

# Economic Outlook

## March 2023



**CENTRALE BANK VAN ARUBA**

## Executive summary

In 2022, the Aruban economy is estimated to have grown by 15.5 percent in nominal terms to Afl. 6.5 billion (USD 3.6 billion), surpassing 2019 by 7.1 percent. This growth was driven mainly by the sustained increase in the level of stay-over visitors. The robust tourism performance led to a wide current account surplus, that more than compensated for the financial account deficit, and thus, resulted in a balance of payments (BOP) surplus of Afl. 227.2 million (2021: Afl. 828.4 million). Given, among others, the relatively high level of inflation, real GDP growth amounted to 9.6 percent, or, Afl. 6.2 billion.

In 2023, nominal GDP growth is projected to range between 8.4 percent and 10.2 percent, with a baseline growth of 9.1 percent. This growth is due to the Aruban economy continuing to benefit – albeit at a diminishing rate – from a higher level of stay-over visitors and persistent elevated tourism spending per night. Accordingly, the BOP is expected to record significant tourism revenue inflows. In addition to the buoyant developments in the tourism sector, the anticipated rise in private-sector wages, and the complete rollback of the COVID-19-related wage reduction in public sector wages are expected to boost consumption.

However, the real GDP of Aruba is forecasted to decline by an estimated 1.8 percent (baseline), due primarily to persistent inflationary pressures. Real GDP contraction ranges between a drop of 2.4 percent in a pessimistic scenario and 0.9 percent in an optimistic scenario. The primary reason for this real contraction is persistent inflationary pressures. Nonetheless, the Aruban economy is expected to continue to benefit – albeit at a diminishing rate – from an increased level of stay-over visitors; tourism spending per night is assumed to remain elevated. Accordingly, the balance of payments (BOP) is expected to record significant tourism revenue inflows. These developments, complemented by the anticipated rise in private-sector wages and the complete rollback of the COVID-19-related wage reduction in public sector wages are expected to boost consumption. As a result of the wage increases and tourism growth, import payments should rise also, leading to outflows on the BOP.

Hence, the nominal gains in tourism exports, consumption, and investment are likely to be eroded in large part by the anticipated higher level of inflation in 2023 (6.0 percent). Other factors that will contribute to the economic downturn are the likely contraction in the wage bill of the Government of Aruba, and reduced health cost coverage of the AZV. Moreover, real private domestic investment is forecasted to contract, given high inflation rates worldwide, domestic red tape, and uncertainty pertaining to the pending implementation of the 2023 fiscal reform in Aruba. Public investment is also projected to lag, due in part to limited fiscal space. With regard to the BOP, expected nominal direct inward investment from nonresidents will likely rise. In contrast, outflows related to other and portfolio investment are projected to narrow. On balance, the projected BOP is likely to record a surplus of Afl. 239.4 million in 2023.

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## 1. Introduction

**The current Economic Outlook provides updates on the Centrale Bank van Aruba's (CBA) economic projections for 2022, published in June 2022.** Furthermore, the CBA includes its initial forecasts for 2023. This publication addresses main developments that unfolded in 2022, and discusses relevant trends foreseen for 2023, elaborating on their expected impact and the projected economic growth for Aruba.

### 1.1 Looking back at 2022<sup>1</sup>

**Similar to 2021, the tourism sector drove real economic growth in 2022.** The number of stay-over visitors increased by 36.5 percent to 1.1 million visitors, and was well underway to reach its pre-pandemic 2019-level.

**Visitors from the United States were the main contributors to stay-over tourism, with the Netherlands and Canada as the second and third most important source markets.** According to the Aruban Tourism Authority (ATA), in total, the number of stay-over visitors in 2022 is estimated to have reached 98.0 percent of those in 2019. The positive development in stay-over visitors, paired with an expansion in the general price level of goods and services, resulted in a 45.2 percent upturn in tourism spending compared to 2021, which is equal to 123.4 percent of that of 2019. Accordingly, estimated tourism revenue was instrumental in attaining a current account surplus on the BOP.

**Domestic investment activities, on the other hand, were depressed.** In particular, estimated inward direct investment softened, albeit net direct investment still showed a surplus on the financial account of the BOP. Projects that were set to start in 2020 and 2021, or that already suffered delays due to the COVID-19 shelter-in-place measures, continued at a moderate pace during 2022. The slow pace of activities resulted from high inflation rates worldwide, which affected the price of, amongst others, construction materials. Furthermore, despite efforts to digitize services offered by the Department of Infrastructure and Planning (DIP) in 2022, the process to obtain permits was still perceived by project developers as being rigid and redundant<sup>2</sup>. Finally, uncertainty related to the implementation of the announced fiscal reform of January 2023 adversely affected the investment climate and investors' confidence. The sluggish developments in private investment were exacerbated by a low level of public investment, due in part to the late approval of the government's budget. However, outbound investment flourished, reflected in sizeable outflows and the subsequent estimated deficit in the portfolio investment account and other investment account. These outflows were likely related to the unwinding of the capital restrictions in late 2021.

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<sup>1</sup> The reported figures for 2022 are based on the CBA's assumptions at the moment of conducting the forecast, unless stated otherwise.

<sup>2</sup> Based on information gathered during stakeholder sessions.

**Unlike 2021, the FASE<sup>3</sup> and wage subsidy programs by the Government of Aruba (GoA) were not available in 2022.** Consequently, private consumption was mainly driven by the positive performance of the tourism sector. The related expansion in employment and gradual return to pre-COVID-19 wage levels pushed up total consumption. An additional factor improving consumption levels in 2022 was the partial (i.e., 5.0 percent) roll-back of the COVID-19 related cuts in public sector wages as of July 2022. Following the aforementioned developments in exports, investment, and consumption, imports rose in tandem in 2022, in part mitigating the current account surplus.

**One of the biggest economic challenges of 2022 was inflation.** The upward pressure on prices due to COVID-19-related supply chain disruptions was amplified by the Russian invasion of Ukraine that started in February 2022. The latter impacted the supply of gas, particularly to Europe, and the global commodity market. Furthermore, low gasoline inventories paired with ample demand for gasoline led to inflated gasoline prices in the first half of 2022. Climate-related events also contributed to the rise in prices, as intense heat waves and prolonged droughts negatively affected the production of various agricultural commodities.

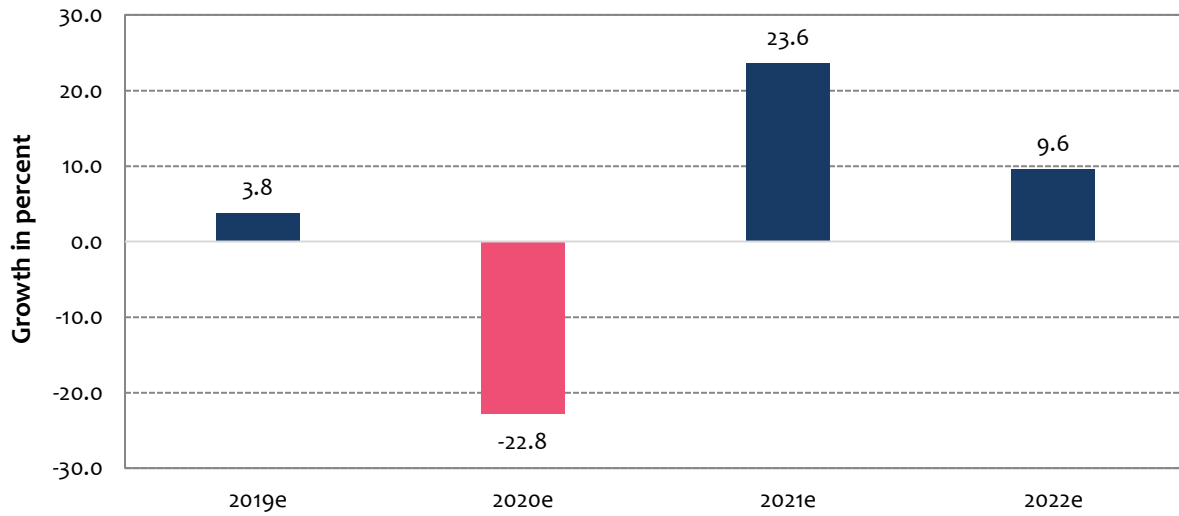
**While inflation in Aruba lagged compared to those registered in developed economies, such as the United States and the Netherlands, the general level of prices of goods and services followed a rising trend in 2022.** In addition to the import of elevated prices from its export partners and increased gasoline prices in the first half of 2022, various domestic developments, such as the hike in utility tariffs in August and September 2022, also pushed up inflation in 2022.

**As a result of the aforementioned developments , CBA's estimated real GDP growth for Aruba amounted to 9.6 percent in 2022 (Chart 1), falling just short of reaching double-digit expansion.** Because of the robust estimated growth and the ensuing smaller fiscal deficit, the GoA's foreign borrowing needs contracted compared to 2021. Furthermore, the GoA in large part financed its deficit locally. Consequently, the government sector recorded significantly smaller inflows on the financial account and likely experienced a small surplus on the financial account. On balance, the estimated tourism-driven current account surplus was mitigated partially by imports, portfolio investment related outflows, and other investment outflows. Accordingly, the estimated BOP surplus reached Afl. 227.2 million in 2022 (Chart 2).

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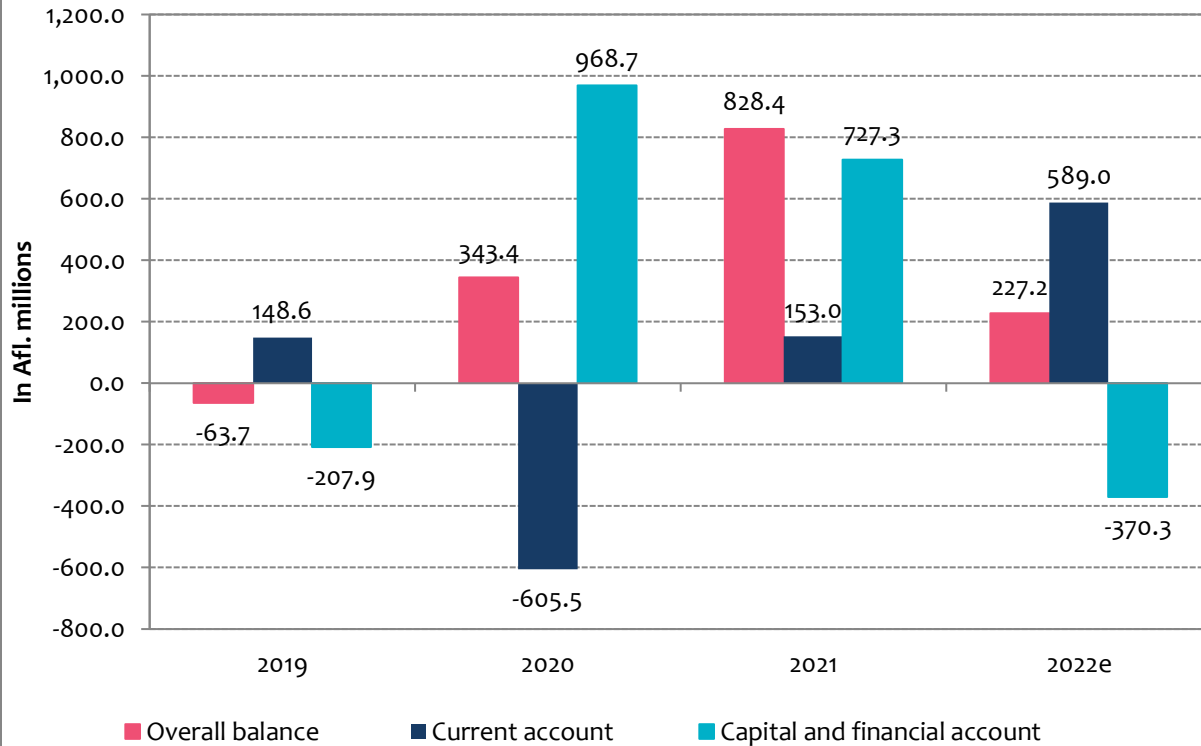
<sup>3</sup> Fondo di Asistencia Social di Emergencia: Benefit program targeting employees who lost their jobs due to the COVID-19 pandemic.

### Chart 1: Real GDP growth estimates 2019 - 2022



Source: CBA

### Chart 2: BOP overall balance 2019-2022



Source: CBA

## 2. Economic forecast

### 2.1 Expectations for 2023

**For 2023, the CBA expects the tourism sector to continue to perform strongly.** The total number of stay-over arrivals for the year is foreseen to surpass the 2019-level, with a recovery of 105.0 percent. Furthermore, tourism spending per night is assumed to remain elevated. At US\$ 585.6, average daily spending by stay-over visitor is forecasted to exceed the 2022 (US\$ 560.9) and pre-pandemic 2019 (US\$ 452.3)-levels. As a result, total tourism revenue is expected to reach 136.1 percent of the 2019-level, representing significant inflows to the current account of the BOP. Furthermore, the projected strong tourism performance and the 2023 tax reform conduce to a fiscal surplus (GoA 2023 budget: Afl. 63.0 million). Accordingly, the assumption is that the GoA will only borrow local funds to finance maturing external debt in 2023. The latter excludes the short-term loans for liquidity support received by the GoA from the Netherlands. Consequently, no net financial account inflows by the GoA are projected for 2023.

**On the investment front, the CBA does not foresee much change in terms of large investment projects compared to 2022.** In particular, expected inward direct investment edges up, and net direct investment again exhibits a surplus i.e., Afl. 223.5 million on the financial account of the BOP. Ongoing construction projects, mostly related to the tourism sector, are expected to continue, while no large projects have been identified to spur new investment growth. Public investment is also expected to remain flat at Afl. 37.1 million due to limited fiscal space. Furthermore, an expected higher inflation rate of 6.0 percent compared to 2022 spurred in part by the 1.0 percentage point BBO rate increase of January 1, 2023, is not indicative of improved investment conditions. Meanwhile, forecasted outward investment flows diminish, assuming the effect of the unwinding of capital restrictions gradually dissipates in 2023. Consequently, the private sector financial account potentially incurs fewer private sector outflows related to portfolio and other investments resulting in an Afl. 122.4 million net outflow, down from Afl. 383.7 million in 2022. The government sector financial account is expected to record a deficit of Afl. 304.1 million as the GoA will presumably finance its foreign maturing debt domestically.

**In 2023, consumption (+ 4.8 percent) is again expected to be primarily driven by the anticipated robust performance of the tourism sector.** As a result of heightened tourism sector activities, a lower level of unemployment is expected in 2023 (4.1 percent) compared to 2022 (6.0 percent). Moreover, private-sector wages are assumed to rise in 2023, due to partial inflation indexation and tight conditions in the labor market. Consequently, projected outgoing remittances are anticipated to expand. The announced roll-back of the remainder of the 12.6 percent COVID-19 related cuts in public sector wages is likely to contribute further to the improvement of consumption in 2023. However, these expected gains in consumption are foreseen to be mitigated by the anticipated high rate of inflation, a smaller public sector, and reduced health cost coverage by the AZV. Imports are forecasted to follow the developments in consumption, investment, and exports, thereby increasing by 3.7 percent in 2023. Consequently, the foreseen level of imports surpasses 2019-levels by 18.9 percent, and

the projected current account registers increased outflows related to imports (+Afl. 103.2 million compared to 2022).

To summarize the expected BOP results, nominal gains in (tourism) exports spur a current account surplus, although offset in part by imports, outward portfolio investment, and outward other investment. The outgoing flows related to portfolio investment and other investment are anticipated to be notably weaker than in 2022.

**Twelve-month average inflation is expected to rise further in 2023.** While oil prices are likely to remain relatively flat, trending slightly downwards, there are several developments producing upward pressure on prices:

1. Supply chain disruptions are predicted to remain largely unresolved due to the existing geopolitical tensions, climate-related factors, and the re-emergence of COVID-19 outbreaks.
2. The 2022 utility tariff hike will continue to contribute to average inflation throughout 2023.
3. The 1.0 percentage point BBO tariff hike introduced on January 1, 2023, will further push up the general price level of goods and services in the Aruban economy, and lead to inflation acceleration surpassing 2022 levels.

As a result of these aforementioned developments, the CBA forecasts a 12-month average inflation rate of 6.0 percent for 2023, which (partially) erodes the expected nominal gains in consumption, domestic investment, and exports.



## 2.2 Projections for 2023

**Based on the expected developments, the CBA produced three scenarios for real economic growth in 2023.** The baseline scenario presents the most likely outcome for 2023, based on the latest available information and data<sup>4</sup>, as well as the assumptions of the CBA. The optimistic and pessimistic scenarios deviate from the baseline based on tourism sector performance. Namely, in the pessimistic scenario, tourism exports are adjusted based on a predicted contraction in the real GDP of the United States of 0.3 percent<sup>5</sup>. In comparison, the optimistic scenario considers an expected expansion in real GDP of the United States of 1.5 percent<sup>6</sup>. Furthermore, the CBA made projections for the 2023 BOP outcome and foreign exchange reserves.

### 2.2.1 Real economic growth

#### 1. *Baseline scenario 2023*

**In the 2023 baseline scenario, real GDP is projected to contract by 1.8 percent.** Despite a foreseen expansion in real tourism exports (+0.5 percent) and the related upturn in employment, total real consumption is expected to decrease by 1.7 percent. This contraction is driven by a 2.2 percent decline in real public consumption and a 1.5 percent downturn in real private consumption. Notwithstanding the complete roll-back of the COVID-19-related cuts in public sector wages and the uptick in private sector wages, both real public consumption and real private consumption will likely be pushed down in large part by the anticipated relatively high rate of inflation. A lower number of public sector employees and reduced health cost coverage by the AZV further reduce public consumption. In addition, total real investment is foreseen to decrease by 3.4 percent. Limited fiscal space leads to a 5.0 percent reduction in real public investment, while the lack of sizeable new investment projects to compensate for the completion of ongoing large investment projects will likely contribute to an expected 3.3 percent drop in real private investment. The impact of the forecasted growth in real exports on real imports will likely be offset in part by contractions in real consumption and real investment. On balance, real imports are expected to increase by 0.6 percent.

#### 2. *Pessimistic scenario 2023*

**The forecasted decline of real GDP under the pessimistic scenario amounts to 2.4 percent for 2023.** Contrary to the baseline scenario, the assumed contraction in real GDP of the United States in the pessimistic scenario results in a 0.5 percent drop in real tourism exports. This decline in tourism exports, in turn, drives down real private consumption (-2.0 percent) in the pessimistic scenario. Compared to the baseline scenario, total real

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<sup>4</sup> Cutoff date: November 25, 2022.

<sup>5</sup> Federal Open Market Committee: Lower end of range of change in real GDP for 2023 (September 2022).

<sup>6</sup> Federal Open Market Committee: Upper end of central tendency of change in real GDP for 2023 (September 2022).

investment remains unchanged, registering a 3.4 percent contraction. The weaker performance of tourism exports further impacts real imports, which is expected to remain virtually unchanged in this scenario (+0.1 percent).

### 3. *Optimistic scenario 2023*

**Real GDP is expected to decline by 0.9 percent in the optimistic scenario for 2023.**

Assuming a better performance of the U.S. economy in comparison to the baseline, improved real tourism exports (+1.4 percent) pushes real private consumption (-0.1 percent) up in comparison to the baseline. Total real investment in the optimistic scenario (-3.4 percent) equals total real investment in the baseline scenario, given the same anticipated investment conditions for the private sector and fiscal space limitations. Following the developments in real exports, real consumption, and real investment, real imports is forecasted to grow by 1.4 percent.

The predicted growth in GDP and its components is summarized in Table 1.

Table 1: Growth of real GDP and its components 2022 – 2023 (in percent)				
Indicator	2022 e	2023 p f	2023 b f	2023 o f
<b>Current Outlook</b>				
<b>GDP</b>	9.6	-2.4	<b>-1.8</b>	-0.9
<b>Consumption</b>	4.4	-2.1	<b>-1.7</b>	-0.7
<b>Private consumption</b>	7.0	-2.0	<b>-1.5</b>	-0.1
<b>Public consumption</b>	-2.1	-2.2	<b>-2.2</b>	-2.2
<b>Investment</b>	-0.9	-3.4	<b>-3.4</b>	-3.4
<b>Private investment</b>	-0.2	-3.3	<b>-3.3</b>	-3.3
<b>Public investment</b>	-19.9	-5.0	<b>-5.0</b>	-5.0
<b>Exports</b>	27.5	-0.4	<b>0.5</b>	1.4
<b>Tourism exports</b>	30.2	-0.5	<b>0.5</b>	1.5
<b>Imports</b>	19.3	0.1	<b>0.6</b>	1.4

Source: CBA

e = estimate, f = forecast, o = optimistic, b = baseline, p = pessimistic

## 2.2.2 Nominal economic growth

The nominal output projection for 2023 ranges between 8.4 percent and 10.2 percent, with a baseline growth rate of 9.1 percent (Table 2). This is a slowdown from the growth rate of 15.5 percent estimated for 2022.

Table 2: Growth of nominal GDP and its components 2022 – 2023 (in percent)				
Indicator	2022 e	2023 p f	2023 b f	2023 o f
<b>Current Outlook</b>				
<b>GDP</b>	15.5	8.4	<b>9.1</b>	10.2
<b>Consumption</b>	9.9	4.4	<b>4.8</b>	5.9
<b>Private consumption</b>	13.0	3.9	<b>4.4</b>	5.9
<b>Public consumption</b>	1.6	6.1	<b>6.1</b>	6.1
<b>Investment</b>	6.1	1.7	<b>1.7</b>	1.7
<b>Private investment</b>	6.9	1.8	<b>1.8</b>	1.8
<b>Public investment</b>	-14.2	0.0	<b>0.0</b>	0.0
<b>Exports</b>	40.8	8.7	<b>9.6</b>	10.7
<b>Tourism exports</b>	45.2	9.3	<b>10.3</b>	11.4
<b>Imports</b>	31.4	3.1	<b>3.7</b>	4.5

Source: CBA

e = estimate, f = forecast, o = optimistic, b = baseline, p = pessimistic

## 2.2.3 Balance of payments and foreign exchange reserves

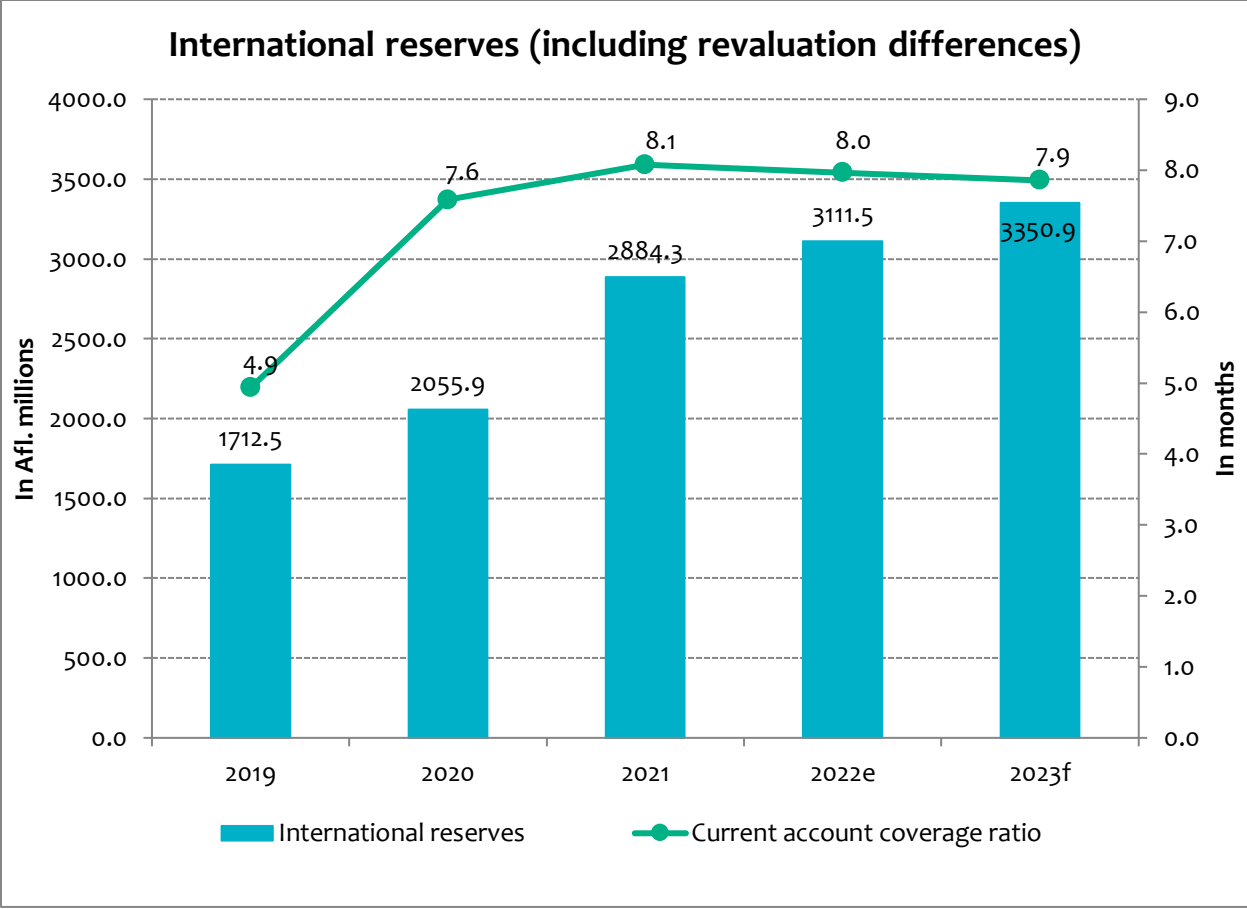
### 1. *Balance of payments*

**In 2023, the overall BOP is projected to register an Afl. 239.4 million surplus driven primarily by the continued strong performance in the tourism sector.** Although leveling off, sustained growth in tourism arrivals and elevated tourism spending per night are expected to push a net foreign exchange inflow of Afl. 751.9 million on the current account. These revenues are projected to expand by 10.3 percent compared to 2022 and lead to an Afl. 4,759.5 million inflow. However, increased domestic demand and higher prices are foreseen to boost the value of imports of goods and services, partially mitigating the expansion in tourism revenue. Imports of goods are expected to expand and induce an Afl. 2,599.8 million outflow of foreign funds, while imports of services are projected to grow to Afl. 2,000.0 million. Furthermore, higher interest rates and improved business performance are likely to increase income payments and result in a net outflow on the income account of Afl. 281.9 million.

**The financial account is anticipated to record an Afl. 430.3 million deficit resulting primarily from net outflows on the private sector portfolio and other investment accounts, as well as the government portfolio account.** However, the previously mentioned private outflows are anticipated to decline compared to 2022 as the pent-up demand related to the unwinding of the foreign exchange restrictions in late 2021 dissipates. Moreover, the continued improvement in the GoA's fiscal balance reversed the government's net inflow of foreign funds on the financial account witnessed during the pandemic. In 2023, the GoA is assumed to borrow on the domestic market to repay maturing external debt. On the other hand, the repayment of the short-term liquidity loans received during 2020-2022 is expected to be financed externally. Incoming foreign direct investment is anticipated to remain high, mainly related to the real estate sector and the expectation that elevated real estate prices and strong demand will persist in 2023. As such, the direct investment account is projected to reach Afl. 223.5 million in net inflows, partially mitigating the outflows on the portfolio and other investment accounts.

### 2. *Foreign exchange reserves*

**As a result of the Afl. 239.4 million surplus in the overall BOP, the expected level of international reserves (excluding revaluation differences) increases from Afl. 3,111.5 million in 2022 to Afl. 3,350.9 million in 2023.** To assess reserve adequacy, revaluation differences are included. Against this background, international reserves (including revaluation differences) are anticipated to comfortably cover the minimum of three (3) months of current account payments. Furthermore, projected official reserves (including revaluation differences) are foreseen to remain within the optimal bandwidth of the ARA metric (i.e., well above 100 percent and below 150 percent).



## 2.3 Outlook risks

The presented scenarios for 2023 are subject to the following risks:

- **Inflation.** While the general level of prices of goods and services across the globe was already elevated in 2022, a further inflation surge remains a risk for 2023. Continued warfare between Russia and Ukraine, and the resulting sanctions on imports from Russia will likely continue to impact energy and commodity prices in 2023. Moreover, ongoing supply chain disruptions might worsen due to the re-emergence of COVID-19 outbreaks, particularly in China, leading to the unavailability and further increases in the prices of imported goods. Oil market volatility also poses a risk to inflation, stemming from, among others, production decisions of OPEC+, as well as additional geopolitical tensions. Furthermore, climate-related floods, heat waves, and droughts remain a threat to agriculture, and as such to the availability and prices of food items. In addition to these global factors, domestic developments such as the implementation (of additional components) of the proposed fiscal reform of January 1, 2023 may also lead to added upward pressure on prices.
- **Re-emergence of COVID-19 outbreaks.** The impact of new COVID-19 variants and subsequent waves of contagion may affect the presented economic growth scenarios, as well as the BOP and foreign exchange projections, exerting significant downside risks on the results.
- **Investment projects.** The timely execution of relatively large investment projects is always a source of risk for GDP, BOP, and foreign exchange projections. The execution of investment projects is susceptible to a range of conditions, among others, (perceived) red tape, available fiscal space, inflation, labor market conditions, financial market conditions, and the availability of construction materials.
- **Additional government measures.** On January 1, 2023, the Government of Aruba increased the BBO tax rate by 1.0 percentage point to 7.0 percent<sup>7</sup>. This development in the turnover tax rate is part of a broader fiscal reform plan to be implemented in 2023. The implementation of additional pending components of this plan, as well as the introduction of additional measures to improve its financial position, such as further lowering personnel expenses and the introduction of other income-generating or expenditure reducing measures, could dampen private and public consumption. Furthermore, the GoA's financial position could affect its foreign borrowing, and, consequently, the BOP and foreign exchange outcome.

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<sup>7</sup> The 7.0 percent tax rate reflects the combined turnover tax rate, consisting of the BBO (2.5 percent), the BAVP (1.5 percent), and the BAZV (3.0 percent).

- **The GoA refinancing needs.** The ongoing negotiations with the Netherlands regarding refinancing conditions and subsequent refinancing risks due to external financing conditions could significantly alter the GoA's fiscal position.
- **Financial account outflows by the private sector.** The assumption that pent-up demand – related to the unwinding of the capital restrictions in late 2021 -- gradually dissipates in 2023 is based on the latest available data. However, the actual speed at which pent-up demand subsides may turn out faster or slower, forming a risk to the private sector outflows from the financial account.

### 3. Concluding remarks

The Aruban economy benefitted strongly from a significantly increased inflow of stay-over visitors and tourism spending during 2022. Consequently, economic growth in real terms is estimated at 9.6 percent in 2022. Moreover, the positive results of tourism reflected in the current account of the balance payments, drove a BOP surplus, and, thus, a rise in international reserves. **For 2023, however, economic growth forecasts point to a reversal of growth in the baseline scenario, with the economy expected to contract by 1.8 percent in real terms (pessimistic: -2.4 percent; optimistic: -0.9 percent).** The 2023-outlook is more favorable for the BOP; expected tourism inflows are likely to again produce a current account surplus, while dissipating pent-up demand potentially drives down financial account outflows. Accordingly, the BOP is projected to record a significant surplus, further pushing up the international reserves. As the expected buoyant performance of the tourism-sustained positive economic developments play an essential role in projecting economic output and the BOP outcome in 2023, the current economic outlook is subject to multiple (downside) risks.



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