

Dominican Republic

Informational Update

November 30th, 2004



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The economic and financial crisis

SECTION 1

Origins of the crisis

- In 2003 the Dominican Republic was hit by a severe economic crisis from which it is still only just recovering
- The crisis resulted from a combination of endogenous and exogenous factors, principally:
 - The collapse of a number of important domestic banks, which forced the Government to intervene at a considerable fiscal cost in order to avoid a systemic crisis
 - Adverse external conditions in the shape of a slowdown in the US and European economies and rising international oil prices



Features of the crisis

- The collapse of the domestic banks led to a generalised run on deposits as depositor confidence was eroded
- This run made the banking crisis more acute, and translated into massive capital flight
- The drain of reserves placed pressure on the exchange rate, which weakened from an average of DR\$17.6:US\$1 during December 2002 to DR\$49.2:US\$1 in February 2004
- Inflation rose drastically as a consequence, peaking at 65% on a 12-month basis in May 2004, whilst interest rates on the certificates issued by the Central Bank reached levels of more than 55%
- The resulting collapse of domestic demand strained public finances, already weakened by bank rescues that caused public debt to double to more than 55% of GDP



The 2004 Paris Club Agreement

- Faced with severe resource constraints, the Dominican Republic approached the Paris Club in April 2004 with a request for debt relief in the context of an IMF Stand-by programme
- The resultant agreement rescheduled arrears accumulated over 2003 and maturities falling due in 2004 over a period of 12 years, with six years' grace
- The agreement has provided cash flow relief of almost US\$200 million over 2004, and extended the average life of the treated debt by almost 10 years
- The debt relief provided by the Paris Club has been crucial to the Government's efforts to bridge fiscal and external financing gaps this year
- The 2004 agreement with the Paris Club includes a standard comparability of treatment clause obliging the Dominican Republic to seek comparable debt relief from other creditors



Recent economic developments

- Over the last six months, a degree of stability has returned to the macroeconomic environment, as witnessed in the key variables
- This stability began to take hold with the successful conclusion of the electoral process in May, and gathered momentum with the submission to Congress in July of the emergency fiscal adjustment package formulated by the newly-elected government of President Fernandez (the package received congressional approval in October)
- The nascent recovery in confidence is most obvious in the exchange rate, which has strengthened and stabilised at around DR\$30:US\$1
- Inflation has fallen by 15 percentage points from its peak to just over 45% on a 12-month basis, and the Central Bank is now able to place paper with longer tenors at annual rates of approximately 25%
- Despite this, the recovery remains fragile, and the Government continues to face considerable challenges





The 2005 economic programme

SECTION 2

Key features of the 2005 economic programme

- The broad aims of the Government are to ensure that the fragile recovery which is being witnessed takes root, and to establish the conditions required to sustain economic growth over the medium term
- This will be done by implementing an economic programme that:
 - Restores fiscal discipline and financial stability
 - Strengthens institutions in a way that enhances governance and promotes transparency
- This economic programme will be supported by a 24-month Stand-by arrangement with the IMF which has been agreed at the technical level, and which is scheduled to be approved by the IMF Executive Board in January 2005



Key features of the 2005 economic programme

- The principal elements of the programme are:
 - Macroeconomic and structural policies aimed at entrenching price stability and promoting the resumption of sustained growth
 - Improvements to the design and implementation of fiscal policy through institutional reform, so as to ensure the achievement of a sufficiently large fiscal adjustment
 - A strategy to strengthen the banking system and establish sound financial intermediation
 - Further strengthening of the Central Bank and banking supervision
 - A plan to improve the efficiency of the electricity sector and ensure its financial viability



The macroeconomic framework

Macroeconomic assumptions

	2004 ^f	2005 ^f	2006 ^f
Real GDP growth (% change)	1.8	2.5	4.0
Inflation (% , annual basis at end-period)	37.0	12-15	9.0
Current account balance (% of GDP)	6.1	4.5	2.8
Gross International Reserves (US\$ million)	742	1,169	1,795
NFPS primary surplus (% of GDP)	-0.8	2.3	3.2
NFPS balance (% of GDP)	-3.1	-0.7	0.7
Consolidated public sector balance (% of GDP)	-7.0	-3.9	-1.7
Gross public sector debt (% of GDP)	52.7	46.7	45.3

Source: Secretaria de Finanzas; BCRD; IMF



The fiscal adjustment programme

- The fiscal adjustment programme builds on the emergency fiscal package formulated by the newly-elected government of President Fernandez during the transition period and approved by Congress in October
- Comprising expenditure and revenue measures yielding approximately 2.8% of GDP, this emergency package seeks to curtail the fiscal imbalance and address the severe liquidity crunch facing the Government
- The Government's overriding objective on the fiscal front is now to complete the stabilisation of public finances, and introduce further policy and structural measures designed to deepen fiscal discipline and improve efficiency in fiscal management



Key fiscal measures introduced so far

- The tax reform package which was recently introduced included:
 - An increase in VAT from 12% to 16%
 - An increase in excise taxes on alcohol and tobacco
 - An inflation adjustment to fuel excises
 - A retargeting of subsidies on liquefied gas (LPG)
 - A reduction in electricity subsidies, and their complete elimination in the case of corporate users and high-end residential users
 - A reduction in the central government payroll
 - Greater use of the financial transaction tax



The 2005 budget

- The Government recently submitted the 2005 budget to Congress, in accordance with the parameters of the forthcoming IMF programme
- By entrenching the fiscal adjustment already underway, the 2005 budget seeks to reduce the deficit of the non-financial public sector (NFPS) from an estimated 3.1% in 2004 to approximately 0.7% of GDP
- The key measures contemplated in the 2005 budget are:
 - A freeze in central government employment
 - A containment of growth in non-priority recurrent spending
 - Further retargeting of LPG and electricity subsidies
 - The scaling back of public investment projects



Structural fiscal reforms

- The improvements to the fiscal position which will be brought about by the emergency fiscal package and the 2005 budget will be complemented by a number of structural fiscal reforms:
 - A tax reform designed to increase revenue by broadening the tax base, whilst simplifying the tax system and phasing out distortionary taxes in line with the DR/CAFTA
 - Improvements to tax compliance
 - The reform of current budget, procurement, treasury, public debt, and financial management system practices
 - Enhanced expenditure monitoring and control
 - Improvements to the management and control of externally-financed capital expenditure



Monetary policy

- The monetary programme is designed to strengthen the Central Bank's ability to pursue inflation and interest rate objectives, while remaining committed to a unified and competitive foreign exchange market
- Monetary policy will be consistent with further declines in inflation (which will reach single-digit levels by 2006), and will observe strict limits on monetary aggregates whilst allowing for an increase in international reserves (of approximately US\$500 million in the 2005-06 period)
- In this context, the Central Bank will continue its efforts to mop up excess liquidity, reduce the quasi-fiscal deficit, and limit roll-over risk by increasing the issuance of certificates with longer maturities and lower rates of interest
- With these aims in mind, the Central Bank is introducing the public auction of indexed instruments
- The Government is committed to recapitalising the Central Bank



Banking system reform

- The strategy for banking system reform seeks to:
 - Strengthen the financial system, through a bank recapitalisation programme
 - Strengthen the institutional framework, by fostering better Central Bank/Superintendency governance and accountability
- The financial system will be strengthened through:
 - The elimination of forbearance
 - The introduction of a minimum capital ratio of 10% of risk-weighted assets
 - A transition from local to international rules for asset valuation
 - Rehabilitation/penalties for undercapitalization
 - Equal capitalisation for public and private-sector banks
 - A stronger regulatory framework



Banking system reform

- The institutional framework will be improved through:
 - A strengthened Monetary Board
 - Steps to increase the independence and accountability of the Central Bank and the Superintendency of Banks through the extension of appointment periods for the board and managers
 - The introduction of an improved system to monitor bank liquidity
 - A permanent freeze on further compensation to resolved banks
 - Continued efforts to bring to justice those responsible for the recent bank failures
 - Efforts to strengthen other financial intermediaries





The 2005 financing outlook

SECTION 3

The 2005 financing outlook

- Despite the considerable fiscal adjustment being implemented by the Government, and the expectation that the general macroeconomic environment will continue to improve, significant fiscal and external financing gaps are projected for 2005
- The NFPS is expected to post a primary surplus of 2.3% of GDP in 2005, but will face a domestic financing gap of approximately US\$424 million in 2005 after taking negative net domestic financing into account
- The Government will seek to cover most of this gap with positive net external financing made possible by disbursements from largely official sources on project and non-project related facilities
- Despite this, it is estimated that the NFPS is facing an overall financing shortfall in the region of almost US\$190 million in 2005
- This shortfall is also reflected in the balance-of-payments, which is expected to register a financing gap of a similar magnitude next year
- Preliminary estimates indicate that the shortfalls in the fiscal accounts and the balance-of-payments will continue into 2006





Appendices





Appendix A



NFPS balance and financing

	2003	2004	2005
	Est.	Proj.	Proj.
A. NFPS balance (DR\$ bn)	-24.4	-23.2	-6.7
Central government balance	-22.8	-24.0	-6.7
Total Revenue and Grants	81.3	127.6	154.5
Current revenue	80.1	126.4	151.8
<i>of which: tax revenue</i>	74.7	116.9	140.9
Capital revenue	0.0	0.0	0.0
Grants	1.2	1.2	2.7
Total Expenditure	104.1	151.6	161.2
Current expenditure	59.5	93.8	118.1
<i>of which: interest payments</i>	9.7	14.8	22.0
Capital expenditure	16.3	41.0	38.6
Other expenditure	28.2	16.8	4.5
Rest NFPS	-1.6	0.7	0.0
B. Domestic financing (DR\$ bn)			-9.3
Commercial banks			-0.9
Arrears to suppliers			-2.9
Other			-5.5
Domestic Gap (DR\$ bn) =[A+B]			16.0
C. Domestic Gap (in US\$m)			424
D. External financing (US\$m)			238
Disbursements			886
World Bank (budget support)			150
IDB (budget support)			60
Caracas agreement			226
Project-loan			451
Amortizations			-648
Central government			-610
Rest NFPS			-38
E. Financing Gap (US\$m) -[C+D]			186

Note: figures may not add due to rounding

Source: Secretaria de Finanzas; BCRD; IMF





Appendix B



Balance of payments

US\$ million	2003	2004	2005
	Est.	Proj.	Proj.
Current account	1,036	1,054	445
Trade balance	-2,156	-2,244	-2,744
Exports f.o.b.	5,471	5,710	5,384
Imports f.o.b.	-7,627	-7,954	-8,128
<i>Of which</i> : oil	-1,416	-1,850	-2,517
Nonfactor services	2,254	2,322	2,353
<i>Of which</i> : travel	2,845	2,858	2,913
Factor services	-1,393	-1,486	-1,764
<i>Of which</i> : interest on public debt	-282	-367	-471
Transfers	2,330	2,462	2,764
Capital account	2,004	825	1,106
Direct investment	1,011	654	769
Portfolio investment	-68	-30	-30
Other medium- and long-term investment	1,060	200	375
Public sector	1,209	58	189
Disbursements	1,719	711	889
Amortization	-510	-653	-700
Private sector	-149	143	179
Other capital, including errors and omissions	-3,302	-1,720	-1,535
Overall balance	-262	159	18
Financing	262	-409	-206
Exceptional Financing	10	-7	0
Change in NIR (increase, -)	252	-402	-206
FINANCING GAP	0	250	188

Source: Secretaria de Finanzas;BCRD; IMF





Appendix C



The External Public Debt of the Dominican Republic

Medium- and long-term public external debt by creditor as of 30 September 2004

(US\$ million)	Debt Outstanding				
	As of 30-Sep-04	Of which arrears		Oct-Dec 2004	
		P	I	P	I
TOTAL	6,375.4	228.7	104.1	204.9	85.1
I. Multilateral	1,963.6	5.7	3.1	31.0	21.3
IADB	1,322.0	2.8	1.3	19.0	11.5
World Bank	389.0	2.9	1.7	10.5	7.6
IMF	192.9	0.0	0.0	0.0	2.0
Others	59.7	0.0	0.0	1.5	0.2
II. Bilateral	2,128.4	185.2	62.6	131.0	43.4
Paris Club	1,838.6	174.6	59.8	110.5	35.1
Non-Paris Club	289.8	10.6	2.7	20.5	8.3
III. Banks	339.2	30.1	7.5	31.4	5.4
IV. Bonds	1,551.2	0.0	23.8	0.0	3.4
(a) Brady bonds	427.4	0.0	0.0	0.0	3.4
(b) Eurobonds	1,123.8	0.0	23.8	0.0	0.0
V. Suppliers	393.0	7.6	7.3	11.5	11.5

Source: BCRD; Secretaria de Finanzas



The External Public Debt of the Dominican Republic

Medium- and long-term public external debt by creditor as of 30 September 2004

(US\$ million)

	Total 2005			2006		
	P	I	Total	P	I	Total
Total	700.2	432.3	1,132.5	1,263.1	430.4	1,693.5
I. Multilateral	121.9	104.0	225.9	139.7	107.1	246.8
IADB	72.7	67.7	140.4	79.4	70.9	150.3
World Bank	43.1	23.8	66.9	39.2	22.2	61.3
IMF	0.0	11.6	11.6	15.8	13.1	28.8
Others	6.1	0.9	7.0	5.4	1.0	6.4
II. Bilateral	375.1	137.6	512.7	447.8	135.1	582.9
Paris Club	325.6	117.1	442.7	365.9	112.5	478.4
Non-Paris Club	49.6	20.5	70.1	81.9	22.5	104.5
III. Banks	139.7	20.2	159.9	117.1	14.3	131.4
IV. Bonds	19.8	120.1	139.9	519.8	127.5	647.3
(a) Brady bonds	19.8	18.4	38.2	19.8	25.8	45.6
(b) Eurobonds	0.0	101.7	101.7	500.0	101.7	601.7
V. Suppliers	43.6	50.5	94.1	38.7	46.4	85.2

Source: BCRD; Secretaria de Finanzas



The External Public Debt of the Dominican Republic

Medium- and long-term public external debt by creditor as of 30 September 2004

(US\$ million)

	2007			2008			2009		
	P	I	Total	P	I	Total	P	I	Total
Total	843.8	345.4	1,189.2	814.6	306.2	1,120.8	754.3	270.7	1,025.0
I. Multilateral	295.8	102.7	398.5	420.6	90.5	511.1	394.3	76.1	470.4
IADB	139.0	69.1	208.1	127.9	62.5	190.4	131.2	56.1	187.2
World Bank	45.7	20.5	66.2	50.1	18.3	68.4	58.2	15.5	73.7
IMF	106.4	12.2	118.5	238.4	8.9	247.3	200.9	3.8	204.8
Others	4.7	0.9	5.6	4.2	0.8	5.0	4.0	0.8	4.8
II. Bilateral	402.8	113.6	516.4	308.2	95.6	403.8	297.0	80.9	377.9
Paris Club	328.0	94.6	422.6	251.0	80.3	331.3	242.1	68.7	310.8
Non-Paris Club	74.8	19.0	93.8	57.3	15.3	72.5	54.9	12.2	67.1
III. Banks	88.6	6.2	94.8	27.4	1.3	28.8	2.6	0.1	2.7
IV. Bonds	19.8	78.8	98.5	19.8	77.4	97.2	19.8	76.3	96.1
(a) Brady bonds	19.8	24.5	44.3	19.8	23.2	43.0	19.8	22.1	
(b) Eurobonds	0.0	54.2	54.2	0.0	54.2	54.2	0.0	54.2	54.2
V. Suppliers	36.9	44.1	81.0	38.6	41.3	79.9	40.6	37.3	77.9

Source: BCRD; Secretaria de Finanzas

