Centrale Bank van Aruba

Economic Outlook 2018[1]

December 2017

[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 reliance on this information.

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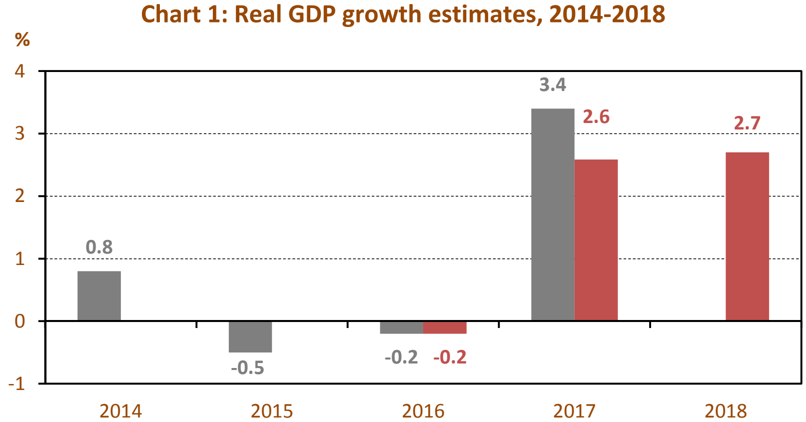
1. Introduction

The Centrale Bank van Aruba (CBA) revised its GDP estimates to reflect the most recent developments and data for 2016 and 2017 and added projections for 2018. GDP growth for 2017 was revised downward from 3.4 percent to 2.6 percent in real terms when compared to 2016. For 2018, a 2.7 percent growth is expected (Chart 1).

Chart 1: Real GDP growth estimates, 2014-2018



Source: CBA.

2. Economic forecast

2.1 Gross domestic product and its components

The revised growth estimate for 2016 remains equal to the previous estimate in real terms (Table 1), though it constitutes a decrease of 0.7 percentage point in nominal output compared to the previous estimate. The revision reflects updates based on more complete data available. The forecast for 2017 represents a downward adjustment of 0.8 percentage points driven primarily by lower investments for 2017 as well as an adjustment in the deflator. This edition of the economic outlook also presents the results of a forecasting exercise conducted for 2018, which points to a growth in real output of 2.7 percent.

Table 1: Comparison of economic estimates and forecasts for 2016, 2017, and 2018

Indicator (real)	Current estimate (percent)	Previous estimate (percent)	Change (percentage point)
	2016		
GDP	−0.2	−0.2	0.0
Consumption	−3.0	−3.7	0.7
Investment	0.3	−0.7	1.0
Exports	-0.9	0.3	−1.2
Imports	−3.5	−3.5	0.0

Indicator (real)	Current forecast (percent)	Previous forecast (percent)	Change (percentage point)
	2017		
GDP	2.6	3.4	−0.8
Consumption	2.1	2.8	−0.7
Investment	14.9	28.6	−13.7
Exports	1.8	−0.3	2.1
Imports	5.4	7.5	-2.1

Indicator (real)	Current forecast (percent)	Previous forecast (percent)	Change (percentage point)
	2018		
GDP	2.7	-	-
Consumption	1.9	-	-
Investment	8.5	-	-
Exports	1.6	-	-
Imports	3.0	-	-

Source: CBA.

Tourism

Activities in tourism service exports, the main driver of economic growth, are estimated to expand by 3.8 percent in 2017. This estimate takes a drop in Venezuelan tourism into consideration which leads to an overall decrease of 4.6 percent in tourist arrivals. However, this decrease is compensated in terms of tourism receipts by an increase of 8 percent in arrivals from the U.S. market. Supporting an increase in tourism service exports, the Aruba Hotel and Tourism Association registered an increase of 11.8 percent in total revenue for its members for the first half of 2017. The outlook for 2018 is positive as well with respect to expected tourism service exports with a forecast of 2.4 percent growth.

Investments

Significant large investment projects that were (partially) executed in 2017 included the continuation of the renovation of the Dr. Horacio E. Oduber Hospital, the Green Corridor, the Watty Vos Boulevard, the airport and refinery refurbishment. Additionally, observed indicators of construction activity as well as credit indicate some (initial) improvement in overall investment activity for 2017. On the other hand, delays in the large investments relating to refurbishment of the oil refinery into an oil upgrader that were expected to have reached peak activity in the third quarter of 2017 caused significant postponements of investments to 2018 and beyond.

To monitor the investment activity relating to the refurbishment of the oil refinery, the CBA has included a preliminary estimate of the project's potential contribution to its nominal GDP estimates. The assessment benefitted from consultation meetings between the CBA staff and representatives of the Refineria di Aruba (RDA), CITGO Aruba, and the government in July 2017. Given the preliminary nature of the project execution plan and considering that the scope and planning (involving third parties that will execute components of the project) still need to be completed, forecasts at this point inevitably face significant 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.

These limitations already were incorporated in the economic outlook published in May 2017, and are now essential given that full capacity in refurbishment activities have yet to be reached.

Based on the mentioned consultation meetings conducted in July 2017, the following assumptions are made in this Economic Outlook:

- While the intention was that the rehabilitation activities would begin by July 2017, these activities have now been rescheduled to a later date.
- Preparatory work already has commenced, including the construction of a so-called "man camp" to host non-resident workers.
- At the peak of the refurbishment work, the refinery is projected to employ 1,000 workers, 600 of whom are considered highly skilled.

Consumption subdued

Consistent with the pickup in tourism export as well as in investment activity, private consumption is estimated to expand by 1.9 percent in 2017 and by 2.8 percent in 2018. While consumer sentiments remained largely pessimistic over the first half year of 2017, the activity and additional employment generated in 2017 (both refinery-related and otherwise), along with an upward movement of the minimum wage, is deemed to have fueled consumption for the year as a whole. For the 2018 projection, the activities in the refinery are expected to help stimulate consumption as well.

Deflation

Consumer prices, as measured by the CPI, are expected to remain in deflationary territory in 2017 (–0.3 percent), followed by minimal inflation in 2018 (0.3 percent). The decrease in prices in 2017 occurred primarily as a result of the 14 percent reduction in electricity tariffs introduced in January 2017, while its downward pull is expected to persist until December 2017. As of yet, the forecast for 2018 assumes electricity and water prices will remain unchanged throughout the year. Gasoline prices however, are expected to increase gradually in 2017 as crude oil on the world market is expected to reach US$ 52 per barrel by December 2017 and US$ 54 per barrel by December 2018.

Nominal growth rates

GDP in nominal terms is estimated to increase by 2.6 percent in 2017 (Table 2). This is the same growth rate as projected for real GDP as a result of a constant overall GDP deflator. A growth rate of 2.9 percent in nominal terms is foreseen in 2018.

Table 2: Nominal GDP estimates and forecasts

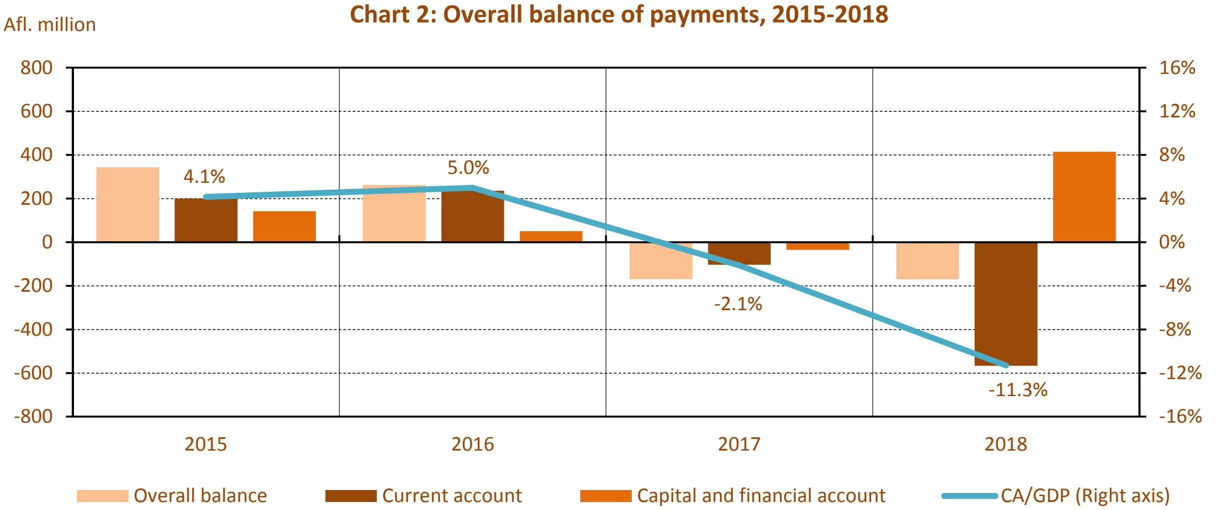
		2014 e	2015 e	2016 e	2017 f	2018 f
GDP	Afl. mln.	4,742,5	4,817.8	4,738.5	4,863.4	5004.4
	% change	2.6	1.6	–1.6	2.6	2.9
Consumption	Afl. mln.	4,124.8	4,072.6	3,922.5	4,033.2	4,124.4
	% change	–0.8	–1.3	–3.7	2.8	2.3
Investment	Afl. mln.	1,087.1	1,034.8	1,043.3	1,215.1	1,324.7
	% change	–2.0	–4.8	0.8	16.5	9.0
Exports	Afl. mln.	3,313.1	3,354.1	3,309.1	3,420.4	3,490.0
	% change	4.5	1.2	–1.3	3.4	2.0
Imports	Afl. mln.	3,782.5	3,643.8	3,536.5	3,805.2	3,934.7
	% change	–0.8	–3.7	–2.9	7.6	3.4

Source: CBA. e = estimation; f = forecast.

2.2 Balance of payments

The balance of payments is estimated to record an overall deficit of Afl. 169.6 million in 2017 and a deficit of Afl. 169.9 million in 2018. The deficit in 2017 is largely the result of expected deficits in both the current account (Afl. 103.2 million, equivalent to -2.1 percent of GDP) and the capital and financial account deficit (Afl. 35.4 million). In 2018, the current account is projected to record an overall deficit of Afl. 566.4 million (or -10.1 percent of GDP), while the capital and financial account is expected to report an Afl. 414.5 million surplus (Chart 2). The differences between the overall balance and the sum of the accounts are the items that can not be classified.

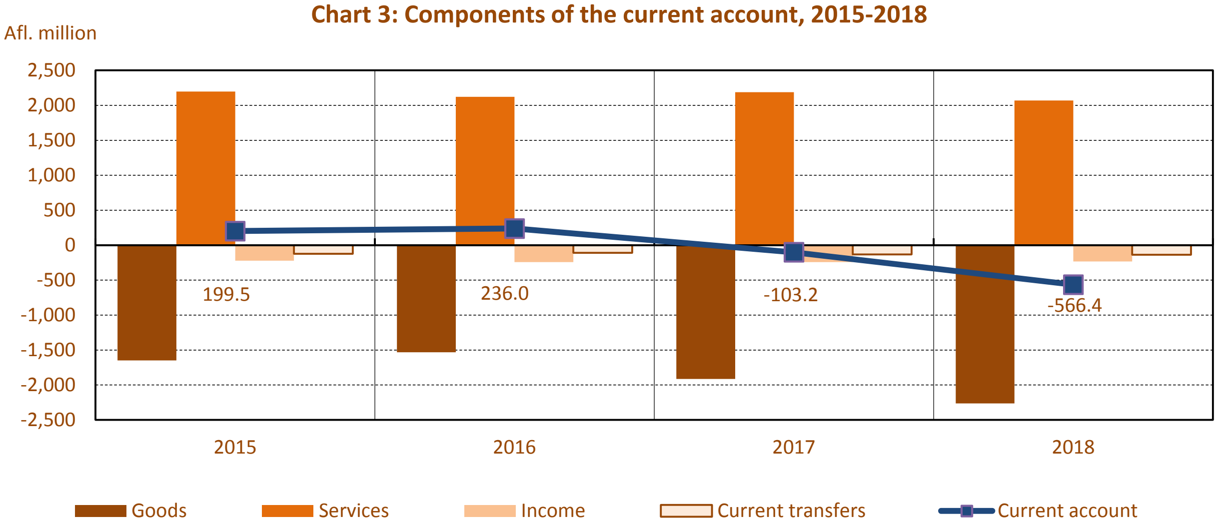
Chart 2: Overall balance of payments, 2015-2018



Source: CBA.

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 2018. The goods account deficit is forecasted to expand by Afl. 349.6 million to Afl. 2,263.2 million in 2018 (Chart 3). Import payments for goods are projected to increase by 15.5 percent with a significant part of that increase directly attributed to the import of goods for the refurbishment of 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 2.4 percent in 2018. On balance, the services account surplus is projected to contract by Afl. 118.6 million to Afl. 2,069.3 million in 2018.

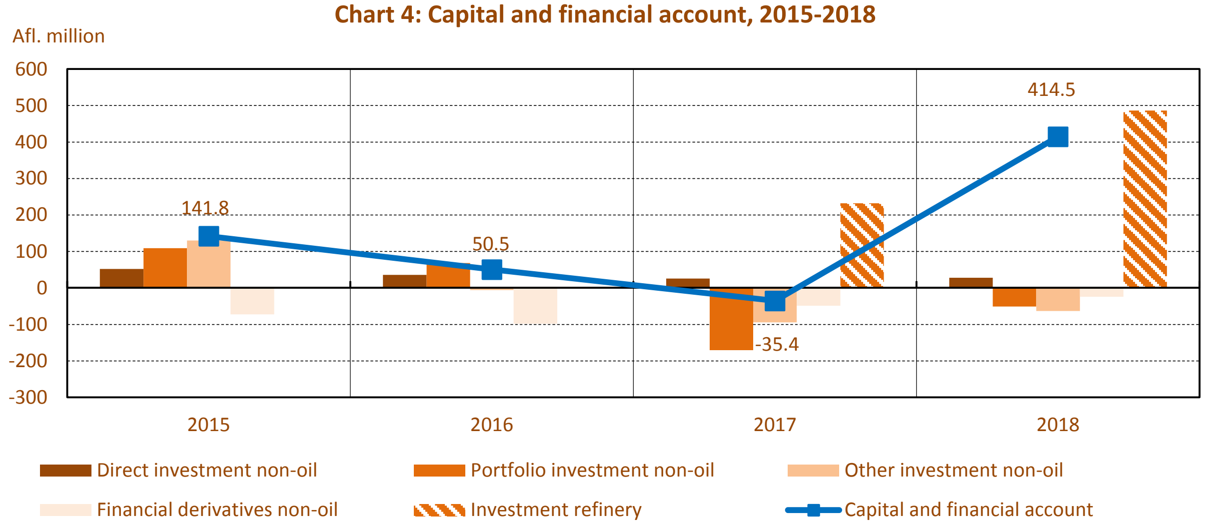
Chart 3: Components of the current account, 2015-2018



Source: CBA.

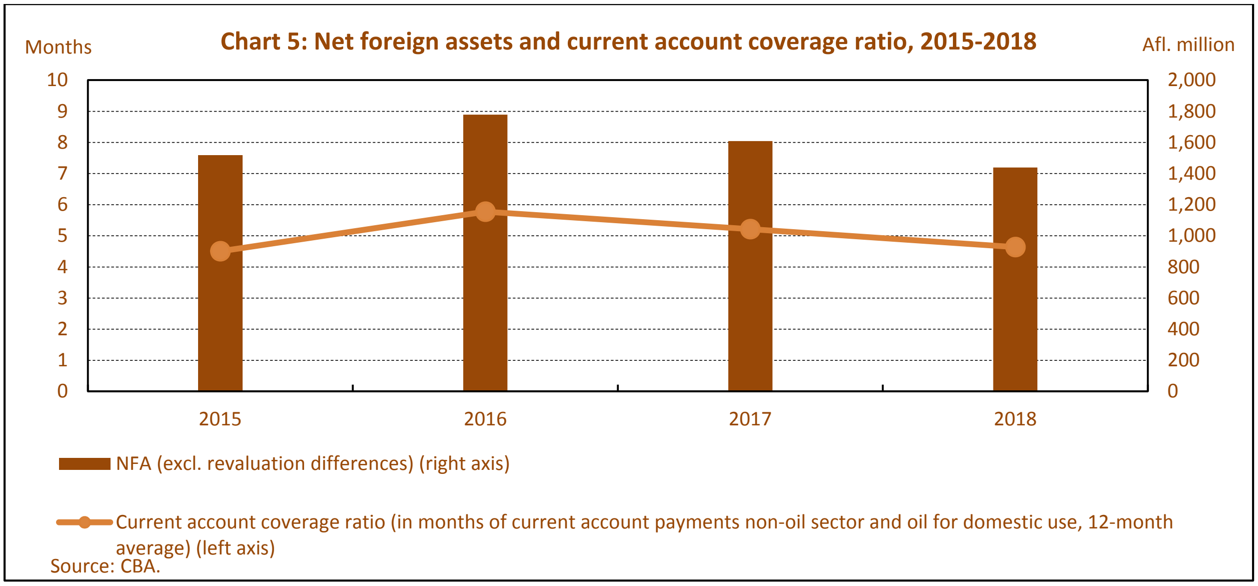
The capital and financial account is expected to record an Afl. 414.5 million surplus in 2018 (Chart 4). The refinery would contribute a substantial amount of investment in 2018. Additionally, foreign direct investments are anticipated to continue contributing positively to the financial account in 2018, pushed by an inflow of foreign currency from real estate and timeshare sales, as well as other tourism-related investment projects. Conversely, an outflow of funds related to the private and public sectors' portfolio investments and other investments abroad is expected. Finally, some outflow of funds associated with the hedging of oil prices is expected, registered in the financial derivatives account.

Chart 4: Capital and financial account, 2015-2018



Source: CBA.

The net foreign assets (NFA, excluding revaluation differences) are expected to decrease by Afl. 169.6 million to Afl. 1,608.0 million in 2017 and are forecasted to further decrease by Afl. 169.9 million in 2018 (Chart 5). Hence, the NFA is projected to reach a level of Afl. 1,438.1 million at the end of 2018. 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 2018 current account coverage ratio is forecasted to reach 4.6 months, i.e., 1.6 months higher than the benchmark.



2.3 Outlook risks

The GDP forecast is subject to a number of risks for the last quarter of 2017 and for 2018 onwards.

Starting with the upward risks:

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

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 gains in consumption and employment. Therefore, any delay in the execution of large investment projects dampens 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 potentially could jack 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. However, the exact status and timeline of the upgrader project remains highly uncertain. While preliminary work has commenced at the facilities in San Nicolas and the construction of housing facilities for foreign contract workers is currently underway, the exact timeline for upgrader work related investments continues to add uncertainty to the overall investment forecast and subsequently to GDP projections. To account for the added uncertainty, the CBA calculated a baseline medium-term (real) GDP growth scenario that includes the refinery operations as stipulated in the investment paragraph, as well as an alternative scenario which exclude refinery related activities from 2018 onwards (Table 3).

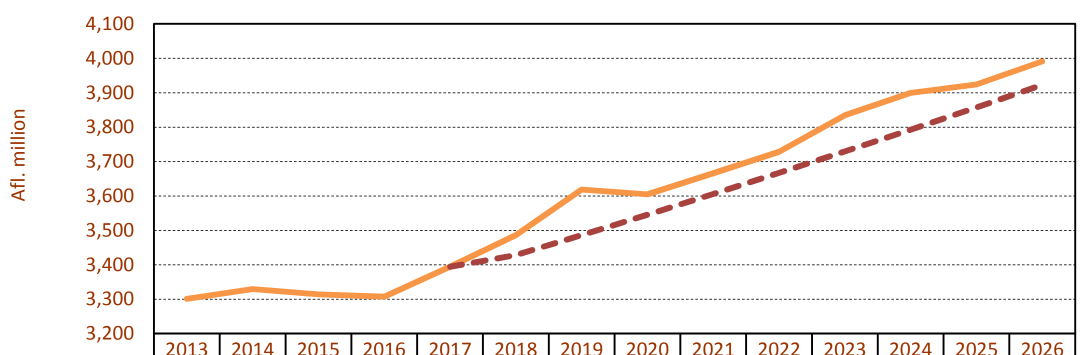
Table 3: Medium-term GDP growth rates (including refinery development)

	2017	2018	2019	2020	2021	2022	2023	2024
Real GDP	2.6	2.7	3.8	-0.4	1.7	1.7	2.8	1.7
Nominal GDP	2.6	2.9	5.2	1.0	3.1	3.1	4.2	3.1

Source: CBA.

In the absence of the refinery refurbishment activities, real GDP is estimated to grow by 1.0 percent in 2018 (Chart 6).

Chart 6: Real GDP medium term estimates and forecasts, 2013-2026 (base year 2000)



	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
Real GDP including refinery	3,301	3,329	3,314	3,307	3,394	3,486	3,618	3,604	3,666	3,728	3,834	3,899	3,924	3,991
Real GDP excluding refinery					3,394	3,428	3,486	3,546	3,606	3,667	3,730	3,793	3,857	3,923

3. Concluding remarks

Following two consecutive years of economic growth contraction, the Aruban economy is set to resume growth in 2017 and 2018 expanding by, respectively, 2.6 percent and 2.9 percent in real terms. Tourism service exports are the main driver of economic growth. Nevertheless, a key precondition to the extent of growth is the (timely) execution of the upgrade of the refinery, as well as other large planned investment projects. Execution of the refinery project is expected to result in the medium term in a higher level of gross domestic project (GDP), but with limited annual growth in domestic output. However, there is still considerable uncertainty about the project.