Centrale Bank van Aruba

Economic outlook[1]

April 2018

[1] This document includes forecasts that represent assumptions and expectations of the Centrale Bank van Aruba (CBA) in light of the information available at end-March 2018. 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

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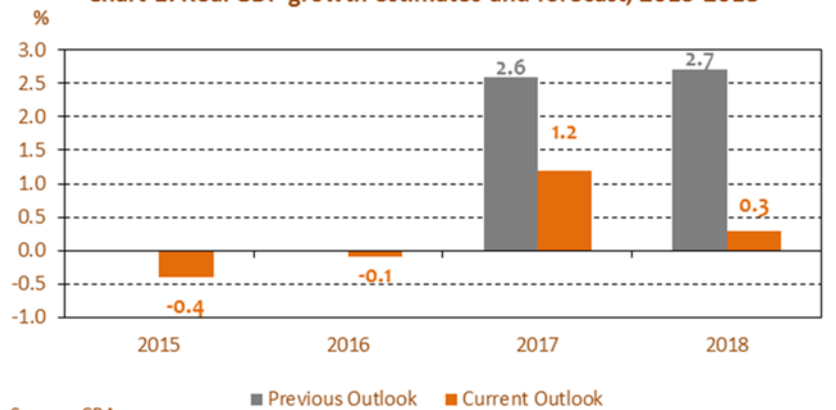
1. Introduction

The Centrale Bank van Aruba (CBA) revised its gross domestic product (GDP) estimations for 2017 to reflect the most recent developments and data, as well as its projections for 2018. As a result hereof, GDP growth for 2017 is now estimated at 1.2 percent in real terms, down from 2.6 percent. For 2018, the forecasted growth rate has also been adjusted downwards from 2.7 percent to 0.3 percent (Chart 1). The recently announced measures by the Government of Aruba to reduce its financial deficit, which were approved during the Budget 2018 debate in Parliament, are not yet included in this forecast. The potential effects of these measures on the economic output will be considered in a subsequent cycle of forecast analysis.

Chart 1: Real GDP growth estimates and forecast, 2015-2018



Source: CBA.

2. Economic forecast

2.1 Gross domestic product and its components

The lower output growth estimate for 2017 is based on the availability of more detailed and complete data for 2017. Furthermore, the substantial delay in various investment projects, such as the refurbishment of the refinery into an upgrader, was an important factor in the downward adjustment of the previously measured growth for 2017. The correction of 2.4 percentage points in the 2018 forecast is due primarily to lower expected investments for that year (Table 1).

Table 1: Comparison of economic estimates and forecasts for 2017 and 2018

Indicator (real)	Current estimate (percent)	Previous estimate (percent)	Change (percentage point)
	2017		
GDP	1.2	2.6	−1.4
Consumption	1.4	2.1	−0.7
Investment	−1.7	14.9	−16.6
Exports	1.7	1.8	−0.1
Imports	0.9	5.4	−4.5

Indicator (real)	Current forecast (percent)	Previous forecast (percent)	Change (percentage point)
	2018		
GDP	0.3	2.7	−2.4
Consumption	0.9	1.9	−1.0
Investment	−2.9	8.5	−11.4
Exports	1.1	1.6	−0.5
Imports	0.6	3.0	−2.4

Source: CBA.

Tourism

Activities in tourism service exports, the main driver of economic growth, is estimated to have grown by 5.5 percent in 2017. This growth resulted despite a drop in the number of Venezuelan tourists, which led to a 2.9 percent overall decline in tourist arrivals, thanks to higher spending triggered by an 11 percent rise in tourist arrivals from the U.S. market. Sustaining the growth in tourism service exports, the Aruba Hotel and Tourism Association reported an increase in total revenue of 12 percent for its members during 2017. The tourism outlook for 2018 is positive in terms of expected tourism service exports with a forecast of 4.4 percent growth, driven again mainly by the U.S. market.

Investments

Significant large investment projects that were (partially) executed in 2017 include the continuation of the renovation of the Dr. Horacio E. Oduber hospital, the Green Corridor, the Watty Vos Boulevard, and the upgrading activities at the airport. Observed indicators of construction activity, including imports of investment-related goods and the number and value of construction permits granted, show a moderate pick-up in investment behavior in 2017. Also, loans to enterprises and housing mortgages display modest increases.

However, the large investment to refurbish the oil refinery into an upgrader that was expected to reach peak activity in the third quarter of 2017 was delayed, causing significant shifts in investment projections. The length of this delay is unclear with implications on the 2018 investment forecast figures. Other investment projects, such as the Dr. Horacio E. Oduber hospital, the Watty Vos Boulevard, and investments by the airport will likely drive overall (private) investments.

Consumption

Consistent with the pickup in tourism export services, private consumption is estimated to have expanded in 2017 (+1.4 percent) and will likely continue to grow moderately in 2018 (+0.9 percent). While consumer sentiments remained largely pessimistic in 2017, decreasing by 1.5 index points compared to 2016, estimated additional employment is deemed to have contributed to increased consumption for the year 2017 as a whole. The higher tourism-related employment that is forecast for 2018 is attributed to anticipated increasing consumption as well.

Inflation

The year 2017 resulted in a (12-month average) deflation of 0.5 percent, related to reduced electricity tariffs introduced in January 2017. Consumer prices, as measured by the CPI, are expected to increase by 0.8 percent in 2018. The forecast for 2018 assumes electricity and water prices will remain unchanged throughout the year, while gasoline prices will rise gradually, based on the expected slight upward movement of oil prices on the world market. Meanwhile, the prices of the other components of the consumption basket also are projected to edge up during the year.

Nominal growth rates

GDP in nominal terms is estimated to have increased by 2.0 percent in 2017 (Table 2). For 2018, a nominal growth of 1.4 percent is foreseen.

Table 2: Nominal GDP estimates and forecasts

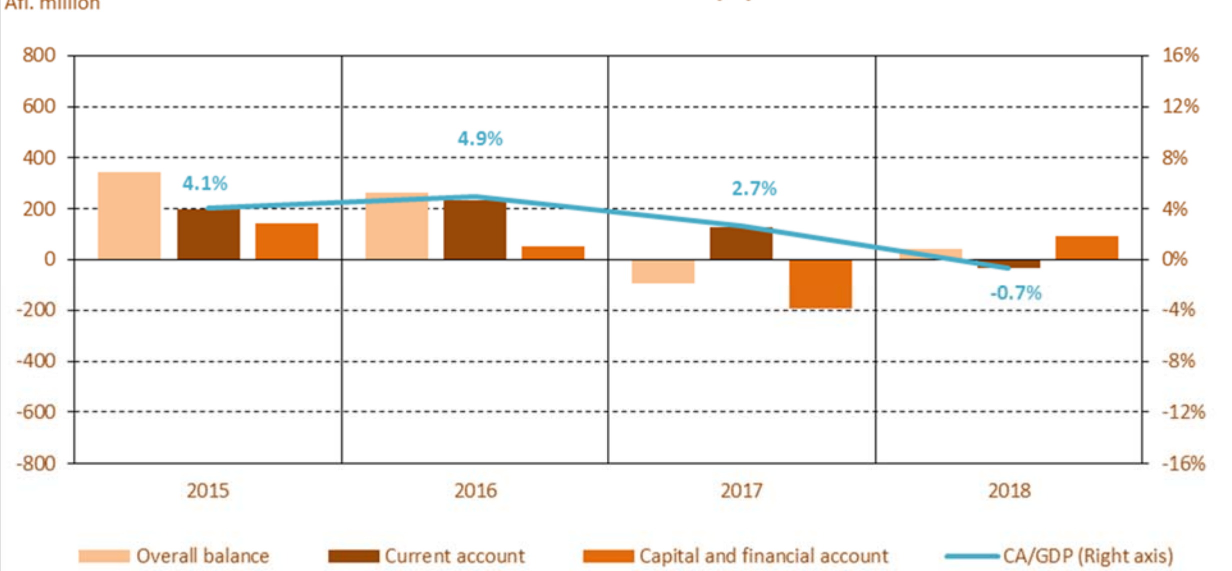
		2015 e	2016 e	2017 e	2018 f
GDP	Afl. million	4,817.8	4,738.5	4,833.6	4,903.3
	% change	1.6	−1.6	2.0	1.4
Consumption	Afl. million	4,072.6	3,922.5	4,009.7	4,078.9
	% change	−1.3	−3.7	2.2	1.7
Investment	Afl. million	1,034.8	1,043.3	1,038.0	1,022.3
	% change	−4.8	0.8	−0.5	−1.5
Exports	Afl. million	3,354.1	3,309.1	3,422.8	3,531.2
	% change	1.2	−1.3	3.4	3.2
Imports	Afl. million	3,643.8	3,536.5	3,636.9	3,729.1
	% change	−3.7	−2.9	2.8	2.5

Source: CBA. e = estimate; f = forecast

2.2 Balance of payments

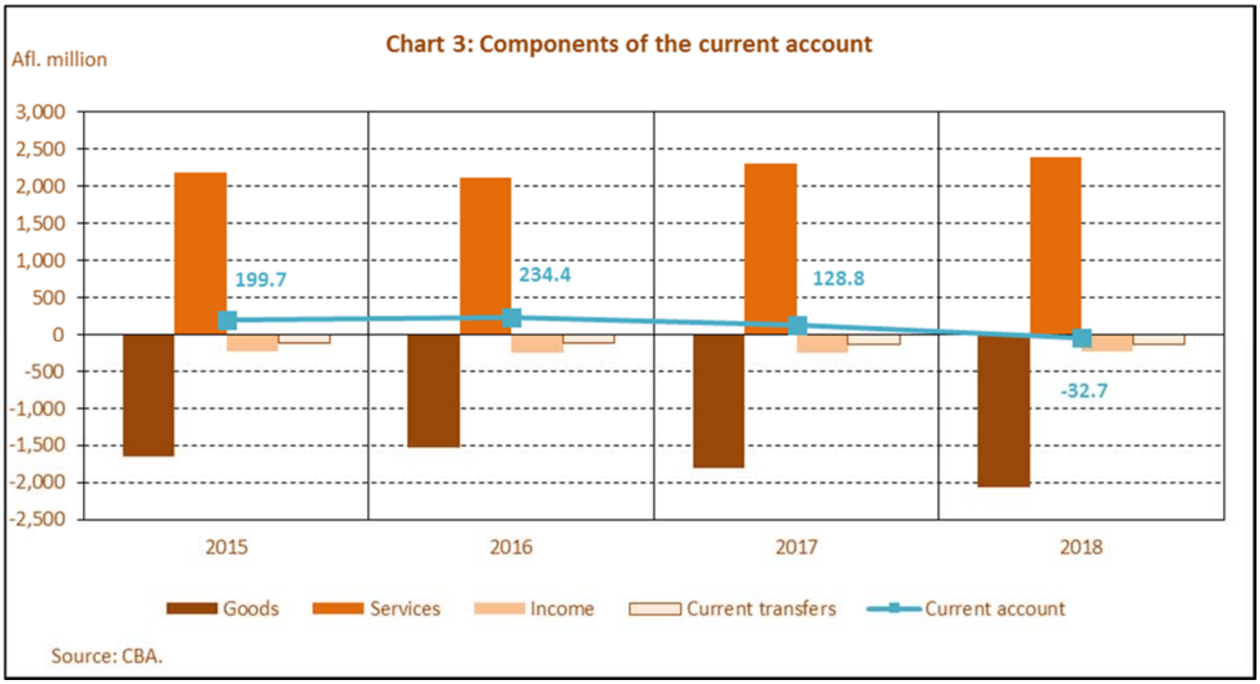
The balance of payments is estimated to record an overall deficit of Afl. 92.7 million in 2017 and a surplus of Afl. 40.0 million in 2018. The outcome in 2017 is the result of an expected capital and financial account deficit of Afl. 191.6 million, mitigated by an anticipated current account surplus of Afl. 128.8 million (Chart 2). In 2018, the current account is projected to record an overall deficit of Afl. 32.7 million, while an Afl. 90.7 million surplus is expected in the capital and financial account.

Chart 2: Overall balance of payments



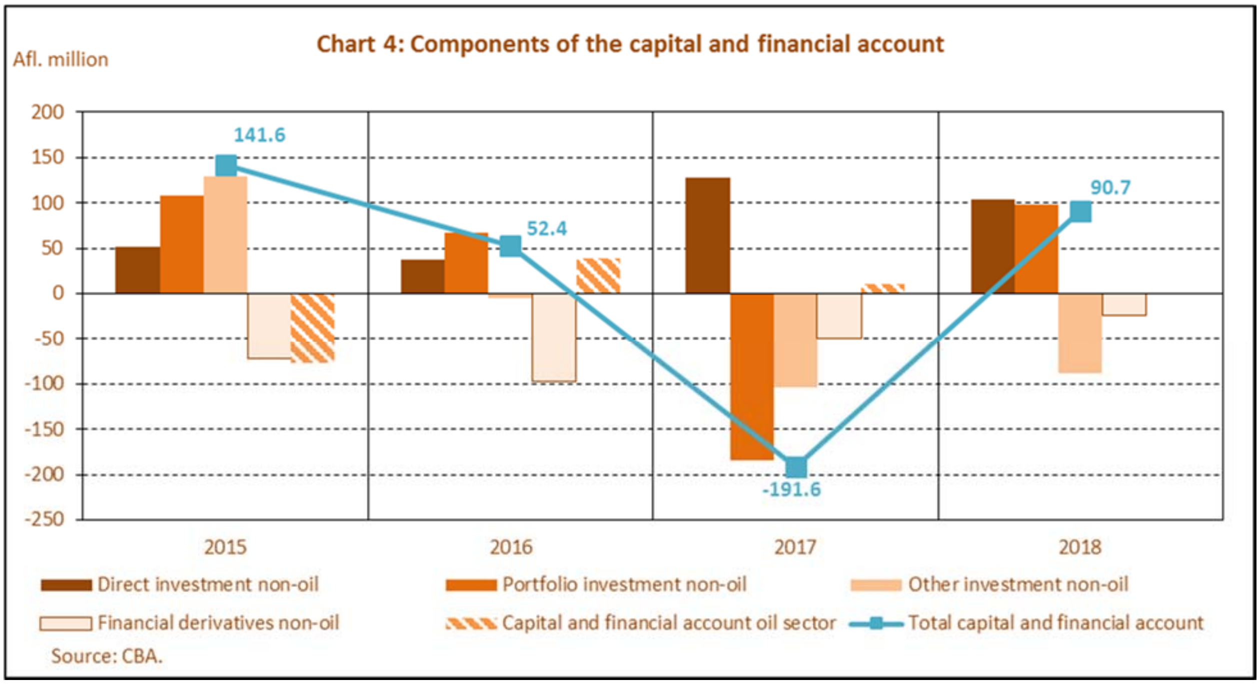
Source: CBA.

The main driver for the estimated current account outcome in 2017 is higher service receipts (Chart 3). Services receipts should have expanded, due primarily to an estimated 5.5 percent increase in tourism receipts, rising to Afl. 3,919.0 million. Import of goods remained relatively flat for 2017, thus sustaining a current account surplus. A current account surplus is not projected for 2018, as higher envisaged import of non-oil goods will drive the current account into negative territory. The contributing factor for the higher goods import will be the anticipated growth in demand for consumption goods by both residents and tourists. The surplus in the service account will rise by 3.8 percent as the higher projected receipts from tourism will likely be offset partially by elevated payments for international services.

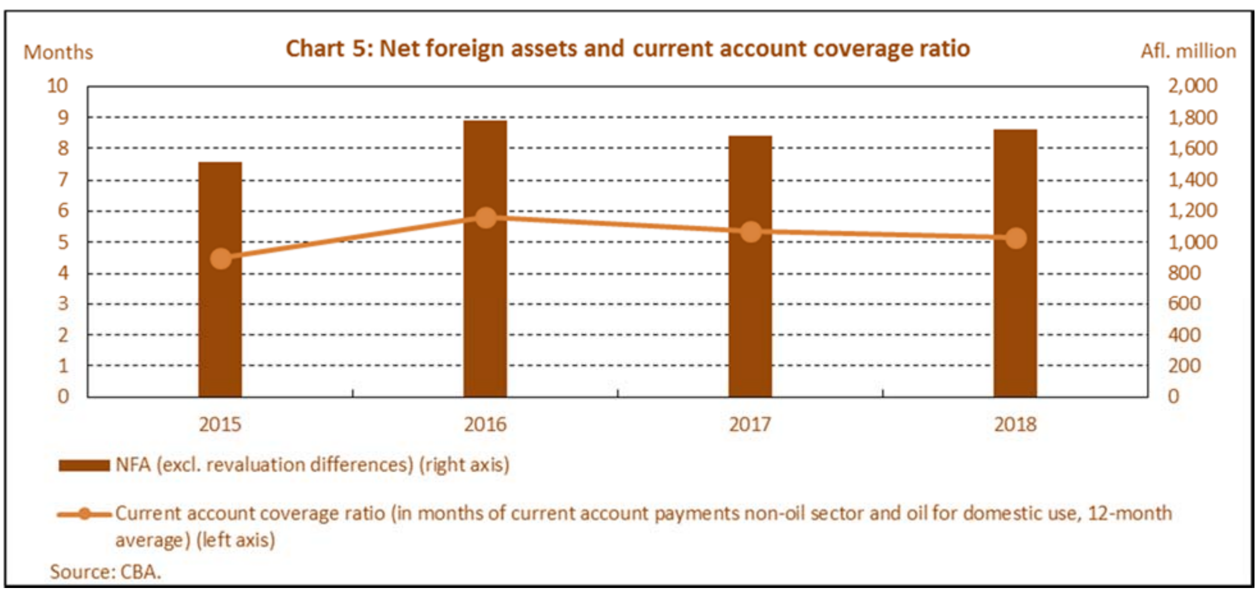


The capital and financial account likely recorded an Afl. 191.6 million deficit in 2017, pushed by a net outflow of funds related to the private and public sectors' portfolio investments and other investments abroad (Chart 4). Net inflows of foreign currency from real estate and timeshare sales, as well as from other tourism-related investment projects were not sufficient to compensate for this deficit.

In 2018 and onwards, the public sector portfolio investment account is expected to have foreign fund inflows as it is assumed that the government will meet its financing requirements partially on the external capital market. Foreign direct investment net inflows are expected to continue, although the size of the inflows is expected to be somewhat lower than in 2017, an assessment based primarily on the outlook of several large tourism-related investment projects. As the refurbishment of the refinery has been slowed down, no input from the oil sector in the capital and financial account is assumed. As a result, for the year 2018, a surplus of Afl. 90.7 million is expected on the capital and financial account.



The net foreign assets (NFA, excluding revaluation differences) fell by Afl. 92.7 million to Afl. 1,684.8 million in 2017, and are forecasted to increase by Afl. 40.0 million in 2018 (Chart 5). Hence, the NFA is projected to reach a level of Afl. 1,724.8 million at the end of 2018. To assess reserve adequacy, the CBA monitors several benchmarks, including the coverage of total reserves to cover current account payments of at least 3 months. Given the projected development in the NFA relative to current account payments, the current account coverage ratio is estimated to have reached 5.4 months in 2017, i.e., 2.4 months higher than the benchmark, and is expected to be 5.2 months in 2018.



2.3 Outlook risks

The GDP forecast is subject to a number of risks for 2018 onwards.

The upward risks:

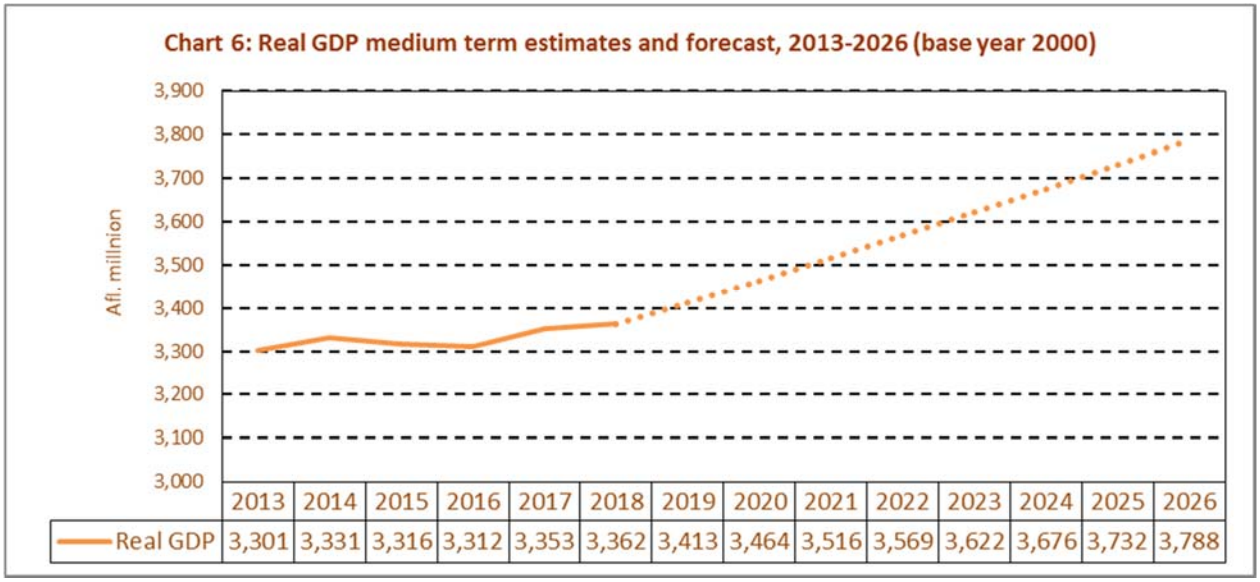
- A stronger recovery than expected in tourism, spurring export earnings. This could occur, for instance, if global growth is more positive than expected, or if international uncertainty diminishes.
- A significant rebound in consumer confidence, leading to a boost in consumer spending. More rapid implementation of various investment projects could positively influence consumer sentiments and overall confidence.
- The refinery refurbishment resumes. Resumption most likely will boost investment and consumption activities significantly.

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 geopolitical tension.
- 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 the growth in both 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 increase local gasoline prices as well as import prices for goods.
- The recently announced measures by the Government of Aruba, related to increasing its revenues, will have a significant effect on inflation and consumption. The net effect on GDP and the balance of payments will be ascertained in a subsequent cycle of forecast analysis.

2.4 Medium-term GDP and NFA

Maintaining and expanding the level of the (real) GDP in the medium term rely heavily on private investment projects and a strong tourism performance, more so since the refinery refurbishment activities experienced significant delay. The real GDP is estimated to grow by an estimated 1.5 percent in the medium term, based on initial indications of future investment projects related to the airport, the container port, and several tourism-related projects, which potentially could further expand the volume of tourism (Chart 6).



	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
Real GDP	3,301	3,331	3,316	3,312	3,353	3,362	3,413	3,464	3,516	3,569	3,622	3,676	3,732	3,788

The NFA is expected to increase to Afl. 1,780 million by the end of 2020. The intention of the government to finance a large part of its financing needs internationally is *the* determining factor of the projected rise in NFA. Additionally, the deficit on the current account is assumed to expand to Afl. 165 million in 2020 as the growth in tourism receipts will probably not be enough to compensate for increasing goods imports. CBA's analysis indicates that the currently expected foreign exchange earning capacity of the Aruban economy is insufficient to generate enough foreign reserves to pay for the goods and services imported. Structural economic policy measures, including economic diversification (beyond refining and tourism), are urgently needed to enlarge the (foreign exchange) earning capacity of the economy, in order to structurally elevate the level of NFA in a sustainable and resilient manner.

3. Concluding remarks

Following two years of consecutive economic output contraction (2015 and 2016), as estimated by the CBA, the Aruban economy appeared to have resumed tepid growth in 2017, which is forecasted to continue in 2018, expanding by, respectively, 1.2 percent and 0.3 percent in real terms. Even though there are risks related to tourism markets and delays of investment projects, the potential also exists for a modest annual growth of 1.5 percent in real terms in the medium term. Economic diversification to generate additional foreign reserves remains pivotal to sustain growth.