

Report on the Dominican Economy 2007

Executive Summary

For the third consecutive year, the Dominican economy registered solid growth, increasing by 8.5% during January-December 2007. On average, the economy grew by 9.5% over the last three years as measured by the Gross Domestic Product, base year 1991. During 2007 almost all sectors grew actively; notable among these were: Financial Intermediation (25.6%); Communications (14.9%); Commerce (13.9%); Energy and Water (9.7%); Transportation (6.8%); Education (5.7%); and Other Services (5.2%). In addition, Local Manufacturing expanded 4.8% and the Construction, Hospitality, and Agricultural sectors increased by 3.2%, 3.7%, and 1.2%, respectively. In contrast to this performance, slowdowns were seen in the Mining (-1.4%) and Industrial Free Zone sectors (-10.0%).

With regard to expenditure, private consumption increased by 12.3%, resulting from a notable improvement in labor market indicators and an environment of exchange rate stability and moderate inflation. Other factors that contributed to strong growth in private consumption were a 31.4% rise in banking credit to the private sector and a 22.0% expansion of consumer goods imports valued in U.S. dollars.

The inflation rate for year-end 2007 reached 8.88%, thus remaining in single digits despite the economy's struggling with an unfavorable external scenario. This achievement is a reflection of the Central Bank's prudent application of monetary policy. It is further confirmed by the fact that, excluding the impact of oil price increases, the inflation rate was 5.68%. We should note that a determining factor in the spike in inflation during the last two months of the year was the internal shock of Tropical Storms Noel and Olga, and their impact on the agricultural sector.

Regarding the labor market, the National Labor Force Survey of October 2007 shows an extended unemployment rate of 15.5%, reflecting a 0.1 percentage point reduction compared to April of that year and 4.2 percentage points lower than October 2004. This reflected the creation of 392,113 new jobs between April 2004 and October 2007. Additionally, the open unemployment rate fell by 0.3 percentage points, from 4.6 to 4.3%, between April 2004 and October 2007.

Regarding the external sector, the current account balance for 2007 showed a deficit of US\$ 2.23 billion, mainly as a consequence of an increase in the deficit of the commercial balance of goods. In absolute terms, total imports rose to a level of US\$ 13.82 billion, which is higher by US\$ 1.64 billion than the prior year figure. It is important to note that the current account deficit reflects in part the valuation adjustment for national imports, undertaken by the General Customs Directorate and in force since October 2006. Another factor that influenced performance in this sector was the oil import bill, which grew by US\$ 479.3 million in 2007.

Regarding exports, including industrial free zones, domestic goods increased by US\$ 627.0 million during the period in question. These were led by higher general

merchandise exports (42.5%) as a result of higher worldwide demand for nickel. Another determining factor in the country's export growth was a US\$ 263.8 million increase in non-traditional goods. In contrast to this, free zone exports fell by US\$ 115 million, or 2.5%.

As concerns the service trade balance, tourist sector income grew by US\$ 108.7 million, due to a 1.7% rise in visitors and a 3.1% increase in average spending per unit of visitation. The average length of stay held steady at around 9 nights, same as the prior year figure. Additionally, household remittances went up by 10.8%. The category of household remittances represents 7.4% of GDP and 89% of total net current transfers registered in the balance of payments.

In 2007, the Dominican Republic received large inflows of foreign capital, as can be observed in the balance of payments capital account. Preliminary figures show that the capital and financial account ended the year with a positive balance of US\$2.55 billion, a level that surpasses the 2006 figure by US\$ 764.0 million. This performance was largely driven by inflows of foreign direct investment, which reached the unprecedented amount of US\$ 1.70 billion.

For the January-December 2007 period, Central Government fiscal operations on an accrual basis registered a surplus balance of RD\$ 162 billion, in stark contrast to the RD\$ 12.98 billion deficit balance for full-year 2006.

The Consolidated Non-Financial Public Sector balance showed a surplus of RD\$ 1.45 billion. This was achieved despite the government increasing public spending as 2007 drew to a close, in order to mitigate the effects in close succession of the devastating Tropical Storms Noel and Olga. According to the Economic Commission for Latin America (ECLAC), the storms were responsible for damages to various sectors of the economy estimated to run close to RD\$ 14.13 billion.

During the period in question, total Central Government revenues on an accrual basis were 25% higher than during the same prior year period, reaching RD\$ 236.01 billion compared to RD\$ 188.86 billion. Central Government spending, excluding the residual or statistical discrepancy, rose to RD\$ 241.32 billion for an absolute increase of RD\$ 36.14 billion or 17.6% compared to the same period in 2006.

The Central Bank's implementation of its monetary policy managed to keep inflation within single digits, in compliance with the 2007 Monetary Program. This objective was achieved using open market operations as the principal instrument. They were applied in the context of an adverse external environment, with persistent higher prices for oil and other commodities such as corn, sorghum, and wheat, among others. Monetary policy in 2007 made room for a 13.7% expansion in currency issued. The latter indicator serves as an operating variable for monetary targets. The above mentioned expansion was consistent with the Dominican Republic's Stand-By Agreement with the International Monetary Fund.

In 2007, the positive performance of the financial sector was in consonance with the country's macroeconomic stability and with the greater confidence shown in the economy by macroeconomic agents. Consequently, total assets and liabilities for the sector as of December, 2007 registered increases of 13.6% and 14.9%, respectively, compared to the same prior year period.

One of the factors contributing to financial sector asset growth was the reduction in interest rates that took place in 2007. As of December 31, 2007, annual liability rates for multiple service banks, savings and loan associations, and savings and credit banks stood at 6.64%, 7.31%, and 9.38%, respectively. These were, again respectively, 1.05, 1.07, and 0.79 percentage points lower than in December, 2006. Asset rates averaged 15.34%, 13.50%, and 29.03% for these institution categories. For multiple service banks and savings and loan associations, these rates fell compared to December, 2006, when they stood at 16.44% and 16.04%, respectively.

With regard to the financial sector regulatory framework, in the first quarter of the year a Draft Amendment to the Monetary and Financial Law was submitted to the National Congress. The changes in question principally respond to the need to continue adapting the Monetary and Financial Law in order to comply with international best practices.