

Report on the Economy of the Dominican Republic
January – September, 2008
Executive Summary

During the third quarter of 2008 the Dominican economy began to experience a reduction in the rate of growth that had characterized its performance since 2005. This was predictable given a scenario that included an international financial crisis, a slowdown in the world economy, higher oil and imported commodity prices, as well as the monetary policy put into place by the Central Bank in order to reduce internal demand. In this regard, real GDP grew by 5.4% during the January-September period, a slower rate of growth than that registered during the same prior year period.

Economic performance during this nine-month period showed a real growth rate for final consumption of 6.6%, basically driven by public consumption, which rose by 15.1%. Gross capital formation increased its rate of growth from 9.9% to 13.4%, while exports accounted for a marginal contribution of 2.2%.

Cumulative inflation in the first nine months of the year reached 10.76%, basically attributable to oil and food price increases on the international markets. This was reflected in the positive variances evident in Transportation (16.54%) and in the Food, Beverage, and Tobacco category (12.10%). These sectors had the greatest impact on the CPI, together representing 72.60% of inflation for the period.

Preliminary balance of payments data for the January-September 2008 period are indicative of the weak international economic panorama, especially in the United States and Europe, and its impact on the Dominican Republic's external accounts. Accordingly, the balance of payments' overall balance was a negative US\$261.1 million and was covered almost completely by the Central Bank's international reserves.

The current account ended the period with a deficit of US\$4.02 billion. This is a direct consequence of the negative shock brought on by price rises for oil and food in the international market, which accounted for 55.9% of the increase in this deficit. The current account balance was essentially financed by higher foreign direct investment flows, which reached US\$2.35 billion.

Regarding fiscal performance, Central Government operations registered a deficit of RD\$26.22 billion, equal to 2.3% of GDP. This deficit was financed with external funding of RD\$11.93 billion and internal funding equal to RD\$14.29 billion. Including the Non-Financial Public Sector, these results reached RD\$27.23 billion.

Despite the fact that during the period in question Central Government revenues rose in absolute terms, there was a slowdown in the growth rate for these, due among other reasons to the diminished economic activity, both internal and external. However, Central Government spending, which reached RD\$214.78 billion, increased due to a significant expansion in capital expenditure and current transfers.

Given the prevailing situation during the early part of 2008, characterized by strong inflationary pressures and an acceleration of internal demand, monetary policy decisions initially were directed toward raising the benchmark interest rate in order to elevate the incremental cost of funds. Starting in June 2008, these decisions were complemented with a newly modified and restructured method of calculating the legal reserve. Additionally, interest rates were raised for direct certificate placings with the general public, and the window for placings with the public of redeemable securities was reopened, with rates as high as 16% for a three-year maturity.

As a result of the monetary policy measures that were adopted, it was possible to slow the annualized growth in issued currency to 12.1%. This was below the inflation rate, indicating that in real terms currency issued experienced a contraction. Even more significant, the volume of currency issued stood at RD\$120.14 billion at the end of September, a level that is within the range stipulated in the 2008 Monetary Program.

At month-end September, the financial sector registered favorable performance levels although these were slightly lower than in the two previous quarters. Financial intermediaries registered a slowdown in their annualized growth rates for local currency loan portfolios to the private sector and, as a direct consequence of the Central Bank's monetary policy measures, rising asset and liability rates

During the third quarter, the process of mergers and transformations among financial entities continued, pursuant to the Monetary and Financial Law, and these institutions made progress in their compliance with the requirements set by the monetary authorities for the purpose of adapting their organizational structures to conform to the operational necessities of the new types of institutions.