

DOCUMENT OF INTERNATIONAL MONETARY FUND AND NOT FOR PUBLIC USE

MASTER FILES
ROOM C-130

0451

EBS/89/144

CONFIDENTIAL

July 21, 1989

To: Members of the Executive Board
From: The Acting Secretary
Subject: Dominican Republic - Real Effective Exchange Rate -
Information Notice

Attached for the information of the Executive Directors is an information notice on the real effective exchange rate of the Dominican peso.

Mr. Gilman (ext. 8524) is available to answer technical or factual questions relating to this paper.

Att: (1)

INTERNATIONAL MONETARY FUND

DOMINICAN REPUBLIC

Real Effective Exchange Rate--Information Notice

Prepared by the Western Hemisphere and
the Exchange and Trade Relations Departments

(In consultation with the Legal and the Research Departments)

Approved by S.T. Beza and Eduard Brau

July 21, 1989

The recent evolution of the real effective exchange rate of the Dominican Republic, as measured by the standard index developed in connection with the information notice system, is set out in the attached table and chart. The index shows that as of April 1989 the Dominican peso had appreciated by more than 10 percent since the last occasion on which exchange rate developments in the Dominican Republic were discussed by the Executive Board--the 1988 Article IV consultation in October 1988 (EBM/88/159, 10/26/88). The increase in the real effective value of the Dominican peso since October 1988 is estimated to have amounted to 13.1 percent, on the basis of a 6.4 percent nominal effective appreciation and a 6.4 percent relative increase in Dominican consumer prices. In terms of the U.S. dollar, the value of the Dominican peso was kept unchanged during this period.

Since mid-1987, the exchange rate system in the Dominican Republic has been modified frequently, alternating between freely floating and managed exchange rate arrangements. Following a period of rapid depreciation of the peso, a new foreign exchange system administered by the Central Bank was introduced on August 1, 1988. Under this system, all receipts are subject to surrender and most payments require prior approval of the Central Bank. Since that date, the official exchange rate has been maintained at RD\$6.34 per U.S. dollar (mid-point). Until the end of June 1989, a preferential exchange rate of RD\$5.15 per U.S. dollar applied to imports of oil and its by-products. The authorities have notified the Fund that, with effect from July 1, 1989, the preferential rate has been eliminated altogether. A spread of some 7 percent is reported to exist between the exchange rates in the official and the illegal parallel market.

Economic developments in the Dominican Republic during 1988 were characterized by a slowdown in the pace of activity, high inflation, and continuing fiscal and external imbalances. After rising by 8 percent in 1987 on the strength of public investment, real GDP increased by about 0.5 percent in 1988, reflecting capacity constraints in the construction sector as well as the effect of unfavorable weather conditions and

frequent power outages. The 12-month rate of increase in consumer prices accelerated from 25 percent in December 1987 to almost 58 percent in December 1988. The rise in the rate of price increase in 1988 was associated in part with the depreciation of the peso which took place in the first half of the year.

On the basis of a strong growth of revenue that stemmed in part from nonrecurrent factors, the overall deficit of the public sector declined from 4 1/2 percent of GDP in 1987 to about 4 percent in 1988, even though public investment continued to increase and subsidies rose sharply. With low recourse to foreign financing, this deficit was covered mostly by domestic bank credit and a further accumulation of external payments arrears. In order to contain the pressures from domestic financing of the public sector deficit, the authorities tightened credit to the private sector by enforcing reserve requirements more strictly, strengthening controls over the operations of previously unregulated nonbank financial intermediaries, and raising interest rate ceilings. With these actions, the growth in total bank credit was slower in 1988 than in 1987.

As a result of the tightening of credit, the depreciation of the currency, and gains in the terms of trade, the external current account deficit fell from 6 percent of GDP in 1987 to around 3 percent in 1988 and the overall balance of payments deficit declined from US\$610 million in 1987 to US\$175 million last year. After taking into account debt rescheduling and the further accumulation of external payments arrears, net official international reserves increased by about US\$145 million in 1988.

The information available for the first four months of 1989 shows a deceleration in inflation, with consumer prices rising by 5.7 percent in this period compared with 10.2 percent during January-April 1988. Net official international reserves declined by about US\$20 million during January-April 1989.

A staff mission is due to visit Santo Domingo later this year to conduct the 1989 Article IV consultation with the Dominican Republic. At that time the staff will review the Government's current economic policies, including the stance of exchange rate policy, and will discuss with the authorities the means for correcting existing imbalances and assuring an adequate degree of external competitiveness.

Table 1. Dominican Republic: Real Effective Exchange Rate and Related Series

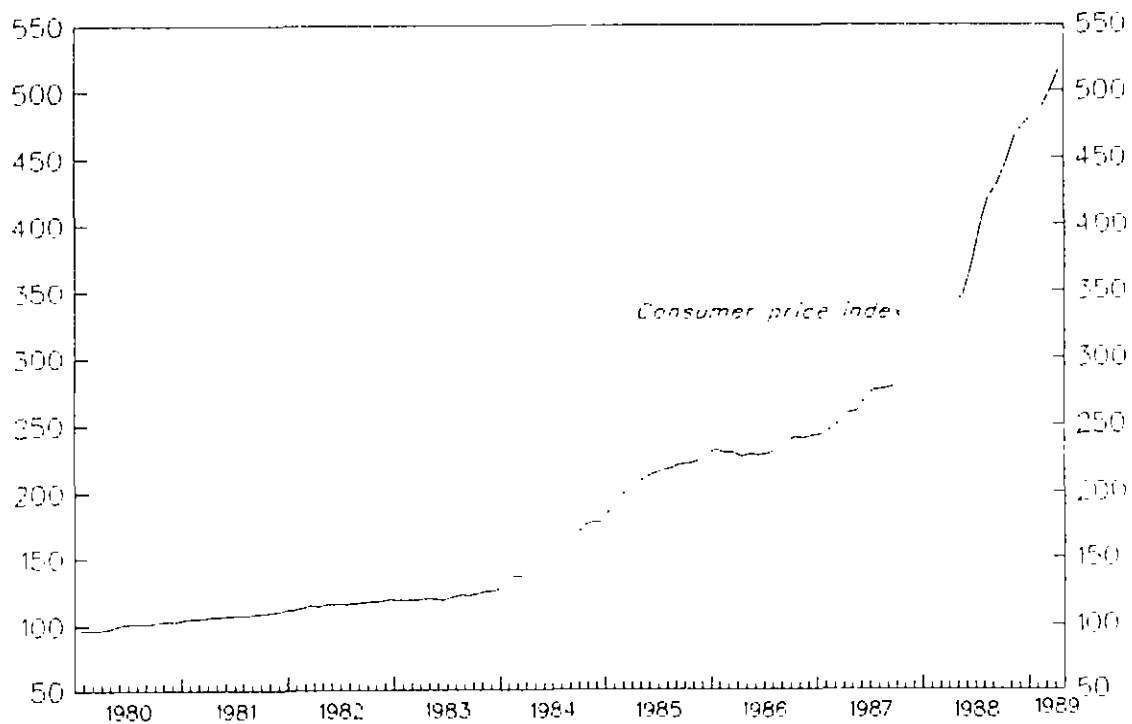
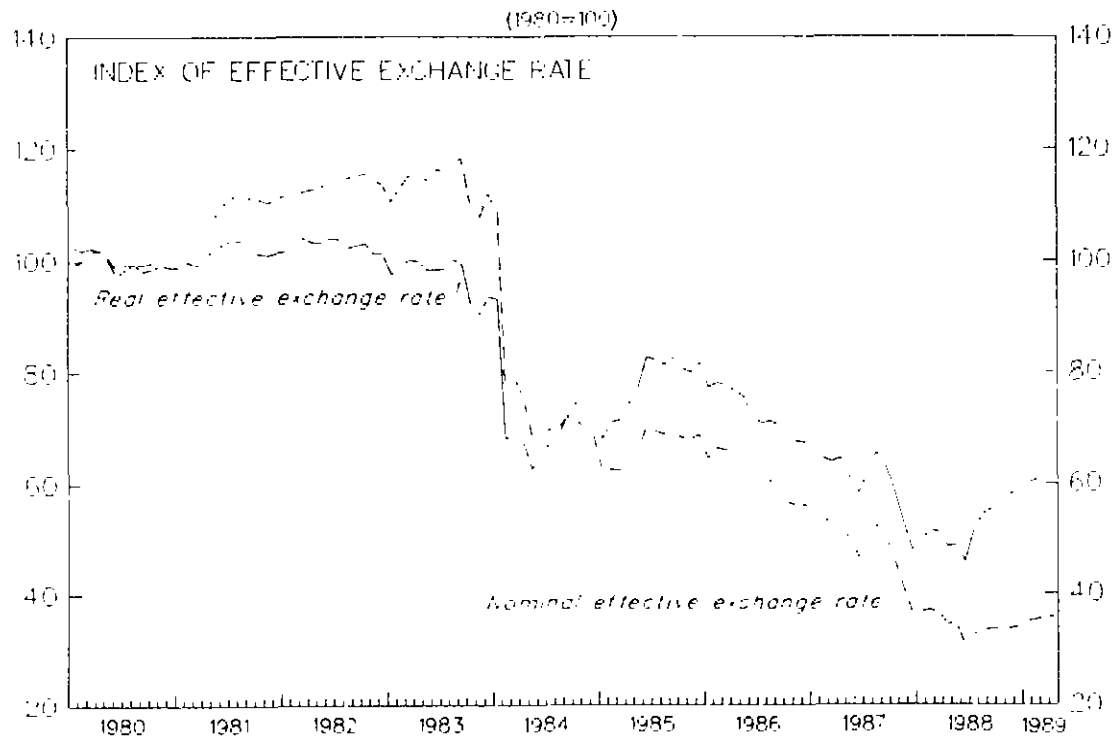
(Indices: 1980 = 100)

	Real Effective Exchange Rate <u>1/</u> <u>2/</u>	Nominal Effective Exchange Rate <u>1/</u>	Relative Consumer Prices (Local Currencies)	Exchange Rate in Terms of U.S. Dollars <u>1/</u>	Consumer Price Index (Seasonally Adjusted)	Consumer Price Index (Not Seasonally Adjusted)
Quarterly						
1983						
I	98.8	112.7	87.6	87.9	118.8	119.4
II	98.8	115.2	85.7	86.4	119.6	119.2
III	99.3	117.2	85.7	84.8	121.9	121.0
IV	92.1	109.9	83.8	77.5	124.8	125.4
1984						
I	76.8	88.2	87.3	60.8	134.2	134.9
II	65.1	70.8	92.0	47.7	145.5	145.2
III	69.2	70.4	98.2	45.2	160.3	159.1
IV	72.9	69.8	104.4	43.3	176.2	176.9
1985						
I	70.0	62.4	112.2	36.9	195.4	196.6
II	78.0	66.6	117.0	38.8	210.1	209.4
III	82.0	69.2	118.5	40.4	218.1	216.6
IV	80.7	68.2	118.2	40.5	223.7	224.7
1986						
I	77.6	65.6	118.2	39.3	229.8	231.1
II	74.6	64.1	116.5	38.9	227.1	226.1
III	70.7	60.0	117.9	37.0	232.0	230.7
IV	67.7	56.2	120.6	34.6	250.7	241.9
1987						
I	64.7	53.7	120.4	33.3	256.4	247.9
II	61.1	49.6	123.2	30.4	262.4	260.8
III	63.7	50.8	125.5	30.1	276.1	274.6
IV	53.2	41.3	129.0	24.7	292.5	291.3
1988						
I	50.9	36.7	138.7	21.7	324.6	326.4
II	47.9	33.2	144.5	19.1	352.2	350.0
III	53.8	33.1	162.6	17.9	416.4	414.2
IV	57.7	33.6	171.5	17.9	462.7	465.7
1989						
I	60.9	35.1	173.4	17.9	489.8	492.1
Monthly						
1988						
Oct. <u>3/</u>	56.5	33.5	168.2	17.9	446.1	447.1
Nov.	57.9	33.5	173.1	17.9	466.5	467.6
Dec.	58.9	33.9	173.4	17.9	475.5	482.3
1989						
Jan.	59.9	34.8	172.3	17.9	491.6	490.7
Feb.	60.5	35.1	172.4	17.9	496.9	490.7
Mar.	62.4	35.5	175.5	17.9	500.9	498.9
Apr.	63.8	35.7	178.9	17.9	516.6	509.8
Percentage change						
Oct. 1988- Apr. 1989	13.1	6.4	6.4	—	15.8	14.0

Source: Information Notice System.

1/ Increases from appreciation.2/ Using seasonally adjusted price indices.3/ Date of latest consideration by Executive Board.

DOMINICAN REPUBLIC
INFORMATION NOTICE SYSTEM INDEX OF
EFFECTIVE EXCHANGE RATE



Source: Information Notice System. Seasonally adjusted
1 Trade weighted index of average monthly nominal effective exchange rate deflated by seasonally adjusted consumer prices; increase means appreciation

