

**FOR
AGENDA**

EBS/05/9
Correction 1

January 27, 2005

To: Members of the Executive Board

From: The Secretary

Subject: **Dominican Republic—Request for Stand-By Arrangement, Activation of the Trade Integration Mechanism, Cancellation of Current Arrangement, and Extension of Repurchase Obligation**

The attached factual corrections to EBS/05/9 (1/18/05) have been provided by the staff:

Page 7, para. 5, line 12: for “the government was able to”
read “the government reported that it was able to
new footnote 2: Added to read “This amount excludes about US\$7.6 million of arrears due to various external suppliers by the state-owned electricity holding (CDEEE) that are in dispute and about US\$6.6 million of arrears on a publicly-backed turn-key project that are also under discussion.”
Subsequent footnotes renumbered.

Page 28, heading, below columns 3 and 4: Added “Indicative”
footnote 4: for “Actual figures...foreign currency deposits.”
read “Figures include reserve requirements in the form of investment certificates and exclude reserve requirements on foreign currency deposits.”

Page 30, Table 1c, footnote 6: for “Include reserve requirement on investment certificates.”
read “Includes reserve requirements in the form of investment certificates.”

Page 54, Core Statistical Indicators: Updated as of January 18, 2005

Questions may be referred to Mr. S. Phillips (ext. 37187), Mr. Lopetegui (ext. 39688), and Mr. Cubeddu (ext. 36231) in WHD.

This document will shortly be posted on the extranet, a secure website for Executive Directors and member country authorities.

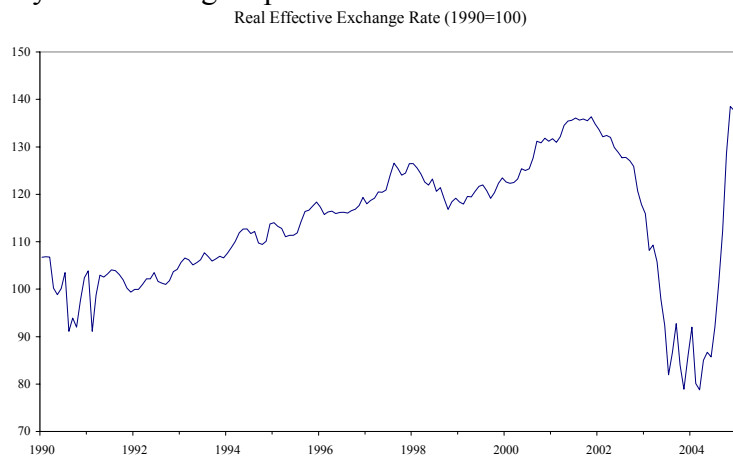
Att: (4)

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the third quarter. Still, without a fiscal correction, arrears accumulated further, and by August the government was approaching default on all categories of its debt. Very little progress on bank reforms was made during the political transition period.

5. **At his inauguration on August 16, President Fernández announced an emergency plan for the first 100 days of his administration, emphasizing the need for immediate fiscal tightening and a new agreement with the Fund.** To underscore ownership of the new economic program, the new authorities preferred to cancel the existing arrangement and seek a new SBA. The fiscal effort began with prompt across-the-board expenditure restraint, followed by other measures that could be implemented by the executive branch: higher excises, cuts in LPG and electricity subsidies, and cuts in public employment. In a political breakthrough, the opposition-controlled congress approved a tax package—worth 1.7 percent of GDP on an annual basis, and including a 4 percentage point rise in the VAT rate—that took effect on October 1, 2004. On the financing side, the authorities reaffirmed their country’s commitment to the terms of the April 2004 Paris Club agreement, including the need to obtain comparable treatment from non-Paris Club creditors. Late in the year, the government reported that it was able to eliminate all arrears to official creditors (though some US\$45 million in late payments to foreign commercial banks and suppliers remained)².

6. **Markets responded positively to these policy efforts.** Sovereign bond spreads have declined and the peso strengthened markedly—recovering its pre-crisis level in real terms. The stronger-than-expected peso recovery, in turn, further helped the fiscal accounts, by reducing electricity sector and debt service costs, initiating a virtuous cycle, and pulling down inflation. The decline in inflation and in inflation expectations prompted a market-led decline in interest rates on central bank paper, from near 60 percent in August to around 25 percent in December. Improvement in confidence also allowed the central bank to extend the average maturity of new issues of certificates, from less than 3 weeks to about 5 months. Meanwhile, the central bank kept liquidity growth low, even as it took the opportunity to begin rebuilding reserves (Figure 1).



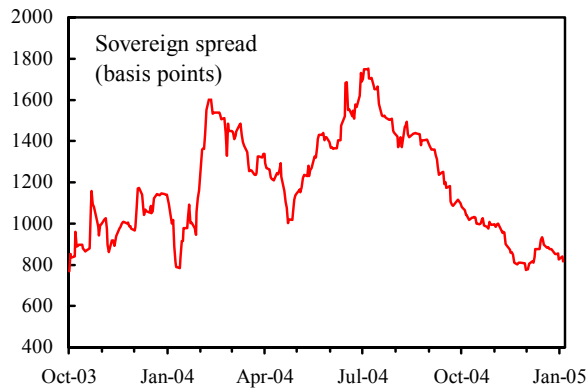
7. **Macroeconomic outcomes for 2004 were thus mixed, but in most areas tended to improve as the year progressed:**

- A restrictive monetary policy took most of the policy burden in achieving a degree of stability, and in time became successful. While inflation for the year was far beyond program (29 percent compared to 14 percent), the entire deviation arose in the first

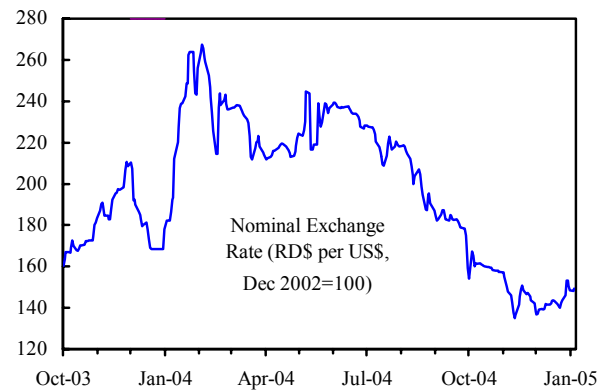
² This amount excludes about US\$7.6 million of arrears due to various external suppliers by the state-owned electricity holding (CDEEE) that are in dispute and about US\$6.6 million of arrears on a publicly-backed turn-key project that are also under discussion.

Figure 1. Dominican Republic: Selected Indicators

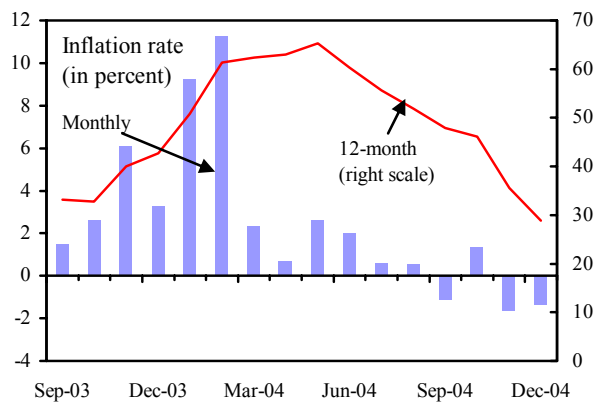
Sovereign spreads have declined markedly...



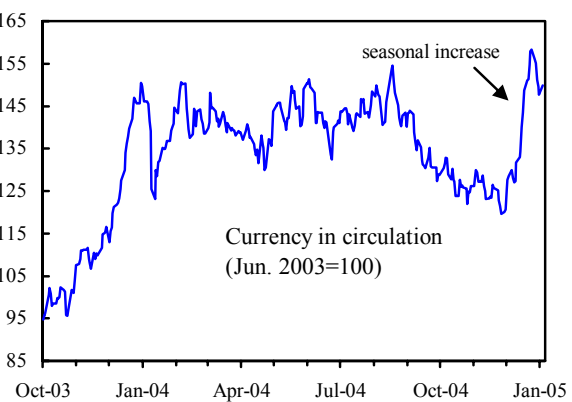
... and the peso also has recovered strongly since the May presidential elections.



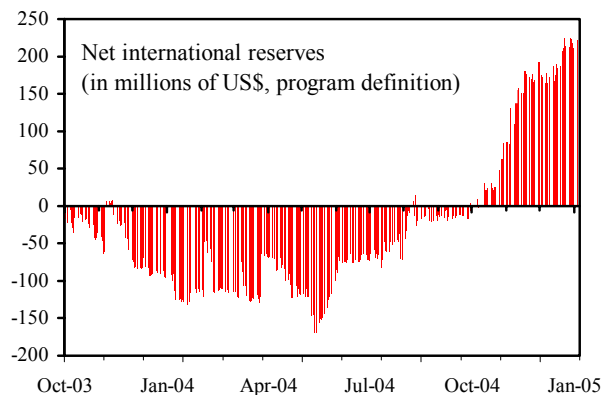
Inflation has fallen sharply...



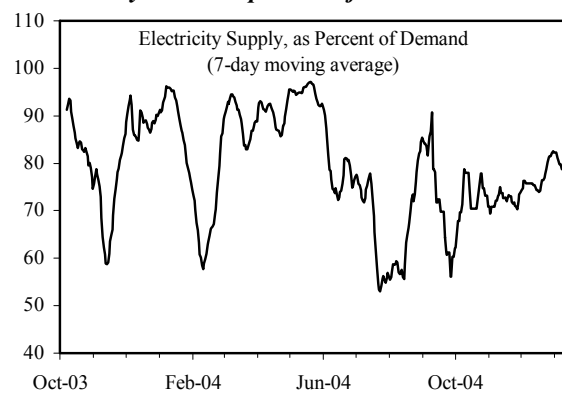
...as the central bank has been able to contain liquidity growth...



...while rebuilding international reserves through market purchases.



Electricity supply has been more stable lately, but meets only about 75 percent of demand.



Source: Central Bank of Dominican Republic, JP Morgan, Organismo Coordinador del Sistema Electrico, and Fund staff estimates.

B. Extension of Repurchase Expectations

1. The Dominican Republic has requested an extension to the obligations schedule of the time-based repurchase expectation in the credit tranches, in an amount equivalent to SDR 10.945 million, that arises in 2005 on December 2nd.
2. The Fund approves the request.

Table 1a. Dominican Republic: Quantitative Performance Criteria and Indicative Targets under the Previous SBA in 2004 1/

	Program				Actual			Est.		Comments
	Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep.	Dec.		
1. Quantitative Performance Criteria										
(In millions of Dominican Republic pesos)										
A. Non financial public sector (NFPS) balance (cumulative floor)	300	760	1,300	1,140	-12,884	-19,585	-18,581	-21,279		Not observed
B. Change in NFPS borrowing from the banking system (cumulative ceiling)	-5,250	-6,130	-7,180	-10,360	-1,121	5,277	2,308	7,310		Not observed
C. Central bank net domestic assets (ceiling) 2/	71,540	72,200	70,700	75,850	75,087	88,166	85,246	82,606		Not observed
(In millions of U.S. dollars)										
D. Gross accumulation of public sector external arrears (cumulative ceiling)	0	0	0	0	54	53	81	175		Not observed
E. Contracting of external debt (cumulative ceiling)	800	950	1,330	1,580	1,056	1,067	1,091	...		Not Observed (except Sep./Dec.)
F. Central Bank NIR (floor) 3/	-100	-100	-50	0	-67	-72	6	211		Observed
2. Indicative Targets										
(In millions of Dominican Republic pesos)										
A. Central government expenditures (cumulative ceiling)	24,700	49,600	74,050	101,000	40,560	80,575	115,924	149,335		Not observed
B. Quasi-fiscal loss of the central bank (cumulative ceiling)	6,740	13,300	19,200	25,050	5,651	14,200	22,769	31,034		Not observed (except March)
C. Change in central government deposits in central bank (cumulative floor)	4,770	5,300	6,000	8,350	4,780	-2,864	-3,268	-3,024		Not observed (except March)
D. Money base (ceiling) 4/	67,540	68,200	68,700	75,850	72,410	85,272	85,483	91,054		Not observed
Of which: Reserve requirement on investment certificates	7,765	12,680	12,680	12,680		

1/ Cumulative change are relative to end-Dec 2003.

2/ Defined as difference between base money and NIR at an accounting exchange rate of DR\$40 per US\$.

3/ Excludes reserves requirements on foreign currency deposits.

4/ Figures include reserve requirements in the form of investment certificates and exclude reserve requirements in foreign currency deposits.

Table 1b. Dominican Republic: Structural Performance Criteria and Benchmarks under the Previous SBA in 2004 1/

	Date Expected	Outcome
Structural Performance Criteria		
1. Approval of MPL by-laws on capital adequacy, eliminating any existing forbearance on loan provisioning, and on prudential regulations governing loan classification and provisioning, on the basis of international best practices	Feb. 2004	Completed, but with delay. 1/
2. Finalize the design of a comprehensive strategy for the restructuring of undercapitalized banks	Feb. 2004	Completed.
3. Submission to congress of tax reform proposal.	Jul. 2004	Not completed.
4. No administrative interference in the foreign exchange market.	Continuous	Observed.
Structural Benchmarks		
1. Completion of all internationally assisted inspection reports.	Jan. 2004	Completed, but with delay
2. Approval of exchange market by-law.	Feb. 2004	Observed.
3. Establishment of a governance structure to manage and dispose of assets acquired as a result of the resolution of problem banks.	Feb. 2004	Not completed. Work is ongoing.
4. Completion of a plan for the institutional strengthening of the superintendency of banks.	Feb. 2004	Not completed. Work is ongoing.
5. Establishment of procedures for an independent review by the central bank controller of the program data reported to the Fund and the bank's accounting records; and initiation of an independent risk management and bank-wide internal control review of the central bank.	Feb. 2004	Partially completed. Work ongoing.
6. Technical discussion for a proposal of tax reform.	Mar. 2004	Completed, but with delay. 2/
7. Approval of by-laws on: (i) related-party credit and definition of economic groups; (ii) external auditors; (iii) consolidated accounting in line with international best practices; and (iv) fit and proper conditions for bank managers and shareholders.	Mar. 2004	Partially completed. 3/
8. Establishment of an independent committee at the central bank to oversee the bank's external and internal audit functions; approval of the new role, reporting lines, and scope of activities of the Internal Audit Department (IAD); and beginning of preparation of an action plan for strengthening capacity of the IAD.	Mar. 2004	Completed with delay. 4/

1/ Capital adequacy regulation passed only 30 March, 2004, and the elimination of forbearance was transferred to the asset evaluation regulation, which was approved on Dec.29, 2004.

2/ Completed in April 2004.

3/ Item (i) observed; (ii) completed August 2004; (iii) not completed (now rescheduled for March 2005); (iv) completed May 2004.

4/ Finalized in December 2004.

Table 1c. Dominican Republic: Quantitative Performance Criteria and Indicative Targets for 2005–06

	Estimate Dec-04	Performance criteria		Indicative targets		
		Mar-05	Jun-05	Sep-05	Dec-05	Dec-06
I. Quantitative Performance Criteria 1/						
(In billions of Dominican Republic pesos)						
A. Nonfinancial public sector (NFPS) balance (cumulative floor) 2/	-2.7	-6.0	-6.6	-7.3	-9.1	7.1
B. Central Bank net domestic assets (ceiling) 3/	25.1	26.0	24.5	22.5	26.5	21.3
(In millions of U.S. dollars)						
C. Gross accumulation of public sector external arrears (continuous ceiling)	0	0	0	0	0	0
D. Contracting of external debt by the public sector (cumulative ceiling) 2/ 4/	200	380	655	855	1,105	950
E. Central Bank NIR, excluding bank's foreign currency deposits (floor)	211	150	200	225	350	650
II. Indicative Targets						
(In billions of Dominican Republic pesos)						
A. Change in NFPS net credit from the domestic banking system (cumulative ceiling) 2/ 5/	4.8	6.5	5.0	3.0	1.0	-7.5
B. Monetary base, excluding reserves on foreign currency deposits (ceiling) 6/	91.1	89.4	91.8	93.0	104.0	117.4

1/ As defined in the Technical Memorandum of Understanding. Performance criteria are proposed for March and June 2005.

At the time of the first review, performance criteria will be set for September and December 2005.

2/ For 2005, cumulative from end-September 2004. For 2006, cumulative from the beginning of the year.

3/ Defined as currency in circulation less NIR (program definition) valued at the accounting exchange rate of DR\$35 per US\$.

4/ Ceilings exclude any new debt instruments issued as part of the process of debt restructuring and rescheduling.

5/ Credit is defined on a net (of deposits) basis, and includes the central bank.

6/ Includes reserve requirements in the form of investment certificates.

monthly. The SB publishes (in hardcopy form) its Boletín Informativo (on banking statistics) twice a year monthly banking statistics are available on-line with a lag of one month.

Balance of payments

Since February 1997, balance of payments statistics adopted the methodology suggested in the fifth edition of the Balance of Payments Manual. However, problems in coverage remain in imports, capital transfers, income, and the financial account, giving rise to large errors and omissions. Most recent revisions of the statistics were made in May 2002. The Monetary and Financial Law establishes sanctions for noncompliance with reporting obligations to the CBDR. Three missions of technical assistance took place (in late 2002, mid 2003, and late 2004) to assist the CBDR in improving balance of payments statistics and preparing the International Investment Position (IIP). IIP statistics should become available in early 2005. The compilation of the external accounts complies with the requirements of the GDDS in terms of periodicity and timeliness.

Data dissemination

The authorities publish quarterly reports on economic developments. The reports contain timely preliminary data on real GDP, consumer prices, interest rates, exchange rates, balance of payments, exports and imports, operations of the central government, and the banking system. The Quarterly Bulletin of the CBDR contains more detailed information on sectoral developments, but the bulletin is published with delays of about four months. The CBDR also maintains a website that presents selected data on a relatively timely basis. Participation in the General Data Dissemination System (GDDS) is expected by early 2005 after the completion of a comprehensive set of metadata, which is being translated in the IMF for immediate publication.

DOMINICAN REPUBLIC—CORE STATISTICAL INDICATORS
As of January 18, 2005

	Exchange Rates	International Reserves	Central Bank Balance Sheet	Reserve/ Base Money	Broad Money	Interest Rates	Consumer Price Index	Exports/ Imports	Current Account Balance	Government Revenue	Government Spending	GDP/ GNP	External Debt/ Debt Service
Date of Latest Observation	1/17/05	1/17/05	November 04	1/17/05	November 04	1/14/05	December 04	Q3 04	Q3 04	November 04	November 04	Q3 04	Q3 04
Date Received	1/18/05	1/18/05	Week of 12/20/04	1/18/04	Week of 12/20/04	1/18/05	Week of 1/10/05	10/15/04	10/15/04	Week of 12/20/04	Week of 12/20/04	11/15/04	10/15/04
Frequency of Data	Daily	Daily	Monthly	Daily	Monthly	Daily	Monthly	Quarterly	Quarterly	Monthly	Monthly	Quarterly	Quarterly
Frequency of Reporting	Daily	Daily	Monthly	Daily	Monthly	Daily	Monthly	Quarterly	Quarterly	Monthly	Monthly	Quarterly	Quarterly
Source of Data	CBDR	CBDR	CBDR	CBDR	CBDR	CBDR	CBDR	CBDR	CBDR	CBDR	CBDR	CBDR	CBDR
Mode of Reporting	E-mail	E-mail	E-mail	E-mail	E-mail	E-mail	E-mail	E-mail	E-mail	E-mail	E-mail	E-mail	E-mail
Confidentiality	Unrestricted	Unrestricted	Unrestricted	Unrestricted	Unrestricted	Unrestricted	Unrestricted	Unrestricted	Unrestricted	Unrestricted	Unrestricted	Unrestricted	Unrestricted
Frequency of Publication	Monthly	Monthly	Monthly	Monthly	Monthly	Monthly	Monthly	Quarterly	Quarterly	Monthly	Monthly	Quarterly	Quarterly