

Press Release
**MONETARY BOARD AUTHORIZES CENTRAL BANK TO ADOPT
INFLATION TARGETING**

The Central Bank of the Dominican Republic wishes to inform the public that the Monetary Board, in its First Resolution of December 15, 2011, **authorized the establishment by the Central Bank of a monetary policy framework based on Inflation Targeting (IT) as of January 2012**. In this regard, the Central Bank recently released its 2012 Monetary Program in conformity with an Inflation Targeting framework.

The inflation target is defined as the year-on-year change in the Consumer Price Index (CPI), following the best practices of many central banks that implement this monetary policy strategy. The current scenario approved by the Monetary Board authorizes the Central Bank to follow a declining inflation target for the next 4 years, according to the scale listed below:

Year	Inflation Target central value	Deviation
2012	5.5%	+/-1%
2013	5.0%	+/-1%
2014	4.5%	+/-1%
2015	4.0%	+/-1%

The long term inflation target of 4% has come about as a result of research that indicates that this is an optimal level, sustainable over time and compatible with the potential GDP growth rate.

Under Inflation Targeting, central banks report the decisions relative to monetary policy and the arguments that support such measures taken. Beginning in 2005, the Central Bank began preparing the technical aspects needed to achieve a gradual transition from a monetary aggregate target to an inflation targeting framework, with the advice of experts from the major central banks of the region and the IMF.

In view of this, for the past several years the Central Bank has been holding monthly Monetary Policy Meetings to determine whether to maintain or vary its monetary policy stance, as reflected in the interest rate corridor resulting from short-term interest-bearing deposits, which carry the policy rate, and the Lombard interest rate. These meetings discuss the trade-offs between domestic and international risks to the established inflation target and make the adjustments deemed necessary given the estimated transmission channels of monetary policy, as is the case with all central banks that have adopted an inflation targeting framework.

Decisions arising from this monthly meeting are published in a communiqué on the Central Bank website. In addition, the Central Bank publishes biannually, in June and December, a Monetary Policy Report (IPoM), which looks at the history, strategy, and results of the monetary policy implemented during the previous period, as well as the short and medium-term prospects for the relevant macroeconomic variables, especially inflation, with the aim of strengthening transparency with regard to monetary policy decisions.

In its 2010-13 Strategic Plan, under Objective 1 for 'Price Stability' the Central Bank formalized the strategy of adopting a monetary policy framework based on inflation targeting, and has been involved in a gradual transition, introducing elements of IT, among which are:

- *Strengthening of macroeconomic variable forecast systems,*
- *Studies on the various monetary policy transmission channels,*
- *Surveys of macroeconomic expectations and business community opinions,*
- *Definition of the monetary policy interest rate corridor,*
- *Use of indirect monetary policy instruments for liquidity management,*
- *Institutionalization of monetary policy meetings and publication of the communiqués,*
- *Publication of the Monetary Policy Report.*

The Monetary Board's decision to adopt an Inflation Targeting framework draws upon Article 228 of the Constitution of the Dominican Republic, which provides, *inter alia*, that the Central Bank is to ensure price stability. Furthermore, it draws upon the acknowledgement that after the banking crisis of 2003-2004, the relationship between base money and inflation was debilitated due to the sophistication of the financial system and the payment system. This is a situation shared with many other countries.

The goal of transforming monetary policy into an Inflation Targeting based scheme is also contained in the Stand-by Agreement with the International Monetary Fund, which runs until February 2012, in which the Central Bank pledges to establish a monetary policy framework based on inflation targeting by 2012.

Unlike the traditional system based on monetary aggregates, under the new IT strategy monetary aggregates become indicative or tracking variables. Accordingly, anchoring inflation expectations to the announced target becomes the intermediate objective of monetary policy, given that the IT framework is forward-looking in the sense that it acts to prevent possible inflation deviations with respect to the announced target.

The Central Bank of the Dominican Republic (CBDR), aware of its role as the main monetary authority and of its principal objective of ensuring price stability as established in the Constitution of the Dominican Republic and the Monetary and Financial Law, is implementing this new Inflation Targeting Framework in the furtherance of institutional strengthening and modernization of its management of the economy.

“This new methodology will allow us to bring certainty to economic agents, creating the conditions for inflation to gradually converge on the objective. It will also enable further institutional progress and greater autonomy for the Central Bank.”

Hector Valdez Albizu - Governor of the Central Bank (November 26, 2011)

Among the benefits provided by this new framework is that IT allows for the anchoring of the economic agents' and investors' expectations to the Central Bank inflation target, so as to create confidence and help eliminate unwanted expectations that affect the business environment, and thus, stability. In effect, with regard to inflation, this will allow businesses to plan their activities each year within a horizon of security.