

**EXECUTIVE SUMMARY
DOMINICAN ECONOMY
January-September 2005**

Gross Domestic Product

Measured in real terms, Gross Domestic Product (GDP) grew 7.3% during the period January-September 2005, a clear sign of consolidation of the recovery process initiated in the second half of last year. This performance was notable for the 10.6% expansion in GDP during the third quarter of 2005.

The dynamism shown by the economy has been driven by greater macroeconomic stability, reflected by factors such as the relative stability of the exchange rate, low inflation, and interest rate reductions.

The reduction of more than 10 percentage points in interest rates for commercial bank loans, and the increase in loan disbursements, which reached RD\$9,911.6 million during July-September 2005, contributed to the economic performance.

On the demand side, private consumption was the main beneficiary of low inflation and low interest rates, expanding by 17.4% during the period under consideration. Accordingly, gross domestic investment, increased 3.1% during January-September of this year, after experimenting a falloff of over 10% during the same period last year. As a result of the dynamism shown in these macroeconomic aggregates, internal demand grew 10.8% during the period under study.

The economic activities contributing to the economic dynamism shown during January-September 2005, were Agriculture (5.2%) Manufacturing (2.4%), Commerce (19.0%), Hotels, Bars and Restaurants (5.5%), Transportation (7.8%), and Communications (25.4%). These sectors, jointly with other activities such as Electricity and Water (3.6%), Finance (3.5%) Housing Property (2.1%) and Other Services (21%), represented 81.6% of GDP.

In contrast with this performance, there were contractions in Mining activities (-2.8%), Construction (-2.1%) and Government (-1.6%), which were the sectors that accounted for the remaining 18.4% of Gross Domestic Product.

Prices. Growth in the first three quarters was achieved within a low inflation environment, despite the sustained oil price increases in international markets. Inflation during the first nine months of the year was 6.13%, a substantial improvement with respect to the 31.11% observed in January-September 2004. It is important to highlight that, of the 6.13% inflation increase during the period under study, the price of energy accounted for 5.05 percentage points; that is, if we isolate this impact, the Consumer Price Index (CPI) would only have increased 1.08%. Thus, the increase in internal prices

was not attributable to monetary causes, but to exogenous factors of the Dominican economy. In annualized terms, the reduction of inflation was still greater: 12-month CPI to September was reduced from 47.89% in 2004 to 4.22% in 2005.

Balance of Payments. During the period in question, the balance of payments reflected a positive global balance of US\$550.8 million, which is higher by US\$359.8 million than that registered during the same period in 2004. This result is basically due to the dynamic of the tourist sector, the high level of performance of current transfers, as well as to an increase in foreign direct investment (FDI). This result allowed the authorities to continue with the replenishment of international reserves, in an environment of exchange rate stability .

Current Accounts. The January-September 2005 period ended with a US\$137.4 million current account deficit (0.7% of PIB), reversing the positive trend in existence since 2003, due to a greater dynamism in the economy, which resulted in an increase of US\$960.0 million, or 50.6%, in other imports. The impact of the oil shock was considerable, representing an increase of US\$600.5 million in the petroleum invoice, equal to 49.7 percent.

Trade Balance. The trade balance experienced a 75.6% increase in its negative balance with relation to the same period in 2004, for the reasons mentioned above. In effect, while total exports increased by \$200.5 million (4.7%) total national imports increased by US\$1,346.4 million (23.4%). This performance of the trade balance, and in particular imported goods, is consistent with the recovery of the Dominican economy, and with the appreciation of the national currency that has taken place.

Financial and Capital Account Balances fell to US\$210.5 million mainly due to a reduction of the flow in net foreign debt during this period, particularly in the public sector. Similarly, **direct foreign investment** registered a growth of 21.6% with respect to the same period in 2004. This performance was due to an increase in the reinvestment of profits (42.7%), and inflows from new shares issued (32.6%), due basically to the startup and development of several foreign direct investment projects in the tourist, communications and free-trade zone sectors.

Foreign External Debt. During January-September 2005, the public sector received disbursements equal to US\$517.0 million, 32.8% less than in the same period in 2004. This is consistent with efforts to maintain the external financing caps agreed to in the IMF Stand-By Agreement. Of the total amount received, 49.0% was provided by multilateral organizations, 47.9% from bilateral sources, and the remaining amount from commercial banks.

External public debt service payments were made on time and reached US\$534.7 million, almost the same as in 2004. Nevertheless, renegotiation of the sovereign bonds generated savings in interest payments of US\$49.3 million during the third quarter of 2005.

International Reserves. The favorable environment generated by the domestic economy due to fiscal and monetary policies, has created conditions for a greater capital inflows allowing a significant accumulation of reserves. As of September 30, 2005, gross international reserves reached US\$1,557.4 million and net reserves US\$1,272.7 million, thus increasing by US\$970.4 and US\$899.8 million, respectively, in comparison to September 2004. With these reserve levels, the country is reaching the international standards recommended by the financial multilateral organizations and the country's risk evaluation entities, which established that international reserve levels should be maintained equal to or higher than three months of imports.

Using the definitions of the Stand-by agreement with the IMF, net international reserves at the Central Bank (liquidity) rose to US\$683.6 million, representing an increase of US\$5.6 million with respect to the prior figure of US\$678 million, as of 30 September 2004. This accumulation has surpassed the target of US\$650 million established in the last revision of the IMF Agreement at the end of 2006.

Public Sector. During the January-September 2005 period, the Fiscal Authorities' efforts have been directed toward complying with the economic program target established by the Stand-by IMF Agreement, so that public finances contribute to macroeconomic stability.

On the fiscal side, Central Government operations, with the accrual basis method, showed a surplus of RD\$10,012.8 million, equivalent to 1.8% of GDP, in contrast to a 5.2% deficit registered during the same period last year. A similar performance characterizes the non Financial Public Sector (SPNF), which surpassed the target established by the Stand-By Agreement, reaching over RD\$16,900 million.

Monetary Policy. The recovery of the economic agents' confidence in economic policies has been a key element in reversing the inflationary process resulting from the financial crisis. On the monetary side, the authorities have implemented a strategy focused on monetary targets, thus allowing them to comply comfortably with the goal established in the IMF Stand-By Agreement. As of September 2005, base money was RD\$89,785.8 million, which is below the cap of RD\$93,000.00 million established in the Government's Letter of Intent to the IMF.

The main instruments of this strategy, used within the framework of monetary targets, have been open market operations, placing certificates of investment with the objective of exerting control over base money. At the end of September 2005 the stock of certificates rose to RD\$144,829.60 million, an increase of 4.8% over June 2005. Nevertheless, this growth in the stock of certificates and the monetary policy implemented have created conditions for a significant reduction of interest rates resulting in a reduction in monthly payments made by the Central Bank to investors. At the end of September, the interest rate for zero coupon certificates was 11.31%, in contrast with 32.37% reached in September 2004.

During the month of September, the total amount of certificates reaching maturity amounted to RD\$14,706.4 million, which represented a challenge for monetary policy. Nevertheless, thanks to the economic agents' trust in Central Bank monetary policy instruments, the totality of these certificates were renewed to longer terms and lower rates, in average, than those originally established.

Within the framework of the Stand-By Agreement with the International Monetary Fund (IMF) , preliminary figures for September show that the performance criteria in terms of the quantitative and indicative targets have been complied with comfortably. This outcome is similar to that for the first half of 2005.

Financial Sector. Macroeconomic stability contributed to strengthening financial sector activities. As of September 30 2005, the sector loans and liability operations grew by 11.3% and 10.8% respectively, in comparison with the amounts registered in December 2004. Likewise, financial sector net worth grew 15.9% during the first nine months of the year. These increases occurred in an environment of new financial sector regulations, which is involved in an institutional strengthening process within the framework of the IMF Stand-By Agreement.

FORECASTS

The rapid recovery of the Dominican economy has surprised not only national analysts but also international organizations following the country's economic performance very closely. With the results achieved during the first nine months of the year, economic agents are more certain of their forecasts. **The GDP growth estimate, in real terms, is 7.0% for full year 2005. In turn, inflation is forecast to reach 9.40% for the year 2005, which is just below double digit levels.**

Within the Latin America/Caribbean context, these forecasts place the Dominican Republic in third place in comparison with those countries with greater expected economic growth for 2005, only surpassed by Argentina (7.3%) and Venezuela (7.0%).

Finally, the Dominican economy continues growing in an environment of price stability, at the same time that it complies satisfactorily with the quantitative and indicative targets established within the IMF Stand-By Agreement.

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