



Session 2: Global Financial Crisis and capital flows Dominican Republic

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A close-up, artistic photograph of several Dominican Republic coins. The coins are golden and feature the national coat of arms, which includes a cross, a book, and a laurel wreath. The word "REPÚBLICA" is visible on the coins. The image is partially cut off on the right side.

Contents

1. Capital flows in DR
2. Exchange rate market in DR
3. Transmission mechanisms

Exchange rate policy and capital flows in DR during the last two decades have been conditioned by several internal factors:

I. **Domestic financial crisis (2003-2004), leading to:**

- *Economic recession and high inflation*
- *Drop of exchange rate as nominal anchor*
- *Total loss of international reserves (IR)*

The CBDR needed to accumulate IR, while going through a process of capitalization.

II. **The adoption of Inflation Targeting (2012), combined with an managed float exchange rate regime, considering:**

- *A high exchange rate pass-through to inflation*
- *Relevance for financial stability*

III. **Highly concentrated exchange rate market, still in early stages of development**

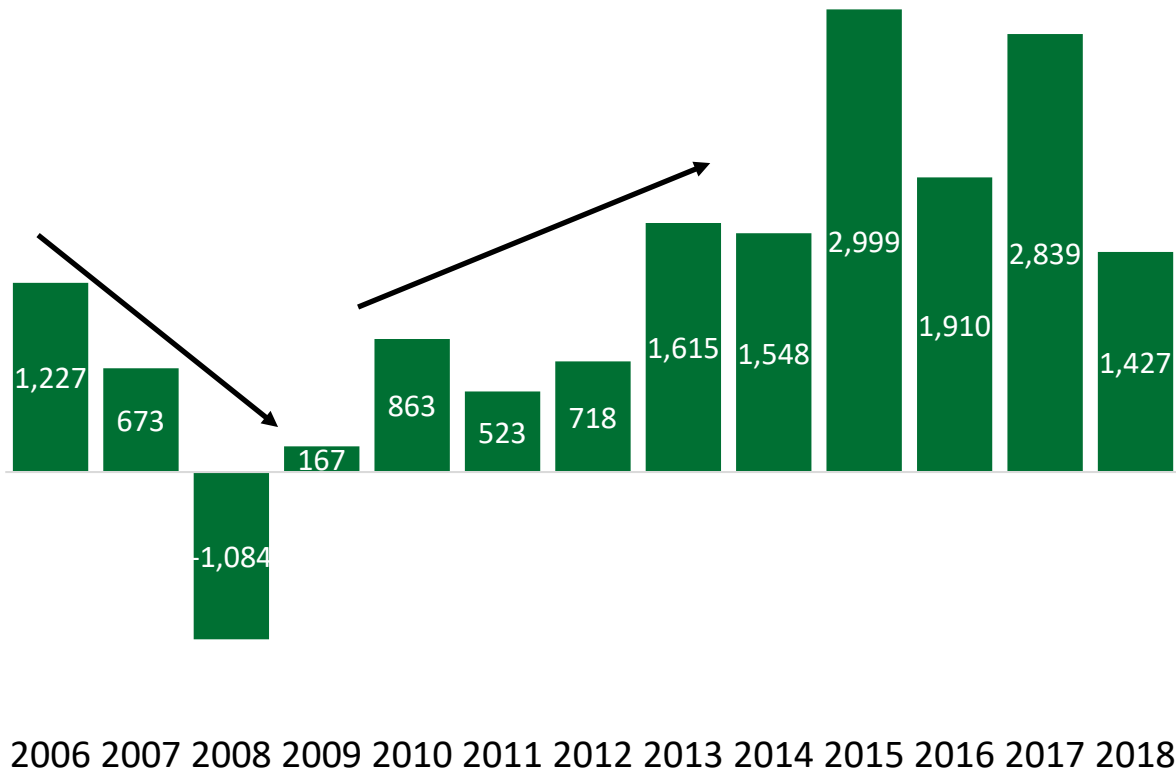


Capital flows in DR

The DR ranks first within Central America in outstanding portfolio investment, as annual inflows have averaged 2.1% of GDP over the last decade...

Foreign Investment Inflow to DR
In US\$ Million

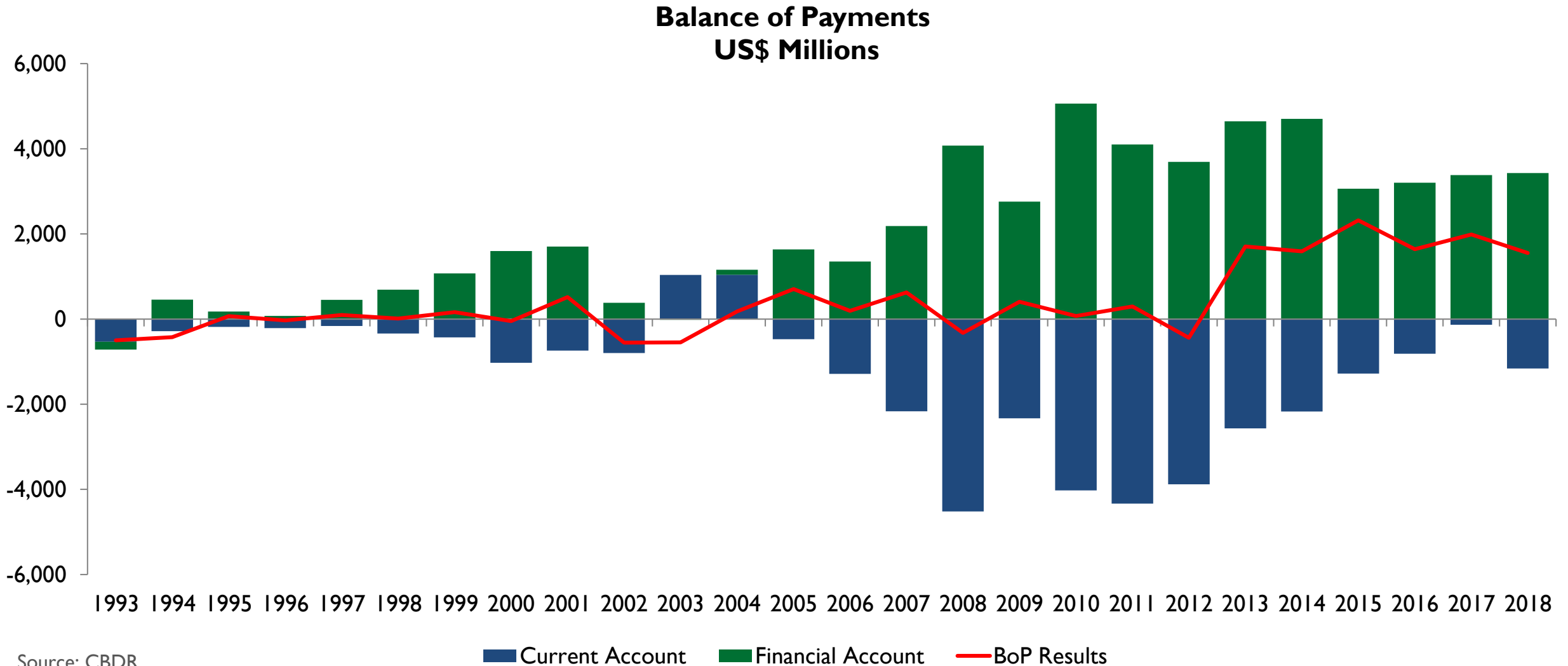
■ Portfolio Investment



*Liabilities from the International Investment Position (IIP)

Latin America	Outstanding Portfolio Investment (% GDP)
Mexico	40%
Chile	32%
Panamá	29%
Perú	27%
Brazil	27%
Colombia	24%
Argentina	22%
Dominican Republic	20%
El Salvador	19%
Costa Rica	15%
Honduras	9%
Guatemala	6%
Nicaragua	1%

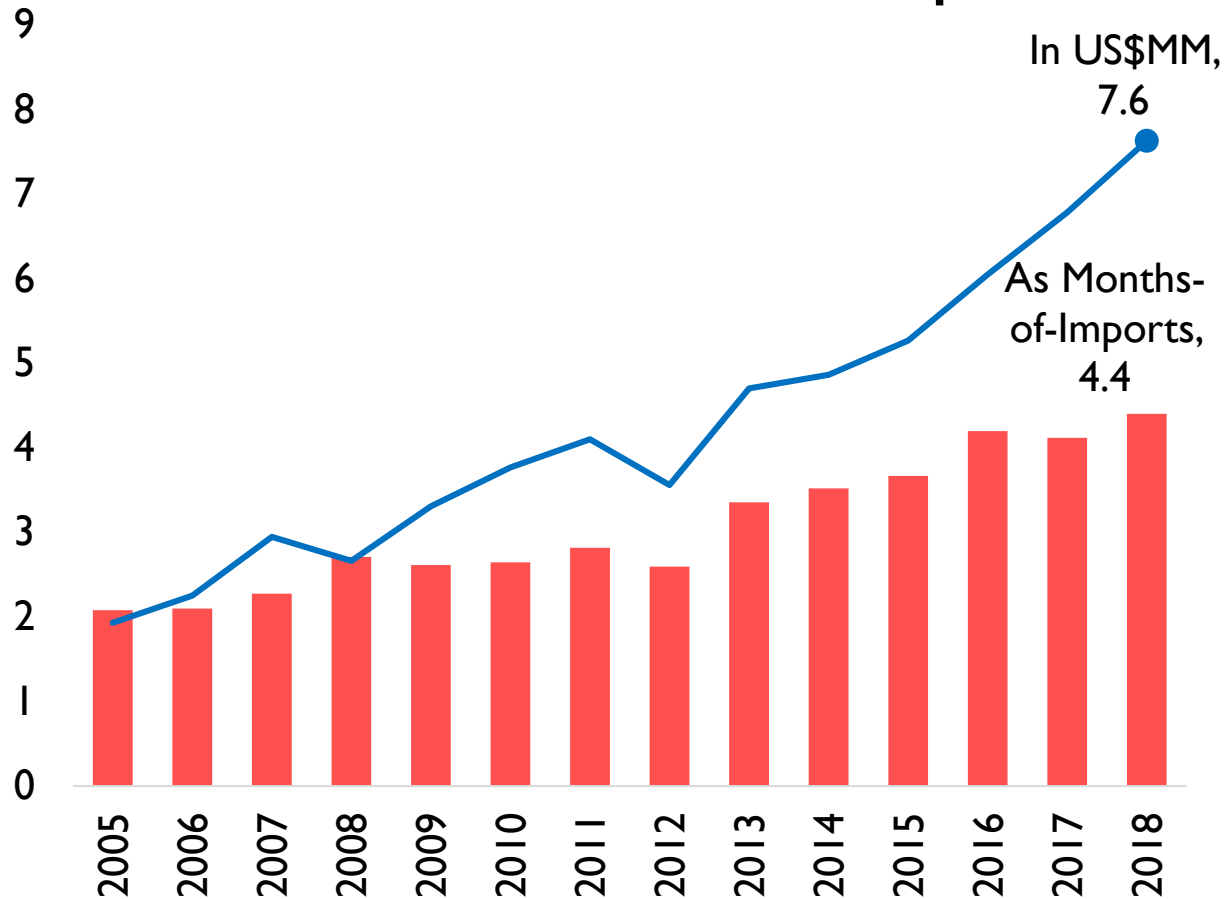
The increase of capital flows during the last decade is reflected in the financial account, which, in addition to a lower CA deficit, has contributed to a positive performance of the BoP...



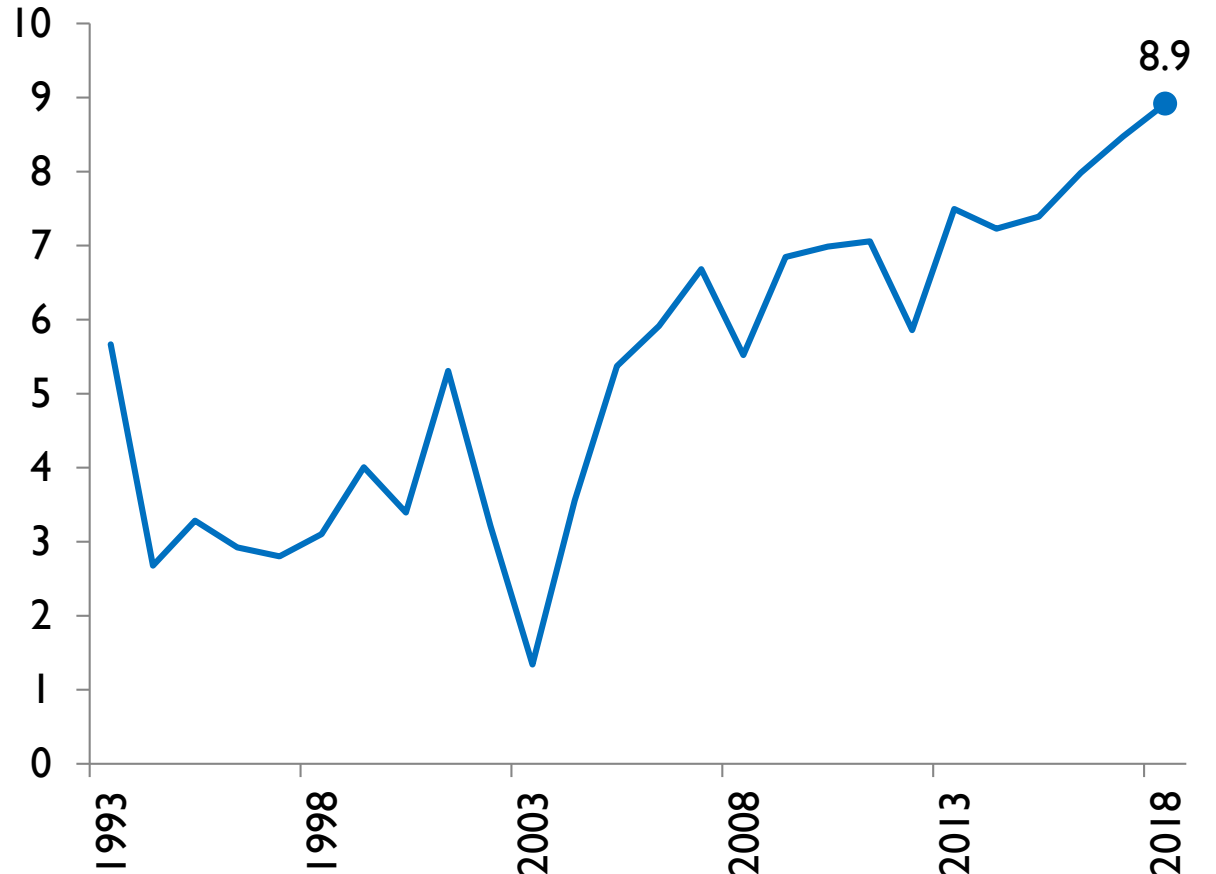
Which allowed the accumulation of international reserves...

Gross International Reserves

In US\$MM and as Months-of-Imports



As % GDP



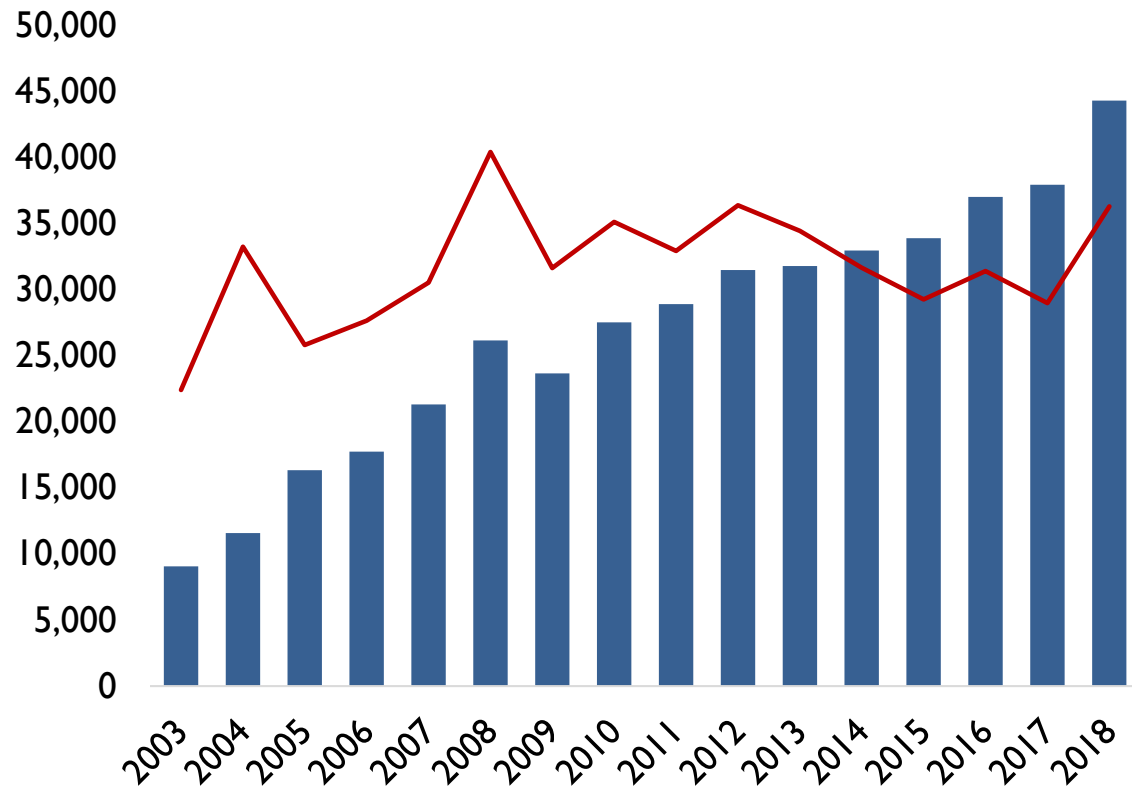
A close-up, artistic photograph of several Dominican Republic coins. The coins are golden and feature the national coat of arms, which includes a shield with a cross, a book, and a scale, surrounded by a laurel wreath. The word "REPUBLICA" is visible on the coins. The coins are arranged in a way that they overlap, creating a sense of depth and texture.

Exchange Rate Market in DR

Annual FX operations represent around 50% of GDP. Most of these transactions are carried through financial intermediaries...

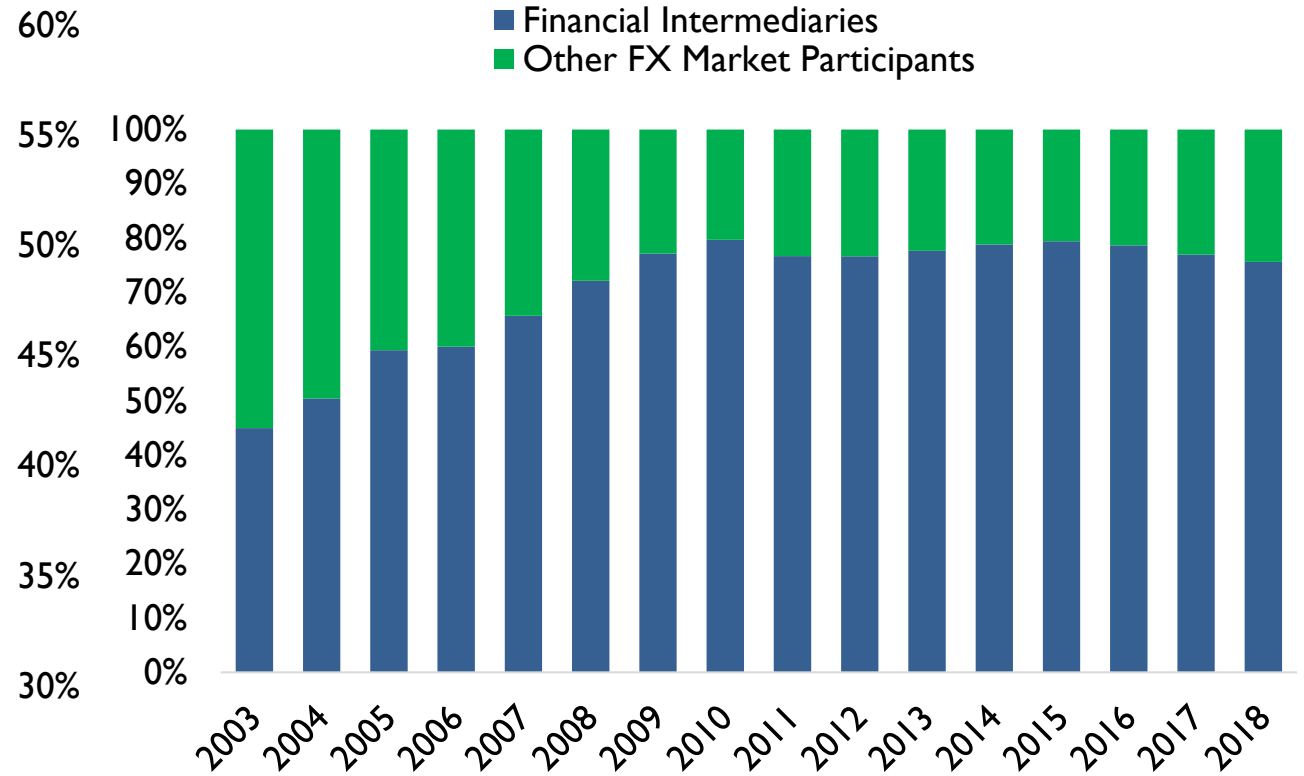
Volume of Gross FX Operations

■ US\$ Millions — % GDP



Volume of Gross FX Operations By Type of Intermediary (% Total)

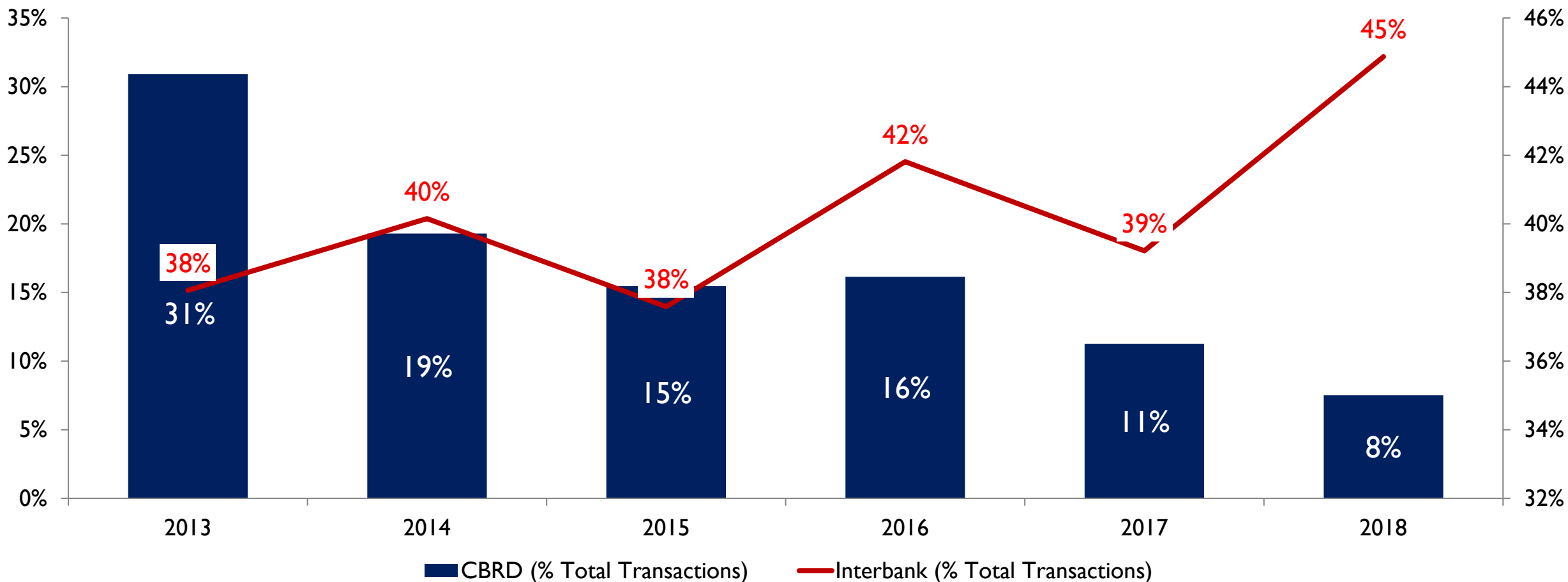
■ Financial Intermediaries
■ Other FX Market Participants



60% of these operations are carried out by three entities and 98% of them take place at the spot market...

In recent years the CBDR has decreased its participation in the ER market, while interbank operations have increased their role...

FX Operations





Transmission Mechanisms

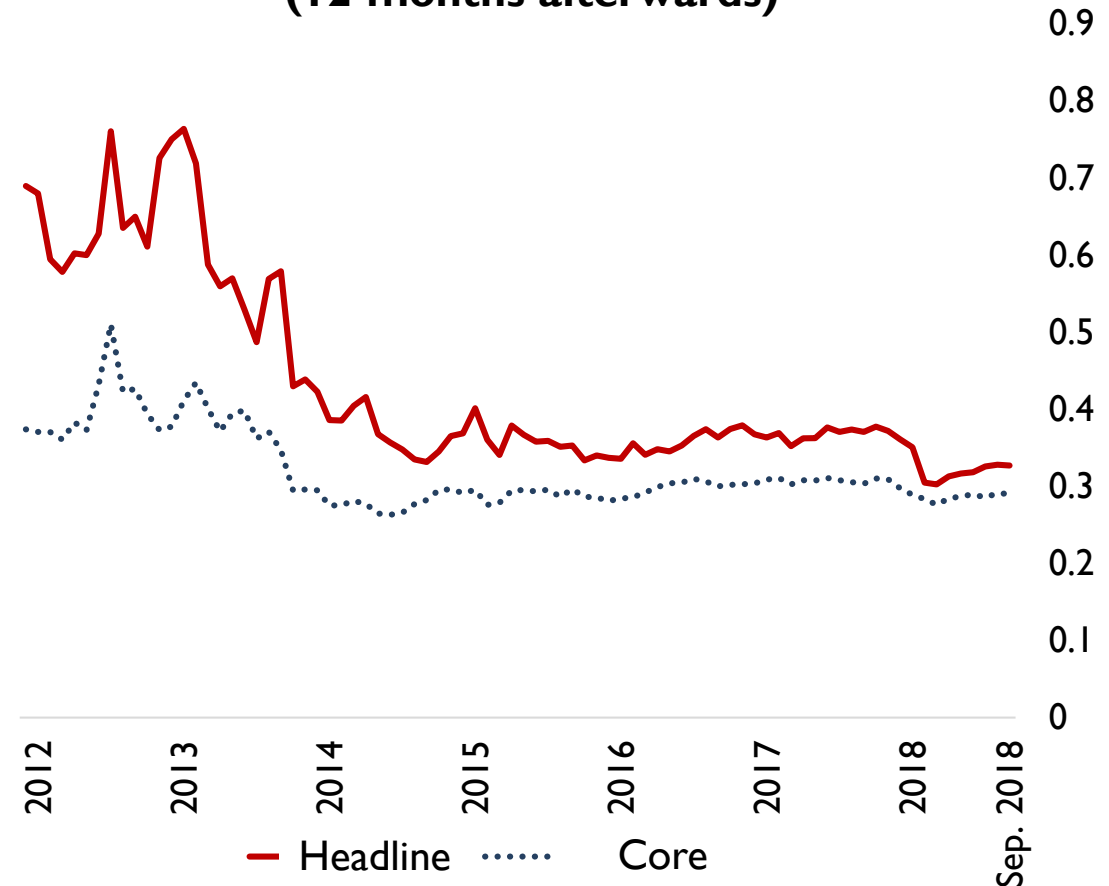
There has been a reduction of the exchange rate pass-through to inflation in recent years, even though it is still significant...

Previous studies evidenced:

- **A pass-through to inflation close to 80% in the medium-run** (*Williams et al.(2003); Hernández (2006); Fuentes et al. (2007)*).
- **An asymmetric pass-through by income quintile** (*Fuentes et al.,2009*)

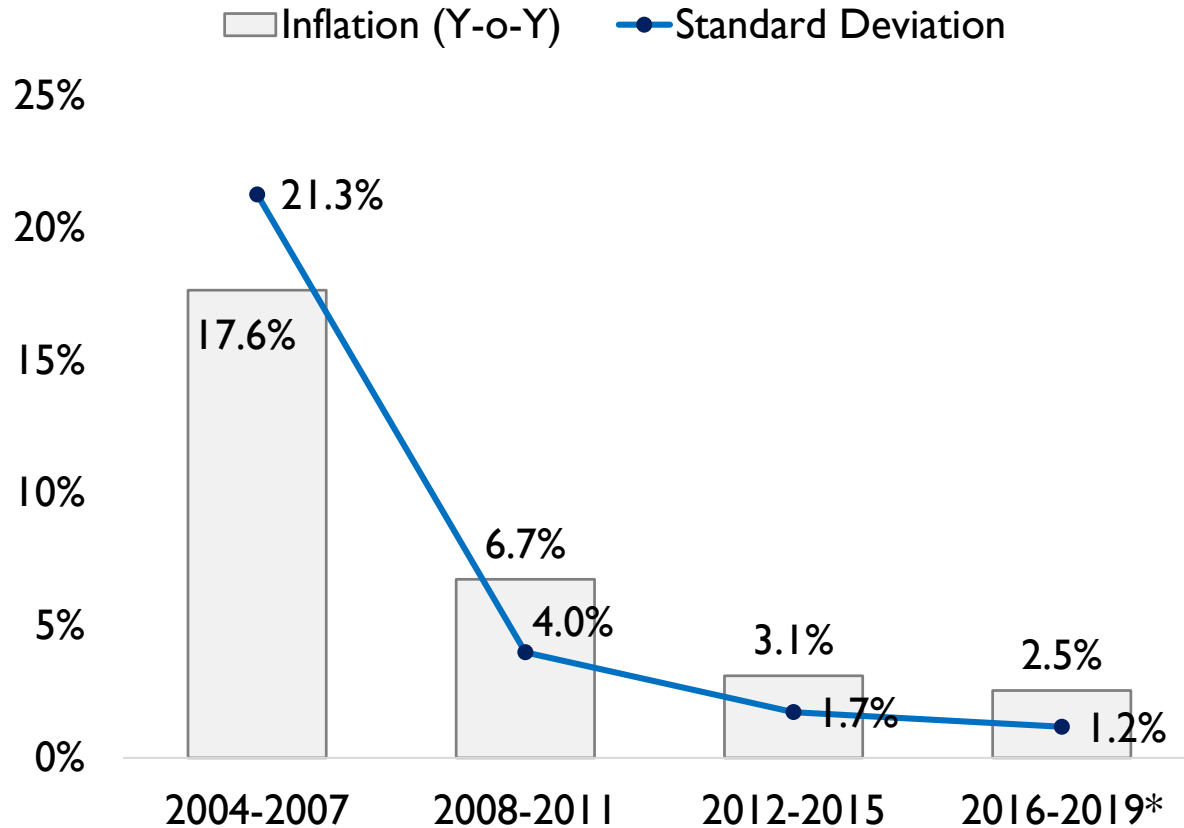
However, after the implementation of the IT regime, a reduction of the pass-through on impact, as well as for the medium-run, has been observed...

Pass-through from Exchange Rate to Inflation (12-months afterwards)

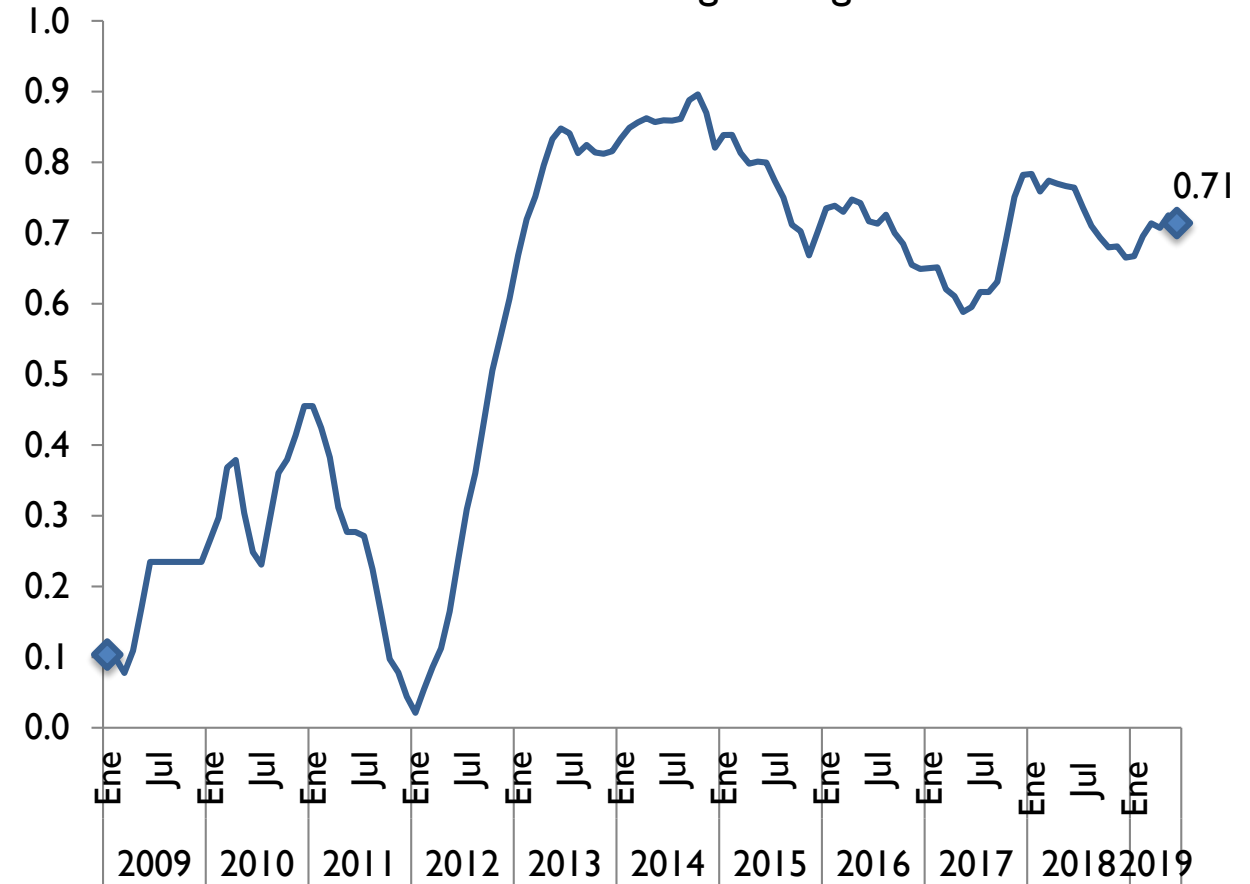


This relates to the strengthening of the IT regime and greater anchorage of inflation expectations ...

Average Inflation Y-o-Y(%)

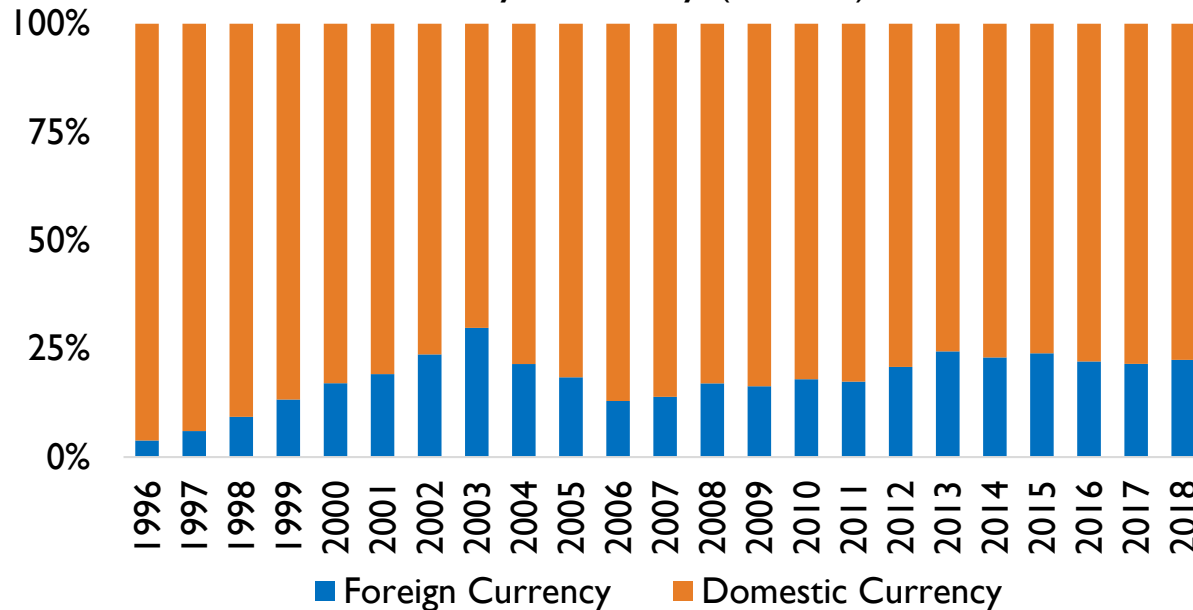


Inflation Expectations Anchorage Index 12-Month Moving Average

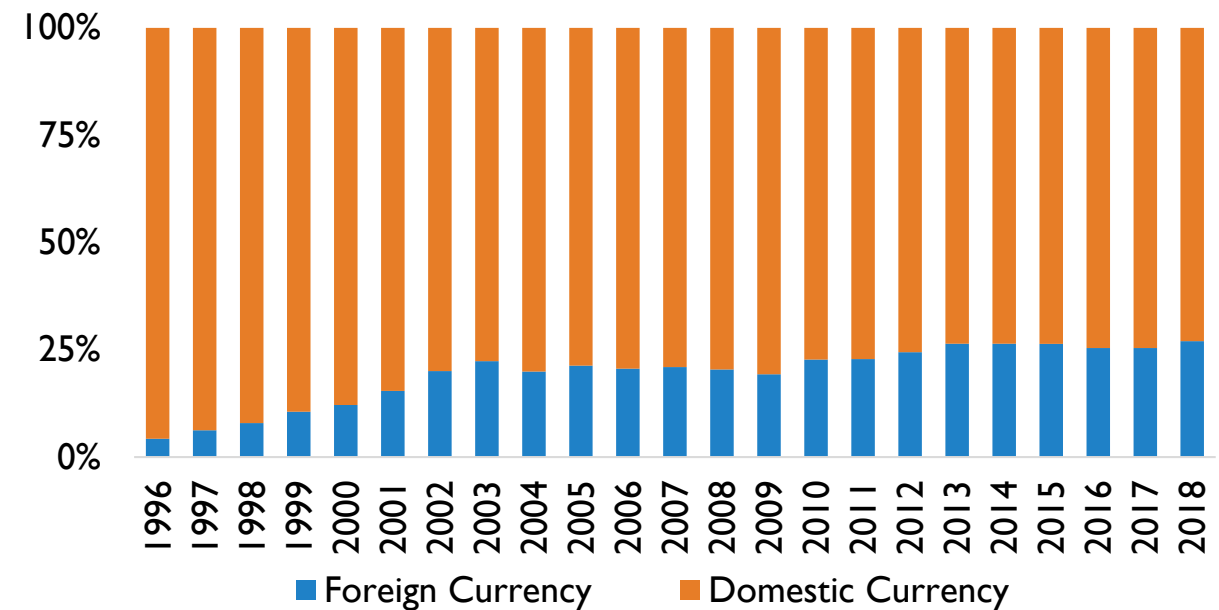


Regarding financial stability considerations, dollarization of the financial system have remained relatively low and stable...

Loans of the Financial System
By Currency (% Total)



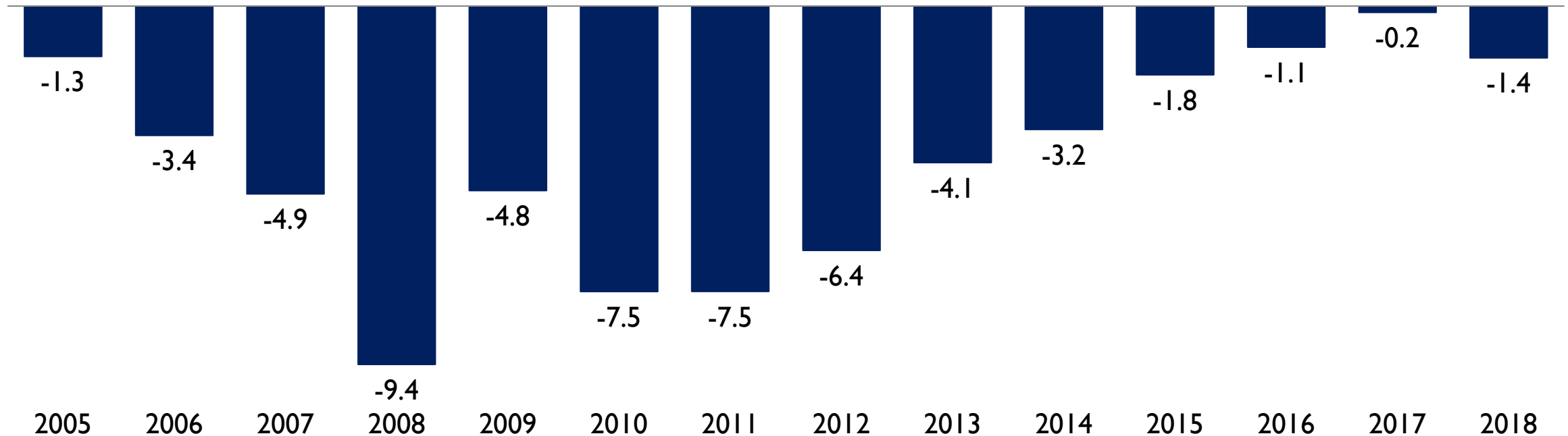
Deposits of the Financial System
By Currency (% Total)



- Studies evidence that **interest rate differential impacts deposit dollarization, specially when combined with an acceleration of the exchange rate depreciation.**
- In addition, the **CBDR is working on the development of hedging instruments** that moderate financial vulnerabilities to Exchange rate volatility.

A more competitive REER and more favorable terms of trade have allowed the Current Account balance to improve...

Current Account Balance
(% GDP)



Recent developments and challenges ahead...

- **Implementation of the CBDR electronic FX trading platform**
 - Fostering transparency and efficiency in the FX market.
- **Use of derivatives in FX interventions**
 - With the purpose of moderating the monetary effects of FX interventions and smoothing the seasonal demand for FX.
- **Improving regulatory framework** for FX operations and macroprudential policies
- **Challenges in communicating** the objectives of FX interventions and its consistency with monetary policy stance.