

EXECUTIVE SUMMARY
ECONOMIC PERFORMANCE OF THE DOMINICAN REPUBLIC
JANUARY-DECEMBER 2006

At year-end 2006, the **Gross Domestic Product (GDP) using base year 1991**, grew by 10.7% in real terms, reflecting the robust economic recovery that has been taking place since the middle of the previous year, when the economy enjoyed double-digit growth. This level of growth has been the highest achieved by this economy in 19 years; in fact, the rate of increase was 10.1% for 1987. The Dominican Republic had one of the highest economic growth rates in the Latin America and the Caribbean region.

At **current prices**, the **Gross Domestic Product** measured by economic activity increased by 15.3%, and the GDP implicit deflator was 4.1%, which is consistent with inflation, that increased by 5.0% during 2006. These results also reflect a high correlation between nominal GDP growth and monetary issuance, which increased by 16.1% in the same period.

During 2006, the economic sectors registering positive growth were: Agriculture and Livestock (9.9%), Mining (9.3%), Local Manufacturing (7.4%), Construction (22.9%), Energy and Water (7.2%), Commerce (11.7%), Tourism and Hospitality (5.5%), Transportation and Storage (8.3%), Communications (26.1%), Financial Intermediation and Insurance (22.4%), Rental Housing (3.4%), Public Administration and Defense (4.6%), Education (4.1%), Health (2.1%), Other Services (8.3%). These activities as a whole represented 88.2% of the total GDP. Only the Industrial Free Zones registered a decrease of 8.3%, due to the impact of an 18.4% reduction in the textile sub-sector.

The performance of imported goods and multiple service banks' loan portfolio were two of the important factors driving the recent growth in the Dominican economy. Worth noting is the correlation between these variables and GDP growth. Another significant aspect is that, during the past year, growth has been based on the increases in production of goods and domestic manufacturing exports, as well as on gross domestic investment.

Within this context, multiple service banking sector **total loans** increased by RD\$27.63 billion in 2006, of which RD\$24.45 billion corresponded to the private sector, for an increase of 16.0%. Of the growth in the portfolio to the private sector, 72.2% was allocated toward production, where disbursements expanded by 21.4%. Within this category, construction loans jumped 84.3% and domestic manufacturing loans rose by 42.4%. The remaining 27.8% of the portfolio increase corresponded to personal loans, which grew 9.7% through December 2006. This is in contrast to the prior year's 32.8% increase for this caption. Additionally, it is important to take note of the 55.9% increase in housing loans, as well as 44.0% in consumer loans.

The favorable loan portfolio performance is tied to a substantial reduction in interest rates. Since 2004, rates have declined gradually until reaching almost half their prior levels at the end of the period in question. That is, the average multiple service bank asset portfolio interest rate, which was 32.28% in 2004, declined to 16.44% by the end of 2006. It should be noted that during the past year, important transactions have taken place with marginal rates that range between 10% and 14%. The interest rate fell by 3.73 percentage points compared to 2005, indicating that it was one of the factors that had a bearing on the loan recovery during 2006.

When analyzing the **GDP through expenditures**, the components of the Gross Domestic Product in 2006, measured in constant terms at 1991 prices, exhibited a strong growth trend, notably in gross capital formation, which increased by 19.3%. This is higher than the prior year's growth rate of 12.1%, and is a consequence of the 22.9% increase in construction activity and its multiplier effect on the rest of the economy. The increase in capital goods imports (19.2% measured in US\$) has also influenced performance, as well as higher levels of direct foreign investment, which rose to US\$1.18 billion. This is equivalent to an increase of 15.7% during this period compared to 2005.

At year-end 2006, the **Consumer Price Index (CPI)** had risen by 5.0%, which is less than the 7.44% corresponding to same prior-year period. These results are the product of maintenance of stability and controls over internal prices, and they reaffirm that the IMF and CBDR Monetary Program single-digit inflation target levels (5 to 7 percent) were amply met.

The **broad unemployment rate**, obtained through the National Labor Force Survey as of October 2006, reflects a continued downward trend at 16.0%. This is 3.7 percentage points lower than the October 2004 rate of 19.7%. This reduction in unemployment represents an increase of around 286,636 new jobs between April 2004 and October 2006. Job creation during this period occurred mainly in the sectors registering the greatest activity, as reflected in the GDP. These are: Agriculture and Livestock (42,891 jobs), Local Manufacturing (46,686), Construction (25,140), Commerce (63,705), Tourism and Hospitality (36,218), Transportation and Communications (22,154), Finance and Insurance (10,330), and Other Services (70,892).

With regard to the **external sector**, preliminary reports indicate that the country's balance of payments reflected a surplus balance of US\$271.0 million at year-end 2006, due in great part to the increase of Central Bank international reserves. Accordingly, these results indicate that the balance of the current account was more than amply funded by the financial account balance, especially due to the volume generated by foreign direct investment, which for the second straight year rose above US\$1.0 billion.

Regarding the **commercial balance** in 2006, national exports generated additional income levels of US\$ 538.3 million, which is an increase of 38.6%. This nearly doubles the growth attributed to income from tourism. Among exports, it should be noted that general merchandise rose by US\$ 498.3 million, or 47.1%.

Total imports increased by US\$1.32 billion with respect to 2005, basically driven by the 18.7% growth of national imports. Within this growth, it should be noted that Other Imports rose by US\$1.13 billion, equivalent to 27.9%. This includes tradable goods, which mainly influence growth in economic activities. Raw materials imports grew by 26.3% and imports of capital goods by 19.2%. This is in consonance with the expansion in goods production and the increase in Gross National Investment.

International reserves strengthened during all of 2006, becoming an instrument of great support for foreign exchange and monetary policies in their efforts to meet the exchange rate stability target, and satisfactory performance with regard to national and international payments. It is worth highlighting the role played by the reserve accumulation policy in the prevention of currency appreciation. Central Bank gross international reserves rose to US\$2.25 billion during the period in question and net reserves reached US\$1.79 billion

at the close of December. Liquid international reserves reached US\$1.13 billion, thus exceeding the IMF Agreement's US\$750.0 million target by US\$378.4 million. As of December 2006, Central Bank gross international reserves covered three months of national imports. Consequently, these levels of reserves contributed to the climate of macroeconomic stability and are the highest ever achieved in the Dominican economy.

As a result of the country's favorable economic performance, the country's risk ratings, according to important international rating firms, have remained at B3 and B. This acts to reinforce the country's credit position in international financial markets.

As for the **public sector**, Central Government tax receipts came in at RD\$188.9 billion, which is RD\$31.27 billion, or 19.8%, higher than 2005's results. The tax burden reached 16.9%, rising 0.1% with respect to the former year and reaffirming the upward trend that has been apparent by means of this indicator since 2004. Total expenses for 2006 rose to RD\$203.5 billion, which is higher by 19.1 % than the 2005 figure. During this period, current expenses represented 76% of total expenses, while capital expenses represented 24%. Current expenses grew by RD\$26.14 billion (20.3%). Capital expenses rose by RD\$6.46 billion (15.2%) and within these, fixed investments, composed of construction projects, machinery and equipment, increased by 46.9 percent.

Central Government fiscal operations on an accrual basis registered a deficit of RD\$12.91 billion, equivalent to 1.22% of GDP. But if we consider the surplus balance of the Non Financial Public Sector (a quantitative performance criterion as established in the economic program, within the framework of the IMF Stand-By Agreement), which is equal to 0.35% of GDP, then the deficit is reduced to RD\$ 9.21 billion, or 0.87% of GDP.

With regard to **monetary policy**, it is evident that prudent management, within the limits established in the Stand-By Agreement with the IMF, resulted in the achievement of the inflation target established for 2006. At the end of the year, the inflation rate stood at 5.0%, thus occupying the floor of the range established in the Letter of Intent. In addition to this goal, the policy successfully managed the quasi-fiscal deficit that had its origins in the banking crisis of 2003. Accordingly, the deficit equaled 2.5% of GDP, well below the goal of 2.8% established in the IMF agreement.

Since mid-year 2005, the Central Bank has been implementing a strategy oriented toward increasing the maturities and modifying the mix of outstanding securities. This strategy has allowed extending the average maturity from 7.5 months in 2004 to 13.5 months in 2005, and to 16 months in December 2006. It should be noted that the changes that were made with regard to the mix of certificates impact the modification of the structure of direct placements. The proportion of certificates placed by the public that allowed for early redemption was reduced, from approximately half of the total outstanding to one-third during the year in question.

Monetary issuance grew by 16.1% in 2006, driven by the growth of sight deposits of financial intermediaries at the Central Bank. These increased by 26.9% percent. Coin and paper currency, which is another significant component, expanded by 7% during the year in question, underscored by the 14.8% increase of currency in circulation, a figure comparable to the nominal GDP growth of 15.1 percent.