



CENTRALE BANK VAN ARUBA

# Economic outlook<sup>1</sup>

May 2017

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<sup>1</sup> This document includes forecasts that represent assumptions and expectations of the Centrale Bank van Aruba (CBA) in light of currently available information. These forecasts involve uncertainties. The actual results may differ from those projected in this document. Consequently, no guarantee is presented or implied as to the accuracy of specific forecasts contained herein. The CBA does not assume any liability for any loss that may result from reliance on this information.

**Contact:**

Centrale Bank van Aruba

Research Department

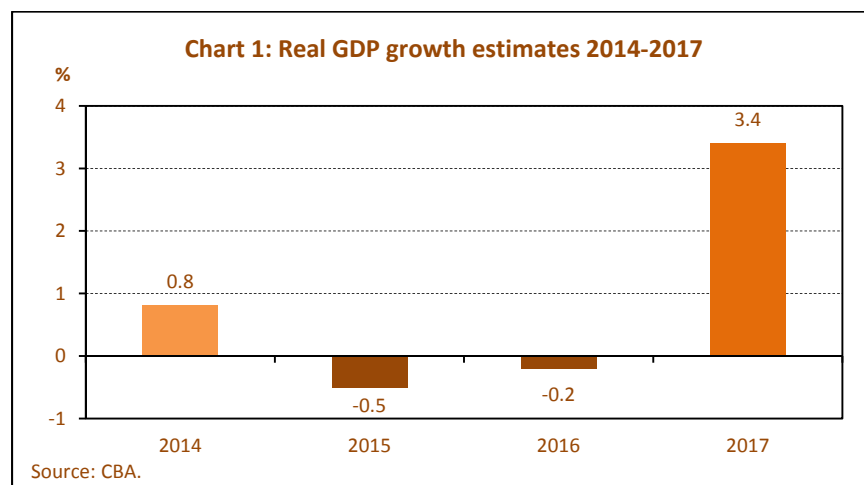
[researchmanagers@cbaruba.org](mailto:researchmanagers@cbaruba.org)

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## 1. Introduction

The Centrale Bank van Aruba (CBA) revised its GDP forecast to reflect the most recent developments and data for 2016 and 2017. According to the new estimates, GDP contracted in real terms during 2016 when compared to 2015, while a 3.4 percent growth is expected for 2017 (see Chart 1).



## 2. Economic forecast

### 2.1 Gross domestic product and its components

The *revised* growth forecast for 2016 constitutes a decrease in real output of 0.6 percentage point compared to the previous forecast (see Table 1). The update reflects mainly two major developments in opposite directions: an upward revision in tourism exports following better-than-anticipated tourism receipts, and a downward revision in investments driven chiefly by a postponement in the refurbishment of the oil refinery. While this activity at the refinery was previously expected to lead to a substantial investment in the fourth quarter of 2016, the current estimate takes into account that only limited (operational) activities took place during 2016. Real GDP in 2017 is expected to grow by 3.4 percent, driven in large part by private investment activity related to the transformation of the oil refinery into an upgrader and commensurate consumption.

**Table 1: Comparison of economic estimates and forecasts for 2016 and 2017**

Indicator (real)	Current estimate (percent)	Previous estimate (percent)	Change (percentage point)
<b>2016</b>			
GDP	-0.2	0.4	-0.6
Consumption	-3.7	0.2	-3.9
Investment	-0.7	24.1	-24.8
Exports	0.3	-2.0	2.3
Imports	-3.5	5.5	-9.0
Indicator (real)	Current forecast (percent)	Previous forecast (percent)	Change (percentage point)
<b>2017</b>			
GDP	3.4	3.2	0.2
Consumption	2.8	-	-
Investment	28.6	-	-
Exports	-0.3	-	-
Imports	7.5	-	-

Source: CBA.

### *Tourism*

**Activities in tourism service exports, the main driver of economic growth, were virtually flat for 2016.** Overall visitor nights decreased by 4.3 percent in 2016, attributed mainly to a drop in Venezuelans staying at other accommodations (mainly private homes) while visitor nights of tourists from the United States, the main tourism market, showed a growth of 0.4 percent. Whereas tourism receipts were previously anticipated to decrease by 3.4 percent for 2016, the first three quarters of the year registered only a slight drop, prompting an upward adjustment to an estimated contraction of 0.2 percent for the year 2016 as a whole.

**Tourism receipts, as registered in the balance of payments, are forecasted to grow nominally by 1.3 percent in 2017.** Crucial here is the intention of the hotel sector to ask a higher average daily rate for hotel rooms. In real terms, tourism will decrease slightly as the number of stay-over visitors and visitor nights are expected to decline by 1.9 percent and 1.7 percent, respectively. An anticipated increase in airlift from the United States should contribute to a growth in visitors from the U.S. market but this is insufficient to fully eliminate the significant drop in visitors from Venezuela.

### *Investments*

**Notable large investment projects in 2016 included the Green Corridor and the renovations of the Dr. Horacio E. Oduber hospital, the Hilton hotel, and the Marriott hotel.** Additionally, observed indicators of construction activity as well as credit indicate some improvement in overall investment activity for 2016. On the other hand, delays in the large investments relating to the oil refinery

refurbishment into an upgrader that were expected to commence in the fourth quarter of 2016 caused significant shifts in investments towards 2017.

The 2017 forecast considers a number of tourism-related accommodation projects that are in the pipeline as well as a continuation of various large projects that got underway in 2016, such as the renovation of the hospital and the Green Corridor.

Taking into account an imminent start of construction activity to refurbish the oil refinery, the CBA has included a preliminary estimate of the project's potential contribution to its nominal GDP estimates. The estimates benefitted from consultation meetings between the CBA staff and representatives of the Refineria di Aruba (RDA), CITGO Aruba, and the government. Given the preliminary nature of the project execution plan and considering that the scope and planning (involving a third party that will execute the project) still needs to be completed, forecasts at this point inevitably face uncertainties relating to:

- the timing of different phases of investment activities;
- the total sum of investments;
- the average labor needs, given various intensity levels through the different phases; and
- the overall duration of the refurbishment activities.

Based on the mentioned consultation meetings, the following assumptions are made:

- Refinery refurbishment investments are phased in over a period of 48 months, starting in July 2017. This constitutes a deferral in investment activities compared to the previous GDP estimates.
- In the second half of 2022 and the first half of 2023, large reinvestments are anticipated to complete a planned turnaround.
- RDA, the entity that owns the refinery, will receive annual lease payments from CITGO Aruba.
- The refinery will start operations at two-thirds capacity in 2020 with transition to full capacity in 2021.

### *Consumption subdued*

**Consistent with the faltering tourism industry performance, private consumption is estimated to have contracted (-3.9 percent) in 2016 as consumption-related indicators underperformed.**

Consumer sentiments remained largely pessimistic, reflected also in a 4.8 percent decrease in consumer credit, mainly fueled by a lower amount of personal loans as well as car loans. The conclusion of a slowdown in consumption is corroborated by 4.0 percent higher savings deposits at the commercial banks at the end of 2016 compared to 2015.

Further analysis of consumption indicates that housing mortgages expanded by 4.5 percent with an average monthly growth of Afl. 4.2 million in 2016. Initial analysis of the foregoing consumer trends suggests that collaborative consumption, or the so-called 'sharing economy', could be partially responsible for inducing the continued growth in housing mortgages. Findings indicate that perhaps

a 60 percent of growth in housing mortgages is related to the rapid rise in visitors seeking alternative tourism accommodations, estimated at 26 percent of total visitor arrivals in 2016. It thus seems that both international tourism markets trends and domestic consumption habits experienced structural shifts over the course of 2016, and are likely to continue during 2017 and beyond.

In 2017 consumption is expected to pick up by 2.8 percent, in large part due to increasing investments leading to additional disposable income through higher employment.

### *Continued deflation*

**Consumer prices, as measured by the CPI, are expected to remain in deflationary territory in 2017 (-1.1 percent) following a decline of 0.9 percent in 2016.** While the decrease in prices in 2016 occurred primarily as a result of reduced electricity tariffs and lower gasoline prices following decreased oil prices on the international market, a forecasted rebound in oil prices is expected to incite inflationary pressures in 2017. Nevertheless, these would be offset by the 15 percent reduction in the electricity tariff for households introduced in January 2017. While international oil prices are expected to rise in 2017 leading to an increase in domestic gasoline prices, the effect of the lower electricity tariff is expected to drive down the overall price level for 2017 as well, reaching -1.1 percent for the year as a whole.

### *Nominal growth rates*

**GDP in nominal terms is estimated to have contracted by 0.9 percent in 2016 (Table 2).** Following the deflation in consumer prices realized in 2016 and projected for 2017, the nominal GDP growth estimates are generally lower than the projected growth in real terms.

**Table 2: Nominal GDP estimates and forecasts**

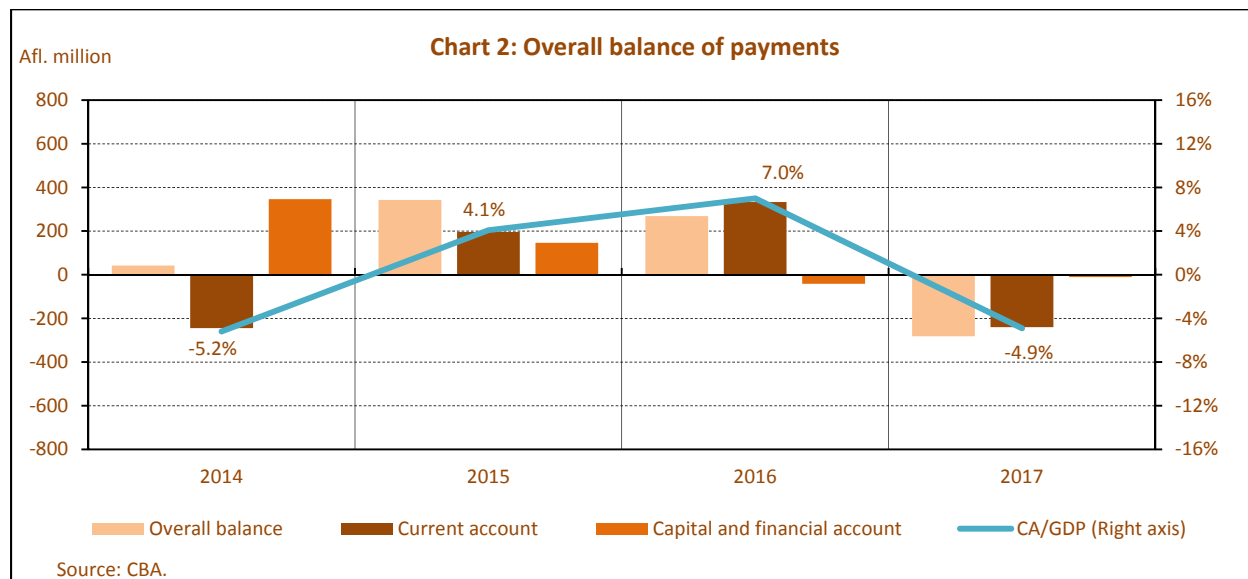
		2014 <sup>e</sup>	2015 <sup>e</sup>	2016 <sup>e</sup>	2017 <sup>f</sup>
GDP	Afl. mln.	4,742.5	4,819.6	4,774.1	4,876.0
	%-change	2.6	1.6	-0.9	2.1
Consumption	Afl. mln.	4,124.8	4,086.0	3,936.6	4,026.7
	%-change	-0.8	-0.9	-3.7	2.3
Investment	Afl. mln.	1,087.1	1,034.8	1,035.5	1353.6
	%-change	-2.0	-4.8	0.1	30.7
Exports	Afl. mln.	3,313.1	3,349.3	3,350.6	3,391.4
	%-change	4.5	1.1	0.0	1.2
Imports	Afl. mln.	3,782.5	3,650.6	3,548.6	3,895.7
	%-change	-0.8	-3.5	-2.8	9.8

Source: CBA.

e = estimation; f = forecast.

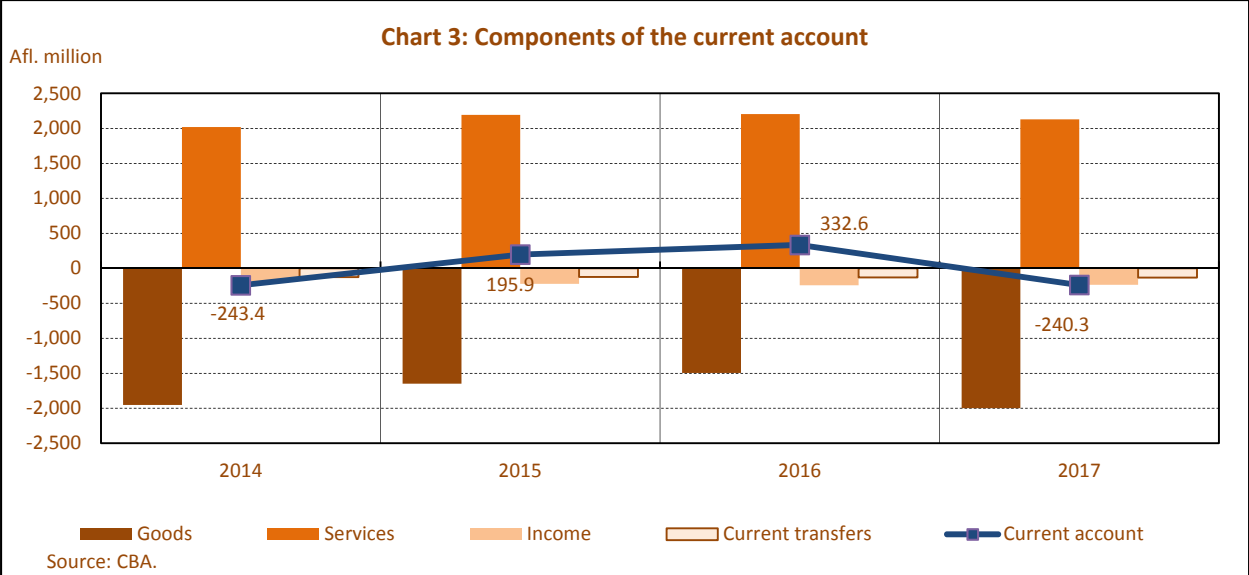
## 2.2 Balance of payments

The balance of payments is estimated to record an overall surplus of Afl. 268.3 million in 2016, but for 2017 this would turn into a deficit of Afl. 281.5 million. The surplus in 2016 is the result of an expected positive current account balance of Afl. 332.6 million (equivalent to 7.0 percent of GDP) mitigated by an anticipated capital and financial account deficit of Afl. 41.6 million (Chart 2). In 2017, the current account is projected to record an overall deficit of Afl. 240.3 million (or 4.9 percent of GDP), while the capital and financial account is expected to report an Afl. 10.6 million deficit.

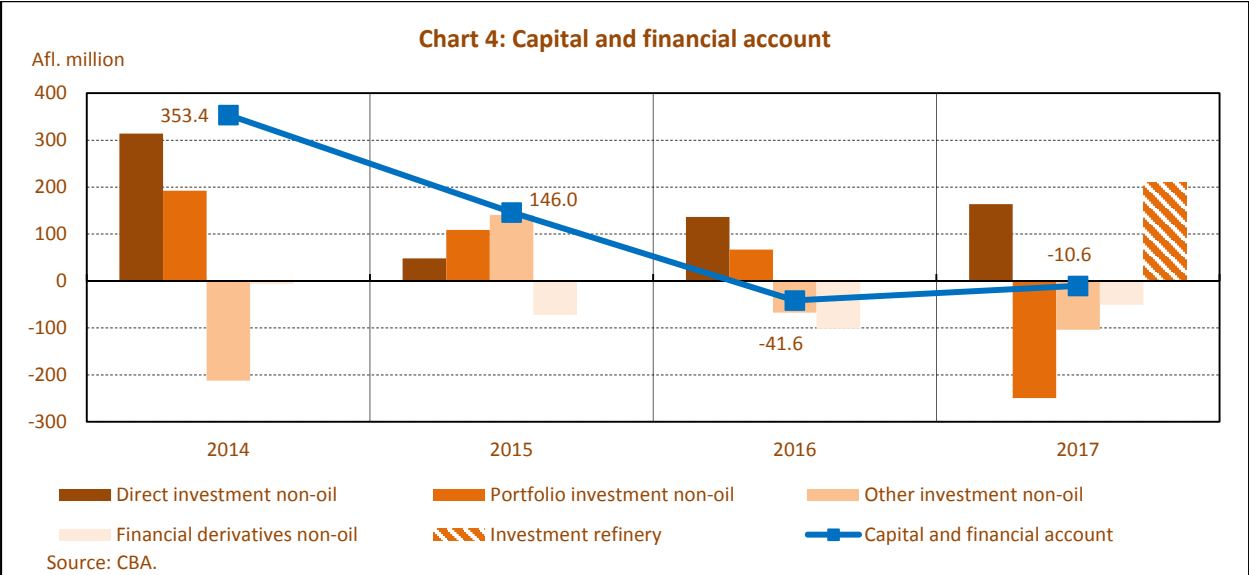


Higher import payments related to increased investment and consumption goods along with rising imports of goods and services attributed to the rehabilitation of the refinery are the main drivers for the projected current account outcome in 2017. The goods account deficit is forecasted to expand by Afl. 502.5 million to Afl. 1,998.8 million in 2017 (Chart 3). Import payments for goods is projected to increase by 28.6 percent; 45 percent of that increase would be attributed to the refinery. On the other hand, tourism receipts would mitigate some of the deficits related to the import of goods and services, as these receipts are forecasted to expand by 1.3 percent in 2017. On balance, the services account surplus is projected to contract by Afl. 74.2 million to Afl. 2,128.7 million in 2017.

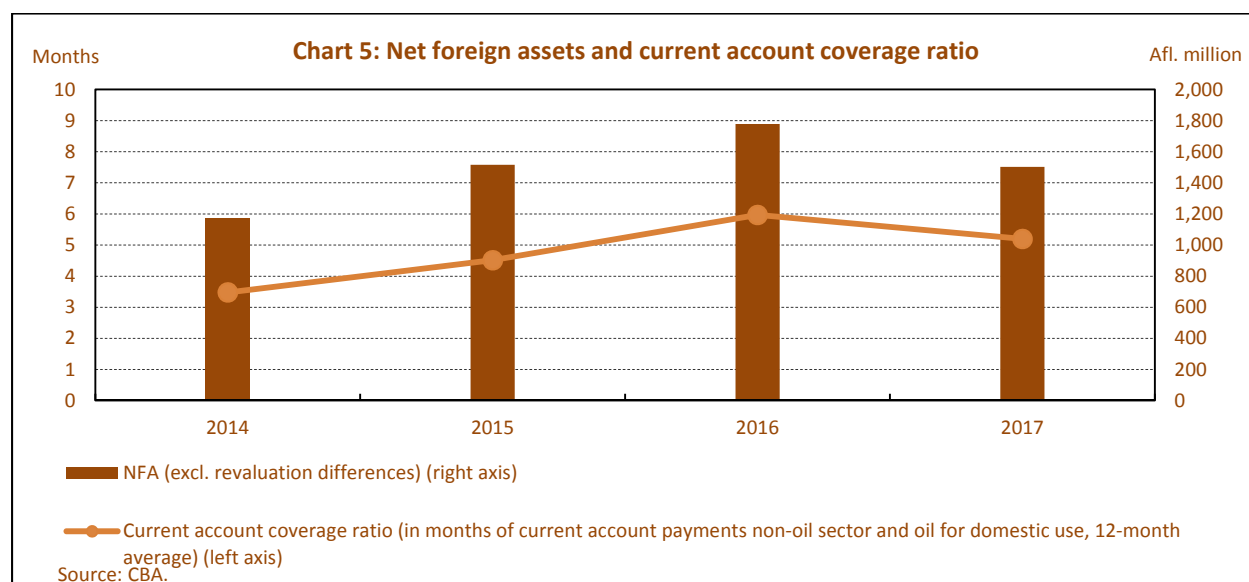




**The capital and financial account is expected to record an Afl. 10.6 million deficit in 2017 (Chart 4).** The refinery would contribute a substantial amount of investment in 2017. Additionally, foreign direct investments are anticipated to continue contributing positively to the financial account in 2017, pushed by an inflow of foreign currency from real estate and timeshare sales, as well as from other tourism-related investment projects. Conversely, an outflow of funds related to the private and public sector’s portfolio investments and other investments abroad is expected. Finally, a substantial outflow of funds associated with the hedging of oil prices is anticipated, although smaller than in 2016 as the hedging costs are expected to completely wind down in 2018.



The net foreign assets (NFA, excluding revaluation differences) increased by Afl. 261.8 million to Afl. 1,777.5 million in 2016 and are forecasted to decrease by Afl. 275.0 million in 2017 (Chart 5). Hence, the NFA is projected to reach a level of Afl. 1,502.5 million at the end of 2017. To assess reserve adequacy, the CBA monitors several benchmarks. One benchmark is that total reserves should cover current account payments of at least 3 months. Given the projected development in the NFA relative to current account payments, the 2017 current account coverage ratio is forecasted to reach 5.2 months, i.e., 2.2 months higher than the benchmark.



### 2.3 Outlook risks

The GDP forecast for 2017 is subject to a number of risks.

Starting with the upward risks:

- A stronger recovery than expected in tourism, spurring export earnings. This could for instance happen when global growth turns out more positive than expected or when international uncertainty diminishes.
- Rebounds in consumer confidence leading to a boost in consumer spending. Rapid progress of the various investment projects could lead to this.

On the downward risks:

- Tourism service exports are affected by shifts stemming particularly from market changes on the demand side, the economic crisis in Venezuela and growing international political-geographic tensions.
- Apart from the investment risks related to the timing and financing of the refinery activity, relatively large investment projects weigh significantly on the growth of the investment component as well as on projections for gains in consumption and employment. Therefore, any

potential delay in the execution of large investment projects could dampen both the growth in investments and consumption.

- Oil prices have proven quite volatile in the past, leading to significant movement in the domestic inflation rate. Despite mitigating measures by the utility company to partially hedge the price of its fuel oil consumption, large upward movements in oil prices could potentially flare up local gasoline prices as well as import prices for goods.

## 2.4 Medium-term GDP-level

### *Refining contribution*

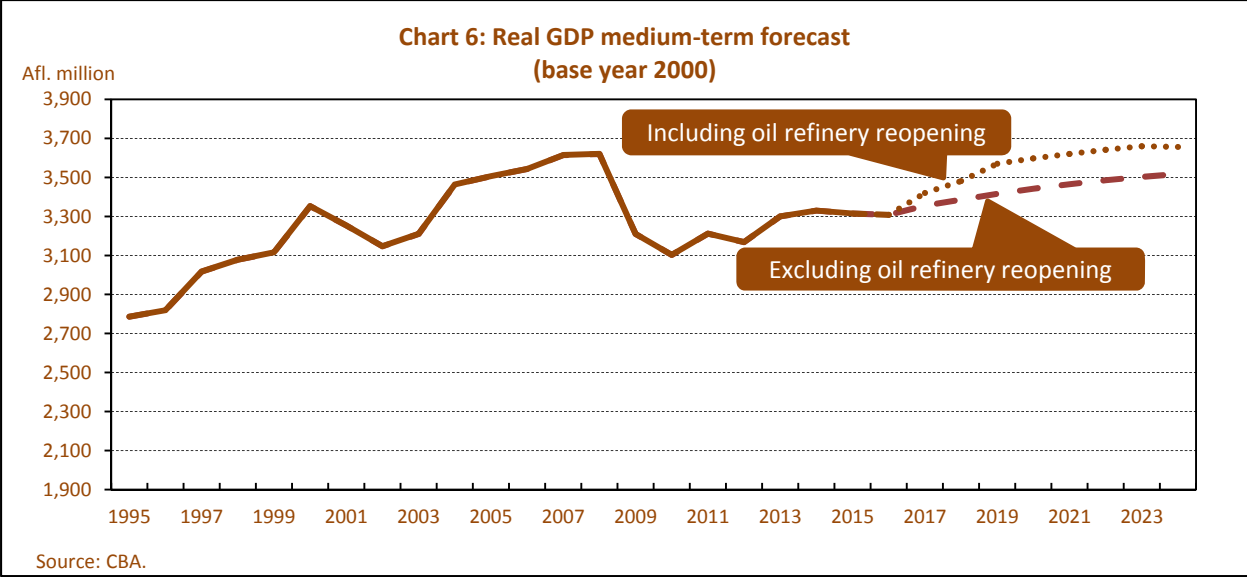
**Going forward, maintaining the level of the (real) GDP in the medium-term relies heavily on the operation of the refinery as an oil upgrader.** To offer a preliminary output estimate, the CBA calculated a baseline medium-term (real) GDP growth scenario that includes the refinery operations as stipulated in the investment paragraph. Although the additional growth spurred by the rehabilitation of the refinery would lead to an initial upward shift in GDP levels in 2017 and 2018, it is important to note that the refinery operations does not necessarily imply higher growth rates when there is an increase in refining output (Table 4).

Table 4: Medium-term GDP growth rates

	2017	2018	2019	2020	2021	2022	2023	2024
Real GDP	3.4	1.8	2.6	0.8	0.6	0.6	0.5	-0.1
Nominal GDP	2.1	3.7	4.5	2.7	2.5	2.5	2.4	1.8

Source: CBA.

Additionally, an alternative scenario is presented in Chart 6 that excludes the refinery operations in 2017. In the absence of the refinery refurbishment activities in 2017, real GDP growth is estimated to be 1.4 percent.



*Medium-term scenario: balance of payments*

**The balance of payments is projected to record deficits for consecutive years in the medium term causing the net foreign assets to reach an estimated Afl. 1,257.4 million in 2019 with a current account coverage ratio of 3.8 months.** The deficits on the balance of payments are caused mainly by an increase in imports of goods, which are related to improved economic conditions. Furthermore, a less buoyant performance in the tourism sector could produce growth in tourism receipts of 1.0 percent in 2018 and 2019, respectively. These minor growth rates would not be sufficient to mitigate outflows from the anticipated increase in import of goods.

The refinery would contribute only minimally to the net foreign assets in 2018 as it is expected to still be in the rehabilitation phase. Once in full operation, the refinery is projected to contribute to an annual net inflow of foreign funds of an estimated Afl. 74 million (using an average of the overall balance of the oil sector for the period 2000-2008). This contribution is expected to commence in the second half of 2019, which results in the refinery contributing, on a net basis, about Afl. 37 million in NFA for 2019.

Finally, the projections included in this section assume that the government would meet all of its financing needs on the domestic market in 2017 and would borrow Afl. 150 million on the domestic market in 2018 and 2019. These assumptions could entail diminished inflows of foreign funds attributed to borrowing abroad, as the government intends to reach a balanced budget. An estimated outflow of Afl. 443 million in foreign exchange, mainly related to foreign loan repayment by the government, is anticipated for the period 2018-2019. This decreasing trend in NFA is most likely to continue after 2019 if the inflow of funds (from tourism receipts, the refinery, and/or private FDI) is insufficient to cover outflows related to the import of goods.

### 3. Concluding remarks

**The Aruban economy is projected to expand (in real terms) in 2017 by 3.4 percent, driven in large part by the refurbishment activities of the oil refinery.** Investment is likely to pick up, as some large projects, particularly in the tourism industry, materialize in 2017. Furthermore, the Aruban economy is expected to experience further deflation in consumer prices in 2017 driven by lower electricity tariffs, following deflation observed in 2016. While significant upside and downside risks persist for the 2017 forecast and beyond, the medium term is expected to result in a higher level of GDP, but with limited annual growth in domestic output.