Dominican Republic Viewpoint

Macro policies to tackle the slowdown

10 August 2023

GEM Economics
LatAm | Dominican Republic

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Policymakers rolling out measures to fight slowdown

The monthly GDP proxy (IMAE) barely grew 1.2% year-over-year in the first half of 2023. Well below what policymakers consider to be the economy's potential GDP growth rate, around 5%. Cognizant of the weak activity, the Ministry of Finance and the Central Bank are mobilizing to tackle the slowdown. In this report, we analyze and attempt to predict how far policymakers could go with the stimuli.

Revising down 2023 growth to 2%, vs. 3.3% consensus

Given weak results in Q2, we are revising down our GDP growth forecasts for 2023, to 2% (from 2.5%), and 2024, to 5.1% (from 5.2%). Median expectations for 2023, according to the Bloomberg survey, are 3.3%. To reach a 3.3% growth rate, GDP would need to expand at an annualized pace (qoq/saar) of 14% in Q3 and Q4. Except for the post-covid recovery (from 3Q20 to 3Q21) this has never happened. The government and the IMF are more optimistic, saying 2023 GDP growth will be 4%.

Fiscal policy will likely be constrained by circumstances

Considering the proximity of the elections, the rollout of a large fiscal stimulus could be misinterpreted with political motivations. Investors we spoke with are expecting DomRep to rebuild the fiscal space it lost during covid. The debt ratio is close to the limit considered prudent for emerging markets (40%-50% of GDP). If debt is pushed above the limit, the new Fiscal Rule framework – being discussed in Congress – would be less credible. The Fiscal Rule could be negatively impacted. This is not our base-case scenario though.

Central Bank will likely deliver substantial easing

We forecast 225bp of rate cuts in the next ten months, with a terminal rate of 5.50%. The BCRD survey shows locals expect 175bp in twelve months. Well-anchored inflation expectations and headline at the 4% target provide room. Nevertheless, we foresee the BCRD proceeding in small steps (25bp clips), mindful of exchange rate depreciation. DomRep is the LatAm country with the highest foreign currency share of public debt (over 70%). So, a large DOP depreciation is risky for financial stability.

BCRD: Central Bank

Economic slowdown in 2023

Weak results in first half of year

GDP barely grew 1.4% year-over-year in Q1, which implied a sequential contraction of -1.4% quarter-over-quarter (seasonally adjusted) according to Central Bank estimates. In Q2, the monthly GDP proxy (IMAE) – highly consistent with GDP – posted a modest expansion of 1% year-over-year. Nevertheless, we see some leading and coincident indicators pointing to higher growth in the second half of 2023 (see Exhibit 1).

BofA growth forecast for 2023, 2% vs. 3.3% consensus

Against this backdrop, we are revising down our Dominican Republic's GDP growth forecast for 2023, to 2% (from 2.5%), and 2024, to 5.1% (from 5.2%). Excluding 2020, the pandemic, it would be the lowest growth rate since 2009 (0.9%) in the aftermath of the global financial crisis. Consensus expectations for 2023, as per the Bloomberg survey, are 3.3%. The Central Bank's survey (July 2023) shows locals have median expectations of 4% growth – more optimistic – which match the forecasts of the government and the IMF (Article IV report published in June 2023).

Recovery driven by macro policies, real wages, tourism

As shown in Exhibit 2, we are projecting an acceleration of the economy in the second half of 2023. In our view, the pick-up will be driven by monetary easing (stimulating investment and consumption), government expenditures, higher real wages (given falling inflation), and the tourism sector consistently expanding above GDP growth.

We foresee a rebound of quarterly growth rates (qoq) to 1.7% in Q3 and Q4, leaving the full-year growth of 2023 at 2%. For 2024, we expect an annual expansion of 5.1%, lifted by a favorable base effect, even though sequential growth (qoq) will probably be lower.

Exhibit 1: Leading and coincident indicators of the Dominican Republic's economic activity

Rows shaded in green are indicators showing strength, which – in our view – will lead the recovery of the economy in the quarters ahead. In the color-code, red means weak and yellow is moderate

Indicator	2022 annual growth (%)	1Q 2023 (% yoy)	2Q 2023 (% yoy)
Monthly GDP proxy (IMAE)	**4.9**	**1.5**	**1.0**
Indicators related to private consumption			
Commerce value-added (retail and wholesale)	5.4	-0.4	not available yet
Worker remittances	-5.3	3.6	3.0
Formal employment (number of workers affiliated to social security)	5.9	2.8	3.7
Real wages (calculated by Ministry of Economy, Planning & Dev.)	0.3	3.3	4.9
Value added tax collections (ITBIS)	19	12.1	5.1
Imports of consumer goods, excluding fuels	9.3	5.2	3.6
Consumer credit (end-of-period)	23.5	21.9	22.3
Indicators related to private investment			
Construction output	0.7	-3.5	not available yet
Financial credit to firms (end-of-period)	12.1	13.7	17.9
Mortgage loans	17.4	16.5	15.9
Imports of capital goods	27.8	27.6	3.1
* PMI of Industrial Association (IMAM index, >50 = expansion)	58.3	55.2	54
* Business confidence (Central Bank survey)	44.9	40.2	38.2
Indicators related to public sector demand			
Central Government current primary expenditures	17.6	34.1	8.6
Central government capital expenditures	29.5	49.4	18.0
Indicators related to external demand			
Exports of goods, customs data (DGA)	6.4	-1.7	-0.9
Manufacturing free trade zones value-added	5.4	-2.4	not available yet
Non-resident tourist arrivals by air	43.4	21.1	9.7
Tourist arrivals by cruise	297.9	137.4	106.8
US GDP growth	2.1	1.8	2.6

Source: Central Bank (BCRD), National Council of Social Security (CNSS), Tax Agency (DGII), Customs Agency (DGA), Association of Industries of DomRep (AIRD), Ministry of Finance, US Bureau of Economic Analysis

* **Note**: The IMAM manufacturing PMI and the Central Bank's business confidence indicator are in a different scale, not year-over year (yoy).

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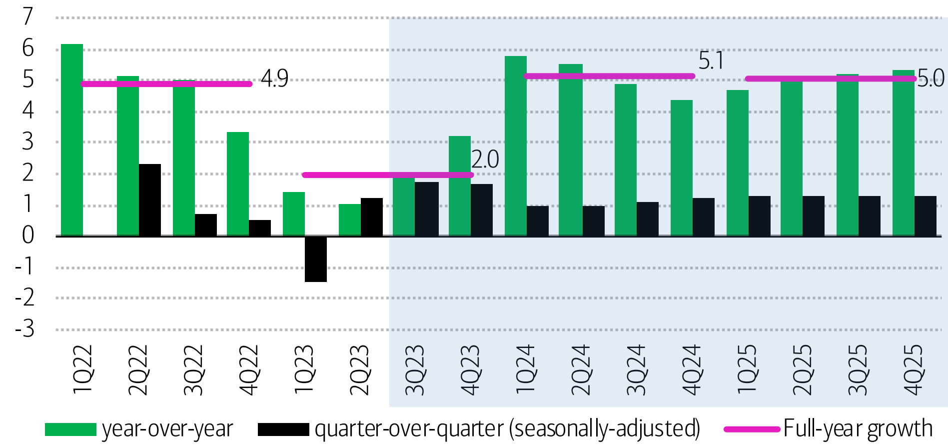
Exhibit 2: BofA's GDP growth forecasts

We expect a sequential (qoq) acceleration in the second half of 2023, and less momentum in 2024 (correlated with US soft landing). For 2025, we foresee growth stabilizing around the 5% potential



Source: Central Bank (BCRD), BofA Global Research estmates

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because of a slowdown in the US economy (soft landing, no recession) and the Dominican government rolling back the fiscal stimulus.

For 2025, our scenario assumes growth stabilizes around 5%, its potential, goldilocks, steady-state growth. 5% might sound overly optimistic to readers who are unfamiliar with DomRep. But the facts are growth has historically been sticky around those levels. DomRep was the second-fastest growing economy in Latin America since the 1990s, only below Panama, and the top (#1) if one looks at the ten years prior to the pandemic.

Macro policy options to face slowdown

More degrees of freedom on monetary than fiscal policy

Cognizant of the unsatisfactory economic activity in the first half of 2023, the Ministry of Finance and the Central Bank seem increasingly willing to roll out stimulus measures.

The government hiked primary expenditures by 20.8% yoy in the January-June period. Moreover, in early August it submitted a reformulated budget to Congress which increases 2023 expenditures by 0.93pp of GDP, compared to the original budget law. Nevertheless, we believe the fiscal stimulus will be constrained by the current circumstances. We will explain what we mean by this in the next section.

The Central Bank may have more degrees of freedom, considering its strong credibility and the fact inflation is finally down at the 4% target. The BCRD initiated its easing cycle in May, the third earliest in LatAm, after Costa Rica and Uruguay. It has already cut rates by 75bp and launched a liquidity program (2pp of GDP) aimed at supporting lending to firms and households. However, we think risks of exchange rate depreciation will make the board proceed in measured, gradual, steps.

Exhibit 3: Quarterly GDP growth rate paths consistent with different scenarios – Consensus scenario seems to be overestimating growth

To reach a 3.3% growth rate in full-year 2023, like in median market expectations, GDP would need to expand at an annualized pace (qoq/saar) of 14.3% in Q3 and Q4. Except for the post-covid recovery (from 3Q2020 to 3Q2021) this has never happened

Scenarios	2023 full-year growth	Q1			Q2 (preliminary)			Q3 forecasts			Q4 forecasts		
		yoy	qoq	qoq/saar	yoy	qoq	qoq/saar	yoy	qoq	qoq/saar	yoy	qoq	qoq/saar
Median expectations in Bloomberg survey (consensus)	3.3	1.4	-1.5	-5.7	1.0	1.2	5.1	3.7	3.4	14.3	6.7	3.4	14.3
Government, IMF, Central Bank survey (local analysts)	4.0							4.6	4.3	18.3	8.5	4.3	18.3
BofA base-case	2.0							2.1	1.7	7.1	3.2	1.7	7.0
Bearish	1.0							0.8	0.5	2.0	0.8	0.5	2.0

Source: Central Bank (BCRD), IMF, Bloomberg, BofA Global Research estimates

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Fiscal space constrained by circumstances

Large stimulus might be frowned upon by markets

Risk of fiscal support being mistaken for "electoral expenditures"

Given the proximity of the presidential and legislative elections – to be held in May 2024 – we believe the rollout of a large fiscal stimulus would be frowned upon by markets. Some LatAm countries have institutional checks that significantly limit the extent in which an incumbent government can use the budget for electoral purposes (e.g., "Guarantees Law" in Colombia). But not the Dominican Republic.

At the current juncture, using fiscal policy as the main response to face the economic slowdown could be misinterpreted by markets as "electoral spending". It would be risky. Rating agencies and investors are increasingly sensitive to governance issues. Therefore, we expect government expenditures to grow robustly in the second half of 2023 – supporting economic growth – but not to the point that is comparable to a crisis-like fiscal stimulus package.

Fiscal impulse will likely be moderate, far smaller than in the pandemic

For instance, in 2020 government expenditures were 4.5pp of GDP larger than in 2019. If one calculates the fiscal impulse in a different way – such as the variation in the structural primary balance (the more negative, the larger the impulse) – the conclusion is the same. In 2023 the fiscal impulse will probably be significant enough to make a difference on GDP growth, yet not large compared to previous stimulus plans.

Tellingly, the reformulated/amended budget, submitted by the Abinader administration to Congress in August, targets expenditures at 19.1% of GDP for 2023. That is 0.9pp of GDP larger than in the original budget law, but only 0.4pp higher than the government expenditures observed in 2022.

Reformulated budget widens deficit by 0.2pp of GDP, vs. 2023 Budget Law

The reformulated/amended budget – which will likely be approved by Congress in the coming weeks – increases the fiscal deficit assumption by 0.2pp, to 3.2% of GDP. Expenditures are hiked by 0.93pp of GDP, mainly through capex. Revenues are assumed to increase by 0.72pp of GDP versus the initial budget law. The justification of the revenue increase is the following: i) prepayment of taxes by financial institutions (0.4% of GDP, already collected in June, see Exhibit 5); ii) a tax amnesty; and iii) and changes to the asset forfeiture law that would fast-track the sale and lease of confiscated property.

Exhibit 4: Comparison of Central Government budget balances between 2022 and 2023

The government's revenue assumptions seem too optimistic, in our view, given the slowdown of GDP

	2022 (observed results)		2023 Budget Law		2023 Reformulated Budget	
	DOP bn	% of GDP	DOP bn	% of GDP	DOP bn	% of GDP
I) Revenues	956	15.3	1040	15.1	1087	15.8
II) Expenditures (= i + ii + iii)	1,170	18.7	1248	18.1	1309	19.1
i) Primary current expenditures	829	13.2	867	12.6	888	12.9
ii) Interest expenditures	178	2.8	226	3.3	227	3.3
iii) Capital expenditures	163	2.6	155	2.3	193	2.8
Overall balance (= I - II + III)	-203	-3.2	-208	-3.0	-222	-3.2
Primary balance (= I - II + III + ii)	-25	-0.4	18	0.3	5	0.1
III) Statistical discrepancy *	11	0.2	0	0	0	0
nominal GDP (DOP billions)		6,261		6885		6869
Nominal GDP growth		16.1		10.0		9.7
Real GDP growth		4.9		4.8		4.0

Source: Ministry of Finance (Hacienda), Central Bank (BCRD), BofA Global Research

* Note: The statistical discrepancy is published in the official government statistics. It is the difference between the overall fiscal balance using the IMF's 2014 Manual (net acquisition of financial assets minus net borrowing) and the old 1986 manual (revenues minus expenditures).

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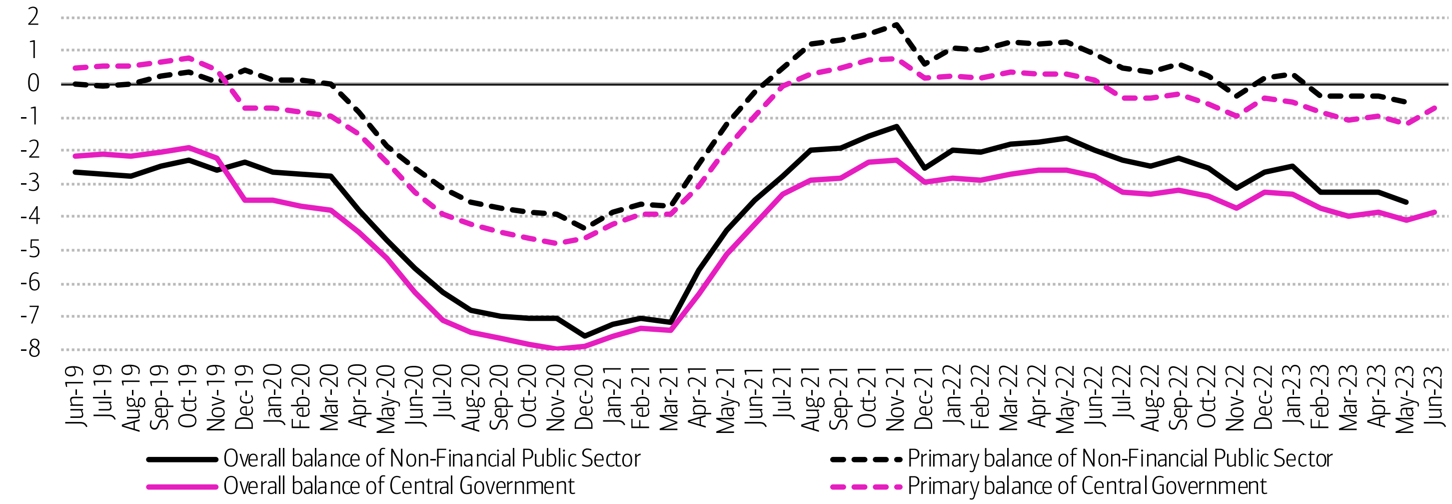
Exhibit 5: Fiscal balances of the Central Government and the Non-Financial Public Sector (rolling 12 months, % of GDP)

The rolling 12-month deficits of the Central Government and the Non-Financial Public Sector widened in the first half of 2023. There was a large one-off revenue in June (DOP 25bn, 0.4% of GDP), attributable to prepayment of taxes by financial institutions, that prevented a further widening



Source: Ministry of Finance (Hacienda), Central Bank (BCRD), BofA Global Research

Note: Last data point for the Central Government is June (preliminary, from budget execution data). Last data point for the Non-Financial Public Sector is May.

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Markets and rating agencies expect DomRep to rebuild fiscal buffers

Another reason why, in our view, a large fiscal stimulus package would be frowned upon by markets is the expectation that fiscal buffers must be repaired. The Dominican Republic had a bulky fiscal deficit in 2020, 7.6% of GDP (Non-Financial Public Sector), which put upward pressure in the public debt ratio. The government has been rebuilding fiscal space since then. If it goes back to expansionary mode, the debt ratio would start climbing again from a starting point (45.6% of GDP in 2022) that is more than 5pp above the pre-pandemic level.

Debt ratio at border in which policy can be reasonably operated with stabilizers

The ability of a government to successfully use fiscal policy as an economic management tool depends on credibility. According to Borg (2014), countries with high public debt lose this ability because markets will always demand them to deliver fiscal consolidation.[1] Countries with strong fiscal positions, on the contrary, Borg argues, can afford active fiscal policy without putting credibility at risk.

And countries in between – like DomRep – have the option of operating fiscal policy with a “rule-based approach” whereby the government can expand expenditures in bad times in exchange for accumulating savings in good times. This sort of automatic-stabilizer philosophy is precisely what is embedded in the Fiscal Rule bill that has been submitted by the Abinader administration to Congress.

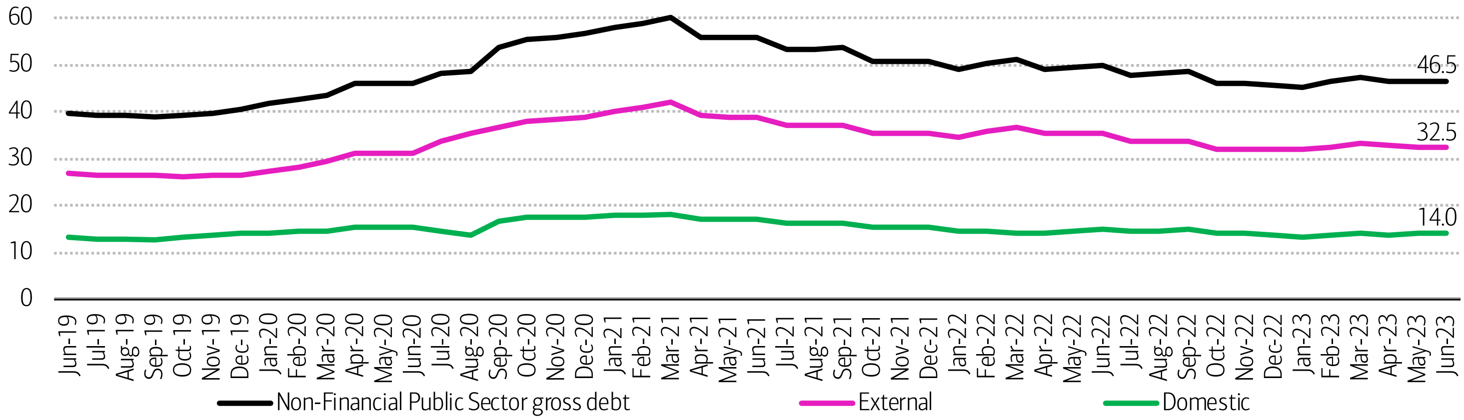
The classic Reinhart and Rogoff (2010) paper says the critical value of public debt for advanced economies is 90% of GDP.[2] For emerging markets the threshold is much lower. More like 40-50%. DomRep is in that vicinity, and above it if one considers the quasi-fiscal debt of the Central Bank (16.2% of GDP). Our point is that launching a large fiscal stimulus program to boost the economy in 2023 would make the public debt ratio increase, and thus risk sabotaging the credibility of the new Fiscal Rule framework, even before it enters into force.

[1] George A. Akerlof & Olivier Blanchard & David Romer & Joseph E. Stiglitz (ed.), 2014. "What Have We Learned? Macroeconomic Policy After the Crisis," MIT Press Books. Chapter 15, by Anders Borg, “Fiscal Policy in the Shadow of Debt: Surplus Keynesianism Still Works”, pages184-185.

[2] Reinhart, Carmen, and Kenneth Rogoff. 2010. “Growth in a Time of Debt.” American Economic Review (May): 573-578.

Exhibit 6: Gross debt of the Non-Financial Public Sector (% of GDP)

Gross public debt increased to US$ 54.8bn (46.5% of GDP) by June 2023, from US$ 51.9bn (45.6% of GDP) in year-end 2022



Source: Ministry of Finance (Hacienda), Central Bank (BCRD), BofA Global Research

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We expect NFPS deficit to widen by 1.3pp of GDP in 2023

In our base case scenario, the overall deficit of the Non-Financial Public Sector (NFPS) will widen to 4% of GDP in 2023, from 2.7% in 2022, dragged by the sharp slowdown of activity and pressured by the hike of expenditures proposed in the reformulated budget. Notably, the latest data shows the deficit already widened to 3.5% of GDP in the rolling twelve months ended in May (see Exhibit 5), although we think it went to 3.2% in June because of the (one-off) prepayment of taxes by financial institutions.

The Central Government deficit – which is a narrower definition of the public sector – would be close to 4.5% of GDP by year-end, which is wider than the 3.5% median expectations (consensus) in the Bloomberg survey. In the rolling twelve months ended in June, the Central Government's deficit was 3.8% of GDP. There is one more month of info for the Central Government than for the NFPS because of budget execution data. A higher fiscal deficit would imply larger financing needs.

Exhibit 7: Projected funding needs and sources of the Non-Financial Public Sector

We expect the government to tap international markets again around September 2023, issuing a US$ 1.5bn external bond

	2023		2024		2025	
	US$ mn	% of GDP	US$ mn	% of GDP	US$ mn	% of GDP
Funding needs (= I + II)	6,862	5.7	5,633	4.5	5,825	4.3
I) Fiscal deficit	4,788	4.0	4,160	3.3	3,378	2.5
II) Amortizations	2,074	1.7	1,474	1.2	2,446	1.8
A) External	1,394	1.2	1,116	0.9	2,269	1.7
B) Domestic	680	0.6	358	0.3	177	0.1
Funding sources (= III + IV + V)	6,862	5.7	5,633	4.5	5,825	4.3
III) External	4,750	4.0	4,500	3.6	4,450	3.3
C) Multilaterals	1,300	1.1	900	0.7	1,300	1.0
D) Bilaterals	150	0.1	100	0.1	150	0.1
E) External bonds	3,300	2.8	3,500	2.8	3,000	2.2
i) Hard currency	2,200	1.8	2,500	2.0	2,000	1.5
ii) DOP-linked	1,100	0.9	1,000	0.8	1,000	0.7
F) Banks	-	0.0	-	0.0	-	0.0
IV) Domestic	1,574	1.3	1,133	0.9	1,375	1.0
G) Bonds	1,574	1.3	1,133	0.9	1,375	1.0
V) Cash balances	538	0.4	-	0.0	-	0.0
Nominal exchange rate (USDDOP, average)		55.8		57.9		59.3
Nominal GDP (US$ millions)		119,709		126,046		135,137

Source: BofA Global Research, Ministry of Finance (Hacienda), Central Bank (BCRD)

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Monetary policy has more room for action

Inflationary outlook looks appropriate for easing cycle

Given the limitations and risks affecting fiscal policy, we believe the Central Bank (BCRD) has more degrees of freedom than the Treasury to fight the economic slowdown. Inflation is on a downward path (see Exhibit 8). Headline inflation declined to the BCRD's 4% target in June. We expect it to fall to 3.4% by year-end 2023. Core inflation is a bit higher – still above the upper bound of the tolerance range (4%, +/- 1pp) – but decelerating significantly. Slack in the economy should help bring it down.

Strong credibility and anchored inflation expectations

Another fact that should be reassuring for the BCRD is that inflation expectations have been re-anchored. They are close to 4% across all the time horizons of the monthly survey (end of current year, 12 months, end of next year, and 24 hours). This reflects the strong credibility of the BCRD.

Exhibit 8: BofA's inflation forecasts for the Dominican Republic

Energy prices (fuels and electricity) were repressed since 2Q2022. However, vehicle fuel prices were unfrozen in May 2023. We expect electricity prices to be hiked again in 2025, after the elections, when the new administration resumes the implementation of the electricity reform

	CPI		* Core	
	% mom	% yoy	% mom	% yoy
Dec-22	0.96	7.83	0.60	6.57
Jan-23	0.63	7.24	0.69	6.61
Feb-23	0.11	6.38	0.41	6.40
Mar-23	0.21	5.90	0.28	6.15
Apr-23	0.24	5.16	0.32	5.82
May-23	-0.19	4.44	0.20	5.51
Jun-23	0.22	4.00	0.37	5.33
Jul-23	0.45	3.95	0.33	5.05
Aug-23	0.36	4.11	0.39	4.89
Sep-23	0.34	4.16	0.37	4.76
Oct-23	0.30	4.17	0.18	4.57
Nov-23	0.27	3.97	0.25	4.48
Dec-23	0.42	3.42	0.31	4.17
Jan-24	0.31	3.09	0.39	3.86
Feb-24	0.34	3.32	0.28	3.73
Mar-24	0.37	3.48	0.27	3.72
Apr-24	0.33	3.57	0.23	3.64
May-24	0.14	3.91	0.14	3.57
Jun-24	0.32	4.01	0.21	3.41
Jul-24	0.44	4.00	0.29	3.37
Aug-24	0.39	4.03	0.38	3.35
Sep-24	0.37	4.06	0.38	3.37
Oct-24	0.33	4.10	0.20	3.39
Nov-24	0.31	4.14	0.27	3.41
Dec-24	0.46	4.18	0.33	3.43
Jan-25	0.35	4.22	0.41	3.45
Feb-25	0.38	4.26	0.30	3.47
Mar-25	0.51	4.41	0.29	3.49
Apr-25	0.37	4.45	0.26	3.52
May-25	0.18	4.49	0.17	3.55
Jun-25	0.45	4.63	0.24	3.58
Jul-25	0.47	4.65	0.29	3.58
Aug-25	0.41	4.68	0.38	3.58
Sep-25	0.49	4.80	0.36	3.56
Oct-25	0.35	4.82	0.18	3.54
Nov-25	0.32	4.83	0.25	3.52
Dec-25	0.57	4.94	0.31	3.50

Source: BofA Global Research, Central Bank (BCRD)

* Note: Core prices are defined as the CPI excluding agricultural goods of high volatility, alcoholic beverages, tobacco, fuels, regulated services and transport. The core price index has a weight of 69.81% in the CPI.

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We note some inflation-targeting central banks in Latin America are still having problems with the de-anchorage of inflation expectations, above their tolerance ranges. This delays the initiation of monetary easing cycles. To be sure, cutting rates with de-anchored inflation expectations is like walking on thin ice. Or put differently, it reduces the central bank's capacity to cut rates and stimulate the economy without fanning inflation. It messes up the transmission of monetary policy. The BCRD does not have to worry about that problem.

We forecast 225bp of rate cuts in next ten months

In our scenario, the BCRD would cut rates by 25bp at the August 31st meeting; pause in September – when the Fed hikes – mindful of exchange rate depreciation; and then cut 25bp in each monthly meeting until reaching a policy rate of 5.50% by May 2024 (see Exhibit 9). We believe the BCRD will neither go faster with the pace (25bp) nor deeper with the terminal rate (5.50%) for three reasons.

First, they are already rolling out other monetary stimulus measures of large proportions. In June, the BCRD launched a Funding for Lending program of DOP 119bn (2% of GDP) which has two legs: i) 2 percent cut in local currency reserve requirements (DOP 34bn),

Exhibit 9: BofA forecasts for the Dominican Republic's monetary policy rate (end-of-period, %)
We believe the easing cycle will be gradual, transitioning from a contractionary to a neutral stance

Month	Monetary policy rate (%)
Dec-22	8.50
Jan-23	8.50
Feb-23	8.50
Mar-23	8.50
Apr-23	8.50
May-23	8.00
Jun-23	7.75
Jul-23	7.75
Aug-23	7.50
Sep-23	7.50
Oct-23	7.25
Nov-23	7.00
Dec-23	6.75
Jan-24	6.50
Feb-24	6.25
Mar-24	6.00
Apr-24	5.75
May-24	5.50
Jun-24	5.50
Jul-24	5.50
Aug-24	5.50
Sep-24	5.50
Oct-24	5.50
Nov-24	5.50
Dec-24	5.50
Jan-25	5.50
Feb-25	5.50
Mar-25	5.50
Apr-25	5.50
May-25	5.50
Jun-25	5.50
Jul-25	5.50
Aug-25	5.50
Sep-25	5.50
Oct-25	5.50
Nov-25	5.50
Dec-25	5.50

Source: BofA Global Research, Central Bank (BCRD)
Note: If the Central Bank meeting is on the last day of a month, we assume the rate decision (new value of the policy rate) becomes effective on that same day.

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and ii) the Rapid Liquidity Facility (FLR) to channel DOP 85bn to productive sectors and households. The take-up has been quick. On July 18th, the BCRD issued a press release saying DOP 59bn (50%) had already been disbursed.[3]

Second, the Dominican Peso is under depreciation pressure. Between the end of May and August, the DOP weakened more than 3% to the US dollar. In DomRep the implications of exchange rate depreciation are more complex than in inflation targeting LatAm peers. Given DomRep is the country in LatAm with the highest foreign currency share of public debt (over 70%) a large DOP depreciation can beget concerns about financial instability. Let alone the financial system is partially dollarized.

At this moment, the BCRD and the Fed are adjusting policy in opposite directions. Holding everything else constant, the DOP should weaken in response to the narrowing of the interest rate differential, as peso-denominated assets become relatively less attractive. Thus, we think it makes more sense to assume the BCRD will proceed with caution, in small steps. Such strategy would make large moves in the currency less likely.

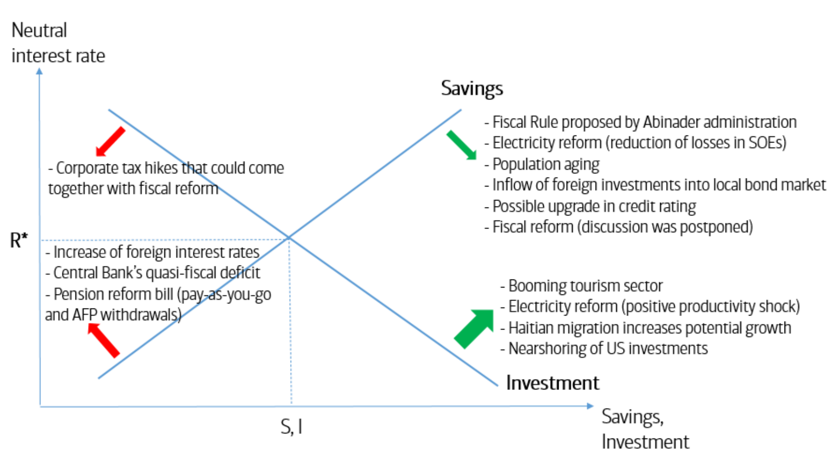
Third and last – more related to the terminal rate than the pace of the cuts – by the time the policy rate reaches 5.50%, that is May 2024 (in our scenario), the GDP growth outlook will probably have already improved a lot. We expect a rebound of GDP growth to 5.1% in 2024, and 5% in 2025. This is around the potential growth rate of the Dominican economy. With the economy in goldilocks mode (growth and inflation near desired levels), the BCRD will no longer feel the pressure to deliver more easing.

Moving from contractionary to neutral stance

A monetary policy rate of 5.50% would be broadly in line with what the BCRD considers the neutral interest rate. Their official estimate of the neutral rate is – to be more precise – made for the interbank interest rate. The BCRD estimates the neutral level of the interbank interest rate between 1% and 2%, in ex-ante real terms, or between 5% and 6% in nominal terms (adding the 4% inflation target).

In 2023, there has been an abnormally large spread between the interbank rate and the policy rate, of around 300bp, much higher than the historical average (~100bp). We believe the rollout of the liquidity measures (2% of GDP) and other actions will likely help to

Exhibit 10: Forces shaping (or that might shape) the neutral interest rate in the Dominican Republic
Neutral rate is fundamentally pinned down by the balance of savings and investment. In DomRep, we believe the thicker green line, pushing investment up, is what dominates



Source: BofA Global Research

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[3] See details here, https://www.bancentral.gov.do/a/d/5733-recursos-desembolsados-por-el-banco-central-para-sectores-productivos-hogares-y-mipymes-alcanzan-rd58741-millones-con-rd9662-millones-para-las-micro-pequenas-y-medianas-empresas.

bring down the spread to normal levels in the coming months. The latest data shows the spread is down to 218bp in August.

Remarkably, in June, the BCRD reduced the interest rate corridor in an asymmetric way, cutting the overnight deposit rate more than the repo rate (discount window). Thus, the spread between the repo interest rate (at which banks borrow from the BCRD) and the policy rate remains at 50bp, whereas the spread rate between the overnight deposit rate (earned by banks which have deposits at the BCRD) was widened to 100bp. In other words, the deeper reduction in the overnight deposit rate (to 6.75%) should nudge banks to lend more in the interbank market, instead of parking their funds at the BCRD.

Finally, we wouldn't be surprised if the BCRD increases its estimates of the neutral interest rate. Thinking about the forces that shape the neutral rate (see Exhibit 10), the ones that push rates up – either through higher investment or lower savings – are already happening (except for the pension reform). The strong track-record (and outlook) of investment – in our view – is the main force. We think that explains, at least partly, why the Dominican Republic historically stands out as a fast-growing economy. Strong, sustained, economic growth implies high returns to capital (interest rates). In contrast, the forces pushing rates down in Exhibit 10 are mainly a list of possibilities, rather than events that have materialized (except for population aging and the electricity reform).

Exhibit 11: Summary of macroeconomic forecasts for the Dominican Republic
We expect GDP growth to pick up in coming years, after a soft patch in 2023

	2016	2017	2018	2019	2020	2021	2022	2023F	2024F	2025F
Nominal GDP (US$ billions)	75.7	80.0	85.5	88.9	78.9	94.3	113.6	119.7	126.0	135.1
GDP growth (% year-over-year)	6.7	4.7	7.0	5.0	-6.7	12.3	4.9	2.0	5.1	5.0
CPI inflation (year-over-year, end-of-period)	1.7	4.2	1.2	3.7	5.6	8.5	7.8	3.4	4.2	4.9
Current account balance (% of GDP)	-1.1	-0.2	-1.5	-1.3	-1.7	-2.8	-5.6	-3.2	-2.7	-2.0
Net international reserves (US$ billions)	6.0	6.8	7.6	8.8	10.8	13.0	14.4	16.4	17.9	19.4
Nominal exchange rate (DOP/US$, end-of-period)	46.7	48.2	50.4	53.1	58.2	57.3	56.2	57.0	58.4	59.9
Monetary policy rate (%, end-of-period)	5.50	5.25	5.50	4.50	3.00	4.50	8.50	6.75	5.50	5.50
Gross Non-Financial Public Sector debt (% of GDP)	35.4	36.9	37.6	40.4	56.6	50.6	45.6	47.0	47.6	47.0
Non-Financial Public Sector primary balance (% of GDP)	-0.1	-0.2	0.3	0.4	-4.3	0.6	0.2	-0.9	-0.2	0.5
Non-Financial Public Sector overall balance (% of GDP)	-2.7	-2.8	-2.3	-2.3	-7.6	-2.5	-2.7	-4.0	-3.3	-2.5

Source: BofA Global Research, Central Bank (BCRD), Ministry of Finance (Hacienda), Bloomberg

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