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Dominican Republic: Staff Report for the 2009 Article IV Consultation and Request for a Stand-By Arrangement; Supplement to the Staff Report and Staff Statement; Public Information Notice and Press Release on the Executive Board Discussion

The following documents have been released and are included in this package:

- The staff report, prepared by a staff team of the IMF, following discussions that ended on September 17, 2009, with the officials of Dominican Republic on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on October 26, 2009. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- A supplement to the staff report.
- A staff statement.
- A Public Information Notice (PIN).
- A Press Release.

The document(s) listed below will be separately released.

Letter of Intent sent to the IMF by the authorities of Dominican Republic*
Memorandum of Economic and Financial Policies by the authorities of Dominican Republic*
Technical Memorandum of Understanding*
*Also included in Staff Report

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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INTERNATIONAL MONETARY FUND

DOMINICAN REPUBLIC

Staff Report for the 2009 Article IV Consultation and Request for a Stand-By Arrangement

Prepared by the Western Hemisphere Department
(In consultation with other departments)

Approved by Rodrigo Valdés and Dominique Desruelle

October 26, 2009

EXECUTIVE SUMMARY

- **Backdrop**. A financial crisis in 2003 (fueled by the failure of several fraud-ridden banks) led to a generalized loss of confidence and a major bailout that doubled public debt. An SBA (2003-05) went quickly off-track. However, confidence improved after President Fernández took office in mid-2004 and his new administration designed a strong economic program supported by another SBA (2005-08) that successfully stabilized the economy. President Fernández was re-elected in 2008 and continued with broadly adequate macro policies but the global financial crisis is threatening growth prospects and stability.
- **2008 Article IV**. The last consultation was concluded in January 2008. At that time, Directors commended the authorities for the impressive recovery from the 2003 financial crisis. They considered the main policy challenge was to better target social spending, while generating primary fiscal surpluses to lower public debt to pre-crisis levels.
- **Developments**. The economy grew 5¼ percent in 2008, but decelerated to 1½ percent in the first half of 2009. Inflation rose to 15 percent (yoy) in August 2008, and then fell to –1½ percent in September 2009. Monetary policy switched from a tightening cycle in 2008 to a loosening stance in 2009. Fiscal policy was expansionary and the consolidated public deficit more than doubled to 4½ percent of GDP in 2008 and then fell to about 3 percent in the first half of 2009 (on an annual basis). The external current account deteriorated to almost 10 percent of GDP in 2008 due to higher food and fuel prices but has improved in the first half of 2009 as import demand fell and the terms of trade improved.
- **Policies**. The authorities intend to implement a strong macroeconomic program and a well-balanced structural reform agenda to face the adverse external environment. Staff stressed the need to enhance mechanisms to respond to the global financial crisis and recommended a fiscal stimulus in 2009 and the first half of 2010 as well as the continuation of a flexible monetary and exchange rate policy while deepening structural reforms to secure macroeconomic stability.
- **SBA Request**. The authorities are requesting a 28-month SBA for SDR 1,094.5 million (500 percent of quota). The main objectives of the program are to pursue short-term countercyclical policies while strengthening medium-term sustainability; reduce vulnerabilities exposed during the global crisis, and lay the foundations for a gradual recovery and sustained growth.
- **Discussions**. These took place during August 24-28 in Washington and September 4-17, 2009 in Santo Domingo. The mission met with Central Bank Governor Valdez, Finance Minister Bengoa, Economy Minister Montás, senior government officials, representatives of the banking community, and the private sector. The staff team consisted of A. Santos (head), G. Bannister, M. Dehesa, A. Alichi, (all WHD), K. Hosono (SPR), and M. Cortes (MCM). J. Estrella (OED) participated in the meetings.

LIST OF ACRONYMS

BCRD	Central Bank of the Dominican Republic
CAR	Capital Adequacy Ratio
CCT	Conditional Cash Transfer
DSA	Debt Sustainability Analysis
FDI	Foreign Direct Investment
FSAP	Financial Sector Assessment Program
GDP	Gross Domestic Product
GNFS	Good and Non-factor Services
IDB	Inter-American Development Bank
IMF	International Monetary Fund
LOLR	Lender of last resort
MEFP	Memorandum of Economic and Financial Policies
NFA	Net Foreign Assets
NDA	Net Domestic Assets
NFPS	Non-Financial Public Sector
NIR	Net International Reserves
NPL	Nonperforming Loans
OECD	Organziation for Economic Co-operation and Development
PC	Performance Criteria
PFM	Public Financial Management
PPM	Post Program Monitoring
PRA	Blackout Reduction Program
REER	Real Effective Exchange Rate
ROSC	Report on the Observance of Standards and Codes
SB	Superintendence of Bankstructural Benchmark
SBA	Stand-By Arrangement
SDR	Special Drawing Rights
TMU	Technical Memorandum of Understanding
VAT	Value Added Tax
WB	World Bank
WHD	Western Hemisphere Department
yoy	year-on-year

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I. TRENDS, DEVELOPMENTS AND VULNERABILITIES

A. Introduction

1. **Context**. The global economic and financial crisis has significantly worsened the short-term economic prospects and may jeopardize some of the achievements of the last 5 years. Economic recovery from the 2003 financial crisis has been impressive. Real GDP grew 40 percent in the last 5 years, one of the highest expansions in Latin America and the best performance of the Dominican economy in the last quarter of a century. Inflation fell from over 40 percent in 2003 to 4½ percent in 2008. Fiscal deficits have been cut in half, from almost 9 percent of GDP for the consolidated public sector in 2003 to about 4½ percent in 2008. The public debt-to-GDP ratio was reduced by almost one-half, from about 60 percent in 2003 to 35 percent in 2008. However, social progress remains a challenge, and despite recent improvements, poverty indicators are still weaker than before the 2003 crisis.

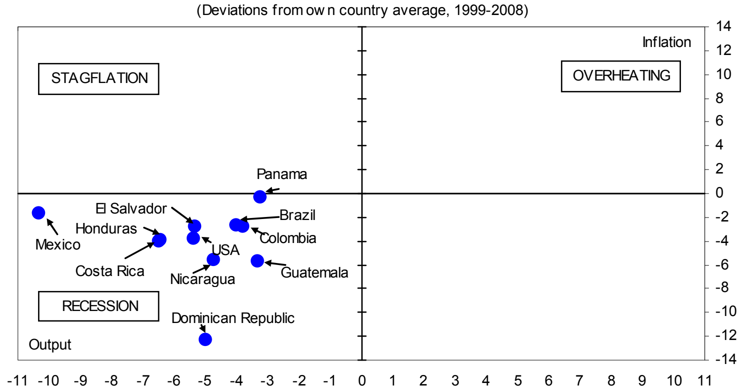
2. **Program**. To safeguard the achievements of the last several years, and against the background of unfavorable external conditions, large uncertainties and a sizable balance of payments need, the authorities are requesting a 28-month SBA for 500 percent of quota (SDR 1,094.5 million). The objectives of the program are twofold: first, to conduct counter-cyclical policies at the beginning of the program (from the last quarter 2009 to the first half 2010) to mitigate the drastic economic downturn; and second, to address debt and fiscal sustainability issues in the latter part of the program (after mid-2010), while embracing an ambitious structural reform agenda. Successful implementation of a Fund-supported program will unlock significant financing from other multilateral sources.

B. Economic Conditions

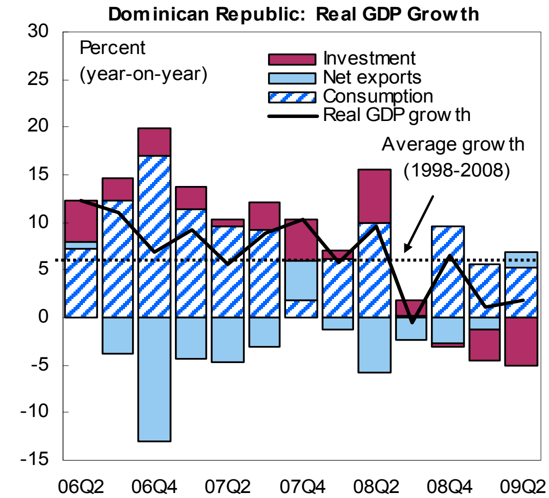
3. **Output.** Following a period of high economic growth of some 9½ percent per year in the period 2004-07 and 5¼ percent in 2008, growth slowed significantly to 1½ percent year-on-year (yoy) in the first half of 2009, in line with other economic slumps in the region. The rapid deceleration was the result of the global credit crunch, a weak external demand and a procyclical fiscal policy, which together pushed the economy to the brink of stagnation.

- ***Demand***. The near stagnation is the result of lower external and domestic demand with exports, private investment and public spending showing the largest deceleration.

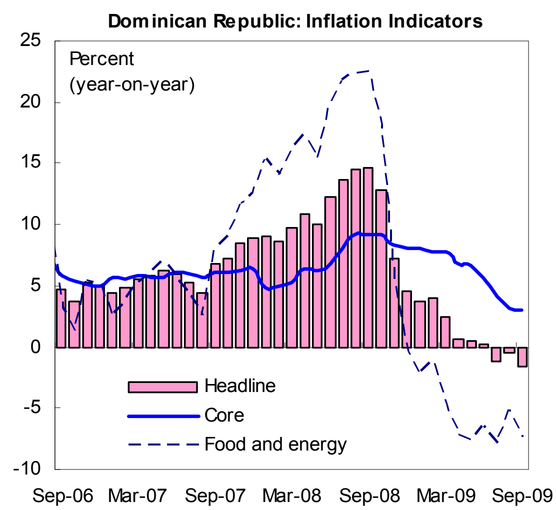
Dominican Republic: Regional Comparison of Output and Inflation, 2009
(Deviations from own country average, 1999-2008)



- ***Sectors***. The economic slow down was broad based, with manufacturing, trade and financial services being the most affected.



4. **Inflation**. There are disinflationary pressures due to the unwinding of supply shocks and the cooling off of the economy. While supply shocks (mostly on food and fuel) took headline inflation to 15 percent in August 2008 (yoy), the reversal of these shocks, in addition to a tightening of monetary policy, brought inflation down to 4½ percent in December 2008 (a 10½ percentage point disinflation in 4 months). Inflation continued falling in 2009 as the economy decelerated further and inflation in September 2009 turned negative (–1½ percent yoy), while cumulative inflation in the first 9 months of the year amounted to 4⅓ percent. However, core inflation (which excludes food and energy prices) has been less volatile, rising to 9¼ percent in August 2008 (yoy) as the effects of the supply shocks began to affect expectations and other prices in the economy, and falling to 8½ percent in December 2008. Despite a loosening of monetary policy in 2009, core inflation fell further to about 3 percent in September 2009 as domestic demand remained weak.



5. **Fiscal position**. Against the background of lower tax collections and higher energy subsidies, fiscal policy was relaxed significantly in 2008 and the overall deficit of the consolidated public sector (including the quasi-fiscal deficit of the central bank) more than doubled (from 1¾ percent of GDP in 2007) to 4½ percent of GDP. The relaxed fiscal stance was reversed in the first half of 2009 due to financing constraints, and the deficit shrank to some 3 percent of GDP (on an annual basis), but the broad procyclicality of the policy continued.

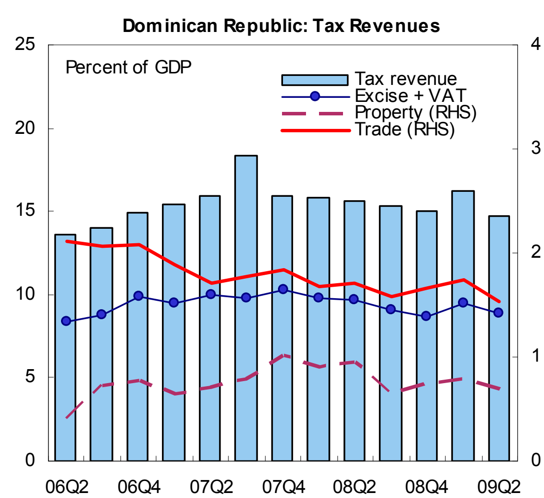
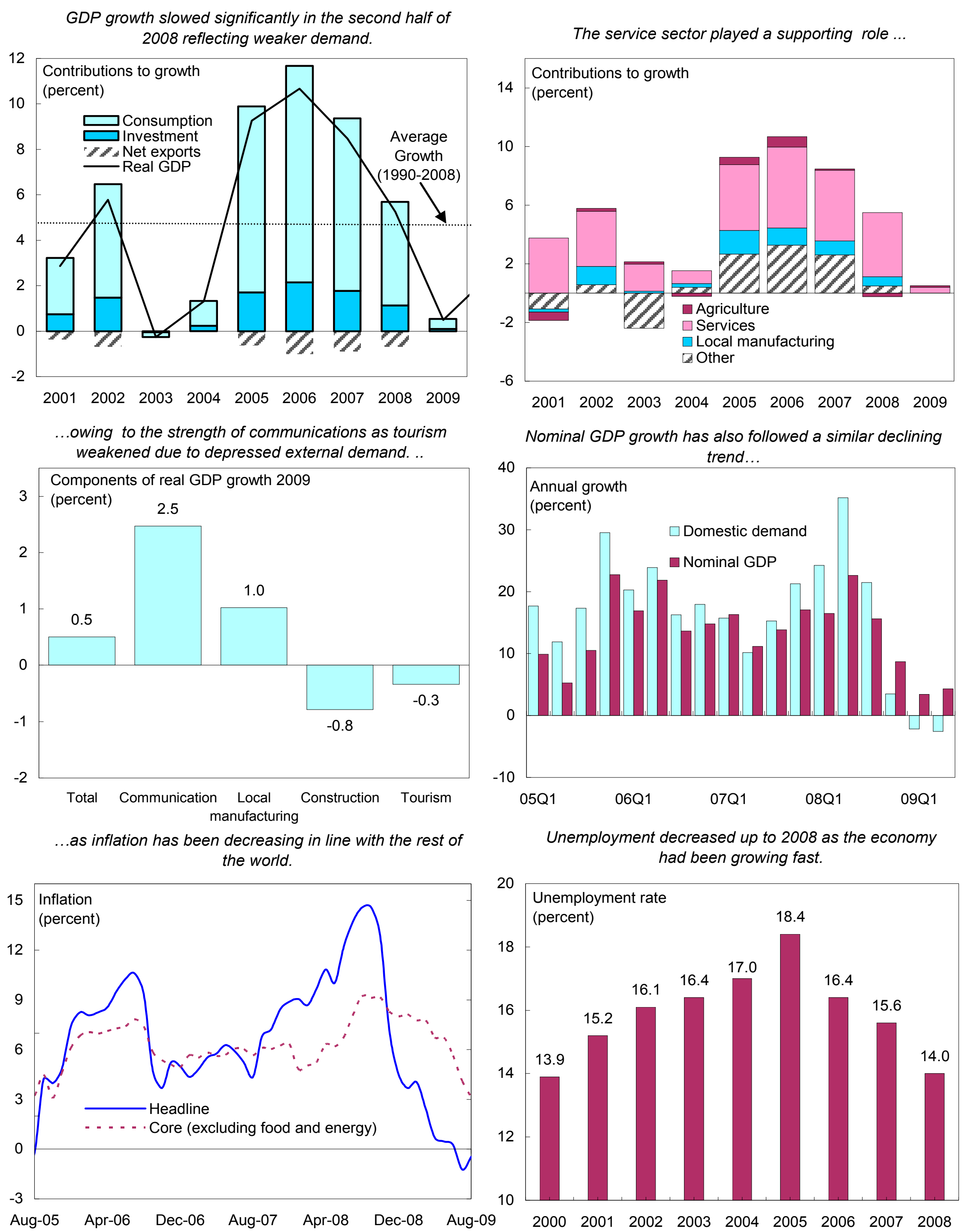


Figure 1. Dominican Republic: Real Sector Developments

GDP growth and inflation are on a downward path on the back of weak external environment and domestic demand.

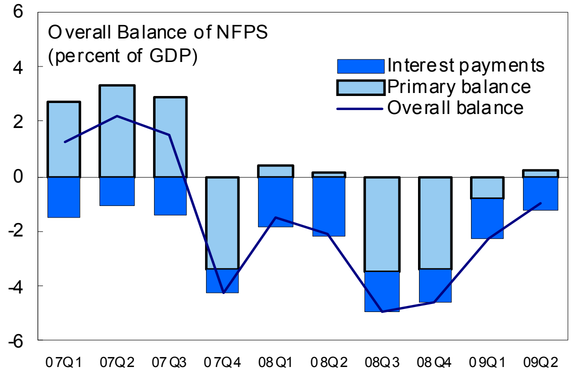


Sources: Dominican authorities; and Fund staff estimates.

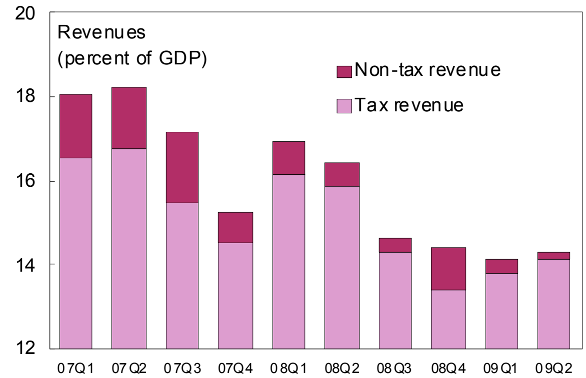
Figure 2. Dominican Republic: Fiscal Developments

Fiscal policy was relaxed in 2008, as tax exemptions were introduced and energy subsidies increased, but it was tightened considerably in the first half of 2009 as large declines in revenues were matched by cuts in expenditure.

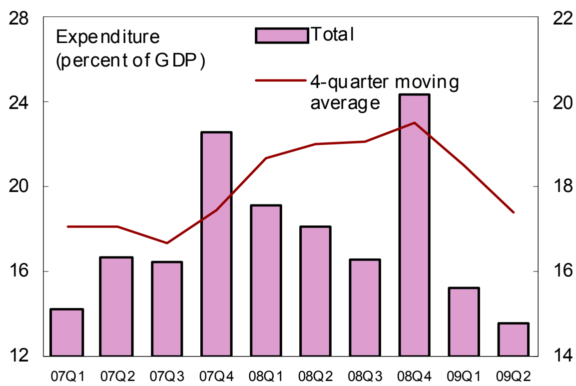
The fiscal position tightened significantly in the first half of 2009...



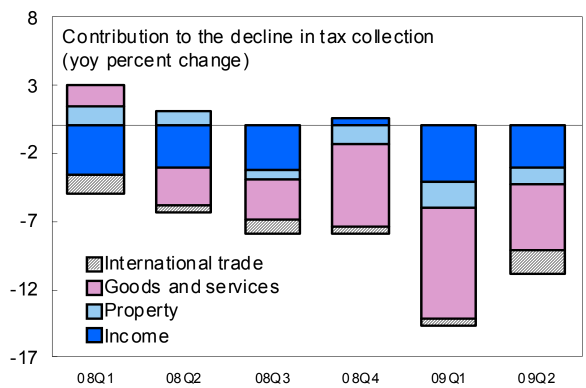
...as large declines in tax and non-tax revenue...



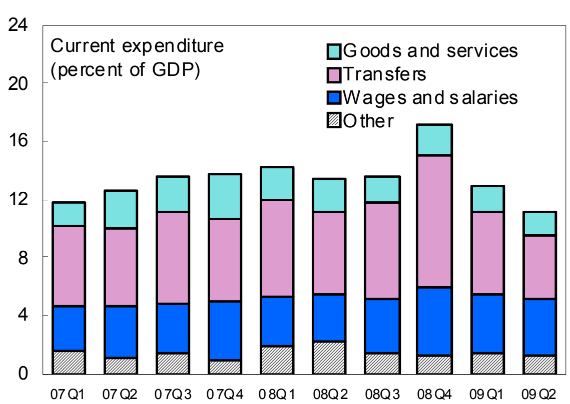
...were matched by a large decline in expenditures.



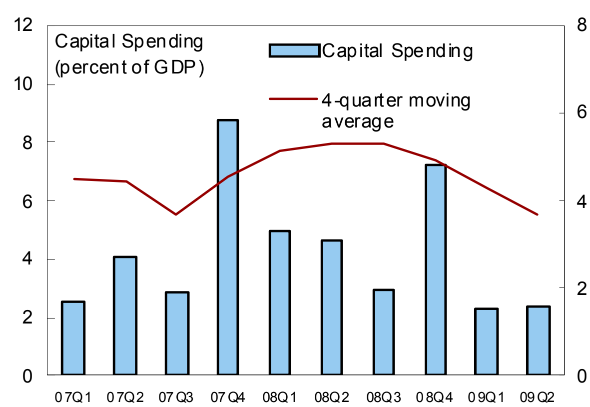
Tax collections fell across the board...



...while current expenditures fell mainly due to a decline in transfers to cover electricity subsidies...



... and capital spending was cut significantly.



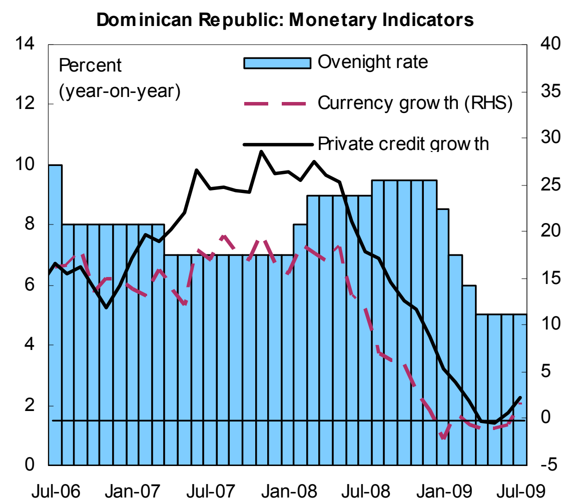
Source: Dominican Authorities; and IMF staff calculations.

- ***Revenues***. Tax collections declined by 1½ percent of GDP in 2008 due to one-off extraordinary capital gains tax in 2007 and the introduction of exemptions aimed at improving competitiveness. Non-tax revenues also fell significantly due to the decline in royalties from the main nickel mine. Tax revenues declined further in the first half of 2009 (over 10 percent in real terms) due to the deteriorating economic environment.

- ***Expenditures***. Current spending increased by 1¼ percent of GDP in 2008, mostly as a result of higher untargeted electricity subsidies due to higher world oil prices, which amounted to almost 2¾ percent of GDP. During the first half of 2009, current expenditures fell by 7 percent in real terms with capital expenditures even more depressed as financing was tight.

6. **Monetary stance**. Monetary policy has been largely countercyclical, switching form a tightening cycle in 2008 when supply shocks (food and fuel) threatened to spill over to other prices in the economy, to a loosening stance in 2009 when inflation was controlled, and the economy was softening.

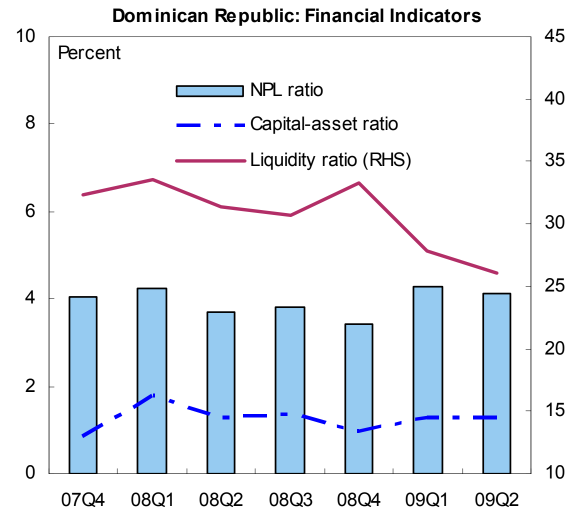
- ***Interest rates***. The overnight deposit rate—the main policy rate—was tightened by 200 basis points to 9½ percent during 2008. The policy was reversed in 2009 and the overnight rate has been reduced by 550 basis points to 4 percent by end-September 2009, and reserve requirements were also reduced from 20 to 17½ percent.



- ***Money growth***. Growth of monetary aggregates was severely restrained with money supply contracting 7½ percent in 2008, and currency in circulation remaining almost flat in 2008. However, the central bank moved to an "easy money" policy in 2009. While monetary aggregates are beginning to expand again, the additional liquidity has not translated yet to further credit to the private sector as banks and firms have acted cautiously against increased market uncertainties.

- ***Exchange rate and reserves***. The gross international reserve position of the central bank stood at about US$2½ billion at end-2008 (about 2¼ months of imports of goods and nonfactor services) with limited intervention in the foreign exchange market and a gradual weakening of the exchange rate. The Dominican peso depreciated about 3 percent against the U.S. dollar at end-2008 (yoy). During the first three quarters of 2009, the level of international reserves was relatively stable and the exchange rate depreciated further by 1½ percent against the U.S. dollar.

7. **Financial system**. Banks remain well-capitalized, liquid and profitable. The good policies of the post-crisis period have enhanced the ability of the financial system to weather this global storm. Banks continue to be liquid to insure against the uncertain global economy and in response to weak private credit demand, reducing profitability somewhat in the first half of 2009. Non-performing loans remain low but banks are concerned about a possible deterioration of asset quality in coming months as economic activity remains weak. The FSAP Update mission (conducted in February 2009) found significant improvements in prudential regulation and supervision since the 2003 crisis, but noted that soundness indicators should be taken with caution giving remaining shortcomings in regulation, supervision and accounting standards. A stress test indicated that some banks (accounting for 20 percent of the system's assets) would need additional capital under the unlikely scenario in which the economy contracts by 5 percent.



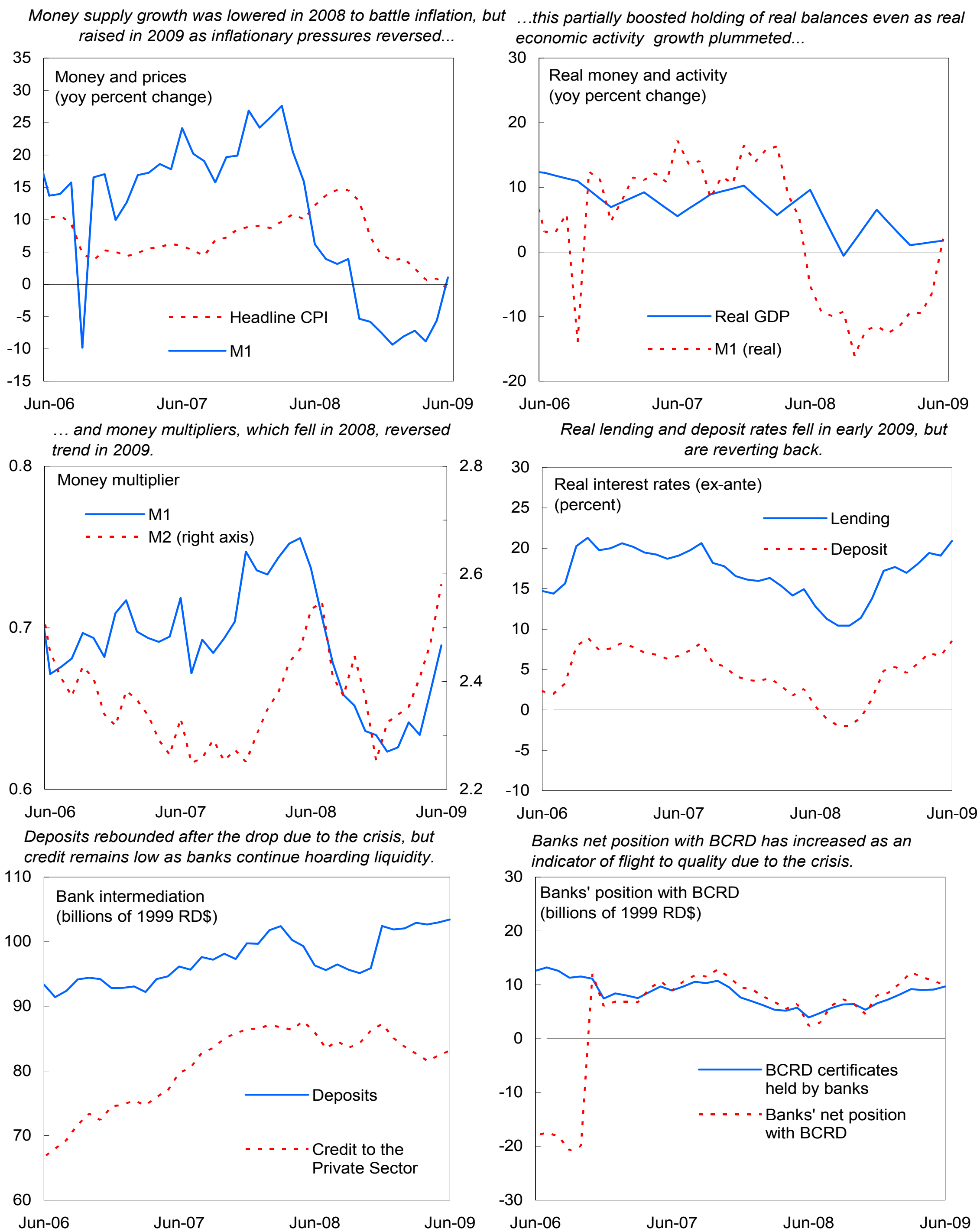
8. **External accounts**. The external position has weakened due to a number of diverse and recurrent external shocks.

- ***Current account***. A severe deterioration in the terms of trade in 2008 (due to higher food and fuel prices) and a fiscal expansion led to a sharp increase in imports and doubled the external current account deficit to nearly 10 percent of GDP. While external demand has weakened considerably, a recovery in the terms of trade (with import prices falling faster than export prices) and a depressed domestic demand has resulted in an improvement of the external current account deficit to about 6 percent of GDP in 2009.

- ***Financial account***. The large current account imbalance of 2008 was financed by record high foreign direct investment (FDI) and additional public borrowing, which limited the reserve loss to some US$300 million in 2008 (less than 1 percent of GDP). The financial account surplus is projected to be smaller in 2009 due to lower private flows as external financial conditions deteriorated.

Figure 3. Dominican Republic: Monetary Developments

Monetary policy has been expansive in 2009 in response to lower inflationary pressures and slower economic activity, but credit has not picked up as demand remains dampened.

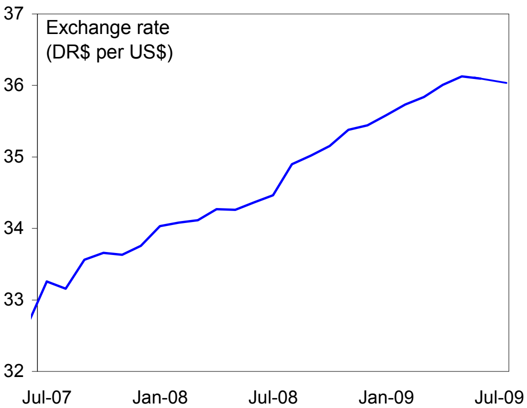


Sources: Dominican authorities; and Fund staff estimates.

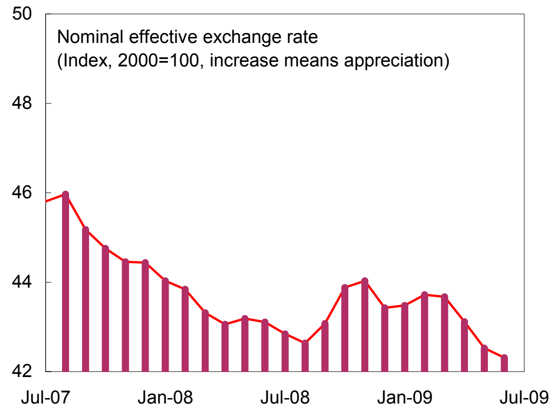
Figure 4. Dominican Republic: Exchange Rate Developments

The Dominican peso has gradually depreciated since 2008, as the Central Bank has smoothed fluctuations in the exchange rate, keeping NIR broadly unchanged.

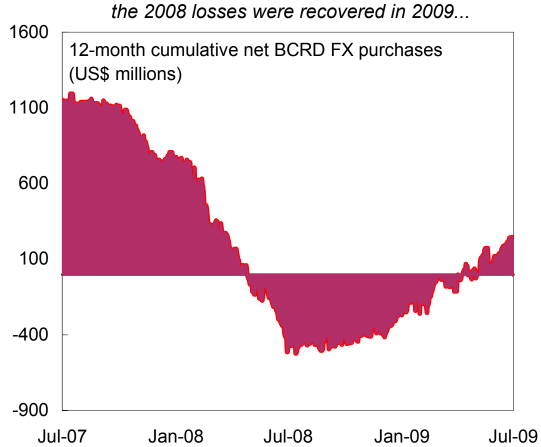
The peso depreciated slightly, since last quarter of 2008 as external conditions worsened...



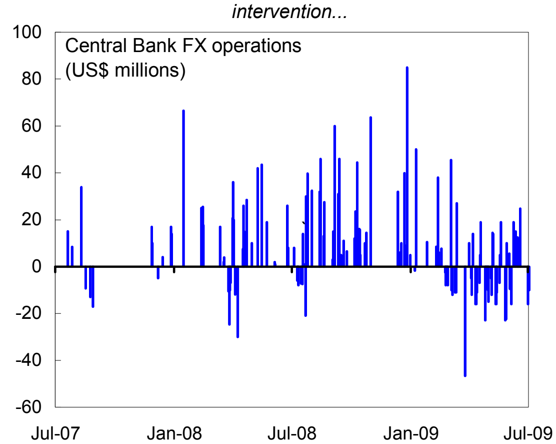
...keeping the NEER broadly stable since mid-2008.



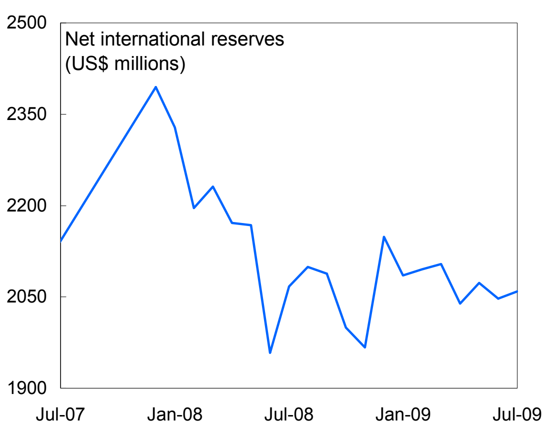
Net FX operations remained broadly unchaged as some of the 2008 losses were recovered in 2009...



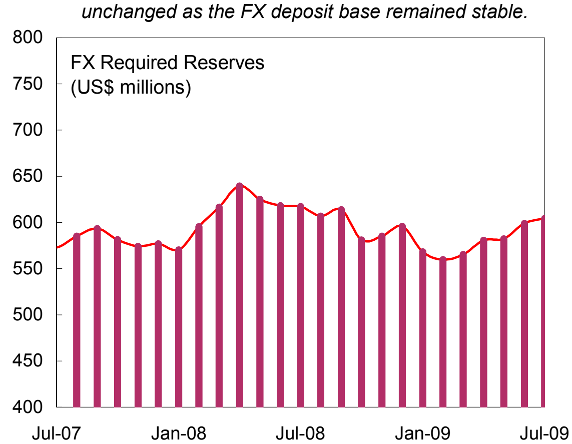
...as it smoothed the exchange rate through limited intervention...



...leaving the NIR broadly flat.

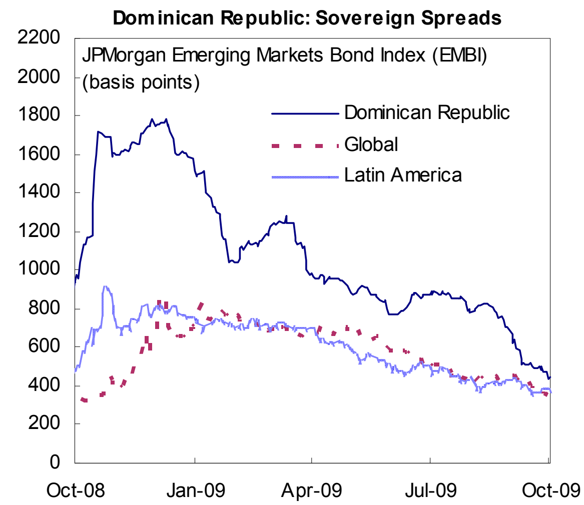


FX reserves requirements have remained broadly unchanged as the FX deposit base remained stable.



Sources: Dominican authorities; and Fund staff estimates.

- ***Sovereign spread***. Lower appetite for emerging market risk (and payment difficulties of private corporations and electricity distributors) increased spreads on sovereign bonds from under 300 basis points at end-2007 to over 1700 basis points at end-2008. Spreads fell gradually and hovered around 800-900 basis points for most of the first three quarters of 2009, but then fell significantly to below 450 basis points by early-October 2009 on the news of a possible Fund arrangement.



C. Domestic and External Landscape

9. **Outlook**. The prospects for the Dominican economy for the last quarter of 2009 and 2010 are not encouraging given the continued negative impact of the global crisis and the weak external and domestic demand. Economic conditions are expected to remain depressed, but improved policies adopted over the last few years and the sound fundamentals would make it possible for the economy to rebound gradually in the second half of 2010, once the global crisis is over. The economy is expected to bottom out at the end of 2009 and growth is expected to bounce back gradually in 2010, although it will remain below potential until 2014. Tourism is likely to be depressed in the short-run as the global economy recovers gradually and the one-off increase in tourist arrivals in the second quarter (due to the A-H1N1 influenza virus scare in Mexico) is not likely to be repeated. The high investment in mining and tourism in the past has enhanced the capacity in the economy and will facilitate a rebound once external conditions improve.

10. **Risks**. The Dominican Republic continues to be vulnerable to external shocks with risks tilted to the downside. The incipient global economic recovery could be slower than envisioned or even stall, reducing tourism receipts and exports, and opening up a financing gap in the balance of payments as well as putting pressure on the currency. Large movements in the exchange rate could affect some household and corporate balance sheets that are dollarized and could further impact consumption and growth. Tighter external financing and higher spreads on external bonds could also affect the ability to finance a larger fiscal deficit—forcing an early procyclical fiscal adjustment, and eventually depressing private sector confidence. Although banking sector indicators reveal a relatively healthy system, a large negative output gap and high unemployment could further impact bank asset quality and put stress on particular banks. While only a handful of A-H1N1 influenza cases have been reported, it could depress tourism demand further if the virus spreads quickly.

D. Social and Political Environment

11. **Tensions**. The depressed economic conditions are likely to deteriorate unemployment, poverty and social indicators in the absence of policy actions. There are some social tensions over low public salaries, and weak delivery of basic services (electricity, water, health, and public safety). Demonstrations by health care employees over salary increases have intensified and expanded to other low-paid public employees.

12. **Politics**. Political parties continue to discuss the new Constitution proposed by President Fernández that aims at modernizing the country's legal system. The new Constitution includes a chapter on the monetary authority, which enshrines Central Bank independence. A consensus has been reached to ban consecutive re-election of the president, but to allow a president to run again after four years out of office. With this provision, President Fernández will not be allowed to run for a third consecutive term in the 2012 election. Legislative elections will take place in mid-2010, but there are no polls to predict electoral preferences. These elections are particularly important as the next legislative term will last 6 years, or 2 years more than previous ones.

II. Article IV Discussions

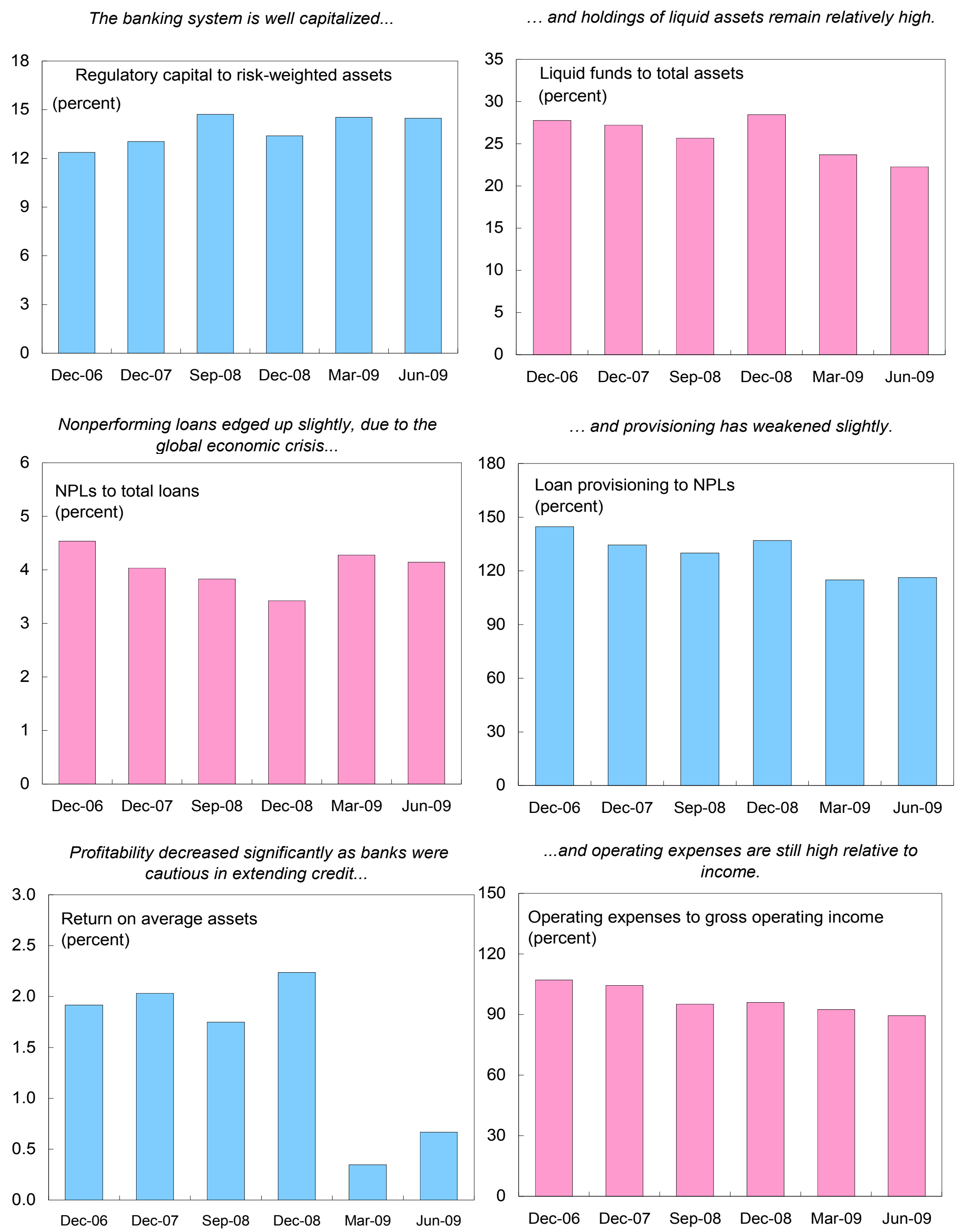
13. **Focus**. The consultation discussions focused on the viability of easing macroeconomic policies to limit the negative impact of the global economic slowdown, and to regain the path of high sustainable growth. The authorities and staff recognized the need to achieve fiscal consolidation over the medium-term; to strengthen financial institutions and regulations (as highlighted by the recent FSAP update); and to adopt longer-term structural reforms to strengthen competitiveness and enhance growth prospects. Staff stressed the need to conduct countercyclical policies while doing the necessary ground work to adopt long-term policies, including strengthening fundamentals, ensuring debt sustainability and implementing an adequate reform agenda.

A. Short-Term Macroeconomic Policies

14. **Output gap**. Standard estimation procedures indicate that output was about 2½ percent above its potential in 2008. However, estimates of potential output are subject to large uncertainties as the adoption of deep structural reforms in the aftermath of the 2003 banking crises are bound to have a permanent effect on growth fundamentals. With growth projected between ½ and 1½ percent in 2009, staff estimates that the output gap will be negative by 3 percent by end-2009, bottoming out at -5 percent around mid-2010; the authorities agreed with that assessment. The emergence of a negative output gap calls for the adoption of more supportive countercyclical policies (Box 1).

Figure 5. Dominican Republic: Financial Soundness Indicators

The banking system is well-capitalized and liquid, but nonperforming loans have slightly increased, provisioning weakened, and profitability suffered as a result of the recent global financial crises.

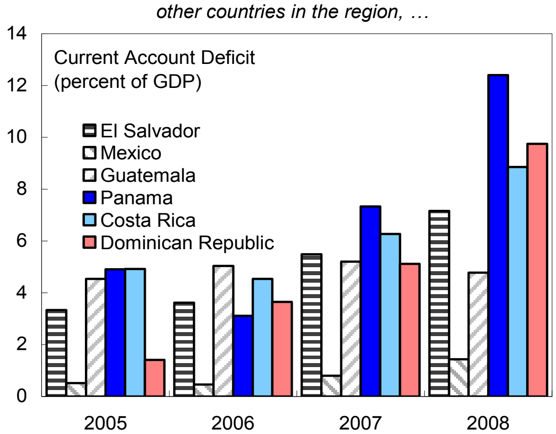


Sources: Dominican authorities; and Fund staff estimates.

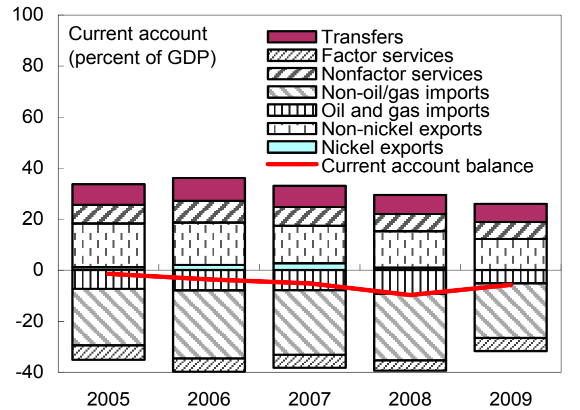
Figure 6. Dominican Republic: External Sector Developments

The external current account deficit increased significantly in 2008 due to higher energy prices. For 2009, the decline in the price of oil and import volumes will be partially offset by lower exports, tourism receipts and remittances.

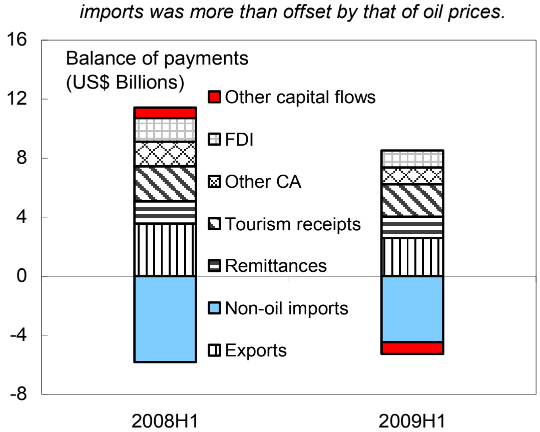
The external current account deficit increased in line with other countries in the region, …



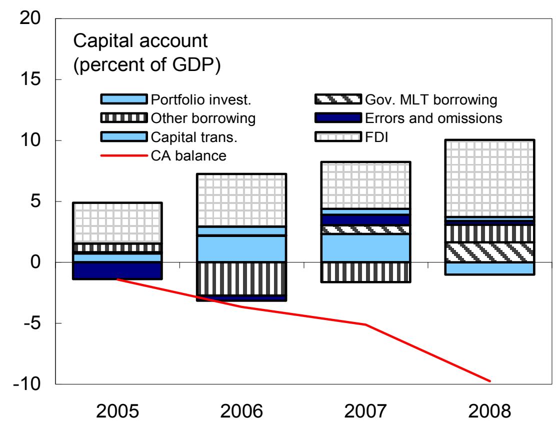
… mainly due to the increase in oil prices.



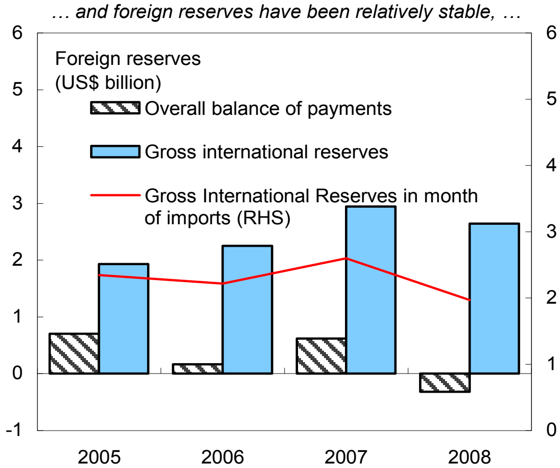
In 2009H1 the decline in exports, tourism receipts and imports was more than offset by that of oil prices.



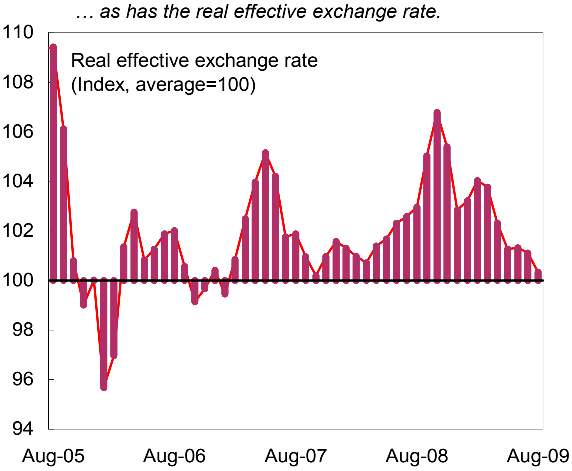
The higher current account deficit of the last few years has been financed by FDI and increased government borrowing, …



… and foreign reserves have been relatively stable, …



… as has the real effective exchange rate.



Source: Dominican Authorities; and IMF staff calculations.

15. **Fiscal impulse**. While the public finances are not ideally positioned to engage in countercyclical policies due to the large deficit of the consolidated public sector in 2008, there is a strong case for relaxing the fiscal stance in the remainder of 2009 and part of 2010, and then to start a process of fiscal consolidation once the world economy strengthens and the output gap begins to close. The 2009 budget is consistent with a consolidated fiscal deficit of 3⅓ percent of GDP. However, in the absence of adequate financing, the budget deficit could be as low as 2½ percent of GDP, implying a highly procyclical response. Staff estimates that this policy would entail a negative fiscal impulse of around 1 percent of GDP. The 2010 budget should also be framed in the context of a relaxed fiscal policy given the large and increasing negative output gap. The authorities shared staff views and concurred with the need to strengthen fiscal policy over the medium-term to return to the path of declining debt to GDP ratios.

- ***Automatic stabilizers***. While it is important to allow automatic stabilizers to work on the economic downturn, there is a risk that the decline in revenues observed in 2008-09 may be partly related to tax evasion and other abuses in the context of the tax exemptions contained in competitiveness laws. Maintaining tax revenue will thus require the development of a tax compliance strategy including sustained effort to improve tax and customs administration and rationalization of tax exemptions.

- ***Discretionary policy***. Increases in spending should be focused on social expenditures to protect the poor, and capital expenditures for the greatest fiscal multiplier effect. A large proportion of transfers continues to be taken up by the electricity sector, which will absorb over 1 percent of GDP in 2009. Electricity reform is thus crucial to free up resources for social and infrastructure investments. The authorities agreed with this analysis.

16. **Monetary easing**. There is limited scope for further cutting of the policy rate given the aggressive cuts of the first three quarters of 2009. The rapid reduction in policy rates has resulted in real short-term interest rates (ex-ante) of about zero for 2009-10. Further easing through interest rates may not be successful in boosting the real economy because of the strong liquidity preference by banks and the low demand for credit. Moreover, further easing could compromise exchange rate stability and international reserves. While the central bank should be satisfying the additional demand for liquidity, the authorities should remain vigilant and stand ready to gradually withdraw liquidity once the demand for private credit picks up. The monetary authority broadly agreed with this assessment and stressed that they have a good track record of switching their policy stance in a timely fashion.

17. **Exchange rate management**. Macroeconomic policies have been conducted in a manner that aims at relative stability of the currency. The Dominican peso has been weakening gradually against the U.S. dollar (especially since the last quarter of 2008) while remaining broadly in line with macro fundamentals in the context of their managed floating regime. The relative stability of the Dominican peso is in sharp contrast to the weaknesses in the other

currencies in the region during 2009. The central bank intervenes frequently with small amounts to reduce the variability of the exchange rate and to ensure the smooth working of the foreign exchange market, in the context of stable foreign reserves. The authorities see relative exchange rate stability as an important variable to maintain confidence. In contrast to other cases, staff does not see currency mismatches as a valid argument to prevent further exchange rate flexibility. The central bank should be prepared to allow more flexibility in the exchange rate, especially if the weaker global environment causes further pressures on the balance of payments. The authorities agreed with this assessment and pointed out that the Dominican peso has recently fluctuated much more than in previous years as a result of market forces. There was agreement that the Dominican peso is in line with fundamentals (Box 2).

B. Near-Term Financial Policies

18. **Rationale**. Given the disruptive and costly financial crisis of 2003, staff emphasized the importance of continuing strengthening the financial sector to ensure the efficient and sustainable intermediation of financial savings in the economy. The authorities acknowledged the importance of the sector and noted significant institutional strengthening since the 2003 crisis, in particular the improvement in prudential regulations and the strategy to recapitalize the Central Bank.

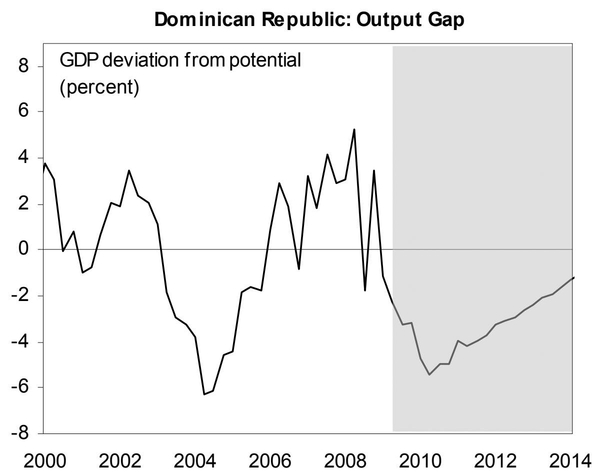
19. **Credit flow**. Credit to the private sector has been the weakest in many years as a result of the economic slowdown, bank's risk aversion, stringent credit policies, and the global credit crunch. The authorities were encouraged to maintain the lower reserve requirements to facilitate a higher supply of credit in the economy. The authorities noted that credit conditions have started to improve, with lending rates falling ten percentage points since the beginning of the year accompanying the decline in the policy rate, although they considered that they still need to maintain an expansive policy stance.

20. **Crisis management framework**. The FSAP Update mission assessed the crisis management framework as broadly appropriate, with room for improvements. In particular, the powers of the Superintendence of Banks (SB) to issue "cease and desist" orders could be established in law and the terms for the provision of lender of last resort (LOLR) assistance could be better specified. The framework is largely untested, particularly with regard to the application of the Systemic Risk Law, and therefore it is recommended that crisis simulation exercises be conducted to identify gaps, including on coordination arrangements.

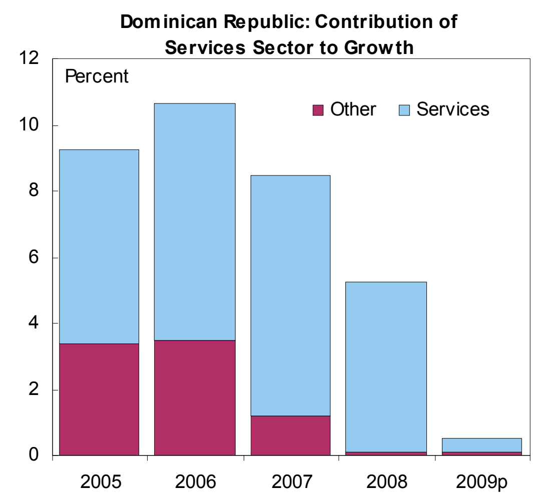
21. **Financial soundness**. Some financial soundness indicators have shown a moderate deterioration (e.g., the NPLs ratio rose to 4½ percent in August 2009 from just below 4 at end-2008), but the system remains well capitalized (with a capital adequacy ratio of 15 percent), sufficient to withstand the stress that could be associated with a more pronounced downturn. In any case, close monitoring of the situation should continue in order to ensure the system remains solid. The authorities should abstain from adopting forbearance of their norms and regulations, and the temporary removal of certain loan risk classification requirements

Box 1. Dominican Republic: Calculating the Output Gap

The methodology used to calculate the output gap is standard. The output gap is the deviation of observed output (either actual or expected) from the potential output. Observed output was calculated as the seasonally-adjusted series of the quarterly GDP data for 1999:Q1- 2009:Q2 and program projections until end-2014. Potential output was calculated by using a Hodrick-Prescott filter to a similar time series.



These calculations indicate that the Dominican economy is currently below its potential. Real GDP growth averaged 5.6 percent during 1994-2008, but is expected to be close to zero in 2009. While output was above its potential in 2008, it is estimated to have fallen below potential in 2009. It is estimated that the output gap was -2¼ percent in the second quarter of 2009 and that it will bottom out at around -5 percent by mid-2010.



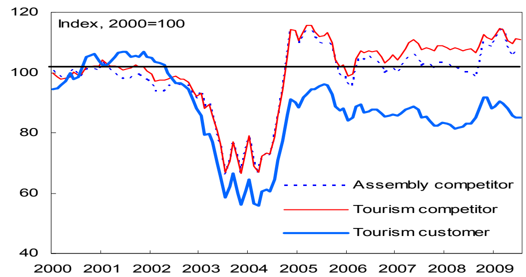
The current negative output gap is expected to be reduced along with the recovery in the global economy in the medium term. With the recovery of the global economy, Dominican output is expected to firm up and the output gap to be closed by 2014. Risks for the return of output growth to potential are mainly driven by risks in the recovery of the world economy.

The main source of growth in the past has been the services sector, and the recovery will depend on it. Services sector output is heavily driven by communications, commerce and the critical contribution of tourism, which is largely dependent on the U.S. and European economies.

Box 2. Dominican Republic: Exchange Rate Assessment

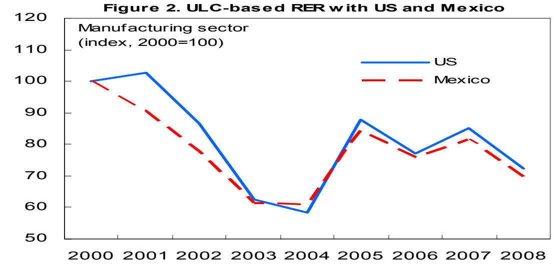
Available indicators suggest that the exchange rate is broadly in line with macroeconomic fundamentals, although there are some statistical uncertainties. A number of different indices suggest that the real exchange rate depreciated significantly in 2003-2004 in reaction to the financial crisis, but appreciated back to its pre-crisis level in 2006-2007, and remained relatively stable since then.

Figure 1. Competitor and customer-based REER



Real effective exchange rate (REER). The REER vis-à-vis manufacturing assembly competitors (mostly Central America and Mexico) and tourism competitors (Mexico and the Caribbean) appreciated somewhat in 2008-09, but the REER vis-à-vis the main tourism customer countries (Europe, the U.S. and Canada) remained more depreciated (Figure 1).

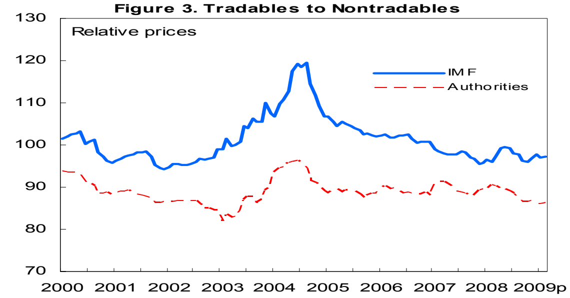
Figure 2. ULC-based RER with US and Mexico



Unit labor costs. Bilateral comparison with the US and Mexico indicates a slight real depreciation through 2008 (Figure 2).

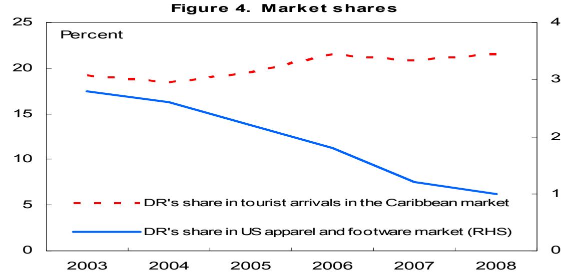
Relative price of non-tradeables. The price of tradables fell relative to non-tradables after the 2004, and is now back to the pre-crisis level (Figure 3).

Figure 3. Tradables to Nontradables



Market share. While the Dominican Republic has lost market share to Asian competitors in the U.S. apparel and footwear market, it has increased its market share in tourism vis-à-vis other Caribbean countries (Figure 4).

Figure 4. Market shares



Econometric models. These models and other analysis suggest that the exchange rate is broadly in line with macro-fundamentals. Using parameters for emerging market countries, the macro-balance approach suggests a current account deficit norm of about 4 percent of GDP. With an underlying current account deficit of about 4 percent of GDP (taking into account the temporary shocks from the global financial crisis and the projected increase in mining exports) this analysis suggests that the exchange rate is broadly in line with macroeconomic fundamentals. The external stability analysis suggests that the exchange rate is about 3 percent above (i.e., overvalued) the rate that would maintain the NFA position at its current level. The fundamental equilibrium real effective exchange rate analysis suggests that movements of the observed real effective exchange rate are not statistically different from their long-run fundamentals (although the standard errors are significant).

introduced early in the year should be allowed to lapse at end-2009.

22. **Central Bank recapitalization**. Legislation was enacted in July 2007 to gradually recapitalize the BCRD and to buttress its credibility. A capitalization of about 20 percent of GDP was expected to be done in 10 years (an average transfer of 2 percent of GDP per year). Implementation of the law ran into trouble last year, with the government falling behind in covering interest payments, in part reflecting a sharp drop in tax revenues and the limited ability of the government to access domestic capital markets. In view of these difficulties, staff supported the authorities plan to keep the spirit of the recapitalization plan but to proceed with an amendment to the law to allow for the recapitalization to take place over 15 (rather than 10) years, but cautioned that further delays could seriously erode the credibility of the central bank (Box 3).

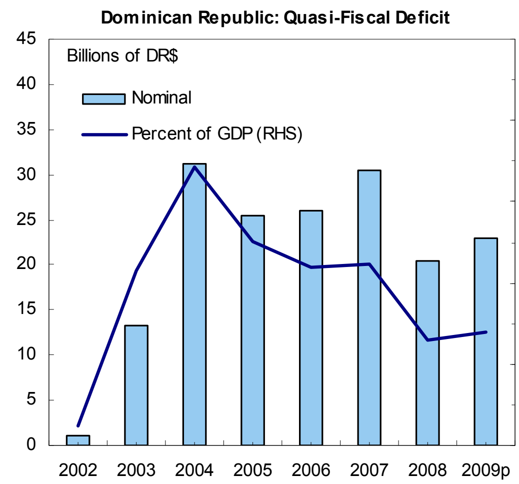
C. Medium-Term Structural Policies

23. **Fiscal issues**. It will be critical to reinvigorate structural fiscal reforms to facilitate fiscal consolidation over the medium-term. Staff pointed out that annual consolidated public sector primary surpluses of about 2 percent of GDP are needed over the medium-term to put the public debt-to-GDP ratio on a declining path and ensure debt sustainability (see Appendix 1). To reach this goal the authorities will have to review and strengthen tax policy, revenue administration, and public financial management. Tax policy priorities include measures to avoid abuse from recent tax incentives, strengthening criteria for eligibility of tax benefits on investment, reviewing appropriateness of tax rates, and rationalizing tax exemptions. Improving customs administration, including updating the customs code and related legislation, is also a priority. The authorities agreed with this assessment and mentioned that they had introduced a new framework for public financial management under the previous program, but some actions are still needed to make the framework operational, including fully implementing the treasury single account system and a medium-term budget framework. On the expenditure side, it will be critical to address the problems of the electricity sector.

24. **Monetary anchor**. Considerable work is needed to establish a proper monetary anchor. There is some confusion about the anchor followed by the central bank and the risk of pursuing multiple objectives. The introduction of a full-fledged inflation targeting regime will clarify objectives and policy instruments. It will be important to continue with the recapitalization exercise (even in a modified form) to strengthen credibility of the central bank. As intermediate steps, it will be important that the central bank establishes a credible medium-term inflation objective, commits itself to price stability, strengthens communication policy, increases transparency, and enhances accountability. A proper inflation targeting regime will anchor expectations and cement a low inflation environment. The authorities are committed to their inflation objectives (currently between 6 and 7 percent), and mentioned that they have gained

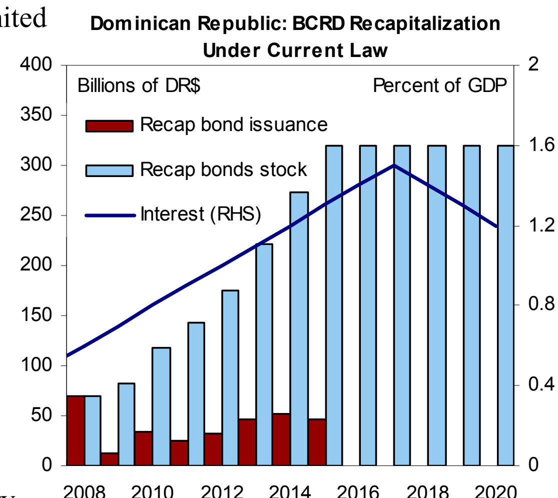
Box 3. Dominican Republic: Central Bank Recapitalization

Large interventions during the 2002-03 crisis significantly worsened the capital position of the central bank (BCRD). To control the liquidity impact of its assistance to banks (for which it received assets of uncertain quality), the BCRD issued short-term certificates and raised reserve requirements. As a result, quasi-fiscal losses increased, and the central bank's capital was eroded to an estimated minus 20 percent of GDP at end-2005. Quasi-fiscal losses in percent of GDP have declined in recent years, reflecting rapid economic growth, but they remain high in absolute terms highlighting the continued fragility of BCRD's balance sheet.



Stressing the importance of a strong capital base, the government enacted the BCRD Recapitalization Law in mid-2007, but implementation has run into problems. The law sets a ten year period to recapitalize the central bank with the pace linked to a projection of nominal GDP and the interest cost of BCRD's certificates. In particular, it mandates that budgetary transfers to cover interest on recapitalization bonds gradually rise as a proportion of expected GDP (from 0.5 percent of GDP in 2007 to 1.5 percent of GDP in 2017). However, the government was unable to meet fully its recapitalization obligations in 2008.

A lengthening of the recapitalization period is needed to ensure the government has the ability to meet its obligations. The level of budgetary transfers associated with a ten-year plan places significant strains on public finances given the limited access to capital markets. The authorities are thus considering that the recapitalization period be extended by up to 5 years, concluding no later than 2021. This extension would delay the unwinding of the stock of BCRD certificates, projected to rise for a few more years, and would result in higher quasi-fiscal losses compared to the original plan. The weaker balance sheet position may make the pursuit of other policy objectives more challenging and undermine the credibility of the Bank, particularly in making the switch to inflation targeting. In any case, it is critical that BCRD's ability to implement monetary policy not be encumbered by, for example, requiring the prior consultation of government agencies on the interest cost this may entail.



significant credibility over the last few years, but acknowledged the benefits of the inflation targeting regime.

25. **Electricity bottlenecks.** The electricity sector continues to be a major source of inflexibility for macroeconomic policy given the significant public subsidies it absorbs each year.[1] Despite recent progress made in the context of projects with the IDB and the World Bank, the electricity sector has been the Achilles heel of all reform programs. To address serious shortcomings in the sector, the authorities should aim at a comprehensive reform of the sector with the objective of generating and distributing electricity at a competitive price while at the same time eliminating indiscriminate subsidies and increasing cost recovery. This structural reform should require the appropriate legal framework and the political will to implement it. The success of such a reform hinges on: (i) enforcing the criminalization of electricity theft; (ii) revising and making more transparent the contracts between generators and (public sector owned) distributors that have traditionally resulted in energy prices much higher than costs for the distribution system; (iii) automatically adjusting consumer tariffs to reflect costs; (iv) improving governance of the public corporation and the distributors; (v) disconnecting the amount of subsidies to distributors from their losses (to encourage efficiency); and (vi) restructuring the public sector distribution companies with a view to lower their high operational costs and target their investment program in favor of higher efficiency and capacity. The authorities are aware of the inefficiencies of the current institutional framework and agreed that indiscriminate subsidies are not a cost-effective way to conduct policy.

26. **Growth impediments**. The *Doing Business 2010: Reforming through Difficult Times* report by the World Bank highlights the progress made by the country in reforming some of the impediments to growth related to business regulations. The business environment improved substantially in the area of protecting investors, reducing the overall ease of doing business ranking to 86 from 102 the previous year (out of 183 countries). The gain in the overall ranking is mostly due to the adoption of a new company law that strengthened investor security by requiring greater corporate disclosure, director liability, and shareholder access to information. Nevertheless, significant impediments still exist, particularly in the area of ease of starting and closing a business as well as registering property. While the Dominican Republic compares favorably with respect to the average for Latin America (average rank 106) and is similar to the ranking of the Caribbean region (average rank 83), the authorities intend to work with World Bank staff to ensure policies are adequate and to keep making progress in the overall ranking. Staff identified the high cost of borrowing as an impediment to growth, to start new business

[1] The government spent 2¾ percent of GDP in electricity subsidies in 2008, or about US$1.2 billion. If these resources were to be allocated each year as transfers to the poor (about 750,000 families), each family would have received US$130 a month, which would go a long way toward eliminating poverty in the country (currently estimated at about 30 percent of the population). This transfer would be more than enough to eliminate extreme poverty.

and to increase private investment in general. The authorities recognize the importance of eliminating impediments to growth and mentioned their intention to take measures to continue improving on these indices.

27. **Poverty alleviation**. Poverty is still above the pre-2003 crisis levels, and inequality remains entrenched. About a third of the population is considered to live in poverty. Some progress was made in reducing urban poverty, but less was achieved in rural areas. Moreover, spending for human development remains below regional averages, and tends to be procyclical. A conditional cash transfer (CCT) program (*Solidaridad*) has made progress in targeting the poor, but needs to expand coverage, enhance targeting, institutional organization, and identification of beneficiaries. The conditional aspect of the cash transfer program also needs to be strengthened to ensure that it improves health and nutrition indicators. The government should also strengthen the fully subsidized health insurance regime (which covers 1¼ million individuals), and should increase its coverage to reduce out-of-pocket expenditures among the poorest members of society, with a view to implement the mandates of the universal health insurance laws. The authorities agreed with the assessment and reiterated their commitment to implement polices to alleviate poverty, including under the *Solidaridad* program.

III. THE 2009-12 ECONOMIC PROGRAM

28. **Goals**. In view of the difficult economic situation, the mounting balance of payments need, and the challenging budget position, the authorities are requesting a 28-month SBA for 500 percent of quota (SDR 1,094.5 million) to support their economic program and unlock multilateral financing. The program's objectives are to pursue a countercyclical policy at the beginning of the program and then to switch focus to sustainability and structural issues in the remaining period of the program as laid out during the surveillance discussions.[2] In view of the large public sector borrowing requirements and the limited financing available, part of the Fund purchases will be directed to the budget to satisfy the public sector's external need. The program also attempts to meet a large international reserve accumulation need at the central bank coming from the relatively low level of reserves, and the uncertain external conditions. The economic program has been designed to address the macroeconomic deficiencies and institutional weaknesses identified in the current Article IV consultation (Section II). The technical assistance will be refocused to achieve structural reforms under the program.

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[2] Broadly speaking, the program will cover 10 quarters (from 2009:Q4 to 2010:Q1). Countercyclical policies will be the main policy issue in about 30 percent of the time covered by the program (Q4-2009 to Q2-2010), whereas sustainability issues will be the main policy concern in the remaining 70 percent of the time (Q3-2009 to Q1-2012).

A. Macroeconomic Management

29. **Macroeconomic framework**. The recovery of the world economy is likely to be slow and it will take some time for external demand to firm up, resulting in low remittances and a relatively weak demand for tourism and exports in the next several quarters. Against this background, the program was designed on the assumption that the economy will grow modestly in 2009 (between ½ and 1½ percent) and that there will be a gradual recovery in 2010 (2-3 percent) before growth reaches 6 percent by 2011 and beyond. The negative output gap is expected to reach its highest level around mid-2010 (about 5 percent). Low aggregate demand will not put pressure on prices and inflation is being targeted at 6-7 percent for 2009-10 (the official central bank objective) although recent developments indicate that the risks are on the downside, inflation is expected to fall gradually to 3 percent over the medium-run. The external current account deficit is expected to reach 6 percent in 2009-10 and will be moderating to 4 percent over the medium-term as exports rebound with the world economy, and fiscal consolidation efforts will reduce the debt to GDP ratio to 35 percent by 2014 (MEFP ¶ 7-9).[3]

Dominican Republic: Macroeconomic Framework

		Program		Projection	
	2008	2009	2010	2011	2012
(Annual percent change)					
Real GDP	5.3	½-1½	2-3	6.0	6.0
Inflation (e.o.p.)	4.5	6-7	6-7	4.0	3.0
Money supply	-7.5	12.1	8.8	10.8	10.5
(In percent of GDP)					
External current account	-9.7	-6.2	-6.0	-4.8	-4.0
Primary fiscal balance 1/	-1.3	-0.8	0.0	1.0	2.0
Overall fiscal balance 1/	-4.6	-4.5	-4.0	-3.0	-2.0
Public sector debt	35.5	39.0	40.3	40.2	38.7

Sources: Dominican authorities; and staff estimates; 1/ Consolidated public sector

30. **Fiscal policy**. It will be sequenced to achieve two different objectives: (i) support aggregate demand and limit the foregone output by pursuing a countercyclical policy in the short-run; and (ii) achieve a primary fiscal surplus target to ensure debt sustainability by tightening the stance over the medium-term (MEFP ¶ 11-15).

- ***Short-term countercyclical policy***. The program will accommodate a fiscal expansion in the last quarter of 2009 and the first half of 2010 to address the growing output gap. For the last

Dominican Republic: Fiscal Program
(In percent of GDP)

		Budget	Passive	Prog	Prog	Projection	
	2008		2009		2010	2011	2012
Central Government							
Revenues	**15.8**	**15.3**	**13.9**	**14.0**	**14.5**	**15.3**	**15.7**
o/w Taxes	15.0	14.8	13.6	13.6	14.1	14.7	15.1
Expenditures	**19.1**	**17.1**	**15.0**	**17.1**	**17.1**	**16.9**	**16.3**
Current	14.1	13.1	13.0	13.0	12.6	11.9	11.3
Capital	5.0	4.0	2.0	4.1	4.5	5.0	5.0
Overall balance	**-3.2**	**-1.9**	**-1.1**	**-3.1**	**-2.6**	**-1.6**	**-0.6**
Primary balance	-1.5	0.6	0.9	-1.1	-0.4	0.6	1.6
Central Bank							
Quasi-fiscal losses	**-1.3**	**-1.4**	**-1.4**	**-1.4**	**-1.4**	**-1.4**	**-1.4**
Consolidated Public Sector							
Overall balance	**-4.6**	**-3.3**	**-2.5**	**-4.5**	**-4.0**	**-3.0**	**-2.0**
Primary balance	-1.3	0.9	1.2	-0.8	0.0	1.0	2.0

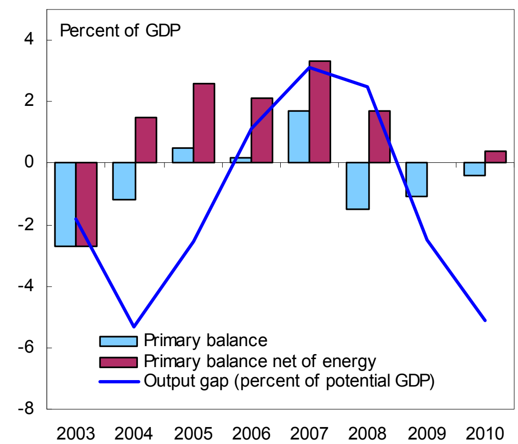
Sources: Dominican authorities; and Fund staff estimates.

[3] The number in parenthesis after the ¶ sign refers to the paragraph number in the Memorandum of Economic and Financial Policies MEFP (Attachment 2).

Box 4. Dominican Republic: Fiscal Response to the Crisis

A process of fiscal consolidation began after the 2003 crisis, aimed at reducing the consolidated public debt-to-GDP ratio from close to 60 percent of GDP to its pre-crisis level of 25 percent of GDP. This trend moderated significantly in 2008, when fiscal policy was relaxed as nickel-related and other extraordinary revenues fell, and electricity and food subsidies rose due to the steep increase in international prices. In the first half of 2009, fiscal policy was tightened again considerably as a cyclical decline in revenues and a scarcity of financing led to a sharp reduction in primary spending. Under a passive scenario this policy would have resulted in a primary surplus of 0.9 percent of GDP for the year for the Central Administration, an adjustment of almost 2 ½ percent of GDP with respect to 2008. The Fund-supported program aims to secure financing for a fiscal expansion to avoid this procyclical contraction and impart a stimulus to counteract the effects of the global crisis.

Dominican Republic: Primary Balance and Output Gap



The OECD methodology was used to derive a measure of the fiscal stance.[1] Calculations were based on the non-financial public sector non-energy primary balance as interest payments are mostly made to non-residents and changes in subsidies reflect changes in international oil prices rather than domestic demand. The primary balance is decomposed into the cyclical primary balance (the part that moves with the economic cycle) and the cyclically adjusted primary balance (the effect of discretionary policy). The change in the cyclical primary balance represents automatic stabilizers, while the change in the cyclically adjusted primary balance is the fiscal impulse.

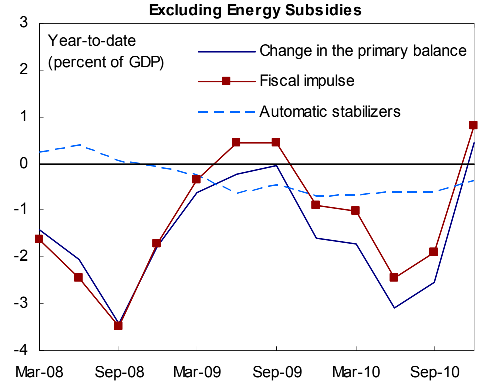
Dominican Republic: Fiscal Impulse Calculations
(In percent of GDP)

	2008	2009 Passive	2009 Prog	2010 Prog
Fiscal Stance				
A. Primary balance (B + C) 1/	1.6	2.2	0.0	0.4
B. Cyclically adjusted primary balance 1/	1.3	2.5	0.4	1.2
C. Cyclical primary balance 1/	0.4	-0.3	-0.3	-0.7
Fiscal Stimulus				
D. Primary momentum (ΔA = ΔB + ΔC) 2/	-1.8	0.6	-1.6	0.4
E. **Fiscal impulse (ΔB)** 2/	**-1.7**	**1.2**	**-0.9**	**0.8**
F. Automatic stabilizers (ΔC) 2/	-0.1	-0.6	-0.7	-0.4
Memorandum item:				
Energy subsidies	3.2	1.3	1.1	0.8
Output gap (percent of potential)	2.5	-2.5	-2.5	-5.1

Sources: Dominican authorities; and Fund staff estimates.
1/ Primary balance of the NFPS excluding energy subsidies.
2/ Negative implies an expansive policy (i.e., a reduction in the primary non-energy balance)

In the absence of a Fund-supported program, fiscal policy would be highly procyclical. In 2008, fiscal policy was very expansionary with the non-energy primary deficit increasing by 1.8 percent of GDP of which 1.7 percent of GDP was due to the fiscal impulse (see Table). The contribution of automatic stabilizers was small as the economy was estimated to be very close to potential. Under a passive scenario, fiscal policy would have been decidedly contractionary in 2009 with the primary balance rising by 0.6 percent of GDP, and a contractionary fiscal impulse of 1.2 percent of GDP. Access to financing under the Fund program will allow for a loosening of fiscal policy for 2009 of 1.6 percent of GDP, of which almost one percent of GDP (0.9 percent) will be due to the fiscal impulse. Fiscal policy will remain expansionary in the first half of 2010 but, starting mid-2010, it will return to a more sustainable stance as the economy recovers and the fiscal consolidation planned under the program begins.

Dominican Republic: Fiscal Impulse and Automatic Stabilizers Excluding Energy Subsidies

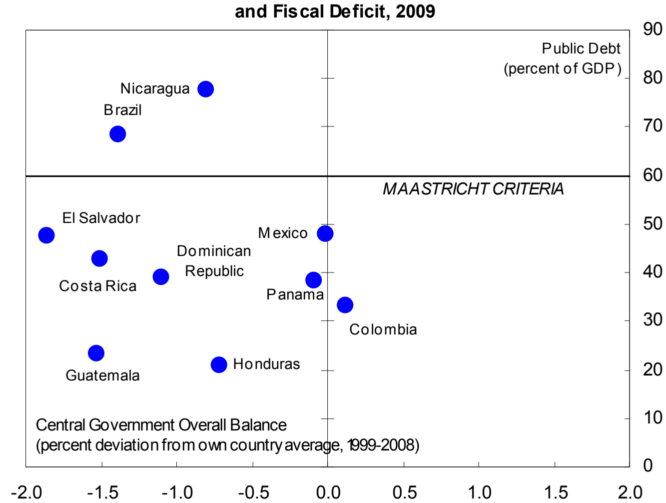


[1] Girouard and André, "Measuring Cyclically-adjusted Budget Balances for OECD Countries" OECD Economic Department Working Papers No. 434, OECD 2005, using aggregate elasticities for income and expenditure with respect to output.

quarter of 2009, the authorities' fiscal program will allow a relaxation of policies of as much as 2 percent of GDP compared to a passive scenario which assumes no program (or 1¼ percent of GDP compared to the 2009 budget). This would result in an overall public sector deficit of about 4½ percent of GDP for the year as a whole, validating lower tax collections while avoiding further cuts in capital expenditure. The higher fiscal deficit will be financed by disbursements from the World Bank, IDB and IMF as well as placements in the embryonic domestic bond market. Staff estimates that the proposed fiscal policy for 2009 will inject a fiscal impulse of almost 1 percent of GDP, which is within the norm of countries in the region. For the first half of 2010, the policy stance will continue to be supportive; the 2010 budget will be executed more quickly and the program envisages a fiscal stimulus of as much as 2 percent of GDP to contain a further widening of the output gap (Box 4). There is a risk that the fiscal stimulus of the last quarter of 2009 is not fully implemented, for that reason fiscal targets are being established on a cumulative basis for 2009 and 2010 so that the fiscal stimulus can be carried over to 2010 and is not aborted, while at the same time the quality of the spending is not compromised.

- ***Medium-term consolidation efforts***. Beginning in the second half of 2010, the policy will switch to fiscal moderation by executing the remaining 2010 budget, marking the start of the fiscal consolidation efforts. All in all, the consolidated fiscal deficit for 2010 as a whole will fall to 4 percent (which represents a withdrawal of fiscal stimulus by the end of the year). The authorities will adjust their policies to achieve a consolidated primary fiscal balance in 2010, and a consolidated primary surplus of 1 percent of GDP in 2011 and 2 percent in 2012 and later years.[4] This would constitute an improvement of over 3 percent of GDP during the program (from a consolidated primary deficit of almost 1 percent of GDP in 2009). The authorities believe that this fiscal consolidation effort can be achieved by: (i) strengthening tax and customs administrations and

Dominican Republic: Regional Comparison of Public Debt and Fiscal Deficit, 2009



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[4] While the program ends in early 2012, staff will work closely with the authorities in the preparation of the 2012 budget to ensure that it is consistent with the medium-term objective of a primary fiscal surplus of 2 percent of GDP.

Box 5. Dominican Republic: International Reserve Adequacy

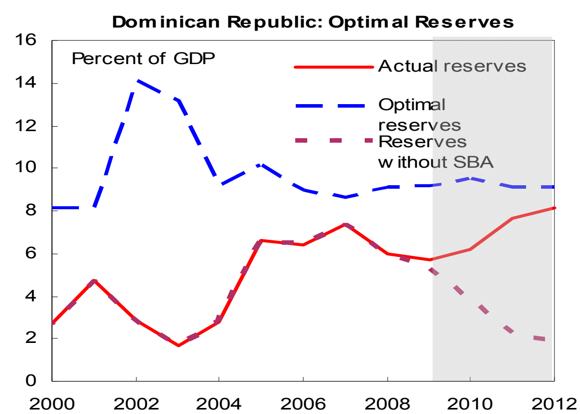
The recent global crisis has raised questions about the adequacy of international reserve levels. Gross international reserves fell from 4¾ percent of GDP in 2001 to the low level of 1¾ percent of GDP in 2003 following the financial crisis and the decline in market confidence that precipitated significant outflows. However, as policies were strengthened and confidence recovered, reserves increased to 7½ percent of GDP in 2007. The food and fuel price shock and the global crisis led to a moderate international reserve loss in 2008. A comparison with other economies in the region reveals that reserves are relatively low. The peer group of countries have larger reserves as measured by months of imports and other common benchmarks including the ratio of reserves to monetary aggregates.

Dominican Republic: Comparison of International Reserves: 2008

	In Months of Imports 1/	Percent of Broad money	Percent of Reserve Money	Percent of GDP
Dominican Republic	1.8	22.2	54.3	5.8
Costa Rica	2.8	23.0	97.5	12.8
El Salvador	2.7	25.2	…	11.0
Guatemala	3.4	29.1	89.4	8.5
Honduras	2.4	35.0	108.7	16.7
Mexico	3.4	15.5	183.3	15.5
Nicaragua	2.6	51.6	132.1	17.9
Panama	3.0	11.0	…	9.7
Regional Average	2.8	26.6	110.9	12.3

Source: International Financial Statistics; and Fund staff estimates
1/ In months of 2008 imports of goods and services.

Reserve adequacy can also be assessed with the Jeanne (2007) insurance model that estimates the optimal level of international reserves required to deal with external shocks, with the benchmark calibrations modified to reflect a higher crisis probability, given the recent financial turmoil.[1] An optimal level of reserves is derived from the trade off between the benefit of holding reserves to smooth domestic absorption in the event of a crisis and the cost of holding reserves as they earn a lower yield than the interest paid by the government on its external debt. Using this methodology, the optimal level of reserves in the Dominican Republic shot up to 14 percent of GDP during the crisis in 2002 and subsequently fell to 9 percent of GDP in 2008.



Actual reserves are below the optimal level needed to withstand a shock equivalent to all short term external debt and foreign currency deposits. The international reserves shortfall declined in the recovery phase (2005-07) and is projected to diminish again during 2009-12 under the program thanks to exchange rate flexibility, improved fundamentals and better debt management. In the absence of an SBA the gap between optimal and actual reserves would have been around 6½ percent of GDP in 2010-2012, while with the proposed program the gap would be less than 2 percent of GDP.

[1] Jeanne, Olivier, 2007, "International Reserves In Emerging Market Countries: Too Much of a Good Thing?" *Brookings Papers on Economic Activity*, 1:2007, 1-79.

streamlining the large tax exemptions (by 1½ percent of GDP)[5]; (ii) eliminating untargeted electricity subsidies (about 1 percent of GDP); and (iii) wage moderation (by about ½ percent of GDP). Public debt analysis stresses the need of fiscal consolidation over the medium-term to ensure non-explosive paths for the debt-to-GDP ratio (see Appendix I).

- ***IMF budgetary support***. The Fund is supporting the budget because there is a balance of payments need coming from the public sector which is difficult to satisfy as: (i) credit conditions globally remain tight and the government has limited access to international capital markets; (ii) the Central Bank Law prohibits public financing by the central bank, making it impossible for the central bank to satisfy the public sector's external need, even when it has access to Fund resources; and (iii) the domestic public bond market is still at an early stage of development (otherwise the central bank could provide enough liquidity to facilitate the private purchase of Treasury bonds). A special public account is being opened at the central bank to credit Fund support for the budget and the central bank will make external debt payments directly from this account on behalf of the government. All Fund purchases in support of the budget are expected to finance external debt payments; about ¼ of the SBA will be devoted to budgetary support (SDR 300 million, of which SDR 200 million will be made available in 2009 and SDR 100 million in 2010), and the remaining ¾ will go to support the international reserve position of the central bank (SDR 795 million), which still falls short of the usual metrics of adequacy (Box 5). It is estimated that the Fund will cover about 12½ percent of the financing needed for the fiscal impulse.

Dominican Republic: Public Sector Borrowing Requirements
(In billions of U.S. dollars)

	Program 2009	Program 2010	Impulse (Q4-09/ Q2-10)	% of Impulse PSBR
Requirements	**2.8**	**2.6**	**3.0**	**100.0**
NFPS Deficit	1.4	1.2	1.8	58.9
Amortizations	1.0	1.3	0.9	31.2
Floating debt	0.3	0.0	0.3	9.9
Sources	**2.8**	**2.6**	**3.0**	**100.0**
External	1.9	2.1	2.9	96.9
Budget support	1.1	0.6	1.3	44.4
World Bank	0.4	0.2	0.3	11.0
IDB	0.4	0.2	0.6	20.1
IMF	0.3	0.2	0.4	12.5
CAF	0.0	0.0	0.0	0.7
Project financing	0.5	0.7	0.8	26.0
Petrocaribe	0.2	0.3	0.2	6.5
Soverign bond	0.0	0.6	0.6	20.0
Domestic	0.9	0.4	0.1	3.1
Financing gap	**0.0**	**0.0**	**0.0**	**0.0**

Sources: Dominican authorities; and Fund staff estimates.

[5] It is estimated that the cost of all tax exemptions currently amounts to about 6 percent of GDP; the quantitatively most relevant exemptions that could be eliminated in the short-run are: (i) the value added tax on imports (0.4 percent of GDP); (ii) exemptions to hydrocarbons (0.9 percent of GDP); and (iii) tariffs (0.2 percent of GDP). Under the system of preferences for exporting industries (PROINDUSTRIA), certain firms retain the privilege of not paying VAT at the border but only after sales in the domestic market. The cost of these exemptions is estimated at 0.2 percent of GDP.

31. **Monetary policy**. The immediate policy objective will be to support aggregate demand by continuing to implement a countercyclical policy while ensuring that inflation is under control and declines gradually over the medium-term. The authorities proposed a monetary program that uses base money as the anchor. Given the low level of private credit, the central bank has reduced reserve requirement and is prepared to increase liquidity by expanding currency issue by as much as 12 percent in 2009 and 8 percent in 2010 (on the assumption that some of the 2009 liquidity injection is reversed in 2010). The growth of base money will be much lower in 2009 than in previous years due to the reduction in reserve requirements (which increases the money multiplier) but will recover in 2010. The proposed monetary program is consistent with the central bank's inflation objective of 6-7 percent for 2009-10 (MEFP ¶ 16-17).

- ***Net domestic assets (NDA)***. The central bank intends to conduct a relatively accommodative monetary policy for the rest of 2009 and most of 2010 to create the conditions for a rebound in the depressed level of private credit. There will not be an NDA ceiling for 2009 or the first half of 2010 to signal that the objective of the program is to create the conditions to restore credit in the economy and not to limit credit. However, an NDA ceiling has been set for September and December of 2010, when credit conditions are expected to have normalized. The central bank is satisfying the higher demand for liquidity through a reduction in reserve requirements and an expansion of its NDA for 2009 and 2010 (MEFP ¶ 19).

Dominican Republic: Monetary Program 1/
(In percent of base money the previous period)

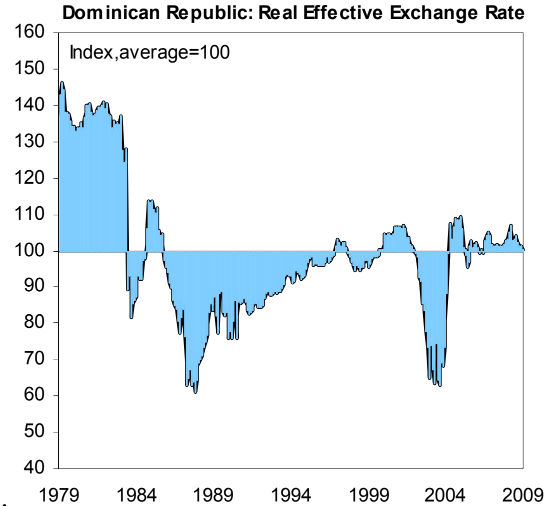
		Program		Projection	
	2008	2009	2010	2011	2012
Base Money	**9.8**	**0.4**	**8.9**	**12.0**	**12.0**
Net domestic assets	**13.8**	**7.8**	**8.9**	**0.0**	**0.0**
Public sector (net)	0.8	-0.4	0.0	0.0	0.0
Banks (net)	5.3	-14.3	-21.3	-34.3	-21.9
Private sector (non-bank)	-13.8	0.8	27.3	33.2	21.2
Other items (net)	21.5	21.7	3.0	1.0	0.7
Net international reserves	**-4.1**	**-7.5**	**0.0**	**12.0**	**12.0**

Sources: Dominican authorities; and Fund staff estimates; 1/ Central Bank Accounts.

- ***Net international reserves (NIR)***. Given the severe external shock, the program will allow for a reduction in NIR of about US$350 million in 2009. Part of the decline in NIR can be attributed to the use of US$300 million of Fund resources for budgetary support, as the government will use the resources to pay their debt service in the last quarter of 2009. For 2010, it is expected that NIR will remain flat for the year as a whole (despite the government's use of US$150 million of Fund resources for budget support) while allowing for some moderate use of reserves in the first half of the year (MEFP ¶ 18).[6] The NIR are expected to rise after 2010 as external and credit conditions normalize, reducing further vulnerabilities in the economy.

[6] The Fund support of the budget will not be recorded in the Central Bank balance sheet as a reserve liability because it will be an obligation of the central government. For program monitoring purposes, staff will adjust the Central Bank's balance sheet to record all the reserve liabilities of the country (with a corresponding peso counterpart in NDA).

32. **Exchange rate policy**. While the exchange rate has depreciated gradually in the recent past, the central bank is prepared to conduct a more flexible policy, especially if there are significant changes in market fundamentals or market pressures beyond those envisaged in the program. The central bank will intervene in the foreign exchange market only to prevent wide swings in the exchange rate due to bulky or seasonal transactions (MEFP ¶ 18).



33. **External issues**. The external current account deficit is projected to decline to around 6 percent of GDP in 2009-10 and then will continue declining during the rest of the program period, in line with the gradual recovery of the global economy, albeit some uncertainties and risks remain. Exports, tourism and remittances are expected to recover gradually, including the resumption of nickel exports, and the projected start of gold exports in 2011. As the current account deficit declines, while FDI is projected to rebound gradually, the external borrowing requirement becomes smaller, and is expected to be covered mainly by disbursements from official creditors. For 2009, the external financing requirements are expected to amount to US$3.4 billion, which will be covered mostly by private sector sources (US$1.5 billion), public sector borrowing (US$1.6 billion, the bulk of it from multilateral sources); and the Fund (US$0.3 billion)[7]. For 2010, the financing requirements will increase to US$3.9 billion, and they are expected to be covered broadly with private sector flows (US$1.5 billion), public indebtedness (US$2.0 billion, including a bond placement for US$0.6 billion), and the Fund (US$0.4 billion). Despite the larger borrowings in the short-term, external debt analysis show that once a proper adjustment period is allowed, the fundamentals will continue strengthening and the external debt-to-GDP ratio will return to a declining path (see Appendix I).

Dominican Republic: Balance of Payments
(In percent of GDP)

		Program		Projection	
	2008	2009	2010	2011	2012
Current Account	**-9.7**	**-6.2**	**-6.0**	**-4.8**	**-4.0**
Exports	14.9	11.6	12.1	12.9	13.2
Imports	-35.1	-26.7	-27.0	-26.5	-26.2
Other	10.5	8.9	8.8	8.7	9.0
Capital Account	**9.0**	**5.5**	**6.0**	**5.8**	**5.0**
Public sector (net)	1.7	2.0	2.8	1.6	0.5
Private sector (net) 1/	7.4	3.4	3.2	4.2	4.5
Overall Balance	**-0.7**	**-0.7**	**0.0**	**0.9**	**1.0**

Sources: Dominican authorities; and Fund staff estimates; 1/ Incl. errors and omissions

[7] External financing is on track to meet program projections for 2009. Public sector borrowing through end-October 2009 is estimated at about US$1.0 billion following the IDB approval of budgetary support loans of US$0.5 billion in late October. The World Bank's Board is scheduled to discuss two policy development loans for US$0.3 billion in mid-November.

34. **Adjustor**. In recognition of possible delays in disbursements from external sources, the program will accommodate transitory shortfalls in programmed external financing for up to US$300 million. Both the program ceiling on net domestic assets and the program floor on net international reserves of the central bank will be adjusted accordingly (see Technical Memorandum of Understanding, Attachment 3).

B. Institutional Strengthening

35. **Tax administration reinforcement**. Reversing the decline in tax collections of 2008-09 will require a strengthening of tax and customs administration. Staff has tentatively identified measures in this area that could improve collections without changing tax rates or tax policy, including: (i) approving a new customs code and related legislation; (ii) implementing a new organizational structure for the customs and the tax administrations; (iii) strengthening the audit function; and (iv) modernizing and simplifying customs procedures. The authorities will design a plan to strengthen customs and internal tax collections by reinforcing tax administration and rationalizing tax exemptions by March 2010. The authorities are requesting technical assistance from the Fund to help them in the design of the plan. Once the plan is designed, it will be implemented in the context of the program and key measures will become future structural benchmarks (MEFP ¶ 21-23).

36. **Basel criteria adoption**. Elimination of forbearance on regulatory requirements will be key to strengthen credibility. The Superintendence of Banks (SB) has issued most of the necessary regulations for risk-based supervision, but additional efforts are needed to achieve a complete implementation of this process. Risk-based supervision allows individual banks to take different levels of risk as long as they demonstrate the ability to manage and price those risks, a necessary condition for an efficient banking system. The initial implementation of prudential regulations on a consolidated basis and the SB's efforts to coordinate its work with other domestic financial sector supervisors is a step in the right direction. The authorities will develop a comprehensive framework for information and supervisory-practices exchange to support effective implementation. In addition, the authorities will strengthen the regulatory framework by developing, by March 2010, a plan to achieve compliance with all of the Basel core principles for effective supervision by 2012. The authorities are requesting technical assistance from the Fund for this purpose. The strategy will be implemented in the context of the program and key steps of the strategy will become structural benchmarks at a later stage (MEFP ¶ 24).

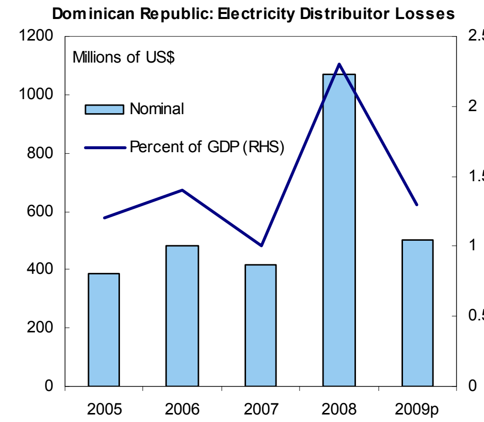
Dominican Republic: Structural Benchmarks for 2009-10

	Reform Area	Measure	Date
1.	Fiscal	Design a plan to stregthen tax administration and rationalize tax exemptions to achieve the medium-term objectives of the program	Mar 2010
2.	Financial	Develop a plan to achieve compliance with all Basel core principles for bank supervision by 2012	Mar 2010
3.	Financial	Create a plan to adopt a full-fledge inflation tageting framework by early-2012	Jun 2010
4.	Pro-Growth	Design a strategy to reform the electricity sector including by eliminating indiscriminate subsidies	Dec 2009
5.	Pro-Growth	Develop a strategy to develop domestic capital markets and reduce borrowing costs	Sep 2010
6.	Social	Increase coverage of the conditional cash transfer program to 70,000 families in extreme poverty	Dec 2009

Sources: Dominican authorities and Fund staff.

Box 6. Dominican Republic: Structural Issues in the Electricity Sector

The electricity sector in the Dominican Republic has a track record of poor performance. The distributors have been registering significant losses for many years. These losses are very high by regional standards. While losses have eventually been covered by government subsidies, the sector has failed to deliver acceptable service to the public and blackouts have become common in most parts of the country. The sector's poor performance is less due to the level of electricity tariffs, which are high by Central and Latin American standards, but more due to structural shortcomings, which have led to very low efficiency in the distribution system. The poor performance and uncertainties in the distribution system have also contributed to low investment in generation capacity.



The major structural impediments in the sector are non-technical and are related to its poor management structure. Technical losses, related to inefficient transmission of electricity, comprise only a fraction of total losses in the Dominican electricity distributors and are in line with regional averages. What differentiates the Dominican distribution system from the rest of the region is its high non-technical losses—of about 40 percent, including: theft (more than 30 percent of electricity is used illegally and for free); restrictive contracts between generators and distributors with energy prices not reflecting actual input prices; weak electricity tariff structure (adjustment mechanism is not automatic to reflect changes in costs); badly designed subsidy structure (non-focused subsidies to consumers and moral hazard for distributors due to expectation of government coverage of losses); low operating efficiency of the distribution companies; and weak financial planning (there are unnecessary delays in fulfilling financial commitments, with adverse effects on the sector and economy's risk rating).

Dominican Republic: Regional Electricity Distribution Indicators, 2005

Indicator	Dominican Republic	LAC and Caribbean	Central America	Caribbean
Profitability				
Distributional losses (%)	53	15	16	12
Technical	10	8	8	7
Non-technical	42	7	8	5
Price				
Residential tariff (US$/MWh)	140	122	112	232
Industrial tariff (US$/MWh)	146	97	101	229
Operational Efficiency				
Residential connections/employee	219	469	510	173
Electricity sold/employee (MWh)	862	2568	2969	901

Sources: World Bank; and Fund staff calculations. LAC = Latin American Countires.

Medium term policies could help tackle these structural issues in the distribution system and lower the electricity sector's adverse pressure on public finances. These include: implement the electricity theft criminalization law, install proper meters and ensure that they are not tampered with or removed, design fixed price contracts to users whose consumption is hard to monitor, rationalize the restrictive contracts between distributors and generators, make the tariff changes automatic to reflect costs, phase out non-focused subsidies and replace them with targeted ones (this has already started with the elimination of the blackout reduction program PRA and the introduction of BONOLUZ), improve operational management and governance of distribution companies, and revamp the payment system to minimize arrears to the generators. Given that public finances are currently under heavy pressure, now it is relatively more politically feasible to resolve the structural impediments in the electricity sector.

37. **Inflation targeting framework**. The authorities have been successful in controlling inflation, but it will be important to continue strengthening institutions and procedures to better anchor inflationary expectations and be able to implement a full-fledged inflation targeting framework by the end of the program. The authorities will create a plan by June 2010 to formally adopt an inflation targeting regime in early 2012. The authorities are requesting technical assistance from the Fund for this purpose. Implementation of the strategy will become structural benchmarks for the remainder of the program (MEFP ¶ 24).

38. **Electricity sector policy**. The shortcomings in the electricity sector are well known and the sector has been the weakest reform area in previous programs. The authorities intend to eliminate indiscriminate electricity subsidies by 2012. They are in the process of creating a commission led by the minister of economy to oversee all aspects of this reform. The authorities will present a strategy paper on how to conduct electricity sector reform with a view to eliminating untargeted subsidies by end-December 2009. The authorities will request technical assistance from the IDB and the World Bank for this purpose. As in other cases, implementation of the strategy will become structural benchmarks later on in the program (MEFP ¶ 26) (Box 6).

39. **Developing domestic capital markets**. While the financial system continues to improve, private investment could grow faster if borrowing costs were reduced. The authorities' efforts to achieve fiscal consolidation over the medium term will go a long way towards reducing long-term interest rates and foster private investment. However, there is room for action in the short-run as market conditions do not reflect (at times) the underlying fundamentals of the economy. To address this issue, the authorities will design by September 2010 a plan to: (i) develop capital markets; (ii) adopt a debt management strategy; and (iii) reduce the perception of country risk and the borrowing costs in the economy, including by having greater communication with international capital market participants. Implementation of the strategy will become structural benchmarks for the remainder of the program (MEFP ¶ 27).

C. Social Safety Net Reinforcement

40. **Conditional cash transfers program enhancements**. Against the background of deteriorating economic conditions, the authorities intend to strengthen significantly the social safety nets and the conditional cash transfer (CCT) programs to reduce the social cost of unemployment and other economic hardships. The government has committed to increase the expenditures for education and health by ¾ percent of GDP a year during 2010-12. In addition, the government will increase the coverage of the CCT program by 70,000 families and will increase the transfer to some 45,000 families already covered by the program by December 2009 (MEFP ¶ 28).

IV. SURVEILLANCE AND PROGRAM ISSUES

A. Medium-Term Scenario

41. **Baseline scenario**. The economy is expected to recover by 2011 and to grow at the average rate of 6 percent thereafter. The output gap is expected to disappear by 2014. Under the baseline scenario, inflation will come down gradually to align with world inflation and will stay at around 3 percent. Fiscal consolidation efforts will be completed by 2012 and the consolidated public sector will generate a primary fiscal surplus of 2 percent of GDP, enough to put the public debt-to-GDP ratio on a declining path. Public debt will go up to 40 percent of GDP in 2010-11 but will come down to 35 percent by 2014 and 30 percent by 2020. On the external front, the economy will adjust to higher oil prices and exports will rebound, in line with the world economy, reducing the external current account deficit to about 4 percent of GDP, mostly financed with private flows (especially FDI).

B. Program Modalities

42. **Access**. The severity of the shocks, the magnitude of the balance of payments need, the uncertainty created by the global crisis, and the length of the global slow down justifies having a longer and larger arrangement. The authorities and staff believe that an arrangement covering most of the remainder of President Fernandez's term will help insulate the country from undue expenditure pressures, while providing the right timing for conducting key structural reforms (i.e., electricity) and facilitating financing from other multilateral organizations. The proposed 28-month SBA amounting to SDR 1,094.5 million (500 percent of quota) would have 10 quarterly purchases. The proposed access and the quarterly purchases are designed to fully cover the balance of payment needs. It will increase the gross international reserve coverage to 3 months of imports by 2012, exceeding the peak of the last five years as the global economy recovers and uncertainties in the external environment ease. It is estimated that Fund purchases under the SBA will cover about ¼ of the balance of payments need of the country in 2009-10. The SBA will also catalyze disbursements from other international financial institutions that altogether will cover almost ¾ of the balance of payments need in the same period (with the remaining amounts being covered by the placement of a sovereign bond and the SDR allocation).

Dominican Republic: Balance of Payments Need
(In billions of U.S. dollars)

	Program		Projection	
	2009	2010	2011	2012
Sources of BOP Need	**1.4**	**1.5**	**0.9**	**0.2**
Current account deficit	2.8	2.9	2.5	2.3
Private capital account 1/	-1.3	-1.5	-2.4	-2.5
Public capital account 1/ 2/	-0.1	-0.4	-0.4	-0.3
Reserve accumulation	-0.1	0.4	1.0	0.6
IMF repurchases	0.0	0.1	0.2	0.1
Financing of BOP Need	**1.4**	**1.5**	**0.9**	**0.2**
SDR allocation	0.3	0.0	0.0	0.0
IMF (SBA)	0.3	0.5	0.7	0.2
World Bank	0.4	0.2	0.1	0.0
IDB	0.4	0.2	0.1	0.1
Sovereign bond	0.0	0.6	0.0	0.0

Sources: Dominican authorities; and Fund staff estimates.
1/ Autonomous capital inflows are recorded as a negative BOP need.
2/ Ex-ante (i.e. excludes disbursements to cover the BOP need).

43. **Safeguards assessment**. An update safeguards assessment of the *Banco Central de la Republica Dominicana* has been initiated in accordance with Fund policy. The update safeguards assessment is expected to be completed by the time of the first program review.

44. **Working groups**. The authorities intend to create an inter-institutional task force with staff from the central bank, the ministry of finance, and the ministry of economy to monitor program implementation and report to policy makers on a timely basis. In addition, there will be a program monitoring group consisting of members of the staff and the authorities to ensure that the program is properly implemented and to identify problems at an early stage. The monitoring group is expected to meet every other week through video conference and to share information and ideas.

C. Miscellaneous Issues

45. **Capacity to repay the Fund**. Notwithstanding the rather low NIR, the Dominican Republic's capacity to repay the Fund is strong. The repurchase burden remains at a comfortable level, and the DSA suggests that the relatively low level of current public debt (about 35 percent) will increase through 2012 and then decline for the rest of the decade. The Dominican Republic's debt burden is one of the lowest in the region (even after the SBA purchases). The government is fully committed to macroeconomic stability and prudent policies, and has never had arrears to the Fund.

46. **Post program monitoring**. At the time of the last SBA review in January 2008, the level of Fund credit outstanding was 190 percent of quota. In line with Fund policies (at that time) which expected countries with Fund exposure above 100 percent of quota to engage in post program monitoring (PPM), the IMF Executive Board took the decision that a PPM was needed in August 2008. The first PPM review was completed in January 2009 with the expectation that the second review would take place 6 months later. However, access limits were modified in March 2009 and the threshold for PPM was raised to 200 percent of quota. Against this background, and given the new SBA request, no further PPM is warranted.

47. **Exchange system**. The Dominican Republic has accepted the obligations of Article VIII, sections 2, 3, and 4, and does not have restrictions on payments and transfers for current international transactions nor multiple currency practices.

48. **Statistical issues**. The Dominican Republic subscribes to the General and Special Data Dissemination Standards. Economic data are generally adequate for surveillance and program monitoring, although there are several areas where data provision could be improved (including timeliness of fiscal data, accuracy of imports data, expanding private capital flows databases, measurement of credit of cooperatives, and the activities in the country of offshore branches and subsidiaries of financial groups). A Report on the Observance of Standards and Codes (ROSC) on statistical issues was presented to the IMF Executive Board in 2006.

V. Staff Appraisal

49. **Overall**. The Dominican economy has been hit by a number of exogenous shocks: the food and fuel price shock in 2008, and the global financial crisis in 2009. These shocks were unprecedented in level and scope and (at times) overwhelmed the authorities' ability to respond. The monetary authority was quick to tighten policies in 2008 to contain inflation and prevent a spill over of price pressures and inflation expectations to other goods, and then loosened policies swiftly in 2009 once the economy softened. However, the fiscal authority faced a number of inflexibilities that prevented them from reacting adequately. Price rigidities magnified electricity subsidies in 2008 to very large levels and lack of financing forced the authorities to follow an inadequate procyclical budgetary stance for the first 3 quarters of 2009 (repeating the same procyclical pattern of 2008). Nevertheless, the program designed by the authorities addresses these shortcomings by adopting a more flexible and countercyclical policy response while at the same time providing an exit strategy to reduce public indebtedness and return to long-term sustainability.

50. **Fiscal.** An adequate fiscal response is the centerpiece of the program, which aims at pursuing expansive policies in 2009-10. The Fund-supported program will catalyze financing from multilateral development banks and international capital markets. The program's fiscal stimulus is appropriate given the need to cushion the economy from the effects of the weak global economy and facilitate its recovery in the second half of 2010. However, the implementation of the program will be challenging. The authorities' ability to tap domestic and international bond markets will depend in large measure on establishing a credible track record of performance early on in the program with well-targeted expenditures (predominantly in capital and social spending). Similarly, the implementation of fiscal structural reforms and the electricity reform will greatly facilitate the achievement of the fiscal targets under the program after 2010 to bring the primary fiscal balance up to 2 percent of GDP, ensuring sustainability and lowering the debt-to-GDP ratio over the medium term. The authorities have signaled their commitment to these reforms, and they are well-advised to begin these reforms as early as possible to fully reap the benefits of these policies later on in the program.

51. **Monetary.** The central bank is quickly becoming a flexible monetary institution able to adopt appropriate policies in a timely manner. The management of policies in 2008 and 2009 demonstrated that it has come a long way from the old days of handling banking problems and financial crisis in 2003. While the pass-through from the exchange rate to prices remains high in the Dominican Republic, the central bank still needs to gradually introduce more flexibility in the exchange rate to avoid giving the impression that the monetary anchor in the economy is the exchange rate (this is especially important giving the relatively low level of gross international reserves by regional and international standards). The program proposed by the authorities will provide a good opportunity for the central bank to demonstrate that it can strengthen its policy framework and can credibly introduce an inflation targeting regime. Dollarization continues to be a challenge and it is expected to decline gradually as the policy framework is strengthened. It will be equally important that the government stand by their

commitments to finalize the recapitalization of the central bank, even if it is under a modified schedule that would require 15 rather than 10 years.

52. **Financial**. The FSAP update indicated that there have been significant improvements in the regulation, supervision and financial strength of the banking system. It has been reassuring to find out that in the middle of a global credit crunch, Dominican banks remain liquid, solvent and profitable. It will be important to continue monitoring the banking system closely and to be prepared to take the necessary measures to prevent any systemic problem.

53. **External**. The external shocks have generated large balance of payments needs that are being covered by this program. It will be important to maintain a strong implementation of the program to avoid compromising any of the secured financing. The current account deficit is expected to remain high at about 6 percent of GDP in 2009-10 and will continue to be a source of vulnerability, especially if oil prices increase beyond program projections. An additional concern is the timing of the rebound in tourism. While the world economy is expected to continue with a shallow recovery in 2010, tourism demand may take longer to pick up as potential tourists may still need to deal with high levels of indebtedness, reductions in their wealth, or lack of a job in their home countries. Over the medium term, the outlook is more positive; the Dominican Republic is believed to have relatively large mining reserves of gold that are likely to attract large direct foreign investment, which in turn will generate significant foreign exchange for the country. NIR accumulation will become significant after 2010, which would help to reduce vulnerabilities further.

54. **Structural**. The structural reform agenda is adequate, ambitious and diverse. It strikes the right balance between fiscal, financial, growth and poverty concerns. It also presents an approach that is bound to enhance ownership in the agenda by emphasizing the design of plans and strategies by the authorities themselves which they need to implement later. The proper implementation of the reform agenda will require a high degree of coordination among the different policy makers involved. This will provide an excellent opportunity for the inter-institutional working group in Santo Domingo to identify problems ahead of time and to ensure proper implementation of the program.

55. **Vulnerabilities**. There is the evident risk that the authorities may implement the first phase of the program (countercyclical policy) and not the second part (sustainability issues). However, the authorities are fully committed to the implementation of the whole program as they will be reaping the benefits of the reforms. This is a difficult program that will require a large level of coordination; there is a risk that the authorities run into capacity constraints. Early work on developing strategy papers for the implementation of structural reforms will be key to avoid slippages. In addition to the economic risks, there are also political and social uncertainties. On the economic side, the global recovery may be softer or the world economy may deteriorate further. On the political side, there are congressional elections in mid-2010 and the government may be under pressure to spend beyond program projections. On the social side, the situation is tense and pressures to increase current spending may compromise capital

expenditures and the objectives of the program. Because of these risks, it will be important that the government explain to the population all the elements of the program. In this sense, the success of the program will depend not only on the authorities determination to strongly implement the reforms contained in the program, but also on their ability to communicate policies appropriately and persuade stake holders about the merits of the policies adopted.

56. **Staff position**. On program issues, staff supports the authorities request for a new SBA. The authorities' program strikes a good balance between short-term business cycle considerations and medium-term structural and sustainability issues. Achieving the ambitious objectives of the program will require sustained efforts on the part of the authorities and the full support of the international community. On surveillance issues, staff proposes that the next Article IV consultation take place within the 24-month cycle subject to the provisions of the decision on Article IV consultation cycles.

Table 1. Dominican Republic: Selected Economic Indicators

Main export products: tourism, textiles, nickel.			
GDP per capita (U.S. dollars, 2008 PPP)	5,122	Income share by highest	
Population (millions, 2009 estimate)	10.1	10 percent (percent, 2006)	39.0
Life expectancy at birth (years, 2008)	73.3	Extreme poverty rate (2006)	13.1
Under 5 mortality rate (per thousand, 2008)	31	Adult literacy rate (percent, 2007)	95.1

				Projections			
	2006	2007	2008	2009	2010	2011	2012
National accounts and prices	**(12-month percentage changes, unless otherwise indicated)**						
Nominal GDP (RD$ billion)	1,190	1,364	1,576	1,648	1,811	2,015	2,211
Dollar GDP (US$ billion)	35.3	41.0	45.5	45.5	47.8	52.2	56.5
Real GDP	10.7	8.5	5.3	0.5-1.5	2-3	6.0	6.0
Consumer price index (period average)	7.6	6.1	10.6	1.5-2.5	6-7	5.0	3.5
Consumer price index (eop)	5.0	8.9	4.5	6-7	6-7	4.0	3.0
Exchange rate (RD$/US$ - period average)	33.7	33.3	34.6	…	…	…	…
Exchange rate (RD$/US$ - eop)	33.8	34.3	35.5	…	…	…	…
Social Indicators							
Unemployment rate (in percent)	16.4	15.6	14.0	…	…	…	…
Households below the poverty line (in percent)							
Public finances 1/	**(In percent of GDP)**						
Central government primary balance	0.2	1.7	-1.5	-1.1	-0.4	0.6	1.6
Total revenues (including grants)	16.2	17.6	15.8	14.0	14.5	15.3	15.7
Primary spending	16.0	15.8	17.4	15.1	14.9	14.7	14.1
Interest expenditure	1.4	1.6	1.7	2.0	2.2	2.2	2.2
Nonfinancial public sector overall balance	-0.9	0.1	-3.3	-3.1	-2.6	-1.6	-0.6
Quasi-fiscal balance of the central bank	-2.2	-1.8	-1.3	-1.4	-1.4	-1.4	-1.4
Consolidated public sector balance	-3.1	-1.7	-4.6	-4.5	-4.0	-3.0	-2.0
Of which: primary balance	0.4	1.8	-1.3	-0.8	0.0	1.0	2.0
Total public debt	38.3	35.8	35.5	39.0	40.3	40.2	38.7
Of which: foreign currency denominated	20.6	19.0	17.1	19.2	20.1	19.3	18.1
Money and credit	**(12-month percentage changes, unless otherwise indicated)**						
Liabilities to private sector (M3)	12.7	16.0	8.8	11.5	6.4	12.0	12.0
Currency issue	7.0	16.4	0.3	12.5	8.0	12.0	12.0
Deposits	4.5	17.0	10.7	12.0	10.2	12.0	12.0
Net domestic assets of the banking system	11.5	13.0	16.8	16.3	7.3	10.9	11.0
Credit to the private sector	14.3	26.3	8.8	6.0	11.9	12.0	12.0
M3, in percent of GDP	37.1	37.5	35.3	37.7	36.5	36.7	37.5
Balance of payments	**(In millions of U.S. dollars, unless otherwise indicated)**						
Current account	-1,288	-2,096	-4,414	-2,814	-2,891	-2,524	-2,285
Merchandise trade balance	-5,564	-6,437	-9,174	-6,881	-7,107	-7,076	-7,353
Exports	6,610	7,160	6,782	5,272	5,796	6,738	7,447
Imports	-12,174	-13,597	-15,955	-12,154	-12,903	-13,814	-14,800
Of which: oil and gas	-2,788	-3,224	-4,241	-2,640	-3,220	-3,402	-3,552
Services and transfers (net)	4,276	4,341	4,759	4,067	4,216	4,552	5,068
Of which: interest on public debt 2/	-396	-428	-372	-442	-553	-604	-668
Capital and financial account	1,598	2,359	4,008	2,135	2,891	3,004	2,822
Of which: foreign direct investment	1,528	1,579	3,076	1,966	1,863	1,993	2,116
Errors and omissions	-147	357	104	359	0	0	0
Overall balance	164	620	-303	-320	0	481	537
Of which: change in NIR (increase -)	-268	-607	230	350	0	-481	-537
Current account (in percent of GDP)	-3.6	-5.1	-9.7	-6.2	-6.0	-4.8	-4.0
Exports of goods (in US$, annual percentage chg)	7.6	8.3	-5.3	-22.3	9.9	16.2	10.5
Imports of goods (in US$, annual percentage chg)	23.3	11.7	17.3	-23.8	6.2	7.1	7.1
International reserve position and external debt							
Gross official reserves	2,251	2,946	2,662	2,566	2,942	3,914	4,506
(in months of imports) 3/	1.8	2.0	2.3	2.1	2.3	2.8	3.0
Net international reserves 4/	1,788	2,395	2,165	1,815	1,815	2,296	2,833
Outstanding external public debt, in percent of GDP	20.0	18.0	16.5	17.6	18.1	17.6	16.5
Oil price (WEO) (US$/bbl)	64.3	71.1	97.0	61.5	76.5	79.5	81.0

Sources: Dominican authorities; World Bank; and Fund staff estimates.
1/ Fiscal projections include unidentified measures.
2/ Includes interests on loans and bonds.
3/ In relation to imports of goods and nonfactor services of the following year.
4/ The projections for 2009-12 assume that all prospective purchases under the proposed SBA will be made to meet the gross reserves objectives of the balance of payments projections.

Table 2. Dominican Republic: Fiscal Accounts
(In percent of GDP)

			Budget	Passive	Jan-Sep	Year	Jan-Mar	Jan-Jun	Jan-Sep	Year	Projections	
	2007	2008	2009				2010				2011	2012
						A. Central Government						
Total revenue and grants	**17.6**	**15.8**	**15.3**	**13.9**	**10.4**	**14.0**	**3.5**	**7.2**	**10.8**	**14.5**	**15.3**	**15.7**
Total revenue	**17.4**	**15.6**	**15.1**	**13.8**	**10.3**	**13.8**	**3.4**	**7.1**	**10.6**	**14.3**	**15.1**	**15.5**
Tax revenues	16.0	15.0	14.8	13.6	10.1	13.6	3.4	7.0	10.5	14.1	14.7	15.1
Income and property 1/	4.9	4.5	4.1	4.1	3.1	4.1	1.0	2.1	3.0	4.0	4.3	4.5
VAT	4.9	4.7	4.7	4.3	3.2	4.3	1.0	2.1	3.2	4.3	4.5	4.5
Excises	4.5	4.1	4.5	3.8	2.8	3.8	0.9	1.9	3.0	4.1	4.2	4.2
International trade	1.7	1.6	1.6	1.4	1.0	1.4	0.4	0.9	1.3	1.8	1.7	1.9
Other	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Nontax revenue	1.4	0.7	0.3	0.2	0.1	0.2	0.1	0.1	0.1	0.2	0.4	0.4
Capital revenue	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Grants	**0.2**	**0.2**	**0.2**	0.1	**0.1**	**0.2**	**0.0**	**0.1**	**0.1**	**0.2**	**0.2**	**0.2**
Primary expenditures 2/	**15.8**	**17.4**	**14.7**	**13.0**	**10.1**	**15.1**	**4.1**	**8.4**	**11.6**	**14.9**	**14.7**	**14.1**
Wages and salaries	3.5	3.8	3.9	4.1	2.9	4.1	0.9	1.7	2.6	3.8	3.7	3.6
Goods and services	2.3	2.1	2.2	1.6	1.2	1.7	0.6	1.1	1.5	2.0	2.0	2.0
Transfers, *o/w* :	5.3	7.1	4.7	5.2	3.6	5.1	1.1	2.3	3.6	4.5	4.0	3.5
Gas subsidy	0.4	0.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Electricity transfers	1.2	2.7	0.8	1.3	0.9	1.1	0.2	0.4	0.6	0.8	0.4	0.0
Other	3.7	3.9	3.9	3.9	2.7	4.0	0.9	1.9	3.0	3.7	3.6	3.5
Capital expenditure	4.7	5.0	4.0	2.0	2.0	4.1	1.5	3.2	3.9	4.5	5.0	5.0
Statistical discrepancy 2/	0.0	-0.6	0.0	0.0	0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Primary balance	**1.7**	**-1.5**	**0.6**	**0.9**	**0.3**	**-1.1**	**-0.6**	**-1.1**	**-0.8**	**-0.4**	**0.6**	**1.6**
Interest	**1.6**	**1.7**	**2.4**	**2.0**	**1.4**	**2.0**	**0.3**	**0.6**	**1.3**	**2.2**	**2.2**	**2.2**
Foreign	0.9	0.8	0.8	0.7	0.5	0.7	0.1	0.3	0.5	0.9	0.9	0.9
Domestic 3/	0.7	0.8	1.7	1.3	0.9	1.3	0.1	0.3	0.9	1.3	1.3	1.3
Overall balance	**0.1**	**-3.2**	**-1.9**	**-1.1**	**-1.1**	**-3.1**	**-0.9**	**-1.7**	**-2.2**	**-2.6**	**-1.6**	**-0.6**
						B. Rest of the Non-Financial Public Sector						
Overall balance rest of NFPS 4/	**0.0**	**-0.1**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
						C. Non-Financial Public Sector (A+B)						
Overall balance NFPS	**0.1**	**-3.3**	**-1.9**	**-1.1**	**-1.1**	**-3.1**	**-0.9**	**-1.7**	**-2.2**	**-2.6**	**-1.6**	**-0.6**
Primary balance	1.7	-1.6	0.6	0.9	0.3	-1.1	-0.6	-1.1	-0.8	-0.4	0.6	1.6
Interest	1.6	-1.7	2.4	2.0	1.4	2.0	0.3	0.6	1.3	2.2	2.2	2.2
Financing NFPS	**-0.1**	**3.3**	**1.9**	**1.1**	**1.1**	**3.1**	**0.9**	**1.7**	**2.2**	**2.6**	**1.6**	**0.6**
External financing	0.5	0.2	1.7	0.5	-0.2	2.5	0.8	1.5	2.3	3.1	-0.3	-0.4
Domestic financing	-0.4	3.0	0.1	0.6	0.9	0.6	0.1	0.2	-0.1	-0.5	1.5	1.0
						D. Central Bank						
Quasi-fiscal balance of the central bank	**-1.8**	**-1.3**	**-1.4**	**-1.4**	**-1.1**	**-1.4**	**-0.4**	**-0.7**	**-1.0**	**-1.4**	**-1.4**	**-1.4**
Of which: non interest	0.1	0.4	0.3	0.3	0.2	0.3	0.1	0.2	0.3	0.4	0.4	0.4
						E. Consolidated Public Sector (C+D)						
Consolidated public sector balance	**-1.7**	**-4.6**	**-3.3**	**-2.5**	**-2.1**	**-4.5**	**-1.3**	**-2.5**	**-3.2**	**-4.0**	**-3.0**	**-2.0**
Primary balance	1.8	-1.3	0.9	1.2	0.6	-0.8	-0.5	-1.0	-0.6	0.0	1.0	2.0
Interest	3.4	3.3	4.1	3.7	2.7	3.7	0.7	1.5	2.7	4.0	4.0	4.0
Memorandum items:												
Interest for central bank recapitalization	0.4	0.6	0.8	0.6	0.5	0.6	0.2	0.4	0.6	0.8	0.9	1.0
Primary spending excl. electricity and gas	14.2	14.2	13.9	11.7	9.2	14.0	3.9	8.0	11.0	14.0	14.3	14.1
Overall spending by central government	17.4	19.0	17.2	15.0	11.5	17.1	4.4	9.0	13.0	17.1	16.9	16.3

Sources: Dominican authorities; and Fund staff estimates.
1/ Includes social security contributions. For 2007 includes the capital gains windfall of Verizon for 0.5 percent of GDP.
2/ Primary expenditures include the difference between the financing below the line and the overall balance registered above the line.
3/ Includes interest payments on Central Bank recapitalization bonds.
4/ Including electricity distribution companies (Edenorte and Edesur).

Table 3. Dominican Republic: Fiscal Accounts
(In billions of Dominican pesos)

			Budget	Passive	Jan-Sep	Year	Jan-Mar	Jan-Jun	Jan-Sep	Year	Projections	
	2007	2008	2009				2010				2011	2012
A. Central Government												
Total revenue and grants	**240.1**	**249.5**	**251.9**	**228.8**	**171.3**	**230.3**	**63.1**	**130.9**	**195.4**	**262.5**	**305.0**	**342.6**
Total revenue	**237.4**	**246.6**	**248.8**	**227.2**	**169.4**	**227.2**	**62.2**	**129.1**	**192.7**	**258.9**	**301.0**	**338.2**
Tax revenues	218.3	235.9	244.0	224.1	167.0	224.1	60.7	126.7	190.1	255.6	293.1	329.5
Income and property 1/	66.8	71.5	66.9	66.9	50.5	66.9	18.6	38.8	54.7	72.4	85.8	98.9
VAT	66.8	74.3	77.1	70.6	53.1	70.6	17.4	37.5	58.1	77.2	89.8	98.1
Excises	61.4	64.9	73.7	63.4	46.3	63.4	16.6	34.7	53.4	73.4	83.8	91.5
International trade	23.2	25.0	26.6	23.2	17.1	23.2	8.1	15.8	23.9	32.6	33.6	41.0
Other	0.0	0.1	-0.2	0.5	0.6	0.5	-0.7	0.4	0.7	0.5	5.1	5.6
Nontax revenue	19.1	10.7	4.8	3.1	2.4	3.1	1.5	2.4	2.6	3.4	8.0	8.7
Capital revenue	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.1
Grants	2.7	2.9	3.1	1.6	1.9	3.1	0.9	1.8	2.7	3.6	4.0	4.4
Primary expenditures 2/	**216.9**	**273.5**	**242.6**	**214.0**	**166.0**	**248.1**	**74.6**	**151.6**	**210.5**	**268.9**	**293.4**	**307.3**
Wages and salaries	47.7	59.5	63.8	68.4	47.0	68.3	15.6	31.4	47.0	69.7	73.9	78.5
Goods and services	31.4	33.5	35.8	26.4	20.0	28.1	10.4	20.5	27.4	36.2	39.9	43.6
Transfers, *o/w* :	72.3	111.4	77.4	86.2	59.3	84.0	20.6	41.1	65.8	80.9	79.8	76.3
Gas subsidy	5.5	7.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.0	0.0
Electricity transfers	16.4	41.9	13.5	21.9	14.9	18.1	3.6	7.2	10.9	14.5	8.0	0.0
Other	50.5	61.8	63.9	64.3	44.5	65.9	16.9	33.9	54.9	66.3	71.9	76.3
Capital expenditure	64.4	78.1	65.6	33.1	32.2	72.5	28.0	58.6	70.3	82.1	99.8	109.0
Statistical discrepancy 2/	1.4	-9.6	0.0	0.0	7.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Primary balance	**23.2**	**-24.0**	**9.3**	**14.8**	**5.4**	**-17.8**	**-11.5**	**-20.7**	**-15.2**	**-6.4**	**11.6**	**35.3**
Interest	**21.8**	**26.1**	**40.2**	**33.7**	**23.1**	**33.7**	**5.0**	**10.8**	**24.3**	**40.6**	**43.9**	**47.9**
Foreign	12.4	12.4	13.0	11.6	8.7	11.6	2.7	6.0	8.7	16.5	18.2	20.6
Domestic 3/	9.4	13.7	27.2	22.1	14.4	22.1	2.3	4.7	15.7	24.1	25.7	27.4
Overall balance	**1.4**	**-50.1**	**-30.9**	**-18.9**	**-17.7**	**-51.5**	**-16.5**	**-31.5**	**-39.5**	**-47.0**	**-32.3**	**-12.7**
B. Rest of the Non-Financial Public Sector												
Overall balance rest of NFPS 4/	**0.0**	**-1.7**	**0.0**	**0.0**	**0.3**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
C. Non-Financial Public Sector (A+B)												
Overall balance NFPS	**1.4**	**-51.8**	**-30.9**	**-18.1**	**-17.4**	**-51.5**	**-16.5**	**-31.5**	**-39.5**	**-47.0**	**-32.3**	**-12.7**
Primary Balance	23.2	-25.8	9.3	14.8	5.7	-17.8	-11.5	-20.7	-15.2	-6.4	11.6	35.3
Interest	21.8	-26.1	40.2	33.0	23.1	33.7	5.0	10.8	24.3	40.6	43.9	47.9
Financing NFPS	**-1.4**	**51.8**	**30.9**	**18.1**	**17.4**	**51.5**	**16.5**	**31.5**	**39.5**	**47.0**	**32.3**	**12.7**
External financing	6.8	2.7	28.6	8.0	-3.6	41.5	13.8	27.7	41.5	55.3	-6.0	-8.7
Domestic financing	-5.5	47.5	2.3	10.1	14.4	10.0	2.7	3.8	-2.0	-8.3	30.1	21.9
D. Central Bank												
Quasi-fiscal balance of the central bank	**-24.6**	**-20.4**	**-23.1**	**-23.1**	**-17.3**	**-23.0**	**-6.5**	**-13.5**	**-19.0**	**-25.5**	**-27.9**	**-30.5**
Of which: non interest	1.4	5.6	4.9	4.9	3.7	4.9	1.6	3.2	4.8	6.4	8.0	8.7
E. Consolidated Public Sector (C+D)												
Consolidated public sector balance	**-23.2**	**-72.1**	**-54.0**	**-41.2**	**-34.7**	**-74.5**	**-23.0**	**-45.0**	**-58.5**	**-72.5**	**-60.2**	**-43.2**
Primary Balance	24.6	-20.2	14.2	19.8	9.4	-12.9	-9.9	-17.6	-10.4	0.0	19.6	44.0
Interest	46.4	52.0	68.2	61.0	44.1	61.6	13.1	27.4	48.1	72.5	79.8	87.2
Memorandum items:												
Interest for central bank recapitalization	5.8	9.1	12.4	9.7	6.2	12.4	3.5	7.0	10.4	13.9	17.4	21.6
Primary spending excl. electricity and gas	195.1	223.9	229.1	192.1	151.1	230.0	71.0	144.4	199.6	254.3	285.4	307.3
Overall spending by central government	238.7	299.6	282.8	247.7	189.0	281.8	79.6	162.4	234.9	309.5	337.3	355.2

Sources: Dominican authorities; and Fund staff estimates.
1/ Includes social security contributions. For 2007 includes the capital gains windfall of Verizon for 0.5 percent of GDP.
2/ Primary expenditures include the difference between the financing below the line and the overall balance registered above the line.
3/ Includes interest payments on Central Bank recapitalization bonds.
4/ Including electricity distribution companies (Edenorte and Edesur).

Table 4. Dominican Republic: Public Sector Gross Financing Requirements and Sources

(In millions of U.S. dollars)

	Q1	Q2	Q3	Q4	Annual	Q1	Q2	Q3	Q4	Annual	Projection	
	2009					2010					2011	2012
Gross Financing Requirements	**522**	**334**	**402**	**1,500**	**2,758**	**769**	**730**	**545**	**532**	**2,576**	**2,179**	**1,434**
Non-Financial Public Sector Deficit	236	105	135	935	1,411	**435**	**395**	211	198	1,239	837	323
Amortizations	286	229	267	267	1,049	334	334	334	334	1,337	1,342	1,111
Floating Debt	0	0	0	298	298	0	0	0	0	0	0	0
Financing Sources	**522**	**334**	**402**	**1,500**	**2,758**	**769**	**730**	**545**	**532**	**2,576**	**2,179**	**1,434**
External	**152**	**110**	**247**	**1,384**	**1,892**	**986**	**578**	**352**	**218**	**2,135**	**1,380**	**1,225**
Budget Support	20	0	60	1,039	1,119	83	253	188	53	575	210	50
World Bank	20	0	0	330	350	0	0	150	0	150	100	0
IDB	0	0	60	389	449	15	215	0	15	245	110	50
CAF	0	0	0	20	20	30	0	0	0	30	0	0
IMF	0	0	0	300	300	38	38	38	38	150	0	0
Project Financing	90	41	123	280	533	238	261	100	101	700	900	900
Petrocaribe	42	69	64	65	240	65	65	65	65	260	270	275
Sovereign Bonds	0	0	0	0	0	600	0	0	0	600	0	0
Domestic	**370**	**224**	**155**	**117**	**866**	**-217**	**151**	**193**	**314**	**441**	**799**	**209**
Bonds	84	137	147	-14	353	-217	151	73	314	321	799	209
Banking system	243	87	8	131	470	0	0	0	0	0	0	0
Arrears	67	42	0	-109	0	0	0	0	0	0	0	0
Other	-24	-42	0	109	43	0	0	120	0	120	0	0
Gap	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**

Sources: Dominican authorities; and Fund staff estimates.

Table 5. Dominican Republic: Summary Accounts of the Monetary Authority 1/

(In billions of Dominican pesos, unless otherwise specified)

			Sep	Dec	Mar	Jun	Sep	Dec	Projections	
	2007	2008	2009 2/		2010 2/				2011 2/	2012 2/
Monetary base	**121.9**	**133.8**	**120.0**	**134.3**	**127.0**	**127.7**	**127.6**	**146.3**	**163.8**	**183.4**
Currency issue	62.3	62.5	54.0	70.3	61.7	60.8	58.9	75.9	85.0	95.2
Reserve requirements (peso deposits)	59.6	71.3	66.0	64.0	65.4	66.9	68.7	70.4	78.7	88.2
Net international reserves	**81.3**	**76.3**	**81.8**	**66.3**	**62.6**	**60.8**	**62.6**	**66.3**	**83.8**	**103.4**
(In millions of U.S. dollars) 3/	2394.9	2165.4	2241.7	1815.4	1715.4	1665.4	1715.4	1815.4	2295.9	2832.9
Net domestic assets	**40.7**	**57.5**	**38.2**	**68.0**	**64.4**	**66.9**	**65.0**	**80.0**	**80.0**	**80.0**
Nonfinancial public sector (net) 4/	3.6	4.6	4.0	4.0	4.0	4.0	4.0	4.0	4.0	4.0
Central government	0.6	1.5	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Rest of NFPS	3.1	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0
Commercial banks (net)	-57.9	-51.5	-94.0	-70.6	-83.7	-100.3	-113.4	-99.2	-149.3	-185.2
Monetary control notes and bills	-32.7	-25.6	-65.0	-40.3	-51.7	-67.6	-79.9	-64.2	-110.5	-142.2
Reserve requirements (FX deposits)	-19.6	-21.0	-22.5	-23.2	-24.6	-25.0	-25.4	-26.4	-27.9	-29.6
Overnight facility	-12.7	-14.6	-13.5	-14.1	-14.4	-14.7	-15.1	-15.7	-17.9	-20.4
Liquidity support	7.1	9.7	7.0	7.0	7.0	7.0	7.0	7.0	7.0	7.0
Nonfinancial private sector (certificates)	-144.1	-160.9	-166.4	-159.8	-151.3	-133.4	-123.7	-123.2	-74.6	-39.9
Other items (net) 5/	239.0	265.3	294.6	294.5	295.5	296.6	298.1	298.4	300.0	301.2
Recapitalization account	232.9	262.6	290.4	290.4	290.4	290.4	290.4	290.4	290.4	290.4
Accumulated profits and losses	22.5	18.1	15.7	20.7	21.3	21.8	22.4	23.0	25.8	28.6
Peso counterpart to IMF budget support				11.0	12.3	13.7	15.1	16.4	16.4	16.4
Other, net	-16.3	-15.4	-11.5	-27.6	-28.5	-29.3	-29.8	-31.4	-32.7	-34.2
					(Percentage change, y-o-y)					
Memorandum items:										
Monetary base	13.7	9.7	-0.4	0.4	2.5	5.1	6.3	8.9	12.0	12.0
Currency issue	16.4	0.3	3.0	12.5	11.0	10.0	9.0	8.0	12.0	12.0
Quasi-fiscal balance (in percent of GDP)	-2.2	-1.3	-1.1	-1.4	-0.3	-0.6	-0.9	-1.4	-1.4	-1.4

Sources: Dominican authorities; and Fund staff estimates.

1/ The Central Bank's balance sheet is adjusted to incorporate the reserve liability that emerges from the IMF budgetary support for 2009 and onwards.

2/ Foreign currency denominated accounts valued at DR$36.5 per U.S. dollar.

3/ Projections for 2009-12 assume SBA purchases are made.

4/ Excludes transfers related to Central Bank recapitalization.

5/ Includes transfers related to Central Bank recapitalization.

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

			Sep	Dec	Mar	Jun	Sep	Dec	Projections	
	2007	2008	2009 2/		2010 2/				2011 2/	2012 2/
					Central Bank 1/					
Monetary base	**121.9**	**133.8**	**120.0**	**134.3**	**127.0**	**127.7**	**127.6**	**146.3**	**163.8**	**183.4**
Currency issue	62.3	62.5	54.0	70.3	61.7	60.8	58.9	75.9	85.0	95.2
Reserve requirements (peso deposits)	59.6	71.3	66.0	64.0	65.4	66.9	68.7	70.4	78.7	88.2
Net international reserves	**81.3**	**76.3**	**81.8**	**66.3**	**62.6**	**60.8**	**62.6**	**66.3**	**83.8**	**103.4**
(In millions of U.S. dollars) 3/	2394.9	2165.4	2241.7	1815.4	1715.4	1665.4	1715.4	1815.4	2295.9	2832.9
Net domestic assets	**40.7**	**57.5**	**38.2**	**68.0**	**64.4**	**66.9**	**65.0**	**80.0**	**80.0**	**80.0**
Nonfinancial public sector (net) 4/	3.6	4.6	4.0	4.0	4.0	4.0	4.0	4.0	4.0	4.0
Commercial banks (net)	-57.9	-51.5	-94.0	-70.6	-83.7	-100.3	-113.4	-99.2	-149.3	-185.2
Nonfinancial private sector (certificates)	-144.1	-160.9	-166.4	-159.8	-151.3	-133.4	-123.7	-123.2	-74.6	-39.9
Other items (net) 5/	239.0	265.3	294.6	294.5	295.5	296.6	298.1	298.4	300.0	301.2
					Banking System					
Net foreign assets	**123.7**	**103.4**	**109.1**	**93.5**	**91.1**	**89.3**	**91.1**	**94.8**	**112.3**	**131.9**
(In millions of U.S. dollars)	3649.8	2886.1	2993.4	2567.0	2467.0	2417.0	2467.0	2567.0	3047.5	3584.5
Net domestic assets	**388.2**	**453.5**	**483.7**	**527.3**	**526.2**	**524.2**	**537.0**	**565.7**	**627.3**	**696.2**
Net credit to the nonfinancial public sector	233.9	288.3	334.3	338.3	339.5	340.7	341.9	341.9	360.1	361.4
Of which : excluding quasi-fiscal related	1.1	25.7	43.9	47.9	49.1	50.3	51.5	51.5	69.7	71.0
Credit to the private sector	259.1	281.9	278.0	298.9	297.4	305.4	309.2	334.5	374.6	419.6
Medium- and long-term external liabilities	-11.6	-10.5	-9.7	-9.7	-9.7	-9.7	-9.7	-9.7	-9.7	-9.7
Capital and accumulated surplus	15.8	6.2	3.2	8.2	8.7	9.3	9.9	10.4	13.3	16.0
Other assets net (includes valuation effects)	-109.0	-112.4	-122.1	-108.5	-109.8	-121.5	-114.3	-111.4	-111.1	-91.2
M3	**511.9**	**556.9**	**592.8**	**620.8**	**617.4**	**613.5**	**628.2**	**660.5**	**739.6**	**828.1**
Currency in circulation	51.2	51.7	44.5	57.6	50.7	49.7	48.3	61.8	68.9	76.9
Deposits	298.9	330.9	355.9	370.7	377.7	385.2	392.9	408.5	457.7	512.7
Central bank certificates held outside banks	161.7	174.3	192.4	175.9	172.0	160.4	155.7	148.8	118.8	96.8
Commercial bank certificates held by the public 6/				16.5	16.9	18.2	31.4	41.3	94.1	141.7
					(Percentage change, y-o-y)					
Memorandum items:										
Credit to the private sector	26.3	8.8	8.8	6.0	9.3	9.5	11.2	11.9	12.0	12.0
Deposits	17.0	10.7	12.0	12.0	11.4	11.0	10.4	10.2	12.0	12.0
M3	16.0	8.8	10.1	11.5	10.0	6.6	6.0	6.4	12.0	12.0
M3 Velocity	2.7	2.8	2.7	2.7	2.7	2.9	2.8	2.7	2.7	2.7

Sources: Dominican authorities; and Fund staff estimates.
1/ The Central Bank's balance sheet is adjusted to incorporate the reserve liability that emerges from the IMF budgetary support for 2009 and onwards.
2/ Foreign currency denominated accounts valued at DR$36.5 per U.S. dollar.
3/ Projections for 2009-12 assume SBA purchases are made.
4/ Excludes transfers related to Central Bank recapitalization.
5/ Includes transfers related to Central Bank recapitalization.
6/ For 2010 onwards, projections assumes that private banks issue certificates to the public, so that the sum of certificates of the banking system in hands of the public grows at an annual rate of 10 percent.

Table 7. Dominican Republic: Selected Financial Soundness Indicators of the Banking System
(In percent)

	2006	2007	2008	March 2009	June 2009
Capital adequacy					
Net worth to total assets	10.0	9.5	9.7	8.7	9.2
Regulatory capital to risk-weighted assets	12.4	13.0	13.4	14.5	14.5
Asset quality					
Loan growth	24.7	27.1	15.3	16.5	15.0
NPLs to total loans	4.5	4.0	3.5	4.3	4.1
Loan provisions to NPLs	144.7	134.5	133.1	114.9	116.3
NPLs net of provisions to net worth	-10.8	-8.2	-7.2	-4.2	-4.3
Fixed and net foreclosed assets to net worth	52.0	57.2	58.0	60.9	57.4
Earnings and efficiency					
Return on average assets	1.9	2.0	2.1	0.3	0.7
Return on average equity	19.7	21.3	21.4	3.9	7.0
Gross operating income to average assets	9.9	9.8	2.4	0.4	0.8
Financial margin to average assets	6.8	6.7	6.9	1.3	2.7
Operating expenses to net financial margin	107.1	104.4	96.3	92.4	89.4
Liquidity					
Liquid funds to deposits	33.0	32.3	33.1	27.8	26.0
Liquid funds to total assets	27.7	27.2	28.4	23.7	22.3

Sources: Dominican authorities; and Fund staff estimates.

Table 8. Dominican Republic: Balance of Payments

(In millions of U.S. dollars, unless otherwise specified)

			Projections					
	2007	2008	2009	2010	2011	2012	2013	2014
Current account	**-2,096**	**-4,414**	**-2,814**	**-2,891**	**-2,524**	**-2,285**	**-2,518**	**-2,543**
Trade balance	-6,437	-9,174	-6,881	-7,107	-7,076	-7,353	-8,081	-8,893
Exports f.o.b.	7,160	6,782	5,272	5,796	6,738	7,447	7,826	8,221
Of which: nickel	1,099	492	0	232	370	232	218	204
Of which: gold	0	0	0	0	488	1,000	1,025	1,050
Imports f.o.b.	-13,597	-15,955	-12,154	-12,903	-13,814	-14,800	-15,906	-17,114
Of which: oil and gas	-3,224	-4,241	-2,640	-3,220	-3,402	-3,552	-3,763	-4,002
Nonfactor services	3,021	3,114	2,868	2,969	3,227	3,577	3,993	4,460
Of which: travel receipt	4,064	4,176	3,885	3,936	4,271	4,698	5,205	5,772
Factor services	-2,081	-1,781	-1,985	-2,051	-2,243	-2,451	-2,803	-2,963
Of which: interest on public debt 1/	-428	-372	-442	-553	-604	-668	-824	-766
Transfers	3,401	3,425	3,185	3,297	3,568	3,942	4,374	4,853
Capital and financial account	**2,359**	**4,008**	**2,135**	**2,891**	**3,004**	**2,822**	**3,122**	**3,218**
Capital account	195	143	86	106	292	310	333	355
Financial account	2,163	3,865	2,049	2,785	2,712	2,512	2,789	2,863
Direct investment, net	1,579	3,076	1,966	1,863	1,993	2,116	2,442	2,531
Portfolio investment, net	954	-457	-563	241	100	100	100	100
Other investment, net	-369	1,246	646	680	620	296	248	232
Of which: public sector MLT, net	294	756	927	751	628	301	261	283
Disbursements	942	1,364	1,593	1,385	1,380	1,225	1,175	1,175
Amortization	-648	-608	-666	-634	-752	-924	-914	-892
Other	-663	491	-280	-71	-8	-6	-13	-51
Of which: SDR allocation			266					
Errors and omissions	357	104	359	0	0	0	0	0
Overall balance	**620**	**-303**	**-320**	**0**	**481**	**537**	**604**	**675**
Financing	**-620**	**303**	**320**	**0**	**-481**	**-537**	**-604**	**-675**
Change in NIR (increase, -)	-607	230	350	0	-481	-537	-604	-675
Change in GIR (increase, -)	-695	284	96	-376	-971	-593	-351	-142
Net Fund purchases	63	-42	254	376	491	56	-254	-534
Exceptional financing	-4	58	-30	0	0	0	0	0
Debt rescheduling	34	0	0	0	0	0	0	0
Debt foregiveness	11	9	4	0	0	0	0	0
Net change in arrears	-49	50	-34	0	0	0	0	0
Memorandum items:								
Current account in percent of GDP	-5.1	-9.7	-6.2	-6.0	-4.8	-4.0	-4.1	-3.8
Non-oil-gas current account in percent of GDP	2.8	-0.4	-0.4	0.7	1.7	2.2	2.0	2.2

Sources: Dominican authorities; and Fund staff estimates.

1/ Includes interests on loans and bonds.

Table 9. Dominican Republic: External Financing Requirements and Sources

(In millions of U.S. dollars)

	2008	Projections 2009	2010	2011	2012
Financing requirement	**4,739**	**3,384**	**3,901**	**4,247**	**3,802**
Current account deficit	4,414	2,814	2,891	2,524	2,285
Amortization of public sector medium- and long-term loan	608	666	634	752	924
Change in gross reserves (increase =+)	-284	-96	376	971	593
Financing sources	**4,739**	**3,384**	**3,901**	**4,247**	**3,802**
Capital transfer	143	86	106	292	310
Foreign Direct Investment, net	3,076	1,966	1,863	1,993	2,116
Portfolio investment, net	-457	-563	241	100	100
Public sector medium- and long-term loans	1,364	1,593	1,385	1,380	1,225
Net Fund purchases	-42	254	376	491	56
Other 1/	655	48	-71	-8	-6

Sources: Dominican authorities; and Fund staff estimates.

1/ Includes other private capital flows, exceptional financing and errors and omissions.

Table 10. Dominican Republic: Indicators of External Vulnerability

	2006	2007	2008	Proj. 2009
Merchandise exports (percentage change)	7.6	8.3	-5.3	-22.3
Merchandise imports (percentage change)	23.3	11.7	17.3	-23.8
Real effective exchange rate (percentage change, appreciation -)	-5.2	1.8	1.4	1.5
Current account balance (percent of GDP)	-3.6	-5.1	-9.7	-6.2
Capital and Financial account balance (percent of GDP)	4.5	5.8	8.8	4.7
Foreign direct investment, net (percent of GDP)	4.3	3.9	6.8	4.3
Portfolio investment, net (percent of GDP)	2.2	2.3	-1.0	-1.2
Other investment, net (percent of GDP)	-2.7	-0.9	2.7	1.4
External debt (percent of GDP)	24.9	25.2	25.1	26.9
Debt service (in percent of exports of GNFS) 1/	15.2	13.9	17.0	18.8
Gross reserves (in millions of U.S. dollars)	2,251	2,946	2,662	2,566
Gross reserves (in months of imports of GNFS)	1.8	2.0	2.3	2.1

Sources: Dominican authorities; and Fund staff estimates.
1/ Interest payments and medium- and long-term debt amortization.

Table 11. Dominican Republic: Schedule of Reviews and Purchases

Date	Amount of Purchase 1/				Conditions
	Millions of SDRs				
	Central Bank	Ministry of Finance	Total	Percent of Quota	
Board approval	0.00	200.00	200.00	91.4	Approval of arrangement
March 15, 2010	54.27	25.00	79.27	36.2	First review and end-December 2009 performance criteria
June 15, 2010	54.27	25.00	79.27	36.2	Second review and end-March 2010 performance criteria
September 15, 2010	54.26	25.00	79.26	36.2	Third review and end-June 2010 performance criteria
December 15, 2010	84.45	25.00	109.45	50.0	Fourth review and end-September 2010 performance criteria
March 15, 2011	109.45	0.00	109.45	50.0	Fifth review and end-December 2010 performance criteria
June 15, 2011	109.45	0.00	109.45	50.0	Sixth review and end-March 2011 performance criteria
September 15, 2011	109.45	0.00	109.45	50.0	Seventh review and end-June 2011 performance criteria
December 15, 2011	109.45	0.00	109.45	50.0	Eighth review and end-September 2011 performance criteria
February 28, 2012	109.45	0.00	109.45	50.0	End-December 2011performance criteria
Total	**794.50**	**300.00**	**1094.50**	**500.0**	

Source: Fund staff estimates.
1/ All purchases are made by the member country. The split between the Central Bank and the Ministry of Finance reflects the intention of the member

Table 12. Dominican Republic: Indicators of Capacity to Repay the Fund

	2008	2009	2010	2011	2012	2013	2014
		Projections					
Fund repurchases and charges							
In millions of SDRs	119.2	35.3	105.5	123.8	87.4	183.1	366.9
In millions of U.S. dollars	188.4	53.0	158.3	185.7	131.1	274.6	550.4
In percent of exports of goods and nonfactor services (GNFS)	1.6	0.5	1.5	1.6	1.0	2.0	3.7
In percent of external public debt service	13.3	2.7	10.0	10.5	7.1	12.4	22.4
In percent of quota	54.5	16.1	48.2	56.5	39.9	83.6	167.6
In percent of gross international reserves	7.1	2.1	5.4	4.7	2.9	5.7	11.0
Fund credit outstanding							
In millions of SDRs	319.6	488.9	739.9	1,066.9	1,104.1	935.1	579.3
In millions of U.S. dollars	505.0	733.4	1109.8	1600.4	1656.2	1402.6	869.0
In percent of exports of goods and nonfactor services (GNFS)	4.3	7.4	10.6	13.6	12.8	10.1	5.8
In percent of external public debt service	35.7	37.7	70.4	90.5	90.0	63.4	35.3
In percent of quota	146.0	223.4	338.0	487.4	504.4	427.2	264.7
In percent of gross international reserves	19.0	28.6	37.7	40.9	36.8	28.9	17.4
Memorandum items							
Exports of GNFS (millions of U.S. dollars)	11,716	9,916	10,508	11,808	12,968	13,879	14,867
External public debt service (millions of U.S. dollars) 1/	1,414	1,943	1,576	1,768	1,841	2,211	2,461
Quota (millions of SDRs)	218.9	218.9	218.9	218.9	218.9	218.9	218.9
Quota (millions of U.S. dollars)	345.9	328.4	328.4	328.4	328.4	328.4	328.4
Gross international reserves (millions of U.S. dollars)	2,662	2,566	2,942	3,914	4,506	4,857	4,999
U.S. dollars per SDR (period average)	0.63	0.67	0.67	0.67	0.67	0.67	0.67

Sources: Fund staff estimates; and projections.

1/ Amortization and interest payments.

Table 13. Dominican Republic: Medium-Term Scenario 2006-14
(In percent of GDP unless specified)

				Projections					
	2006	2007	2008	2009	2010	2011	2012	2013	2014
Growth and prices									
Real GDP growth	10.7	8.5	5.3	0.5	2.5	6.0	6.0	6.0	6.0
CPI inflation, end of period	5.0	8.9	4.5	6.0	6.0	4.0	3.0	3.0	3.0
CPI inflation, average	7.6	6.1	10.6	1.5	6.3	5.0	3.5	3.0	3.0
Nominal GDP (billions of U.S. dollars)	35.3	41.0	45.5	45.5	47.8	52.2	56.5	61.1	66.1
Gross investment	18.3	18.8	18.2	16.8	17.3	18.4	18.4	18.4	18.4
National Savings	14.6	13.6	8.5	10.6	11.3	13.6	14.4	14.3	14.6
Public Sector									
Revenue	16.2	17.6	15.8	14.0	14.5	15.3	15.7	15.7	15.7
Spending	17.4	19.2	20.4	18.5	18.5	18.3	17.7	17.7	17.7
Noninterest spending	16.0	15.7	17.1	14.8	14.5	14.3	13.7	13.7	13.7
Overall balance	-1.2	-1.6	-4.6	-4.5	-4.0	-3.0	-2.0	-2.0	-2.0
Primary balance	0.2	1.9	-1.3	-0.8	0.0	1.0	2.0	2.0	2.0
Balance of payments and external debt									
External current account (millions of U.S. dollars)	-1288	-2096	-4414	-2814	-2891	-2524	-2285	-2518	-2543
In percent of GDP	-3.6	-5.1	-9.7	-6.2	-6.0	-4.8	-4.0	-4.1	-3.8
Official reserves (millions of U.S. dollars)	2251	2946	2662	2566	2942	3914	4506	4857	4999
In months of imports goods and non-factor services	1.8	2.0	2.3	2.1	2.3	2.8	3.0	3.0	2.9
Public external debt	20.0	18.0	16.5	17.6	18.1	17.6	16.5	15.3	14.1

Sources: Dominican authorities; and Fund staff estimates.

ANNEX I: SUMMARY OF ANNEXES

Fund Relations

As of end-September 2009, the Dominican Republic's outstanding obligations to the Fund amounted to SDR 288.94 million (132 percent of quota), which remain from the latest Fund Stand-By Arrangement (SDR 437.8 million) approved January 31, 2005. The last Article IV consultation was concluded on January 30, 2008 and the First Post-Program Monitoring Review was concluded on January 12, 2009. FAD, MCM and STA have provided substantial technical assistance since 2004 and an FSAP Update was conducted in March 2009 (the original FSAP was conducted in 2001). A safeguards assessment of the Central Bank of the Dominican Republic (BCRD) was completed in 2005, and an updated assessment will be completed before the first review under the proposed arrangement. The earlier safeguard assessment noted that the BCRD implemented a number of recommendations from earlier assessments, but also identified vulnerabilities mainly in the areas of internal controls over the reporting of monetary data to the IMF, financial reporting and external audit. The Dominican Republic has not yet ratified the Fourth Amendment.

Relations with the World Bank Group

As of September 30, 2009 the World Bank's total loan commitments in the Dominican Republic amounted to US$326.2 million of which US$234 million remains to be disbursed. The loan portfolio consists of ten loans: seven for investment, two for Technical Assistance, and an Emergency Recovery Loan. Two Development Policy Loans (DPLs) have recently been negotiated (Public Finance and Social Sector; and Performance and Accountability of Social Sectors) and their congressional ratification is expected before the end of 2009. Portfolio performance in the Dominican Republic is improving, with the disbursement ratio at 14 percent as of October 2009, above the regional (Latin America and the Caribbean) average.

Relations with the Inter-American Development Bank

As of October 9, 2009, the IDB's loan portfolio amounted to US$604.7 million of which $303.1 was undisbursed. On October 21, 2009 the IDB approved a Financial Emergency Loan to support a Fiscal Strengthening Program for US$500 million, of which US$300 million will be disbursed in 2009 and the remainder in 2010. The IDB is currently in the final stages of the design of the IDB Country Strategy for the period 2009-2012.

Statistical Issues

Economic data reported to the Fund are generally adequate for surveillance purposes, but there are some weaknesses which are currently being addresses with the help of STA technical assistance. The Dominican Republic has participated in the General Data Dissemination System (GDDS) since November 2005.

APPENDIX 1. DEBT SUSTAINABILITY ANALYSIS

External debt sustainability

External debt appears to be sustainable in the medium-term, although the external debt-to-GDP ratio is expected to increase in the short-term as economic growth slows and sizable public external borrowing takes place to smooth the adjustment to the external shock. Over the medium-term the external current account deficit is expected to decline as: (i) tourism and remittances recover with the global economy; (ii) exports grow as the benefits of CAFTA-DR and significant foreign direct investment in the mining industry begin to bear fruit; and (iii) prudent fiscal and monetary policies and structural reforms are implemented under the program. Foreign direct investment and support from official creditors are expected to be sufficient to finance the reduced level of the external current account deficit over the medium-term.

Public debt sustainability

Despite the temporary run-up in public debt as a result of the current crisis, fiscal policy under the program will result in a declining ratio of public debt-to-GDP in the medium-term. The program calls for a primary deficit of the consolidated public sector of 0.8 percent of GDP in 2009, gradually moving to a primary surplus of 2 percent of GDP by 2012, and remaining at this level going forward. Under these assumptions, the ratio of public debt-to-GDP would rise to 40 percent by 2010-11, but fall back to its end-2008 level of 35 percent of GDP by 2014. Maintaining a primary surplus of 2 percent of GDP, and assuming an average growth rate of real GDP of 6 percent and inflation around 3 percent would gradually bring the public debt to 30 percent of GDP by 2020.

Bound tests

External and public debt would remain sustainable under shocks represented by standard bound tests. A combined shock to interest rates, real GDP growth and the external current account deficit of ¼ of a standard deviation around historical averages would bring the ratio of external debt to GDP to 32 percent in 2012, before starting to fall again in 2013. A similar shock to public debt (with interest rates, real GDP and the primary deficit at ¼ of a standard deviation around historical averages) would bring the ratio of public debt to GDP up to 44 percent in 2013 before starting to fall in 2014. A one-time 30 percent real depreciation in 2010 would increase external debt to 41 percent of GDP and public debt to 50 percent of GDP in that year, but they would fall to 30 and 45 percent respectively by 2014.

Appendix Table 1. Dominican Republic: External Debt Sustainability Framework, 2006-14

(In percent of GDP, unless otherwise indicated)

		2006	2007	2008	2009	2010	2011	2012	2013	2014	Debt-stabilizing non-interest current account 6/
					Projections						
1	**Baseline: External debt**	**24.9**	**25.2**	**25.1**	**26.9**	**28.4**	**28.9**	**27.9**	**26.5**	**24.7**	**-4.3**
2	Change in external debt	2.9	0.4	-0.2	1.9	1.5	0.4	-1.0	-1.4	-1.8	
3	Identified external debt-creating flows (4+8+9)	-1.8	-2.2	0.5	1.8	1.5	-0.5	-1.5	-1.4	-1.4	
4	Current account deficit, excluding interest payments	2.0	3.3	8.0	4.9	4.6	3.4	2.5	2.5	2.4	
5	Deficit in balance of goods and services	7.3	8.3	13.3	8.9	8.7	7.4	6.7	6.7	6.7	
6	Exports	31.6	29.1	25.7	22.0	22.0	22.6	23.0	22.7	22.5	
7	Imports	38.9	37.4	39.1	30.9	30.7	30.0	29.7	29.4	29.2	
8	Net non-debt creating capital inflows (negative)	-4.4	-3.9	-6.7	-4.4	-3.9	-3.8	-3.9	-4.0	-3.8	
9	Automatic debt dynamics 1/	0.6	-1.6	-0.9	1.2	0.9	-0.1	-0.1	0.1	0.0	
10	Contribution from nominal interest rate	1.7	1.8	1.7	1.4	1.5	1.5	1.5	1.7	1.5	
11	Contribution from real GDP growth	-2.2	-1.8	-1.2	-0.1	-0.6	-1.6	-1.6	-1.5	-1.5	
12	Contribution from price and exchange rate changes 2/	1.1	-1.6	-1.3	...	...	...	...	...	...	
13	Residual, incl. change in gross foreign assets (2-3) 3/	4.7	2.6	-0.6	0.1	0.0	1.0	0.5	0.0	-0.3	
	External debt-to-exports ratio (in percent)	78.7	86.7	97.4	122.6	129.1	127.6	121.3	116.4	109.7	
	Gross external financing need (in billions of US dollars) 4/	**2.4**	**3.0**	**5.7**	**4.1**	**4.1**	**4.0**	**3.8**	**4.3**	**4.6**	
	in percent of GDP	6.8	7.3	12.4	9.0	8.7	7.7	6.7	7.0	7.0	
	Scenario with key variables at their historical averages 5/				**26.9**	**23.4**	**21.0**	**17.8**	**14.3**	**10.5**	**-4.7**
	Key Macroeconomic Assumptions Underlying Baseline										
	Real GDP growth (in percent)	10.7	8.5	5.3	0.5	2.5	6.0	6.0	6.0	6.0	
	GDP deflator in US dollars (change in percent)	-4.9	7.1	5.5	-1.3	3.1	3.2	2.1	2.0	2.0	
	Nominal external interest rate (in percent)	8.0	8.6	7.3	5.4	5.9	5.7	5.6	6.5	6.0	
	Growth of exports (US dollar terms, in percent)	10.9	6.9	-1.8	-15.4	6.0	12.4	9.8	7.0	7.1	
	Growth of imports (US dollar terms, in percent)	21.2	11.7	15.8	-21.6	5.1	6.9	6.9	7.3	7.4	
	Current account balance, excluding interest payments	-2.0	-3.3	-8.0	-4.9	-4.6	-3.4	-2.5	-2.5	-2.4	
	Net non-debt creating capital inflows	4.4	3.9	6.7	4.4	3.9	3.8	3.9	4.0	3.8	

Sources: Dominican authorities; and Fund staff estimates.

1/ Derived as $[r - g - \rho(1+g) + \varepsilon\alpha(1+r)]/(1+g+\rho+g\rho)$ times previous period debt stock, with r = nominal effective interest rate on external debt; ρ = change in domestic GDP deflator in US dollar terms, γ = real GDP growth rate, ε = nominal appreciation (increase in dollar value of domestic currency), and α = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as $[-\rho(1+g) + \varepsilon\alpha(1+r)]/(1+g+\rho+g\rho)$ times previous period debt stock. ρ 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.

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.

Appendix Table 2. Dominican Republic: Public Sector Debt Sustainability Framework, 2004-14

(In percent of GDP, unless otherwise indicated)

	2006	2007	2008	Projections 2009	2010	2011	2012	2013	2014	Debt-stabilizing primary balance 9/
1 **Baseline: Public sector debt 1/**	**39.5**	**35.8**	**35.5**	**39.0**	**40.3**	**40.2**	**38.7**	**37.1**	**35.1**	**2.0**
o/w foreign-currency denominated	20.0	18.0	16.5	17.6	18.1	17.6	16.5	15.3	14.1	
2 Change in public sector debt	0.0	-3.8	-0.3	3.5	1.3	-0.1	-1.5	-1.7	-1.9	
3 Identified debt-creating flows (4+7+12)	0.0	-2.8	0.9	7.3	5.1	3.8	3.5	3.7	3.9	
4 Primary deficit	-0.4	-1.8	1.3	4.5	4.0	3.0	2.0	2.0	2.0	
5 Revenue and grants	16.2	17.6	15.8	14.0	14.5	15.3	15.7	15.7	15.7	
6 Primary (noninterest) expenditure	15.8	15.8	17.1	18.5	18.5	18.3	17.7	17.7	17.7	
7 Automatic debt dynamics 2/	0.0	-1.4	-0.9	2.2	0.5	-0.1	0.5	0.7	0.9	
8 Contribution from interest rate/growth differential 3/	0.0	-1.7	-1.5	2.2	0.5	-0.1	0.5	0.7	0.9	
9 Of which contribution from real interest rate	0.0	1.3	0.1	2.3	1.4	2.1	2.6	2.9	2.9	
10 Of which contribution from real GDP growth	0.0	-2.9	-1.6	-0.2	-0.9	-2.2	-2.2	-2.1	-2.0	
11 Contribution from exchange rate depreciation 4/	0.0	0.3	0.6	...	...	...	...	...	...	
12 Other identified debt-creating flows	0.0	0.4	0.6	0.6	0.6	0.9	1.0	1.0	1.0	
13 Privatization receipts (negative)	0.0	0.0	0.0	0.0	-0.2	0.0	0.0	0.0	0.0	
14 Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
15 Other (specify, e.g. bank recapitalization)	0.0	0.4	0.6	0.6	0.8	0.9	1.0	1.0	1.0	
16 Residual, including asset changes (2-3) 5/	0.0	-1.0	-1.2	-3.7	-3.8	-3.9	-4.9	-5.4	-5.8	
Public sector debt-to-revenue ratio 1/	243.7	203.2	224.3	278.9	278.1	262.6	246.7	236.0	223.7	
Gross financing need 6/	**4.6**	**3.0**	**8.8**	**10.6**	**12.5**	**9.5**	**7.6**	**7.3**	**7.3**	
in billions of U.S. dollars	1.6	1.2	4.0	4.8	6.0	4.9	4.3	4.5	4.8	
Scenario with key variables at their historical averages 7/				**39.0**	**33.7**	**28.9**	**23.6**	**18.2**	**12.8**	**0.0**
Scenario with no policy change (constant primary balance) in 2009-14				**39.0**	**40.9**	**42.2**	**43.3**	**44.3**	**45.0**	**2.3**
Key Macroeconomic and Fiscal Assumptions Underlying Baseline										
Real GDP growth (in percent)	10.7	8.5	5.3	0.5	2.5	6.0	6.0	6.0	6.0	
Average nominal interest rate on public debt (in percent) 8/	9.7	9.9	10.7	10.9	11.3	11.0	10.9	11.3	11.8	
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	0.0	4.2	0.9	6.9	4.1	6.0	7.4	8.3	8.8	
Nominal appreciation (increase in US dollar value of local currency, in percent)	3.3	-1.5	-3.4	...	...	...	...	...	...	
Inflation rate (GDP deflator, in percent)	5.4	5.7	9.8	4.0	7.1	5.0	3.5	3.0	3.0	
Growth of real primary spending (deflated by GDP deflator, in percent)	20.8	8.3	13.9	8.7	2.6	4.8	2.5	6.0	6.0	
Primary deficit	-0.4	-1.8	1.3	4.5	4.0	3.0	2.0	2.0	2.0	

Sources: Dominican authorities; and Fund staff estimates.

1/ Indicate coverage of public sector, e.g., general government or nonfinancial public sector. Also whether net or gross debt is used.

2/ Derived as $[(r - \pi(1+g) - g + \alpha\varepsilon(1+r)]/(1+g+\pi+g\pi))$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; α = share of foreign-currency denominated debt; and ε = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

3/ The real interest rate contribution is derived from the denominator in footnote 2/ as $r - \pi (1+g)$ and the real growth contribution as -g.

4/ The exchange rate contribution is derived from the numerator in footnote 2/ as $\alpha\varepsilon(1+r)$.

5/ For projections, this line includes exchange rate changes.

6/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.

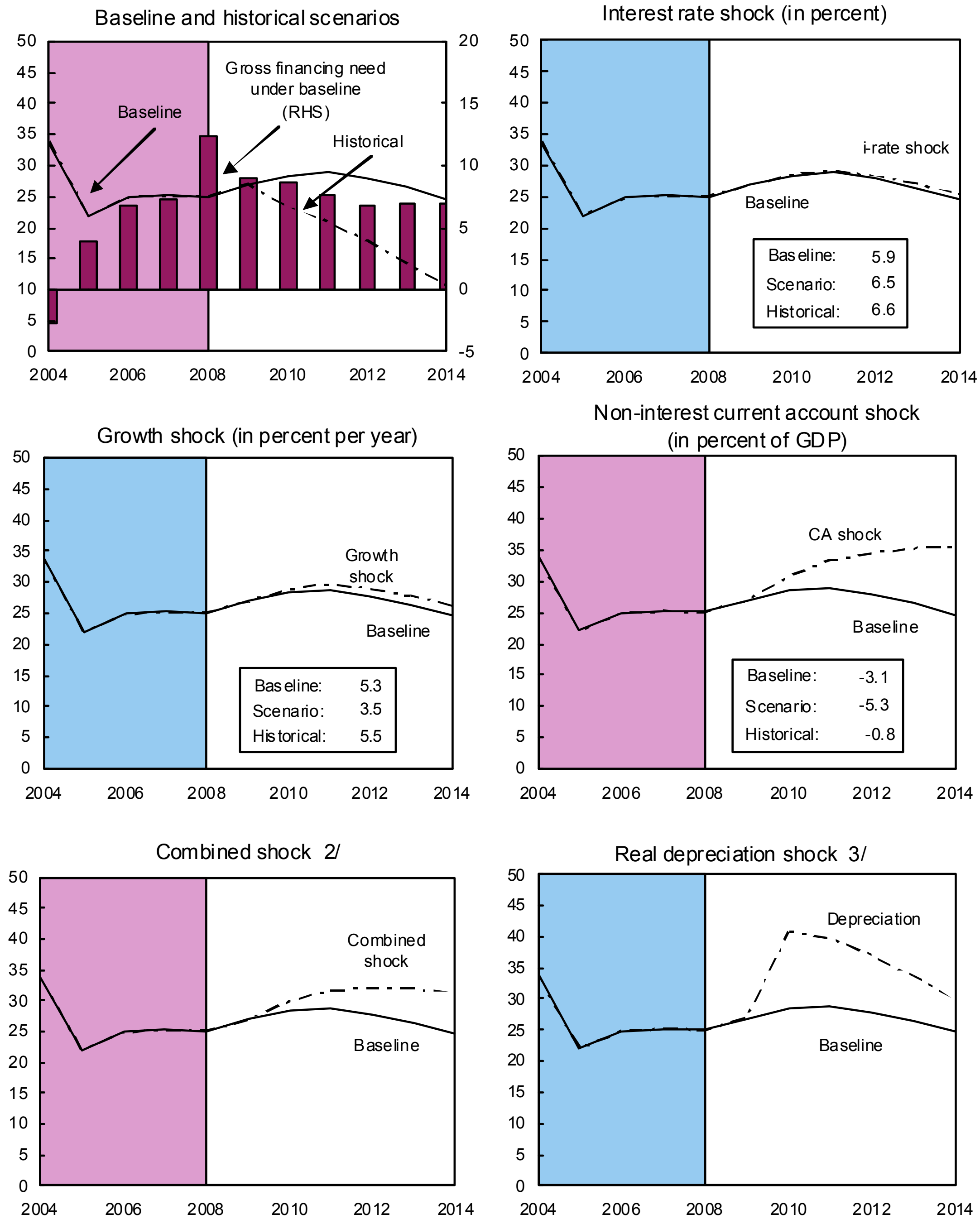
7/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.

8/ Derived as nominal interest expenditure divided by previous period debt stock.

9/ 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.

Appendix Figure 1. Dominican Republic: External Debt Sustainability: Bound Tests 1/

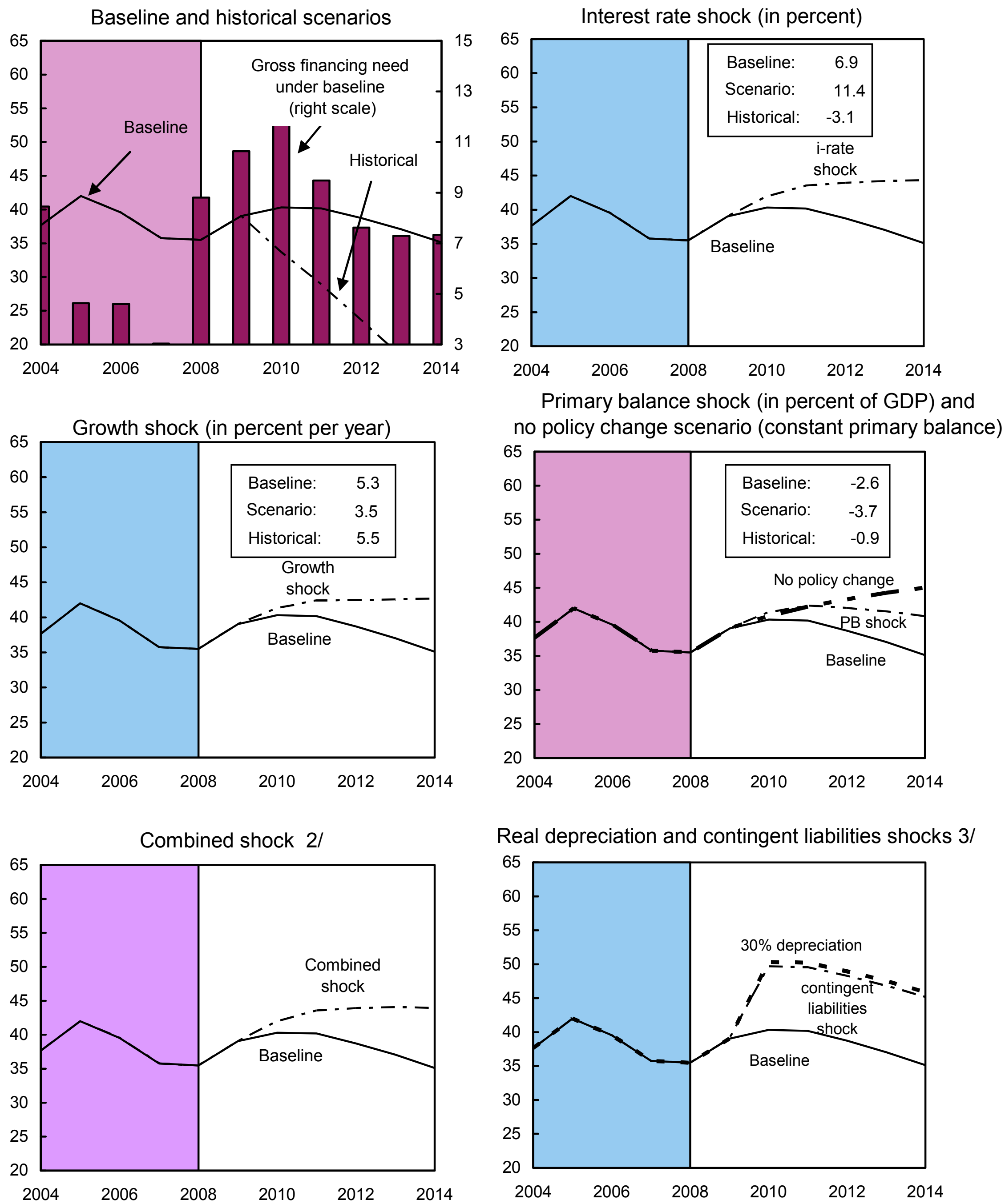
(External debt in percent of GDP)



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/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
3/ One-time real depreciation of 30 percent occurs in 2010.

Appendix Figure 2. Dominican Republic: Public Debt Sustainability: Bound Tests 1/

(Public debt in percent of GDP)



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/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and primary balance.

3/ One-time real depreciation of 30 percent and 10 percent of GDP shock to contingent liabilities occur in 2009, with real depreciation defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

ATTACHMENT 1. LETTER OF INTENT

Banco Central de la República Dominicana
Secretaría de Estado de Hacienda
Secretaría de Estado de Economía, Planificación y Desarrollo

Istanbul, Turkey
October 6, 2009

Mr. Dominique Strauss Kahn
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Mr. Strauss-Kahn:

Like many economies around the world, the Dominican Republic has been adversely affected by the global economic crisis and the credit crunch in capital markets, with a deteriorating external outlook, falling aggregate demand, and lower tax revenues; while the limited financing for our budget is creating the conditions for a procyclical fiscal response, greatly constraining our ability to react to these shocks. This letter and the attached memorandum of economic and financial policies (MEFP) outline an economic program that the Government of the Dominican Republic intends to adopt to strengthen its capacity to respond to the crisis.

The main objective of this program is to boost economic recovery in an environment of macroeconomic stability and strengthen our growth prospects by conducting a counter-cyclical policy in the short-run while achieving sustainability over the medium-term. These efforts are being supported by the adoption of a reinvigorated structural reform agenda. To this end, we are requesting a 28-month Stand-By Arrangement (SBA) through February 2012 in an amount equivalent to SDR 1,094.5 million or 500 percent of quota (about US$1,700 million) which will support the program detailed in the attached MEFP.

The previous SBA (2004-07) was very successful and allowed us to recover from the domestic financial crisis of 2003 and paved the way to achieve high growth with low inflation in the period 2004-08. In fact, the Dominican Republic grew 40 percent in that period, equivalent to some 8 percent per annum and became one of the fastest growing economies in Latin America. In our view, the international outlook will remain unfavorable for some time. Thus, we would like to replicate the past experience of success with the Fund by designing a strong economic strategy to achieve the highest and most sustainable growth possible for our economy.

The government believes that the policies set forth in the MEFP are adequate to achieve the objectives of its program, but it will take any further measures that may become appropriate for this purpose. The government will consult with the Fund on the adoption of these measures, and in advance of revisions to the policies contained in the MEFP, in accordance with the Fund's policies on such consultation. We will also provide Fund staff with all the relevant information required to complete program reviews and monitor performance.

The authorities will observe the standard performance criteria against imposing or intensifying exchange restrictions, introducing or modifying multiple currency practices, concluding bilateral payments agreements that are inconsistent with Article VIII of the Fund's Articles of Agreement, and imposing or intensifying import restrictions for balance of payments reasons.

During the period covered by the program, there will be quarterly quantitative performance criteria (Table 1) and structural benchmarks (Table 2). There will be eight quarterly reviews to be completed by mid-March, mid-June, mid-September, and mid-December of 2010 and 2011. These reviews will be associated with the observance of the relevant performance criteria.

We have authorized the Fund to publish this letter and the attached Memorandum of Economic and Financial Policies (MEFP), to facilitate a wider access and review of our policies to the international community and to economic agents within the Dominican Republic.

Sincerely yours,

_________/s/_________	_________/s/_________	_________/s/_________
Héctor Manuel Valdez	Vicente Bengoa	Temístocles Montás
Governor of the Central Bank	Minister of Finance	Minister of Economy

ATTACHMENT 2. MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES OF THE GOVERNMENT OF THE DOMINICAN REPUBLIC

I. Background

1. After emerging from the 2003 financial crisis as one of the fastest growing economies in Latin America, the Dominican Republic was hit by external shocks in 2008 that affected macroeconomic performance. In the first half of 2008, a sharp deterioration in the terms of trade due to falling nickel and rising food and energy prices led to sharp increases in the external current account deficit and an acceleration in inflation. The fiscal position deteriorated mostly as a result of measures to alleviate the effect of these shocks on vulnerable groups which generated higher energy and food subsidies, among others, while monetary policy was tightened to address emerging inflationary pressures. In the second half of 2008, as the economy was adjusting to the external supply shocks, it was further hit by the effects of the global financial crisis. Bank lending came to a halt and international trade slowed considerably reflecting increased risk aversion and the rapid weakening of external demand. As a result, growth slowed significantly to 5.3 percent for 2008 (compared to almost 9 percent for 2007), inflation fell to 4.5 percent, the lowest in Latin America (after reaching a high of 15 percent year-on-year in August 2008), and the exchange rate depreciated moderately by 3.5 percent against the US dollar.

II. 2009 Developments

2. During 2009, the economy has continued to feel the effects of the international crisis, although it has been one of the best performers in the region. Growth reached 1.4 percent in the first half of the year, compared to a fall of 1 percent in Latin America as a whole, mainly due to the expansion of agriculture. At the same time, inflation continued decelerating to –0.5 percent year-on-year in August, well below the average for the region, as commodity prices continued to fall while core inflation remained at around 5 percent.

3. This resilience of the Dominican Republic economy has in part been due to the timely and speedy loosening of monetary policy that was implemented since the beginning of 2009. Following the tightening in 2008, the policy interest rate (overnight) was lowered by 550 basis points to 4 percent in the first eight months of the year. In addition, reserve requirements were lowered to promote bank lending to priority sectors. While credit remained stagnant in the first quarter of the year, as banks preferred to absorb the additional liquidity in the system, there were signs that bank lending was beginning to recover in the second quarter of 2009, as lower interest rates stimulated demand for construction and mortgage lending.

4. Fiscal policy was tight in the first half of 2009 as the cyclical decline in tax revenue and restrictions in financing limited expenditure. Tax revenues fell by 11 percent in the first

semester, due mainly to the decline in imports and the weakening of consumption. At the same time, primary expenditure fell by more than 10 percent compared to 2008, as electricity transfers fell (related to the lower cost of fuel) but also due to lower expenditures on goods and services, and capital spending related to the restrictions in financing. As a result, the consolidated public sector primary balance for the first half of the year was zero.

5. Despite the rapid deterioration of the world economy, the exchange rate and international reserves have remained relatively stable. The external current account deficit narrowed to around 3.5 percent of GDP on an annual basis in the first half of 2009 (from a deficit of 10 percent of GDP in 2008), as the decline in exports, tourism and remittances was offset by an even larger decline in oil and non-oil imports. At the same time, inflows of foreign direct investment remained strong but lower than in previous years. International reserves fell by about $150 million (about 6 percent) in the first half of 2009, reflecting mainly lower disbursements of international financial institutions, while the nominal exchange rate depreciated by about 3 percent in line with the deteriorated fundamentals.

III. Medium-Term Macro-framework for 2009-12

6. The government's program for 2009-12 aims at implementing a counter-cyclical policy through an expansionary fiscal stance and an accommodative monetary position in the short-run, to counteract the effects of the global financial crisis on the economy, and a gradual fiscal consolidation effort over the medium-term (starting in mid-2010) to ensure fiscal sustainability and the return of the public debt-to-GDP ratio to a declining path. Monetary policy will continue to maintain in the short-term an accommodative stance to offset the effects of the global financial crisis in the economy. At the same time, recognizing the importance of increasing the potential for growth and sustaining a strong expansion in economic activity, the program will aim to implement structural reforms in key areas of the economy. Over the next few months, the government will produce detailed strategy papers in key areas outlining specific structural measures to be implemented during the course of the program. The main elements of the structural agenda include:

- Institutional reforms aimed at strengthening public financial management to allow the adoption of a medium-term expenditure framework to support fiscal consolidation. In addition, higher tax collections will be achieved by improving tax administration, strengthening enforcement of the legislation on fuel taxes, and limiting tax exemptions and incentives;

- A reform of the electricity sector to improve the efficiency of distribution, eliminate indiscriminate subsidies and ensure financial viability, reducing its burden on public finances;

- Monetary and financial sector reforms, including: (i) technical adjustments to the ongoing recapitalization of the central bank through amendments to the law while maintaining the spirit the original draft; (ii) enhancing banking supervision; and (iii) the implementation of an inflation targeting framework to help safeguard financial stability, control inflation, and anchor expectations;

- A strategy for the development of local debt markets and public debt management that will improve access to longer term financing and lower the cost of finance for the government and the Dominican private sector in domestic and international markets, with a view to improve the rating of the public debt.

7. The program aims to restore real GDP growth to the robust rates that prevailed before the external crisis. Output growth is estimated at 0.5 to 1.5 percent in 2009, but recovering to the 2.5-3.5 percent range in 2010 as the fiscal stimulus takes effect and the economy recovers. Going forward, real GDP growth is expected to recover to its potential of 6 percent in 2011 and beyond. Inflation pressures for 2009-10 are expected to remain subdued, well within the original target range that the central bank has established of 6-7 percent, and falling gradually to the level of main trading partners (3 percent) over the medium-term.

8. The external current account deficit is expected to fall to around 6 percent for 2009-10, as the recovery in exports and tourism receipts is partly matched by a recovery in oil imports and non-oil imports related to investment. In the capital account, flows of foreign direct investment to the mining sector are expected to continue, while other private financing flows will remain subdued. Over the medium-term, the external current account deficit is expected to fall gradually to around 4 percent of GDP, as exports recover with external demand and mining sector investments for export become operational.

9. Following the fiscal expansion in 2009-10, the program aims at achieving fiscal consolidation in the medium-term to bring the debt-to-GDP ratio back to its 2008 level. For 2009 the program aims at a primary fiscal deficit of the consolidated public sector of 0.8 percent of GDP, consistent with an overall deficit of 4.5 percent of GDP (significantly higher than the deficit of 3.3 percent of GDP which is consistent with the 2009 budget). For 2010 the program aims at a gradual consolidation, bringing the consolidated primary fiscal balance to zero, mainly through improvements in tax administration and recovery of tax revenues due to higher economic activity. Going forward, increasing revenue from the proposed structural reforms and a moderate containment in expenditure (especially energy subsidies) will lead to a gradual increase in the primary surplus of the combined public sector to 1 percent of GDP in 2011 and 2 percent of GDP in 2012 and beyond. Under these assumptions, the overall public debt is expected to increase from 35 percent of GDP in 2008 to 40 percent of GDP in 2011, only to fall to 35 percent of GDP by 2014, and continue declining in subsequent years.

IV. Macroeconomic Policies for 2009-10

10. In order to facilitate the monitoring of the program, the government will establish an inter-institutional task force with staff from the Central Bank, the Ministry of Finance, and the Ministry of Economy to monitor implementation and provide timely information to policy makers on program developments on a high frequency basis.

A. Fiscal Policy

11. The government intends to implement a countercyclical fiscal policy for the rest of 2009 and the first half of 2010. This will lead to a loosening of expenditures (predominantly in capital and social expenditures), which have been constrained in the first half of the year by the fall in tax revenues and the lack of external financing. The program aims at increasing the fiscal deficit of the central government by about 1.2 percent of GDP (from the level of 1.9 percent of GDP in the original budget) to 3.1 percent of GDP in 2009. This is consistent with a loosening of the primary fiscal balance from a surplus of 0.6 percent of GDP in the 2009 budget to a primary deficit of about 1.1 percent of GDP in this program. Excluding interest payments and transfers related to the energy sector (which have little effect on final demand), it is estimated that this expansion would result in a fiscal impulse of about 0.9 percent of GDP for 2009 compared to the fiscal stance in 2008. In 2010 the program aims at a gradual consolidation that would begin in the second half of the year as the economy recovers, leading to an overall deficit of the central government of 2.6 percent of GDP (consistent with a primary deficit of 0.4 percent of GDP).

12. The government will implement a number of measures to improve tax administration and compliance in 2009-10. A central element of this strategy will be the rationalization and better implementation of Law 112-00 on hydrocarbon taxation and Law 557-05 (article 23), which creates the selective ad-valorem tax on fuels to improve tax collections, make more transparent price calculations, rationalize tax exemptions and transfer the administration of tax collection to the domestic tax directorate (DGII). It is expected that this change will produce higher tax collections of 0.2 percent of GDP. Additional revenue enhancing measures planned for 2009-10, which could yield 0.3 percent of GDP a year, include:

- Transfer to DGII collection of taxes under Law 112-00 on fossil fuels until the new hydrocarbon's law gets approved.

- Control underinvoicing and contraband of fuel products through the creation of an inter-institutional committee of public sector agencies related to the energy sector to oversee the functioning of the hydrocarbon sector (Decree 369-09), which will integrate information from different agencies;

- The introduction of an information system (impresoras fiscales) to register the value of cash transactions in commercial establishments such as supermarkets and other retail outlets, to improve the efficiency and efficacy of collections;

- Simplification of tax procedures for small and medium-sized enterprises to improve compliance and increase the tax base.

- Considering the high level of tax exemptions in the country, the government will review all the legislation that includes tax breaks and tax exemptions with a view to eliminating those that do not conform with the objective of the legislation.

13. On the expenditure side, the government will prioritize public investment and social spending, to maximize the effects of the fiscal expansion on economic activity. In particular, central government expenditure on wages and salaries will decline gradually after reaching about 4 percent of GDP in 2009, while current spending on goods and services will remain stable as a share of GDP. Transfers to the electricity company CDEEE will be limited in line with reform in the sector, bringing them down from 2.7 percent of GDP in 2008 to 1.1 percent of GDP in 2009 and no more than 0.8 percent of GDP in 2010. This will allow the government to increase capital spending to 4 percent of GDP in 2009 (from the depressed levels of the first half of the year) and 5 percent in 2010, with the aim of promoting important infrastructure projects, and to increase priority social spending. It will be particularly important for the inter-institutional task force on program implementation to closely monitor the level and composition of expenditures to ensure the greatest benefit from the fiscal loosening in 2009-10.

14. Implementing the fiscal expansion contemplated for 2009 will result in a gross public sector borrowing requirement of about US$2.8 billion, or around 6 percent of GDP, which is US$700 million higher than originally contemplated in the budget for 2009. The government's financing strategy seeks to secure the multilateral financing originally envisaged in the budget and gain access to additional multilateral financing through emergency loans and the use of IMF financing. The bulk of multilateral financing would be used in 2009, with about US$350 million coming from the World Bank, US$450 million from the IDB and US$300 million from the use of IMF resources for the budget. These resources would be complemented by some US$250 million from Petrocaribe and around US$550 million of project financing for public investment, with the remainder coming from domestic bank loans and the domestic bond market.

15. For 2010 the program envisages a gross public sector borrowing requirement of about US$2.6 billion, or around 5.5 percent of GDP, which would be secured through a mix of multilateral resources and private sector financing. As the program increases the level of capital spending, the largest source of financing in 2010 will be project financing with US$700-800 million, followed by multilateral organizations with some US$550 million in budgetary support (US$250 million from the IDB, US$150 million from the World Bank, and

US$150 million from the IMF). Petrocaribe will continue contributing with US$240 million and some US$100 million are expected from the sale of state assets. The government will complement its financing requirements through the placement of a bond in international capital markets for US$500-600 million once conditions improve and spreads fall. The remaining amounts will come from domestic bank loans and the domestic bond market.

B. Monetary and Exchange Rate Policy

16. After the loosening in the first eight months of the year, the central bank will continue to maintain an accommodative monetary policy stance to support the fiscal expansion, while at the same time safeguarding its inflation objective of 6-7 percent for 2009-10. Given the rapid reduction in interest rates over the last several months, there is limited scope for further monetary easing.

17. As the economy recovers in 2010, the central bank will be prepared to adapt its monetary and exchange rate policy to the new economic conditions with the objective of preserving macroeconomic stability, prevent capital outflows and safeguard their international reserves.

18. The central bank will continue to manage monetary policy within the framework of a managed floating exchange rate regime. Gross international reserves reached a record level in 2007 and fell significantly in 2008 and in the first months of 2009 due to the international financial crisis. In the short run, gross international reserves will be replenished gradually and by end-2010, they are expected to recover the level of 2007. While this level is low for an economy as open as the Dominican Republic, the authorities consider that, under the current circumstances, the programmed level of reserve accumulation is consistent with very limited intervention in the foreign exchange market to avoid undue pressures on the exchange rate as the economy recovers.

19. One of the principal objectives of the government's program is to support the recovery of domestic credit as economic growth accelerates. Under current circumstances, the short-term monetary program does not contemplate using the traditional limits on net domestic assets, to avoid unnecessarily restraining the policy space of the central bank to support the growth of bank credit. As the economic recovery takes hold in the second half of 2010, however, the traditional programming ceiling on net domestic assets will be reincorporated to ensure a growth of monetary aggregates consistent with the program's inflation objective. The monetary program envisions a relatively large growth of currency issue in 2009 despite low inflation and growth to satisfy bank's demand for additional liquidity and to create the conditions for higher private credit. The demand for currency issue is expected to moderate in 2010 as conditions in credit markets normalizes. Private sector credit is expected to remain subdued, growing at around 5 percent per year for 2009-10, before recovering to its historical level in subsequent years.

V. Structural Reforms for 2009-10

20. The government's reform agenda aims to safeguard medium-term fiscal sustainability while strengthening the institutional framework for financial stability and rapid and sustainable growth. The government sees these as self-reinforcing objectives that will help lower the overall cost of finance and improve the growth potential for the economy.

A. Tax Administration Reform

21. The main focus of public sector reform will be to ensure a return to fiscal sustainability after the expansion in 2009-10. The government continues to be committed to an ambitious goal of reducing the debt-to-GDP ratio to the 25-30 percent of GDP range in the medium-term, considering this to be an optimal level given the vulnerabilities that the economy faces. To achieve this target, sustained primary surpluses on the order of 2 percent of GDP for the combined public sector are necessary.

22. On the revenue side, improvements in the fiscal position will be supported by reforms in tax administration and a strengthening of customs administration. There will be a higher level of integration between the two tax collection institutions (DGII and Customs) to exchange information and exploit synergies. The reform does not contemplate changes in tax rates to achieve this fiscal objective. The program will contain a structural benchmark on the design of a tax administration strategy, which will be developed with technical assistance from the IMF and other institutions by March 2010. The reform will include measures to strengthen the institutional capacity of the tax and customs authorities and audit and control procedures, as well as a plan to rationalize tax exemptions.

23. There is also a need to improve budgetary procedures and expenditure control at the commitment level for all levels of the government. The design and presentation of the budget will be enhanced by including the job structure and number of positions in each budgetary chapter, by better programming and executing expenditures and by developing and gradually implement procedures to monitor the budget of decentralized agencies, municipalities and public enterprises. While there is a single treasury account, some expenditure commitments continue to be unregistered and the treasury account does not cover all levels of the public sector. The government is committed to improve the coverage and implementation of the single treasury account and will develop a program for the improvement of public financial management practices. This program will include the consolidation of all receipts received by all municipalities and other public institutions as well as international aid and domestic and external loans (the loans from multilateral financial institutions in foreign exchange will be exchanged for local currency at the central bank as a way to contribute to the strengthening of the international reserves and to meet the reserve objectives under the program). The practice of budgetary advances will be severely restricted.

B. Financial Sector Reform

24. Financial sector reform is essential to support the recovery of economic activity by facilitating the intermediation of credit, lowering risk and avoiding financial turbulence. The main elements of the financial sector reform effort will include:

- Preparation for the implementation of an inflation targeting framework by early 2012, to strengthen the credibility of monetary policy and anchor inflationary expectations in the context of a more flexible exchange rate. The particular elements of this strategy include, inter alia, the strengthening of an integrated process for macroeconomic monitoring, forecasting, and policy formulation to enable a shift in the basis for policy decisions to the medium-term outlook for inflation and growth, and a strengthened communication strategy to promote understanding of the new policy framework and the basis for policy decisions. The program will include a structural benchmark for June 2010 on the formulation of a plan detailing roll-out of these elements over the next two years.

- The government remains committed to the transfer of resources to recapitalize the central bank in line with the objectives of the BCRD Capitalization Law, recognizing that this is essential to enhance the credibility of monetary policy and the successful adoption of an inflation targeting framework while supporting the gradual reduction in reserve requirements and the build-up of international reserves. However, the government plans to submit to Congress a limited set of amendments to the law including technical adjustments and the lengthening of the period of recapitalization from 10 to 15 years, which will allow for a less onerous schedule of transfers in the context of an unexpected decline in economic activity in 2009 and 2010, while following the spirit of the original legislation.

- Building on the wide ranging legislative and regulatory reforms for the banking system of the last few years, the government is fully committed to support continued efforts to improve supervisory practices as recommended in the recent update to the Financial Sector Assessment Program (FSAP). In particular, the program will include a structural benchmark to develop a strategy to deepen and widen the implementation of risk-based supervision by March 2010. Such strategy will include plans for strengthening the capacity to asses the quality of banks' management and risk-management policies and practices, the development of comprehensive risk profiles of banks, and the introduction of supporting changes to the organizational structure of the Superintendence of Banks. Effective implementation of such a strategy will support ongoing efforts to preserve and strengthen financial sector resilience, improve compliance with the Basel Core Principles for Effective Banking Supervision, and help in the effective application of consolidated supervision

C. Recovery and Growth Enhancement

25. It will be important to adopt a number of additional measures to safeguard the economic recovery while strengthening the growth prospects of the economy. We believe that measures in the electricity sector as well as those directly aimed at reducing the cost of borrowing in the economy (other than through monetary policy), including by reducing the external perception of country risk, should be key to achieve a successful recovery from this crisis.

26. Improving the functioning of the electricity sector will enhance the prospects for high and sustainable growth in the economy by ensuring an adequate and stable supply of energy, while at the same time supporting the objective of fiscal sustainability by reducing its dependence on the public finances. The government has begun to develop a strategy for reform in the sector, in conjunction with the World Bank and the IDB, and will formalize a program of specific structural reforms by December 2009, which will constitute a structural benchmark under the program. The main elements of the strategy will include:

- Tariff adjustments and the implementation of a more flexible tariff system to cover the costs of generation and distribution;
- Gradually eliminating the generalized electricity subsidy by 2012 and focusing it on the poor;
- Reducing technical losses and improving metering to reduce electricity theft;
- Improving management of distribution companies;
- Creating a special account to implement government payments to generation and distribution companies;
- Implementing an external audit of the finances of the government distribution companies, and the corporate unit;
- Developing a plan to invest in new generation and distribution capacity.

27. All of the reforms mentioned above will lower borrowing costs and reduce country risk to the extent that they improve financial intermediation and reduce financial and fiscal risks. To complement these reforms the program will include a structural benchmark for September 2010 on the development of a strategy to strengthen public debt management and the development of local debt markets to enhance access to longer term financing. In addition, the strategy will include an agenda of additional reforms aimed at improving the government's creditworthiness and the credit rating of Dominican Republic sovereign bonds in international

markets, thus lowering the financing costs for domestic private sector which uses public debt as a benchmark.

D. Social Safety Net

28. As economic conditions deteriorated over the last several quarters, this has created pressures over the most vulnerable groups of society, especially the poor and the unemployed. The government intends to strengthen the social safety net by increasing social spending and prioritizing public investment. The government will increase the coverage of the conditional cash transfer program by 70,000 families living in extreme poverty and will increase the payment to over 45,000 families already covered by the program. The government will increase its spending in health and education by 0.75 percent of GDP a year in 2010-12 with a view to: (i) increase the coverage of the public health system to include unemployed and people living in extreme poverty as well as strengthen preventive medical care; and (ii) increase the number of classrooms and improve maintenance of existing schools.

VI. Other Issues

29. The government has no external arrears, and it will regularize all outstanding domestic arrears, including those with electricity generators, by using the available financial mechanisms before the end of the year.

Table 1. Dominican Republic: Quantitative Performance Criteria 2009-10 1/

	2009	2010			
	end-Dec	end-Mar	end-Jun	end-Sep	end-Dec
Fiscal Targets					
1. Overall balance of the central administration (floor) 2/ 3/	-51.5	-68.0	-83.0	-91.0	-98.5
2. Overall balance of the consolidated public sector (floor) 2/ 3/	-74.5	-97.5	-119.5	-133.0	-147.0
Monetary Targets					
3. Net international reserves (floor) 4/	1,815	1,715	1,665	1,715	1,815
4. Net domestic assets (ceiling) 3/	--	--	--	65.0	80.0
Debt Targets					
5. Accumulation of public arrears with electricity generators (ceiling) 2/ 4/	0.0	0.0	0.0	0.0	0.0
6. Accumulation of external public debt arrears 4/ 5/	0.0	0.0	0.0	0.0	0.0

1/ Targets defined in the Technical Memorandum of Understanding.
2/ Cumulative flows from December 2008.
3/ In billions of Dominican Republic pesos.
4/ In millions of U.S. dollars.
5/ Continuous target.

Table 2. Dominican Republic: Structural Benchmarks for 2009-10

Measure	Timing
Tax Administration Reform	
A. Design a strategy to rationalize and limit tax exemptions, strengthen tax administration, and continue modernizing customs to achieve the medium-term revenue objectives of the program	end-Mar 2010
Financial Sector Reform	
B. Design a plan to achieve compliance with all Basel core principles for effective bank supervision by 2012	end-Mar 2010
C. Design a plan to formally adopt a full-fledge inflation targeting framework by early 2012	end-Jun 2010
Recovery and Growth Enhancement	
D. Design a strategy to reform the electricity sector, including by eliminating indiscriminate electricity subsidies to achieve the medium-term budgetary expenditure objectives of the program	end-Dec 2009
E. Design a strategy to develop domestic capital markets and debt management including by lowering the country risk and the borrowing costs for the economy	end-Sep 2010
Social Safety Net	
F. Increase the permanent coverage of the conditional cash transfer program by 70,000 families living in extreme poverty	end-Dec 2009

ATTACHMENT 3. TECHNICAL MEMORANDUM OF UNDERSTANDING

This Technical Memorandum Understanding (TMU) presents the definitions of the variables included in the quantitative performance criteria annexed to the *Memorandum of Economic and Financial Policies (MEFP)*, and the information requirements needed to ensure adequate monitoring of economic and financial developments.

I. Quantitative Performance Criteria: Definition of Variables

A. Cumulative Floor on the Central Government Balance

The overall balance of the central government covers government activities as specified in the budget.

Revenues are recorded when the funds are deposited in the Treasury account. Revenues will also include grants. Central government expenditures are recorded on an accrual basis and will include transfers to other government units as well as all transfers to the electricity sector. Interest payments, however, will be recorded on a due basis. Capital expenditure will include any in-kind capital expenditures defined as the externally financed investment projects (through loans and grants) in case they are not included in the execution of the budget.

The balance of the central government will be measured from "below the line" as the change in the central government's net financial position (assets minus liabilities). The net financial position of the central government includes: (a) non-bank central government debt, external and domestic, including debt with the IMF for budgetary support and short-term debt approved by the Ministry of Finance; (b) external and domestic bank borrowing (net of deposits), including deposits in the central bank; and (c) any other nonbank financing, domestic or external, including the sale of public assets and the net change in the stock of domestic and external arrears, including arrears to electricity distributors. Domestic arrears of the nonfinancial public sector are defined as delays in the payment of contractual obligations beyond the grace period set in the respective loan or debt contract or 30 days in case the grace period is not specified. Capitalizations or purchases of equity in public companies will be treated as an above-the-line expenditure transaction. External debt flows (i.e., disbursements and debt service), will be converted to Dominican Republic pesos at the exchange rate of the day in which the transaction takes place.

The following uses of funds will not affect the deficit and will be recorded below the line in 2009: (i) clearance of central government domestic arrears incurred before end-December 2008; (ii) amortization of loans and bonds; (iii) bonds issued for the recapitalization of the Central Bank and Banco de Reservas; and (iv) other arrears with suppliers incurred by end-December 2008. A memorandum line in the information reporting the Central Government fiscal operations will report items (i) to (iv) in this paragraph.

1. Targets on the Overall Balance of the Central Government

Cumulative Balance from December 31, 2008	Floor (In billions of RD$)
End-October 2009 (program projection)	-18.3
End-November 2009 (program projection)	-35.0
End-December 2009 (performance criterion)	-51.5
End-January 2010 (program projection)	-53.0
End-February 2010 (program projection)	-58.0
End-March 2010 (performance criterion)	-68.0
End-April 2010 (program projection)	-70.4
End-May 2010 (program projection)	-75.8
End-June 2010 (performance criterion)	-83.0
End-July 2010 (program projection)	-85.1
End-August 2010 (program projection)	-85.8
End-September 2010 (performance criterion)	-91.0
End-October 2010 (program projection)	-90.4
End-November 2010 (program projection)	-88.8
End-December 2010 (performance criterion)	-98.5

B. Cumulative Floor on the Consolidated Public Sector Balance

The consolidated public sector comprises: (i) the operations of the nonfinancial public sector; and (ii) the quasi-fiscal operations of the central bank. The balance of the nonfinancial public sector comprises the overall balances of the central government (as defined before) and the rest of the nonfinancial public sector (municipalities, decentralized entities, social security entities, and public enterprises).

The rest of the nonfinancial public sector includes the following non financial public enterprises: Corporación Dominicana de Empresas Eléctricas Estatales (CDEEE, including Empresa de Generación Hidroeléctrica Dominicana), Empresas Distribuidoras de Electricidad del Norte (EDENORTE), Empresas Distribuidoras de Electricidad del Sur (EDESUR), Empresas Distribuidoras de Electricidad del Este (EDESTE) , Consejo Estatal del Azúcar, Corporación de Fomento Hotelero y Desarrollo Turístico, Corporación de Acueducto y Alcantarillado de Santo Domingo, Acueducto y Alcantarillado de Santiago, Acueducto y Alcantarillado de Moca, Acueducto y Alcantarillado de la Romana, Instituto Nacional de

Aguas Potables y Alcantarillados, Corporación de Acueducto y Alcantarillado de Puerto Plata, Proyecto de la Cruz de Manzanillo, Instituto Postal Dominicano, Corporación Estatal de Radio y Televisión, Instituto Nacional de la Vivienda, Lotería Nacional, Autoridad Portuaria Dominicana, Refinería Dominicana de Petróleo.

The overall balance of the rest of the nonfinancial public sector will be measured from "below the line" as the change in the net financial position (assets minus liabilities) on the basis of changes in: (i) domestic bank credit and deposits; (ii) domestic and external arrears, and (iii) external disbursements less amortizations.

The quasi-fiscal balance of the central bank included in the consolidated public sector balance is measured as all the administrative and financial revenues minus costs (including costs of monetary policy and interest on the central bank debt and operational expenditures). Given uncertainties on interest payments of the central bank by the end of 2009, the cumulative floor on the consolidated public sector will be adjusted downward by up to a limit of RD$0.5 billion for interest payments in excess of RD$27.5 billion for 2009. No adjustments will be applied for 2010 unless agreed between the authorities and the Fund staff in case there is a change in the recapitalization plan of the central bank.

Profits and losses arising from valuation changes of foreign currency denominated assets and liabilities will not be considered to determine the balance of the nonfinancial public sector.

Fiscal targets for 2009 and 2010 will be measured as a cumulative floor measured from end-December 2008.

2. Targets on the Overall Balance of the Consolidated Public Sector

Cumulative Balance from December 31, 2008	Floor (In billions of DR$)
End-October 2009 (program projection)	-40.1
End-November 2009 (program projection)	-56.4
End-December 2009 (performance criterion)	-74.5
End-January 2010 (program projection)	-78.2
End-February 2010 (program projection)	-85.4
End-March 2010 (performance criterion)	-97.5
End-April 2010 (program projection)	-102.2
End-May 2010 (program projection)	-110.0
End-June 2010 (performance criterion)	-119.5
End-July 2010 (program projection)	-123.4
End-August 2010 (program projection)	-125.9
End-September 2010 (performance criterion)	-133.0
End-October 2010 (program projection)	-134.6
End-November 2010 (program projection)	-135.1
End-December 2010 (performance criterion)	-147.0

The information to compute the overall balance of the nonfinancial public sector will be provided to the Fund by the central bank, based on information provided by the government's accounting office (expenditure) and various units of the Secretaría de Hacienda (revenue, nonbank domestic debt and arrears, external debt and arrears, and externally financed capital expenditure).

C. Floor on Central Bank Consolidated Net International Reserves (NIR)

For program monitoring purposes, the consolidated NIR is defined as the difference between gross international reserves of the central bank and reserve liabilities, including debt of the Ministry of Finance with the IMF as follows:

Gross international reserves include claims against non-residents, denominated in foreign convertible currencies that are in the direct effective control of the central bank and are readily available for such purposes as foreign exchange market intervention. Such assets include gold (valued in dollars at end-2008 prices), cash, deposits abroad (excluding funds used as collateral for central bank or other nonfinancial public sector liabilities), holdings of SDRs, and the IMF reserve position.

Reserve liabilities include debt with the IMF, including that of the Ministry of Finance, and short-term (up to one year) foreign-currency-denominated liabilities, including commitments to sell foreign exchange from derivatives or other contracts, and other guarantees or contingent liabilities.

The consolidated NIR definition does not modify the central bank balance sheet accounting rules. The consolidated NIR as defined above differs from the NIR definition included in the previous 2005 Stand-By Arrangement that excluded reserve requirements on foreign currency deposits, and government and bank deposits in foreign currency as they were considered part of the reserve liabilities.

To meet this performance criterion at each relevant date, the 5-day average of daily consolidated NIR values must be above the floor. The 5-day average will be calculated on the basis of the last five working days of each relevant month.

3. Targets on the Consolidated Net international Reserves

Outstanding stock	Floor (In millions of US$)
End-October 2009 (program projection)	2125
End-November 2009 (program projection)	2010
End-December 2009 (performance criterion)	1815
End-January 2010 (program projection)	1780
End-February 2010 (program projection)	1750
End-March 2010 (performance criterion)	1715
End-April 2010 (program projection)	1700
End-May 2010 (program projection)	1680
End-June 2010 (performance criterion)	1665
End-July 2010 (program projection)	1680
End-August 2010 (program projection)	1700
End-September 2010 (performance criterion)	1715
End-October 2010 (program projection)	1750
End-November 2010 (program projection)	1780
End-December 2010 (performance criterion)	1815

Consolidated NIR targets will also be adjusted upward *(downward)* by the surplus (*shortfall*) in program disbursements up to US$300 million. Program disbursements are defined as uncommitted external disbursements that are usable for the financing of the overall central government budget.

4. External Program Disbursements (program projections)

Cumulative flows from December 2008	(In million US$)
End-October 2009	80
End-November 2009	519
End-December 2009	819
End-January 2010	819
End-February 2010	864
End-March 2010	864
End-April 2010	864
End-May 2010	1079
End-June 2010	1079
End-July 2010	1229
End-August 2010	1229
End-September 2010	1229
End-October 2010	1229
End-November 2010	1244
End-December 2010	1244

D. Ceiling on Central Bank Net Domestic Assets (NDA)

Central Bank net domestic assets (NDA) are defined as the difference between the monetary base and Consolidated NIR, as defined above. For the purposes of the program the monetary base is defined as equivalent to *emisión monetaria* , which includes currency issue (currency in circulation plus cash in vault) plus peso reserve requirements held by financial institutions at the central bank.

To meet this performance criterion at each relevant date, the 5-day average of daily NDA values must be below the ceiling. The 5-day average will be calculated on the basis of the last working days of each relevant month.

For accounting purposes, dollar accounts will be converted to *pesos* at the accounting exchange rate of RD$36.5 per dollar.

5. Targets on the Net Domestic Assets

Outstanding stock	Ceiling (In billions of DR$)
End-October 2009 (program projection)	48
End-November 2009 (program projection)	58
End-December 2009 (program projection)	68
End-January 2010 (program projection)	67
End-February 2010 (program projection)	66
End-March 2010 (program projection)	64
End-April 2010 (program projection)	65
End-May 2010 (program projection)	66
End-June 2010 (program projection)	67
End-July 2010 (program projection)	66
End-August 2010 (program projection)	67
End-September 2010 (performance criterion)	65
End-October 2010 (program projection)	70
End-November 2010 (program projection)	75
End-December 2010 (performance criterion)	80

NDA targets will be adjusted upward *(downward)* for any *increase (decrease)* in reserve requirement deposits *(encaje)* associated with peso deposits at the central bank. NDA targets will be adjusted downward *(upward)* by the surplus *(shortfall)* in program disbursements up to US$300 million.

E. Ceiling on the Accumulation of Arrears of Public Electricity Distributors with Generators

The government will regularize all outstanding domestic arrears (as defined in section IA above) with electricity generators using the available financial mechanisms before the end of the year. Arrears to private energy generating companies are defined as the balance of current invoices for energy sales to electricity distribution companies for which no payment has been made within 45 days following the contractual due date.

F. Continuous Ceiling on the Gross Accumulation of Public Sector External Arrears

The central government and any other entity of the nonfinancial public sector, as defined above, as well as the central bank, will not incur new arrears in the payment of their external obligations at any time during the program. Arrears are defined as a delay in the payment of contractual obligations beyond the grace period set in the respective loan or debt contracts or 30 days in case the grace period is not specified.

II. Information requirements

To ensure adequate monitoring of economic variables and reforms, the authorities will provide the following information:

A. Daily

- Deposits in the banking system, exchange rate in the official and free markets, interest rates on bank loans and deposits, Consolidated NIR, currency in circulation, deposits held by financial institutions at the central bank, excess reserves of the banking sector in local and foreign currency, liquidity assistance to banks, central bank certificates, and all other remunerated liabilities of the central bank.
- Deposit of, and liquidity assistance to, troubled institutions, by institution.
- Central bank purchases and sales of foreign currency.
- Central bank intervention operations in domestic currency, including results of auctions of central bank paper (interest rates, details of bids, including minimum and maximum rates, volumes, and maturities).

B. Monthly

- Tax collection and expenditure of the central government, with a lag of no more than two weeks after the closing of each month.
- Starting in September 2009, revenue, expenditure, and financing of the nonfinancial public sector, including decentralized agencies and public enterprises of the previous month.
- Saving-investment account of the central government.
- Net financial position of the central government (as defined in section I.A.) with a lag of no more than two weeks after the end of each month.
- Central government's domestic interest, contractually due in the period and effectively paid, with a lag of no more than two weeks after the end of each month.

- Authorizations and stock of administrative debt, including the economic classification of the expenditure that has been financed with such debt, with a lag of no more than two weeks after the end of each month.
- Value of outstanding checks issued by the Treasury with a lag of no more than two weeks after the end of each month, starting in September 2009.
- Legal measures that affect the revenue of the central government (tax rates, import tariffs, exemptions, etc).
- In-kind capital expenditure statistics.
- Balance sheet of the central bank, *Banco de Reservas*, and deposit money banks (cable file).
- Balance sheet of the central bank excluding operations related to the recapitalization of the central bank and quasi fiscal.
- Quasi-fiscal balance of the central bank.
- Stock of central bank certificates, notes and bills each by type of holder.
- Maturity of certificates, detailing amortizations in the following 12 months (i.e., following the end of the current month).
- Public external debt service for the preceding month and revised monthly projections for the forthcoming year, with a lag of no more than two weeks.
- Monthly external public disbursements and revised monthly projections for the forthcoming year, with a lag of no more than two weeks.
- Monthly contracting of external public debt and monthly stock of contracted, but not disbursed external public debt, with projections of the stock of debt contracted, but not disbursed for the forthcoming year.
- Foreign exchange cash flow of the central bank (la balanza cambiaria).
- Electricity sector collections, losses, cash recovery index and central government transfers to the electricity sector, according to the following definitions: Collection rate: is defined as the ratio between the electricity invoices effectively paid (collected) and electricity invoices issued by electricity distributors in any given period. Loss rate: is defined as the ratio between electricity lost and electricity purchased by electricity distributors in any given period. Electricity lost is the difference between electricity invoiced and electricity purchased. Central government transfers to the electricity sector: is the sum of all transfers to the sector from the central government, including remaining PRA subsidies, FETE (*Fondo de Estabilización de la Tarifa Eléctrica*) and transfers to electricity companies, and all payments related to Bono Luz. The CDEEE will provide on a monthly basis (with a maximum 21-day lag) information on the arrears the generation companies accumulate with the CDEEE on energy purchases and transmission fees.

- Price of each fuel as set in the contracts for the purchase of electricity by each distributor and CDEEE from each producer for the next 6 months for coal and 3 months for other fuels.

- Purchases of electricity by each of the three distibutors and CDEEE from each generator. This includes quantity of electricity purchased (in KWh) and the unit price of each fuel charged by type of fuel and the quantity used in electricity generation. In addition report the quantity and unit price of electricity purchased by each distributor and CDEEE in the spot market.

C. Quarterly

- Revised balance of payments outturn for the preceding quarter and quarterly projections for the forthcoming year, with a lag of no more than four weeks.
- Revised estimates of the stock of short-term and medium- and long-term public external debt, by creditor, at the end of quarter, with a lag of no more than four weeks.
- Stock of public sector domestic debt, including public sector debt in the electricity sector.
- Stock of *avales* and any other guarantees or contingent liabilities of the public sector.
- Revised estimates of the quarterly disbursements, debt service and stocks of short-term and medium- and long-term private external debt, by debtor, at the end of quarter, with a lag of no more than two weeks.
- Stock of public external late payments and arrears (program definition), by debtor and creditor, with details on new arrears incurred in the last month and clearance of old arrears, with a lag of no more than 5 working days.
- Stock of domestic arrears, starting with figures for December 2008, with details on new arrears incurred in the period and clearance of old arrears.

INTERNATIONAL MONETARY FUND

DOMINICAN REPUBLIC

Staff Report for the 2009 Article IV Consultation and Request for a Stand-By Arrangement – Informational Annex

Prepared by Western Hemisphere Department
(In collaboration with other departments)

Approved by Rodrigo Valdés and Dominique Desruelle

October 26, 2009

Contents Page

Annex I–Relations With The Fund
(as of September 30, 2009)

I.	**Membership Status: Joined: December 28, 1945**		**Article VIII**
	A. Financial Relations		
II.	**General Resources Account:**	**SDR Million**	**% Quota**
	Quota	218.9	100.00
	Fund holdings of currency	507.84	232.00
	Reserve Tranche Position	0.00	0.00
	Lending to the Fund Holdings Exchange Rate		
III.	**SDR Department:**	**SDR Million**	**%Allocation**
	Net cumulative allocation	208.83	100.00
	Holdings	178.13	85.30
IV.	**Outstanding purchases and Loans:**	**SDR Million**	**% Quota**
	Stand-by Arrangements	288.94	132.00

V. Latest Financial Arrangements:

Type	Date of Arrangement	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
Stand-By	Jan 31, 2005	Jan 30, 2008	437.80	437.80
Stand-By	Aug 29, 2003	Jan 31, 2005	437.80	131.34
Stand-By	Jul 09, 1993	Mar 28, 1994	31.80	16.80

VI. Projected payments to Fund 1/
(SDR Million: based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2009	2010	2011	2012	2013
Principal		96.32	110.76	72.23	9.63
Charges/Interest	0.95	3.45	2.03	0.77	0.12
Total	0.95	99.77	112.79	73.00	9.75

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

VII. **Safeguards Assessment.** The BCRD was subject to a safeguards assessment with respect to the Stand-By Arrangement approved on January 31, 2005. The assessment, completed on April 27, 2005, noted that the BCRD implemented a number of earlier safeguards recommendations, but also identified vulnerabilities mainly in the areas of internal controls over the reporting of monetary data to the IMF, financial reporting and external audit.

VIII. **Article IV Consultation**. The last Article IV consultation was concluded by the Executive Board on January 30, 2008. The First Post-Program Monitoring Review was concluded on January 12, 2009.

IX. **FSAP Participation**. An FSAP update was completed in March 2009. A Financial System Stability Assessment report for the Dominican Republic was issued on May 20, 2002. The corresponding FSAP report was issued in November 2001.

X. **Technical Assistance** has been substantial since 2004.

XI. **Resident Representative**. The Fund representative office was closed in July 2008.

XII. **Other**. The Dominican Republic has not yet ratified the Fourth Amendment.

Annex II—Relations with the World Bank Group

1. The World Bank's total loan commitments in the Dominican Republic amounts to US$326.2 million, of which US$234.0 million remains to be disbursed. The loan portfolio consists of ten loans: seven for investment (Water and Sanitation in Tourist Areas, Early Childhood Development, Health Sector Reform I and II, Youth Development, Social Protection -including an additional financing of US$10 million- and Energy Distribution); two for Technical Assistance (Financial Sector and Energy Sector); and an Emergency Recovery Loan. The Water and Sanitation in Tourist Areas loan, the Health Sector Reform II loan and the additional financing for Social Protection will be signed by the end of November, 2009 and their congressional ratification is expected to take place before the end of the year.

2. Two DPLs have been recently negotiated and their congressional ratification is also expected to take place before the end of 2009.These are: the Public Finance and Social Sector DPL and the First Performance and Accountability of Social Sectors DPL.

3. One investment project is under preparation: Municipal Development Project (US$20 million). The World Bank Group portfolio also includes additional commitments from the IFC and MIGA.

4. Portfolio performance in the Dominican Republic is starting to improve after the last FY09 setback. As of October 2009, the disbursement ratio is 14 percent, above of the regional (Latin-American and the Caribbean) and sub-regional (Caribbean) average of 7.8 and 9.7 percent respectively; commitments at risk are 7.7 percent and projects at risk are 10 percent. If the portfolio follows the trend observed in the first quarter of FY10 (July – August 2009), we could expect significant improvements in its performance by the end of the year.

5. A comprehensive set of analytical studies has been completed in recent years. In FY 2009, a Growth Study CEM (Country Economic Memorandum), an update of the Financial Sector Assessment Program, a new Country Partnership Strategy (FY09-FY13) and an update of the Report of the Observance of Standards and Codes (ROSC) in Accounting and Auditing. The Bank will be delivering in November 2009 a set of Policy Notes that have been feeding the National Development Strategy.

Dominican Republic: Recent Technical Assistance Missions

Mission title	Start date	End date	Number of members	Department
National accounts statistics	1/11/2004	1/23/2004	1	STA
GDDS: metadata development	3/15/2004	3/20/2004	1	STA
National accounts statistics	4/19/2004	4/30/2004	1	STA
Money and banking statistics and GDDS development	6/30/2004	7/14/2004	1	STA
GDDS: metadata development for real sector	7/11/2004	7/16/2004	1	STA
GDDS: metadata development for government finance statistics	7/11/2004	7/16/2004	1	STA
Balance of payments statistics: peripatetic expert: 3 of 3	10/4/2004	12/3/2004	1	STA
ROSC data module	8/3/2005	8/16/2005	6	STA
Government finance statistics	4/26/2007	5/11/2007	1	STA
Tax reform-discussions with authorities	4/16/2004	4/17/2004	2	FAD
CARTAC-VAT implementation	4/19/2004	4/23/2004	1	FAD
Tax Administration diagnostic mission with CARTAC	2/24/2005	3/9/2005	4	FAD
Public expenditure management diagnostic mission	8/14/2005	8/28/2005	4	FAD
Public expenditure management follow-up mission	7/25/2005	8/5/2005	4	FAD
Restructuring of fiscal institutions, treasury modernization, and budget coordination.	7/26/2006	8/8/2006	4	FAD
Tax reform-discussions with authorities	10/10/2006	10/13/2006	2	FAD
Bank restructuring	2/2/2004	2/13/2004	2	MFD
AML/CFT	2/9/2004	2/13/2004	3	MFD
Monetary operations	3/1/2004	3/12/2004	1	MFD
Develop bank resolution strategy	3/8/2004	3/19/2004	2	MFD
Bank restructuring	7/21/2004	7/23/2004	2	MFD
AML/CFT controls for central bank operations	7/27/2004	8/2/2004	1	MFD
Bank restructuring	8/10/2004	8/13/2004	2	MFD
Bank restructuring	3/13/2005	3/18/2005	4	MFD
Electronic forex trading platforms and regulations	5/16/2005	5/20/2005	2	MFD
Banking supervision	5/30/2005	6/2/2005	1	MFD
Bank restructuring	7/26/2005	7/29/2005	1	MFD
Asset recovery	8/17/2005	8/26/2005	1	MFD
Asset recovery	11/29/2005	12/6/2005	1	MFD
Bank restructuring	1/23/2006	2/2/2006	1	MFD
Monetary policy and operations	3/18/2006	3/31/2006	8	MFD
Central bank recapitalization	3/20/2006	3/27/2006	3	MFD
Debt management	3/20/2006	3/27/2006	4	MFD
Asset recovery	6/26/2006	7/1/2006	1	MCM
Consolidated supervision	7/17/2006	7/21/2006	5	MCM
Debt management and central bank recapitalization	11/6/2006	11/15/2006	5	MCM
Banking law	3/12/2007	3/13/2007	2	MCM/LEG
Asset recovery	3/15/2007	3/23/2007	1	MCM

A. IBRD and IDA Operations [1]				
Loan	Sector	Commitments	Disbursements	Undisbursed Amount
DO: Telecom Regulatory Reform /2	TELECOM	12.3	10.3	2.0
DO(APL1)Water&Sanitation inTourist Areas	WATER	27.5	0.0	27.5
DO-EARLY CHILDHOOD EDUCATION PROJECT	EDUCATION	42.0	26.7	15.3
DO-HIV/AIDS Prevention & Control Proj./3	HEALTH	25.0	20.4	4.6
DO-Health Reform Support (APL)	HEALTH	30.0	25.5	4.5
DO Financial Sector Technical Assistance	FINANCIAL	12.5	5.5	7.0
DO Pow er Sector Program Loan /4	ENERGY	150.0	100.0	50.0
DO Pow er Sector TA Project	ENERGY	7.3	5.8	1.5
DO Electricity Distrib Rehabilitation	ENERGY	42.0	0.1	41.9
DO Social Sectors Investment Program	SOCIAL PROTECTION	29.4	0.7	28.7
DO Youth Development Project	SOCIAL PROTECTION	25.0	5.8	19.2
DO (APL2) Health Ref II	HEALTH	30.5	0.0	30.5
DO Emergency Recovery & Disaster Mgmt	EMERGENCY	80.0	22.2	57.8
1/ As of October 8, 2009				
/2 US$2 millions (third trench) w as cancelled. It is closed				
/3 US$4.6 millions (third trench) w as cancelled. It is closed				
/4 US$50 millions (third trench) w as cancelled. It is closed				

B. IFC Operations				
	Loans	Equity	Quasi-Equity	Participants
Held	87.66	33.89	52.27	9.25
Disbursed	87.66	33.89	52.27	9.25
As of Oct 8, 2009				

C. MIGA

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009*
Outstanding gross guarantees	152.4	181.4	242.8	183.7	91.3	78.7	157.3	127.9	126	124.7

*As of November 30, 2008 (Fiscal Year 2009)

D. IBRD and IDA Loan Transactions (Fiscal year)

	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Disbursements	11.3	42.8	77	50.8	52.4	41.9	71.2	40.4	39.4	69.1	74.8	8.5
Repayments	24.6	22.7	20.14	22.49	23.8	27.1	34.6	37.9	35.5	36.9	40.6	22.0
Net lending	-13.3	20.1	56.9	28.4	28.6	14.8	36.6	2.5	3.9	32.21	34.3	-13.4
Valuation adjustments	-17.7	6.7	0.3	-1.3	0.8							
Debt outstanding	212.3	239.1	295.6	322	350.7	365.3	401.2	393	402.6	435.16	477.99	461.2
Interest and charges	14.7	14.8	19.4	22.5	22	21	18.8	19.9	21.14	22.6	25	10.7

Annex III—Relations with the Inter-American Development Bank

1. In 2009, the IDB estimates disbursements for US$285,7 million, excluding a probable US$300 million disbursement from the Fiscal Strengthening Program, to be approved in October 2009 (see below).

Dominican Republic: Relations with the Inter-American Development Bank
(As of October 09, 2009, in millions of U.S. dollars)

A. Operations

Sector	Commitments	Disbursed	Undisbursed Amounts
Agriculture	55.0	53.7	1.3
Science and Technology	-	-	-
Urban Dev. And Housing	-	-	-
Education	80.0	61.0	19.0
Labor Market, Training, and Transfers	10.0	5.8	4.2
Sanitation	31.3	6.7	24.6
State Modernization	234.0	134.2	99.8
Health	-	-	-
Transportation	50.0	10.5	39.5
Private Sector Development	9.4	9.4	-
Disaster Prevention	25.0	20.3	4.7
Energy	40.0	-	40.0
Social Investment	70.0	-	70.0
Total	604.7	301.6	303.1

B. Loan Transactions

B. Loan Transactions

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009 1/
Disbursements	58.3	142.4	184.1	155.1	254.2	135.7	118.1	109.5	137.4	285.7
Repayments	38.4	45.5	50.7	118.8	63.9	67.0	75.5	171.7	167.4	135.9
Net Lending	19.9	96.9	133.4	36.3	190.3	68.7	42.6	-62.2	-30.0	149.8
Interests and Charges	33.2	36.0	40.9	48.0	52.0	56.0	66.1	66.0	62.3	56.6
Subscriptions and Contributions	7.3	0.7	0.5	0.4	4.0	3.8	2.1	1.9	0.0	0.0
Net Transfer	-20.6	60.2	92.0	-12.1	134.3	8.9	-25.6	-130.1	-92.3	93.2

1/ Estimate, excluding a probable US$300 million disbursement from the Fiscal Strengthening Program, to be approved in october 2009.

2. As of October 2009 the Bank is close to approving a Fiscal Strengthening Program (US$500 million), which would contemplate additional disbursements in two tranches (US$300 million in 2009 and US$200 million in 2010). For 2010, the Bank will work in the preparation of three investment projects: the second phase of the Program to Support an Agricultural Competitive Transition (US$30 million); the Education Decennial Plan Support Program (US$39 million); and the second phase of a Social Protection Program (US$35 million). Additionally, the Bank is currently in the final stages of the design of the IDB Country Strategy for the period 2009-2012.

Annex IV—Statistical Issues

General issues and data adequacy for surveillance

3. Data provision has some shortcomings, but is broadly adequate for surveillance. The authorities are working to correct weaknesses in their statistical database. The country has participated in the General Data Dissemination System (GDDS) since November 2005.

4. In 2005, a data ROSC mission assessed the statistical system, which is highly centralized in the Central Bank of the Dominican Republic (BCRD). The mission found that notwithstanding recent efforts to improve the quality of macroeconomic statistics, important weaknesses remained. The legal framework is adequate for monetary and balance of payments statistics, but not for other macroeconomic statistics. In most areas the macroeconomic statistics should more closely follow current international methodologies, and source data need to be more fully developed. Statistical techniques are broadly adequate, except for the significant shortcomings of the consumer price index (where weights and reference periods are not aligned). Periodicity and timeliness of data meet or exceed GDDS recommendations. Revision analysis and studies are generally absent or not disseminated.

Real sector statistics

5. *GDP data.* Five STA missions from January 2002 to April 2004 assisted the BCRD in compiling consistent quarterly GDP estimates, and updating the base year of the annual series to 1991. Although a new series for the period 1991–2003 was published in July 2004, the new series was not immediately incorporated in the official quarterly GDP figures. The revised annual and quarterly series for the period 1991–2005 were released on March 16, 2006. The revised GDP estimates are, on average, 17 percent higher than the previous ones. The new base year of 1991 is already outdated as international guidelines on national accounts compilation recommend updating the base year at least every five years.

6. *CPI data.* The CPI weights are based on the 1997–98 household expenditure and income survey and need to be updated. The 2005 data ROSC noted the need for appropriate adjustments for seasonal and missing price imputations, changes in product specifications and quality, and new products. The CPI also needs to take into account imputed rent for owner-occupied dwellings and dwellings used by third parties without payment.

7. *Other.* Data are not always reported for publication in *International Financial Statistics* (*IFS*) with the required timeliness and have weak coverage of major real sector indicators. There are no available series for producer prices and wages (except minimum wages). Quarterly and annual industrial production data are posted on the central bank's website.

Government finance statistics

8. The April 2002 multisector technical assistance mission and the August 2005 data ROSC mission identified significant shortcomings in the fiscal data on the general government. These shortcomings included (i) legislation that does not clearly define the responsibility for collecting, compiling, and disseminating government finance statistics (GFS); (ii) data sources and data collection procedures that need to be more fully developed; (iii) an analytical framework for compiling GFS that is not fully aligned with international guidelines; (iv) lack of formal procedures to coordinate the exchange of information among GFS compilers; and (v) the absence of an integrated system of financial management that supports GFS compilation.

9. The 2002 mission prepared an action plan to improve collection, compilation, and dissemination of fiscal data, and elaborated a table to bridge the budgetary and the *Government Finance Statistics Manual 2001* (*GFSM 2001)* classifications. The 2005 mission concluded that the number of staff of the State Secretariat of Finance (SSF) was insufficient for the compilation of GFS and that the coverage of the GFS remained incomplete. An April/May 2007 statistics mission assisted the BCRD and the SSF in improving the collection, compilation, and reporting of GFS, on accrual and cash bases, based on the *GFSM 2001*. The BCRD compiles and disseminates annual GFS data published in the *Government Finance Statistics Yearbook*.

10. The country is currently participating in a regional project for the harmonization of GFS for Central America, Panama, and the Dominican Republic (CAPDR). As part of this project, a June 2009 mission provided further assistance to tackle the issues raised in the previous paragraphs and assisted the authorities in improving the quality of annual accrual-based data.

Monetary and financial statistics

11. The monetary statistics currently reported to WHD are affected by the following issues: (i) lack of sufficient detail to allow for a proper sectorization of accounts and classification of financial instruments; (ii) concepts and principles underlying valuation, classification of financial instruments, and sectorization of institutional units are inconsistent with internationally accepted methodology; (iii) the institutional and financial instrument coverage is not comprehensive; and (iv) the system for reporting lacks a consistent methodology. To address these issues, April 2003 and July 2004 monetary statistics missions began the development of an integrated database to be used by the authorities, STA, and WHD, based on the methodology recommended in the *Monetary and Financial Statistics Manual*. Although the methodology applied in the new database is sound, several problems remain, including lack of data on financial cooperatives and offshore operations of resident banks.

12. The country began to report monetary data to STA in the standardized report forms (SRFs) in August 2007, which are being used for national publications as well since July 2009. SRFs based data overcome the shortcomings described in the previous paragraph;

however, the lack of data on financial cooperatives and offshore operations of resident banks still remains. 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.

External sector statistics

13. Since February 1997, balance of payments statistics have been compiled according to the *fifth edition of the Balance of Payments Manual*. However, problems of coverage remain for imports, capital transfers, income, and the financial account, giving rise to large errors and omissions. Three technical assistance missions during 2002–04 have assisted the BCRD in improving balance of payments statistics and preparing the International Investment Position (IIP) data, which are now available up to 2007. A follow up mission was conducted in August 2007 that focused on sample surveys and statistical techniques to improve the compilation of direct investment, portfolio investment, and other nonfinancial private sector assets and liabilities, as well as domestically issued public debt held by nonresidents. A 15-month action plan with recommendations for improving the balance of payments and IIP statistics was prepared by the mission in consultation with the BCRD. The compilation of the external accounts complies with the requirements of the GDDS in terms of periodicity and timeliness.

Data dissemination

14. The authorities publish quarterly reports on economic developments. The reports contain timely preliminary data on real GDP, consumer prices, interest rates, exchange rates, balance of payments, exports and imports, operations of the central government, and the banking system. The Quarterly Bulletin of the BCRD contains more detailed information on sectoral developments, but the bulletin is sometimes published with delays. The BCRD also maintains a website that presents selected data on a relatively timely basis.

Dominican Republic: Table of Common Indicators Required for Surveillance

As of October 6, 2009	Date of latest observation	Date received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of Publication[7]	Memo Items: Data Quality – Methodological Soundness[9]	Memo Items: Data Quality – Accuracy and Reliability[8]
Exchange Rates	Oct 2009	10/2/09	D	D	M		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	Oct 2009	10/2/09	D	D	M		
Reserve/Base Money	Oct 2009	9/18/09	D	D	M	LNO, O, LO, LO	LO, O, O, O, LO
Broad Money	Oct 2009	9/18/09	M	M	M		
Central Bank Balance Sheet	Oct 2009	9/18/09	M	M	M		
Consolidated Balance Sheet of the Banking System	Oct 2009	9/18/09	M	M	M		
Interest Rates[2]	Agust 2009	9/20/09	D	D	M		
Consumer Price Index	August 2009	9/19/09	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	June 2009	8/30/09	M	M	M		
Stocks of Central Government and Central Government-Guaranteed Debt[5]			Q	Q	Q		
External Current Account Balance	2008	3/27/09	Q	Q	Q	O, LO, LO, LO	LO, O, LO, LO, NO
Exports and Imports of Goods and Services	2009	3/27/08	Q	Q	Q		
GDP/GNP	2009 Q2	9/15/09	Q	Q	Q	LNO, LO, LNO, LO	LNO, LO, LNO, O, LNO
Gross External Debt			Q	Q	Q		
International Investment Position[6]	2008	5/5/09	Q	I	I		

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[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.
[7] Daily (D); weekly (W); monthly (M); quarterly (Q); annually (A); irregular (I); and not available (NA).
[8] Reflects the assessment provided in the data ROSC or the Substantive Update (published on June 27, 2006, and based on the findings of the mission that took place during August 3–16, 2006) or the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O); largely observed (LO); largely not observed (LNO); not observed (NO); and not available (NA).
[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 the IMF Staff Representative on the Dominican Republic
November 9, 2009

This statement provides additional information on developments since the issuance of the staff report for the 2009 Article IV Consultation and Request for a SBA for the Dominican Republic. This information does not change the thrust of the staff report.

I. Recent Developments

The latest economic indicators confirm that the recession continues. Economic activity remains weak, there are no pressure on domestic prices and the sharp contraction in trade and taxes is still ongoing.

- ***Aggregate demand remains depressed***. Non-oil imports fell by almost 25 percent in the first half of 2009 (yoy) and continued to fall at the same rate in the third quarter. Similarly, exports fell by over 35 percent in the first half of 2009 (yoy) and 30 percent in the third quarter. Electricity consumption was down 8 percent to August 2009 (yoy). Travel arrivals are the exception, having fallen 3½ percent in the first half of 2009 (yoy), they expanded by 1½ percent in the third quarter (yoy).

- ***Inflation continues to be subdued***. Headline inflation for October 2009 was 0.2 percent, taking the 12-month rate to -0.3 percent and cumulative inflation in the year to 4.5 percent.

- ***Monetary policy remains accommodative***. The monetary council met on October 30 and decided to leave interest rates unchanged. The growth of monetary aggregates and private credit remains low.

- ***The foreign exchange market continues to be stable***. The Dominican peso stayed flat with respect to the U.S. dollar in October 2009, after having depreciated only 3 percent in the previous 12 months. The Central Bank had virtually no intervention in October (net sales of US$75 million).

- ***The fiscal position remains tight.*** Preliminary information indicates that overall revenues fell by 10 percent in the period January-September 2009 (yoy). The fall in revenues was matched by a similar fall in expenditures, with current expenditure down 2 percent and capital expenditure down over 30 percent.

II. Debt Issues

There are no sovereign arrears to external creditors. However, there are potential claims on the government. In addition, the authorities are carrying out an inventory of claims to ensure accuracy of the debt reporting system.

- ***Clearance of arrears***. In October 2009, the authorities settled arrears to external creditors for some US$16 million outstanding as of end-September 2009. Payments for about US$2½ million were made mostly to suppliers and about US$13½ million were reconciled and securitized with PDVSA (the state oil company of Venezuela) following the principles of the 2005 Caracas accord.

- ***Potential claims on the government.*** There are potentially two large claims on the government: (i) an American company has threatened to sue the Dominican government in U.S. courts for US$100 million for breach of a contract signed in 2002 on a housing project that was never carried out; and (ii) the heir of a former owner of several companies expropriated in the early 1960s during the Trujillo administration is seeking compensation from the government. According to the claimant, the value of these claims could be over US$1 billion.

- ***Debt verification.*** The authorities are conducting an exercise to verify the amounts recorded in their debt reporting systems. According to the system, there are unverified claims for about US$6 million to several foreign suppliers of the public electricity corporation (CDEEE) from the late 1980s for which records are incomplete and partly inconsistent; the records do not allow yet to form a view as to whether the claims are valid. If the verification exercise determines that these claims are not valid, staff will propose to take them out of the debt reporting system.

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Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

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

IMF Executive Board Concludes 2009 Article IV Consultation with the Dominican Republic

On November 9, 2009, the Executive Board of the International Monetary Fund (IMF) concluded the 2009 Article IV consultation with the Dominican Republic.[1]

Background

The Dominican economy has been adversely affected by the global crisis. Output has been below potential as real Gross Domestic Product (GDP) growth is decelerating rapidly from over 5 percent in 2008 to an estimated 0.5 to 1.5 percent in 2009. Inflation has fallen rapidly to -0.3 percent year-over-year in October 2009 as the supply shocks of last year have unwound. The external current account deficit is estimated to be around 6 percent of GDP in 2009, about 4 percentage points lower than in 2008, as imports have fallen more than exports, tourism and remittances. The banking system has withstood the global crisis and remains liquid, well-capitalized and profitable.

Monetary authorities have responded to the crisis in a timely manner, but fiscal policy has been constrained by a lack of external financing. The Central Bank lowered its policy interest

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. 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.

rate by 550 basis points to 4 percent during 2009, and reserve requirements were also lowered by 250 basis points to 17.5 percent. Following a relaxed stance in 2008, fiscal policy has been tight in the first 3 quarters of 2009, as a decline in tax revenues of 10 percent to September (with respect to January–September 2008) was met with a larger decline in expenditures. The deficit of the consolidated public sector was about 2 percent of GDP during the first three quarters of 2009, or around 1 percentage point of GDP lower than during the first three quarters of 2008.

Structural impediments in the fiscal and electricity sector put a heavy burden on public finances. There is a risk that the decline in tax revenues observed in 2008-09 (of more than 10 percent) may be partly related to undue use of tax exemptions contained in competitiveness laws. Serious structural weaknesses continue to leave the state-owned electricity distribution companies with large losses. Untargeted subsidies to cover these losses remain a drain on public finances, absorbing over one percent of GDP in 2009. Notwithstanding these subsidies, the quality of service to citizens in the electricity sector remains very poor.

The authorities' program aims to limit the effects of the global slowdown on the economy while establishing the conditions for robust and sustainable growth. The program is expected to catalyze financing from multilaterals for the conduct of a countercyclical fiscal policy in the short term, while monetary policy will remain flexible to respond to the liquidity needs of the economy. The medium-term program calls for a gradual fiscal consolidation to ensure sustainability as the economic activity rebounds. International reserves will also be increased to comfortable levels as the exchange rate is gradually made more flexible and the Central Bank adopts a full-fledged inflation targeting regime in the medium-term. The authorities' program also aims to address fiscal impediments, especially in the area of revenue collection, and to eliminate untargeted electricity subsidies. The authorities' economic program is supported by a Stand-By Arrangement with the IMF, which was alslo approved by the Executive Board on November 9 (see Press Release 09/393).

Executive Board Assessment

Executive Directors agreed with the thrust of the staff appraisal. They noted that the global economic recession has significantly weakened the Dominican economy, with growth declining markedly in 2009. Inflation has remained subdued and the current account deficit narrowed. Directors welcomed the authorities' economic program, which aims at returning the economy to its high, sustainable growth path, through flexible, countercyclical policies in the short run, and pursuing over the medium term a fiscal consolidation strategy and an ambitious structural reform agenda.

Directors supported the temporary fiscal stimulus in 2009-10, including the full play of automatic stabilizers, in light of well below potential output and as financing constraints are relieved. Fiscal policy could be relaxed as additional external financing is secured, targeting investment projects with high social returns while strengthening social safety nets. At the same time, Directors called on the authorities to follow through on their commitment to medium-term sustainability by shifting to a fiscal consolidation effort beginning in the second half of 2010. Work should start promptly on the planned structural measures, in particular improvements in tax administration, with Fund technical assistance, and on the elimination of untargeted electricity subsidies. The finalization and implementation of a comprehensive plan to address structural impediments in the electricity sector also remain a high priority.

Directors welcomed the flexible implementation of monetary policy, with a timely shift to an accommodative stance in 2009 to stimulate economic activity. While this stance remains appropriate at present, Directors noted the limited scope for further reducing policy interest rates, as well as banks' high liquidity preference. Directors encouraged the monetary authorities to remain vigilant and stand ready to withdraw liquidity gradually as private credit picks up. They commended the authorities for the progress in strengthening the central bank as an effective monetary authority, and stressed the importance of proceeding with the recapitalization plan to enhance its credibility further.

Directors welcomed the monetary authorities' commitment to a flexible exchange rate, and took note of the staff assessment that the real effective exchange rate is broadly in line with fundamentals. Given the relatively low level of international reserves, gradually introducing more flexibility within the current managed floating regime would help cushion potential external shocks. Consideration would also need to be given to continued strengthening of the monetary anchor, and Directors supported the authorities' intention to move to an inflation-targeting regime once the supporting institutional framework has been put in place.

Directors welcomed significant improvements in the regulation, supervision, and financial strength of the banking system. As a result of previous reforms, the Dominican banking system remains liquid, solvent, and profitable, despite the global credit crunch. Directors emphasized the need to continue monitoring the system closely and stand ready to take necessary measures to prevent systemic problems. They encouraged the authorities to advance the implementation of risk-based consolidated bank supervision and regulation, and to formulate strategies for domestic capital market development and debt management.

It is expected that the next Article IV consultation with the Dominican Republic will be held in accordance with the Executive Board decision on the consultation cycle for members with Fund arrangements.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case.

Dominican Republic: Selected Economic Indicators

Main export products: tourism, textiles, nickel.			
GDP per capita (U.S. dollars, 2008 PPP)	5,122	Income share by highest	
Population (millions, 2009 estimate)	10.1	10 percent (percent, 2006)	39.0
Life expectancy at birth (years, 2008)	73.3	Extreme poverty rate (2006)	13.1
Under 5 mortality rate (per thousand, 2008)	31	Adult literacy rate (percent, 2007)	95.1

				Projections			
	2006	2007	2008	2009	2010	2011	2012
National accounts and prices							
Nominal GDP (RD$ billion)	1,190	1,364	1,576	1,648	1,811	2,015	2,211
Dollar GDP (US$ billion)	35.3	41.0	45.5	45.5	47.8	52.2	56.5
Real GDP	10.7	8.5	5.3	0.5-1.5	2-3	6.0	6.0
Consumer price index (period average)	7.6	6.1	10.6	1.5-2.5	6-7	5.0	3.5
Consumer price index (eop)	5.0	8.9	4.5	6-7	6-7	4.0	3.0
Exchange rate (RD$/US$ - period average)	33.7	33.3	34.6	…	…	…	…
Exchange rate (RD$/US$ - eop)	33.8	34.3	35.5	…	…	…	…
Social Indicators							
Unemployment rate (in percent)	16.4	15.6	14.0	…	…	…	…
Households below the poverty line (in percent)							
Public finances 1/							
Central government primary balance	0.2	1.7	-1.5	-1.1	-0.4	0.6	1.6
Total revenues (including grants)	16.2	17.6	15.8	14.0	14.5	15.3	15.7
Primary spending	16.0	15.8	17.4	15.1	14.9	14.7	14.1
Interest expenditure	1.4	1.6	1.7	2.0	2.2	2.2	2.2
Nonfinancial public sector overall balance	-0.9	0.1	-3.3	-3.1	-2.6	-1.6	-0.6
Quasi-fiscal balance of the central bank	-2.2	-1.8	-1.3	-1.4	-1.4	-1.4	-1.4
Consolidated public sector balance	-3.1	-1.7	-4.6	-4.5	-4.0	-3.0	-2.0
Of which: primary balance	0.4	1.8	-1.3	-0.8	0.0	1.0	2.0
Total public debt	39.5	35.8	35.5	39.0	40.3	40.2	38.7
Of which: foreign currency denominated	20.6	19.0	17.1	19.2	20.1	19.3	18.1
Money and credit							
Liabilities to private sector (M3)	12.7	16.0	8.8	11.5	6.4	12.0	12.0
Currency issue	7.0	16.4	0.3	12.5	8.0	12.0	12.0
Deposits	4.5	17.0	10.7	12.0	10.2	12.0	12.0
Net domestic assets of the banking system	11.5	13.0	16.8	16.3	7.3	10.9	11.0
Credit to the private sector	14.3	26.3	8.8	6.0	11.9	12.0	12.0
M3, in percent of GDP	37.1	37.5	35.3	37.7	36.5	36.7	37.5
Balance of payments							
Current account	-1,288	-2,096	-4,414	-2,814	-2,891	-2,524	-2,285
Merchandise trade balance	-5,564	-6,437	-9,174	-6,881	-7,107	-7,076	-7,353
Exports	6,610	7,160	6,782	5,272	5,796	6,738	7,447
Imports	-12,174	-13,597	-15,955	-12,154	-12,903	-13,814	-14,800
Of which: oil and gas	-2,788	-3,224	-4,241	-2,640	-3,220	-3,402	-3,552
Services and transfers (net)	4,276	4,341	4,759	4,067	4,216	4,552	5,068
Of which: interest on public debt 2/	-396	-428	-372	-442	-553	-604	-668
Capital and financial account	1,598	2,359	4,008	2,135	2,891	3,004	2,822
Of which: foreign direct investment	1,528	1,579	3,076	1,966	1,863	1,993	2,116
Errors and omissions	-147	357	104	359	0	0	0
Overall balance	164	620	-303	-320	0	481	537
Of which: change in NIR (increase -)	-268	-607	230	350	0	-481	-537
Current account (in percent of GDP)	-3.6	-5.1	-9.7	-6.2	-6.0	-4.8	-4.0
Exports of goods (in US$, annual percentage chg)	7.6	8.3	-5.3	-22.3	9.9	16.2	10.5
Imports of goods (in US$, annual percentage chg)	23.3	11.7	17.3	-23.8	6.2	7.1	7.1
International reserve position and external debt							
Gross official reserves	2,251	2,946	2,662	2,566	2,942	3,914	4,506
(in months of imports) 3/	1.8	2.0	2.3	2.1	2.3	2.8	3.0
Net international reserves 4/	1,788	2,395	2,165	1,815	1,815	2,296	2,833
Outstanding external public debt, in percent of GDP	20.0	18.0	16.5	17.6	18.1	17.6	16.5
Oil price (WEO) (US$/bbl)	64.3	71.1	97.0	61.5	76.5	79.5	81.0

Sources: Dominican authorities; World Bank; and Fund staff estimates.

1/ Fiscal projections include unidentified measures.

2/ Includes interests on loans and bonds.

3/ In relation to imports of goods and nonfactor services of the following year.

4/ The projections for 2009-12 assume that all prospective purchases under the proposed SBA will be made to meet the gross reserves objectives of the balance of payments projections.

INTERNATIONAL MONETARY FUND
EXTERNAL RELATIONS DEPARTMENT

Press Release No. 09/393
FOR IMMEDIATE RELEASE
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International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Approves US$1.7 Billion Stand-By Arrangement for the Dominican Republic

The Executive Board of the International Monetary Fund (IMF) approved today a 28-month Stand-By Arrangement for the Dominican Republic in the amount of SDR 1,094.5 million (about US$1.7 billion) to support the country's strategy to cope with the adverse effects of the global economic environment.

The authorities' program aims to pursue short-term countercyclical policies; strengthen medium-term sustainability; reduce vulnerabilities exposed during the global crisis; and lay the foundations for a gradual recovery and sustained growth. The Stand-By Arrangement is designed to bolster confidence in the policy framework and catalyze additional financing from other multilateral sources.

Following the Executive Board discussion on the Dominican Republic, Mr. Murilo Portugal, Deputy Managing Director and Acting Chair, made the following statement:

"Following several years of rapid growth, the Dominican economy has weakened significantly in 2009, due to the global economic recession. The authorities timely adjusted their monetary policy stance to stimulate economic activity on the back of subdued inflation. The financial system has weathered the recent global crisis relatively well, as a result of reforms undertaken after the 2003 financial crisis. The lack of adequate financing, however, constrained the conduct of countercyclical fiscal policy.

"The authorities' macroeconomic framework, supported by a Stand-by Arrangement with the Fund, aims to limit the effects of the global recession on the economy through the implementation of short-term countercyclical polices, while establishing the conditions for robust, sustainable growth. Successful implementation of this program will unlock significant financing from other multilateral sources, creating space for an adequate fiscal response. It will be important that the authorities follow through with their fiscal consolidation plan and structural reform agenda critical for medium-term sustainability.

"The planned fiscal stimulus will focus on high-return investment projects and current expenditures to strengthen social safety nets. The authorities are committed to addressing deficiencies in the revenue administration, and implementing a comprehensive plan to tackle structural issues in the electricity sector, aimed at abolishing untargeted subsidies while providing adequate service to the public.

"Monetary policy will continue to support economic activity and build up international reserves, with exchange rate flexibility to help cushion against external shocks. Implementing the plan for central bank recapitalization remains an important priority, crucial for the credibility of the monetary policy framework. The central bank intends to adopt full-fledged inflation targeting over the medium term.

"The Dominican banking system remains liquid, solvent, and profitable, despite the global credit crunch. The authorities continue to monitor the impact of the economic slowdown, and plan to advance the implementation of risk-based consolidated bank supervision and regulation," Mr. Portugal said.

ANNEX

Recent Economic Developments

The global economic and financial crisis has significantly worsened short-term economic prospects and may jeopardize some of the achievements of the last 5 years. Economic recovery from the 2003 financial crisis has been impressive. Real GDP grew 40 percent in the last 5 years, one of the highest expansions in Latin America and the best performance of the Dominican economy in the last quarter of a century. Inflation fell from over 40 percent in 2003 to 4.5 percent in 2008. Fiscal deficits have been cut in half, from almost 9 percent of GDP for the consolidated public sector in 2003 to about 4.5 percent in 2008. The public debt-to-GDP ratio was reduced by almost one-half, from about 60 percent in 2003 to 35 percent in 2008. However, social progress remains a challenge, and despite recent improvements, poverty indicators are still weaker than before the 2003 crisis.

Program Summary

To safeguard the achievements of the last several years, and against the background of unfavorable external conditions, large uncertainties and a sizable balance of payments need, the authorities are requesting a 28-month SBA for 500 percent of quota (SDR 1,094.5 million). The objectives of the program are twofold: first, to conduct countercyclical policies at the beginning of the program (including the last quarter 2009 and the first half 2010) to mitigate the drastic economic downturn; and second, to implement actions to address debt and fiscal sustainability issues in the latter part of the program (starting in mid-2010), while embracing an ambitious structural reform agenda.

take additional measures to keep the program on track, if necessary. We ask the Board to support a program that is expected to help decisively in bringing the Dominican Republic's economy back to a path of robust and sustainable growth.