



DOMINICAN REPUBLIC

August 2017

2017 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR THE DOMINICAN REPUBLIC

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2017 Article IV consultation with the Dominican Republic, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its March 24, 2017 consideration of the staff report that concluded the Article IV consultation with the Dominican Republic.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on March 24, 2017, following discussions that ended on February 10, 2017 with the officials of the Dominican Republic on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on March 10, 2017.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for the Dominican Republic.

The documents listed below have been or will be separately released.

Selected Issues

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

Copies of this report are available to the public from

International Monetary Fund • Publication Services
PO Box 92780 • Washington, D.C. 20090
Telephone: (202) 623-7430 • Fax: (202) 623-7201
E-mail: publications@imf.org Web: <http://www.imf.org>
Price: \$18.00 per printed copy

International Monetary Fund
Washington, D.C.



INTERNATIONAL MONETARY FUND



Press Release No. 17/79
FOR IMMEDIATE RELEASE
March 27, 2017

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2017 Article IV Consultation with the Dominican Republic

On March 24, 2017, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation¹ with the Dominican Republic.

The Dominican economy maintained the strong growth momentum of the past three years, which is only now beginning to taper off towards potential. Growth averaged 7 percent since 2014, outperforming most emerging markets and all the economies in the Americas, buoyed by domestic demand. Real GDP expanded by 6.6 percent in 2016, with both consumption and investment easing in the second half of the year as financing conditions tighten. Labor markets and social indicators are steadily improving, and real labor income has begun to catch up to strong productivity growth in the last two years, after remaining stagnant for over a decade.

Strong growth was accompanied by low inflation and a strengthened external current account, as lower oil prices kept pressures at bay. Headline and core inflation averaged 1¾ percent during 2016, remaining below the central banks' inflation target range of 4±1 percent for over two years. More recently, inflation has begun to pick up with recovering food and fuel prices. The current account deficit narrowed significantly, to an estimated 1½ percent in 2016, as lower oil prices and a strong growth in tourism and remittances more than offset an underlying weakness in goods exports.

Both fiscal and monetary policies tightened somewhat in 2016, providing a countercyclical offset to the positive output gap. The fiscal position improved slightly despite increasing spending pressures, as the authorities' strong revenue administration effort had begun to pay off. The consolidated public sector registered a deficit of 4.3 percent of GDP in 2016, which pushed public debt to an estimated 49.7 percent of GDP by end-year. Monetary policy was tightened in November 2016 after remaining on hold for over a year. The policy interest rate was increased from 5 to 5½ percent to prevent potential overshooting of inflation, as commodity prices begin to unwind against a backdrop of a positive output gap and robust credit growth. Financial

¹ Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

soundness indicators for the banking system remain strong, with healthy capitalization, low asset impairment and strong provisioning.

The economic outlook is favorable. Growth is expected to slow towards the potential rate of around 5 percent from 2017 onward, while the recent rise in fuel prices will push inflation to target and will widen the current account deficit moderately from 2017 onward. Risks around this baseline outlook are balanced. Key risks stem from the uncertainty surrounding the economic and policy outlook for the external trading partners, notably the U.S., the outlook for oil prices, higher than expected global interest rates and the ensuing dollar appreciation.

Executive Board Assessment²

Executive Directors agreed with the thrust of the staff appraisal. They welcomed the Dominican Republic's dynamic economic performance, as evidenced by sustained output and employment growth, low inflation and stronger current account. Directors commended the authorities' pursuit of macroeconomic stability and structural reforms to improve social outcomes. They noted that the medium-term outlook is favorable, but risks remain. Directors encouraged further efforts to consolidate the fiscal position, build larger buffers, strengthen policy frameworks, and advance structural reforms to promote inclusive growth.

Directors welcomed the authorities' commitment to fiscal discipline and encouraged them to take early action to prevent a further buildup in debt, given the strong cyclical position of the economy. This would require containing the fiscal deficit this year and moving to meaningfully improve the fiscal balance over the next few years. In light of the heavy debt servicing burden, Directors welcomed the efforts to broaden the narrow tax base through renewed revenue administration reforms. They also encouraged more comprehensive reforms to sustainably broaden the base, simplify the tax system, and streamline tax exemptions and incentives. Directors saw scope for improving the quality of spending, especially on untargeted energy subsidies, while protecting pro-poor and pro-growth spending.

Directors agreed that strengthening the medium-term fiscal framework will be critical to imparting discipline, predictability and credibility to fiscal policy. Recognizing various reform options, they noted that a medium-term fiscal anchor would help guide fiscal policies, while simple and credible rules could support its implementation.

Directors viewed the current tightening bias of monetary policy as appropriate. Welcoming the authorities' commitment to continue building reserves buffers, they encouraged a gradual transition to greater exchange rate flexibility to help absorb external shocks. Increased flexibility

² At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: <http://www.imf.org/external/np/sec/misc/qualifiers.htm>.

should be supported by efforts to build up foreign exchange market infrastructure, develop hedging instruments, and reduce balance sheet mismatches in the public sector.

Directors welcomed the health and stability of the banking system. They supported ongoing efforts to strengthen the regulation and supervision of nonbanks, bridge the remaining gaps in compliance with the international transparency initiatives, and enhance the macro-financial framework. These reforms would identify and address emerging systemic risks, and ensure financial system's continued support for economic growth.

Directors emphasized that far-reaching structural reforms are needed to secure better longer-term growth and social outcomes. They endorsed the ongoing focus on improving the quality of education and providing low-income housing. Decisively addressing challenges of the electricity sector, including weak governance, poor infrastructure and below-cost pricing is also critical. Directors supported the authorities' efforts toward improving the business environment, strengthening institutions and governance, and supporting stronger employment growth and social protection.

Table 1. Dominican Republic: Selected Economic Indicators
(percent change from previous period, unless otherwise indicated)

	2013	2014	2015	2016	Projections	
					2017	2018
National production and Income						
Real GDP	4.7	7.6	7.0	6.6	5.3	5.0
Net exports (contribution to growth)	3.3	0.6	-2.7	0.2	-0.6	-0.6
Total domestic demand	1.8	5.2	8.5	6.3	6.4	5.1
Total consumption	1.4	3.9	5.0	4.7	4.8	4.8
Private final consumption	2.3	3.6	4.8	4.8	4.8	4.8
Public consumption expenditure	-5.9	6.8	7.7	4.7	4.7	4.7
Gross fixed domestic investment	2.0	14.8	20.0	12.7	9.5	3.5
Private fixed investment	17.0	16.6	17.4	13.1	9.5	6.0
Public Fixed investment	-39.7	6.7	33.4	11.1	9.6	-7.9
Nominal GDP	8.7	9.7	8.0	8.3	9.4	9.4
Employment and prices						
Unemployment rate	7.0	6.4	5.9	5.5	5.7	6.0
Consumer price inflation (end of period)	3.9	1.6	2.3	1.7	4.3	4.0
Consumer price inflation (period average)	4.8	3.0	0.8	1.6	3.9	4.2
GDP deflator	3.7	1.9	0.9	1.6	3.9	4.2
Output gap (percent of potential GDP)	-2.0	-0.3	0.6	1.1	0.6	0.2
REER	97.0	97.0	99.8	97.3	...	...
Exchange rate RD\$/US\$ (eop)	42.7	44.3	45.5	46.7	...	...
Exchange rate RD\$/US\$ (average)	41.7	43.5	45.0	46.0	...	...
Balance of Payments						
Current account balance (percent of GDP)	-4.0	-3.3	-2.0	-1.5	-2.0	-2.5
Export volume (goods)	11.2	7.6	5.5	6.8	0.8	3.1
Import volume (goods)	-2.5	7.0	10.7	8.6	5.2	5.9
Terms of trade (goods)	-2.7	1.5	2.0	2.0	2.1	1.4
Net international investment position (percent of GDP)	-59.3	-61.9	-60.6	-60.1	-58.6	-57.7
Saving and investment (percent of GDP)						
Gross national saving	19.6	20.6	21.4	23.0	23.7	23.5
Public	0.6	0.1	0.5	0.0	-0.1	-0.2
Private	19.1	20.5	21.0	23.0	23.8	23.7
Gross domestic investment	23.7	23.9	23.5	24.5	25.7	25.9
Public	3.6	3.8	4.3	4.4	4.6	4.1
Private	20.1	21.0	20.1	21.3	22.2	22.4
Fiscal accounts (percent of GDP)						
Consolidated Public Sector Debt	47.8	47.2	47.3	49.7	51.1	52.3
Consolidated Public Sector Overall Balance	-4.9	-4.4	-1.6	-4.3	-4.9	-4.8
Primary	-1.4	-0.7	2.2	-0.2	-0.5	-0.2
Interest payments	3.5	3.7	3.8	4.1	4.4	4.6
Memorandum items:						
Nominal GDP RD\$ (millions)	2,590,678	2,841,203	3,068,139	3,322,409	3,634,413	3,977,400
Nominal GDP US\$ (billions)	62.1	65.3	68.2	72.2	76.9	81.7
Sources: Country authorities; World Bank; and Fund staff calculations and estimates.						



DOMINICAN REPUBLIC

STAFF REPORT FOR THE 2016 ARTICLE IV CONSULTATION

March 10, 2017

KEY ISSUES

Context. The Dominican economy continues to grow rapidly, buoyed by low energy prices, strengthening labor markets, dynamic investment, and the recovery in the U.S. Lower oil prices have balanced the effects of strong domestic demand on inflation and the external position. The outlook is favorable: the pace of expansion—which averaged around 7 percent over the past three years—is tapering off towards potential, inflation is set to increase to target as commodity prices recover, and a healthy financial sector is well poised to support growth.

Challenges. Nonetheless, the economy faces structural and policy vulnerabilities. A structurally weak fiscal position has been aided by strong growth and favorable financing conditions; policy frameworks may not be sufficiently robust; an underperforming electricity sector holds back a higher potential growth; and social outcomes remain feeble despite strong recent improvements.

Policy advice. The consultation focused on policies to build macroeconomic buffers, strengthen policy frameworks, and advance structural reforms. Key recommendations include:

- Proceeding early with the needed fiscal consolidation, underpinned by reforms to widen the tax base and improve quality of spending.
- Adopting a credible medium-term fiscal anchor.
- Maintaining the tightening bias of monetary policy in view of the anticipated inflation pressures, and allowing for more exchange rate flexibility.
- Strengthening the macro-financial framework through reinforcing the supervision of nonbanks, addressing gaps in compliance with global transparency initiatives, bolstering capacity to monitor systemic risks, and preparing financial stability reports.
- Advancing structural reforms to address bottlenecks to potential growth, especially in the electricity sector.

Approved By:
Robert Rennhack
(WHD) and Yan Sun
(SPR)

Discussions took place in Santo Domingo during January 31–February 10, 2017. The mission comprised A. Cebotari (head), S. Cerovic, A. Komaromi, X. Ding, and B. Sutton (all WHD). Mr. Rennhack (WHD) joined the mission during February 8–9. F. Fuentes (OED) participated in the discussions. The mission met with Central Bank Governor, Minister of Finance, Minister of Economy, Planning and Development, Minister of Trade and Industry, other senior officials, independent economists, and private sector representatives.

CONTENTS

CONTEXT	4
RECENT DEVELOPMENTS: ROBUST GROWTH AND UNDERSHOOTING INFLATION	4
OUTLOOK AND RISKS	7
STRENGTHENING POLICIES FOR RESILIENCE AND GROWTH	9
A. Fiscal Policy: Are Enough Buffers Being Built in Good Times?	10
B. Strengthening the Medium-Term Fiscal Policy Framework	12
C. Building External Buffers and Strengthening the Monetary Policy Framework	13
D. Strengthening the Macro-Financial Policy Framework	14
E. Structural Reforms to Increase Potential Growth and Lower Poverty	16
STAFF APPRAISAL	18
FIGURES	
1. Real Activity Developments	20
2. Social Indicators in a Regional Perspective	21
3. Monetary Developments	22
4. External Developments	23
5. Fiscal Developments	24
TABLES	
1. Selected Economic Indicators	25
2. Public Sector Accounts (in percent of GDP)	26
3. Public Sector Accounts (in billions of Dominican pesos)	27
4. Income Statement of the Central Bank	28
5. Summary Accounts of the Monetary Authority	29
6. Summary Accounts of the Banking System	30

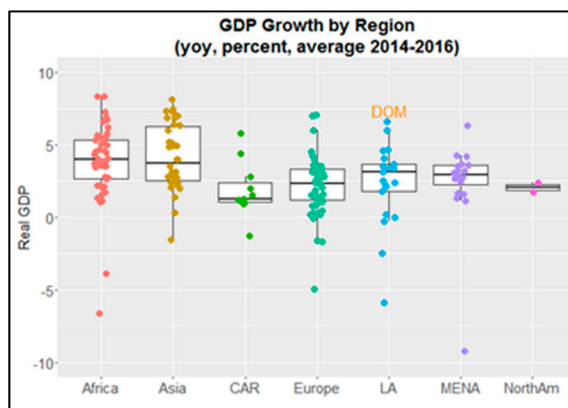
7. Balance of Payments	31
8. Financial Soundness Indicators of Commercial Banks	32

ANNEXES

I. External Sector Assessment	33
II. Risk Assessment Matrix	38
III. Debt Sustainability Analysis: An Update	39
IV. Options for Revenue Mobilization: Technical Assistance Advice	46
V. Strengthening the Medium-Term Fiscal Policy Framework	49

CONTEXT

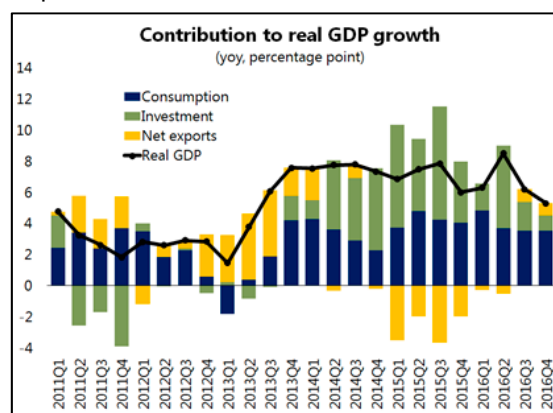
1. The Dominican economy rebounded strongly from the global financial crisis. Since 2014, the Dominican Republic outperformed most emerging markets and all the economies in the Americas, with growth averaging 7 percent. There are a number of factors behind the strong performance. First, due to its dependence on oil imports, tourism, and remittances, the country benefited from the end of the commodity supercycle and from the recovery in the U.S., the main source of tourism and remittances. The same external tailwinds helped reduce inflation and narrow the external current account deficit to historical lows. Second, a strengthened banking system and stable macroeconomic policies provided the necessary backdrop to the recovery. Strong growth over the past few years helped reduce unemployment, poverty, and inequality, but these still remain high.



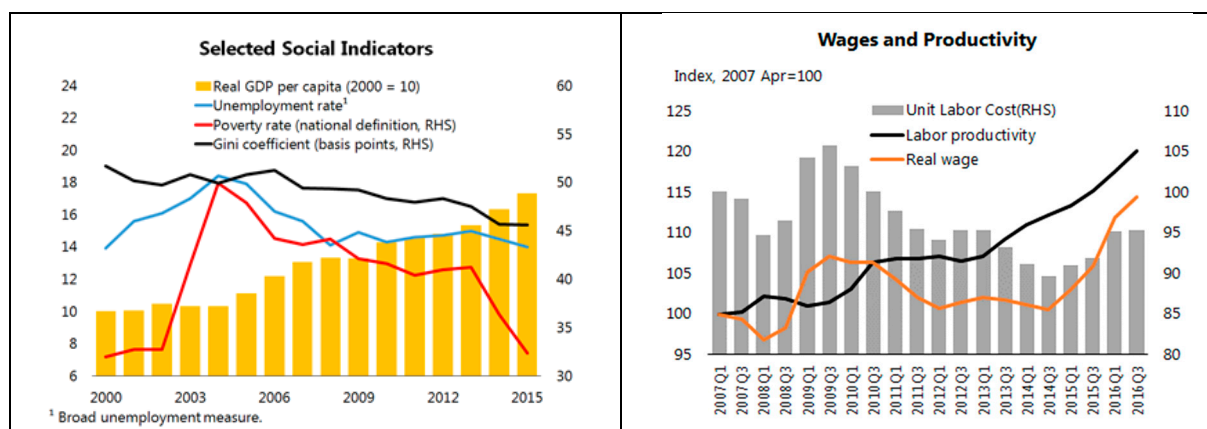
2. A new cabinet took office in late 2016. It continues to prioritize the inclusive growth agenda of reelected president Danilo Medina and will have to tackle a number of other economic and policy challenges, including a weak electricity sector and lack of a medium-term fiscal anchor.

RECENT DEVELOPMENTS: ROBUST GROWTH AND UNDERSHOOTING INFLATION

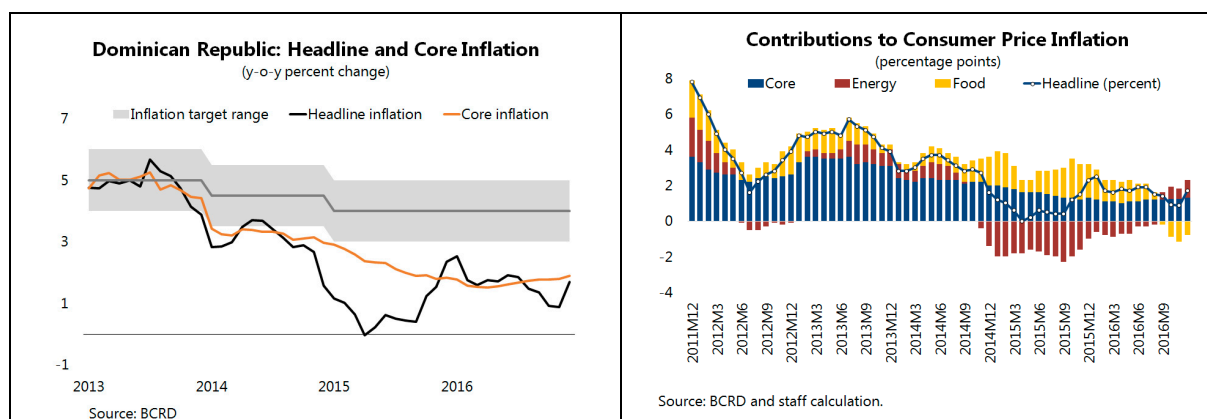
3. Economic momentum remains strong, but has begun to taper off towards potential. Activity expanded by 6.6 percent in 2016, the highest in the Latin American and Caribbean region, with domestic demand remaining the main growth driver. Investment was supported by strong credit, FDI inflows, public and private investment in low-income housing, and the construction of coal plants. Consumption was boosted by a recovery in employment and real wages, persistently low oil prices, and a fast growth in remittances. Both consumption and investment have eased in the second half of the year, as activity is moderating towards potential and some areas of the country were affected by heavy rainfalls and floods at end 2016. Net exports have been a weak contributor to growth, despite strong tourism and the resumption of gold exports, largely due to a drop in exports to Haiti following an overland import ban. With three years of above-potential growth, the output gap is estimated to have widened to 1–1.5 percent of potential GDP in 2016, although uncertainty around these estimates is high (Selected Issues Paper (SIP) I.A).



4. Labor markets and social indicators are steadily improving. Employment rose by 10 percent over the past three years, the bulk of the increase in the formal sector, and unemployment fell from its recent 7 percent peak to 5.3 percent of the labor force in October 2016.¹ Real wages have also begun to catch up to strong productivity growth in the last two years, after remaining stagnant for over a decade. The recovery in disposable incomes helped reduce poverty and income inequality. Between 2013 and 2015, the official poverty rate fell nearly 9 percentage points to 32½ percent (still among the highest in the region), extreme poverty dropped from 10 to 7 percent of the population, while the Gini coefficient fell two points to 45½ (remaining below the regional median).

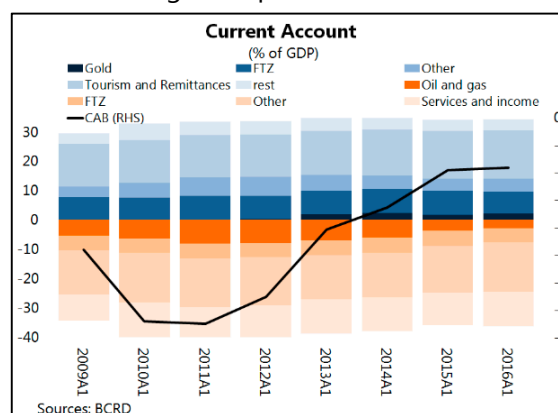


5. Positive supply shocks have kept inflation subdued. Headline and core inflation averaged 1¾ percent during 2016, remaining below the central banks' inflation target range of 4±1 percent for over two years. The oil price decline has pulled inflation down in 2015 and early 2016. As the direct effect of lower oil prices had begun to dissipate in late 2016, a temporary decline in food prices continued to dampen headline inflation. Core inflation has also been contained by low imported inflation, direct and indirect effects of lower food prices, and by the reduction in overall production costs in the economy due to permanently low energy and transportation prices.

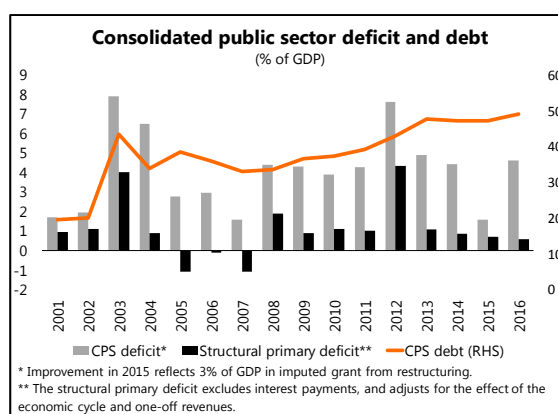


¹ An alternative definition of unemployment calculated by the central bank, which includes the discouraged workers as part of the labor force, shows unemployment falling from 14.1 to 13½ percent over the same period.

6. The external position is broadly in line with the fundamentals. The external current account deficit has strengthened with the favorable terms-of-trade and recovery of trading partner growth. The current account deficit narrowed from about 7 percent of GDP during 2010–12 to an estimated 1½ percent in 2016, the lowest in ten years. The bulk of the adjustment was driven by the decline in the oil import bill, but other contributing factors include the resumption of gold mining activity (which increased exports by about 2 percent of GDP), and a surge in tourism and remittances with the recovery in the U.S. and with visitor inflows from crises hit countries (Venezuela). On the other hand, core manufacturing and free trade zones exports have weakened despite the real effective depreciation of the peso (by 2.8 percent in 2016) along with the U.S. dollar. This reflected feeble manufacturing production and a temporary Haitian ban on overland imports from the Dominican Republic, which reduced exports to Haiti (the second-largest importer of Dominican goods) by a fifth.² The current account deficit was more than financed by foreign direct investment and public sector borrowing, which has strengthened the overall balance and allowed continued accumulation of reserves to 3.8 months of imports by end-2016. Staff estimates the current account balance and the real exchange rate to be broadly in line with fundamentals and the desired policy settings, based on three EBA-lite approaches (Annex I). The medium-term external debt is sustainable and resilient to a number of shocks.



7. The underlying fiscal position improved somewhat in 2016 despite spending pressures in the social and energy sectors. The consolidated public sector deficit is estimated at 4.3 percent of GDP in 2016, 0.3pp below 2015 levels (excluding one-off grants³). The authorities exercised a concerted effort to restrain the fiscal deficit in the face of accelerated spending on coal plants,⁴ election-related pressures, and wage/payroll increases in education and health, which have added some 0.5 percent of GDP in spending relative to



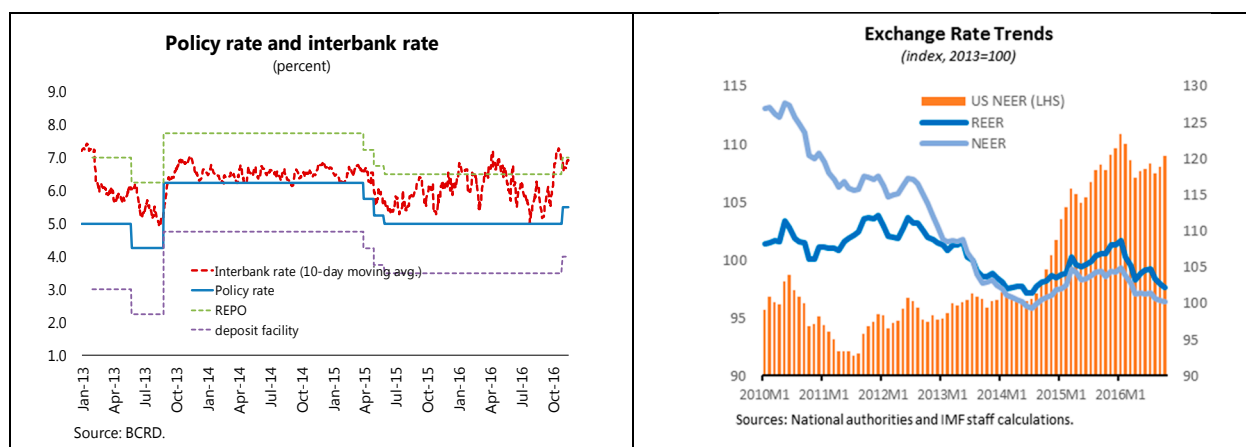
² Haiti imposed a ban on the overland imports of a number of Dominican products in September 2015, citing the need to control quality and tax compliance. The ban was lifted in 2016, but the change has not taken full effect yet.

³ The gains from the 2015 restructuring of the country's debt under the PetroCaribe arrangement with Venezuela, bought back at a discount of over 50 percent, are recorded as an above-the-line capital grant in 2015 (3 percent of GDP), boosting the headline fiscal balance for that year.

⁴ The construction of two coal plants started in 2014, with an estimated cost of US\$2 billion and a generation capacity of 760 MW or 20 percent of current capacity. The plants are expected to enter into operation in the second half of 2018. With the new coal plants, the public sector will have substantial presence in a hitherto largely private electricity generation sector, while the diversification of the energy matrix away from heavy fuels is expected to reduce the volatility of input prices and, at times of higher international oil prices, also lower the cost of generation.

initial plans for the year. While restraint elsewhere, especially in capital spending, limited the impact of these pressures on the overall deficit, temporary financing strains emerged as external financing from Brazil for the coal plants fell through.⁵ Public debt increased to 49.7 percent of GDP by end-2016, as large consolidated deficits offset the growth effects on debt dynamics.

8. Monetary policy had been on hold for over a year before tightening in November. The policy interest rate was unchanged since June 2015, as temporary effects of the commodity price shock were allowed to work themselves through the system. As these shocks began to unwind—against a backdrop of a positive output gap, robust credit growth, and depreciation pressures—the central bank increased the policy interest rate from 5 to 5½ percent in November 2016 to prevent potential overshooting of inflation. This level of interest rates is in line with staff estimates for nominal neutral interest rate (5½–6 percent). Financial conditions have tightened along with the policy rate hike: real borrowing costs have been pushed up by a notable tightening of liquidity in the domestic financial markets and declining inflation, which were only partly offset by a real depreciation of the peso throughout 2016.⁶



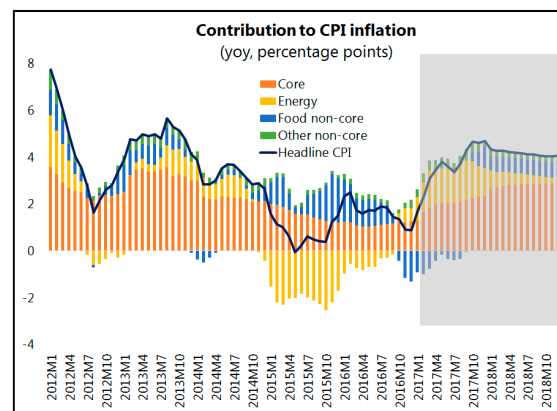
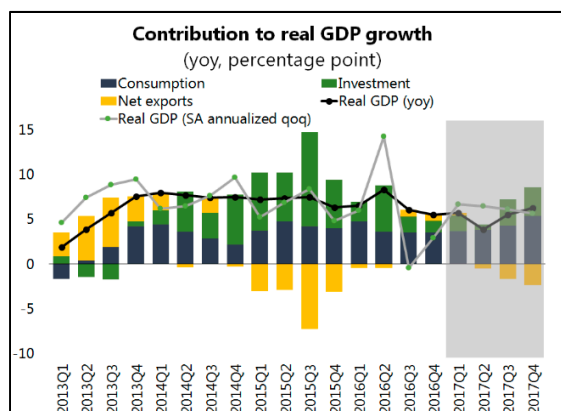
OUTLOOK AND RISKS

9. Growth is expected to remain strong and converge to its potential over the forecast horizon. The ongoing recovery in real wages and employment bode well for consumption growth going forward, while investment will continue to benefit from FDI inflows, and a high demand for lower-income housing. Thus, both consumption and investment should maintain the growth momentum in the near term, but tighter monetary conditions and a rebound in commodity prices will gradually soften domestic demand. Thus, growth is expected to moderate to about 5.3 percent in

⁵ In February 2015, the Dominican Republic and the Brazilian Bank for Economic and Social Development (BNDES) signed a US\$656 million (0.8 percent of GDP) loan agreement for the financing of the new coal plants. The financing has been delayed to follow compliance requirements facing the lender, leaving a substantial financing gap in the project during 2016.

⁶ For a short time, the tighter interbank liquidity reflected the suspension of the repo window at the central bank for two weeks in response to presumed speculative pressure in the foreign exchange markets.

2017 and to slow further to its medium-term potential rate of 5 percent in 2018, closing the positive output gap by 2019.



10. Inflation is projected to return to the target range in 2017, as supply shocks dissipate.

The recovery in fuel and food prices will put upward pressure on headline inflation. At the same time, core inflation is expected to increase in response to the sustained positive output gap and recent marked gains in real wages. As a result, headline inflation may reach the upper half of the central bank's inflation tolerance range during 2017 before moderating to the 4 percent mid-range towards end-year (SIP II.A).

11. The outlook for the balance of payments remains favorable. With the oil prices projected to recover only moderately over the medium term, the current account deficit will widen somewhat to 3.9 percent of GDP by 2022, close to the average of the last 15 years. Firmer growth in the U.S. and other trading partners should support continued growth in exports and remittances, while the moderation in domestic demand will soften non-oil imports. The current account deficit will be largely financed by foreign direct investment, which is projected to remain at around 3 percent of GDP, and government borrowing. As a result, further reserve accumulation is projected over the medium term, with reserve coverage reaching the equivalent of 4.2 months of imports by 2022.

Dominican Republic: Baseline Macroeconomic Framework 2013-2022										
	2013	2014	2015	2016	2017	2018	Projections			
							2019	2020	2021	2022
Output and Inflation (annual percentage change)										
Real GDP	4.7	7.6	7.0	6.6	5.3	5.0	5.0	5.0	5.0	5.0
CPI Inflation (end of period)	3.9	1.6	2.3	1.7	4.3	4.0	4.0	4.0	4.0	4.0
Fiscal accounts and public debt (in percent of GDP, unless otherwise indicated)										
Consolidated public sector overall balance	-4.9	-4.4	-1.6	-4.3	-4.9	-4.8	-4.7	-4.8	-5.0	-5.2
Underlying consolidated public sector balance 1/	-5.1	-4.8	-4.6	-4.5	-4.9	-4.8	-4.7	-4.8	-5.0	-5.2
Consolidated public sector debt 2/	47.8	47.2	47.3	49.7	51.1	52.3	53.4	54.5	55.7	57.1
External sector										
Current account balance (in percent of GDP)	-4.0	-3.3	-2.0	-1.5	-2.0	-2.5	-2.6	-3.1	-3.5	-3.9
GIR (in months of imports, excluding maquila)	3.4	3.5	3.7	3.8	3.9	4.0	4.0	4.0	4.0	4.2

Sources: Country authorities; and Fund staff calculations and estimates.

1/ Excludes one-off items in 2014 (windfall taxes) and 2015 (windfall capital gains from the restructuring of Petrocaribe debt).

2/ Includes debt with electricity generators.

12. Staff and the authorities agreed that uncertainty around the baseline outlook is high, but that risks are broadly balanced (see Annex II for the Risk Assessment Matrix). *Upside risks* to the baseline stem from: (i) a stronger near-term recovery in the U.S., potentially from a fiscal stimulus of the new administration (SIP I.B), and (ii) a prolonged period of lower than envisaged energy prices. *On the downside:*

- A faster tightening of international financial conditions resulting from tighter U.S. monetary policy would negatively affect the Dominican economy. Higher external funding costs would have only a moderate impact on growth due to relatively limited financial integration, but spillovers to the domestic interest rates through tighter monetary policy is likely to be significant. In particular, faster policy rate hikes or foreign exchange interventions would push up domestic borrowing costs and/or appreciate the peso along the U.S. dollar, reducing aggregate demand. Nevertheless, to the extent that tighter financial conditions are due to higher growth in the U.S., the overall net effect on activity in the Dominican Republic is estimated to be positive (SIP I.B).
- Direct spillovers from potential changes in U.S. immigration and trade policies are currently assessed to be small, as the bulk of the Dominican migrants to the U.S. are legal and the U.S. has not signaled concerns about the DR-CAFTA trade agreement. The U.S. withdrawal from the TPP trade agreement may have positive spillover effects as it could prevent diversion of apparel exports to more competitive Asian countries. At the same time, the risks of any revisions to the DR-CAFTA agreement may be a low probability but high impact event, as a large share of Dominican exports are traded under this agreement and the increase in the effective tariff would be among the highest in the region.⁷ The indirect effect of a potential slowdown in world trade poses an additional downside risk.
- A sharper increase in oil prices and a slower recovery in the main trading partners pose a significant downside risk.
- On the domestic side, downside risks may stem from the confidence and policy credibility effects of potentially slow progress in the investigation of the recent corruption probe related to a Brazilian construction company or in advancing structural reforms, especially in the fiscal and electricity sectors.

STRENGTHENING POLICIES FOR RESILIENCE AND GROWTH

The economy's strong cyclical position and the increasingly uncertain external environment call for further strengthening of policy buffers. A credible fiscal adjustment, aimed at addressing structural weaknesses in the tax system and electricity sector, and a stronger medium-term fiscal framework are needed to maintain debt sustainability. Monetary policy remains appropriately vigilant to risks of overshooting inflation, while increasing reliance on the exchange rate as a shock-absorber should help

⁷ Increasing tariffs from current levels to most favored nation levels (which WTO member countries promise to impose on imports from other WTO members unless there is a preferential trade agreement) would imply a 19 percentage point rise in the effective tariff rate, among the highest in the region, due to the large share of tobacco exports with significant tariff differentials.

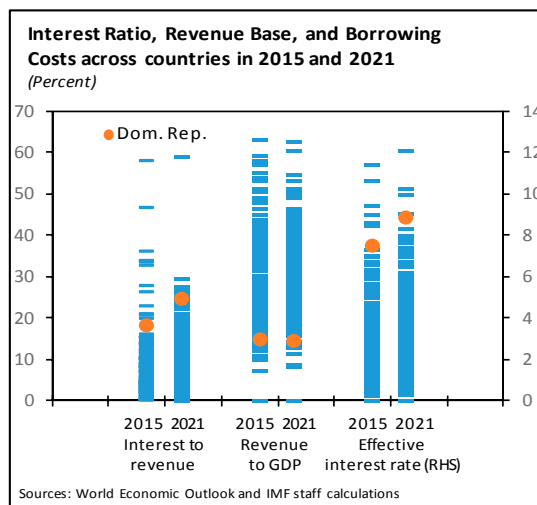
build up reserve buffers. Reviving the structural reform momentum will be critical for building economic and social resilience in the face of a fragile external environment.

A. Fiscal Policy: Are Enough Buffers Being Built in Good Times?

13. Further reductions in the fiscal deficits will be challenging without reforms. The 2017 budget targets an implicit improvement of the central government's fiscal position, but expenditure pressures may defy the authorities' resolve. On the revenue side, the government has focused its efforts on strengthening revenue administration and closing tax loopholes, with a budgeted yield of some 0.6 percent of GDP that is increasingly feasible in light of recent results.⁸ At the same time, off-budget spending on coal plants (0.6 percent of GDP) and rebuilding infrastructure in the aftermath of the recent floods (0.2 percent of GDP) is expected to weaken the fiscal position in 2017. Thus, staff projects that the consolidated public sector deficit will widen from 4.3 percent of GDP in 2016 to 4.9 percent in 2017, a 0.4 percentage points deterioration in structural terms. In absence of policy measures, the fiscal position will slowly deteriorate over the medium term, as substantial tax reforms needed to widen the very narrow tax base have been postponed and as the interest bill grows with higher debt and borrowing costs. Consolidated public debt, under this baseline scenario, would increase from 49 $\frac{2}{3}$ percent of GDP estimated for 2016 to 57 percent by 2022.

14. While baseline debt dynamics already raise sustainability concerns, risks around the baseline are building on a number of fronts:

- **Growth risks.** A slowdown in growth relative to staff's baseline path would significantly deteriorate the debt dynamics, pushing the debt-to-GDP ratio above 60 percent in the medium term (Annex III).
- **Interest rate risk.** The debt servicing burden is increasing, bringing into question the affordability of debt. The interest to revenue ratio is among the highest in international comparison, both because of relatively high real interest rates and a very narrow tax base due to numerous exemptions (SIP III and Annex IV).⁹ The servicing burden would increase further if global interest rates normalize faster than currently expected.
- **Currency risk.** Heavy reliance on external financing has increased public sector's exposure to currency risk, with about 70 percent of the nonfinancial public sector debt denominated in dollars



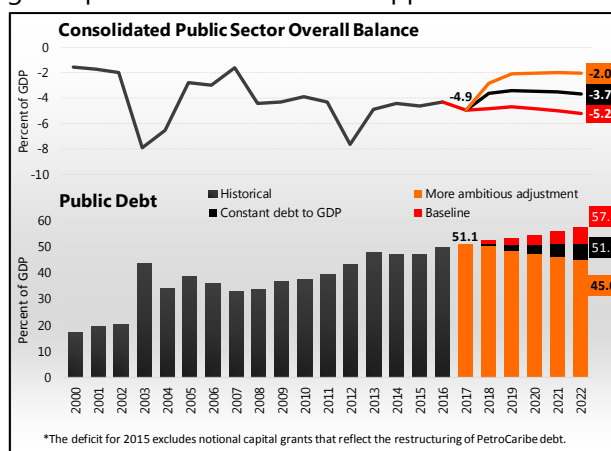
⁸ Among the measures included in the 2017 budget that are likely to yield additional revenues are: taxing dividends of free trade zones companies, revising the reference prices used in the determination of hotel room taxes, indexing excises to match cumulative inflation, and stricter enforcement of VAT and excise exemption rules. Staff projects a potential shortfall in the yield from revenue administration measures of only 0.1 percent of GDP.

⁹ Staff analysis suggest that the high real interest rates can be explained by weaknesses in the fiscal position, institutions, and relatively low reserve buffers (see SIP III).

(55 percent at the consolidated public sector level). A stronger than envisaged depreciation of the peso against the U.S. dollar would significantly increase borrowing costs. The authorities are gradually moving towards increased peso financing, which would reduce the public balance sheet vulnerability to currency risk and could facilitate transition towards a more flexible exchange rate. However, the domestic markets may be currently too shallow to meet all fiscal financing needs (projected at 8 percent of GDP in 2017 and widening gradually to over 9 percent by 2021).

15. The favorable cyclical conditions provide a unique opportunity to decisively strengthen the fiscal position.

In 2017, policies should aim at preventing a deterioration in the fiscal position despite large off-budget spending and at developing comprehensive reforms to support the fiscal consolidation. A fiscal adjustment of 2½–3 percent of GDP during 2018–19 will then be needed to lower public debt to around 45 percent of GDP over the medium term.¹⁰ An adjustment of this size would help mitigate the sustainability and financing risks, as well as improve debt affordability indicators to levels closer to peers with an investment grade credit rating, a strategic goal of the authorities (SIP III). A front-loaded tightening would also help avoid a pro-cyclical adjustment later under less favorable economic circumstances.



16. The fiscal adjustment needs to be underpinned by comprehensive reforms that address structural weaknesses in the tax base and expenditure quality.

Numerous past reforms have not yielded durable increases in the tax base due to either their ad hoc nature or lack of political will to follow through with the reforms. Over time, these have led to increased complexity and unpredictability of the tax system, without meaningful increases in revenues. The reforms, therefore, need to focus on simplifying the system and widening the tax base, by eliminating the large number of exemptions under the VAT, property, and other taxes; rationalizing tax incentives; and reducing the high personal income tax allowance (Annex IV). In turn, addressing long-standing weaknesses in the electricity sector will be important in reducing the fiscal drag from generalized subsidies and overall losses in the sector. Improving overall spending quality and efficiency, including rationalizing spending on inefficient public institutions, could also yield additional savings. At the same time, policy efforts should be mindful of the need to provide

Key fiscal measures	Expected yield (% of GDP)
Total	2.5-2.7
Reducing VAT and property tax exemptions to regional levels	1.3
Reducing the PIT allowance to two minimum salaries	0.2
Eliminating electricity subsidies	0.8-1
Improving spending efficiency	0.2

¹⁰ The improvement in the fiscal deficit needed to achieve this debt reduction is close to 3 percent of GDP relative to the projected 2017 outcomes, but the *fiscal effort* may be less if spending is allowed to fall with the end of coal plant investments or if ongoing tax administration reforms yield more than projected. Staff's baseline assumes that as spending on coal plants drops out on the expenditure side, the recovery of other capital expenditure partially compensates.

adequate room for growth-friendly infrastructure investment and social spending to protect the most vulnerable groups.

Authorities' Views

The authorities agreed with staff that strengthening the tax base and averting the upward debt dynamics is a near term priority. They explained that in the near term the fiscal adjustment efforts will focus on recovering lost ground from the weakening in tax and customs administration over the past several years. Technical assistance from the IMF in both areas is supporting this effort. Once the yield of these reforms becomes clear and discussions on the electricity pact advance, policy attention could focus on the remaining adjustment needs. They indicated that an automatic reduction in capital spending with the end of coal plant construction and some streamlining of tax exemptions and incentives may cover most of the adjustment needs in the absence of additional expenditure pressures, potentially obviating the need for a comprehensive reform, but an assessment would be made in the context of a fiscal pact.

B. Strengthening the Medium-Term Fiscal Policy Framework

17. Lack of a medium-term fiscal anchor creates policy uncertainty. Over the past several years, the authorities have made significant effort to offset unfunded mandates for higher spending on education and pressures from other social sectors and coal plant construction, at the expense of a contraction in growth-supporting investment. Maintaining these efforts over the medium term is not sustainable, while remaining deviations from budget targets are permanently entrenched in higher deficits and debt.

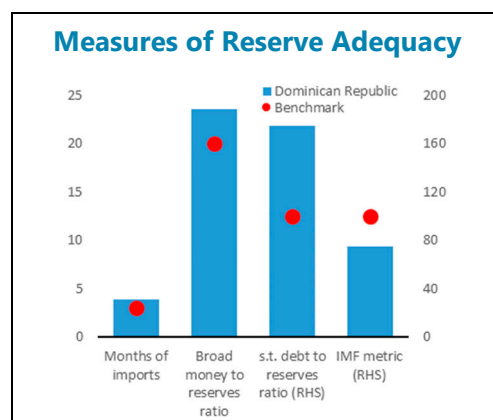
18. Staff welcomes authorities' efforts to move towards a medium-term fiscal framework with fiscal responsibility elements. Staff considers that such a framework could focus on two main pillars: a medium-term fiscal anchor (debt-to-GDP ratio) and an operational target (expenditure growth rule) (Annex V). Following the necessary adjustment in the primary balance, the expenditure growth rule would maintain the average fiscal balance through the cycle at levels needed to reduce or stabilize debt. Additional stock and flow correction mechanisms would ensure that persistent deviations from the targeted balances are corrected as they may come about for reasons other than the cycle. Consideration could also be given to setting up an independent fiscal council to improve policy monitoring and enforcement.

Authorities' Views

The authorities see substantial merit in introducing a medium term fiscal framework that would provide a more explicit and strategic guidance for their efforts to maintain fiscal discipline. They have begun exploring feasible options for practical implementation, and the reform options discussed with the staff will inform the authorities' decision as they move forward.

C. Building External Buffers and Strengthening the Monetary Policy Framework

19. The favorable external conditions have helped the continued buildup of external buffers, but these still remain relatively low. Reserves have strengthened relative to the Fund's reserve adequacy metric, but are relatively low by international standards and still at about 75 percent of the Fund's metric. A faster accumulation of reserves was prevented by frequent interventions in the foreign exchange rate market to stabilize the exchange rate, which has depreciated on average by 3½ percent a year over the past ten years (SIP II.B).



20. A steady move towards increased exchange rate flexibility will help bolster reserves in the face of increased external uncertainty. A more flexible exchange rate should be the first line of defense against external shocks, with interventions limited to smoothing excessive volatility. The authorities have initiated important steps towards such a transition. They have already announced the auction for the foreign exchange trading platform, which would increase transparency and efficiency of the market and is expected to be in place in 2017. They are also preparing legislation on foreign currency hedging and futures markets to facilitate the management of currency risk. They are receiving technical assistance for these reforms and for the formulation of intervention policies consistent with a more flexible exchange rate, which could include gradually widening tolerance bands aimed to curb excessive exchange rate volatility and counter possible disorderly market conditions.

21. The tightening bias of monetary policy is appropriate. The projected pickup in inflation to the upper half of the target range suggests that further monetary tightening may be needed to keep projected inflation within the range. The authorities, therefore, stand ready to tighten monetary policy further if domestic or external factors generate stronger pressures on projected inflation than anticipated in the baseline. Staff supported this tightening bias, while emphasizing that foreign exchange interventions should be geared towards dealing with disorderly market conditions.

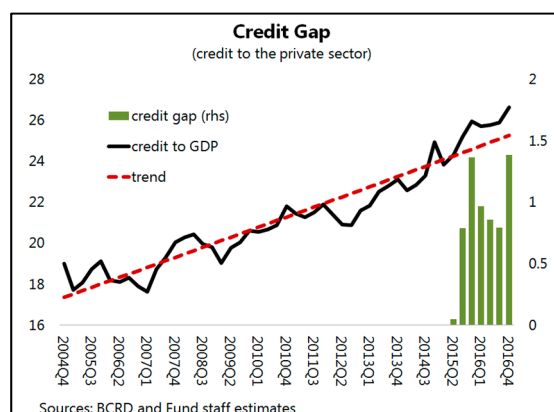
Authorities' Views

The authorities emphasized that the tightening bias is warranted both by the buildup in inflationary pressures and by the need to anchor expectations in the face of increased external uncertainty. They agreed that the strengthened external position allows for an additional buildup in reserves, which are an important buffer against external shocks and would help in the move towards investment grade rating. They noted that foreign exchange interventions are driven by the need to smooth volatility in the relatively shallow and concentrated market, where discrete transactions could lead to excessive exchange rate movements. The authorities pointed out that the transition to a more flexible exchange rate therefore needs to be gradual, and should be preceded by improving the market infrastructure for foreign exchange

transactions and the development of derivatives markets for foreign exchange to enhance capacity to manage foreign currency risks; reforms are underway on both fronts.

D. Strengthening the Macro-Financial Policy Framework

22. Macro-financial vulnerabilities appear limited. The financial sector is relatively small, and its indicators remain solid. Private credit inched up to 26.6 percent of GDP in 2016, remaining low compared to regional standards and the level of economic development. Strong credit growth in the last two years has opened up a modest positive credit gap, but the IMF credit toolkit suggests that loan dynamics are in line with the underlying fundamentals and are not building up vulnerabilities.¹¹ Nonperforming loans remain low and well provisioned, and the capital adequacy ratio, already above the regulatory minimum, improved to 15½ percent largely through reinvested profits. Dollarization of loans and deposits is broadly stable at 21 and 25 percent respectively, relatively low from a regional perspective, with both foreign exchange and credit risk limited by strict prudential requirements on lending in foreign currencies.



Dominican Republic: Financial Soundness Indicator Heat Map								
	2013Q4	2014Q4	2015Q1	2015Q2	2015Q3	2015Q4	2016Q1	2016Q2
Overall Financial Sector Rating	M	M	M	M	L	L	M	L
Credit cycle	L	L	L	L	L	L	L	L
Change in credit / GDP ratio (pp, annual)	1.5	1.8	1.2	1.5	1.9	1.0	1.9	1.5
Growth of credit / GDP (% , annual)	7.0	7.8	5.4	6.4	8.2	4.2	8.0	6.0
Credit-to-GDP gap (st. dev)	1.3	2.2	-0.4	0.1	1.0	1.4	0.3	-0.2
Balance Sheet Soundness	M	M	M	M	L	L	M	L
Balance Sheet Structural Risk	M	M	M	M	L	L	M	L
Deposit-to-loan ratio	93.8	97.6	97.4	98.6	99.9	105.5	99.3	101.5
FX liabilities % (of total liabilities)	32.0	32.7	30.8	30.2	6.2	32.3	30.6	29.6
FX loans % (of total loans)	18.4	21.4	19.4	19.3	21.1	21.9	21.9	21.2
Balance Sheet Buffers	L	L	L	L	L	L	L	L
Leverage	L	L	L	L	L	L	L	L
Leverage ratio (%)	9.7	9.5	9.5	9.7	9.8	9.8	10.0	9.8
Profitability	L	L	L	L	L	L	L	L
ROA	1.9	2.3	2.5	2.5	2.5	2.3	2.3	2.3
ROE	24.6	23.9	25.8	26.6	25.8	24.0	22.8	23.5
Asset quality	L	L	L	L	L	M	M	M
NPL ratio	1.9	1.3	1.4	1.4	1.5	1.5	1.6	1.6
NPL ratio change (% , annual)	-44.4	-29.9	-27.8	-22.7	-8.4	14.1	14.8	10.2
Sources: BIS, FSIs, and national authorities								
Below lower threshold	Medium vulnerability							
Between lower and upper threshold	Low vulnerability							
Above upper threshold								

¹¹ Credit grew by some 12 percent in 2016, compared to an estimated nominal GDP growth of 8–9 percent. Credit growth was broad based, but highest in construction, consumer, and mortgage loans (15 percent on average), although asset impairment has not shown more adverse trends in these sectors.

23. The withdrawal of financial services by international banks has been limited to exchange houses and the smallest banks, with the larger banks able to maintain their correspondent relations. The financial institutions and the authorities are maintaining an open dialogue with correspondent banking institutions to preempt restrictions on or termination of a relationship without a thorough assessment of the risks associated with the specific customer. They are also actively participating in a regional initiative with other Central American countries to create a common action plan with measures to strengthen exchange of information and standardize regulation.

24. The authorities continue strengthening the supervision of banking institutions. They are currently focused on strengthening consolidated supervision of cross-border financial conglomerates and on risk-based supervision, on upgrading banking regulations and norms to improve compliance with the Basel standards, and on further strengthening the system through a program of voluntary exit of smaller and weaker institutions.

25. The macroprudential toolkit to identify and address systemic risks is being upgraded. While risks are closely monitored at the individual institution level, reform efforts are now focused on bolstering capacity to monitor systemic risks, in line with the recommendations of recent IMF and CAPTAC technical assistance. In addition to developing a formal framework for measuring and assessing systemic risks, the authorities are strengthening the financial stability function of the central bank by setting up a permanent working committee to operationalize work on macroprudential issues, and by broadening central bank powers to employ a wider range of macroprudential tools, such as imposing additional capital requirements for counter-cyclical purposes and for systemic risk (important in light of the high concentration of the banking system). Staff also welcomed progress made in strengthening the stress testing framework, and encouraged the authorities to finalize the first Financial Stability Report.

26. Staff supports ongoing effort to bring the Dominican legislation in compliance with international initiatives on financial and tax transparency, which will further strengthen the macro-financial framework.

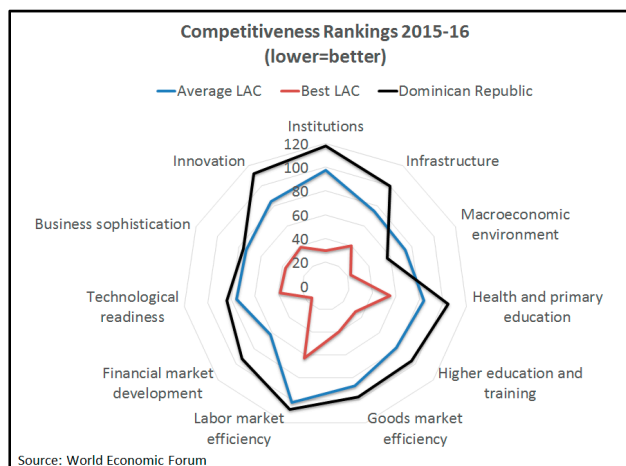
- *Shadow banking.* The focus of the financial reform agenda on strengthening the supervision of shadow banking, which was the main pocket of vulnerability identified during last year's discussions, is welcome. Draft legislation is advanced to charge the Bank Superintendency with the supervision of large credit unions, which so far have been outside the authorities' regulatory perimeter.
- *Other AML/CFT issues.* The authorities are also revising the broader AML/CFT framework to address potential gaps that could arise in the context of the upcoming evaluation by the GAFILAT, including on widening the coverage of criminal and financing of terrorism activities, strengthening sanctions, clarifying responsibilities among institutions and their cooperation, and extending reporting requirements to all relevant participants.
- *Transparency in international taxation.* A recent evaluation by the Global Forum on transparency and exchange of information identified some gaps related to the continued issuance of bearer shares and ease of access to banking information, which the authorities are decisively addressing.

Authorities' Views

The authorities noted that the banking system has been strengthened significantly over the past few years. They pointed out that vulnerability to external shocks is limited by reliance on domestic sources for funding, strong capital buffers, and proactive identification and reduction of risks by the supervisory authority. They noted that weaknesses in the supervision of the shadow banking system are now being actively addressed, which will also help close gaps ahead of the GAFILAT evaluation. The authorities are fully committed to aligning domestic legislation to international standards on tax transparency and anti-money laundering. They will also continue strengthening their macro-financial surveillance capacity, and will focus on addressing remaining data gaps before issuing the first Financial Stability Report.

E. Structural Reforms to Increase Potential Growth and Lower Poverty

27. The Dominican Republic has embarked on a long-term reform agenda to tackle poverty and raise potential growth. Despite its strong macroeconomic performance and recent success in reducing poverty and inequality, the country is still trailing regional peers in terms of poverty reduction and securing a competitive environment to support growth. The main challenges have been weak institutions, poor quality of public education, healthcare and infrastructure, especially in terms of electricity supply, and inefficient labor markets. Policies to address these have been guided by the national development strategy for 2012–30. Its four pillars are: (i) strengthening state institutions for a more efficient government and increased security; (ii) inclusive growth through distributive policies and better provision of education, health and basic needs; (iii) strengthened potential growth through a more diversified, competitive, and employment-rich economy; and (iv) a sustainable development, resilient to economic and climate risks. As part of this reform agenda, the government is implementing far-reaching reforms in the education sector, where outcomes are among the weakest in the world,¹² has embarked on discussions with all social partners on a comprehensive electricity pact to reform the sector, which have been underway over the past two years, and is addressing shortages of low-income housing through public private initiatives.



¹² Under these reforms, education spending doubled to 4 percent of GDP with the construction of new schools, the roll-out of an 8-hour school day, hiring and training of teachers, and wage increases. The Dominican Republic participated for the first time in the OECD's PISA student assessment in 2015, ranking last among 72 participating nations, which underscored the significance and the potential impact of the educational reforms.

28. Delays in reforming the electricity sector are costly, and the recent resumption of electricity pact discussions is welcome. The sector continues to be a significant drag on growth and fiscal accounts due to unreliable electricity supply, large losses and generalized subsidies.¹³ Discussions among social partners over the past two years on the electricity pact have stalled on disagreements about the role of the state in the sector and have resumed only recently. The authorities should take full advantage of the social dialogue to find a lasting solution to the decades old challenges in the sector. These include poor infrastructure in public transmission and distribution, weak governance, including lack of a transparent and predictable regulatory environment and enforcement, and below-cost tariffs.

29. In addition to electricity, other structural reforms are needed to sustain higher trend growth when current tailwinds subside. A friendlier business environment to boost investment and reduce the cost of doing business could be created through addressing red tape, easing product market regulations and reducing barriers to entry, strengthening institutions and governance, and increasing fiscal space to offset a long period of public underinvestment in infrastructure. These will be important in supporting authorities' objectives of boosting the economy's competitiveness and setting up a logistics hub for regional trade.

30. Reforms are also needed to secure a durable improvement in social outcomes and ensure a more inclusive growth.

- *Labor markets.* A faster growth of labor income, one of the main determinants of poverty reduction, has been hindered by low labor force participation, high payroll costs, and apparent skill mismatches. Ongoing implementation of the full-time school model is boosting female labor participation, which has already been an important contributor to poverty reduction over the past few years. Removing further barriers to employment creation—by reducing non-wage payroll expenses, addressing hindrances to more flexible work and conflict resolution arrangements, fostering graduation from safety nets into labor force and promoting training and apprenticeship programs—could go a long way in further boosting incomes.
- *Public services and social protection.* The government is considering reforms in the healthcare sector—where the level of public spending and quality of service are low—to address weaknesses in terms of its governance, quality and access. In a related move, reforms of the social security system are being developed to address gaps in social insurance coverage (pensions, healthcare) for those in the informal sector. This, if complemented by policies to encourage employment formalization, could relieve the fiscal burden of the publicly subsidized pillar, strengthen social protection, and widen the tax base. Finally, strict enforcement of the employer and employee contributions to the social security system will be important to ensure the sustainability of the health system and sufficient replacement income at retirement.¹⁴

¹³ For a discussion of the main weaknesses in the electricity sector, see Box 2 on "Electricity Sector: Issues and Reforms" in the 2015 Article IV staff report for the Dominican Republic.

¹⁴ For instance, ensuring that biannual pension statements clearly convey contributions received and benefit projections to affiliates could improve the density of contribution payments.

Authorities' Views

The authorities agreed that the reforms of the electricity sector are critical to the growth prospects, and are focusing on finalizing the social dialogue on the electricity pact. They stressed their strong commitment to continued improvement in social outcomes, noting that reforms are being developed to tackle weaknesses in the social security legislation, labor code, and healthcare. They viewed the recent tepid performance in manufacturing and exports, as well as increased risks to world trade outlook, as adding urgency to the need to strengthen the country's competitiveness and productivity, and are examining reform options.

STAFF APPRAISAL

31. The Dominican economy is in a cyclically strong position, but faces structural and policy vulnerabilities. The economy is operating above potential, with positive supply shocks muting inflationary pressures and strengthening the external position. Sustained strong growth and prudent policies of the past several years helped improve social indicators and build up confidence. However, the dividend from this higher growth has accrued unevenly and has been moderated by delays in structural reforms to address vulnerabilities in the electricity and fiscal sectors.

32. Growth is projected to remain healthy while tapering off towards potential, and inflation is expected to pick up towards target. Domestic demand will continue to drive growth, buoyed by recovering real incomes, growth in the U.S., and strong investment. The pace of expansion is expected to slow from 6 $\frac{2}{3}$ percent in 2016 towards the potential of around 5 percent from 2017 onward, as both external and domestic financing conditions tighten. Inflation is set to increase to target during 2017 with the recovery in commodity prices and the current account to widen moderately.

33. Risks around this baseline outlook are balanced, but uncertainty is particularly elevated. Key risks and uncertainties stem from the uncertainty surrounding the economic and policy outlook for the external trading partners, notably the U.S., the outlook for oil prices, and tighter global financing conditions.

34. The fiscal position needs to be decisively strengthened to maintain sustainability in the face of increasing risks. The authorities' commitment to fiscal discipline helped safeguard the fiscal position in the face of increasing pressures, through both expenditure restraint and a strong revenue administration effort. Nevertheless, large structural deficits projected for the medium-term generate both sustainability and affordability concerns, and the fiscal position is susceptible to interest, exchange rate and funding risks under tightening global financing conditions. A strong fiscal adjustment effort would be needed in the near term to bring public debt down to more comfortable levels, with significant front-loading warranted by a still favorable cyclical position. A comprehensive reform to broaden the very narrow tax base, simplify the tax system and make it more equitable, should underpin the consolidation. This should go along with reforms to address the fiscal drag of the electricity sector and increase spending efficiency.

35. Adopting a robust medium-term framework would ensure that annual fiscal policies are consistent with sustainability objectives. The medium-term fiscal framework should be anchored on a medium-term debt-to-GDP ratio and operationalized through a well-designed fiscal rule. Integrating fiscal responsibility objectives in the framework and introducing monitoring by a fiscal council could further cement fiscal discipline.

36. The tightening bias of monetary policy is appropriate, and progress towards a more flexible exchange rate framework should continue. Given upside pressures on inflation from external and domestic factors, monetary policy is appropriately leaning towards tightening. Staff welcomes the authorities' commitment to continue to build up reserve buffers in the face of increased uncertainty, with foreign exchange interventions limited to smoothing excessive volatility. Staff strongly supported the authorities' plans to move towards a progressively more flexible exchange rate, through building up market infrastructure and instruments to facilitate such a transition. Such a transition should be facilitated by the broad alignment of the real effective exchange with economic fundamentals.

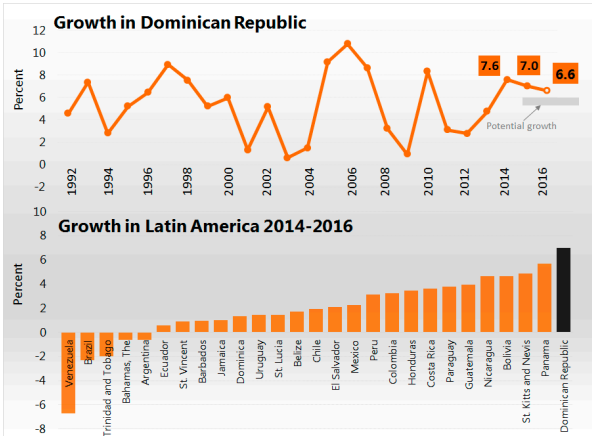
37. Ongoing reforms to strengthen the macro-financial framework will help entrench financial stability. Financial soundness indicators for the banking system remain strong, and the authorities are appropriately focusing on addressing gaps in the regulation and supervision of nonbanks. Completing reforms that will address the gaps identified in the context of the recent Global Forum evaluation on tax transparency and those that could arise in the context of the upcoming GAFILAT evaluation on AML/CFT will be important in supporting revenue mobilization and preserving the integrity of the financial system. Staff also supported authorities' efforts to strengthen the macro-prudential framework through bolstering capacity to monitor and address systemic risks, further developing stress testing capacity and preparing financial stability reports.

38. Ambitious structural reforms remain critical to securing better longer-term growth and social outcomes in a fragile external environment. The government's reform agenda appropriately focuses on improving educational outcomes, boosting housing supply and strengthening social safety nets. At the same time, ongoing discussions on the electricity pact provide a unique opportunity to address the long-standing governance challenges, infrastructure gaps and pricing policies in the electricity sector, one of the major drags on growth. Other reforms that would remove bottlenecks to higher longer-term growth include strengthened institutions and governance, increased predictability of the tax system, and continued public investment in infrastructure. Policies to boost employment—through improved labor markets, graduation from safety nets into labor force, and skill development and retooling—would directly support government's poverty-reduction objectives. Finally, social protection could also be strengthened through expanded coverage of social insurance, addressing challenges in the public healthcare system, and policies to encourage formalization.

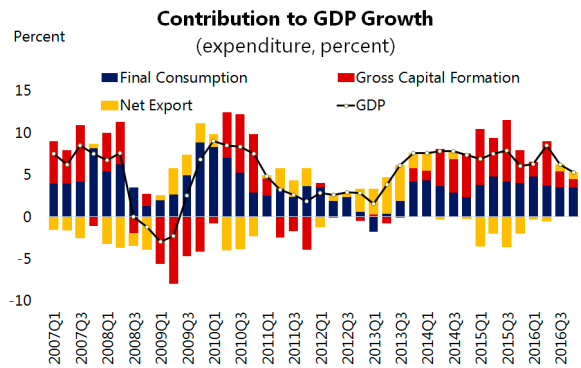
39. It is recommended that the next Article IV consultation take place on the standard 12-month cycle.

Figure 1. Dominican Republic: Real Activity Developments

Average growth over the past three years was the highest in Latin America, ...

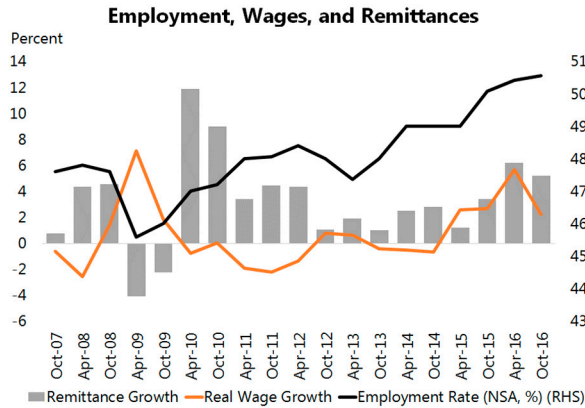


... driven by vibrant consumption and investment.

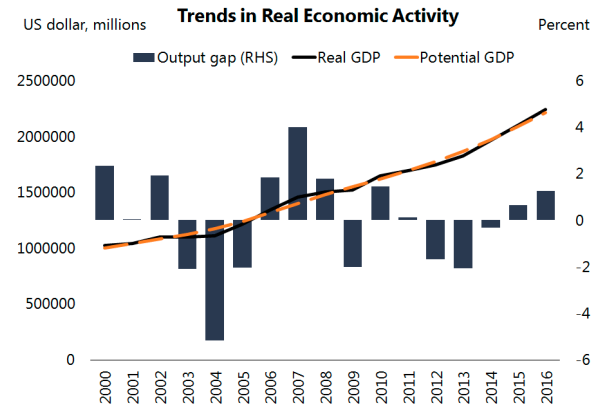


Source: BCRD and staff calculation.

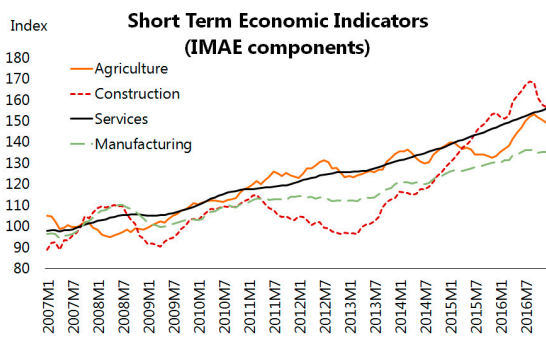
Consumption was supported by strong remittances, increasing employment and a pick-up in real wages.



Strong growth led to a widening of the output gap to an estimated 1.2 percent above potential level.

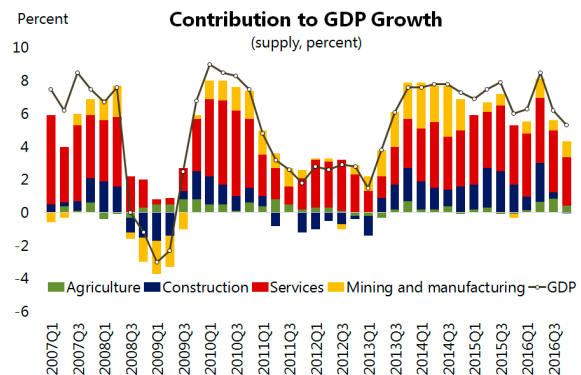


On the supply side, economic activity was strong across all sectors, particularly in construction, ...



Source: BCRD and staff calculation.
Note: IMAE index is calculated as 6 months moving average.

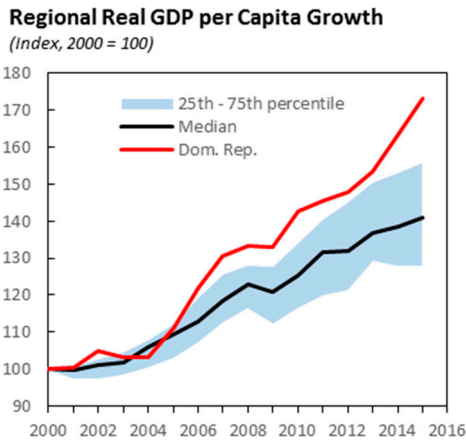
...which, along with services and mining, contributed notably to growth in 2016.



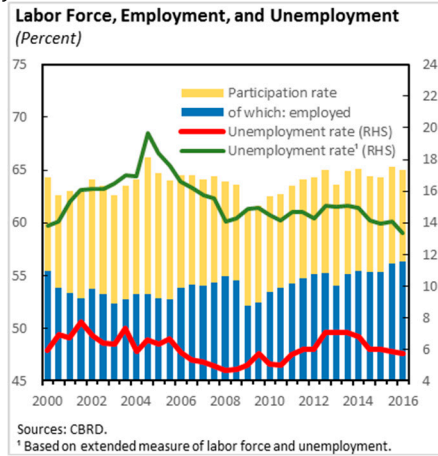
Source: BCRD and staff calculation.

Figure 2. Dominican Republic: Social Indicators in a Regional Perspective

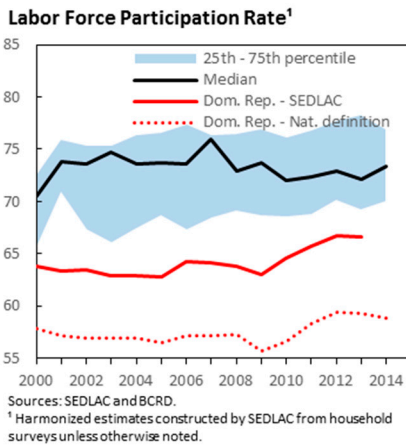
Strong growth following the 2003-04 banking crisis allowed a strong catchup in per capita income relative to the LAC region



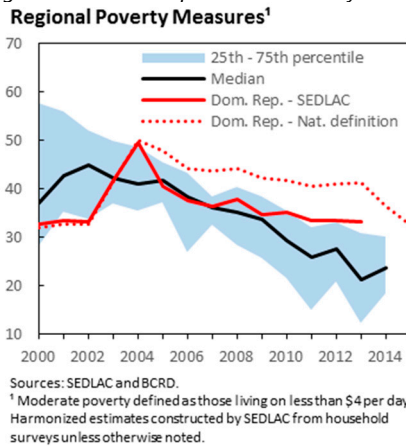
Employment is recovering after the slump during the global financial crisis, and the growth in labor force participation reduced the unemployment rate in the last three years



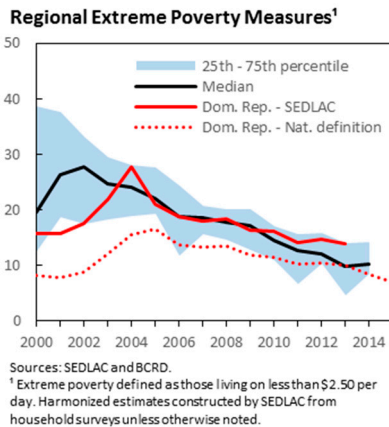
Nevertheless, labor force participation remains very low compared to the region, constraining a faster employment growth



The reduction in poverty, which dropped significantly only in the past two years, has lagged behind both relative to the region and to the expansion in activity.



Extreme poverty, on the other hand, has fallen significantly over the years, especially according to the national definition



Inequality continues to decline as well, with significant improvements over the past three years

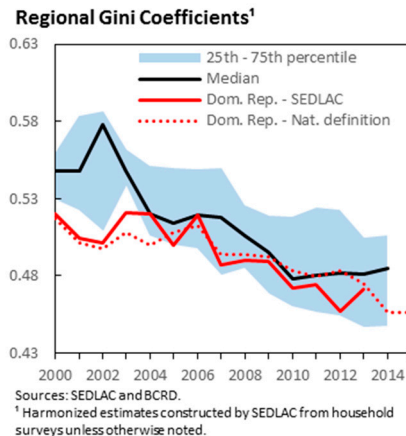
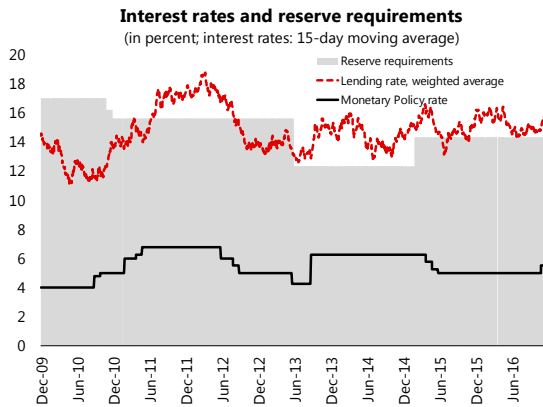
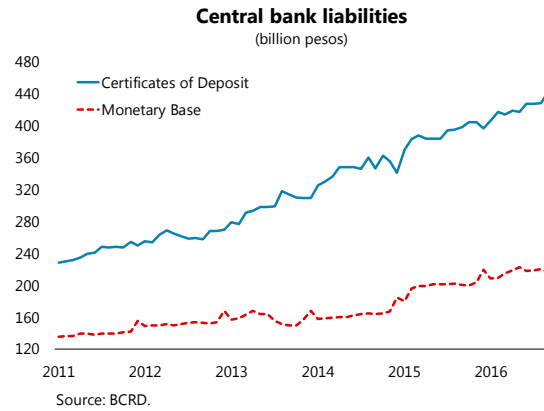


Figure 3. Dominican Republic: Monetary Developments

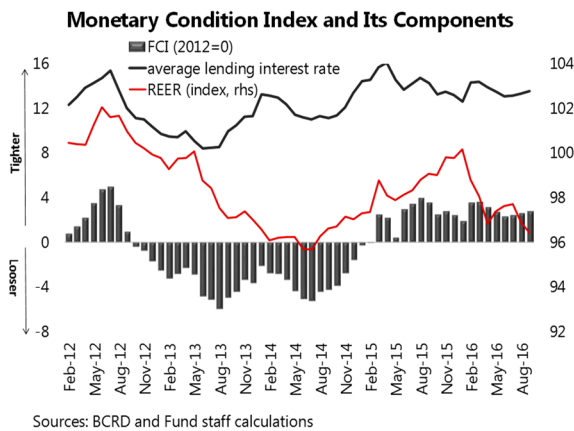
The monetary policy rate was on hold until November....



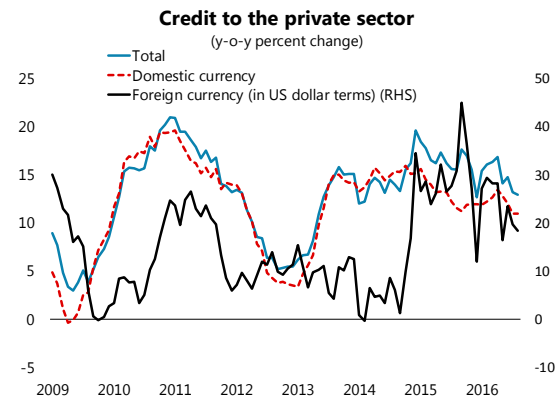
...while the central bank was managing liquidity by issuing certificates.



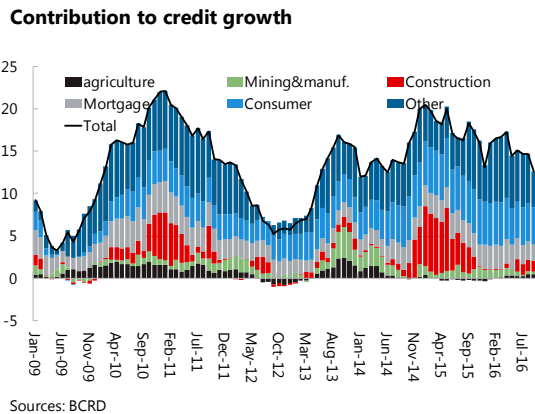
Financial conditions tightened slightly...



...while credit to the private sector remained robust...



...mostly driven by consumer and mortgage lending.



Financial dollarization remained moderate.

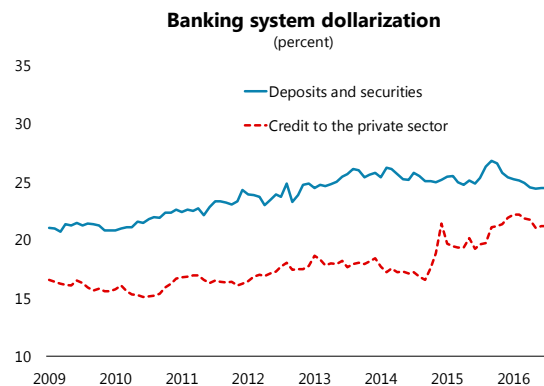
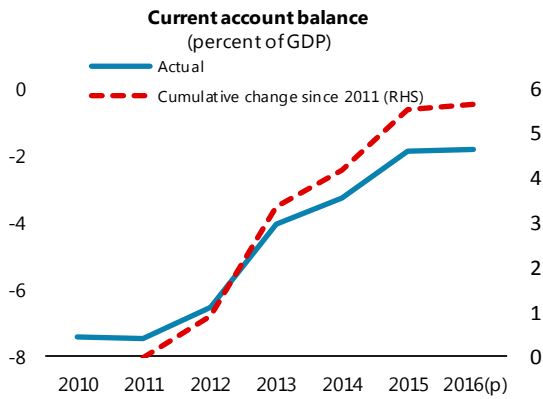
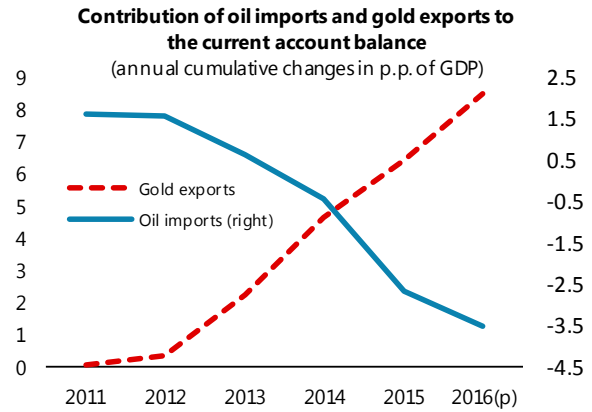


Figure 4. Dominican Republic: External Developments

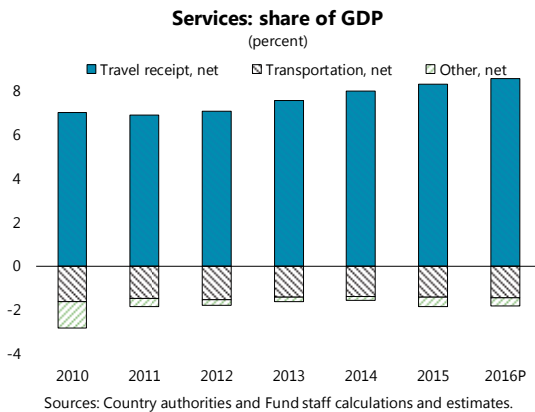
The current account has improved notably over the past few years,...



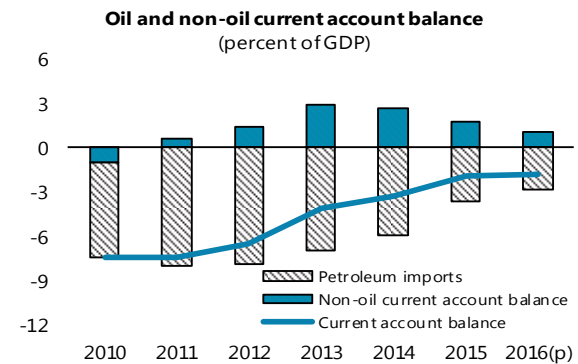
...helped by lower oil bill and gold export...



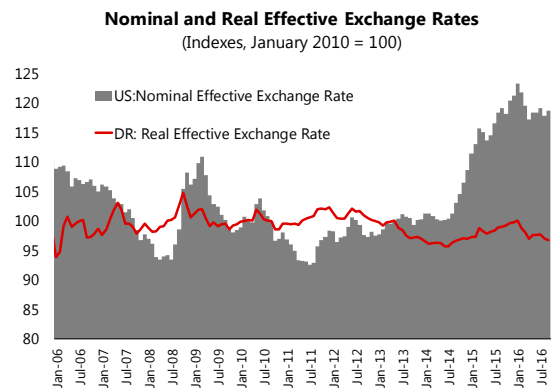
...as well as strong tourism receipts.



Non-oil current account has weakened, largely due to higher interest payments on public debt



Exchange rate depreciated somewhat in 2016, offsetting the earlier appreciation in line with the U.S. dollar



Reserves have been accumulating, although remain volatile.

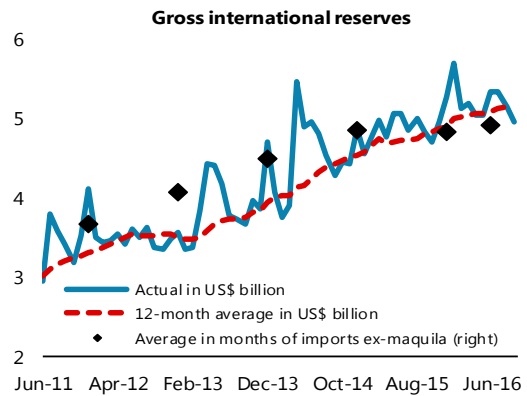
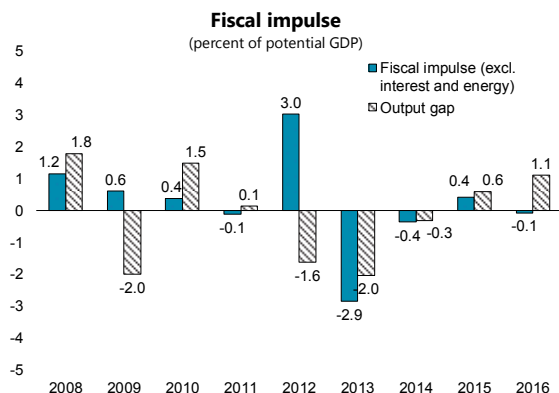
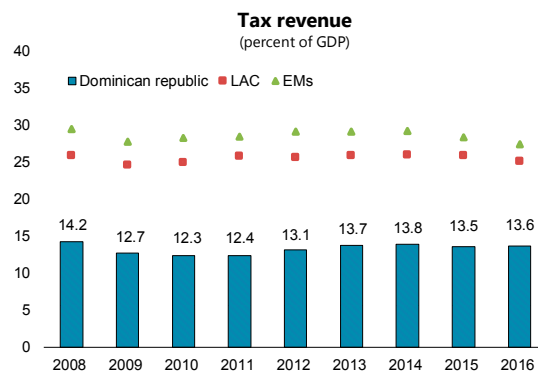


Figure 5. Dominican Republic: Fiscal Developments

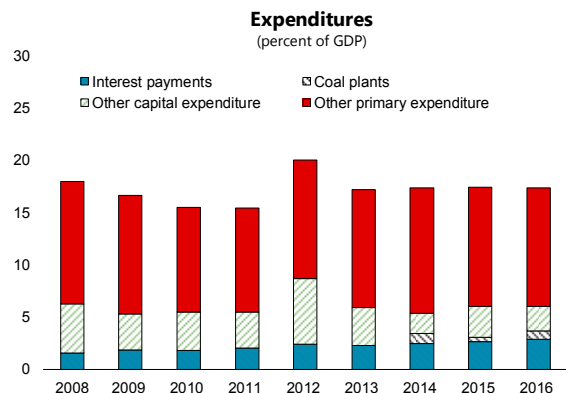
The fiscal stance was slightly contractionary in 2016.



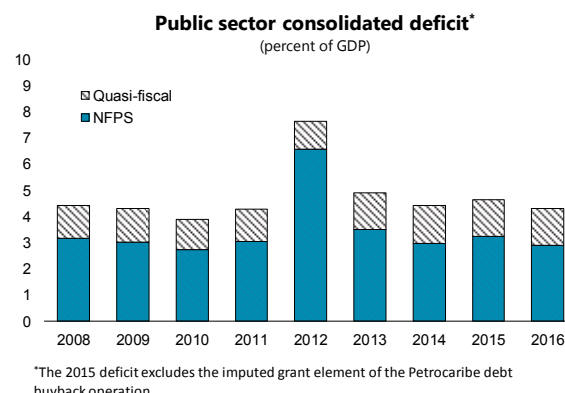
Tax revenues have stagnated at a very low level in international comparison...



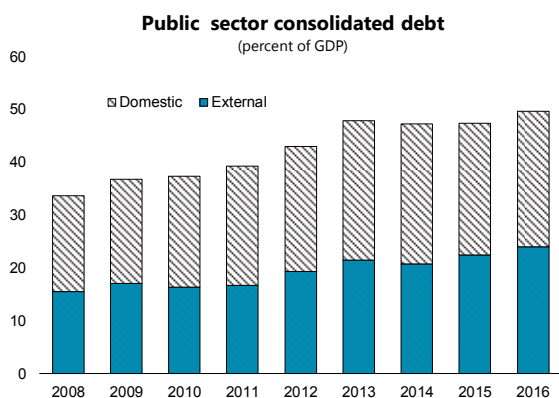
...while significant efforts were needed to contain expenditures due to rising interest payments and coal plant spending.



The small reduction in the consolidated deficit as a share of GDP...



...was insufficient to halt the upward debt dynamics.



However, debt levels remain moderate by global standards.

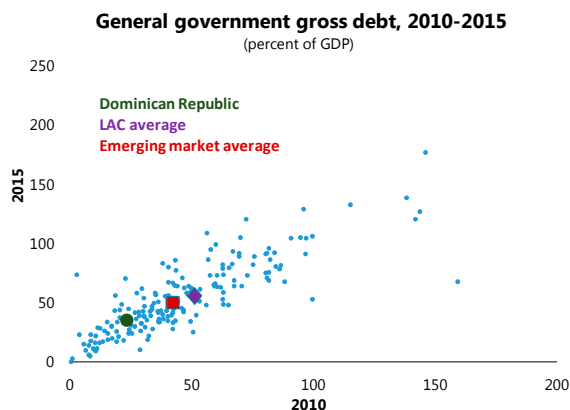


Table 1. Dominican Republic: Selected Economic Indicators
(percent change from previous period, unless otherwise indicated)

	2013	2014	2015	2016	Projections					
					2017	2018	2019	2020	2021	2022
National production and income										
Real GDP	4.7	7.6	7.0	6.6	5.3	5.0	5.0	5.0	5.0	5.0
Net exports (contribution to growth)	3.3	0.6	-2.7	0.2	-0.6	-0.6	-0.4	-0.4	-0.7	-0.6
Total domestic demand	1.8	5.2	8.5	6.3	6.4	5.1	5.0	5.2	5.3	5.2
Total consumption	1.4	3.9	5.0	4.7	4.8	4.8	4.7	5.0	5.1	4.9
Private final consumption	2.3	3.6	4.8	4.8	4.8	4.8	4.7	5.0	5.1	5.0
Public consumption expenditure	-5.9	6.8	7.7	4.7	4.7	4.7	4.7	4.7	4.7	4.7
Gross fixed domestic investment	2.0	14.8	20.0	12.7	9.5	3.5	5.3	6.0	6.0	6.0
Private fixed investment	17.0	16.6	17.4	13.1	9.5	6.0	6.0	6.0	6.0	6.0
Public Fixed investment	-39.7	6.7	33.4	11.1	9.6	-7.9	1.5	5.9	6.0	6.0
Nominal GDP	8.7	9.7	8.0	8.3	9.4	9.4	9.2	9.2	9.2	9.2
Employment and prices										
Unemployment rate	7.0	6.4	5.9	5.5	5.7	6.0	6.1	6.1	6.1	6.1
Consumer price inflation (end of period)	3.9	1.6	2.3	1.7	4.3	4.0	4.0	4.0	4.0	4.0
Consumer price inflation (period average)	4.8	3.0	0.8	1.6	3.9	4.2	4.0	4.0	4.0	4.0
GDP deflator	3.7	1.9	0.9	1.6	3.9	4.2	4.0	4.0	4.0	4.0
Output gap (percent of potential GDP)	-2.0	-0.3	0.6	1.1	0.6	0.2	0.0	0.0	0.0	0.0
REER	97.0	97.0	99.8	97.3	...	...	...	...	...	...
Exchange rate RD\$/US\$ (eop)	42.7	44.3	45.5	46.7	...	...	...	...	...	...
Exchange rate RD\$/US\$ (average)	41.7	43.5	45.0	46.0	...	...	...	...	...	...
Balance of Payments										
Current account balance (percent of GDP)	-4.0	-3.3	-2.0	-1.5	-2.0	-2.5	-2.6	-3.1	-3.5	-3.9
Export volume (goods)	11.2	7.6	5.5	6.8	0.8	3.1	2.9	3.6	3.3	4.8
Import volume (goods)	-2.5	7.0	10.7	8.6	5.2	5.9	4.4	5.2	5.3	5.2
Terms of trade (goods)	-2.7	1.5	2.0	2.0	2.1	1.4	0.0	0.2	-0.1	0.0
Net international investment position (percent of GDP)	-59.3	-61.9	-60.6	-60.1	-58.6	-57.7	-57.1	-57.0	-57.3	-58.0
Saving and investment (percent of GDP)										
Gross national saving	19.6	20.6	21.4	23.0	23.7	23.5	23.8	23.6	23.3	23.0
Public	0.6	0.1	0.5	0.0	-0.1	-0.2	-0.4	-0.5	-0.7	-0.9
Private	19.1	20.5	21.0	23.0	23.8	23.7	24.2	24.1	24.0	23.9
Gross domestic investment	23.7	23.9	23.5	24.5	25.7	25.9	26.1	26.3	26.5	26.7
Public	3.6	3.8	4.3	4.4	4.6	4.1	4.0	4.0	4.0	4.0
Private	20.1	21.0	20.1	21.3	22.2	22.4	22.6	22.8	23.0	23.3
Fiscal accounts (percent of GDP)										
Consolidated Public Sector Debt	47.8	47.2	47.3	49.7	51.1	52.3	53.4	54.5	55.7	57.1
Consolidated Public Sector Overall Balance	-4.9	-4.4	-1.6	-4.3	-4.9	-4.8	-4.7	-4.8	-5.0	-5.2
Primary	-1.4	-0.7	2.2	-0.2	-0.5	-0.2	0.0	0.0	-0.1	-0.2
Interest payments	3.5	3.7	3.8	4.1	4.4	4.6	4.7	4.8	4.9	5.0
Memorandum items:										
Nominal GDP RD\$ (millions)	2,590,678	2,841,203	3,068,139	3,322,409	3,634,413	3,977,400	4,343,320	4,742,906	5,179,253	5,655,745
Nominal GDP US\$ (billions)	62.1	65.3	68.2	72.2	76.9	81.7	86.6	91.8	97.3	103.2

Sources: Country authorities; World Bank; and Fund staff calculations and estimates.

Table 2. Dominican Republic: Public Sector Accounts
(in percent of GDP)

	2013	2014	2015	2016	2017	Projections					
						2017 Budget	2018	2019	2020	2021	2022
A. Central Government											
Total revenue and grants	14.4	14.8	17.5	14.6	14.8	14.9	14.7	14.7	14.6	14.6	14.5
Total revenue	14.3	14.7	14.4	14.6	14.8	14.9	14.7	14.6	14.6	14.5	14.5
Tax revenues	13.7	13.8	13.5	13.6	13.9	13.9	13.8	13.8	13.7	13.6	13.6
Income and property 1/	5.1	5.1	4.6	4.8	4.7	4.8	4.7	4.7	4.7	4.7	4.7
VAT	4.4	4.6	4.8	4.8	4.9	5.1	4.9	4.9	4.9	4.9	4.9
Excises	3.3	3.2	3.1	3.1	3.1	3.0	3.1	3.0	3.0	2.9	2.9
International trade	0.9	0.9	1.0	1.0	1.1	1.1	1.1	1.1	1.1	1.1	1.1
Nontax revenue	0.5	0.7	0.9	0.9	0.9	0.9	0.9	0.9	0.9	0.9	0.9
Grants	0.1	0.1	3.1	0.0	0.0	0.1	0.0	0.0	0.0	0.0	0.0
Primary expenditures	14.9	14.9	14.8	14.5	14.9	14.1	14.6	14.5	14.5	14.5	14.5
Wages and salaries 2/	4.1	4.5	5.0	4.5	4.3	4.3	4.3	4.3	4.3	4.3	4.3
Goods and services	1.5	1.7	1.6	1.4	2.1	2.2	2.1	2.1	2.1	2.1	2.1
Transfers	5.9	6.0	4.8	5.3	4.9	4.9	4.8	4.7	4.7	4.6	4.6
Electricity transfers	1.3	1.4	0.8	0.5	0.5	0.5	0.4	0.3	0.3	0.3	0.3
Other	4.6	4.6	4.0	4.8	4.4	4.4	4.4	4.4	4.4	4.4	4.4
Capital expenditure	3.6	2.9	3.4	3.2	3.5	2.7	3.3	3.3	3.3	3.3	3.3
Statistical discrepancy	-0.2	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Primary balance	-0.5	-0.1	2.8	0.2	-0.1	0.8	0.1	0.2	0.2	0.1	0.0
Interest	2.3	2.5	2.6	2.9	3.2	3.1	3.3	3.4	3.5	3.7	3.7
Foreign	0.8	0.9	1.1	1.2	1.4	1.4	1.5	1.6	1.7	1.7	1.8
Domestic 3/	1.5	1.6	1.5	1.6	1.7	1.7	1.8	1.8	1.9	1.9	2.0
o/w: interest for central bank recapitalization	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7
Overall balance	-2.8	-2.6	0.1	-2.7	-3.3	-2.3	-3.2	-3.2	-3.4	-3.6	-3.7
B. Rest of the Non-Financial Public Sector 4/											
Overall balance rest of NFPS	-0.7	-0.4	-0.3	-0.2	-0.3		-0.3	-0.2	-0.2	-0.2	-0.2
C. Non-Financial Public Sector (A+B)											
Overall balance NFPS	-3.5	-3.0	-0.2	-2.9	-3.6		-3.5	-3.4	-3.6	-3.8	-3.9
Primary balance	-1.2	-0.5	2.4	0.0	-0.4		-0.2	0.0	-0.1	-0.1	-0.2
Interest	2.3	2.5	2.6	2.9	3.2		3.3	3.4	3.5	3.7	3.7
D. Central Bank											
Quasi-fiscal balance of the central bank	-1.4	-1.5	-1.4	-1.4	-1.4		-1.3	-1.3	-1.2	-1.2	-1.3
Of which: non interest	0.5	0.5	0.5	0.6	0.6		0.7	0.7	0.7	0.7	0.7
E. Consolidated Public Sector (C+D)											
Consolidated public sector balance	-4.9	-4.4	-1.6	-4.3	-4.9		-4.8	-4.7	-4.8	-5.0	-5.2
Interest	3.5	3.7	3.8	4.1	4.4		4.6	4.7	4.8	4.9	5.0
Memorandum items:											
Consolidated public sector debt	47.8	47.2	47.3	49.7	51.1		52.3	53.4	54.5	55.7	57.1
Non-financial public sector	34.3	33.7	33.0	34.7	35.8		37.1	38.4	39.8	41.2	42.8
Central Bank 5/	13.5	13.5	14.3	14.9	15.3		15.2	15.0	14.8	14.5	14.3
Underlying consolidated public sector balance	-5.1	-4.8	-4.6	-4.5	-4.9		-4.8	-4.7	-4.8	-5.0	-5.2
Structural balance 6/	-0.7	-0.4	-0.2	0.2	0.1		0.4	0.7	0.7	0.6	0.5
Central government primary spending excl. energy subsidies	13.6	13.5	14.0	14.0	14.4		14.2	14.2	14.2	14.2	14.2
Central government overall spending	17.2	17.4	17.4	17.3	18.1		17.9	17.9	18.0	18.1	18.2
Overall balance of the electricity sector	-1.9	-2.3	-1.5	-1.6	-1.8		-1.3	-1.0	-0.9	-0.9	-1.0
Nominal GDP (DR\$ billion)	2,591	2,841	3,068	3,322	3,634	3,620	3,977	4,343	4,743	5,179	5,656

Sources: Country authorities; and Fund staff calculations and estimates.
1/ Includes social security contributions.
2/ The nominal decrease in wages and salaries in 2016 reflects a reclassification of certain items to transfers.
3/ Includes interest payments on Central Bank recapitalization bonds.
4/ Includes the Dominican Corporation of State Electricity Companies (CDEEE). The figure for 2016 is staff's estimate based on preliminary data.
5/ Includes outstanding stock of all central bank securities.
6/ Consolidated public sector primary structural balance; excludes one-off items

Table 3. Dominican Republic: Public Sector Accounts
(in billions of Dominican pesos)

	2013	2014	2015	2016	2017	Projections					
						2017 Budget	2018	2019	2020	2021	2022
A. Central Government											
Total revenue and grants	372.5	419.5	538.0	485.6	537.8	539.5	585.5	637.2	693.5	754.1	819.6
Total revenue	369.4	417.4	441.9	484.6	536.7	537.6	584.3	635.8	692.1	752.5	817.9
Tax revenue	355.3	393.2	414.2	453.2	504.4	504.0	548.9	597.2	649.9	706.4	767.6
Income and property 1/	132.4	144.8	140.3	158.0	172.3	172.5	187.6	204.9	223.9	243.9	265.3
VAT	113.3	130.4	147.0	159.2	179.7	183.4	196.6	214.7	234.5	256.0	279.6
Excises	85.8	90.9	95.2	101.8	113.0	108.1	121.6	130.5	140.1	150.4	161.5
International trade	23.8	26.6	31.1	33.5	38.6	39.3	42.3	46.2	50.4	55.1	60.1
Nontax revenue	14.1	21.2	27.5	31.4	32.3	33.7	35.3	38.6	42.1	46.0	50.3
Grants	3.1	2.1	96.2	1.0	1.1	1.9	1.2	1.3	1.5	1.6	1.7
Primary expenditures	386.0	423.2	453.4	480.4	542.0	511.1	580.6	629.0	686.4	749.0	817.5
Wages and salaries 2/	105.3	127.8	153.0	150.9	157.0	155.1	171.8	187.6	204.9	223.8	244.3
Goods and services	39.3	47.4	48.3	46.9	77.4	79.4	84.7	92.5	101.0	110.3	120.4
Transfers	153.4	169.7	147.6	175.5	177.9	177.0	190.1	202.6	220.7	240.6	262.2
Electricity transfers	34.6	40.2	24.6	16.8	19.3	19.3	16.6	13.0	13.7	14.5	15.4
Other	118.8	129.4	123.0	158.7	158.6	157.7	173.6	189.5	207.0	226.0	246.8
Capital expenditure	93.7	81.5	104.6	104.8	128.2	98.0	132.4	144.5	157.8	172.3	188.2
Statistical discrepancy	-6.1	-3.5	-1.1	0.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Primary balance	-13.5	-3.8	84.6	5.2	-4.2	28.4	4.9	8.2	7.2	5.0	2.1
Interest	59.2	70.0	80.1	95.6	114.6	113.3	130.7	148.4	167.7	189.7	211.6
Foreign	20.5	25.4	32.9	41.3	52.1	51.6	60.1	68.9	78.6	89.7	100.9
Domestic 3/	38.7	44.6	47.2	54.2	62.6	61.7	70.7	79.5	89.1	100.0	110.7
o/w: interest for central bank recapitalization	17.4	19.2	21.2	22.8	25.4	25.3	27.8	30.4	33.2	36.3	39.6
Overall balance	-72.7	-73.8	4.5	-90.3	-118.8	-84.9	-125.8	-140.2	-160.6	-184.7	-209.5
B. Rest of the Non-Financial Public Sector 4/											
Overall balance rest of NFPS	-18.3	-10.8	-10.4	-6.0	-10.9		-13.6	-9.4	-9.6	-10.1	-13.0
C. Non-Financial Public Sector (A+B)											
Overall balance NFPS	-91.0	-84.5	-6.0	-96.3	-129.7		-139.4	-149.6	-170.1	-194.7	-222.5
Primary Balance	-31.7	-14.5	74.1	-0.8	-15.0		-8.7	-1.2	-2.4	-5.1	-10.9
Interest	59.2	70.0	80.1	95.6	114.6		130.7	148.4	167.7	189.7	211.6
D. Central Bank											
Quasi-fiscal balance of the central bank	-36.2	-41.2	-43.0	-46.4	-49.3		-52.7	-54.4	-58.5	-63.0	-71.2
Of which: non interest	12.3	13.6	15.7	18.5	21.6		26.9	32.0	34.6	37.9	41.3
E. Consolidated Public Sector (C+D)											
Consolidated public sector balance	-127.2	-125.8	-49.0	-142.7	-178.9		-192.1	-204.0	-228.6	-257.7	-293.8
Interest	90.4	105.7	117.7	137.8	160.1		182.4	204.4	227.7	254.3	284.6
Memorandum items:											
Consolidated public sector debt	1,239	1,341	1,452	1,651	1,857		2,079	2,318	2,586	2,887	3,230
Non-financial public sector	888	958	1,014	1,154	1,300		1,476	1,667	1,886	2,136	2,423
Central Bank 5/	351	383	438	496	556		604	651	700	751	807
Underlying consolidated public sector balance	-132	-137	-142	-148	-179		-192	-204	-229	-258	-294
Structural balance 6/	-16.9	-10.8	-5.7	7.2	3.4		17.2	30.8	32.2	32.8	30.4
Central government primary spending excl. energy subsidies	351.4	383.0	428.9	463.6	522.7		564.1	615.9	672.6	734.5	802.1
Central government overall spending	445.2	493.3	533.5	576.0	656.6		711.3	777.4	854.1	938.7	1029.1
Overall balance of the electricity sector	-50.3	-66.0	-46.1	-54.7	-64.9		-53.3	-42.1	-44.9	-48.1	-54.1

Sources: Country authorities; and Fund staff calculations and estimates.

1/ Includes social security contributions.

2/ The nominal decrease in wages and salaries in 2016 reflects a reclassification of certain items to transfers.

3/ Includes interest payments on Central Bank recapitalization bonds.

4/ Includes the Dominican Corporation of State Electricity Companies (CDEEE). The figure for 2016 is staff's estimate based on preliminary data.

5/ Includes outstanding stock of all central bank securities.

6/ Consolidated public sector primary structural balance; excludes one-off items

Table 4. Dominican Republic: Income Statement of the Central Bank
(in billions of Dominican pesos, unless otherwise specified)

	2013	2014	2015	2016	Proj.	
					2017	2018
Revenues	19.0	21.2	23.0	26.2	30.0	36.1
Interest	19.0	21.0	23.0	26.0	29.8	35.8
International reserves	0.7	0.9	1.2	2.1	3.1	6.6
BCRD recapitalization 1/	17.4	19.2	21.2	22.8	25.4	27.8
Other	0.8	0.9	0.6	1.2	1.3	1.4
Other revenues	0.0	0.2	0.0	0.2	0.2	0.3
Expenditures	55.2	62.4	66.0	72.6	79.3	88.8
Administrative	6.1	7.0	6.8	7.1	7.7	8.5
Interest	48.6	54.9	58.8	64.9	70.9	79.5
Securities	46.8	52.0	56.2	60.8	66.3	74.5
Other	1.8	2.9	2.6	4.2	4.6	5.0
Other expenditures 2/	0.5	0.6	0.4	0.6	0.7	0.7
Quasi-fiscal balance	-36.2	-41.2	-43.0	-46.4	-49.3	-52.7
	(Percent of GDP)					
Revenues	0.7	0.7	0.7	0.8	0.8	0.9
Interest	0.7	0.7	0.7	0.8	0.8	0.9
International reserves	0.0	0.0	0.0	0.1	0.1	0.2
BCRD recapitalization	0.7	0.7	0.7	0.7	0.7	0.7
Other	0.0	0.0	0.0	0.0	0.0	0.0
Other revenues	0.0	0.0	0.0	0.0	0.0	0.0
Expenditures	2.1	2.2	2.2	2.2	2.2	2.2
Administrative	0.2	0.2	0.2	0.2	0.2	0.2
Interest	1.9	1.9	1.9	2.0	1.9	2.0
Securities	1.8	1.8	1.8	1.8	1.8	1.9
Other	0.1	0.1	0.1	0.1	0.1	0.1
Other expenditures 2/	0.0	0.0	0.0	0.0	0.0	0.0
Quasi-fiscal balance	-1.4	-1.5	-1.4	-1.4	-1.4	-1.3
Memo items:						
BCRD securities outstanding 3/	305.8	342.3	403.7	453.0	511.8	557.6
In percent of GDP	11.8	12.0	13.2	13.6	14.1	14.0

Sources: Country authorities; and Fund staff calculations and estimates.

1/ Includes both interest on recapitalization bonds and direct transfers.

2/ Includes the cost of issuing money bills.

3/ Stock at end of period. Equivalent to the par value, minus the net discount/premium at which paper was sold, plus accrued but unpaid interest.

Table 5. Dominican Republic: Summary Accounts of the Monetary Authority 1/
(in billions of Dominican pesos, unless otherwise specified)

	2013	2014	2015	2016	Proj.	
					2017	2018
Net foreign assets 2/	139.7	175.4	218.2	266.3	297.4	331.0
In millions of US\$	3,275	3,968	4,799	5,713	6,187	6,687
Net domestic assets	-46.0	-70.7	-106.7	-148.3	-169.0	-190.5
Nonfinancial public sector (net) 3/	-17.1	-1.4	-1.0	-3.0	-3.0	-3.0
Central government	-19.7	-4.2	-3.6	-5.7	-5.7	-5.7
Rest of NFPS	2.6	2.8	2.6	2.7	2.7	2.7
Financial institutions (net)	-390.6	-432.4	-480.3	-569.5	-622.4	-681.7
<i>of which:</i> Monetary control notes and bills	-89.6	-75.0	-82.5	-91.1	-102.9	-112.1
<i>of which:</i> Reserves on peso deposits	-74.4	-79.4	-108.2	-116.9	-126.3	-138.7
<i>of which:</i> Reserves on FX deposits	-52.1	-52.7	-62.1	-80.2	-76.6	-84.1
<i>of which:</i> Overnight facility	-33.0	-55.1	-25.0	-36.8	-40.4	-44.4
Nonfinancial private sector (certificates)	-94.7	-120.5	-144.4	-147.5	-166.7	-181.6
Other items (net)	456.4	483.6	519.0	571.8	623.1	675.8
Capital account	404.5	447.5	494.4	550.0	601.4	654.0
<i>of which:</i> Cumulative losses	408.4	449.6	492.7	539.1	588.3	0.0
<i>of which:</i> Cumulative government transfers 4/	-102.6	-121.8	-142.9	-165.7	-191.1	-219.0
Peso counterpart to IMF budget support	29.2	12.8	2.0	0.0	0.0	0.0
Other, net	22.8	23.3	22.6	21.8	21.8	21.8
Currency issue	93.7	104.7	111.5	118.0	128.4	140.5
Memorandum items:						
Monetary base (in billions of pesos)	168.1	184.1	219.7	234.9	254.6	279.2
Currency issue (percent change, y-o-y)	8.4	11.7	6.5	5.8	8.8	9.4
	(In millions of U.S. dollars)					
Gross international reserves	4,701	4,862	5,266	6,047	6,522	7,022
minus: Liabilities to the IMF	995	500	114	0	0	0
minus: Other short-term external liabilities	1	1	1	1	1	1
Equals: Net international reserves 5/	3,704	4,361	5,152	6,047	6,521	7,021
minus: Foreign currency liabilities to residents	2,112	1,751	1,980	2,433	2,374	2,551
Equals: Net international reserves 6/	1,592	2,610	3,172	3,614	4,147	4,470

Source: Country authorities; and Fund staff calculations and estimates.

1/ The central bank's balance sheet is adjusted to incorporate the reserve liability that emerges from the IMF budgetary support under the 2009 SBA.

2/ On a residency basis.

3/ Excludes transfers related to central bank recapitalization.

4/ Recapitalization transfers as provided for by law 167-07 and annual

5/ On a residency basis. Corresponds to the concept of Consolidated NIR under the 2009 SBA.

6/ NIR on a currency basis. Gross reserves less all short-term foreign currency liabilities of the central bank and government liabilities to the IMF.

Table 6. Dominican Republic: Summary Accounts of the Banking System
(in billions of Dominican pesos, unless otherwise specified)

	2013	2014	2015	2016	Proj.	
					2017	2018
I. Central Bank 1/						
Net foreign assets	139.7	175.4	218.2	266.3	297.4	331.0
(in millions of US\$) 2/	3,275	3,968	4,799	5,713	6,187	6,687
Net domestic assets	-46.0	-70.7	-106.7	-148.3	-169.0	-190.5
Nonfinancial public sector (net) 3/	-17.1	-1.4	-1.0	-3.0	-3.0	-3.0
Financial institutions (net)	-390.6	-432.4	-480.3	-569.5	-622.4	-681.7
Nonfinancial private sector (certificates)	-94.7	-120.5	-144.4	-147.5	-166.7	-181.6
Other items (net)	456.4	483.6	519.0	571.8	623.1	675.8
Currency issue	93.7	104.7	111.5	118.0	128.4	140.5
II. Deposit Money Banks						
Net foreign assets	-7.1	-11.1	-49.3	-54.3	-60.5	-65.4
(in millions of US\$) 2/	-166	-252	-1,085	-1,164	-1,260	-1,320
Net domestic assets	810.1	883.4	1031.6	1117.5	1228.9	1348.7
Net claims on central bank	269.2	275.5	295.2	330.5	368.7	404.3
Net credit to the nonfinancial public sector	98.0	68.7	129.1	131.6	146.7	162.6
Central government	96.6	67.2	95.2	91.5	106.0	122.3
Rest of NFPS	1.4	1.6	33.9	40.1	40.7	40.3
Credit to the private sector	591.1	707.0	796.3	884.9	970.7	1063.3
In pesos	482.3	555.4	621.6	695.4	762.8	835.5
In foreign currency	108.8	151.6	174.7	189.5	207.9	227.7
Capital and accumulated surplus	-138.1	-150.9	-168.2	-188.3	-205.8	-225.1
Other items (net)	-10.2	-16.9	-20.8	-41.2	-51.4	-56.4
Liabilities to the private sector	803.0	872.2	982.3	1063.2	1168.4	1283.3
In pesos	596.0	652.6	732.5	797.0	875.9	962.0
In foreign currency	207.0	219.6	249.8	266.2	292.5	321.3
III. Banking System 4/						
Net foreign assets	132.7	164.3	168.9	212.0	236.8	265.7
(in millions of US\$) 2/	3,109	3,717	3,714	4,548	4,927	5,367
Net domestic assets	960.1	1,057.8	1,224.1	1,308.2	1,443.6	1,575.9
Nonfinancial public sector 3/	81.0	67.3	128.1	128.6	143.7	159.6
Credit to the private sector	596.1	712.6	802.2	891.0	976.8	1069.4
Other items (net)	283.0	277.9	293.9	288.5	323.0	346.9
M3	891.1	973.9	1,393.0	1,197.5	1,314.6	1,443.1
Currency in circulation	73.5	82.5	89.4	94.3	102.3	111.8
Deposits	575.9	605.8	688.0	756.8	831.6	913.4
Central bank certificates held outside commercial banks	14.6	19.1	19.4	21.0	23.1	25.0
Commercial bank certificates held by the public	227.1	266.4	294.3	325.4	357.6	392.8
(percent change, y-o-y)						
Memorandum items:						
Credit to the private sector	15.0	19.5	12.6	11.1	9.6	9.5
Currency issue	8.4	11.7	6.5	5.8	8.8	9.4
Deposits and commercial bank certificates	12.2	8.6	12.6	8.2	9.9	9.8
M3	11.9	9.3	14.0	9.1	9.8	9.8
M3 Velocity (ratio of GDP to M3)	2.9	2.9	2.2	2.8	2.8	2.8

Source: Country authorities; and Fund staff calculations and estimates.

1/ The central bank's balance sheet is adjusted to incorporate the reserve liability that emerges from the IMF budgetary support under the 2009 SBA.

2/ On a residency basis.

3/ Excludes transfers related to central bank recapitalization.

4/ Includes the central bank, Banco de Reservas, and all other deposit-taking institutions. Excludes other financial institutions.

Table 7. Dominican Republic: Balance of Payments
(in millions of U.S. dollars, unless otherwise specified)

	2013	2014	2015	2016	2017	2018	Projections			
							2019	2020	2021	2022
Current account	-2,568	-2,170	-1,335	-1,066	-1,507	-2,059	-2,230	-2,832	-3,438	-3,998
Trade balance	-7,377	-7,374	-7,466	-7,661	-8,616	-9,238	-9,948	-10,713	-11,670	-12,460
Exports f.o.b., o/w:	9,424	9,899	9,398	9,724	10,414	10,863	11,325	11,866	12,378	13,117
gold	1,191	1,545	1,227	1,557	1,445	1,347	1,251	1,210	1,176	1,193
core exports 1/	2,925	2,900	2,656	2,576	2,732	2,883	3,057	3,264	3,491	3,735
Imports f.o.b., o/w:	-16,801	-17,273	-16,863	-17,384	-19,030	-20,101	-21,273	-22,579	-24,048	-25,577
oil and gas	-4,352	-3,878	-2,525	-2,308	-3,035	-3,224	-3,385	-3,599	-3,843	-4,112
core imports 2/	-9,338	-9,972	-10,841	-11,646	-12,314	-12,958	-13,739	-14,605	-15,594	-16,607
Nonfactor services, o/w:	3,634	4,084	4,406	4,990	5,201	5,424	5,855	6,129	6,349	6,563
travel receipt	5,055	5,630	6,116	6,722	7,199	7,624	8,088	8,572	8,986	9,367
Factor services, o/w:	-2,972	-3,247	-3,027	-3,436	-3,455	-3,884	-4,242	-4,730	-4,997	-5,406
interest on public debt 3/	-560	-659	-836	-963	-1,101	-1,233	-1,380	-1,534	-1,705	-1,867
cost recovery (mining)	-336	-278	-246	-336	-250	-233	-217	-209	-180	-179
Transfers	4,148	4,368	4,752	5,042	5,363	5,638	6,105	6,482	6,880	7,305
Capital and financial account	-4,274	-3,762	569	-2,734	-1,987	-2,559	-2,740	-3,322	-3,898	-4,498
Capital account	0	0	2,087	0	0	0	0	0	0	0
Financial account	-4,274	-3,762	-1,518	-2,734	-1,987	-2,559	-2,740	-3,322	-3,898	-4,498
Direct investment, net 4/	-1,991	-2,209	-2,222	-2,593	-2,382	-2,531	-2,684	-2,845	-3,016	-3,198
Portfolio investment, net	-1,787	-1,482	-3,458	-1,680	-1,072	-1,136	-1,700	-1,700	-1,700	-1,700
Other investment, net, o/w:	-496	-71	4,162	1,540	1,467	1,108	1,644	1,223	819	400
Public sector MLT, net 5/	766	261	-3,115	57	740	679	593	880	1,203	1,524
Disbursements	1,612	1,774	1,680	1,324	1,512	1,410	1,530	1,810	2,091	2,372
Amortization	-846	-1,065	-4,932	-728	-772	-731	-936	-930	-888	-848
Other, o/w:	-1,263	-332	7,277	1,483	727	429	1,050	344	-384	-1,124
cost recovery (mining)	164	479	430	587	436	407	378	365	315	313
private sector MLT loans, net	-101	-208	-986	-399	0	0	0	0	0	0
Errors and omissions	-372	-941	-1,500	-776	0	0	0	0	0	0
Overall balance	1,334	650	770	892	480	500	510	490	460	500
Financing	-1,334	-650	-770	-892	-480	-500	-510	-490	-460	-499
Change in NIR (increase, -) 6/	-1,336	-652	-772	-894	-480	-500	-510	-490	-460	-500
Change in GIR (increase, -)	-1,139	-195	-407	-780	-480	-500	-510	-490	-460	-500
Net Fund purchases	-197	-457	-365	-114	0	0	0	0	0	0
Exceptional financing	2	2	2	2	0	0	0	0	0	1
Memorandum items:										
Current account in percent of GDP	-4.0	-3.3	-2.0	-1.5	-2.0	-2.5	-2.6	-3.1	-3.5	-3.9
Underlying current account in percent of GDP 7/	-3.9	-2.6	-1.3	-0.7	-1.4	-2.0	-2.1	-2.7	-3.2	-3.6
Non-oil-gas current account in percent of GDP	2.9	2.6	1.7	1.7	2.0	1.4	1.3	0.8	0.4	0.1
Growth rate of the volume of exports of goods	11.2	7.6	5.5	6.8	0.8	3.1	2.9	3.6	3.3	4.8
Growth rate of the volume of imports of goods	-2.5	7.0	10.7	8.6	5.2	5.9	4.4	5.2	5.3	5.2
GIR in months of imports (excl. maquila) 8/	3.4	3.5	3.7	3.8	3.9	4.0	4.0	4.0	4.0	4.2

Sources: Country authorities; and Fund staff calculations and estimates.

1/ Excludes exports of metals, FTZs and goods procured in ports.

2/ Excludes imports of petroleum and FTZs; does not include imports of machinery and equipment for the power plants in 2015-17 (US\$1,455 million).

3/ Includes interest on loans and bonds.

4/ 2012 includes the change in ownership of a beer company offset by portfolio outflows (approximately US\$1 billion).

5/ Excludes Fund purchases and repurchases by the central government.

6/ On residency basis. Net of central bank and central government obligations to the Fund.

7/ Includes net gold exports, after subtracting capital outflows related to investment recovery by the gold company.

8/ In relation to imports of goods and non-factor services of the following year, excluding maquila.

Table 8. Dominican Republic: Financial Soundness Indicators of Commercial Banks
(in percent)

	2008	2009	2010	2011	2012	2013	2014	2015	Dec 2016
Capital adequacy									
Net worth to total assets	9.5	9.1	9.3	9.7	10.0	9.7	9.5	9.8	10.0
Regulatory capital to risk-weighted assets 1/	13.4	13.8	12.9	14.6	15.8	14.8	14.0	14.4	15.3
Asset quality									
Loan growth (twelve-month percent change)	15.9	12.4	14.5	11.4	13.7	20.4	12.0	16.4	8.7
NPLs to total loans	3.4	4.0	2.9	2.6	3.2	1.9	1.3	1.5	1.5
Loan provisions to NPLs	137.0	114.8	135.8	129.2	108.3	169.8	228.6	181.9	185.9
NPLs net of provisions to net worth	-7.7	-3.8	-6.6	-4.4	-1.5	-8.3	-10.9	-8.0	-8.0
Fixed and net foreclosed assets to net worth	56.9	51.3	46.1	46.1	41.7	39.0	35.2	34.4	31.5
Earnings and efficiency									
Return on average assets	2.7	2.3	2.6	2.4	2.2	2.3	2.3	2.3	2.2
Return on average equity	27.6	28.3	25.3	24.4	22.6	24.6	23.9	24.0	22.0
Gross operating income to average assets	10.7	11.2	9.6	10.0	11.0	10.5	10.0	9.7	9.7
Financial margin to average assets	6.2	6.1	6.2	6.2	6.5	6.6	6.2	6.0	5.6
Operating expenses to net financial margin	96.0	91.1	85.7	90.5	90.8	86.4	90.4	93.9	94.2
Liquidity									
Liquid funds to deposits	31.1	28.0	26.2	26.3	25.1	25.0	26.7	24.7	25.0
Liquid funds to total assets	25.6	23.7	22.1	21.7	20.8	20.3	21.3	19.6	19.6

Source: Country authorities.

1/ Value for 2016 is as of end-November.

Annex I. External Sector Assessment

Staff assess the current account balance and the real exchange rate to be broadly in line with fundamentals and the desired policy settings, although all three assessments (current account, exchange rate and external sustainability) point to marginal undervaluation of the real exchange rate. The central bank continues to accumulate reserves, but their 2016 level remains below the Fund's risk-weighted adequacy metric.

Current Account and Exchange Rate Assessment

According to the EBA-lite current account panel regression, the cyclically-adjusted current account balance is close to its norm. The external current account has strengthened over the last few years on account of the dramatic drop in global oil prices since 2014, to below 2 percent in 2015–16. The EBA-lite panel regression estimates a current account gap of about 1.4 percent of GDP relative to its adjusted norm of -2.8 percent. The norm takes into account the desired policy setting such as a fiscal adjustment of 3 percent of GDP and a slightly faster accumulation of reserves. Assuming an exchange rate elasticity of 20 percent, the methodology suggests a real exchange rate undervaluation of about 7 percent. Given the large uncertainty surrounding the estimates and the large errors and omissions in the balance of payments, staff considers the current account and the real exchange rate to be broadly in line with fundamentals and desired policies.

EBA-Lite Current Account Panel Regression			
Percent of GDP		Percent of GDP	
(a) Actual current account	-1.5%	(e) Fitted current account	-3.1%
(b) Adjusted current account norm = (e) - (g)	-2.8%	(f) Residual (a) - (e)	1.6%
(c) Adjusted current account gap = (a)-(b)	1.4%	(g) Policy gap = (h) + (i) + (j)	-0.2%
(d) Real exchange rate elasticity	-20.0%	(h) Fiscal policy	-0.6%
		(i) Change in GIR	0.1%
		(j) Private credit to GDP	0.3%
Real exchange rate gap = (c)/(d)	-6.9%		

Source: IMF staff calculations.

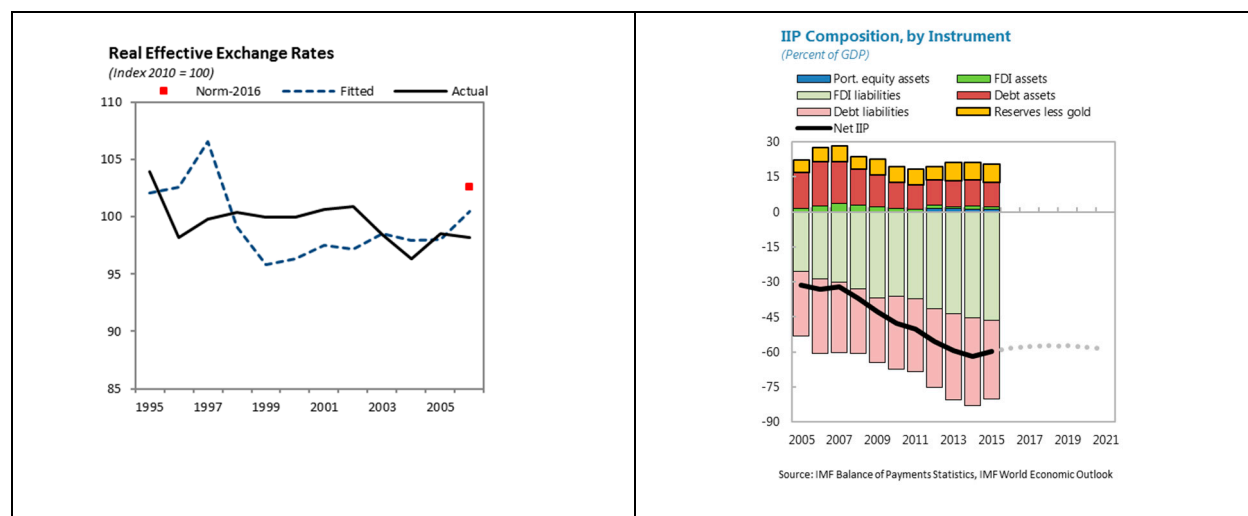
The EBA-Lite real effective exchange rate model similarly suggests the exchange rate is in line with its fundamental determinants. The EBA-lite real exchange rate panel regression indicates that the real rate is about 4.3 percent weaker than the expected value derived from its fundamentals and thus broadly consistent with fundamentals and desirable policy settings.

External Sustainability Assessment

The net IIP position has been deteriorating over the last couple of years, but non-debt creating flows mitigate risks. While the IIP is negative at around 60 percent of GDP, FDI comprises close to 60 percent of total liabilities, and they are the main contributor to deteriorating IIP position (60 percent of increase in liabilities in last five years is driven by FDIs), together with government borrowing (close to 40 percent of increase in liabilities). At the same time, most of government

liabilities have long maturities. Overall external debt is estimated at 35 percent of GDP at end-2016, mostly comprising of public external borrowing. Private external debt has been hovering at around 9 percent of GDP over the last 5 years.

The EBA-Lite external stability module suggests that the current account is also in line with the levels needed to stabilize the IIP. The estimated IIP-stabilizing current account deficit is 3.5 percent of GDP, about the average of projected current accounts over the next five years.



Going forward, the external debt-to-GDP ratio is projected to increase to 40 percent of GDP, mostly on account of government debt trajectory. The external debt sustainability analysis indicates that the medium-term debt profile is resilient to a number of shocks (Figure 1). However, a real depreciation shock would raise the external debt ratio to 57 percent, by lowering the value of GDP in U.S. dollars.

Reserve Adequacy

The central bank continues to accumulate reserves, and despite a measured improvement against the Fund’s risk-weighted adequacy measure, reserves remain below the benchmark. International reserves of the central bank are sufficient to meet some reserve metrics like months of imports, broad money, and short term debt coverage. The Fund’s risk-based metric also indicates the central bank has sufficient reserve coverage to accommodate any of the 4 stress scenarios in isolation: the need to

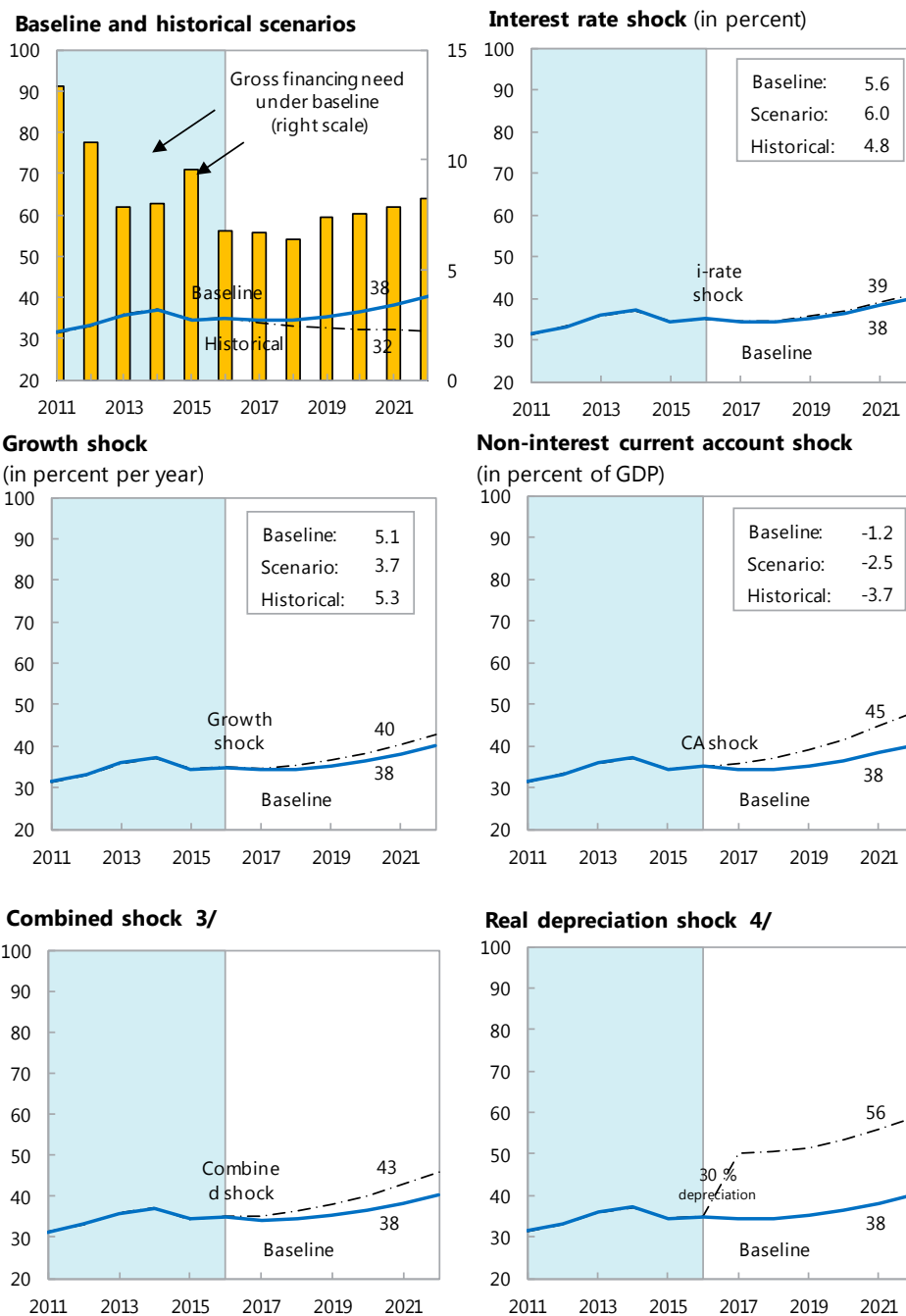
Metric	Benchmark coverage	Actual NIR coverage		
		2014	2016(p)	2020(p)
Months of imports	3.0	3.3	3.8	4.0
Broad money	20%	21.1	23.6	24.3
Short-term debt	100	89.2	174.6	195.3
IMF reserve adequacy metric ¹	100 - 150	65.3	74.5	75.8
Foreign currency debt, bn USD (percent of NIR)		22.3	22.8	31.4
Net international reserves, bn USD		458.5	377.6	383.3
Additional reserves needed to reach IMF reserve metric of 100, bn USD		4.7	6.0	8.0
		2.5	2.1	2.6

Sources: National authorities and IMF staff calculations.
¹Emerging market metric for fixed exchange rate countries: net reserves divided by the sum of 30% of short-term debt (remaining maturity basis), 10% of broad money (M3); 20% of IIP MLT portfolio liabilities; and 10% of exports.

provide foreign exchange to cover (a) 30 percent of short term debt; (b) 20 percent of medium and long-term foreign portfolio liabilities; (c) the loss of 10 percent of export income; and (d) a spike in precautionary dollar demand of up to 10 percent of broad money. However, reserves are currently at about 75 percent of the level needed to accommodate these combined shocks, although mitigating factors include a low share of short term debt¹ (13.7 percent); long-term external liabilities that are largely comprised of foreign direct investment and public debt largely owed to official creditors; and relatively diverse sources of foreign exchange, reflecting inflows from tourism, remittances and gold. Over the medium term, reserve adequacy is projected to further improve, albeit still remaining below the Fund's risk-weighted metric.

¹ Short term external debt on a remaining maturity basis is 13.1% of GDP in 2016, of which amortization coming due is 5.2%

Annex I. Figure 1. External Debt Sustainability: Bound Tests 1/ 2/



Sources: International Monetary Fund, Country desk data, and staff estimates.
 1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
 2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.
 3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
 4/ One-time real depreciation of 30 percent occurs in 2017.

Annex I. Table 1. External Debt Sustainability Framework, 2011–2022

	Actual						Projections						Debt-stabilizing non-interest current account 6/
	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	
Baseline: External debt	31.4	33.1	35.8	37.1	34.5	34.9	34.2	34.4	35.2	36.5	38.2	40.1	-3.3
Change in external debt	0.5	1.7	2.8	1.2	-2.6	0.5	-0.7	0.2	0.8	1.2	1.8	1.9	
Identified external debt-creating flows (4+8+9)	1.4	0.0	0.1	-1.9	-2.8	-4.0	-2.8	-2.2	-2.2	-1.7	-1.3	-1.0	
Current account deficit, excluding interest payments	6.2	5.1	2.6	1.9	0.6	-0.1	0.3	0.7	0.7	1.2	1.6	1.8	
Deficit in balance of goods and services	10.4	9.1	5.9	4.9	4.5	3.7	4.5	4.7	4.7	5.0	5.5	5.7	
Exports	24.3	24.7	25.6	25.9	24.9	24.9	24.9	24.6	24.4	24.2	23.9	23.7	
Imports	34.7	33.8	31.5	30.8	29.3	28.6	29.4	29.3	29.1	29.2	29.4	29.5	
Net non-debt creating capital inflows (negative)	-3.9	-5.2	-3.2	-3.4	-3.3	-3.6	-3.1	-3.1	-3.1	-3.1	-3.1	-3.1	
Automatic debt dynamics 1/	-0.9	0.1	0.7	-0.4	-0.1	-0.4	0.0	0.2	0.2	0.2	0.2	0.2	
Contribution from nominal interest rate	1.3	1.5	1.4	1.4	1.4	1.5	1.7	1.8	1.8	1.9	2.0	2.0	
Contribution from real GDP growth	-0.9	-0.8	-1.5	-2.6	-2.5	-2.1	-1.7	-1.6	-1.6	-1.7	-1.7	-1.8	
Contribution from price and exchange rate changes 2/	-1.3	-0.5	0.8	0.8	0.9	0.2	...	...	...	...	...	...
Residual, incl. change in gross foreign assets (2-3) 3/	-0.9	1.7	2.7	3.1	0.2	4.5	2.1	2.4	3.0	2.9	3.1	2.9	
External debt-to-exports ratio (in percent)	129.2	133.9	139.8	143.0	138.7	140.0	137.5	139.8	144.4	150.5	160.0	169.0	
Gross external financing need (in billions of US dollars) 4/	7.7	6.6	4.8	5.2	6.6	4.9	5.0	5.3	6.1	6.8	7.5	8.3	
in percent of GDP	13.3	10.8	7.8	8.0	9.7	6.8	6.6	6.5	7.1	7.4	7.8	8.1	
Scenario with key variables at their historical averages 5/							33.4	32.2	31.5	30.8	30.3	0.0	-3.9
							-47.31	-47.88	-43.65	-41.76	-39.99	-38.44	
Key Macroeconomic Assumptions Underlying Baseline													
Real GDP growth (in percent)	3.1	2.8	4.7	7.6	7.0	6.6	5.3	5.0	5.0	5.0	5.0	5.0	
GDP deflator in US dollars (change in percent)	4.4	1.8	-2.4	-2.2	-2.5	-0.7	1.3	3.4	1.1	1.2	1.0	1.0	
Nominal external interest rate (in percent)	4.6	4.8	4.3	4.0	4.0	4.7	4.8	0.8	5.6	5.7	5.7	5.7	
Growth of exports (US dollar terms, in percent)	14.8	6.4	6.1	6.4	0.1	6.3	5.2	8.6	6.3	5.0	5.3	4.6	
Growth of imports (US dollar terms, in percent)	9.1	2.1	-4.7	2.8	-0.5	3.4	5.0	13.7	9.4	5.7	5.4	6.6	
Current account balance, excluding interest payments	-6.2	-5.1	-2.6	-1.9	-0.6	0.1	-3.7	2.6	-0.3	-0.7	-1.2	-1.6	
Net non-debt creating capital inflows	3.9	5.2	3.2	3.4	3.3	3.6	4.1	0.9	3.1	3.1	3.1	3.1	

1/ Derived as $(r - g - r(1+g) + ea(1+r)/(1+g+rr))$ times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate.

e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as $[-r(1+g) + ea(1+r)/(1+g+rr)]$ times previous period debt stock. r increases with an appreciating domestic currency ($e > 0$) and rising inflation (based on GDP deflator).

3/ For projection, line includes the impact of price and exchange rate changes.

4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Annex II. Risk Assessment Matrix

Risk Assessment Matrix 1/			
Source of Risks	Relative Likelihood	Expected Impact	Policy Response
Downside risks			
Policy and geopolitical uncertainty	High	Low Potential changes in U.S. immigration and trade policies could slow remittance, trade and FDI inflows.	Advance structural reforms that would facilitate job creation and increase income; more accelerated fiscal consolidation may be required to create needed space for social spending.
Significant further strengthening of the US dollar and/or higher interest rate	High	Medium A more rapid Fed normalization or decompression of term premia may put pressures on the capital account, exchange rate and/or increase financing costs.	Fiscal consolidation; shift to domestic financing sources; readiness of monetary authorities to further tighten policy if needed; continue building reserve buffers.
Reduced financial services by correspondent banks ("de-risking")	High	Low Possible loss of correspondent banking services could curtail cross-border payments, trade finance, and remittances.	Further strengthen supervision and regulation of the financial sector. Continue efforts at full compliance with international transparency initiatives.
Weaker-than-expected global growth	H (advanced economies)/M (emerging markets)	Medium Weakening of exports, tourism receipts, and remittances; weaker economic activity and fiscal receipts.	Build external and fiscal buffers to safeguard macroeconomic stability; advance structural reforms to improve competitiveness.
Slow implementation of structural reforms	Medium	Medium Slow structural reforms, especially in the fiscal and electricity sectors, may hurt confidence, increase the sovereign premium, affect fiscal sustainability and growth prospects.	Revive the structural reform momentum, including in the fiscal and electricity sectors.
Upside risks			
Stronger near-term recovery in the U.S.	High	Medium Stronger exports, tourism receipts, and remittances; stronger economic activity and fiscal receipts.	Take advantage of favorable conditions to accelerate fiscal consolidation and build fiscal and external buffers.
Lower energy prices	Low	Medium The production cuts by OPEC countries and other major producers may not materialize, keeping prices lower than the baseline. This would lead to a higher real income, boosting demand and output.	Use savings on transfers to electricity sector to improve fiscal position. Accelerate electricity sector reforms.

1/ The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly. "Short term" and "medium term" are meant to indicate that the risk could materialize within 1 year and 3 years, respectively.

Annex III. Debt Sustainability Analysis: An Update

Gross debt levels in the Dominican Republic, estimated at 49.7 percent of GDP by end-2016, remain moderate in international comparison. Gross financing needs are manageable between 8–10 percent of GDP over the forecast horizon. However, baseline debt dynamics has an upward trend and the different DSA scenarios presented in this section demonstrate that public debt is vulnerable to various shocks. Lower real GDP growth could shift the debt trajectory up significantly, although even under such a scenario, gross debt would remain below 65 percent of GDP. Given the relatively large share of foreign currency denominated debt, large and sudden exchange rate depreciation could also raise the public debt-to-GDP ratio immediately. At the same time, most debt profile vulnerability indicators remain below the upper early warning benchmarks, with the exception of the share of debt held by non-residents.

A. Realism of Baseline Scenario

Debt. After a stabilization of gross debt levels in 2015 due to the one-off PDVSA debt buy-back operation, the debt ratio increased again in 2016 as the high fiscal deficit outweighed the effect of strong growth. Although there are plans for some consolidation in the central government's budget for 2017, staff projects that pressures from coal plant spending and losses in the electricity sector will contribute to increasing debt levels in 2017 and 2018. The primary balance of the consolidated public sector is expected to improve by 2019 (after the completion of the new coal plants), but it does not reach the debt-stabilizing level—1.6 percent of GDP—by 2022 under the baseline. As a result, debt remains on a rising trajectory over the forecast horizon.

Growth. Past projections of growth outcomes show a tendency for pessimistic forecasts, most recently in 2015 when Dominican Republic recorded an impressive 7.0 percent economic growth (one of the highest in Latin America). Dominican Republic's debt dynamics are also sensitive to sudden changes in GDP growth, as indicated by the relevance of growth shocks under the DSA stress tests. In this context, should growth turn out to be higher than expected in 2017 (5.3 percent), it will impact positively on debt.

Fiscal adjustment. Under the baseline scenario without fiscal reforms, there is no significant adjustment in the cyclically-adjusted primary balance over the forecast horizon. The DSA template provides the distribution of projected fiscal adjustments across countries, and places the Dominican Republic very close to the median based on the expected evolution of the cyclically-adjusted primary balance during the forecast horizon. From 2018 onward, after the completion of coal plants, the fiscal impulse converges to 0, implying a broadly neutral fiscal policy in the absence of major policy changes (for example, implementation of measures under the Fiscal Pact).

Sovereign yields. Dominican Republic's foreign currency sovereign bonds currently have an average credit spread of 360 basis points relative to U.S. Treasury Bonds, which is slightly above the average of other emerging market economies but compares favorably relative to Latin-American countries (with spreads of 337 and 439 basis points, respectively). Given upward projections for the U.S. Treasury bills and Libor rates over the medium term, the effective nominal interest rate on Dominican

Republic's sovereign debt is projected to increase from 9.5 percent in 2016 to 10.8 percent by 2019. Following other rating agencies, Fitch upgraded the Dominican Republic's foreign and local currency credit rating to BB- in November 2016, and since then all credit rating agencies have maintained a stable or positive outlook for the country's sovereign ratings.

B. Debt Profile

Maturity, currency composition and rollover. The US\$1,200 million sovereign bond placement in January 2017 lengthened the average maturity of debt (now estimated at around 9.4 years for total non-financial public sector debt) and lowered the variable rate risk (with 18.7 percent of NFPS debt contracted at variable rates). Given the large share of foreign-currency denominated debt (some 55 percent of total debt), a real exchange rate depreciation could have a significant effect on debt dynamics. Furthermore, some 52 percent of total gross debt is held by non-residents, making rollover risk sensitive to shifts in market sentiment. However, since most of the non-resident holdings are held at maturities longer than one year, rollover risks are deemed reasonable at present.

C. Stochastic Simulations

Fan charts. The fan charts illustrate the possible evolution of the debt ratio over the medium term subject to shocks drawn from a symmetric and an asymmetric distribution. Assuming a symmetric distribution of shocks, there is a 90 percent probability that debt will be below 65 percent of GDP over the medium term. If restrictions are imposed on the primary balance (i.e. the asymmetric scenario, where it is assumed that there are no positive shocks to the primary balance), the debt path is still expected to remain below 65 percent of GDP with 75 percent probability.

D. Stress Tests

Real GDP growth shock. The debt ratio remains under 60 percent of GDP under all shock scenarios except the growth shock where it reaches 63 percent of GDP by the end of the projection horizon. This scenario also results in a drastic increase in public gross financing needs, which increases above 11 percent in 2019.

Combined shock. Since the combined shock incorporates the largest effect of individual shocks on all relevant variables (real GDP growth, inflation, primary balance, exchange rate and interest rate), it produces the most extreme debt trajectory. Under this scenario, debt exceeds 60 percent of GDP in 2019, almost reaches 70 percent by 2022, and results in average gross financing needs of around 12 percent of GDP over the medium term.

Annex III. Figure 1. Dominican Republic DSA Risk Assessment

Heat Map

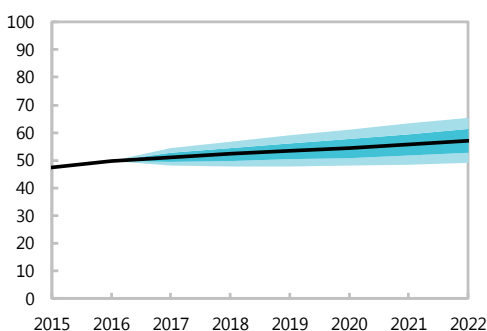
Debt level ^{1/}	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability shock
Gross financing needs ^{2/}	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability Shock
Debt profile ^{3/}	Market Perception	External Financing Requirements	Change in the Share of Short-Term Debt	Public Debt Held by Non-Residents	Foreign Currency Debt

Evolution of Predictive Densities of Gross Nominal Public Debt

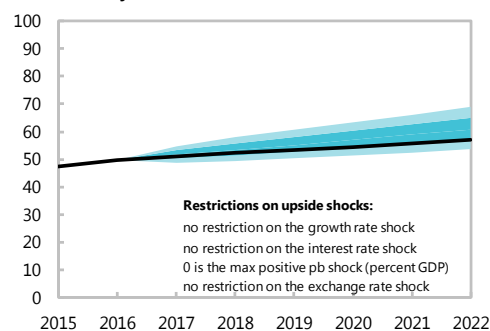
(in percent of GDP)

— Baseline Percentiles: ■ 10th-25th ■ 25th-75th ■ 75th-90th

Symmetric Distribution

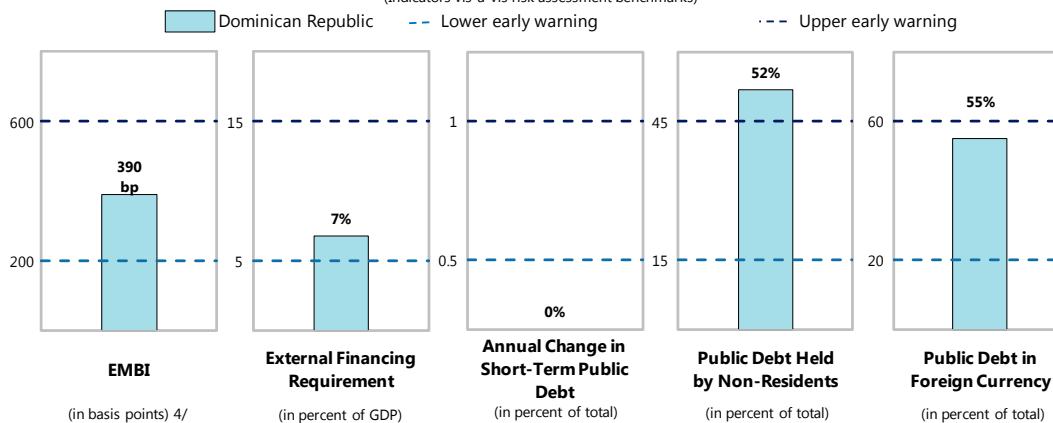


Restricted (Asymmetric) Distribution



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks)



Source: Fund staff calculations and estimates.

1/ The cell is highlighted in green if debt burden benchmark of 70% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

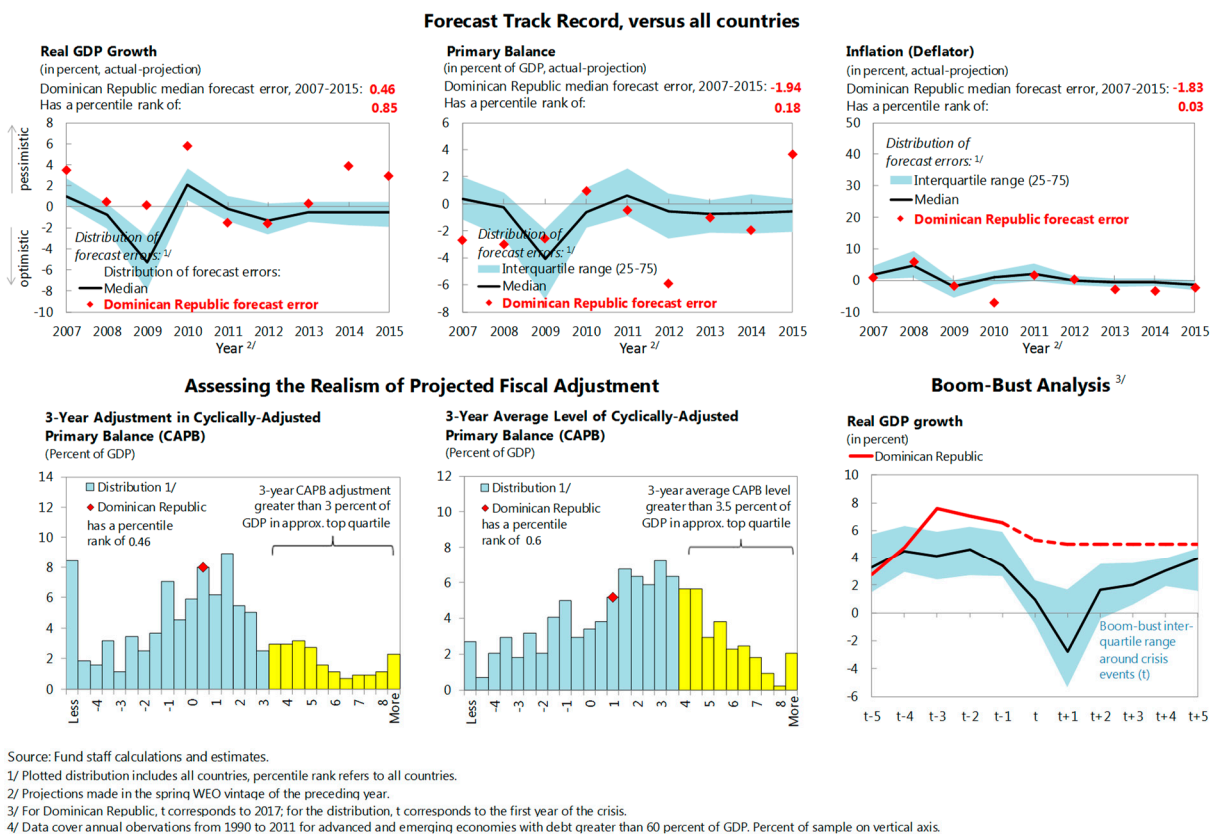
2/ The cell is highlighted in green if gross financing needs benchmark of 15% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

3/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant, cell is white. Lower and upper risk-assessment benchmarks are:

200 and 600 basis points for bond spreads; 5 and 15 percent of GDP for external financing requirement; 0.5 and 1 percent for change in the share of short-term debt; 15 and 45 percent for the public debt held by non-residents; and 20 and 60 percent for the share of foreign-currency denominated debt.

4/ An average over the last 3 months, 09-Nov-16 through 07-Feb-17.

Annex III. Figure 2. Dominican Republic DSA – Realism of Baseline Assumptions



Annex III. Figure 3. Dominican Republic Public Sector Debt Sustainability Analysis (DSA) – Baseline Scenario

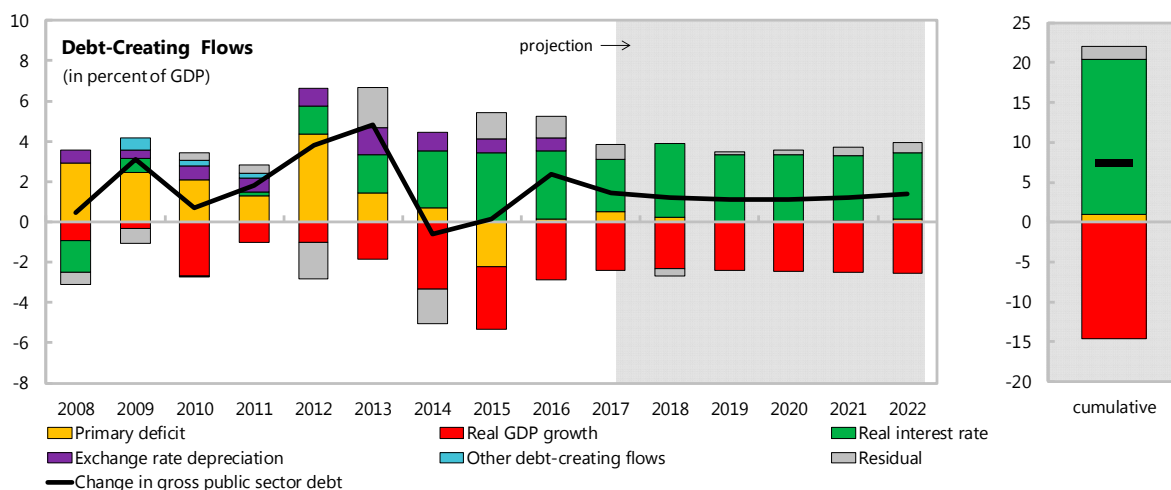
(In percent of GDP, unless otherwise indicated)

Debt, Economic and Market Indicators ^{1/}

	Actual			Projections						As of February 07, 2017		
	2006-2014	2015	2016	2017	2018	2019	2020	2021	2022	Sovereign Spreads		
Nominal gross public debt	39.3	47.3	49.7	51.1	52.3	53.4	54.5	55.7	57.1	EMBI (bp)		360
Public gross financing needs	8.9	5.3	6.3	8.0	8.7	9.5	9.5	9.5	11.5	Ratings		Foreign Local
Real GDP growth (in percent)	5.5	7.0	6.6	5.3	5.0	5.0	5.0	5.0	5.0	Moody's	B1	B1
Inflation (GDP deflator, in percent)	5.5	0.9	1.6	3.9	4.2	4.0	4.0	4.0	4.0	S&P's	BB-	BB-
Nominal GDP growth (in percent)	11.3	8.0	8.3	9.4	9.4	9.2	9.2	9.2	9.2	Fitch	BB-	BB-
Effective interest rate (in percent) ^{2/}	6.8	8.8	9.5	9.7	10.1	10.8	10.8	10.1	9.8			

Contribution to Changes in Public Debt

	Actual			Projections						Cumulative	Debt-stabilizing primary balance ^{7/}
	2006-2014	2015	2016	2017	2018	2019	2020	2021	2022		
Change in gross public sector debt	1.0	0.1	2.4	1.4	1.2	1.1	1.1	1.2	1.4	7.4	
Identified debt-creating flows	1.2	-1.2	1.3	0.7	1.6	1.0	0.9	0.8	0.9	5.8	
Primary deficit	1.9	-2.2	0.2	0.5	0.2	0.0	0.0	0.1	0.2	1.0	1.6
Primary (noninterest) revenue and grants	14.3	17.5	14.6	14.8	14.7	14.7	14.6	14.6	14.5	87.9	
Primary (noninterest) expenditure	16.2	15.3	14.8	15.3	15.0	14.7	14.6	14.6	14.7	88.9	
Automatic debt dynamics ^{3/}	-0.9	1.1	1.1	0.2	1.3	1.0	0.9	0.7	0.7	4.8	
Interest rate/growth differential ^{4/}	-1.4	0.3	0.5	0.2	1.3	1.0	0.9	0.7	0.7	4.8	
Of which: real interest rate	0.5	3.4	3.4	2.6	3.7	3.4	3.3	3.2	3.3	19.4	
Of which: real GDP growth	-1.9	-3.1	-2.9	-2.4	-2.3	-2.4	-2.4	-2.5	-2.6	-14.6	
Exchange rate depreciation ^{5/}	0.6	0.7	0.6	...	...	...	...	...	...	...
Other identified debt-creating flows	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Privatization receipts (negative)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Floating debt	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes ^{6/}	-0.2	1.3	1.1	0.7	-0.4	0.1	0.2	0.4	0.5	1.6	



Source: Fund staff calculations and estimates.

1/ Public sector is defined as consolidated public sector.

2/ Defined as interest payments divided by debt stock at the end of previous year.

3/ Derived as $[(r - p(1+g) - g + ae(1+r))/(1+g+p+gp)]$ times previous period debt ratio, with r = interest rate; p = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).4/ The real interest rate contribution is derived from the denominator in footnote 4 as $r - \pi(1+g)$ and the real growth contribution as $-g$.5/ The exchange rate contribution is derived from the numerator in footnote 2/ as $ae(1+r)$.

6/ For projections, this line includes exchange rate changes during the projection period.

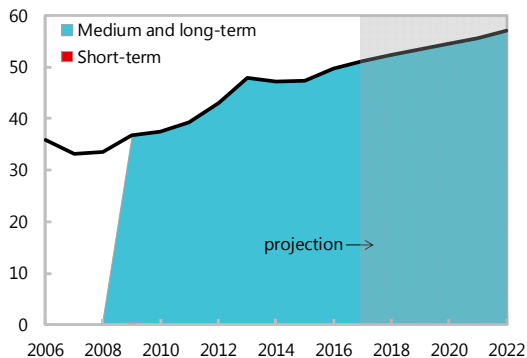
7/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Annex III. Figure 4. Dominican Republic Public DSA – Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

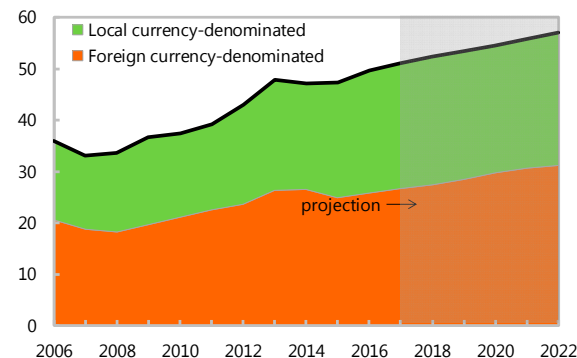
By Maturity 1/

(in percent of GDP)



By Currency

(in percent of GDP)



Alternative Scenarios

— Baseline

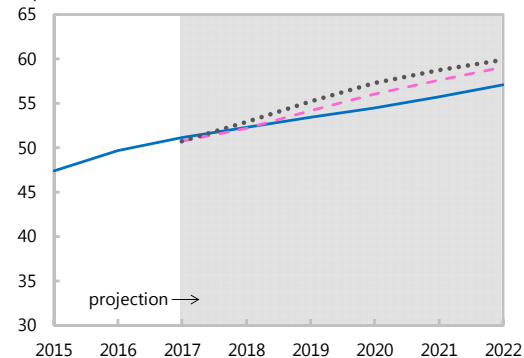
..... Historical

- - - Constant Primary Balance

Constant Primary Balance

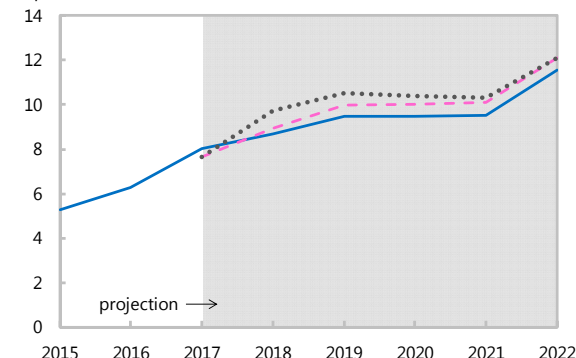
Gross Nominal Public Debt

(in percent of GDP)



Public Gross Financing Needs

(in percent of GDP)



Underlying Assumptions

(in percent)

Baseline Scenario	2017	2018	2019	2020	2021	2022
Real GDP growth	5.3	5.0	5.0	5.0	5.0	5.0
Inflation	3.9	4.2	4.0	4.0	4.0	4.0
Primary Balance	-0.5	-0.2	0.0	0.0	-0.1	-0.2
Effective interest rate	9.7	10.1	10.8	10.8	10.1	9.8

Constant Primary Balance Scenario	2017	2018	2019	2020	2021	2022
Real GDP growth	5.3	5.0	5.0	5.0	5.0	5.0
Inflation	3.9	4.2	4.0	4.0	4.0	4.0
Primary Balance	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5
Effective interest rate	9.7	10.1	10.8	10.7	10.0	9.7

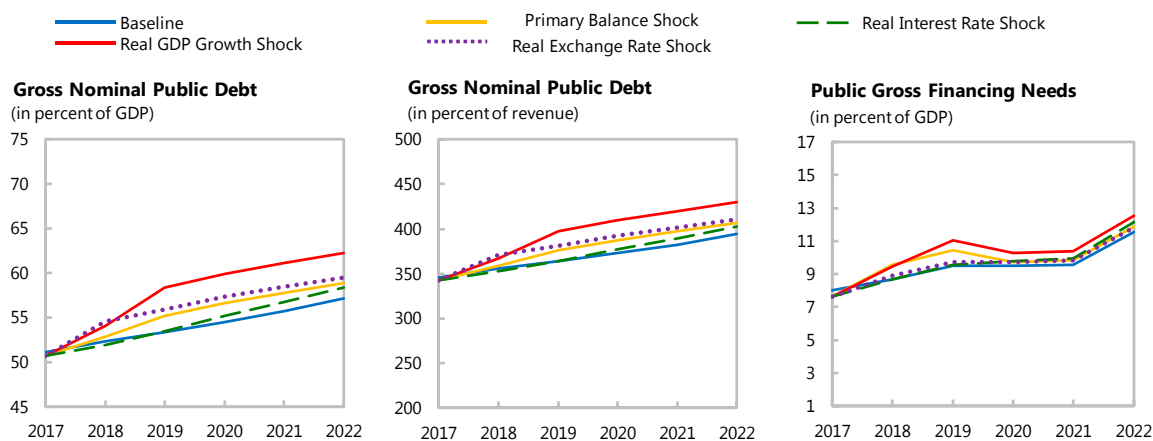
Historical Scenario	2017	2018	2019	2020	2021	2022
Real GDP growth	5.3	5.3	5.3	5.3	5.3	5.3
Inflation	3.9	4.2	4.0	4.0	4.0	4.0
Primary Balance	-0.5	-1.3	-1.3	-1.3	-1.3	-1.3
Effective interest rate	9.7	10.1	10.2	9.6	8.5	7.9

Source: Fund staff calculations and estimates.

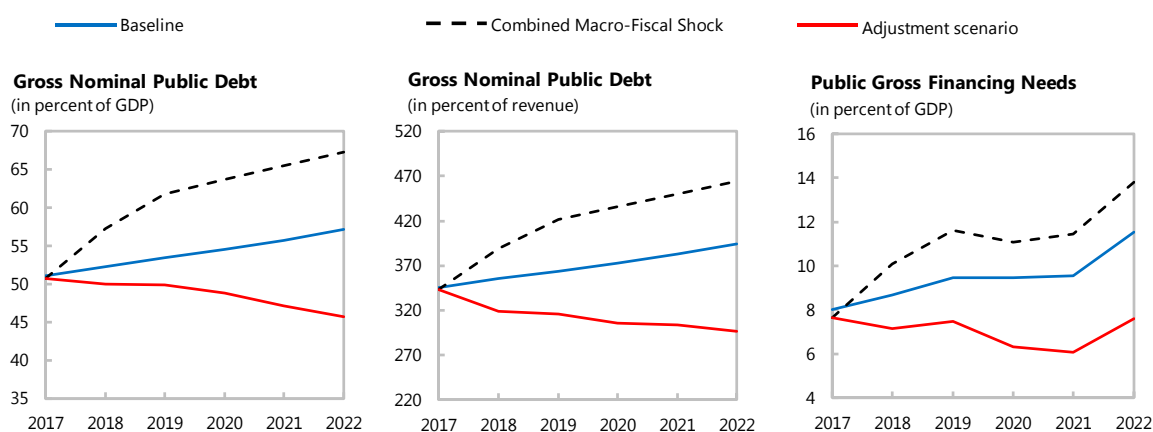
1/ Short-term debt includes unidentified financing during the projection horizon.

Annex III. Figure 5. Dominican Republic Public DSA – Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests

Underlying Assumptions
(in percent)

	2017	2018	2019	2020	2021	2022
Primary Balance Shock						
Real GDP growth	5.3	5.0	5.0	5.0	5.0	5.0
Inflation	3.9	4.2	4.0	4.0	4.0	4.0
Primary balance	-0.5	-1.2	-0.9	0.0	-0.1	-0.2
Effective interest rate	9.7	10.1	10.8	10.8	10.0	9.8
Real Interest Rate Shock						
Real GDP growth	5.3	5.0	5.0	5.0	5.0	5.0
Inflation	3.9	4.2	4.0	4.0	4.0	4.0
Primary balance	-0.5	-0.2	0.0	0.0	-0.1	-0.2
Effective interest rate	9.7	10.1	11.1	11.4	10.9	10.8
Combined Shock						
Real GDP growth	5.3	2.3	2.3	5.0	5.0	5.0
Inflation	3.9	3.6	3.3	4.0	4.0	4.0
Primary balance	-0.5	-1.2	-1.0	0.0	-0.1	-0.2
Effective interest rate	9.7	10.5	10.9	11.2	10.8	10.7
Real GDP Growth Shock						
Real GDP growth	5.3	2.3	2.3	5.0	5.0	5.0
Inflation	3.9	3.6	3.3	4.0	4.0	4.0
Primary balance	-0.5	-0.7	-1.0	0.0	-0.1	-0.2
Effective interest rate	9.7	10.1	10.8	10.8	10.0	9.8
Real Exchange Rate Shock						
Real GDP growth	5.3	5.0	5.0	5.0	5.0	5.0
Inflation	3.9	4.2	4.0	4.0	4.0	4.0
Primary balance	-0.5	-0.2	0.0	0.0	-0.1	-0.2
Effective interest rate	9.7	10.5	10.6	10.6	9.9	9.6
Adjustment Scenario						
Real GDP growth	5.3	3.2	4.6	4.6	4.9	4.5
Inflation	3.9	4.3	4.0	4.0	4.0	4.0
Primary balance	-0.5	1.3	1.8	2.7	2.5	2.4
Effective interest rate	9.7	10.0	10.9	10.9	10.0	9.7

Source: Fund staff calculations and estimates.

Annex IV. Options for Revenue Mobilization: Technical Assistance Advice¹

A. Tax Policy Issues

The tax system of Dominican Republic needs a comprehensive structural reform, aimed at simplifying the system and widening the tax base. The reform should eliminate the large number of exemptions under the VAT, property, and other taxes, and rationalize tax incentives. For instance, reducing VAT and property tax expenditure in the Dominican Republic to the average level in the region—including by phasing out the large list of goods and services exempted from the VAT, while maintaining the exemption for education, health and basic food—could result in an increase in revenue by 1.3 percentage points of GDP. In turn, the reduction in the PIT allowance to about two minimum salaries would yield about 0.2 percent of GDP.

Although tax rates are comparatively high, tax revenue are low (Table 1). Tax revenue amounted to only 13⅓ percent of GDP in 2015, five percentage points below Central American average and some 11 points below the OECD average. The low tax effort is a result of ubiquitous tax incentives and exemptions, which reached 6.7 percent of GDP in 2016, one of the highest in Latin America. The granting of several tax amnesties has also been a disincentive to voluntary tax compliance (3 tax amnesties have been enacted during the last 10 years).

	Dominican Republic	Central America without Dom Rep	LACs without Dom Rep	OCDE /1
Tax Revenue	13.7	18.7	17.5	25.2
Tax on income	4.0	5.0	5.4	11.6
PIT	1.2	1.5	1.6	8.9
CIT	2.0	2.8	3.1	2.8
VAT - ITBIS	4.9	5.4	6.4	6.7
Excise	2.8	1.7	1.7	2.6
On Inmovable Property	0.1	0.1	0.3	1.1
Others	1.3	0.7	1.8	1.6
VAT (ITBIS) Standard Rate	18.0	15.3	12.5	19.1
PIT Top Marginal Rate	25.0	23.7	29.3	35.7
PIT Lowest Rates	15.0	11.7	10.3	11.0
CIT Standard Rate	27.0	26.7	27.4	23.3
CIT and Dividend Rate	34.3	33.4	32.5	
VAT Non-compliance	38.6	30.6	27.8	13.9
Tax Expenditure	6.7	3.8	3.5	-

Source: WEO, IBFD, and Tax Laws (tax revenue without social contributions)

The extensive use of differential treatments results in a complex tax system that is difficult to administer and comply with, and makes it prone to tax avoidance. More than a general tax system, it is a large collection of laws and regulations that establish differential treatment for multiple sectors, products, regions, and activities. Tax exemptions and zero rates are extensively applied in tariff and VAT (half of tax expenditures comes from this tax). Many tax incentives have also undermined the corporate income tax (CIT) base.² Only 15 percent of formal employees pay the personal income tax, due to the high level of the tax threshold and weak controls that allows declaration of lower salary levels than the one actually paid. The property tax revenue reached only

¹ Prepared by staff of the Fiscal Affairs Department (Ricardo Fenochietto, Enrique Rojas, Azael Perez Azcarraga).

² The large number of tax holidays is in part due to tax competition; in fact, most Caribbean and Central America countries have introduced them.

0.06 percent of GDP in 2015 due to exemptions on commercial, industrial, and agricultural properties, as well as an outdated cadaster.

A number of steps could help to improve the functioning, efficiency and equity of the system:

- *Rationalizing the use of tax incentives*, including by refraining from creating new tax incentives and reviewing the existing ones, improving the estimation of the cost of tax incentives and the control over them, carrying-out cost-benefit analysis of major tax expenditures.
- *Phasing-out most VAT (ITBIS) exemptions*, in particular those on goods and services consumed by high-income individuals, due to their limited impact on income redistribution and the negative impact on revenue.
- *Improving environmental taxation by eliminating all tax exemptions on fuel and energy products* and aligning taxation at a level where prices reflect the negative externality on environment.
- *Strengthening the capacity to deal with profit-shifting by multinationals.*
- *Simplifying the tax system by creating two special tax regimes for small tax payers* (in lieu of VAT and CIT): one for the very small taxpayers (annual gross turnover lower than US\$5,600) and another for businesses with annual sales below US\$50,000.

Consecutive tax reforms have not yielded a meaningful increase in tax revenues. The tax reform of 2010 yielded about 0.3 percent of GDP but its measures expired in 2013, and the tax reform of 2012 yielded about 1.3 percent of GDP by 2013, but some measures were temporary and other increased the burden on those who paid taxes instead of eliminating tax exemptions and incentives (e.g. through the tax on bank assets and the increase in CIT and VAT rates).³

B. Revenue Administration Issues

Revenue administration effort has weakened over the past years, but picked up a strong momentum in late 2016 under the new administration. Recent technical assistance missions in tax and revenue administration from the IMF's Fiscal Affairs Department identified a number of weaknesses and recommended reforms to address them, with a view to improving tax administration efficiency and revenue performance. These include:

In tax administration (DGII):

- Modify the organizational structure in order to clearly separate strategic and operational functions, and to ensure that core business functions and processes are well integrated.
- Define and approve a new strategic plan that aims to reduce tax evasion and facilitate taxpayer compliance; implement an operational plan aligned with this strategic plan; and set performance incentives to help reach these institutional goals.

³ The main measures of the 2012 packages include a 1 percent tax on bank assets; minimum income tax for casinos and gambling houses; increase of CIT rate from 25 to 29 percent, of the VAT rate from 16 to 18 percent, and of the withholding tax on sales of goods and services to the government from 0.5 to 3 percent; and introduction of a sales tax at 2.5 percent on domestic sales from free trade zones.

- Implement a new management model in which the head of each core business area assumes full responsibility for designing the strategy, defining the workload, and redesigning processes and systems of his/her area; these 'core business strategies' should be aligned with the strategic plan.
- The new management model should promote teamwork and discourage working according to a silo approach, as is now the DGII's culture.

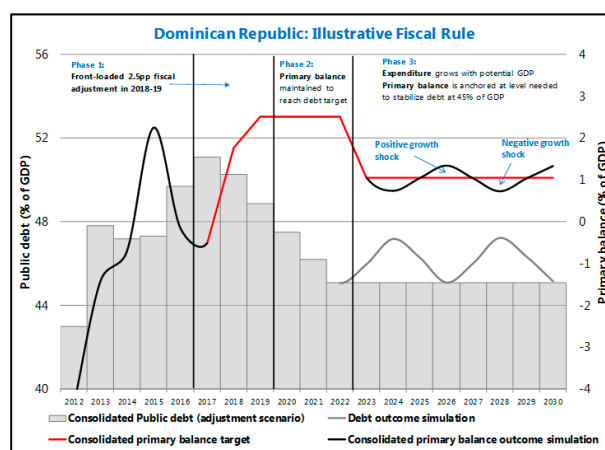
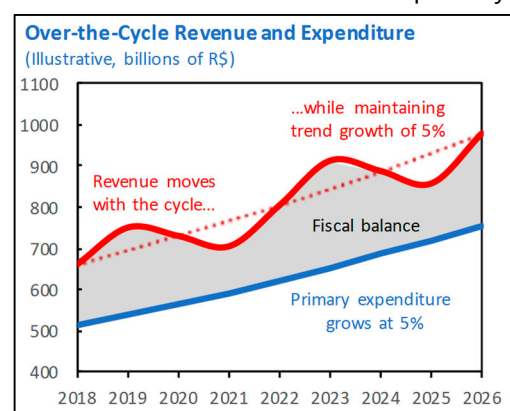
In customs administration (DGA):

- Define a strategic plan that becomes a tool for achieving the institution's objectives, which in addition to improved revenue performance and higher voluntary compliance, should also emphasize increasing the effectiveness and transparency of customs processes.
- Simplify the organizational structure and develop and publish manual of job positions and functions consistent with the DGA's legal powers.
- Reduce the discretion of key processes, starting by lowering the percentages of physical inspections.
- Implement a methodology to classify goods and importers based on their relative importance considering different variables; this should support the selectivity of the information technology (IT) system and help prioritize audits.
- Define joint initiatives to strengthen control of special regimes, address undervaluation and tackle the non-payment of excise taxes.
- Complete the bulk data exchange process for analytical purposes with the tax administration (DGII).

Annex V. Strengthening the Medium-Term Fiscal Policy Framework

Option to strengthen the medium-term fiscal framework. The fiscal framework should introduce an anchor for fiscal policy and provide an operational rule to achieve and maintain it through the cycle. Countries have increasingly adopted fiscal rules to guide policy, and these have varied in substance and form. Experience has shown that to be effective, the rules need to balance simplicity and flexibility, while being tailored to the level of institutional development of the country. The framework described below is one option that meets these conditions, and the parameters used to illustrate the framework would need to be calibrated based on additional analysis and policy decisions.

- **Anchor:** Staff recommended that the anchor be defined in terms of a consolidated debt to GDP ratio target to be achieved over the medium term, which could be set at 40-45 percent of GDP.¹
- **Rule to achieve the debt target:** The operational fiscal rule would maintain the desired primary balance over the cycle, for example through a simple expenditure rule that requires that *primary spending grow not faster than potential GDP*. Such a rule would first aim to maintain the primary balance that is needed to reduce debt to, for example, 45 percent of GDP (estimated at 2.5 percent of GDP) and subsequently it would maintain the primary balance that is needed to stabilize debt at the targeted level (estimated at 1 percent of GDP). Thus, primary spending growth would be capped at potential GDP growth (5 percent in real terms, an estimate that should be recalibrated periodically through formula-based potential GDP proxies), while allowing revenues to fall and rise with economic activity. As a result, the actual primary balance would fluctuate with the cycle, but over a period of 2-5 years it would average the targeted level.
- **Considerations:** The rule has the advantages that it is: (i) easy to understand and implement in the budget process; (ii) allows revenues to adjust to economic circumstances to provide space for *automatic* countercyclical fiscal policy; this mimics a structural balance target but without the



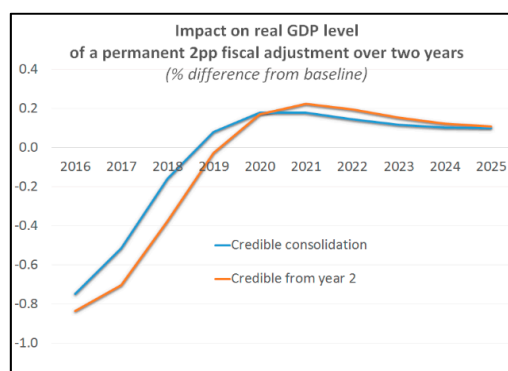
¹ Such a target would be consistent with the adjustment required to address vulnerabilities on the financing side and would provide sufficient buffers for countercyclical policies.

measurement complications that accompany such targets. At the same time: (i) persistent deviations from the target need to be corrected, as they could be for reasons other than the cycle; (ii) any policy changes need to be deficit-neutral, so that policies do not create permanent deviations.

- **Flow corrective mechanism.** A cumulative deviation from the primary balance target of, for example, 3 percentage points of GDP from the date the framework comes into effect would trigger a change in the level of revenue and/or expenditures, implemented over two years to correct the imbalance.
- **Stock corrective mechanism.** Deviations from the debt target would be allowed only within a tolerance band (of up to 5 percentage points of GDP on the upside), after which a similar correction would be triggered as in the case of the expenditure rule, to be implemented over two years. This stock correction mechanism provides an additional safeguard, in case the flow correction was not triggered for one reason or another.
- **Escape Clauses.** In recognition that certain one-off rare events could justify temporary deviations from the rules, the proposed framework would include escape clauses. Escape clauses could be proposed for natural disasters, severe economic contractions, and financial crises, and should be well specified and quantified. The triggering of an escape clause should provide for a suspension of the rules-based framework for a period not longer than one year, but corrective measures will be allowed to be undertaken within a three-year period to ensure a return to full compliance with the rules.

Macroeconomic Effects of a Credible Fiscal Adjustment. The combination of a fiscal adjustment along with the introduction of Fiscal Responsibility Legislation would have at least two beneficial effects: the fiscal adjustment could be more credible and the declines in borrowing costs could be larger than implied by the consolidation alone.

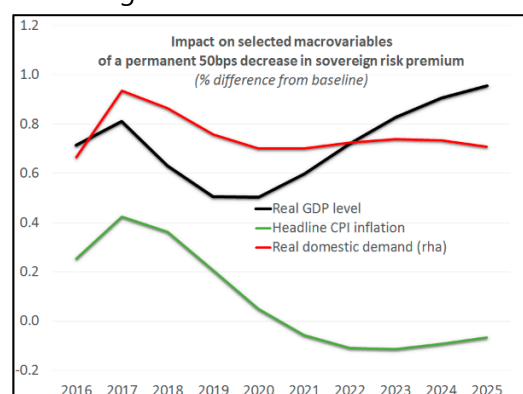
- **A more credible fiscal adjustment.** The fiscal adjustment supported by a medium-term anchor and fiscal rules would be more credible, mitigating its impact on growth. To illustrate the potential impact of the credibility effect, staff used FSGM simulations to consider two scenarios: one of a credible fiscal adjustment (of 2pp of GDP in one year) and another of a similar fiscal adjustment that becomes credible after one year of implementation.² In the model, when households and firms do not perceive a fiscal consolidation to be credible, they assume that the announced change in the fiscal stance will only last one year, followed by a permanent return to the previous fiscal stance. For illustrative purposes, the adjustment is assumed to be undertaken through a



² FSGM simulations provided by Keiko Honjo (RES).

combination of tools: an increase in VAT taxes (50%), increase in consumption taxes (25%) and a reduction in current spending (25%). As expected, in both cases GDP contracts with the fiscal adjustment, but the contraction is higher in the case of a noncredible adjustment. This is because neither households nor firms anticipate a permanently lower interest rate and consequently do not adjust their portfolios, keeping the exchange rate and the positive response of net exports muted in the short-term. GDP recovers subsequently, as investment and net exports respond to the decline in interest rates and real exchange rate depreciation. However, the recovery happens somewhat earlier in the case of a credible consolidation because of a faster investment recovery.

- Additional reduction in borrowing costs.** A more credible fiscal adjustment, accompanied by structural fiscal reforms (such as fiscal responsibility legislation), is likely to reduce interest rates beyond what would be warranted by the consolidation itself. This is supported by the empirical findings that deficit cuts preceded by high perceived sovereign risk are indeed less contractionary (WEO 2010) or that investors reward government's commitment with lower borrowing costs, especially when reforms are initiated in good times and in countries facing higher initial borrowing costs (Ebeke, 2016).³ The simulation results suggest that a permanent 50 basis point reduction in the sovereign risk premium would boost both consumption and investment, with an overall positive impact on GDP of 0.7pp in the short-term and close to 1pp in the long-term.



³ "Will It Hurt? Macroeconomic Effects of Fiscal Consolidation", 2010, WEO Chapter 3; "Who Dares, Wins: Structural Reforms and Sovereign Risk", 2016, by C. Ebeke, IMF (forthcoming).



DOMINICAN REPUBLIC

STAFF REPORT FOR THE 2016 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

March 10, 2017

Prepared By

The Western Hemisphere Department

CONTENTS

FUND RELATIONS	2
RELATIONS WITH THE WORLD BANK	5
RELATIONS WITH THE INTER AMERICAN DEVELOPMENT BANK	6
STATISTICAL ISSUES	7

FUND RELATIONS

(As of January 31, 2017)

Membership Status: Joined on December 28, 1945; Article VIII

General Resources Account:	SDR Million	Percent of Quota
Quota	477.40	100.00
Fund holdings of currency	412.77	86.46
Reserve Tranche Position	64.63	13.54

SDR Department:	SDR Million	Percent of Allocation
Net cumulative allocation	208.83	100.00
Holdings	5.05	2.42

Outstanding Purchases and Loans:

Stand-By Arrangements (SBA) none

Latest Financial Arrangements:

Type	Date of Arrangement	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
SBA	Nov 9, 2009	Mar 8, 2012	1,094.50	766.15
SBA	Jan 31, 2005	Jan 30, 2008	437.80	437.80
SBA	Aug 29, 2003	Jan 31, 2005	437.80	131.34

Projected Payments to Fund: 1/

(SDR million: based on existing use of resources and present holdings of SDRs):

	Forthcoming			
	2017	2018	2019	2020
Principal	0.00	0.00	0.00	0.00
Charges/Interest	0.62	0.66	0.66	0.66
Total	0.662	0.6	0.66	0.66

^{1/} When a member has overdue financial obligations outstanding for more than three months, the amount of such arrears will be shown in this section.

Article IV Consultation. The last Article IV consultation was concluded by the Executive Board on February 19, 2016.

FSAP Participation. An FSAP update was completed in February 2009. The corresponding report was issued in November 2009.

Exchange Rate Arrangement. The Dominican Republic's *de jure* exchange rate arrangement is classified as "managed floating", while the *de facto* exchange rate arrangement is classified as a "crawl-like arrangement." Over the last two years, the *peso* has been depreciating against the U.S. dollar by an average rate of 2.8 percent per year. The Dominican Republic maintains an exchange system free of restrictions on the making of payments and transfers for current international transactions.

Technical Assistance, 2015–16:

Year	Subject	Action	Timing	Counterpart
2015	Customs administration	Missions	Multiple missions 2015	MoF, DGA
	Public financial management: Treasury single account	Missions	Multiple missions 2015	MoF
	Tax administration	Missions	Multiple missions Mar. -Apr. 2015	MoF, DGII
	Support to develop the thrusts scheme	Missions	Multiple missions Jan. -Mar. 2015	BCRD
	Public financial management	Mission	Mar. 2015	MoF
	Macroeconomic analysis and projections	Mission	Mar. 2015	BCRD
	Exchange position limits	Mission	Apr. 2015	BCRD
	Bank supervision and regulations	Missions	Multiple missions Apr. - May 2015	SIB
	Balance of payments statistics and international investment position (IIP)	Missions	Multiple missions Apr. - Sep. 2015	BCRD
	National accounts: flow of funds table	Mission	Jul. 2015	BCRD
	External debt statistics	Mission	Aug. 2015	BCRD
	Consumer and producer prices	Mission	Jul. 2015	BCRD
	Risk-based supervision	Missions	Multiple missions Sep. - Dec. 2015	SIB
	Supervision of market and liquidity risks	Mission	Sep. - Oct. 2015	BCRD, SIB
	Tax system, revenue mobilization, tax expenditures	Mission	Oct. 2015	MoF, DGII
	Treasury modernization processes	Missions	Multiple missions Oct. - Dec. 2015	MoF
	Macro stress testing model	Mission	Apr. 2015	BCRD

DOMINICAN REPUBLIC

	Balance of payments statistics and international investment position (IIP)	Missions	Multiple missions Apr. – Sep. 2015	BCRD
	National accounts: flow of funds table	Mission	Jul. 2015	BCRD
	External debt statistics	Mission	Aug. 2015	BCRD
	Consumer and producer prices	Mission	Jul. 2015	BCRD
	Risk-based supervision	Missions	Multiple missions Sep. – Dec. 2015	SIB
	Supervision of market and liquidity risks	Mission	Sep. – Oct. 2015	BCRD, SIB
	Tax system, revenue mobilization, tax expenditures	Mission	Oct. 2015	MoF, DGII
	Treasury modernization processes	Missions	Multiple missions Oct. – Dec. 2015	MoF
2016				
	Macroprudential policies	Mission	Feb. 2016	BCRD, SIB
	Stress testing model for the financial system	Mission	Feb.-March 2016	SIB
	Strengthening the operational framework for foreign exchange operations	Mission	March 2016	BCRD
	National Accounts Statistics	Missions	Multiple missions Jan. - May 2016	BCRD
	Revenue Administration (Customs)	Mission	June 2016	DGA
	Tax Administration	Mission	Nov. 2016	DGII
	The Assessment of Saving and Loan Cooperatives	Missions	Multiple missions Oct-Dec 2016	
	Credit valuation and provisioning regulation	Mission	Dec 2016	SIB

Resident Representative: The Fund representative office was closed on July 1, 2014.

RELATIONS WITH THE WORLD BANK

Lending Operations (In millions of U.S. dollars)				
Products	Total loan	Undisbursed through FY17	Projected disbursements in FY17	Closing date
DO Support to the Nat. Education Pact	50.0	34.8	17.5	06/30/20
DO Distribution Grid Modernization & Loss Red.	120.0	0.3	25.0	12/31/20
DO Municipal Development Project	17.0	1.9	2.00	06/15/17
DO Integrated Social Protect & Promotion	75.0	72.9	40.0	03/30/19
DO Strengthening PFM – DPL	60.0	60.0	0.0	06/30/17
DO Water and Sanitation in Tourist Areas	27.5	7.0	7.0	06/30/17
Total	349.5	113.52	91.5	

Source: World Bank. As of February 3, 2017.

Analytical and Advisory Products			
Title	Products	Product type	Expected delivery date
World Bank	Dominican Republic - Public Expenditures Management TA	Technical assistance	05/25/2017
	DR Female Biz and Worker training	Impact Evaluation	06/30/2017
	Exports and Global Value Chains in DR	Report	03/31/2017
	DO Fiscal and Equity Analysis	Economic and Sector Work	06/29/2017
	DO Investment Promotion and Retention	Technical assistance	12/01/2016
	Dominican Republic Policy Notes	Report	12/09/2016

Source: World Bank. As of February 3, 2017.

RELATIONS WITH THE INTER AMERICAN DEVELOPMENT BANK

(As of February 20, 2017)

(In millions of U.S. dollars)			
Operations			
Sector	Approved	Disbursed	Undisbursed amount
Social Investment	5.0	5.0	0.0
Transport	50.0	50.0	0.0
Energy	78.0	27.1	50.9
Agriculture	10.0	6.4	3.6
Education	250.0	47.4	202.6
Tourism	120.0	26.8	93.2
Private Sector Development	35.0	7.6	27.4
Water and Sanitation	60.0	27.0	33.0
Health	246.0	183.9	62.1
Social Assistance	310.0	289.4	20.6
Total	1,164.0	670.6	493.4
Source: Inter-American Development Bank.			

Loan Transactions						
	2011	2012	2013	2014	2015	2016
Repayments	86.4	88.5	272.1	445.4	117.9	121.6
Disbursement	300.7	104.0	576.4	146.7	590.4	400.9
Net Lending	214.3	15.5	304.3	-298.7	472.5	279.3
Subscriptions and Contributions	1.2	4.3	1.2	2.3	2.3	3.3
Interest and Charges	61.2	67.6	68.0	59.4	50.2	70.2
Net Cash Flow	152.1	-56.4	235.2	-360.5	420.0	205.8
Source: Inter-American Development Bank.						

STATISTICAL ISSUES

(As of December 31, 2016)

I. Assessment of Data Adequacy for Surveillance
<p>General: Data provision is broadly adequate for surveillance, with some data shortcomings. Most macroeconomic statistics are compiled by the Central Bank, with the National Statistics Office producing underlying surveys and the population census. Fiscal data are compiled by the Ministry of Finance.</p>
<p>National Accounts: The Central Bank updated the base year of the national accounts to 2007 in August 2014; the previous base year was 1991. This initiative benefitted from both IMF technical assistance and input from other experts. Staff from the IMF's Statistics Department has reviewed the methodology and has provided comments and suggestions, which have been largely incorporated. The Monthly Index of Economic Activity (<i>Indice Mensual de Actividad Económica</i>) is now published by the Central Bank on its website.</p>
<p>Price Statistics: CPI data has a base date of December 2010; weights are based on the survey of Income and Expense of Households of 2007-2008. The Central Bank has implemented improvements in the adjustments for seasonal and missing price imputations, changes in product specifications and quality, and new products. It has also harmonized the index with those of Central America and Panama as part of a regional harmonization project.</p>
<p>Government Finance Statistics: Both the Ministry of Finance and the Central Bank compile and disseminate government finance statistics (GFS).</p> <p>Although aggregate data are available for the consolidated general government, the balance of the Rest of the Non-Financial Public Sector is estimated only from the financing side, as above-the-line data coverage on local governments and some non-central government entities is incomplete and not timely. The authorities have made progress in fiscal data presentation, but the lack of a suitable classification of data on the execution of the budget remains a constraint on effectively monitoring fiscal developments during the year. The authorities have not yet transitioned to the GFSM 2014 framework, but requested technical assistance to do so.</p> <p>The country participates in a regional project for the harmonization of GFS for Central America, Panama, and the Dominican Republic. The authorities are currently working to implement International Public Sector Accounting Standards (IPSAS) and introduce a results-based program budgeting system. The authorities are encouraged to involve strategic units in elaborating the chart of accounts under IPSAS, create a GFS committee to reconcile fiscal data, and review the regulatory framework for financial management prior to the adoption of international standards.</p>
<p>Monetary and Financial Statistics: The country has reported monetary data to STA in the standardized report forms (SRFs) since August 2007, and this has been the base for national publications since July 2009. SRFs-based data has helped improve coverage and classification of the data. The SRFs were developed in the context of a regional project for the harmonization of monetary and financial statistics in Central America and the Dominican Republic that ended in December 2008. Currently, the central bank disseminates the harmonized monetary statistics via its web page.</p>

<p>Financial sector surveillance: The Dominican Republic has begun reporting Financial Soundness Indicators (FSIs) to the IMF on a monthly basis with data beginning in 2008. The Dominican Republic's FSIs have been posted, and are now available, on the IMF's FSIs website (http://fsi.imf.org).</p>	
<p>External sector statistics: The authorities started disseminating balance of payments (BOP) statistics according to BPM6 in March 2015. Problems of coverage remain for exports, imports, factor services, capital transfers, income, and the financial account including the private sector, giving rise to large errors and omissions. External debt statistics, notably for the private sector, also require further improvements. Several technical assistance missions have assisted the BCRD in improving balance of payments statistics (including migration to BPM6), external debt statistics and preparing the International Investment Position (IIP) data according to BPM6, which are now available for the period 2010Q4–2016Q3, and need to be extended backwards.</p>	
<p>II. Data Standards and Quality</p>	
<p>The country is a GDDS participant. However, most of its metadata, with the exception of the fiscal sector and socio-demographic metadata, were last updated in June 2007. Fiscal sector metadata was last updated in November 2005, while socio-demographic metadata are not available. The authorities are working to update the metadata.</p>	<p>Data ROSC was published on June 27, 2006.</p>

Dominican Republic: Table of Common Indicators Required for Surveillance (As of February 23, 2017)

	Date of latest Observation	Date Received	Frequency of Data ⁷	Frequency of Reporting ⁷	Frequency of Publication ⁷	Memo Items:	
						Data Quality – Methodological Soundness ⁸	Data Quality – Accuracy and Reliability ⁹
Exchange Rates	2/21/2017	2/22/2017	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities ¹	2/21/2017	2/22/2017	D	D	M		
Reserve/Base Money	2/21/2017	2/22/2017	D	D	W	LNO, O, LO, LO	LO, O, O, O, LO
Broad Money	2/17/2017	2/22/2017	W	W	W		
Central Bank Balance Sheet	1/2017	2/22/2017	M	M	M		
Consolidated Balance Sheet of the Banking System	12/2016	1/18/2017	M	M	M		
Interest Rates ²	2/21/2017	2/22/2017	D	D	D		
Consumer Price Index	1/2017	2/17/2017	M	M	M	O, O, O, O	O, LNO, LNO, O, LO
Revenue, Expenditure, Balance and Composition of Financing ³ – General Government ⁴						LO, NO, LO, LO	LNO, O, LO, O, LNO
Revenue, Expenditure, Balance and Composition of Financing ³ –Central Government	12/2016	2/2017	M	M	M		
Stocks of Central Government and Central Government-Guaranteed Debt ⁵	12/2016	2/2017	Q	Q	Q		
External Current Account Balance	12/2016	2/2017	Q	Q	Q	O, LO, LO, LO	LNO, O, LO, LO, NO
Exports and Imports of Goods and Services	12/2016	2/2017	Q	Q	Q		
GDP/GNP	Q4/2016	2/2017	Q	Q	Q	LNO, LO, LNO, LO	LNO, LO, LNO, O, LNO
Gross External Debt	Q3/2016	12/2016	Q	Q	Q		
International Investment Position ⁶	Q3/2016	12/2016	Q	I	I		

¹ Any reserve assets that are pledged or otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.

² Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.

³ Foreign, domestic bank, and domestic nonbank financing.

⁴ The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.

⁵ Including currency and maturity composition.

⁶ Includes external gross financial asset and liability positions vis-à-vis nonresidents, including of offshore banks.

⁷ Daily (D); Weekly (W); Monthly (M); Quarterly (Q); Annually (A); Irregular (I); Not Available (NA).

⁸ Reflects the assessment provided in the Report on the Observance of Standards and Codes (ROSC)—Data Module published on June 27, 2006, based on the findings of the mission that took place during August 3–16, 2005. For the dataset corresponding to the variable in each row, the assessment indicates whether international standards concerning (respectively) concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O), largely observed (LO), largely not observed (LNO), or not observed (NO).

⁹ Same as footnote 8, except referring to international standards concerning (respectively) source data, assessment of source data, statistical techniques, assessment and validation of intermediate data and statistical outputs, and revision studies.

**Statement by Alexandre Tombini, Executive Director for the Dominican Republic
and Frank Fuentes, Senior Advisor to the Executive Director
March 24, 2017**

1. The authorities of the Dominican Republic want to thank the IMF team for a very constructive dialogue and valuable policy advice. As underlined in the staff report, the Dominican economy continues its dynamic performance, expanding at an average pace of 7 percent during 2014-16, leading the Latin America and Caribbean (LAC) region for the third year in a row. Low oil prices helped maintain inflationary pressures subdued, as headline inflation closed 2016 at 1.7 percent, the second lowest rate since 1984. Furthermore, the unemployment rate declined to 5.3 percent in October 2016 from 5.9 percent in October 2015.

2. The Dominican government remains committed to fiscal discipline and to safeguarding the sustainability of public finances. The non-financial public sector (NFPS) deficit reached 2.7 percent of GDP in 2016, in line with the deficit budgeted for the year. In the external sector, the current account deficit narrowed to 1.5 percent of GDP in 2016, the lowest in a decade, supported by rising exports, tourism receipts and remittances, and fully financed by foreign direct investment. All major credit agencies have reported a stable or positive outlook for the Dominican economy, as the authorities continue to work towards an investment grade credit rating.

Recent developments and outlook

3. Growth momentum in the global economy, particularly in the U.S., is supportive to domestic economic activity. Nonetheless, remaining policy uncertainty, the ongoing normalization of monetary policy in the U.S., and the slow growth in the LAC region deserve close monitoring. Against this background, the Dominican Republic continues to sustain a strong expansion pace, propelled by a robust private consumption and investment growth. The leading indicator of economic activity (IMAE) reached 5.5 percent growth in January (year-on-year) as the economy gradually converges to its potential, estimated by the Central Bank of the Dominican Republic (CBDR) at 5.1 percent. Commerce (7.7%), agriculture (6.2%), local manufacturing (6.1%), and tourism (5.9%), were among the most dynamic activities. In 2017, real GDP growth is expected to hover around potential and close the output gap, as domestic demand moderates.

4. According to data from the Continuous National Workforce Survey, a total of 148,532 new jobs were created in 2016, an increase of 3.6 percent. This new survey, implemented with technical assistance from the International Labor Organization (ILO) and the UN's Economic Commission for Latin America and the Caribbean (ECLAC), delivers more detailed labor market data at a quarterly basis (instead of bi-annually as in

the traditional National Workforce Survey), and provides closer alignment with international labor indicators and statistical standards.

5. Headline inflation returned to the 4 ± 1 percent target range this year, reaching 3.3 percent in February, as the positive supply shock dissipates on the back of rising oil prices. Developments in international commodity markets and their impact on local energy prices and transportation costs continue to be closely monitored by the CBDR, and could prompt additional interest rates increases in 2017.

Fiscal policy

6. The fiscal consolidation process will continue in 2017, as the targeted deficit falls to 2.3 percent of GDP, due to a combination of a 0.3 of GDP increase in tax revenue and a similar cutback in primary expenditures. A sizeable drop in public spending (capital investment and transfers) will take place with the end of coal plants construction, once they become operational in the second half of 2018.

7. The government agrees with staff that strengthening the tax base is a near term priority. Therefore, efforts to strengthen tax administration, and streamline some tax exemptions and incentives will remain a dominant policy objective, playing an important role in the ongoing fiscal adjustment and laying the groundwork for further actions, if necessary, as discussions for the electricity and fiscal pacts advance. IMF technical assistance is supporting the efforts of the internal revenue (DGII) and customs (DGA) agencies to improve revenue collection performance.

8. Consolidated debt reached 47.6 percent of GDP at year-end 2016, with a sustainable medium-term outlook and resilient to external shocks, as highlighted in staff's Debt Sustainability Analysis.¹ Nonetheless, the authorities continue to be fully committed to maintain the debt-to-GDP ratio on a downward trajectory. The debt reduction efforts will greatly benefit from the ongoing improvement in tax and customs administration. Moreover, authorities see merit in establishing a medium term fiscal framework and have begun exploring feasible options around the notion of a primary surplus target.

Monetary policy

9. The CBDR continues to strengthen its monetary policy framework under inflation targeting. As in most oil importing countries, low crude prices eased inflationary

¹ The discrepancy between the level of consolidated debt-to-GDP ratios estimated by the IMF and the Ministry of Finance arises from differences in exchange rates (authorities use average exchange rate for the year, and staff uses end-of-period), debt conversion procedures (authorities convert all debt into US dollars, and staff convert it to Dominican pesos), and the inclusion by the IMF of the Dominican Corporation of State Electricity Companies (CDEEE) debt to generators as part of the Non-Financial Public Sector debt.

pressures in 2016, maintaining inflation under the target range. Nonetheless, CBDR tightened monetary conditions with a half a point increase in monetary policy rate last October, as heightened external uncertainty warranted precautionary actions to keep market expectations anchored. This decision has helped redirect credit growth back to rates similar to nominal GDP expansion. CBDR remains fully committed to maintain inflation within the target band.

10. The CBDR authorities agree with staff that the real exchange rate is broadly in line with macroeconomic fundamentals and consistent with the policy framework. Monetary authorities are working towards a gradual transition to greater exchange rate flexibility, and increasing efficiency and transparency in the local foreign exchange market by establishing an electronic trading platform, instituting intervention rules, and legislating on hedging and futures markets to enable exchange rate risk management. Technical assistance from the Fund's Regional Technical Assistance Center (CAPTAC-DR) is currently supporting these efforts.

11. The CBDR has continued to accumulate international reserves to buttress external buffers. In 2016, favorable external conditions and a narrowing current account deficit allowed the CBDR to reach its highest level in history (US\$ 6,047 millions), equivalent to 3.9 months of imports (excluding *maquilas*). Although current reserve levels meet traditional adequacy indicators, the monetary authorities are committed to continue to build up reserves to levels closer to those recommended by the IMF's composite reserve adequacy metric.

Financial system

12. The banking system is growing steadily with strong financial soundness indicators. Banks are profitable, with adequate liquidity levels and well-capitalized. By December 2016, non-performing loans remain low at only 1.5 percent, the average return on equity (ROE) was 22 percent, and the capital adequacy ratio reached 15.6 percent, comfortably exceeding legal requirements. The system exhibits high resilience to external shocks as a result of strong capital buffers, increasing reliance on domestic sources for funding, and relatively low levels of dollarization of loans and deposits.

13. Authorities are fully committed to align domestic legislation to international standards, and continue to work intensely to close regulation gaps in advance of the Financial Action Task Force of Latin America (GAFILAT) evaluation, which is expected to begin in May 2017. Vulnerabilities emanating from the cooperatives sector are being emphatically addressed by comprehensive reforms considering all FATF recommendations. Initiatives aimed at strengthening the macro-prudential framework to address systemic risks are underway, including the upcoming publication of the financial

stability report. In terms of the de-risking process affecting the financial systems of some Caribbean and Central American nations, the risk faced by the Dominican Republic remains low, as most banks maintain correspondent banking relationships with major U.S. financial institutions.

Structural reforms

14. The implementation of a medium-term plan to boost power generation capacity and reduce the cost of electricity is a key component of the energy reform agenda. The construction of two new coal-fueled plants should be finalized during the second half of 2018, adding 720 MW of low cost generation capacity. Additionally, the government has established a new medium term framework for the power purchase agreement (PPA) bidding process to promote the expansion and further diversification of the power matrix, in order to meet energy demand growth and reduce the generation cost and price of electricity to consumers.

15. Finally, the government has successfully engaged in increasing investment in education, and in fostering poverty reduction policies. In order to improve education outcomes, authorities have now shifted their attention to enhancing teacher quality and updating the curriculum. Poverty rates have decreased from 42.2 percent in September 2012 to 30 percent in September 2016 according to the National Workforce Survey, taking over one million Dominicans out of poverty. Despite these accomplishments, the structural reform agenda will continue to focus on further improving social outcomes, through tackling weaknesses in the social security legislation, labor code, and healthcare. Additionally, authorities are working to improve the business climate and several actions are underway that focus on reviewing the procedures for opening new businesses, facilitating financing and protecting investment.