ECONOMIC OUTLOOK July 2023

CENTRALE BANK VAN ARUBA

Mangroves are hotspots of biodiversity, connecting life on land with life below water. These ‘forests of the sea’ are essential to the health and vibrancy of our coastal ecosystems, including our community livelihoods. They provide a vital habitat for marine life, help to protect against coastal erosion and storm surges, as well as filter pollutants from the sea. Mangroves are one of nature’s most effective tools in the fight against climate change and are integral to nature.

Executive summary

Following a strong rally in 2022, tourism related activities continued to grow steadily in the first quarter of 2023. This had, simultaneously, a positive impact on hotel sector performance. In 2023, 2024, and the medium term (2025 – 2027), tourism will likely remain the principal contributor to Gross Domestic Product (GDP) growth.

For 2023 the Central Bank of Aruba (CBA) projects a real GDP increase of 0.4 percent, mostly brought about by higher income from tourism activities. The latter results from an increase in stay-over visitors and a rise in tourism spending. Consequently, the balance of payments (BOP) expects to record higher tourism revenue inflows. Investment is also estimated to push up GDP, albeit to a lesser degree. The growth in real investment is positively influenced by expansions in both real private and real public investment, notwithstanding elevated prices and uncertainty regarding pending fiscal reform measures. As a result of the increased level of investment, import payments will rise also, leading to ouflows on the BOP. On balance, the BOP is likely to record a deficit of Afl. 79.7 million in 2023, driven by a large net financial account outflow.

For 2024, the CBA projects a real GDP growth of 1.2 percent, primarily driven by expansions in real exports and real consumption. The number of stay-over visitors and tourism spending will likely continue to grow, again contributing to inflows on the BOP. Real private consumption further contributes to the expected growth in GDP, due to an anticipated expansion in employment and wages, that are sufficient to compensate for the relatively low level of inflation expected in 2024. The broader level of consumption leads to additional import payments, resulting in outflows in the BOP. Nonetheless, the CBA estimates a surplus of Afl. 342.2 million on the BOP for 2024, as tourism revenues outpace import payments and drive a large current account surplus. The latter is partially offset by outflows on the financial account.

For respectively 2025-2027, the CBA forecasts moderate real GDP growth of 1.4 percent, 0.6 percent, and 1.5 percent. Similar to the short term, tourism exports are likely to drive the medium-term GDP.

Centrale Bank van Aruba

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1. Introduction

The current Economic Outlook (EO) contains updates on the Centrale Bank van Aruba's (CBA) economic growth estimates for 2022 and projections for 2023. In addition, the EO presents an initial forecast for 2024 and the medium-term (2025-2027).

1.1 Economic developments in the first quarter of 2023[1]

Following the strong uptick in 2022, tourism continued to grow at a steady pace in the first quarter of 2023. Total stay-over visitors increased by 31.1 percent to 306,305 visitors, compared to 233,666 visitors in the first quarter of 2022. This increase mainly resulted from expansions in the number of visitors from the United States (+46,348 visitors), Canada (+13,885 visitors), and Colombia (+3,362 visitors).

Concurrently, output in the hotel sector also improved. In the first quarter of 2023, the average occupancy rate was 83.5 percent, compared to 62.2 percent in the same period of the previous year. The average daily rate (ADR) also rose by 14.7 percent to US$ 407,73 during the period under review. Consequently, revenue per available room (RevPAR) registered an upturn of 54.2 percent in the first quarter of 2023.

The aforementioned developments, combined with a rise in the general price level of goods and services, led to a 34.8 percent expansion in tourism spending compared to the first quarter of 2022.

Furthermore, investment-related indicators pointed to an uptick in investment during the first quarter of 2023. The value of the import of construction materials (+28.0 percent), base metals and derivated works (+27.7 percent), as well as machinery and electrotechnical equipment (+4.4 percent) all registered growth. In addition, the value of new commercial mortgages at local commercial banks rose by 45.0 percent. The growth of these components may indicate in part continued soaring prices of construction-related goods from Aruba's import partners, as well as container prices which have remained elevated compared to their pre-pandemic levels. However, in line with the developments mentioned previously, results from the CBA's Business Perception Survey (BPS) of the first quarter of 2023 revealed that the share of businesses reporting an improvement in investment rose by 10.9 percentage points. A leading indicator on future construction provided further evidence of the perceived favorable investment climate, as the total value of construction permits jumped by 63.1 percent in the first quarter of 2023.

In the first quarter of 2023, the number of employment contracts registered at the Social Insurance Bank (SVb Aruba) grew by 5.8 percent compared to the first quarter of 2022, pointing to an expansion in employment. At the same time, 69.1 percent of respondents of the CBA's BPS reported an improvement in the wage conditions of their employees. Indeed, the CBA's Consumer Confidence Survey (CCS) for the first quarter of 2023 shows that the share of respondents that experienced an increase in income rose by 5.1 percentage points. In addition to the developments mentioned earlier, the Government of Aruba (GoA) completely rolled back the COVID-19-related cuts in public sector wages as of the first quarter of 2023. All of the aforementioned factors had a positive effect on consumption in the first quarter of 2023.

With regard to inflation, the 12-month average Consumer Price Index (CPI) reached 6.2 percent at the end of the first quarter of 2023. The resulting inflation rate was 4.1 percentage points higher than the rate of inflation measured at the end of the first quarter of 2022. The main factors that put pressure on

[1] For an ample discussion of economic developments in the first quarter of 2023, please consult the CBA's Q1-2023 State of the Economy publication.

the general level of prices during the period under review were the higher prices for utilities, food, gasoline, and the purchase of new vehicles. However, increases in the CPI, measured on a year-over-year basis, started to wane during the first quarter of 2023.

Overall, the developments observed in the first quarter of 2023 depict a positive economic performance during the period under review.

2. Economic forecast

2.1 Drivers for 2023 and 2024

In 2023 and 2024, tourism will likely remain the principal contributor to Gross Domestic Product (GDP) growth. Stay-over visitors are likely to reach 105.0 percent of the 2019 level in 2023. Moreover, for 2024, a recovery of 107.0 percent of the 2019-level is estimated. Average daily spending is anticipated to grow by 6.4 percent to Afl. 587.47 in 2023, due to an expected 10.0 percent growth in the Average Daily Rate (ADR) and a 4.1 percent increase in non-accommodation spending. In 2024, average daily spending is expected to increase by 6.4 percent to Afl. 625.07. As a result of these developments, nominal tourism credit is likely to expand by 12.6 percent in 2023 and 8.4 percent in 2024.

Investment is also projected to push up GDP, albeit to a lesser degree. Compared to 2022, the CBA identified a small number of new and large projects for 2023 and 2024. The investment panorama, however, remains largely unchanged compared to 2022, with most sizeable construction projects being related to the tourism industry. Despite the elevated level of prices of goods and services, in addition to uncertainty regarding the implementation of the BBO at the border scheduled for July 1, 2023, the ongoing construction projects are anticipated to pick up speed. Public investment is also foreseen to grow, even though limited fiscal space is anticipated to dampen public investment in 2023 and 2024.

In 2023, consumption is projected to contract despite the strong performance of the tourism sector. Employment is foreseen to expand by 2.1 percent, as the growth in private-sector employment is expected to more than compensate for a decline in the number of public-sector employees. Furthermore, employees are likely to have a 1.4 percent increase in wages. This assumption is based on the expectation of partial inflation indexation and the relatively tight conditions on the labor market. Moreover, it takes into account the complete rollback of the 12.6 percent COVID-19-related cuts in public sector wages as of January 1, 2023. Nonetheless, inflation will likely mitigate nominal consumption growth, resulting in a contraction in real consumption for 2023. Contrary to 2023, consumption is expected to expand in 2024. During the respective year, the anticipated 1.7 percent upturn in employment and 0.3 percent rise in wages enable nominal consumption growth to surpass the forecasted inflation rate in 2024.

During 2023 and 2024, imports will likely record an increase following the developments in consumption, investment, and exports.

The CBA projects an acceleration in the twelve-month average inflation rate in 2023 and 2024. The main factors producing upward pressure on prices are:

1. **Supply chain disruptions:** Commodity prices are still affected by unresolved supply chain disruptions from existing geo-political tensions and climate-related factors. In addition, domestic shipping constraints further contribute to the costs of imported goods.
2. **Utility tariffs.** The utility price increases of August 2022 and September 2022 will continue to impact the average inflation rate throughout 2023.

3. **Fiscal measures.** The 1.0 percentage point increase in the BBO rate introduced on January 1, 2023, as well as the BBO at the border scheduled for July 1, 2023, will affect the general level of prices for goods and services in the Aruban economy in 2023. The aforementioned measures will continue to have an upward impact on the average inflation rate in 2024.

The developments mentioned above result in a forecasted twelve-month average inflation rate of 4.1 percent for 2023 and 0.9 percent in 2024, which (partially) erode the expected nominal gains in consumption, investment, and exports, particularly in 2023.

2.2 Projections for 2023 and 2024

The CBA updated its forecasts for 2023, and presents its initial estimates for 2024 contingent on the developments mentioned in the previous section. The results reflect the most likely outcome based on the latest available information and data[2], as well as the assumptions of the CBA.

2.2.1 Real economic growth

2023

The CBA projects a real GDP increase of 0.4 percent in 2023, mostly caused by increased real exports (+3.8 percent) and real investment (+2.8 percent). The outcome in real exports mainly results from higher income from tourism activities (+4.3 percent), due to an increase in stay-over visitors and a rise in tourism spending. The growth in real tourism exports is complemented by a 1.8 percent increase in real non-tourism exports. Meanwhile, real investment is positively influenced by advancements in both real private (+2.8 percent) and real public (+3,8 percent) investment, notwithstanding elevated prices and uncertainty regarding pending fiscal reform measures. On the other hand, real consumption is projected to decline by 0.6 percent related to contractions in real private (-0.7 percent) and real public (-0.2 percent) consumption. In this regard, the inflationary pressures throughout the year, as well as the lower number of public-sector employees, are projected to mitigate the gains in wages and private-sector employment.

2024

For 2024, the CBA foresees a real GDP growth of 1.2 percent, primarily driven by expansions in real exports (+4.1 percent) and real consumption (+0.6 percent). Meanwhile, the number of stay-over visitors and tourism spending will likely continue to expand, resulting in a 5.0 percent increase in real tourism exports compared to 2023. The latter is in addition to an upturn in real non-tourism exports of 1.1. percent. Real private consumption (+1.1 percent) is the main driver of the growth in real consumption, which is mitigated in part by a reduction in real public consumption (-0.8 percent). The positive developments expected for real private consumption, result from the anticipated expansion in employment and wages, which are sufficient to compensate for the relatively low level of inflation expected in 2024. The lower number of public sector employees and the foreseen level of inflation in 2024, in turn, outweigh the automatic indexation of public sector wages causing a contraction in public consumption. In 2024, real investment (+0.0 percent) is projected to remain flat, following unchanged real private investment (+0.0 percent), and an increase in real public investment (+1.2 percent). The private investment outcome reflects a lack of new large investment projects currently planned.

[2] Cutoff date: May 2023.

Table 1 summarizes the predicted growth in GDP and its components.

Table 1: Growth of real GDP and its components 2022 – 2024 (in percent)			
Indicator	2022 e	2023 f	**2024 f**
Current outlook			
GDP	10.5	0.4	1.2
Consumption	-0.9	-0.6	0.6
Private consumption	-1.5	-0.7	1.1
Public consumption	0.7	-0.2	-0.8
Investment	5.1	2.8	0.0
Private investment	8.1	2.8	0.0
Public investment	-72.6	3.8	1.2
Exports	28.0	3.8	4.1
Tourism exports	29.6	4.3	5.0
Imports	11.8	3.7	3.4

Source: CBA

e = estimate, f = forecast

2.2.2 Nominal economic growth

The CBA projects nominal economic growth to reach 8.6 percent in 2023 and 4.0 percent in 2024. These growth rates represent a gradual normalization of economic growth following the post-pandemic surges experienced in 2021 and 2022.

Table 2: Growth of nominal GDP and its components 2022 – 2023 (in percent)			
Indicator	2022 e	2023 f	**2024 f**
Current outlook			
GDP	14.2	8.6	4.0
Consumption	4.0	3.7	1.7
Private consumption	3.9	3.4	2.0
Public consumption	4.1	4.6	0.9
Investment	12.7	7.2	1.8
Private investment	15.9	7.2	1.7
Public investment	-70.6	8.1	3.0
Exports	37.5	10.8	7.2
Tourism exports	40.8	12.6	8.4
Imports	24.7	5.9	4.7

Source: CBA

e = estimate, f = forecast

2.2.3 Balance of payments and foreign exchange reserves

For 2023, the CBA projects the overall BOP to register an Afl. 79.7 million deficit, driven by a large net financial account outflow. The expectation of domestic refinancing of maturing foreign debt in 2023 contributes to the financial account net outflow. Moreover, no new foreign borrowings for fiscal deficits are anticipated due to an improvement in the GoA's finances. However, the projected financial account net outflows will be mitigated in part by net inflows on the current account, which is bolstered by the continued strong tourism performance. For 2024, the CBA foresees an Afl. 342.2 million BOP surplus. This results from the presumption of the current account surplus outweighing the financial account deficit unlike 2023. The 2024 projection assumes the GoA will borrow more externally to pay off maturing foreign debt, while private sector outflows expand, thus driving the net outflow on the financial account.

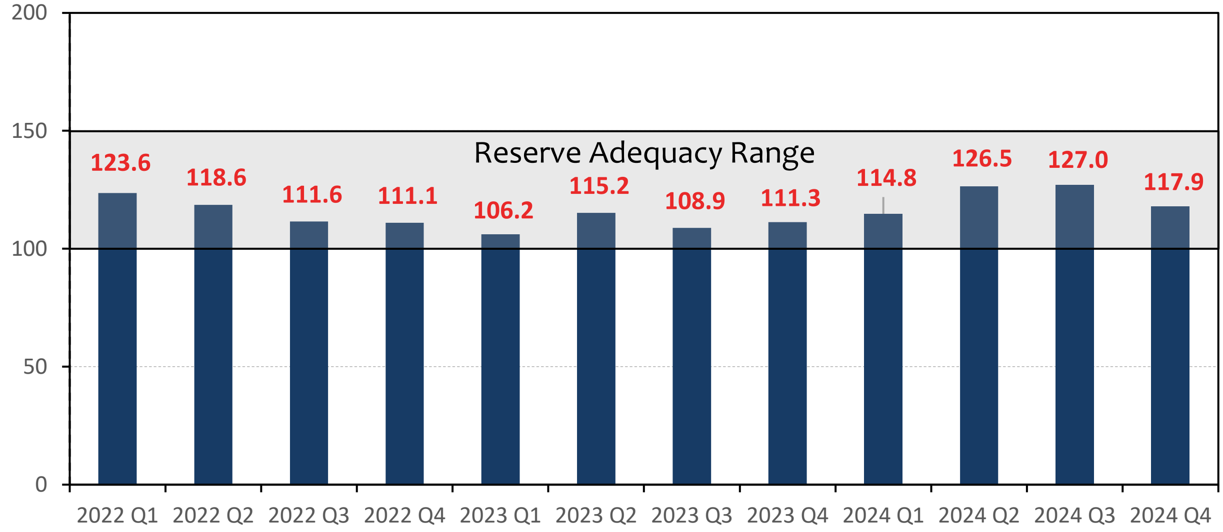
The current account surplus is anticipated to reach Afl. 671.5 million in 2023 and Afl. 937.7 million in 2024. This surplus is the result of service inflows surging due to tourism exports, while imported inflation for services payments – although faltering -- pushes up outflows. Additionally, increased domestic and tourism consumption, in addition to imported inflation, are anticipated to raise the import of goods. Furthermore, against the background of robust tourism growth, hotel dividend payments drag down the current account surplus alongside financial sector dividend payments.

The financial account is likely to register an Afl. 549.7 million deficit in 2023, and an Afl. 575.7 million deficit in 2024. These deficits result primarily from portfolio (private- and government sector), as well as other investment (private sector) net outflows, which are partly offset by direct investment net inflows in 2023 and 2024. Private portfolio account outflows are likely to remain near 2022-levels, considering the expected elevated pent-up demand for portfolio investments following the suspension of additional capital restrictions implemented during the pandemic. Furthermore, it is assumed that the GoA will cover all maturing debt, except for the Dutch liquidity loans received during the pandemic[3], through domestic borrowing and foregoing foreign financing. The latter is expected to contribute to the 2023 financial account deficit. In contrast, for 2024, maturing debt is estimated to be financed only partially in the local capital market with the remainder being financed abroad. Private other investment outflows due to pent-up demand are forecasted to wind down in 2023 and 2024, based on preliminary BOP data and extended foreign exchange licenses. In addition, an expected surplus in the GoA's 2023 and 2024 fiscal balance will enable the GoA to repay maturing debt, reducing the need for government foreign borrowing. For 2023 and 2024, foreign direct investments are anticipated to remain near 2022-levels (if incidental transactions of 2022 are excluded). The related inflows are mainly driven by real estate investments.

In 2023, a projected Afl. 79.7 million deficit in the overall BOP results in a decrease in international reserves (excluding revaluation differences), i.e., from Afl. 3,111.5 million in 2022 to Afl. 3,031.7 million in 2023. However, a rebound in the overall BOP is forecasted to raise international reserves to Afl. 3,374.9 million in 2024. To assess reserve adequacy, revaluation differences are included. International reserves, including revaluation differences, are anticipated to remain adequate, with the current account coverage ratio compliant with the minimum of 3 months of current account payments. Furthermore, official reserves are forecasted to grow and remain within the optimal bandwidth of the IMF ARA metric in 2023 and 2024 (Figure 1).

[3] This forecast assumes that the Dutch liquidity loans will be refinanced in foreign markets. Accordingly, the effect on the BOP is neutral.

Figure 1: Reserve adequacy during 2022-2024
(percent of lower bound IMF ARA metric)



2.3 Medium-term outlook

For 2025-2027, the CBA foresees moderate real GDP growth of 1.4 percent, 0.6 percent, and 1.5 percent, respectively. Similar to the short term, tourism exports are likely to drive the medium-term real GDP. In connection with Aruba Airport Authority (AAA) 's expected capacity expansions, tourist arrivals are projected to widen by 2.0 percent each year. In terms of spending per night, a continued growth is likely, owing to increasing ADR and non-accommodation spending. Related to tourism, there are several construction projects that will push up investment in the medium-term, most notably the APA Port City project. Besides APA's Port City project, other new large construction projects are foreseen to commence in 2025. The ensuing base effect explains the smaller GDP growth in 2026. In 2027, real GDP growth picks up again as, unlike 2025 and 2026, employment growth outpaces inflation, contributing positively to real consumption. Medium-term real import is a function of consumption, investment and exports, with medium-term import growth peaking in 2025 due to a jump in investments.

2.4 Outlook risks

The projected results are subject to the following domestic and international risks:

- **Strength of tourism growth.** The specific assumptions regarding the increase in stay-over visitors and tourism spending play an important part in the outcomes of the forecast. Deviations from the assumed propensities to travel and spend, due to, among others, a potential economic recession, and the 2024 United States presidential election, may affect the anticipated GDP growth.

- **Inflation.** The general level of prices of goods and services is projected to be lower in 2023 and 2024 compared to 2022. Despite the expected normalization of prices, an inflation surge remains a risk to the forecast. Global factors contributing to this risk are the continued warfare between

Russia and Ukraine, and the resulting sanctions on imports from Russia. Furthermore, supply chain disruptions and oil market volatility also pose a risk to inflation. Moreover, climate-related floods, heat waves, and droughts continue to be a threat to agriculture and 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 2023 may also lead to added upward pressure on prices.

- **Investment projects.** The timely execution of relatively large investment projects is always a source of risk for GDP, BOP, and foreign exchange projections. The implementation 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.

- **Labor.** The forecast results hinge on the possibility to import labor to accommodate the expansion in tourism growth and additional room inventory. Moreover, wages are presumed to increase due to partial inflation indexation. It should be noted that any departure from the assumed labor market conditions may lead to a variation in the projected GDP growth.

- **Additional government measures.** On January 1, 2023, the GoA raised the BBO tax rate by 1.0 percentage point to 7.0 percent[4]. This development in the turnover tax rate is part of a broader fiscal reform plan to be implemented in 2023. The effects of the implementation of additional pending components of this plan, such as the BBO at the border scheduled for July 1, 2023, and the introduction of additional measures to improve its financial position, including 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.

- **The pace of unwinding pent-up demand.** Based on the latest available data, the assumption of a gradual deceleration of financial account outflows is included in the current BOP forecast. However, the pace at which the dissipation will occur may be faster or slower than anticipated, which could form a risk to the private sector outflows of the financial account.

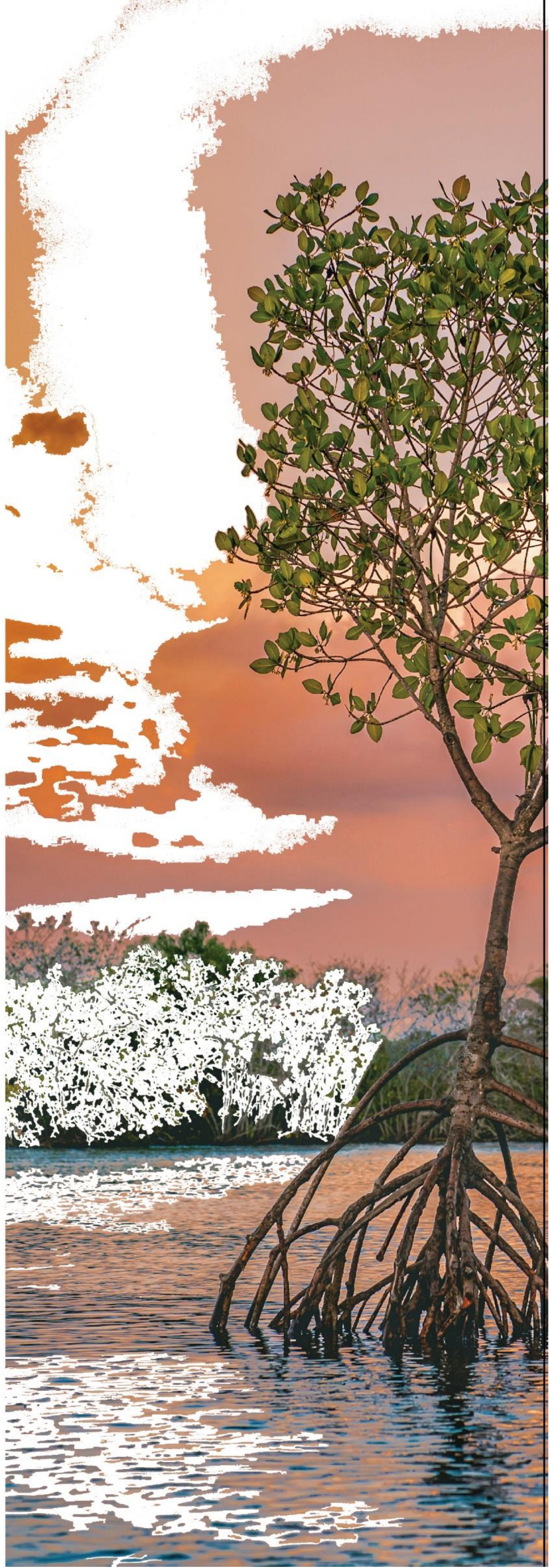
- **External financing conditions.** The ongoing negotiations with the Netherlands regarding the refinancing of foreign debt, and risks associated with the changing external financing conditions could impact the GoA's fiscal position. Depending on the persistence of inflation globally, external financing conditions may have a positive or negative effect on GoA's fiscal position.

[4] 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).

3. Concluding remarks

Following the strong performance of the tourism sector in 2022, the CBA expects tourism to continue to grow and remain the principal contributor to GDP growth. In 2023, real GDP is estimated to inch up by 0.4 percent, mostly driven by tourism exports and (private) investments. The 1.2 percent growth of real GDP in 2024, in turn, is primarily the result of tourism exports and private consumption. In the medium term, CBA forecasts real GDP to expand between 0.6 percent and 1.5 percent, mainly driven by increased tourism exports.

In 2023, the overall BOP is likely to register an Afl. 79.7 million deficit driven by a large net financial account outflow. The latter is partly mitigated by a net inflow on the current account, which is boosted by the continued strong tourism performance. In 2024, the BOP is expected to register an Afl. 343.2 million surplus, as the current account surplus outweighs the financial account deficit. Despite tourism growth declining, its anticipated level is strong enough to bring about a BOP surplus in 2024. As for the financial account, the assumption is that the GoA will borrow more externally compared to 2023, to pay off maturing foreign debt, and private sector outflows are projected to expand.



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