

Economic outlook¹

September 2016

¹ 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 the reliance upon this information.

Contact:

Centrale Bank van Aruba

Research Department

researchmanagers@cbaruba.org

Table of Contents

1. Introduction.....	1
1.1 Muted global prospects.....	1
1.2 A retrospective on 2015	1
2. Economic forecast 2016	2
2.1 Gross domestic product and its components.....	2
2.2 Balance of payments.....	5
2.3 Outlook risks.....	7
3. Medium-term scenarios	8
4. Concluding remarks.....	10

1. Introduction

1.1 Muted global prospects

The IMF and World Bank have recently revised their world output growth projections for 2016 downwards to, respectively, 3.1 percent and 2.4 percent.² The revision reflects a loss in growth momentum for both the advanced economies as well as emerging market economies and lower-income countries attributed to heightened domestic uncertainties and a more challenging external environment.

According to the World Bank, the expansion in the world economy is expected to remain roughly at the insipid pace experienced the year before, implying that after seven years the world's economy is still recovering from the global financial crisis.

For Latin America and the Caribbean as a whole, the growth prospects are even bleaker than the world average, as the region is plagued by depressed commodity prices and domestic challenges in the region's largest economies, leading the World Bank to estimate a contraction of 1.3 percent for the region. Brazil and particularly Venezuela are both mired in deep recessions, while Argentina is facing significant economic challenges. Growth prospects for the Caribbean sub-region are more positive, as ECLAC forecasts a Caribbean GDP-growth of 1.8 percent in 2016, carried by the service economies.³

1.2 A retrospective on 2015

The current estimates for the Aruban economy for 2015 are based on the latest available information and statistical data. More specifically, the inclusion of fourth quarter data for 2015 caused downward adjustments to non-tourism exports (due mainly to free-zone exports) and investments. In turn, this adjustment led to lower estimates for imports and private consumption. Overall, real GDP contracted by 0.5 percent (Table 1). Despite several large investment projects underway in 2015, including the Dr. Horacio E. Oduber Hospital expansion and the Green Corridor, indicators of overall private investment activities such as business credit and business short-term future perception, and imports of machinery to Aruba suggest a continued contraction in gross capital formation.

Non-tourism exports and imports, in particular free-zone activities, declined notably in the final quarter of 2015 driven in large part by the economic crisis in Venezuela, as well as a 37 percent

² IMF – World Economic Outlook Update, July 2016;
World Bank – Global Economic Prospects, June 2016.

³ ECLAC – The Hummingbird, August 2016.

devaluation of the Colombian currency in 2015. Tourism exports grew by 2.8 percent in 2015 reflecting growth in both tourism receipts and visitor nights, yet tourism receipts per visitor night decreased by 5.1 percent.

Table 1: Estimated economic growth expressed in real terms (percentage change)

Indicator (real)	2014	2015
GDP	0.8	-0.5
Consumption	-2.1	1.7
Investment	-2.9	-5.1
Exports	3.1	-0.1
Imports	-1.5	-2.8

Source: CBA.

2. Economic forecast 2016

2.1 Gross domestic product and its components

In 2016, the Aruban economy is expected to grow by 0.4 percent in real terms (Table 2). The realization of this growth depends on the start of the rebuilding of the oil refinery in the final quarter of 2016, which is expected to induce a total of Afl. 234 million in additional investment capital boosting overall private investments.

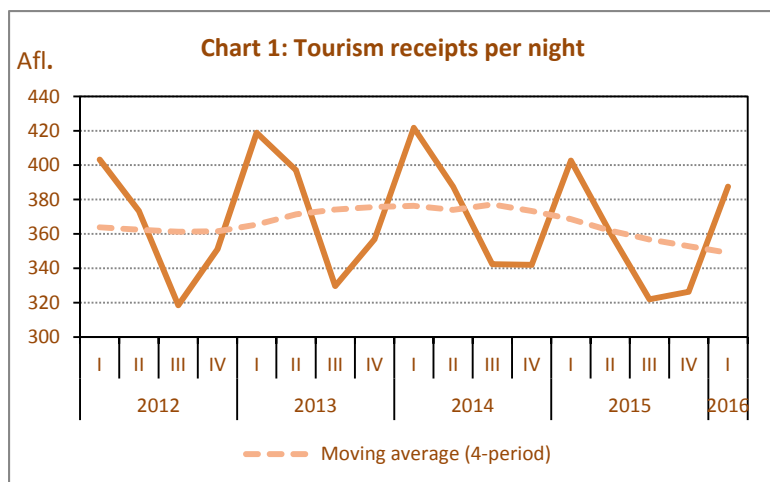
Table 2: Economic forecast results comparison for 2016

Indicator (real)	Current forecast (%)	Previous forecast (%)	Change
GDP	0.4	1.1	-0.7
Consumption	0.2	-0.3	0.5
Investment	24.1	2.5	21.6
Exports	-2.0	1.8	-3.8
Imports	5.5	0.7	4.7

Source: CBA.

Tourism: a stuttering economic growth engine

Since the fourth quarter of 2014, developments in tourism service exports, the main driver of economic growth, have been less favorable than expected, when tourism receipts per visitor night moved to a downward path (Chart 1).



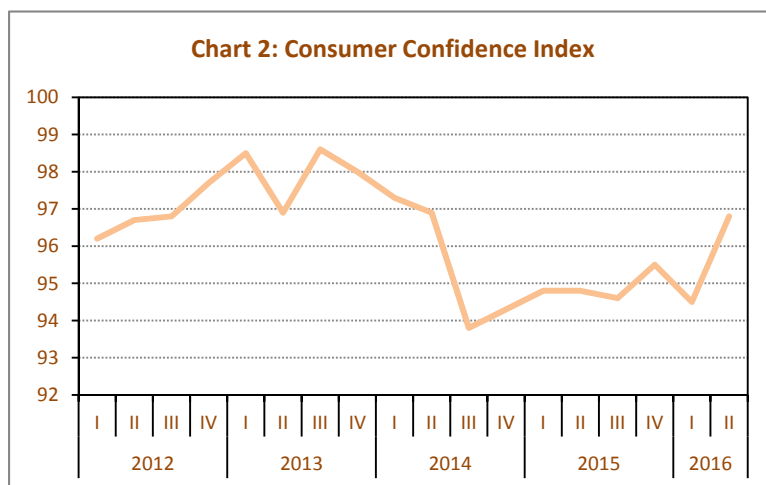
Tourism receipts are projected to decrease by 3.4 percent for 2016, a development expected to carry through from the first quarter of 2016 when tourism receipts fell by 1.4 percent. The expected decline in tourism receipts is corroborated by a decline of 0.4 percentage point in the occupancy rate of hotels as well as a 5.3 percent drop in ADR and a 5.8 percent decrease in RevPAR for the first six months of the year.⁴

Investments turning around

In 2016, investment activities are expected to increase significantly (+24.1 percent), driven mainly by the reopening of the oil refinery. While other sizable projects are planned, including the continuation of the expansion of the hospital, the Green Corridor, and the start of the Watty Vos Boulevard, the inclusion of turnaround activities for the oil refinery is expected to be the primary factor driving private investment. The growth in private investments will be significantly lower if the oil refinery does not restart in 2016.

Consumption subdued

Consistent with the faltering performance of the tourism industry, private consumption is forecasted to linger (+0.2 percent) as consumer sentiments remain largely pessimistic. Against this background, the consumer confidence index has been on a declining trend since the first quarter of 2014 (97.3), reaching an index level of 94.5 in the first quarter of 2016. The index rebounded to 96.8 in the second quarter, which may be attributed to the announcement of the re-opening of the oil refinery (Chart 2). Nevertheless, consumer sentiments remain relatively pessimistic. Consumer credit is projected to continue to decline in 2016.



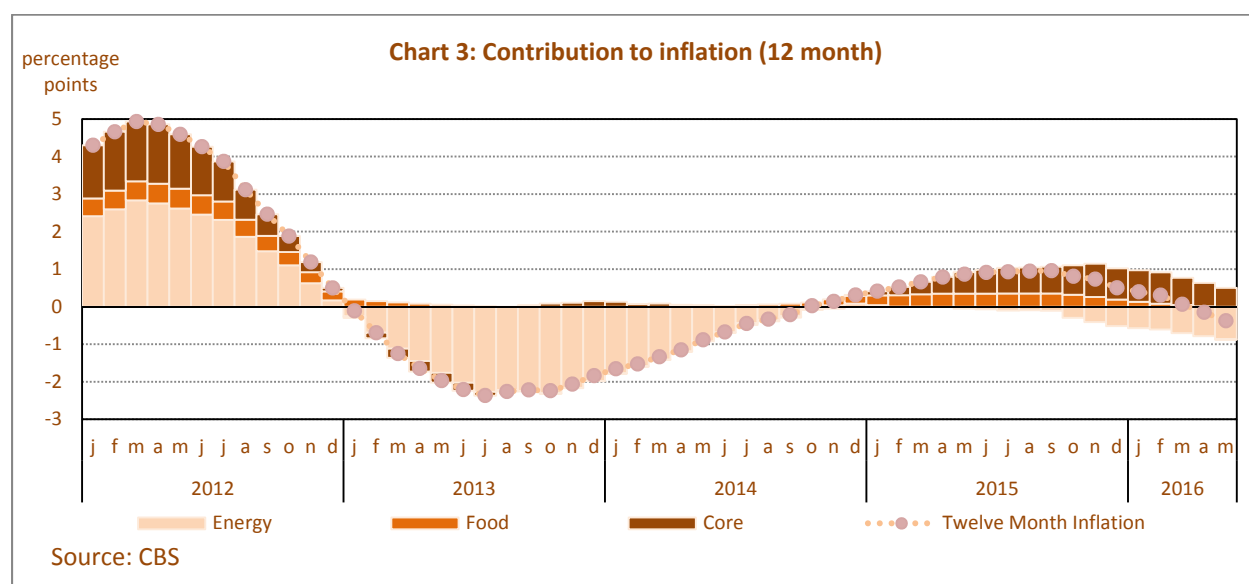
⁴ Figures obtained from AHATA's June 2016 monthly report.

Imports

The previously mentioned increases in investments are reflected in higher imports (+5.5 percent). The investment projects planned for 2016 as well as the expected restart of the oil refinery will require significant imports of materials and are estimated at Afl. 176 million.

Deflation predicted

Prices in 2016 are likely to remain below 2015 levels. Following decreases in gasoline prices and energy tariffs, the consumer price index (CPI) for 2016 is anticipated to fall by 0.8 percent (Chart 3). In particular, the tariff reduction for household electricity consumption as of January 1, 2016, is expected to push the energy component of inflation into negative territory. This follows a year of minimal inflation in 2015 (+0.5 percent) with limited domestic price pressures.



Nominal growth rates

In 2016, GDP is projected to contract by 1.3 percent in nominal terms (Table 3). The negative growth is largely attributed to a disappointing performance of the tourism sector. It is unlikely that the planned investments from the restart of the oil refinery will be sufficient to compensate for the drop in tourism service exports.

Table 3: Nominal GDP figures 2014-2016

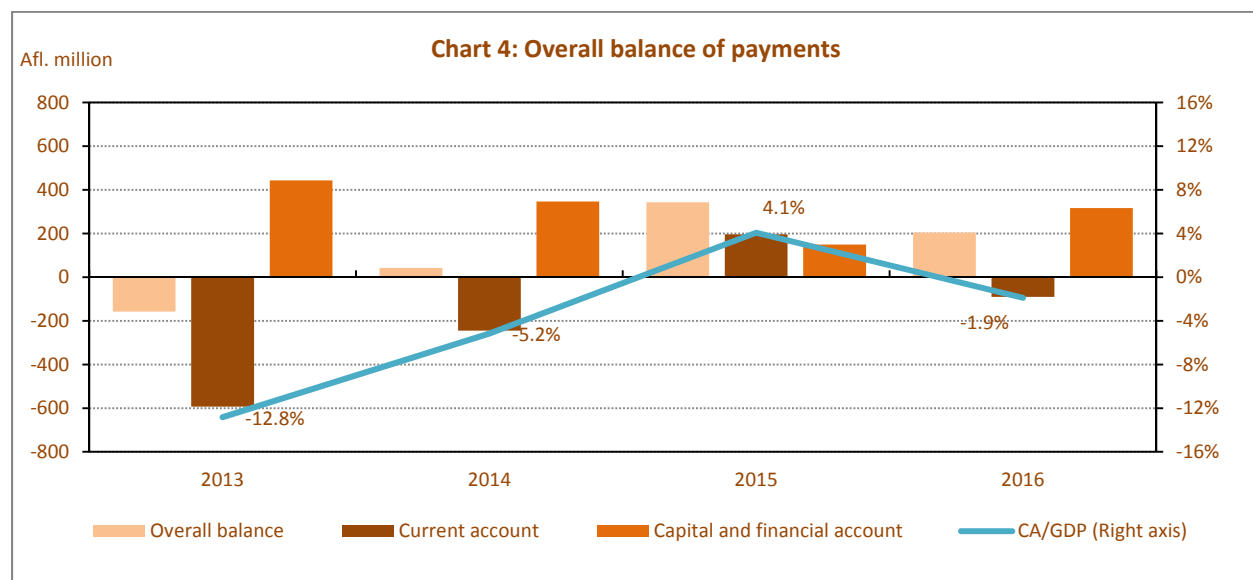
		2014 ^e	2015 ^e	2016 ^f
GDP	Afl. million	4,742.5	4,818.3	4,754.7
	%-change	2.6	1.6	-1.3
Consumption	Afl. million	4,124.8	4,082.6	4,082.5
	%-change	-0.8	-1.0	0.0
Investment	Afl. million	1,087.1	1,034.8	1,289.7
	%-change	-2.0	-4.8	24.6
Exports	Afl. million	3,313.1	3,349.3	3,264.7
	%-change	4.5	1.1	-2.5
Imports	Afl. million	3,782.5	3,648.4	3,882.3
	%-change	-0.8	-3.5	6.4

Source: CBA

e = estimate; f= forecast

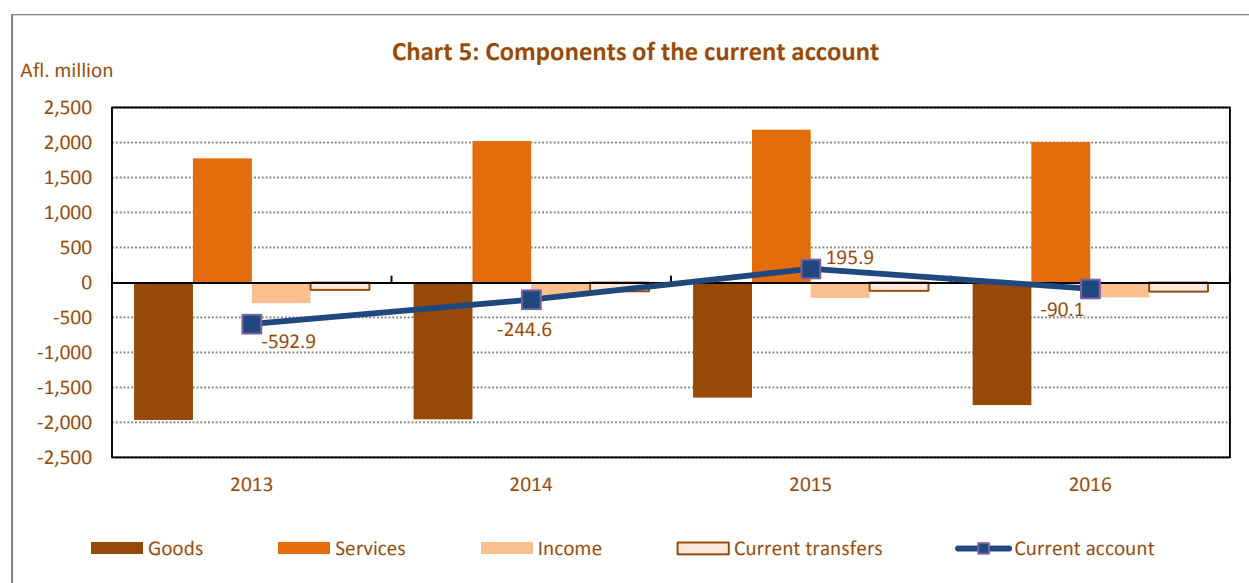
2.2 Balance of payments

The balance of payments is forecasted to record an overall surplus of Afl. 204.4 million in 2016. This surplus is the result of an expected positive capital and financial account balance of Afl. 316.5 million mitigated by an anticipated current account deficit balance of Afl. 90.1 million (equivalent to -1.9 percent of GDP) (Chart 4).

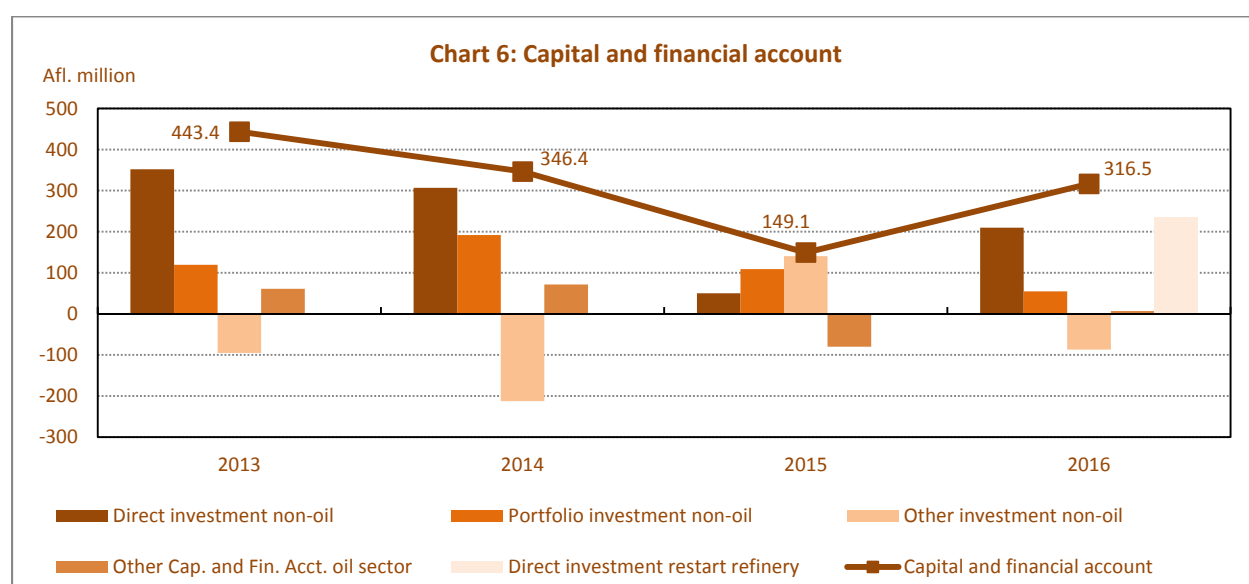


The positive contribution of tourism receipts to the services account is likely to be smaller than previously estimated as initial figures for 2016 have been lower than expected (Chart 5). The goods account deficit is forecasted to grow by 6.5 percent in 2016. Free-zone imports and exports of goods are projected to decrease in 2016 as a result of the ongoing socio-economic crisis in Venezuela. On the other hand, increases in investments also are reflected in higher import of (investment) goods. Furthermore, a smaller payment outflow related to the imports of oil-related products is expected

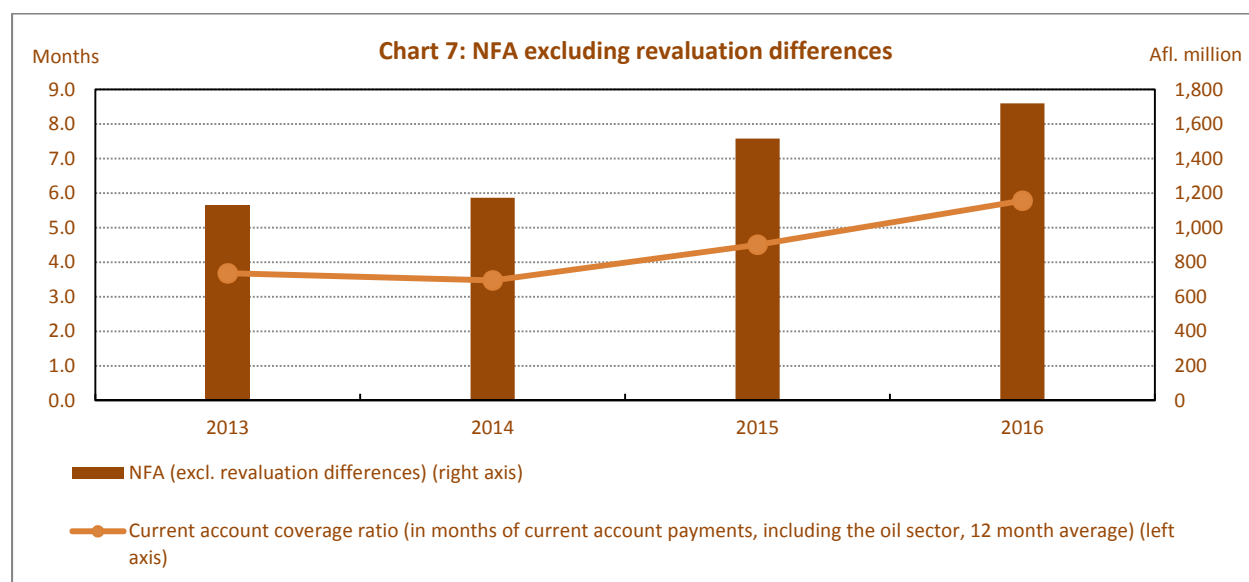
due to estimated lower oil prices in 2016 than in 2015. Overall, imports of goods are expected to fall by 0.7 percent in 2016.



The capital and financial account is projected to record a surplus of Afl. 316.5 million in 2016 (Chart 6). Foreign Direct Investments (FDI) are anticipated to contribute positively to the financial account in 2016 as the steady overall foreign currency inflow from real estate and timeshare sales, and from other tourism-related investment projects, is expected to continue. For example, the renovation of the Hilton Hotel, planned for 2016, will induce international capital investments. Additionally, the restart of the oil refinery is expected to generate a total of Afl. 234 million in FDI for 2016. Furthermore, it is assumed that the government will cover a large part of its financing needs (Afl. 179 million) in 2016 with funds borrowed on the international capital market.



The net foreign assets (NFA, excluding revaluation differences) are forecasted to increase by Afl. 204.4 million in 2016 (Chart 7). Hence the NFA is projected to reach Afl. 1,720.1 million in 2016. To assess reserve adequacy, the CBA monitors several benchmarks. One of these benchmarks is that reserves should cover current account payments of at least 3 months. The 2016 current account coverage ratio is forecasted to reach 5.8 months, given the projected increase in the NFA relative to current account payments. This is 2.8 months higher than the 3-month international benchmark.



2.3 Outlook risks

Notwithstanding the positive impact of a restart of the oil refinery (see Chapter 3), outlook scenarios as well as the GDP forecast for 2016 are subject to a number of upward and downward risks.

- Tourism service exports would be negatively affected by significant uncertainty stemming particularly from market changes and consumer preferences on the demand side, and the ongoing socio-economic crisis in Venezuela, in addition to increasing regional competition.
- Regulatory and investment climate uncertainty could dampen private investment initiatives.
- Apart from the risks relating to the timing and financing of the restart of the oil refinery, relatively large investment projects significantly impact the growth of the investment component as well as projections for subsequent gains in consumption and employment. Therefore, any potential delay in the execution of large investment projects could dampen both the growth in investments as well as consumption, hence forecasted GDP-growth.
- 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, significant movement in oil prices could potentially influence local gasoline prices as well as import prices for goods.

- The upward risks to the forecast include a rebound in tourism receipts and a further decline in oil prices.

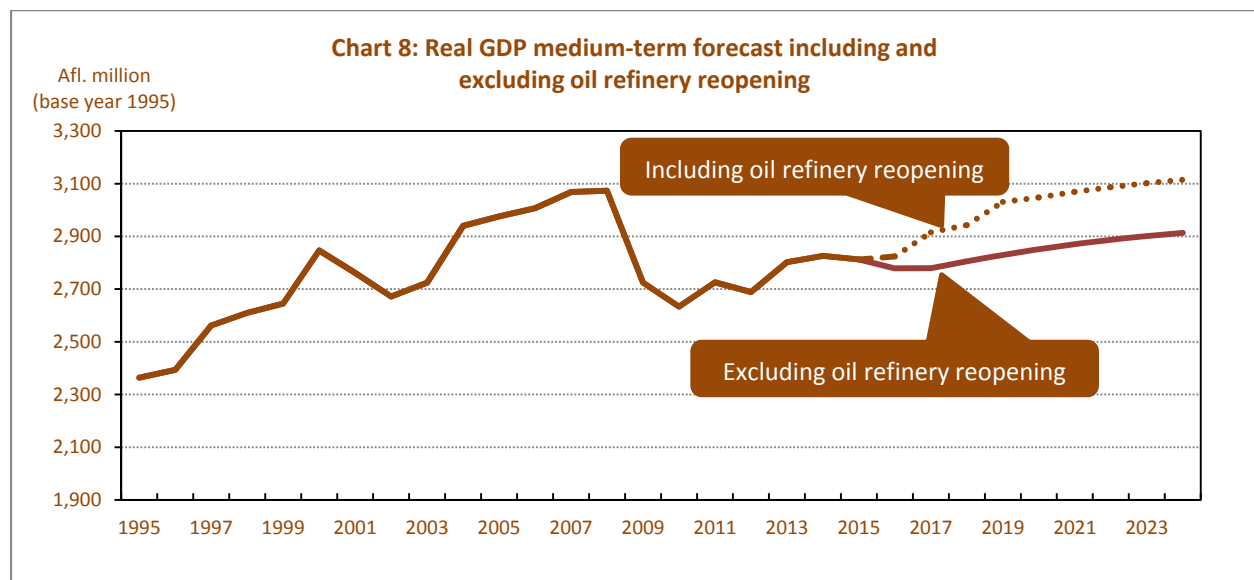
3. Medium-term scenarios

With or without an oil refinery?

Going forward, the medium-term (real) GDP relies heavily on how quickly the refinery as an oil upgrader will be operational. To offer a preliminary output estimate, the CBA provides two medium-term (real) GDP growth scenarios (Chart 8).

1. A baseline setting with the oil refinery operational which assumes that the output will receive a boost from the oil refinery operations and will reach elevated levels.
2. An alternative scenario in which no restart of the oil refinery is assumed, and all other major economic activities are presumed to remain equal to the baseline.

The baseline scenario presumes that the rebuilding of the oil refinery into an upgrader by CITGO will stimulate substantial investments and contribute to employment from the final quarter of 2016 onwards. Additional investments are assumed for the period of 2018 onwards, during which time the oil refinery is expected to become fully operational. This will contribute significantly to GDP and close the (real) output gap by 2022. Alternatively, without substantial investments and subpar tourism service export growth, real output is expected to adjust to a significantly lower long-term growth path.

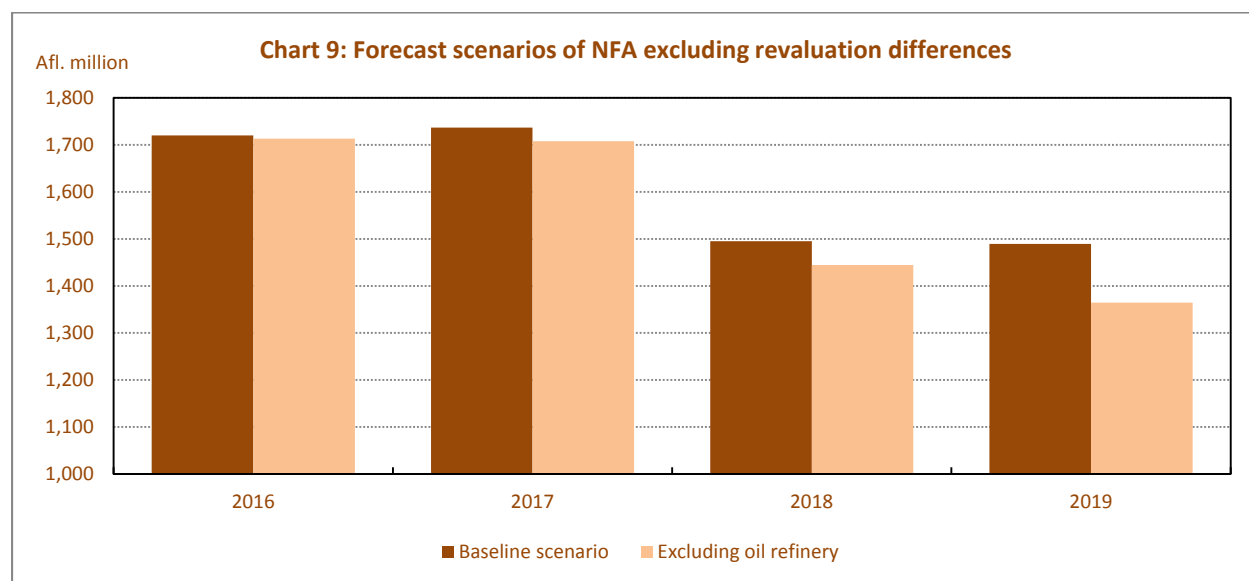


Net foreign assets 2016-2019

The baseline scenario takes into account that the oil refinery restart would not make a large contribution to NFA during the period 2016-2018 as processing would be limited, and only funds to pay wages will flow in (an estimated Afl. 7 million in 2016 and Afl. 22 million for 2017-2018). Using an average of the overall balance of the oil sector for the period 2000-2008, it is projected that the oil refinery could contribute to an annual net inflow of foreign funds of around Afl. 74 million starting in 2019.

Additionally, tourism receipts are projected to grow at 1.7 percent in the years 2017 to 2019. This projection assumes that the U.S. market will drive this growth, while the declining pattern in receipts per visitor night will level off. Furthermore, tourism-related investment projects are forecasted to contribute to the NFA with on average Afl. 240 million annually. Imports are likely to pick up in 2017-2019 as investment projects are assumed to commence and/or continue and new projects are in the pipeline. Finally, the government is assumed to borrow Afl. 150 million on the domestic market in 2017-2019, which entails diminishing inflow of foreign funds attributed to borrowing abroad as the government reaches a balanced budget. NFA is estimated at Afl. 1,489.3 million (Chart 9) with a current account coverage ratio that is projected to reach 4.3 months in 2019. The decline in the NFA level is attributed to rising imports as the inflows from tourism receipts, FDI, the contribution from the oil refinery, and funds borrowed by the government from abroad are not sufficient to cover this increase.

The alternative scenario, wherein the oil refinery does not restart, excludes all inflows to the balance of payments that are attributed to the restart of the oil refinery. NFA would total Afl. 1,364.4 million in 2019 with a current account coverage ratio that is projected to reach 3.7 months. This ratio is 0.7 months higher than the 3-month international benchmark.



4. Concluding remarks

In 2016, the Aruban economy is projected to expand (in real terms) by 0.4 percent, driven by the intended large investment to rebuild the oil refinery into an upgrader by CITGO. The presumed positive effect of these activities would, however, be largely mitigated by an expected sustained sluggish performance in the exports of tourism services throughout the year, as measured by tourism receipts. The latter development is also the main factor for the downward revision of the previous GDP-forecast by 0.7 percentage point.

Investment is also likely to be pushed up by some large infrastructure projects, that started in 2015, gaining further momentum in 2016. Despite the additional employment boost related to the restart of the oil refinery, consumption is expected to contribute in a limited way to economic growth, reflecting in part the subdued consumer sentiments and expected decline in disposable income related to the lackluster development in the tourism sector. On the other hand, a deflation of 0.8 percent is forecasted for 2016, driven by lower electricity tariffs and gasoline prices, as well as limited non-energy price pressures.

The balance of payments is forecasted to record an overall surplus in 2016, resulting from a positive balance on the capital and financial account, partially mitigated by a deficit on the current account. The largest inflow of foreign funds to the balance of payments would be from tourism receipts, foreign direct investment, and foreign borrowings by the government of Aruba. Consequently, the level of net foreign assets (excluding revaluation differences) is set to increase by Afl. 204.4 million to Afl. 1,720.1 million. This means that reserves would cover 5.8 months of current account payments, comfortably above the 3-month international benchmark.

The main risks to this outlook are potential delays to investment projects, particularly those related to the rebuilding of the refinery into an upgrader. Also, considering the geopolitical uncertainties in the region, as well as the weak international economic environment, and the increasing regional competition, the tourism sector is likely to remain vulnerable to demand shocks.