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# Dominican Republic: Second and Third Reviews Under the Stand-By Arrangement and Request for Waivers of Applicability—Staff Report; Staff Supplement; Informational Annex; Press Release on the Executive Board Discussion.

In the context of second and third reviews under the stand-by arrangement and request for waivers of applicability, the following documents have been released and are included in this package:

- The staff report for the Dominican Republic: Second and Third Reviews Under the Stand-By Arrangement and Request for Waivers of Applicability, prepared by a staff team of the IMF, following discussions that ended on September 2, 2010, with the officials of Dominican Republic on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on October 13, 2010. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- A staff supplement of October 19, 2010 updating information on recent developments.

- An informational annex.

- A Press Release summarizing the views of the Executive Board as expressed during its October 22, 2010 discussion of the staff report that completed the request and/or review.

The documents listed below have been or will be separately released.

Letter of Intent sent to the IMF by the authorities of Dominican Republic*
Technical Memorandum of Understanding*

*Also included in Staff Report

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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INTERNATIONAL MONETARY FUND

DOMINICAN REPUBLIC

# Second and Third Reviews Under the Stand-By Arrangement and Request for Waivers of Applicability

Prepared by the Western Hemisphere Department
(In consultation with other departments)

Approved by Rodrigo Valdés and Dominique Desruelle

October 13, 2010


## Executive Summary

- **Arrangement**. Against the background of deteriorating external conditions due to the global financial crisis, the Executive Board approved a 28-month Stand-By Arrangement (SBA) for the Dominican Republic in the amount of SDR 1,094.5 million (500 percent of quota) on November 9, 2009. The first SBA review was completed on April 7, 2010. The second review was delayed because the authorities needed more time to articulate policies for the second half of 2010. The main objective of the authorities' program is to limit the procyclicality of policies in the short-run while strengthening medium-term sustainability and growth prospects through a combination of fiscal consolidation and a focused structural reform agenda.

- **Developments**. The macroeconomic situation has improved significantly, beyond what was expected under the program. Activity has gained momentum with no signs of overheating. Real GDP expanded 7½ percent in the first half of 2010 (yoy), after being (almost) stagnant in mid-2009. Exports, imports, tax collections and credit to the private sector have all rebounded in the first half of the year. Headline inflation has been contained (5 percent yoy in August 2010, against a target of 6–7 percent for the year), and core inflation remains at about 3½ percent. The authorities regained access to international capital markets by issuing a bond for US$750 million at favorable terms in April 2010.

- **Reviews**. The program remains on track. All performance criteria and structural benchmarks for end-March and for end-June 2010 were observed, but progress with electricity reform and efforts to strengthen tax collections continue to disappoint. With the first part of the program completed (i.e., a countercyclical effort in the low part of the cycle), the authorities are implementing the second part, strengthening the fiscal position to reinforce debt sustainability and continuing with structural reforms.

- **2011 Program**. The authorities remain committed to the fiscal consolidation originally envisaged in the program and aim for policies that support continued high growth. Real economic activity is projected to grow 5½-6 percent in 2011 with inflation at 5-6 percent. The consolidated public sector deficit is expected to fall by 1 percent of GDP to 3 percent of GDP, and the external current account deficit is expected to narrow to about 6½ percent of GDP.

- **Appraisal**. Staff supports completion of the second and third SBA reviews and the targets proposed for 2011 in view of the positive macroeconomic performance.

## List of Acronyms

| | |
|---|---|
| BCP | Basel Core Principles |
| BCRD | Central Bank of the Dominican Republic |
| BONOLUZ | Targeted Electricity Subsidy |
| CCT | Conditional Cash Transfer |
| CDEEE | Public Electricity Company |
| COMA | Open Market Committee |
| CRI | Cash Recovery Index |
| DGA | Customs Office |
| DGI | Domestic Tax Office |
| EDENORTE | Northern Electricity Distribution Company |
| EDEs | Electricity Distribution Companies |
| EDEESTE | Eastern Electricity Distribution Company |
| EDESUR | Southern Electricity Distribution Company |
| FAD | Fiscal Affairs Department |
| FETE | Stabilization Fund for the Electricity Tariff |
| GDP | Gross Domestic Product |
| GIMPO | Inter-institutional Program Monitoring Group |
| IDB | Inter-American Development Bank |
| ITBIS | VAT on Industrialized Commodities and Services |
| LEG | Legal Department |
| LOI | Letter of Intent |
| MCM | Monetary and Capital Markets Department |
| MEFP | Memorandum of Economic and Financial Policies |
| NDA | Net Domestic Assets |
| NFPS | Nonfinancial Public Sector |
| NIR | Net International Reserves |
| NPL | Nonperforming Loans |
| OSFI | Office of the Superintendent of Financial Institutions |
| PC | Performance Criteria |
| PFM | Public Financial Management |
| PLD | Dominican Liberation Party |
| PRA | Blackout Reduction Program |
| REFIDOMSA | Public Refining Company |
| SB | Structural Benchmark |
| SIB | Superintendent of Banks |
| SBA | Stand-By Arrangement |
| SDR | Special Drawing Rights |
| TA | Technical Assistance |
| TMU | Technical Memorandum of Understanding |
| UNDP | United Nations Development Program |
| VAT | Value Added Tax |
| WB | World Bank |
| WHD | Western Hemisphere Department |

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## I. Developments and Perspective [1]

1. **Context**. The Dominican Republic's economy has recovered noticeably, aided by less adverse external conditions and stimulative policies which were part of the IMF-supported program through mid-2010. The economy faced a difficult external and domestic environment in 2009. The global economic and financial crisis depressed exports, remittances and tourism, which, coupled with deteriorated confidence, reduced private spending, while tax collections dropped considerably for most of 2009. The central bank lowered its policy rate aggressively but private credit remained weak. Difficulties in domestic and foreign capital markets limited financing to the government and forced a procyclical tightening of the fiscal position in the first half of 2009. Against this background, the authorities negotiated a multi-year Stand-By Arrangement (SBA) to limit the procyclical policy bias in a first phase of the program (through mid-2010), followed by a strengthening of fiscal sustainability through gradual fiscal consolidation and a focused structural reform (through early-2012). The Board approved the SBA in November 2009. The first SBA review was completed in April 2010, but the second review was delayed because the authorities needed more time to articulate policies for the second half of 2010.

2. **Strategy**. While the first phase of the program successfully helped to rapidly reinvigorate the economy in the first half of 2010, including through a modest fiscal impulse, the second phase of the program had a difficult start. The electricity reform has produced disappointing financial results and efforts to strengthen tax collections were partially derailed due to strong opposition from the private sector. In these circumstances, the authorities agreed to limit expenditures (mostly capital) to achieve the program targets for the second half of 2010. To avoid similar problems in the future and to safeguard fiscal sustainability, the authorities plan to present to Congress a budget for 2011 aligned with the fiscal objectives under the original program described in the October 2009 staff report (EBS/09/165), but with conservative assumptions about the impact of tax measures recently adopted and a modest capital expenditure increase. This represents a significant deterioration in the quality of adjustment (compared to the vision in the original program) as valuable capital expenditures would need to be restrained in favor of untargeted electricity subsidies and tax exemptions. However, as additional revenues materialize, the authorities will send a supplementary budget to Congress to authorize additional capital expenditures (partly regaining some of the adjustment quality previously lost). The authorities remain committed to reduce the electricity subsidy and to continue strengthening tax administration efforts and rationalizing tax exemptions.

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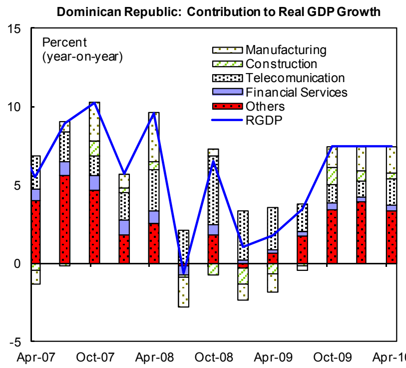
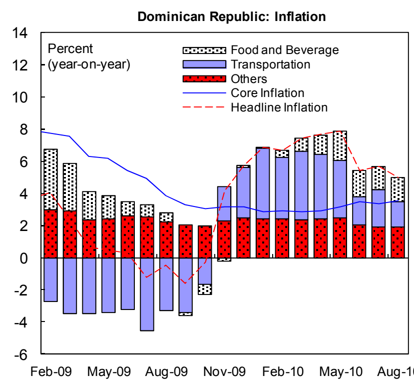
[1] Discussions took place during May 18–28, June 14-15, August 3-19, 2010 in Santo Domingo, and August 30-September 2 in Washington. The missions met with President Fernández, Central Bank Governor Valdez, Finance Minister Bengoa, Economy Minister Montás, senior government officials, representatives of the banking community, and the private sector. The staff team consisted (at different times) of A. Santos (head), G. Bannister, A. Alichi, J. Araujo (all WHD), R. Espinoza (SPR) and E. Crivelli (FAD). The authorities also met with the Deputy Managing Director, Mr. Portugal, and WHD senior staff while in Washington. The mission liaised with the World Bank and IDB staff in Santo Domingo. Mr. Estrella (OED) participated in the meetings.

## A. Economic Conditions

3. **Output.** Activity is growing solidly, led mainly by the expansion of domestic demand, and the output gap is progressively narrowing. During the first half of 2010 real GDP growth maintained the high annual rate of 7½ percent seen in the last quarter of 2009. Since late 2009, the recovery has become broad-based. There is a rebound in construction associated with public investment, and higher demand for food related to higher exports to Haiti. The rate of unemployment fell by half a percentage point from 15 percent in October last year to 14½ percent in April 2010. Other indicators also point to a broad-based expansion; in the first half of 2010 exports (excluding free trade zones) increased close to 40 percent year-on-year (yoy), non-oil imports grew over 20 percent, tax revenue expanded at over 12 percent, and commercial bank credit advanced by over 15 percent.




4. **Inflation.** There are no signs of demand-driven inflationary pressures yet. Headline inflation fell to 5 percent (yoy) in August 2010 (below the 6-7 percent central bank target), partly reflecting lower fuel prices. So far this year, transportation has contributed about 3¼ percentage points to headline inflation, contrasting with a negative contribution last year. Core inflation (which excludes food and fuel prices) remained at 3½ percent (yoy) in August 2010, and has been stable in the last 12 months, well below the rate observed in the previous 4 years.




5. **Fiscal position**. The modest fiscal impulse programmed for the first half of the year was maintained partly due to lower-than-programmed revenues. While tax collections firmed up in the second quarter of 2010, led by a strong expansion in value added tax receipts, they remained 0.4 percent of GDP below program projections for the first half of the year, as income tax revenues (heavily influenced by 2009 income levels) remain weak. Expenditures were contained (in line with revenue shortfalls) leading up to the May legislative and municipal elections, and the fiscal deficit of the central administration through June 2010 was within program projections. Overruns in the electricity transfer of close to 0.1 percent of GDP were compensated by lower capital spending to meet the program targets in the central administration. The quasi-fiscal deficit of the central bank was lower than expected at 0.6 percent of GDP, leading to a consolidated public sector deficit of 2.3 percent of GDP in the first half of 2010, 0.1 percent of GDP below program projections.

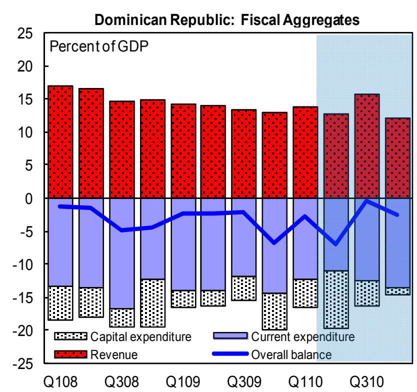
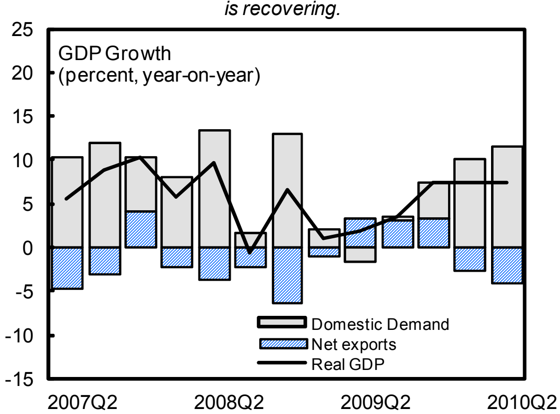


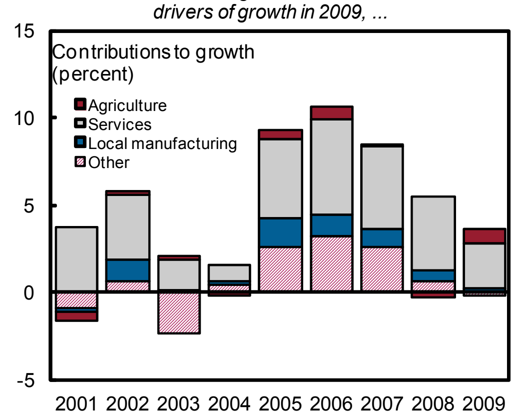
**Figure 1. Dominican Republic: Real Sector Developments**

*GDP growth strengthened significantly while inflation remained subdued on the back of a negative output gap and stable exchange rate. Unemployment has improved slightly.*

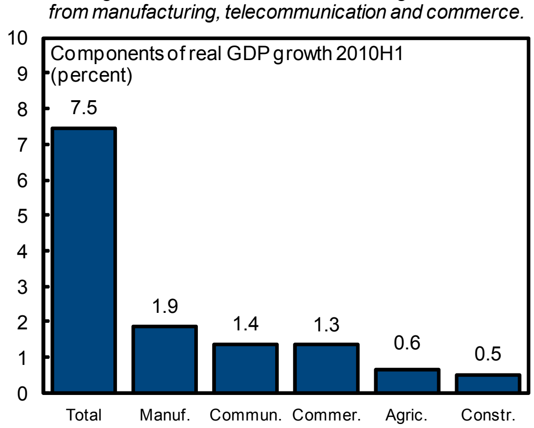
*After slowing down significantly in 2009, GDP growth is recovering.*



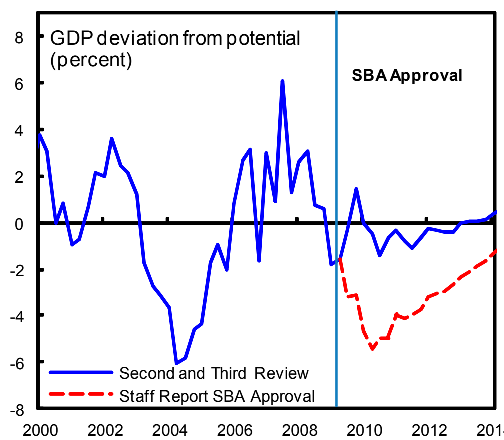

*While the services and agriculture sectors were the main drivers of growth in 2009, ...*



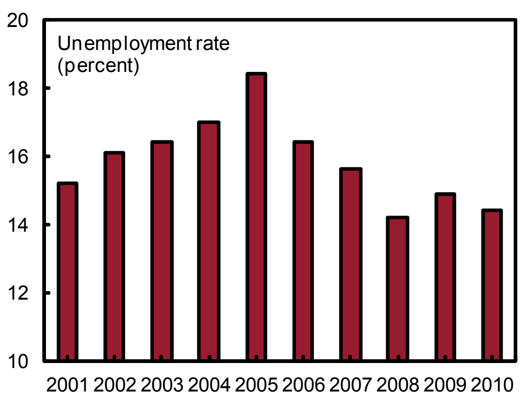

*...GDP growth is now broad-based with largest contribution from manufacturing, telecommunication and commerce.*



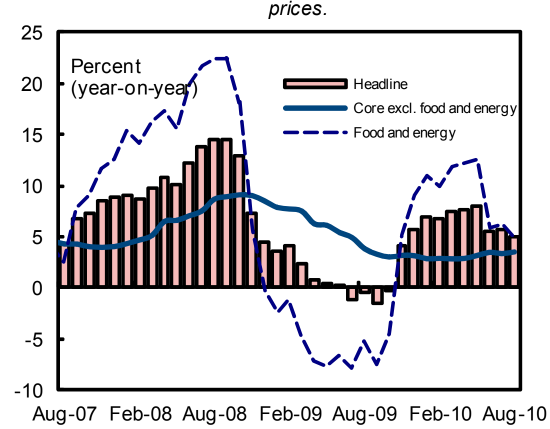

*Faster growth significantly reduced the negative output gap,...*




*... lowering the unemployment rate in 2010.*



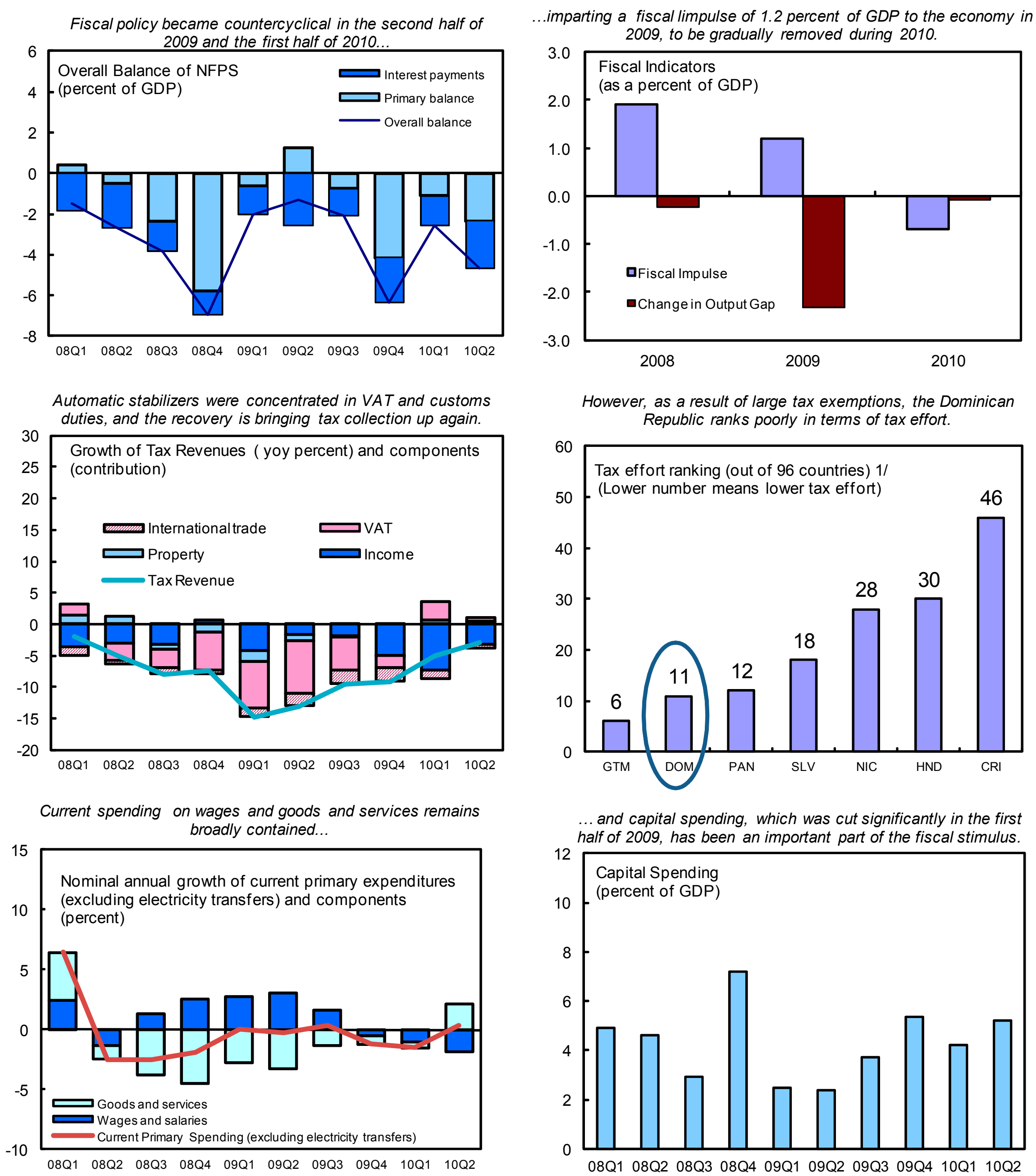

*Headline inflation fell, but largely tracking energy prices.*




Sources: Dominican authorities; and Fund staff estimates.

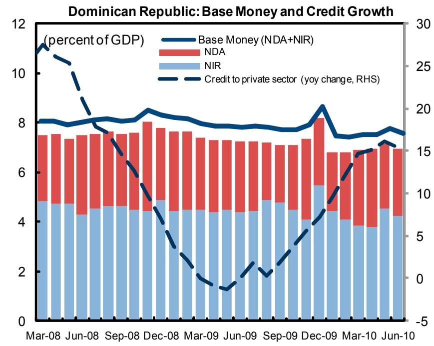
**Figure 2. Dominican Republic: Fiscal Developments**

*Fiscal policy was tightened considerably in the first half of 2009 as large declines in revenues were matched by cuts in expenditure. With the imparted fiscal stimulus starting in the second half of 2009, tax collection and capital spending are recovering.*

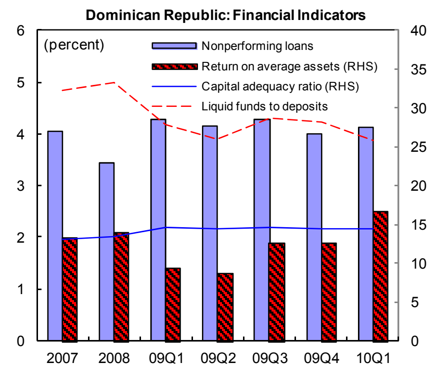



Source: Dominican Authorities; and Fund staff calculations.
1/ Tax effort is defined as the gap between a country's maximum tax revenue capacity (as determined by its economic, social, institutional, and demographic characteristics) and its actual tax collection. See Fenochietto, R. and Pessino, C., (forthcoming), "Determining Countries' Tax Effort."

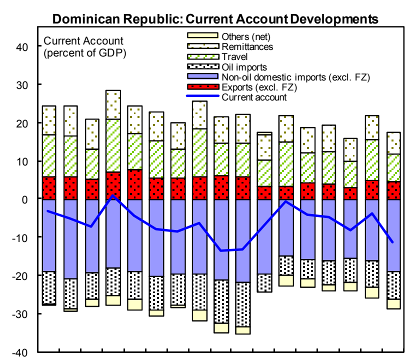
6. **Monetary.** The central bank has maintained its accommodative stance for almost a year. After an aggressive easing in the first eight months of 2009 when the policy rate was reduced from 9½ percent to 4 percent, and lowering the reserve requirement rate from 20 to 17.5 percent, the BCRD maintained the policy rate at 4 percent, during the monetary policy meeting of the Open Market Committee (COMA) of end-August 2010 for the eleventh consecutive month. Mindful of the possible need to tighten interest rates in the near-term, recent official communications of the COMA emphasize its commitment to its inflation target and its readiness to take necessary measures to achieve that objective. Monetary aggregates are expanding, M1 grew about 15 percent (yoy) in August 2010, and credit to the private sector exceeded 15 percent (yoy) in July 2010. Net international reserves (NIR) stood at US$2.1 billion at end-August 2010 after exceeding program levels in end-June.




7. **Financial.** There are no signs of stress in the banking system. Banking soundness indicators through June 2010 keep signaling adequate capital (14 percent of assets), regained profitability (a ROA of about 2½ percent) and low non-performing loans (3½ percent of total loans). Banks have been reducing their still somewhat high liquidity positions to finance the rebound in private credit.




8. **External.** The decline in trade activities reverted in the last months of 2009 and total imports expanded by over 25 percent (yoy) in the first half of 2010. Despite strong export growth of over 40 percent in the first half of 2010 (excluding free trade zones), and stable travel receipts in the high season, the current account deficit widened to almost 8 percent of GDP in the first half of 2010, driven by imports and declining remittances. However, the current account is expected to improve somewhat in the second half of the year due to a moderation in import growth. Following a Moody's sovereign credit rating upgrade (from B2 to B1, which is still 3 notches below investment grade), the authorities issued an 11-year sovereign bond for US$750 million (1½ percent of GDP) at an interest rate of 7.5 percent in late April 2010 (some 375 basis points over US Treasury bond rates). The amount raised by the bond issuance was US$150 million higher than envisaged in the program, helping reduce the dependence on local financing (Box 1).

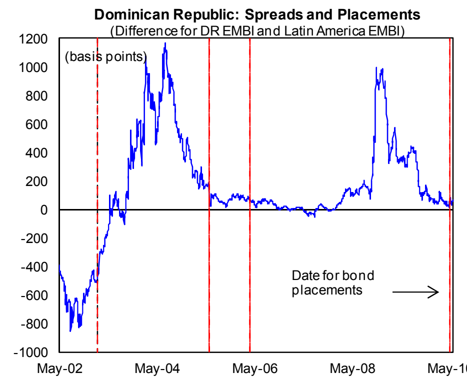



9. **Regional.** The Haiti earthquake initially disturbed trade routes with the Dominican Republic but exports to Haiti have resumed. As Haiti suffered damage to its ports and airports, a good part of the humanitarian aid (i.e., mostly food items) was channeled through

## Box 1. Dominican Republic: Re-Entry to International Capital Markets

**The Dominican Republic re-entered international capital markets in April 2010 after an absence of more than 4 years**. On April 29, the authorities issued a US$750 million sovereign bond, the largest placement at one of the lowest coupons and spreads ever achieved by the country. The issue was originally planned for US$600 million but was augmented following high investor demand, the book being oversubscribed six times. The issue brings the total outstanding bonded debt of the Dominican Republic issued in international capital markets to some US$2.1 billion (4¼ percent of GDP), with an average maturity of 10½ years, and an average coupon of 8¾ percent.

**The Dominican Republic's presence in international capital markets is a relatively new phenomenon**. The first sovereign issuance in international markets (after the Brady operation of 1994) occurred at the end of 2001, soon after the September 11 attacks, with a 5-year US$500 million bond. The authorities proceed with the issue despite uncertainty in the markets. A second international sovereign bond was issued in January 2003 (US$600 million with a 10-year maturity) with the intention of retiring short-term debt, but this came just three months before the banking crisis in 2003, and was eventually used to support international reserves in the context of widening spreads, a sharp depreciation of the peso, and capital flight.




**Following the crisis, a voluntary debt exchange was launched in 2005 to swap the bonds issued in 2001 and 2003 for longer maturity bonds.** The exchange was part of a broad-based financing strategy to help solve the country's short term liquidity problems and in line with the comparability-of-treatment provision of the 2004 Paris Club restructuring. The government aimed to extend maturity by 5 years (the duration was increased by 2 years only because the amortization profile was frontloaded), without a significant NPV cut for bond holders. The restructuring was a success: participation reached 97 percent, and the cash flow relief amounted to about US$550 million over the period 2005-06. This facilitated the issue of a new US$300 million bond in March 2006, with a maturity of 21 years and rate of 8½ percent (oversubscribed more than 3 times), which was used to finance the buyback of debt owed to a Spanish electricity company (Union Fenosa) in the context of a financial restructuring of the sector.

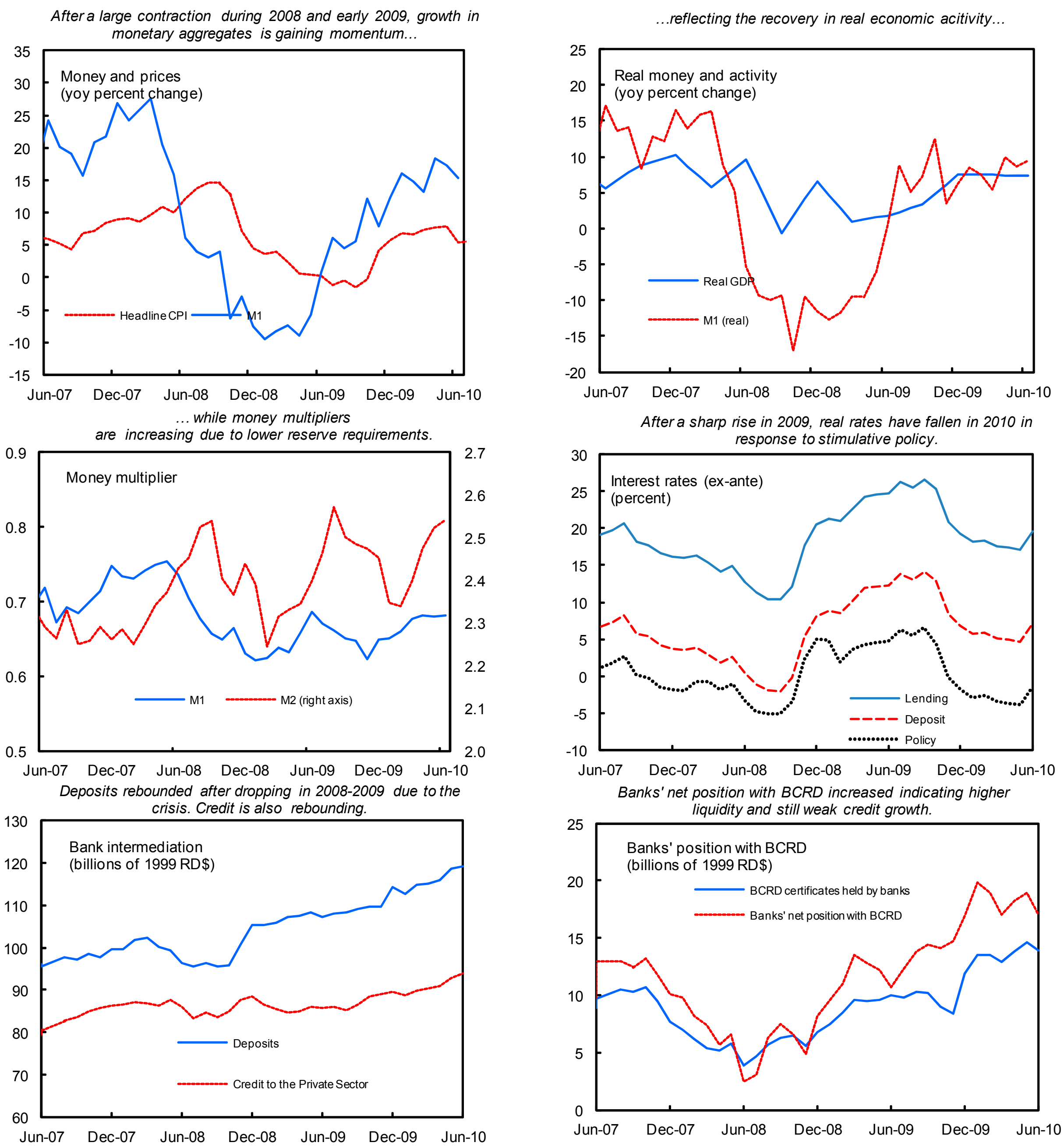
**Dominican Republic: History of Sovereign Bond Placements**

| | Brady Bonds | | | | Voluntary Debt Exchange (01/03) 1/ | | | |
|---|---|---|---|---|---|---|---|---|
| | Discount | PDI | | | | | | |
| | Aug 1994 | Aug 1994 | Sep 2001 | Jan 2003 | May 2005 | May 2005 | Mar 2006 | Apr 2010 |
| Amount issued (mn US$) | 329 | 191 | 500 | 600 | 586 | 480 | 300 | 750 |
| Amount outstanding (mn US$) | 329 | -- | -- | 14 | 586 | 144 | 300 | 750 |
| Coupon (%) | floating | floating | 9.5 | 9.0 | 9.0 | 9.5 | 8.6 | 7.5 |
| Spread at placement (pb) | 81 | 81 | 569 | 463 | 431 | 517 | 345 | 376 |
| Maturity (years) | 30 | 15 | 5 | 10 | 13 | 6 | 21 | 11 |
| Year bond matures | 2024 | 2009 | 2006 | 2013 | 2018 | 2011 | 2027 | 2021 |
| Oversubscription (demand/issuance) | 1.0 | 1.0 | 1.5 | 2.1 | 0.97 | 0.97 | 3.3 | 6.0 |

Source: Dominican authorities and Fund staff estimates.
1/ This debt exchanged the 2001 and 2003 bonds for new bond at longer maturities with no debt reduction.

**Figure 3. Dominican Republic: Monetary Developments**

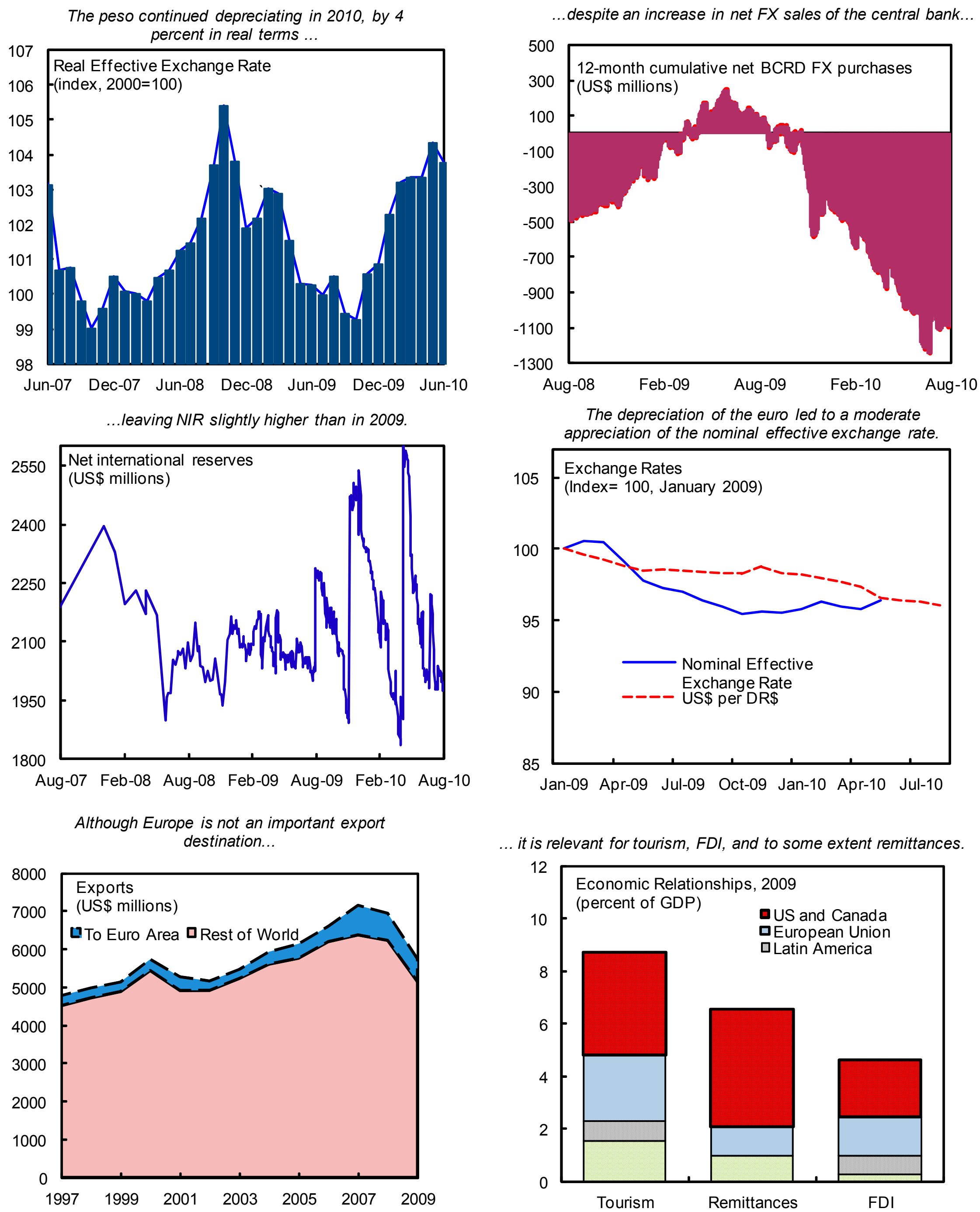
*Monetary policy was stimulative since 2009, in response to lower inflationary pressures and slower economic activity, but credit only started picking up in late 2009 as demand remained weak.*




Sources: Dominican authorities; and Fund staff estimates.

**Figure 4. Dominican Republic: Exchange Rate Developments**

*The depreciation of the peso continued at a moderate pace, although the fall in the euro contributed to stabilize the effective exchange rate. The central bank has intervened to smooth fluctuations in the first months of 2010, but reserves remain above 2008 levels.*




Source: National Authorities; and Fund staff calculations.

the Dominican Republic. The main impact to date has been felt in the higher demand for fresh and processed food products which have been exported to Haiti. Demand for building materials also increased in anticipation of the reconstruction needs later this year. Additional demand for goods and services during the reconstruction phase will further expand exports, even though Haiti's ports and airports reopened. The Dominican authorities are cooperating with the Haitian government on several fronts (including a university project in Haiti funded by the Dominican government) and the Mixed Bilateral Dominican-Haitian Commission (*Comisión Mixta Bilateral Dominico-Haitiana* (CMBDH)) was reactivated to discuss a common agenda.

### B. Non-Economic Factors

10. **Politics.** In the mid-May 2010 legislative and municipal elections, the ruling Dominican Liberation Party (PLD) of President Fernández achieved an overwhelming victory. With all, but one of the 32 senatorial seats in the Congress, and with a majority in the chamber of deputies and municipalities, the PLD will be able to continue supporting President Fernández's economic program. The next political cycle is expected to begin in the second half of 2011in advance of presidential elections in May 2012.

11. **Social.** The poverty rate fell by about 3 percentage points to 34½ percent in 2009 and is expected to have fallen further in 2010. The implementation of an expansive fiscal policy and the strengthening of the social safety net have eased some of the past social tensions, especially with public workers in the health and education sectors. In addition, the government announced, after the May legislative and municipal elections, that it would increase public health sector wages by 30 percent in 3 installments through mid-2011 (after a 3 year wage freeze). The protests over poor social services, especially electricity, have lessened as blackouts have decreased. However, an increased influx of Haitian immigrants (following the earthquake of January 2010) looking for jobs and demanding social services has recently raised social tensions.

### C. Perspective

12. **Outlook and Risks**. The outlook for the rest of the year is positive and risks appear roughly balanced. The dynamics of the broad-based expansion, ample global liquidity, and the effects of the reconstruction of Haiti could make the expansion to pick up its pace. The Haitian reconstruction effort is expected to begin in the last quarter of 2010, mobilizing resources for an average of about US$ 1 billion per year, of which a significant portion could be oriented to the purchase of materials and labor in the Dominican Republic and could even create some inflationary pressures. On the other hand, uncertainties in the international economy could affect the Dominican Republic adversely. The sluggish recovery in advanced economies threatens to choke off an important market for tourism and foreign direct investment, and a deterioration of the sovereign debt problems in Europe could restrict external financing. Should another external shock hit the economy, there would be limited space for expansionary fiscal and monetary policies to soften the blow.

## II. Performance under the 2010 Program

13. **Quantitative targets**. All performance criteria for end-March and end-June 2010 were met.

- ***Consolidated fiscal balance.*** The consolidated public sector deficit amounted to 0.9 percent of GDP in the first quarter of 2010 (about 0.4 percent of GDP lower than envisioned) as a tighter-than expected central government position was reinforced by a lower-than-expected quasi-fiscal deficit of the central bank. For end-June, the consolidated fiscal target deficit was observed with a much smaller margin (0.1 percent of GDP) as the deficit for the central government increased in line with higher investment spending and higher transfers to the electricity sector.

- ***Central administration fiscal balance.*** The overall deficit of the central government was 0.6 percent of GDP in the first quarter of 2010 (0.2 percent of GDP below program projections), as lower-than-expected revenues were more than offset by lower expenditures on investment and goods and services. The revenue shortfall (0.3 percent of GDP) was mainly due to lower receipts from taxes on income and international trade. Meanwhile, planned investment was delayed due to a temporary shortfall in financing.2 Electricity transfers at 0.4 percent of GDP were twice the programmed level, due to higher-than-projected prices of fuels used for generation (not reflected in final prices) and supply constraints (i.e., a drought reduced generation by the public hydroelectric power plant requiring additional purchases from private generators). For end-June 2010, the overall deficit of the Central Administration reached 1.6 percent of GDP or slightly below the program target, as the shortfall in tax revenues (0.4 percent of GDP) and excess electricity subsidies (0.1 percent of GDP) were offset with lower investment spending.

**Dominican Republic: Performance Criteria**

| | Mar 2010 | | | Jun 2010 | | |
|---|---|---|---|---|---|---|
| | Prog. | Act. | | Prog. | Act. | |
| (In percent of GDP) | | | | | | |
| **Fiscal Targets** | | | | | | |
| Consolidated fiscal deficit | 1.3 | 0.9 | ✓ | 2.4 | 2.3 | ✓ |
| Central administration deficit | 0.8 | 0.6 | ✓ | 1.6 | 1.6 | ✓ |
| (In percent of base money) | | | | | | |
| **Monetary Targets** | | | | | | |
| Net international reserves | 47.5 | 56.8 | ✓ | 51.7 | 59.6 | ✓ |
| (In percent of payments due) | | | | | | |
| **Debt Targets** | | | | | | |
| External arrears | 0.0 | 0.0 | ✓ | 0.0 | 0.0 | ✓ |
| Arrears to generators | 0.0 | 0.0 | ✓ | 0.0 | 0.0 | ✓ |

Source: Dominican authorities and Fund staff estimates.

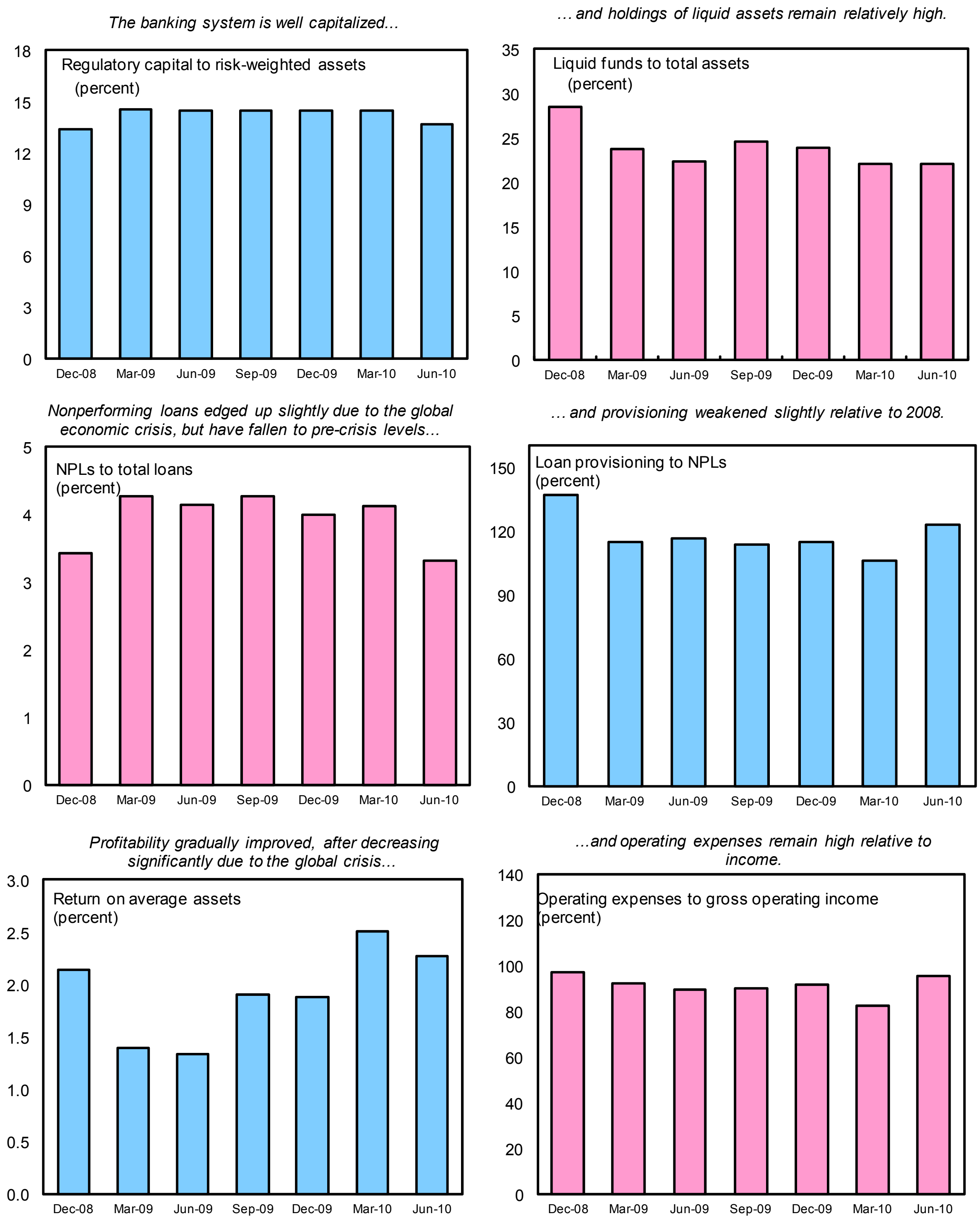
- ***International reserves position***. The floor on net international reserves (NIR) of the monetary authority was met at end-March and end-June 2010 by over US$200 million. The NIR amounted to US$2.0 and US$2.1 billion at end-March and end-June, respectively (also above the end-September and end-December 2010 targets).

- ***Arrears to electricity generators.*** The performance criterion on zero arrears to the electricity generators (under the program definition of no more than 45 days of

[2] The sovereign bond was originally planned for the first quarter but was issued in the second quarter. Receipts of the bond placement are earmarked for public investment.

**Figure 5. Dominican Republic: Financial Soundness Indicators**

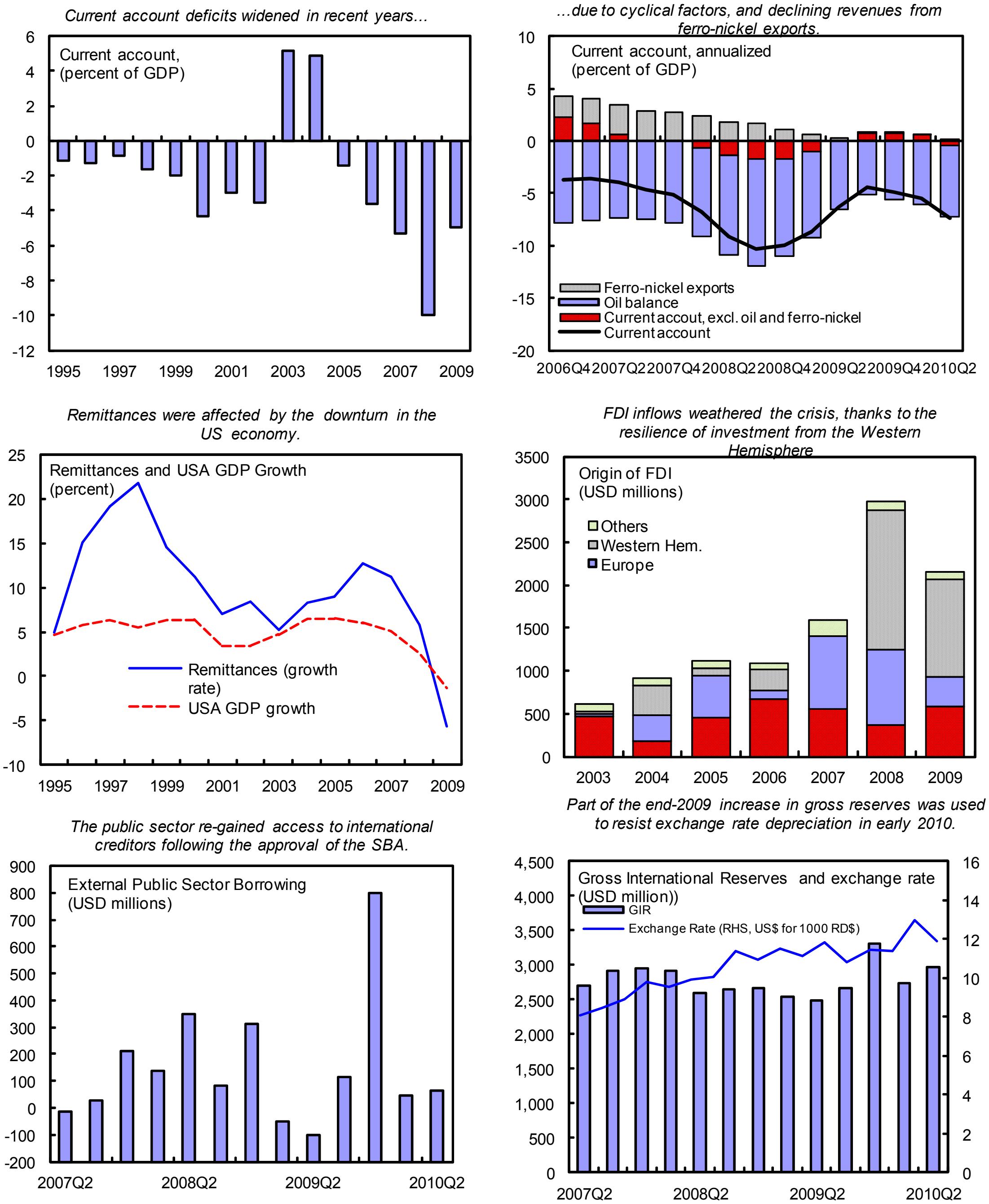
*The banking system is well-capitalized and liquid, and non-performing loans have fallen to their pre-crisis levels, but provisioning has weakened slightly. Profitability has also rebounded after suffering from the recent global financial crisis.*




Sources: Dominican authorities; and Fund staff estimates.

**Figure 6. Dominican Republic: External Sector Developments**

*Current account deficits have widened in recent years because of cyclical factors and the fall in ferro-nickel exports. Remittances and FDI flows were affected by the crisis, but financing was supported by multilateral flows and the recent access to international markets.*




Source: National Authorities; and Fund staff calculations.

unpaid balances) was met at end-March and end-June 2010. There were some arrears to generators between end quarter test dates but these were cleared.

- ***External arrears***. The performance criterion on the non-accumulation of external arrears (on a continuous basis) was observed.

14. **Structural benchmarks**. All structural benchmarks for March and June 2010 (and one for December 2010) were observed:

- ***Tax collections.*** The authorities presented a plan to rationalize and limit tax exemptions, strengthen tax administration and continue modernizing customs to achieve the tax revenue objectives under the program. The authorities' plan benefitted from a Fund technical assistance mission (from FAD) in February 2010. In the implementation phase of some of these measures, aimed at achieving the tax revenues objectives for 2010, the authorities faced strong opposition from the private sector and some measures were diluted or postponed (Box 2 and Section III.B).

- ***Prudential regulations.*** The authorities presented a plan to achieve compliance with Basel core principles for effective banking supervision. The plan is part of the ongoing efforts to improve supervision and benefitted from assistance of the Canadian Office of the Superintendent of Financial Institutions (OSFI), as well as from the Fund (MCM) (Box 3).

**Dominican Republic: Structural Benchmarks**

| Policy Action | Timing | | Status |
|---|---|---|---|
| 1. Design a strategy to rationalize and limit tax exemptions, strengthen tax administration, and modernize customs | Mar 2010 | ● | **Fully met**. Satisfactory strategy provided in March 2010 |
| 2. Design a plan to achieve compliance with all Basel core principles for effective bank supervision by 2012 | Mar 2010 | ● | **Fully met**. Satisfactory plan provided in March 2010 |
| 3. Design a plan to formally adopt a full-fledged inflation targeting framework by early-2012 | Jun 2010 | ● | **Fully met**. Satisfactory plan provided in June 2010 |
| 4. Increase the coverage of the BONOLUZ program to 50,000 clients | Dec 2010 | ● | **Fully met**. More than 100,000 clients in July 2010 |

Source: Dominican authorities and Fund staff estimates.

- ***Inflation targeting.*** The authorities presented a plan to formally adopt a full-fledged inflation targeting framework by early 2012, with a clear outline of monthly steps to be taken (Box 4).

- ***Targeted electricity subsidy.*** The objective to increase the coverage of the BONOLUZ program to 50,000 clients by December 2010 has been achieved. By June 2010 there were 100,000 clients under the program.

## III. Policy Discussions and the 2011 Program

15. **Focus**. The authorities agreed that the early results of the program have been very positive but that further efforts were needed to achieve the program objectives. Discussions centered on the implementation of the second phase of the program (starting in mid-2010)

## Box 2. Dominican Republic: Benchmark on Tax Collection Strategy

**Fiscal consolidation under the program relies partially on gradually increasing the ratio of tax revenues to GDP (tax pressure).** The program originally envisaged an increase in tax pressure from 13.1 percent in 2009 to 15 percent in 2012. To achieve this increase, the authorities presented a strategy in March (a benchmark under the program), based on Fund technical assistance (from FAD), which has three main elements: (i) the rationalization of tax exemptions and improvements in their administration; (ii) strengthening of customs administration; and (iii) strengthening of internal tax administration. However, delays and opposition to tax measures implies that the 15 percent target will only be achieved by 2013. This is a deterioration compared to the original program. This will require an increase in tax pressure of 0.5 percent of GDP per year on average, which is achievable given the relatively high ratios reached in 2006-08 (15-16 percent) (see http://www.hacienda.gov.do/).

**Examining the change in tax pressure from 2006 to 2009 can be instructive to gauge the feasibility of the plans under the program**. A large part of the change over this period can be explained by one-off tax revenues and tax policy measures, including a tax amnesty, a new fiscal code (which lowered income tax rates), the introduction of free trade agreements, and exemptions for strategic industries under the "*Proindustria*" Law, and the business cycle. Together, these factors can account for 0.6 percent of GDP of the 1 percent increase in 2007, 0.9 percent of GDP of the 1 percent decline in 2008, and 1.4 percent of GDP of the 1.9 percent decline in 2009. The unexplained residual (0.4 percent of GDP in 2007, -0.1 percent of GDP in 2008 and -0.5 percent of GDP in 2009) can be attributed to tax compliance and other factors which are not directly observable.

**Dominican Republic: Dynamics of the Tax Pressure**
(In percent of GDP)

| | | | | Projection | | | |
|---|---|---|---|---|---|---|---|
| | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 |
| **Tax Pressure (T)** | **16.0** | **15.0** | **13.1** | **13.2** | **13.3** | **14.5** | **15.0** |
| Chainge in tax pressure (ΔT) | 1.0 | -1.0 | -1.9 | 0.1 | 0.1 | 1.2 | 0.5 |
| 1. One-off revenue measures 1/ | 0.6 | 0.3 | -0.3 | -- | -- | -- | -- |
| 2. Previous tax measures | -0.3 | -1.2 | -0.7 | -- | -- | -- | -- |
| Tax amnesty (Law 183/07) | 0.2 | 0.1 | -- | -- | -- | -- | -- |
| New fiscal code | -0.2 | -0.7 | -0.1 | -- | -- | -- | -- |
| Free trade agreements | -0.2 | -0.3 | -0.3 | -- | -- | -- | -- |
| Proindustria exemptions | -0.1 | -0.3 | -0.3 | -- | -- | -- | -- |
| 3. Program tax measures | -- | -- | -- | 0.3 | 0.1 | 0.7 | 0.3 |
| Hydrocarbons tax indexation | -- | -- | -- | 0.2 | 0.1 | 0.1 | -- |
| Proindustria VAT modification | -- | -- | -- | 0.1 | 2/ | 2/ | -- |
| Income tax on casino prizes | -- | -- | -- | 2/ | 2/ | 0.1 | -- |
| Improvements in tax administration | -- | -- | -- | -- | 2/ | 0.2 | 0.1 |
| Rationalization of tax exemptions | -- | -- | -- | -- | 2/ | 0.3 | 0.2 |
| 4. Business cycle | 0.3 | -- | -0.4 | -0.2 | -- | 0.3 | 0.1 |
| 5. Tax compliance 3/ | 0.4 | -0.1 | -0.5 | -- | -- | 0.2 | 0.1 |

Source: Dominican Republic authorities and Fund Staff calculations.
1/ Includes presumptive taxes on extraordinary capital gains from private enterprises (Verizon/Brugal/Claro), dividends, and the loss of income taxes from the closure of mining operations.
2/ Amounts to less than 0.1 percent of GDP.
3/ Includes tax evasion and other unidentified factors; estimated as a residual for 2007-09.

**Staff estimates that the measures proposed by the authorities are broadly adequate to achieve medium-term tax collection objectives under the program.** To reach the revised target of tax pressure of 15 percent of GDP by 2013 the program assumes conservatively an increase of 0.1 percent of GDP in 2010 and 2011 (with significant upside risk), 1.2 percent of GDP in 2012, and 0.5 percent of GDP in 2013. This will be achieved mainly through new measures phased in over the next years, including the indexation of specific taxes as dictated by the law on hydrocarbon taxation (Ley 112-00) (0.4-0.5 percent of GDP), payment of VAT at customs for a critical mass of enterprises eligible for tax benefits under the "*Proindustria*" law, and a strong control of the proper use of the benefit (0.1-0.2 percent of GDP), advances of the income tax for winners of prizes in casinos and lotteries (0.1-0.2 percent of GDP), as well as improvements in tax administration (0.3-04 percent of GDP), and rationalization of tax exemptions (0.5-0.6 percent of GDP). Estimates of the rise in tax pressure from the cycle and tax compliance over these years are modest, given past experience in the Dominican Republic. The program scenario assumes an "autonomous" increase in tax pressure of 0.5 percent of GDP in 2012 (from the business cycle and tax compliance), and 0.2 percent of GDP in 2013, over a period where the economy is expected to grow at fairly high rates. This contrasts with the increase in tax pressure of 0.7 percent of GDP in 2007 and the decline of 0.9 percent of GDP in 2009, both of which are highly correlated to changes in the level of economic activity.

which aims at achieving an orderly and gradual fiscal consolidation, strengthening the debt sustainability fundamentals, and making progress in implementing focused structural reforms. In particular, staff discussions focused on how to: (i) reinvigorate tax administration reform after the strong opposition of the private sector to the first set of measures; (ii) revitalize electricity reform given the large deviations with respect to the program; and (iii) design effective expenditure restraint (mostly on capital spending) to offset shortfalls in taxes and overruns in electricity subsidies. As a result, the authorities reached consensus with the private sector on tax issues, made further progress on electricity reform by changing management of the electricity distribution companies (EDEs), and moderated their public sector investment program (implementing in the short-term projects with the highest social rate of return) through a supplementary budget sent to Congress in July (and approved in September) to secure observance of end-2010 fiscal targets. Spending restraint was also used in the design of the 2011 budget, which envisages a fiscal adjustment of 1 percent of GDP. Real primary spending would fall by about 2 percent in 2011. On monetary issues, the central bank is aware that the output gap is closing and that soon a tightening phase needs to start. Currently, there are no inflationary pressures or signs of overheating, and planned fiscal consolidation in the second half of the year will be the first line of defense.

## A. Policy Framework

16. **Macroeconomic framework**. The speed of the recovery implies a higher growth path than previously anticipated. Accordingly, the authorities and staff agreed to revise upward the real GDP growth projection to 5½-6 percent for 2010 (from 3-4 percent before) and a similar range for 2011. Even after the upward revision, the authorities mentioned some upside risks, stemming from renewed inflows of foreign direct investment, and the strong recovery in imports, tax receipts and domestic credit. Staff noted that there are also some downside risks associated to a slower recovery in tourism and remittances in view of the economic difficulties in advanced economies. Under the revised projections the output gap is estimated to remain slightly negative, albeit considerably narrower than the program initially envisaged. Real GDP would remain around potential in the outer years as growth is sustained over the medium-term.

**Dominican Republic: Macroeconomic Framework**

| | 2009 | Prog. 2010 | Proj. 2010 | Prog. 2011 | Proj. 2012 |
|---|---|---|---|---|---|
| (Annual percent change, unless noted) | | | | | |
| Real GDP | 3.5 | 3-4 | 5½-6 | 5½-6 | 6.0 |
| Output gap (% of potential) | -0.6 | -5.1 | -0.6 | -0.7 | -0.4 |
| Headline inflation (e.o.p) | 5.8 | 6-7 | 6-7 | 5-6 | 4-5 |
| Core inflation (e.o.p.) | 3.2 | … | 3.5 | 5.5 | 4.5 |
| (In percent of GDP) | | | | | |
| External current account | -4.6 | -6.1 | -7.0 | -6.4 | -4.2 |
| Primary fiscal balance 1/ | -0.5 | 0.0 | 0.2 | 1.2 | 2.0 |
| Fiscal deficit 1/ | -4.4 | -3.9 | -3.9 | -3.0 | -2.0 |
| Fiscal impulse 2/ | 1.2 | -0.8 | -0.7 | -0.6 | -0.4 |
| Public debt 1/ 3/ | 36.9 | 37.2 | 35.7 | 35.3 | 33.8 |

Source: Dominican authorities and Fund staff estimates.
1/ Consiolidated public sector.
2/ Non-financial public sector. Positive implies expansionary policy.
3/ Excludes BCRD recapitalization bonds.

## B. Fiscal Policy

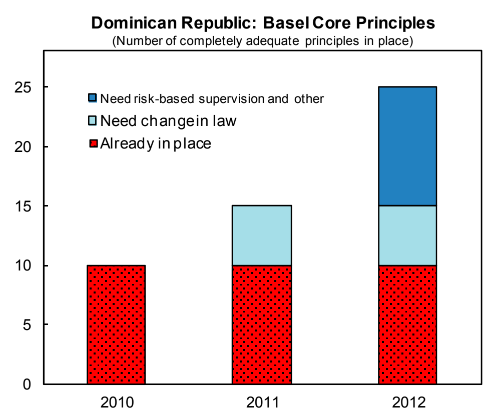
17. **Potential fiscal overruns**. Fiscal policy shifted from an expansionary stance in the first half of the year to a consolidation phase in the second half, in line with the program. The implementation of this strategy was hampered by lower-than-programmed revenues despite the recovery of economic activity. This was partly due to the lagged effect of the 2009

### Box 3. Dominican Republic: Benchmark on Implementing Basel Core Principles

**The authorities have prepared a plan for achieving the Basel core principles for effective banking supervision**. The plan entails a reform of the financial system to achieve much improved supervision, based on best international practices and the recommendations of the 2009 FSAP update. According to the FSAP report, 18 principles are "broadly adequate", of which 10 are "completely adequate". Strict execution of the plan would result in full compliance with all 25 Basel core principles by end-2012 (see http://www.supbanco.gov.do/).

**The plan includes modifications to the Monetary and Financial Law and the introduction of consolidated risk-based supervision**. Changes in the law 183-02 (enacted in November 2002) are needed to give sufficient authority to the supervisor in discharging its obligations effectively. Risk-based supervision would improve efficiency in the financial system and reduce systemic risk (compared to the current compliance-based supervision). In addition, there are other supporting elements in the plan, all aimed at strengthening financial sector supervision. In summary, the plan requires the following actions:

- ***Modify the Monetary and Financial Law***. This would help achieve or strengthen 5 Basel Core Principles (1, 2, 4, 6, and 23). The modifications proposed consist of: (i) granting full autonomy to the supervisor, both in resources and responsibilities; (ii) defining permissible activities of the supervisor; (iii) granting the right to the supervisor to demand additional capital over the minimum required based on the risk profile of each organization; and (iv) establishing the proportional deduction rules in primary and secondary capital.




- ***Prepare and implement the guidelines for risk-based supervision***. Currently supervision is mostly based on compliance with fixed norms, irrespective of risk levels. Adoption of risk-based supervision would help achieve, or strengthen more than 10 Basel Core Principles (7, 8, 9, 10, 12, 13, 14, 15, 16, 17, 20, 21, 22, and 24).

- ***Prepare other supporting regulations and guidelines***. The authorities will complete compliance with all the 25 Basel Core Principles by introducing a law for financial groups aimed at implementation of effective consolidated supervision; modifying some of the current regulations; and preparing various guidelines and instruction documents (all detailed in the authorities plan).

recession on income tax receipts in 2010, and to the unsuccessful attempts by the authorities to pass timely administrative measures that would significantly increase the level of tax revenue.[3] This led to an expected shortfall in revenues relative to the program of about 0.6 percent of GDP for the year. The shortfall in tax revenues was exacerbated by an overrun in transfers to the electricity sector. These transfers were originally programmed to be 0.8 percent of GDP (about $380 million), but delays in implementing reforms (especially increases in electricity tariffs), led to an expected transfer of 1.2 percent of GDP ($604 million) for the year. Overall, the shortfall in tax revenues and the higher-than-expected transfers to the electricity sector led to a need for adjustment of about 1 percent of GDP.

18. **2010 Fiscal measures.** To meet program targets the authorities had to introduce additional measures to increase tax revenues and hold down expenditures (LOI ¶6b1).[4]

- ***Revenue measures.*** The authorities implemented administrative measures in September, estimated to increase revenues by 0.3 percent of GDP in the rest of 2010, of which tax revenues are about 0.1 percent of GDP and non-tax revenues 0.2 percent of GDP. The revenue measures include: (i) reinstituting the indexation of the specific tax on hydrocarbons to inflation and implementing retroactive indexation from 2007 to the present; (ii) collecting the VAT on imports from some of the companies that were previously exempt under the Proindustria Law and crediting the VAT when items are sold on the domestic market; and (iii) collecting advances on income tax on casino and lottery prize gains. These measures will increase the tax to GDP ratio to 13.2 percent in 2010.

**Dominican Republic: Fiscal Program**
(In percent of GDP)

| | | Prog. | Proj. | Prog. | Proj. |
|---|---|---|---|---|---|
| | 2009 | 2010 | | 2011 | 2012 |
| **Central Government** | | | | | |
| Revenues | 13.7 | 14.3 | 14.0 | 14.0 | 15.1 |
| o/w taxes | 13.1 | 13.8 | 13.2 | 13.3 | 14.5 |
| Expenditures | 17.2 | 16.7 | 16.3 | 15.6 | 15.7 |
| Current | 13.6 | 12.3 | 12.6 | 11.8 | 11.0 |
| Capital | 3.6 | 4.4 | 3.7 | 3.8 | 4.7 |
| **Overall balance** | **-3.5** | **-2.4** | **-2.3** | **-1.6** | **-0.6** |
| Primary balance | -1.6 | -0.2 | -0.2 | 0.8 | 1.6 |
| **Rest of Public Sector** | | | | | |
| Rest of NFPS | 0.4 | -0.1 | -0.2 | 0.0 | 0.0 |
| BCRD quasi-fiscal | -1.3 | -1.4 | -1.4 | -1.4 | -1.4 |
| **Consolidated Public Sector** | | | | | |
| **Overall balance** | **-4.4** | **-3.9** | **-3.9** | **-3.0** | **-2.0** |
| Primary balance | -0.5 | 0.0 | 0.2 | 1.2 | 2.0 |
| Memorandum item: | | | | | |
| Fiscal impulse 1/ | 1.2 | -0.8 | -0.7 | -0.6 | -0.4 |

Source: Dominican authorities and Fund staff estimates.
1/ Non-financial public sector. Positive implies expansionary policy.

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[3] The authorities submitted a strategy to rationalize and limit tax exemptions, strengthen tax administration, and continue modernizing customs to achieve the medium-term revenue objectives of the program in March 2010 (Box 2). However, there was strong private sector opposition to these measures and they are being implemented in a weaker and more gradual manner. This has lead to a deterioration in the tax effort for 2010 and 2011 compared to the original program.

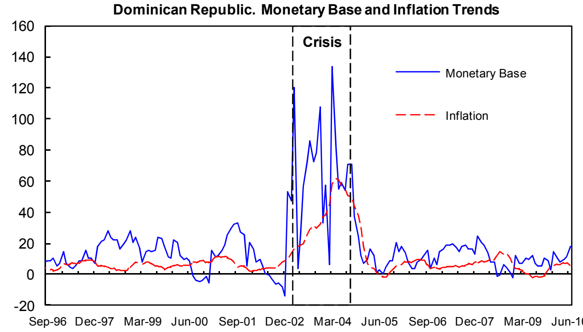
[4] The number in parenthesis after the ¶ sign refers to the paragraph number in the LOI (Attachment 1), whereas the number after the letter "b" refers to the bullet number in the relevant LOI paragraph.

## Box 4. Dominican Republic: Benchmark on Inflation Targeting Plan

**The authorities designed a well-articulated plan to adopt an "Inflation Targeting" (IT) framework for monetary policy by early 2012**. This was a structural benchmark for June 2010 under the program (see http://www.bancentral.gov.do/publicaciones_economicas/otros/Informe_metas_inflacion.pdf.). The adoption of an inflation anchor would serve the Dominican authorities better than the more common monetary anchor. In fact, the relationship between monetary base and inflation strengthened during the crisis period (2002-03), but has weakened considerably in the post crisis period. In addition, the exchange rate has also been playing an anchoring role. Therefore, adopting an explicit inflation anchor would seem desirable for better monetary control and to allow the exchange rate to fluctuate more. Moreover, there are other reasons to adopt IT, including more transparency and credibility.

**Previous successful reforms in the current monetary framework will facilitate a smooth transition to IT.** The current legal framework defines the mandate of the central bank as maintaining price stability and leaves the choice of the appropriate targets and instrument to the monetary board. The central bank already uses the overnight (policy) rate to signal its policy stance and conducts open market operations to control liquidity—two desired instruments for monetary policy under IT. There is an established monetary policy committee (COMA) that holds regular meetings. There are annual monetary programs and monthly COMA communications, which inform the public about the plans, monetary policy decisions, and forecasts of economic conditions and policies. Finally, technical capacity of the central bank in forecasting has significantly improved.

**Dominican Republic. Monetary Base and Inflation Trends**




| | 1996-2002 | 2003-2004 | 2005-2009 |
|---|---|---|---|
| Volatility, Monetary Base /1 | 0.82 | 0.86 | 1.62 |
| Volatility, Inflation /1 | 0.39 | 0.80 | 0.73 |
| Correlation, Mon. Base and Inflation | -0.21 | 0.63 | 0.05 |

/1 Volatility is defined as the ratio of period standard deviation and period average.

Source: Dominican Authorities; and Fund staff calculations.

**However, additional measures are needed to implement a full-fledged IT framework**. To complete the required steps for the transition to an IT regime, the authorities' plan envisages, *inter-alia,* adoption of the following steps by 2012:

- ***Adopt additional policy instruments***. While the overnight facility and the open market operations are well functioning and will be kept, the high rates of the Lombard lending facility will be gradually reduced and a repo market will be developed to complement the Lombard facility. The repo market is more efficient for liquidity management of the banking system than the Lombard facility, which is not collateralized and is expensive, resulting in a strong stigma related to its use.

- ***Increase transparency***. The BCRD will issue a monetary policy report by June 2011. The schedule of COMA meetings will be publicly announced several months in advance and the contents of COMA's monthly communications will be adapted for an IT regime to include justifications for deviations from the target, and explanations of the decisions taken to direct the economy towards achieving the optimal inflation forecast target. Finally, the central bank will schedule data releases, including the monthly index of economic activity, monthly headline and core inflation figures, and a detailed report of the results of the survey of economic agents' expectations.

- ***Enhance modeling capacity***. The central bank will continue benefiting from the experiences of other countries and devote several of its highly trained staff to keep improving different forecasting models, which would help in guiding policy.

- ***Expenditure measures***. The authorities submitted a supplementary budget in July 2010, which authorized a reallocation of spending away from investment to pay for the increase in transfers to the electricity sector. The supplementary budget reduced public investment by 0.4 percent of GDP. Additional administrative measures in the last quarter of 2010 are likely to reduce public investment by an additional 0.3 percent of GDP. These measures would leave investment at about the same level in terms of GDP in 2010 as in 2009, namely 3.7 percent.

19. **2011 Budget**. The authorities remain committed to the fiscal adjustment outlined in their original program for 2011. They aim to implement a fiscal consolidation of about 1 percent of GDP with respect to 2010, with a deficit of the combined public sector of 3 percent of GDP (a primary surplus of 1.2 percent of GDP), comprising a deficit at the level of the central administration of 1.6 percent of GDP and a quasi-fiscal deficit of the central bank of 1.4 percent of GDP. The authorities have been cautious in projecting tax revenues given the recent experience with delays in the implementation of their reforms in tax administration and the rationalization of tax exemptions. They are conservatively projecting an increase of tax revenues of about 6 percent in real terms, with which they would reach 13.3 percent of GDP in 2011 (0.1 percent of GDP more than in 2010), for overall revenues of 14 percent of GDP. On the expenditure side, wages and salaries will grow slightly above inflation, mainly due to the increase in compensation of public health workers agreed in June 2010, while transfers to the electricity sector are expected to fall to 0.6 percent of GDP, and expenditure on goods and services is expected to decline by 0.2 percent of GDP. This would leave space for capital expenditures of 3.7 percent of GDP, the same ratio as in 2010. Staff believes that the conservative approach to projecting tax revenues is appropriate. Should revenues exceed the program projections, the authorities have indicated that they will use the excess to increase investment spending (but not current spending), a plan that staff supports (LOI ¶7b1).

20. **Financing for 2010-11**. A large fraction of the fiscal financing for both 2010 and 2011 will come from external sources. For 2010, US$750 million budget support from the World Bank, the IDB and *Petrocaribe* is complemented by the proceeds from the issuance of US$750 million in external sovereign bonds in April, and US$150 million of budget support from the Fund to cover external payments. In addition the Fund will provide US$250 million that will go to finance interest payments from the treasury to the central bank on recapitalization bonds (see paragraph 29 below). Domestic finance would amount to US$700 million, mostly in the form of bonds. For 2011, budget support from the World Bank and IDB and *Petrocaribe* (US$500 million) declines in line with lower gross financing needs, and the authorities plan to issue US$500 million in external bonds following the successful placement this year. An additional US$250 million of Fund disbursements are proposed to cover the transfers of interest from the treasury to the central bank. For both years, net financing from domestic bonds, at US$500 - US$600 million, is modest given the growing appetite in local markets.

## C. Monetary Policy

21. **2010 Monetary response**. The monetary program remains appropriate and there was no need to modify the monetary targets. The central bank is aware that the output gap is closing and that soon a tightening phase needs to start. However, there is no evidence of inflationary pressures and core inflation is at a historical low and below program objectives. The central bank is confident in observing monetary targets and did not see risks in observing performance criteria on NDA and NIR for September and December 2010 (LOI ¶6b3).

22. **2011 Monetary program.** Given the current expansion of economic activity, the focus of monetary policy will change from credit expansion in 2010 to reserve accumulation in 2011. There will not be a need for the central bank to actively expand its net domestic assets (NDA) in 2011, as the credit channels and the level of private sector credit is expected to have been completely restored by then. The monetary program for 2011 assumes, conservatively, an increase in the demand for base money of some 7 percent and a level of NDA constant at the level programmed for end-2010, as monetary policy moves from accommodative to a more neutral stance. With the focus of monetary policy switching to reserve accumulation, NIR is expected to increase by at least US$300 million in 2011, improving a still relatively low level of international reserves (LOI ¶7b3).

**Dominican Republic: Monetary Program**
(12-month changes in percent of base money the previous period)

| | 2009 | Prog. 2010 | Proj. 2010 | Prog. 2011 | Proj. 2012 |
|---|---|---|---|---|---|
| **Base money** | **3.2** | **11.2** | **11.2** | **7.1** | **13.9** |
| **Net domestic assets** | **-9.0** | **25.0** | **25.0** | **0.0** | **0.0** |
| Public sector (net) | -2.9 | 2.4 | 2.0 | 0.0 | 0.0 |
| Banks (net) | -15.2 | -11.0 | -19.4 | -36.4 | -32.3 |
| Private sector (non-bank) | -1.0 | 26.6 | 20.3 | 27.0 | 21.1 |
| Other items (net) | 10.1 | 7.0 | 22.0 | 9.4 | 11.2 |
| **Net international reserves** | **12.2** | **-13.8** | **-13.8** | **7.1** | **13.9** |

Source: Dominican authorities and Fund staff estimates.

## D. External Policy

23. **Balance of payments prospects.** With the coming on stream of gold exports and the re-opening of the ferro-nickel mine, export growth will likely increase to about 15 percent in 2011, which together with a deceleration in imports is likely to lead to a narrowing of the current account deficit from about 7 percent of GDP in 2010 to some 6½ percent of GDP in 2011. Strong foreign direct investment, the planned sovereign bond issuance and multilateral lending will finance the current account deficit in 2011, while sustaining foreign reserves in line with the program. Over the medium term, the current account deficit is expected to narrow to below 4 percent as ferro-nickel and gold production significantly increase exports. Needless to say, this will make the balance of payments more vulnerable to metal prices shocks. The current account deficit will, however, remain sensitive to oil prices (a US$5 increase in oil prices would increase the current account deficit by 0.4 percent of GDP).

**Dominican Republic: Balance of Payments**
(In percent of GDP)

| | 2009 | Prog. 2010 | Proj. 2010 | Prog. 2011 | Proj. 2012 |
|---|---|---|---|---|---|
| **Current account** | **-4.6** | **-6.1** | **-7.0** | **-6.4** | **-4.2** |
| Exports | 11.8 | 11.0 | 12.4 | 13.2 | 15.6 |
| Imports | -26.3 | -26.2 | -28.8 | -28.6 | -29.1 |
| Other | 9.8 | 9.0 | 9.3 | 9.0 | 9.3 |
| **Capital account** | **5.5** | **5.1** | **6.0** | **6.9** | **5.3** |
| Public sector (net) | 1.7 | 2.6 | 2.5 | 1.7 | 1.0 |
| Private sector (net) 1/ | 3.8 | 2.5 | 3.5 | 5.3 | 4.3 |
| **Overall balance** | **0.9** | **-1.0** | **-1.1** | **0.6** | **1.1** |

Source: Dominican authorities and Fund staff estimates.
1/ Includes errors and omissions.

24. **Exchange rate policy.** The nominal exchange rate remained relatively stable in the first half of 2010, depreciating by about 2½ percent against the US dollar, as the central bank intervened by purchasing foreign exchange in the market to meet the NIR target under the program. In real effective terms, the exchange rate depreciated by about 3 percent in the first half of 2010. The central bank is committed to increase flexibility in the exchange rate within its managed floating regime in the context of the preparatory work towards the introduction of a full-fledged inflation targeting regime in 2012.

### E. Structural Policies

25. **Tax administration and exemptions.** The program includes new benchmarks for 2010-11 based on the strategy designed by the authorities in March 2010 to achieve the tax objectives mentioned above:

- ***Tax exemption framework.*** Reform the institutional and administrative framework for granting and monitoring tax exemptions to centralize this power in the Ministry of Finance by issuing a decree (structural benchmark for December 2010) (LOI¶6b5).

- ***Evaluation of current exemptions.*** Create a unit at the Ministry of Finance with the capacity to evaluate the economic and administrative costs and benefits of the current exemptions framework and of future proposed exemptions (structural benchmark for December 2010) (LOI¶6b5).

- ***Measures to improve tax collections.*** To continue safeguarding fiscal sustainability and creating room for additional capital expenditures, the authorities will prepare a list of revenue administration measures to yield 0.5 percent of GDP in 2011 with a time table for their implementation (structural benchmark for December 2010) (LOI¶6b5).

- ***Removal of exemptions.*** Prepare a report on the costs and benefits of the current exemption regime and a timetable for the rationalization and reduction of exemptions to reach the revenue goals of the government (structural benchmark for March 2011). This timetable will become the basis for further structural benchmarks in 2011 (LOI¶7b5).

26. **Inflation targeting.** The authorities have presented a plan to transition to inflation-targeting by 2012 (observed structural benchmark for June 2010). This plan builds on many elements that the central bank has already achieved towards the objective of adopting

inflation targeting.[5] On the basis of this plan, the program includes the following new benchmarks:

- ***Dematerialization of BCRD securities.*** To improve monetary control and marketability, all new securities issued by the central bank will be dematerialized (structural benchmark for December 2010) (LOI¶6b5).

- ***Monetary policy report.*** The BCRD will publish the first monetary policy report under inflation targeting to make the public aware of the change in monetary regime (structural benchmark for June 2011). This will be done for informational purposes as the new regime will start in early 2012 (LOI¶7b5).

- ***Monetary program.*** The BCRD will publish a monetary program for 2012 as established by law but emphasizing the role of the inflation target as the new nominal anchor (structural benchmark for December 2011) (LOI¶7b5).

27. **Prudential regulations.** To ensure implementation of the plan presented by the authorities in March 2010 to adopt all Basel core principles for effective banking supervision in the medium-term (observed structural benchmark), the following benchmark will be introduced:

- ***Monetary and financial law.*** The authorities will send to Congress amendments to the monetary and financial law which, among other elements, eliminates legal impediments to change from compliance-based to risk-based supervision (structural benchmark for March 2011) (LOI¶7b5).

- ***Financial and industrial conglomerates law.*** To facilitate the implementation of consolidated risk-based supervision, the authorities will send to Congress a new law on the consolidated supervision of financial and industrial groups (structural benchmark for March 2011) (LOI¶7b5).

28. **Electricity reform.** While the electricity reform has been moving ahead in 2010, the pace is slower than programmed. Transfers from the government to the state-owned electricity holding company (CDEEE) have increased due to higher costs of electricity generation owing partly to higher fuel prices (while tariff adjustments have lagged) and reduced (low-cost) hydroelectric generation due to a lower than normal rainfall in the first half of 2010. The state-owned distribution companies (EDEs) have managed to convert about 70 percent of users in the old PRA zones (i.e., users that used to receive indiscriminate subsidies within an area) into regularized clients, advancing on the September 2010 structural

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[5] Some of the positive conditions at BCRD for the introduction of inflation targeting include: (i) high credibility of the central bank; (ii) *de facto* independence of the central bank; (iii) monthly decisions of the Monetary Board published with forward looking explanations; (iv) a relatively high amount of data on monetary and other economic indicators is timely published; and (v) the main role of the BCRD as a guarantor of price stability is emphasized.

benchmark (i.e., 1.9 million new clients). Notwithstanding this progress, the authorities believe that indiscriminate subsidies in 2010 could reach about US$600 million, about 0.4 percent of GDP higher than originally programmed for 2010 (and higher than in 2009). In an effort to strengthen the reform in the sector (strengthening bill collection and improvements in the provision of the service), the authorities announced in early September 2010 the change in the management of all the EDEs, appointing highly reputable professionals with international experience. To ensure that these efforts result in lowering subsidies, the authorities will increase the number of new regulated clients of the distribution companies by 250,000 to 2.15 million in September 2011 (structural benchmark for September 2011) (LOI¶7b5) and take further measures as appropriate. It is expected that all the reform efforts in the sector will lead to significant savings and a reduction in the current deficit of the sector to US$350 million in 2011 (about 0.6 percent of GDP). [6]

29. **Central bank recapitalization**. The government has remained current on transfers to recapitalize the central bank in accordance with the current legislation. It is no longer considering the planned modification to the law, originally envisioned under the program, to lengthen the period of recapitalization. In order to finance this and next year's commitments, the government is considering using part of the Fund disbursements to the BCRD (some US$250 million a year) for the purpose of financing the interest payments for the recapitalization of the central bank by transferring the liabilities corresponding to these Fund purchases from the BCRD to the Ministry of Finance (Table 15). Under this scheme, the accumulation of reserves at the BCRD and the fiscal deficit agreed under the program will not change, but the mix of financing required by the Ministry of Finance to fulfill its obligations of transfers to the central bank would shift from the domestic market to international (IMF) financing (Box 5).[7] This simple reallocation of liabilities will allow the government to maintain its original schedule of recapitalization for the central bank (over 10 years) and help bolster the credibility and effectiveness of monetary policy. In view of this, staff has proposed that the Ministry of Finance and BCRD revise the memorandum of understanding that delineates responsibility of each agency to cover obligations to the Fund.

[6] In addition, the authorities are considering reducing obligations to private electricity generators. Under the program definition, unpaid balances to generators cannot exceed 45 days. Given the high interest rate charged on these balances, the authorities intend to reduce these amounts, in which case the performance criterion on these unpaid balances would be measured with no delay rather than the current 45 days.

[7] Under this proposal, Fund purchases will be allocated to three different accounts at the Central Bank: (i) purchases assigned to the Central Bank will be deposited at the general international reserve account; (ii) purchases assigned to cover external payments of the Ministry of Finance will be deposited at the government account (*cuenta única*) at BCRD; and (iii) purchases assigned to cover interest payments on BCRD recapitalization bonds will be deposited in a special government account created for this purpose at BCRD, whose balances can only be transferred to the general international reserve account when the interest payments on the BCRD recapitalization bonds are due, effectively strengthening the reserve position of the Central Bank (see Table 15).

**Box 5. Dominican Republic: Using SBA Financing for BCRD Recapitalization**

**The current Stand-By Arrangement includes revising the central bank (BCRD) recapitalization law to extend the period of recapitalization from 10 to 15 years**. This lengthening of the period will result in lower transfers from the Ministry of Finance to the BCRD making it easier for the government to meet its obligations in the context of the global crisis and economic recession (see Box 3 in EBS/09/165). However, this results in higher BCRD cash losses over time and may reduce the credibility of the monetary authority.

**The authorities are proposing a new mechanism to prevent changes in the legislation**. Under this proposal Fund disbursements are reoriented to the Ministry of Finance to support the recapitalization, allowing the process to return to the 10-year timetable (with no need to modify current legislation).

**The authorities' proposal has merits and staff supports it**. The new proposal entails the same borrowing from domestic markets than under a modified law but with a strengthening of the recapitalization process. As anillustration, the tabulation below shows the implications of the different recapitalization strategies for 2010 and highlights why the authorities' proposal could preserve the best features of the current law (by not delaying the recapitalization of the central bank) and a modified law (by reducing the financing burden in domestic markets of the Ministry of Finance) while achieving the same reserve accumulation target for 2010:

- ***Current Legislation Scenario.*** Under the IMF program, the BCRD receives US$370 million in disbursements from the IMF that go towards accumulation of gross reserves. The Ministry of Finance transfers an additional US$380 million to the BCRD under the recapitalization law, to finance part of its quasi-fiscal deficit (US$700 million). The remainder is borrowed from domestic capital markets. This implies an overall borrowing need by the BCRD of US$690 million.
- ***Modified Law Scenario.*** The Ministry of Finance lowers their transfers to the BCRD to US$130 million resulting in a BCRD need to borrow an additional US$250 in domestic capital markets. BCRD borrowing requirements increase to US$940 million (to compensate the lower government transfer), delaying the process of recapitalization.
- ***New Authorities' Proposal.*** Under the revised program, Fund disbursements to the BCRD would be reduced to US$120 million, but an additional US$250 would be disbursed to the Ministry of Finance, to be transferred to the BCRD, for a total reserve accumulation of US$370 million, as in the other scenarios. The BCRD would have to borrow the same amount in domestic markets as under the modified law (US$570 million) to finance its quasi-fiscal deficit, but its total borrowing would be lower than in the revised law scenario, and the current law would not be modified, allowing for a faster pace of recapitalization

**Dominican Republic: Stylized BCRD Financing Scenarios for 2010**
(In millions of US$)

| | Current Law | Modified Law | New Proposal |
|---|---|---|---|
| **Financing Needs** | | | |
| **Total** | **1,070** | **1,070** | **1,070** |
| International Reserves | 370 | 370 | 370 |
| IMF | 370 | 370 | 120 |
| Ministry of Finance | -- | -- | 250 |
| Quasi-Fiscal Deficit | 700 | 700 | 700 |
| Ministry of Finance | 380 | 130 | 130 |
| Domestic Markets | 320 | 570 | 570 |
| **Borrowing Requirements** | | | |
| **Total** | **1,070** | **1,070** | **1,070** |
| Central Bank | 690 | 940 | 690 |
| IMF | 370 | 370 | 120 |
| Domestic Markets | 320 | 570 | 570 |
| Ministry of Finance | 380 | 130 | 380 |
| IMF | -- | -- | 250 |
| Domestic Markets | 380 | 130 | 130 |

### F. Poverty Alleviation

30. **Social policy.** The conditional cash transfer (CCT) program is being successfully implemented.[8] However, the increase in the number of families covered under the CCT in December 2009 (an observed structural benchmark under the program), has created a strain in the provision of public services related to health and education. The government remains committed to continue strengthening the effectiveness of the CCT by increasing the needed supply of public services related to health and education. In particular, the government has increased spending on the construction and rehabilitation of public schools and medical services in poor areas, and on nutritional supplements for poor children to cover the new demand that resulted from the recent expansion of the program. In addition, the government has completed the expansion of the BONOLUZ program (the targeted electricity subsidy program) covering over 50,000 clients (exceeding a December 2010 structural benchmark), and provides a subsidy on natural gas (BONOGAS) to 800,000 families. Against that background, the authorities intend to conduct the following policies for 2011:

- ***CCT program***. Increase the permanent coverage of the conditional cash transfer program "Solidaridad" by 60,000 additional families to 590,000 families (structural benchmark for December 2011) (LOI¶7b5).

- ***BONOLUZ program.*** Increase the coverage of the targeted electricity subsidy program "BONOLUZ" from the 50,000 target for December 2010 to 250,000 families (structural benchmark for December 2011) (LOI¶7b5).

## IV. Program Issues

31. **Balance of payments need**. While the targets on NIR of the monetary authority have been observed for end-March and end-June 2010 (respectively US$2.0 billion and US$2.10 billion), NIR remains low, at less than 2.5 months of import. The current account deficit in 2011 is expected to remain high, which would put further pressure on the balance of payments. The low reserve coverage and the high current account deficit justify the access under the program.

32. **Conditionality.** The attached letter of intent reiterates the authorities' commitment to the program and details an economic program for 2011. It introduces new structural benchmarks based on the strategies and plans designed by the authorities as well as a quantitative target for 2011 on the current balance of the public electricity company (CDEEE).

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[8] The CCT program provides a modest amount of financial assistance to families with children in extreme poverty in exchange for meeting certain conditions including school attendance, vaccinations, visits to public clinics and basic sanitation.

33. **Waiver of applicability.** Since the Board meeting for the second and third SBA review will take place in mid-October and some performance criteria for end-September would not be known, the authorities are requesting waivers of applicability of all relevant end-September 2010 performance criteria. Staff will report on the status of these performance criteria at the time of the Board meeting and a revised proposed decision will be issued accordingly.

34. **Safeguards**. An update of the previous safeguards assessment of the BCRD (completed in April 2005) was conducted in the context of the new SBA. The assessment was completed on June 1, 2010 and noted that the BCRD had implemented some of the previous safeguards recommendations, relating to its external and internal audit mechanisms, and the internal control framework. In addition, periodic reviews by the Internal Audit Division of the compilation, reconciliation, and reporting of net international reserves and net domestic assets at each test date under the SBA program, against definitions agreed under the Technical Memorandum of Understanding, have been instituted. However, several weaknesses identified previously remained regarding shortcomings with the Monetary and Financial Law (MFL), in particular, related to the autonomy of the central bank. The BCRD continues to prepare its financial statements in accordance with accounting policies that do not represent an internationally recognized financial reporting framework, such as International Financial Reporting Standards (IFRS). A methodology for separately calculating realized and unrealized foreign currency gains/losses is also lacking. The authorities have undertaken to address the remaining weaknesses.

## V. Staff Appraisal

35. **Overall**. Performance under the program has been uneven but there is a remarkable economic recovery, and a significant improvement of most macroeconomic indicators. The short-term objective of supporting demand, strengthening confidence, and preventing a deepening of the recessionary environment of the first half of 2009 has been achieved, and a more demanding phase of the program has started. Policy coordination remains an issue, as highlighted by the difficulties in implementing the electricity reform and the delays in completing this review. The opening of a resident representative office in Santo Domingo, expected for this fall, will help in improving policy coordination.

36. **Fiscal policy in 2010**. Staff commends the authorities for meeting the fiscal targets for the first half of the year, and for designing a credible plan to close the fiscal gap to reach the 2010 end-year targets. Improvements are needed in expenditure control, especially in the electricity subsidy, and the authorities should adhere to their plan for electricity reform, including the implementation of a new tariff structure and better management of the state-run electricity distribution companies, to reduce the burden of the electricity sector on the public finances. Improvements are also needed in tax administration, and the plan to evaluate and limit tax exemptions will be key to this effort; this might require additional technical assistance from the Fund. Tax expenditures in the Dominican Republic amount to close to 6 percent of GDP, which is high by regional standards, and above the level compatible with a tax system collecting around 14 percent of GDP. Accordingly, reduction of untargeted

exemptions and a better control of remaining exemptions will be a significant improvement of the tax system.

37. **2011 Budget.** Approving a budget for 2011 in line with the program will be important to maintain the momentum of fiscal consolidation, and move towards reaching the target of a primary surplus of 2 percent of GDP for the consolidated public sector in 2012. The expansionary policies implemented in 2009 and the first half of 2010 were important to soften the blow of the international financial crisis, but they came at the cost of a higher debt to GDP ratio and reduced fiscal space to face future shocks. Therefore it is important to begin stabilizing and lowering the public debt to safeguard debt sustainability in the face of future fiscal challenges. This will also enhance the credibility of fiscal policy and facilitate access to international financial markets, and the development of domestic debt markets.

38. **Monetary**. The central bank has maintained an accommodative monetary policy stance to support domestic demand. By and large, this policy has been successful. The central bank has a good track record of adjusting monetary policy flexibly and stands ready to tighten its stance as soon as risks of inflationary pressures become evident. As credit growth has picked up, the central bank should be mindful of its performance criterion on NDA. While dollarization is mild by Latin American standards, it remains a challenge. The authorities are well-advised to strengthen their policy framework to gradually reduce dollarization further. The government and the central bank should be commended for their efforts to transfer resources in support of the recapitalization of the central bank according to current legislation (avoiding a weakening of the law), including by using part of the SBA purchases for this purpose.

39. **Exchange rate.** It will be essential to pursue a flexible exchange rate policy in the short-term given the uncertainties in the external environment. This will also facilitate the switch in monetary regime to inflation targeting (even if only formally adopted in 2012), foster de-dollarization, and strengthen the effectiveness and credibility of monetary policy.

40. **Reform**. The authorities should be commended for observing the structural benchmarks. Three important strategies on tax collections, prudential regulations and inflation targeting were designed in the first half of 2010. Looking forward, the authorities will need to focus on the two main structural pillars of the program that so far have proved difficult, namely: (i) reinforcing tax administration to enhance collections by rationalizing exemptions; and (ii) eliminating indiscriminate electricity subsidies. The authorities should implement both reforms vigorously to make up for the early difficulties experienced. The authorities should strive to adopt policies aimed at reducing the deficit of the electricity sector, which would prevent an undue contraction in public investment.

41. **Risks.** All in all, risks remain balanced. In the short-run, downside risks relate to a possible weakening in the world economy due to financial instability in parts of Europe and a less robust recovery in the US economy, which could lead to lower growth at home and make implementation of the program more difficult. A policy of accommodating deviations in the electricity sector with lower public investment could be counter-productive in the long-run as it reduces growth prospects. On the upside, activity could continue expanding at a brisk pace with the reconstruction of Haiti or if FDI gathers momentum. This would require a more

active role of monetary policy. It is important to note that two significant risks have been eliminated in 2010: the political risk of higher non-programmed spending associated with the elections; and the risk of not having access to international capital markets to finance the budget. For 2011 the risk of policy implementation remains, particularly for the ambitious reform agenda in electricity and tax administration, on which the quality of the fiscal consolidation depends. The fact that the budget is being crafted conservatively partially alleviates the risk of hampering fiscal consolidation if progress in tax collection is slow.

42. **Review**. Notwithstanding disappointing results on electricity reform and serious setbacks to the tax collection efforts, staff supports completion of the second and third SBA reviews, as well as the authorities' request for waivers of applicability of end-September 2010 performance criteria, in light of the very positive macroeconomic results and appropriate offsetting measures.

**Table 1. Dominican Republic: Quantitative Performance Criteria 2009-11 1/**

| | Prog. | Actual | Margin | | Prog. | Actual | Margin | | Prog. | Actual | Margin | | Prog. 6/ | | Prog. 7/ | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Dec | | | | Mar | | | | Jun | | | | Sep | Dec | Mar | Jun | Sep | Dec |
| | 2009 | | | | 2010 | | | | | | | | | | 2011 | | | |
| **Fiscal Targets** | | | | | | | | | | | | | | | | | | |
| 1. Overall balance of the central administration (floor) 2/ 3/ | -51.5 | -58.0 | -6.5 | X | -73.7 | -69.3 | 4.4 | ✓ | -88.4 | -87.5 | 0.9 | ✓ | -95.8 | -102.3 | -14.9 | -21.3 | -27.9 | -33.5 |
| 2. Overall balance of the consolidated public sector (floor) 2/ 3/ | -74.5 | -74.2 | 0.3 | ✓ | -97.5 | -91.3 | 6.2 | ✓ | -119.5 | -118.4 | 1.1 | ✓ | -133.0 | -147.0 | -21.5 | -35.6 | -49.5 | -63.8 |
| **Electricity Targets** | | | | | | | | | | | | | | | | | | |
| 3. Overall current balance of the public electricity sector (floor) 4/ | … | -744.3 | … | | … | -201.4 | … | | … | -279.6 | … | | … | … | -77.0 | -145.2 | -241.6 | -350.0 |
| **Monetary Targets** | | | | | | | | | | | | | | | | | | |
| 4. Net international reserves (floor) 4/ | 1,815 | 2,464 | 649 | ✓ | 1,730 | 2,025 | 296 | ✓ | 1,888 | 2,128 | 240 | ✓ | 1,865 | 2,015 | 1,665 | 1,765 | 1,865 | 2,315 |
| 5. Net domestic assets (ceiling) 3/ | … | 45.4 | … | … | … | 57.5 | … | | … | 50.9 | … | | 65.0 | 80.0 | 80.0 | 80.0 | 80.0 | 80.0 |
| **Debt Targets** | | | | | | | | | | | | | | | | | | |
| 6. Accumulation of public arrears with electricity generators (ceiling) 2/ 4/ | 0.0 | 100.5 | 100.5 | X | 0.0 | 0.0 | 0.0 | ✓ | 0.0 | 0.0 | 0.0 | ✓ | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| 7. Accumulation of external public debt arrears 4/ 5/ | 0.0 | 0.0 | 0.0 | ✓ | 0.0 | 0.0 | 0.0 | ✓ | 0.0 | 0.0 | 0.0 | ✓ | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |

1/ Targets for end of the month, defined in the Technical Memorandum of Understanding.

2/ Cumulative flows from December 2008 for targets in 2010 and cumulative flows from December 2010 for targets in 2011.

3/ In billions of Dominican Republic pesos.

4/ In millions of U.S. dollars.

5/ Continuous target.

6/ Same targets as previous Letter of Intent.

7/ New targets.

**Table 2. Dominican Republic: Structural Benchmarks for 2009-11**

| Measure | Timing | SBA Approval | First Review | Second and Third Review | Status |
|---|---|---|---|---|---|
| **Public Sector Reform** | | | | | |
| **A.** Design a strategy to rationalize and limit tax exemptions, strengthen tax administration, and continue modernizing customs to achieve the medium-term revenue objectives of the program. | Mar 2010 | ☼ | | | **Done** Strategy provided on time. |
| **B.** Issue a decree to centralize the power to grant tax exemptions in the Ministry of Finance. | Dec 2010 | | | ☼ | **New benchmark** |
| **C.** Create a unit at the Ministry of Finance to conduct cost-benefit analyses of current and future exemptions and make recommendations to the Minister of Finance on granting and rationalizing exemptions. | Dec 2010 | | | ☼ | **New benchmark** |
| **D.** Prepare a list of additional revenue administration measures to yield 0.5 percent of GDP in 2011 with a timetable for their implementation. | Dec 2010 | | | ☼ | **New benchmark** |
| **E.** Prepare a report on the costs and benefits of the current exemption regime and a timetable for the rationalization and reduction of exemptions to help achieve the government's tax revenue target of 15 percent of GDP. | Mar 2011 | | | ☼ | **New benchmark** |
| **Financial Sector Reform** | | | | | |
| **F.** Design a plan to achieve compliance with all Basel core principles for effective bank supervision by 2012. | Mar 2010 | ☼ | | | **Done** Plan designed by Superintendency of Banks by March 2010. |
| **G.** Design a plan to formally adopt a full-fledged inflation targeting framework by early 2012. | Jun 2010 | ☼ | | | **Done** Plan designed by BCRD by June 2010. |
| **H.** New Central Bank securities will be dematerialized. | Dec 2010 | | | ☼ | **New benchmark** |
| **I.** Send to congress amendments to the Monetary and Financial Law to eliminate legal impediments to introduce the Basel core principles and risk based supervision. | Mar 2011 | | | ☼ | **New benchmark** |
| **J.** Send to congress a new law on consolidated supervision of financial and industrial groups with a view to facilitate risk based supervision. | Mar 2011 | | | ☼ | **New benchmark** |
| **K.** Publish the first monetary policy report under inflation target for informational purposes only. | Jun 2011 | | | ☼ | **New benchmark** |
| **L.** Publish a monetary program for 2012 (as established by law) within the new inflation target framework. | Dec 2011 | | | ☼ | **New benchmark** |
| **Recovery and Growth Enhancement** | | | | | |
| **M.** Design a strategy to reform the electricity sector, including by eliminating indiscriminate electricity subsidies to achieve the medium-term budgetary expenditure objectives of the program. | Dec 2009 | ☼ | | | **Done** Satisfactory action plan provided to Staff in December 2009. |
| **N.** Increase the number of regulated clients of the distribution companies (EDES) to 1.9 million. | Sep 2010 | | ☼ | | **In progress** The number of regulated clients as of end-August 2010 was close to 1.9 million. |
| **O.** Design a strategy to develop domestic capital markets and debt management including by lowering the country risk and the borrowing costs for the economy. | Sep 2010 | ☼ | | | **In progress** The BCRD and the Ministery of Finance are working on this issue. |
| **P.** Adopt a flexible pricing mechanism for electricity tariffs with a view to eliminate the gap between current tariffs and the "indexed" tariff as defined by the Superintendency of Electricity. | Dec 2010 | | ☼ | | **In progress** Design of a new tariff structure is underway. |
| **Q.** Increase the number of regulated clients of the electricity companies (EDEs) to 2.15 million. | Jun 2011 | | | ☼ | **New benchmark** |
| **Social Safety Net** | | | | | |
| **R.** Increase the permanent coverage of the conditional cash transfer program by 70,000 families living in extreme poverty. | Dec 2009 | ☼ | | | **Done** More than 70,000 families were incorporated into the Solidaridad program |
| **S.** Increase the coverage of the BONOLUZ program to 50 thousand clients. | Dec 2010 | | ☼ | | **Done** More than 100 thousand clients benefit from Bonoluz in July 2010. |
| **T.** Increase the coverage of the Bonoluz program from the 50,000 target of December 2010 to 250,000 clients. | Dec 2011 | | | ☼ | **New benchmark** |
| **U.** Increase the permanent coverage of the conditional cash transfer program (Solidaridad) by 60,000 additional families to 590,000 families. | Dec 2011 | | | ☼ | **New benchmark** |

## Table 3. Dominican Republic: Selected Economic Indicators

| | | | |
|---|---|---|---|
| Main export products: tourism, textiles, nickel | | Income share of highest | |
| GDP per capita (U.S. dollars, 2009 PPP) | 4,500.2 | 10 percent (percent, 2006) | 39.0 |
| Population (millions, 2009 estimate) | 10.1 | Poverty (headcount index, 2008) | 37.8 |
| Life expectancy at birth (years, 2008) | 73.3 | Extreme poverty (headcount index, 2008) | 11.7 |
| Under 5 mortality rate (per thousand, 2008) | 31.0 | Adult literacy rate (percent, 2007) | 95.1 |

| | 2008 | 2009 | 2010 Prog. | 2010 Proj. | 2011 Prog. | 2012 Proj. |
|---|---|---|---|---|---|---|
| **National accounts and prices** | **(12-month percentage changes, unless otherwise indicated)** | | | | | |
| Nominal GDP (RD$ billion) | 1,576 | 1,679 | 1,857 | 1,884 | 2,095 | 2,332 |
| Dollar GDP (US$ billion) | 45.5 | 46.7 | 50.1 | 49.7 | 53.7 | 57.9 |
| Real GDP | 5.3 | 3.5 | 3.0-4.0 | 5.5-6.0 | 5.5-6.0 | 6.0 |
| Consumer price index (period average) | 10.6 | 1.4 | 6-7 | 6.4 | 5.4 | 4.5 |
| Consumer price index (eop) | 4.5 | 5.8 | 6-7 | 6.0-7.0 | 5.0-6.0 | 4.0-5.0 |
| Exchange rate (RD$/US$ - period average) | 34.6 | 35.9 | … | … | … | … |
| Exchange rate (RD$/US$ - eop) | 35.5 | 36.1 | … | … | … | … |
| **Social Indicators** | | | | | | |
| Unemployment rate (in percent) | 14.2 | 14.9 | … | … | … | … |
| **Public finances** | **(In percent of GDP)** | | | | | |
| Central government primary balance | -1.4 | -1.6 | -0.2 | -0.2 | 0.8 | 1.6 |
| Total revenues (including grants) | 15.8 | 13.7 | 14.3 | 14.0 | 14.0 | 15.1 |
| Primary spending | 17.2 | 15.2 | 14.5 | 14.2 | 13.2 | 13.5 |
| Interest expenditure | 1.7 | 1.9 | 2.2 | 2.1 | 2.4 | 2.2 |
| Nonfinancial public sector overall balance | -3.1 | -3.1 | -2.5 | -2.5 | -1.6 | -0.6 |
| Quasi-fiscal balance of the central bank | -1.3 | -1.3 | -1.4 | -1.4 | -1.4 | -1.4 |
| Consolidated public sector balance | -4.4 | -4.4 | -3.9 | -3.9 | -3.0 | -2.0 |
| *Of which*: primary balance | -0.9 | -0.5 | 0.0 | 0.2 | 1.2 | 2.0 |
| Total public debt | 38.1 | 41.8 | 42.2 | 41.3 | 42.0 | 41.2 |
| *Of which:* foreign currency denominated | 17.8 | 19.4 | 21.6 | 21.2 | 21.6 | 21.0 |
| Total public debt (excluding BCRD recapitalization bonds) | 33.7 | 36.9 | … | 35.7 | 35.3 | 33.8 |
| **Money and credit** | **(12-month percentage changes, unless otherwise indicated)** | | | | | |
| Liabilities to private sector (M3) | 8.7 | 11.1 | 9.2 | 15.7 | 11.4 | 13.3 |
| Currency issue | 0.3 | 12.3 | 11.0 | 10.7 | 10.1 | 13.9 |
| Deposits | 10.5 | 14.7 | 13.6 | 14.8 | 11.2 | 13.4 |
| Net domestic assets of the banking system | 17.1 | 10.1 | 20.5 | 23.9 | 11.3 | 12.0 |
| Credit to the private sector | 7.0 | 7.2 | 14.9 | 12.5 | 13.0 | 12.0 |
| M3, in percent of GDP | 35.3 | 36.8 | 36.3 | 37.9 | 38.0 | 38.7 |
| **Balance of payments** | **(In millions of U.S. dollars, unless otherwise indicated)** | | | | | |
| Current account | -4,529 | -2,159 | -3,071 | -3,493 | -3,421 | -2,445 |
| Merchandise trade balance | -9,245 | -6,741 | -7,583 | -8,140 | -8,278 | -7,801 |
| Exports | 6,748 | 5,519 | 5,534 | 6,152 | 7,100 | 9,046 |
| Imports | -15,993 | -12,260 | -13,117 | -14,291 | -15,378 | -16,848 |
| *Of which:* oil and gas | -4,241 | -2,641 | -3,307 | -3,384 | -3,544 | -3,702 |
| Services and transfers (net) | 4,717 | 4,582 | 4,512 | 4,646 | 4,857 | 5,356 |
| *Of which:* interest on public debt | -372 | -427 | -570 | -525 | -565 | -522 |
| Capital and financial account | 4,384 | 2,655 | 2,548 | 2,967 | 3,721 | 3,072 |
| *Of which:* foreign direct investment | 2,900 | 2,067 | 1,863 | 1,354 | 1,990 | 2,228 |
| Errors and omissions | -181 | -90 | 0 | 0 | 0 | 0 |
| Overall balance | -326 | 406 | -523 | -526 | 300 | 627 |
| *Of which:* change in NIR (increase -) | 230 | -370 | 523 | 523 | -300 | -627 |
| Current account (in percent of GDP) | -10.0 | -4.6 | -6.1 | -7.0 | -6.4 | -4.2 |
| Exports of goods (in US$, annual percentage chg.) | -5.8 | -18.2 | 0.3 | 11.5 | 15.4 | 27.4 |
| Imports of goods (in US$, annual percentage chg.) | 17.6 | -23.3 | 7.0 | 16.6 | 7.6 | 9.6 |
| **International reserve position and external debt** | | | | | | |
| Gross official reserves | 2,662 | 3,303 | 3164.1 | 3,154 | 3,943 | 4,623 |
| (in months of imports) 1/ | 2.3 | 2.4 | 2.4 | 2.2 | 2.5 | 3.0 |
| Net international reserves 2/ | 2,165 | 2,535 | 2,015 | 2,015 | 2,315 | 2,942 |
| Outstanding external public debt, in percent of GDP | 18.3 | 20.0 | 18.1 | 21.6 | 19.5 | 16.5 |
| Oil price (WEO) (US$/bbl) | 97.0 | 61.8 | 78.3 | 77.1 | 80.0 | 82.8 |

Sources: Dominican authorities; World Bank; and Fund staff estimates.

1/ In relation to imports of goods and nonfactor services of the following year.

2/ The projections for 2010-12 assume that all prospective purchases under the proposed SBA will be made to meet the gross reserves objectives of the balance of payments projections.

**Table 4. Dominican Republic: Fiscal Accounts**

(In percent of GDP)

| | | | Prog. | Actual | Prog. | Proj. | Prog. | | | | Proj. | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | Jan-Jun | | Jan-Dec | | Jan-Mar | Jan-Jun | Jan-Sep | Jan-Dec | | |
| | 2008 | 2009 | 2010 | | | | 2011 | | | | 2012 | 2013 |
| | | | **A. Central Government** | | | | | | | | | |
| **Total revenue and grants** | **15.8** | **13.7** | **7.0** | **6.7** | **14.3** | **14.0** | **3.3** | **6.9** | **10.3** | **14.0** | **15.1** | **15.6** |
| **Total revenue** | **15.7** | **13.5** | **6.9** | **6.7** | **14.1** | **13.7** | **3.2** | **6.8** | **10.2** | **13.8** | **14.9** | **15.4** |
| Tax revenues | 15.0 | 13.1 | 6.8 | 6.4 | 13.8 | 13.2 | 3.1 | 6.6 | 9.9 | 13.3 | 14.5 | 15.0 |
| Income and property 1/ | 4.5 | 3.9 | 2.1 | 1.9 | 3.9 | 3.6 | 0.8 | 2.1 | 2.9 | 3.7 | 4.3 | 4.4 |
| VAT | 4.7 | 4.2 | 2.0 | 2.1 | 4.2 | 4.3 | 1.1 | 2.2 | 3.3 | 4.3 | 4.4 | 4.5 |
| Excises | 4.1 | 3.7 | 1.9 | 1.8 | 4.0 | 3.9 | 0.9 | 1.7 | 2.7 | 3.9 | 4.1 | 4.2 |
| International trade | 1.6 | 1.3 | 0.9 | 0.6 | 1.8 | 1.4 | 0.3 | 0.6 | 0.9 | 1.4 | 1.7 | 1.9 |
| Other | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Nontax revenue | 0.7 | 0.3 | 0.1 | 0.3 | 0.3 | 0.5 | 0.1 | 0.2 | 0.3 | 0.6 | 0.4 | 0.4 |
| Capital revenue | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| **Grants** | **0.2** | **0.2** | **0.1** | **0.1** | **0.2** | **0.2** | **0.0** | **0.1** | **0.1** | **0.2** | **0.2** | **0.2** |
| **Primary expenditures 2/** | **17.2** | **15.2** | **8.1** | **7.4** | **14.5** | **14.2** | **3.4** | **6.8** | **9.9** | **13.2** | **13.5** | **14.1** |
| Wages and salaries | 3.8 | 4.1 | 1.7 | 1.8 | 3.8 | 3.8 | 0.9 | 1.7 | 2.6 | 3.8 | 3.5 | 3.5 |
| Goods and services | 2.1 | 1.8 | 1.1 | 0.9 | 2.0 | 1.8 | 0.4 | 0.8 | 1.2 | 1.6 | 1.8 | 1.8 |
| Transfers, *o/w* : | 7.1 | 5.5 | 2.2 | 2.5 | 4.4 | 4.9 | 0.9 | 1.9 | 2.8 | 4.1 | 3.5 | 3.4 |
| Gas subsidy | 0.5 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Electricity transfers | 2.7 | 1.3 | 0.4 | 0.5 | 0.8 | 1.2 | 0.1 | 0.3 | 0.4 | 0.6 | 0.3 | 0.1 |
| Other | 3.9 | 4.2 | 1.8 | 1.9 | 3.6 | 3.7 | 0.8 | 1.6 | 2.4 | 3.5 | 3.2 | 3.3 |
| Capital expenditure | 5.0 | 3.6 | 3.1 | 2.3 | 4.4 | 3.7 | 1.2 | 2.4 | 3.2 | 3.8 | 4.7 | 5.4 |
| Statistical discrepancy 2/ | -0.6 | 0.3 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| **Primary balance** | **-1.4** | **-1.6** | **-1.1** | **-0.7** | **-0.2** | **-0.2** | **-0.1** | **0.2** | **0.4** | **0.8** | **1.6** | **1.5** |
| **Interest** | **1.7** | **1.9** | **0.6** | **0.9** | **2.2** | **2.1** | **0.6** | **1.2** | **1.8** | **2.4** | **2.2** | **2.1** |
| Foreign | 0.8 | 0.7 | 0.3 | 0.3 | 0.9 | 0.8 | 0.2 | 0.4 | 0.6 | 0.9 | 0.9 | 0.6 |
| Domestic 3/ | 0.8 | 1.2 | 0.3 | 0.6 | 1.3 | 1.3 | 0.4 | 0.8 | 1.2 | 1.5 | 1.3 | 1.5 |
| **Overall balance** | **-3.0** | **-3.5** | **-1.6** | **-1.6** | **-2.4** | **-2.3** | **-0.7** | **-1.0** | **-1.3** | **-1.6** | **-0.6** | **-0.6** |
| | | | **B. Rest of the Non-Financial Public Sector** | | | | | | | | | |
| **Overall balance rest of NFPS** | **-0.1** | **0.4** | **-0.1** | **-0.1** | **-0.1** | **-0.2** | **0.0** | **0.0** | **0.0** | **0.0** | **0.0** | **0.0** |
| | | | **C. Non-Financial Public Sector (A+B)** | | | | | | | | | |
| **Overall balance NFPS** | **-3.1** | **-3.1** | **-1.7** | **-1.7** | **-2.5** | **-2.5** | **-0.7** | **-1.0** | **-1.3** | **-1.6** | **-0.6** | **-0.6** |
| Primary balance | -1.5 | -1.2 | -1.1 | -0.8 | -0.4 | -0.4 | -0.1 | 0.2 | 0.4 | 0.8 | 1.6 | 1.5 |
| Interest | 1.7 | 1.9 | 0.6 | 0.9 | 2.2 | 2.1 | 0.6 | 1.2 | 1.8 | 2.4 | 2.2 | 2.1 |
| **Financing NFPS** | **3.1** | **3.1** | **1.7** | **1.7** | **2.5** | **2.5** | **0.7** | **1.0** | **1.3** | **1.6** | **0.6** | **0.6** |
| External financing | 0.2 | 2.1 | 1.5 | 1.7 | 2.9 | 3.2 | 0.1 | 1.4 | 1.7 | 1.9 | -0.4 | 0.3 |
| Domestic financing | 1.9 | 1.6 | 0.3 | 0.0 | -0.4 | -0.9 | 0.6 | -0.4 | -0.4 | -0.4 | 1.0 | 0.3 |
| | | | **D. Central Bank** | | | | | | | | | |
| **Quasi-fiscal balance of the central bank** | **-1.3** | **-1.3** | **-0.7** | **-0.6** | **-1.4** | **-1.4** | **-0.3** | **-0.7** | **-1.0** | **-1.4** | **-1.4** | **-1.4** |
| *Of which:* non interest | 0.6 | 0.7 | 0.2 | 0.2 | 0.3 | 0.5 | 0.2 | 0.3 | 0.5 | 0.4 | 0.4 | 0.4 |
| | | | **E. Consolidated Public Sector (C+D)** | | | | | | | | | |
| **Consolidated public sector balance** | **-4.4** | **-4.4** | **-2.4** | **-2.3** | **-3.9** | **-3.9** | **-1.0** | **-1.7** | **-2.4** | **-3.0** | **-2.0** | **-2.0** |
| Primary balance | -0.9 | -0.5 | -1.0 | -0.5 | 0.0 | 0.2 | 0.0 | 0.5 | 1.0 | 1.2 | 2.0 | 1.9 |
| Interest | 3.6 | 3.9 | 1.5 | 1.8 | 3.9 | 4.0 | 1.1 | 2.2 | 3.3 | 4.2 | 4.0 | 3.9 |
| ***Memorandum items:*** | | | | | | | | | | | | |
| Interest for central bank recapitalization | 0.6 | 0.7 | 0.4 | 0.3 | 0.8 | 0.8 | 0.2 | 0.5 | 0.7 | 0.9 | 1.0 | 1.1 |
| Primary spending excl. electricity and gas | 14.1 | 13.9 | 7.7 | 6.9 | 13.7 | 13.0 | 3.2 | 6.3 | 9.3 | 12.6 | 13.2 | 14.0 |
| Overall spending by central government | 18.9 | 17.1 | 8.7 | 8.3 | 16.7 | 16.3 | 4.0 | 7.9 | 11.6 | 15.6 | 15.7 | 16.2 |
| Nominal GDP (DR$ billion) | 1576 | 1678 | 1857 | 1884 | 1857 | 1884 | 2095 | 2095 | 2095 | 2095 | 2332 | 2607 |
| Real GDP Growth (percent) | | | | | | | | | | | | |

Sources: Dominican authorities; and Fund staff estimates.
1/ Includes social security contributions.
2/ Primary expenditures include the difference between the financing below the line and the overall balance registered above the line.
3/ Includes interest payments on Central Bank recapitalization bonds.

**Table 5. Dominican Republic: Fiscal Accounts**
(In billions of Dominican pesos)

| | | | Prog. | Actual | Prog. | Proj. | Prog. | | | | Proj. | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | Jan-Jun | | Jan-Dec | | Jan-Mar | Jan-Jun | Jan-Sep | Jan-Dec | | |
| | 2008 | 2009 | 2010 | | | | 2011 | | | | 2012 | 2013 |
| | | | | | | | **A. Central Government** | | | | | |
| **Total revenue and grants** | **249.8** | **229.4** | **130.7** | **127.1** | **265.2** | **263.1** | **68.7** | **145.1** | **215.9** | **293.2** | **351.7** | **406.9** |
| **Total revenue** | **246.9** | **225.8** | **128.9** | **126.0** | **261.6** | **259.0** | **67.7** | **143.2** | **213.0** | **289.3** | **347.1** | **401.7** |
| Tax revenues | 236.2 | 220.0 | 126.7 | 120.1 | 255.6 | 248.9 | 65.3 | 139.0 | 206.5 | 277.7 | 337.8 | 391.2 |
| Income and property 1/ | 71.5 | 66.0 | 38.8 | 35.8 | 72.4 | 67.6 | 17.5 | 44.8 | 60.7 | 78.1 | 100.3 | 115.4 |
| VAT | 74.7 | 69.9 | 37.5 | 39.4 | 77.2 | 81.8 | 22.4 | 46.3 | 69.3 | 90.2 | 102.6 | 117.3 |
| Excises | 64.9 | 62.2 | 34.7 | 33.2 | 73.4 | 72.9 | 19.6 | 35.9 | 57.0 | 80.9 | 95.6 | 109.5 |
| International trade | 25.0 | 21.9 | 15.8 | 10.9 | 32.6 | 25.8 | 5.7 | 11.9 | 19.5 | 28.5 | 39.2 | 49.1 |
| Other | 0.0 | 3.5 | 0.0 | 0.7 | 0.0 | 0.7 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Nontax revenue | 10.7 | 5.8 | 2.2 | 6.0 | 6.0 | 10.1 | 2.4 | 4.2 | 6.5 | 11.7 | 9.3 | 10.4 |
| Capital revenue | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| **Grants** | 2.9 | 3.5 | 1.8 | 1.0 | 3.6 | 4.1 | 1.0 | 1.9 | 2.9 | 3.9 | 4.7 | 5.2 |
| **Primary expenditures 2/** | **271.3** | **255.4** | **150.3** | **139.4** | **268.9** | **267.2** | **71.6** | **141.7** | **206.6** | **276.8** | **314.9** | **367.6** |
| Wages and salaries | 59.5 | 68.5 | 31.4 | 33.4 | 69.7 | 72.3 | 18.2 | 36.4 | 54.5 | 78.8 | 81.6 | 91.2 |
| Goods and services | 32.5 | 29.6 | 20.5 | 16.8 | 36.2 | 33.0 | 8.2 | 16.4 | 24.6 | 32.9 | 42.0 | 46.9 |
| Transfers, *o/w*: | 111.4 | 92.9 | 41.2 | 46.6 | 80.8 | 91.9 | 19.7 | 39.1 | 59.7 | 86.2 | 81.6 | 88.6 |
| Gas subsidy | 7.7 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Electricity transfers | 41.9 | 21.7 | 7.3 | 10.3 | 14.5 | 22.4 | 3.0 | 5.6 | 9.4 | 13.6 | 7.0 | 2.6 |
| Other | 61.8 | 71.2 | 33.9 | 36.4 | 66.3 | 69.5 | 16.8 | 33.5 | 50.3 | 72.6 | 74.6 | 86.0 |
| Capital expenditure | 78.1 | 60.0 | 57.3 | 42.8 | 82.1 | 70.0 | 25.4 | 49.8 | 67.8 | 78.9 | 109.6 | 140.8 |
| Statistical discrepancy 2/ | 0.0 | 4.4 | 0.0 | 0.5 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| **Primary balance** | **-21.5** | **-26.0** | **-19.6** | **-12.3** | **-3.7** | **-4.1** | **-2.9** | **3.4** | **9.3** | **16.4** | **36.9** | **39.3** |
| **Interest** | **26.1** | **32.0** | **10.8** | **17.2** | **40.6** | **40.2** | **12.0** | **24.7** | **37.2** | **49.9** | **51.5** | **55.1** |
| Foreign | 12.4 | 11.3 | 6.0 | 5.5 | 16.5 | 15.7 | 3.9 | 8.6 | 13.0 | 17.9 | 21.2 | 16.0 |
| Domestic 3/ | 13.6 | 20.7 | 4.7 | 11.7 | 24.1 | 24.5 | 8.1 | 16.1 | 24.1 | 32.0 | 30.3 | 39.1 |
| **Overall balance** | **-47.6** | **-58.0** | **-30.4** | **-29.5** | **-44.3** | **-44.3** | **-14.9** | **-21.3** | **-27.9** | **-33.5** | **-14.6** | **-15.8** |
| | | | | | | | **B. Rest of the Non-Financial Public Sector** | | | | | |
| **Overall balance rest of NFPS** | **-1.7** | **6.2** | **-1.4** | **-2.4** | **-3.0** | **-3.0** | **0.0** | **0.0** | **0.0** | **0.0** | **0.0** | **0.0** |
| | | | | | | | **C. Non-Financial Public Sector (A+B)** | | | | | |
| **Overall balance NFPS** | **-49.3** | **-51.7** | **-31.8** | **-31.9** | **-47.3** | **-47.3** | **-14.9** | **-21.3** | **-27.9** | **-33.5** | **-14.6** | **-15.8** |
| Primary Balance | -23.2 | -19.8 | -21.0 | -14.7 | -6.7 | -7.1 | -2.9 | 3.4 | 9.3 | 16.4 | 36.9 | 39.3 |
| Interest | 26.1 | 32.0 | 10.8 | 17.2 | 40.6 | 40.2 | 12.0 | 24.7 | 37.2 | 49.9 | 51.5 | 55.1 |
| **Financing NFPS** | **49.3** | **51.7** | **31.8** | **31.9** | **47.3** | **47.3** | **14.9** | **21.3** | **27.9** | **33.5** | **14.6** | **15.8** |
| External financing | 24.3 | 34.9 | 27.7 | 31.9 | 55.3 | 61.1 | 2.3 | 28.9 | 35.8 | 40.8 | -9.3 | 7.9 |
| Domestic financing | 30.7 | 26.3 | 3.8 | -1.0 | -8.3 | -13.9 | 12.6 | -7.6 | -8.0 | -7.4 | 23.4 | 7.9 |
| | | | | | | | **D. Central Bank** | | | | | |
| **Quasi-fiscal balance of the central bank** | **-20.7** | **-22.4** | **-13.5** | **-12.2** | **-25.5** | **-25.4** | **-6.6** | **-14.3** | **-21.6** | **-30.3** | **-32.7** | **-36.5** |
| *Of which:* non interest | 9.1 | 11.6 | 3.2 | 4.7 | 6.4 | 10.2 | 3.7 | 7.2 | 10.8 | 8.4 | 9.3 | 10.4 |
| | | | | | | | **E. Consolidated Public Sector (C+D)** | | | | | |
| **Consolidated public sector balance** | **-70.0** | **-74.2** | **-45.3** | **-44.2** | **-72.8** | **-72.7** | **-21.5** | **-35.6** | **-49.5** | **-63.8** | **-47.2** | **-52.3** |
| Primary Balance | -14.1 | -8.2 | -17.9 | -10.0 | -0.3 | 3.1 | 0.8 | 10.6 | 20.1 | 24.8 | 46.2 | 49.7 |
| Interest | 56.0 | 66.0 | 27.4 | 34.1 | 72.5 | 75.8 | 22.3 | 46.2 | 69.6 | 88.6 | 93.5 | 102.0 |
| ***Memorandum items:*** | | | | | | | | | | | | |
| Interest for central bank recapitalization | 9.1 | 12.4 | 7.3 | 6.0 | 14.5 | 14.5 | 4.7 | 9.4 | 14.1 | 18.9 | 22.7 | 27.5 |
| Primary spending excl. electricity and gas | 221.3 | 233.7 | 143.1 | 129.1 | 254.4 | 244.3 | 66.1 | 132.2 | 194.3 | 263.1 | 307.9 | 365.0 |
| Overall spending by central government | 297.0 | 287.4 | 161.1 | 156.6 | 309.5 | 307.4 | 83.6 | 166.4 | 243.8 | 326.7 | 365.9 | 422.3 |

Sources: Dominican authorities; and Fund staff estimates.
1/ Includes social security contributions.
2/ Primary expenditures include the difference between the financing below the line and the overall balance registered above the line.
3/ Includes interest payments on Central Bank recapitalization bonds.

**Table 6. Dominican Republic: Public Sector Gross Financing Requirements and Sources 1/**

(In millions of U.S. dollars)

| | 2010 | | | | 2011 | | | | | Projection | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | Jan-Jun | | Jan-Dec | | Prog. | | | | | | |
| | Prog. | Actual | Prog. | Proj. | Q1 | Q2 | Q3 | Q4 | Annual | 2012 | 2013 |
| **Gross Financing Requirements** | **1,526** | **1,669** | **2,531** | **2,971** | **816** | **599** | **602** | **578** | **2,595** | **1,536** | **1,410** |
| Non-Financial Public Sector Deficit | 857 | 843 | 1,275 | 1,247 | 381 | 165 | 168 | 144 | 858 | 362 | 397 |
| Amortizations | 669 | 827 | 1,337 | 1,723 | 434 | 434 | 434 | 434 | 1,737 | 1,174 | 1,014 |
| Floating Debt | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| **Financing Sources** | **1,526** | **1,669** | **2,531** | **2,971** | **816** | **599** | **602** | **578** | **2,595** | **1,536** | **1,410** |
| **External** | **1,572** | **1,219** | **2,135** | **2,275** | **268** | **768** | **303** | **431** | **1,771** | **972** | **875** |
| Budget Support | 335 | 54 | 575 | 845 | 63 | 63 | 98 | 226 | 448 | 97 | 0 |
| World Bank | 0 | 0 | 150 | 150 | 0 | 0 | 0 | 70 | 70 | 0 | 0 |
| IDB | 230 | 15 | 245 | 286 | 0 | 0 | 35 | 93 | 128 | 97 | 0 |
| CAF | 30 | 0 | 30 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| IMF | 75 | 38 | 150 | 408 | 62.5 | 62.5 | 62.5 | 62.5 | 250 | 0 | 0 |
| Project Financing | 507 | 214 | 700 | 350 | 136 | 136 | 136 | 136 | 543 | 600 | 600 |
| Petrocaribe | 130 | 202 | 260 | 330 | 70 | 70 | 70 | 70 | 280 | 275 | 275 |
| Sovereign Bonds | 600 | 750 | 600 | 750 | 0 | 500 | 0 | 0 | 500 | 0 | 0 |
| **Domestic** | **-46** | **450** | **396** | **700** | **547** | **-169** | **299** | **147** | **824** | **564** | **535** |
| Bonds | -46 | 390 | 317 | 513 | 489 | -228 | 240 | 88 | 589 | 564 | 535 |
| Banking system | 0 | 60 | 0 | 66 | 59 | 59 | 59 | 59 | 235 | 0 | 0 |
| Other | 0 | 0 | 79 | 120 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| **Gap** | **0** | **0** | **0** | **0** | **0** | **0** | **0** | **0** | **0** | **0** | **0** |

Sources: Dominican authorities; and Fund staff estimates.

1/ Non-financial public sector.

**Table 7. Dominican Republic: Quasi-fiscal Balance of the Central Bank**

(In billions of Dominican pesos, unless otherwise specified)

| | | | | Proj. | Prog. | | | |
|---|---|---|---|---|---|---|---|---|
| | | | Jan-Jun | Jan-Dec | Jan-Mar | Jan-Jun | Jan-Sep | Jan-Dec |
| | 2008 | 2009 | 2010 | | 2011 | | | |
| **Revenues** | **13.7** | **17.0** | **7.3** | **16.0** | **5.3** | **10.5** | **15.6** | **20.6** |
| Interest | 13.4 | 15.8 | 7.3 | 15.9 | 5.3 | 10.4 | 15.6 | 20.5 |
| International reserves | 3.7 | 1.3 | 0.7 | 1.1 | 0.4 | 0.7 | 1.1 | 1.3 |
| BCRD recapitalization | 9.2 | 12.9 | 6.4 | 14.5 | 4.7 | 9.4 | 14.1 | 18.9 |
| Other | 0.6 | 1.5 | 0.2 | 0.4 | 0.2 | 0.3 | 0.3 | 0.3 |
| Other revenues | 0.3 | 1.2 | 0.0 | 0.1 | 0.0 | 0.0 | 0.1 | 0.1 |
| **Expenditures** | **34.5** | **39.4** | **19.6** | **41.4** | **12.0** | **24.7** | **37.3** | **50.9** |
| Administrative | 4.2 | 5.1 | 2.5 | 5.6 | 1.6 | 3.1 | 4.7 | 8.3 |
| Interest | 29.8 | 34.0 | 16.9 | 35.6 | 10.3 | 21.5 | 32.4 | 38.7 |
| Securities | 26.8 | 31.9 | 16.0 | 33.7 | 9.8 | 20.2 | 31.1 | 36.5 |
| Other | 3.0 | 2.1 | 0.9 | 1.9 | 0.5 | 1.3 | 1.3 | 2.2 |
| Cost of issuing money bills | 0.4 | 0.3 | 0.1 | 0.2 | 0.0 | 0.1 | 0.1 | 0.1 |
| Other expenditures | 0.1 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 3.8 |
| **Quasi-fiscal balance** | **-20.7** | **-22.4** | **-12.2** | **-25.4** | **-6.6** | **-14.3** | **-21.6** | **-30.3** |
| | | (Percent of GDP) | | | | | | |
| **Revenues** | **0.9** | **1.0** | **0.4** | **0.8** | **0.3** | **0.5** | **0.7** | **1.0** |
| Interest | 0.9 | 0.9 | 0.4 | 0.8 | 0.3 | 0.5 | 0.7 | 1.0 |
| International reserves | 0.2 | 0.1 | 0.0 | 0.1 | 0.0 | 0.0 | 0.1 | 0.1 |
| BCRD recapitalization | 0.6 | 0.8 | 0.3 | 0.8 | 0.2 | 0.4 | 0.7 | 0.9 |
| Other | 0.0 | 0.1 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Other revenues | 0.0 | 0.1 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| **Expenditures** | **2.2** | **2.3** | **1.0** | **2.2** | **0.6** | **1.2** | **1.8** | **2.4** |
| Administrative | 0.3 | 0.3 | 0.1 | 0.3 | 0.1 | 0.1 | 0.2 | 0.4 |
| Interest | 1.9 | 2.0 | 0.9 | 1.9 | 0.5 | 1.0 | 1.5 | 1.8 |
| Securities | 1.7 | 1.9 | 0.8 | 1.8 | 0.5 | 1.0 | 1.5 | 1.7 |
| Other | 0.2 | 0.1 | 0.0 | 0.1 | 0.0 | 0.1 | 0.1 | 0.1 |
| Printing money bills | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Other expenditures | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| **Quasi-fiscal balance** | **-1.3** | **-1.3** | **-0.6** | **-1.4** | **-0.3** | **-0.7** | **-1.0** | **-1.4** |
| **Memo items:** | | | | | | | | |
| Quasi-fiscal primary balance | 9.1 | 11.6 | 4.7 | 10.2 | 3.7 | 7.2 | 10.8 | 8.4 |
| In percent of GDP | 0.6 | 0.7 | 0.2 | 0.5 | 0.2 | 0.3 | 0.5 | 0.4 |
| Securities (eop) | 192.8 | 202.1 | 206.5 | 193.7 | 199.8 | 193.2 | 206.7 | 217.7 |
| In percent of GDP | 12.2 | 12.0 | 11.0 | 10.3 | 9.5 | 9.2 | 9.9 | 10.4 |

Sources: BCRD, and Fund staff estimates.

**Table 8. Dominican Republic: Consolidated Accounts of the Public Electricity Sector**
(In millions of U.S. dollars)

| | 2009 | 2010 | Prog. Jan - Mar 2011 | Prog. Jan - Jun 2011 | Prog. Jan - Sep 2011 | Prog. Jan - Dec 2011 |
|---|---|---|---|---|---|---|
| **Revenue (A)** | **1,348.8** | **1,533.4** | **428.6** | **905.0** | **1,390.2** | **1,867.1** |
| Electricity Distribution Companies (EDE's) | **1,146.9** | **1,312.9** | **371.4** | **780.0** | **1,196.1** | **1,601.6** |
| Regular Clients | 1,007.8 | 1,154.4 | 325.5 | 682.7 | 1,047.3 | 1,399.8 |
| Priority Clients 1/ | 85.6 | 117.6 | 32.4 | 68.0 | 104.3 | 139.4 |
| Municipalities | 25.4 | 30.00 | 10.4 | 22.2 | 34.3 | 45.9 |
| Others | 28.1 | 11.0 | 3.0 | 7.1 | 10.2 | 16.4 |
| CDEEE and Others 2/ | **201.9** | **220.5** | **57.3** | **125.0** | **194.1** | **265.5** |
| Energy Sales | 199.5 | 220.0 | 56.8 | 124.0 | 192.6 | 263.5 |
| Other | 2.4 | 0.5 | 0.5 | 1.0 | 1.5 | 2.0 |
| **Current Expenditure (B)** | **2,093.1** | **2,137.4** | **505.6** | **1,050.3** | **1,631.8** | **2,217.1** |
| Electricity distribution Companies (EDE's) | **1,574.2** | **1,665.6** | **405.0** | **834.6** | **1,310.4** | **1,781.9** |
| Operating Costs | 204.8 | 158.8 | 34.0 | 65.0 | 100.0 | 130.0 |
| o/w Personnel | 74.3 | 60.4 | 13.4 | 25.0 | 39.6 | 54.1 |
| o/w Suppliers | 109.7 | 86.0 | 18.0 | 35.2 | 53.2 | 65.4 |
| o/w Others | 20.8 | 12.4 | 2.6 | 4.8 | 7.2 | 10.5 |
| Energy Purchases | 1,311.5 | 1,454.9 | 356.3 | 741.2 | 1,168.1 | 1,595.9 |
| Interests | 32.5 | 35.0 | 6.0 | 12.0 | 18.0 | 24.0 |
| Others | 25.4 | 16.9 | 8.7 | 16.4 | 24.3 | 32.0 |
| CDEEE and Others 2/ | **518.9** | **471.8** | **100.6** | **215.7** | **321.4** | **435.2** |
| Operating Costs | 82.9 | 40.0 | 10.0 | 20.0 | 30.0 | 40.0 |
| Energy Purchases | 397.6 | 382.3 | 78.6 | 171.7 | 255.4 | 347.2 |
| Interests | 38.4 | 49.5 | 12.0 | 24.0 | 36.0 | 48.0 |
| **Current Balance (C=A-B)** | **-744.3** | **-604.0** | **-77.0** | **-145.2** | **-241.6** | **-350.0** |
| **Capital Expenditure (D)** | **248.5** | **112.0** | **25.0** | **60.0** | **90.0** | **119.0** |
| Electricity Distribution Companies (EDE's) | **78.2** | **50.0** | **15.0** | **35.0** | **50.0** | **70.0** |
| CDEEE and Others 2/ | **170.3** | **62.0** | **10.0** | **25.0** | **40.0** | **49.0** |
| **Overall Balance (E=C-D)** | **-992.8** | **-716.0** | **-102.0** | **-205.2** | **-331.6** | **-469.0** |
| **Financing** | **992.8** | **716.0** | **102.0** | **205.2** | **331.6** | **469.0** |
| **Current Financing** | **744.3** | **604.0** | **77.0** | **145.2** | **241.6** | **350.0** |
| Government Transfers | 606.0 | 706.0 | 72.0 | 135.2 | 224.7 | 330.0 |
| Bonoluz | 28.5 | 0.0 | 5.0 | 10.0 | 16.9 | 20.0 |
| Net Credit from the Banking System | 43.2 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Accumulation of Arrears (Net) 3/ | 102.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Payment of Arrears of the Previous Years | -35.4 | -102.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| **Capital Financing** | **248.5** | **112.0** | **25.0** | **60.0** | **90.0** | **119.0** |
| Externally Financed | 170.3 | 69.0 | 10.0 | 25.0 | 40.0 | 49.0 |
| Domestically Financed | 78.2 | 43.0 | 15.0 | 35.0 | 50.0 | 70.0 |
| o/w Government Transfers | 66.6 | 0.0 | 6.2 | 14.3 | 20.7 | 30.0 |
| o/w with Own Resources | 11.6 | 43.0 | 8.8 | 20.7 | 29.3 | 40.0 |
| **Discrepancy** | **0.0** | **0.0** | **0.0** | **0.0** | **0.0** | **0.0** |

1/ Clients that by law cannot be cut off from electricity supply.
2/ Includes EGEHID, ETED and UERS.
3. Under the definition of zero days of arrears to private electricity generators.

**Table 9. Dominican Republic: Summary Accounts of the Monetary Authority 1/**

(In billions of Dominican pesos, unless otherwise specified)

| | | | Prog. | Actual | Prog. | Proj. | Prog. | | | | Proj. |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | June | | Dec | | Mar | June | Sep | Dec | |
| | 2008 | 2009 | 2010 2/ | | | | 2011 2/ | | | | 2012 2/ |
| **Monetary base** | **133.8** | **138.1** | **133.3** | **130.4** | **153.5** | **153.6** | **140.8** | **144.4** | **148.1** | **164.5** | **187.4** |
| Currency issue | 62.5 | 70.2 | 61.6 | 63.1 | 77.9 | 77.7 | 69.7 | 72.7 | 73.0 | 85.5 | 97.5 |
| Reserve requirements (peso deposits) | 71.3 | 67.9 | 71.8 | 67.3 | 75.6 | 75.9 | 71.1 | 71.7 | 75.1 | 79.0 | 89.9 |
| **Net international reserves** | **76.3** | **92.6** | **64.4** | **79.5** | **73.6** | **73.6** | **60.8** | **64.4** | **68.1** | **84.5** | **107.4** |
| (In millions of U.S. dollars) 3/ | 2165.4 | 2538.4 | 1765.4 | 2178.6 | 2015.4 | 2015.4 | 1665.4 | 1765.4 | 1865.4 | 2315.4 | 2942.2 |
| **Net domestic assets** | **57.5** | **45.4** | **68.9** | **50.9** | **80.0** | **80.0** | **80.0** | **80.0** | **80.0** | **80.0** | **80.0** |
| Nonfinancial public sector (net) 4/ | 4.6 | 0.7 | 4.0 | -2.8 | 4.0 | 3.5 | 3.5 | 3.5 | 3.5 | 3.5 | 3.5 |
| Central government | 1.6 | -2.3 | 1.0 | -5.9 | 1.0 | -0.4 | -0.4 | -0.4 | -0.4 | -0.4 | -0.4 |
| Rest of NFPS | 3.0 | 3.0 | 3.0 | 3.1 | 3.0 | 3.9 | 3.9 | 3.9 | 3.9 | 3.9 | 3.9 |
| Commercial banks (net) | -51.2 | -78.0 | -83.4 | -97.7 | -85.8 | -100.8 | -118.8 | -129.4 | -140.3 | -156.7 | -210.0 |
| Monetary control notes and bills | -25.6 | -36.7 | -44.0 | -57.2 | -43.7 | -58.3 | -75.4 | -84.1 | -94.1 | -108.9 | -155.3 |
| Reserve requirements (FX deposits) | -21.0 | -24.9 | -25.2 | -30.0 | -26.7 | -30.5 | -31.8 | -33.1 | -33.0 | -33.9 | -38.1 |
| Overnight facility | -15.5 | -23.2 | -20.9 | -16.4 | -22.2 | -17.9 | -17.6 | -18.3 | -19.2 | -19.9 | -22.6 |
| Liquidity support | 10.9 | 6.8 | 6.8 | 6.0 | 6.8 | 6.0 | 6.0 | 6.0 | 6.0 | 6.0 | 6.0 |
| Nonfinancial private sector (certificates) | -160.9 | -162.2 | -135.8 | -152.6 | -125.5 | -134.1 | -120.4 | -114.1 | -107.5 | -92.6 | -57.9 |
| Other items (net) | 264.4 | 284.9 | 315.0 | 304.0 | 309.4 | 311.4 | 315.6 | 320.0 | 324.4 | 325.9 | 344.4 |
| Capital account | 280.7 | 290.1 | 290.0 | 295.9 | 301.1 | 301.1 | 303.0 | 306.0 | 308.6 | 312.4 | 323.3 |
| Cumulative losses | 295.8 | 318.2 | 324.5 | 330.4 | 337.7 | 343.6 | 350.2 | 357.9 | 365.2 | 373.7 | 407.3 |
| Cumulative Government transfers | -15.1 | -28.0 | -34.5 | -34.5 | -36.6 | -42.5 | -47.2 | -51.9 | -56.6 | -61.4 | -84.1 |
| Medium and long term external liabilities | -10.5 | -9.2 | -9.3 | -9.0 | -9.3 | -8.9 | -8.9 | -8.9 | -8.9 | -8.9 | -8.9 |
| Peso counterpart to IMF budget support | 0.0 | 11.4 | 15.2 | 12.1 | 17.9 | 26.0 | 28.3 | 30.6 | 32.9 | 35.2 | 35.2 |
| Other, net | -5.8 | -7.5 | 19.1 | 4.9 | -0.4 | -6.8 | -6.8 | -7.7 | -8.3 | -12.9 | -5.2 |
| | | | | | **(Percentage change, y-o-y)** | | | | | | |
| Memorandum items: | | | | | | | | | | | |
| Monetary base | 11.4 | 3.2 | 9.7 | 7.3 | 11.2 | 11.2 | 8.1 | 10.7 | 11.5 | 7.1 | 13.9 |
| Currency issue | 0.3 | 12.3 | 11.4 | 14.2 | 11.0 | 10.7 | 9.4 | 15.2 | 16.1 | 10.1 | 13.9 |
| Quasi-fiscal balance (in percent of GDP) | -1.3 | -1.3 | -0.6 | -0.6 | -1.4 | -1.4 | -0.3 | -0.7 | -1.0 | -1.4 | -1.4 |

Sources: Dominican authorities; and Fund staff estimates.

1/ The Central Bank's balance sheet is adjusted to incorporate the reserve liability from the IMF budgetary support for 2009 and onwards.

2/ Foreign currency denominated accounts valued at DR$36.5 per U.S. dollar for December 2009 and onwards..

3/ Projections for 2010-12 assume that all SBA purchases are made.

4/ Excludes transactions related to Central Bank recapitalization.

**Table 10. Dominican Republic: Summary Accounts of the Banking System**

(In billions of Dominican pesos, unless otherwise specified)

| | | | Prog. | Actual | Prog. | Proj. | Prog. | | | | Proj. |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | Jun | | Dec | | Mar | June | Sep | Dec | |
| | 2008 | 2009 | 2010 1/ | | | | 2011 2/ | | | | 2012 2/ |
| | | | | | **Central Bank 2/** | | | | | | |
| **Monetary base** | **133.8** | **138.1** | **133.3** | **130.4** | **153.5** | **153.6** | **140.8** | **144.4** | **148.1** | **164.5** | **187.4** |
| Currency issue | 62.5 | 70.2 | 61.6 | 63.1 | 77.9 | 77.7 | 69.7 | 72.7 | 73.0 | 85.5 | 97.5 |
| Reserve requirements (peso deposits) | 71.3 | 67.9 | 71.8 | 67.3 | 75.6 | 75.9 | 71.1 | 71.7 | 75.1 | 79.0 | 89.9 |
| **Net international reserves** | **76.3** | **92.6** | **64.4** | **79.5** | **73.6** | **73.6** | **60.8** | **64.4** | **68.1** | **84.5** | **107.4** |
| (In millions of U.S. dollars) 3/ | 2165.4 | 2538.4 | 1765.4 | 2178.6 | 2015.4 | 2015.4 | 1665.4 | 1765.4 | 1865.4 | 2315.4 | 2942.2 |
| **Net domestic assets** | **57.5** | **45.4** | **68.9** | **50.9** | **80.0** | **80.0** | **80.0** | **80.0** | **80.0** | **80.0** | **80.0** |
| Nonfinancial public sector (net) 4/ | 4.6 | 0.7 | 4.0 | -2.8 | 4.0 | 3.5 | 3.5 | 3.5 | 3.5 | 3.5 | 3.5 |
| Commercial banks (net) | -51.2 | -78.0 | -83.4 | -97.7 | -85.8 | -100.8 | -118.8 | -129.4 | -140.3 | -156.7 | -210.0 |
| Nonfinancial private sector (certificates) | -160.9 | -162.2 | -135.8 | -152.6 | -125.5 | -134.1 | -120.4 | -114.1 | -107.5 | -92.6 | -57.9 |
| Other items (net) | 264.4 | 284.9 | 315.0 | 304.0 | 309.4 | 311.4 | 315.6 | 320.0 | 324.4 | 325.9 | 344.4 |
| | | | | | **Banking System 6/** | | | | | | |
| **Net foreign assets** | **101.9** | **117.5** | **89.4** | **101.0** | **98.5** | **94.9** | **82.1** | **85.8** | **89.4** | **105.9** | **128.7** |
| (In millions of U.S. dollars) | 2886.1 | 3226.7 | 2448.9 | 2763.6 | 2698.9 | 2600.4 | 2250.4 | 2350.4 | 2450.4 | 2900.4 | 3527.2 |
| **Net domestic assets** | **454.5** | **500.4** | **540.3** | **558.5** | **602.8** | **619.9** | **659.9** | **673.0** | **673.1** | **690.2** | **772.9** |
| Net credit to the nonfinancial public sector 4/ | 30.8 | 53.1 | 58.8 | 50.0 | 60.0 | 52.4 | 62.0 | 66.5 | 71.1 | 55.9 | 42.2 |
| Credit to the private sector | 277.3 | 297.2 | 320.2 | 320.1 | 341.5 | 334.3 | 336.9 | 352.7 | 368.5 | 377.6 | 423.0 |
| Other assets net (includes valuation effects) | 146.4 | 150.2 | 161.3 | 188.4 | 201.3 | 233.3 | 261.1 | 253.8 | 233.6 | 256.7 | 307.7 |
| *Of which*: Recapitalization account | 262.6 | 278.1 | 273.5 | 303.1 | 299.8 | 298.3 | 296.8 | 300.4 | 304.1 | 327.5 | 357.8 |
| Medium- and long-term external liabilities of Central Bank | -10.5 | -9.2 | -9.3 | -9.0 | -9.3 | -8.9 | -8.9 | -8.9 | -8.9 | -8.9 | -8.9 |
| Capital and accumulated surplus | 6.2 | 5.4 | 8.1 | -8.3 | 11.4 | 7.7 | 8.4 | 9.2 | 9.9 | 7.7 | 11.0 |
| **M3** | **556.4** | **617.9** | **629.6** | **659.5** | **675.0** | **714.9** | **742.0** | **758.8** | **762.5** | **796.0** | **901.6** |
| Currency in circulation | 51.7 | 56.3 | 49.5 | 51.5 | 60.5 | 62.4 | 57.1 | 59.8 | 60.3 | 68.7 | 77.9 |
| Deposits | 330.4 | 379.0 | 405.8 | 406.7 | 430.7 | 435.1 | 434.4 | 451.4 | 467.0 | 483.8 | 548.6 |
| Central bank certificates held outside banks | 174.3 | 176.5 | 153.4 | 171.3 | 143.9 | 157.4 | 150.5 | 147.7 | 145.2 | 136.2 | 120.0 |
| Commercial bank certificates held by the public 7/ | 0.0 | 6.0 | 21.0 | 30.0 | 40.0 | 60.0 | 100.0 | 100.0 | 90.0 | 107.3 | 155.1 |
| | | | | | **(Percentage change, y-o-y)** | | | | | | |
| Memorandum items: | | | | | | | | | | | |
| Credit to the private sector | 7.0 | 7.2 | 15.5 | 15.4 | 14.9 | 12.5 | 9.9 | 10.2 | 11.9 | 13.0 | 12.0 |
| Deposits | 10.5 | 14.7 | 17.1 | 17.3 | 13.6 | 14.8 | 11.4 | 11.0 | 11.2 | 11.2 | 13.4 |
| M3 | 8.7 | 11.1 | 9.5 | 14.7 | 9.2 | 15.7 | 18.7 | 20.4 | 15.6 | 11.4 | 13.3 |
| M3 Velocity | 2.8 | 2.7 | 2.9 | 2.9 | 2.7 | 2.6 | 2.6 | 2.8 | 2.7 | 2.6 | 2.6 |

Sources: Dominican authorities; and Fund staff estimates.

1/ Foreign currency denominated accounts valued at DR$36.5 per U.S. dollar for December 2009 and onwards.

2/ The Central Bank's balance sheet is adjusted to incorporate the reserve liability from the IMF budgetary support.

3/ Projections for 2010-12 assume that all SBA purchases are made.

4/ Excludes transactions related to Central Bank recapitalization.

5/ Includes transactions related to Central Bank recapitalization.

6/ Includes the Central Bank, Banco de Reservas, and all other multiple banks. Excludes other financial institutions.

7/ For 2010 and onwards, projections assume that private banks issue certificates to the public, so that the sum of certificates of the banking system in hands of the public, increases at least by 12 percent, annually.

**Table 11. Dominican Republic: Selected Financial Soundness Indicators of the Banking System**
(In percent)

| | 2007 | 2008 | 2009 | Jun 2010 |
|---|---|---|---|---|
| **Capital adequacy** | | | | |
| Net worth to total assets | 9.5 | 9.7 | 9.1 | 8.9 |
| Regulatory capital to risk-weighted assets | 13.0 | 13.4 | 14.5 | 13.7 |
| **Asset quality** | | | | |
| Loan growth | 27.1 | 15.3 | 12.4 | 20.0 |
| NPLs to total loans | 4.0 | 3.5 | 4.0 | 3.3 |
| Loan provisions to NPLs | 134.5 | 133.1 | 115.0 | 123.0 |
| NPLs net of provisions to net worth | -8.2 | -7.2 | -3.9 | -5.2 |
| Fixed and net foreclosed assets to net worth | 57.2 | 58.0 | 51.4 | 49.2 |
| **Earnings and efficiency** | | | | |
| Return on average assets | 2.0 | 2.1 | 1.9 | 2.3 |
| Return on average equity | 21.3 | 21.4 | 19.9 | 35.8 |
| Gross operating income to average assets | 9.8 | 2.4 | 2.3 | 2.6 |
| Financial margin to average assets | 6.7 | 6.9 | 7.7 | 7.9 |
| Operating expenses to net financial margin | 104.4 | 96.3 | 91.4 | 95.5 |
| **Liquidity** | | | | |
| Liquid funds to deposits | 32.3 | 33.1 | 28.1 | 25.7 |
| Liquid funds to total assets | 27.2 | 28.4 | 23.9 | 22.0 |

Sources: Dominican authorities; and Fund staff estimates.

**Table 12. Dominican Republic: Balance of Payments**

(In millions of U.S. dollars, unless otherwise specified)

| | | | Prog. | Proj. | Prog. | | | | Proj. |
|---|---|---|---|---|---|---|---|---|---|
| | | | Jan-Dec | Jan-Dec | Jan-Mar | Jan-Jun | Jan-Sep | Jan-Dec | |
| | 2008 | 2009 | 2010 | | 2011 | | | | 2012 |
| **Current account** | **-4,529** | **-2,159** | **-3,071** | **-3,493** | **-422** | **-1,517** | **-2,478** | **-3,421** | **-2,445** |
| Trade balance | -9,245 | -6,741 | -7,583 | -8,140 | -1,874 | -3,963 | -6,201 | -8,278 | -7,801 |
| Exports f.o.b. | 6,748 | 5,519 | 5,534 | 6,152 | 1,563 | 3,246 | 5,122 | 7,100 | 9,046 |
| *Of which:* nickel | 492 | 4 | 0 | 0 | 0 | 0 | 119 | 297 | 624 |
| *Of which:* gold | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 207 | 1,245 |
| Imports f.o.b. | -15,993 | -12,260 | -13,117 | -14,291 | -3,437 | -7,209 | -11,323 | -15,378 | -16,848 |
| *Of which:* oil and gas | -4,241 | -2,641 | -3,307 | -3,384 | -875 | -1,825 | -2,709 | -3,544 | -3,702 |
| Nonfactor services | 2,962 | 3,046 | 3,171 | 3,113 | 1,140 | 1,911 | 2,700 | 3,329 | 3,732 |
| *Of which:* travel receipt | 4,166 | 4,051 | 4,126 | 4,259 | 1,426 | 2,515 | 3,627 | 4,540 | 5,046 |
| Factor services | -1,759 | -1,769 | -2,068 | -1,888 | -518 | -1,095 | -1,585 | -2,085 | -2,194 |
| *Of which:* interest on public debt 1/ | -372 | -427 | -570 | -525 | -117 | -258 | -396 | -565 | -522 |
| Transfers | 3,513 | 3,305 | 3,409 | 3,421 | 830 | 1,629 | 2,609 | 3,613 | 3,819 |
| **Capital and financial account** | **4,384** | **2,655** | **2,548** | **2,967** | **720** | **1,887** | **2,849** | **3,721** | **3,072** |
| Capital account | 135 | 107 | 132 | 87 | 25 | 49 | 84 | 107 | 237 |
| Financial account | 4,249 | 2,548 | 2,416 | 2,880 | 695 | 1,838 | 2,765 | 3,615 | 2,835 |
| Direct investment, net | 2,900 | 2,067 | 1,863 | 1,354 | 471 | 1,047 | 1,538 | 1,990 | 2,228 |
| Portfolio investment, net | -376 | -450 | 100 | 523 | -18 | 542 | 629 | 765 | -103 |
| Other investment, net | 1,725 | 931 | 453 | 1,002 | 243 | 249 | 598 | 860 | 709 |
| *Of which:* public sector MLT, net | 760 | 794 | 709 | 500 | 60 | 168 | 332 | 392 | 567 |
| Disbursements | 1,367 | 1,417 | 1,385 | 1,148 | 176 | 475 | 770 | 1,016 | 1,272 |
| Amortization | -607 | -623 | -676 | -648 | -116 | -307 | -438 | -624 | -705 |
| Other | 965 | 137 | -256 | 502 | 183 | 81 | 267 | 468 | 142 |
| *Of which:* SDR allocation | 0 | 275 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Errors and omissions | -181 | -90 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| **Overall balance** | **-326** | **406** | **-523** | **-526** | **-350** | **-250** | **-150** | **300** | **627** |
| **Financing** | **326** | **-406** | **523** | **526** | **350** | **250** | **150** | **-300** | **-627** |
| Change in NIR (increase, - ) | 230 | -363 | 523 | 523 | 350 | 250 | 150 | -300 | -627 |
| Change in GIR (increase, - ) | 284 | -638 | 139 | 145 | 226 | 16 | -211 | -789 | -680 |
| Net Fund purchases | -42 | 275 | 384 | 378 | 124 | 234 | 361 | 489 | 53 |
| Exceptional financing | 58 | -43 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Debt rescheduling | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Debt forgiveness | 9 | 301 | 0 | 3 | 0 | 0 | 0 | 0 | 0 |
| Net change in arrears | 49 | -344 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Memorandum items: | | | | | | | | | |
| Current account in percent of GDP | -10.0 | -4.6 | -6.1 | -7.0 | -3.5 | -5.9 | -6.4 | -6.4 | -4.2 |
| Non-oil-gas current account in percent of GDP | -0.6 | 1.0 | 0.5 | -0.2 | 3.7 | 1.2 | 0.6 | 0.2 | 2.2 |

Sources: Dominican authorities; and Fund staff estimates.

1/ Includes interests on loans and bonds.

**Table 13. Dominican Republic: External Financing Requirements and Sources**

(In millions of U.S. dollars)

| | | | Projections | | |
|---|---|---|---|---|---|
| | 2008 | 2009 | 2010 | 2011 | 2012 |
| **Financing requirement** | **4,842** | **3,419** | **3,995** | **4,834** | **3,830** |
| Current account deficit | 4,519 | 2,159 | 3,493 | 3,421 | 2,445 |
| Amortization of public sector medium- and long-term | 607 | 623 | 648 | 624 | 705 |
| Change in gross reserves (increase =+) | -284 | 638 | -145 | 789 | 680 |
| **Financing sources** | **4,842** | **3,419** | **3,995** | **4,834** | **3,830** |
| Capital transfer | 135 | 107 | 87 | 107 | 237 |
| Foreign Direct Investment, net | 2,870 | 2,067 | 1,354 | 1,990 | 2,228 |
| Portfolio investment, net | -376 | -450 | 523 | 765 | -103 |
| Public sector medium- and long-term loans | 1,367 | 1,417 | 1,148 | 1,016 | 1,272 |
| Net Fund purchases | -42 | 275 | 378 | 489 | 53 |
| Other 1/ | 887 | 4 | 505 | 468 | 142 |

Sources: Dominican authorities; and Fund staff estimates.

1/ Includes other private capital flows, exceptional financing and errors and omissions.

## Table 14. Dominican Republic: Indicators of External Vulnerability

| | 2007 | 2008 | 2009 | June 2010 |
|---|---|---|---|---|
| Merchandise exports (percentage change) | 8.3 | -5.8 | -18.2 | 11.0 |
| Merchandise imports (percentage change) | 11.7 | 17.6 | -23.3 | 28.0 |
| Real effective exchange rate (percentage change, appreciation · | 1.8 | 1.4 | 1.5 | 2.7 |
| Current account balance (percent of GDP) | -5.3 | -9.9 | -4.6 | -8.1 |
| Capital and Financial account balance (percent of GDP) | 5.8 | 9.2 | 5.7 | 7.3 |
| Foreign direct investment, net (percent of GDP) | 4.1 | 6.3 | 4.4 | 2.7 |
| Portfolio investment, net (percent of GDP) | 2.3 | -0.8 | -1.0 | 2.5 |
| Other investment, net (percent of GDP) | -1.1 | 3.5 | 2.0 | 2.0 |
| External debt (percent of GDP) | 25.5 | 23.0 | 24.0 | 27.8 |
| Debt service (in percent of exports of GNFS) 1/ | 14.0 | 17.1 | 18.9 | 20.6 |
| Gross reserves (in millions of U.S. dollars) | 2,946 | 2,662 | 3,307 | 2,979 |
| Gross reserves (in months of imports of GNFS) | 2.0 | 2.3 | 2.4 | 2.0 |

Sources: Dominican authorities; and Fund staff estimates.

1/ Interest payments and medium- and long-term debt amortization.

## Table 15. Dominican Republic: Schedule of Reviews and Purchases

(In millions of SDRs unless otherwise specified)

| Date | Amount of Purchase 1/ | | | | | | | Percent of Quota | Conditions |
|---|---|---|---|---|---|---|---|---|---|
| | Original UFR Composition | | Revised UFR Composition | | | | | | |
| | | | | Ministry of Finance | | | | | |
| | 2/ Central Bank | 3/ Ministry of Finance | 2/ Central Bank | External 3/ Payments | BCRD 4/ Recap. | Total | Total SBA | | |
| **Purchases Already Made** | | | | | | | | | |
| November 9, 2009 | 0.00 | 200.00 | 0.00 | 200.00 | 0.00 | 200.00 | 200.00 | 91.4 | Approval of arrangement |
| April 7, 2010 | 54.27 | 25.00 | 54.27 | 25.00 | 0.00 | 25.00 | 79.27 | 36.2 | First review and end-December 2009 performance criteria |
| **Purchases To Be Made** | | | | | | | | | |
| June 15, 2010 | 54.27 | 25.00 | 0.00 | 25.00 | 54.27 | 79.27 | 79.27 | 36.2 | Second review and end-March 2010 performance criteria |
| September 15, 2010 | 54.26 | 25.00 | 0.00 | 25.00 | 54.26 | 79.26 | 79.26 | 36.2 | Third review and end-June 2010 performance criteria |
| December 15, 2010 | 84.45 | 25.00 | 26.31 | 25.00 | 58.14 | 83.14 | 109.45 | 50.0 | Fourth review and end-September 2010 performance criteria |
| March 15, 2011 | 109.45 | 0.00 | 67.78 | 0.00 | 41.67 | 41.67 | 109.45 | 50.0 | Fifth review and end-December 2010 performance criteria |
| June 15, 2011 | 109.45 | 0.00 | 67.78 | 0.00 | 41.67 | 41.67 | 109.45 | 50.0 | Sixth review and end-March 2011 performance criteria |
| September 15, 2011 | 109.45 | 0.00 | 67.78 | 0.00 | 41.67 | 41.67 | 109.45 | 50.0 | Seventh review and end-June 2011 performance criteria |
| December 15, 2011 | 109.45 | 0.00 | 67.78 | 0.00 | 41.67 | 41.67 | 109.45 | 50.0 | Eighth review and end-September 2011 performance criteria |
| February 28, 2012 | 109.45 | 0.00 | 109.45 | 0.00 | 0.00 | 0.00 | 109.45 | 50.0 | End-December 2011performance criteria |
| **Total** | **794.50** | **300.00** | **461.07** | **300.00** | **333.43** | **633.43** | **1094.50** | **500.0** | |
| **Memorandum item:** | | | | | | | | | |
| 2009 | 0.00 | 200.00 | 0.00 | 200.00 | 0.00 | 200.00 | 200.00 | 91.37 | |
| 2010 | 247.25 | 100.00 | 80.58 | 100.00 | 166.67 | 266.67 | 347.25 | 158.63 | |
| 2011 | 437.80 | 0.00 | 271.13 | 0.00 | 166.67 | 166.67 | 437.80 | 200.00 | |
| 2012 | 109.45 | 0.00 | 109.45 | 0.00 | 0.00 | 0.00 | 109.45 | 50.00 | |

Source: Fund staff estimates.

1/ The original split between the Central Bank and the Ministry of Finance reflects the intention of the member to assign Fund resources to different entities as explained in the LOI of October 2009 .The revised split reflects the changes due to the central bank recapitalization plans as explained in the revised LOI of October 2010.

2/ Purchases made for reserve accumulation purposes.

3/ Purchases made to cover external debt obligations and public sector imports of goods and services.

4/ Purchases made to cover interest payments on bonds issued to recapitalize the Central Bank, that the Central Bank will use for reserve accumulation purposes.

**Table 16. Dominican Republic: Medium-Term Scenario 2008-14**
(In percent of GDP unless specified)

| | | | Projections | | | | |
|---|---|---|---|---|---|---|---|
| | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 |
| **Growth and prices** | | | | | | | |
| Real GDP growth | 5.3 | 3.5 | 5.5-6.0 | 5.5-6.0 | 6.0 | 6.0 | 6.0 |
| CPI inflation, end of period | 4.5 | 5.8 | 6.0-7.0 | 5.0-6.0 | 4.0-5.0 | 4.0 | 4.0 |
| CPI inflation, average | 10.6 | 1.4 | 6.4 | 5.4 | 4.5 | 4.0 | 4.0 |
| Nominal GDP (billions of U.S. dollars) | 45.5 | 46.7 | 49.7 | 53.7 | 57.9 | 62.3 | 67.3 |
| Gross investment | 18.2 | 16.8 | 17.3 | 18.4 | 18.4 | 18.4 | 18.4 |
| National Savings | 8.2 | 12.1 | 10.3 | 12.0 | 14.2 | 14.7 | 15.0 |
| **Public Sector** | | | | | | | |
| Revenue | 15.8 | 13.7 | 14.0 | 14.0 | 15.1 | 15.6 | 15.6 |
| Expenditure | 20.5 | 18.1 | 17.9 | 17.0 | 17.1 | 17.6 | 17.6 |
| Noninterest expenditure | 17.0 | 14.2 | 13.9 | 12.8 | 13.1 | 13.7 | 13.7 |
| Overall balance | -4.6 | -4.4 | -3.9 | -3.0 | -2.0 | -2.0 | -2.0 |
| Primary balance | -1.1 | -0.5 | 0.1 | 1.2 | 2.0 | 1.9 | 1.9 |
| **Balance of payments and external debt** | | | | | | | |
| External current account (millions of U.S. dollars) | -4529 | -2159 | -3493 | -3421 | -2445 | -2447 | -2467 |
| In percent of GDP | -10.0 | -4.6 | -7.0 | -6.4 | -4.2 | -3.7 | -3.4 |
| Official reserves (millions of U.S. dollars) | 2662 | 3303 | 3154 | 3943 | 4623 | 4796 | 4927 |
| In months of imports goods and non-factor services | 2.3 | 2.4 | 2.2 | 2.5 | 2.7 | 2.7 | 2.9 |
| Public external debt | 18.3 | 20.0 | 21.6 | 19.5 | 16.5 | 15.9 | 14.7 |

Sources: Dominican authorities; and Fund staff estimates.

## Table 17. Dominican Republic: Indicators of Capacity to Repay the Fund

| | 2008 | 2009 | Projections 2010 | 2011 | 2012 | 2013 | 2014 |
|---|---|---|---|---|---|---|---|
| **Fund repurchases and charges** | | | | | | | |
| In millions of SDRs | 119.2 | 35.4 | 104.4 | 127.1 | 96.3 | 151.6 | 373.2 |
| In millions of U.S. dollars | 188.5 | 54.6 | 157.0 | 189.9 | 144.2 | 227.1 | 559.7 |
| In percent of exports 1/ | 1.6 | 0.5 | 1.4 | 1.5 | 1.0 | 1.4 | 3.1 |
| In percent of external public debt service | 13.3 | 2.6 | 10.0 | 11.8 | 9.8 | 9.7 | 18.5 |
| In percent of quota | 54.5 | 16.2 | 47.7 | 58.0 | 44.0 | 69.3 | 170.5 |
| In percent of gross international reserves | 7.1 | 1.7 | 5.0 | 4.8 | 3.1 | 4.7 | 11.3 |
| **Fund credit outstanding** | | | | | | | |
| In millions of SDRs | 319.6 | 488.9 | 739.9 | 1,066.9 | 1,104.1 | 974.7 | 619.0 |
| In millions of U.S. dollars | 505.2 | 754.2 | 1113.1 | 1594.7 | 1652.1 | 1460.2 | 928.3 |
| In percent of exports 1/ | 4.3 | 7.2 | 9.8 | 12.7 | 11.0 | 8.8 | 5.2 |
| In percent of external public debt service | 35.7 | 36.0 | 71.0 | 99.3 | 111.8 | 62.4 | 30.6 |
| In percent of quota | 146.0 | 223.4 | 338.0 | 487.4 | 504.4 | 445.3 | 282.8 |
| In percent of gross international reserves | 19.0 | 22.9 | 35.3 | 40.4 | 35.7 | 30.3 | 18.7 |
| **Memorandum items** | | | | | | | |
| Exports of GNFS (millions of U.S. dollars) | 11,670 | 10,437 | 11,333 | 12,599 | 15,079 | 16,533 | 17,851 |
| External public debt service (millions of U.S. dollars) 2/ | 1,414 | 2,096 | 1,568 | 1,605 | 1,478 | 2,339 | 3,032 |
| Quota (millions of SDRs) | 218.9 | 218.9 | 218.9 | 218.9 | 218.9 | 218.9 | 218.9 |
| Quota (millions of U.S. dollars) | 346.1 | 337.7 | 329.3 | 327.2 | 327.5 | 327.9 | 328.3 |
| Gross international reserves (millions of U.S. dollars) | 2,662 | 3,300 | 3,154 | 3,943 | 4,623 | 4,827 | 4,958 |
| U.S. dollars per SDR (period average) | 0.63 | 0.65 | 0.66 | 0.67 | 0.67 | 0.67 | 0.67 |

Sources: Fund staff estimates and projections.
1/ Goods and non-factor services (GNFS).
2/ Amortization and interest payments.

## Appendix 1: Debt Sustainability

### External Debt Sustainability

External debt appears sustainable in the medium run, despite the moderate increase in the debt-to-GDP in the period 2008-11. As in pre-crisis years, the increase in external debt will be driven by large current account deficits and public sector borrowing in the context of a growing economy. Over the medium term, current account deficits are expected to decline as fiscal consolidation proceeds and large FDI-financed projects in the gold industry provide export revenues. Imports would remain stable, in proportion to GDP, under the fiscal consolidation and prudent monetary policy expected under the program. In addition to foreign direct investment and support from official creditors, an additional source of external finance opened up in April 2010 when the government placed successfully a US$750 million global bond. More sovereign bond issuances are expected to finance future budgets. These three sources of financing are expected to support the current account deficit in the coming years.

### Public Debt Sustainability

The transition from a fiscal expansion as part of the first phase of the program to a fiscal consolidation will contribute to a declining path of the public sector debt-to-GDP ratio over the medium term. In 2009, the primary balance of the consolidated public sector was in deficit by 0.7 percent of GDP but is expected to end 2010 close to balance and to move to a primary surplus of 2 percent of GDP by 2012. Under these assumptions, the ratio of public debt-to-GDP (excluding BCRD recapitalization bonds) would rise to 35 percent of GDP by 2011, but fall to 29 percent of GDP by 2015, below its end-2008 level. Over the long run, maintaining a primary surplus of 1¼ percent of GDP, and assuming an average growth rate of real GDP of 6 percent and inflation of 4 percent would bring public debt to 24 percent of GDP by 2020.

### Bound Tests

External and public debt would remain sustainable under the standard shocks presented in the bound tests. Shocks to the current account and to the exchange rate would have the largest effect on external debt, bringing it to around 40 percent of GDP by 2012, whereas the largest effect on public debt would arise from exchange rate shocks, bringing it to 43 percent of GDP in this same year. A combined shock to interest rates, real GDP growth and the external current account deficit of ¼ of a standard deviation around historical averages would bring the ratio of external debt to GDP to peak at 35 percent in 2012. External debt would decline from 2013 onwards. A similar shock to public debt (with interest rates, real GDP and the primary deficit at ¼ of a standard deviation around historical averages) would generate an increase in the ratio of public debt to GDP to 39.5 percent in 2015.

Appendix Table 1. Dominican Republic: External Debt Sustainability Framework, 2007-2015
(In percent of GDP, unless otherwise indicated)

| | | Actual | | Projections | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | **Debt-stabilizing non-interest current account 6/** |
| 1 | **Baseline: External debt** | 25.4 | 27.2 | **29.6** | **31.5** | **30.8** | **28.9** | **26.4** | **23.4** | **-4.4** |
| 2 | Change in external debt | -0.9 | 1.8 | 2.3 | 1.9 | -0.7 | -1.9 | -2.4 | -3.1 | |
| 3 | Identified external debt-creating flows (4+8+9) | 1.0 | -0.7 | 2.9 | 1.2 | -1.4 | -1.7 | -2.1 | -2.6 | |
| 4 | Current account deficit, excluding interest payments | 8.3 | 3.3 | 5.6 | 4.9 | 2.9 | 2.2 | 1.8 | 1.3 | |
| 5 | Deficit in balance of goods and services | 13.8 | 7.9 | 10.1 | 9.2 | 7.0 | 6.2 | 5.6 | 4.9 | |
| 6 | Exports | 25.6 | 22.4 | 22.8 | 23.4 | 26.1 | 26.6 | 26.5 | 26.6 | |
| 7 | Imports | 39.5 | 30.3 | 32.9 | 32.7 | 33.1 | 32.8 | 32.1 | 31.5 | |
| 8 | Net non-debt creating capital inflows (negative) | -6.3 | -4.4 | -2.7 | -3.7 | -3.9 | -3.9 | -3.9 | -3.9 | |
| 9 | Automatic debt dynamics 1/ | -1.0 | 0.5 | 0.0 | 0.0 | -0.4 | -0.1 | 0.0 | 0.0 | |
| 10 | Contribution from nominal interest rate | 1.7 | 1.3 | 1.4 | 1.5 | 1.3 | 1.6 | 1.6 | 1.4 | |
| 11 | Contribution from real GDP growth | -1.2 | -0.9 | -1.4 | -1.5 | -1.8 | -1.7 | -1.6 | -1.5 | |
| 12 | Contribution from price and exchange rate changes 2/ | -1.4 | ... | ... | ... | ... | ... | ... | ... | |
| 13 | Residual, incl. change in gross foreign assets (2-3) 3/ | -2.0 | 2.5 | -0.6 | 0.8 | 0.7 | -0.2 | -0.4 | -0.5 | |
| | External debt-to-exports ratio (in percent) | 99.2 | 121.8 | 129.7 | 134.3 | 118.2 | 108.8 | 99.7 | 87.8 | |
| | **Gross external financing need (in billions of US dollars) 4/** | 8.2 | 5.5 | 7.0 | 7.2 | 6.6 | 7.4 | 7.9 | 7.0 | |
| | in percent of GDP | 18.1 | 11.8 | 14.1 | 13.4 | 11.4 | 11.9 | 11.8 | 9.7 | |
| | **Scenario with key variables at their historical averages 5/** | | | **22.9** | **20.4** | **17.6** | **14.2** | **10.7** | **7.1** | **-4.7** |
| | **Key Macroeconomic Assumptions Underlying Baseline** | | | | | | | | | |
| | Real GDP growth (in percent) | 5.3 | 3.5 | 5.5 | 5.5 | 6.0 | 6.0 | 6.0 | 6.0 | |
| | GDP deflator in US dollars (change in percent) | 5.5 | -0.9 | 0.9 | 2.4 | 1.1 | 2.0 | 2.0 | 2.0 | |
| | Nominal external interest rate (in percent) | 7.0 | 5.3 | 5.6 | 5.4 | 4.5 | 5.5 | 5.9 | 5.9 | |
| | Growth of exports (US dollar terms, in percent) | -2.4 | -10.6 | 8.6 | 11.2 | 19.7 | 9.6 | 8.0 | 8.5 | |
| | Growth of imports (US dollar terms, in percent) | 17.0 | -21.3 | 15.8 | 7.3 | 9.1 | 6.5 | 5.9 | 6.1 | |
| | Current account balance, excluding interest payments | -8.3 | -3.3 | -5.6 | -4.9 | -2.9 | -2.2 | -1.8 | -1.3 | |
| | Net non-debt creating capital inflows | 6.3 | 4.4 | 2.7 | 3.7 | 3.9 | 3.9 | 3.9 | 3.9 | |

1/ Derived as $[r - g - \rho(1+g) + \varepsilon\alpha(1+r)]/(1+g+\rho+g\rho)$ times previous period debt stock, with r = nominal effective interest rate on external debt; $\rho$ = change in domestic GDP deflator in US dollar ter
g = real GDP growth rate, $\varepsilon$ = nominal appreciation (increase in dollar value of domestic currency), and $\alpha$= share of domestic-currency denominated debt in total external debt.
2/ The contribution from price and exchange rate changes is defined as $[-\rho(1+g) + \varepsilon\alpha(1+r)]/(1+g+\rho+g\rho)$ times previous period debt stock. $\rho$ increases with an appreciating domestic currency ($\varepsilon$
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.
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.

Appendix Table 2. Dominican Republic: Public Sector Debt Sustainability Framework, 2005-2015
(In percent of GDP, unless otherwise indicated)

| | | Actual | | Projections | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | **Debt-stabilizing primary balance 9/** |
| 1 | **Baseline: Public sector debt 1/** | 33.7 | 36.9 | **35.7** | **35.3** | **33.8** | **32.4** | **30.5** | **28.7** | **1.3** |
| | o/w foreign-currency denominated | 16.5 | 16.9 | 17.6 | 17.1 | 16.2 | 15.1 | 13.9 | 12.8 | |
| 2 | Change in public sector debt | 0.5 | 3.2 | -1.2 | -0.4 | -1.5 | -1.4 | -1.9 | -1.8 | |
| 3 | Identified debt-creating flows (4+7+12) | 0.7 | 3.1 | -0.4 | -0.6 | -1.4 | -1.2 | -1.1 | -0.9 | |
| 4 | Primary deficit | 1.3 | 0.7 | -0.1 | -1.2 | -2.0 | -1.9 | -2.0 | -2.0 | |
| 5 | Revenue and grants | 15.8 | 13.7 | 14.0 | 14.0 | 15.1 | 15.6 | 15.7 | 15.7 | |
| 6 | Primary (noninterest) expenditure | 17.1 | 14.4 | 13.9 | 12.8 | 13.1 | 13.7 | 13.7 | 13.7 | |
| 7 | Automatic debt dynamics 2/ | -0.6 | 2.4 | 0.0 | 0.6 | 0.6 | 0.7 | 0.9 | 1.1 | |
| 8 | Contribution from interest rate/growth differential 3/ | -1.2 | 1.8 | 0.0 | 0.6 | 0.6 | 0.7 | 0.9 | 1.1 | |
| 9 | Of which contribution from real interest rate | 0.3 | 2.9 | 1.8 | 2.4 | 2.5 | 2.6 | 2.7 | 2.7 | |
| 10 | Of which contribution from real GDP growth | -1.5 | -1.1 | -1.8 | -1.8 | -1.9 | -1.8 | -1.8 | -1.7 | |
| 11 | Contribution from exchange rate depreciation 4/ | 0.6 | 0.6 | ... | ... | ... | ... | ... | ... | |
| 12 | Other identified debt-creating flows | 0.0 | 0.0 | -0.2 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | |
| 13 | Privatization receipts (negative) | 0.0 | 0.0 | -0.2 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | |
| 14 | Recognition of implicit or contingent liabilities | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | |
| 15 | Other (specify, e.g. bank recapitalization) | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | |
| 16 | Residual, including asset changes (2-3) 5/ | -0.2 | 0.1 | -0.8 | 0.2 | -0.1 | -0.2 | -0.8 | -0.8 | |
| | Public sector debt-to-revenue ratio 1/ | 212.9 | 269.3 | 255.0 | 252.1 | 223.8 | 207.9 | 194.3 | 183.0 | |
| | **Gross financing need 6/** | 8.8 | 10.4 | 11.9 | 9.2 | 7.3 | 7.0 | 6.9 | 6.9 | |
| | in billions of U.S. dollars | 4.0 | 4.9 | 5.9 | 5.0 | 4.2 | 4.4 | 4.6 | 5.0 | |
| | **Scenario with key variables at their historical averages 7/** | | | **35.7** | **34.2** | **32.4** | **30.7** | **28.5** | **26.5** | **-1.7** |
| | **Scenario with no policy change (constant primary balance) in 2010-2015** | | | **35.7** | **38.1** | **39.4** | **40.8** | **41.8** | **43.3** | **1.9** |
| | **Key Macroeconomic and Fiscal Assumptions Underlying Baseline** | | | | | | | | | |
| | Real GDP growth (in percent) | 5.3 | 3.5 | 5.5 | 5.5 | 6.0 | 6.0 | 6.0 | 6.0 | |
| | Average nominal interest rate on public debt (in percent) 8/ | 11.5 | 12.0 | 12.2 | 13.1 | 12.6 | 12.7 | 13.3 | 14.1 | |
| | Average real interest rate (nominal rate minus change in GDP deflator, in p | 1.7 | 9.2 | 5.7 | 7.7 | 8.1 | 8.7 | 9.3 | 10.1 | |
| | Nominal appreciation (increase in US dollar value of local currency, in perc | -3.3 | -3.6 | ... | ... | ... | ... | ... | ... | |
| | Inflation rate (GDP deflator, in percent) | 9.8 | 2.8 | 6.4 | 5.4 | 4.5 | 4.0 | 4.0 | 4.0 | |
| | Growth of real primary spending (deflated by GDP deflator, in percent) | 13.9 | -12.8 | 1.5 | -2.6 | 9.0 | 10.3 | 6.0 | 6.0 | |
| | Primary deficit | 1.3 | 0.7 | -0.1 | -1.2 | -2.0 | -1.9 | -2.0 | -2.0 | |

1/ Consolidated public sector (includes quasi-fiscal losses of Central Bank). The levels of consolidated public debt exclude recapitalization bonds given to the Central Bank.

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

3/ The real interest rate contribution is derived from the denominator in footnote 2/ as $r - \pi(1+g)$ and the real growth contribution as -g.

4/ The exchange rate contribution is derived from the numerator in footnote 2/ as $\alpha\varepsilon(1+r)$.

5/ For projections, this line includes exchange rate changes.

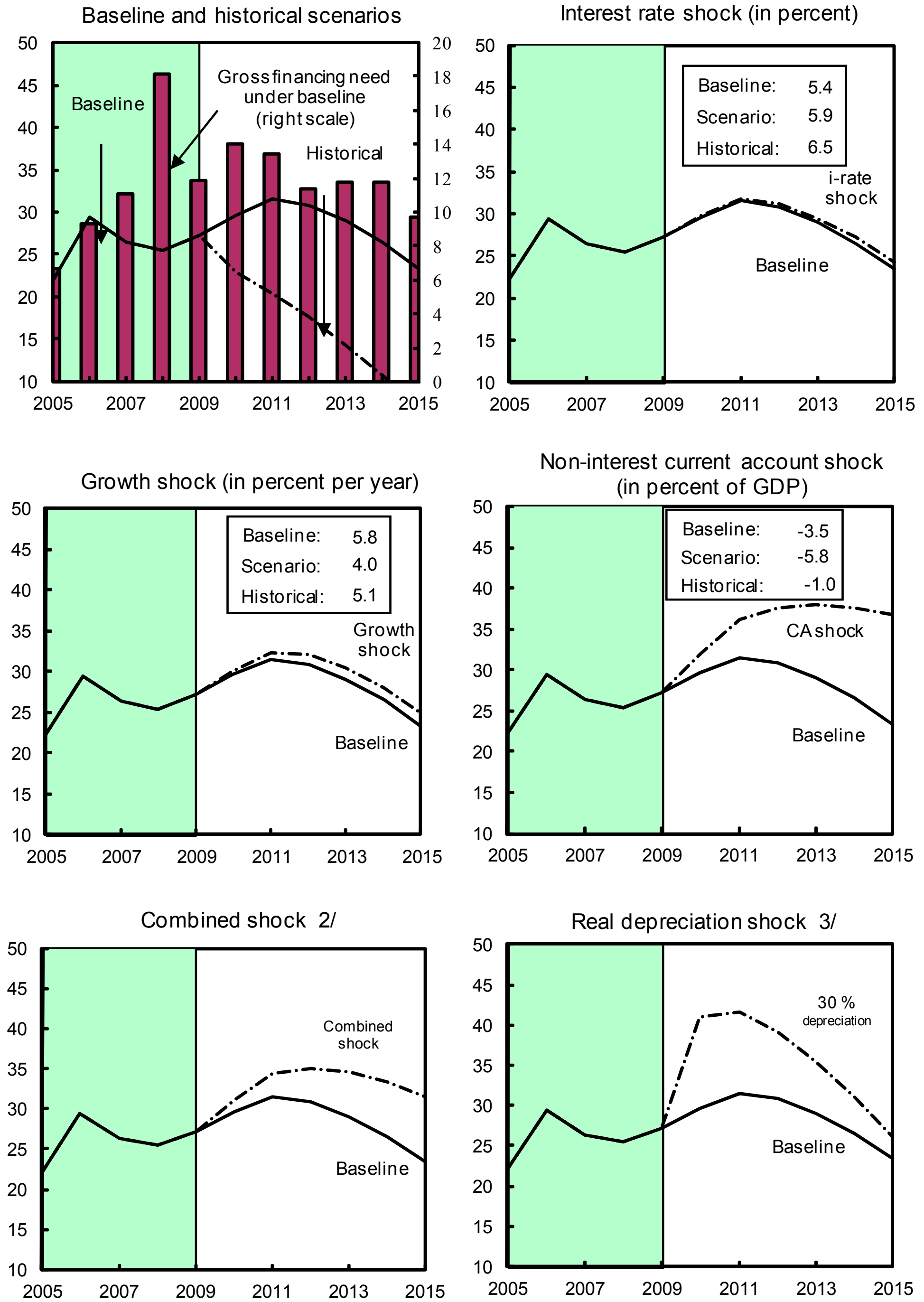
6/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.

7/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.

8/ Derived as nominal interest expenditure divided by previous period debt stock.

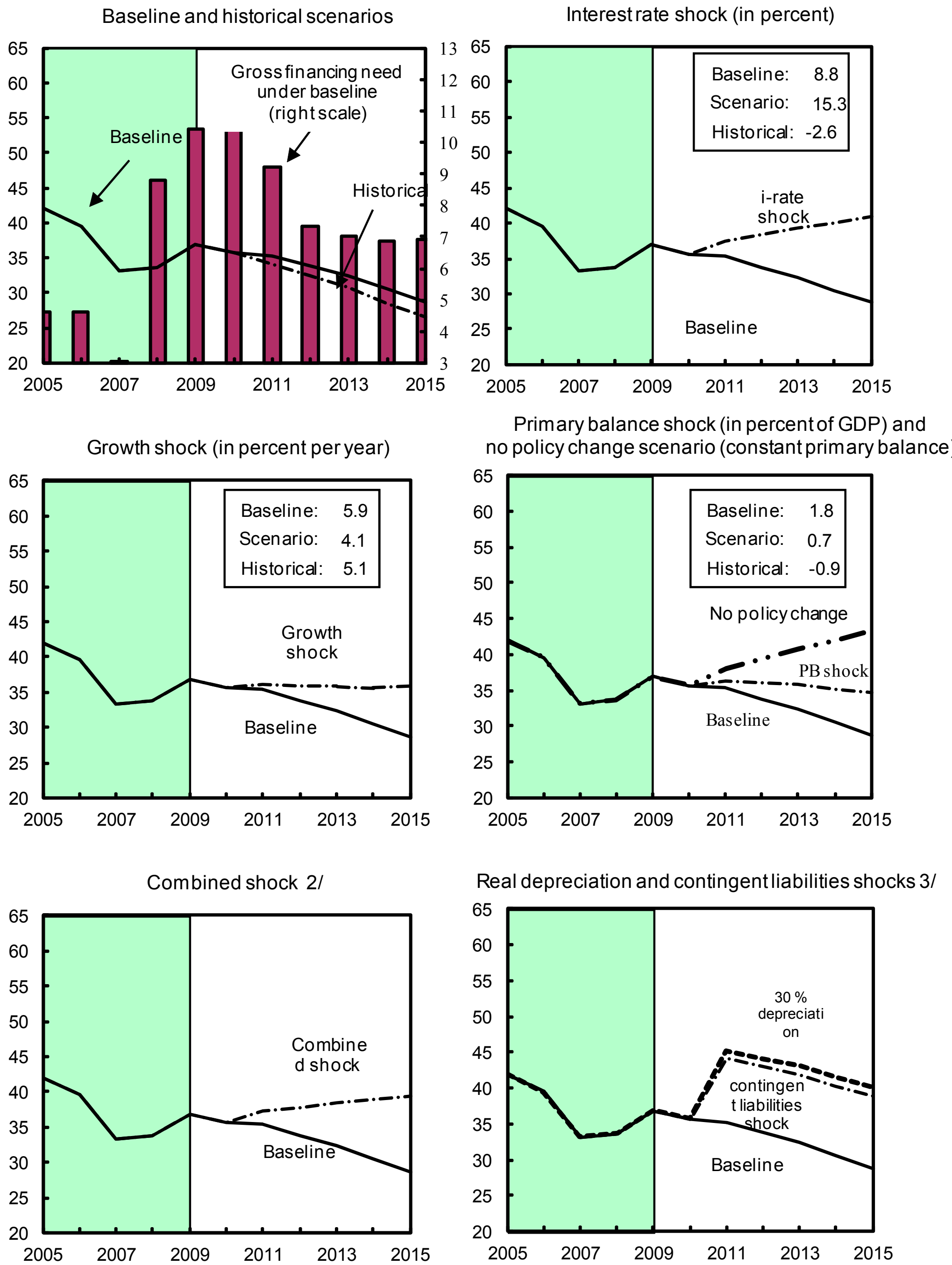
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Appendix Figure 1. Dominican Republic: External Debt Sustainability: Bound Tests 1/




Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
3/ One-time real depreciation of 30 percent occurs in 2010.

Appendix Figure 2. Dominican Republic: Public Debt Sustainability: Bound Tests 1/




Sources: International Monetary Fund, country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and primary balance.
3/ One-time real depreciation of 30 percent and 10 percent of GDP shock to contingent liabilities occur in 2009, with real depreciation defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

## APPENDIX 2: WORK PROGRAM

| Mission | Dates |
|---|---|
| **Fourth SBA Review** | |
| Mission | Oct 27–Nov 9, 2010 |
| Board Meeting | December 20, 2010 |
| **Fifth SBA Review** | |
| Mission | February 2-15, 2011 |
| Board Meeting | March 16, 2011 |
| **Sixth SBA Review** | |
| Mission | May 4-17, 2011 |
| Board Meeting | June 15, 2011 |
| **Memorandum items**: | |
| SBA Approval | November 9, 2009 |
| First SBA Review | April 7, 2010 |
| Second and Third SBA Review | Mid-October 2010 |

## ATTACHMENT 1: LETTER OF INTENT

***Banco Central de la República Dominicana***
***Ministerio de Hacienda***
***Ministerio de Economía, Planificación y Desarrollo***

Santo Domingo, Dominican Republic
October 7, 2010

Mr. Dominique Strauss-Kahn
Managing Director
International Monetary Fund
Washington DC, 20431

Dear Mr. Strauss-Kahn:

1. **Perspective**. The government's program announced in the Letter of Intent (LOI) and Memorandum of Economic and Financial Policies (MEFP) of October 6, 2009, and amended in the LOI for the first review of March 19, 2010, has yielded very positive results (http://www.imf.org/external/country/dom/index.htm). The economy has undergone a robust recovery, aided by the rapid and coordinated response of monetary and fiscal policy facilitated by the Fund-supported program, which also bolstered confidence. Inflation remains subdued and the exchange rate stable. The government was able to place a sovereign bond in international markets at historically low spreads in April, after a sovereign credit rating upgrade. These successful outcomes confirm that our approach in designing the program was correct and maintains our resolve to continue implementing it. At the same time, an agenda of structural reforms to address long-standing challenges, such as the functioning of the electricity sector, is in progress, with results that have been somewhat slower than expected. Although all quantitative performance criteria and structural benchmarks have been met, lower-than-expected tax revenues, and higher-than-expected transfers to the electricity sector in the first half of the year, required corrective polices to ensure that the government can meet its fiscal objectives under the program for the end of the year. The formulation and implementation of these corrective policies resulted in a delay in completing the second review, but these policies are now fully in place.

2. **Request**. Against this background, we are writing this letter to update and supplement our LOI and MEFP of October 2009 and March 2010. In particular, we are: (i) requesting

completion of the second and third reviews under the Stand-By Arrangement (SBA) based on compliance with the quantitative performance criteria and structural benchmarks for end-March and end-June 2010; (ii) setting new policies for the rest of 2010 to meet the end-year objectives under the program; (iii) presenting the macroeconomic policies that will form the basis of the program supported by the SBA for 2011; (iv) establishing structural benchmarks for the remainder of 2010 and 2011 to strengthen our institutional framework in all areas related to the program; and (v) requesting waivers of applicability of the relevant end-September 2010 performance criteria given that the information is not available at this moment. We are not proposing modification of any quantitative performance criteria for 2010, although we propose to add a quantitative performance criterion on the current deficit of the electricity sector for 2011. Recent developments as well projections, policies, targets, and benchmarks are presented in the attached tables.

3. **Economic situation.** Since the last review, there are clear signs that the economic recovery is gaining momentum:

- ***Growth***. Real GDP continued growing at 7.5 percent in the first half of 2010, after rising by 7.5 percent in the last quarter of 2009. The recovery seems to be broad based, with other indicators of economic activity (private credit, trade, remittances and tourism) growing at healthy rates relative to their 2009 levels. Accordingly, we have revised upward our estimate of growth for 2010 to 5.5-6.0 percent (which is well above the average for Latin America) from our previous range of 3-4 percent, reducing the output gap more rapidly than anticipated. Risks to the growth projections are balanced. While there are upside risks if the reconstruction efforts in Haiti speed up, there are also downside risks related to a weaker-than-expected recovery of the international economy and lower tourism from Europe and the United States.

- ***Inflation***. Headline inflation reached 5.0 percent in August 2010 (yoy) and is expected to remain within the central bank's target range (6-7 percent) for the end of the year. Core inflation, which excludes food and fuel-related prices, remained at a low level of 3.5 percent in August confirming that underlying price dynamics are still benign.

- ***Fiscal outcome***. Tax revenues came in below program expectations while electricity subsidies exceeded program levels. An additional complication from the budgetary point of view was that the 2010 budget was designed under the assumption of a modification of the central bank recapitalization law, which implied lower interest payments (0.2 percent of GDP). In the event, we decided not to modify the law but that decision required a supplementary budget to allow payments of interest to the central bank under the current law (0.8 percent of GDP). This required a reorganization of expenditure priorities to meet program targets. For the year as a whole, tax revenues were programmed to grow by 0.5 percent of GDP in 2010 but are now projected to increase by only 0.1 percent of GDP due to: (i) a more pronounced (lagged) effect of slower economic growth in 2009 on income tax receipts; and (ii) difficulties in the implementation of the government's program of improvements in tax administration and the rationalization of exemptions. At the same time, transfers to the electricity sector and to other public entities are expected to exceed program levels by about 0.6 percent of GDP, due to difficulties in implementation of reforms and somewhat higher oil prices. Overall, this would result in an expected deviation of about 1 percent of GDP for 2010 compared to the program, requiring further revenue and expenditure measures (described below) to meet end-year targets.

- ***Monetary position***. Monetary policy has remained stimulative. The policy rate was maintained at 4 percent by the Central Bank's Open Market Operations Committee in August for the eleventh consecutive month. Credit to the private sector has been expanding at a rate of 15 percent (yoy) in August.

- ***Financial system***. Banking soundness indicators continue to signal adequate capital, low non-performing loans and a recovery of profitability, pointing to an absence of stress on the financial system. Although banks have reduced their liquidity position to finance the expansion in private credit, liquidity indicators remain at adequate levels.

- ***External sector***. The external current account deficit fell to about 6 percent of GDP in the first half of 2010 as the recovery in imports was more than offset by a recovery of exports, remittances and tourism arrivals. Imports grew at 28 percent in nominal terms in the first half of the year, while national exports (excluding free trade zones) grew at 39 percent. Private capital inflows increased in the first half of 2010 in line with the recovery of economic activity. The exchange rate and net international reserves have remained stable relative to their end-2009 levels.

4. **Program targets**. All quantitative performance criteria and structural benchmarks under the program for end-March and end-June 2010 were met:

- ***Fiscal targets***. The government observed the floor on the overall balance of the central government for end-March 2010 by a margin of 0.2 percent of GDP, and the end-June target with a small margin. The floor on the overall balance of the consolidated public sector for end-March was also observed by a margin of 0.4 percent of GDP, as the quasi-fiscal deficit of the central bank was below program projections, while for end-June it was met with a smaller margin.

- ***Monetary targets***. The floor on the net international reserves of the central bank for both end-March and end-June was met by wide margins of over US$200 million in both cases, as part of the over performance of the December 2009 target was preserved, even in the context of an expansion of domestic credit to support the economic recovery.

- ***Debt targets***. The performance criteria on the non-accumulation of external arrears and non-accumulation of domestic arrears with electricity generators were both met, and the government remains current on all its obligations.

- ***Structural benchmarks***. The two structural benchmarks for March 2010, and one for June 2010, were met. The government presented a strategy to rationalize and limit tax exemptions, strengthen tax administration, and continue modernizing customs administration (March 2010), to achieve the fiscal revenue objectives under the program. The government also presented a strategy to achieve compliance with Basel core principles for effective banking supervision (March 2010), and a plan to fully implement an inflation targeting framework by 2012 (June 2010). These plans have been published and form the basis for new structural benchmarks under the program, as discussed below: http://www.hacienda.gov.do/; http://www.supbanco.gov.do/; and http://www.bancentral.gov.do/publicaciones_economicas/otros/Informe_metas_inflacion.pdf.

5. **Objectives for 2010-12.** A principal objective under the program is to implement a gradual fiscal consolidation to safeguard public debt sustainability and to reduce the debt to GDP ratio to the level observed before the international financial crisis (about 35 percent in 2007-08) by 2014 and regain fiscal space after the expansionary phase of the program that ended in mid-2010, while at the same time trying to increase public investment as much as possible through efficiency gains in revenues and expenditures. To do this, the government reiterates its objective of a primary fiscal balance of zero for the consolidated public sector in 2010 and to move to a primary surplus of about 1 percent of GDP in 2011 and 2 percent of GDP in 2012 and thereafter, to reduce the consolidated public debt to GDP ratio (excluding BCRD recapitalization bonds) to below 30 percent over the medium-term (from about 37 percent at end-2010). Fiscal adjustment will be achieved through a combination of increases in revenue of some 1.5 percent of GDP between 2009-12, to be obtained through improvements in tax administration and the rationalization of exemptions (as well as the recovery of taxes that the economic cycle will bring), and a cut in untargeted subsidies to the electricity sector of about 1 percent of GDP over the same period. Due to difficulties in the implementation of the strategy to improve tax administration and rationalize exemptions, we do not anticipate reaching our goal of increasing tax pressure to 15 percent of GDP before 2013, but we remain committed to work towards that objective. On the monetary side, the program seeks to reduce inflation to around 4 percent by 2012 and over the medium term, minimizing the differential with major trading partners. This will be achieved through the implementation of a more moderate credit policy in 2011 and an inflation targeting framework in 2012. Finally, the program also aims to foster growth and increase potential GDP through public investment in infrastructure, as described below.

6. **Policies for 2010.** The government's policies for the rest of 2010 will continue to be guided by the program as presented in the LOI/MEFP of October 9, 2009 and amended in the LOI of March 19, 2010. Quantitative targets under the program are unchanged.

- ***Fiscal policy***. The gradual fiscal consolidation will continue during the second half of the year to reach the annual target of zero for the primary balance of the consolidated public sector, consistent with an overall deficit of 2.3 percent of GDP for the central administration (taking in to account the higher GDP for 2010) and 3.9 percent for the combined public sector (taking in to account the higher GDP for 2010). To meet these goals, the government has submitted a supplementary budget to congress which includes cuts in spending equivalent to 0.4 percent of GDP to counteract the expected overrun in transfers to the electricity sector. In addition, the government has announced a number of tax and non-tax revenue administration measures of about 0.2 percent of GDP, which will help to counteract the lower than expected level of tax revenues compared to the program. The remaining adjustment of about 0.4 percent of GDP will come from administrative measures to further reduce the execution of planned capital expenditures. The revenue measures implemented in 2010 include:

    - ***Indexing of the specific tax on hydrocarbons***. Hydrocarbon sales are taxed with a specific and an ad-valorem tax which vary by fuel type. By law, the specific tax should be indexed to inflation with quarterly adjustments, but the government has chosen in the past not to implement this indexation since 2007. The government has taken up the indexation and, to compensate for past inflation, which will gradually increase the specific tax during the rest of 2010.

    - ***Collection of VAT on imports under the framework of the Proindustria law.*** The *Proindustria* law exempts certain firms from paying VAT on imported inputs and capital goods. The government has agreed with a critical mass of firms that during the life of the program they will pay the value added tax on imports at customs. This will improve cash flow for the government and enhance control at customs.

    - ***Advances on income tax on casino gains and lottery prizes.*** The government will withhold 15 percent of the winnings from lotteries and casinos.

- ***Electricity sector***. We remain committed to the reform of the sector and the elimination of indiscriminate electricity subsidies as outlined in the strategy designed in December 2009 (http://transparencia.cdeee.gob.do/wfPlanEstrategico.aspx) and the structural benchmarks described in previous LOIs. For 2010, we have committed to limit the current deficit of the electricity sector (including the consolidated accounts of the CDEEE, EDEs, EGEHID, ETED, and UERS, but excluding investment) to about US$600 million (1.2 percent of GDP) in accordance with the supplementary budget presented to congress in June. CDEEE and the rest of the sector will continue with their efforts to improve efficiency in the electricity system and reduce their operating costs. In this regard, it is worth mentioning the efforts of the current

CDEEE administration in reducing administrative costs significantly during this year and appointing three new chief executive officers with ample international experience to manage the EDEs. In addition, and subject to availability of suitable financing, the government will eliminate all accounts payable to private electricity generators (which have previously been kept at 45 days, in line with the program), significantly lowering their financing costs. Once these transactions are completed, CDEEE will limit accounts payable to electricity generators to a level that does not require the payment of interest (effectively maintaining zero days of arrears), and the performance criteria on arrears to private electricity generators will remain at zero but under a definition of no delays in payments (rather than tolerating the current 45 days).

- ***Monetary policy***. The accommodative monetary policy under the program has supported the economic recovery, and the central bank sees no inflationary pressures at the moment. However, the central bank remains vigilant, as always, and will act decisively if the risk of inflationary pressures should arise, especially in the context of the economic recovery and the reconstruction of Haiti, which may imply additional demand pressures for the Dominican Republic's economy. The ongoing fiscal consolidation gives some room for a policy of gradual monetary normalization.

- ***Central Bank recapitalization and use of Fund resources.*** The government has remained current on transfers necessary to recapitalize the central bank (BCRD) in accordance with the law, and has not yet moved to reform the law to lengthen the period of recapitalization, as was originally proposed in the LOI under the program. Rather than modify the law to extend the recapitalization period and lower the transfers to the BCRD, we propose keeping the current legislation, which will allow the government to maintain its original schedule of recapitalization of the central bank (10 years) and help bolster the credibility and effectiveness of monetary policy. In this context, the authorities have reallocated part of the SBA resources to finance the budget, allowing the government to use these resources (US$400 million) as part of its financing policy, of which US$250 million will be use to cover interest on the bonds for the BCRD recapitalization. Under this scheme, the accumulation of reserves at the BCRD under the program and the fiscal deficit agreed remain unchanged.

- ***Structural reform***. As mentioned above, the government has presented reform plans to help achieve the goals of the program**.** The following measures have been selected from these plans to add to the structural benchmarks already in the program:

    - ***Measures to rationalize tax exemptions.*** These measures will include two key components to help achieve the medium-term revenue objective of a tax pressure of 15 percent of GDP by 2013: (i) issue a decree to centralize the power to grant tax exemptions in the Ministry of Finance (December 2010);

and (ii) creation of a unit at the Ministry of Finance to conduct cost-benefit analyses of current and future exemptions and make recommendations to the Minister of Finance on granting and rationalizing exemptions (December 2010).

- ***Measures to improve tax collections***. To safeguard our fiscal position and allow room to increase capital expenditures, we will prepare a list of revenue administration measures to yield 0.5 percent of GDP in 2011 with a time table for their implementation (December 2010).

- ***Strengthening monetary control infrastructure***. The central bank will begin to issue dematerialized securities (December 2010). It is expected that all central bank securities with be dematerialized by end-2015.

7. **Policies for 2011.** In conducting policies during 2011 the authorities will continue to follow the blueprint and spirit of policies outlined in the LOI of October 2009.

- ***Fiscal policy***. Difficulties in the implementation of reforms to tax administration have led us to take a cautious approach to projecting revenue growth in 2011. We project conservatively an increase in tax pressure to 13.3 percent of GDP (0.1 percent above the level in 2010) which would yield overall revenue (including non-tax revenue and grants) of 14 percent of GDP. On the expenditure side, wages and salaries are projected to grow slightly above the level of inflation due to the increase in compensation negotiated with public sector health workers in June. Expenditure on goods and services are expected to decline as a percent of GDP while transfers will be reduced in line with the lower deficit of the electricity sector (expected to fall from 1.2 percent of GDP in 2010 to 0.6 percent of GDP in 2011). Capital expenditure will reach a level of 3.7 percent of GDP, roughly equal to the level in 2010. All this would result in a deficit of 1.6 percent of GDP at the level of the central administration, and 3 percent at the level of the consolidated public sector (including a quasi-fiscal deficit of the central bank of 1.4 percent of GDP). This would be consistent with a primary surplus for the consolidated public sector of about 1 percent of GDP. If the revenue measures begin to yield results beyond those projected, we will submit to Congress a supplementary budget to allocate these additional resources in full to public investment in line with the government's goal of increasing infrastructure investment, but we would not increase current spending.

- ***Electricity sector***. For 2011 we plan to limit the current deficit of the electricity sector to US$350 million (0.6 percent of GDP), including US$150 for the electricity distribution companies and US$200 for the CDEEE (from about US$600 million estimated for 2010), under the condition that the cost of electricity consumed by priority government agencies (i.e. hospitals and military – "*no cortables*"), and the subsidy to beneficiaries of the *Bonoluz* program (at the ongoing electricity tariff), are paid through the budget. We propose a new quantitative performance criterion under the program for the current deficit of the electricity sector reflecting these plans. This level of deficit will be achieved through improvements in collections, reductions in theft and a flexible tariffs structure (in line with our commitments under the structural benchmarks established during the first review). We intend to reduce all accounts payable to electricity generators to a level that does not require the payment of interest (effectively zero days of arrears).

- ***Monetary policy***. The monetary program assumes conservatively a growth in the demand for money of 7 percent, and net domestic assets (NDA) constant in nominal terms at their end-2010 programmed level as monetary policy moves towards a more neutral stance. Accordingly, the focus of the program will be on the accumulation of net international reserves, which are expected to rise by at least US$300 million during the year.

- ***Central bank recapitalization and use of Fund resources***. Following our practice for 2010, the government will continue to support the recapitalization of the central bank according to the current legislation. To that end, we will continue with the reallocation of SBA resources to finance the budget, increasing Fund support to the budget for US$250 million as part of the government's financing policy for 2011 to cover interest on the bonds for the BCRD recapitalization.

- ***Structural reforms***. Additional structural measures for 2011 include:

  - ***Tax administration and the rationalization of exemptions.*** Prepare a report on the costs and benefits of the current exemption regime and a timetable for the rationalization and reduction of exemptions to help achieve the government's tax revenue target of 15 percent of GDP (March 2011).

  - ***Strengthening banking supervision.*** With the aim of providing the legal framework for the implementation of the Basel core principles of effective bank supervision and to facilitate risk-based supervision, the authorities will send to Congress: (i) amendments to the Monetary and Financial Law (March 2011); and (ii) a new law on consolidated supervision of financial and industrial groups (March 2011).

  - ***Inflation targeting***. In preparation for the introduction of an inflation targeting (IT) regime, the central bank will: (i) publish a report on monetary policy under IT (June 2011); and (ii) publish a monetary program for 2012 (as established by law) but within the new IT framework (December 2011).

- ***Recovery and Growth Enhancement.*** Increase the number of regulated clients of the electricity distribution companies (EDEs) to 2.15 million (June 2011).

- ***Social Safety Net***. To enhance the social safety net, the government will increase the coverage of the BONOLUZ program to 250,000 clients (September 2011); and increase the permanent coverage of the conditional cash transfer program (*Solidaridad*) by 60,000 additional families to 590,000 families (December 2011).

8. **Assurances**. The government believes that the policies set forth in the MEFP attached to the LOI of October 6, 2009, the LOI of March 19, 2010, and the modifications indicated above, are adequate to achieve the objectives of its program, but it will take any further measures that may become appropriate for this purpose, while refraining from taking any measure that goes against the program. The government will maintain the productive and fruitful dialogue we have had with the Fund in the past. In this spirit of cooperation, the government will consult with the Fund on the adoption of these measures (and in advance of revisions to the policies contained in the LOI), and will continue providing Fund staff with all the relevant information required to complete program reviews and monitor performance.

9. **Transparency.** We have already published the staff report for the 2009 Article IV Consultation which included the original SBA program (October, 2009) and intend to publish the subsequent staff reports with all the program reviews once they are translated. In addition, as part of our communication strategy we intend to publish this letter on the websites of the Central Bank, the Ministry of Finance, and the Ministry of the Economy, Planning and Development, to maintain our citizens, other domestic economic agents and the investment community informed about our policy actions and intentions. We also authorize the Fund to publish this letter to facilitate a wider access and review of our policies by the international community.

Sincerely yours,

| | | |
|---|---|---|
| _________/s/_________ | _________/s/_________ | _________/s/_________ |
| Héctor Manuel Valdez | Vicente Bengoa | Temístocles Montás |
| Governor of the Central Bank | Minister of Finance | Minister of Economy |

Attachments

[The LOI includes tables 1-16 of the staff report.]

## ATTACHMENT 2: TECHNICAL MEMORANDUM OF UNDERSTANDING

This Technical Memorandum Understanding (TMU) presents the definitions of the variables included in the quantitative performance criteria annexed to the Letter of Intent (LOI), and the information requirements needed to ensure adequate monitoring of economic and financial developments.

## I. Quantitative Performance Criteria: Definition of Variables

### A. Cumulative Floor on the Central Government Balance

The overall balance of the central government covers government activities as specified in the budget.

Revenues are recorded when the funds are deposited in the Treasury account. Revenues also include grants. Central government primary expenditures are recorded on an accrual basis and include transfers to other government units as well as all transfers to the public electricity sector. Interest payments, however, will be recorded on a due basis. Capital expenditure will include any in-kind capital expenditures defined as the externally financed investment projects (through loans and grants) in case they are not included in the execution of the budget.

The balance of the central government will be measured from below-the-line as the change in the central government's net financial position (assets minus liabilities). The net financial position of the central government includes: (a) non-bank central government debt, external and domestic, including debt with the IMF for budgetary support and short-term debt approved by the Ministry of Finance; (b) external and domestic bank borrowing (net of deposits), including deposits in the central bank; and (c) any other nonbank financing, domestic or external, including the net change in the stock of domestic and external arrears, including arrears to electricity distributors, and the sale of public assets. Domestic arrears of the nonfinancial public sector are defined as delays in the payment of contractual obligations beyond the grace period set in the respective loan or debt contract or 30 days in case the grace period is not specified. Capitalizations or purchases of equity in public companies will be treated as an above-the-line expenditure transaction. Privatizations and sales of public assets will be recorded below-the-line as offsetting financing items with no impact on the deficit. External debt flows (i.e., disbursements and debt service), will be converted to Dominican Republic pesos at the exchange rate of the day in which the transaction takes place.

The following uses of funds will not affect the deficit and will be recorded below-the-line: (i) clearance of central government domestic arrears incurred the year before; (ii) amortization of loans and bonds; (iii) bonds issued for the recapitalization of the Central Bank and Banco de Reservas; and (iv) other arrears with suppliers incurred in previous years. A memorandum line in the information reporting the Central Government fiscal operations will report items (i) to (iv) in this paragraph.

In the event of a change in the central bank recapitalization law that affects interest payments from the central administration to the central bank, the target on the overall balance of the central government will be adjusted accordingly. Any decline (increase) in interest payments relative to the program value will result in a higher (lower) overall balance target by the same amount.

**1. Targets on the Overall Balance of the Central Government**

| | Floor (In billions of RD$) |
|---|---|
| Cumulative Balance (from December 31, 2008) | |
| End-September 2010 (performance criterion) | -95.8 |
| End-October 2010 (program projection) | -96.5 |
| End-November 2010 (program projection) | -98.6 |
| End-December 2010 (performance criterion) | -102.3 |
| Cumulative Balance (from December 31, 2010) | |
| End-January 2011 (program projection) | -5.0 |
| End-February 2011 (program projection) | -9.9 |
| End-March 2011 (performance criterion) | -14.9 |
| End-April 2011 (program projection) | -17.0 |
| End-May 2011 (program projection) | -19.2 |
| End-June 2011 (performance criterion) | -21.3 |
| End-July 2011 (program projection) | -23.5 |
| End-August 2011 (program projection) | -25.7 |
| End-September 2011 (performance criterion) | -27.9 |
| End-October 2011 (program projection) | -29.7 |
| End-November 2011 (program projection) | -31.6 |
| End-December 2011 (performance criterion) | -33.5 |

### B. Cumulative Floor on the Consolidated Public Sector Balance

The consolidated public sector comprises: (i) the operations of the nonfinancial public sector; and (ii) the quasi-fiscal operations of the central bank. The balance of the nonfinancial public sector comprises the overall balances of the central government (as defined before) and the rest of the nonfinancial public sector (municipalities, decentralized entities, social security entities, and public enterprises).

The rest of the nonfinancial public sector includes the following non-financial public enterprises: Corporación Dominicana de Empresas Eléctricas Estatales (CDEEE, including Empresa de Generación Hidroeléctrica Dominicana), Empresas Distribuidoras de Electricidad del Norte (EDENORTE), Empresas Distribuidoras de Electricidad del Sur (EDESUR), Empresas Distribuidoras de Electricidad del Este (EDESTE), Consejo Estatal del Azúcar, Corporación de Fomento Hotelero y Desarrollo Turístico, Corporación de Acueducto y Alcantarillado de Santo Domingo, Acueducto y Alcantarillado de Santiago, Acueducto y Alcantarillado de Moca, Acueducto y Alcantarillado de la Romana, Instituto Nacional de Aguas Potables y Alcantarillados, Corporación de Acueducto y Alcantarillado de Puerto Plata, Proyecto de la Cruz de Manzanillo, Instituto Postal Dominicano, Corporación Estatal de Radio y Televisión, Instituto Nacional de la Vivienda, Lotería Nacional, Autoridad Portuaria Dominicana, Refinería Dominicana de Petróleo.

The overall balance of the rest of the nonfinancial public sector will be measured from below-the-line as the change in the net financial position (assets minus liabilities) on the basis of changes in: (i) net domestic bank credit and deposits; (ii) domestic and external arrears, and (iii) external disbursements less amortizations.

The quasi-fiscal balance of the central bank included in the consolidated public sector balance is measured as all the administrative and financial revenues minus costs (including costs of monetary policy and interest on the central bank debt and operational expenditures). Changes in the recapitalization law will be reflected in a lower interest bill for the central government and a higher quasi-fiscal deficit for the central bank in the same amount, so that the overall deficit of the combined public sector does not change. In this case, the target of the overall balance of the central government will be modified. Profits and losses arising from valuation changes of foreign currency denominated assets and liabilities will not be considered to determine the balance of the nonfinancial public sector.

Fiscal targets for 2010 will continue to be measured as cumulative floors from end-December 2008. Fiscal targets for 2011 will be measured as cumulative floors from end-December 2010.

The information to compute the overall balance of the nonfinancial public sector will be provided to the Fund by the central bank, based on information provided by the government's accounting office (expenditure) and various units of the Secretaría de Hacienda (revenue, nonbank domestic debt and arrears, external debt and arrears, and externally financed capital expenditure).

**2. Targets on the Overall Balance of the Consolidated Public Sector**

| | Floor (In billions of RD$) |
|---|---|
| Cumulative Balance (from December 31, 2008) | |
| End-September 2010 (performance criterion) | -133.0 |
| End-October 2010 (program projection) | -135.9 |
| End-November 2010 (program projection) | -140.1 |
| End-December 2010 (performance criterion) | -147.0 |
| Cumulative Balance (from December 31, 2010) | |
| End-January 2011 (program projection) | -7.2 |
| End-February 2011 (program projection) | -14.3 |
| End-March 2011 (performance criterion) | -21.5 |
| End-April 2011 (program projection) | -26.2 |
| End-May 2011 (program projection) | -30.9 |
| End-June 2011 (performance criterion) | -35.6 |
| End-July 2011 (program projection) | -40.2 |
| End-August 2011 (program projection) | -44.8 |
| End-September 2011 (performance criterion) | -49.5 |
| End-October 2011 (program projection) | -54.2 |
| End-November 2011 (program projection) | -59.0 |
| End-December 2011 (performance criterion) | -63.8 |

## C. Floor on Central Bank Consolidated Net International Reserves (NIR)

For program monitoring purposes, the consolidated NIR is defined as the difference between gross international reserves of the central bank and reserve liabilities, including debt of the Ministry of Finance with the IMF as follows:

Gross international reserves include claims against non-residents, denominated in foreign convertible currencies that are in the direct effective control of the central bank and are readily available for such purposes as foreign exchange market intervention. Such assets include gold (valued in dollars at end-2008 prices), cash, deposits abroad (excluding funds used as collateral for central bank or other nonfinancial public sector liabilities), holdings of SDRs, and the IMF reserve position.

Reserve liabilities include debt with the IMF, including that of the Ministry of Finance, and short-term (up to one year) foreign-currency-denominated liabilities, including commitments to sell foreign exchange from derivatives or other contracts, and other guarantees or contingent liabilities.

The consolidated NIR definition does not modify the central bank balance sheet accounting rules. The consolidated NIR as defined above differs from the NIR definition included in the previous 2005 Stand-By Arrangement that excluded reserve requirements on foreign currency deposits, and government and bank deposits in foreign currency as they were considered part of the reserve liabilities.

**3. Targets on the Consolidated Net International Reserves**

| Outstanding Stock | Floor (In millions of US$) |
|---|---|
| End-September 2010 (performance criterion) | 1865 |
| End-October 2010 (program projection) | 1915 |
| End-November 2010 (program projection) | 1965 |
| End-December 2010 (performance criterion) | 2015 |
| End-January 2011 (program projection) | 1899 |
| End-February 2011 (program projection) | 1782 |
| End-March 2011 (performance criterion) | 1665 |
| End-April 2011 (program projection) | 1699 |
| End-May 2011 (program projection) | 1732 |
| End-June 2011 (performance criterion) | 1765 |
| End-July 2011 (program projection) | 1915 |
| End-August 2011 (program projection) | 2065 |
| End-September 2011 (performance criterion) | 1865 |
| End-October 2011 (program projection) | 2015 |
| End-November 2011 (program projection) | 2165 |
| End-December 2011 (performance criterion) | 2315 |

To meet this performance criterion at each relevant date, the 5-day average of daily consolidated NIR values must be above the floor. The 5-day average will be calculated on the basis of the last five working days of each relevant month.

Consolidated NIR targets will also be adjusted upward *(downward)* by the surplus (*shortfall*) in program disbursements up to US$300 million. Program disbursements are defined as uncommitted external disbursements, and external sovereign bond issuance, that are usable for the financing of the overall central government budget (this includes the World Bank, IDB, CAF and external sovereign bond placements). For the purpose of adjusting the NIR in 2011, the values of the program disbursements will be measured as cumulative flows from December 2010.

**4. External Program Disbursements**

| | (In millions of US$) |
|---|---|
| Cumulative Flows (from December 2008) | |
| End-September 2010 | 1793 |
| End-October 2010 | 1793 |
| End-November 2010 | 1819 |
| End-December 2010 | 1819 |
| Cumulative Flows (from December 2010) | |
| End-January 2011 | 0 |
| End-February 2011 | 0 |
| End-March 2011 | 0 |
| End-April 2011 | 0 |
| End-May 2011 | 0 |
| End-June 2011 | 500 |
| End-July 2011 | 500 |
| End-August 2011 | 500 |
| End-September 2011 | 535 |
| End-October 2011 | 535 |
| End-November 2011 | 535 |
| End-December 2011 | 698 |

### D. Ceiling on Central Bank Net Domestic Assets (NDA)

Central Bank net domestic assets (NDA) are defined as the difference between the monetary base and Consolidated NIR, as defined above. For the purposes of the program the monetary base is defined as equivalent to *emisión monetaria*, which includes currency issue (currency in circulation plus cash in vault) plus peso reserve requirements held by financial institutions at the central bank.

To meet this performance criterion at each relevant date, the 5-day average of daily NDA values must be below the ceiling. The 5-day average will be calculated on the basis of the last five working days of each relevant month.

**5. Targets on the Net Domestic Assets**

| Outstanding Stock | Ceiling (In billions of RD$) |
|---|---|
| End-September 2010 (performance criterion) | 65 |
| End-October 2010 (program projection) | 70 |
| End-November 2010 (program projection) | 75 |
| End-December 2010 (performance criterion) | 80 |
| End-January 2011 (program projection) | 80 |
| End-February 2011 (program projection) | 80 |
| End-March 2011 (performance criterion) | 80 |
| End-April 2011 (program projection) | 80 |
| End-May 2011 (program projection) | 80 |
| End-June 2011 (performance criterion) | 80 |
| End-July 2011 (program projection) | 80 |
| End-August 2011 (program projection) | 80 |
| End-September 2011 (performance criterion) | 80 |
| End-October 2011 (program projection) | 80 |
| End-November 2011 (program projection) | 80 |
| End-December 2011 (performance criterion) | 80 |

For accounting purposes, dollar accounts will be converted to *pesos* at the accounting exchange rate of RD$36.5 per dollar.

NDA targets will be adjusted upward *(downward)* for any increase *(decrease)* in reserve requirement deposits *(encaje)* associated with peso deposits at the central bank. NDA targets will be adjusted downward *(upward)* by the surplus *(shortfall)* in program disbursements up to US$300 million.

### E. Cumulative Floor on the Current Balance of the Public Electricity Sector

The public electricity sector comprises: (i) Corporación Dominicana de Empresas Eléctricas Estatales (CDEEE); (ii) Empresa de Generación Hidroeléctrica Dominicana (EGEHID); (iii) Empresa de Transmisión Eléctrica Dominicana (ETED); (iv) Unidad de Electrificación Rural y Suburbana (UERS); (v) Empresas Distribuidoras de Electricidad del Norte (EDENORTE); (vi) Empresas Distribuidoras de Electricidad del Sur (EDESUR); and (vii) Empresas Distribuidoras de Electricidad del Este (EDESTE).

The overall balance of the public electricity sector will be measured from below-the-line as the change in the electricity sector's net financial position (assets minus liabilities). The net financial position of the public electricity sector includes: (a) transfers from the government to the electricity sector; (b) changes in arrears with electricity generators; (c) changes in the net credit of the banking system to the electricity sector companies; and (d) external disbursements to the electricity sector.

The current balance of the public electricity sector will be measured as the overall balance of the public electricity sector plus externally financed investment in the public electricity sector and the programmed domestically financed investment in the public electricity sector.

For the purpose of the program, domestically financed investment in the public electricity sector for 2011 will be capped at US$ 60 million. In the event of domestically financed investment in the public electricity sector exceeding US$ 60 million, the excess amount would be considered additional current deficit of the electricity sector.

Payment of arrears do not constitute deficit of the public electricity sector. In the event of clearance of arrears of the electricity sector by the Ministry of Finance, the transaction will be recorded as a net transfer from Ministry of Finance and a corresponding reduction in arrears without any effect on the below-the-line deficit of the public electricity sector or the central administration.

It is expected that priority clients (no-cortables) and municipalities (ayuntamientos) will cover their electricity bills through the budget, and that all Bonoluz bills will be paid by clients.

**6. Targets on the Current Balance of the Public Electricity Sector**

| | Floor (In millions of US$) 1/ |
|---|---|
| Cumulative Balance (from December 31, 2009) | |
| End-September 2010 (program projection) | -445 |
| End-October 2010 (program projection) | -498 |
| End-November 2010 (program projection) | -551 |
| End-December 2010 (program projection) | -604 |
| Cumulative Balance (from December 31, 2010) | |
| End-January 2011 (program projection) | -26 |
| End-February 2011 (program projection) | -51 |
| End-March 2011 (performance criterion) | -77 |
| End-April 2011 (program projection) | -100 |
| End-May 2011 (program projection) | -122 |
| End-June 2011 (performance criterion) | -145 |
| End-July 2011 (program projection) | -177 |
| End-August 2011 (program projection) | -209 |
| End-September 2011 (performance criterion) | -242 |
| End-October 2011 (program projection) | -278 |
| End-November 2011 (program projection) | -314 |
| End-December 2011 (performance criterion) | -350 |

1/ Value each flow monthly at the exchange rate of the corresponding month.

## F. Ceiling on the Accumulation of Arrears of Public Electricity Distributors with Generators

The government will regularize any outstanding domestic arrears (as defined in section IA above) with private electricity generators using the available financial mechanisms and will remain current on its obligations. Arrears to private energy generating companies are defined as the balance of current invoices for energy sales to electricity distribution companies for which no payment has been made within 45 days following the contractual due date.

In the event the Ministry of Finance covers payments of arrears which are within 45 days from the contractual due date, these payments will not constitute deficit of the electricity sector. The transaction will be recorded as a net transfer from the Ministry of Finance to the public electricity sector and as a corresponding reduction in arrears without any effect on the below-the-line deficit of the electricity sector or the central administration. In this case the arrears performance criterion will be modified and measured with zero days (i.e., no delays).

### G. Continuous Ceiling on the Gross Accumulation of Public Sector External Arrears

The central government and any other entity of the nonfinancial public sector, as defined above, as well as the central bank, will not incur new arrears in the payment of their external obligations at any time during the program. Arrears are defined as a delay in the payment of contractual obligations beyond the grace period set in the respective loan or debt contracts or 30 days in case the grace period is not specified.

## II. Information Requirements

To ensure adequate monitoring of economic variables and reforms, the authorities will provide the following information:

### A. Daily

- Deposits in the banking system, exchange rate in the official and free markets, interest rates on bank loans and deposits, Consolidated NIR, currency in circulation, deposits held by financial institutions at the central bank, excess reserves of the banking sector in local and foreign currency, liquidity assistance to banks, central bank certificates, and all other remunerated liabilities of the central bank. These data will be provided with a lag of no more than 5 working days.

- Deposit of, and liquidity assistance to, troubled institutions, by institution.

- Central bank purchases and sales of foreign currency.

- Central bank intervention operations in domestic currency, including results of auctions of central bank paper (interest rates, details of bids, including minimum and maximum rates, volumes, and maturities).

### B. Monthly

- Tax collection and expenditure of the central government, with a lag of no more than two weeks after the closing of each month.

- Starting in September 2009, revenue, expenditure, and financing of the nonfinancial public sector, including decentralized agencies and public enterprises of the previous month. These data, and all other data required to assess the performance criteria on the overall balance of the consolidated public sector as specified in Section I.B, will be provided with a lag of no more than five weeks.

- Saving-investment account of the central government.
- Net financial position of the central government (as defined in section I.A.) with a lag of no more than two weeks after the end of each month.
- Central government's domestic interest, contractually due in the period and effectively paid, with a lag of no more than two weeks after the end of each month.
- Authorizations and stock of administrative debt, including the economic classification of the expenditure that has been financed with such debt, with a lag of no more than two weeks after the end of each month.
- Value of outstanding checks issued by the Treasury with a lag of no more than two weeks after the end of each month, starting in September 2009.
- Legal measures that affect the revenue of the central government (tax rates, import tariffs, exemptions, etc).
- In-kind capital expenditure statistics.
- Balance sheet of the central bank, including the net domestic assets as specified in Section I.D, *Banco de Reservas*, and deposit money banks (cable file), will be provided with a lag of no more than two weeks.
- Balance sheet of the central bank excluding operations related to the recapitalization of the central bank and quasi fiscal.
- Quasi-fiscal balance of the central bank.
- Stock of central bank certificates, notes and bills each by type of holder.
- Maturity of certificates, detailing amortizations in the following 12 months (i.e., following the end of the current month).
- Public external debt service for the preceding month and revised monthly projections for the forthcoming year, with a lag of no more than two weeks.
- Monthly external public disbursements and revised monthly projections for the forthcoming year, with a lag of no more than two weeks.
- Monthly contracting of external public debt and monthly stock of contracted, but not disbursed external public debt, with projections of the stock of debt contracted, but not disbursed for the forthcoming year.
- Foreign exchange cash flow of the central bank (la balanza cambiaria).
- Electricity sector collections, losses, cash recovery index and central government transfers to the electricity sector, according to the following definitions: Collection rate: is defined as the ratio between the electricity invoices effectively paid (collected)

and electricity invoices issued by electricity distributors in any given period. Loss rate: is defined as the ratio between electricity lost and electricity purchased by electricity distributors in any given period. Electricity lost is the difference between electricity invoiced and electricity purchased. Central government transfers to the electricity sector: is the sum of all transfers to the sector from the central government, including remaining PRA subsidies, FETE (*Fondo de Estabilización de la Tarifa Eléctrica*) and transfers to electricity companies, and all payments related to Bono Luz. The CDEEE will provide on a monthly basis (with a maximum 21-day lag) information on the arrears of the immediate past month that CDEEE and other distributors accumulate with the generation companies on energy purchases and transmission fees.

- The CDEEE will provide current information on electricity tariffs at the beginning of each month (with a maximum 10-day lag) or at any moment the tariff changes, including 43 prices and fees related to different consumption brackets, of which 13 are fixed fees related to the types of client, 7 are fixed fees related to power and 23 are prices related to energy.

- Monthly net credit of the banking system to the companies of the public electricity sector.

- Monthly investment in the public electricity sector specifying total domestically financed investment and externally financed investment.

- Price of each fuel as set in the contracts for the purchase of electricity by each distributor and CDEEE from each producer for the next 6 months for coal and 3 months for other fuels.

- Purchases of electricity by each of the three distributors and CDEEE from each generator. This includes quantity of electricity purchased (in KWh) and the unit price of each fuel charged by type of fuel and the quantity used in electricity generation. In addition report the quantity and unit price of electricity purchased by each distributor and CDEEE in the spot market.

## C. Quarterly

- Revised balance of payments outturn for the preceding quarter and quarterly projections for the forthcoming year, with a lag of no more than four weeks.

- Revised estimates of the stock of short-term and medium- and long-term public external debt, by creditor, at the end of quarter, with a lag of no more than four weeks.

- Stock of public sector domestic debt, including public sector debt in the electricity sector.
- Stock of *avales* and any other guarantees or contingent liabilities of the public sector.
- Revised estimates of the quarterly disbursements, debt service and stocks of short-term and medium- and long-term private external debt, by debtor, at the end of quarter, with a lag of no more than two weeks.
- Stock of public external late payments and arrears (program definition), by debtor and creditor, with details on new arrears incurred in the last month and clearance of old arrears, with a lag of no more than 5 working days.
- Stock of domestic arrears, starting with figures for December 2008, with details on new arrears incurred in the period and clearance of old arrears.

INTERNATIONAL MONETARY FUND

DOMINICAN REPUBLIC

# Second and Third Reviews Under the Stand-By Arrangement, Requests for a Waiver of Nonobservance of a Performance Criterion, and Waivers of Applicability of Performance Criteria – Supplementary Information, and Supplementary Letter of Intent

Prepared by the Western Hemisphere Department
(In consultation with other departments)

Approved by Rodrigo Valdés and Dominique Desruelle

October 19, 2010

*This supplement provides information on developments and performance since the issuance of the staff report for the Second and Third Reviews Under the SBA, and supports the authorities' new request for a waiver of the non-observance of the performance criterion on arrears to electricity generators for end-September 2010. The information contained in this supplement does not materially change the thrust of the staff report.*

## I. Recent Developments

1. **Recent indicators suggest that the strong economic expansion continues and point to a closing of the output gap.** These developments are welcome and validate the authorities' policy stance, which calls for a gradual adjustment that began in the second half of 2010 and should continue in 2011.

- ***Economic activity continues expanding***. The monthly index of economic activity (IMAE) increased 7.4 percent (yoy) in August 2010 following 5.2 percent (yoy) in July 2010. The expansion continues to be broad-based. Real GDP increased by 7.5 percent (yoy) in the first half of 2010.

- ***There was an uptick in inflation which is now aligned with the Central Bank target***. The monthly rate of headline inflation was 0.8 percent in September 2010 (from 0.2 percent in August) taking the 12-month rate to 5.7 percent (from 5 percent in August). The monthly rate of core inflation (which excludes food and fuels) also jumped to 1.0 percent in September 2010 (from 0.5 percent in August) taking the 12-month rate to 3.9 percent (from 3.5 percent in August).

- ***Monetary policy moved to a tightening phase***. The open market operation committee at the Central Bank (COMA) decided to increase the policy rate by 75 basis points to

4.75 percent in its last meeting. The announcement mentions this is a pre-emptive move as the COMA does not see inflationary pressures (this announcement was made before the inflation figure for September was released). http://www.bancentral.gov.do/notas_pm.asp?a=bc2010-10-01

## II. Performance Criteria [1]

2. **Information is available for four of the six quantitative targets for end-September 2010; one target was missed, and the authorities have requested a waiver of non-observance.** The end-September 2010 performance criterion on the zero ceiling on arrears to private electricity generators (under the program definition) was not observed. The authorities indicated that these payments were not made on time due to unexpected delays in the enactment of the supplementary budget (submitted to Congress in July and approved in September) and in the related transfer to allow the payments to electricity generators as well as difficulties in securing alternative financing solutions. However the delay was short (4 business days, arrears were cleared by October 6) and the authorities are current on these obligations. The supplementary letter of intent (attached) requests a waiver for the non-observance of this performance criterion, which staff supports given the temporary nature of the deviation from the target. The other three end-September 2010 performance criteria for which information is available were observed: (i) the floor on net international reserves of the Central Bank; (ii) the ceiling on net domestic assets of the Central Bank; and (iii) the ceiling of zero on arrears to external creditors.[2]

**Dominican Republic: Performance Criteria**
(Quantitative targets for end-September 2010)

| | Sep 2010 | | | Request for Waivers of | |
|---|---|---|---|---|---|
| | Prog. | Actual | Status | Applicability | Non-observance |
| | (In percent of GDP) | | | | |
| **Fiscal Targets** | | | | | |
| Consolidated public sector deficit | 3.1 | 2.9 1/ | ? | Y | … |
| Central administration deficit | 2.0 | 1.8 1/ | ? | Y | … |
| | (In percent of base money) | | | | |
| **Monetary Targets** | | | | | |
| Net international reserves | 45.1 | 54.9 | ✓ | N | N |
| Net domestic assets | 54.9 | 45.1 | ✓ | N | N |
| | (In percent of payments due) | | | | |
| **Debt Targets** | | | | | |
| External arrears | 0.0 | 0.0 | ✓ | N | N |
| Arrears to electricity generators | 0.0 | 3.9 | x | N | Y |

Source: Dominican authorities and Fund staff estimates.
1/ Estimates of fiscal targets for end-August 2010; data for end-September not available.

[1] Given the timing of the Board meeting on the completion of the second and third SBA reviews, the end-September 2010 performance criteria are the controlling targets.

[2] The zero external arrears performance criterion has been observed continuously through the date of issuance of this supplement. Moreover, the authorities have also confirmed that they have met all other standard continuous performance criteria, including on non-imposition or intensification of exchange restrictions, or of import restrictions for balance of payments reasons, and non-introduction or modification of multiple currency practices.

3. **There is no final information to assess two of the six targets for September 2010, for which the authorities are requesting a waiver of applicability.**[3] The two relevant performance criteria are: (i) the overall balance of the central administration; and (ii) the overall balance of the combined public sector. Preliminary information through end-August 2010 suggests that there was room to run small deficits in September. The cumulative fiscal deficit of the Central Administration and the consolidated public sector through August 2010 were equivalent to about 90 percent of the ceilings for end-September 2010 set under the program. The authorities believe that the end-September 2010 fiscal targets were observed, and staff has no clear evidence to suggest otherwise. The authorities requested waivers of applicability of these performance criteria in the letter of intent, which staff supports.

## III. Structural Benchmarks

4. **The authorities have prepared a strategy paper to develop domestic capital markets in connection with a structural benchmark for end-September**. The strategy aims at reducing domestic and external borrowing costs and improving the credit rating of the country. Staff is evaluating the strategy and will report to the Board on the formal status of the benchmark at the time of the next review.

[3] Given the schedule for data reporting set in the technical memorandum of understanding (TMU), final information on observance of these targets should be available by November 5, 2010.

## Table 1. Dominican Republic: Quantitative Performance Criteria 2010-11 1/

| | Prog. | Actual | Margin | | Prog. | Actual | Margin | | Prog. | Actual | Margin | | Prog. | Prog. | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Mar | | | | Jun | | | | Sep | | | | Dec | Mar | Jun | Sep | Dec |
| | 2010 | | | | | | | | | | | | | 2011 | | | |
| **Fiscal Targets** | | | | | | | | | | | | | | | | | |
| 1. Overall balance of the central administration (floor) 2/ 3/ | -73.7 | -69.3 | 4.4 | ✓ | -88.4 | -87.5 | 0.9 | ✓ | -95.8 | … | … | | -102.3 | -14.9 | -21.3 | -27.9 | -33.5 |
| 2. Overall balance of the consolidated public sector (floor) 2/ 3/ | -97.5 | -91.3 | 6.2 | ✓ | -119.5 | -118.4 | 1.1 | ✓ | -133.0 | … | … | | -147.0 | -21.5 | -35.6 | -49.5 | -63.8 |
| **Electricity Targets** | | | | | | | | | | | | | | | | | |
| 3. Overall current balance of the public electricity sector (floor) 4/ | … | -201.4 | … | | … | -279.6 | … | | … | … | … | | … | -77.0 | -145.2 | -241.6 | -350.0 |
| **Monetary Targets** 4/ | | | | | | | | | | | | | | | | | |
| 4. Net international reserves (floor) 5/ | 1,730 | 2,025 | 296 | ✓ | 1,888 | 2,128 | 240 | ✓ | 1,643 | 1,967 | 324 | ✓ | 2,015 | 1,665 | 1,765 | 1,865 | 2,315 |
| 5. Net domestic assets (ceiling) 3/ | … | 57.5 | … | | … | 50.9 | … | | 73.2 | 59.1 | 14.1 | ✓ | 80.0 | 80.0 | 80.0 | 80.0 | 80.0 |
| **Debt Targets** | | | | | | | | | | | | | | | | | |
| 6. Accumulation of public arrears with electricity generators (ceiling) 2/ 5/ | 0.0 | 0.0 | 0.0 | ✓ | 0.0 | 0.0 | 0.0 | ✓ | 0.0 | 91.2 | 91.2 | X | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| 7. Accumulation of external public debt arrears 5/ 6/ | 0.0 | 0.0 | 0.0 | ✓ | 0.0 | 0.0 | 0.0 | ✓ | 0.0 | 0.0 | 0.0 | ✓ | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |

1/ Targets for end of the month, defined in the Technical Memorandum of Understanding.

2/ Cumulative flows from December 2008 for targets in 2010 and cumulative flows from December 2010 for targets in 2011.

3/ In billions of Dominican Republic pesos.

4/ Program targets are adjusted for shortfalls/excesses in external budgetary financing according to the Technical Memorandum of Understanding.

5/ In millions of U.S. dollars.

6/ Continuous target.

***Banco Central de la República Dominicana***
***Ministerio de Hacienda***
***Ministerio de Economía, Planificación y Desarrollo***

Santo Domingo, Dominican Republic
October 19, 2010

Mr. Dominique Strauss-Kahn
Managing Director
International Monetary Fund
Washington, DC 20431

Dear Mr. Strauss-Kahn:

In addition to our letter of intent of October 7, 2010 which reiterates our commitment to the program supported by a Stand-By Arrangement from the International Monetary Fund and outlines our policies for the rest of 2010 and 2011, we are sending this letter to bring the Executive Board up to date on recent developments. Unfortunately, due to delays in the approval of the Supplementary Budget for 2010, which authorizes additional transfers from the Ministry of Finance to the state electricity company (CDEEE) for 2010, the performance criterion on the accumulation of public sector arrears with private electricity generators for end-September, 2010 was missed by US$ 91.2 million. The budgetary allocation was transferred to CDEEE on September 30, 2010 and the payment to generators took several days. These arrears were cleared by October 6, 2010 and the ceiling of zero arrears has been observed since then. Accordingly, we request a waiver of non-observance of the performance criterion on the accumulation of public sector arrears with private electricity generators for end-September 2010. It is our policy to remain current in our obligations to electricity generators (under program definitions) and to all creditors and suppliers.

Sincerely yours,

| | | |
|---|---|---|
| _________/s/_________ | _________/s/_________ | _________/s/_________ |
| Héctor Manuel Valdez | Vicente Bengoa | Temístocles Montás |
| Governor of the Central Bank | Minister of Finance | Minister of Economy |

INTERNATIONAL MONETARY FUND

DOMINICAN REPUBLIC

# Second and Third Reviews Under the Stand-By Arrangement and Request for Waivers of Applicability—Informational Annex

Prepared by Western Hemisphere Department
(In collaboration with other departments)

Approved by Rodrigo Valdés and Dominique Desruelle

October 19, 2010

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## Annex I: Relations With the Fund

(As of September 30, 2010)

**I. Membership Status:** Joined on December 28, 1945; Article VIII

| **II. General Resources Account:** | **SDR Million** | **Percent of Quota** |
|---|---|---|
| Quota | 218.90 | 100.00 |
| Fund holdings of currency | 729.32 | 333.17 |
| Reserve Tranche Position | 0.00 | 0.00 |

| **III. SDR Department:** | **SDR Million** | **Percent of Allocation** |
|---|---|---|
| Net cumulative allocation | 208.83 | 100.00 |
| Holdings | 114.85 | 55.00 |

| **IV. Outstanding Purchases and Loans:** | **SDR Million** | **Percent of Quota** |
|---|---|---|
| Stand-By Arrangements (SBA) | 510.42 | 233.17 |

**V. Latest Financial Arrangements:**

| **Type** | **Date of Arrangement** | **Expiration Date** | **Amount Approved (SDR Million)** | **Amount Drawn (SDR Million)** |
|---|---|---|---|---|
| SBA | Nov 9, 2009 | Mar 8, 2012 | 1,094.50 | 279.27 |
| SBA | Jan 31, 2005 | Jan 30, 2008 | 437.80 | 437.80 |
| SBA | Aug 29, 2003 | Jan 31, 2005 | 437.80 | 131.34 |

**VI. Projected Payments to Fund:** 1/
(SDR million: based on existing use of resources and present holdings of SDRs):

| | Forthcoming | | | | |
|---|---|---|---|---|---|
| | 2010 | 2011 | 2012 | 2013 | 2014 |
| Principal | 38.53 | 110.76 | 72.23 | 129.45 | 139.64 |
| Charges/Interest | 1.74 | 5.92 | 4.62 | 3.43 | 1.68 |
| **Total** | 40.26 | 116.68 | 76.85 | 132.88 | 141.31 |

[1/] When a member has overdue financial obligations outstanding for more than three months, the amount of such arrears will be shown in this section.

**VII. Safeguards Assessment.** An update of the previous safeguards assessment of the Banco Central de la República Dominicana (BCRD), which was completed in April 2005, was conducted in the context of the Stand-By Arrangement approved by the Board on November 9, 2009. The assessment was completed on June 1, 2010 and noted that the BCRD had implemented some of the previous safeguards recommendations relating to its external and internal audit mechanisms, and the internal control framework. In addition, periodic reviews have been instituted by the Internal Audit Division of the compilation, reconciliation, and reporting of Net International Reserves and Net Domestic Assets at each test date under the SBA program, against definitions agreed under the Technical Memorandum of Understanding. However, there remain several weaknesses identified previously with regard to shortcomings in the Monetary and Financial Law (MFL), in particular with respect to the autonomy of the central bank. In addition, the BCRD continues to prepare its financial statements in accordance with accounting policies that do not reflect an internationally recognized financial reporting framework, such as the International Financial Reporting Standards (IFRS). A methodology for separately calculating realized from unrealized foreign currency gains/losses is also lacking. The authorities have undertaken to address the remaining weaknesses.

**VIII. Article IV Consultation**. The last Article IV consultation was concluded by the Executive Board on November 9, 2009.

**IX**. **FSAP Participation**. An FSAP update was completed in March, 2009. A Financial System Stability Assessment report for the Dominican Republic was issued on May 20, 2002. The corresponding FSAP report was issued in November 2001.

**X**. **Technical Assistance** has been substantial since 2004, and concentrated on financial sector supervision, tax reform and administration, and national accounts statistics.

**XI**. **Resident Representative**. The Fund representative office was closed in July 2008, but is scheduled to be reopened in November 2010. Mr. Mario Dehesa has been selected as resident representative.

**XII**. **Other**. The Dominican Republic has not yet ratified the Fourth Amendment.

## Annex II: Joint Management Action Plan (JMAP)

1. **The IMF and World Bank Dominican Republic teams held joint meetings and coordinated extensively in 2009-2010.**[1] There exist a close cooperation between the staff of the IMF and the World Bank. The regular meetings also included staff of the Inter-American Development Bank (IADB). The main focus of cooperation has been on electricity sector reform, an important part of the World Bank portfolio and of the structural reforms under the IMF Stand-By Arrangement (SBA). Discussions also included broad macroeconomic issues including fiscal and tax administration reforms, as well as poverty alleviation and external financing. In the fall of 2009 teams from all three international financial institutions (IFIs) met with President Fernández to establish a path for electricity sector reform, which eventually lead to the official reform strategy of the government. Subsequently, following the approval of the Stand-By Arrangement in November 2009, the three IFIs provided considerable external financing to help the government implement a counter-cyclical fiscal policy and address important structural reforms. The most recent meetings included participation of the IMF team in the ROC discussion of the second PASS loan due to be presented at the WB board in November 2010.

2. **Successful coordination between the WB and IMF teams has resulted in significant synergies between the policies supported by both institutions.** In practice this has meant a close cooperation in the design of policies in the IMF SBA and those supported by the forthcoming WB loan. Given the relevance of the electricity sector for macro balances, competitiveness and growth, it is expected that the cooperation between the IMF and the WB teams will continue in the future. The WB expertise on structural issues is well established and the IMF team is keen on cooperating with the WB to reinforce the momentum for structural reforms which are expected to support macro balance in the near to medium term. The call for cooperation has also arisen from the IMF board during its meeting for the discussion of the SBA on Nov 9, 2009, where several EDs reiterated the need for close cooperation with the WB on electricity and social issues.

3. **The WB and IMF teams meet informally in Washington every fortnight, have held joint meetings in the Dominican Republic and frequently share information and data.** Bi-weekly meetings are used to update country teams on developments and to discuss joint strategy in moving forward on country programs. In the course of 2010, IMF and WB missions have purposely overlapped in the Dominican Republic and the teams have had the opportunity to meet jointly with government officials, including the President of Dominican Republic, to discuss reforms of the energy sector. As a matter of routine, IMF missions have meetings with World Bank and IDB resident representatives.

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[1] The World Bank country director is Ms. Yvonne Tsikata and the IMF mission chief is Mr. Alejandro Santos. The list of staff members attending regular meetings include: Ali Alichi (IMF), Pedro Antmann (WB), Juliana Araujo (IMF), Geoffrey Bannister (IMF), Philippe Benoit (WB), Laura Berman (WB), Maurizio Bussolo (WB), Juan Miguel Cayo (WB), Rodrigo Chaves (WB), Carine Clert (WB), Ernesto Crivelli (IMF), Raphael Espinoza (IMF), Kenji Hosono (IMF), David Reinstein (WB), and Roby Senderowitsch (WB).

4. **The key macroeconomic and structural policy areas that have benefited from close coordination include:**

- ***Macroeconomic management*** (IMF). The current Stand-By Arrangement seeks to implement a gradual fiscal consolidation through 2012 to safeguard debt sustainability and anchor medium-term growth. The strategy is based on two pillars: improvements in tax administration and the rationalization of exemptions to increase tax pressure; and reform in the electricity sector to make it financially self-sustaining and reduce the transfers from the budget, freeing up resources for public investment.

- ***Institutional strengthening*** (IMF, World Bank and IADB). Structural reforms in a number of key areas to support growth and fiscal consolidation are included in the Stand-By Arrangement.

    - *Tax administration* (IMF, World Bank and IADB). A mission from the Fund in early 2010 identified priorities in tax administration reform and rationalization of tax exemptions. This effort is also being supported by World Bank and IDB projects which seek to establish a medium-term fiscal analysis and budgeting framework and improve the quality and efficiency of public expenditure.

    - *Prudential regulations* (IMF and World Bank). Based on the joint IMF-World Bank analysis of needs identified during the FSAP-Update, performed in early 2009, the Fund program seeks to introduce new practices in risk-based prudential regulation in line with Basel core principles.

    - *Inflation targeting* (IMF). The authorities have presented a plan to introduce a fully-fledged inflation targeting framework for monetary policy by early 2012.

    - *Reforming the energy sector* (IMF, World Bank and IADB). The institutions agreed on a path of reform that will improve the functioning of the electricity sector while reducing its impact on the government budget. The WB and the IDB have focused on management issues in the electricity distribution companies (EDEs) and other issues of microeconomic efficiency. Fund staff has concentrated on the integration of the electricity sector finances in the budget, reducing untargeted transfers to the sector, and overall macroeconomic implications of the sector.

    - *Capital market development* (IMF, World Bank). The authorities have made significant efforts to develop the local government debt market and plan to continue work to improve the primary and secondary markets for government debt, including by reforms to the regulatory and tax frameworks and institutional arrangements for market-making and clearing.

- ***Social safety net*** (World Bank and IADB). Multilateral development banks continue to devote a substantial portion of their portfolio to development projects in the health and education sectors, as well as sanitation and other pro-poor spending. The IMF has supported these efforts by including the expansion of the Solidaridad conditional cash transfer program and the widening the coverage of the Bonoluz program (a targeted electricity subsidy program) as structural benchmarks under the SBA.

## Annex III: Relations With the World Bank Group

(As of September 30, 2010)

1. The World Bank's total loan commitments in the Dominican Republic (DR) amounts to US$308.9 million, of which US$223.0 million remains to be disbursed. The loan portfolio consists of nine loans: seven for investment (Water and Sanitation in Tourist Areas, Early Childhood Education, Municipal Development, Health Sector Reform II, Youth and Development, Social Protection—including an additional financing of US$10 million—and Energy Distribution); one for Technical Assistance (Financial Sector) and an Emergency Recovery Loan.

2. The Municipal Development Project (US20 million) has been approved by the Lower Chamber and is expected to become effective in the first week of November. The second programmatic DPL (US$150 million) of the Performance and Accountability in the Social Sectors series will be negotiated in October and should be disbursed in the last two months of the year.

3. Portfolio performance in the Dominican Republic has improved substantially in terms of effectiveness delays and disbarment rates since February 2009. The portfolio review held form March 10-12, 2010, indicated a 35 percent decrease (on average) in effectiveness delays and an increase of almost a factor of four (on average) in the disbursement rate. Effectiveness delays went from 13.7 months to 8.9 months between February 2009 and March 2010. Disbursement rates went from 4.9 percent to 19.3 percent in the same period of time.

4. Both indicators also showed relative improvements when compare to LAC and the Caribbean region. In February 2009, effectiveness delays (on average) in DR were as twice as high as those of the LAC Region. Today, they are almost the same (DR: 8.9 months; LAC: 13.7 months).The same was also truth for the disbursement rate when compare to the Caribbean region. In February 2009, DR disbursement rate was as twice as low as the Caribbean (10.7 percent).

5. A comprehensive set of analytical studies has been completed in recent years. In FY 2009, a Growth Study CEM (Country Economic Memorandum), an update of the Financial Sector Assessment Program, a new Country Partnership Strategy (FY09-FY13), an update of the Report of the Observance of Standards and Codes (ROSC) in Accounting and Auditing and a set of Policy Notes that fed the National Development Strategy. The Bank is preparing several NLTS targeting: (i) social sectors, (ii) competitiveness, (iii) quality of public expenditures and (iv) risk management and climate change.

**A. IBRD and IDA Operations (as of September 30, 2010)**
(In millions of U.S. dollars)

| Active Projects | Sector | Commitments | Disbursements | Undisbursed |
|---|---|---|---|---|
| DO(APLI) Water and sanitation in tourist areas | Water | 27.5 | 1.1 | 26.4 |
| DO-Early childhood education project | Education | 42.0 | 35.7 | 6.3 |
| DO Financial sector technical assistance | Energy | 12.5 | 6.7 | 5.8 |
| DO Electricity distribution and rehabilitation | Energy | 42.0 | 0.4 | 41.6 |
| DO Social sectors investment program | Social Protection | 29.4 | 3.9 | 25.5 |
| DO Municipal Development | Agriculture and rural development | 20.0 | 0.0 | 20.0 |
| DO Youth development project | Social Protection | 25.0 | 12.3 | 12.7 |
| DO (APL2) Health reform, II | Health | 30.5 | 1.9 | 28.6 |
| DO Emergency recovery and disaster management | Emergency | 80.0 | 23.9 | 56.1 |
| **Total** | | **308.9** | **85.9** | **223.0** |

Source: World Bank

**B. IFC Operations (as of September 30, 2010)**
(In millions of U.S. dollars)

| | Loans | Equity | Quasi-Equity | Participants | Total |
|---|---|---|---|---|---|
| Held | 117.6 | 33.9 | 44.7 | 3.1 | 199.2 |
| Disbursements | 87.6 | 33.9 | 39.7 | 3.1 | 164.2 |

Source: World Bank

**C. MIGA (as of September 30, 2010)**
(In millions of U.S. dollars)

| | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 |
|---|---|---|---|---|---|---|
| Outstanding gross guarantees | 78.7 | 157.3 | 127.9 | 126.0 | 99.6 | 107.6 |

Source: World Bank

**D. IBRD and IDA Loan Transactions (fiscal year)**
(In millions of U.S. dollars)

| | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 |
|---|---|---|---|---|---|---|
| Disbursements | 40.4 | 39.4 | 69.1 | 19.9 | 351.2 | 16.7 |
| Repayments | 37.9 | 35.5 | 36.9 | 40.3 | 52.3 | 27.4 |
| Net lending | 2.5 | 3.9 | 32.2 | -20.4 | 298.9 | -10.7 |
| Valuation adjustments | … | … | … | … | … | … |
| **Debt outstanding** | **393.0** | **402.6** | **435.2** | **447.1** | **748.6** | **737.6** |
| Interest and charges | 19.9 | 21.1 | 22.6 | 23.8 | 20.7 | 14.4 |

Source: World Bank

## Annex IV: Relations With the Inter-American Development Bank

(As of September 30, 2010)

1. In 2010, the IDB estimates making disbursements for US$411 million, of which, US$200.00 million correspond to the Fiscal Strengthening Program. There will also be a $110.0 million disbursement from the Program to Support Competitiveness Policy–Phase II.

**Dominican Republic: Relations with the Inter-American Development Bank**

(In millions of U.S. dollars)

A. Operations

| Sector | Commitments | Disbursed | Undisbursed Amounts |
|---|---|---|---|
| Agriculture | 55.0 | 55.0 | 0.0 |
| Science and Technology | - | - | - |
| Urban Dev. And Housing | 10.0 | 7.3 | 2.7 |
| Education | 130.0 | 71.7 | 58.3 |
| Labor Market, Training, and Transfers | - | - | - |
| Sanitation | 31.3 | 8.5 | 22.8 |
| State Modernization | 541.5 | 306.0 | 235.5 |
| Health | - | - | - |
| Transportation | 50.0 | 10.5 | 39.5 |
| Private Sector Development | 11.0 | 10.2 | 0.8 |
| Disaster Prevention | 5.0 | 0.6 | 4.4 |
| Energy | 40.0 | 0.1 | 39.9 |
| Social Investment | 80.0 | 74.3 | 5.7 |
| Total | 953.8 | 544.3 | 409.5 |

B. Loan Transactions

| | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 |
|---|---|---|---|---|---|---|---|---|---|---|
| Disbursements | 142.4 | 184.1 | 155.1 | 254.2 | 135.7 | 118.1 | 109.5 | 137.4 | 485.0 | 411.3 |
| Repayments | 45.5 | 50.7 | 118.8 | 63.9 | 67.0 | 73.3 | 173.6 | 168.9 | 134.2 | 95.0 |
| Net Lending | 96.9 | 133.4 | 36.3 | 190.3 | 68.7 | 42.8 | 64.1 | -31.5 | 351.3 | 316.3 |
| Interests and Charges | 36.0 | 40.9 | 48.0 | 52.0 | 56.0 | 60.7 | 64.3 | 56.1 | 53.1 | 49.3 |
| Subscriptions and Contributions | 0.7 | 0.5 | 0.4 | 4.0 | 3.8 | 2.1 | 1.9 | 0.0 | 0.0 | 0.0 |
| Net Transfer | 60.2 | 92.0 | -12.1 | 134.3 | 8.9 | -17.9 | -128.4 | -87.6 | 298.2 | 267.0 |

2. For 2010, the Bank has been working on the preparation of five loans in the areas of education (US$ 50 million), agricultural innovation (US$ 30 million), water and sanitation (US$ 35 million), support competitiveness policy (US$ 120 million) and social protection (US$100 million). On September 27th, the Bank approved the Country Strategy for the period 2010–13.

INTERNATIONAL MONETARY FUND EXTERNAL RELATIONS DEPARTMENT

Press Release No. 10/399
FOR IMMEDIATE RELEASE
October 26, 2010

International Monetary Fund
Washington, D.C. 20431 USA

**IMF Executive Board Completes Second and Third Review Under Stand-By Arrangement with Dominican Republic, Approves US$249 Million Disbursement**

The Executive Board of the International Monetary Fund (IMF) has completed the second and third reviews of the Dominican Republic's economic performance under a program supported by a 28-month Stand-By Arrangement (SBA). The completion of the reviews allowed the immediate disbursement of an amount equivalent to SDR 158.5 million (about US$249 million at current rates), bringing total disbursements under the arrangement to an amount equivalent to SDR 437.8 million (about US$687.6 million at current rates).

The SBA was approved on November 9, 2009 (see Press Release No. 09/393), for an amount equivalent to SDR 1.1 billion (about US$1.72 billion at current rates), or 500 percent of the Dominican Republic's IMF quota. The first review of the program was completed on April 7, 2010 (see Press Release No. 10/137), for an amount equivalent to SDR 79.27 million (about US$124.5 million at current rates). The second review was postponed as authorities needed additional time to articulate policies for the second half of 2010.

In addition to completing the reviews on October 22, 2010, the Executive Board approved a waiver of non-observance for the end-September performance criterion for public sector arrears to electricity generators (which were subsequently corrected); and waivers of applicability for two fiscal targets for which data on performance were not available at the time of the Executive Board Meeting. The Executive Board also approved additional performance criteria for 2011 and structural benchmarks for 2010 and 2011. All quantitative and structural benchmarks for the second and third reviews were met.

Following the Executive Board's discussion, Mr. Murilo Portugal, Deputy Managing Director and Acting Chair, made the following statement:

"Following near stagnation at the beginning of last year, the Dominican economy is rebounding strongly. It is expected that real GDP will increase more than previously projected in 2010 and 2011, with low inflation. The positive economic activity has been achieved thanks to stimulative monetary and fiscal policies through mid-2010 and less adverse external conditions. The financial system has weathered the global crisis well.

"Fiscal policy has entered now a new phase in the second half of 2010 and the process of fiscal consolidation has appropriately begun. To ensure observance of the fiscal targets for 2010, the authorities exercising a strict control on current spending. The 2011 budget envisages a consolidated fiscal deficit of 3 percent of GDP, which represents an adjustment of 1 percent of GDP, to be achieved through a reduction in indiscriminate electricity subsidies and a strengthening of tax collections by rationalizing tax exemptions and improving tax administration, targets that are in line with the original program.

"The central bank has managed monetary policy flexibly and has a commendable track record in this area. Given the shrinking output gap, the central bank recently increased its policy rate to 4¾ percent—a still stimulative stance—after about a year of keeping it at 4 percent. The central bank indicated it stands ready to undertake further tightening if needed to confront eventual inflationary pressures. The authorities' plan to adopt inflation targeting by 2012 would be aided by a more flexible exchange rate. Continuing with the plan for recapitalization of the central bank is essential for monetary policy credibility. The authorities also plan to implement risk-based consolidated supervision which would further shield the banking system against financial shocks.

"Risks to the outlook remain balanced and could be managed with continued structural reforms and flexible macroeconomic policy. Reforms in the electricity sector, to lower its burden on public finances, and improvements in tax collections will be critical for fiscal sustainability."