



DOMINICAN REPUBLIC

August 2019

2019 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR THE DOMINICAN REPUBLIC

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 2019 Article IV consultation with the Dominican Republic, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its June 5, 2019, consideration of the staff report that concluded the Article IV consultation with the Dominican Republic.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on June 5, 2019, following discussions that ended on March 21, 2019, 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 May 20, 2019.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for the Dominican Republic.

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June 5, 2019

IMF Executive Board Concludes 2019 Article IV Consultation with the Dominican Republic

On June 5, 2019, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation¹ with the Dominican Republic.

The economy rebounded to a record high growth of 7 percent in 2018, with the positive momentum carrying into early 2019. The return to above potential growth in 2018 reflected a strong private investment and consumption response to a timely monetary impulse after the slowdown in 2017, favorable external conditions and a continued strengthening of labor markets. The very strong economic performance over the past several years, aided by the authorities' policies, led to substantial reduction in poverty, inequality and continued income convergence to advanced economy levels. The acceleration in activity has not put pressures on either internal or external balances: inflation remained subdued and the external position strong. This allowed monetary and fiscal policies to switch to neutral-to-tightening gear in 2018, guiding activity towards potential levels.

The outlook is favorable, with moderate and balanced risks to growth. Growth is expected to moderate to around 5½ percent in 2019 and 5 percent over the medium-term, both within the estimated potential range. The moderation will be driven by a slowdown in credit expansion, a less supportive external environment, and higher oil prices. Inflation is expected to rise gradually to the central bank's target range of 4±1 percent with the pickup in food and oil prices. The external position is projected to remain broadly consistent with fundamentals and more than adequately financed by FDI. Main downside risks to the outlook are weaker-than-expected external demand and higher energy prices. On the upside, the domestic demand momentum in the near term could be stronger than anticipated, reflecting the solid income growth.

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.

Executive Board Assessment²

Executive Directors commended the authorities for the strong economic performance, including dynamic growth, low inflation, stable external position, and improved social outcomes. Directors noted that while the outlook remains favorable, it is subject to risks. They encouraged the authorities to take advantage of the current favorable environment to further increase the economy's resilience to shocks by building fiscal and reserve buffers, while strengthening long-term growth and social outcomes through reforms to address structural bottlenecks.

Directors welcomed the authorities' commitment to improve the fiscal position, including through ambitious tax administration reforms to curb evasion, mobilize revenues, and improve governance. Nonetheless, given that public debt is trending up despite strong growth, Directors called for further efforts to improve debt sustainability. They underscored the need for a front-loaded fiscal adjustment aimed at widening the tax base and curtailing the electricity sector's drag on the budget, while safeguarding fiscal space for growth-enhancing public investment and social spending. Directors also supported adoption of a medium-term fiscal framework, with a clear policy anchor and fiscal responsibility elements, to ensure policy credibility and limit fiscal risks.

Given subdued inflation, Directors supported maintaining the current neutral monetary policy stance, while remaining data dependent should pressures emerge. They welcomed the continued efforts to strengthen the monetary policy framework, highlighting the dividend from anchoring inflation expectations, and supported plans to recapitalize the central bank and introduce the foreign exchange trading platform to increase transparency and efficiency of foreign exchange markets and policies. In light of the favorable external position, Directors encouraged the continued accumulation of international reserves.

Directors welcomed financial system stability and wide-ranging reforms to further enhance financial resilience. They supported the ongoing modernization of the institutional framework for systemic risk oversight, strengthening of banking regulation and supervision, and cybersecurity reforms. They encouraged the authorities to take further action, including to strengthen the supervisory oversight of non-bank financial institutions. Directors welcomed recent progress in updating the AML/CFT legal framework and encouraged the authorities to enhance the effectiveness of the regime.

Directors emphasized the importance of continued structural reforms to address impediments to higher productivity, income convergence, and social inclusion. Building on recent gains, they encouraged further measures to improve the business environment, remove trade and

² At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: <http://www.imf.org/external/np/sec/misc/qualifiers.htm>.

investment barriers, and continue reforms to education, health, and the pension system. Directors reiterated the need to decisively address the long-standing structural weaknesses that continue to weigh on potential growth, particularly losses in the electricity sector and inefficiencies in the product and labor markets. They also noted the need to broaden and strengthen the social security system, which will require additional fiscal space.

Table 1. Dominican Republic: Selected Economic Indicators

	2016	2017	2018	Projection	
				2019	2020
Output	(Annual percentage change, unless otherwise stated)				
Real GDP	6.6	4.6	7.0	5.5	5.2
<i>Contributions to growth</i>					
Consumption	3.8	3.6	3.8	4.0	3.9
Investment	3.9	-0.6	3.7	1.3	1.3
Net exports	0.2	2.0	-0.7	-1.1	-0.4
Output gap (in percent of potential output)	1.0	-0.3	0.9	0.8	0.6
Unemployment and Prices	(In percent)				
Unemployment rate (period average)	7.1	5.5	5.7	5.5	5.5
Consumer price inflation (end of period)	1.7	4.2	1.2	4.2	4.0
Consumer price inflation (period average)	1.6	3.3	3.6	2.1	4.1
Consolidated public sector 1/	(In percent of GDP)				
Debt	48.7	51.5	53.1	54.3	54.9
Primary balance	-0.4	-0.6	0.1	0.0	-0.3
Overall balance	-4.2	-4.5	-3.8	-4.2	-4.6
Central government balance	-3.2	-3.4	-2.4	-3.3	-3.3
Revenues and grants	14.5	14.7	14.9	15.0	15.1
Primary spending	15.1	15.5	14.6	15.3	15.2
Interest expenditure	2.6	2.7	2.7	3.1	3.1
Central bank quasi-fiscal balance	-1.3	-1.2	-1.2	-1.1	-1.1
Rest of NFPS	0.3	0.2	-0.3	0.2	-0.3
Financial sector	(Annual percentage change, unless otherwise stated)				
Broad money (M3)	9.8	11.2	7.0	7.6	10.9
Credit to the private sector	12.1	10.1	11.1	8.2	9.8
Policy interest rate 2/	5.5	5.3	5.5	5.5	...
Balance of payments	(In percent of GDP)				
Current account, <i>of which:</i>	-1.1	-0.2	-1.4	-1.5	-1.7
Trade balance	-3.6	-2.7	-4.2	-4.0	-4.0
Financial account, <i>of which:</i>	-2.2	-1.8	-2.3	-1.5	-1.7
Foreign direct investment, net	-3.3	-4.7	-3.1	-3.1	-3.1
NIR (in millions of U.S. dollars)	6,047	6,780	7,627	8,016	8,622
NIR in months of imports	3.4	3.4	3.7	3.7	3.7
Total external debt (in percent of GDP)	40.7	43.2	41.5	41.6	40.1
<i>of which:</i> Public sector	26.9	29.2	28.7	29.5	29.2

Sources: National authorities and IMF staff calculations.

1/ The consolidated public sector covers the central government, decentralized non-financial institutions, municipalities, social security, non-financial public institutions, the electricity holding company, and the central bank.

2/ Latest available.



DOMINICAN REPUBLIC

STAFF REPORT FOR THE 2019 ARTICLE IV CONSULTATION

May 20, 2019

KEY ISSUES

Context. The Dominican economy has enjoyed strong growth since 2014 (6.6 percent, the highest in the Western Hemisphere), supported by stable macroeconomic and financial policies, and a favorable external environment. Growth has generally been above potential, but inflation remains muted and the external position is in line with fundamentals. The strong economic and policy performance has strengthened resilience to downside risks, but vulnerabilities remain. The fiscal position is under moderate sustainability and affordability pressures; key structural bottlenecks have not been addressed; and social outcomes can be further strengthened. Upcoming elections in 2020 are likely to dominate the near-term policy landscape.

Outlook and Risks. The outlook is favorable, with growth moderating to potential, inflation picking up towards target with fading supply shocks, and the external position normalizing. Risks are moderate and balanced: on the upside, solid income and credit growth could sustain domestic demand, while on the downside external risks are building up.

Key Policy Recommendations:

- **Fiscal policies.** Tighter fiscal policies are warranted by demand, sustainability and affordability considerations. A frontloaded adjustment, anchored on widening the tax base and mindful of the distributional effects of the adjustment measures, would help reverse the upward debt dynamics. A medium-term fiscal framework, with a clear anchor and fiscal responsibility elements, should be put in place in order to enhance credibility about policy sustainability.
- **Monetary policy.** With few signs of inflationary pressures, the authorities have space to keep rates on hold, while remaining data dependent if pressures emerge. Reforms to support the move towards a more flexible exchange rate and strengthen the credibility of the inflation targeting regime are welcome and should be carried through. Reserve accumulation should continue, but at a pace consistent with manageable sterilization costs.
- **Financial policies.** Wide-ranging reforms have strengthened the financial system, but remaining pockets of vulnerability, especially in the supervision and regulation of nonbank institutions, need to be addressed.
- **Structural reforms.** More ambitious reforms to lift barriers to long-term growth and improve social outcomes will support healthy and inclusive growth.

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

The staff team comprised Aliona Cebotari (head), Javier Arze del Granado, Joel Okwuokei, Olga Bepalova, Julia Faltermeier (all WHD) and Hui He (ICD), who joined the mission for three days to provide training. Marina Rousset and Ben Sutton (both WHD) supported the mission from the headquarters. Frank Fuentes (OED) participated in the discussions. The mission met with President Danilo Medina Sánchez, Central Bank Governor Héctor Valdez Albizu, Minister of Finance Donald Guerrero Ortiz, Minister of Economy Isidoro Santana López, Superintendent of Banks Luis Armando Asunción, other government officials and representatives of the financial and private sectors.

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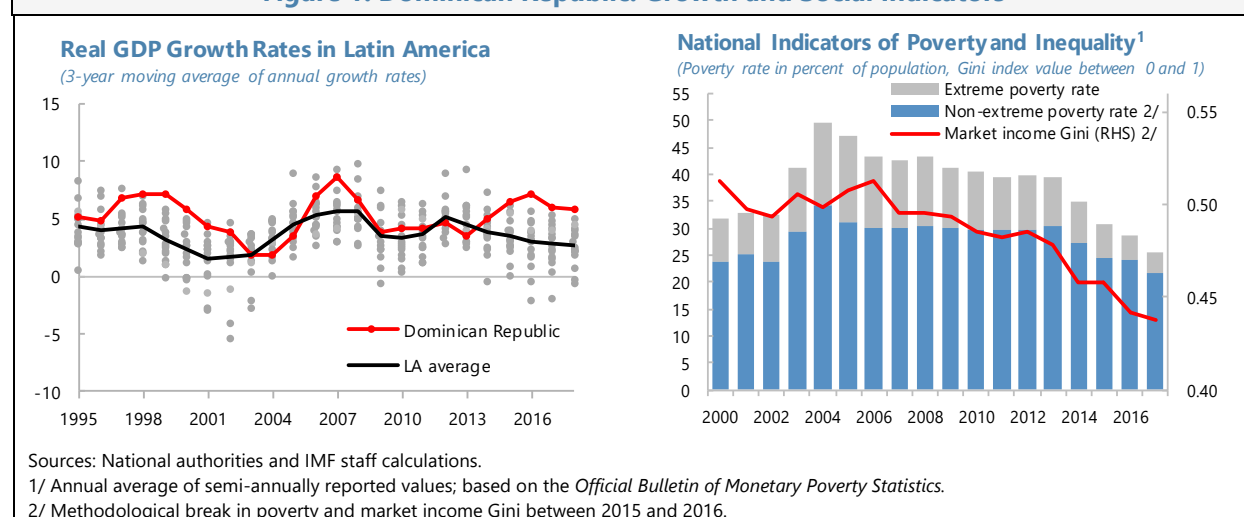
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OVERVIEW

1. The economy remains among the most dynamic in the Western Hemisphere, with low inflation and a stable external position. The Dominican Republic has enjoyed a strong expansion over the last five years (6 $\frac{2}{3}$ percent on average), supported by a strengthened policy framework, a supportive external environment and favorable terms of trade. Inflation remains muted, unemployment is at historical lows, and the external position is broadly in line with fundamentals. The strong growth performance—supported by a policy focus on strengthening social outcomes—has resulted in continued convergence of income per capita towards advanced economy levels, and a significant decline in poverty and inequality (Annex I).

Figure 1. Dominican Republic: Growth and Social Indicators

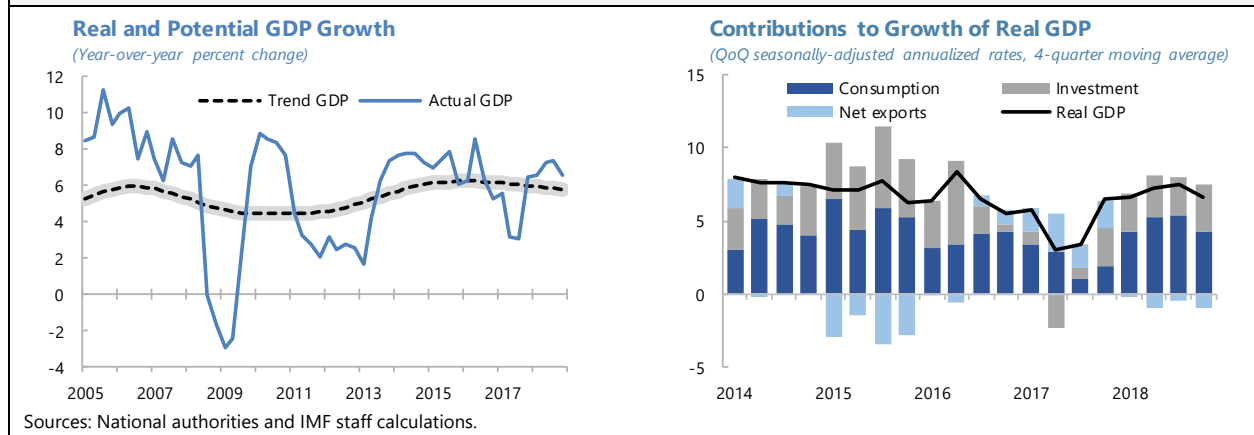


2. The current growth momentum provides a window of opportunity to address remaining challenges to maintain a strong, sustainable and more inclusive growth. These challenges include moderate sustainability and affordability pressures on the fiscal position, despite strong growth; structural bottlenecks to higher productivity, especially in the electricity sector; still elevated poverty and inequality, while social safety nets are not fully developed. Although the upcoming general elections in May 2020 may be dominating the near-term policy landscape, the reform effort needs to be sustained to tackle these challenges.

RECENT DEVELOPMENTS

3. After a temporary moderation, growth regained momentum in 2018. The economy expanded by 7 percent in 2018, and the positive momentum continued in early 2019 despite a severe drought in the North, albeit at a slower pace. The dynamism in 2018 reflected a recovery in investment from its 2017 slump and a strengthening of consumption. Growth also benefitted from buoyant external demand, although the demand and fuel-price related pickup in imports turned its net contribution negative in 2018. The above-potential growth widened the output gap to an estimated 0.9 percent of potential GDP in 2018.

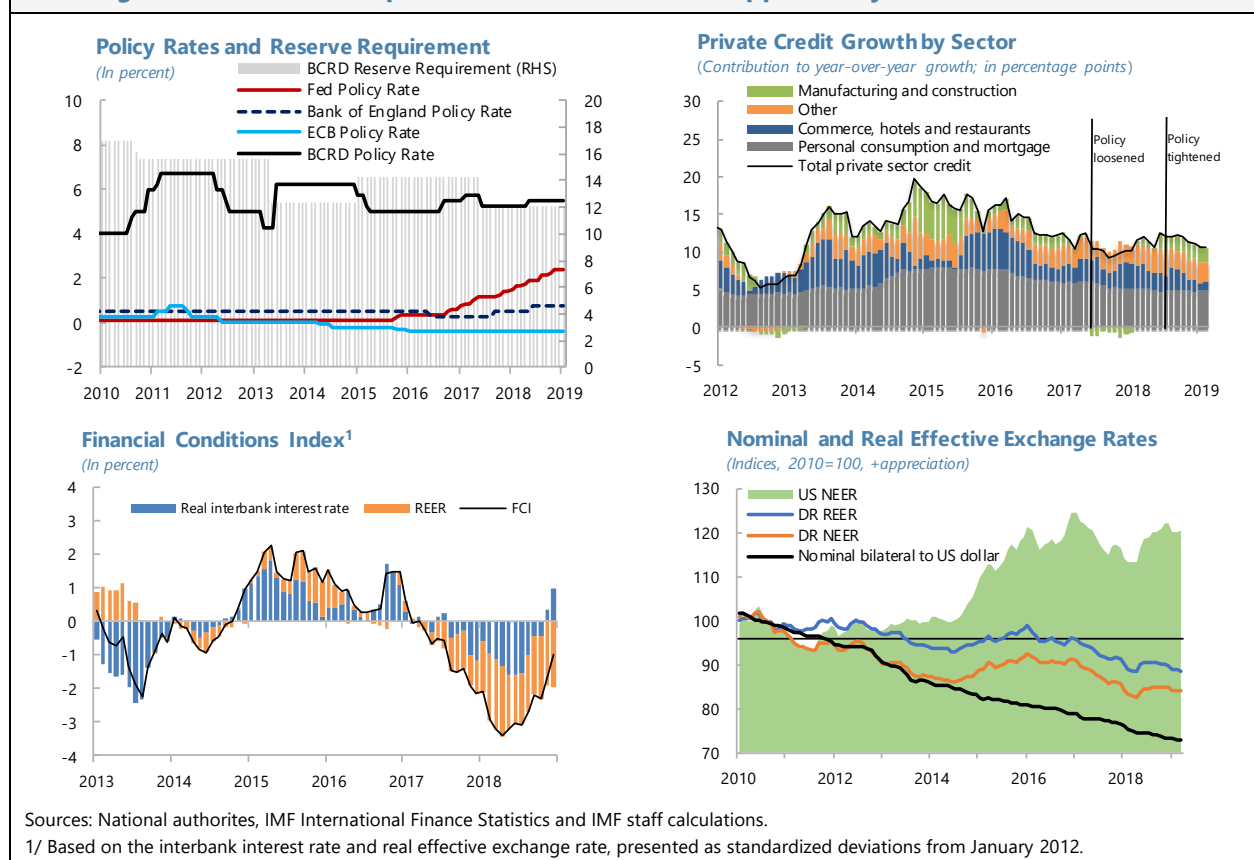
Figure 2. Dominican Republic: Strong Expansion Due to Recovery in Domestic Demand



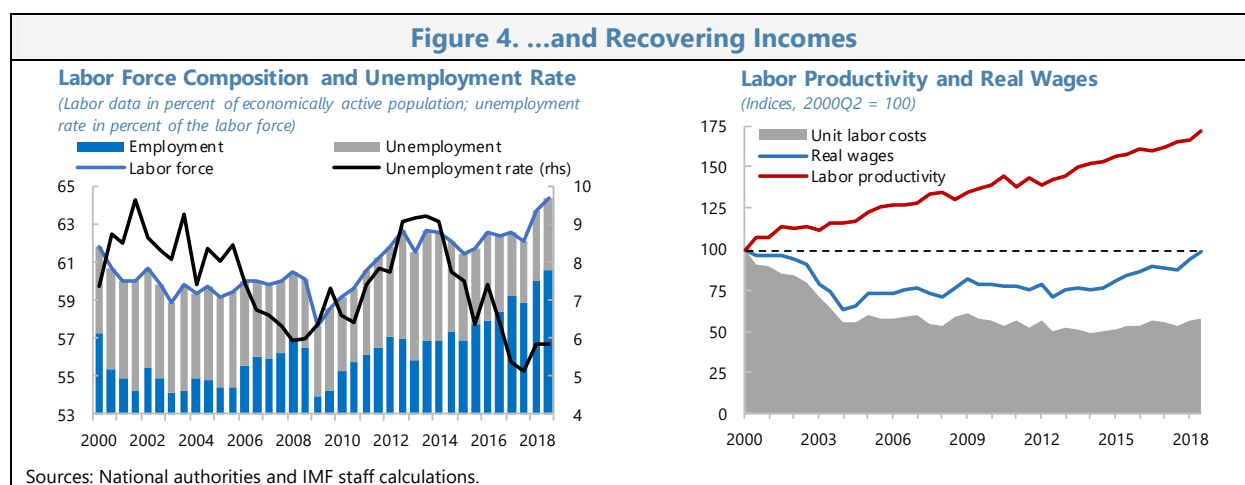
4. The timely relaxation of monetary policy in response to the economic slowdown in 2017, the supportive external conditions and strengthening incomes fueled the 2018 recovery.

- *Accommodative monetary conditions early in the year strengthened credit growth...* The mid-2017 cut in the domestic policy rate and reserve requirements led to a recovery in credit growth (to above 12 percent by mid-2018), especially in sectors most affected by the mid-2017 slowdown, such as construction (Figure 3, top row). The strong demand response is consistent with the finding of the growth-at-risk exercise that domestic interest rates and credit are particularly potent when growth falls below its average values (Annex II).

Figure 3. Dominican Republic: Domestic Demand Supported by Financial Conditions...



- *...which moderated as the central bank removed the stimulus.* The strong demand response and the anticipated inflation pressures led the central bank to reverse the easing cycle and increase its policy rate in July 2018 by 25 basis points to 5.5 percent. With the latest increase, the monetary policy stance became marginally contractionary at end-2018, moderating private sector credit growth to 10½ percent by March 2019. Overall financial conditions, however, were still supportive due to the real exchange rate depreciation (Figure 3, bottom row).
- *External financial conditions remained supportive.* The nominal exchange rate depreciated moderately (by around 4 percent, more than in previous years) against the U.S. dollar in 2018 with narrowing interest differentials against advanced countries. Due to subdued inflationary pressures, the real exchange rate depreciated against the U.S. dollar along the nominal one, although in effective terms this depreciation was muted by the strong U.S. dollar vis-à-vis trading partners.
- *Stronger incomes with recovery in labor markets and growing remittances.* Employment is growing strongly as discouraged workers reenter the labor force, increasing the labor force participation rate to an 18-year peak (64⅓ percent of active population) by end-2018 (Figure 4). This increase in the participation rate also led to a recent uptick in unemployment to 5.8 percent by end-2018, still below its long-term average. The bulk of the increase in employment has been in the formal sector, pushing formal employment to 43½ percent of the total at end-2018.¹ Real wages also continued to grow, recovering only now to their levels before the 2003-04 financial crisis, and broadly in line with productivity growth, keeping unit labor costs largely unchanged since the crisis and inflationary pressures at bay. Wage growth has been stronger in the lower deciles of the wage distribution, thus lowering inequality and poverty. Net remittances strengthened to a historical high of 7.3 percent of GDP in 2018, further boosting incomes.

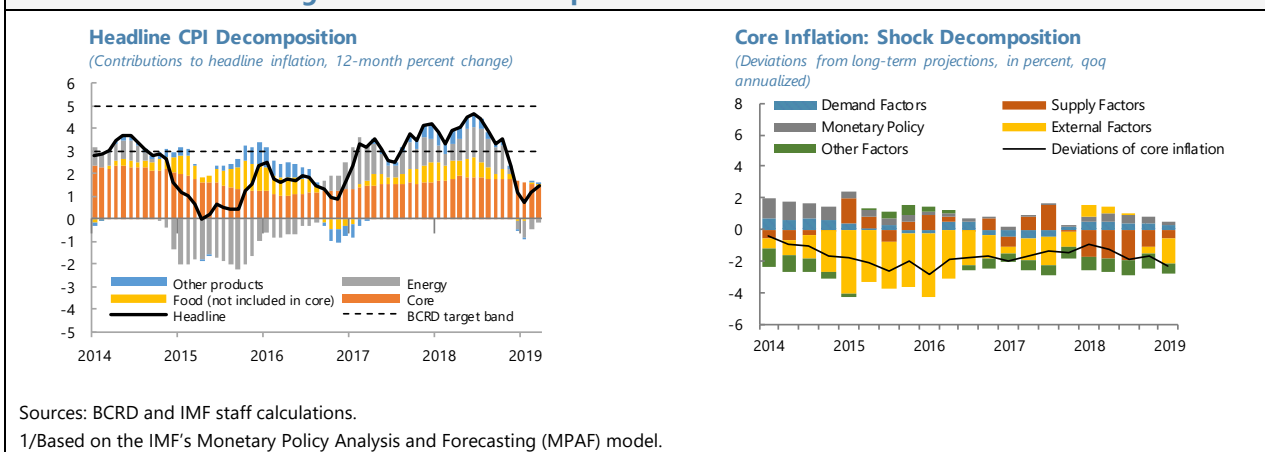


5. Despite strong activity, there are no signs of overheating. Headline inflation accelerated to near the upper band of the inflation target (4±1 percent) by mid-2018, due to a weather-related shock to domestic food production and rising fuel prices. Both supply shocks reversed in the second

¹ The implied informality rate of 56½ percent may appear high but is not comparable to levels reported by other countries in the region, as the authorities were among the first to adopt the ILO definition of informality based on access to social security benefits, as opposed to employment in enterprises with 5 or fewer employees.

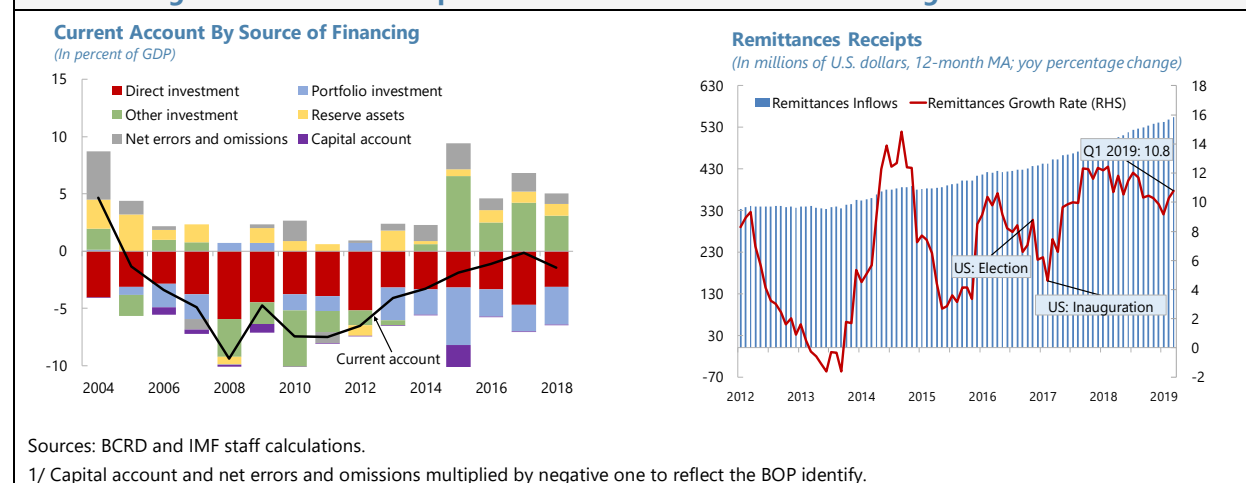
half of the year, pushing headline inflation down to 1.2 percent at end-December (well below the target band). In early 2019, international oil market developments and a drought in the agricultural areas of the country drove headline inflation back up towards 1.5 percent in March. Core inflation failed to respond to demand conditions and remained stable at around 2.5 percent in 2018, easing slightly in the first quarter of 2019. Staff estimates suggest that the downside pressures from the second-round effects of the positive supply shocks have more than offset the upside pressures from demand and policy factors during 2018 and kept core inflation subdued (Figure 5). A higher than estimated potential growth could be another explanatory factor.

Figure 5. Dominican Republic: Inflation Remains Subdued



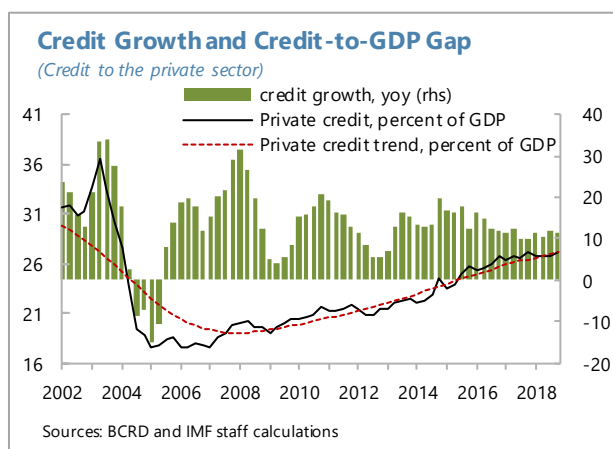
6. The external position weakened somewhat in 2018 but remains solid. Higher oil prices and a demand-related increase in imports widened the current account deficit from a near balance to 1.4 percent of GDP in 2018, still stronger than the historical average. High external demand (especially for tourism), the depreciation of the real exchange rate, and strong remittances (which remain around 1 percent of GDP above the historical average) only somewhat offset these pressures. High remittances are linked to increasing U.S. employment and wages, as well as uncertainty surrounding U.S. immigration policy. The current account deficit stayed adequately financed by foreign direct investment (FDI), and reserve coverage reached 3.7 months of prospective imports (4.5 months excluding the imports of the free trade zones). Overall, the widening of the current account deficit in

Figure 6. Dominican Republic: External Position Reflects Strong Fundamentals



2018—broadly in line with staff projections—has shifted the external position from being considered moderately stronger than fundamentals in 2017 to broadly consistent with medium-term fundamentals and desirable policy settings in 2018 (Annex III).

7. The financial sector remains sound and macro-financial vulnerabilities appear limited, although financial depth is constrained. After expanding for more than a decade to around 27 percent of GDP, private credit stabilized at broadly these levels during 2018—remaining low by historical and international standards but closing the slightly positive credit-to-GDP gap of previous years. Further deepening may be hindered by crowding-out effects, as investing in sovereign debt (currently at about 15 percent of banks' assets or 123 percent of their equity) provides attractive yields and does not carry capital requirements. Credit quality improved during 2018, with nonperforming assets falling to 1.6 percent of the loan portfolio by end-2018, while provisioning increased. Higher provisioning reduced somewhat capital adequacy during 2018, but—at 17.1 percent at year-end—it remains significantly above the regulatory minimum of 10 percent. Dollarization of assets and liabilities remained broadly stable at around 20 percent and 30 percent, respectively, and banks enjoy healthy liquidity and profitability. The consolidation of the banking system has continued through voluntary restructuring or liquidation.



Text Table. Dominican Republic: Financial Soundness Heat Map 1/

	2016Q2	2016Q3	2016Q4	2017Q1	2017Q2	2017Q3	2017Q4	2018Q1	2018Q2	2018Q3	2018Q4
Overall Financial Sector Rating	L	L	L	L	L	L	L	L	L	L	L
Credit cycle	L	L	L	L	L	L	L	L	L	L	L
Change in credit / GDP ratio (pp, annual)	1.6	1.2	1.1	1.0	1.2	0.6	0.4	0.6	0.2	0.3	0.0
Growth of credit / GDP (% , annual)	6.6	4.6	4.2	3.8	4.5	2.2	1.6	2.2	0.6	1.2	0.1
Credit-to-GDP gap (st. dev)	0.1	0.1	0.5	-1.2	-1.1	-1.7	-1.1	-1.8	-1.8	-1.6	-1.1
Balance Sheet Soundness	L	L	L	L	L	L	L	L	L	L	L
Balance Sheet Structural Risk	L	L	L	L	L	L	L	L	L	L	L
Deposit-to-loan ratio 2/	131.9	132.3	129.7	126.9	129.2	127.4	128.2	126.0	126.3	126.4	122.8
FX liabilities % (of total liabilities)	28.6	30.8	30.5	28.2	27.8	29.9	29.5	28.8	30.2	31.3	30.7
FX loans % (of total loans)	21.0	20.6	21.4	22.2	21.9	20.5	19.9	20.5	19.8	19.8	20.3
Balance Sheet Buffers	L	L	L	L	L	L	L	L	L	L	L
Leverage	L	L	L	L	L	L	L	L	L	L	L
Leverage ratio (%)	11.2	11.5	11.3	11.6	11.5	11.6	11.6	11.7	11.6	11.9	11.8
Profitability	L	L	L	L	L	L	L	L	L	L	L
ROA	2.3	2.3	2.2	2.1	2.0	2.0	1.9	2.4	2.4	2.4	2.4
ROE	20.1	20.0	19.0	18.2	17.4	17.1	16.7	20.4	20.7	20.2	20.0
Asset quality	M	M	L	M	M	M	M	L	L	L	L
NPL ratio	1.7	1.8	1.7	2.0	2.0	2.1	1.9	1.9	1.9	1.8	1.6
NPL ratio change (% , annual)	6.0	6.6	0.4	13.4	15.2	16.6	10.1	-2.6	-6.1	-12.8	-14.0

Medium vulnerability
 Low vulnerability
 Below lower threshold
 Above upper threshold

Sources: National authorities and IMF staff calculations.

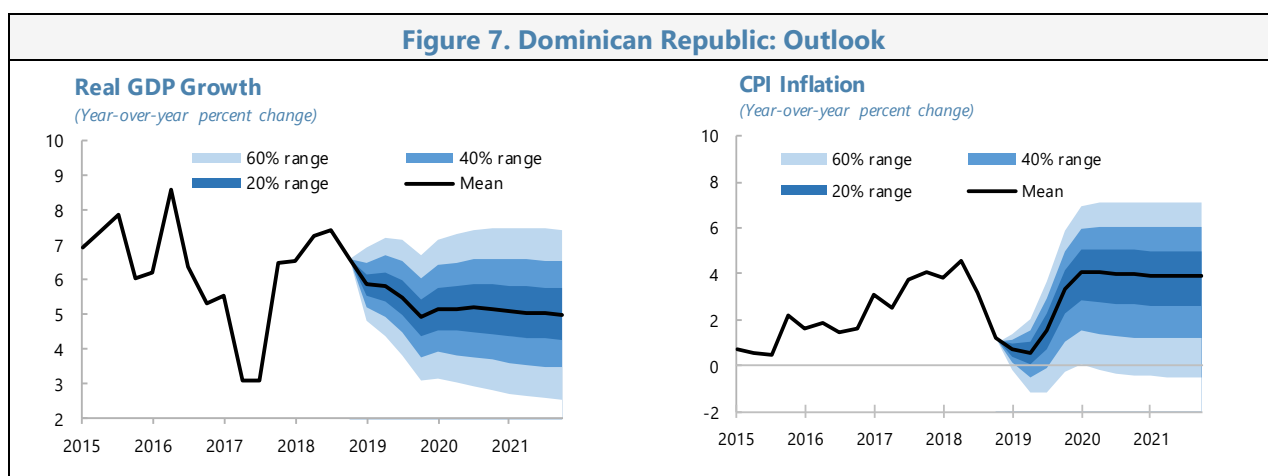
1/ Methodology is detailed at [http://www-intranet.imf.org/departments/MCM/tools/tools/Pages/Financial%20Soundness%20Indicators%20\(FSIs\).aspx](http://www-intranet.imf.org/departments/MCM/tools/tools/Pages/Financial%20Soundness%20Indicators%20(FSIs).aspx)

2/ Relative to previous reports, the deposit base now includes certificates of deposits, which are equivalent to term deposits in the local financial system.

OUTLOOK AND RISKS

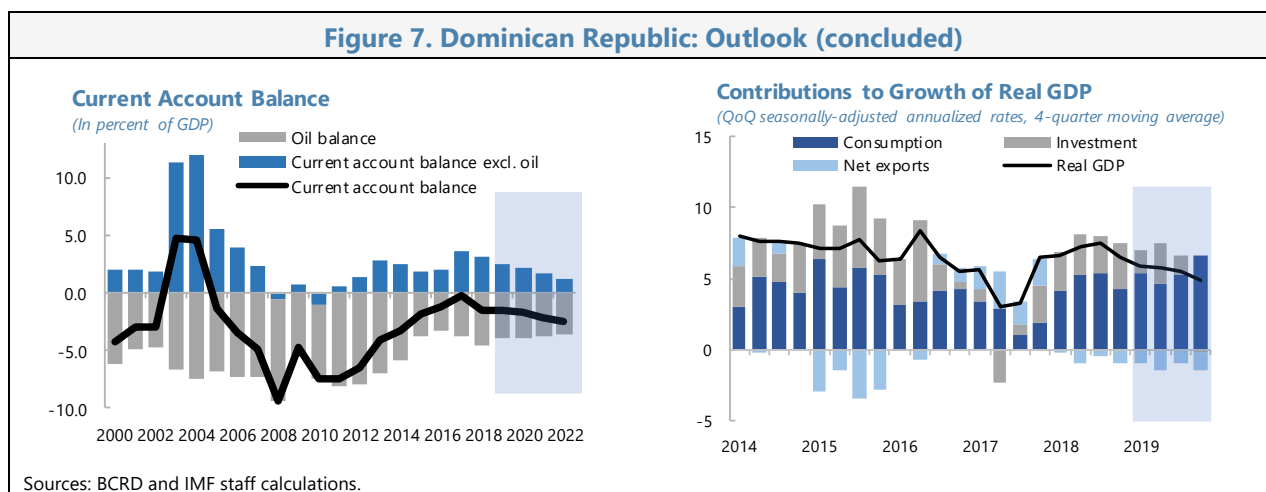
8. After the impressive growth performance over the past five years, economic activity is expected to slow to its potential. The tightening financial conditions, a less supportive external environment and higher oil prices (and on the supply side the early 2019 drought) are expected to slow down growth to around 5½ percent in 2019 and 5 percent over the medium term, both within the estimated range of potential growth. With positive supply shocks fading and negative supply shocks emerging amid drought conditions, inflation will gradually move back towards the inflation target band of 4±1 percent. The external position is projected to normalize around somewhat higher deficits. The slowdown in remittances and the gradual moderation of gold exports will widen the current account deficit closer to its historical average of 3 percent of GDP over the medium term, offset partly by a projected fall in the oil bill (especially in 2019). FDI, particularly in the tourism sector, is expected to continue to more than adequately finance the current account deficit.

9. Risks to the outlook appear moderate and broadly balanced (Annex IV). On the downside, a faster-than-expected weakening of external demand—especially from the U.S.— is the main risk to growth, and it would only be mildly offset by the concomitant looser financing conditions if the U.S. monetary policy normalization cycle is slowed (a 1pp temporary decline in U.S. demand is estimated to reduce growth in the Dominican Republic by 0.4pp through trade and remittances channels). Higher energy prices could contribute to weaker demand and wider fiscal and current account deficits. Domestically, the main risks stem from uncertainty about the domestic demand momentum relative to staff’s baseline scenario, although these are tilted to the upside in the near term in light of the April 2019 increase in public sector wages and pensions, the ongoing wage negotiations in the private sector, and the negotiation of a free trade agreement with China, which could unlock Chinese markets for Dominican exports and attract tourists and foreign investment.² On the downside, potential extreme weather events could pose a risk to tourism and agricultural exports while cyberattacks could disrupt financial markets and commercial infrastructure.



² The Dominican Republic established diplomatic relations with China in May 2018 after cutting its ties with Taiwan Province of China.

Figure 7. Dominican Republic: Outlook (concluded)



Authorities' Views

10. The authorities broadly share staff's views on the economy's cyclical position, outlook and risks. They see the economy as operating above potential and expect growth to move close to potential in 2019 but see more upside risks to near-term growth as the strong performance has persisted throughout the first quarter of 2019. Robust private investment (both domestic and foreign) and private consumption highlight the strong fundamentals supporting growth. The authorities consider a slowdown in the U.S. economy the largest downside risk to growth. They also expect headline inflation to remain towards the lower bound of the 4 ± 1 percent target range by end-2019, and to move closer to the center of the band subsequently. Strong export performance, especially in tourism, and high remittances support the external position, which authorities expect to gradually converge to historical averages.

POLICY DISCUSSIONS

Policy discussions focused on (i) the need to strengthen the fiscal position and framework to reduce sustainability risks; (ii) maintaining a data-dependent monetary stance and progress in strengthening the financial system framework; and (iii) policies to support higher productivity and income convergence.

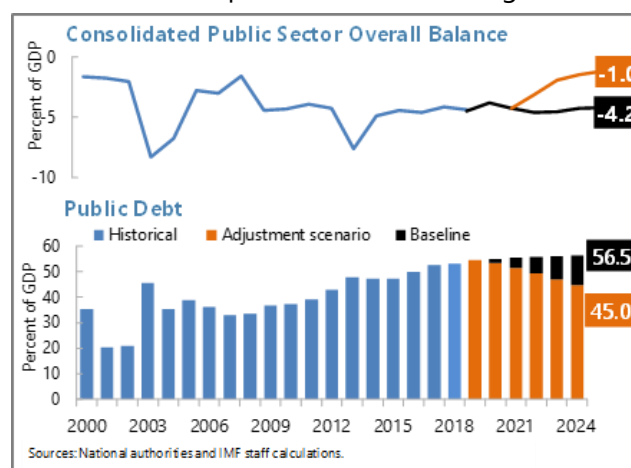
A. Fiscal Policies and Framework

11. Fiscal policy faces the challenge of maintaining sustainability, amid weak debt carrying capacity. Despite strong growth, consolidated public debt continues to grow as a share of GDP (53.1 percent of GDP in 2018) due to persistent structural deficits, averaging around $4\frac{1}{2}$ percent of GDP over the last five years.³ The government is aiming to put a dent in the deficits through expenditure restraint and concerted efforts to increase tax collection by closing loopholes and curbing pervasive

³ In staff's analysis, the consolidated public sector covers the central government, other non-financial public sector institutions and the central bank, due to its large quasi-fiscal liabilities. Staff's estimates for the consolidated debt are higher than the authorities' (50.4 percent of GDP) in that they include the accrued interest on central bank bullet bonds (0.6 percent of GDP), securitized arrears of the electricity sector (1.6 percent of GDP), with the remaining balance due to methodological differences for currency conversion.

evasion (Annex V, section C). Ongoing efforts are critical for widening the revenue base and correcting previous governance gaps in revenue administration. However, the gains from revenue administration measures (estimated at 0.2 percent of GDP in 2018) have been broadly neutralized by declines in one-off revenues, and tax revenue has not visibly increased so far. The tax base remains low by international comparison (at 13.7 percent of GDP) due to widespread exemptions and incentives (tax expenditure in 2018 is estimated at 5.1 percent of GDP). In addition to a narrow tax base, the main contributors to persistent public sector deficits are the electricity sector (with an average annual subsidization cost of 1.7 percent of GDP during 2014–18) and a high interest burden (3.9 percent of GDP, or 28.5 percent of tax revenues in 2018). The high cost of debt relative to a narrow revenue stream suggests a low debt carrying capacity, with additional fiscal risks stemming from a high share of foreign currency debt (54 percent at the consolidated level) and relatively high financing needs (averaging 9⅓ percent of GDP in 2019–23) (Annex VI).

12. The authorities aim to continue improving the fiscal position in 2019, but this will be challenging. The planned adjustment relies on a high anticipated yield from revenue administration efforts (0.9 percent of GDP) to help offset higher investment in infrastructure and a growing interest bill.⁴ If successful, the authorities' strategy would at least stabilize public debt or—if spending pressures are not significant—could even put debt on a downward path. However, the targets will be challenging to attain in the absence of substantive tax and electricity sector reforms, and with additional pressures from post-budget increases in minimum public sector wages and pensions (0.1–0.2 percent of GDP) and an expected scale-up in investment to upgrade the electricity infrastructure.⁵ Staff estimates that, without additional measures, consolidated deficits would remain at around 4 percent of GDP and debt would gradually increase in the medium term, reaching about 56.5 percent of GDP in five years.



13. Positive surprises to the fiscal outlook are possible, but there are also downside risks.

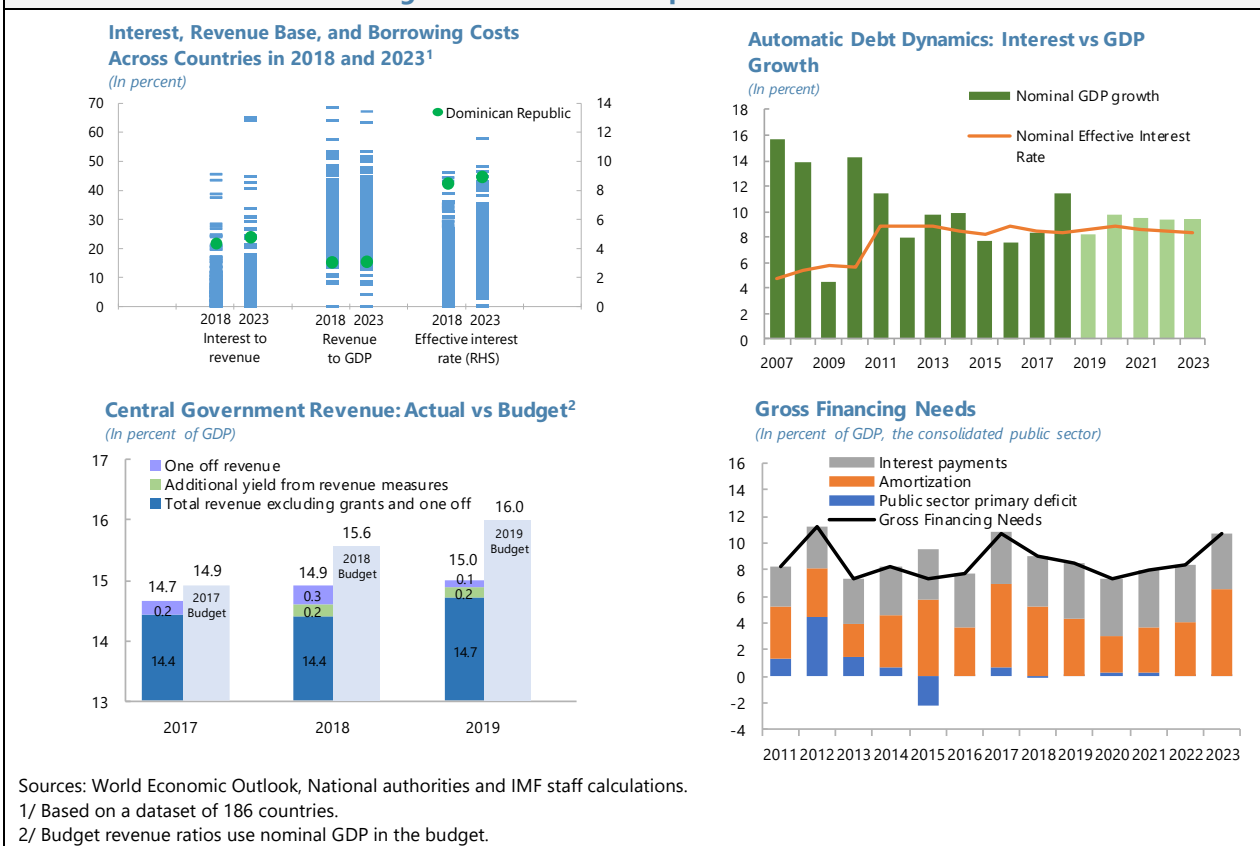
On the upside, the authorities' efforts to curb tax evasion may be more successful than assumed in staff's baseline; cost savings from the new Punta Catalina coal-powered generation plant could be larger; and divesting state's shares in the coal plant, as planned by the government, could also reduce

⁴ Measures underlying the planned adjustment in the 2019 budget include the introduction of a digital tax stamps system for tobacco and alcoholic beverages to track the products till final sale, electronic billing for VAT and income tax, and administrative adjustments in fuel excises, among others.

⁵ Public sector wages in education, health and security have been increased over the past several years in line with the policy focus on these sectors, but wages in the rest of the public sector have remained frozen since the banking crisis of 2003–04. The recent increase entails raising the minimum public wage by 95 percent and minimum pension by 57 percent, with wages and pensions at higher scales by 5–10 percent.

debt directly, recovering at least partly the cost of its construction.⁶ On the downside, in addition to macroeconomic risks from higher borrowing costs, lower growth or a larger depreciation than expected, the government may face liabilities from potential arrears of non-central government entities to the private pension system. Finally, the government is exposed to fiscal risks from natural disasters (hurricanes, floods and earthquakes), although the authorities have also taken some steps to build resilience, including by signing a contingent precautionary loan with the World Bank (Catastrophe Deferred Drawdown Option, or CAT-DDO).

Figure 8. Dominican Republic: Fiscal Risks



14. Sustainably improving the fiscal position will require comprehensive reforms to broaden the tax base and address electricity sector weaknesses. To ensure fiscal sustainability, contain fiscal risks, and reduce borrowing costs, the upward debt dynamics should be reversed. Staff recommends targeting a debt reduction sufficiently below 50 percent of GDP to allow room for countercyclical policies and potential fiscal risk materialization without exceeding this ceiling.⁷ This will require an additional adjustment effort relative to staff's baseline of 2-2½ percent of GDP over two years to bring debt to 45-47 percent of GDP over five years, with a frontloaded adjustment

⁶ The plant will supply an estimated 20 percent of the current demand for electricity, displacing the least efficient and more costly fossil fuel generation. With distribution and transmission already in public hands, this will increase the public sector footprint in the generation sector, although the authorities intend to auction off up to half of the government's stake in the plant. The plant was built during 2014-19 at an estimated cost of US\$2.6 billion or around 3.6 percent of GDP.

⁷ The staff's views on such a framework are discussed in more detail in Annex V of the [2017 Article IV Consultation](#).

warranted by the current cyclical position.⁸ The adjustment should focus on reducing generalized subsidies on electricity, rationalizing CIT incentives, phasing out the least progressive exemptions from the VAT, and reducing the high PIT threshold (less than 10 percent of those employed have income above the threshold). In doing this, the authorities would need to be mindful of the distributional effects of the measures, and the additional fiscal space created from a lower interest burden could be used to strengthen social protection and support growth through higher investment spending.⁹ In case of a negative demand shock, the authorities have some fiscal space to respond, but current demand, sustainability and affordability considerations argue against its use.

Key Fiscal Measures	Expected yield (% of GDP)		
	2020	2021	Total
Reducing VAT (other indirect) and property tax exemptions to regional levels	1.0	0.5	1.5
Reducing CIT exemptions	0.1	0.1	0.2
PIT: not adjusting tax rate benchmark for inflation and reducing PIT allowance to two minimum salaries	0.1	0.1	0.2
Eliminating electricity subsidies and improving spending efficiency	0.3	0.3	0.5
Total	1.5	1.0	2.5

15. Given the uncertainty around the fiscal policy path, a policy framework anchored on a medium-term debt target and fiscal responsibility would strengthen policy credibility. Such a framework would clarify the government's medium-term objectives, guide current policies towards the debt anchor through an operational rule and remove policy uncertainty in light of the unlikely launch of discussions on the Fiscal Pact. Enacting such fiscal responsibility legislation, which could enter in effect in 2020, would help advance the fiscal reform agenda in a pre-election environment, build public trust in fiscal policies and potentially lower the sovereign risk premium. The framework could also strengthen the management of fiscal risks, through the identification and quantification of existing exposures, developing principles for taking these on and strategies for managing them better. Staff welcomes the authorities' work on developing a fiscal risk statement and encourages its publication during the next budget.

16. The authorities have focused on strengthening the institutional framework for fiscal policies. They are improving the quality and frequency of published fiscal statistics, including through transition to GFSM2014. They are also reinforcing the capacity of the debt management office; broadening the coverage of the treasury single account to virtually all public institutions; and strengthening the institutional capacity to assess risks from public-private partnerships (associated legislation is in congress). Ongoing reforms have also aimed to enhance governance: the procurement system has been modernized to allow real-time public access to information during the procurement cycle through a transactional portal; bearer shares have been eliminated, and tax fraud and bribery have been criminalized (Annex V).¹⁰ Remaining challenges include broadening the coverage of fiscal reporting and statistics (including debt) to public institutions outside the central government (municipalities and decentralized institutions), for which reforms have already been

⁸ The improvement in the overall balance would be larger than the fiscal effort (at 2½-3½ percent of GDP), because the decline in the interest bill along with debt would save an additional 0.5-0.6 percent of GDP.

⁹ See staff analysis of the distributional effects of fiscal adjustment measures in the [2018 Article IV Consultation](#), Box 1.

¹⁰ The authorities have also used the procurement system to advance their social objectives, introducing the *Dominican Model for Inclusive and Sustainable Purchases* that gives priorities to domestic SMEs and female-led supplier companies.

initiated, and revisiting the system of intergovernmental relations to clarify responsibilities and the intergovernmental transfer system.

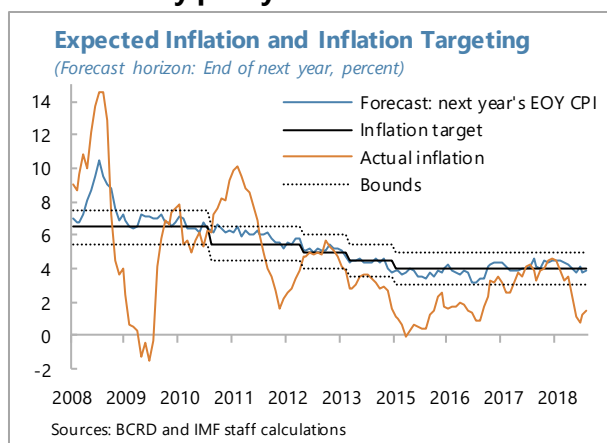
Authorities' Views

17. The authorities recognize that achieving the 2019 budget targets will be challenging but remain committed to improving the fiscal position. They believe that the staff's baseline scenario is too conservative and underestimates: (i) the ability of the envisaged revenue administration measures to increase the tax base, and (ii) the decline in the electricity sector deficits from lower electricity purchase prices with the entry into operation of Punta Catalina, as well as from the expected profits from the plant. In their views, these two reforms, plus other measures, could deliver the needed adjustment to reduce the debt ratio over the medium term. The authorities agreed on the desirability of the fiscal responsibility framework, but they see its adoption as unlikely in the near term. A medium-term fiscal framework for 2018-22 has been developed and is being used internally to guide fiscal analysis, accompanied by an assessment of fiscal risks around the medium-term baseline projections. The authorities have also developed an internal fiscal risk report that assesses risks associated with macroeconomic shocks, natural disasters, the pension system, the electricity sector and public-private partnerships.

B. Monetary Policies

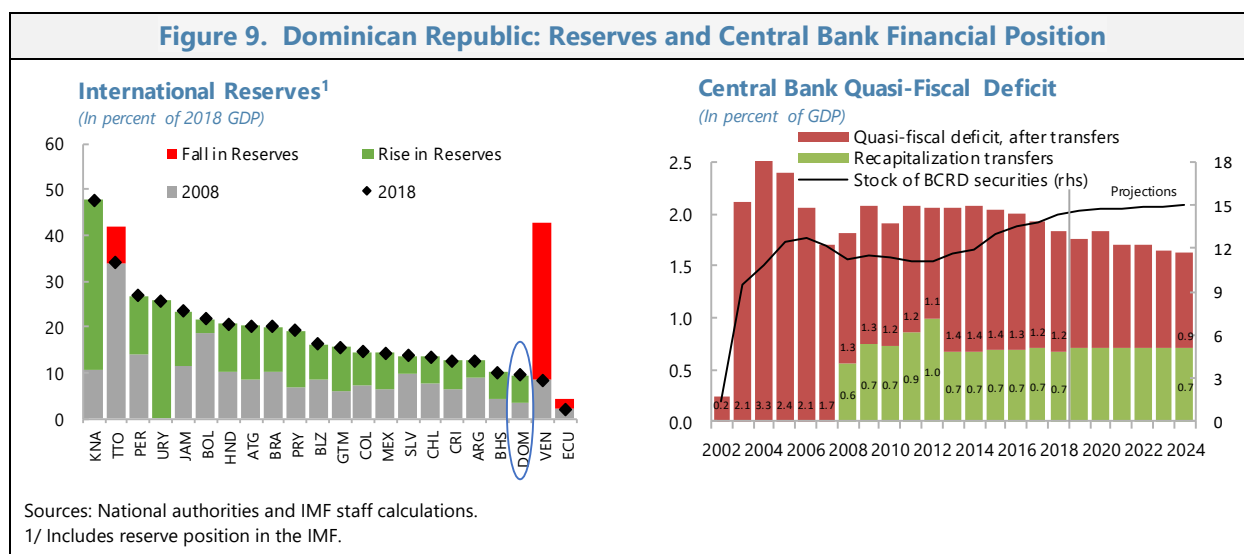
18. The monetary policy stance is appropriate, and any future change should depend on domestic demand and changes in external financing conditions. Muted inflationary pressures provide some space for keeping the monetary policy on hold, but policy should remain data dependent. The positive output gap and the potential second-round effects from rebounding fuel and food prices are consistent with a near-term recovery in inflation and may require monetary policy tightening, especially if tightening financial conditions in the rest of the world bear pressure on domestic inflation. At the same time, while the mid-2018 increase in the policy rate was effective in moderating credit growth, there are indicators that demand may be slowing, and signs of capacity constraints have not yet shown up in core inflation. This suggests that the authorities have room to keep the monetary policy stance unchanged until there are firmer indications of either resource pressures or slack.

19. The central bank continues to strengthen the monetary policy framework and its credibility is increasingly anchoring inflation expectations. Evidence from surveys on macroeconomic expectations shows that inflation expectations are well-anchored seven years after the switch to inflation targeting (Annex VII). To further increase the credibility of its inflation targeting framework, the central bank has recently introduced forward guidance in the monthly press releases and will launch a foreign exchange trading platform in June 2019. The introduction of the platform is expected to



increase market transparency, lower price dispersion and information asymmetry, and help promote usage of foreign exchange derivatives.¹¹ While exchange rate volatility is relatively limited, the real exchange rate has been broadly in line with fundamentals, there are no sustained pressures on the currency, and foreign exchange interventions have been moderate and double-sided. With inflation expectations increasingly anchored and with the foreign exchange trading platform in place soon, the authorities would be in a position to increasingly limit the use of foreign exchange interventions to smoothing excessive volatility or accumulating reserves.

20. The strong external position allows further accumulation of reserve buffers, but the pace will likely be constrained by high sterilization costs. Reserve coverage has increased to 68 percent of the IMF's reserve adequacy (ARA) metric compared to only 28 percent in 2012, but remains below the recommended 100-150 percent.¹² Staff considers that there is scope for further accumulation of international reserves, taking advantage of the favorable external position. Nevertheless, the rate of such accumulation will be constrained by the costs of sterilizing the reserves: the relatively high domestic interest rates imply a significant negative carry for reserves. This adds to the already large quasi-fiscal deficit and debt of the central bank, a legacy of recapitalizing commercial banks during the 2003-04 crisis and sterilizing the associated debt service (Figure 9). A recent agreement to recapitalize the central bank aims to gradually move these quasi-fiscal liabilities to the balance sheet of the central government over a 15-year period; draft legislation to this effect will be submitted to congress as soon as the agreement is formalized. The approval of the plan and steadfast adherence to the recapitalization schedule will be important for strengthening the central bank's financial position and improving public debt management.¹³



¹¹ In the absence of the electronic trading platform, the central bank cannot monitor the foreign currency market in real time, which makes it harder to interpret the main drivers behind market movements and introduces unnecessary volatility in a relatively shallow market.

¹² The IMF classifies the Dominican Republic's exchange rate regime as a "crawl-like arrangement". If the regime were classified as flexible, reserves would amount to about 102 percent of the ARA metric.

¹³ The 2007 recapitalization agreement fell short of its objectives to complete the recapitalization by 2016, as annual transfers from the government were significantly below the central bank's quasi-fiscal deficit and agreed levels.

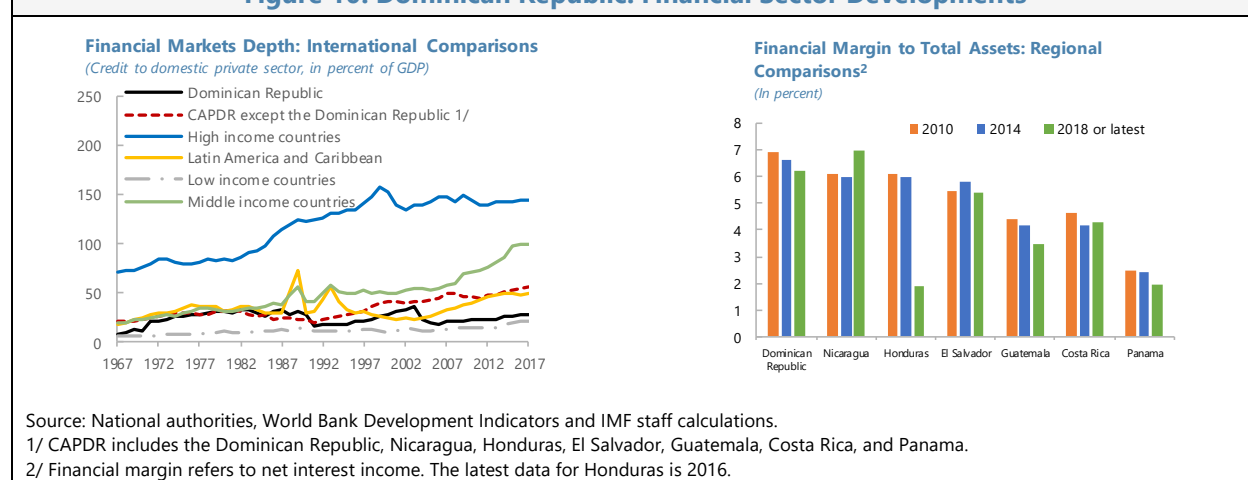
Authorities' Views

21. The authorities agreed that the neutral policy stance and continued reserve accumulation are appropriate. They stand ready to tighten if inflationary pressures increase while remaining vigilant to downside risks to the global economy and domestic demand moderation. They will continue to exploit the favorable external balance and the steady inflow of foreign exchange to build precautionary buffers. The implementation of the electronic exchange trading platform will help to make the foreign exchange market more transparent and efficient, including through developing the foreign exchange derivatives market. An updated agreement to recapitalize the central bank will help reduce the quasi-fiscal deficit and raise its capital to an adequate level.

C. Financial Sector Policies

22. Macro-financial risks appear limited, but pockets of vulnerability remain and are monitored by authorities. The financial system remains healthy by international comparison, in terms of its capitalization, asset quality, liquidity and profitability (¶7; text table). Limited information about borrower creditworthiness and a large share of foreign currency loans extended to non-exporters (although highly collateralized) may be adding to credit risks.¹⁴ Bank profitability relies on high intermediation spreads to offset operating costs (suggesting room for exploiting economies of scale through consolidation) and on high commissions (likely undermining ongoing efforts to increase financial inclusion).¹⁵ Other risks may also require attention, including potential liquidity risks in banks that have large shares of wholesale deposits from pension funds, and large investments in sovereign debt that could expose banks to interest risk. Pension funds, which became over the years the largest institutional investor (17 percent of GDP in assets), also have a high concentration of their portfolio in sovereign debt. Finally, risks in the financial cooperatives are not well known - the sector is relatively small (3 percent of financial system assets), but some cooperatives are as large as banks and are not regulated or supervised.

Figure 10. Dominican Republic: Financial Sector Developments



¹⁴ For a more in-depth discussion of financial system strength and vulnerabilities see the Selected Issues Paper accompanying the 2018 Article IV "A Flight over the Hispaniola Fifteen Years after the Financial Crisis".

¹⁵ Financial inclusion and deepening have also been held back by the 0.15 percent tax on bank transfers, introduced as a temporary measure after the 2003-04 financial crisis and whose removal should be considered as fiscal space is created.

Text Table. Financial Soundness Indicators in 2018: Regional Perspective¹

	Costa Rica	Dominican Republic	Guatemala	Honduras	Nicaragua	Panama	El Salvador	CAPDR ²	LA5 ³
Regulatory Capital to Risk-Weighted Assets	16.7	17.1	15.9	13.8	17.0	15.9	16.6	16.1	16.0
Capital to Assets Ratio	9.7	9.6	7.1	11.1	9.0	12.9	13.0	10.4	11.3
Nonperforming Loans (NPLs) to Total Loans Ratio	2.1	1.6	2.2	2.1	2.4	1.7	1.8	2.0	3.1
Provisions to Nonperforming Loans Ratio	156.7	171.7	61.5	140.4	155.5	102.5	n.a.	131.4	134.8
Return on Assets	0.9	2.4	1.5	1.8	1.9	1.5	1.1	1.6	1.9
Return on Equity	6.5	20.0	15.3	18.5	15.3	13.0	8.7	13.9	17.3
Liquid Assets to Total Assets Ratio	27.7	25.3	31.3	22.0	22.2	12.9	22.1	23.4	20.0

Source: National authorities, World Bank Development Indicators and IMF staff calculations.

1/ Covers the overall financial sector.

2/ CAPDR includes the Dominican Republic, Nicaragua, Honduras, El Salvador, Guatemala, Costa Rica, and Panama.

3/ LA5 includes Brazil, Chile, Colombia, Mexico, and Peru.

23. The authorities continue to strengthen the financing system through improved bank and systemic risk oversight, upgrading its regulation and institutional framework:

- *The authorities are modernizing the institutional framework for systemic financial oversight.* Macroprudential surveillance has been strengthened with the operationalization of the Systemic Risk Committee—chaired by the Central Bank and comprising the Ministry of Finance and the Bank Superintendency. The committee recently launched the Financial Stability Report, providing an overview of the financial system health and its resilience to shocks.¹⁶ Given contained macro-stability risks, no macroprudential tool was deployed yet, and the authorities continue to develop their toolkit.
- *The authorities are gradually moving towards adopting international reporting (IFRS) and supervisory (Basel III) principles,* with remaining gaps related to consolidated supervision, capital, market risk and liquidity requirements. The mark-to-market regulation, in particular, is being rolled out gradually by 2020 and could reveal additional capital requirements, especially if financial conditions tighten.
- *Risk-based supervision is also being strengthened* with a recent tightening of reporting requirements.
- *Putting in place a strong cybersecurity framework has become a critical priority for the authorities.* The recent strategic plan for 2018-21 and the cybersecurity regulation for the financial sector, both approved in 2018, aim to create a state-of-the-art cybersecurity center that would provide cyber defense and data protection functions to the central bank, commercial banks, and other public institutions (Annex V, section B).

¹⁶ Authorities' stress tests show that the financial system is resilient to the liquidity, market, credit, and growth risks.

24. Further action is needed to strengthen the authorities' ability to respond to risks and prevent their buildup.

- *Nonbank financial system needs to be brought into the supervisory perimeter.* Reforms to bring the regulation and supervision of the sector on a par with banks are critical but need to be designed carefully so as not to overwhelm the financial regulatory capacity.
- *Further developing the prudential toolkit.* This would require legislative and regulatory changes that would bring the regulatory, reporting and resolution regimes closer to international norms, including to allow for (i) countercyclical and risk-based capital requirements;¹⁷ (ii) improved consolidated financial supervision; (iii) automatic increases in the capital of the public bank (the largest in the system), which are currently done through one-off legislation; (iv) tuning up the resolution tools for banks and households; and (v) formalizing regulatory limits on borrower leverage. In addition, developing a housing price index would help monitor risks given the rapid development of the sector. These reforms, along with those to bring bank commissions to regional averages, are already being considered by the authorities. The authorities should also monitor risks associated with concentrated exposure to sovereign risk and analyze prospects of allowing pension funds to diversify investments abroad while preserving macroeconomic stability.
- *Continue efforts in effectively implementing the AML/CFT framework.* The authorities overhauled the AML/CFT legal framework in 2017, and GAFILAT's 2018 AML/CFT assessment found a relatively strong technical compliance with the Financial Action Task Force (FATF) standard. However, the assessment also concluded that the AML/CFT regime is only effective to some extent and that major improvements are needed to mitigate money laundering and terrorism financing risks.

Authorities' Views

25. The authorities noted that the financial system, having benefitted from years of continuous reforms since the 2003-04 crisis, is strong and has ample capital and liquidity cushions. Nevertheless, they are committed to continued vigilance and integrating additional tools to strengthen supervisory oversight over banks and the overall system to prevent a buildup of risks. They also agreed with the need to regulate and supervise financial cooperatives, but views differed on whether the supervision should rest with the current bank authorities (without affecting the current quality of bank supervision) or with a new self-supervisory authority.

D. Policies for Stronger and More Inclusive Growth

26. The main medium-term challenge is to boost productivity and continue improving social outcomes. The National Development Strategy for 2010–30, which guides the authorities' reform agenda, aims at reaching advanced economy status by 2030. While the country's economic outlook is very favorable, staff's baseline medium-term growth projections (around 5 percent, or 4 percent in per capita terms) suggest a slower convergence to these levels (Annex I). The authorities have focused on measures that are feasible and can yield quick productivity gains. However,

¹⁷ The regulator lacks powers to require financial institutions to hold capital above the minimum requirement of 10 percent depending on its risk profile.

structural policies need to address a few long-standing bottlenecks weighing on the potential growth outlook, including costly electricity disruptions, administrative and regulatory hurdles, shortages of skilled labor, weak institutions and inefficiencies in the transport sector.

27. Improving the investment climate has been a strong policy focus over the past few years.

The National Competitiveness Council, headed by the President, has fostered closer collaboration between the private and the public sector to improve the business environment and increase productivity. Its structural reform agenda in 2018 focused on trade facilitation and easing regulatory requirements, including through the introduction of a one-stop shop for exports and one for construction permits, significant reduction in the time for obtaining permits, extending operating hours for ports and airports, simplifying customs procedures, and good progress in implementing the recently ratified WTO Trade Facilitation agreement, among others. In 2019, the agenda will focus on promoting innovation, the weakest-rated pillar in the World Economic Forum's competitiveness index for the country. Progress has also been made in the last few years in strengthening institutions and governance (another relative weakness) in some areas, especially in curbing tax evasion, reforming revenue administration and improving the AML/CFT legal framework (Annex V).



28. Promoting more inclusive growth through social reforms has been the long-standing focus of the current administration.

Strengthening of the physical and human infrastructure in the education and health sectors, where outcomes lag regional peers, has been supported by higher investments, wage increases, and training of teachers for the additional schools. The government has recently initiated a reform of the pension system, which aims at increasing returns through a reduction in pension fund fees and regularization of employer arrears, and at improving the administration of the system.

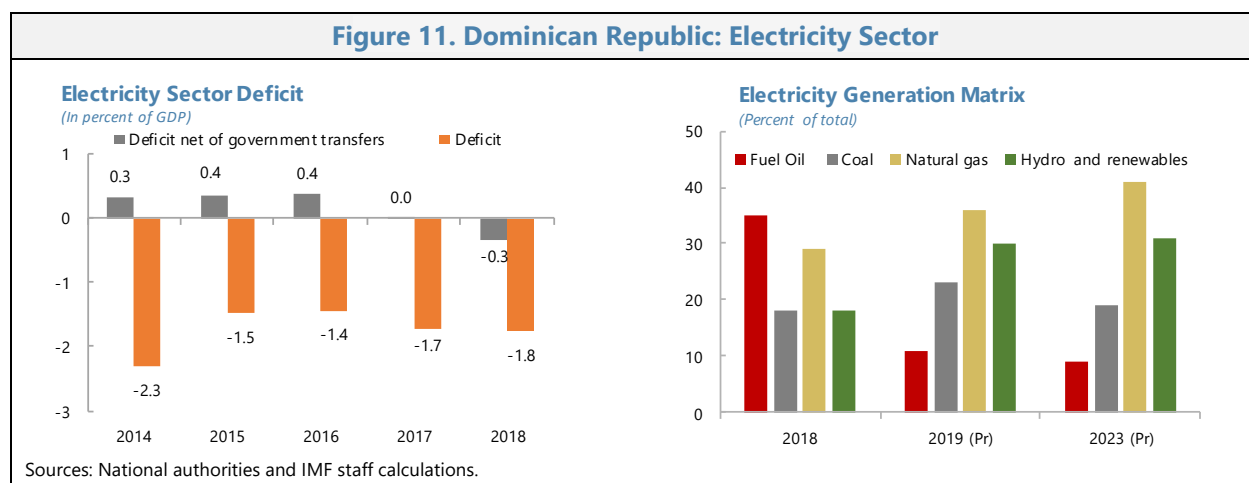
29. Going forward, structural reforms will need to tackle areas that present the most binding constraints on growth and social inclusion.

- *Electricity sector.* The electricity sector faces multi-decade weaknesses caused by infrastructure gaps and inefficiencies in the state-run transmission and distribution sectors.¹⁸ The Electricity Pact agreed among most civil society participants in 2018 after three years of negotiation, has not been enacted due to opposition by some stakeholders.¹⁹ While a broadly supported Pact would provide the needed backing for reforms—including the alignment of electricity tariffs closer to costs and the institutional reform of the sector—the authorities could undertake needed reforms even in the absence of the pact. The authorities' strategy to improve the financial standing of the

¹⁸ For a discussion of the issues faced by the electricity sector and the solutions agreed between the government and the civil society in the context of the Electricity Pact, see Annex V in the [2018 Article IV Consultation](#) staff report.

¹⁹ Under the National Development Strategy, the authorities have committed to formulating three "pacts" with social partners to address key challenges, including in education (2014), electricity (partially agreed in 2018, but not enacted) and fiscal responsibility.

sector currently relies on (i) the coming online of the new coal-fueled power plant (Punta Catalina) to reduce electricity costs and shield the sector from the more volatile fuel prices; (ii) increased investments to help reduce infrastructure gaps and technical losses in the electricity sector; and (iii) continued shift towards green and gas energy. In staff estimates, these may not be sufficient to eliminate the deficit in the sector without tariff adjustments, higher investments, and increased efficiency in the sector—although upside risks around the gains from the coal plant are high (P13).



- *Aligning education with needed skills.* Weak educational outcomes have limited the Dominican Republic's capacity for innovation and attracting skill-intensive industries. The primary and secondary education reforms started in 2014 under the auspices of the Education Pact have not had time to translate into improved outcomes. As these reforms mature, there is scope for developing vocational education to address skill mismatches and better align tertiary training to productive needs; the authorities are currently developing such a strategy.
- *Addressing weaknesses in product and labor markets.* In product markets, the cost of cargo transport is one of the highest in the region due to the oligopoly structure of the sector and strong trade unions; reforms could help reduce logistics costs across the economy and improve competitiveness. In labor markets, the almost 30-year-old labor code needs to be modernized to allow more flexible working hours and improve the mediation/litigation mechanisms. There is broad agreement among the social partners in these areas, but reforms have stalled on disagreements about the severance pay, where a right balance is being sought between relieving the burden on employers and providing protection to employees in case of unemployment.
- *Further strengthening the investment environment.* A simpler, more streamlined and broader-based tax system—in addition to supporting a fiscal adjustment—would also relieve the compliance and the tax burden on the formal sector, facilitate formalization, and remove one of the major doing-business impediments cited by the private sector. The investment environment would also benefit from steadfast implementation of ongoing reforms to improve the efficiency and governance of state institutions, including to reduce vulnerability to corruption, and from addressing other remaining vulnerabilities.
- *Further progress in improving social outcomes will require deeper social security reforms.* The social security system, established in 2001, currently receives contributions for pension, healthcare and

other social insurance schemes only from those formally employed (43½ of the population). Two of the system's pillars have not been fully operationalized due to fiscal costs, preventing access to pension and healthcare insurance by the self-employed or those employed in the informal sector (contributory-subsidized pillar) and by those that cannot contribute (subsidized pillar). Even the active contributory pillar is not functioning efficiently, as many employers have accumulated arrears to the privately-managed funded schemes; controls over contributions and arrears are weak; and pension benefits are estimated to be inadequate when the first wave of retirements under the system picks up in about five years (the replacement rate is currently estimated at 30 percent of last wages). The authorities have recently tabled a reform of the social security system to strengthen the management and control of the system, regularize arrears, and reduce pension fund fees in order to increase pension benefits. Staff welcomes these important steps, but a more far-reaching reform, including parametric adjustments, will be needed to ensure broader access to the social security system and adequate retirement income when the system matures.

Authorities' Views

30. The authorities agree that achieving a higher level of income and social prosperity hinges on the country's ability to boost productivity and strengthen social safety nets. This spurred the relaunch of the National Competitiveness Council to identify, together with the private sector, obstacles to easier trade, business environment and innovation. It also fueled the multi-year focus on strengthening the education and health sectors, fostering financial inclusion, boosting employment and incomes, and developing opportunities for the less privileged. In education, the authorities pointed out that as reforms mature, the focus will shift from building infrastructure to training teachers – but results in terms of improved educational outcomes and reducing shortages of skilled labor will take longer to materialize. In healthcare, the focus remains on building modern well-equipped hospitals. The authorities acknowledged that outstanding reforms to simplify the tax system, modernize the labor code, broaden social security coverage and benefits, and addressing electricity sector deficits—many of which have undergone extensive discussions with the civil society—require extended negotiations and consensus building that can lengthen the process. They argued, however, that substantial progress was made on many fronts already: the launch of a new power plant and expected large investments in distribution infrastructure should improve electricity supply and reduce costs for the state-owned distribution companies; and the reforms of the management of social security and pension fund fees will help increase retirement income.

STAFF APPRAISAL

31. The economy likely reached its cyclical peak in 2018 and is expected to moderate to potential growth rates. The strong expansion over the past decades and the economic and social reforms being put in place have made the economy more resilient and brought many people out of poverty. However, even at potential growth rates of 5-5½ percent, incomes will converge only slowly to advanced economy levels. A combination of factors is holding back higher productivity and growth, including unreliable electricity supply, weak institutions and red tape, a complex tax system, and relatively weak social safety nets. These should be addressed while the cyclical position remains favorable and external demand strong, to safeguard against potential headwinds, especially from external global factors.

32. Undertaking fiscal adjustment in the near term would reduce uncertainty about fiscal sustainability and take due advantage of the favorable cyclical conditions. While the public debt level of around 53 percent of GDP does not breach accepted sustainability thresholds and is broadly in line with other emerging markets, its dynamics remain unfavorable despite vibrant growth and ambitious revenue administration reforms. In addition, high interest costs, a low revenue base, and a large share of foreign currency debt limit the country's debt carrying capacity. Tax administration reforms alone are not likely to be sufficient to put a dent in public deficits, which would require addressing the main deficit drivers – the electricity sector and base-eroding tax incentives and exemptions. Reforms in both areas are politically and socially difficult but should be designed to offset their negative distributional effects. A meaningful fiscal adjustment would not only contribute to reducing real interest rates but would also create additional fiscal space to strengthen social safety nets and undertake priority infrastructure projects.

33. A credible fiscal path is needed, especially if deficits take longer to reduce. Fiscal responsibility legislation could help establish a medium-term debt anchor, mark out the path towards this debt target through an operational rule, and determine responses to and accountability for structural deviations from targets. It could also establish a framework for taking on fiscal risks, including from public-private partnerships, and limit contingent liabilities. Such legislation could impart additional credibility to the needed fiscal adjustment, with positive feedback effects on sovereign spreads.

34. Monetary policy faces weak inflation, despite strong demand, and a neutral policy setting appears appropriate. The recent policy tightening has slowed credit growth, helping the economy adjust towards potential levels. With core inflation still weak, monetary policy has room to remain on hold in the near term, while being mindful of both upside and downside pressures on inflation, including from external financial conditions, the speed of moderation of domestic demand, and higher food and fuel prices.

35. The external position is broadly in line with fundamentals. The temporary boost in remittances and steady foreign exchange inflows, especially from tourism, provide conditions that are favorable to continue building the needed reserve buffers. Nevertheless, the pace of such a buildup will be moderated by its sterilization costs amid already high quasi-fiscal deficits. Finalizing and implementing the agreement to recapitalize the central bank will be important for reducing the burden of the quasi-fiscal losses on monetary policy. The introduction of the electronic foreign exchange trading platform and the development of the foreign exchange derivatives market will help further strengthen the monetary policy framework.

36. Systemic financial risks appear limited, but progress in strengthening the financial system architecture should continue. The strengthening of the systemic risk oversight through the development of the macroprudential policy framework, a continued strengthening of bank regulation and supervision, and cybersecurity reforms are welcome reforms to strengthen the financial system. The main challenge going forward will be the steady implementation of these reforms, including the transition to international regulatory and reporting standards in the banking system, developing tools to monitor risks in all corners of the financial system (including housing and borrower creditworthiness), and bringing the financial cooperative sector into the financial system's supervisory

and regulatory net without overwhelming it. Staff also welcomes the revised AML/CFT legislation and encourages the authorities to work on ensuring its effectiveness.

37. There is a pressing need to address barriers to higher productivity, income convergence and social inclusion. Staff commends the fast pace of structural reforms to remove trade and investment barriers, strengthen the education and health systems, and improve the administration and regulation of the social security system. Nevertheless, important bottlenecks to an improved doing business environment remain. Needed reforms to address them include the implementation of the Electricity Pact, reducing the complexity of the tax system, stopping anti-competitive business practices, especially in transportation, and modernizing the labor code to allow for more flexible work arrangements. Social outcomes would also be strengthened further by widening access to the social security system, which would help reduce informality, and ensuring adequate retirement incomes.

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

Table 1. Dominican Republic: Selected Economic Indicators

	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Population (millions, 2018 estimate)	10.27				GDP per capita 2018 (U.S. dollars)				7,926	
Quota	477.40 millions SDRs / 0.23% of total				Poverty (2018, share of population)				22.8	
Main export product	tourism, gold, tobacco				Extreme poverty (2018, % of pop.)				2.9	
Key export markets	U.S., Canada, Haiti				Adult literacy rate (percent, 2018)				93	
					Projection					
	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Output	(Annual percentage change, unless otherwise stated)									
Real GDP	7.0	6.6	4.6	7.0	5.5	5.2	5.0	5.0	5.0	5.0
<i>Contributions to growth</i>										
Consumption	4.2	3.8	3.6	3.8	4.0	3.9	3.7	3.7	3.7	3.7
Investment	4.5	3.9	-0.6	3.7	1.3	1.3	1.5	1.6	1.7	1.3
Net exports	-2.9	0.2	2.0	-0.7	-1.1	-0.4	-0.4	-0.3	-0.4	0.0
Nominal GDP (RD\$ billion)	3,100	3,333	3,613	4,025	4,354	4,781	5,236	5,728	6,266	6,848
Nominal GDP (US\$ billion)	68.9	72.4	76.1	81.4	...	...	...	...	...	...
Gross national saving (percent of GDP)	20.7	20.8	21.7	22.9	22.7	22.4	22.2	21.9	21.9	21.8
Output gap (in percent of potential output)	0.5	1.0	-0.3	0.9	0.8	0.6	0.5	0.4	0.2	0.0
Unemployment										
Unemployment rate (in percent; period average)	7.3	7.1	5.5	5.7	5.5	5.5	5.5	5.5	5.5	5.5
Prices										
Consumer price inflation (end of period)	2.3	1.7	4.2	1.2	4.2	4.0	4.0	4.0	4.0	4.0
Consumer price inflation (period average)	0.8	1.6	3.3	3.6	2.1	4.1	4.0	4.0	4.0	4.0
Exchange rate										
Exchange rate (RD\$/US\$ - period average) 1/	45.0	46.0	47.5	49.5	...	...	...	...	...	...
Exchange rate (RD\$/US\$ - eop) 1/	45.5	46.7	48.2	50.2	...	...	...	...	...	...
Real effective exchange rate (eop, - depreciation) 1/	2.3	-0.8	-2.3	-2.0	...	...	...	...	...	...
Government finances	(in percent of GDP)									
Consolidated public sector debt 2/	46.2	48.7	51.5	53.1	54.3	54.9	55.4	55.8	56.2	56.5
Consolidated public sector overall balance 3/	-1.7	-4.2	-4.5	-3.8	-4.2	-4.6	-4.6	-4.3	-4.2	-4.2
Consolidated public sector primary balance	1.9	-0.4	-0.6	0.1	0.0	-0.3	-0.3	0.0	-0.1	0.0
Central government balance	0.0	-3.2	-3.4	-2.4	-3.3	-3.3	-3.1	-3.1	-3.0	-2.9
Revenues and grants	17.2	14.5	14.7	14.9	15.0	15.1	15.1	15.1	15.1	15.1
Primary spending, o.w.:	14.8	15.1	15.5	14.6	15.3	15.2	15.0	15.0	15.0	14.9
Transfers to electricity sector	0.8	0.6	0.5	0.4	0.5	0.5	0.5	0.5	0.5	0.5
Interest expenditure	2.4	2.6	2.7	2.7	3.1	3.1	3.2	3.2	3.2	3.1
Rest of NFPS	-0.3	0.3	0.2	-0.3	0.2	-0.3	-0.5	-0.2	-0.3	-0.4
Financial sector	(Annual percentage change; unless otherwise stated)									
Broad money (M3)	12.3	9.8	11.2	7.0	7.6	10.9	10.3	10.2	10.1	9.9
Credit to the private sector	12.7	12.1	10.1	11.1	8.2	9.8	9.5	9.4	9.4	9.3
Policy interest rate 1/	5.0	5.5	5.3	5.5	...	...	...	...	...	...
Average deposit rate (1-year; in percent) 1/	7.7	6.8	5.0	7.0	...	...	...	...	...	...
Average lending rate (1-year; in percent) 1/	16.7	14.5	11.2	13.3	...	...	...	...	...	...
Balance of payments	(in percent of GDP)									
Current account	-1.9	-1.1	-0.2	-1.4	-1.5	-1.7	-2.1	-2.5	-2.8	-2.8
Goods, net	-10.8	-10.4	-10.0	-11.4	-11.2	-11.2	-11.2	-11.3	-11.4	-11.4
Services, net	6.3	6.8	7.3	7.2	7.2	7.2	7.1	7.1	7.0	7.0
Income, net	2.6	2.5	2.5	2.8	2.5	2.3	2.0	1.7	1.7	1.6
Capital account	3.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial account	-1.1	-2.2	-1.8	-2.3	-1.5	-1.7	-2.1	-2.5	-2.8	-2.8
Foreign direct investment, net	-3.2	-3.3	-4.7	-3.1	-3.1	-3.1	-3.1	-3.1	-3.1	-3.1
Portfolio investment, net	-5.0	-2.4	-2.3	-3.3	-2.0	-1.1	-1.8	0.3	-0.4	-1.0
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	6.6	2.5	4.2	3.1	3.2	1.8	2.1	-0.4	0.0	0.6
Reserves, net	0.6	1.1	1.0	1.0	0.5	0.7	0.7	0.6	0.6	0.6
NIR (in millions of U.S. dollars)	5,152	6,047	6,780	7,627	8,016	8,622	9,278	9,955	10,683	11,454
Total external debt (in percent of GDP)	39.9	40.7	43.2	41.5	41.6	40.1	39.0	38.0	37.4	36.8
of which: Public sector	25.9	26.9	29.2	28.7	29.5	29.2	29.1	28.9	29.0	28.9

Sources: National authorities; World Bank; and IMF staff calculations.

1/ Latest available.

2/ Improvement in 2015 reflects the grant element of a debt buy back operation with Venezuela's state owned-oil company (PDVSA) of 3.1 percent of GDP.

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

Table 2. Dominican Republic: Public Sector Accounts
(in percent of GDP)

	2015	2016	2017	2018	2019		2020	2021	2022	2023	2024
					Budget	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
A. Central Government 1/											
Revenue	17.2	14.5	14.7	14.9	16.0	15.0	15.1	15.1	15.1	15.1	15.1
Tax revenues	13.2	13.5	13.7	13.7	14.7	13.7	13.7	13.8	13.8	13.8	13.8
Taxes on income, profits, and capital gains	3.8	4.0	4.2	4.2	4.6	4.0	4.1	4.1	4.1	4.1	4.1
Tax on property	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Taxes on goods and services	8.2	8.2	8.3	8.3	8.8	8.4	8.4	8.4	8.4	8.4	8.4
Value-added taxes	4.7	4.8	4.7	4.8	5.2	4.8	4.9	4.9	4.9	4.9	4.9
Excises	2.4	2.3	2.4	2.3	2.3	2.4	2.4	2.4	2.4	2.4	2.4
Taxes on international trade and transactions	1.0	1.0	1.0	1.0	1.1	1.1	1.1	1.1	1.1	1.1	1.1
Social security contributions	0.0	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Grants 2/	3.1	0.0	0.1	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Other revenues	0.8	1.0	0.9	1.2	1.2	1.3	1.3	1.3	1.3	1.3	1.3
Expenditure	17.2	17.7	18.1	17.4	18.2	18.3	18.3	18.2	18.2	18.1	18.0
Current spending (expense)	15.0	15.9	16.4	15.8	16.2	16.3	16.3	16.1	16.1	16.1	15.9
Compensation of employees	4.9	4.5	4.6	4.7	4.3	4.6	4.7	4.7	4.7	4.7	4.7
Use of goods and services	1.6	1.5	1.9	1.8	2.3	2.0	2.0	2.0	2.0	2.0	2.0
Interest	2.4	2.6	2.7	2.7	3.1	3.1	3.1	3.2	3.2	3.2	3.1
Subsidies	1.1	0.9	0.7	0.6	0.9	0.8	0.8	0.8	0.8	0.8	0.8
Electricity	0.8	0.6	0.5	0.4	0.6	0.5	0.5	0.5	0.5	0.5	0.5
Other	0.3	0.3	0.2	0.2	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Grants	2.4	3.2	2.8	2.8	2.8	2.7	2.7	2.7	2.7	2.7	2.7
Social benefits	1.3	1.3	1.3	1.3	1.3	1.4	1.4	1.4	1.4	1.4	1.4
Other transfers	1.2	1.9	2.3	1.8	1.5	1.6	1.5	1.2	1.2	1.2	1.1
Net acquisition of nonfinancial assets	2.2	1.7	1.9	1.6	2.0	2.1	2.1	2.1	2.1	2.1	2.1
Primary balance	2.4	-0.6	-0.8	0.3	0.9	-0.3	-0.1	0.1	0.1	0.1	0.2
Overall balance	0.0	-3.2	-3.4	-2.4	-2.2	-3.3	-3.3	-3.1	-3.1	-3.0	-2.9
B. Rest of the Non-Financial Public Sector											
Overall balance rest of NFPS	-0.3	0.3	0.2	-0.3	...	0.2	-0.3	-0.5	-0.2	-0.3	-0.4
C. Non-Financial Public Sector											
Overall balance NFPS	-0.3	-2.9	-3.3	-2.7	...	-3.2	-3.5	-3.6	-3.3	-3.3	-3.3
Primary balance	2.0	-0.3	-0.6	0.1	...	0.0	-0.3	-0.3	0.0	-0.1	-0.1
Interest	2.4	2.6	2.7	2.7	...	3.1	3.1	3.2	3.2	3.2	3.1
D. Central Bank											
Quasi-fiscal balance of the central bank	-1.4	-1.3	-1.2	-1.2	...	-1.1	-1.1	-1.0	-1.0	-0.9	-0.9
Primary balance	0.5	0.5	0.7	0.6	...	0.7	0.7	0.7	0.7	0.7	0.7
Interest	1.9	1.9	1.9	1.8	...	1.7	1.8	1.7	1.7	1.6	1.6
E. Consolidated Public sector											
Overall balance of the consolidated public sector	-1.7	-4.2	-4.5	-3.8	...	-4.2	-4.6	-4.6	-4.3	-4.2	-4.2
Primary balance	1.9	-0.4	-0.6	0.1	...	0.0	-0.3	-0.3	0.0	-0.1	0.0
Interest	3.6	3.8	3.9	3.9	...	4.2	4.4	4.3	4.3	4.2	4.2
Memorandum items:											
Consolidated Public Sector Debt	46.2	48.7	51.5	53.1	...	54.3	54.9	55.4	55.8	56.2	56.5
NFPS	37.1	38.7	40.9	41.7	...	42.4	42.6	43.0	43.1	43.2	43.4
Central Bank	13.4	14.0	14.3	14.7	...	14.9	15.1	15.0	15.1	15.1	15.1
Underlying consolidated overall balance 3/	-5.0	-4.3	-4.8	-4.2	...	-4.4	-4.6	-4.6	-4.3	-4.2	-4.2
Cyclically adjusted consolidated overall balance 4/	-5.1	-4.9	-4.4	-4.4	...	-4.3	-4.7	-4.6	-4.4	-4.3	-4.2
Fiscal impulse	0.0	0.2	0.5	-0.1	...	-0.4	-0.4	0.1	0.3	0.1	0.0
Extraordinary revenue 2/	3.3	0.2	0.2	0.3	...	0.1	...	...	...	...	...
Overall balance of the electricity sector 5/	-1.5	-1.4	-1.7	-1.8	...	-1.0	-1.3	-1.3	-1.0	-1.1	-1.1
Nominal GDP (DR\$ billion)	3,100	3,333	3,613	4,025	4,318	4,354	4,781	5,236	5,728	6,266	6,848

Sources: National authorities and IMF staff calculations.

1/ Based on Government Financial Statistics Manual (GFSM) 2014.

2/ Outcome in 2015 reflects the grant element of a debt buy back operation with Venezuela's state owned-oil company (PDVSA) of 3.1 percent of GDP.

3/ Net of one-off revenues, including gains from PDVSA debt buy back.

4/ Adjusts revenues and expenditures for the economic cycle, and excludes one-off gains from PDVSA debt buy back.

5/ Before government transfers; it covers the Dominican Corporation of State Electricity Companies (CDEEE).

Table 3. Dominican Republic: Public Sector Accounts
(in billions of Dominican pesos)

	2015	2016	2017	2018	2019		2020	2021	2022	2023	2024
					Budget	Proj.					
A. Central Government 1/											
Revenue	534	484	531	601	690	654	721	790	864	946	1033
Tax revenues	410	449	493	550	634	595	657	720	788	862	942
Taxes on income, profits, and capital gains	118	135	153	168	200	176	194	213	233	255	279
Tax on property	6	6	7	8	9	8	9	10	11	12	13
Taxes on goods and services	255	275	298	334	379	366	404	442	484	529	578
Value-added taxes	147	159	170	195	226	210	233	255	279	306	334
Excises	73	76	87	94	101	105	116	127	139	152	166
Taxes on international trade and transactions	31	33	35	39	45	46	50	55	60	66	72
Social security contributions	1	2	3	3	3	3	3	3	4	4	4
Grants 2/	96	1	2	1	3	1	1	1	1	2	2
Other revenues	26	32	34	48	51	54	60	66	72	78	86
Expenditure	534	591	656	699	787	798	877	952	1041	1136	1232
Current spending (expense)	464	531	592	635	699	798	877	952	1041	1136	1232
Compensation of employees	153	151	166	189	186	201	226	248	271	297	324
Use of goods and services	49	49	70	72	99	87	96	105	115	126	137
Interest	74	88	97	110	134	133	149	167	182	198	215
Subsidies	33	29	26	26	39	35	39	42	46	50	55
Electricity	25	21	18	17	26	22	24	27	29	32	35
Other	8	8	9	9	13	13	14	16	17	19	20
Grants	74	106	103	112	119	119	131	143	157	172	188
Social benefits	42	43	49	53	56	61	67	74	81	88	97
Other transfers	39	64	82	74	66	70	70	64	70	76	75
Net acquisition of nonfinancial assets	69	58	68	64	88	91	100	110	120	131	143
Primary balance	74	-19	-27	12	37	-11	-7	5	6	7	16
Overall balance	0	-108	-124	-97	-97	-144	-156	-162	-176	-191	-199
B. Rest of the Non-Financial Public Sector											
Overall balance rest of NFPS	-10	10	6	-10	...	7	-12	-24	-13	-16	-25
C. Non-Financial Public Sector											
Overall balance NFPS	-11	-97	-118	-108	...	-137	-168	-186	-189	-207	-224
Primary balance	64	-9	-21	5	...	0	-15	-15	-2	-3	-3
Interest	74	88	97	110	...	133	149	167	182	198	215
D. Central Bank											
Quasi-fiscal balance of the central bank	-42	-44	-44	-47	...	-46	-54	-53	-57	-59	-63
Primary balance	15	18	25	25	...	30	34	37	40	44	48
Interest	58	63	69	72	...	76	88	90	97	103	111
E. Consolidated Public Sector											
Overall balance of the Consolidated public sector	-53	-142	-162	-154	...	-183	-222	-239	-246	-266	-288
Primary balance	58	-13	-22	3	...	-1	-14	-14	-2	-3	-3
Interest	111	128	141	157	...	182	208	224	245	263	284
Memorandum items:											
Consolidated Public Sector Debt	1,433	1,625	1,860	2,137	...	2,365	2,623	2,902	3,198	3,520	3,871
NFPS	1,148	1,292	1,477	1,679	...	1,848	2,035	2,249	2,469	2,708	2,969
Central Bank	417	466	515	591	...	649	720	785	862	944	1,034
Overall balance of the electricity sector 3/	-46	-48	-62	-71	...	-45	-62	-67	-59	-66	-72
Nominal GDP	3,100	3,333	3,613	4,025	4,318	4,354	4,781	5,236	5,728	6,266	6,848

Sources: National authorities and IMF staff calculations.

1/ Based on Government Financial Statistics Manual (GFSM) 2014.

2/ Outcome in 2015 reflects the grant element of a debt buy back operation with Venezuela's state owned-oil company (PDVSA) of 3.1 percent of GDP.

3/ Before government transfers; it covers the Dominican Corporation of State Electricity Companies (CDEEE).

Table 4. Dominican Republic: Income Statement of the Central Bank
(in billions of Dominican pesos, unless otherwise specified)

	2015	2016	2017	2018	Projection					
					2019	2020	2021	2022	2023	2024
Revenues	23.0	26.2	33.9	35.2	40.7	45.8	49.4	53.5	58.4	63.8
Interest	23.0	26.0	33.5	33.9	39.8	44.7	48.5	52.5	57.5	62.8
International reserves	1.2	2.1	3.4	6.0	8.4	10.2	10.7	11.2	12.3	13.4
BCRD recapitalization 1/	21.2	22.8	25.3	27.1	30.5	33.5	36.7	40.1	43.9	47.9
Other	0.6	1.2	4.8	0.9	0.9	1.0	1.1	1.2	1.3	1.5
Other revenues	0.0	0.2	0.4	1.3	0.8	1.0	0.9	1.0	1.0	1.0
Expenditures	65.3	70.6	78.3	82.1	86.4	99.8	102.0	110.5	117.4	127.1
Administrative	6.8	7.1	7.8	8.1	8.7	9.6	10.5	11.5	12.5	13.7
Interest	57.7	62.5	69.1	71.6	75.8	88.3	89.6	97.1	102.9	111.5
Securities	56.2	60.8	66.3	69.3	73.3	85.5	86.5	93.7	99.3	107.5
Other	1.5	1.8	2.8	2.3	2.5	2.8	3.1	3.3	3.7	4.0
Other expenditures 2/	0.8	1.0	1.5	2.3	1.9	1.9	1.9	1.9	1.9	1.9
Quasi-fiscal balance	-42.3	-44.3	-44.4	-46.9	-45.8	-54.0	-52.6	-56.9	-59.0	-63.3
	(in percent of GDP)									
Revenues	0.7	0.8	0.9	0.9	0.9	1.0	0.9	0.9	0.9	0.9
Interest	0.7	0.8	0.9	0.8	0.9	0.9	0.9	0.9	0.9	0.9
International reserves	0.0	0.1	0.1	0.1	0.2	0.2	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	0.1	0.0	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	2.1	2.1	2.2	2.0	2.0	2.1	1.9	1.9	1.9	1.9
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	1.8	1.7	1.8	1.7	1.7	1.6	1.6
Securities	1.8	1.8	1.8	1.7	1.7	1.8	1.7	1.6	1.6	1.6
Other	0.0	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	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Quasi-fiscal balance	-1.4	-1.3	-1.2	-1.2	-1.1	-1.1	-1.0	-1.0	-0.9	-0.9
Memo items:										
BCRD securities outstanding 3/	403.7	453.0	501.2	576.5	634.2	705.3	770.3	846.8	927.8	1,017.9
In percent of GDP	13.0	13.6	13.9	14.3	14.6	14.8	14.7	14.8	14.8	14.9

Sources: National authorities and IMF staff calculations.

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 5. Dominican Republic: Summary Accounts of the Banking System
(in billions of Dominican pesos, unless otherwise specified)

	2015	2016	2017	2018	Projection					
					2019	2020	2021	2022	2023	2024
I. Central Bank										
Net foreign assets 1/ (in millions of US\$)	206	252	301	362	395	436	484	535	590	651
Net domestic assets	-94	-134	-167	-215	-236	-262	-293	-326	-362	-401
Nonfinancial public sector (net) 2/	-1	-3	-2	-18	-19	-21	-23	-25	-28	-30
Financial institutions (net)	-480	-570	-628	-690	-782	-927	-1,094	-1,293	-1,535	-1,828
Nonfinancial private sector (certificates)	-132	-133	-123	-134	-148	-166	-182	-200	-220	-243
Other items (net)	519	571	586	627	713	852	1,005	1,192	1,421	1,699
Currency issue	112	118	134	147	159	174	191	209	228	249
II. Deposit Money Banks										
Net foreign assets 1/ (in millions of US\$)	-49	-58	-51	-48	-61	-67	-72	-78	-85	-92
Net domestic assets	1,032	1,140	1,237	1,308	1,425	1,564	1,712	1,872	2,047	2,237
Net claims on central bank	299	346	374	383	425	466	511	559	611	668
Net credit to the nonfinancial public sector	129	140	151	130	142	150	159	169	179	191
Central government	95	100	94	79	85	94	103	112	123	134
Rest of NFPS	34	40	57	52	57	57	57	57	57	57
Credit to the private sector	797	894	985	1,095	1,185	1,301	1,425	1,559	1,705	1,863
In pesos	622	702	787	872	943	1,036	1,134	1,241	1,357	1,483
In foreign currency	175	192	198	223	242	265	291	318	348	380
Capital and accumulated surplus	-168	-192	-213	-237	-236	-235	-235	-235	-235	-235
Other items (net)	-24	-47	-59	-63	-90	-118	-147	-179	-213	-250
Liabilities to the private sector	983	1,082	1,186	1,261	1,364	1,497	1,640	1,794	1,962	2,145
In pesos	733	810	893	927	1,002	1,101	1,205	1,319	1,442	1,576
In foreign currency	250	272	293	334	361	397	435	475	520	568
III. Banking System										
Net foreign assets 1/ (in millions of US\$)	156	194	250	314	333	369	412	456	505	558
Net domestic assets	1,224	1,330	1,437	1,516	1,633	1,797	1,960	2,142	2,339	2,554
Net credit to non-financial public sector	128	137	149	113	123	129	136	144	152	161
Credit to the private sector	803	900	991	1,102	1,192	1,308	1,433	1,568	1,715	1,874
Other items (net)	293	294	297	302	319	359	391	431	473	519
M3	1,072	1,177	1,309	1,401	1,507	1,671	1,843	2,030	2,235	2,457
Currency in circulation	89	94	102	117	130	143	157	171	188	205
Deposits	688	757	832	905	979	1,075	1,177	1,288	1,409	1,539
Central bank certificates held outside commercial banks	19	21	21	23	16	16	16	16	16	16
Commercial bank certificates held by the public	294	326	354	356	385	423	463	506	554	605
Memorandum items:	(Annual percentage change; unless otherwise stated)									
Credit to the private sector	12.7	12.1	10.1	11.1	8.2	9.8	9.5	9.4	9.4	9.3
Currency issue	6.5	5.8	13.2	9.8	8.2	9.8	9.5	9.4	9.4	9.3
Deposits and commercial bank certificates	12.7	10.1	9.6	6.3	8.2	9.8	9.5	9.4	9.4	9.3
Broad money (M3)	12.3	9.8	11.2	7.0	7.6	10.9	10.3	10.2	10.1	9.9
M3 Velocity (ratio of GDP to M3)	2.9	2.8	2.8	2.9	2.9	2.9	2.8	2.8	2.8	2.8

Sources: National authorities and IMF staff calculations.

1/ On a residency basis.

2/ Excludes transfers related to central bank recapitalization.

Table 6. Dominican Republic: Balance of Payments

	2015	2016	2017	2018	Projection					
					2019	2020	2021	2022	2023	2024
	(in millions of U.S. dollars)									
Current account	-1,280	-815	-133	-1,160	-1,264	-1,546	-2,063	-2,632	-3,179	-3,472
Goods, net	-7,465	-7,559	-7,600	-9,301	-9,595	-10,294	-11,088	-11,978	-13,049	-13,959
Exports, f.o.b.	9,442	9,840	10,135	10,908	11,383	12,050	12,730	13,433	14,106	15,056
Imports, f.o.b.	16,907	17,399	17,734	20,209	20,978	22,344	23,818	25,411	27,155	29,015
Services, net	4,368	4,940	5,550	5,886	6,192	6,625	7,072	7,517	7,959	8,579
Income, net	1,817	1,805	1,917	2,256	2,139	2,124	1,953	1,829	1,910	1,907
Capital account 1/	2,089	2	2	2	2	2	2	2	2	2
Financial account	-741	-1,561	-1,390	-1,865	-1,262	-1,544	-2,061	-2,630	-3,177	-3,470
Foreign direct investment, net	-2,205	-2,407	-3,571	-2,535	-2,608	-2,805	-3,019	-3,239	-3,476	-3,727
Portfolio investment, net	-3,458	-1,729	-1,757	-2,696	-1,737	-1,033	-1,795	347	-467	-1,223
Financial derivatives, net	0	0	0	0	0	0	0	0	0	0
Other investment, net	4,515	1,795	3,207	2,518	2,694	1,689	2,097	-414	37	709
Reserve assets, net	407	780	731	849	389	606	656	676	728	770
Net errors and omissions	-1,550	-748	-1,259	-708	0	0	0	0	0	0
	(in percent of GDP)									
Current account	-1.9	-1.1	-0.2	-1.4	-1.5	-1.7	-2.1	-2.5	-2.8	-2.8
Goods, net	-10.8	-10.4	-10.0	-11.4	-11.2	-11.2	-11.2	-11.3	-11.4	-11.4
Exports, f.o.b.	13.7	13.6	13.3	13.4	13.3	13.1	12.9	12.6	12.4	12.3
of which: Gold	1.8	2.2	1.9	1.7	1.5	1.3	1.2	1.0	0.9	0.8
of which: Other	11.9	11.4	11.4	11.7	11.8	11.8	11.7	11.6	11.5	11.5
Imports, f.o.b.	24.5	24.0	23.3	24.8	24.5	24.3	24.1	23.9	23.8	23.7
of which: Oil	3.7	3.2	3.8	4.6	4.0	3.9	3.7	3.6	3.5	3.5
of which: Other	20.8	20.8	19.5	20.3	20.5	20.4	20.3	20.3	20.3	20.3
Services, net	6.3	6.8	7.3	7.2	7.2	7.2	7.1	7.1	7.0	7.0
of which: Travel, net	8.2	8.6	8.7	8.6	8.6	8.5	8.4	8.4	8.3	8.3
Income, net	2.6	2.5	2.5	2.8	2.5	2.3	2.0	1.7	1.7	1.6
Primary income, net	-4.3	-4.5	-5.0	-4.7	-4.9	-4.9	-4.9	-5.0	-4.8	-4.7
Of which: Direct investment, net	-4.3	-4.5	-5.0	-4.7	-4.9	-4.9	-4.9	-5.0	-4.8	-4.7
Secondary income, net	6.9	7.0	7.5	7.5	7.4	7.2	6.9	6.7	6.4	6.2
Of which: Workers' remittances, net	6.6	6.6	7.2	7.3	7.3	7.0	6.8	6.6	6.4	6.2
Capital account 1/	3.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial account	-1.1	-2.2	-1.8	-2.3	-1.5	-1.7	-2.1	-2.5	-2.8	-2.8
Foreign direct investment, net	-3.2	-3.3	-4.7	-3.1	-3.1	-3.1	-3.1	-3.1	-3.1	-3.1
Portfolio investment, net	-5.0	-2.4	-2.3	-3.3	-2.0	-1.1	-1.8	0.3	-0.4	-1.0
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	6.6	2.5	4.2	3.1	3.2	1.8	2.1	-0.4	0.0	0.6
Reserves, net	0.6	1.1	1.0	1.0	0.5	0.7	0.7	0.6	0.6	0.6
Net errors and omissions	-2.2	-1.0	-1.7	-0.9	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	-2.2	-1.0	-1.7	-0.9	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:										
Export of goods and services (annual percent change)	0.2	6.9	4.6	6.3	4.6	6.3	6.2	6.0	5.6	7.1
Imports of goods and services (annual percent change)	-0.8	3.4	1.3	12.2	3.9	6.5	6.6	6.7	6.9	6.9
Oil trade balance (percent of GDP)	-3.7	-3.2	-3.8	-4.6	-4.0	-3.9	-3.7	-3.6	-3.5	-3.5
Gross international reserves (in millions of U.S. dollars)	5,266	6,047	6,781	7,628	8,016	8,622	9,279	9,955	10,684	11,454
NIR (in millions of U.S. dollars)	5,152	6,047	6,780	7,627	8,016	8,622	9,278	9,955	10,683	11,454
NIR in percent of ARA metric 2/	54	59	62	68	68	69	70	71	71	74
NIR (in months of prospective imports)	3.0	3.4	3.4	3.7	3.7	3.7	3.7	3.8	3.8	3.8
NIR (in months of prospective imports, excl. Free Trade Zones)	3.6	4.2	4.1	4.5	4.4	4.4	4.5	4.5	4.5	4.5
External debt (in percent of GDP)	41.9	42.8	43.2	41.5	41.6	40.1	39.0	38.0	37.4	36.8

Sources: National authorities and IMF staff calculations.

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

2/ The ARA metric shows the adequate level of international reserves as precautionary buffers. The benchmark coverage lies between 100 - 150 percent. The IMF classifies the Dominican Republic's exchange rate regime as a "crawl-like arrangement". If the regime were classified as flexible, reserves would have reached over 100 percent of the metric in 2018.

Table 7. Dominican Republic: Financial Soundness Indicators
(in percent; end of year)

	2011	2012	2013	2014	2015	2016	2017	2018
I. Financial System								
Capital adequacy								
Leverage ratio	11.7	11.8	11.5	11.3	11.2	11.3	11.6	11.8
Regulatory capital to risk-weighted assets 1/	17.3	18.2	16.7	16.1	16.0	17.2	18.3	17.1
Asset quality								
NPLs to total loans	2.9	3.4	2.2	1.5	1.7	1.7	1.9	1.6
Loan provisions to NPLs	121.8	103.4	144.7	202.4	164.1	167.5	161.5	171.7
NPLs net of provisions to net worth	-3.0	-1.0	-5.5	-8.6	-6.4	-6.6	-6.4	-6.2
Fixed and net foreclosed assets to net worth	36.8	34.2	32.4	29.4	29.8	27.7	25.1	22.4
Earnings and efficiency								
Return on average assets	2.4	2.2	2.3	2.3	2.3	2.2	1.9	2.4
Return on average equity	19.9	18.8	20.6	19.9	20.1	19.0	16.7	20.0
Gross operating income to average assets	10.5	11.6	10.9	10.3	10.0	10.0	10.2	9.7
Financial margin to average assets	6.4	6.7	6.8	6.4	6.1	5.8	5.6	5.8
Operating expenses to net financial margin	89.6	89.6	86.2	90.0	93.2	93.6	89.9	89.6
Liquidity								
Liquid funds to deposits	24.6	23.5	23.3	25.0	23.4	23.6	20.1	21.6
Liquid funds to total assets	19.9	19.0	18.7	19.7	18.4	18.4	15.8	17.0
II. Commercial Banks								
Capital adequacy								
Leverage ratio	9.7	10.0	9.7	9.5	9.8	10.0	10.3	10.4
Regulatory capital to risk-weighted assets 1/	14.6	15.8	14.8	14.0	14.4	15.6	16.4	15.8
Asset quality								
NPLs to total loans	2.6	3.2	1.9	1.3	1.5	1.5	1.7	1.5
Loan provisions to NPLs	118.8	100.5	153.6	202.9	165.0	169.8	160.3	163.8
NPLs net of provisions to net worth	-4.4	-1.5	-8.3	-10.9	-8.0	-8.0	-7.7	-7.5
Fixed and net foreclosed assets to net worth	46.1	41.7	39.0	35.2	34.4	31.5	28.3	25.3
Earnings and efficiency								
Return on average assets	2.4	2.2	2.3	2.3	2.3	2.2	2.0	2.3
Return on average equity	28.9	24.4	22.6	24.6	23.9	24.0	19.9	21.8
Gross operating income to average assets	10.0	11.0	10.5	10.0	9.7	9.7	9.8	9.4
Financial margin to average assets	6.2	6.5	6.6	6.2	6.0	5.6	5.5	5.6
Operating expenses to net financial margin	90.5	90.8	86.4	90.4	93.9	94.2	90.5	90.7
Liquidity								
Liquid funds to deposits	26.3	25.1	25.0	26.7	24.7	24.9	21.0	22.9
Liquid funds to total assets	21.7	20.8	20.3	21.3	19.6	19.6	16.7	18.2

Sources: National authorities.

1/ Includes all deposit-taking institutions.

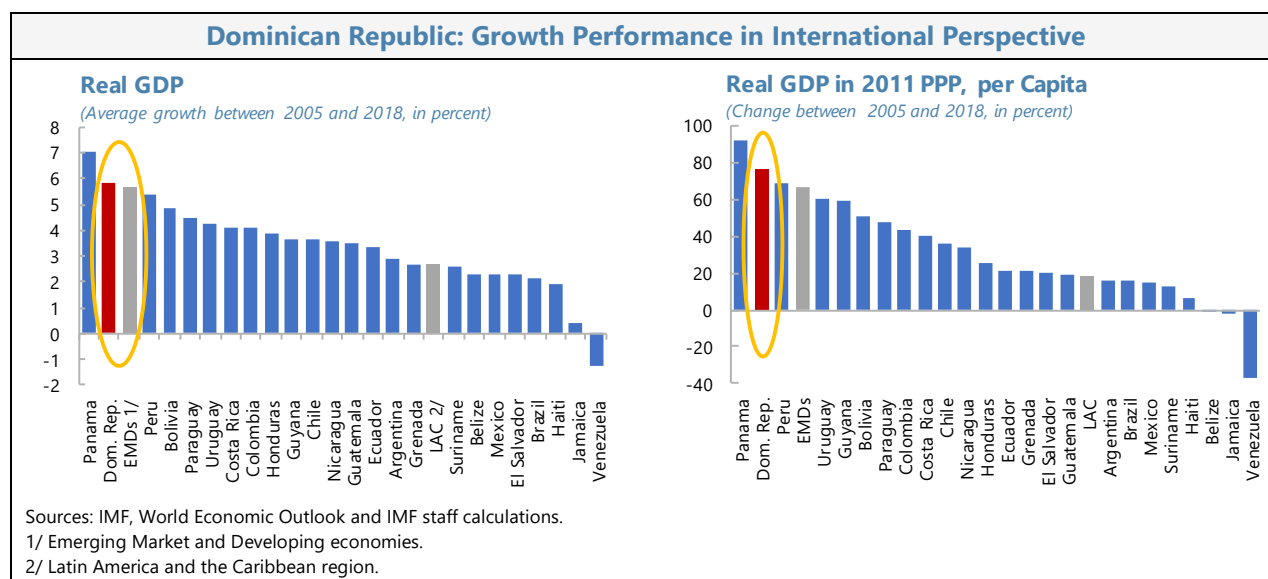
Annex I. Growth, Social Gains and Income Convergence¹

The Dominican economy demonstrated impressive growth in recent times, which – along with targeted policies – helped raise real incomes and reduce poverty and inequality. Despite its undeniable strengths, a combination of factors, such as unaddressed domestic institutional and policy weaknesses as well as unfavorable changes in external conditions, may dampen Dominican growth prospects going forward, making it difficult for the country to reach high-income status by 2030.

A. Growth Performance

1. The Dominican Republic was among the two fastest growing economies in the region over the last two decades. Among the countries of the Latin America and the Caribbean region, growth in the Dominican Republic was outpaced only by Panama over the last two decades, despite the recession of 2003-04 triggered by a banking crisis. In the post-crisis period (2005-18), the Dominican economy grew faster than the average for emerging and developing economies and was the twenty-seventh fastest growing economy in the world, outperformed largely by important commodity exporters who benefitted from the commodity super-cycle of 2000-14.

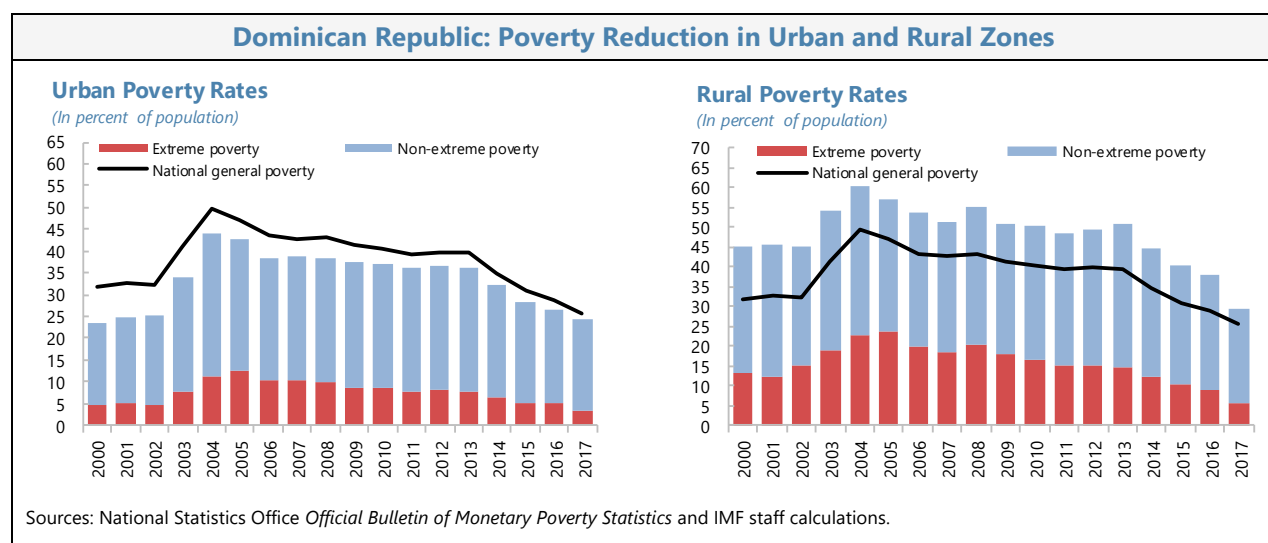
2. Impressive post-crisis growth rates yielded significant gains in per-capita incomes. With an average output growth of 5.9 percent since 2005 – supported initially by a sizable depreciation of the exchange rate (and therefore higher export competitiveness), and later by robust domestic demand and an internal devaluation – the Dominican economy generated a near doubling of per-capita income, to US\$7,926 by 2018. The country reached upper-middle-income status in 2008, according to the World Bank classification methodology.



¹ Prepared by M. Rousset.

B. Improved Social Outcomes

3. Robust growth and a committed social policy contributed to a sustained reduction in the poverty headcount.² The social cost of the 2003-04 banking crisis was long lasting, with the incidence of poverty increasing dramatically during the crisis and remaining above its pre-crisis level for over a decade, until 2015. In recent years, the incidence of poverty declined from 39.7 to 25.5 percent of the population between 2012 and 2017, and extreme poverty from 9.9 to 3.8 percent. This reduction in the poverty headcount has been more pronounced in rural areas, especially with respect to extreme poverty (although rural poverty rates remain above the national average). This was due to the prolonged economic expansion – which boosted real incomes, particularly for the poor – along with increased spending on education and healthcare, which complemented earlier reforms to strengthen social safety nets. Notably, since public education in the Dominican Republic is mainly consumed by lower income households, raising the public expenditure on education from 2 to 4 percent of GDP in 2013 was an important policy shift and a signal of the authorities’ commitment to strengthening social outcomes.



4. Similarly, income inequality declined in recent years, especially in urban areas, amid wage and remittance growth. Income inequality as measured by the Gini coefficient (an index value between 0 and 1, with higher values indicating more inequality) dropped from 0.49 in 2012 to 0.44 in 2017 indicating a reduction in the spread between the highest- and lowest-income households.³ Geographical disaggregation indicates that most of the inequality reduction took place

² Poverty as defined by the National Statistics Office *Official Bulletin of Monetary Poverty Statistics*. Extreme poverty threshold is defined as survey-based per-capita income that covers food essentials only but is not enough to purchase other basic goods and services. The general poverty line is defined as income that covers food essentials and a basket of basic goods and services such as clothing, footwear, housing, education, healthcare, and transportation.

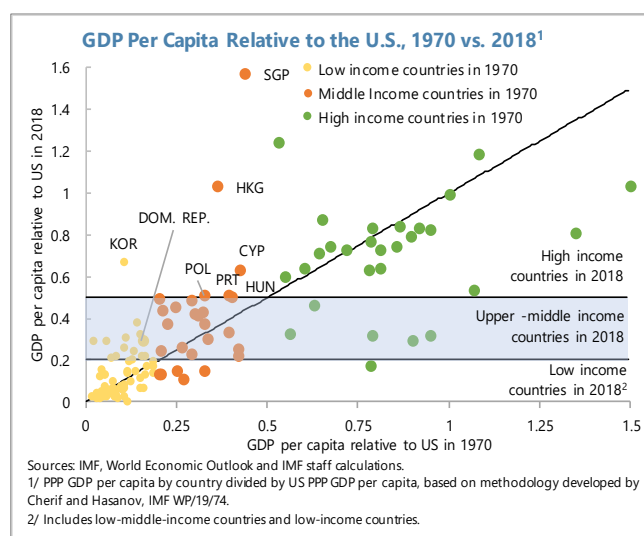
³ The latest Gini coefficient is calculated using the updated labor market survey, ENCFT. Calculations of income trends using administrative data on tax revenues confirm the declining trend in inequality. Note that other data sources, such as World Data Atlas, cite a higher estimate for the Dominican Republic’s Gini coefficient at 45.7 (2016) but their data may not be based on the latest survey.

in urban areas, yet rural areas still exhibit relatively lower levels of inequality. The decrease in inequality can be attributed to growth in real wages in the lower income decile, but also expanding non-labor income due to the government's continued expansion of conditional cash transfers and robust remittance growth, which reached double digits in 2016-18.

C. Income Convergence

5. Income levels in the Dominican Republic reached almost 30 percent of those in the U.S., surpassing the regional average from 2016 onwards. With robust per-capita output growth in the post-crisis period, convergence to U.S. income levels in the Dominican Republic overtook the median for Latin America and the Caribbean in recent years. When compared to high-income economies more broadly, incomes in the Dominican Republic reached 36 percent of the advanced-economy average in 2018. Currently, several countries in Latin America and the Caribbean that are classified as high-income: Chile and Uruguay (both since 2012), Argentina (in 2014 and 2017 – present), Panama (since 2017), and a number of Caribbean states.

6. Anticipated convergence to high-income status by 2030 may take longer. The Dominican Republic aspires to reach high-income country status by 2030, which is articulated in its National Development Strategy (Vision 2030). However, in order to achieve this ambitious target while pursuing the goals of inclusivity and shared prosperity, the economy would have to grow somewhat faster than staff's currently assumed 5 percent over the medium term. Per-capita output in the Dominican Republic was only in the second quintile of the upper-middle-to-high income range in 2017. According to estimates based on GNI per capita and GDP per capita in PPP terms, it would take about 15-20 years for the Dominican economy to converge to high-income country status absent major changes.⁴

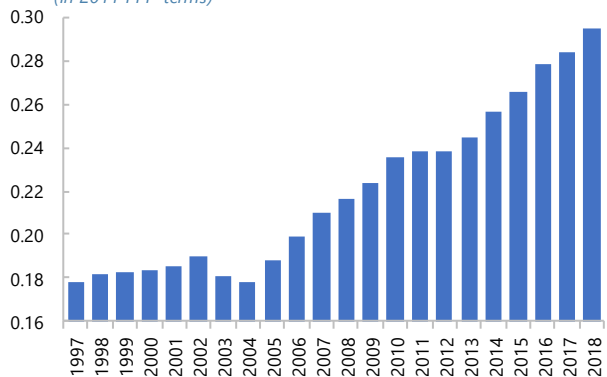


⁴ The first estimate uses nominal GNI per capita in PPP dollars as “income” and compares the 2018 income of the Dominican Republic growing at projected nominal rates through the medium term and a fixed rate of 7.2 percent thereafter to the 2018 minimum income across advanced economies per WEO definition, growing at WEO-projected nominal rates in the medium term and a fixed rate of 3.7 percent thereafter, both adjusted for WEO-projected population growth. The second estimate defines income convergence as reaching 50 percent of U.S. GDP per capita in PPP terms, based on the methodology developed by Cherif and Hasanov (IMF WP/19/74).

Dominican Republic: Income Convergence

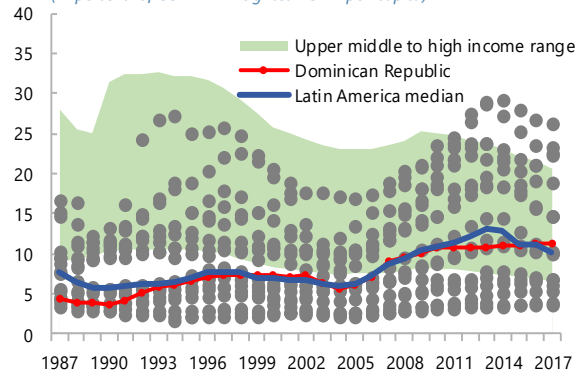
Real GDP per Capita Relative to the U.S.

(In 2011 PPP terms)



PPP GDP Per Capita in Latin America

(In percent of USA PPP-weighted GDP per capita)

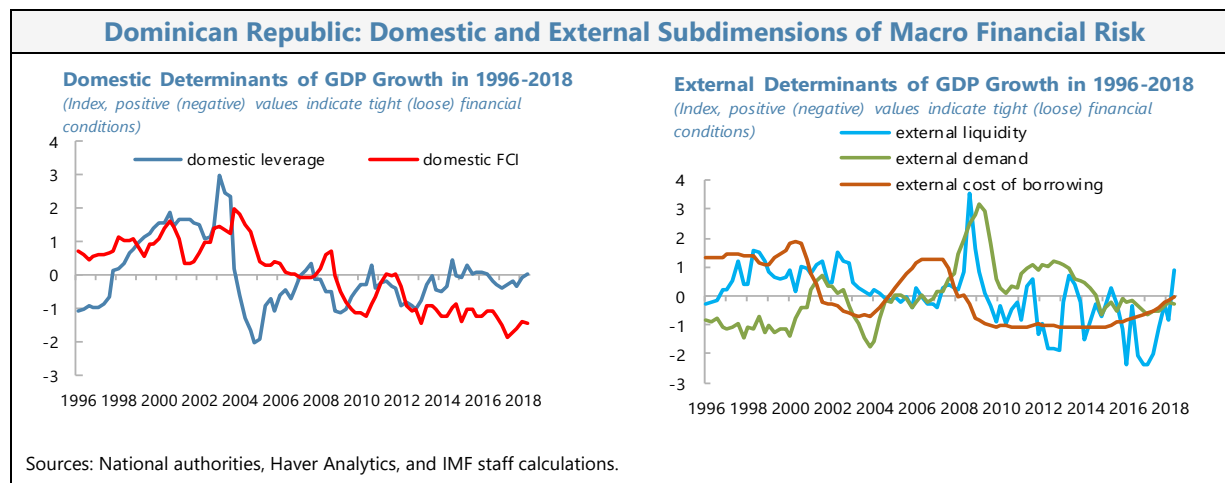


Sources: IMF, World Economic Outlook, World Bank, World Development Indicators and IMF staff calculations.

Annex II. Growth at Risk in the Dominican Republic¹

This annex uses the Growth-at-Risk (GaR) methodology to examine how macro-financial conditions affect the growth outlook and its probability distribution.² We apply the GaR methodology to evaluate risks to GDP growth in the Dominican Republic using quarterly data for 1996-2018 based on 32 indicators. Our findings show that domestic monetary policy plays a particularly important role in reducing growth vulnerabilities when the economy is weak, and that the Dominican economy is sensitive to external demand conditions regardless of its growth position.

1. We derive five broad indicators of financial conditions for the Dominican Republic, which on average point to currently neutral financial conditions. These indicators are derived as principal components of 32 quarterly economic series for 1996-2018, normalized around zero, i.e. indicating tight (easy) stance of financial conditions for their positive (negative) values (see table). Domestic leverage (credit) indicators point to neutral conditions, which is consistent with the recent closing of the credit gap as the mid-2018 monetary policy tightening slowed credit growth (see chart). Domestic financial conditions (which capture domestic spreads, interest rates, monetary aggregates, inflation, reserve requirements and the policy rate) suggest still accommodative conditions as EMBIG spreads and inflation remain low. External financial indicators—*external cost of borrowing, liquidity and demand*—reflect the normalization of external financial conditions from the earlier accommodative stance, with tightening liquidity conditions capturing lower bond flows and higher volatility in financial markets.



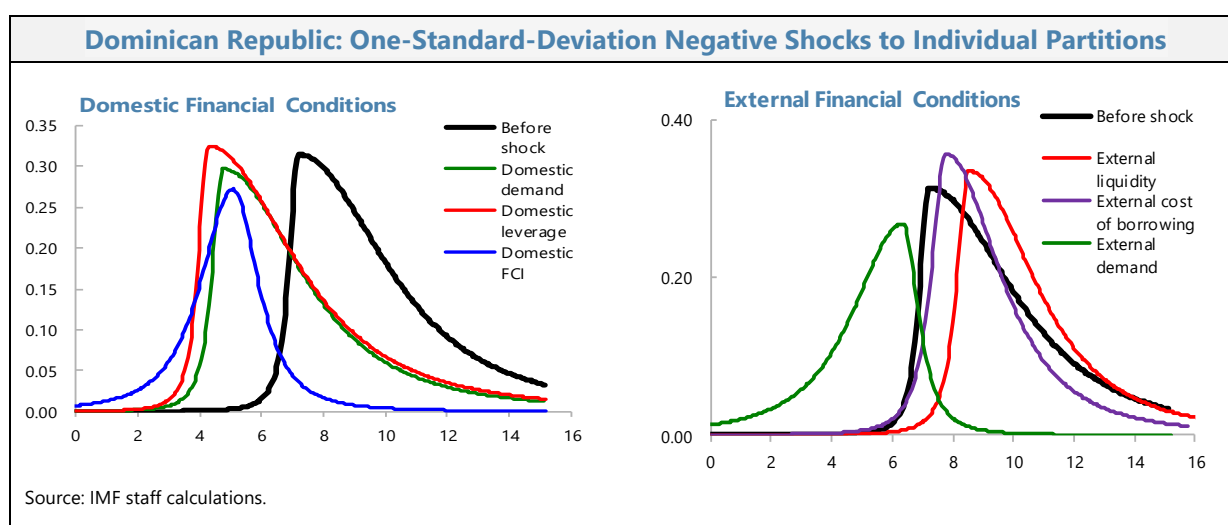
2. Our analysis indicates that growth in the Dominican Republic is most vulnerable to negative shocks to domestic financial conditions, domestic leverage, and external demand

¹ Prepared by O. Beshalova and M. Rousset, based on "Growth at Risk in the Dominican Republic" (forthcoming).

² The methodology was developed by Adrian, Boyarchenko and Giannone (AER, April 2019). The GaR methodology includes the following steps: (i) selecting relevant variables and their grouping into partitions (i.e. using principal component analysis); (ii) estimating a quantile regression for the GDP growth using partitioned indicators as regressors; (iii) deriving a probability density function for the GDP growth using a skewed generalized t distribution; (iv) quantifying the downside risks to future growth under the baseline and alternative shock scenarios. See IMF WP/19/36 (2019) *Growth at Risk: Concept and Application in IMF Country Surveillance* for further details.

(see chart). Such shocks—calibrated as one standard deviation of the composite indicators— would shift the entire growth distribution leftwards, intensifying downside risks:

- Deterioration of *external demand* conditions would be the most detrimental to domestic growth, increasing the probability of a recession by a factor of 25, from 0.02 percent to 5.3 percent. They have a negative and statistically significant impact on future growth in the Dominican Republic at all three considered forecast horizons (4, 8 and 12 quarters ahead), regardless of the initial growth conditions (i.e. “good” times or “bad” times).
- Tighter *domestic financial conditions* would increase the probability of a recession from 0.02 percent to 2.54 percent, shifting the 5th percentile of the weakest growth outcomes from 4¾ percent to 2 percent. Domestic financial conditions have the strongest impact in “bad” times and in the short-run (4 quarters ahead), suggesting a particularly large role for monetary policy in staving off growth slowdowns.
- Negative shocks to *domestic leverage* would reduce the modal projection of growth by 3 percentage points, while maintaining the previous balance of upside and downside risks. A tightening in domestic leverage in particular—caused by slower credit growth, worsening credit quality or higher regulatory capital requirements—has a negative and statistically significant impact on future growth at all forecast horizons, and under all initial growth conditions. Thus, policy makers will have to be mindful of deteriorating domestic credit.
- *External liquidity conditions and the cost of borrowing* do not have a strong effect on growth in the Dominican Republic, given its relatively weak integration in global financial markets. In fact, the positive (but on average statistically insignificant) effect in the short run likely reflects the concomitant improvement in growth prospects in the country’s trading partners, which have a larger first order effect on growth than their accompanying tightening of monetary policy.



Dominican Republic: Determinants of Growth at Risk

Domestic Price of Risk	Domestic Leverage	External Cost of Borrowing	External Liquidity	External Demand
M1	Private credit-to-GDP	6-month LIBOR	World bond flows	Terms of Trade
M2	Credit growth	US Fed Funds rate	EM bond flows	Euro area growth
M3	Regulatory capital		MOVE index	Net exports-to-GDP
Saving interest rate in USD	NPLs		VIX	US growth
Lending interest rate in USD				REER
30-day interest rate				Oil price
Reserve requirements rate				
Inflation				
Policy rate				
Commercial interest rate				
EMBIG spread				
Average lending rate				
2-year interest rate				
Personal interest rate				
Interbank interest rate				
Mortgage interest rate				

Annex III. External Sector Assessment

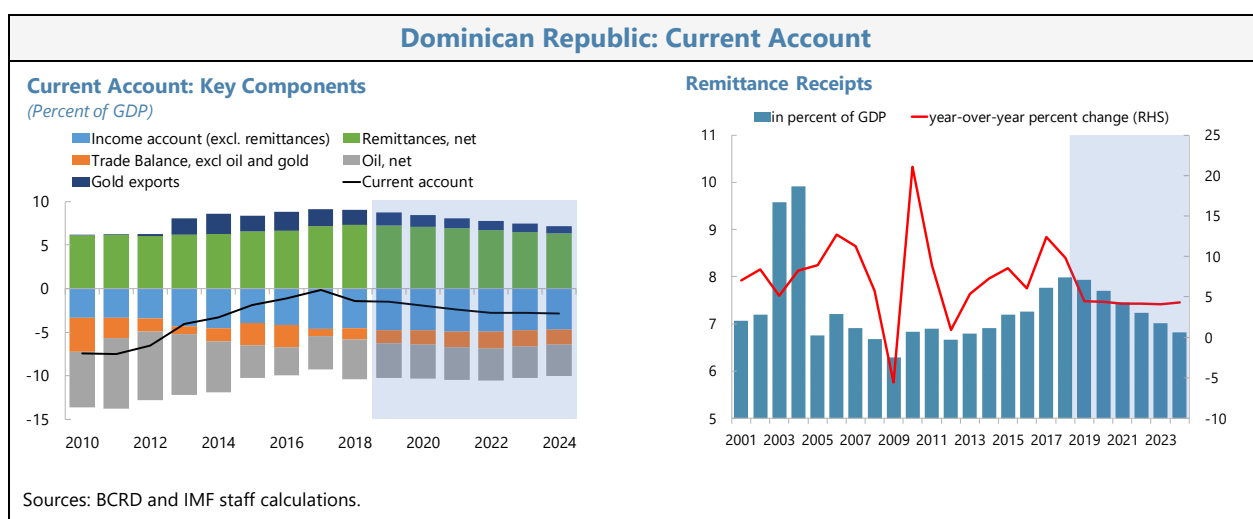
The 2018 external position is estimated to be broadly in line with medium-term fundamentals and desirable policies. Risks to external stability are limited as FDI inflows remain strong and external debt is stable. Reserve adequacy has improved and exceeds traditional metrics but remains below the IMF's risk-weighted adequacy metric.

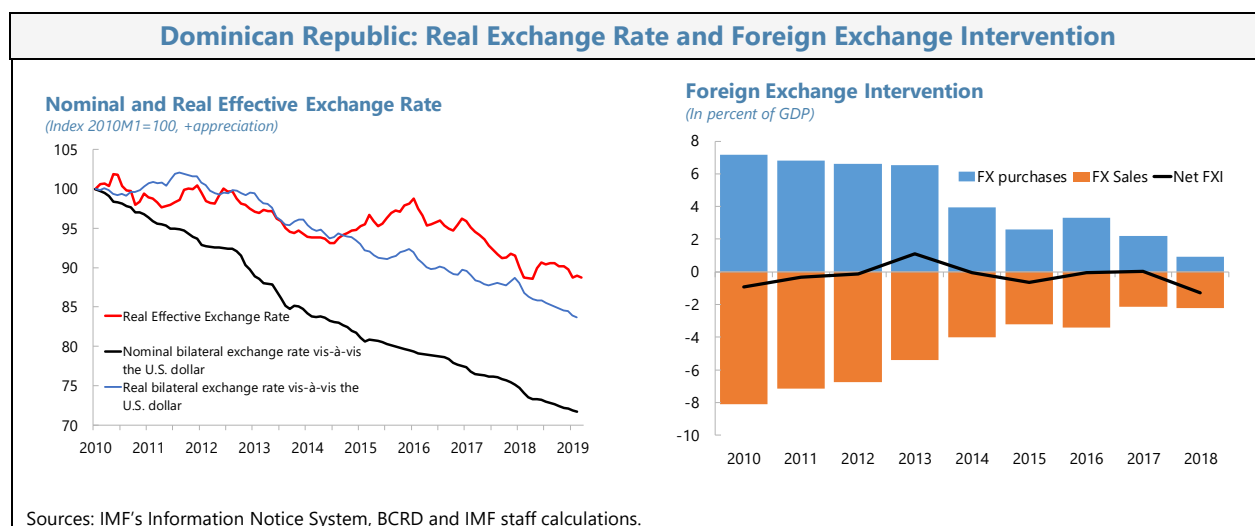
A. Background

Current Account

1. In line with higher oil prices and growing private investment, the current account deficit has widened to 1.4 percent of GDP in 2018, after more than five years of decline. The current account balance remains strong compared to its historical average of around -3.5 percent of GDP. After benefiting from low world oil prices in 2017, higher oil prices over most of 2018 and the pickup in private investment account for most of the increase in the trade deficit. Strong export growth, especially in the tourism sector and in the free trade zones, partially offset this negative impact. With remittances about 1 percent of GDP higher than the historical average, 2018 saw again a strong secondary income balance.

2. The current account deficit will be dampened by falling oil prices throughout 2019 but is expected to widen gradually – up to 2.8 percent of GDP by 2024 – as remittances return to historical norms and investment remains high. After three years of exceptionally high inflows, remittances are expected to normalize as U.S. employment growth moderates, the main source of remittances for the Dominican Republic. Strong economic growth will sustain the demand for imports to finance investment. Although gold exports will continue to decline gradually as resources deplete, this will largely be offset by a relatively low oil bill.





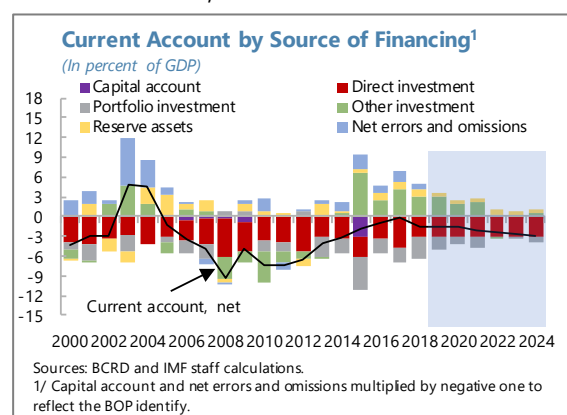
B. Real Exchange Rate

3. The average real effective exchange rate depreciated by 3.4 percent in 2018, reflecting the depreciation of the nominal exchange rate (4.1 percent) against the U.S. dollar. Although recent movements are consistent with the managed float exchange rate regime, the recent depreciation vis-à-vis the U.S. dollar is stronger than in previous years. The appreciation of the U.S. dollar has not translated into an appreciation of the real effective exchange rate. FX intervention continued to be double-sided, but overall sales slightly exceeded purchases in 2018. Nevertheless, the accumulation of foreign reserves continued throughout 2018. The central bank's foreign currency purchases continued to be sterilized.

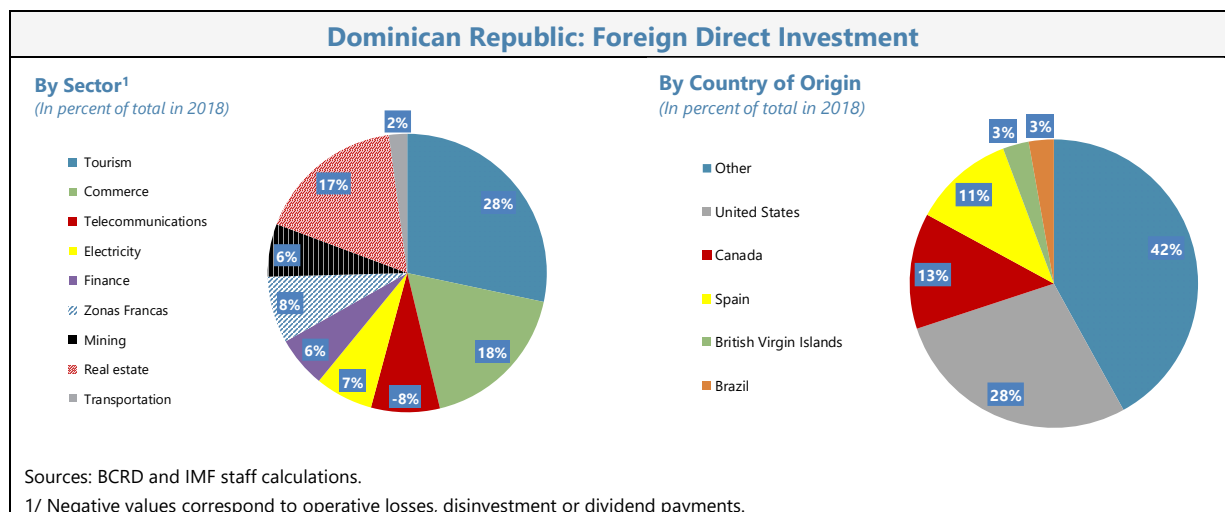
Capital and Financial Flows

4. The financing structure of the current account supports external stability.

With 2.5 billion U.S. dollars (3.1 percent of GDP) of net FDI flows in 2018, the current account deficit remains adequately financed.¹ In the medium term, Dominican Republic's well diversified FDI inflows are expected to stay at around 3 percent of GDP. Portfolio inflows increased relative to 2017 due to a large external issuance of government bonds but are predicted to stay between 1 and 2 percent of GDP over the medium run. Since 2015, other investment outflows have been higher than average as private holdings of foreign currency and external deposits increased, and loans were paid back, a trend that is expected to moderate over the medium term.

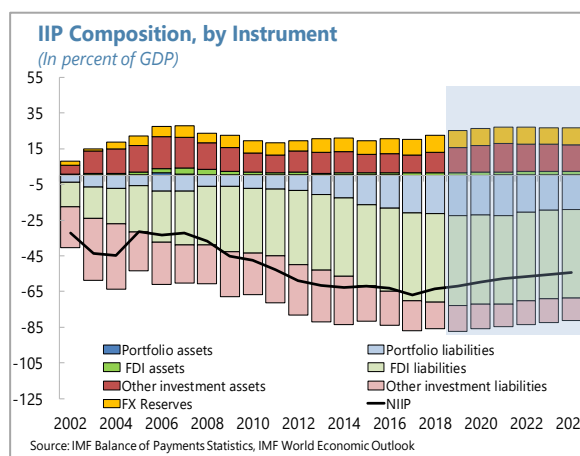


¹ 2017 saw temporarily large FDI inflows driven by the sale of a large Dominican company to a foreign investor, explaining the decrease in 2018 compared to the previous year.

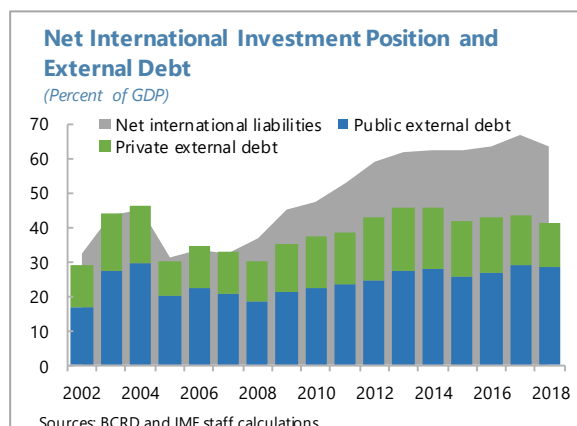


Foreign Asset and Liability Position and Trajectory

5. The net international investment position (NIIP) reached its lowest level at -66.9 percent of GDP in 2017 and improved to -63.5 percent of GDP in 2018 with assets reaching 22.4 percent and liabilities 86.0 percent of GDP. Foreign direct investment and portfolio liabilities, largely foreign-held government bonds, make up most of the liabilities. In the medium term the NIIP is projected to improve to about -55 percent of GDP due to a combination of continued robust growth and a relatively small current account deficit. Risks to external stability are limited with FDI making up around 57 percent of total liabilities and the projected path over the medium term showing a gradual improvement of the NIIP.



6. External debt reached 41.5 percent of GDP in 2018. While private external debt has declined to 12.7 percent of GDP, down from 18.6 percent in 2013, public external debt has increased to 28.7 percent of GDP.² Public external debt thus accounts for about 69 percent of the total. Direct enterprise borrowing makes up around 40 percent of private external debt while deposit-taking institutions account for only around 15 percent.



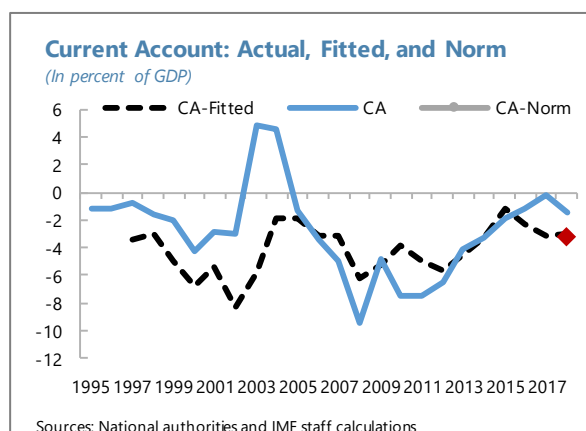
² Here external debt is defined by residency.

7. Gross external debt is expected to stabilize below 40 percent of GDP in the medium term. While private debt is projected to continue to decrease as a share of GDP, public debt will stabilize around 29 percent of GDP. The external debt sustainability assessment suggests that the medium-term debt profile is resilient to several shocks, with the most important risk related to a depreciation, which would raise the external debt ratio significantly.

C. Assessment

8. While all methodologies point to some undervaluation of the real exchange rate, the external position is broadly in line with fundamentals and desirable policy settings.

- **The current account assessment** uses the EBA-lite methodology, adjusted to reflect the temporary boost in remittances reflecting uncertainty related to U.S. immigration policy. The underlying current account gap is assessed to be 0.7 percent of GDP and the REER is undervalued by 3.9 percent suggesting that the 2018 external position is broadly in line with fundamentals. Without the adjustment for remittances, the undervaluation of the REER would be 6.4 percent. The current account gap is driven by unexplained factors (residual) rather than policy deviations. Although there are policy gaps, they largely offset each other. For example, fiscal policy is looser than the desirable policy setting, given the need for fiscal adjustment of about 2.5 percent of GDP while private credit to GDP and its growth are lower than would be desirable to support financial deepening.



Dominican Republic: EBA Lite Current Account Panel Regression

	% GDP		% GDP
(a) Actual current account	-1.4%	(b) Adjusted Fitted current account	-2.5%
Residual (a)-(b)	1.1%	Fitted current account	-3.0%
		Adjustment for remittances	0.5%
(c) Current account norm (b)-(d)-(f)	-2.2%	(d) Multilateral adjustment¹	-0.2%
(e) Current account gap (a)-(c)	0.7%	(f) Policy gap	-0.1%
(g) Real exchange rate elasticity	-19%	Fiscal policy	-0.3%
		Public Health Expenditure	-0.8%
Real exchange rate gap (e)/(g)	-3.9%	Change in GIR	0.3%
Real exchange rate gap excl. adjustment	-6.4%	Private Credit to GDP	0.2%
		Private Credit Growth	0.2%
		Capital Control	0.2%

1/ Adjusts for natural disasters and conflict, and multilateral consistency

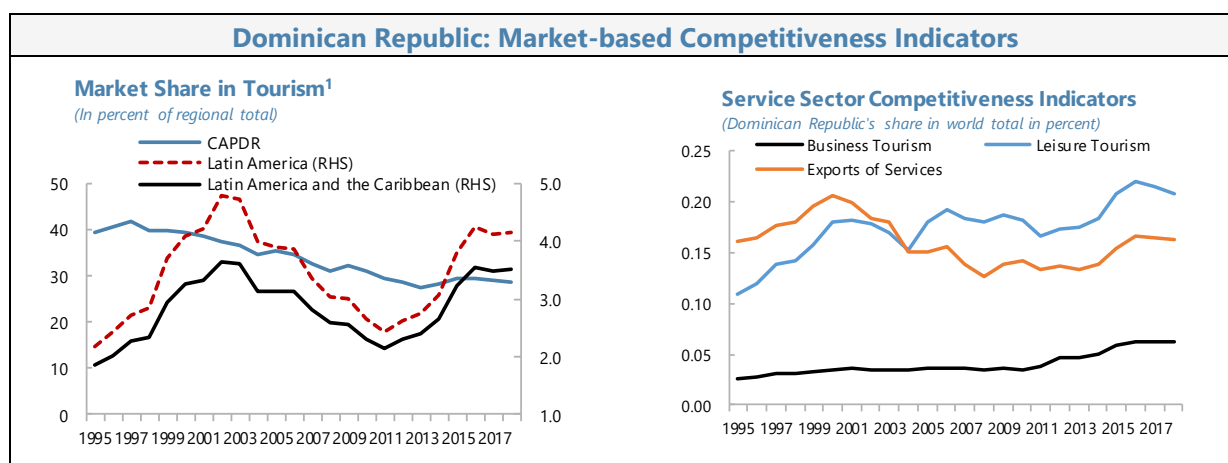
- **The external stability approach** estimates the external position to be in line with fundamentals if the NIIP is stabilized at its 2018 level. This implies an IIP-stabilizing current account deficit of 4.1 percent of GDP, which is higher than the projected deficit of 3.0 percent of GDP over the

medium term, suggesting a REER undervaluation of 5.3 percent. Reducing the NIIP from -64 percent of GDP in 2018 to 55 percent of GDP over five years, consistent with staff's projections for a gradual improvement in the NIIP, would require a current account deficit of 2.4 percent of GDP and implies an exchange rate overvaluation of 3.3 percent.

- IMF's multilaterally consistent estimates following the **REER index approach** of EBA-lite suggest an exchange rate undervaluation of 14.6 percent, with the gap driven by a large residual rather than deviations from desirable policy. Staff builds its overall assessment on the current account approach which has a larger explanatory power.

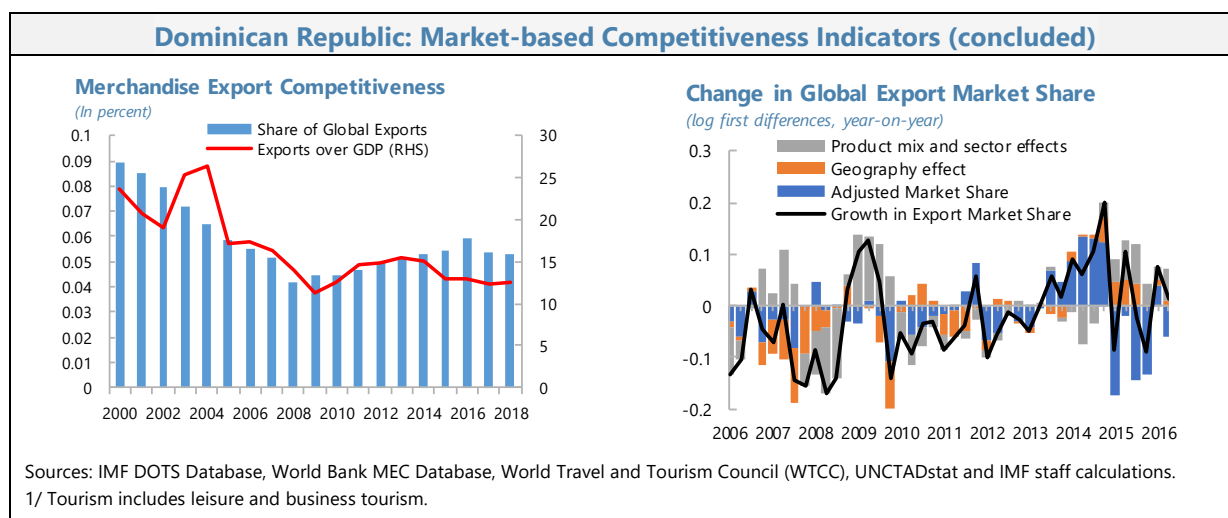
D. Other Competitiveness Indicators

11. The Dominican Republic continues to perform well in its main exports. After a strong surge in competitiveness between 2011 and 2016 due to shifts in the export composition recovering from the decline in the textiles industry, the Dominican Republic's market shares have remained broadly unchanged over the past two years. Tourism exports reached 7.6 billion U.S. dollars in 2018 (9.3 percent of GDP), a 5.2 percent increase over the previous year. The Dominican Republic's income from tourism is the highest in Latin America and the Caribbean³ in absolute terms. This strong performance has boosted its market share in world tourism, especially leisure. Only its share within the CAPDR region has fallen, with Panama capturing more of the market. The Dominican Republic has also maintained its market share in world exports of goods after a sustained increase since the global financial crisis, mainly driven by exports from the free trade zones. A decomposition of the growth in world market export shares suggests that stagnating productivity compared to competitors explains why market shares have plateaued. After 2014, positive contributions of product mix and growth in Dominican export markets (geography effects) explain most of this trend. The adjusted market share, which captures price and non-price factors in competitiveness, however, had a negative impact on market shares.⁴

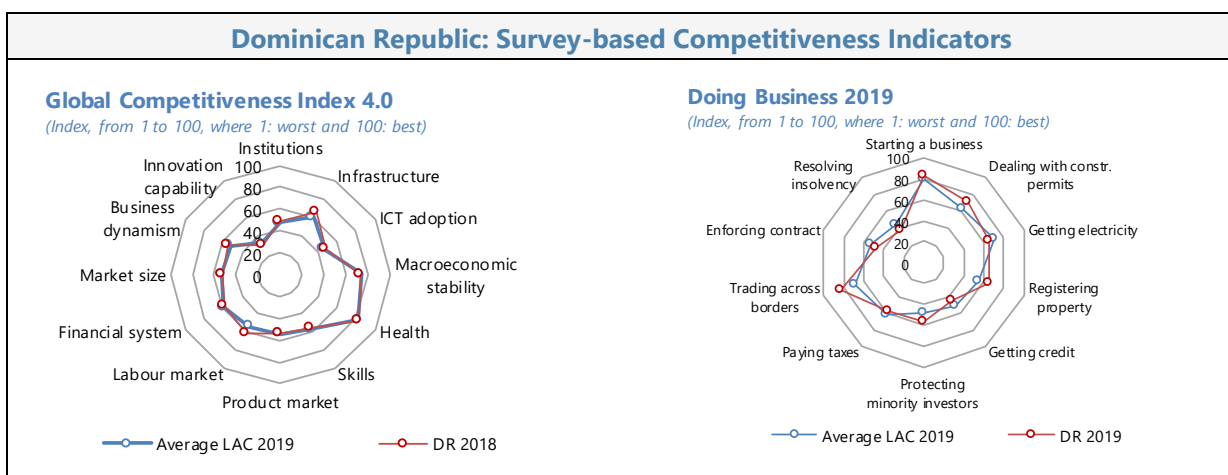


³ Excluding Mexico which is included in North America by the World Tourism Organization.

⁴ World Bank MEC Database ends in 2016Q2.



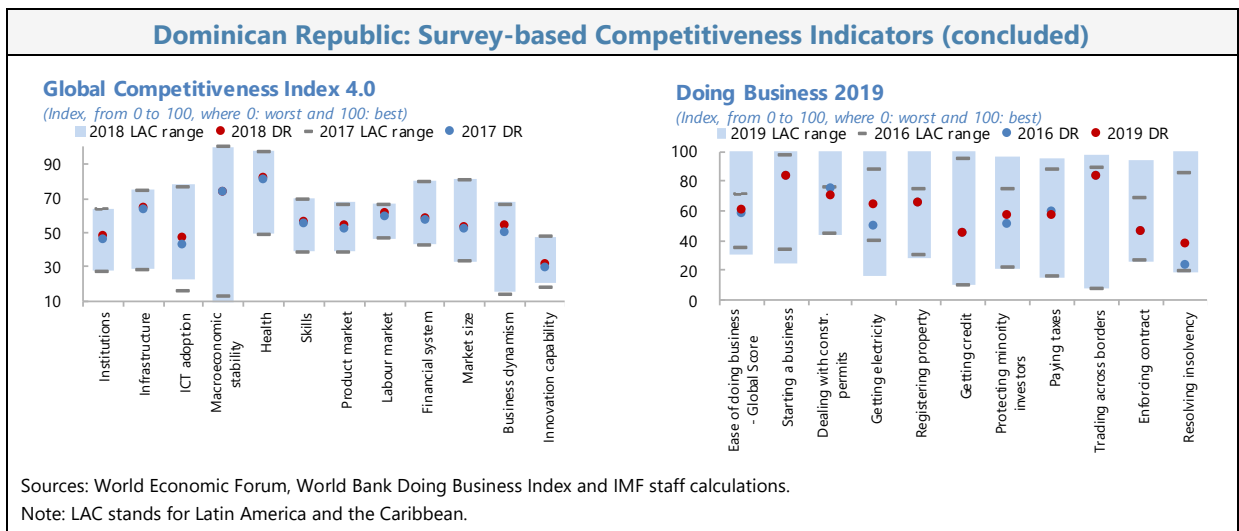
12. Survey-based indicators show an improvement in competitiveness compared to last year.⁵ In the World Economic Forum's (WEF) Global Competitiveness Index⁶, the Dominican Republic received a score of 57.4 (on a scale of 1 to 100) for 2018, an increase compared to its 2017 score of 55.6.⁷ The score improved in all categories, especially Information and Communication Technologies (ICT) adoption and Business Dynamism, reflecting the growing numbers of internet users and reductions in the time and cost of starting a business as well as recent reforms to improve the regulatory framework for insolvency. The index also suggests that addressing shortcomings in Institutions, ICT adoption, and Skills and Innovation Capability will be crucial to enhance competitiveness. Nevertheless, the Dominican Republic outperforms the average for the Latin American and Caribbean. A similar improvement is seen in the Doing Business (DB) 2019 report, with the Dominican Republic's score increasing from 58.8 in DB 2016 to 61.1 in DB 2019, helped by the



⁵ Survey-based indicators reflect investors' perceptions on the business environment.

⁶ The World Economic Forum's Global Competitiveness Index combines both official data and survey responses from business executives on several dimensions of competitiveness.

⁷ The change in methodology from GCI 2017-2018 to GCI 2018 moved the Dominican Republic from rank 104 to rank 82. Applying the updated methodology to the previous year the DR would have also ranked at 82nd place.

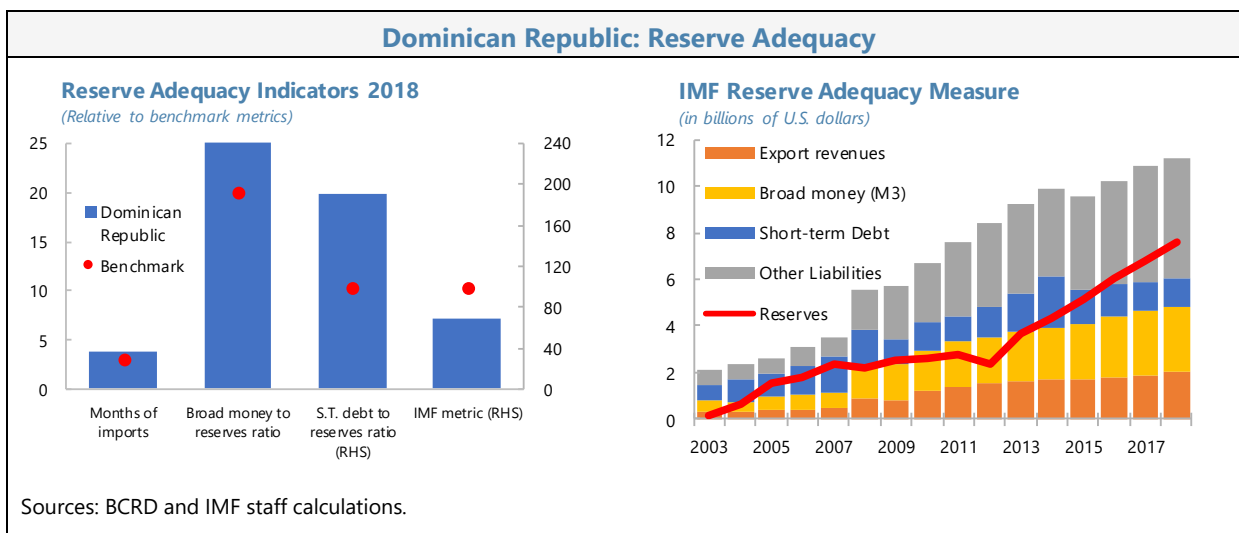


insolvency reform and better access to electricity. Despite the recent improvements, strengthening governance remains a priority to reduce factors hindering business, where the country lags its peers. Further improvements in electricity access are also needed to improve the business environment.

E. Foreign Exchange Intervention and Reserve Adequacy Assessment

13. Reserve adequacy has improved but stays below the IMF’s reserve adequacy metric.

The Dominican Republic continued to accumulate international reserves throughout 2018, sufficient to continue to improve adequacy ratios. Coverage is above traditional metrics (greater than 3 months of prospective imports, 20 percent of broad money, and 100 percent of short-term debt (on a remaining maturity basis). As the Dominican Republic integrates further into the world economy, its external exposure increases, especially through growing portfolio liabilities. Accordingly, the Fund’s recommended buffer of international reserves, which considers medium and long-term external debt in addition to short-term debt, rises. In 2018, the reserve coverage reached 68 percent, up from 63 percent in 2017, but below the recommended 100-150 percent.



However, based on the Fund's metric, allowing for more exchange rate flexibility would lower the amount of additional reserves needed. Under a flexible exchange rate regime, coverage would reach 102 percent of the metric due to lower recommended precautionary holdings. The Dominican Republic has a crawl-like exchange rate arrangement and frequently intervenes in the foreign exchange market. Recently, the central bank has scaled back the size of its foreign exchange interventions and with the introduction of the electronic foreign exchange trading platform in 2019, this trend is expected to continue. If the exchange rate is allowed to absorb more external shocks, the need for large holdings of international reserves will be reduced. In the meantime, the country should continue to build up precautionary buffers.

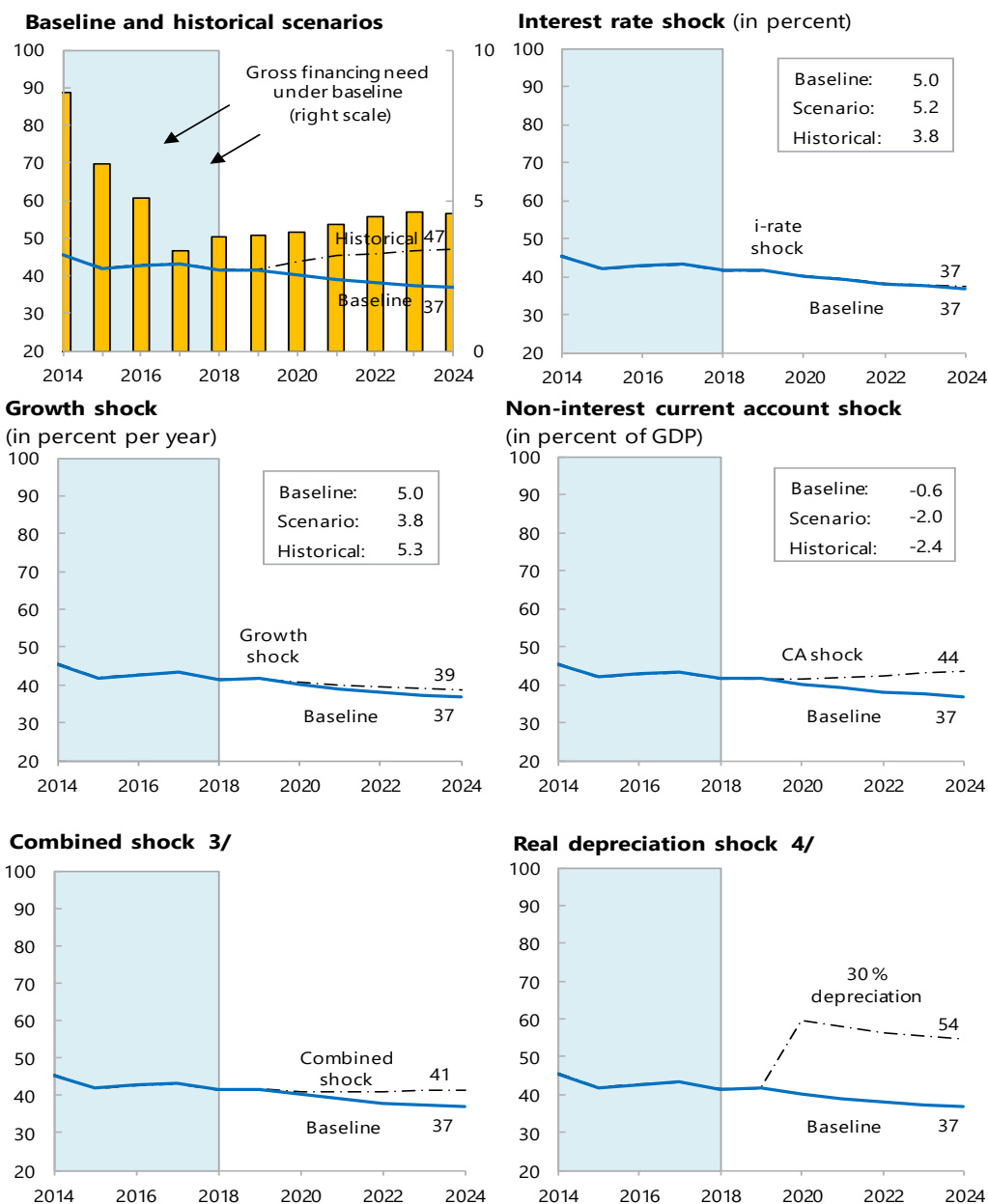
Dominican Republic: Reserve Adequacy					
Metric	Benchmark coverage	NIR coverage			
		2016	2017	2018 (e)	2023(p)
Months of imports	3 months	3.4	3.4	3.7	3.8
Months of imports (excl. free zones)	3 months	4.2	4.1	4.5	4.5
Broad money	20%	23.6	24.6	26.9	26.3
Short-term debt	100%	128.2	168.0	190.7	191.1
IMF reserve adequacy metric ¹	100 - 150%	59	62	68	71
External debt ² , in billions of U.S. dollars		31.0	32.9	33.7	42.6
External debt, in percent of NIR		512.2	484.9	442.4	399.1
Net international reserves, in billions of U.S. dollars		6.0	6.8	7.6	10.7
Additional reserves needed to reach IMF reserve metric of 100, in billions of U.S. dollars		4.2	4.1	3.6	3.8

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. Revised data for IIP MLT portfolio liabilities increased recommended adequate level of reserve holdings, explaining a lower metric for 2016 and 2017 compared to the 2018 Article IV.

2/ Private and public, based on residency.

Figure 1. Dominican Republic: External Sustainability: Bound Tests 1/2/
(External debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and IMF 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 2019.

Table 1. Dominican Republic: External Debt Sustainability Framework, 2015–24

(in percent of GDP, unless otherwise indicated)

	Actual				Projections						Debt-stabilizing non-interest current account 6/		
	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024			
Baseline: External debt	41.9	42.8	43.2	41.5	41.6	40.1	39.0	38.0	37.4	36.8	-1.8		
Change in external debt	-3.5	0.8	0.5	-1.7	0.1	-1.4	-1.1	-1.1	-0.6	-0.6			
Identified external debt-creating flows (4+8+9)	-1.2	-2.1	-3.5	-2.8	-2.1	-1.9	-1.3	-0.5	0.0	0.1			
Current account deficit, excluding interest payments	0.4	-0.4	-1.6	-0.3	-0.4	-0.2	0.2	0.6	1.0	1.1			
Deficit in balance of goods and services	-14.0	-16.2	-16.0	-15.6	-16.5	-16.2	-16.0	-15.9	-15.6	-15.5			
Exports	24.7	25.1	25.0	24.8	24.7	24.4	24.1	23.8	23.4	23.4			
Imports	10.6	8.8	9.0	9.2	8.2	8.2	8.1	7.9	7.8	7.9			
Net non-debt creating capital inflows (negative)	-1.2	-1.1	-1.6	-1.4	-1.4	-1.6	-1.5	-1.1	-1.0	-1.0			
Automatic debt dynamics 1/	-0.4	-0.5	-0.3	-1.1	-0.3	-0.1	0.0	0.1	0.0	0.0			
Contribution from nominal interest rate	1.4	1.6	1.8	1.7	1.8	1.9	1.9	1.9	1.8	1.7			
Contribution from real GDP growth	-3.1	-2.6	-1.9	-2.8	-2.2	-2.0	-1.9	-1.8	-1.8	-1.7			
Contribution from price and exchange rate changes 2/	1.3	0.6	-0.2	0.0	...	...	...	...	...	...
Residual, incl. change in gross foreign assets (2-3) 3/	-2.4	2.9	4.0	1.0	2.2	0.5	0.2	-0.6	-0.6	-0.7			
External debt-to-exports ratio (in percent)	170.0	170.6	173.1	167.1	168.3	164.4	162.1	159.6	159.8	157.4			
Gross external financing need (in billions of US dollars) 4/	4.3	3.7	2.5	3.1	3.3	3.6	4.2	4.7	5.3	5.6			
in percent of GDP	6.2	5.1	3.3	3.8	<u>10-Year</u>	<u>10-Year</u>	3.8	3.9	4.2	4.4	4.6		
Scenario with key variables at their historical averages 5/							41.6	43.5	45.2	45.9	46.6	47.1	-2.0
Key Macroeconomic Assumptions Underlying Baseline					<u>Historical Average</u>	<u>Standard Deviation</u>							
Real GDP growth (in percent)	7.0	6.6	4.6	7.0	5.3	2.4	5.5	5.2	5.0	5.0	5.0	5.0	
GDP deflator in US dollars (change in percent)	-2.7	-1.4	0.5	0.0	0.1	2.3	-0.4	2.3	2.4	2.2	2.2	2.1	
Nominal external interest rate (in percent)	3.3	3.9	4.3	4.2	3.8	0.4	4.6	4.9	5.0	5.2	5.0	4.9	
Growth of exports (US dollar terms, in percent)	0.2	6.9	4.6	6.3	9.2	17.3	4.6	6.3	6.2	6.0	5.6	7.1	
Growth of imports (US dollar terms, in percent)	15.5	-12.4	6.7	9.6	9.7	15.2	-6.2	7.5	6.6	4.6	6.2	8.4	
Current account balance, excluding interest payments	-0.4	0.4	1.6	0.3	-2.4	2.9	0.4	0.2	-0.2	-0.6	-1.0	-1.1	
Net non-debt creating capital inflows	1.2	1.1	1.6	1.4	1.2	0.4	1.4	1.6	1.5	1.1	1.0	1.0	

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 IV. Risk Assessment Matrix¹

Source of Risks (and horizon)	Relative Likelihood	Expected Impact	Policy Response
Downside risks			
Weaker-than-expected global growth (ST, MT)	High (euro area)/Medium (US, China)	Medium An abrupt slowdown in the U.S. following the long expansion as well as deceleration of growth elsewhere could weaken exports, tourism and remittances receipts, and lower economic activity and fiscal receipts.	Build external and fiscal buffers to safeguard macroeconomic stability; advance structural reforms to improve competitiveness.
Tighter global financial conditions (ST)	Medium/Low	Low An abrupt change in global risk appetite could lead to sudden sharp increases in global interest rates from the decompression of risk premia, putting pressure on sovereign financing costs, the exchange rate, and overall fiscal position. With relatively low financial integration, however, the impact on the Dominican Republic is likely to be small, with the negative impact concentrated in the fiscal accounts.	Strengthen the fiscal position; shift to domestic financing sources; continue building reserve buffers and tighten monetary policy if needed.
Large swings in energy prices (ST, MT)	Medium	Medium Oil supply and demand shocks may cause large and persistent price swings. Fuel prices may rise above current expectations, reducing real income, decreasing demand and output and widening the external current account and fiscal deficits.	Accelerate electricity sector reforms to limit the negative impact of higher oil prices on the fiscal position, while using the fiscal space to mitigate the social impact of these reforms.
Policy uncertainty, including from rising protectionism and retreat from multilateralism (ST, MT)	High	Low Externally, escalating and sustained trade actions threaten the global trade system, creating uncertainty about growth directly and through adverse confidence effects. Domestically, political uncertainty ahead of the 2020 presidential elections may contribute to more cautious investment.	Continued structural reforms to strengthen external competitiveness and gradual move towards a more flexible exchange rate.
Slow implementation of structural reforms (ST)	High	Medium Slow structural reforms, especially in the fiscal, electricity and governance areas, 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.
Adverse weather events and natural disasters (ST, MT, LT)	Medium	Medium Hurricanes, earthquakes, floods and droughts, to which the region is prone, can result in important economic, social and fiscal costs.	Develop a comprehensive disaster resilience strategy; build structural and financial resilience, including through disaster insurance.
Cyberattacks (MT, LT)	Medium	High Breach of critical financial and commercial digital infrastructure as well as broader private and public institutions can trigger systemic financial instability or widespread disruptions in socio-economic activities.	Improve legal, institutional and strategic frameworks, devise a centralized plan and cross-sector common rules to combat cyberattacks more effectively.
Upside risks			
Sustained response of domestic demand to income and credit growth (ST)	High	Medium Continued credit and income growth could contribute to a stronger rebound in domestic demand than anticipated.	Tighten monetary policy if inflationary conditions warrant it. Monitor macrofinancial developments and address associated risks with macroprudential policy.

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.

Annex V. Institutional and Governance Reforms: AML/CFT, Cybersecurity and Revenue Administration¹

Several institutional reforms undertaken recently will have important macroeconomic implications for the strength of the financial system, governance and transparency, as well as fiscal outcomes. These include the AML/CFT reforms, cybersecurity, and revenue administration and are discussed in this annex. A fuller discussion of institutional and governance issues in line with the IMF's New Framework for Enhanced Engagement on Governance will be undertaken during the next Article IV consultation.

A. AML/CFT and Other Institutional Reforms

1. The authorities overhauled the AML/CFT legal framework in 2017 and GAFILAT's 2018 assessment concluded a relatively strong technical compliance with the Financial Action Task Force (FATF) standard and overall moderate effectiveness. In 2014, the authorities carried out a National Risk Assessment (NRA), which identified drug trafficking, financial crimes, corruption and crime against the State as the country's main threat to money laundering and terrorism financing (ML/FT). In 2017, the AML/CFT legal framework was comprehensively revamped through the enactment of a new AML/CFT law (Law 155-17). In 2018, GAFILAT evaluated the updated framework and the authorities' overall adherence with FATF 2012 standards and found relatively strong technical compliance and overall moderate level of effectiveness. In what follows, we discuss selective reforms to the extent that they contribute to addressing governance and institutional shortcomings.

- *Criminalization of predicate offences to money laundering.* Law 155-17 doubled the number of predicate offences from 19 to 38, and includes, among others, tax evasion, bribery, financial crimes, fraud, and crimes committed by public officials while in office. The previous lack of criminalization of tax evasion has undermined fiscal outcomes.
- *The AML/CFT supervisory and compliance framework.* The law also brought business activities and professions (e.g. lawyers, accountants, notaries, dealers in precious metals, real estate agents, car dealers), considered as high risk and previously not covered by the AML/CFT framework, under the scope of AML/CFT supervision of the General Directorate of Internal Taxes (DGII), a newly-designated entity for this purpose. Accordingly, it enhanced the powers and resources of relevant agencies, including DGII and the Financial Intelligence Unit (FIU). Furthermore, the law requires all reporting financial and non-financial institutions to adopt, develop and implement a compliance program focused on a risk-based approach. However, as pointed out by GAFILAT in its 2018 assessment, weaknesses remain, particularly in the understanding of risks inherent in these non-financial business activities, partly due to difficulties in obtaining reliable data from some sectors, and the application of customer due diligence measures (CDD) and risk-based approaches. The regulation and supervision of the cooperatives,

¹ Prepared by J. Okwuokei, M. Rousset, and J. Arze del Granado.

insurance and designated non-financial businesses and professions (DNFBPs) sectors remains an important challenge.

- *Identification of Politically Exposed Persons (PEPs)*. The new legal framework defines a PEP, including individuals entrusted with high level public functions currently and in the past, both domestic and foreign. On top of this, the authorities have developed a list of positions and functions to enable reporting entities to identify and perform enhanced due diligence on domestic PEPs, as they are considered high risk by law. As noted by GAFILAT, the authorities should clarify whether individuals that perform key functions, such as representatives of political parties, should be considered as PEPs.
- *Beneficial ownership of corporate and legal arrangements*. The tax code has been modified to require all corporate and legal structures, resident or non-resident, to register in the Registry of National Taxpayers, and together with the computerization of the company registry maintained by the Chambers of Commerce this facilitates greater access to company information, including the beneficiary owner. The issuance of bearer shares has been eliminated. Despite the upgraded database, further progress will be required to ensure accurate and up to date beneficial ownership information and in ensuring that mechanisms are in place for the authorities to have timely access to such company information.
- *Interagency coordination*. Law 155-17 reorganized the National Committee against Money Laundering and Terrorist Financing (CONCLAFIT), comprising key institutions involved in the detection, prevention, and investigation of ML/TF offences; this is allowing for greater powers of access and exchange of information to the FIU. The authorities have also created a specialized Anti-Money Laundering Prosecutor's Office; and specialized body for border security.
- *Asset Declaration by Public Officials*. In recognition of the importance of asset declaration as a powerful anti-corruption tool, several efforts have been made in recent years to enhance the asset declaration regime, notably by amending the law in 2014 to broaden the type of assets to be reported and recording the asset declarations in a centralized public database. While a detailed assessment is required to determine the effectiveness of the new regime, in the meantime, efforts should focus on improving filing, the imposition of appropriate sanctions for non-filers and submission of files for investigation when cases of illicit enrichment are identified. In addition, a bill was submitted to Congress in December 2018, aimed at strengthening valuation of properties for tax and criminal investigation purposes.

B. Cybersecurity Reforms

2. The Dominican authorities have put cybersecurity in the forefront of their policy agenda and are making progress on various aspects of the cyber defense framework. These efforts are focused on putting in place a legal, institutional and strategic framework to combat cyberattacks, centralizing cyber defense functions while expanding their coverage beyond the central bank to reduce vulnerabilities across key institutions:

- *The legal and institutional framework*. In 2013, the Dominican Republic became the first country in Latin America to join the Budapest Convention on Cybercrime, ratifying its provisions into

domestic substantive and procedural law. More recently, the Central Bank of the Dominican Republic (BCRD) developed an *Information and Cybersecurity Regulation (ICR) for the financial sector*, which defined a common legal basis for all entities connected to the national payment system. The goal of the ICR is to ensure the implementation of best practices for information security and cybersecurity risk management across relevant entities (financial institutions, payment system participants, all services and institutions connected to these).

- *Strategic plan for developing technical capacity.* In November 2018, the BCRD Monetary Board approved a *Cybersecurity Strategic Plan 2018–2021* aimed at: (i) addressing the deficiencies in technological infrastructure (creation of threat management and prevention capabilities); (ii) capacity building (including the establishment of cybersecurity culture at BCRD); and (iii) governance. It is intended to centralize the country's cyber defense policy and define a common set of norms and rules to effectively respond to digital threats.
- *Cybersecurity Incidents Response Center for the financial system.* The Center will be equipped with a forensic laboratory and a threat-intelligence unit to prevent, detect and respond to cyberattacks. The Center will cover not only the central bank but also all financial institutions, which would particularly benefit small local banks that lack cyber defense capacity of their own, and the institutions connected to these (e.g. Superintendency of Banks). The Center will also provide data protection services for other core public sector institutions.
- *Cross-sector cooperation and social awareness.* The Dominican authorities have also been broadening cybersecurity measures beyond the financial sector to better protect all digitally-connected infrastructure and business processes (e.g. retail, energy delivery, nonfinancial services) as well as personal privacy and safety. The government is improving its collaboration with the private sector to disclose cyber breaches and provide vulnerability reports, while Dominican Telecommunications Institute's *Healthy Internet* initiative intends to promote social awareness of cybersecurity threats.

C. Revenue Administration Reforms

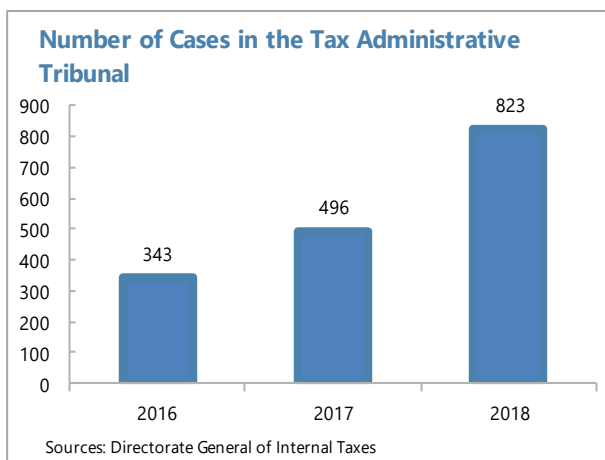
3. Since the new administration entered into office mid-2016, it focused fiscal policies on strengthening the revenue administration functions in order to increase tax collections.

Recent government reports estimate non-compliance with VAT and income taxes at 9.5 percent of GDP, suggesting ample space to increase tax collections through improved revenue administration. The initial efforts were directed towards tackling tax evasion and fraud in excises taxes on alcohol, cigarettes and fuel, and on institutional strengthening of both internal and external revenue administrations.

- *Institutional strengthening:* The two institutions managing revenue collections—General Directorate of Internal Revenues (DGII) and General Directorate of Customs (DGA)—have connected their online system, which allows the automatic exchange of information reported to both institutions and closes an important source of fraud and evasion. Both institutions have also created or strengthened areas related to controls and implementation of the recent AML/CFT legislation, including the Asset Laundering Department, the Fraud and Tax Crimes

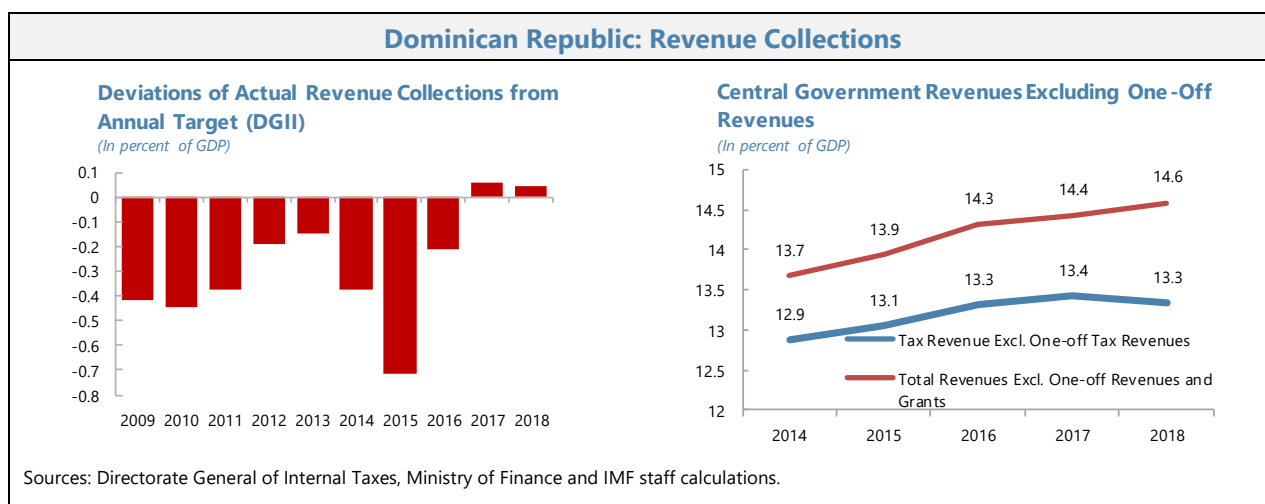
Investigation Management, the Special Regimes Management, the Control Management of Risks, Excise Tax Department, among others.

- Enforcement:* The tax administration has intensified closure of companies that do not comply with their tax obligations, significantly increasing the perception of risk among taxpayers. The number of tax evasion/fraud cases submitted to justice has more than doubled since 2016, supported by the new AML/CFT legislation. There has also been a reduction in the number of administrative cases that are under reconsideration, as the DGII enforces now the freezing of taxpayer's banks accounts during the time of the judicial process, eliminating incentives of taxpayers to dispute with the objective of delaying the collection process (more than 90 percent of the audited taxpayers request a judicial reconsideration).



- Electronic tax invoicing.* The authorities have piloted the use of electronic tax invoicing in a few large companies. By tracing the details of any transaction (e.g. price, quantity, taxes paid or owed), invoicing will not only increase the transparency of business transactions but would also lower tax compliance costs and reduce fraud involving input VAT credit (since the invoicing will help determine taxes due by deducting VAT paid on purchases from VAT payable on sales). Once the pilot is completed, the invoicing will be gradually rolled out to the rest of the companies in 2020.
- Implementation of traceability system for alcoholic beverages and cigarettes.* The system will require that domestically produced or imported products carry tamper-proof digital stamps (with visible and invisible features) that would enable the verification of their authenticity by the authorities and consumers (through a mobile application) and real-time traceability of their production, import and commercialization. The system is expected to be functional by 2020 and to significantly reduce excise tax evasion on these items, estimated as high as 40 percent.
- Simplified tax regime:* A simplified tax regime was introduced for small enterprises to facilitate their compliance with what is viewed as a complex tax system. In addition, tax education programs were expanded, doubling the number of people and entities reached.
- Risk-based collection strategy:* With assistance from the regional center for technical assistance CAPTAC, the authorities are focusing collection efforts based on risk, type of debt, and amount, among other criteria. A new tax risk management division has also been created to evaluate non-compliance risks. The Large Taxpayer Unit is also being strengthened.
- Reforming the tax voucher system:* Tax vouchers (sale receipts provided by the DGII that carry the selling companies' tax IDs) have been traded fraudulently to simulate transactions and claim input tax credits; vouchers will now be issued more selectively and depending on the risk profile of the taxpayer.

4. The authorities are already seeing results in terms of increased tax collections. In nominal terms, internal revenue collection targets in the budget were exceeded in both 2017 and 2018, for the first time in many years, although in part this was also due to stronger than budgeted growth. Revenue collections growth also increased as a percent of GDP: excluding one-off receipts from headline revenues, suggests that tax administration reforms have contributed to an increase of 0.3 percentage points of GDP during 2017-18, and an increase in tax revenue base by 0.4pp of GDP over the same period.



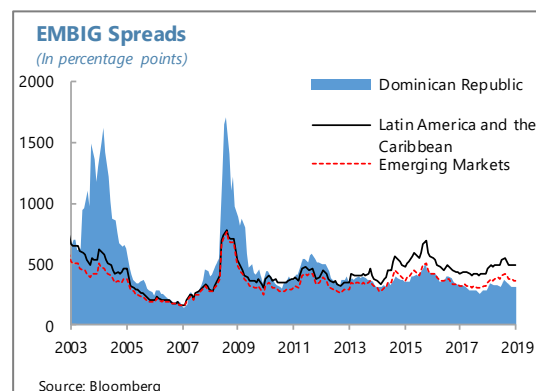
Annex VI. Public Debt Sustainability Analysis

Under current policies, both public debt (53.1 percent of GDP as of 2018) and gross financing needs (9 percent of GDP) remain within the debt burden benchmarks under the baseline and stress scenarios.¹ Nevertheless, public debt is on an upward path, and the debt profile carries vulnerabilities due to a large share of debt held by non-residents or in foreign currency.

A. Debt and Financing Profiles

1. Debt profile. The consolidated public debt-to-GDP ratio is projected to reach 56.2 percent in 2023—3.1 pp higher than end-2018—despite favorable automatic debt dynamics (with a negative contribution from the interest-growth differential).

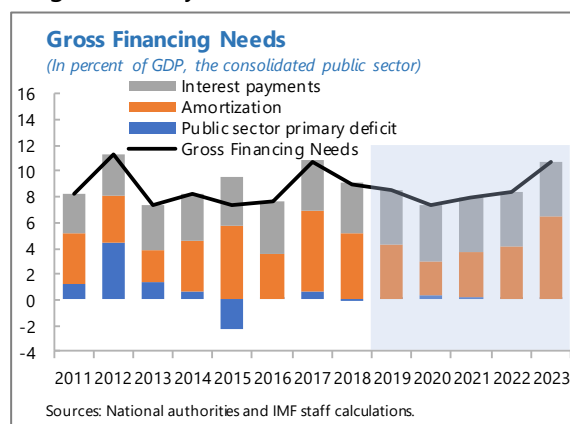
2. Sovereign yields. Dominican Republic's foreign currency sovereign bonds have increased during 2018 along with other emerging markets, but—at an average credit spread of 306 basis points relative to U.S. Treasury Bonds (as of April 2019)—it compares favorably to the average of other emerging market and Latin American economies (with spreads of 364 and 486 basis points, respectively). The effective nominal interest rate on Dominican Republic's total debt is projected to move in line with Libor rates, increasing in the near term from 8.4 percent in 2018 to 8.8 percent in 2020, before moderating to 8.2 percent in 2023. A faster passthrough of the international rates to the effective interest rate on public sector debt is being dampened by a large share of fixed-interest debt (about 80 percent), small share of debt that matures in the near term, and the rollover of the central bank securities at significantly lower rates than issued in the aftermath of the 2003-04 financial crisis. Moody's rating agency upgraded the Dominican Republic's foreign and local currency credit rating to Ba3 in 2017, while Standard and Poor's and Fitch maintained it at BB-, and all credit rating agencies have a stable outlook.



3. Gross financing needs remain below the upper early warning benchmarks over the medium term (17 percent of GDP), but follow an increasing trend after 2022 suggesting the potential for increasing rollover risks over the medium term. Gross financing needs will decrease over the next three years from 9.0 to 7.4 percent of GDP, gradually increasing thereafter with maturing external central government and domestic central bank debt. 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.

¹ Public debt numbers are staff estimates and refer to the consolidated public sector, defined to cover liabilities of the non-financial public sector and the quasi-fiscal debt of the central bank.

4. Public debt profile. The authorities are prioritizing 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 10 years for the non-financial public sector from 7.4 years in 2013; (ii) the share of foreign-currency denominated NFPS debt was reduced to 75 percent in 2018 (within the target of 77 ± 3 percent in the national debt strategy) and to 54.1 percent of total consolidated debt as of 2018 (compared to an upper benchmark of 60 percent); (iii) the share held by non-residents (49 percent of total consolidated debt) is somewhat higher than the corresponding benchmark (45 percent), could expose the country to rollover risk from potential shifts in market sentiment; and (iv) the share of debt under a flexible rate has also declined (with only 20 percent of NFPS debt contracted at variable rates).



B. Realism of Baseline Scenario²

5. Growth. Staff growth forecasts tended to be lower than the actual growth outcomes during the period 2009-17, with a median forecast error of 0.28 percentage points. Nevertheless, the forecast bias has decreased in the past few years.

6. 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 other debt market-access countries, placing the Dominican Republic at the 48th percentile rank 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.

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 (adverse) scenario, debt would remain below the 70 percent of GDP benchmark with 75 percent probability.

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

D. Stress Tests

8. Individual shocks. Under most tests – primary balance shock, growth shock, and real interest rate shock, debt-to-GDP ratio is not expected to breach the 70 percent benchmark. Results suggests that the Dominican Republic is more sensitive to a real growth shock. A one-standard deviation negative real GDP growth shock in 2019 and 2020 would increase debt to 58.2 percent of GDP by 2023 (compared to 56.2 percent of GDP under a no-shock scenario).

9. Combined shock. A combined shock incorporates the largest effect of individual shocks (real GDP growth, inflation, primary balance, exchange rate, and interest rate). In this scenario debt would increase to 63.5 percent of GDP while gross financing needs would increase to 12.6 percent by 2023 (both below the 70 percent and 17 percent benchmarks, respectively).

10. Contingent liability shock. While the contingent liability shock is not triggered since most SOE debt is already accounted for in the headline debt statistics, staff has added a natural disaster shock given the country's exposure to disaster risk. The scenario assumes a disaster with 100-year return period and a 20 percent of GDP economy-wide loss, of which 15 percent (3 percent of GDP) is assumed to be the responsibility of the government. It is also assumed that this disaster has an adverse effect on growth in the first year (–0.9 percentage points), with a slight rebound of 0.3 percentage points the year following the disaster due to reconstruction activity. Under this scenario, debt would increase to 57.1 percent of GDP by 2023 (below the 70 percent benchmark).

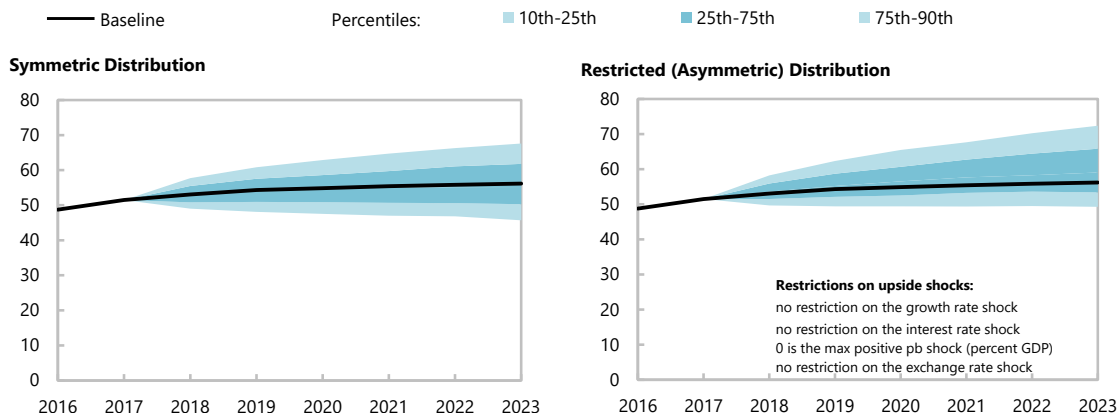
Figure 1. Dominican Republic: Public DSA Risk Assessment

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

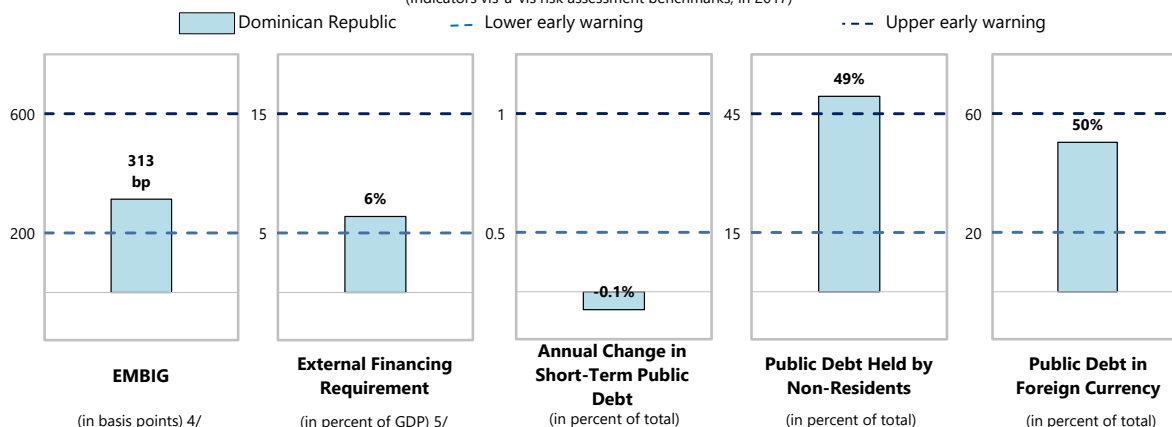
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2017)



Source: IMF staff calculations.

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.

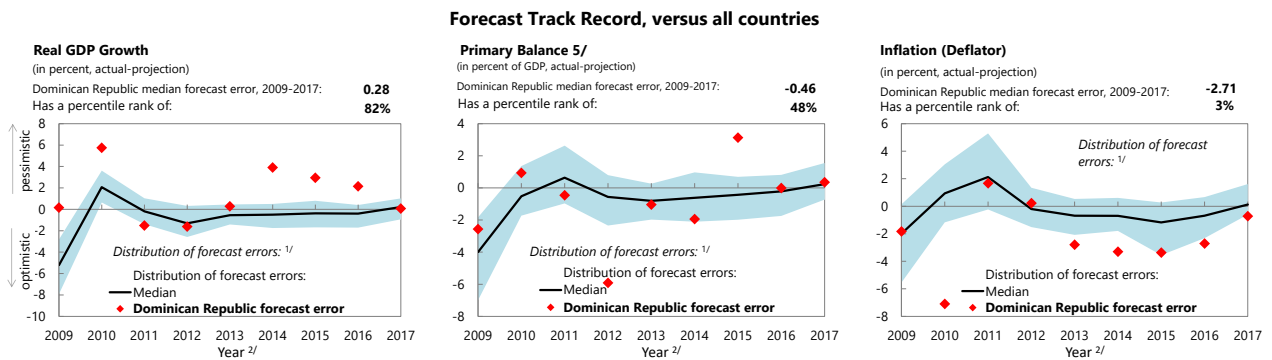
Lower and upper risk-assessment benchmarks are:

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, 09-Feb-19 through 10-May-19.

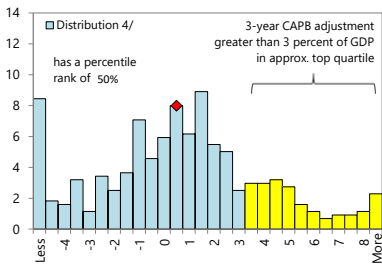
5/ External financing requirement is defined as the sum of current account deficit, amortization of medium and long-term total external debt, and short-term total external debt at the end of previous period.

Figure 2. Dominican Republic: Public DSA-Realism of Baseline Assumptions

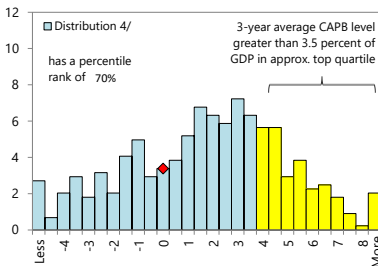


Assessing the Realism of Projected Fiscal Adjustment

3-Year Adjustment in Cyclically-Adjusted Primary Balance (CAPB)
(Percent of GDP)



3-Year Average Level of Cyclically-Adjusted Primary Balance (CAPB)
(Percent of GDP)



Source: IMF staff calculations.

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 observations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

5/ The primary balance surplus in year 2015 reflects a restructuring of Petrocaribe liabilities (for around 3.1% of GDP), which are also accounted as government revenues.

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

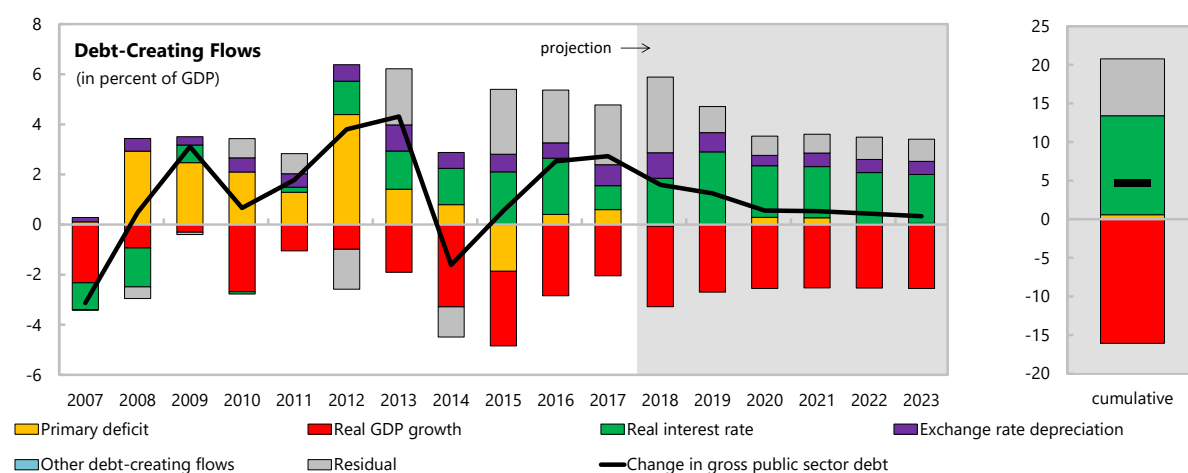
(in percent of GDP, unless otherwise indicated)

Debt, Economic and Market Indicators ^{1/}

	Actual			Projections						As of May 10, 2019		
	2007-2015 ^{2/}	2016	2017	2018	2019	2020	2021	2022	2023	Sovereign Spreads		
Nominal gross public debt	40.2	48.7	51.5	53.1	54.3	54.9	55.4	55.8	56.2	EMBIG (bp) 3/		315
Public gross financing needs	7.6	7.9	10.8	9.0	8.5	7.4	8.0	8.4	10.7	5Y CDS (bp)		n.a.
Net public debt	37.6	46.9	49.8	51.5	52.9	53.5	54.2	54.7	55.1			
Real GDP growth (in percent)	5.0	6.6	4.6	7.0	5.5	5.2	5.0	5.0	5.0	Ratings	Foreign	Local
Inflation (GDP deflator, in percent)	5.3	0.9	3.7	4.2	2.5	4.4	4.3	4.2	4.2	Moody's	Ba3	Ba3
Nominal GDP growth (in percent)	10.6	7.5	8.4	11.4	8.2	9.8	9.5	9.4	9.4	S&Ps	BB-	BB-
Effective interest rate (in percent) ^{4/}	7.2	8.9	8.7	8.4	8.6	8.8	8.6	8.4	8.2	Fitch	BB-	BB-

Contribution to Changes in Public Debt

	Actual			Projections						cumulative	debt-stabilizing primary balance ^{9/}
	2007-2015	2016	2017	2018	2019	2020	2021	2022	2023		
Change in gross public sector debt	1.1	2.5	2.7	1.6	1.2	0.6	0.5	0.4	0.3	4.7	
Identified debt-creating flows	0.8	0.4	0.3	-1.4	0.2	-0.2	-0.2	-0.5	-0.6	-2.7	
Primary deficit	1.5	0.4	0.6	-0.1	0.0	0.3	0.3	0.0	0.1	0.6	
Primary (noninterest) revenue and grant:	14.5	14.5	14.7	14.9	15.0	15.1	15.1	15.1	15.1	90.3	
Primary (noninterest) expenditure	16.0	14.9	15.3	14.9	15.0	15.4	15.4	15.1	15.1	90.9	
Automatic debt dynamics ^{5/}	-0.7	0.0	-0.3	-1.4	0.2	-0.5	-0.5	-0.5	-0.6	-3.3	
Interest rate/growth differential ^{6/}	-1.3	-0.6	-1.1	-1.4	0.2	-0.5	-0.5	-0.5	-0.6	-3.3	
Of which: real interest rate	0.5	2.3	1.0	1.8	2.9	2.1	2.0	2.0	1.9	12.8	
Of which: real GDP growth	-1.8	-2.8	-2.0	-3.2	-2.7	-2.6	-2.5	-2.5	-2.6	-16.1	
Exchange rate depreciation ^{7/}	0.6	0.6	0.8	...	...	...	...	...	...	...
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	
Residual, including asset changes ^{8/}	0.3	2.1	2.4	3.0	1.0	0.8	0.7	0.9	0.9	7.4	



Source: IMF staff calculations.

1/ Public sector is defined as consolidated public sector.

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).

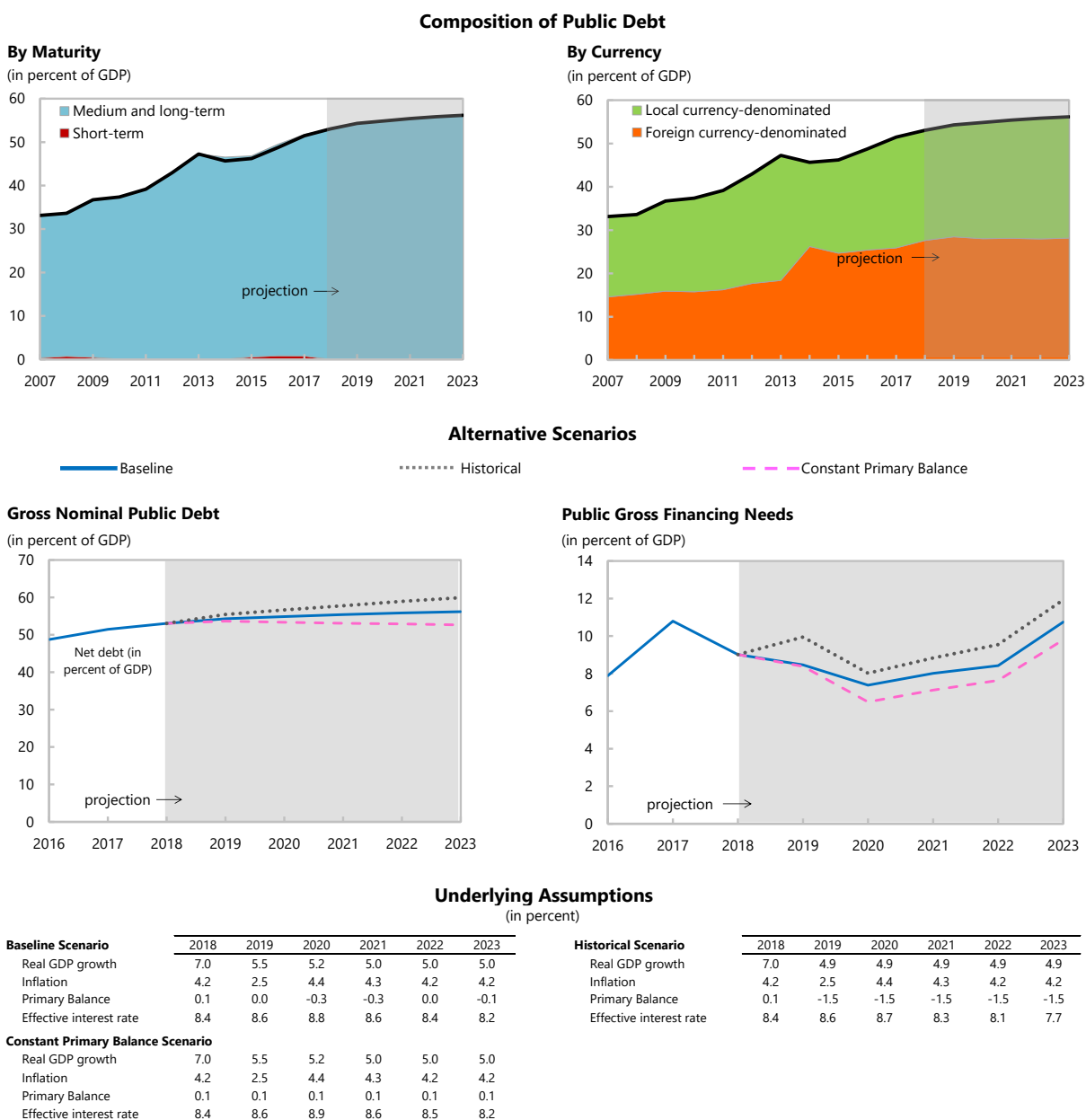
6/ The real interest rate contribution is derived from the numerator in footnote 5 as $r - \pi(1+g)$ and the real growth contribution as $-g$.

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.

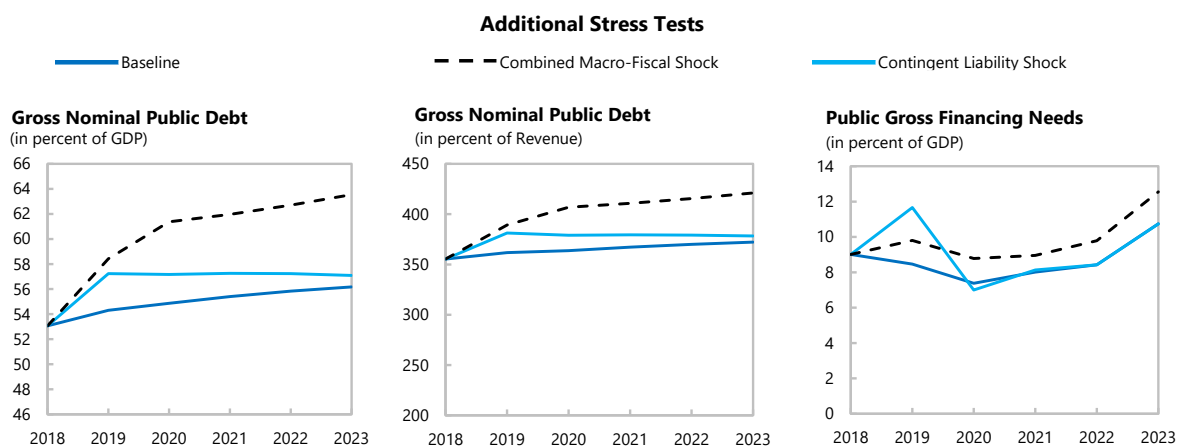
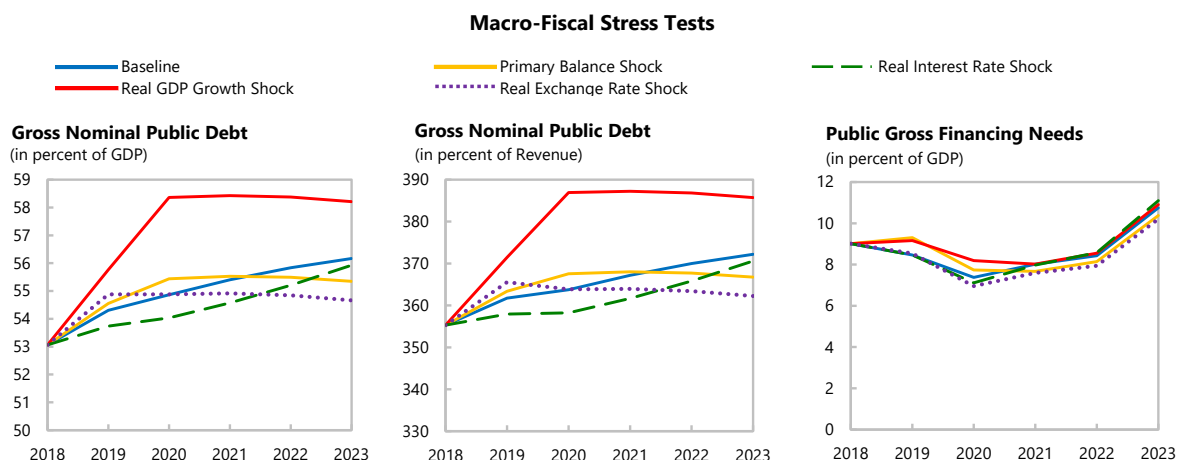
9/ Debt stabilizing of primary balance required to keep the debt-to-GDP ratio constant at its 2023 level. It assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Figure 4. Dominican Republic: Public DSA – Composition of Public Debt and Alternative Scenarios



Source: IMF staff calculations.

Figure 5. Dominican Republic: Public DSA – Stress Tests



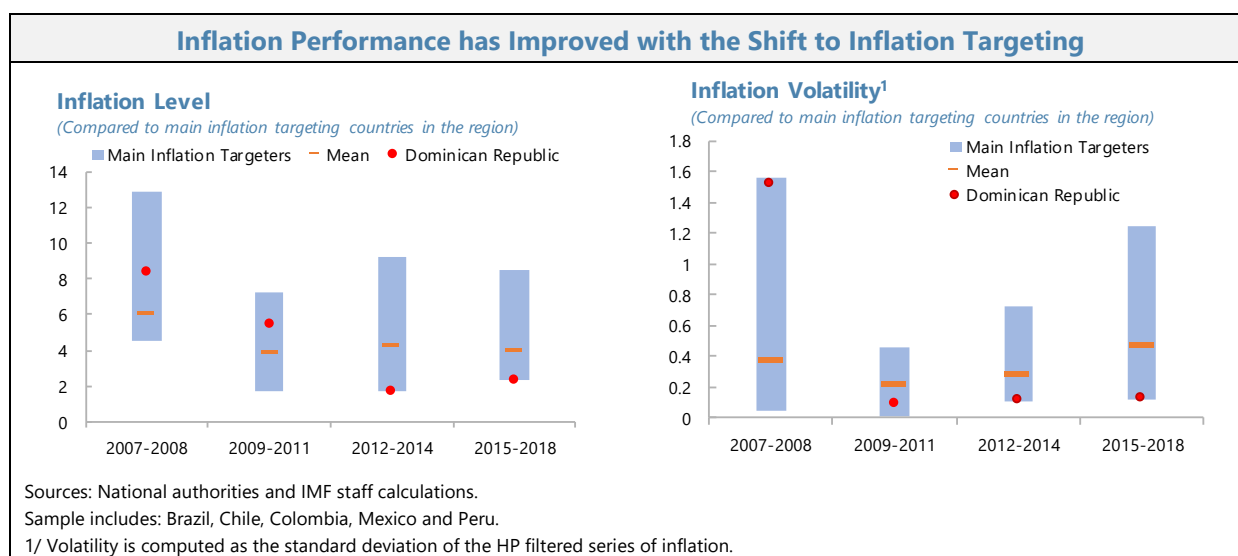
Underlying Assumptions (in percent)

	2018	2019	2020	2021	2022	2023		2018	2019	2020	2021	2022	2023
Primary Balance Shock							Real GDP Growth Shock						
Real GDP growth	7.0	5.5	5.2	5.0	5.0	5.0	Real GDP growth	7.0	3.1	2.7	5.0	5.0	5.0
Inflation	4.2	2.5	4.4	4.3	4.2	4.2	Inflation	4.2	1.9	3.8	4.3	4.2	4.2
Primary balance	0.1	-0.9	-1.1	-0.3	0.0	-0.1	Primary balance	0.1	-0.5	-1.2	-0.3	0.0	-0.1
Effective interest rate	8.4	8.6	8.9	8.7	8.5	8.3	Effective interest rate	8.4	8.6	8.9	8.7	8.5	8.3
Real Interest Rate Shock							Real Exchange Rate Shock						
Real GDP growth	7.0	5.5	5.2	5.0	5.0	5.0	Real GDP growth	7.0	5.5	5.2	5.0	5.0	5.0
Inflation	4.2	2.5	4.4	4.3	4.2	4.2	Inflation	4.2	4.5	4.4	4.3	4.2	4.2
Primary balance	0.1	0.0	-0.3	-0.3	0.0	-0.1	Primary balance	0.1	0.0	-0.3	-0.3	0.0	-0.1
Effective interest rate	8.4	8.6	9.4	9.6	9.9	10.0	Effective interest rate	8.4	8.8	8.8	8.6	8.4	8.2
Combined Shock							Contingent Liability Shock						
Real GDP growth	7.0	3.1	2.7	5.0	5.0	5.0	Real GDP growth	7.0	4.6	5.5	5.0	5.0	5.0
Inflation	4.2	1.9	3.8	4.3	4.2	4.2	Inflation	4.2	2.5	4.4	4.3	4.2	4.2
Primary balance	0.1	-0.9	-1.2	-0.3	0.0	-0.1	Primary balance	0.1	-3.0	-0.3	-0.3	0.0	-0.1
Effective interest rate	8.4	8.8	9.4	9.6	9.9	10.1	Effective interest rate	8.4	8.8	9.0	8.7	8.6	8.3

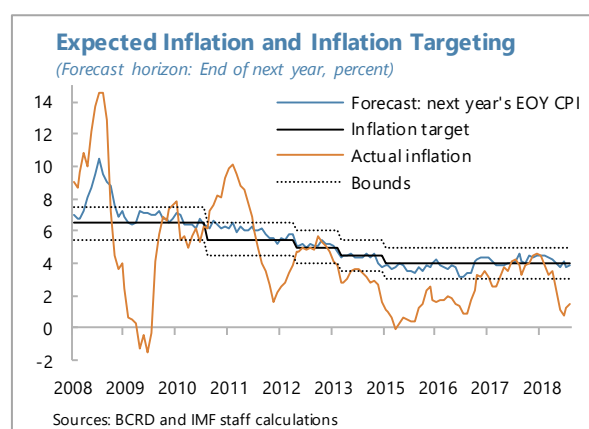
Source: IMF staff calculations.

Annex VII. Monetary Policy Credibility in the Dominican Republic¹

1. The Dominican Republic's shift to inflation targeting has successfully transformed the monetary policy framework. The policy decision taken in 2005 eventually led to the adoption of an explicit inflation target in 2012. Initially set at 5.5 ± 1 percent, the central bank gradually reduced the target to the current level of 4 ± 1 percent, paired with explanations in regularly published monetary policy statements.² Inflation performance, in terms of level and volatility, has improved significantly since this shift in policy. Whereas inflation averaged 5.4 percent in the 3 years preceding the inflation target, the Dominican Republic has successfully stabilized inflation at low levels with substantially lower volatility.



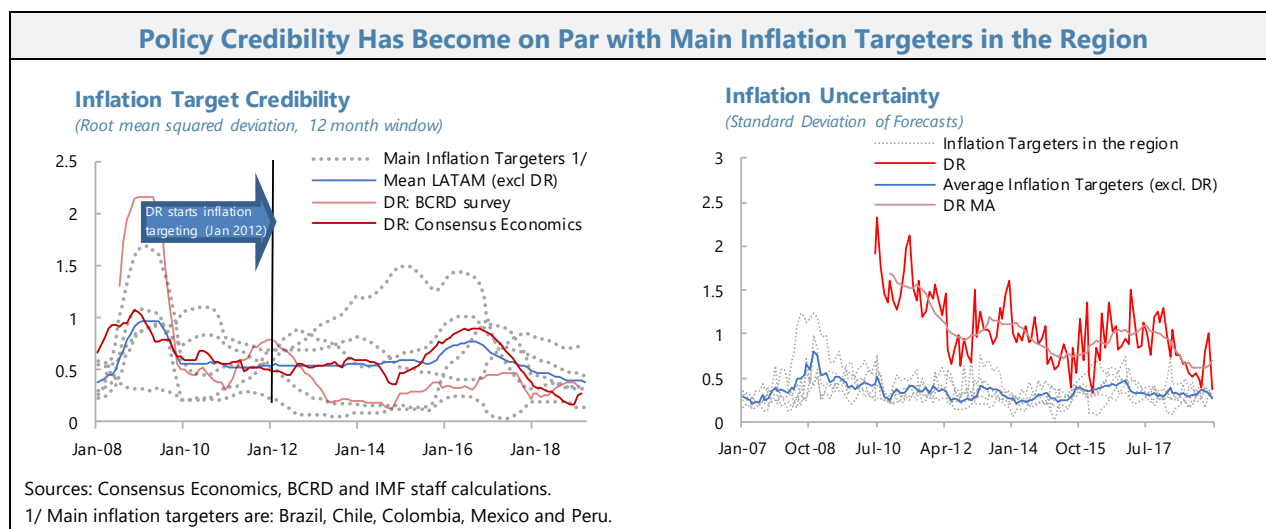
2. Survey evidence shows that inflation expectations in the Dominican Republic are close to the policy target. Well-anchored inflation expectations are the cornerstone of effective monetary policy. Long-run expectations are the most important determinant of inflation and crucial to generate resilience of inflation to external shocks (see Chapter 3, WEO October 2018 and Chapter 3, REO Western Hemisphere April 2018). Both the Central Bank of the Dominican Republic and Consensus Economics publish survey expectations. The deviation of the average inflation forecast from target has gradually declined and remains around the target, even when shocks push inflation outside the target bands, suggesting that monetary policy is credible.



¹ Prepared by J. Faltermeier.

² Monetary policy statements have been issued since 2009.

3. Policy credibility in the Dominican Republic is comparable with the main inflation targeting countries in Latin America with a long track record, despite the policy change being more recent. The deviation of inflation expectations from target has fallen significantly since the onset of inflation targeting. In the last few months, average expectations were closer to the anchor than in most other inflation targeters in the region.³ Inflation uncertainty, as measured by the dispersion of forecasts, has also fallen substantially but remains above the regional average.⁴



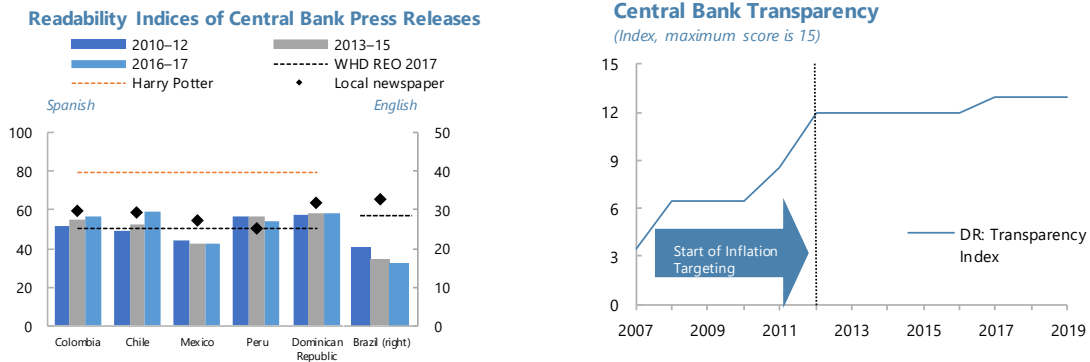
4. Greater transparency in monetary policy operations and effective communication, along with a healthy track record on inflation outcomes, have accompanied the anchoring of inflation expectations. Clear explanations of monetary policy decisions and predictable interest rate movements can be effective tools to manage inflation expectations and enhance policy credibility. The central bank communications are clearly written as suggested by a Legibility Index compiled by IMF staff.⁵ Moreover, an index of central bank transparency suggests that the Dominican Republic has improved transparency along with the monetary policy reform and achieved levels similar to successful inflation targeters such as Chile or Peru. The index points towards room for improvement in the area of communicating central bank forecasts to the general public.

³ This group of countries includes Brazil, Chile, Colombia, Mexico and Peru.

⁴ Consensus Economics does not publish the standard deviation of forecasts for the Dominican Republic. The dispersion is measured from the Macroeconomic Expectations Survey conducted by the Central Bank of the Dominican Republic, so differences in survey methodology may explain the higher standard deviation.

⁵ Details of the methodology are described in the Western Hemisphere Department REO April 2018, Chapter 3. The Spanish press releases for Chile, Colombia, the Dominican Republic, Mexico, and Peru and the English translations for Brazil are used. The Flesch reading ease (RE) index is used for Brazil, which is defined as $RE = 206.835 - (1.015 \times ASL) - (84.6 \times ASW)$, in which ASL = average sentence length, and ASW = average number of syllables per word. Following Taborda (2015), the Flesch-Szigriszt index for documents in Spanish is used for the other economies. That index is defined as $RE = 206.835 - (ASL) - (84.6 \times ASW)$.

Improved Central Bank Transparency Supports Anchoring of Inflation Expectations



Sources: WHD REO April 2018, chapter 3, Bloomberg Finance L.P.; IMF staff calculations; Dincer and Eichengreen (2014) and BCRD.



DOMINICAN REPUBLIC

STAFF REPORT FOR THE 2019 ARTICLE IV CONSULTATION— INFORMATIONAL ANNEX

May 20, 2019

Prepared by:

Western Hemisphere Department
(in consultation with other departments)

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FUND RELATIONS

(As of March 31, 2019)

Membership Status: Joined: December 28, 1945

General Resources Account:	SDR Million	% Quota
Quota	477.40	100.00
Fund holdings of currency (Exchange Rate)	412.77	86.46
Reserve Tranche Position	64.63	13.54
SDR Department:	SDR Million	% Allocation
Net cumulative allocation	208.83	100.00
Holdings	4.93	2.36

Outstanding Purchases and Loans: None

Latest Financial Arrangements:

Type	Date of Arrangement	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
Stand-By	November 9, 2009	March 8, 2012	1,094.50	766.15
Stand-By	January 31, 2005	January 30, 2008	437.80	437.80
Stand-By	August 29, 2003	January 31, 2005	437.80	131.34

Projected Payments to Fund

(SDR Million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2019	2020	2021	2022	2023
Principal	0.00	0.00	0.00	0.00	0.00
Charges/Interest	1.75	2.35	2.35	2.35	2.35
Total	1.75	2.35	2.35	2.35	2.35

Implementation of Enhanced HIPC Initiative: Not Applicable

Implementation of Multilateral Debt Relief Initiative (MDRI): Not Applicable

Implementation of Catastrophe Containment and Relief (CCR): Not Applicable

Exchange Rate Arrangement. The Dominican Republic's *de jure* exchange rate arrangement is classified as "managed floating", while the *de facto* exchange rate arrangement is classified as a "crawl-like arrangement." The Dominican Republic maintains an exchange system free of restrictions on the making of payments and transfers for current international transactions.

Article IV Consultation. The previous round of Article IV consultation discussions took place in Santo Domingo during January 29 – February 10, 2018. The consultation was concluded by the Executive Board on April 11, 2018. The corresponding report was published in October 2018. The Dominican Republic is on the standard 12-month consultation cycle.

FSAP Participation. An FSAP update was completed in February 2009. The corresponding report was issued in November 2009.

Technical Assistance. Technical assistance (TA) delivery to the Dominican Republic takes place through a mix of resident advisors, short-term HQ expert missions, and visits from regional advisors based in the IMF Regional Technical Assistance Center for Central America, Panama and the Dominican Republic (CAPTAC-DR). The key areas of focus are:

- **Revenue Reform:** a resident tax administration advisor supports the internal tax administration (DGII), and the work plan in the last year has focused on the strengthening of taxpayer registry and tax compliance risk management. In the medium term, CAPTAC-DR will continue to support the modernization strategy of tax administration (risk management and tax audit based on cross-information).
- **Customs Administration:** the TA of CAPTAC-DR to the external tax administration (DGA) has been focused in three main areas: (i) strategic planning; (ii) risk management; and (iii) post-clearance audit.
- **Public Financial Management:** the focus of TA is to enable greater efficiency in the use of public resources as well as greater fiscal transparency. Specific TA objectives include (i) the improvement of asset and liability management; (ii) comprehensive, credible and policy-based budget preparation; (iii) strengthened identification, monitoring and management of fiscal risks, and (iv) improved coverage and quality of public sector financial statements.
- **Real Sector Statistics:** TA to compile Input-Output Tables (IOT) for 2007 and 2012 was provided during 2016 and 2017; the dissemination of the IOTs as part of the National Accounts series with base year 2007 is forthcoming. A national accounts rebasing project to 2018 is in progress, for which a *Household Income and Expenditure Survey* was conducted during 2018/19. For National Accounts and prices, TA has been planned to go forward, with the topics to be defined by the central bank in line with the rebasing project needs.
- **Government Finance Statistics:** the work plan for government finance statistics (GFS) was developed in 2017. Follow-up TA missions resulted in the newly-published monthly budgetary central government data fully aligned with the latest international standards, based on joint work between the MOF and the central bank. Forthcoming TA will focus on the expansion of data coverage and improvement of debt data.
- **Financial Sector Supervision and Regulation:** the strategic objective is to bolster the tailored implementation of financial supervision and regulation according to international best practices, with an emphasis on risk-based supervision, cross-border consolidated supervision, and the adoption of prudential criteria based on IFRS and Basel standards. Recent TA activities focused on developing and strengthening banking prudential regulation regarding market risk and IRRBB management; and updating current liquidity risk standards and requirements to banks, by introducing Basel's LCR.

Resident Representative: The Fund representative office was closed on July 1, 2014.

RELATIONS WITH OTHER INTERNATIONAL FINANCIAL INSTITUTIONS

World Bank: <http://www.worldbank.org/en/country/dominicanrepublic>

Interamerican Development Bank: <https://www.iadb.org/en/countries/dominican-republic/overview>

Development Bank of Latin America (CAF): <https://www.caf.com/en/countries/dominican-republic/>

Central American Bank for Economic Integration: <https://www.bcie.org/en/member-countries/regional-non-founding-members/dominican-republic/>

MAIN WEBSITES OF DATA

Central Bank of the Dominican Republic (<https://www.bancentral.gov.do/>)

National accounts
Consumer Price Index
Monthly Indicator of Economic Activity (IMAE)
Balance of Payments
International reserves
Interest rates
Monetary and financial indicators
Tourism statistics
Labor and employment
Exchange rates

Ministry of Finance (<https://www.hacienda.gob.do/>)

Fiscal accounts
Central government budget

Ministry of Economy, Planning and Development (<https://www.economia.gob.do/>)

Household income and expenditure survey
Poverty and inequality
Construction sector statistics

Public Debt Office of the Treasury (<https://www.creditopublico.gov.do/>)

Public debt

Superintendency of Banks (<https://www.creditopublico.gov.do/>)

Balance sheets and income statements
Financial Soundness Indicators

STATISTICAL ISSUES

(As of April 29, 2019)

I. Assessment of Data Adequacy for Surveillance
<p>General: Data provision is broadly adequate for surveillance. Most macroeconomic statistics are compiled by the Central Bank of the Dominican Republic, with the National Statistics Office producing underlying surveys and the population census. Fiscal data are compiled by the Ministry of Finance.</p>
<p>National Accounts: The Central Bank of the Dominican Republic compiles and disseminates national accounts series, based on the concepts and definitions of the <i>System of National Accounts 2008</i>. A rebasing project of national accounts to 2018 is in progress, including a Household Income and Expenditure Survey conducted during 2018/19. Regional GDP estimates are not available. National accounts are compiled by the production and expenditure approaches, both at current prices and chain-linked volume indices with 2007 as the reference year. A Monthly Index of Economic Activity (<i>Indice Mensual de Actividad Económica, IMAE</i>), which is a chain-linked volume index with 2007 as the reference year, is published monthly by the Central Bank.</p>
<p>Price Statistics: The concepts and definitions used in the Consumer Price Index (CPI) follow internationally accepted standards. The CPI basket of goods and services is disaggregated and allows evaluation of prices for 12 groups of goods and services, according to the Classification of Individual Consumption by Purpose (COICOP). The CPI has a base year of 2010 with weights based on the results of the National Household Income and Expenditure Survey (ENIGH), conducted between January 2007 and January 2008. The National Statistical Office compiles a Producer Price Index for manufacturing and services with weights from the national accounts (base year 2007), and reference period of December 2013.</p>
<p>Government Finance Statistics: Both the Ministry of Finance and the Central Bank compile and disseminate government finance statistics (GFS). Although aggregate data are available for the central government, the balance of the Rest of the Non-Financial Public Sector is estimated only from the financing side, as above-the-line data coverage on local governments and some non-central government entities is incomplete and not timely. The authorities have made progress in fiscal data presentation and are posting fiscal execution data on the transparency portal of the Ministry of Finance.</p> <p>The country participates in a regional capacity development program for the harmonization of GFS for Central America, Panama, and the Dominican Republic led by the IMF's Regional Center for Technical Assistance (CAPTAC-DR).</p> <p>The authorities have transitioned to the GFSM 2014 framework, with technical assistance from the Statistics Department of the IMF and CAPTAC DR.</p> <p>The authorities are currently working to implement International Public Sector Accounting Standards (IPSAS) and introduce a results-based program budgeting system.</p>

The authorities are encouraged to involve strategic units in elaborating the chart of accounts under IPSAS, create a GFS committee to reconcile fiscal data with participation of Ministry of Finance and the Central Bank, review the regulatory framework for financial management prior to the adoption of international standards, and disseminate comprehensive fiscal data on a timely basis.

Monetary and Financial Statistics: The Central Bank of the Dominican Republic compiles monetary statistics, including its monetary accounts and the accounts for other depository corporations (ODCs). A consolidated balance sheet of the financial sector is available. Monetary data is reported to the IMF's Statistics Department using standardized report forms on a monthly basis allowing balance sheet analysis of currency and maturity mismatches for depository corporations. The Central Bank of the Dominican Republic also disseminates its harmonized monetary statistics via its webpage. The Dominican Republic reports data on several series and indicators to the Financial Access Survey (FAS), including gender-disaggregated data on use of basic financial services, mobile money and the two indicators of the U.N. Sustainable Development Goals.

Financial sector surveillance: The Dominican Republic is a participant in the IMF's Financial Soundness Indicators (FSIs) database, reporting FSIs monthly with data beginning in 2008. The data is reported by the Superintendency of Banks of the Dominican Republic and is very comprehensive, both for the banking system as a whole, and for individual banks. There is very good coverage of core FSIs, but FSIs on non-financial corporates and households are not available. There is also no data available on real estate markets.

External sector statistics: The Central Bank of the Dominican Republic compiles and disseminates balance of payments and international investment position (IIP) statistics on a BPM6 basis (BPM6 basis balance of payments and IIP data need to be extended historically as they start in 2010 and 2009, respectively). Coverage gaps mainly affect the recording of nonfinancial private sector transactions in the financial account and give rise to persistent errors and omissions in the balance of payments statistics. These coverage issues particularly relate to direct investment and private sector external debt transactions and positions which also impact IIP statistics. The Directorate of Public Credit of the Ministry of Finance publishes the external debt of the government. External debt statistics for the whole economy, including detailed private sector external debt data, are not disseminated. The Dominican Republic does not participate in the Coordinated Portfolio Investment Survey (CPIS) and the Coordinated Direct Investment Survey (CDIS).

II. Data Standards and Quality

The country has been a e-GDDS participant since November 22, 2005 and implemented the e-GDDS on February 21, 2019 by launching a National Summary Data Page (NSDP). The NSDP reflects updated metadata and other recent methodological improvements.

Table 1. Dominican Republic: Common Indicators Required for Surveillance
(as of April 26, 2019)

	Date of latest Observation	Date Received	Frequency of Data ⁷	Frequency of Reporting ⁷	Frequency of Publication ⁷
Exchange Rates	4/26/2019	4/26/2019	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities ¹	4/17/2019	4/25/2019	D	D	M
Reserve/Base Money	4/25/2019	4/26/2019	D	D	W
Broad Money	03/2019	03/2019	W	W	W
Central Bank Balance Sheet	3/2019	04/2019	M	M	M
Consolidated Balance Sheet of the Banking System	3/2019	04/2019	M	M	M
Interest Rates ²	4/26/2019	4/26/2019	D	D	D
Consumer Price Index	3/2019	4/2019	M	M	M
Revenue, Expenditure, Balance and Composition of Financing ³ - General Government ⁴	12/2018	2/2019	M	M	M
Revenue, Expenditure, Balance and Composition of Financing ³ -Central	12/2018	2/2019	M	M	M
Stocks of Central Government and Central Government-Guaranteed Debt ⁵	12/2018	2/2019	Q	Q	Q
External Current Account Balance	12/2018	3/2019	Q	Q	Q
Exports and Imports of Goods and Services	12/2018	3/2019	M	M	M
GDP/GNP	Q4/2018	2/2019	Q	Q	Q
Gross External Debt	NA	NA	NA	NA	NA
International Investment Position ⁶	12/2018	3/2019	Q	Q	Q

¹ Any reserve assets that are pledged or otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.

² Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.

³ Foreign, domestic bank, and domestic nonbank financing.

⁴ The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.

⁵ Including currency and maturity composition.

⁶ Includes external gross financial asset and liability positions vis-à-vis nonresidents, including of offshore banks.

⁷ Daily (D); Weekly (W); Monthly (M); Quarterly (Q); Annually (A); Irregular (I); Not Available (NA).

**Statement by Alexandre A. Tombini, Executive Director for Dominican Republic
and Frank Fuentes, Senior Advisor to the Executive Director
June 5, 2019**

1. The authorities of the Dominican Republic want to thank the mission team for the open and constructive dialogue during this year's Article IV consultation. They welcome staff's thorough analysis and valuable recommendations and look forward to continuing a constructive relationship with the Fund. The authorities take note of staff appraisal and reiterate their commitment to sound macroeconomic policies focused on strong growth, social progress, financial stability, and sustainable public finances.

Recent developments and outlook

2. The Dominican economy maintained a strong growth performance in 2018. The country led growth in the Latin America and the Caribbean region at 7.0 percent, underpinned by a robust private consumption and investment amid less supportive external conditions. In the first quarter of 2019, economic activity continued to grow, albeit at a more moderate pace, reaching 5.7 percent despite severe drought conditions impacting agricultural production. The ongoing expansion is headlined by the dynamism of the construction sector and the sustained growth in services, particularly in tourism. Authorities forecast real GDP growth will finish the year at around 5.5 percent, driven primarily by domestic demand.

3. Sustained and better focused social expenditure is generating a significant improvement in socioeconomic indicators. In addition to bolstering investment in health and education, social programs focused on anti-poverty initiatives and on aid to farmers and small businesses have been instrumental to reduce the poverty headcount from 39.7 percent in 2012 to 22.8 percent in 2018, and extreme poverty from 9.9 percent to 2.9 percent in the same period. More importantly, rural poverty has experienced a substantial reduction underpinned by public policies directed to boost credit access, infrastructure investment and promote gender inclusion. The sustained growth trend in recent years has contributed to reduce the unemployment rate to 5.8 percent as of March 2019. Approximately 80 percent of the jobs generated during last year were in the formal sector, reducing overall labor informality.

Fiscal policy

4. Authorities are committed to fiscal consolidation and to strengthening medium term fiscal sustainability. The Non-Financial Public Sector (NFPS) deficit descended to 2.7 percent of GDP in 2018 on the back of strong revenue growth. It is expected to decline further to 1.7 percent of GDP in 2019, supported by additional efforts to improve tax administration and the decline in transfers to the electricity sector as the Punta Catalina coal-fired power plants become operational. Regarding the institutional framework, the Ministry of Finance is operating under a medium-term fiscal framework for 2018-2022 that provides the guidelines to strengthen fiscal sustainability and monitor risk exposure to macroeconomic shocks. Additionally, fiscal

authorities understand the relevance and benefits of a fiscal responsibility framework and have begun discussions regarding its prospective design and future implementation.

5. Public debt remains sustainable. The debt-to-GDP ratio reached 50.4 percent at end 2018, with a sustainable medium-term outlook and resilient to external shocks, as highlighted by staff in the Debt Sustainability Analysis. In order to strengthen the institutional framework of debt management, the Ministry of Finance has received valuable technical assistance from a mission comprised by experts from MCM and FAD. Regardless, authorities are cognizant of the vulnerabilities associated with the public debt and have emphasized their commitment to place the debt-to-GDP ratio on a firm downward trajectory. Against this background, the government is persuaded that there is room for strengthening tax administration further to reduce evasion and fraud and boost fiscal revenue.

Monetary policy

6. Monetary authorities have preserved price stability notwithstanding high economic growth. The inflation targeting regime, in place since 2012, has supported the Central Bank of the Dominican Republic (CBDR) in fostering low inflation and well-anchored inflation expectations. Since mid-2018, the combination of tighter monetary conditions and lower oil prices have eased the pressure off domestic prices in the context of brisk economic activity, driving down headline inflation below the lower limit of the 4.0 ± 1.0 percent target range (1.17 percent at year-end, the lowest registered since 1984). Inflationary pressures remain muted as year-on-year CPI inflation is still well below the target band reaching 1.6 percent in April 2019. After the staff report was circulated, the CBDR reduced the reserve requirements to provide additional liquidity to support credit to the private sector.

7. The new electronic platform will support CBDR efforts to organize and deepen the FX market. The implementation of the electronic FX platform that will become operational in late June, will enhance efficiency and increase market liquidity and transparency in line with international best practices. After the full implementation of the platform and market adaptation to the system, authorities are planning to introduce an explicit intervention rule to moderate sharp fluctuations in the exchange rate. In preparation, the CBDR has reduced market interventions for stabilization purposes since January.

8. New plan to recapitalize the Central Bank will be signed into law soon. The CBDR and the Ministry of Finance are diligently working to finalize negotiations to reform Law 167-07 to address the outstanding amount of the instruments for the recapitalization of the Central Bank. The new plan will allow for better coordination between the CBDR and the Ministry of Finance regarding debt issuance. Moreover, this framework aims to contribute to lower issuance costs, and systematically reduce the CBDR quasifiscal deficit and debt level in the medium term.

Financial stability

9. The banking system remains well-capitalized, liquid and profitable. According to financial soundness indicators, at the end of April the capital adequacy ratio stood at 15.6 percent, the return on assets (ROA) at 2.0 percent, the return on equity (ROE) reached 18.9 percent, and Non-performing loans (NPL) decreased to 1.6 percent. The CBDR and the Superintendency of Banks are taking actions to boost financial inclusion, including by leveraging advances in financial sector technology (Fintech) under strict regulation. Regarding risks to financial stability, authorities recognize the challenges related to nonbank institutions. As a result, a project to revamp supervision and regulation of the cooperative sector is being evaluated by the Presidency and Congress.

10. Authorities are making steadfast progress in strengthening the AML/CFT framework. In June 2017, the Dominican Republic carried out a comprehensive reform of its AML/CFT legal framework by enacting Law 155-17, which is broadly in line with international standards. Moreover, the 2018 assessment by the Financial Action Task Force of Latin America (GAFILAT) found relatively strong technical compliance with the FATF standards and the country continues to work diligently in implementing the recommendations rendered in the Mutual Evaluation Report. In addition, authorities have strengthened the Financial Analysis Unit (UAF) with the technological and financial resources warranted to implement the new legislation, as the country remains engaged in becoming a member of the Egmont Group.

11. The CBDR and the banking sector have taken important steps towards enhancing cybersecurity. The creation of a Cybersecurity Incidents Response Center will enable financial authorities to monitor threats and prevent attacks on financial institutions and participants of the payments and securities settlement system. In this process, the CBDR has received valuable support from the Fund during two staff visits to headquarters in 2017 and 2018, and ongoing training and technical assistance provided by Israel. A high-level interinstitutional commission is currently working to reform Law 53-07 against High Technology Crimes and Offences to provide a national legal framework to combat cybercrimes.

External sector

12. External sector performance continues to be solid. The current account deficit averaged 0.9 percent of GDP during 2016-18, well below its historical mean, buttressed by tourism and gold and maquila exports in the context of low oil prices. Staff assess the external position and the real exchange rate as broadly in line with medium-term fundamentals and desirable policies. Foreign direct investment (FDI) continues to play a prominent role in financing the external gap, averaging 3.7 percent of GDP since 2010 and fostering economic diversification and job creation. Regarding international trade, relations with the United States, the country's main trading partner, remain strong and anchored by the Dominican Republic-Central America Free-Trade Agreement (DR-CAFTA). Nonetheless, the authorities continue to monitor the risks emanating from global trade tensions and the potential impact on the country's terms of trade and external competitiveness.

13. Reserve adequacy has improved. The level of foreign international reserves has increased steadily since the 2003-04 banking crisis and currently exceeds all traditional reserve adequacy metrics. Nevertheless, authorities are taking actions to continue reserve accumulation in order to solidify the external position, increase the resilience to external shocks and get closer to the adequacy threshold set by the Fund's risk-weighted metric (ARA). Authorities plan to further build-up reserves as opportunities arise.

Structural reforms

14. The structural reform agenda is anchored by the National Development Strategy (NDS) 2030. The NDS was signed into law in 2012 to serve as the strategic roadmap to achieve the Dominican Republic's development goals. The law mandates that three national pacts must be agreed upon between the government, the civil society and the private sector to build the consensus to address key issues in public education, electricity generation and public finances. The national pact for education was signed in 2012 and prompted authorities to double public investment in education to 4 percent of GDP to build new schools, reform the curriculum and boost teacher quality. Thus far, lack of political consensus has delayed the completion of both the electricity and fiscal pacts.

15. Regarding the electricity sector, the government is expecting to boost generation and ease fiscal pressures as the new power plants become operational. The plants have initiated operations with a joint capacity of 752 MW, approximately 30% of the country's gross energy output. To support the project, the government is expected to invest heavily in distribution infrastructure to improve energy reliability and reduce costs for the state-owned distribution companies. Despite being coal-fired, the plants performed well against IFC performance standards. Authorities are now preparing to open the project to private investors (up to 50 percent of ownership). This operation will allow the government to lessen budget pressures and reduce consolidated public debt further. In the meantime, authorities remain committed to take further actions to continue addressing the sector's structural bottlenecks.

16. The government remains engaged in discussions on labor and social security reforms. While extended dialogue with the private sector and trade unions have delayed consensus building to reform the labor code and the social security law, authorities continue to act proactively to advance negotiations. In February, the Executive branch sent a bill to Congress to lower commissions charged by the Pension Fund Administrators (AFPs). The AFPs' high gains and the affiliates low profitability is one of the aspects to be revised in the impending reform. Regarding the labor code, discussions have revolved around finding mechanisms to boost formal employment, add flexibility and increase wages without reducing workers labor rights. In this process, the government continues to mediate between employers and employees, and recently introduced a legislation to raise pensions and the minimum wage in the public sector.

17. The National Competitiveness Council have implemented important initiatives to improve the business climate. Measures to raise the efficiency of public institutions and forge a

more efficient and competitive economy have been adopted, including streamlined procedures to open new businesses and fulfill tax obligations. In addition, a new bill to institute the legal framework for Public-Private Partnerships (PPPs) was submitted to Congress last May. This mechanism will be key to close the infrastructure gap and broaden the range of sectors attracting investment.

18. Authorities continue to work in strengthening the rule of law. The ongoing corruption probe has forcefully pursued allegations against former high-level officials, sending to trial seven defendants, including congressmen and former ministers. The present administration has repeatedly stressed its commitment to sanction those involved in corruption acts. Further progress in enhancing public sector transparency and accountability has been achieved with the revamped asset declaration requirements and measures to enhance fiscal transparency, by prosecuting tax evasion, fraud and money laundering.