INTERNATIONAL MONETARY FUND

IMF Country Report No. 18/294

DOMINICAN REPUBLIC

October 2018

2018 ARTICLE IV CONSULTATION—PRESS RELEASE AND STAFF REPORT

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2018 Article IV consultation with the Dominican Republic, the following documents have been released and are included in this package:

- A **Press Release**.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration a lapse of time basis, following discussions that ended on February 10, 2018, with the officials of the Dominican Republic on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on March 16, 2018.

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

Copies of this report are available to the public from

International Monetary Fund • Publication Services
PO Box 92780 • Washington, D.C. 20090
Telephone: (202) 623-7430 • Fax: (202) 623-7201
E-mail: publications@imf.org Web: http://www.imf.org
Price: $18.00 per printed copy

International Monetary Fund
Washington, D.C.

Press Release No. 18/145
FOR IMMEDIATE RELEASE
April 23, 2018

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

IMF Executive Board Concludes 2018 Article IV Consultation with the Dominican Republic

On April 11, 2018 the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with the Dominican Republic and considered and endorsed the staff appraisal without a meeting.[2]

After three years of robust expansion, the economy moderated to close to its potential level. Economic activity is estimated to have expanded by 4.6 percent in 2017, following above-potential growth of 7.1 percent on average during 2014-16. The growth moderation was concentrated in the first three quarters of 2017 and was driven by a cyclical correction in domestic demand (especially investment), tighter financial conditions, uncertainty related to legislative reforms and economic disruptions caused by the close passage of two category five hurricanes in September 2017. More accomodative monetary policy and a rebound in activity following the hurricanes then contributed to a strong recovery in the last quarter of the year. Labor markets continued to improve with the recovery in employment and real wages over the past two years, and unemployment fell further to 5.1 percent, near historical lows. Headline inflation returned to the central bank's 4±1 percent target band, and the external position strengthened significantly.

The economic outlook remains positive. The monetary easing in mid-2017 is expected to support a continued recovery in economic activity in 2018. Lower lending rates and stronger

[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.

[2] The Executive Board takes decisions under its lapse-of-time procedure when the Board agrees that a proposal can be considered without convening formal discussions.

credit growth following the easing, combined with higher real wages and employment, are expected to continue to support domestic demand. Growth is expected to increase to 5.5 percent in 2018 and then to moderate to its medium-term potential rate of around 5 percent. Inflation is expected to remain within the central bank's 4 +/- 1 percent target band, while the external current account deficit will gradually widen to its historical levels with higher oil prices and stronger domestic demand. However, risks around the outlook persist, with the main downside risks stemming primarily from external factors, including higher world oil prices, tighter-than-anticipated global financial conditions, and weaker-than projected external demand.

Executive Board Assessment

The timely policy response to the economic slowdown in early 2017 has put the economy back on an even keel. Economic activity and its projected growth are reverting to potential, inflation is within the central bank's target, unemployment is near historical lows, and the external current account deficit has narrowed. The overall economic outlook remains positive but risks persist, with the main downside risks stemming from higher oil prices, weaker-than-projected external demand, and tighter-than-anticipated global financial conditions. In this context, the key challenge will be to build resilience to these risks by rebuilding policy buffers, reinvigorating structural reforms, and further reducing poverty and inequality.

Despite welcome efforts to bolster the revenue base, more meaningful action will be required to strengthen the fiscal position. Favorable international financial conditions and strong growth in recent years have kept fiscal vulnerabilities at bay, but public debt continued to increase and the growing interest burden relative to a narrow revenue base is making debt less affordable. Welcome reforms to improve the debt profile and address weaknesses in tax and customs administration are yielding strong results, as evidenced by recent peso debt issuance in the global markets, narrowing bond spreads and increases in the tax base. However, these are not sufficient to offset structural spending pressures, especially in the face of tightening global financing conditions and increasing oil prices. A meaningful fiscal adjustment will be needed to rebuild the buffers and reverse the upward debt dynamic, but its design would need to be particularly mindful of its impact on growth, poverty and inequality. The adjustment should focus on widening the tax base (including through streamlining of tax incentives and exemptions), simplifying the tax system, and rationalizing inefficient expenditures, while prioritizing fiscal space towards increasing public investment and social spending to protect the most vulnerable.

Strengthening the fiscal policy framework should support efforts to improve the fiscal position. A medium-term fiscal framework, which would anchor fiscal policy decision-making in longer-term debt sustainability objectives, would reduce policy uncertainty and strengthen its credibility with the markets. Ongoing efforts to develop such a framework are welcome. Reforms to enhance transparency in the public procurement processes, strengthen public financial management practices and align public statistics with international norms will further contribute to increase policy transparency and predictability, and should be supplemented by wider coverage and timeliness of fiscal statistics.

The neutral monetary policy stance with a tightening bias is consistent with current economic conditions. The neutral stance should help maintain output close to potential and inflation within the central bank's target, but tighter monetary policy may be required if inflation rises faster than expected. The central bank's inflation targeting framework has contributed positively to price stability and would be further enhanced through greater exchange rate flexibility, which would increase resilience to external shocks by providing an automatic adjustment mechanism. The external position is moderately stronger than warranted by medium-term fundamentals and desirable policy settings, but is expected to realign over the medium term with the projected recovery in private domestic demand, especially as structural reforms to improve the investment environment and social outcomes take hold. Its continued strength in the near-term provides an important opportunity to continue building reserve buffers, which have strengthened considerably since the 2003–04 financial crisis.

Perseverance with efforts to strengthen financial sector oversight will enable the financial system to continue supporting strong and inclusive growth. Reforms put in place in the fifteen years since the financial crisis have supported a recovery in the health of the financial system, which compares favorably to regional peers. The ongoing emphasis on strengthening oversight over systemic macro-financial risks will further contribute to financial stability, especially as information on household and firm indebtedness is developed, and as the macroprudential policy framework is finalized to enhance policy flexibility to respond to systemic risks. Continued efforts to improve prudential regulation and supervision will complement these reforms, with the objective of fully aligning the regulatory and supervisory framework with international best practice. Remaining gaps in the supervisory periphery, including the oversight of the largest nonbank institutions, should be filled. Finally, efforts to strengthen the anti-money laundering framework are welcome, with its effective implementation important to promoting integrity in the financial system.

Growth- and socially-oriented structural reforms will be important to enhancing the economy's growth potential and addressing remaining social challenges. The authorities' ongoing reforms to strengthen the doing-business environment and improve outcomes in health, education and infrastructure, as well as to advance the reform agenda for the electricity sector, are welcome and will help to boost the economy's growth potential. The challenge will be to complement these efforts with concrete and immediate policy actions to sustainably reform the electricity sector, and with more ambitious reforms to reduce high transportation costs, simplify the tax system and strengthen the institutional environment. Reforms to widen the coverage of social security and ensure an adequate retirement income will be important to strengthen social outcomes. A stronger fiscal position would also contribute to improved social outcomes by easing pressures on financial resources and interest rates, and providing space to refocus spending towards social safety nets and infrastructure.

Table 1. Dominican Republic: Selected Economic Indicators

(Percent change from previous period; unless otherwise indicated)

Population (millions, 2017 estimate)	10.17	GDP per capita 2017 (U.S. dollars)	7,376
Quota	477.40 millions SDRs / 0.10% of total	Poverty (2016, share of population)	30.5
Main export product	tourism, textiles, gold	Extreme poverty (2016, % of pop.)	6.5
Key export markets	U.S. and Canada	Adult literacy rate (percent, 2014)	91

					Projection					
	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
	(Annual percentage change, unless otherwise stated)									
Output										
Real GDP	7.6	7.0	6.6	4.6	5.5	5.0	5.0	5.0	5.0	5.0
Contributions to growth										
Consumption	3.2	4.2	3.7	3.3	3.4	3.3	3.4	3.6	3.7	3.7
Investment	3.8	5.6	2.7	-0.6	1.8	2.0	1.9	1.7	1.8	1.8
Net exports	0.6	-2.7	0.2	1.9	0.3	-0.3	-0.4	-0.3	-0.5	-0.5
Nominal GDP (RD$ billion)	2,841	3,068	3,298	3,562	3,942	4,282	4,674	5,101	5,568	6,079
Nominal GDP (US$ billion)	65.3	68.1	71.6	74.9	...	...	...	...	...	...
Gross national saving (percent of GDP)	20.6	21.6	21.9	22.6	23.6	23.5	23.6	23.6	23.7	23.8
Output gap (in percent of potential output)	-0.4	0.6	1.2	0.1	0.1	-0.1	-0.1	-0.1	0.0	0.0
Unemployment										
Unemployment rate (in percent; period average)	6.4	5.9	5.5	5.4	5.1	5.1	5.1	5.1	5.1	5.1
Prices										
Consumer price inflation (end of period)	1.6	2.3	1.7	4.2	3.7	3.8	4.0	4.0	4.0	3.9
Consumer price inflation (period average)	3.0	0.8	1.6	3.3	4.4	3.5	4.0	4.0	4.0	4.0
Exchange rate										
Exchange rate (RD$/US$ - period average) 1/	43.6	45.1	46.1	47.6	...	...	...	...	...	...
Exchange rate (RD$/US$ - eop) 1/	44.4	45.7	46.7	48.5	...	...	...	...	...	...
Real effective exchange rate (eop, - depreciation) 1/	-2.1	2.3	-0.8	-2.3	...	...	...	...	...	...
Government finances	(in percent of GDP)									
Consolidated public sector debt 2/	47.2	47.3	50.0	52.7	52.6	53.7	54.4	55.3	56.3	57.3
Consolidated public sector balance 3/	-4.4	-1.6	-4.1	-4.6	-4.3	-4.4	-4.4	-4.5	-4.7	-4.8
Consolidated primary public sector balance	-0.7	2.2	0.0	-0.3	0.3	0.3	0.5	0.5	0.5	0.5
Central government balance	-2.6	0.1	-2.8	-3.2	-2.8	-3.0	-3.1	-3.3	-3.5	-3.6
Revenues and grants	14.8	17.5	14.8	15.1	15.1	15.0	15.1	15.0	15.0	15.0
Primary spending, *o.w.:*	14.9	14.8	14.7	15.3	14.5	14.4	14.3	14.3	14.3	14.3
Transfers to electricity sector	1.4	0.8	0.6	0.5	0.6	0.4	0.3	0.3	0.3	0.2
Interest expenditure	2.5	2.6	2.9	3.1	3.4	3.6	3.8	4.0	4.2	4.3
Rest of NFPS	-0.4	-0.3	0.0	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2
Financial sector	(Annual percentage change; unless otherwise stated)									
Broad money (M3)	9.3	12.1	9.8	9.7	10.6	8.6	9.1	9.1	9.1	9.1
Credit to the private sector	19.5	12.7	12.1	10.1	12.1	9.6	9.1	9.1	9.1	9.1
Policy interest rate 1/	6.3	5.0	5.5	5.3	...	...	...	...	...	...
Average deposit rate (1-year; in percent) 1/	6.4	6.4	6.7	6.0	...	...	...	...	...	...
Average lending rate (1-year; in percent) 1/	13.9	14.9	15.1	14.1	...	...	...	...	...	...
Balance of payments	(in percent of GDP)									
Current account	-3.3	-1.9	-1.1	-0.2	-1.0	-1.4	-1.7	-2.0	-2.3	-2.6
Goods, net	-11.3	-10.9	-10.5	-10.1	-10.7	-10.8	-10.7	-10.8	-10.9	-11.1
Services, net	6.3	6.4	6.9	7.0	7.1	7.4	7.4	7.4	7.4	7.3
Income, net	1.7	2.7	2.5	2.8	2.6	1.9	1.6	1.4	1.3	1.2
Capital account 4/	0.0	3.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial account	-4.8	-1.1	-2.2	-1.2	-1.0	-1.4	-1.7	-2.0	-2.3	-2.6
Foreign direct investment, net	-3.4	-3.2	-3.4	-4.8	-3.3	-3.3	-3.3	-3.3	-3.3	-3.3
Portfolio investment, net	-2.3	-5.1	-2.4	-2.3	-2.5	-1.9	-1.7	-1.7	-1.3	-1.4
Financial derivatives, net	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other investment, net	0.6	6.6	2.5	4.9	3.9	3.0	2.8	2.4	1.8	1.6
Reserves,net	1.8	0.3	0.6	1.1	1.0	0.8	0.7	0.6	0.6	0.6
NIR (in millions of U.S. dollars)	4,361	5,152	6,047	6,780	7,428	8,028	8,578	9,128	9,678	10,178
NIR in months of imports	2.6	3.0	3.4	3.5	3.6	3.7	3.8	3.8	3.8	3.8
NIR in months of imports (excluding free trade zone imports) 5/	3.1	3.5	4.1	4.2	4.3	4.4	4.4	4.4	4.4	4.4
Total external debt (in percent of GDP)	40.0	37.3	37.9	36.8	36.6	37.2	37.4	37.7	38.0	38.3
of which: Public sector	26.6	24.9	25.8	25.9	26.3	27.2	28.0	28.7	29.6	30.4

Sources: Country authorities; World Bank; and Fund staff calculations and estimates.

1/ Latest available.

2/ Historical debt numbers are staff estimates. The debt stock at end-2017 includes a downward stock adjustment of US$324 million (0.5 percent of GDP) in external debt, reflecting the central bank's repurchase of its Brady bonds. External debt is expected to be revised down in the future to exclude some non-debt obligations of the central bank (of 0.4 percent of GDP in 2017).

3/ The consolidated public sector includes the central government, some decentralized entities, the electricity holding company, and the central bank.

4/ For 2015 includes the grant-element of a debt buyback operation with PDVSA of 3.1 percent of GDP.

5/ In relation to imports of goods and nonfactor services of the following year, excluding maquila.

INTERNATIONAL MONETARY FUND

DOMINICAN REPUBLIC

STAFF REPORT FOR THE 2018 ARTICLE IV CONSULTATION

March 16, 2018

KEY ISSUES

Context. 2018 will mark 15 years since the start of the 2003–04 financial crisis. Reforms put in place following the crisis have contributed to strong economic performance over the past decade and a restoration of external stability. The economy is now growing close to potential, inflation is within the central bank's target range, unemployment is near historical lows, and the external current account deficit has narrowed. The economic outlook remains positive with broadly neutral monetary and fiscal policy expected to keep economic activity on trend and inflation within the target band over the medium term. However, risks around the outlook persist, with the main downside risks stemming primarily from external factors. In this context, the key challenge will be to build resilience to these risks by strengthening domestic fundamentals. Progress will be essential to increase potential growth and further reduce poverty and inequality.

Policy advice. The consultation focused on priorities to build macroeconomic buffers, strengthen policy frameworks, and improve structural competitiveness.

- **Fiscal policy**. Fiscal consolidation—underpinned by the adoption of a credible medium-term fiscal anchor and designed to support growth and reduce inequality—is needed to put public debt on a firm downward path.
- **Monetary policy.** The current neutral monetary policy stance with a tightening bias is appropriate. The effectiveness of monetary policy would be enhanced by allowing for greater exchange rate flexibility. Reserve adequacy should continue to be strengthened.
- **Financial regulation and supervision.** A stronger focus on systemic risk assessment and completion of the macroprudential policy framework would support financial stability. Fully aligning the prudential framework for supervision and regulation with international best practice, strengthening supervision of large non-bank financial institutions, and effective implementation of the new AML/CFT legal framework would help fill gaps in the prudential framework.
- **Structural reform**. Sustaining strong competitiveness and growth will require completing long outstanding reforms in the electricity sector, improving the investment environment, simplifying the tax system, and strengthening social policies.

Approved By

Patricia Alonso-Gamo (WHD) and Yan Sun (SPR)

Discussions took place in Santo Domingo during January 29–February 10, 2018. The mission comprised A. Cebotari (head), J. Arze del Granado, K. Beaton, B. Sutton (all WHD), L. Cortavarria (MCM), and H. He (ICD). X. Tang (SPR) and K. Honjo (RES) provided analytical inputs. Ms. Alonso-Gamo (WHD) participated in policy discussions. Mr. Fuentes (OED) accompanied and assisted the mission. The mission met with President Danilo Medina Sánchez, the Governor of the Central Bank Héctor Valdez Albizu, Minister of Finance Donald Guerrero Ortiz, and Minister of Economy, Planning and Development Isidoro Santana, among other officials and members of the private sector.

CONTENTS

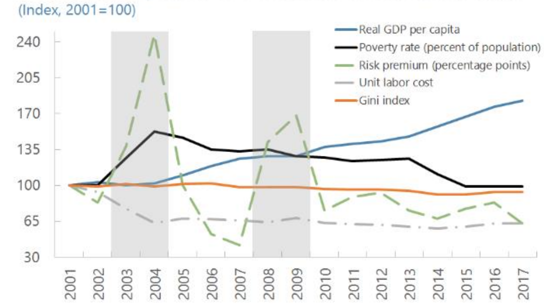
TABLES

ANNEXES

CONTEXT: 15 YEARS AFTER THE FINANCIAL CRISIS

1. **The Dominican economy has undergone an impressive transformation since the 2003–04 financial crisis.** The collapse of the second-largest bank in 2003 triggered a large external devaluation, stagflation, a sharp increase in poverty, loss of all official reserves and a setback in the fiscal position as depositors were bailed out. Post-crisis reforms—many under IMF programs during 2004-12—strengthened the policy framework and macroeconomic outcomes. Economic activity has subsequently been robust, averaging 5.7 percent over 2005–17, supported by the external and later an internal devaluation (through both wage restraint and productivity growth). Per capita income has more than doubled, inflation has stabilized within the central banks' target range, and reserves have gradually been built up. This progress has been reflected in the Dominican Republic's country risk premium, which is below the emerging market average.

Dominican Republic: 15 Years After the Financial Crisis
(Index, 2001=100)



Sources: World Economic Outlook, World Development Indicator and Fund staff estimates.
Note: Latest available data for GDP per capita and risk premium corresponds to 2017, poverty rate, ULC and gini index corresponds to 2016.

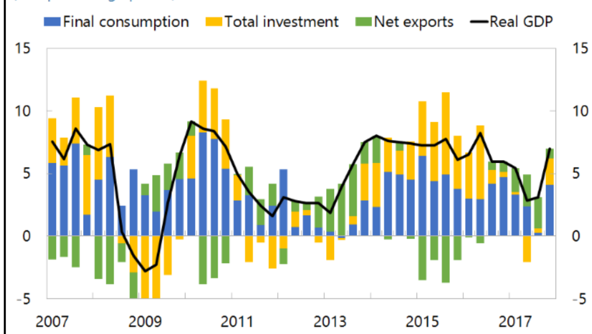
2. **The social cost of the crisis has been long-lasting, however, with poverty only recently declining to pre-crisis levels**. The economic recession and income effects of the external and internal devaluation deteriorated social outcomes, as social safety nets were underdeveloped and unable to provide needed support at the time. Poverty increased to 50 percent of the population, while extreme poverty doubled, and unemployment and inequality increased. Despite strong GDP growth since the crisis, poverty and inequality have fallen only slowly. More rapid progress has been made in the last few years, supported by recent increases in real labor income, especially of the poorest deciles, as well as higher spending on education and healthcare, which have been important complements to the earlier post-crisis reforms to strengthen social safety nets. Nevertheless, inequality remains close to the regional average in the broader Latin American and Caribbean region, a region characterized by one of the highest levels of income inequality globally (see Selected Issues Paper).

3. **The 2018 Article IV discussions took place against the backdrop of slowing, but still healthy, economic momentum.** The economy is growing close to potential, inflation is within the central bank's target, unemployment is near historical lows, and the external current account deficit has narrowed. Reforms since the 2017 Article IV consultation have focused on revamping the legal framework for anti-money laundering and combatting the financing of terrorism (AML/CFT), concluding the Electricity Pact negotiations, and strengthening revenue mobilization and public financial management. A number of challenges remain to be addressed, however, to promote stronger, more sustainable and inclusive growth. These include strengthening the fiscal position, addressing long-standing weaknesses in the electricity sector, bolstering productivity through structural reforms, and further improving inequality and poverty outcomes.

RECENT DEVELOPMENTS

4. After three years of robust expansion, the economy decelerated to close to its potential level in 2017. The economy is estimated to have expanded by 4.6 percent in 2017, following above-potential growth averaging 7.1 percent during 2014–16. Momentum was slowed in part by a cyclical correction in domestic demand, especially investment, reflected in a slowdown in credit, imports and downward pressure on bank lending rates. Tighter financial conditions at end-2016, heightened risk aversion triggered by uncertainty related to the new anti-money laundering (AML/CFT) legislation, and economic disruptions caused by close passage of two category five hurricanes in September 2017 also contributed to the slowdown.[1] Strong external demand, especially for tourism, partially offset slower growth in domestic demand. More accomodative monetary policy and a rebound in activity following the hurricane-related disruptions then contributed to a strong recovery in the last quarter of the year. Labor markets continued to improve, with the recovery in employment and real wages of the past two years and the further fall in unemployment to 5.1 percent, near historical lows.

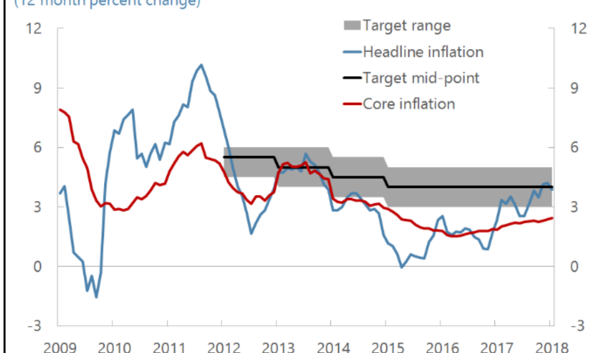
Contributions to Growth of Real GDP
(YoY percentage points)



Source: BCRD and staff calculation.

5. Headline inflation returned to its target band. Rising international oil prices and weather-related shocks to domestic food production pushed energy and food inflation higher, lifting headline inflation firmly into the midpoint of the central bank's 4±1 percent target range. Core inflation slowly accelerated as pass-through effects from the earlier decline in oil prices and other external factors continued to subside, but remains below the central bank's target range.[2]

CPI Inflation and Inflation Target
(12 month percent change)



Source: BCRD.

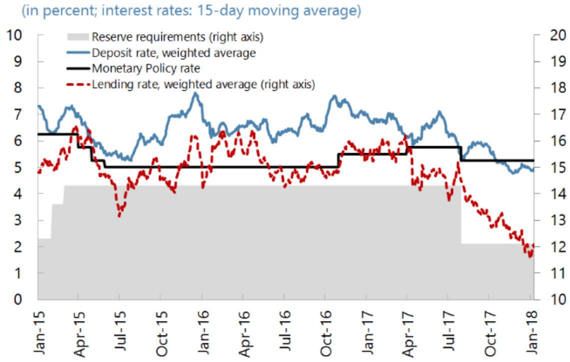
6. Weaker-than-expected growth and inflation in early 2017 provided space for more accommodative monetary policy. In July 2017, the central bank partially reversed the tightening cycle it began in late 2016, lowering the policy rate by 50 basis points (to 5¼ percent) and reserve requirements by 2.2 percentage points (to 12.1 percent). The easing of monetary policy was

[1] The introduction of the new AML/CFT law was associated with heightened uncertainty with respect to firms' financial reporting and tax obligations given the criminalization of tax evasion in the context of an economy characterized by a sizeable informal sector.

[2] Staff estimates (based on the IMF's FPAS model) that the lower oil prices and weaker world demand reduced core inflation by 1.25 percentage points on average during 2015–17.

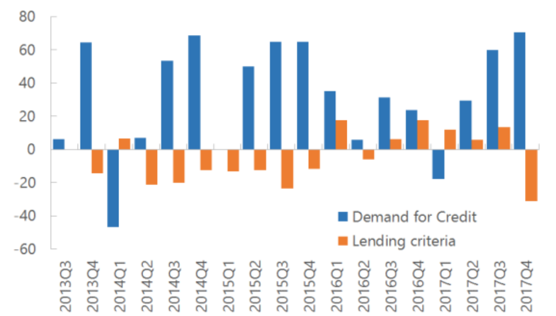
immediately passed through to deposit and lending rates, which fell by significantly more than the policy rate, due to the additional liquidity injection from the reduction in reserve requirements. The reduction in interest rates and easing of lending conditions contributed to a rebound in credit demand and growth, which had decelerated in the first half of 2017 following the earlier tightening of financial conditions and moderation in domestic demand. Overall, credit to the private sector grew 10.1 percent in 2017, down from 12.1 percent in 2016.

Interest Rates and Reserve Requirements
(in percent; interest rates: 15-day moving average)



Source: BCRD.

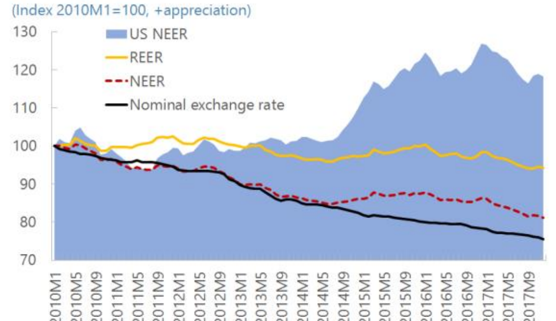
Demand for Credit and Lending Criteria
(balance of opinion)



Source: BCRD. Positive values indicate a rise in the demand for credit and a tightening of credit conditions.

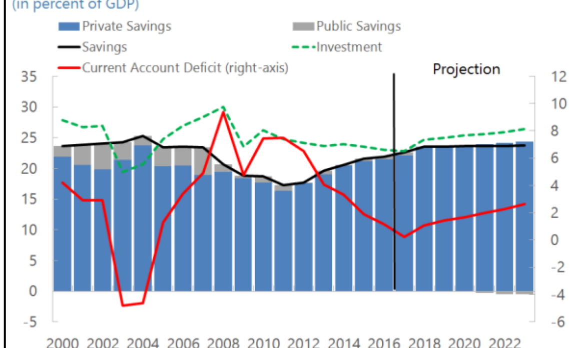
7. The external current account deficit reached the lowest level in a decade in 2017. Weaker domestic demand held back imports, while strong external demand and further real exchange rate depreciation (2.3 percent in 2017), partly driven by the rebuilding of reserves, boosted exports. Strong inflows of remittances, linked to positive developments in the U.S. labor market and uncertainty about U.S. immigration policy, also contributed to the narrowing of the current account deficit. Since the deficit peaked at 7.5 percent of GDP in 2011, higher private savings have accounted for about ¾ of the subsequent reduction, with the remainder due primarily to lower investment. The current account deficit remained more than adequately financed by foreign direct investment (FDI), with reserves coverage strengthening to 3.5 months of imports in 2017 (or 4.2 months excluding imports from the free trade zones).

Dominican Republic: Nominal and Real Effective Exchange Rate
(Index 2010M1=100, +appreciation)



Sources: INS and Fund staff calculations.

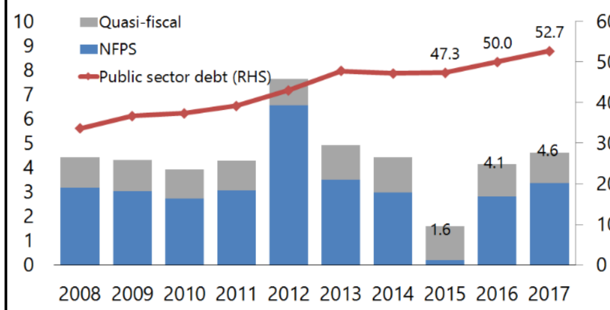
Savings and Investment Balance
(in percent of GDP)



Sources: BCRD and IMF staff calculations.

8. The consolidated fiscal deficit widened to 4.6 percent of GDP in 2017, despite efforts to curb tax evasion. Guided by a new strategic plan to reform tax and customs administration, efforts initiated in 2017 to reduce tax evasion and close loopholes have started to yield results, boosting structural revenues by an estimated 0.4 percent of GDP. However, spending pressures from higher payrolls for education, health, police, and defense, reconstruction after floods and hurricanes, higher spending on the coal plant and an increasing interest bill (0.9 percent of GDP) more than offset the positive impact of these efforts on the overall balance. Public debt continued to increase, reaching an estimated 52.7 percent of GDP at end-2017, a 10 percentage point increase over the past 5 years despite above-potential growth during this period.

Public Sector Consolidated Deficits and Debt*
(percent of GDP)



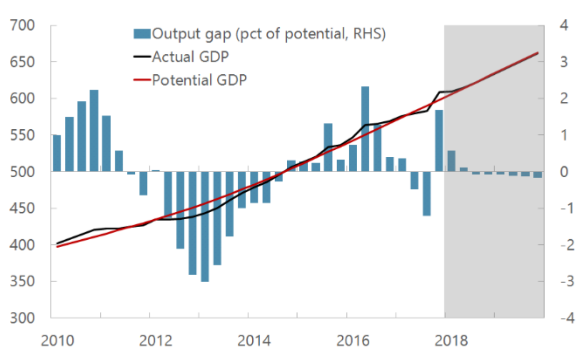
Source public sector debt: Fund staff estimates.
* The 2015 deficit reflects a 3% of GDP in imputed grant from restructuring.

OUTLOOK AND RISKS

9. The monetary easing in mid-2017 is expected to support a continued recovery in economic activity in 2018. Lower lending rates and stronger credit growth following the easing, combined with higher real wages and employment, as well as robust FDI, are expected to continue to support domestic demand. Growth is expected to increase to 5.5 percent in 2018 and then to moderate to its medium-term potential rate of around 5 percent, closing the positive output gap.

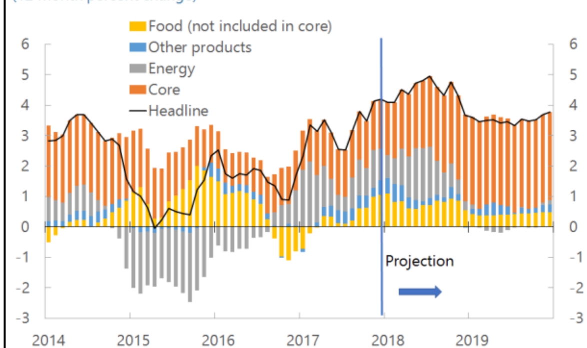
10. Inflation is expected to remain within the central bank's 4±1 percent target range. Higher oil prices in 2018 may briefly push total inflation to around the upper band of the central bank's target range, but as these pressures wane, total inflation is expected to moderate to within the target band, converging to the midpoint by 2019. Core inflation is expected to gradually rise to around 4 percent with firming domestic demand and pass-through effects of higher commodity prices.

Real GDP: Actual, Potential and Output Gap
(Billions of 2007 R$)



Sources: BCRD and IMF staff calculations.

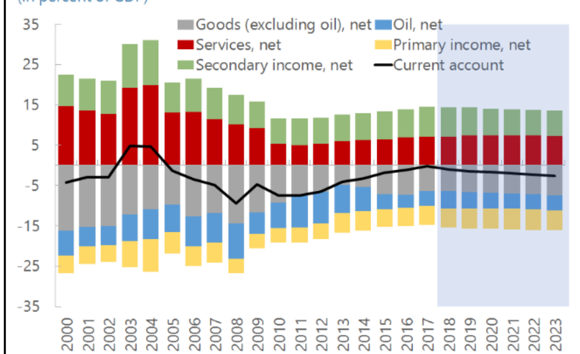
Headline CPI Decomposition
(12 month percent change)



Sources: BCRD and IMF staff calculations.

11. The outlook for the balance of payments is favorable. While the external position is moderately stronger than warranted by medium-term fundamentals and desirable policy settings (Annex I), the current account deficit is expected to gradually realign with the estimated norm over the medium term. The increase in the deficit is expected to be largely driven by the projected recovery in private domestic demand and associated imports, rising interest payments on government external debt, and a decline in remittances (as a share of GDP). Internal appreciation, fueled by the ongoing recovery in real wages and recent monetary easing, will support the recovery in domestic demand and contribute to the realignment. A continued recovery in global growth should support exports. FDI, particularly into the tourism sector, is expected to continue to more than adequately finance the current account deficit, helping to strengthen reserve coverage to 3.8 months of imports (4.4 months excluding imports from the free trade zones) over the medium term.

Dominican Republic: Current Account
(in percent of GDP)



Sources: BCRD and Fund staff calculations.

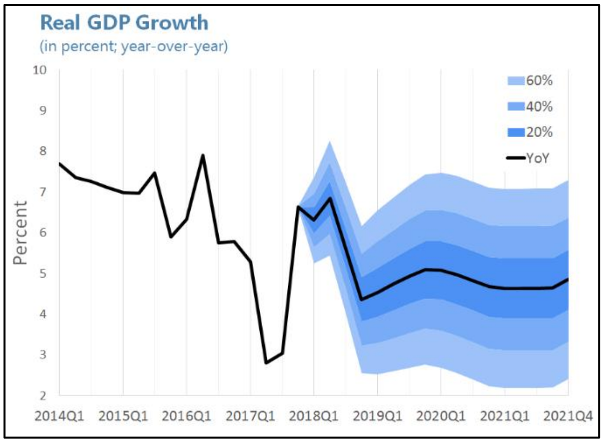
12. Risks to the outlook are moderate and broadly balanced:

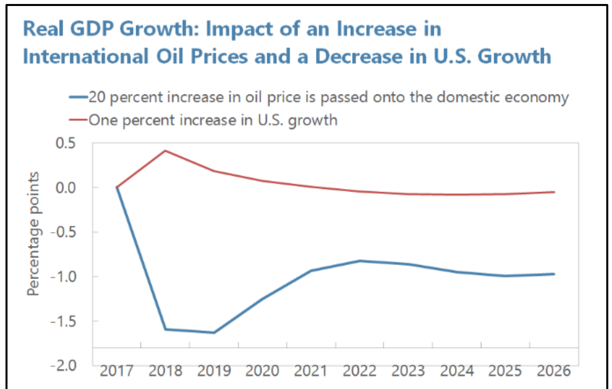
- **External Risks.** The main downside risks stem from higher-than-expected world oil prices, and weaker-than-projected external demand (Annex II).[3] Other downside risks include possible weather events and energy supply disruptions, particularly if an embargo on Venezuela cuts access of offshore oil sales to private agents. The main upside risks are symmetric to the downside ones, and stem from lower oil prices and stronger external demand, especially from the United States. To the extent that tighter global financial conditions—a high likelihood risk at the global level—is associated with stronger growth in the United States, it is expected to have a net positive effect on growth in the Dominican Republic through trade channels, although the effect on the fiscal position will be negative. On balance, while the probability of these risks vary, staff sees the upside risks to growth broadly equal to the downside risks in terms of their impact on the growth outlook.

- **Domestic Risks.** The main source of two-sided uncertainty stems from the strength of momentum in domestic demand in 2018, given the inflexion point induced by the monetary easing in mid-2017. On the downside, delays in structural reforms, including governance, could hurt confidence and affect growth prospects.[4]

[3] Simulations based on the WHDMOD module of the IMF's Flexible System of Global Models (FSGM) suggest that (i) a 20 percent increase in oil prices would be expected to reduce growth by up to 1.6 percentage points per year; and (ii) a 1 percentage point negative U.S. demand shock is estimated to weaken domestic growth by 0.4 percentage points through a decline in exports and remittances. Simulations were done by Keiko Honjo (RES).

[4] On the governance side, the regional corruption probe involving bribes paid by the Brazilian construction company Odebrecht to win procurement contracts prompted a strong social response in the Dominican Republic, and the judiciary is pursuing charges against officials allegedly involved.





Sources: Simulations were done on the basis of the WHDMOD module of the IMF's Flexible System of Global Models (FSGM) by Keiko Honjo (RES).

Authorities' Views:

The authorities broadly shared staff's outlook for growth and inflation. They also agreed with staff's perception of the main risks to the outlook, but saw stronger upside risks to growth, particularly related to impact of the the mid-2017 monetary easing on domestic demand. They noted that they are closely monitoring developments and stand ready to adjust policy to respond to emerging risks. They remain focused on building buffers to support Dominican Republic's capacity to absorb and respond to risks to economic and financial stability.

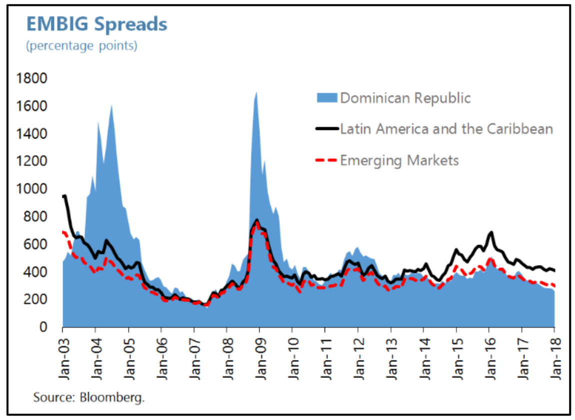
POLICY DISCUSSIONS: REINVIGORATING REFORMS TO SUPPORT RESILIENCE AND INCLUSIVE GROWTH

Discussions focused on policy support for sustained and inclusive growth. In the short-term, growth is likely to maintain its momentum, with activity close to potential, and will not require policy support. To build resilience against downswings or tighter global financial conditions, staff recommended that policy buffers be strengthened. This will require a correction of fiscal imbalances while minimizing growth and distributional effects, a continued buildup in reserves, and gradual movement toward more exchange rate flexibility. Over the medium term, structural reform, particularly of the electricity sector and to strengthen the investment environment, will be needed to sustain high growth. Strengthening social policies will also be important to make growth more inclusive, and reduce poverty and income inequality.

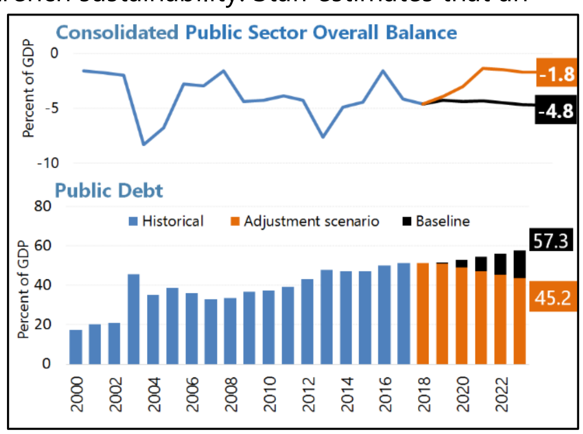
A. Fiscal Policy: Building Buffers and Reducing Medium-Term Risks

13. While fiscal policy is expected to remain neutral over the medium term, pressures will gradually build and erode space for more productive spending. The 2018 budget does not envisage significant policy changes but relies on ongoing tax administration reforms to increase tax collections by 0.5 percent of GDP. Under staff's baseline scenario—which includes a more conservative 0.3 percent yield and unbudgeted spending on coal plants of 0.3 percent of GDP)—the consolidated overall public deficit will narrow to 4.3 percent of GDP in 2018, and possibly further if the tax administration measures yield stronger-than-expected results. However, over the medium term, the consolidated deficit is expected to gradually widen to 4½-4¾ percent of GDP. Public debt would continue to rise, reaching 57⅕ percent of GDP by 2023, contributing to a higher interest burden.

14. The risks that could affect the baseline fiscal outlook, while two sided, have a notable negative skew. On the upside, commitment to maintaining fiscal discipline and progress in improving the debt profile is paying off in terms of lower borrowing costs: the country's EMBIG spreads fell below the emerging markets and regional averages, and the authorities issued their first local currency bonds in global markets in early 2018, one of the few cases on non-investment grade countries in the region to do so. On the downside: (i) tighter than anticipated international financial conditions would still put further pressure on the debt service burden, which – at an interest to revenue ratio of around 21 percent for the nonfinancial public sector– is already among the highest in the world; (ii) higher-than-projected oil prices would further widen the deficit of the electricity sector; (iii) fiscal space to absorb shocks is limited by a large share of nondiscretionary spending and already compressed public investment; and (iv) a dollarized public balance sheet is exposed to notable foreign exchange risks (Annex III).[5]



15. A meaningful fiscal consolidation is needed to ensure that public debt remains sustainable. Staff supports the authorities' ongoing tax administration reforms, which are increasing the efficiency of tax collections, improving compliance and broadening the tax base, but these reforms are likely to fall short of what is needed to entrench sustainability. Staff estimates that an adjustment of about 3 percent of GDP in the overall deficit during 2018–20 would lower debt to around 45 percent of GDP over the next five years.[6] This scenario assumes that the authorities succeed in increasing revenue collection by an additional 0.2 percent of GDP in 2018, as in the budget, with the rest of the adjustment evenly spread over 2019–20 (1.4 percent of GDP in each year), given the neutral cyclical position and the need to articulated a comprehensive and well-calibrated adjustment



[5] The authorities do not expect a notable impact on the corporate environment from the US tax reform (since taxation is unlikely to be an important factor in the decision to invest in the Dominican Republic), therefore fiscal risks from competitiveness pressures are small.

[6] This medium-term debt anchor and modalities to achieve it were discussed in detail in Annex V of the 2017 Article IV staff report.

strategy.[7] Developing such a strategy during 2018 would ensure its readiness ahead of the 2019 budget, while saving any windfall revenues meanwhile would allow an accelerated reduction in debt.

16. The composition of the fiscal adjustment and the savings it generates should aim to minimize its growth and social impact. The adjustment could have a negative effect on the level of economic activity and could increase inequality unless the composition of the adjustment and the use of the savings from a lower interest bill are calibrated to offset these. The adjustment should focus on reducing generalized subsidies on electricity, which are regressive, rationalizing CIT incentives (which do not affect inequality), scaling back the least progressive exemptions from VAT, and reducing the high PIT threshold (under which only the top income decile of the population contributes) (Box 1, and Selected Issues Paper). The negative distributional effects of the consolidation could be further offset with an increase in targeted transfers, while the negative growth effects with a scaling up of infrastructure investment, both financed with the savings from the lower interest bill (estimated at 0.5–0.8 percent of GDP over the medium term).

Key Fiscal measures	Expected yield (% of GDP)			
	2018 1/	2019	2020	Total
Reduced VAT (other indirect) and property tax exemptions to regional levels	0.2	0.6	0.6	1.4
Reducing CIT exemptions	0.0	0.2	0.2	0.3
PIT: not adjusting tax rate benchmark for inflation in 2018 and reducing PIT allowance to two minimum salaries	0.0	0.1	0.1	0.3
Eliminating electricity subsidies and improving spending efficiency	0.0	0.5	0.5	1.0
Total	**0.2**	**1.4**	**1.4**	**3.0**

1/ Measures in the tax reform package included in the 2018 budget

Authorities' Views:

The authorities saw tackling tax evasion as the main priority to strengthen the fiscal position, before assessing the need for further consolidation effort. Given wide-spread fraud and evasion, they saw significant scope to strengthen collections through tax and customs administration efforts, as evidenced by the underlying increase in collections of some 0.4 percent of GDP in 2017, despite the economic slowdown. They were also confident that with collections likely to increase by another 0.5 percent of GDP in 2018, due to measures included in the 2018 National Budget, along with continued restraint in spending, the fiscal accounts will improve.

B. Strengthening the Fiscal Policy Framework

17. Public financial management continues to be strengthened, supporting better governance and transparency. Coverage of the treasury single account has been broadened, which will support better cash management, spending controls, and will lower borrowing costs. A single public portal has been introduced for all government procurement processes, significantly improving their transparency and helping to support efficiency and value for money in government spending. The authorities are also taking steps to strengthen financial reporting by public institutions and are preparing to launch internal audits for these institutions. Continued progress in these areas will be

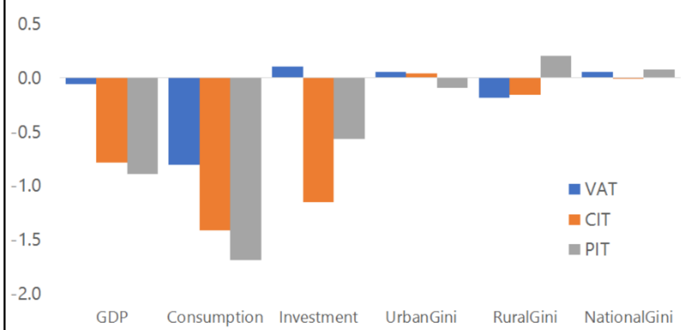
[7] Staff's adjustment scenario also assumes that the interest savings generated by the consolidation (up to ¾ points of GDP over the medium-term) are used for higher infrastructure and social spending. Such a scenario is broadly equivalent to a consolidation effort of 2½–2¾ percent of GDP, with the ensuing fall in the interest bill securing the same 3 percentage points of GDP improvement in the overall deficit.

Box 1. Distributional Effects of Fiscal Consolidation 1/

Against the backdrop of high poverty and inequality, the fiscal consolidation needed to ensure debt sustainability should be carefully designed to minimize its negative growth and distributional effects. This box considers the long-run growth and distributional effects of alternative revenue-mobilization strategies to generate an increase in revenues of about 2 percent of GDP as part of an overall consolidation package of 3 percent of GDP.

The dynamic effect of revenue mobilization on macroeconomic aggregates and the income distribution depends on the specific tax measure. Results from a heterogenous agents general equilibrium model (developed in Peralta-Alva, Tavares, Tam, and Tang (2018)) show that different taxes have different trade-offs between growth and equity: VAT taxes have a relatively limited cost in terms of growth and overall income inequality, while labor income taxes (PIT) are the most detrimental and corporate income taxes have the smallest social effect but a strong effect on growth. However, in the Dominican Republic, the effect of PIT on growth and inequality is likely to be muted by the strong progressivity of the tax. Given these dynamic effects in the context of the existing tax system in the Dominican Republic, a revenue-mobilization package that increases VAT, CIT and PIT receipts by 1.5, 0.25 and 0.25 percent of GDP, respectively, could be considered. Such a package would be estimated to reduce output by close to 1 percent (a fiscal multiplier of close to 0.5).

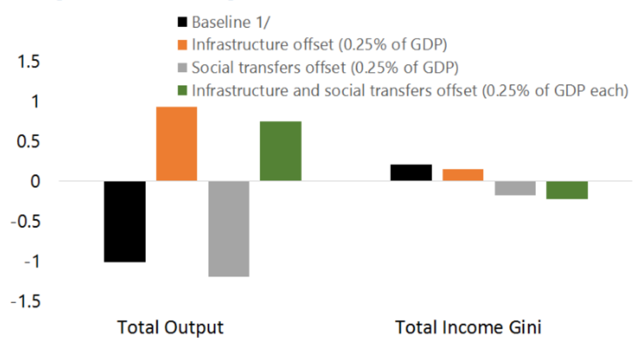
Comparative Impact of Tax Increases
(percent change)



Note: The effect on macrovariables of raising 0.5% of GDP in revenues from VAT, CIT, and PIT separately (through base broadening by 5.6, 18.8, and 23.2 percent respectively).

The detrimental growth and social effects of the revenue mobilization should be offset with a combination of higher infrastructure investment and targeted transfers. Staff estimates that a fiscal adjustment of 3 percent of GDP over 2018-20 would reduce the interest bill by 0.5 to 0.8 percent of GDP over the medium term. This space should be used to both boost infrastructure investment and social spending. Simulations with the dynamic model suggest that investment spending is an efficient instrument to boost growth to offset the demand drag from the adjustment, but it does not contribute to a redistribution of income. Social transfers, on the other hand, may not contribute to better growth outcomes (at least this longer-term effect is not captured by the model at hand), but are very potent at reducing inequality. Therefore, a combination of infrastructure investment (0.25 percent of GDP) and higher targeted transfers to rural area or equivalent spending on health/education (0.25 percent of GDP), within the envelope of the estimated fiscal resources freed up by the adjustment would provide the optimum offset to the growth and social effects of the adjustment (gray scenario in the figure).

Growth and Distributional Effects of Fiscal Consolidation
(% change from baseline, long term effect)



Note: The effect on macrovariables of raising 2% of GDP in revenues (1.5% of GDP from VAT, 0.25% from CIT, 0.25% from PIT), through base broadening by 16.7, 9.4, 11.5 percent, respectively. 1/ Baseline assumes mobilized revenue is used in non-productive current spending.

1/ See Selected Issues Paper for additional details.

important to further strengthen transparency and governance over public accounts. Finally, efforts to strengthen tax transparency have yielded positive results, with a fast-track assessment by the Global Forum in mid-2017 achieving a provisional "largely compliant" rating in recognition of considerable progress made to implement the Exchange of Information on Request standard.

18. The fiscal framework should be strengthened to support policy sustainability. A medium-term fiscal anchor would be an important tool to enhance policy predictability, credibility and sustainability, and a good guide for annual policy decision-making.[8] Additional reforms that would strengthen the fiscal framework include widening the scope and the availability of fiscal statistics for all levels of government, and the introduction of a framework for Public-Private Partnerships to minimize fiscal risks from such arrangements (which are already being rolled out). These elements of prudent fiscal management could usefully be entrenched within fiscal responsibility legislation or as principles within the upcoming Fiscal Pact, with a view to institutionalizing the reforms.

Authorities' Views:

The authorities agreed with the need to strengthen the fiscal framework and pointed out that many reforms are already underway. They are currently developing a medium-term fiscal framework that would be anchored in sustainability objectives and strategic guidance to maintain fiscal discipline, which they expect to finalize before end-April 2018. They are also preparing a fiscal risk management report, which will focus initially on macroeconomic risks, contingent liabilities from disasters and pensions and is also expected to be finalized this year. Finally, the planned move towards the 2014 Government Finance Statistics Manual by March 2018, with IMF technical assistance, will help align fiscal statistics reporting with international best practice.

C. Monetary Policy: Strengthen the Monetary Policy Framework and Reserve Adequacy

19. The neutral monetary policy stance with a tightening bias is appropriate.[9] The monetary easing in mid-2017 was a timely response to the weaker outlook for growth and inflation at that time, in the context of the inflation-targeting monetary policy framework.[10] The easing realigned the real policy interest rate with the estimated neutral rate and prevented a procyclical tightening of monetary conditions. With output projected to converge to its potential and inflation expected to remain within the central bank's target range, staff supported maintaining the neutral monetary policy stance until there are clear signs that activity and inflation are firming. Staff agreed with the

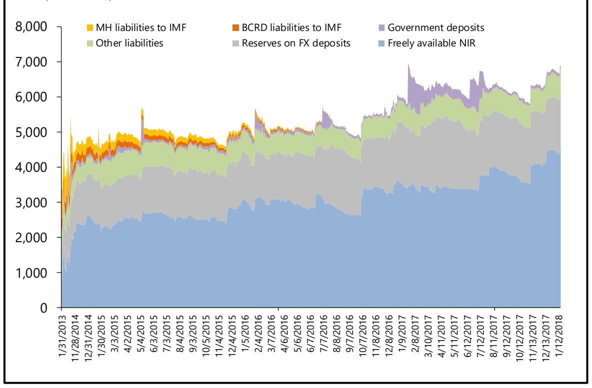
[8] For a more in-depth discussion of fiscal framework reforms see Annex V of the 2017 Article IV staff report.

[9] Tightening bias refers hereinafter to the readiness to increase interest rates if likely upside pressures on inflation materialize.

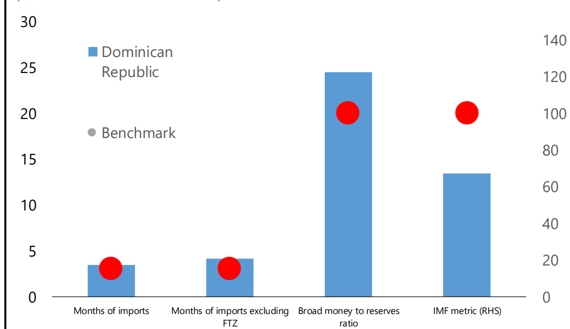
[10] In the short term, the impact on activity is expected to have partly come from the reduction in reserve requirements. The reduction applied to all new deposits, and to existing deposits to the extent that the funds freed up from the reduction of their reserves at the central bank were directed to lending in targeted economic sectors (later expanded to all sectors) at below market interest rates.

authorities' tightening bias given that the projected pick-up in inflation will bring inflation close to the upper band of the authorities' target range and noted that if internal or external inflationary pressures pick-up tighter monetary policy may be required. This argument is reinforced by the anticipated normalization of U.S. interest rates and related prospective U.S. dollar strengthening, which could put depreciation pressure on the peso and fuel inflation.

20. Reserve adequacy has improved with the strengthening of the external position, but there is scope to further enhance buffers. Good progress has been made to rebuild reserve buffers since these were completely depleted after the 2003-04 banking crisis, with a notable improvement in reserve adequacy in 2017 despite the reduction in the reserve requirement ratio.[11] However, coverage remains below the Fund's reserve adequacy metric, at an estimated 67 percent of the metric for 2017 (Annex I).[12] With the current account deficit projected to remain low in the near term and financing expected to remain ample, staff saw it as a good opportunity to further strengthen reserve adequacy toward the Fund's metric.



Dominican Republic: Gross International Reserves
(Million US$)



Dominican Republic: Reserve Adequacy Indicators
(relative to benchmark metrics)

Sources: BCRD; IMF staff calculations.

21. Introducing more flexibility in the exchange rate would support external stability. Staff continues to view additional exchange rate flexibility under the crawl-like arrangement as beneficial to the economy's ability to absorb external shocks and to strengthening the credibility and effectiveness of inflation targeting. However, in the context of an external position that is moderately stronger than fundamentals in the near term and of the need to continue to accumulate reserve buffers, the authorities have space to continue to focus on building their reserves, while developing capacity to enhance flexibility in the exchange rate. Staff welcomed the authorities' plans to introduce a foreign exchange trading platform, which will increase transparency of the market, enhance liquidity and price discovery, and support enhanced exchange rate flexibility. The original timeline for the introduction of the platform has been postponed to ensure that the ultimate

[11] The reduction in reserve requirements reduced commercial banks' reserves at the central bank.

[12] The staff assessment uses the reserve adequacy benchmark applicable to fixed exchange rate regimes given that the country's crawl-like arrangement was considered "fixed" in the derivation of the metric. Under the benchmark for flexible exchange rate regimes the authorities would be above 100% of the metric.

platform is compatible with the central bank's systems, but the authorities expect to proceed with a new request for proposals in the first half of 2018. The planned foreign exchange trading platform presents an opportunity to strengthen intervention policies aimed at curbing excessive volatility. Staff welcomed the authorities' ongoing efforts to develop a derivatives market for foreign exchange to strengthen the economy's capacity to manage exchange rate risks.

22. **Further strengthening the monetary policy framework would support overall public debt management.** The 2003–04 financial crisis continues to weigh on the monetary policy framework, as the central bank manages a large share of public debt stemming from the recapitalization of commercial banks and with the large interest costs contributing to a quasi-fiscal deficit of 1.2 percent of GDP in 2017. The mission welcomed the authorities' plans to finalize the new agreement on the recapitalization of the central bank. In this context, the improved coordination between the monetary and fiscal authorities is important to support overall public debt management.

Authorities' Views:

The authorities agreed that the neutral policy stance with a tightening bias is appropriate and noted that they stand ready to tighten monetary policy if projected inflation picks up faster than anticipated. They agreed that favorable external conditions present an opportunity to further strengthen reserve adequacy and highlighted the progress they have made in rebuilding reserve buffers since the 2003–04 crisis. Furthermore, ongoing reforms to continue the move towards a more flexible exchange rate, including the planned introduction of an electronic foreign exchange platform market, will support the economy's ability to absorb external shocks. An updated agreement to recapitalize the central bank is expected to be concluded in the following months.

D. Financial Supervision and Regulation: Enhancing Financial Stability Fifteen Years After the Financial Crisis

23. **The financial sector has emerged stronger and better supervised than before the 2003–04 financial crisis (see Selected Issues Paper).** Significant restructuring and recapitalization since the crisis has contributed to a healthy consolidation of the previously fragmented financial sector, with 58 entities remaining out of the 141 that existed in 2003. Banking sector assets declined during the crisis and, at about 46 percent of GDP in 2017, remain below pre-crisis levels (about 52 percent of GDP). Private pension funds have grown rapidly in importance since their introduction in 2001, now holding assets of another 17 percent of GDP. The strengthening of banking supervision and prudential regulations, and monitoring by the Monetary Board (MB) of relevant financial sector developments have also enhanced bank soundness indicators: when compared against its regional peers, the Dominican Republic stands high on all key bank soundness indicators, including solvency, asset quality, and profitability.

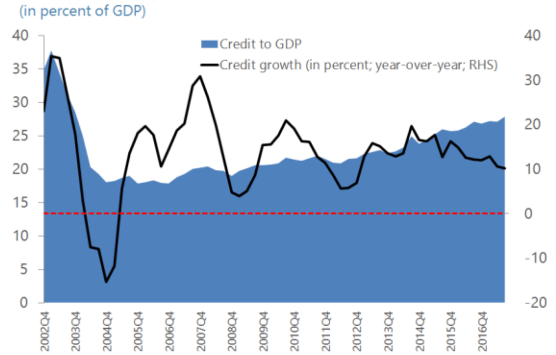
Dominican Republic: Financial Soundness Indicators in Regional Perspective 1/

	Costa Rica	Dominican Republic **	Guatemala	Honduras *	Nicaragua	Panama *	El Salvador	CAPDR 2/	LA5 3/
Regulatory Capital to Risk-Weighted Assets	16.3	16.4	16.0	13.8	14.0	15.7	16.7	15.6	16.3
Capital to Assets Ratio	9.6	10.3	7.2	10.8	7.4	11.4	13.3	10.0	11.4
Nonperforming Loans (NPLs) to Total Loans Ratio	1.9	1.7	2.6	2.5	1.1	3.2	1.9	2.1	3.3
Provisions to Nonperforming Loans Ratio	144.1	177.7	57.3	137.3	220.1	36.4	n.a.	128.8	137.1
Return on Assets	0.6	2.0	1.5	2.0	3.1	1.5	0.9	1.7	1.8
Return on Equity	4.1	19.9	15.8	19.3	27.4	13.5	6.8	15.3	16.1

Sources: FSI database -IMF; and Superintendencia de Bancos of Dominican Republic. For the Dominican Republic, FSI coverage includes commerical banks.
1/ As of September 2017, unless noted otherwise. * As of June 2017, ** as of December 2017.
2/ Comprises Costa Rica, Guatemala, El Salvador, Honduras, Dominican Republic, Nicaragua, and Panama.
3/ Comprises Brazil, Chile, Colombia, Mexico and Peru.

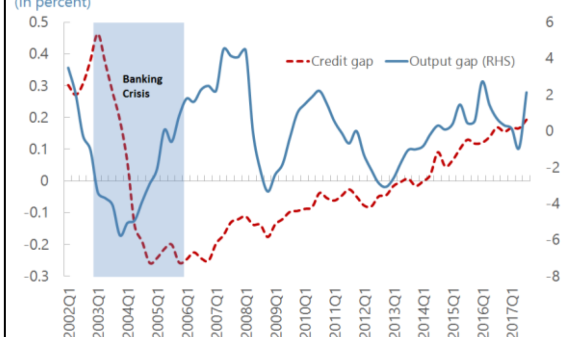
24. Macro-financial vulnerabilities appear limited. Although credit growth picked up in the latter half of 2017, the credit gap remains moderate. Aggregate asset quality indicators suggest that credit dynamics continue to evolve in line with fundamentals. Non-performing loans increased by about 0.2 percentage points from a year earlier given the deceleration in economic activity in mid-2017, but at 1.9 percent for commercial banks, remain relatively low and appear overall adequately provisioned. Financial institutions' profitability remains dependent on high financial spreads and fee-based income. Capital adequacy of commercial banks improved further to 18.2 percent (well above the 10 percent regulatory requirement), largely reflecting capitalization of retained earnings.

Dominican Republic: Credit to the Private Sector
(in percent of GDP)



Sources: BCRD and IMF staff estimates

Dominican Republic: Credit Cycle VS. Business Cycle
(in percent)



Sources: BCRD and IMF Staff estimates.

25. Nonetheless, some pockets of vulnerability remain. Lack of adequate data on borrowers' financials to assess repayment capacity remains a structural weakness and will need to be addressed within a progressive, but clear timetable. In the meantime, close monitoring of credit quality will be key to ensure that the recent adjustment in credit risk assessment guidelines[13] and the release of

[13] These adjustments widen acceptable collateral, minimize downgrading of refinanced but performing loans, and liberalize loan provisions in cases of credit rating improvements.

reserve requirements, initially through targeted lending and at below market rates, do not create risks with respect to asset quality. Other pockets of vulnerability that would need to be monitored include: (i) the health of nonbank financial institutions, which have grown rapidly but are so far outside the supervisory perimeter; (ii) credit risk from dollar loans to unhedged borrowers, which account for one fifth of total loans; (iii) exposure to state risk; a medium-term strategy is needed to gradually deconcentrate such exposure by allowing a broader range of investment instruments, including abroad; (iv) low productivity of banks and their high structural dependence on fee-based income and high spreads, and (v) potential operational risk as regards cross-business activities by financial groups.

26. Ongoing efforts to continue improving prudential supervision and regulation should help to address these risks, but should be complemented with additional efforts. The authorities are considering regulatory changes to liquidity, leverage and market risk management requirements in 2018 to better align them to international practice. They should also prepare for the eventual adoption of International Financial Reporting Standards (IFRS) 9 through a carefully timed and planned strategy that takes into account the impact on banks. The existing supervisory and regulatory framework may also need to be enhanced to *inter alia* strengthen assessment of intercompany activities, give supervisors adequate powers to require higher capitalization for individual banks, and align the banking law more fully to international standards, following lessons learned in the consolidation process since the 2003–04 crisis. Ongoing efforts to address weaknesses in the oversight of the largest nonbank institutions (some of which are now comparable in asset size to banks), including a new draft law to enhance nonbank supervision and regulation, are welcome but should ensure that the effective supervision of core banks is not affected.

27. Systemic risk oversight is also being strengthened and macroprudential policies should be developed in tandem. The central bank has set up a committee responsible for financial stability and macroprudential policy, which will include a representative from the Superintendency of Banks. The committee is now formally responsible for systemic risk assessment and financial stability, and is working to strengthen systemic oversight and develop macroprudential policy instruments to fulfill its mandate. To fully operationalize macroprudential policy, consideration is being given to broaden the Monetary Board's powers for macroprudential policy – staff supported efforts in this direction. In tandem, progress has been made to strengthen systemic risk assessment, which would be further enhanced through publication of a financial stability report, which would in turn enhance transparency and accountability of the authorities' ongoing efforts to strengthen financial resilience. Addressing data gaps with respect to sectoral risks will be also be critical to strengthening systemic risk assessment and would enhance lenders' ability to assess borrower credit risk, thereby contributing to financial stability *ex ante*.

28. An AML/CFT law finalized in 2017 will help strengthen technical compliance with international standards. Staff welcomed steps taken to strengthen the AML/CFT legal framework and encouraged the authorities to continue to focus decisively on its effective implementation, including to support their anti-corruption efforts. The Dominican Republic is currently undergoing an assessment of its compliance with the 2012 FATF standard, which will be concluded in mid-2018. Advancing further on effective implementation of international AML/CFT standards will be essential to continued mitigation of risks stemming from the withdrawal of correspondent banking relationships.[14]

Authorities' Views:

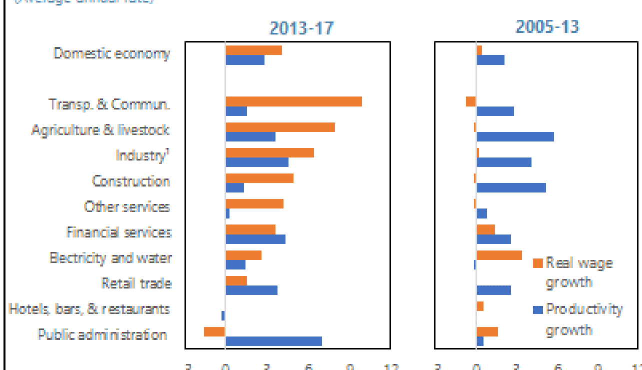
The authorities welcomed staff's feedback on progress made to strengthen financial stability since the financial crisis and the in-depth retrospective. They concurred with the assessment of remaining risks and priorities and the need for future reforms, and indicated their commitment to developing an overall strategy and agenda to further build on achievements made since the financial crisis. They emphasized their commitment to strengthening systemic risks assessment and to finalizing their macroprudential policy framework and toolkit. With respect to the new AML/CFT framework, the authorities indicated their commitment to effective implementation and considered that the new law would also prevent tax avoidance and help to transition the informal sector into the formal economy.

E. Structural Reforms to Strengthen Productivity and Potential Growth

29. The government continues to prioritize growth- and socially-oriented structural reforms, but challenges remain. Competitiveness gains from the post-crisis internal devaluation may be eroding with the recent slowdown in productivity and the needed adjustment in real wages following the rise in the minimum wage. At the same time, structural factors continue to weigh on the country's medium-term growth prospects.

- The main structural impediments to growth come from poor electricity supply, still weak educational outcomes, high transportation costs, relatively weak institutions, and a complex tax system. In addition, better social outcomes are held back by relatively low coverage of social insurance schemes and limited fiscal space.
- The authorities have made significant efforts to improve outcomes in education (where spending has doubled to 4 percent of GDP in recent years), healthcare and infrastructure; an Electricity Pact has been broadly agreed between major social partners; and the doing-business environment is being reformed with impetus from the newly relaunched Competitiveness Council. In addition to strengthening competitiveness, the increases in education and health spending will help to reduce income inequality and poverty given their progressive nature.

Productivity and Real Wage Growth
(Average annual rate)



Sources: BCRD and IMF staff calculations.
[1] Includes mining, free trade zone and local manufacturing activity.

[14] Thus far, financial institutions in the Dominican Republic have maintained stable access to correspondent banking relationships.

30. **Sustaining high and inclusive growth will hinge on continued reforms to enhance productivity and social inclusion.** Staff estimates suggest that addressing the economy's key structural impediments could raise growth by one percentage point over the medium term, which would also support a further catchup in incomes and poverty reduction (Annex IV). The main priorities include:

- ***Reforming the Electricity Sector.*** Decades-long weaknesses in the electricity sector continue to be a drag on economic activity. Electricity shortages average four hours per day, which is highly disruptive to activity and imposes heavy costs. A draft Electricity Pact was agreed by social partners at end-2017 after three years of negotiations, but remains to be fully finalized (Annex V). The draft Pact includes broad policy objectives (reducing losses in the sector, reforming its governance structure, allowing for a larger role for the private sector), but its success will hinge on the political will to follow up with concrete and immediate policy actions to achieve these objectives.

- ***Improving the Investment Environment…***

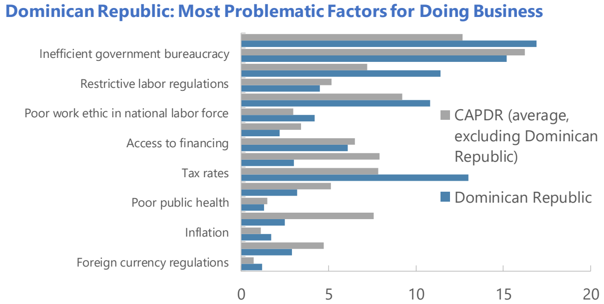
  - *…by facilitating doing-business and trade.* The authorities' efforts are currently focused on reducing the time for setting up companies and introducing a single window for exporters' procedural requirements, with the National Competitiveness Council working to identify remaining challenges.

  - *…by reducing barriers to competition, especially in the transport sector.* Port transportation costs are among the highest in the region due to oligopoly power, which in turn pushes up costs throughout the economy. While institutional and legal reforms have recently been implemented, reform success will hinge on forceful implementation of anti-competition practices.

  - *… by modernizing labor market legislation*. Discussions have been recently relaunched to update the 1992 Labor Code, with the main reforms aimed to make working hours more flexible and to streamline the dispute system. Discussions to reform severance pay, however, are likely to delay agreement on the broader reform given the need to balance unemployment protection considerations against the drag of high labor costs on hiring and formalization of the economy.

  - *…by strengthening institutions and governance*. Perceptions of weak public institutions and governance stand out as the main impediments for doing business and are receiving heightened attention by the civil society. Recent reforms to simplify trade procedures and improve transparency in the public procurement processes will strengthen governance in the public sector, but there is scope for further reforms.

Dominican Republic: Most Problematic Factors for Doing Business



Source: Global Competitiveness Report, World Economic Forum. From the list of factors, respondents to the World Economic Forum's Executive Opinion Survey were asked to select the five most problematic factors for doing business in their country and to rank them between 1 (most problematic) and 5. The score corresponds to the responses weighted according to their rankings.

- ***Creating a Growth- and Investment-Friendly Fiscal Environment…***
    - *…by simplifying the tax system*. The tax system is inefficient, with a low revenue yield and a high cost of compliance. This is due to (i) a complicated system of tax exemptions/incentives, which is hard to administer, costly (6.2 percent of GDP in 2017) and inequitable as it benefits the better off; and (ii) the patchwork of modifications since the 2012 tax reforms make compliance difficult, especially for medium and small enterprises. Simplification would help reduce compliance costs, increase the efficiency of tax administration reforms and improve competitiveness, while also reducing the informal sector and helping to broaden the tax base.
    - *… by creating space for infrastructure and social investment*. Outcomes in education, healthcare and access to social security are still weak, and hinder progress in reducing inequality and poverty. The doubling of spending on education in recent years was an important step forward, but further spending would be needed to improve the quality of these services. Similarly, the quality of the capital stock remains somewhat below peers, and further infrastructure investment could significantly boost longer-term growth and social outcomes.
- ***Finalizing Social Security Reform***. With the social security reform of 2003 not fully implemented, access to pension, healthcare, and disability insurance is limited to formal enterprises, leaving about half of the workforce without social safety nets. The pension system is particularly vulnerable due to low contributory compliance and a relatively low pensionable age. Unless reforms are implemented, only 30 percent of the labor force is expected to receive contributory pensions (among the lowest ratios in Latin America) and at a very low replacement rate (of about 20 percent of average wage), suggesting a potentially high contingent liability for the government. Legislation to finalize the social security reforms is currently under discussion, and should address the issue of pension adequacy while the population is relatively young.

Authorities' Views:

The authorities emphasized their commitment to structural reforms to support a continuation of the positive economic performance experienced since the financial crisis. They remain firmly focused on finalizing the Electricity Pact and reforming the electricity sector. They also underscored the importance of the actions to improve the doing business environment, facilitate exports, upgrade the country's infrastructure in the face of fiscal constraints, pursue better outcomes in education and health through teacher training and continued upgrades of schools and hospitals. They also noted the climate change preparedness efforts, including through reforestation programs. The authorities also agreed with the need to undertake reform of the labor code and the social security system, but recognized that achieving agreement among the social partners may delay the reforms.

STAFF APPRAISAL

31. **The timely policy response to the economic slowdown in early 2017 has put the economy back on an even keel.** Economic activity and its projected growth are reverting to potential, inflation is within the central bank's target, unemployment is near historical lows, and the external current account deficit has narrowed. The overall economic outlook remains positive but risks persist, with the main downside risks stemming from higher oil prices, weaker-than-projected external demand, and tighter-than-anticipated global financial conditions. In this context, the key challenge will be to build resilience to these risks by rebuilding policy buffers, reinvigorating structural reforms, and further reducing poverty and inequality.

32. **Despite welcome efforts to bolster the revenue base, more meaningful action will be required to strengthen the fiscal position.** Favorable international financial conditions and strong growth in recent years have kept fiscal vulnerabilities at bay, but public debt continued to increase and the growing interest burden relative to a narrow revenue base is making debt less affordable. Welcome reforms to improve the debt profile and address weaknesses in tax and customs administration are yielding strong results, as evidenced by recent peso debt issuance in the global markets, narrowing bond spreads and increases in the tax base. However, these are not sufficient to offset structural spending pressures, especially in the face of tightening global financing conditions and increasing oil prices. A meaningful fiscal adjustment will be needed to rebuild the buffers and reverse the upward debt dynamic, but its design would need to be particularly mindful of its impact on growth, poverty and inequality. The adjustment should focus on widening the tax base (including through streamlining of tax incentives and exemptions), simplifying the tax system, and rationalizing inefficient expenditures, while prioritizing fiscal space towards increasing public investment and social spending to protect the most vulnerable.

33. **Strengthening the fiscal policy framework should support efforts to improve the fiscal position.** A medium-term fiscal framework, which would anchor fiscal policy decision-making in longer-term debt sustainability objectives, would reduce policy uncertainty and strengthen its credibility with the markets. Ongoing efforts to develop such a framework are welcome. Reforms to enhance transparency in the public procurement processes, strengthen public financial management practices and align public statistics with international norms will further contribute to increase policy transparency and predictability, and should be supplemented by wider coverage and timeliness of fiscal statistics.

34. **The neutral monetary policy stance with a tightening bias is consistent with current economic conditions.** The neutral stance should help maintain output close to potential and inflation within the central bank's target, but tighter monetary policy may be required if inflation rises faster than expected. The central bank's inflation targeting framework has contributed positively to price stability and would be further enhanced through greater exchange rate flexibility, which would increase resilience to external shocks by providing an automatic adjustment mechanism. The external position is moderately stronger than warranted by medium-term fundamentals and desirable policy settings, but is expected to realign over the medium term with the projected recovery in private

domestic demand, especially as structural reforms to improve the investment environment and social outcomes take hold. Its continued strength in the near-term provides an important opportunity to continue building reserve buffers, which have strengthened considerably since the 2003–04 financial crisis.

35. Perseverance with efforts to strengthen financial sector oversight will enable the financial system to continue supporting strong and inclusive growth. Reforms put in place in the fifteen years since the financial crisis have supported a recovery in the health of the financial system, which compares favorably to regional peers. The ongoing emphasis on strengthening oversight over systemic macro-financial risks will further contribute to financial stability, especially as information on household and firm indebtedness is developed, and as the macroprudential policy framework is finalized to enhance policy flexibility to respond to systemic risks. Continued efforts to improve prudential regulation and supervision will complement these reforms, with the objective of fully aligning the regulatory and supervisory framework with international best practice. Remaining gaps in the supervisory periphery, including the oversight of the largest nonbank institutions, should be filled. Finally, efforts to strengthen the anti-money laundering framework are welcome, with its effective implementation important to promoting integrity in the financial system.

36. Growth- and socially-oriented structural reforms will be important to enhancing the economy's growth potential and addressing remaining social challenges. The authorities' ongoing reforms to strengthen the doing-business environment and improve outcomes in health, education and infrastructure, as well as to advance the reform agenda for the electricity sector, are welcome and will help to boost the economy's growth potential. The challenge will be to complement these efforts with concrete and immediate policy actions to sustainably reform the electricity sector, and with more ambitious reforms to reduce high transportation costs, simplify the tax system and strengthen the institutional environment. Reforms to widen the coverage of social security and ensure an adequate retirement income will be important to strengthen social outcomes. A stronger fiscal position would also contribute to improved social outcomes by easing pressures on financial resources and interest rates, and providing space to refocus spending towards social safety nets and infrastructure.

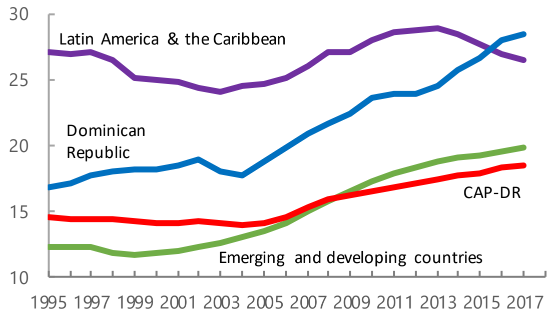
37. It is recommended that the next Article IV consultation take place on the standard 12-month cycle.

Figure 1. Dominican Republic: Real Sector Indicators

Strong growth since the 2003-04 financial crisis, especially above-potential growth of 7.1 percent during 2014-16, has resulted in substantial gains in per capita income.

Per Capita Income

(PPP-GDP per capita in percent of US PPP-GDP per capita)

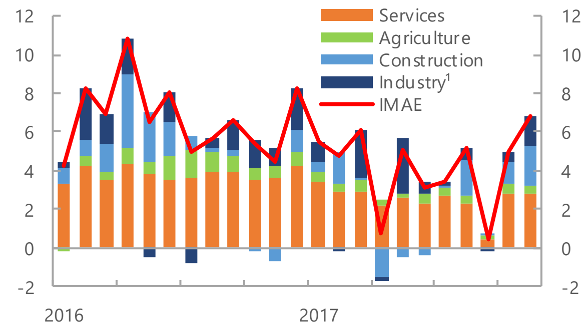


Sources: IMF, World Economic Outlook (April 2018)

The ongoing cyclical slowdown was magnified by several factors in 2017, including close passage of two hurricanes in September, recovery from which supported growth at end-2017 along with policy easing

Economic Activity Index and Components

(12 month percent change)



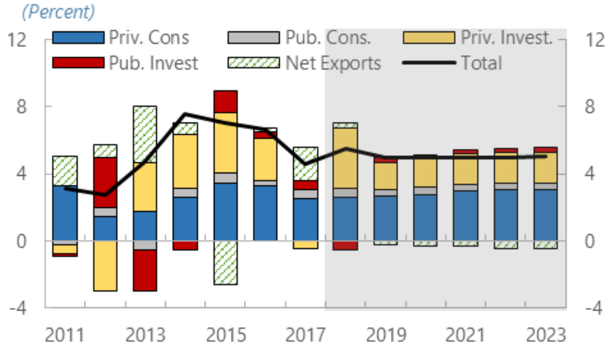
Sources: BCRD and IMF staff calculations.

[1] Includes domestic and free trade zone manufacturing as well as mining activity

On the demand side, the slowdown in early 2017 was driven largely by private investment, which has already shown signs of recovery by early 2018.

Real GDP: Contributions to Growth

(Percent)

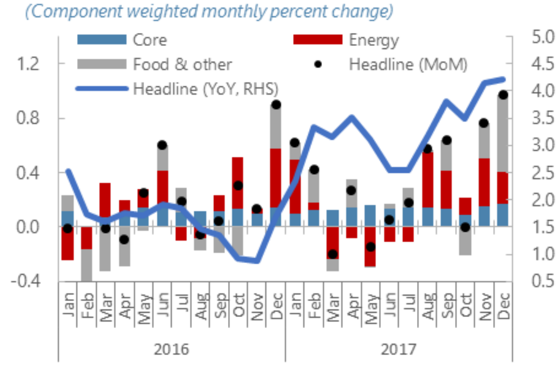


Sources: BCRD and IMF staff calculations.

Weaker demand in early 2017 held back core inflation, with an end-year pickup in headline inflation driven largely by supply-push factors...

Headline CPI Decomposition

(Component weighted monthly percent change)

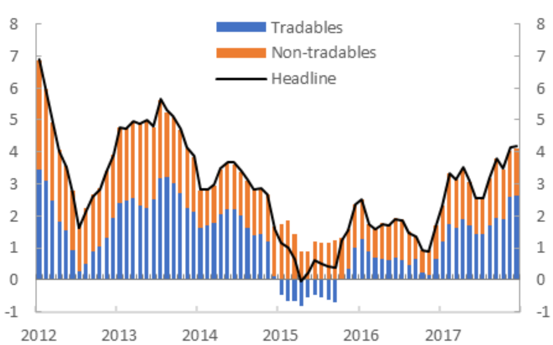


Sources: BCRD and IMF staff calculations.

... including imported energy and food prices.

Tradable and Non-tradable Inflation

(12 month percent changes)

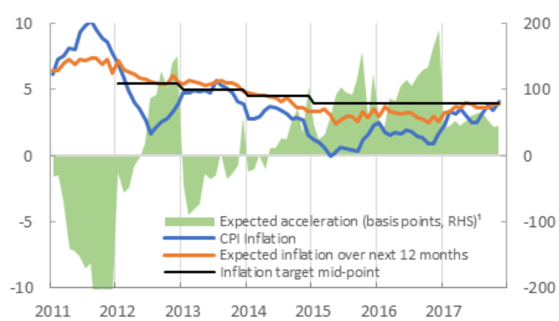


Source: BCRD.

Inflation expectations remain relatively well anchored near the mid-point of the central bank's target band.

Inflation Expectations

(12 month percent changes unless otherwise specified)



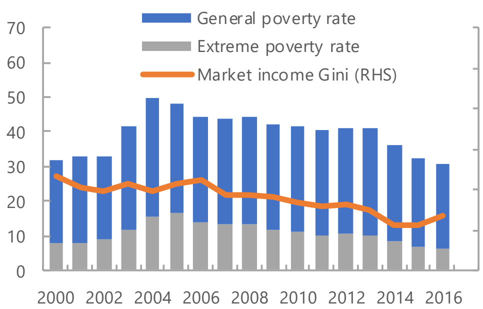
Source: BCRD.

[1] Expected inflation for the following year less expected inflation for the current year.

Figure 2. Dominican Republic: Social and Labor Market Indicators

Poverty and inequality have gradually improved since the 2003-04 financial crisis, especially during 2014-15...

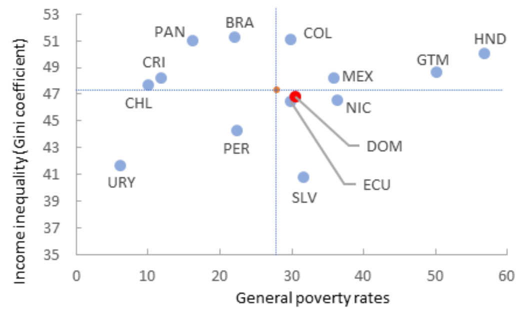
Social Indicators[1]



Sources: BCRD; and Oficina de Estadisticas Nacional de la Republica Dominicana.
[1] Annual average of semi-annually reported values.
[2] Values before 2014 spliced with data from continuous labor force survey.

.. but remain close to the average for Latin and Central America, which is one of the most unequal regions in the world.

Regional Indicators of Poverty and Inequality, 2015[1]



Sources: World Bank, World Development Indicators; and national authorities.
[1] Values for 2015 or latest available. Dotted lines indicate average for reported countries.

Strong labor productivity growth, along with the decline in real wages after the 03-04 financial crisis, contributed to the lower labor costs and higher growth.

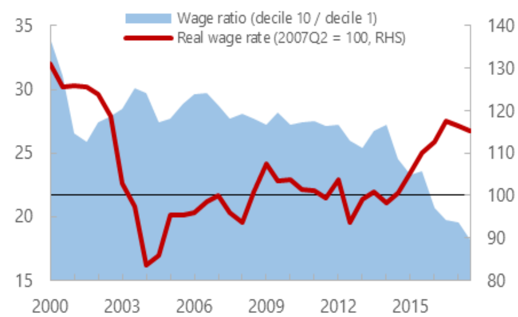
Wages and Productivity

(Indices, 2000Q2 = 100)

Sources: BCRD and IMF staff calculations

More recently, however, the recover in real wages and the faster wage growth in the lower income deciles, contributed to the reductions in poverty and inequality.

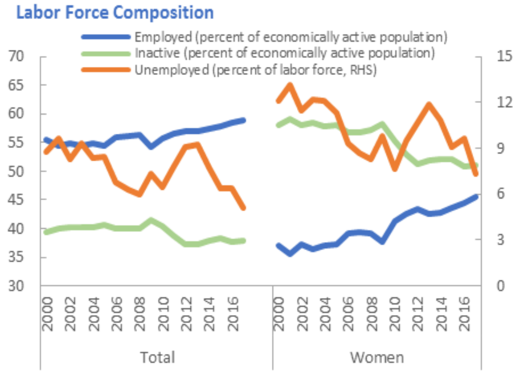
Pay Gap and the Real Wage



Sources: BCRD and IMF staff calculations
[1] Values prior to 2014 spliced from ENFT survey of "open" labor force participation.

Employment is recovering and unemployment falling (even as more inactive join the labor force), particularly for women.

Labor Force Composition

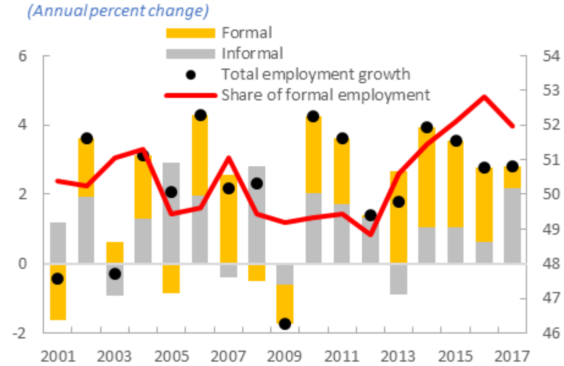


Sources: BCRD continuous labor force survey and IMF staff calculations.
[1] Values prior to 2014 spliced from ENFT survey of "open" labor force participation.

The quality of jobs has improved, as indicated by increasing share of formal sector employment.

Contribution to Growth of Employment by Formality

(Annual percent change)

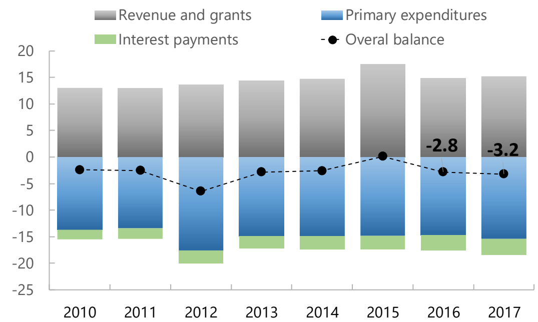


Sources: BCRD and IMF staff calculations.

Figure 3. Dominican Republic: Fiscal Developments

The central government's balance deteriorated somewhat in 2017, due to higher primary and interest spending

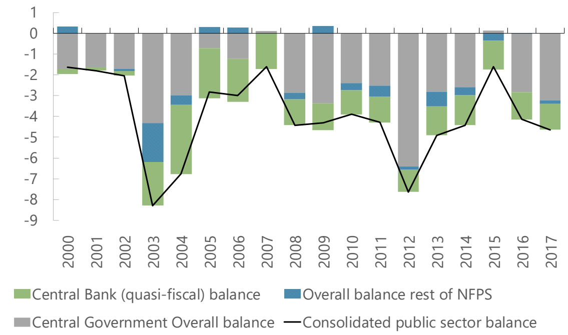
Central Government: Components of Overall Balance
(percent of GDP)



Note. Expenditures are reflected as negative values for ilustration purposes.

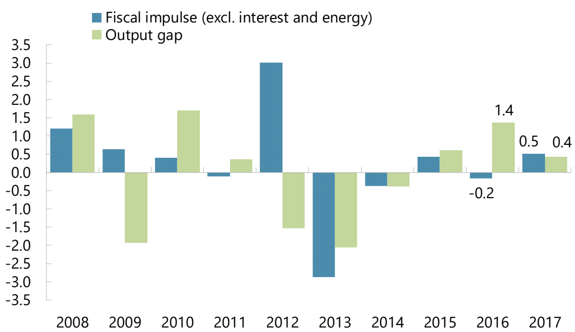
This contributed to some widening of the consolidated deficit, while central bank's quasi-fiscal deficits remained broadly stable

Consolidated Public Sector Overall Balance
(percent of GDP)



This imparted a moderate fiscal impulse in 2017.

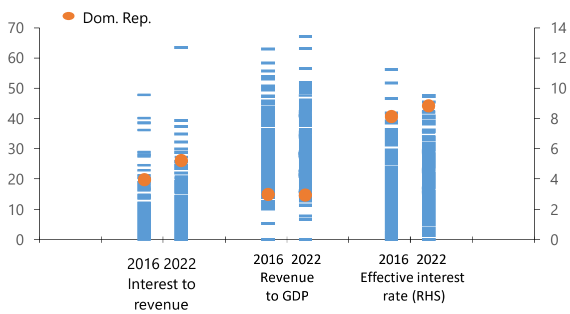
Fiscal Impulse
(percent of potential GDP)



Sources: National authorities and IMF staff calculations

Despite reforms, the tax base remains among the smallest in the world, while interest to revenue ratios and effective interest rates remain among the highest.

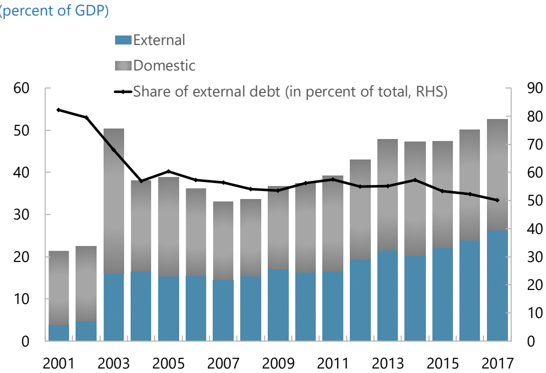
Interest Ratio, Revenue Base, and Borrowing Costs across countries in 2016 and 2022
(Percent)



Sources: World Economic Outlook and IMF staff calculations

Large deficits pushed public debt up despite strong growth, but debt management improved, with the share of external debt declining over time.

Public Sector Consolidated Debt: Distribution by Currency
(percent of GDP)



The increase in consolidated debt is due to the nonfinancial public sector, whereas he quasi-fiscal debt stock remained broadly stable as a share of GDP.

Public Sector Consolidated Debt Distribution by Borrower
(in percent of GDP)

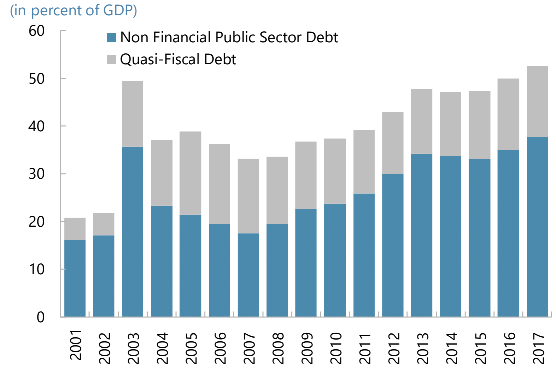
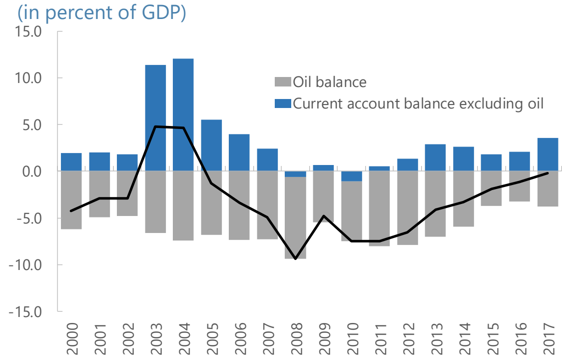


Figure 4. Dominican Republic: External Stability

The recent reduction in the current account deficit was primarily due to lower international oil prices.

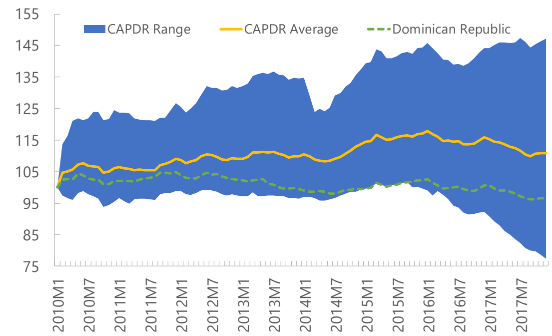
Current Account Balance
(in percent of GDP)



Sources: BCRD and Fund staff calculations and projections.

The exchange rate has continued to depreciate gradually.

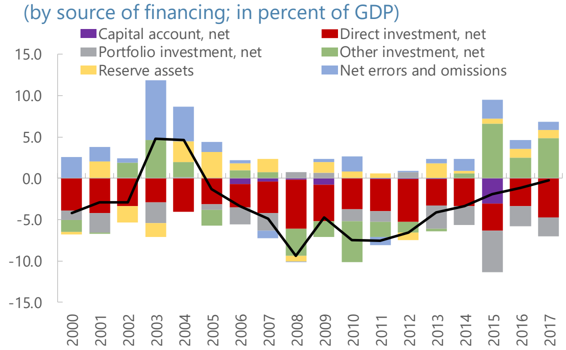
Dominican Republic: Real Effective Exchange Rate
(Index, 2010M1=100, +appreciation)



Sources: INS and Fund staff calculations.

FDI and government borrowing continue to exceed external financing needs…

Current Account
(by source of financing; in percent of GDP)



Sources: BCRD and Fund staff calculations. Capital account and net errors and omissions multiplied by negative one to reflect the balance of payments identify (current account = financial account - capital

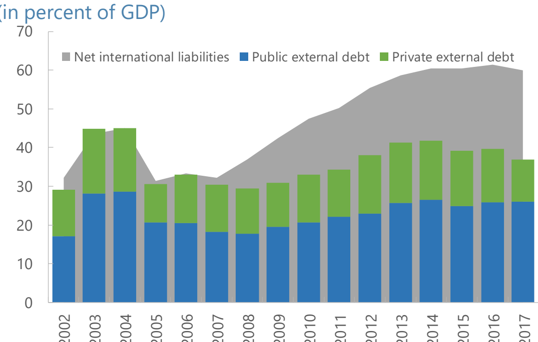
…contributing to a gradual build-up of reserves, particularly since the financial crisis.

Reserve Adequacy
(in months of prospective imports of goods and services)

Sources: BCRD and Fund staff calculations.

External debt is relatively low and concentrated in public sector debt…

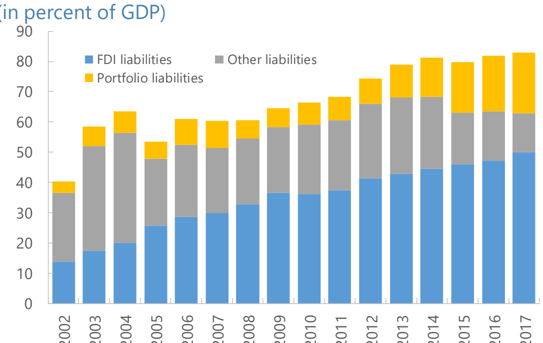
Net International Investment Position and External Debt
(in percent of GDP)



Sources: BCRD and Fund staff calculations and projections.

…with a large portion of external liabilities comprised on non-debt creating FDI inflows.

International Investment Liabilities
(in percent of GDP)

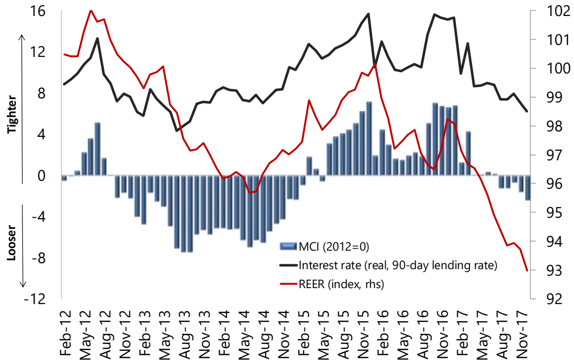


Sources: BCRD and Fund staff calculations and projections.

Figure 5. Dominican Republic: Monetary Developments

Monetary conditions loosened in the second half of 2017…

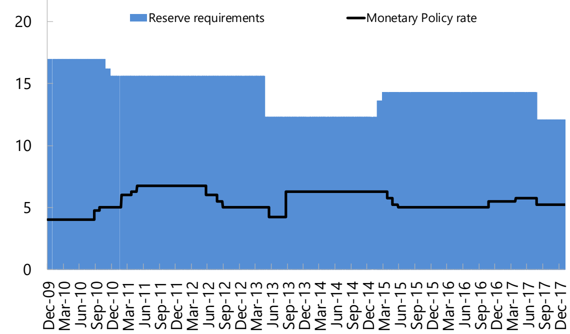
Monetary Condition Index



Sources: BCRD and Fund staff calculations

…in line with the mid-2017 monetary policy easing.

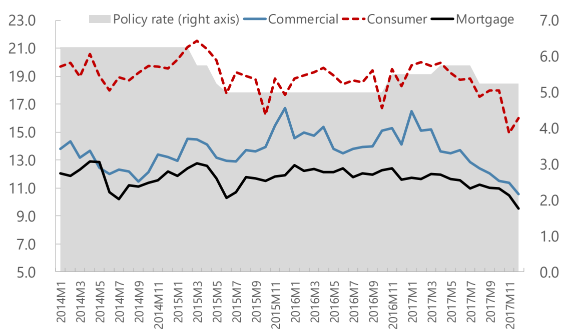
Monetary Policy Stance
(in percent; interest rates: 15-day moving average)



Source: BCRD.

Lending rates fell by significantly more than the policy rate as the liquidity freed up by the reduction in reserve requirements was initially directed to targeted sectors, and at below market interest rates.

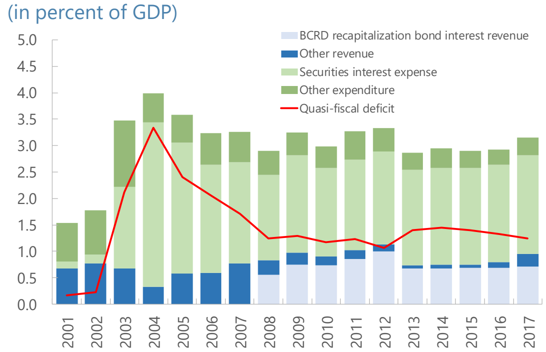
Lending Interest Rates
(in percent)



Sources: BCRD.

The quasi-fiscal deficit has remained relatively stable…

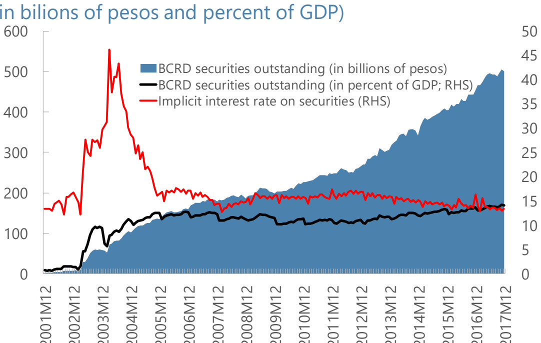
BCRD: Quasi-fiscal Deficit
(in percent of GDP)



Sources: BCRD and Fund staff calculations.

…but continues to put pressure on the stock of central bank securities outstanding.

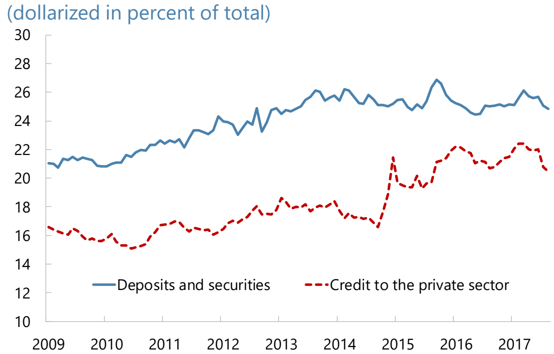
BCRD Securities Outstanding and Interest
(in bilions of pesos and percent of GDP)



Sources: BCRD and Fund staff calculations.

Dollarization has stabilized.

Banking System Dollarization
(dollarized in percent of total)

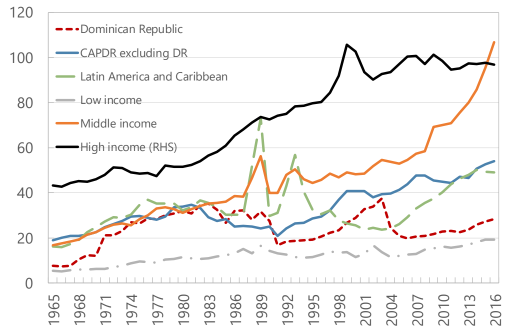


Sources: BCRD and Fund staff calculations.

Figure 6. Dominican Republic: Macrofinancial Developments

Financial development (as measured by the credit to GDP ratio) is below peer countries…

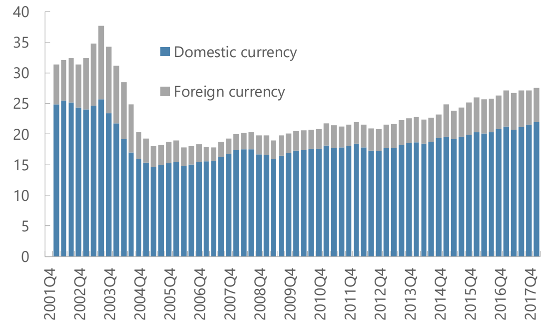
Financial Development
(credit to the domestic private sector; in percent of GDP)



Sources: World Bank World Development Indicators and staff calculations.

…as credit has yet to recover to pre-crisis levels.

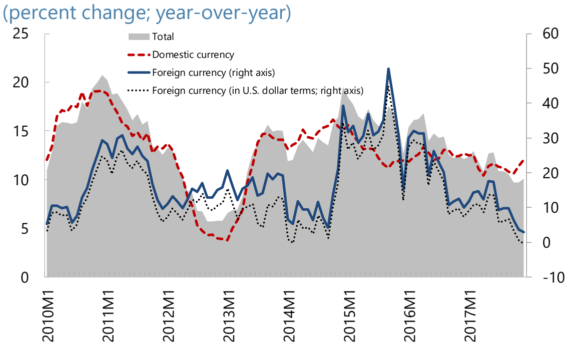
Credit to the Private Sector
(in percent of GDP)



Sources: BCRD and Fund staff calculations.

Foreign currency lending has abated following a recent spike.

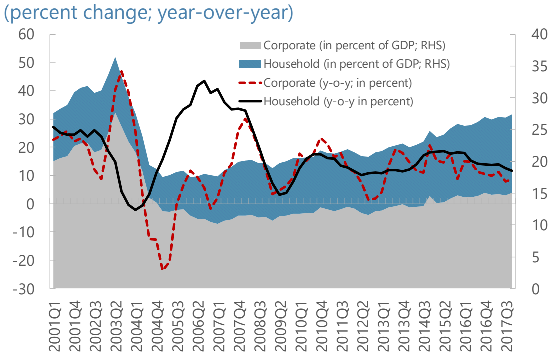
Credit to the Private Sector
(percent change; year-over-year)



Sources: BCRD and Fund staff calculations.

Households are gradually gaining access to finance, but access for corporates remains below pre-crisis levels.

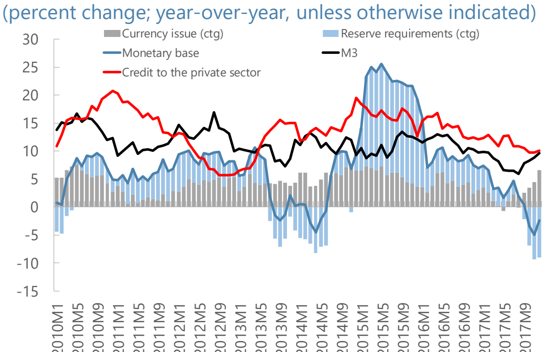
Credit to the Private Sector
(percent change; year-over-year)



Sources: BCRF and Fund staff calculations.

The recent deceleration in credit growth is consistent with that in broad money…

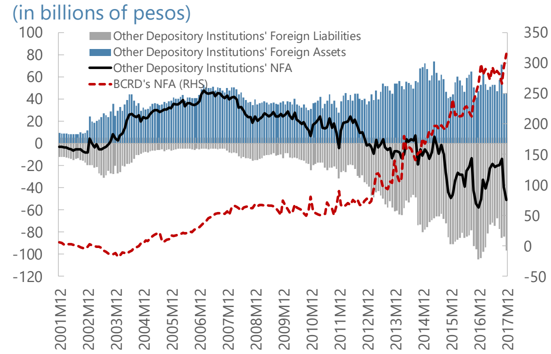
Money and Credit
(percent change; year-over-year, unless otherwise indicated)



Sources: BCRD and Fund staff calculations.

…with the deceleration in credit growth mitigated by banks' increased reliance on foreign funding.

Net Foreign Assets of the Banking System
(in billions of pesos)

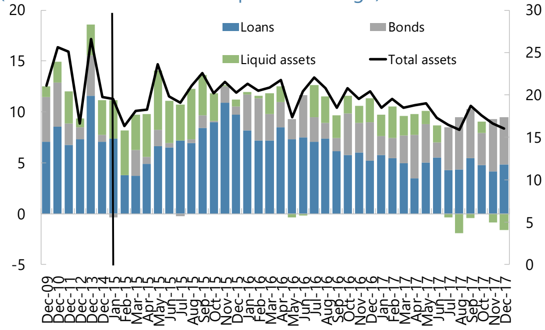


Sources: BCRD and Fund staff calculations.

Figure 7. Dominican Republic: Financial Soundness Indicators

Banks' assets continue to be concentrated in loans, but bonds have contributed notably to asset growth in recent years.

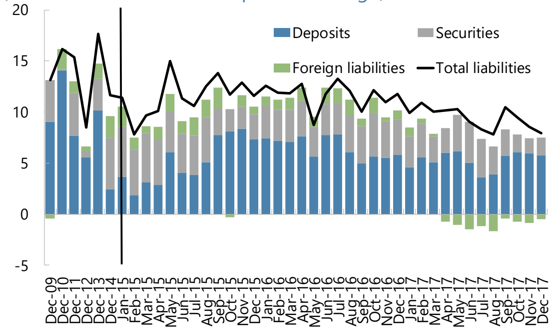
Assets
(contribution to 12-month percent change)



Sources: SIB and Fund staff calculations.

Banks continue to rely primarily on domestic deposits for funding, although securities have recently played an increasingly important role.

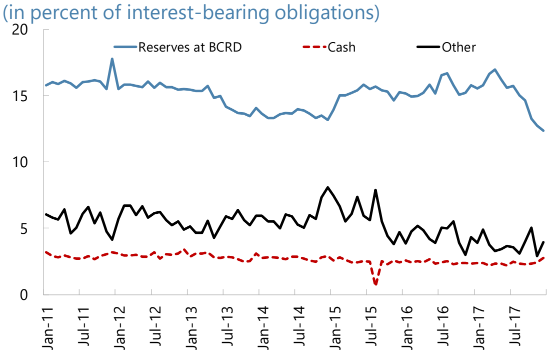
Liabilities
(contribution to 12-month percent change)



Sources: SIB and Fund staff calculations.

Banks' liquidity is heavily concentrated in reserves at the central bank.

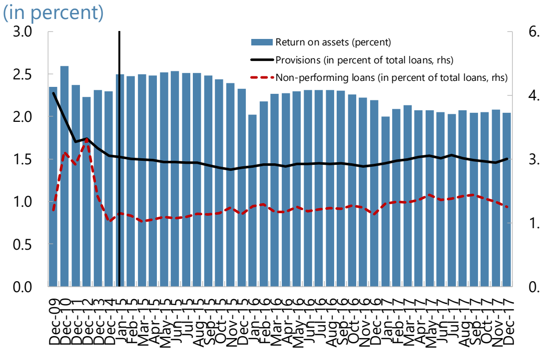
Liquid assets
(in percent of interest-bearing obligations)



Sources: SIB and Fund staff calculations.

Profitability and asset quality remains strong, but both are trending downward with the deceleration in economic activity.

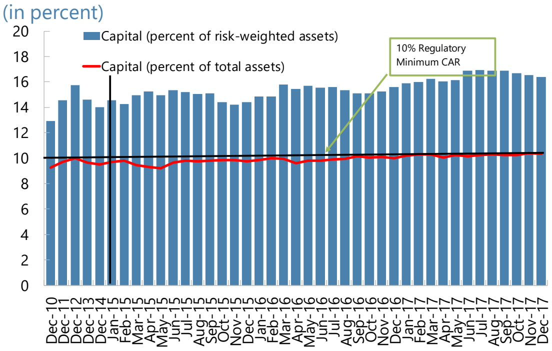
Profitability and asset quality
(in percent)



Sources: SIB and Fund staff calculations

Capital adequacy is well above the regulatory minimum.

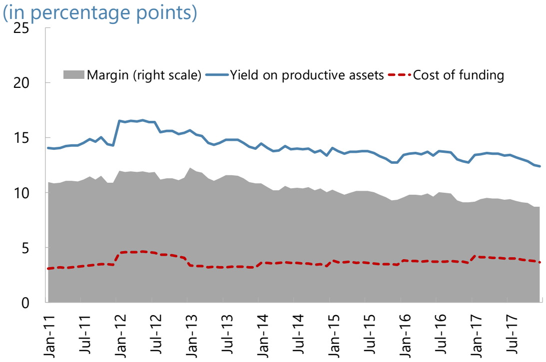
Capital adequacy and leverage
(in percent)



Sources: SIB and Fund staff calculations.

Banks' interest margins have been trending downward.

Interest margin
(in percentage points)



Sources: SIB and Fund staff calculations.

Table 1. Dominican Republic: Selected Economic Indicators

(Percent change from previous period; unless otherwise indicated)

Population (millions, 2017 estimate)	10.17	GDP per capita 2017 (U.S. dollars)	7,376
Quota	477.40 millions SDRs / 0.10% of total	Poverty (2016, share of population)	30.5
Main export product	tourism, textiles, gold	Extreme poverty (2016, % of pop.)	6.5
Key export markets	U.S. and Canada	Adult literacy rate (percent, 2014)	91

					Projection					
	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
	(Annual percentage change, unless otherwise stated)									
Output										
Real GDP	7.6	7.0	6.6	4.6	5.5	5.0	5.0	5.0	5.0	5.0
Contributions to growth										
Consumption	3.2	4.2	3.7	3.3	3.4	3.3	3.4	3.6	3.7	3.7
Investment	3.8	5.6	2.7	-0.6	1.8	2.0	1.9	1.7	1.8	1.8
Net exports	0.6	-2.7	0.2	1.9	0.3	-0.3	-0.4	-0.3	-0.5	-0.5
Nominal GDP (RD$ billion)	2,841	3,068	3,298	3,562	3,942	4,282	4,674	5,101	5,568	6,079
Nominal GDP (US$ billion)	65.3	68.1	71.6	74.9	...	...	...	...	...	...
Gross national saving (percent of GDP)	20.6	21.6	21.9	22.6	23.6	23.5	23.6	23.6	23.7	23.8
Output gap (in percent of potential output)	-0.4	0.6	1.2	0.1	0.1	-0.1	-0.1	-0.1	0.0	0.0
Unemployment										
Unemployment rate (in percent; period average)	6.4	5.9	5.5	5.4	5.1	5.1	5.1	5.1	5.1	5.1
Prices										
Consumer price inflation (end of period)	1.6	2.3	1.7	4.2	3.7	3.8	4.0	4.0	4.0	3.9
Consumer price inflation (period average)	3.0	0.8	1.6	3.3	4.4	3.5	4.0	4.0	4.0	4.0
Exchange rate										
Exchange rate (RD$/US$ - period average) 1/	43.6	45.1	46.1	47.6	...	...	...	...	...	...
Exchange rate (RD$/US$ - eop) 1/	44.4	45.7	46.7	48.5	...	...	...	...	...	...
Real effective exchange rate (eop, - depreciation) 1/	-2.1	2.3	-0.8	-2.3	...	...	...	...	...	...
Government finances	(in percent of GDP)									
Consolidated public sector debt 2/	47.2	47.3	50.0	52.7	52.6	53.7	54.4	55.3	56.3	57.3
Consolidated public sector balance 3/	-4.4	-1.6	-4.1	-4.6	-4.3	-4.4	-4.4	-4.5	-4.7	-4.8
Consolidated primary public sector balance	-0.7	2.2	0.0	-0.3	0.3	0.3	0.5	0.5	0.5	0.5
Central government balance	-2.6	0.1	-2.8	-3.2	-2.8	-3.0	-3.1	-3.3	-3.5	-3.6
Revenues and grants	14.8	17.5	14.8	15.1	15.1	15.0	15.1	15.0	15.0	15.0
Primary spending, *o.w.:*	14.9	14.8	14.7	15.3	14.5	14.4	14.3	14.3	14.3	14.3
Transfers to electricity sector	1.4	0.8	0.6	0.5	0.6	0.4	0.3	0.3	0.3	0.2
Interest expenditure	2.5	2.6	2.9	3.1	3.4	3.6	3.8	4.0	4.2	4.3
Rest of NFPS	-0.4	-0.3	0.0	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2
Financial sector	(Annual percentage change; unless otherwise stated)									
Broad money (M3)	9.3	12.1	9.8	9.7	10.6	8.6	9.1	9.1	9.1	9.1
Credit to the private sector	19.5	12.7	12.1	10.1	12.1	9.6	9.1	9.1	9.1	9.1
Policy interest rate 1/	6.3	5.0	5.5	5.3	...	...	...	...	...	...
Average deposit rate (1-year; in percent) 1/	6.4	6.4	6.7	6.0	...	...	...	...	...	...
Average lending rate (1-year; in percent) 1/	13.9	14.9	15.1	14.1	...	...	...	...	...	...
Balance of payments	(in percent of GDP)									
Current account	-3.3	-1.9	-1.1	-0.2	-1.0	-1.4	-1.7	-2.0	-2.3	-2.6
Goods, net	-11.3	-10.9	-10.5	-10.1	-10.7	-10.8	-10.7	-10.8	-10.9	-11.1
Services, net	6.3	6.4	6.9	7.0	7.1	7.4	7.4	7.4	7.4	7.3
Income, net	1.7	2.7	2.5	2.8	2.6	1.9	1.6	1.4	1.3	1.2
Capital account 4/	0.0	3.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial account	-4.8	-1.1	-2.2	-1.2	-1.0	-1.4	-1.7	-2.0	-2.3	-2.6
Foreign direct investment, net	-3.4	-3.2	-3.4	-4.8	-3.3	-3.3	-3.3	-3.3	-3.3	-3.3
Portfolio investment, net	-2.3	-5.1	-2.4	-2.3	-2.5	-1.9	-1.7	-1.7	-1.3	-1.4
Financial derivatives, net	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other investment, net	0.6	6.6	2.5	4.9	3.9	3.0	2.8	2.4	1.8	1.6
Reserves,net	1.8	0.3	0.6	1.1	1.0	0.8	0.7	0.6	0.6	0.6
NIR (in millions of U.S. dollars)	4,361	5,152	6,047	6,780	7,428	8,028	8,578	9,128	9,678	10,178
NIR in months of imports	2.6	3.0	3.4	3.5	3.6	3.7	3.8	3.8	3.8	3.8
NIR in months of imports (excluding free trade zone imports) 5/	3.1	3.5	4.1	4.2	4.3	4.4	4.4	4.4	4.4	4.4
Total external debt (in percent of GDP)	40.0	37.3	37.9	36.8	36.6	37.2	37.4	37.7	38.0	38.3
of which: Public sector	26.6	24.9	25.8	25.9	26.3	27.2	28.0	28.7	29.6	30.4

Sources: Country authorities; World Bank; and Fund staff calculations and estimates.

1/ Latest available.

2/ Historical debt numbers are staff estimates. The debt stock at end-2017 includes a downward stock adjustment of US$324 million (0.5 percent of GDP) in external debt, reflecting the central bank's repurchase of its Brady bonds.

3/ The consolidated public sector includes the central government, some decentralized entities, the electricity holding company, and the central bank.

4/ For 2015 includes the grant-element of a debt buyback operation with PDVSA of 3.1 percent of GDP.

5/ In relation to imports of goods and nonfactor services of the following year, excluding maquila.

Table 2. Dominican Republic: Public Sector Accounts

(In percent of GDP)

	2014	2015	2016	2017	2018		2019	2020	2021	2022	2023
					Projection						
					Budget						
					A. Central Government						
Total revenue and grants	**14.8**	**17.5**	**14.8**	**15.1**	**15.6**	**15.1**	**15.0**	**15.1**	**15.0**	**15.0**	**15.0**
Total revenue	**14.7**	**14.4**	**14.8**	**15.1**	**15.5**	**15.0**	**15.0**	**15.0**	**15.0**	**15.0**	**14.9**
Tax revenues	13.8	13.5	13.7	14.0	14.6	14.0	14.0	14.1	14.0	14.0	14.0
Income and property 1/	5.1	4.6	4.8	5.1	5.1	4.8	4.8	4.9	4.9	4.8	4.8
VAT	4.6	4.8	4.8	4.8	5.1	4.9	4.9	4.9	4.9	4.9	4.9
Excises	3.2	3.1	3.1	3.2	3.3	3.3	3.3	3.3	3.2	3.2	3.2
International trade	0.9	1.0	1.0	1.0	1.1	1.0	1.0	1.0	1.0	1.0	1.0
Nontax revenue	0.7	0.9	1.0	1.0	0.9	1.0	1.0	1.0	1.0	1.0	1.0
Grants	**0.1**	**3.1**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Primary expenditure	**14.9**	**14.8**	**14.7**	**15.3**	**14.3**	**14.5**	**14.4**	**14.3**	**14.3**	**14.3**	**14.3**
Wages and salaries 2/	4.5	5.0	4.6	4.7	4.4	4.4	4.4	4.4	4.4	4.4	4.4
Goods and services	1.7	1.6	1.4	1.9	2.3	2.2	2.2	2.2	2.2	2.2	2.2
Transfers	6.0	4.8	5.4	5.0	4.8	4.9	4.7	4.6	4.6	4.6	4.5
Electricity transfers	1.4	0.8	0.6	0.5	0.4	0.6	0.4	0.3	0.3	0.3	0.2
Other	4.6	4.0	4.8	4.5	4.4	4.3	4.3	4.3	4.3	4.3	4.3
Capital expenditure	2.9	3.4	3.2	3.6	2.7	3.0	3.0	3.0	3.0	3.0	3.0
Statistical discrepancy	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Primary balance	**-0.1**	**2.8**	**0.1**	**-0.1**	**1.3**	**0.5**	**0.6**	**0.7**	**0.7**	**0.7**	**0.7**
Interest	**2.5**	**2.6**	**2.9**	**3.1**	**3.4**	**3.4**	**3.6**	**3.8**	**4.0**	**4.2**	**4.3**
Foreign	0.9	1.1	1.3	1.3	1.5	1.5	1.6	1.7	1.8	1.9	2.0
Domestic 3/	1.6	1.5	1.6	1.7	1.9	1.9	2.0	2.1	2.2	2.3	2.3
o/w: interest for central bank recapitalization 4/	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7
Overall balance	**-2.6**	**0.1**	**-2.8**	**-3.2**	**-2.2**	**-2.8**	**-3.0**	**-3.1**	**-3.3**	**-3.5**	**-3.6**
					B. Rest of the Non-Financial Public Sector 5/						
Overall balance rest of NFPS	**-0.4**	**-0.3**	**0.0**	**-0.2**	**...**	**-0.2**	**-0.2**	**-0.2**	**-0.2**	**-0.2**	**-0.2**
					C. Non-Financial Public Sector (A+B)						
Overall balance NFPS	**-3.0**	**-0.2**	**-2.8**	**-3.4**	**...**	**-3.0**	**-3.2**	**-3.2**	**-3.4**	**-3.7**	**-3.7**
Primary balance	-0.5	2.4	0.1	-0.3	...	0.4	0.4	0.6	0.6	0.6	0.5
Interest	2.5	2.6	2.9	3.1	...	3.4	3.6	3.8	4.0	4.2	4.3
					D. Central Bank						
Quasi-fiscal balance of the central bank	-1.5	-1.4	-1.3	-1.2	...	-1.3	-1.2	-1.2	-1.1	-1.1	-1.0
Primary balance	0.5	0.5	0.6	0.7	...	0.6	0.6	0.6	0.7	0.7	0.7
Interest	1.9	1.9	1.9	1.9	...	1.9	1.8	1.8	1.8	1.8	1.7
					E. Consolidated Public Sector (C+D)						
Consolidated public sector balance	**-4.4**	**-1.6**	**-4.1**	**-4.6**	**...**	**-4.3**	**-4.4**	**-4.4**	**-4.5**	**-4.7**	**-4.8**
Primary balance	-0.7	2.2	0.0	-0.3	...	0.3	0.3	0.5	0.5	0.5	0.5
Interest	3.7	3.8	4.1	4.3	...	4.5	4.8	4.9	5.1	5.3	5.3
Memorandum items:											
Consolidated public sector debt 6/	47.2	47.3	50.0	52.7	...	52.6	53.7	54.4	55.3	56.3	57.3
Non-financial public sector	33.8	33.2	35.0	37.9	...	36.9	37.9	38.8	39.9	41.2	42.6
Central Bank 7/	13.4	14.2	15.0	14.8	...	15.7	15.8	15.6	15.4	15.1	14.7
Structural balance 8/	-4.1	-4.0	-3.9	-4.4	...	-4.0	-4.1	-4.0	-4.2	-4.4	-4.4
Cyclically-adjusted revenue (excl. one-off revenue)	14.4	14.4	14.3	14.7	...	14.7	14.7	14.7	14.7	14.7	14.7
Cyclically-adjusted expenditure	-18.5	-18.4	-18.3	-19.0	...	-18.7	-18.7	-18.7	-18.9	-19.0	-19.1
Central government primary spending excl. energy su	13.5	14.0	14.1	14.8	...	13.9	14.0	14.0	14.0	14.0	14.0
Central government overall spending	17.4	17.4	17.6	18.3	...	17.9	18.1	18.1	18.3	18.5	18.5
Overall balance of the electricity sector	-2.3	-1.5	-1.5	-1.5	...	-1.3	-1.0	-0.9	-0.9	-0.9	-0.9
Nominal GDP (DR$ billion)	2,841	3,068	3,298	3,562	3,867	3,942	4,282	4,674	5,101	5,568	6,079

Sources: Country authorities and Fund staff calculations and estimates.

1/ Includes social security contributions.

2/ The nominal decrease in wages and salaries in 2016 reflects a reclassification of certain items to transfers.

3/ Includes interest payments on Central Bank recapitalization bonds.

4/ The 2017 amount includes the accrued amount of recapitalization interest, whereas the cash amount was reallocated as approved in the revised 2017 budget.

5/ Includes the Dominican Corporation of State Electricity Companies (CDEEE).

6/ Historical debt numbers are staff estimates. The debt stock at end-2017 includes a downward stock adjustment of US$324 million (0.5 percent of GDP) in external debt, reflecting the central bank's repurchase of its Brady bonds.

7/ External debt is expected to be revised down in the future to exclude some non-debt obligations of the central bank (of 0.4 percent of GDP in 2017).

8/ Consolidated public sector structural balance; excludes one-off items and adjusts revenues and expenditures for the economic cycle.

Table 3. Dominican Republic: Public Sector Accounts

(In billions of Dominican pesos)

	2014	2015	2016	2017	2018 Budget	2018	2019	2020	2021	2022	2023
					Projection						
A. Central Government											
Total revenue and grants	**419.5**	**538.0**	**487.9**	**538.7**	**602.9**	**594.4**	**643.5**	**703.8**	**766.9**	**835.2**	**910.0**
Total revenue	**417.4**	**441.9**	**486.9**	**537.2**	**601.2**	**592.7**	**641.6**	**701.8**	**764.7**	**832.8**	**907.4**
Tax revenue	393.2	414.2	453.2	500.4	564.9	552.9	600.3	656.7	715.5	779.1	848.8
Income and property 1/	144.8	140.3	158.0	180.6	196.1	189.7	206.3	227.4	247.5	269.1	292.8
VAT	130.4	147.0	159.2	169.6	196.3	193.1	209.8	229.0	249.9	272.8	297.8
Excises	90.9	95.2	101.8	115.1	129.1	129.5	140.1	152.3	165.5	179.9	195.6
International trade	26.6	31.1	33.5	34.4	42.8	39.8	43.3	47.2	51.5	56.3	61.4
Nontax revenue	21.2	27.5	33.7	36.7	36.3	39.9	41.3	45.1	49.2	53.7	58.7
Grants	2.1	96.2	1.0	1.5	1.6	1.7	1.8	2.0	2.2	2.4	2.6
Primary expenditure	**423.2**	**453.4**	**485.6**	**543.6**	**552.8**	**573.0**	**618.1**	**669.9**	**729.6**	**794.9**	**866.6**
Wages and salaries 2/	127.8	153.0	150.9	166.0	170.9	174.8	189.9	207.3	226.2	246.9	269.6
Goods and services	47.4	48.3	47.3	69.3	87.4	87.4	95.0	103.6	113.1	123.5	134.8
Transfers	169.7	147.6	179.5	177.3	186.6	192.8	203.3	216.9	234.7	254.3	275.8
Electricity transfers	40.2	24.6	20.8	17.6	17.0	23.1	19.0	15.8	15.2	14.7	14.2
Other	129.4	123.0	158.7	159.7	169.6	169.6	184.3	201.1	219.5	239.6	261.6
Capital expenditure	81.5	104.6	105.6	130.0	106.3	116.4	128.3	140.3	153.6	168.1	184.1
Statistical discrepancy	-3.5	-1.1	0.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Primary balance	**-3.8**	**84.6**	**2.4**	**-5.0**	**50.1**	**21.4**	**25.4**	**33.9**	**37.3**	**40.3**	**43.5**
Interest	**70.0**	**80.1**	**95.6**	**108.7**	**133.3**	**133.3**	**155.5**	**177.2**	**203.7**	**234.5**	**260.2**
Foreign	25.4	32.9	41.3	47.1	58.9	58.9	68.7	79.5	92.7	108.1	121.4
Domestic 3/	44.6	47.2	54.3	61.6	74.4	74.4	86.8	97.7	111.0	126.4	138.8
o/w: interest for central bank recapitalization 4/	19.2	21.2	22.8	25.3	27.6	27.6	30.0	32.7	35.7	39.0	42.6
Overall balance	**-73.8**	**4.5**	**-93.2**	**-113.7**	**-83.2**	**-111.9**	**-130.1**	**-143.3**	**-166.4**	**-194.2**	**-216.8**
B. Rest of the Non-Financial Public Sector 5/											
Overall balance rest of NFPS	**-10.8**	**-10.4**	**0.4**	**-6.1**	**...**	**-6.4**	**-7.1**	**-7.8**	**-8.5**	**-9.3**	**-10.8**
C. Non-Financial Public Sector (A+B)											
Overall balance NFPS	**-84.5**	**-6.0**	**-92.8**	**-119.8**	**...**	**-118.2**	**-137.2**	**-151.1**	**-174.9**	**-203.5**	**-227.5**
Primary Balance	-14.5	74.1	2.8	-11.1	...	15.1	18.3	26.1	28.8	31.0	32.7
Interest	70.0	80.1	95.6	108.7	...	133.3	155.5	177.2	203.7	234.5	260.2
D. Central Bank											
Quasi-fiscal balance of the central bank	**-41.2**	**-43.0**	**-43.9**	**-44.4**	**...**	**-50.3**	**-52.0**	**-54.0**	**-56.4**	**-60.1**	**-63.5**
Primary balance	13.6	15.7	18.5	24.7	...	22.8	26.1	30.2	34.9	38.3	41.8
Interest	54.9	58.8	62.5	69.1	...	73.2	78.1	84.3	91.3	98.4	105.3
E. Consolidated Public Sector (C+D)											
Consolidated public sector balance	**-125.8**	**-49.0**	**-136.8**	**-164.2**	**...**	**-168.6**	**-189.2**	**-205.1**	**-231.3**	**-263.6**	**-291.1**
Primary balance	-20.0	68.7	-1.5	-11.7	...	10.3	14.4	23.7	28.0	30.3	31.9
Interest	105.7	117.7	135.3	152.4	...	178.9	203.6	228.8	259.2	293.9	323.0
Memorandum items:											
Consolidated public sector debt 6/	1,341	1,452	1,651	1,876	...	2,074	2,299	2,544	2,821	3,136	3,484
Non-financial public sector	960	1,017	1,156	1,350	...	1,454	1,622	1,815	2,035	2,294	2,588
Central Bank 7/	380	435	495	526	...	620	677	730	787	842	895
Structural balance 8/	-116.3	-123.5	-129.3	-155.4	...	-156.8	-175.2	-189.0	-212.7	-242.5	-267.5
Cyclically-adjusted revenue (excl. one-off revenue)	409.8	442.4	472.6	522.1	...	579	627	687	750	817	891
Cyclically-adjusted expenditure	-526.1	-565.9	-602.0	-677.5	...	(735)	(803)	(876)	(962)	(1,060)	(1,159)
Central government primary spending excl. energy subsidies	383.0	428.9	464.8	526.1	...	549.8	599.0	654.2	714.4	780.2	852.4
Central government overall spending	493.3	533.5	581.2	652.3	...	706.3	773.6	847.2	933.3	1029.4	1126.8
Overall balance of the electricity sector	-66.0	-46.1	-48.2	-53.2	...	-52.1	-44.7	-44.2	-46.7	-49.6	-54.2

Sources: Country authorities and Fund staff calculations and estimates.

1/ Includes social security contributions.

2/ The nominal decrease in wages and salaries in 2016 reflects a reclassification of certain items to transfers.

3/ Includes interest payments on Central Bank recapitalization bonds.

4/ The 2017 amount includes the accrued amount of recapitalization interest, whereas the cash amount was reallocated as approved in the revised 2017 budget.

5/ Includes the Dominican Corporation of State Electricity Companies (CDEEE).

6/ Historical debt numbers are staff estimates. The debt stock at end-2017 includes a downward stock adjustment of US$324 million (0.5 percent of GDP) in external debt, reflecting the central bank's repurchase of its Brady bonds.

7/ External debt is expected to be revised down in the future to exclude some non-debt obligations of the central bank (of 0.4 percent of GDP in 2017).

8/ Consolidated public sector structural balance; excludes one-off items and adjusts revenues and expenditures for the economic cycle.

Table 4. Dominican Republic: Balance of Payments
(In millions of U.S. dollars; unless otherwise indicated)

	2014	2015	2016	2017	Projection 2018	2019	2020	2021	2022	2023
					(in millions of U.S. dollars)					
Current account	-2170	-1280	-813	-164	-837	-1207	-1494	-1852	-2256	-2752
Goods, net	-7374	-7465	-7558	-7579	-8638	-9104	-9604	-10188	-10904	-11737
Exports, f.o.b.	9899	9442	9840	10121	10760	11312	11939	12599	13279	13992
Imports, f.o.b.	17273	16907	17398	17700	19398	20416	21542	22787	24183	25729
Services, net	4084	4368	4940	5282	5733	6254	6650	7026	7372	7683
Income, net	1120	1817	1806	2132	2067	1643	1460	1310	1276	1302
Capital account 1/	2	2089	2	0	0	0	0	0	0	0
Financial account	-3109	-741	-1561	-877	-837	-1207	-1494	-1851	-2256	-2752
Foreign direct investment, net	-2209	-2205	-2407	-3570	-2646	-2783	-2941	-3107	-3283	-3470
Portfolio investment, net	-1482	-3458	-1729	-1702	-2011	-1569	-1563	-1559	-1344	-1477
Financial derivatives, net	0	0	0	0	0	0	0	0	0	0
Other investment, net	386	4515	1795	3664	3170	2546	2459	2265	1820	1695
Reserve assets, net	195	407	780	731	650	600	550	550	550	500
Net errors and omissions	-941	-1550	-750	-712	0	0	0	0	0	0
					(in percent of GDP)					
Current account	-3.3	-1.9	-1.1	-0.2	-1.0	-1.4	-1.7	-2.0	-2.3	-2.6
Goods, net	-11.3	-10.9	-10.5	-10.1	-10.7	-10.8	-10.7	-10.8	-10.9	-11.1
Exports, f.o.b.	15.2	13.8	13.7	13.5	13.4	13.4	13.4	13.3	13.3	13.3
of which: Gold	2.4	1.8	2.2	1.9	1.9	1.7	1.7	1.6	1.6	1.5
of which: Other	12.8	12.0	11.5	11.5	11.5	11.7	11.7	11.7	11.7	11.7
Imports, f.o.b.	26.4	24.8	24.3	23.6	24.1	24.1	24.1	24.1	24.2	24.4
of which: Oil	5.9	3.7	3.2	3.8	4.4	4.1	3.9	3.8	3.7	3.7
of which: Other	20.5	21.1	21.0	19.8	19.7	20.0	20.2	20.4	20.5	20.7
Services, net	6.3	6.4	6.9	7.0	7.1	7.4	7.4	7.4	7.4	7.3
of which: Travel, net	8.0	8.3	8.7	8.9	9.0	9.3	9.4	9.4	9.4	9.4
Income, net	1.7	2.7	2.5	2.8	2.6	1.9	1.6	1.4	1.3	1.2
Primary income, net	-5.0	-4.3	-4.5	-4.7	-4.7	-5.0	-5.0	-5.1	-5.1	0.0
Of which: Direct investment	-5.0	-4.3	-4.5	-4.7	-4.7	-5.0	-5.0	-5.1	-5.1	0.0
Secondary income, net	6.7	7.0	7.1	7.5	7.3	6.9	6.6	6.5	6.4	0.0
Of which: Workers' remittances	6.4	6.7	6.7	7.3	7.1	6.8	6.5	6.5	6.4	0.0
Capital account 1/	0.0	3.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial account	-4.8	-1.1	-2.2	-1.2	-1.0	-1.4	-1.7	-2.0	-2.3	-2.6
Foreign direct investment, net	-3.4	-3.2	-3.4	-4.8	-3.3	-3.3	-3.3	-3.3	-3.3	-3.3
Portfolio investment, net	-2.3	-5.1	-2.4	-2.3	-2.5	-1.9	-1.7	-1.7	-1.3	-1.4
Financial derivatives, net	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other investment, net	0.6	6.6	2.5	4.9	3.9	3.0	2.8	2.4	1.8	1.6
Reserves, net	0.3	0.6	1.1	1.0	0.8	0.7	0.6	0.6	0.6	0.5
Net errors and omissions	-1.4	-2.3	-1.0	-0.9	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	-1.4	-2.3	-1.0	-0.9	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:										
Export of goods and services (annual percent change)	6.8	0.2	6.9	4.2	7.4	6.4	5.9	5.7	5.5	5.3
Imports of goods and services (annual percent change)	3.5	-0.8	3.4	2.1	9.4	5.4	5.6	5.9	6.2	6.4
Oil trade balance (percent of GDP)	-5.9	-3.7	-3.2	-3.8	-4.4	-4.1	-3.9	-3.8	-3.7	-3.7
Gross international reserves (in millions of U.S. dollars)	4862	5266	6047	6781	7428	8028	8578	9128	9678	10178
Net international reserves (in millions of U.S. dollars)	4361	5152	6047	6780	7428	8028	8578	9128	9678	10178
Net international reserves (in months of prospective imports	2.6	3.0	3.4	3.5	3.6	3.7	3.8	3.8	3.8	3.8
External debt (in percent of GDP)	41.7	39.2	39.7	36.8	36.6	37.2	37.4	37.7	37.9	38.3

Sources: Country authorities and Fund staff calculations and estimates.

1/ For 2015 includes the grant-element of a debt buyback operation with PDVSA of 3.1 percent of GDP.

Table 5. Dominican Republic: Income Statement of the Central Bank

(In billions of Dominican pesos; unless otherwise indicated)

	2014	2015	2016	2017	Projection 2018	2019	2020	2021	2022	2023
Revenues	**21.2**	**23.0**	**26.2**	**33.9**	**32.5**	**36.9**	**41.9**	**47.7**	**52.2**	**57.0**
Interest	21.0	23.0	26.0	33.5	32.3	36.6	41.6	47.4	51.8	56.6
International reserves	0.9	1.2	2.1	3.4	3.8	5.7	7.8	10.5	11.6	12.7
BCRD recapitalization 1/	19.2	21.2	22.8	25.3	27.6	30.0	32.7	35.7	39.0	42.6
Other	0.9	0.6	1.2	4.8	0.9	0.9	1.0	1.1	1.2	1.3
Other revenues	0.2	0.0	0.2	0.4	0.3	0.3	0.3	0.3	0.4	0.4
Expenditures	**62.4**	**66.0**	**70.2**	**78.3**	**82.9**	**88.9**	**95.9**	**104.1**	**112.3**	**120.6**
Administrative	7.0	6.8	7.1	7.8	8.6	9.3	10.2	11.1	12.1	13.2
Interest	54.9	58.8	62.5	69.1	73.2	78.1	84.3	91.3	98.4	105.3
Securities	52.0	56.2	60.8	66.3	70.1	74.8	80.6	87.3	94.0	100.6
Other	2.9	2.6	1.7	2.8	3.1	3.4	3.7	4.0	4.4	4.8
Other expenditures 2/	0.6	0.4	0.6	1.5	1.1	1.5	1.5	1.7	1.8	2.0
Quasi-fiscal balance	**-41.2**	**-43.0**	**-43.9**	**-44.4**	**-50.3**	**-52.0**	**-54.0**	**-56.4**	**-60.1**	**-63.5**
					(in percent of GDP)					
Revenues	**0.7**	**0.7**	**0.8**	**1.0**	**0.8**	**0.9**	**0.9**	**0.9**	**0.9**	**0.9**
Interest	0.7	0.7	0.8	0.9	0.8	0.9	0.9	0.9	0.9	0.9
International reserves	0.0	0.0	0.1	0.1	0.1	0.1	0.2	0.2	0.2	0.2
BCRD recapitalization	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7
Other	0.0	0.0	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Other revenues	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Expenditures	**2.2**	**2.2**	**2.1**	**2.2**	**2.1**	**2.1**	**2.1**	**2.0**	**2.0**	**2.0**
Administrative	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Interest	1.9	1.9	1.9	1.9	1.9	1.8	1.8	1.8	1.8	1.7
Securities	1.8	1.8	1.8	1.9	1.8	1.7	1.7	1.7	1.7	1.7
Other	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Other expenditures 2/	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Quasi-fiscal balance	**-1.5**	**-1.4**	**-1.3**	**-1.2**	**-1.3**	**-1.2**	**-1.2**	**-1.1**	**-1.1**	**-1.0**
Memo items:										
BCRD securities outstanding 3/	342.3	403.7	453.0	501.2	588.6	644.6	696.7	752.3	806.5	858.6
In percent of GDP	12.0	13.2	13.7	14.1	14.9	15.0	14.9	14.7	14.5	14.1

Sources: Country authorities; and Fund staff calculations and estimates.

1/ Includes both interest on recapitalization bonds and direct transfers.

2/ Includes the cost of issuing money bills.

3/ Stock at end of period. Equivalent to the par value, minus the net discount/premium at which paper was sold, plus accrued but unpaid interest.

Table 6. Dominican Republic: Summary Accounts of the Banking System

(In billions of Dominican pesos; unless otherwise indicated)

					Projection					
	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
					I. Central Bank 1/					
Net foreign assets	**175.4**	**218.2**	**266.3**	**314.6**	**356.3**	**398.9**	**441.2**	**485.9**	**533.1**	**579.9**
(in millions of US$) 2/	3,968	4,799	5,713	6,529	7,169	7,769	8,319	8,869	9,419	9,919
Net domestic assets	**-70.7**	**-106.7**	**-148.3**	**-181.1**	**-211.7**	**-241.7**	**-269.7**	**-298.7**	**-328.8**	**-356.8**
Nonfinancial public sector (net) 3/	-1.4	-1.0	-3.0	-2.3	-2.3	-2.3	-2.3	-2.3	-2.3	1.8
Financial institutions (net)	-432.4	-480.3	-569.5	-627.9	-682.0	-746.0	-811.3	-878.8	-951.5	-1026.4
Nonfinancial private sector (certificates)	-120.5	-144.4	-147.5	-162.2	-189.3	-207.3	-224.0	-241.9	-259.4	-276.1
Other items (net)	483.6	519.0	571.8	611.3	661.9	713.9	767.9	824.3	884.4	947.9
Currency issue	**104.7**	**111.5**	**118.0**	**133.5**	**144.7**	**157.2**	**171.5**	**187.2**	**204.3**	**223.1**
					II. Deposit Money Banks					
Net foreign assets	**-11.1**	**-49.3**	**-58.0**	**-51.3**	**-50.9**	**-59.9**	**-67.5**	**-74.2**	**-81.9**	**-91.5**
(in millions of US$) 2/	-252	-1,085	-1,243	-1,064	-1,024	-1,166	-1,274	-1,355	-1,447	-1,565
Net domestic assets	**883.4**	**1032.1**	**1140.4**	**1236.9**	**1363.3**	**1485.5**	**1623.5**	**1772.5**	**1935.5**	**2115.4**
Net claims on central bank	285.1	298.8	346.3	373.5	381.9	415.9	452.8	492.9	535.5	580.8
Net credit to the nonfinancial public sector	69.8	129.1	139.7	151.0	81.4	1.3	-37.2	-94.4	-198.5	-318.9
Central government	68.2	95.2	100.1	93.7	28.2	-47.5	-83.7	-137.7	-236.6	-350.8
Rest of NFPS	1.6	33.9	39.6	57.3	53.3	48.9	46.5	43.3	38.1	31.9
Credit to the private sector	706.9	796.8	893.7	984.1	1104.1	1210.4	1321.1	1441.9	1573.8	1718.3
In pesos	555.3	622.1	701.6	786.4	882.3	967.3	1055.7	1152.3	1257.6	1373.1
In foreign currency	151.6	174.7	192.2	197.7	221.8	243.2	265.4	289.7	316.2	345.2
Capital and accumulated surplus	-150.9	-168.4	-192.2	-212.6	-233.2	-253.1	-275.5	-299.9	-326.5	-355.7
Other items (net)	-27.5	-24.1	-47.1	-59.2	29.1	110.9	162.3	232.0	351.3	490.8
Liabilities to the private sector	**872.2**	**982.7**	**1082.5**	**1185.6**	**1312.4**	**1425.6**	**1556.0**	**1698.3**	**1853.6**	**2023.9**
In pesos	652.6	732.9	810.4	892.8	988.3	1073.6	1171.7	1278.9	1395.9	1524.1
In foreign currency	219.6	249.8	272.1	292.8	324.1	352.1	384.2	419.4	457.7	499.8
					III. Banking System 4/					
Net foreign assets	**164.3**	**168.9**	**208.3**	**263.4**	**305.4**	**339.0**	**373.7**	**411.7**	**451.2**	**488.4**
(in millions of US$) 2/	3,717	3,714	4,469	5,465	6,145	6,603	7,046	7,515	7,972	8,354
Net domestic assets	**1,057.8**	**1,224.5**	**1,330.5**	**1,436.4**	**1,600.7**	**1,735.9**	**1,885.3**	**2,047.3**	**2,220.7**	**2,410.9**
Nonfinancial public sector 3/	68.4	128.1	136.7	148.7	79.1	-0.9	-39.5	-96.6	-200.8	-321.2
Credit to the private sector	712.5	802.7	899.8	990.4	1110.4	1216.7	1327.3	1448.2	1580.1	1724.6
Other items (net)	276.9	293.7	294.0	297.3	411.2	520.1	597.5	695.7	841.5	1007.4
M3	**973.9**	**1,091.5**	**1,197.9**	**1,313.8**	**1,452.6**	**1,578.3**	**1,722.2**	**1,879.3**	**2,050.4**	**2,237.6**
Currency in circulation	82.5	89.4	94.4	102.4	110.2	119.7	130.7	142.6	155.7	170.0
Deposits	605.8	688.5	756.9	831.1	920.0	999.4	1090.8	1190.6	1299.4	1418.8
Central bank certificates held outside commercial l	19.1	19.4	21.0	25.7	30.0	32.9	35.6	38.4	41.2	43.8
Commercial bank certificates held by the public	266.4	294.3	325.6	354.5	392.4	426.2	465.2	507.8	554.2	605.1
					(Annual percentage change; unless otherwise stated)					
Memorandum items:										
Credit to the private sector	19.5	12.7	12.1	10.1	12.1	9.6	9.1	9.1	9.1	9.1
Currency issue	11.7	6.5	5.8	13.2	9.3	8.6	9.1	9.2	9.1	9.2
Deposits and commercial bank certificates	8.6	12.7	10.1	9.5	10.7	8.6	9.1	9.2	9.1	9.2
Broad money (M3)	9.3	12.1	9.8	9.7	10.6	8.6	9.1	9.1	9.1	9.1
M3 Velocity (ratio of GDP to M3)	2.9	2.8	2.8	2.7	2.7	2.7	2.7	2.7	2.7	2.7

Source: Country authorities; and Fund staff calculations and estimates.

1/ The central bank's balance sheet is adjusted to incorporate the reserve liability that emerges from the IMF budgetary support under the 2009 SBA.

2/ On a residency basis.

3/ Excludes transfers related to central bank recapitalization.

4/ Includes the central bank, Banco de Reservas, and all other deposit-taking institutions. Excludes other financial institutions.

Table 7. Financial Soundness Indicators
(In percent; unless otherwise indicated)

	2009	2010	2011	2012	2013	2014	2015	2016	2017
I. Financial System									
Capital adequacy									
Leverage ratio	11.5	11.4	11.7	11.8	11.5	11.3	11.2	11.3	11.6
Regulatory capital to risk-weighted assets 1/	17.4	16.1	17.3	18.2	16.7	16.1	16.0	17.2	18.2
Asset quality									
NPLs to total loans	4.1	3.0	2.9	3.4	2.2	1.5	1.7	1.7	1.9
Loan provisions to NPLs	111.5	130.6	122.0	105.9	149.1	210.3	168.2	172.0	165.4
NPLs net of provisions to net worth	-2.4	-4.7	-3.0	-1.0	-5.5	-8.6	-6.4	-6.6	-6.4
Fixed and net foreclosed assets to net worth	38.5	35.5	36.8	34.2	32.4	29.4	29.8	27.7	25.1
Earnings and efficiency									
Return on average assets	2.4	2.6	2.4	2.2	2.3	2.3	2.3	2.2	1.9
Return on average equity	21.9	20.3	19.9	18.8	20.6	19.9	20.1	19.0	16.7
Gross operating income to average assets	11.9	10.1	10.5	11.6	10.9	10.3	10.0	10.0	11.1
Financial margin to average assets	6.5	6.5	6.4	6.7	6.8	6.4	6.1	5.8	6.1
Operating expenses to net financial margin	89.2	84.9	89.6	89.6	86.2	90.0	93.2	93.6	89.9
Liquidity									
Liquid funds to deposits	25.9	24.3	24.6	23.5	23.3	25.0	23.4	23.6	20.1
Liquid funds to total assets	21.3	19.9	19.9	19.0	18.7	19.7	18.4	18.4	15.8
II. Commercial Banks									
Capital adequacy									
Leverage ratio	9.1	9.3	9.7	10.0	9.7	9.5	9.8	10.0	10.3
Regulatory capital to risk-weighted assets 1/	13.8	12.9	14.6	15.8	14.8	14.0	14.4	15.6	16.4
Asset quality									
NPLs to total loans	4.0	2.9	2.6	3.2	1.9	1.3	1.5	1.5	1.7
Loan provisions to NPLs	114.8	135.8	129.2	108.3	169.8	228.6	181.8	186.7	177.7
NPLs net of provisions to net worth	-3.8	-6.6	-4.4	-1.5	-8.3	-10.9	-8.0	-8.0	-7.7
Fixed and net foreclosed assets to net worth	51.3	46.1	46.1	41.7	39.0	35.2	34.4	31.5	28.3
Earnings and efficiency									
Return on average assets	2.3	2.6	2.4	2.2	2.3	2.3	2.3	2.2	2.0
Return on average equity	28.3	25.3	28.9	24.4	22.6	24.6	23.9	24.0	19.9
Gross operating income to average assets	11.2	9.6	10.0	11.0	10.5	10.0	9.7	9.7	11.7
Financial margin to average assets	6.1	6.2	6.2	6.5	6.6	6.2	6.0	5.6	6.6
Operating expenses to net financial margin	91.1	85.7	90.5	90.8	86.4	90.4	93.9	94.2	90.5
Liquidity									
Liquid funds to deposits	28.0	26.2	26.3	25.1	25.0	26.7	24.7	24.9	21.0
Liquid funds to total assets	23.7	22.1	21.7	20.8	20.3	21.3	19.6	19.6	16.7

Source: Country authorities. Includes all deposit-taking institutions (banks, credit cooperatives, savings and loans institutions).

Table 8. Financial Soundness Indicators: Heatmap

	2016Q1	2016Q2	2016Q3	2016Q4	2017Q1	2017Q2	2017Q3	2017Q4
Credit cycle	**L**	**L**	**L**	**L**	**L**	**L**	**L**	**L**
Change in credit / GDP ratio (pp, annual)	1.9	1.5	1.0	1.1	1.1	1.3	0.6	0.4
Growth of credit / GDP (%, annual)	7.7	6.0	4.1	4.3	4.1	5.2	2.4	1.5
Credit-to-GDP gap (st. dev)	0.3	-0.1	-0.2	0.3	-1.2	-1.1	-1.8	-1.1
Balance Sheet Soundness	**M**	**M**	**M**	**M**	**M**	**M**	**M**	**M**
Balance Sheet Structural Risk	M	M	M	M	M	M	M	M
Deposit-to-loan ratio	87.7	88.9	85.8	84.1	85.4	82.8	84.1	83.9
FX liabilities % (of total liabilities)	30.6	29.6	29.5	31.6	31.2	28.5	27.9	29.9
FX loans % (of total loans)	21.7	21.0	20.6	21.4	22.2	21.9	20.5	20.0
Balance Sheet Buffers	**L**	**L**	**L**	**L**	**L**	**L**	**L**	**M**
Leverage	L	L	L	L	L	L	L	L
Leverage ratio (%)	11.4	11.2	11.5	11.3	11.6	11.5	11.6	11.6
Profitability	L	L	L	L	L	L	L	L
ROA	2.2	2.3	2.3	2.2	2.1	2.0	2.0	2.0
ROE	19.6	20.1	20.0	19.0	18.2	17.4	17.1	16.7
Asset quality	M	M	M	L	M	M	M	H
NPL ratio	1.7	1.7	1.8	1.7	2.0	2.0	2.1	2.1
NPL ratio change (%, annual)	12.5	6.0	6.6	0.4	13.4	15.2	16.6	24.9

Sources: National authorities and Fund staff calculations.

Below lower threshold
Between lower and upper threshold
Above upper threshold
Medium vulnerability
Low vulnerability

Annex I. External Sector Assessment

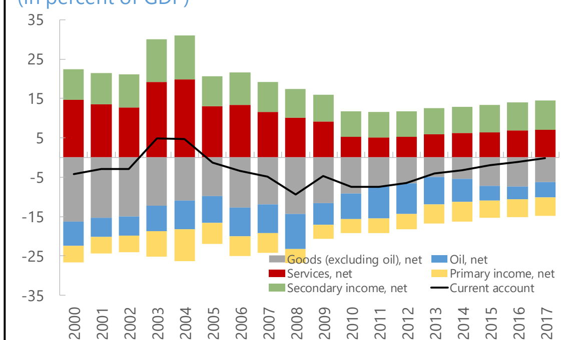
The external position of the Dominican Republic is moderately stronger than fundamentals and desired policy settings, but is expected to gradually realign with fundamentals over the medium term as private demand recovers. Reserve adequacy has continued to strengthen and exceeds traditional metrics, but remains below the Fund's risk-weighted adequacy metric. The expected strength of the external position in the near term should further strengthen reserve adequacy.

A. Background

Current Account

1. The external current account deficit continued to narrow in 2017, reaching a historical low of 0.2 percent of GDP. This marks a significant narrowing in the deficit since the most recent peak of 7.5 percent of GDP in 2011. The decline is largely attributed to lower global commodity prices, but strong external demand for the Dominican Republic's tourism services also boosted the services balance, while weaker domestic demand held-back imports, particularly of goods. More recently, strong inflows in remittances, linked to positive developments in the U.S. labor market and uncertainties related to U.S. immigration policy (where about three-quarters of remittances originate) have also contributed, boosting the income balance despite increased interest payments on the government's external debt.

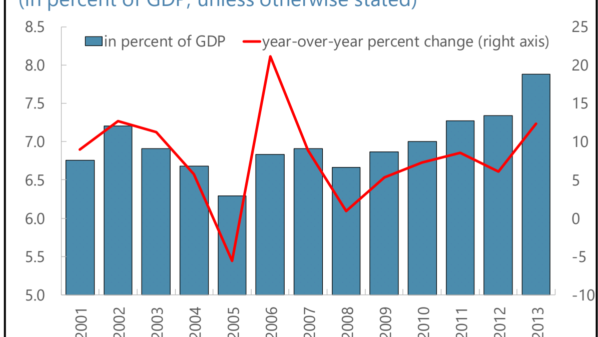
Dominican Republic: Current Account
(in percent of GDP)



Sources: BCRD and Fund staff calculations.

2. Over the medium term, the current account deficit is expected to gradually widen – reaching 2.6 percent of GDP by 2023. The increase is expected to be largely driven by an increase in imports, in line with the projected increase in global commodity prices and the expected recovery in private investment, a further rise in interest payments on government external debt, and a decline in remittances to historical norms as uncertainty related to U.S. immigration policy is resolved. On the export side, a decline in gold exports is expected to be largely offset by continued growth in service exports, primarily driven by the vibrant tourism sector.

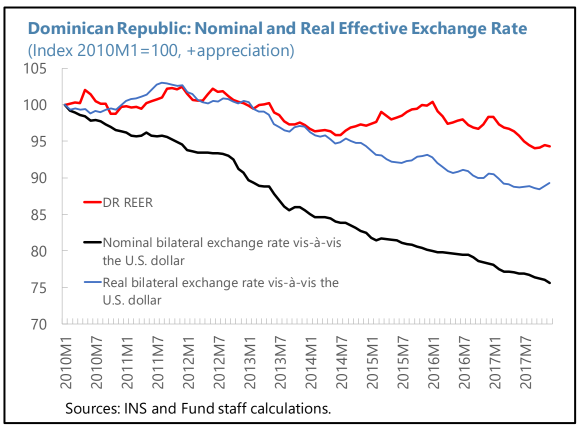
Remittance Receipts
(in percent of GDP; unless otherwise stated)



Sources: BCRD and Fund staff calculations.

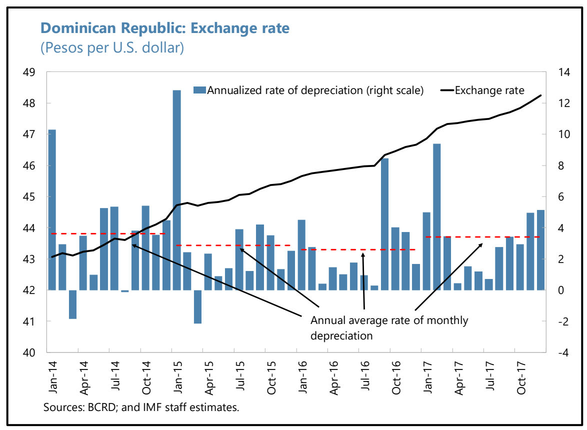
Real Exchange Rate

3. The real effective exchange rate (REER) continued its gradual depreciation in 2017, despite the rapid narrowing of the current account deficit. After depreciating by 0.8 percent in 2016, the REER depreciated by 2.3 percent in 2017, with the REER mirroring developments in the nominal effective exchange rate (NEER) and the U.S. dollar. Recent movements are consistent with the crawl-like exchange rate regime – with the peso depreciating by 2½ to 3 percent a year vis-à-vis the U.S. dollar. The authorities took advantage of the temporary improvement in the external position to further boost reserves given that reserves are still below the IMF's reserve adequacy metric. This required a net purchase of foreign exchange in 2017, compared to historically two-sided interventions oriented toward addressing short-term volatility in the exchange rate. As a result, the exchange rate continued to depreciate despite underlying appreciation pressures from the strength of the external position. The central bank's foreign currency purchases continued to be sterilized.



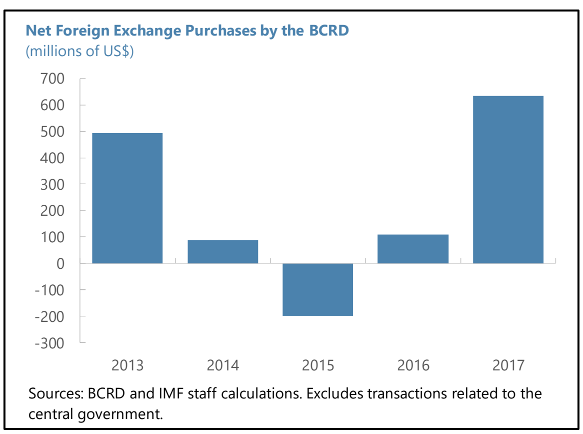
Dominican Republic: Nominal and Real Effective Exchange Rate
(Index 2010M1=100, +appreciation)

Sources: INS and Fund staff calculations.



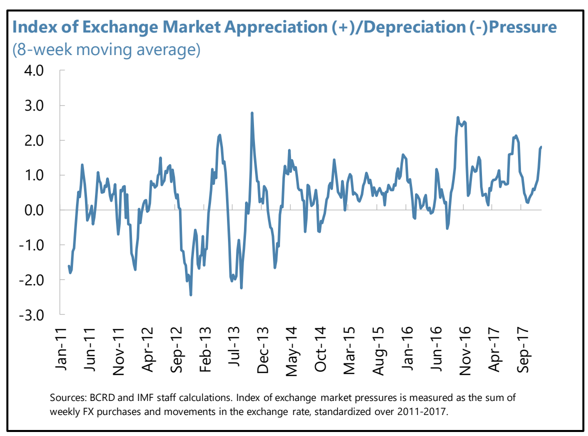
Dominican Republic: Exchange rate
(Pesos per U.S. dollar)

Sources: BCRD; and IMF staff estimates.



Net Foreign Exchange Purchases by the BCRD
(millions of US$)

Sources: BCRD and IMF staff calculations. Excludes transactions related to the central government.



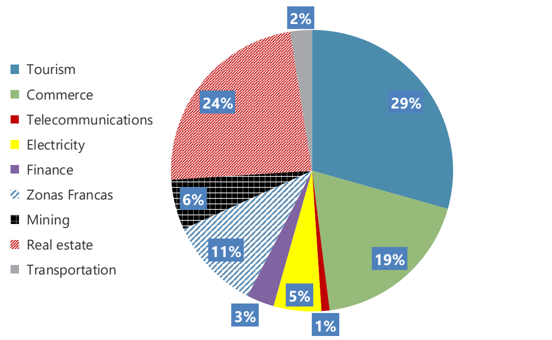
Index of Exchange Market Appreciation (+)/Depreciation (-)Pressure
(8-week moving average)

Sources: BCRD and IMF staff calculations. Index of exchange market pressures is measured as the sum of weekly FX purchases and movements in the exchange rate, standardized over 2011-2017.

Capital and Financial Flows

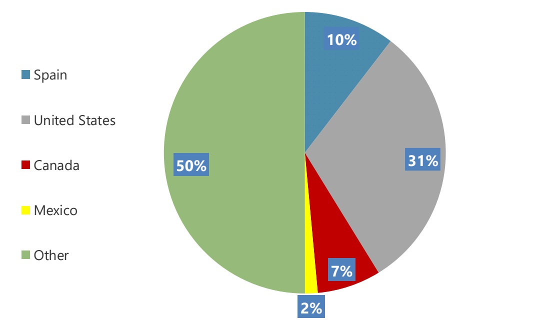
4. The financing structure of the current account deficit is supportive of external stability. The deficit has been adequately financed by FDI, with these inflows expected to continue. These inflows remained robust in 2017, at 4.8 percent of GDP (compared to 3.4 percent in 2016). However, the increase in 2017 was primarily driven by the sale of a Dominican company to a foreign investor, and FDI is expected to revert to decline to 3.3 percent of GDP in 2018. FDI inflows are well diversified across sectors and by country of origin. Portfolio and other capital inflows have played a more limited role given the Dominican Republic's weak financial integration. These flows are primarily concentrated in government borrowing. The government is taking steps to gradually reduce its reliance on external foreign-currency denominated debt and the associated risks. Nevertheless, these flows are expected to remain important over the medium term as the cost of external finance remains attractive relative to domestic debt, with Dominican Republic's risk premium on international markets below that of its emerging market and regional peers. Risks are also mitigated to some extent by the concentration of external public debt in debt from official creditors.

Foreign Direct Investment
(by sector, in percent of total January-September 2017)



Sources: BCRD and Fund staff calculations.

Foreign Direct Investment
(by country of origin; in percent of total January-September 2017)

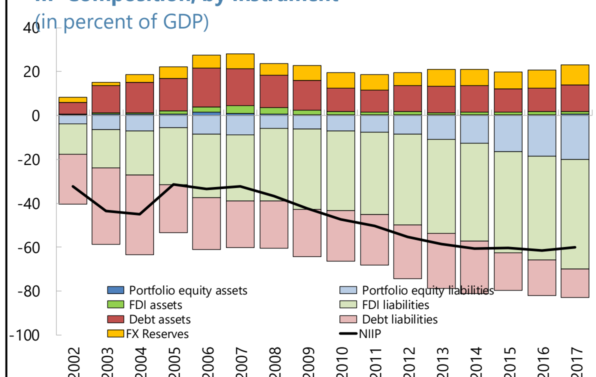


Sources: BCRD and Fund staff calculations.

External Balance Sheets

5. Dominican Republic's external liabilities are expected to have fallen in 2017 after a long period of accumulation. The Dominican Republic's net international investment position (NIIP) is a net liability position - net liabilities are expected to have fallen slightly to 60 percent of GDP in 2017, above their ten-year average of about 50 percent as the accumulation of reserve assets helped to offset a continued increase in liabilities, particularly related to FDI. The downward trend is expected to continue in the near term as the current account deficit remains more than adequately financed by FDI, with liabilities reaching 53 percent of GDP by 2023. Vulnerabilities from the slow build-up of liabilities in recent years, despite the slight decline in 2017, are also mitigated by the concentration of liabilities in non-debt creating FDI inflows. FDI comprises about 60 percent of total liabilities and has driven the deterioration in the NIIP over time.

IIP Composition, by Instrument
(in percent of GDP)



Source: IMF Balance of Payments Statistics, IMF World Economic Outlook

6. **External debt is projected to have fallen to 37 percent of GDP in 2017**. The fall in external debt is primarily related to a reduction in foreign liabilities by banks and the non-financial private sector. Private external debt, including FDI-debt liabilities, is now estimated at a relatively low 11 percent of GDP in 2017, down from 14 percent in 2016. Public external debt accounts for about 70 percent of external debt (at an estimated 26 percent of GDP in 2017). The composition and maturity of gross public external debt has improved in recent years, reflecting favorable external financing conditions and the authorities' efforts to lengthen the maturity structure of the external debt (see Annex III).

7. **Gross external debt is projected to remain relatively stable over the medium term.** Gross external debt is projected to rise only slightly to about 38 percent of GDP, with rising public external debt largely offset by a fall in external private debt. The external debt sustainability analysis indicates that the medium-term debt profile is resilient to several shocks (Figure 1), with the most important risk related to a depreciation, which would raise the external debt ratio significantly.

B. Assessment

8. **The external position is moderately stronger than warranted by fundamentals and desirable policy settings, but is expected to rebalance over the medium term as private demand strengthens with supportive monetary and incomes policies.**

EBA-Lite Assessment Results

	Current Account (CA) Norm	CA Projected/ Cyclically-Adjusted	REER Gap
EBA-Lite			
Macroeconomic Balance			
Unadjusted	-2.7%	-0.3%	-12.6%
Adjusted for temporary factors	-2.7%	-0.8%	-10.1%
External Sustainability			
Stablize net IIP at 2017 level (-60% of GDP)	-3.3%	-2.6%	-3.3%
Stabilize net IIP at 50% of GDP within 10 years	-2.0%	-2.6%	3.2%
Equilibrium REER	NA	NA	-7.6%
Average	-2.7%	-1.6%	-6.1%

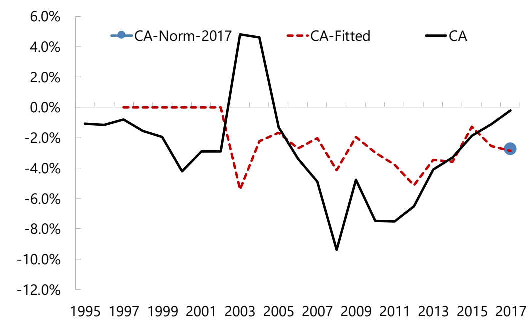
- Estimates from the **current account approach** are consistent with a current account gap of 2 percent of GDP and a REER undervaluation of 10 percent.[1] The approach has been adjusted to reflect a temporary boost in remittances by about 0.5 percentage points of GDP driven by uncertainty related to U.S. immigration policy. Without this adjustment, the estimated

[1] An exchange rate elasticity of 20 percent is assumed in the calculations, consistent with export and import elasticities of -0.71 and 0.92 under the IMF's EBA-lite approach

undervaluation is 12.6 percent. In addition to this temporary factor pulling the current account deficit down, the gap has been driven by the residual rather than deviations from desirable policies on a net basis. However, fiscal policy is weaker than desirable policy settings given the need for a fiscal adjustment of about 3 percentage points of GDP, while private credit-to-GDP is lower than desirable to support financial deepening.

- The **external sustainability approach** estimates that the external position is broadly consistent with fundamentals and desirable policy settings if the Dominican Republic's NIIP position is stabilized at its 2017 level. This implies an IIP-stabilizing current account deficit of 3.3 percent of GDP, which is slightly higher than the projected current account deficit over the medium term, and REER undervaluation of by 3.3 percent. In contrast, reducing the NIIP to 50 percent of GDP over ten years, in line with the average level over the previous decade and staff's projection for a gradual decline in the NIIP deficit, would imply an IIP-stabilizing current account deficit of 2.0 percent of GDP, and would suggest that the exchange rate is overvalued by about 3 percent.

Current Account Balance: EBA-Lite Current Account Model
(in percent of GDP)



Sources: BCRD and Fund staff calculations.

- The **REER approach** estimates undervaluation of the REER by 7.6 percent, with the gap driven by the residual rather than policy gaps.

EBA-Lite Current Account Panel Regression

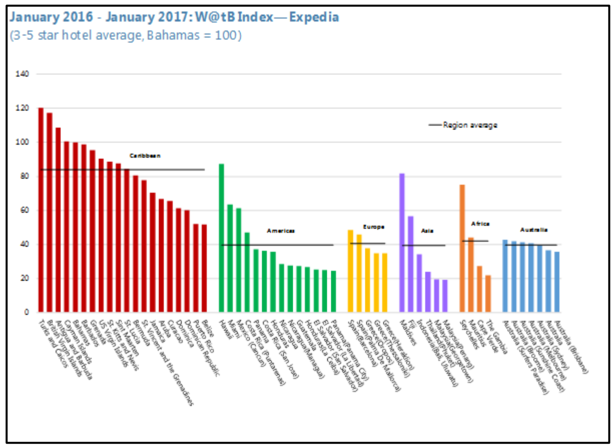
	Percent of GDP			Percent of GDP	
(a)	Actual current account	-0.2%	(g)	Fitted current account	-2.9%
(b)	Temporary factors	0.5%			
(c)	Cyclically adjusted current account	-0.8%			
(d)	Current account norm = (g) - (i)	-2.7%	(h)	Residual (a) - (g)	2.7%
(e)	**Adjusted current account gap = (c)-(d)**	**2.0%**	(i)	Policy gap = (j) + (k) + (l) + (m)	-0.1%
(f)	Real exchange rate elasticity	-20%	(j)	Fiscal policy	-0.7%
			(k)	Change in GIR	0.2%
	Real exchange rate gap CA approach = (e)/(f)	**-10.1%**	(l)	Private credit to GDP	0.4%
	Real exchange rate gap CA approach excluding temporary factors	-12.6%	(m)	Capital control	0.0%

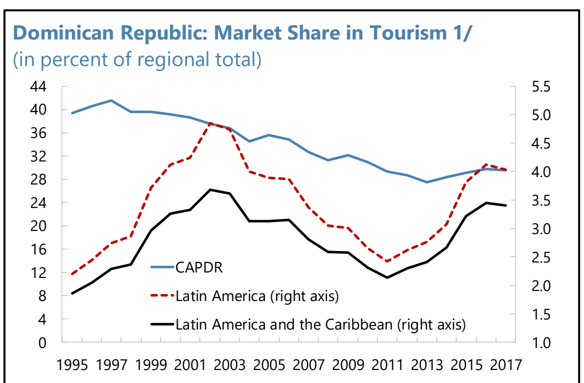
Source: IMF staff calculations.

9. **Despite its current strength, the external position is expected to realign with fundamentals over the medium term.** The recent monetary easing and the internal appreciation are expected to support a recovery in private demand, particularly in investment, widening the savings/investment gap toward fundamentals. There is no fiscal space to support the realignment given the need for fiscal consolidation, but structural reforms to bolster structural competitiveness are expected to help mobilize private investment.

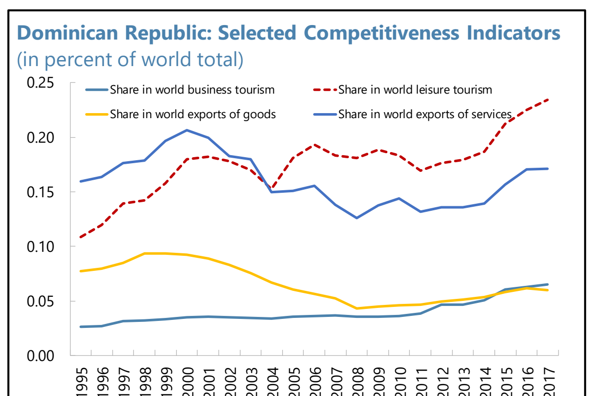
C. Other Competitiveness Indicators

10. Other price-based and market-share indicators are also supportive of the Dominican Republic's competitiveness in its main exports. The price competitiveness of the Dominican Republic's tourism product relative to other tourism-dependent economies in the Caribbean and to Mexico, one of its main competitors (given the similarity of tourism products) has contributed to the strong performance of the tourism sector and boosted its market share in tourism and services. This price competitiveness is reflected in the lower cost of a one-week vacation to the Dominican Republic based on the Week at the Beach Index (W@tB).[2] The Dominican Republic has also been able to maintain its market share in world exports of goods. Compared to its CAPDR neighbors, with which the Dominican Republic competes, particularly for goods produced and exported from the zonas francas, the Dominican Republic has been able to penetrate more export markets than all countries, except for Costa Rica, and exports more than the regional average number of products. This performance is consistent with the quality of exports (based on the IMF's export quality index), which is above all countries in the region except for Costa Rica and Guatemala, likely consistent with the fact that Costa Rica produces more complex goods.



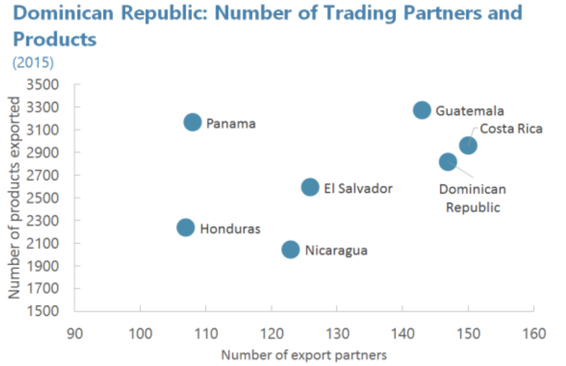


Sources: World Travel and Tourism Council (WTCC) and Fund staff calculations.
1/ Tourism includes leisure and business tourism.

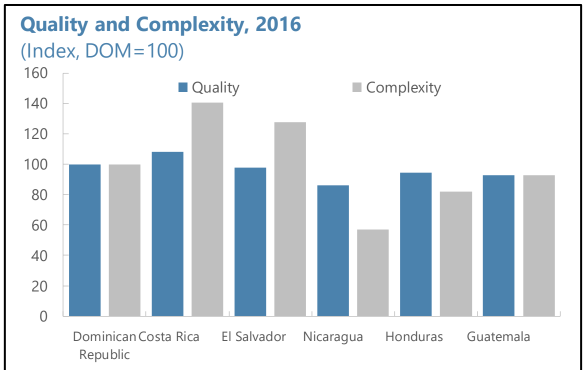


Sources: World travel & tourism council, UNCTADstat and Fund staff

[2] One of Dominican Republic's competitor markets, Cuba, is not included in the W@tB index. See Laframboise, Mwase, Park and Zhou (2014) for more detail on the compilation of the W@tB index.

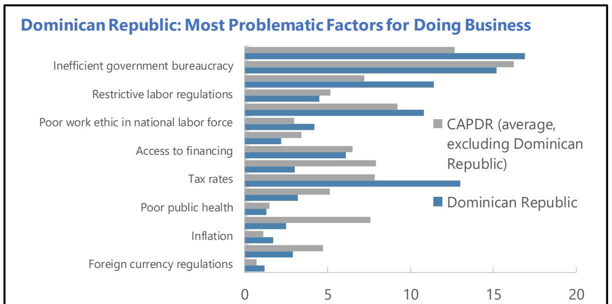


Sources: Would Integrated Trade Solution. Data for Honduras corresponds to 2014.

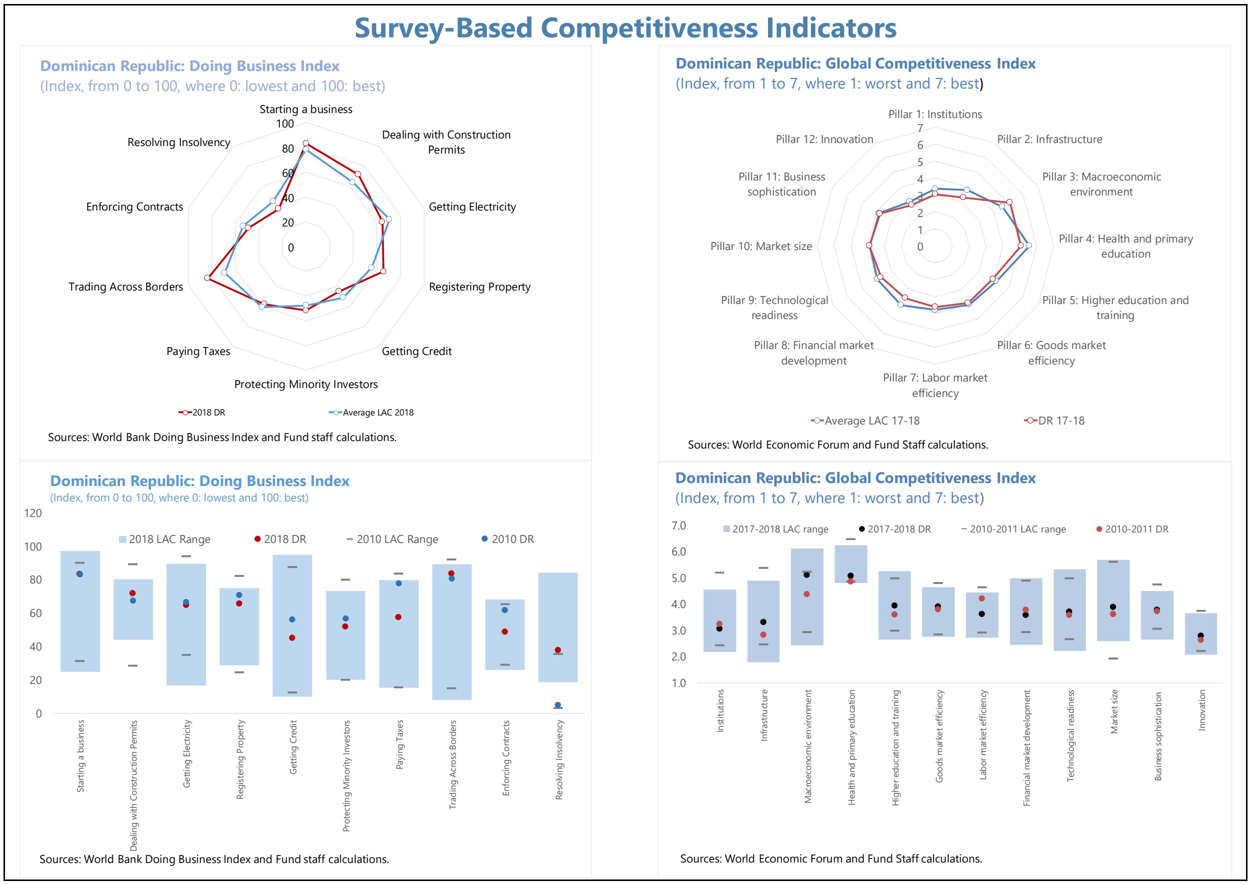


Sources: Atlas of Economic Complexity, IMF export quality index, and Fund staff estimates. Latest available data for export quality is in 2010. Export quality for Honduras corresponds to 2014.

11. Perceptions from survey-based competitiveness indicators suggest that the Dominican Republic may be less competitive than suggested by price-based indicators. In the World Economic Forum's (WEF) Global Competitiveness Index, for example, the Dominican Republic is received a score of 3.87 (on a scale of 1 to 7 with 7 being the best) for 2017–18, a deterioration compared to its 2016–17 score of 3.94. Breaking down the score into its subcomponents, strengthening institutions, goods and labor market efficiency and health and education are critical to strengthening the Dominican Republic's competitiveness. These priorities are mirrored in the most problematic factors for Doing Business identified by the report, which also identifies the need to strengthen governance as a top priority to strengthening the business environment. By contrast, robust growth and the stable macroeconomic environment in recent years have contributed positively to the economy's external competitiveness. Consistent with the WEF score, results from the World Bank's Doing Business report for 2018 put the Dominican Republic's distance to frontier (where the frontier is the best performance measured on a given indicator) at 60.93 out of 100 (the frontier), a slight improvement from 58.41 in 2017. Results suggest that strengthening tax discipline and insolvency regimes will be important to improve the business environment.



Source: Global Competitiveness Report, World Economic Forum. From the list of factors, respondents to the World Economic Forum's Executive Opinion Survey were asked to select the five most problematic factors for doing business in their country and to rank them between 1 (most problematic) and 5. The score corresponds to the responses weighted according to their rankings.



D. Reserve Adequacy Assessment

12. Reserve adequacy has continued to strengthen, but remains below the Fund's reserve adequacy metric. Despite the reduction in banks' reserve requirements at the central bank in August 2017, reserves continued to increase in 2017 in line with the narrowing of the current account deficit in the context of accommodative external financing conditions. Coverage is above traditional metrics (greater than 3 months of imports, 20 percent of broad money, and 100 percent of short-term external debt (on a remaining maturity basis)). Coverage falls below the Fund's risk-based reserve adequacy metric, which recommends coverage against medium and long-term external debt in addition to short-term external debt, for fixed exchange rate regimes, at 67 percent of the metric for 2017, compared to the suggested adequacy range of 100–150 percent.[3] However, based on the Fund's metric, introducing more flexibility into the exchange rate regime, would lower the need for continued reserve accumulation – coverage under the benchmark for flexible exchange rate is above 100 percent of the metric. Over the medium term, reserve coverage is expected to continue to strengthen, but to remain below the Fund's metric for fixed exchange rate regimes.

[3] The assessment is based on the fixed exchange rate regime benchmark given that the country's crawl-like arrangement was considered "fixed" in the derivation of the metric.

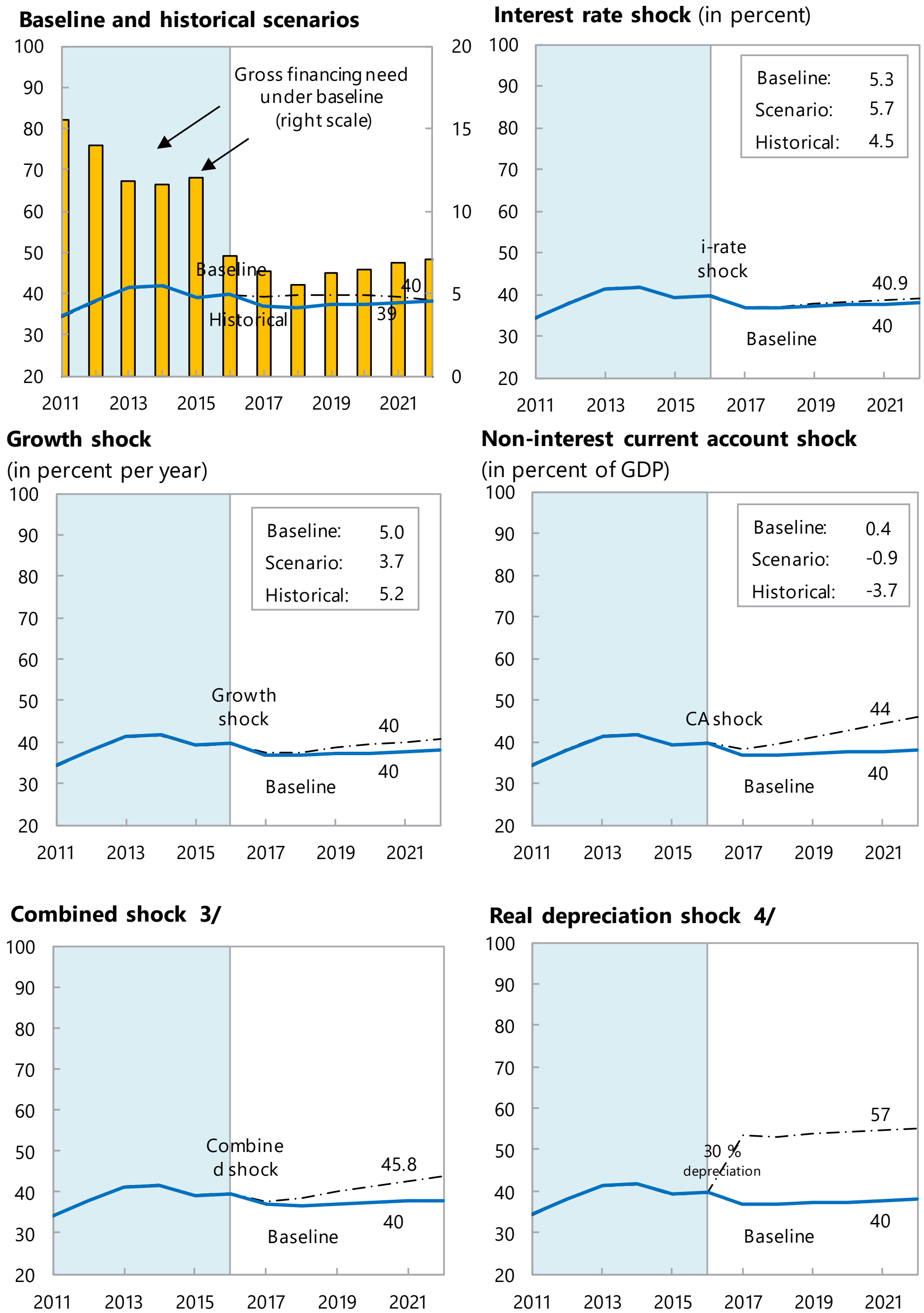
Dominican Republic: Reserve Adequacy

Metric	Benchmark coverage	NIR coverage 2016	2017	2022(p)
Months of imports of goods and services	3 months	3.4	3.5	3.8
Months of imports of goods and services (excluding free trade zones)	3 months	4.1	4.2	4.4
Broad money (M3)	20%	23.2	24.5	26.3
Short-term debt on a remaining maturity basis	100%	137.8	147.7	202.6
IMF reserve adequacy metric[1]	100 - 150%	61.5	67.2	68.8
External debt, bn USD		28.4	27.6	37.9
(percent of NIR)		470.1	407.5	391.2
Net international reserves, bn USD		6.0	6.8	9.7
Additional reserves needed to reach IMF reserve metric of 100, bn USD		3.8	3.3	4.4

Sources: National authorities and IMF staff calculations.

[1]Emerging market metric for fixed exchange rate countries: net reserves divided by the sum of 30% of short-term debt (remaining maturity basis), 10% of broad money (M3); 20% of IIP MLT portfolio liabilities; and 10% of exports.

Annex I. Figure 1. External Debt Sustainability: Bound Tests 1/ 2/



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/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.

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

4/ One-time real depreciation of 30 percent occurs in 2017.

Annex I. Figure 2. External Debt Sustainability Framework, 2011-2023

	Actual								Projections							
	2011	2012	2013	2014	2015	2016			2017	2018	2019	2020	2021	2022	2023	Debt-stabilizing non-interest current account 6/
1 **Baseline: External debt**	34.3	38.0	41.3	41.7	39.2	39.7			**36.8**	**36.6**	**37.2**	**37.4**	**37.7**	**37.9**	**38.3**	**-3.3**
2 Change in external debt	1.2	3.7	3.3	0.4	-2.6	0.5			-2.8	-0.2	0.6	0.2	0.2	0.3	0.4	
3 Identified external debt-creating flows (4+8+9)	1.2	-0.1	0.0	-2.1	-3.1	-4.1			-6.3	-4.2	-3.6	-3.4	-3.1	-2.8	-2.5	
4 Current account deficit, excluding interest payments	6.2	5.1	2.7	1.9	0.4	-0.4			-1.4	-0.6	-0.5	-0.3	0.0	0.2	0.6	
5 Deficit in balance of goods and services	10.4	9.1	5.9	5.0	4.5	3.7			3.1	3.6	3.4	3.3	3.3	3.5	3.8	
6 Exports	24.4	24.8	25.6	26.0	24.9	25.3			25.2	25.2	25.5	25.6	25.6	25.6	25.5	
7 Imports	34.8	34.0	31.5	31.0	29.4	29.0			28.3	28.9	28.9	28.9	29.0	29.1	29.3	
8 Net non-debt creating capital inflows (negative)	-3.9	-5.2	-3.2	-3.4	-3.2	-3.4			-4.8	-3.3	-3.3	-3.3	-3.3	-3.3	-3.3	
9 Automatic debt dynamics 1/	-1.0	-0.1	0.6	-0.7	-0.3	-0.3			-0.1	-0.2	0.2	0.2	0.3	0.3	0.2	
10 Contribution from nominal interest rate	1.3	1.5	1.4	1.4	1.4	1.6			1.6	1.7	1.9	2.0	2.0	2.0	2.1	
11 Contribution from real GDP growth	-1.0	-0.9	-1.8	-3.0	-2.8	-2.5			-1.7	-1.9	-1.7	-1.7	-1.8	-1.8	-1.8	
12 Contribution from price and exchange rate changes 2/	-1.4	-0.6	0.9	0.9	1.0	0.6			...	...	...	...	...	...	...	
13 Residual, incl. change in gross foreign assets (2-3) 3/	-0.1	3.8	3.3	2.5	0.6	4.6			3.4	4.0	4.1	3.6	3.3	3.1	2.9	
External debt-to-exports ratio (in percent)	140.2	152.9	161.5	160.8	157.2	156.6			146.1	145.1	145.6	146.1	147.0	148.3	150.4	
Gross external financing need (in billions of US dollars) 4/	9.0	8.5	7.3	7.6	8.2	5.2			4.8	4.4	5.3	5.8	6.5	7.0	7.7	
in percent of GDP	15.5	14.0	11.8	11.6	12.0	7.3			6.3	5.5	6.3	6.4	6.8	7.0	7.3	
Scenario with key variables at their historical averages 5/									**39.0**	**39.5**	**39.6**	**39.4**	**39.0**	**38.3**	**37.4**	**-3.7**
							10-Year Historical Average	10-Year Standard Deviation	-75.09	-60.19	-52.35	-51.07	-48.07	-46.68	-45.23	
Key Macroeconomic Assumptions Underlying Baseline																
Real GDP growth (in percent)	3.1	2.8	4.7	7.6	7.0	6.6	5.2	2.5	4.6	5.5	5.0	5.0	5.0	5.0	5.0	
GDP deflator in US dollars (change in percent)	4.4	1.8	-2.4	-2.2	-2.5	-1.5	1.4	3.8	0.1	1.6	0.2	0.7	0.7	0.6	0.6	
Nominal external interest rate (in percent)	4.3	4.4	3.7	3.5	3.6	4.2	4.5	0.9	4.3	4.9	5.4	5.6	5.7	5.7	5.7	
Growth of exports (US dollar terms, in percent)	15.6	6.3	5.3	6.8	0.2	6.9	8.9	17.7	4.2	7.4	6.4	5.9	5.7	5.5	5.3	
Growth of imports (US dollar terms, in percent)	13.5	2.0	-5.1	3.5	-0.8	3.4	8.0	19.5	2.1	9.4	5.4	5.6	5.9	6.2	6.4	
Current account balance, excluding interest payments	-6.2	-5.1	-2.7	-1.9	-0.4	0.4	-3.7	2.7	1.4	0.6	0.5	0.3	0.0	-0.2	-0.6	
Net non-debt creating capital inflows	3.9	5.2	3.2	3.4	3.2	3.4	4.0	0.9	4.8	3.3	3.3	3.3	3.3	3.3	3.3	

1/ Derived as [r - g - r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as [-r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock. r 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, plus short-term debt at end of previous period.

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.

Annex II. Risk Assessment Matrix and Past Fund Advice[1]

A. Risk Assessment Matrix

Source of Risks	Relative Likelihood	Expected Impact	Policy Response
Downside risks			
Weaker-than-expected global growth	H (advanced economies)/M (emerging markets)	**Medium** Weakening of exports, tourism receipts, and remittances; weaker economic activity and fiscal receipts.	Build external and fiscal buffers to safeguard macroeconomic stability; advance structural reforms to improve competitiveness.
Tigher global financial conditions	**High**	**Low** Against the backdrop of continued monetary policy normalization, an abrupt change in global risk appetite could lead to sudden sharp increases in global interest rates and financial conditions, putting pressure on sovereign financing costs, weakening the fiscal position with possible pressures on the capital account and exchange rate. WIth low financial integration, however, the impact on the Dominican Republic is likely to be low, with the negative impact concentrated on the fiscal accounts, while, to the extent that higher financial conditions reflect improved global growth prospects, the impact on economic activity, would be expected to be positive.	Strengthen the fiscal position; shift to domestic financing sources; continue building reserve buffers and tighten monetary policy if needed.
Higher energy prices	**Low**	**Medium** Oil supply may be tighter than expected under the baseline, pushing prices up relative to current expectations. This would reduce real income, decreasing demand and output and would widen the external current account deficit. The fiscal deficit would also be widen.	Accelerate electricity sector reforms to limit the negative impact on the fiscal position.
Policy and geopolitical uncertainty	**Medium**	**Low** Two-sided risks to U.S. growth with uncertainties about the positive short-term impact of the tax bill and the extent of potential medium-term adjustment to offset its fiscal costs with unclear implications for U.S. multinationals in the Dominican Republic. Potential changes in U.S. imigration and trade policies could slow remittance, trade and FDI inflows.	Advance structural reforms that would facilitate job creation and increase income; more accelerated fiscal consolidation may be required to create needed space for social spending.
Slow implementation of structural reforms	**Low**	**Medium** Slow structural reforms, especially in the fiscal and electricity sectors and to strengthen governance, may hurt confidence, increase the sovereign premium, affect fiscal sustainability and growth prospects.	Revive the structural reform momentum, including in the fiscal and electricity sectors.
Upside risks			
Higher-than-expected growth in trading partners	**High**	**Medium** To the extent that tighter global financial conditions (high probability) are due to higher growth in the U.S., the overall net effect on economic activity in the Dominican Republic is estimated to be positive.	Stand ready to tighten monetary policy if needed.
Stronger-than-expected response of domestic demand to monetary easing	**Low**	**Medium** The monetary easing in mid-2017 could contribute to a stronger rebound in domestic demand than anticipated, in part through the associated relaxation of lending conditions.	Tighten monetary policy if inflationary conditions warrant. Monitor macrofinancial developments and address associated risks with macroprudential policy.
Lower energy prices	**Low**	**Medium** The production cuts by OPEC countries and other major producers may not materailize, keeping prices lower than the baseline. This would lead to a higher real income, boosting demand and output.	Use savings on transfers to electricity sector to improve fiscal position. Accelerate electricity sector reforms and lock in the lower subsidy levels.

[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly. "Short term" and "medium term" are meant to indicate that the risk could materialize within 1 year and 3 years, respectively.

B. Past Fund Advice

Previous Fund advice focused on:

- *Fiscal consolidation, based on broadening the tax base through streamlining of tax incentives and exemptions.* The government has taken measures to safeguard the fiscal position in the face of important spending pressures, and has focused the adjustment efforts on tackling tax evasion. While these have yielded important results (estimated to increase revenues by some 0.7 percent of GDP during 2017–18), the higher tax base in 2017 has been already offset by higher spending, and the efforts would need to be supplemented by more significant adjustment.
- *The adoption of a credible medium-term fiscal anchor to put debt on a sustainable downward path*. In particular, staff recommended that a medium-term fiscal framework be adopted, anchored on a medium-term debt-to-GDP ratio (e.g. 45 percent of GDP) and operationalized through a well-designed fiscal rule. The authorities are developing such a medium-term fiscal framework that would anchor fiscal policies in debt sustainability objectives, and are strengthening the public financial management, fiscal risk analysis, and public statistics frameworks. Many of these reforms are expected to come to fruition in 2018–19.
- *Transition towards a more flexible exchange rate*. The authorities are in the process of acquiring a foreign exchange trading platform, which will improve market infrastructure and facilitate transition towards a more flexible exchange rate.
- *Continue building reserves*. The authorities are taking advantage of the temporary strength in the external position to continue building reserves, which remain for now below the Fund's reserve adequacy metric, but above the traditional metrics.
- *Strengthen the macro-financial framework, especially to strengthen supervision and regulation of nonbanks*. Reforms to strengthen bank supervision and regulation continue; new AML/CFT legislation has been introduced; and a new draft law to enhance supervision and regulation of non-bank institutions is being discussed.
- *Reforms to address the long-standing weaknesses in the electricity sector, among other structural reforms*. Efforts in the electricity sector have focused on diversifying the energy matrix, reducing electricity distribution losses, and concluding negotiations of the Electricity Pact, which could help address the main challenges in the sector if followed up by required reforms.

Annex III. Debt Sustainability Analysis

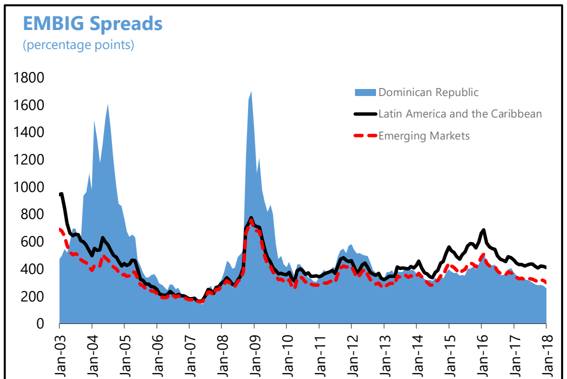
Despite a moderate rising trajectory over the medium term, both public debt (52.7 percent of GDP as of 2017) and gross financing needs (8¾ percent of GDP) are sustainable, and remain within the debt burden benchmarks under stress scenarios.[1] Efforts to improve the debt profile have yielded notable results, but the debt profile still carries some vulnerabilities, especially due to a large share of debt held by non-residents, pointing to rollover risk from potential shifts in market sentiment and a relatively large share of foreign currency debt.

A. Realism of Baseline Scenario[2]

1. Debt. The debt-to-GDP ratio is projected to reach 56.3 percent in 2022—3.6 pp higher than end-2017.[3] Gross debt levels stabilized in 2015 due to a one-off Petróleos de Venezuela S.A. (PDVSA) debt buy-back operation (which reduced debt by 3 percent of GDP), but continued to increase despite strong growth and another debt repurchase operation in 2017.[4] The upward debt dynamics was driven by the real interest rate-growth differential and exchange rate depreciation. The same factors maintain the upward trajectory going forward, while the primary balance (at a 0.2–0.6 percent of GDP surplus) remains below levels needed to stabilize public debt (1 percent of GDP).

2. Growth. Historical growth forecasts have been lower than the actual growth outcomes, with a median forecast error of 0.5 percentage points, which suggests a potentially better outlook for the debt ratio than projected in the baseline scenario.

3. Fiscal Adjustment. Under the baseline scenario, without fiscal reforms, there is no significant adjustment in the cyclically-adjusted primary balance over the forecast horizon. The DSA template provides the distribution of projected fiscal adjustments across countries, and places the Dominican Republic very close to the median based on the expected evolution of the cyclically-adjusted primary balance during the forecast horizon. From 2018 onward, the fiscal impulse converges to zero, implying a broadly neutral fiscal policy.



Source: Bloomberg.

---

1 Public debt numbers are staff estimates.

2 The MAC-DSA framework is described in http://www.imf.org/external/np/pp/eng/2013/050913.pdf.

3 Public debt is defined to cover all liabilities of the consolidated public sector (i.e. non-financial public sector plus the quasi-fiscal debt of the central bank).

4 In the 2015 restructuring operation, the Dominican Republic bought back US$4 billion of its debt to Venezuela's state-owned oil company PDVSA at a discount of about 52 percent. The operation was financed with a sovereign bond placement of US$2.5 billion of 10-year and 30-year maturities, of which US$1.9 billion was used to buy back the debt. In the 2017 operation, the external debt of the central bank was reduced by US$324 million (0.5 percent of GDP) in 2017 due to the central bank's repurchase of its Brady bonds.

4. Sovereign Yields. Dominican Republic's foreign currency sovereign bonds currently have an average credit spread of 276 basis points relative to U.S. Treasury Bonds, which compares favorably to the average of other emerging market economies and Latin-American countries (with spreads of 308 and 420 basis points, respectively). Given upward projections for Libor rates over the medium term, the effective nominal interest rate on Dominican Republic's total debt is projected to increase from 9.2 percent in 2017 to 11.0 percent in 2022. Moody's rating agency upgraded the Dominican Republic's foreign and local currency credit rating to Ba3 in 2017, while Standard and Poor and Fitch maintained it at BB-/B, and all credit rating agencies have a stable outlook.

5. Gross Financing Needs. Gross financing needs are below the upper early warning benchmarks over the medium term (ranging from 8.8 percent of GDP in 2017 to 11.6 percent in 2022). They increase gradually over the medium term as the interest bill grows in line with the public debt stock and world interest rates, and increase more significantly during 2022–24 with a concentration of maturing central bank securities in those year. The authorities are aiming at smoothing the path of amortizations by using instruments of different maturities to minimize financing pressures in their medium-term schedule.

B. Debt Profile

6. Maturity, Currency Composition, and Rollover. The government's debt management strategy prioritizes issuances of longer-term and local currency debt with a view to minimizing public debt vulnerabilities to financing and market risk. Thus: (i) the average maturity of debt has been increased to around 9.2 years for the non-financial public sector from 7.0 years in 2013; (ii) the share of foreign-currency denominated debt was reduced to 74 percent NFPS in 2017 (within the target of 77 ±3 percent in the national debt strategy) and to 54 percent of total consolidated debt as of 2017; (iii) the share held by non-residents fell to 52 percent of total consolidated debt, reducing rollover risk from potential shifts in market sentiment; and (iv) the share of debt under a flexible rate has also declined (with 18 percent of NFPS debt contracted at variable rates). In line with the authorities' strategy to reduce foreign currency risk, the country issued its first local currency bond in the global markets (equivalent to US$822 million, at 8.9 percent interest and 5-year maturity), one of the few non-investment grade countries in the region to have done so.

C. Stochastic Simulations

7. Fan Charts. The fan charts illustrate the possible evolution of the debt ratio over the medium term subject to shocks drawn from a symmetric (upside and downside risks are treated equally) and an asymmetric distribution of risk (which assumes there are no positive shocks to the primary balance). Under the symmetric scenario, there is a 90 percent probability that debt will remain below 70 percent of GDP benchmark for emerging economies over the medium term, while in the asymmetric (worst-case) scenario, debt would remain below the 70 percent of GDP benchmark with 44 percent probability.

D. Stress Tests

8. Real GDP growth shock. The DSA stress tests show that Dominican Republic's debt ratio is more sensitive to (negative) changes in GDP growth than changes in other variables (primary balance, real interest rates, and the exchange rate). A shock that reduces growth by 2.5 percentage points (one standard deviation) would increase the debt ratio to 62 percent of GDP by the end of the projection horizon (from 56.3 percent in the baseline) and gross financing needs to 13 percent (from 11.6 percent in baseline), both remaining within the sustainability benchmarks.

9. Combined shock. The combined shock incorporates the largest effect of four individual shocks (growth, primary balance, exchange rate, and interest rate) producing the most extreme debt trajectory. Under this scenario debt reaches about 67 percent by 2022 and gross financing needs rise to about 14 percent of GDP in the medium term, again within the benchmarks.

10. Contingent liability shock. A contingent liability shock in 2017 equivalent to 2.9 percent of GDP, along with the negative realizations of a growth and borrowing cost shock, would increase the debt ratio to 64 percent of GDP in 2022 and gross financing needs to 13 percent of GDP, remaining within the debt burden benchmark. [5]

[5] This shock is combined with real GDP negative growth shock (1 standard deviation for 2 years). Sovereign borrowing costs are pushed up (25 basis points for each 1 percent of GDP worsening in the primary balance) while inflation declines (0.25 percentage points per 1 percentage point decrease in GDP growth).

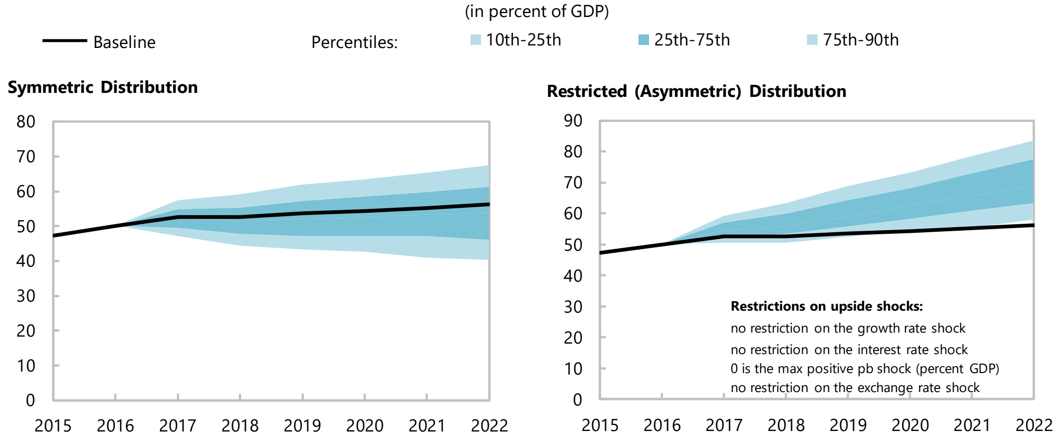
Annex III. Figure 1. Dominican Republic DSA Risk Assessment

Heat Map

Debt level [1/]	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability shock
Gross financing needs [2/]	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability Shock
Debt profile [3/]	Market Perception	External Financing Requirements	Change in the Share of Short-Term Debt	Public Debt Held by Non-Residents	Foreign Currency Debt

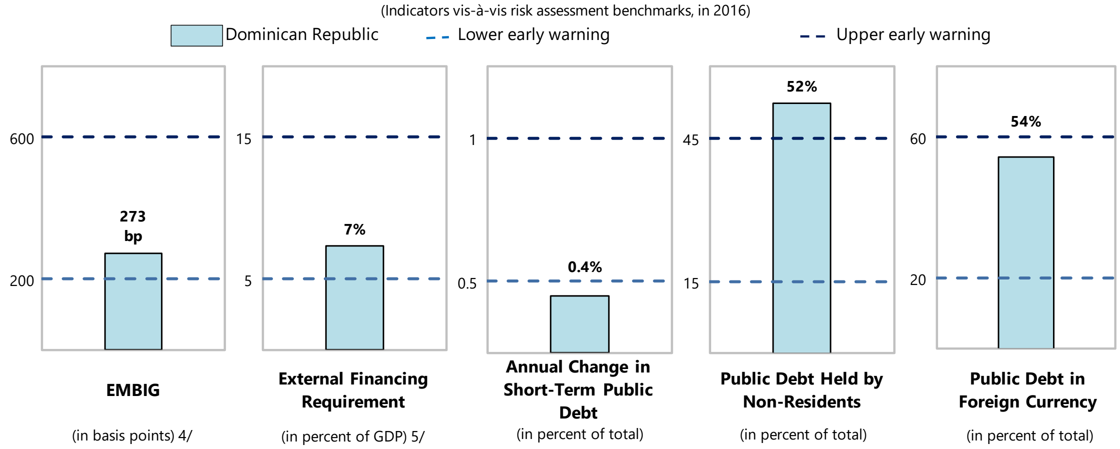
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2016)



Source: IMF staff.

1/ The cell is highlighted in green if debt burden benchmark of 70% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

2/ The cell is highlighted in green if gross financing needs benchmark of 15% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

3/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant, cell is white.

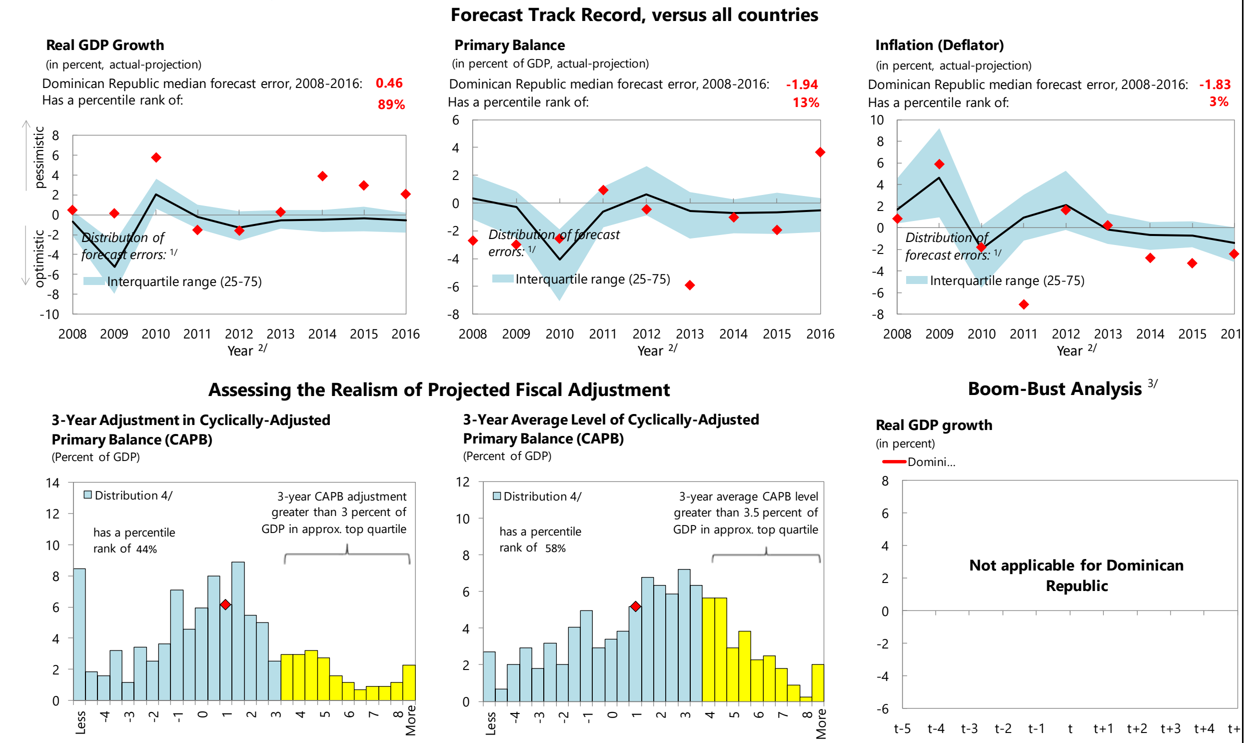
Lower and upper risk-assessment benchmarks are:

200 and 600 basis points for bond spreads; 5 and 15 percent of GDP for external financing requirement; 0.5 and 1 percent for change in the share of short-term debt; 15 and 45 percent for the public debt held by non-residents; and 20 and 60 percent for the share of foreign-currency denominated debt.

4/ EMBIG, an average over the last 3 months, 01-Apr-17 through 30-Jun-17.

5/ External financing requirement is defined as the sum of current account deficit, amortization of medium and long-term total external debt, and short-term total external debt at the end of previous period.

Annex III. Figure 2. Dominican Republic DSA Realism of Baseline Assumptions



Source : IMF Staff.

1/ Plotted distribution includes all countries, percentile rank refers to all countries.

2/ Projections made in the spring WEO vintage of the preceding year.

3/ Not applicable for Dominican Republic, as it meets neither the positive output gap criterion nor the private credit growth criterion.

4/ Data cover annual obervations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

Annex III. Figure 3. Dominican Republic Public Sector Debt Sustainability Analysis (DSA) - Baseline Scenario

(in percent of GDP unless otherwise indicated)

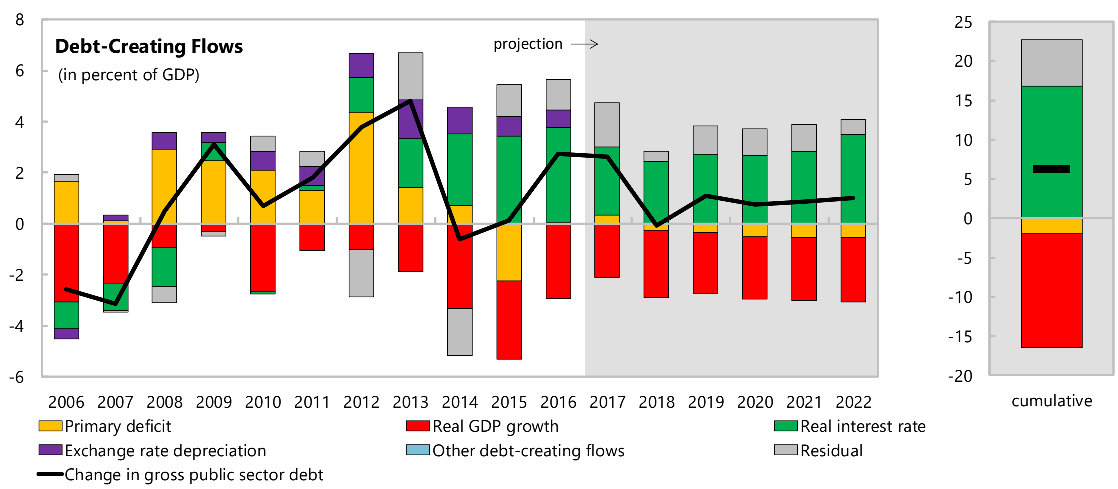
Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2006-2014 [2/]	2015	2016	2017	2018	2019	2020	2021	2022
Nominal gross public debt	39.4	47.3	50.0	52.7	52.6	53.7	54.4	55.3	56.3
Public gross financing needs	6.5	6.2	6.5	8.8	10.0	10.3	8.5	9.5	11.6
Real GDP growth (in percent)	5.3	7.0	6.6	4.6	5.5	5.0	5.0	5.0	5.0
Inflation (GDP deflator, in percent)	5.8	0.9	0.8	3.3	4.9	3.5	4.0	4.0	4.0
Nominal GDP growth (in percent)	11.4	8.0	7.5	8.0	10.7	8.6	9.1	9.2	9.1
Effective interest rate (in percent) [4/]	6.8	8.8	9.3	9.2	10.3	9.3	9.6	9.9	11.1

As of June 30, 2017		
Sovereign Spreads		
EMBIG (bp) 3/		277
5Y CDS (bp)		n.a.
Ratings	Foreign	Local
Moody's	Ba3	Ba3
S&Ps	BB-	BB-
Fitch	BB-	BB-

Contribution to Changes in Public Debt

	Actual			Projections							
	2006-2014	2015	2016	2017	2018	2019	2020	2021	2022	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	0.9	0.1	2.7	2.6	-0.1	1.1	0.8	0.9	1.0	6.3	
Identified debt-creating flows	1.1	-1.1	1.5	0.9	-0.5	0.0	-0.3	-0.2	0.4	0.4	
Primary deficit	1.9	-2.2	0.0	0.3	-0.3	-0.3	-0.5	-0.5	-0.5	-1.9	1.0
Primary (noninterest) revenue and grant	14.3	17.5	14.8	15.1	15.1	15.0	15.1	15.0	15.0	90.3	
Primary (noninterest) expenditure	16.2	15.3	14.8	15.5	14.8	14.7	14.5	14.5	14.5	88.4	
Automatic debt dynamics [5/]	-0.8	1.1	1.5	0.6	-0.2	0.3	0.2	0.4	1.0	2.2	
Interest rate/growth differential [6/]	-1.5	0.3	0.8	0.6	-0.2	0.3	0.2	0.4	1.0	2.2	
Of which: real interest rate	0.4	3.4	3.7	2.7	2.4	2.7	2.7	2.8	3.5	16.8	
Of which: real GDP growth	-1.8	-3.1	-2.9	-2.1	-2.6	-2.4	-2.4	-2.5	-2.5	-14.6	
Exchange rate depreciation [7/]	0.6	0.8	0.7	…	…	…	…	…	…	…	
Other identified debt-creating flows	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Net privatization proceeds (negative)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Please specify (2) (e.g., ESM and Euroar	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes [8/]	-0.1	1.2	1.2	1.7	0.4	1.1	1.0	1.0	0.6	5.9	



Source: IMF staff.

1/ Public sector is defined as general government.

2/ Based on available data.

3/ EMBIG.

4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

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

6/ The real interest rate contribution is derived from the numerator in footnote 5 as $r - \pi(1+g)$ and the real growth contribution as $-g$.

7/ The exchange rate contribution is derived from the numerator in footnote 5 as $ae(1+r)$.

8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

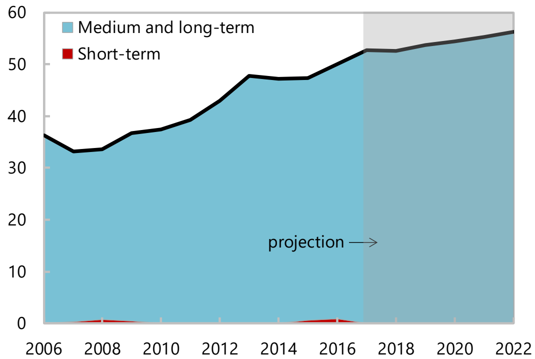
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Annex III. Figure 4. Dominican Republic Public DSA - Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

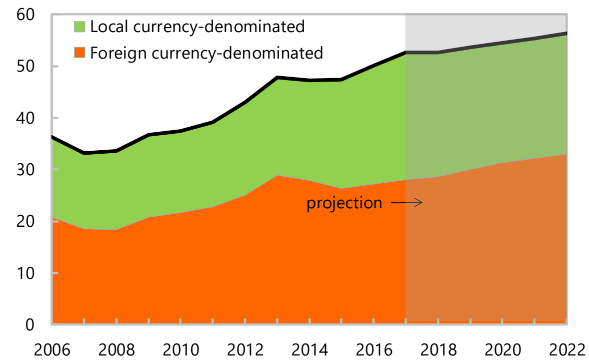
By Maturity

(in percent of GDP)



By Currency

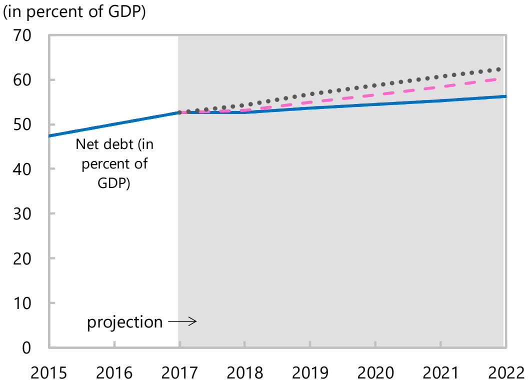
(in percent of GDP)



Alternative Scenarios

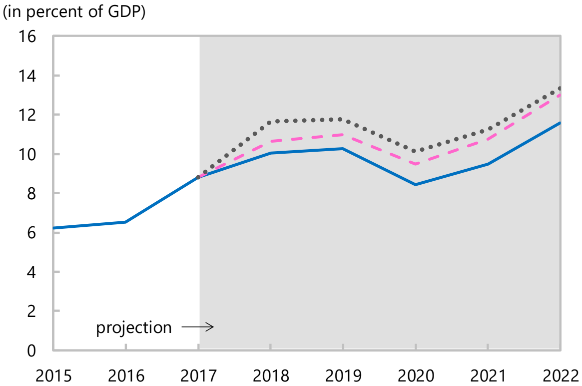
Gross Nominal Public Debt

(in percent of GDP)



Public Gross Financing Needs

(in percent of GDP)



Underlying Assumptions

(in percent)

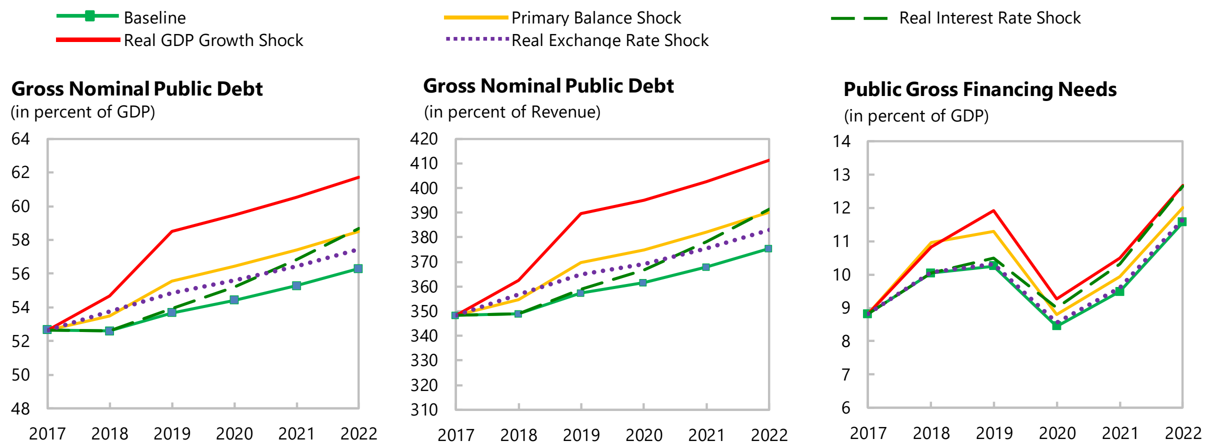
Baseline Scenario	2017	2018	2019	2020	2021	2022
Real GDP growth	4.6	5.5	5.0	5.0	5.0	5.0
Inflation	3.3	4.9	3.5	4.0	4.0	4.0
Primary Balance	-0.3	0.3	0.3	0.5	0.5	0.5
Effective interest rate	9.2	10.3	9.3	9.6	9.9	11.1
Constant Primary Balance Scenario						
Real GDP growth	4.6	5.5	5.0	5.0	5.0	5.0
Inflation	3.3	4.9	3.5	4.0	4.0	4.0
Primary Balance	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3
Effective interest rate	9.2	10.3	9.3	9.6	10.0	11.1

Historical Scenario	2017	2018	2019	2020	2021	2022
Real GDP growth	4.6	5.2	5.2	5.2	5.2	5.2
Inflation	3.3	4.9	3.5	4.0	4.0	4.0
Primary Balance	-0.3	-1.3	-1.3	-1.3	-1.3	-1.3
Effective interest rate	9.2	10.3	8.7	8.5	8.5	9.3

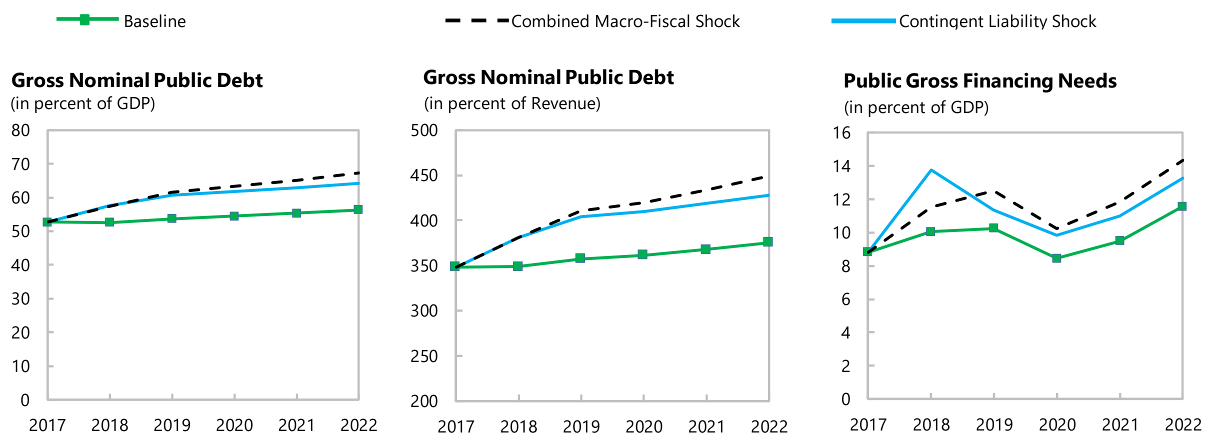
Source: IMF staff.

Annex III. Figure 5. Dominican Republic Public DSA – Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions

(in percent)

	2017	2018	2019	2020	2021	2022
Primary Balance Shock						
Real GDP growth	4.6	5.5	5.0	5.0	5.0	5.0
Inflation	3.3	4.9	3.5	4.0	4.0	4.0
Primary balance	-0.3	-0.7	-0.6	0.5	0.5	0.5
Effective interest rate	9.2	10.3	9.3	9.8	10.0	11.1
Real Interest Rate Shock						
Real GDP growth	4.6	5.5	5.0	5.0	5.0	5.0
Inflation	3.3	4.9	3.5	4.0	4.0	4.0
Primary balance	-0.3	0.3	0.3	0.5	0.5	0.5
Effective interest rate	9.2	10.3	9.8	10.6	11.3	12.7
Combined Shock						
Real GDP growth	4.6	3.0	2.4	5.0	5.0	5.0
Inflation	3.3	4.2	2.9	4.0	4.0	4.0
Primary balance	-0.3	-0.7	-0.6	0.5	0.5	0.5
Effective interest rate	9.2	10.5	9.7	10.6	11.3	12.6

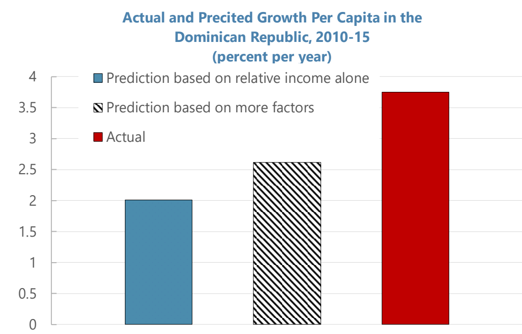
	2017	2018	2019	2020	2021	2022
Real GDP Growth Shock						
Real GDP growth	4.6	3.0	2.4	5.0	5.0	5.0
Inflation	3.3	4.2	2.9	4.0	4.0	4.0
Primary balance	-0.3	-0.2	-0.6	0.5	0.5	0.5
Effective interest rate	9.2	10.3	9.3	9.7	10.0	11.1
Real Exchange Rate Shock						
Real GDP growth	4.6	5.5	5.0	5.0	5.0	5.0
Inflation	3.3	6.9	3.5	4.0	4.0	4.0
Primary balance	-0.3	0.3	0.3	0.5	0.5	0.5
Effective interest rate	9.2	10.5	9.1	9.5	9.8	10.9
Contingent Liability Shock						
Real GDP growth	4.6	3.0	2.4	5.0	5.0	5.0
Inflation	3.3	4.2	2.9	4.0	4.0	4.0
Primary balance	-0.3	-2.6	0.3	0.5	0.5	0.5
Effective interest rate	9.2	11.3	9.5	9.8	10.1	11.2

Source: IMF staff.

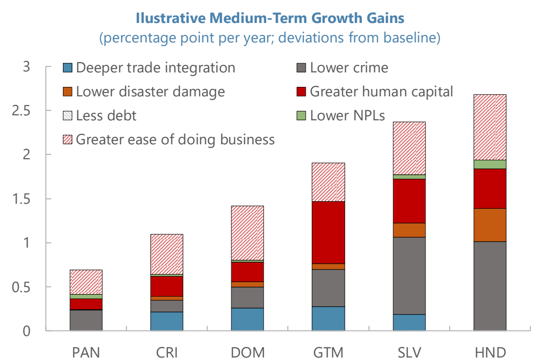
Annex IV. Growth Determinants

1. The Dominican Republic experienced robust growth over the period 2005–17. The pronounced exchange rate depreciation and the period of contained real wage growth that followed the 2003–04 financial crisis increased the country's competitiveness and labor productivity. Structural reforms also contributed to the economic turnaround. Reforms focused on supporting growth through strengthened capacity in the public sector, education reform, and scaled up infrastructure spending. Due to growth convergence, countries that have a lower initial level of per capita income tend to grow at a faster pace than those that have already a higher level. However, growth in the Dominican Republic has been even higher than can be explained by its initial level of per capita income. This higher growth can be partly explained by a panel data including 118 countries for the period 2006–16 including other institutional factors, including, among others, trade integration, public debt level, level of violent crime levels, human capital development, non-performing loans, the business environment, as well as the impact of natural disasters, and shared characteristics across Central America. The estimation used is based on a Cook distance (D) approach.[1]

Dominican Republic: Potential Growth Gains from Structural Reform



Sources: Fund staff estimates based on IMF 2017. Reinvigorating Growth in the Caribbean. Refer to this publication for further details on the estimation model and data.



Sources: Subset of country results extracted from dataset used in IMF 2017, Reinvigorating Growth in the Caribbean.

2. Sustaining high and inclusive growth will hinge on enhancing competitiveness. The competitive advantage from the internal devaluation since the 2003–04 financial crisis may be eroding with the recent slowdown in productivity and the increase in real wages due to the increase in minimum wages. Weak structural dimensions that have yet to be addressed also continue to weigh on the country's longer-term prospects. The main drags on growth come from long-standing bottlenecks in the electricity sector, a complex tax system, inadequate infrastructure and social spending, relatively weak institutions and governance, and rigidities in labor and product markets. As an illustration, the medium-term benefits of addressing structural challenges over the medium term—including an improvement of the institutional variables from their current levels to a level of the top fifth percentile of emerging and developing countries, a reduction in crime and disaster damage by half from the current level, and a reduction in government debt to 40 percent of GDP—could permanently raise GDP growth by one and a half percentage point per year.[2]

[1] For more details on the econometric approach, see "Reinvigorating Growth in the Caribbean," IMF (2017).

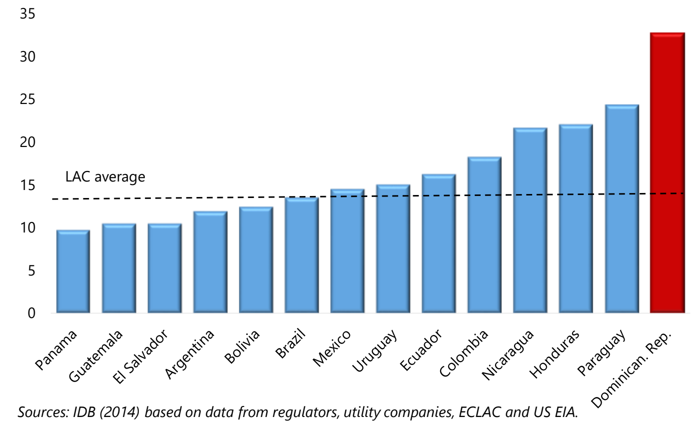
[2] The original estimation was modified so that the reported institutional variables improve to the top fifth percentile of a subsample of emerging and developing economies.

Annex V. The National Electricity Pact

1. Decades-long weaknesses in the electricity sector remain a major drag on the fiscal position and economic growth. These weaknesses stem largely from the distribution and transmission sectors, which are publicly owned, whereas electricity generation remains largely in private hands. National distribution companies generate significant deficits, primarily due to large distribution losses (among the highest in the region), below-cost tariffs and poor targeting of some subsidies:

- The losses reflect a number of factors, including insufficient investments in the distribution grid, governance weaknesses at state-owned distribution companies, high share of unbilled energy, as well as a relatively unfavorable energy matrix, with about half of total electricity generated using fuel oil. Some progress has been made in reducing these losses over the past years (about one percentage point per year), but these remain high at close to 30 percent in 2017, as investments in the maintenance and the upgrading of the grid have been insufficient.

Electricity Losses in LAC:
Average Distribution Losses Over Last Five Years
(in percent of total production)



Sources: IDB (2014) based on data from regulators, utility companies, ECLAC and US EIA.

- These weaknesses have resulted in large financial losses, with the deficits generated by the public electricity sector estimated at 2¼–1¼ percent of GDP between 2013 and 2017. The deficits have narrowed somewhat in recently years, largely reflecting the lower input cost of world oil prices and lower distribution losses.

- The ensuing common blackouts to control the financial losses—with electricity shortages estimated to average four hours per day[1]—adversely affect economic activity, disrupt production processes, and generate additional costs for companies and households, as many have to install their own electricity generators.

- The bulk of the electricity sector deficits have been financed by transfers from the central government, to cover both the generalized subsidies and the investments in the sector. Part of the deficit has historically been financed by arrears to private generators, although the management of arrears has improved in recent years and these have been securitized on several occasions, allowing generators to sell the underlying debt in the market, usually to banks.

[1] Asociación Dominicana de la Industria Eléctrica (ADIE) (2017), "Costo del Apagón para los usuarios del sistema eléctrico. Informe Enero-Agosto 2017".

2. Government efforts to reduce losses have continued through upgrades to the distribution grid, but have recently focused on the expansion of the energy matrix. In particular, the government has contracted the construction of two coal plants at Punta Catalina, which will boost current generation capacity by about 20 percent and will allow a diversification of the energy matrix away from heavy fuels, reducing the volatility of input prices and lowering costs in times of high international oil prices. The construction of the plants since 2014 is estimated to cost US$2 billion (2½ percent of GDP), with the first plant expected to commence operations in the second half of 2018. The government is also continuing efforts to expand the energy matrix towards green energy (currently 2.4 percent of the matrix) and natural gas 18.8 percent).

3. To durably solve the structural challenges in the electricity sector, the National Development Strategy (2014–2030) mandates agreement between social partners on an Electricity Pact. The overall goal of this Pact is to achieve a consensus on the reforms needed to ensure proper functioning of the sector. Negotiations between the social partners (the government, representatives of the electricity sector and private sector more broadly, as well as civil society) have continued for more than three years to reach consensus and the negotiations agreed on a draft Pact in late 2017. As of February 2018, some stakeholders held back from signing the Pact over some disagreement. Therefore, the Pact remains to be signed by President Medina.

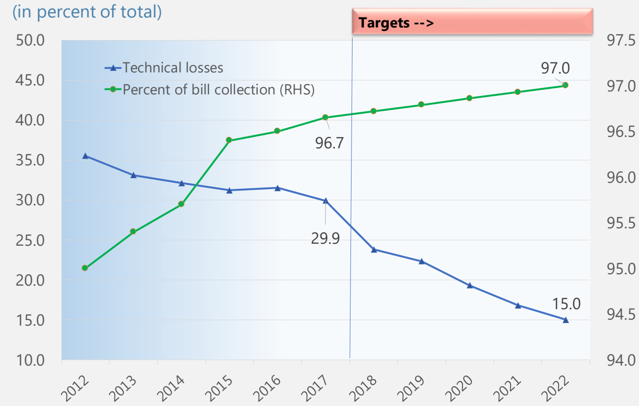
4. Given the scope of the agreement, the Pact consists of a comprehensive set of reform objectives, but its ultimate effectiveness will depend on the will to follow up with specific reforms. Important elements of the Pact include the following:

- *Opening up the distribution sector to private participation*. While the government will maintain monopoly in hydro-generation and transmission, the Pact opens up the possibility of allowing private subcontracting in the distribution subsector. The Pact, however, does not clarify the role of the state in the generation sector once the Punta Catalina plants come into operation, which many market participants were anticipating. Separately, the authorities have expressed their intention to allow private partnerships in the coal plants.
- *Reforming the institutional governance in the sector,* with the view to (i) ensure a clearer separation of the policy-making, regulation and operational functions through the reassignment of these functions across institutions; (ii) strengthen the governing boards of the public entities in the sector; (iii) create two new public entities in charge of managing hydrogeneration and transmission, where the state maintains monopoly.
- *Ensuring a stable and effective regulatory framework for the electricity sector.* The pact reaffirms the objectives of the current legislation to ensure free and fair competition in the sector, and mandates a study on improvements in the concessions framework for the sector. Transparency in the sector will also be increased with the new requirement of timely publication of audited financial statements by state enterprises, as well as full public dissemination of all regulations, decisions, and financial data by all regulatory public institutions in the sector.
- *Ensuring quality supply of electricity.* The pact requires subsequent regulation on setting standards for the supply for electricity, including street lighting; introducing accountability of the

distribution company for meeting these standards; and strengthening consumer rights to receiving needed electricity supply.

- *Restoring financial viability of the electricity sector.* The pact requires each enterprise to develop and be accountable for a plan to increase operating efficiency and reduce losses, with measurable targets to be monitored by the regulators. The pact targets a 15-percentage points reduction in losses over 6 years across all distributors—more the double the annual reduction in losses in recent years—which will require significant capital investment going forward, to be financed by transfers from the central government (although the magnitude of such investments remains uncertain). Several multilateral organizations, including the World Bank, International Development Bank (IDB), The OPEC Fund for International Development (OFID), and the European Investment Bank (EIB) are currently supporting CDEEE and EDEs in the reduction of losses.

Electricity Sector Reform Schedule of Selected Financial and Technical Targets
(in percent of total)



Source: Draft Pacto Nacional Para la Reforma del Sector Electrico, informacion CDEEE

- *Pricing system reforms.* The pact mandates a decision on the long-term pricing policy to be made in the near-term, based on a detailed study. The policy— to be implemented from 2022 onward—will determine the appropriate cost-recovery tariff (albeit based on some pre-specified cost parameters, such at 15% distribution losses) and the level of subsidies. In the interim, the current tariff—which has been frozen since 2011 and is estimated to be notably below cost-recovery—will be adjusted for the cost of fuel (preventing a further increase in subsidies with higher oil prices), but will also be reduced by the imputed effect of at least 2 percentage points of reduction in losses (which could increase the subsidy given historical record of loss reduction). Overall, unless significant investments are made to secure loss reduction, tariffs appear likely to move further away from cost recovery by 2022.

5. **The successful implementation of the Pact will hinge on strong follow-up with required reforms to support the objectives of the Pact.** Most reform elements in the Pact rely on further supporting reforms and/or underlying technical analysis needed to guide these reforms. Therefore, the government's decisive action in designing and implementing concrete reforms in all areas, as well as ensuring timely studies, will be critical.