected to continue its recovery in 2016, driven mainly by the economies of Germany, France and Spain. The projected growth of the world economy for 2016 is placed at around 2.8% for the year, according to data presented by Consensus Forecasts (CFC) in December 2015.

At the local level, the Dominican economy has registered growth rates above 6.0% for the year 2015 as a result of greater momentum in domestic demand. In this regard, growth projections for year-end 2015 are between 6.5% - 7.0%, while for 2016 the growth rate is expected to stand at around 5.0%, approaching the level of potential output. Regarding prices, projections indicate that overall inflation should be around 2.5% year-o-year for the end of 2015, and that it should converge to the central target value of 4.0% ± 1.0% y-o-y in mid-2016.

RECENT PERFORMANCE OF THE ECONOMY

During 2015, the international environment was characterized by a slowdown in global growth as a result of the weakness of the major emerging economies. The developed economies, for their part, maintained a moderate pace of recovery, albeit with low inflation. Thus, CFC estimates that the world economy should grow at an annual rate of 2.6% in 2015, which is lower than for 2014. In addition, during the year, oil prices have continued to fall, while the U.S. dollar has continued to appreciate against most currencies worldwide.

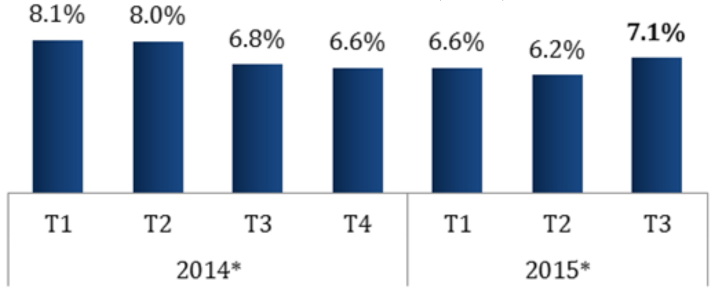
The U.S. economy grew 2.2% y-o-y in the third quarter of 2015, reflecting a pullback compared to second quarter growth. This performance was explained by the contraction in inventory accumulation and a moderation in growth rates for personal consumption and exports. However, this moderation did not hinder job creation, with a reduction in the unemployment rate, settling at 5.0% in October. Inflation remained low throughout the year, reaching 0.2% at the end of October. However, the Fed's projections indicate that inflation should approach the target of 2.0% in the coming years. In this context, the Fed's committee on open market operations decided to increase the federal funds rate, which had remained unchanged since December 2008, from 0.25% to 0.50% per annum. Nevertheless, the authorities made clear that the monetary policy stance would remain flexible, so that conditions in the labor market continue to evolve in a positive fashion and the inflation rate converges to the level of 2.0% in the medium term.

Meanwhile, economic conditions in the Euro Zone have continued to improve gradually, with a year-over-year growth of 1.6% during the third quarter of 2015. For this period, growth was based on increases in household consumption, as well as in inventories. Regarding price levels in that region, the inflation rate remained in negative territory for the first months of the year, rebounding slightly to 0.2% at the end of November. Additionally, the unemployment rate in the Euro Zone has shown a downward trend in the year, down to 10.8% at the end of September.

In Latin America, performance has been influenced by a drop in prices of raw materials, which has negatively affected the major economies. In fact, Brazil and Venezuela are in recession, while growth has slowed down in Argentina, Ecuador, Colombia and Peru. Regarding inflation, Venezuela and Argentina reached double digits, while in the other major countries inflation has risen above that registered in 2014. However, in the Central American countries, inflation has remained low, since these economies are net oil importers and the lower prices have translated into a fall in inflation.

On the domestic front, the Dominican economy kept up a strong drive during 2015. In fact, GDP rose by 7.1% in the third quarter, showing a slight increase compared to the first two quarters. This expansion was driven mainly by a growth in final consumption. With these results the economy has kept growing above its potential, so that the output gap remains positive, and has done so since the last quarter of 2014.

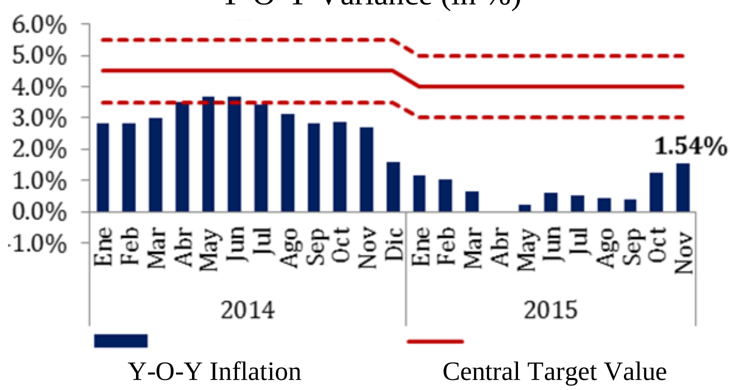
Quarterly Growth – Real GDP
Y-O-Y Variance (in %)



Source: CBDR (Base 2007)

Moreover, headline inflation has remained on average below the lower limit of the target range during 2015, reaching a y-o-y variance of 1.54% in November. Inflation behavior can be explained by the opposing effects of decreasing international oil prices, and rising local food prices due to drought.

Headline Inflation
Y-O-Y Variance (in %)

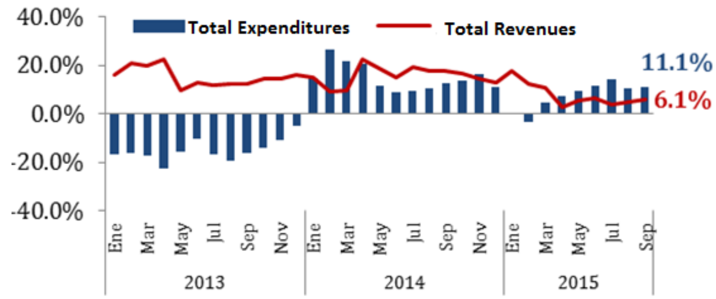


Source: CBDR

As for the conditions affecting the external sector, a correction was registered in the current account deficit of US$704.4 million, attaining a balance of US$441.0 million at the end of the first three quarters of 2015. This improvement in the international position is mainly due to lower international oil prices, which led to a reduction, compared to the third quarter of 2014, of 34.5% in the oil bill (equivalent to US$1,067.6 million).

At the same time, activities generating foreign exchange were more buoyant throughout 2015. On the one hand, remittances showed a variance of 7.0% y-o-y at the end of September 2015, while tourism revenues recorded an expansion of 8.5% y-o-y. In addition, foreign direct investment amounted to approximately US$1,639.7 million, mainly due to activities related to tourism and real estate.

Central Government Revenues and Expenditures
Y-O-Y Variance (In %)



Source: CBDR

The Non-financial Public Sector (NFPS) ended the third quarter with a primary surplus equivalent to 1.1% of GDP, mainly related to increased capital transfers as a result of the advance purchase of the Petrocaribe program debt.

In 2015, the CBDR relaxed its policy stance, gradually reducing the monetary policy rate (MPR) between March and May. Thus, the MPR, which had remained unchanged at 6.25% per annum since August 2013, was reduced to 5.00% per annum by successive adjustments of 50 and 25 basis points (p.bs.). In addition, the monetary authorities decided to increase the reserve requirements for all financial intermediaries by 2.0 percentage points, with the intention of counteracting the effects on inflation of an unusual exchange rate volatility affecting the rate of depreciation in February 2015. The change in the monetary policy stance took into consideration factors, both external and domestic, that could have posed a risk to the compliance of the inflation target.

As a result of the reduction of the MPR, nominal market interest rates decreased gradually. However, as of July, there has been a reversal of this trend, caused by a narrowing of liquidity conditions in the money market. Also, considering that inflation expectations remain stable, real interest rates have remained high, which has caused a slowdown in the growth rate of local currency loans to the private sector, and an 11.9% y-o-y variance at the end of November 2015.

As for monetary aggregates, growth rates remained around the levels seen in 2014. In fact, the liquid money supply (M1) expanded by 15.2% y-o-y for November 2015, while the M2 money supply and broad money (M3) exhibited annual variations of 11.3% and 12.6%, respectively.

INTERNATIONAL OUTLOOK

World economic growth should close 2015 at around 2.6% for the year according to the latest CFC estimates. Economic activity during 2015 has been marked by a slowdown in China's economy. For full year 2016, forecasts point to a global economic expansion of 2.8%.

Among developed economies, the US should end 2015 with an annual growth of 2.5%, and continue the path of recovery in 2016, maintaining a similar growth rate, according to CFC forecasts. At the same time, the job creation kept making stable progress, which should lead to a reduction in the unemployment rate to 4.8% in 2016.

With regard to the Euro Zone, it is expected that this group of countries should end 2015 with a growth of 1.5% annually, and continue its economic recovery during 2016, with an annual growth rate of 1.7%. Germany's economy should expand at a rate of 1.7% annually in 2015 and 1.8% annually for the end of 2016. Likewise, France would have grown 1.1% annually by the end of 2015 and is expected to accelerate in 2016, closing the year with a growth rate of 1.4%, according to CFC projections. In contrast to the perspectives for these two large economies, Spain is leading the economic recovery in the region, with an expected growth of around 3.2% in 2015 and a slight moderation in 2016, with an expected annual growth of 2.7%. Similarly, as a result of increased economic activity, unemployment in the Euro Zone has been declining and is expected to be around 10.6% in 2016. Accordingly, inflation should reach 1.0% y-o-y at the end of that year.

Meanwhile, in Latin America, Brazil's economy is in recession, with prospects of ending 2015 with a decrease of close to 3.0% in its annual output, and is expected to continue that trend during 2016, with a contraction of around 1.6% for the year. Meanwhile, in Chile, CFC analysts predict that there will be an annual growth of 2.1% for the end of 2015 and a slight recovery in 2016, with an expected expansion of 2.4% for the year. Overall, projections indicate that the region will contract by 0.8% this year and recover, albeit very gradually, to grow by 0.2% annually in 2016, excluding estimates for Venezuela, which should register a contraction of 8.0 % for the end of 2015 according to CFC forecasts.

As for oil prices, they are expected to remain at levels similar to those of the present, above all due to the downward pressure caused by the slowdown of the Chinese economy. Similarly, the production of shale oil has moderated, although it is still showing a level of supply greater than that of demand.

Outlook for External Variables

Variables	2014	2015	2016
GDP World Economy (Growth)	2.8%	2.6%	2.8%
Real GDP USA (Growth)	2.4%	2.5%	2.5%
GDP Eurozone (Growth)	0.9%	1.5%	1.7%
GDP Latin America (Growth)	1.5%	-0.8%	0.2%
Petroleum (US$/bbl.)*	96.2	50.9	42.0

Source: Consensus Forecast./*IMF

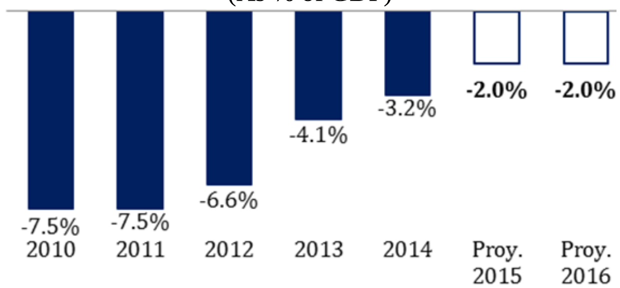
MACROECONOMIC OUTLOOK FOR THE DOMINICAN REPUBLIC

In 2015, domestic currency loans to the private sector recorded a slowdown in their expansion, on average, with a growth rate of around 12.0% y-o-y in November. While nominal market rates gradually declined after the MPR was reduced, high real rates that persisted in the financial market characterized the behavior of local currency loans. In this regard, the most recent projections show a growth of local currency private credit between 10.0% -12.0% y-o-y for year-end 2015. Likewise, the slowdown is expected to continue until 2016, expanding at around 9.0% -10.0% y-o-y, which is in line with nominal GDP growth.

Regarding the performance of the external sector, the outlook continues to suggest a favorable environment for the Dominican economy. These projections take into account improvements in the terms of trade associated with falling oil prices, accompanied by a recovery of other economies, as well as a good performance in activities that generate foreign exchange. Thus, it is expected that the current account should record a deficit of around 2.0% of GDP at the end of 2015 and remain at this level in 2016.

Current Account Balance

(As % of GDP)

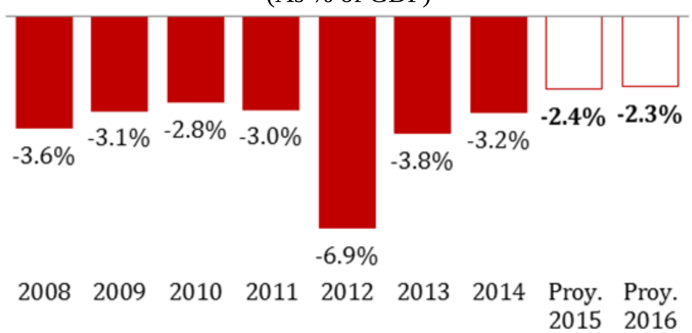


Source: CBDR

In the fiscal sector, given the transfer of capital from the advance purchase of the Petrocaribe program debt, it is expected that the public accounts should register a primary surplus as of December 2015. Also, the 2016 Budget contemplates a primary surplus of 0.7% of GDP, which would be explained by an increase in current expenditures and revenues of 7.0% and 7.7% on a y-o-y basis, respectively. Thus, the NFPS deficit would be corrected to 2.3% of GDP for the end of 2016.

Non-Financial Public Sector Balance

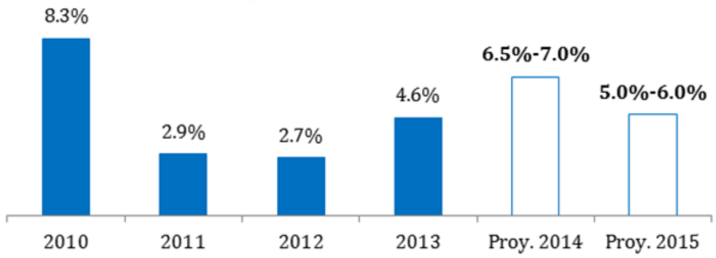
(As % of GDP)



Source: CBDR

Until the third quarter of 2015, economic activity was registering growth rates around 6.6% in real terms, so it is estimated that real GDP will expand between 6.5% - 7.0% annually in 2015 and continue its pace of moderate growth to occupy a range of 5.0% - 6.0% in 2016. With regard to inflation, in the coming months the effect of falling oil prices should dissipate, so the annual rate should stand at 2.4% by year-end 2015, converging to the target of 4.0% ± 1.0% in 2016.

Projected Real GDP
Annual Average (in %)



Source: CBDR (base 2007)

For 2016, the balance of risks to the economic growth forecast is biased upward, since real GDP has continued to grow faster than was expected in 2015. Also, there are expectations of a further expansion of public expenditure, linked to the electoral cycle. Meanwhile, inflation estimates for 2016 remain stable.

Variables	2014	2015	2016
Real GDP (Growth)	7.3%	6.5%-7.0%	5.0% - 6.0%
Inflation (Average)	4.5%	1.1%	4.0% ± 1.0%
Current Account (% of GDP)	-3.2%	-2.0%	-2.0%
Fiscal Balance (% of GDP)	-3.2%	-2.4%	-2.3%

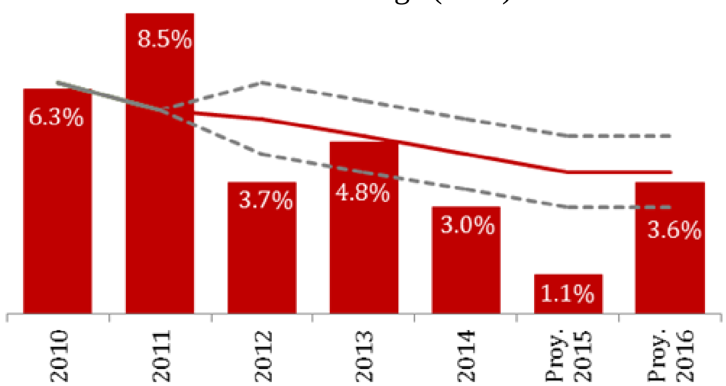
Source: CBDR

INFLATION FORECAST AND EXPECTATIONS

Headline inflation has remained below the target range of 4.0% ± 1.0% over 2015, reaching a y-o-y variance of 1.54% in November. Since late 2014, a slowdown has been observed in the monthly inflation rate as a result of the fall in international oil prices; this has been offset in the final months of 2015 by the impact of a drought on food prices and soft drinks. However, it is expected that the fuel price effect will dissipate during the first half of 2016, which would allow the inflation rate to return to the central value of the target. Accordingly, the most recent projections suggest that inflation would stand at around 2.4% on a y-o-y basis at year-end 2015, for an average of 1.1%. For 2016, it is estimated that inflation will reach an average of 3.6%.

Headline and Target Inflation

Annual Average (in %)



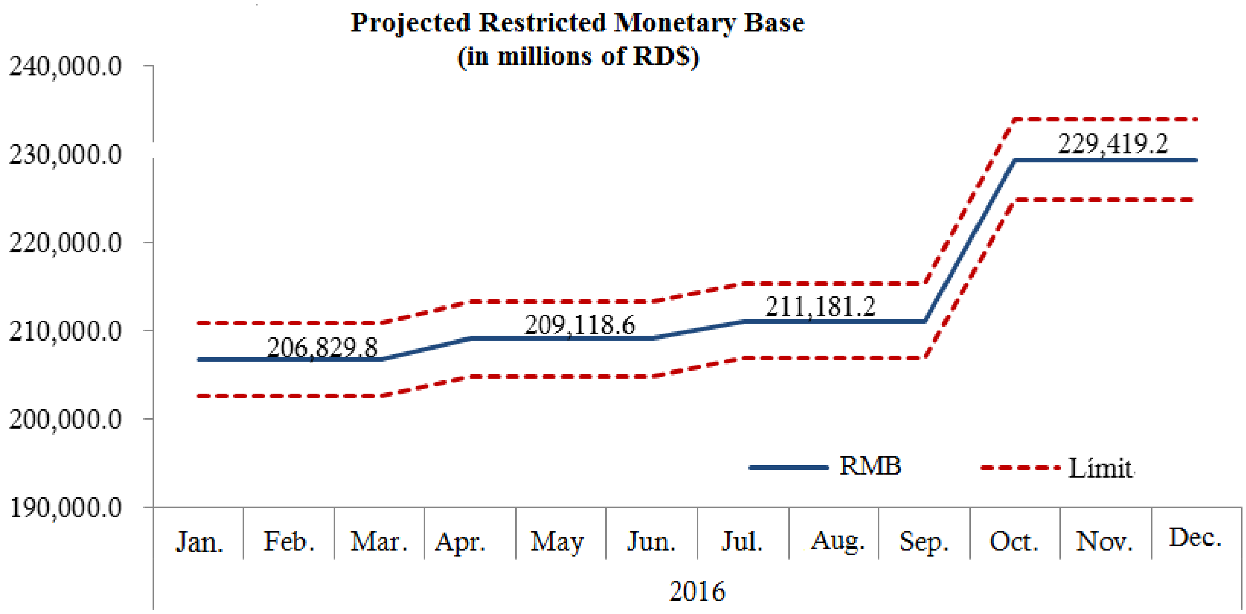
Source: CBDR

Similarly, core inflation has remained below the lower limit of the range, at around 2.3% over 2015. According to estimates, it is expected that the y-o-y variance for this indicator will average 2.2% for year-end 2015. Considering that the economy should be growing above its potential capacity during 2016, it is expected that core inflation will increase, to reach the lower limit of the target range of 4.0% ± 1.0%, on average.

The risks of the inflation forecast for 2016 are balanced. In terms of production, the output gap has remained positive for a long time and it is estimated that this behavior would persist in the short term, exerting pressure on price levels. In contrast, the impact of increased food and beverage prices should tend to fade in the coming quarters and lead to a lower inflation rate. As for petroleum, the forecasts of international organizations suggest that prices will stabilize in 2016, which would have a reduced effect on the domestic price level.

OUTLINE OF MONETARY POLICY: GOALS, INSTRUMENTS AND INDICATORS

Considering that the CBDR manages its monetary policy according to inflation targeting and that in this framework the monetary aggregates are information variables, below we present the expected path for these variables. For 2016, projections indicate that the growth of the Restricted Monetary Base (RMB), consistent with the inflation target of 4.0% ± 1.0% y-o-y, should be around 8.6% y-o-y; this growth would be at levels close to the projected expansion in nominal GDP.



RMB growth would be associated with the performance of the Net International Reserves (NIR), which contemplates an increase of US$339.9 million during 2016. As a result, the NIR would be reaching a balance of US$5,259.7 million at the end of the year.

These projections take into consideration a CBDR revenue recapitalization plan of 0.7% of nominal GDP estimated for 2016. Given this income, as well as interest payments in respect of open market operations and other items, the cuasifiscal deficit should amount to 1.4% of GDP at year-end 2016.

SUMMARY MAIN MACROECONOMIC INDICATORS
2015 PRELIMINARY FIGURES - 2016 FORECAST

A summary of the main macroeconomic indicators is presented below.

Variables	Projection 2015	Projection 2016
Real Sector:		
Real GDP Growth	6.5%-7.0%	5.0%-6.0%
Inflation rate, End of Period	2.4%	4.0%±1.0%
Inflation Rate, Annual Average	1.1%	4.0%±1.0%
Implicit GDP Deflator Growth	1.5%	3.5%
Fiscal Sector:		
Tax Burden	14.3%	14.2%
Percentage Variance of Central Government Total Revenue	7.8%	8.2%
Percentage Variance of CG Tax Revenue	8.8%	7.6%
Percentage Variance of CG Total Expenditure	5.7%	7.0%
NFPS Balance as % of GDP	-2.4%	-2.3%
Quasi-Fiscal Balance as % of GDP	-1.4%	-1.4%
Consolidated Public Sector Balance as % of GDP	-3.8%	-3.7%
External Sector:		
Balance of Payments Current Account as % of GDP	-2.0%	-2.0%
Percentage Variance of Total Exports	-1.7%	3.1%
Percentage Variance of Total Imports	-0.3%	4.4%
Oil Bill (MM US$)	2,543.3	2,419.3
Foreign Direct Investment (MM US$)	2,222.7	2,367.2
Monetary Sector:		
Net International Reserves (MM US$)	4,919.8	5,259.7
Percentage Variance of Restricted Monetary Base	14.7%	8.6%
Percentage Variance of Bank Loans to the Private Sector in RD$	10.0%-12.0%	8.0%-10.0%