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IMF Executive Board Approves US$ 665 Million Stand-By Arrangement for the Dominican Republic, Extends Repayment Expectations

The Executive Board of the International Monetary Fund (IMF) approved a 28-month SDR 437.8 million (about US$ 665.2 million) Stand-By Arrangement for the Dominican Republic to support the country's economic program through May 2007. An amount equivalent to SDR 52.54 million (about US$79.8 million) will be made available immediately under the arrangement to the Dominican Republic. In addition, the Executive Board approved the authorities' request for an extension of repayment expectations that arises in December 2005 to an obligation schedule in an amount equivalent to SDR 10.94 million (about US$16.6 million).

The Executive Board took note of the authorities' intention to avail themselves of the Trade Integration Mechanism (TIM), in light of the possible effect on the Dominican Republic of the end of the textile quotas under the WTO's Agreement on Textiles and Clothing. Should the impact of the end of these quotas be greater than anticipated, the TIM's deviation feature would allow an augmentation of the Stand-By Arrangement by up to 10 percent of quota, or SDR 21.89 million (about US$33.3 million).[1]

Today's decision also cancelled the Stand-By Arrangement for the Dominican Republic approved on August 29, 2003 (see Press Release No. 03/147), and due to expire in August 2005.

Following the Executive Board's discussion of the Dominican Republic, Agustín Carstens, Deputy Managing Director and Acting Chair, made the following statement:

"The Dominican Republic is emerging from the economic crisis caused by the uncovering of a banking sector fraud in 2003-04. This, together with the failure to implement key elements of the Fund-supported program, had undermined confidence and set off a vicious circle of economic deterioration.

"Aware of the urgency of introducing corrective policies, the government that took office in August 2004 moved quickly to implement policies, including a substantial fiscal adjustment, that led to a significant improvement in macroeconomic indicators, including a return to real GDP

[1] For an explanation of the TIM see Press Release No. 04/73

growth, and a major turnaround in confidence. The measures included a major revenue-raising package approved by Congress in October 2004 and important expenditure cuts, particularly in energy subsidies and the government payroll.

“These and other essential measures that the government has recently implemented underscore the authorities’ commitment to their program. By consolidating the recent macroeconomic stabilization and introducing structural reformsn the fiscal, monetary, banking and electricity sectors, the program seeks to re-establish the basis for the high rates of economic expansion the Dominican Republic enjoyed in the 1990s.

“A tight fiscal policy and institutional reforms in the public sphere are at the heart of the program, which envisages an increase in the fiscal primary surplus to a level that would allow a gradual reduction in the public debt burden over the medium term. The fiscal effort will be underpinned by policy reforms aimed at further improving the design and application of fiscal policy, as well as the equity and efficiency of the tax system. The authorities are encouraged to monitor fiscal developments closely and take prompt remedial actions if needed to ensure the success of their economic program.

“Monetary policy will seek to reduce inflation to single digits by 2006, in the context of a floating exchange rate regime. To strengthen the central bank and ensure that monetary policy remains effective, the program envisages a reduction of the central bank’s quasi-fiscal losses, and measures to increase the independence and accountability of the monetary and financial supervisory authorities.

“The reform of the banking system will center on steps to strengthen the regulatory framework, including the adoption of consolidated accounting and supervision, and ensuring that all banks comply with the phased implementation of asset valuation and capital adequacy norms based on international best practices.

“As regards the electricity sector, the strategy is to bring about a quick, sharp reduction of the sector’s deficit while proceeding with reforms to ensure its viability over the medium term. The success of this approach will be critical to improving the public finances and freeing up resources to expand social programs.

“The government will seek to restructure its debt in order to obtain cash flow relief during 2005-06. The authorities intend to pursue a market-friendly restructuring of the public debt, with widespread creditor participation and comparability of treatment for the different classes of creditors,” Mr. Carstens said.

ANNEX

Recent Economic Developments

The Dominican Republic has struggled to overcome the crisis that began in early 2003. At that time, the failure of some significant fraud-ridden banks was followed by a major bailout of depositors that in turn led to jumps in both public debt and monetary growth, high inflation, a sharp peso depreciation, and a generalized loss of confidence. Weakness in implementing an IMF-supported economic program adopted by the government in August 2003 led to a further deterioration in the country's economic performance: although the banking crisis was contained, the fiscal adjustment was insufficient to stabilize the country's public finances, triggering an added loss in confidence and a new wave of instability in late 2003 and early 2004.

Economic policies and confidence improved during the course of 2004. Monetary policy was tightened, leading to some strengthening of the peso and a decline in inflation. The election of a new President in May sparked a turnaround in confidence, and a strong fiscal adjustment began soon after the new government took office in August. The former vicious circle of deteriorating macroeconomic indicators began to reverse as the peso recovered strongly, inflation dropped sharply, and the balance of payments improved.

Program Summary

The authorities' new program aims at consolidating the recent macroeconomic stabilization through a series of actions on the structural front, that will address a wide range of governance and transparency weaknesses in the fiscal, monetary, banking and electricity sectors.

Real GDP growth is projected to rise from 2 percent in 2004 to 2.5 percent in 2005 and to 4-5 percent a year over the medium term, as confidence and domestic demand recover further. End-of period inflation is targeted to drop from 29 percent in 2004 to 11-13 percent in 2005 and to 8 percent in 2006. The external current account surplus is projected to decline from 5.8 percent of GDP in 2004 to 0.5 percent in 2006, mainly reflecting higher imports driven by the economic recovery and the recent strengthening of the peso, as well as higher oil prices. In parallel, private capital outflows are projected to decline and net international reserves are targeted to increase by US$140 million in 2005 and by an additional US$300 million in 2006.

Consolidation of the public finances and institutional reforms in the fiscal area are essential elements of the program. The nonfinancial public sector (NFPS) balance is targeted to improve by 3.5 percentage points of GDP over the next two years—moving from a deficit of 2.7 percent of GDP in 2004 to one of 0.7 percent in 2005, and to a surplus of 0.7 percent by 2006. This important fiscal adjustment is underpinned by the government's recently adopted measures, including the tax package approved by congress in October 2004 and cuts in energy subsidies and government payroll expenditure. Reforms to further strengthen the design, execution, and monitoring of fiscal policy are now being finalized and draft legislation will be submitted to congress in early 2005.

The central bank will continue to control liquidity in line with the program objectives for inflation, in the context of the floating exchange rate system. Auctions of central bank certificates—including new instruments geared toward reducing lengthening maturities—will be used to guide monetary aggregates, in line with the expected continued recovery of demand for pesos balances.

The program seeks to strengthen the banking system with the goal of establishing a sound financial intermediation system to sustain growth. The supervisory authorities will focus on ensuring that all banks gradually comply with stricter regulatory standards based on international best practices, including for asset valuation, treatment of market risk, and consolidated reporting. In this regard, banks' will be required to submit multi-year business plans twice each year to demonstrate their solvency and viability. The program also envisages a plan to increase the supervisory capacity of the superintendency of banks, as well as institutional reforms to strengthen the independence of both the superintendency and the central bank.

The electricity sector reform plan, prepared with the assistance from the World Bank, the Inter-American Development Bank, and USAID, aims to stabilize electricity supply through decisive efforts to reduce losses and raise collections, and to improve the cash flow of distribution companies. The plan is designed to reduce substantially the need for government transfers to the electricity sector, thereby making room for increased social spending to mitigate the effects of the economic crisis on the poor.

The Dominican Republic joined the IMF on December 28, 1945; its quota is SDR218.9 million (about US$330 million). Its outstanding use of IMF credit totals SDR131.34 (about US$200 million).

Dominican Republic: Selected Economic and Financial Indicators

	2000	2001	2002	2003	Prel. 2004	Prog. 2005
(Annual percentage change, unless otherwise indicated)						
National accounts and prices						
Real GDP	7.3	4.0	4.3	-0.4	2.0	2.5
Consumer price index (period average)	7.7	8.9	5.2	27.4	51.5	7.7
Consumer price index (end of period)	9.0	4.4	10.5	42.7	28.9	12.0
Unemployment rate (in percent)	13.9	15.6	16.1	17.0	…	…
Gross domestic investment (in percent of GDP)	24.0	23.1	22.5	23.0	20.5	19.8
Gross national savings (in percent of GDP)	18.8	19.7	18.8	29.3	26.3	21.8
Money and credit						
Liabilities to private sector	11.7	21.3	13.2	28.7	12.7	21.0
Net domestic assets of the banking system	20.2	11.3	80.0	25.2	-0.5	18.3
Of which: credit to the private sector	22.8	24.2	20.3	10.8	-6.1	13.1
(In percent of GDP)						
Public finances						
Nonfinancial public sector balance	-1.7	-1.9	-2.3	-4.8	-2.7	-0.7
Quasi-fiscal balance of the central bank	-0.3	-0.2	-0.3	-2.6	-4.0	-3.2
Consolidated public sector balance	-2.0	-2.1	-2.6	-7.5	-6.7	-3.9
Of which: primary balance	-0.8	-1.0	-1.4	-3.3	-0.9	1.9
Total public debt	24.5	23.3	26.8	54.3	52.1	49.1
(In millions of U.S. dollars, unless otherwise indicated)						
Balance of payments						
Current account	-1,026	-741	-798	1,036	1,071	461
Merchandise trade balance	-3,742	-3,503	-3,673	-2,156	-2,244	-2,744
Exports	5,737	5,276	5,165	5,471	5,710	5,384
Imports	-9,479	-8,779	-8,838	-7,627	-7,954	-8,128
Services and transfers (net)	2,715	2,762	2,875	3,192	3,315	3,205
Of which: interest on public debt	-201	-196	-215	-282	-350	-457
Capital and financial account	1,402	2,005	1,304	2,004	869	1,136
Of which: foreign direct investment	953	1,079	917	1,011	654	769
Overall balance	-84	517	-640	-262	422	-129
Current account (in percent of GDP)	-5.2	-3.4	-3.7	6.3	5.8	2.0
Exports (in U.S. dollars, annual percentage change)	11.7	-8.0	-2.1	5.9	4.4	-5.7
Imports (in U.S. dollars, annual percentage change)	17.9	-7.4	0.7	-13.7	4.3	2.2
Real effective exchange rate (end-period, depreciation -)	6.1	2.7	-11.4	-27.0	60.0	...
International reserve position and external debt						
Gross official reserves	637	1,155	630	279	825	1,257
(in months of imports)	1.0	1.8	1.1	0.5	1.4	2.1
(in terms of short term debt, percent)	52.4	79.7	46.8	22.5	59.3	63.9
Net official reserves	442	962	376	124	602	745
excluding reserve requirements in foreign currency	442	962	356	-96	211	350
Outstanding external public debt (in percent of GDP)	17.7	19.0	21.5	36.6	33.5	30.3

Sources: Central Bank of the Dominican Republic; World Bank; and IMF staff estimates and projections.