

**EXECUTIVE
BOARD
MEETING**

EBS/20/71
Correction 1

April 27, 2020

To: Members of the Executive Board

From: The Secretary

Subject: **Dominican Republic—Request for Purchase Under the Rapid Financing Instrument**

Board Action: The attached corrections to EBS/20/71 (4/22/20) have been provided by the staff:

Evident Ambiguity

Page 3 (para. 2, line 6)

**Factual Errors Not
Affecting the
Presentation of Staff's
Analysis or Views**

Pages 3 (para. 2, line 3), 6, 7, 16

Questions:

Mr. Santos, WHD (ext. 36629)
Mr. Chow, WHD (ext. 36638)
Ms. Rousset, WHD (ext. 34655)
Ms. Bepalova, WHD (ext. 36435)

BACKGROUND

- 1. The Dominican Republic has enjoyed a prolonged period of impressive economic performance.** It has been the fastest growing economy in Latin America (6½ percent) over the last several years, while inflation was muted and the external position strong.
- 2. The political calendar reduces the room for policy maneuver.** Presidential elections (initially scheduled for May 17, 2020) have been postponed to July 5, 2020 due to the COVID-19 pandemic, but the change of government will continue to take place on August 16, 2020. Municipal election (initially scheduled for February 16, 2020) were suspended due to the failure of the e-voting system, which prompted social protests. The rescheduled elections were held on March 15 (despite the COVID-19 outbreak), and the opposition Modern Revolutionary Party won the majority of the mayor offices ~~was the main winner.~~

RECENT DEVELOPMENTS

- 3. The COVID-19 pandemic came at a time of macroeconomic strength and stability:**
 - Economic activity moderated in 2019.** Real GDP growth eased to 5.1 percent in 2019 (from 7.0 percent in 2018). High-frequency indicators point to a robust expansion in January and February.
 - Inflation remained within the Central Bank target range of 4±1 percent.** Inflation increased to 3.7 percent in 2019 (from 1.3 percent in 2018) and stayed at that level through February.
 - The fiscal stance remained relatively neutral.** The consolidated public sector deficit fell to 3.3 percent of GDP (from 3.5 percent in 2018) with no change in the central government deficit.
 - Monetary policy remained accommodative.** The BCRD lowered its policy rate during Q3-2019 by 100 basis points (in 3 stages) to 4.5 percent and eased reserve requirements.
 - The financial system ended 2019 sound but vulnerable.** Banks remained well capitalized, profitable and liquid. Credit continued growing at a healthy rate. NPL fell to 1.6 percent in 2019.
 - The external position remained stable.** In 2019, the current account deficit remained steady at 1.4 percent of GDP (similar to 2018), fully financed by foreign direct investment (FDI).

IMPACT OF COVID-19

- 4. The COVID-19 pandemic has severely affected the Dominican economy.** As of April 13, there were 3,167 confirmed cases with 177 fatalities. President Medina declared

Impact of COVID-19 (Percent of GDP unless otherwise indicated)			
	2020		Δ
	Pre-COVID	Post-COVID	
GDP growth (%)	5.1	-1.0	-6.1
Inflation (%)	4.0	3.0	-1.0
Fiscal deficit	-3.7	-6.0	-2.3
Public debt (NFPS)	53.4	60.9	7.5
Credit growth (%)	9.7	2.5	-7.2
Source: Fund staff calculations.			

that a shortfall of the central government revenues could amount to about $\frac{3}{4}$ percent of GDP. The announced expenditure package is a vital and welcome economic measure. The authorities would need to allocate more resources to health and social benefits, including by redirecting budgetary appropriations from other areas. Staff estimates conservatively that central government expenditures could be $\frac{1}{4}$ percent of GDP higher than before the shock. The government needs to ensure that these public spending measures are both targeted and temporary, focusing on protecting those most vulnerable to the shock and on supporting demand. With that goal in mind, the authorities should allow automatic stabilizers, including the support for the unemployed and means-tested transfers. All in all, the consolidated deficit of the public sector has been conservatively estimated to be 6 percent of GDP in 2020 (some $2\frac{1}{3}$ percent of GDP higher than before the COVID-19 shock). The additional financing needs amount to some US\$1½ billion, of which the RFI could cover almost one-half.

Fiscal Accounts: COVID-19 Impact			
	2020		
	Pre- COVID	Post- COVID	Δ Change
(In percent of GDP)			
Revenue	14.5	13.6	-0.9
o/w tax revenue	13.3	12.5	-0.8
Expenditure	16.8	18.0	1.2
Current	15.0	16.6	1.7
o/w goods and service	2.0	2.4	0.4
o/w social benefits	1.3	1.9	0.7
Capital	1.8	1.5	-0.3
Overall balance (CG)	-2.3	-4.4	-2.1
Consolidated balance	-3.7	-6.0	-2.3
(In billions of U.S. dollars)	-3.5	-5.0	-1.5
(In billions of U.S. dollars)			
Potential financing	...	...	1.5
IMF (RFI)	...	...	0.7
Other IFIs	...	...	0.5
Unidentified support	...	...	0.3

Source: IMF staff estimates.

12. The BCRD eased its monetary policy stance to provide additional liquidity to support the economy.

The monetary policy council of the BCRD decided (in an extraordinary meeting of March 16) to reduce the monetary policy rate by 100 basis points to 3.5 percent, and approved a number of other measures (see text table). The BCRD is monitoring the situation closely and has sufficient monetary space to further ease its policy stance if needed. Staff encouraged the authorities to continue implementing a more flexible exchange rate policy at a measured pace (given unknown foreign exchange exposure in the non-financial private sector), taking into account inflationary expectations and balance sheet exposures, as this can be used as an effective shock absorber, especially if external conditions deteriorate further. Interventions in the foreign exchange market should be limited to preventing disorderly market conditions, and large interventions should be

Monetary Policy: COVID-19 Measures	
Instrument	Measure
1 Policy Rate	Reduce the monetary policy rate by 100 basis points from 4.5 to 3.5 percent.
2 Repo Rate	Reduce the (1-day) REPO facility rate from 6.0 to 4.5 percent.
3 Overnight Rate	Reduce the overnight deposit rate from 3.0 to 2.5 percent.
4 Repo Operations	Ease other REPO operations in an amount of RD\$50 billion (about 1 percent of GDP) to provide additional liquidity to the financial system.
5 Dollar Liquidity	Provide U.S. dollar liquidity for US\$0.5 billion (about $\frac{1}{2}$ percent of GDP), through REPO operations and allowing banks to use public instruments to cover reserve requirements on foreign currency deposits.

Source: BCRD.

avoided given that international reserves are still below IMF's recommended reserve adequacy metric (ARA) of 100–150 percent.²

13. The BCRD also adopted several macroprudential and supervisory measures to provide additional liquidity to support the economy. These measures aim to provide liquidity to the banking system and ease financial tensions. An important measure was the reduction in reserve requirements which would provide significant liquidity to the system (4¾ percent of GDP), as well as a number of other measures (see text table). The authorities should ensure that these extraordinary measures are temporary and targeted specifically to the borrowers adversely affected by the COVID-19 outbreak.³

Macroprudential Policy: COVID-19 Measures	
Instrument	Measure
1 Reserve Requirements	Allow banks to cover reserve requirement with public (and BCRD) bonds up to an amount of RD\$36 billion (about ¾ percent of GDP), which is equivalent to a 3¼ percent reduction in reserve requirements. These resources are earmarked to provide credit to households and businesses at an interest rate capped at 8.0 percent.
2 Ratings	Freeze (temporarily) debtor ratings and provisioning to the prevailing levels as of March 16.
3 Refinancing	Maintain debtor rating in case of loan refinancings during the emergency.
4 Overdue Loans	Classify as current overdue loans for a 60-day period.
5 Guarantees	Provide 90 days for debtors to update loan guarantees.
Source: BCRD.	

RAPID FINANCING INSTRUMENT ISSUES

14. The RFI is the most appropriate instrument at this juncture. The Dominican Republic meets the eligibility requirements for support under the RFI. It faces an urgent BOP need, which, if not addressed, would result in immediate and severe economic disruption. There is also a high degree of uncertainty on the duration and scale of the COVID-19 impact and practical difficulties of holding comprehensive discussions with the authorities in the current no-travel/work-from-home environment.

15. Staff proposes to provide support for 100 percent of quota under the RFI. This access is within applicable limits under the GRA. The annual access of 100 percent of quota (SDR 477.4 million or about US\$650 million) would provide financing relief to the budget. RFI resources will be disbursed to the Ministry of Finance allocated to provide financing for virus-related spending.⁴

² The IMF classifies the Dominican Republic's exchange rate regime as a "crawl-like arrangement". For 2020, reserve coverage is estimated at 65 percent of the ARA metric.

³ To strengthen banks' financial position, the authorities could consider adoption of additional supervisory measures, including: (i) temporary suspend dividends, bonuses, and variable remunerations during the outbreak; (ii) let banks draw upon existing capital buffers to absorb the costs of loan restructuring; (iii) intensify reporting and monitoring requirements, especially for borrowers with modified loans; (iv) help banks with capital restoration plans in case their minimum capital levels are compromised

⁴ As RFI resources are being used for budgetary support, the authorities commit to adhere to best practices in procuring and awarding contracts related to the pandemic as well as publishing an externally audited report on virus-related expenditures once the crisis is over. All public purchases are subject law 340-06 (2006), which adhere to strict principles of efficiency, competition, transparency, equity, responsibility, morality and good faith, and make public servants liable for not following the law. Law 340-06 establishes special rapid procedures in case of emergencies like COVID-19. To that end, the government issued decrees 87-20 and 133-20 (2020) for purchases related to the fight against COVID-19. Under these emergency procedures, the law establishes, inter alia, the

(continued)

Table 1. Dominican Republic: Selected Economic and Social Indicators, 2015–25

Population (millions, 2019)	10.4					GDP per capita 2019 (U.S. dollars)					8,596
Quota	477.40 millions SDRs / 0.1% of total					Poverty (2018, share of population)					22.8
Main export product	tourism, gold, tobacco					Extreme poverty (2018, % of pop.)					2.9
Key export markets	U.S., Canada, Haiti					Adult literacy rate (percent, 2018)					93
	2015	2016	2017	2018	2019	Projection					
						2020	2021	2022	2023	2024	2025
Output	(Annual percentage change, unless otherwise stated)										
Real GDP	6.5	7.0	4.7	7.0	5.1	-1.0	4.0	5.0	5.0	5.0	5.0
Contributions to growth											
Consumption	5.2	4.7	3.5	4.4	3.7	2.2	2.4	4.3	4.3	4.1	4.0
Investment	3.6	3.6	-2.1	4.3	1.3	-1.2	0.0	0.4	0.5	0.5	0.7
Net exports	-2.4	-0.8	2.1	-0.6	-1.2	-5.3	2.0	0.5	0.6	0.5	0.4
Nominal GDP (RD\$ billion)	3,206	3,487	3,803	4,236	4,562	4,679	5,041	5,503	6,008	6,559	7,162
Nominal GDP (US\$ billion)	71.3	75.8	80.1	85.6	89.0	...	...	...	...	...	...
Gross national saving (percent of GDP)	21.6	21.9	22.3	24.4	24.6	19.7	20.3	19.9	19.5	19.1	18.8
Output gap (in percent of potential output)	-0.3	0.7	0.0	2.0	2.8	-1.9	-1.7	-0.7	0.1	0.0	0.0
Unemployment											
Unemployment rate (in percent; period average)	7.3	7.1	5.5	5.7	6.2	9.0	7.0	5.5	5.5	5.5	5.5
Prices											
Consumer price inflation (end of period)	2.3	1.7	4.2	1.2	3.7	3.0	4.0	4.0	4.0	4.0	4.0
Consumer price inflation (period average)	0.8	1.6	3.3	3.6	1.8	3.5	3.6	4.0	4.0	4.0	4.0
Exchange rate											
Exchange rate (RD\$/US\$ - period average) 1/	45.0	46.0	47.5	49.5	51.2	...	...	...	...	...	...
Exchange rate (RD\$/US\$ - eop) 1/	45.5	46.7	48.2	50.2	52.9	...	...	...	...	...	...
Real effective exchange rate (eop, - depreciation) 1/	2.3	-0.8	-2.3	-1.9	-3.3	...	...	...	...	...	...
Government finances						(in percent of GDP)					
Consolidated public sector debt 2/	44.7	46.6	48.9	50.4	53.6	60.9	58.2	57.6	57.2	56.4	55.7
Consolidated public sector overall balance 3/	-1.7	-4.1	-4.1	-3.5	-3.3	-6.0	-4.3	-4.1	-3.9	-3.5	-3.5
Consolidated public sector primary balance	2.1	-0.2	-0.1	0.4	0.8	-1.6	0.2	0.4	0.6	0.9	0.9
Central government balance	0.0	-3.1	-3.1	-2.2	-2.2	-4.4	-2.9	-2.8	-2.7	-2.4	-2.5
Revenues and grants	16.6	13.9	14.0	14.2	14.4	13.6	14.1	14.2	14.2	14.4	14.3
Primary spending, o.w.:	14.4	14.4	14.6	13.7	13.8	15.0	13.9	13.9	13.9	13.9	13.9
Transfers to electricity sector	0.8	0.6	0.5	0.4	0.5	0.3	0.4	0.4	0.4	0.4	0.4
Interest expenditure	2.3	2.5	2.5	2.6	2.7	3.0	3.1	3.0	3.0	2.9	2.9
Rest of NFPS	-0.3	0.3	0.2	-0.2	-0.1	-0.5	-0.4	-0.3	-0.2	-0.1	-0.1
Financial sector						(Annual percentage change, unless otherwise stated)					
Broad money (M3)	12.3	9.8	11.2	7.0	11.7	0.7	8.3	9.6	9.8	9.7	9.7
Credit to the private sector	12.7	12.1	10.1	11.1	11.8	2.5	7.7	9.2	9.2	9.2	9.2
Policy interest rate 1/	5.0	5.5	5.3	5.5	4.5	...	...	...	...	...	...
Average deposit rate (1-year; in percent) 1/	7.7	6.8	5.0	7.4	6.7	...	...	...	...	...	...
Average lending rate (1-year; in percent) 1/	16.7	14.5	11.2	12.1	12.4	...	...	...	...	...	...
Balance of payments						(in percent of GDP)					
Current account	-1.8	-1.1	-0.2	-1.4	-1.4	-5.2	-3.7	-3.4	-3.1	-2.9	-2.9
Goods, net	-10.5	-10.0	-9.5	-10.9	-10.8	-10.5	-10.4	-10.2	-9.9	-10.0	-9.7
Services, net	6.1	6.5	6.9	6.9	6.1	3.8	5.4	5.7	5.8	6.4	6.5
Income, net	2.5	2.4	2.4	2.6	3.3	1.4	1.3	1.1	1.0	0.7	0.4
Capital account	2.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial account	-1.0	-2.1	-1.7	-2.2	-2.8	-5.2	-3.7	-3.4	-3.1	-2.9	-2.9
Foreign direct investment, net	-3.1	-3.2	-4.5	-3.0	-3.4	-2.9	-3.4	-3.4	-3.4	-3.4	-3.4
Portfolio investment, net	-4.9	-2.3	-2.2	-3.1	-2.0	-1.0	-2.0	0.4	-0.7	-0.2	-0.1
Financial derivatives, net	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other investment, net	6.3	2.4	4.0	2.9	1.3	0.0	1.2	-0.9	0.4	0.1	0.0
Reserves, net	0.6	1.0	0.9	1.0	1.3	-1.3	0.5	0.6	0.6	0.6	0.6
NIR (in millions of U.S. dollars)	4,728	5,712	6,528	7,382	8,541	7,448	7,903	8,731	9,343	10,006	10,724
Total external debt (in percent of GDP)	38.1	38.7	41.0	39.4	40.0	44.7	44.5	41.3	40.3	39.2	38.3
of which: Public sector	25.1	25.7	27.7	27.3	28.3	32.7	33.5	31.6	31.3	30.8	30.4

Sources: National authorities; World Bank; and IMF staff calculations.

1/ Latest available.

2/ Improvement in 2015 reflects the grant element of a debt buy back operation with Venezuela's state owned-oil company (PDVSA) of 3.1 percent of GDP.

3/ The consolidated public sector includes the central government, some decentralized entities, the electricity holding company, and the central bank.□