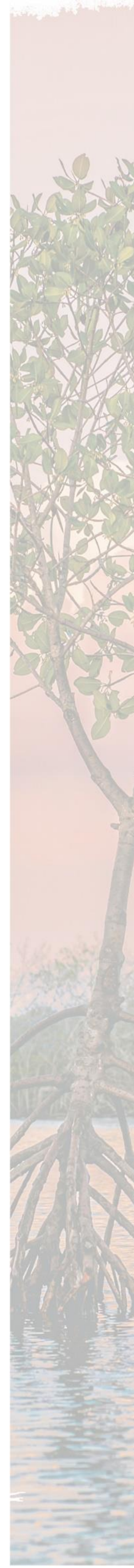
ECONOMIC OUTLOOK March 2024

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

Consistent with developments in 2022, the first half of 2023 benefited from sustained growth in tourism arrivals. The latter positively contributed to hotel sector performance during the period under review. Gross Domestic Product (GDP) growth is foreseen to continue gaining from strong tourism in 2023, 2024, as well as in the medium term (2025 – 2027).

The Centrale Bank van Aruba (CBA) projects a 5.1 percent increase in real GDP for 2023, driven by higher revenue from tourism activities and a pick-up in investment. Real tourism exports and private consumption gained from a sustained expansion in stay-over visitors and average tourism spending per visitor. Real private and public investment, in turn, likely expanded in 2023, due to faster execution of investment projects and available fiscal space. Consistent with the development in tourism activities, the balance of payments (BOP) recorded higher tourism revenue inflows. As a result of higher investments and tourism revenue inflows, import payments also rose, leading to outflows on the BOP. In addition, domestic (re)financing of foreign loans and share purchases by residents from nonresidents, interest payments, and dividend payments caused a further outflow of funds. On balance, the BOP is likely to record a deficit of Afl. 156.8 million in 2023.

For 2024, the CBA forecasts a 0.1 percent contraction in real GDP. Despite upturns in real exports and real consumption resulting from the continued buoyant performance of the tourism sector, the substantial decrease in real investment pushes down real GDP. The latter results from a lack of new investment projects to compensate for the completion of relatively large construction projects in 2023. The number of stay-over visitors and tourism spending per visitor will conceivably continue to grow, again contributing to inflows on the BOP. The broader level of tourism exports and private consumption principally lead to additional import payments, resulting in outflows in the BOP. Nonetheless, the CBA estimates a surplus of Afl. 620.1 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.

In the medium term, CBA foresees modest real GDP growth of 0.7 percent (2025, 2026) and 2.8 percent (2027), mainly fueled by tourism exports complemented by investment (2025) and consumption (2027).

Centrale Bank van Aruba

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1. Introduction

The current Economic Outlook (EO) presents an update to the Centrale Bank van Aruba's (CBA) economic growth projections published in July 2023. It provides estimates for 2022, as well as projections for 2023, 2024, and the medium-term (2025-2027).

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

Emulating the strong performance of the tourism sector in 2022, tourism activities registered marked growth rates in the first half of 2023. Total stay-over visitors jumped by 15.6 percent, reaching 610,582 visitors compared to 528,325 visitors in the first half of 2022. Upturns in stay-over visitors from the United States (+52,842 visitors), Canada (+15,962 visitors), and Colombia (+6,454 visitors) mostly drove the expansion in stay-over visitors.

Hotel sector performance also charged ahead further in the first half of 2023. The June 2023 year-to-date (YTD) average occupancy rate amounted to 79.3 percent, compared to 71.1 percent in the same period of 2022. The June-2023-YTD average daily rate (ADR) also expanded by 15.0 percent to US$ 364. These developments led to an increase of 28.2 percent in the revenue per available room (RevPAR) in the first half of 2023.

Amplified by a rise in the general level of prices of goods and services, tourism revenue[2] rose by 22.5 percent compared to the first half of the previous year.

Investment-related indicators, on the other hand, painted a mixed picture during the first six months of 2023. Buoyant import indicators initially seem to stand in stark contrast with credit indicators. The value of imported construction materials (+46.1 percent), base metals and derivative works (+50.6 percent), as well as machinery and electrotechnical equipment (+23.8 percent) increased during the period under review. On the contrary, the value of both new housing mortgages (-14.4 percent) and new commercial mortgages (-2.5 percent) at local commercial banks contracted. It should be noted, however, that the decline in new mortgages in the first half of 2023 is partly due to artificially elevated levels seen in the first quarter of 2022, as one bank took over the loan portfolio of another bank. If this effect is filtered out, then new housing mortgages incurred an uptick of 9.9 percent. The CBA's Business Perception Survey (BPS) of the second quarter of 2023 sides with new commercial mortgages on matters of investment, as the share of businesses reporting an improvement in investment decreased by 5.2 percentage points compared to the second quarter of 2022. Nonetheless, the growth in the total value of construction permits (+22.9 percent) during the first half of 2023, a leading indicator on future construction, suggests there is more investment underway.

Indicative of consumption growth, employment contracts registered at the Social Insurance Bank of Aruba (SVb Aruba) rose by 5.1 percent in the first half of 2023 compared to the first half of 2022. This development, corroborated by results from the CBA's Q2-2023 BPS (+8.2 percentage points improvement in the number of employees that work for the responding companies), reveals an increase in employment during the period under review. At the same time, the CBA's Consumer Confidence Survey (CCS) recorded a doubling of the share of respondents indicating an increase in income. The aforementioned

[1] For an ample discussion of economic developments in the first half of 2023, please consult the CBA's Q2-2023 State of the Economy publication.

[2] Only those registered at commercial banks.

developments, complemented by the Government of Aruba's (GoA) complete roll-back of the COVID-19-related public sector wage cuts, point to an increase in consumption in the first half of 2023.

At the end of June 2023, the 12-month average inflation rate reached 5.9 percent. The latter comprises a 2.5 percentage points increase compared to the end of June 2022. Higher prices for housing, transport, as well as food and non-alcoholic beverages mainly drove the rise in the 12-month average inflation. It should be noted, however, that during the period under review, increases in the end-of-period (EoP) inflation started to subside. Whereas the EoP inflation rate stood at 5.3 percent at the end of June 2022, it amounted to 2.8 percent at the end of the first half of 2023.

The observed economic indicators point to a vigorous first half of 2023.

2. Economic forecast

2.1 Drivers for 2023 and 2024

Tourism related activities remain the strongest contributor to Gross Domestic Product (GDP) growth in 2023 and 2024. The number of stay-over visitors in 2023 and 2024 are projected to reach 110.0 percent and 113.0 percent of the 2019-level, respectively. Furthermore, average daily spending by visitors likely increased by 5.3 percent in 2023, reaching Afl. 540. An anticipated 10.0 percent upturn in the Average Daily Rate (ADR), accompanied by a presumed 2.9 percent rise in non-accommodation spending, drove the aforementioned expansion. Average daily spending will likely grow by another 5.3 percent in 2024, amounting to Afl. 568. The aforementioned developments result in a nominal tourism revenues growth of 17.7 percent in 2023 and 8.1 percent in 2024.

An anticipated pick-up in the pace of construction projects pushed up investment in 2023, with private and public investment moving in sync. The investment panorama in 2023 and 2024, containing mostly tourism sector projects, remains largely unchanged compared to 2022. The speed at which these projects are executed, however, picks up in 2023, resulting in the finalization of relatively large construction projects during the year. Consequently, due to a lack of new investment projects to compensate for the projects completed in the previous year, investment is forecasted to decline in 2024.

Consumption likely remained stable in 2023, and is anticipated to expand in 2024. Employment is forecasted to grow by 3.5 percent in 2023 and by 3.2 percent in 2024, as the tourism-driven upturn in private-sector employment is expected to be stronger than the decline in public-sector employees. In both years, wages are assumed to go up by 2.5 percent due to partial inflation indexation and tight labor market conditions. In addition, for 2023 the complete rollback of the 12.6 percent COVID-19-related cuts in public sector wages as of January 1, 2023 was taken into account. However, the latter, despite being amplified by the automatic indexation of public sector wages, is anticipated to only partly offset the lower costs related to the expected smaller size of the public sector. Consequently, public consumption weighs down total consumption. Inflation likely eroded nominal gains in private consumption in 2023, contributing further to the flat real consumption growth compared to 2022. As the expected inflation nears zero in 2024, the downward pressure on nominal consumption subsides, resulting in real consumption growth for the year.

Following the developments in consumption, investment, and exports, imports probably increased in 2023 and will likely contract in 2024, as the anticipated upturns in tourism exports and private consumption are not sufficient to compensate for the forecasted decline in investment.

The CBA projects a twelve-month average inflation rate of 2.9 percent in 2023 and 0.1 percent in 2024. The principal factors driving inflation during the period under review are:

1. **Supply chain disruptions:** Existing geo-political tensions and climate-related factors lead to supply chain disruptions that affect commodity prices. Furthermore, domestic shipping constraints also push up the costs of imported goods.
2. **Utility tariffs.** The increases in utility prices of August 2022 and September 2022 affect the 12-month average inflation rate throughout 2023.
3. **Fiscal measures.** The tax reform components implemented in 2023 (January 1st: +1.0 percentage point increase in the BBO rate; August 1st: introduction of BBO at the border) put upward pressure on the general level of prices for goods and services in Aruba in 2023. The impact of these measures on the 12-month average rate of inflation persists in 2024.

2.2 Projections for 2023 and 2024

Based on the developments mentioned in section 2.1, the CBA updated its forecasts for 2023 and 2024. The results put forth in this section describe the most likely outcome contingent on the most recently available information and data[3], as well as on the assumptions of the CBA.

2.2.1 Real economic growth

2023

According to the CBA's forecast, real GDP rose by 5.1 percent in 2023. An expansion in real exports (+9.4 percent) and real investment (+24.5 percent) mostly drove the enhancement in real GDP. An upturn in real tourism exports (+11.4 percent) and non-tourism exports (+2.3 percent) led to the abovementioned growth in real exports. The buoyant performance of real tourism exports was mainly caused by a larger number of stay-over visitors and higher average tourism spending per visitor. Real investment, in turn, was pushed up by improved real private (+23.9 percent) and real public (+81.1 percent) investment. Real consumption probably remained stable (+0.1 percent) as the increase in real private consumption was partly mitigated by a downturn in real public consumption (-2.3 percent).

2024

The CBA anticipates a 0.1 percent contraction in real GDP in 2024. The expected continuous uptick in the number of stay-over visitors and tourism spending per visitor result in a 4.2 percent upturn in real tourism exports, which is further complemented by a 2.2 percent rise in non-tourism exports. Real private consumption growth (+2.7 percent) further complements the developments in tourism, although partially offset by a drop in real public consumption (-2.3 percent). However, real investment (-23.6 percent) is foreseen to decline due to a lack of new construction projects to replenish the stock of relatively large construction projects finalized in 2023. The substantially lower level of investment reduces real imports (-1.7 percent) for 2024.

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

[3] Cutoff date: October 2023.

Table 1: Growth of real GDP and its components 2022 – 2024 (in percent)			
Indicator	**2022 e**	**2023 f**	**2024 f**
	Current outlook		
GDP	8.0	5.1	-0.1
Consumption	-2.2	0.1	1.7
Private consumption	-3.1	1.0	2.7
Public consumption	0.6	-2.3	-1.1
Investment	-0.9	24.5	-23.6
Private investment	1.8	23.9	-24.0
Public investment	-72.6	81.1	-1.3
Exports	29.1	9.4	3.7
Tourism exports	28.9	11.4	4.2
Imports	12.6	9.7	-1.7

Source: CBA

e = estimate, f = forecast

2.2.2 Nominal economic growth

The CBA foresees economic growth to reach 11.9 percent in 2023 and 1.2 percent in 2024, marking an end to the post-pandemic economic growth surges observed since 2021.

Table 2: Growth of nominal GDP and its components 2022 – 2024 (in percent)			
Indicator	2022 e	2023 f	2024 f
	Current outlook		
GDP	11.4	11.9	1.2
Consumption	2.6	3.6	2.2
Private consumption	2.2	3.9	2.8
Public consumption	3.8	2.8	0.6
Investment	6.1	28.9	-22.6
Private investment	9.0	28.4	-23.0
Public investment	-70.6	87.6	0.0
Exports	38.5	15.0	7.1
Tourism exports	40.0	17.7	8.1
Imports	25.2	11.9	1.2

Source: CBA

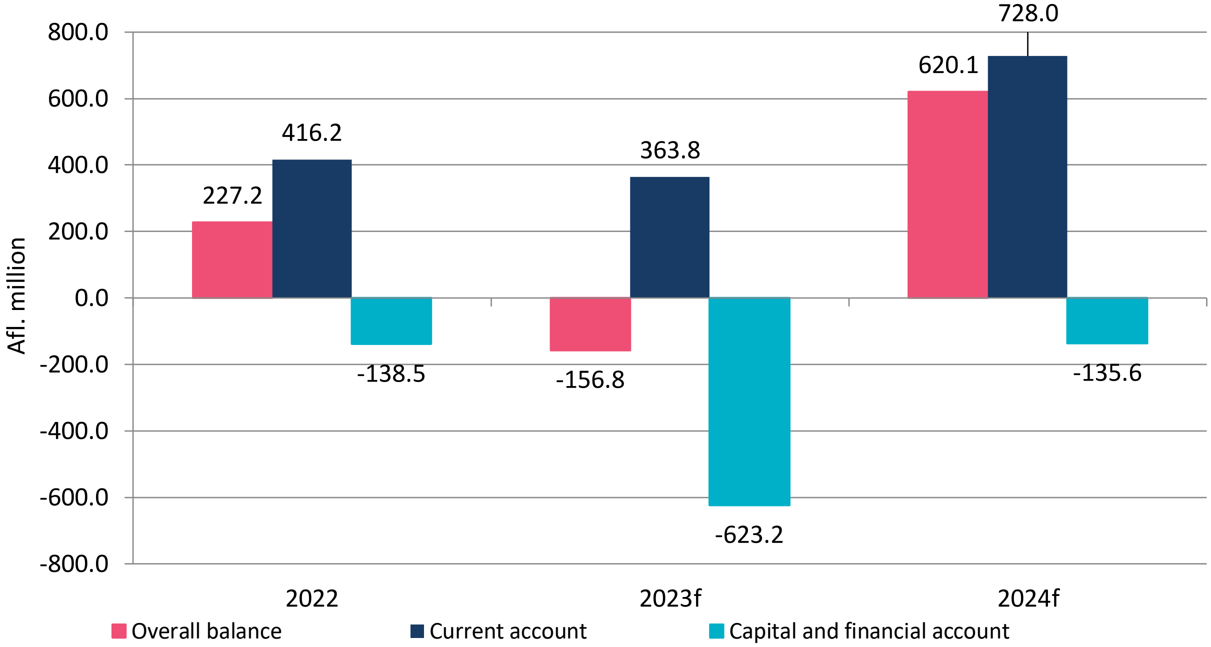
e = estimate, f = forecast

2.2.3 Balance of payments and foreign exchange reserves

For 2023, the CBA estimates that the overall BOP registered an Afl. 156.8 million deficit, spurred by a large net financial account outflow. In 2023, local institutional investors purchased shares in the hotel sector from nonresidents, and the hotel sector financed maturing foreign debt in the domestic market, fomenting the financial account net outflow. Moreover, the CBA anticipated no new foreign borrowings specifically for fiscal deficits due to an improvement in the GoA's finances. The GoA also financed maturing external debt in the domestic market, which generated outflows from the financial account. However, net inflows on the private sector current account, bolstered by the continued strong tourism performance, likely mitigated in part the projected financial account net outflows.

For 2024, the CBA foresees an Afl. 620.1 million BOP surplus. This surplus results from the presumption of a current account surplus, again spurred by the tourism sector, outweighing the financial account deficit, unlike 2023. The 2024-projection for the financial account assumes the GoA will borrow externally to pay off all maturing debt, while private sector outflows related to portfolio investments are presumed to expand, thus driving the net outflow on the financial account.

Figure 1: Overall balance of payments



The current account surplus is likely to reach Afl. 363.8 million in 2023 and is anticipated to amount to Afl. 728.0 million in 2024. The surplus in both years is the result of service inflows surging due to tourism exports, while rising prices for services payments – although faltering – push up outflows. Moreover, increased private consumption and tourism consumption, in addition to higher import prices, are expected to raise the import of goods, although higher import prices play less of a role in 2024. 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. 625.6 million deficit in 2023. This deficit results primarily from the net outflow on the private sector direct investment account (Afl. 544.0 million). The projected net outflow on this account is considerable, as the private sector finances share purchases from nonresidents and maturing foreign loans in the domestic market. Moreover, the CBA observed a normalization of inbound foreign direct investments related to real estate. The expected net outflow on the government portfolio account (Afl. 270.5 million) also contributed to the financial account deficit, caused by government repayments on foreign loans. Specifically, this forecast presumes that the GoA covered the majority of all maturing debt -- except for the Dutch liquidity loans received during the pandemic[4] -- through the fiscal surplus and domestic borrowing, and abstained from foreign financing. Additionally, the private sector's portfolio account contributes to the financial account deficit although considerably less so (Afl. 21.2 million). The expectation of smaller portfolio investment outflows by the private sector stems from institutional investors having improved local investment opportunities in 2023, resulting in

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

reduced investments abroad. The component private sector other investments is the only component anticipated to record a net inflow on the financial account (Afl. 217.1 million), considering a net inflow related to the hotel sector's foreign accounts.

The financial account is projected to incur a reduced deficit of Afl. 139.1 million in 2024. The smaller financial account deficit follows from the portfolio account being subject to the GoA financing maturing debt externally, in contrast to 2023, when the GoA opted for full domestic financing. Consequently, the foreign financing and net outflows from the GoA's portfolio investment account turn into net inflows of Afl. 40.4 million. Additionally, in 2024 the net outflow from direct investments is foreseen to diminish, as tighter expected commercial bank liquidity slows down local financing of share purchases and foreign maturing debt, which restrains outward foreign direct investment (FDI). However, fewer anticipated local investment opportunities stimulate more outflows from the financial account in search of higher investment returns abroad. Explicitly, in combination with the expected higher for longer US interest rates, the projected net outflow on the private sector portfolio investment account will expand to Afl. 194.2 million in 2024. For those same reasons, a smaller net inflow on the other investment account is foreseen at Afl. 125.1 million.

In 2023, the projected Afl. 156.8 million deficit in the overall BOP is likely to result in a decrease in international reserves (excluding revaluation differences), i.e., from Afl. 3,111.5 million in 2022 to Afl. 2,954.6 million in 2023. However, a rebound in the overall BOP is forecasted to raise international reserves to Afl. 3,574.8 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 remaining above the minimum of 3 months of current account payments (Figure 2). Furthermore, official reserves are forecasted to stay within the optimal bandwidth of the IMF ARA metric in 2023 and 2024 (Figure 3).

Figure 2: International reserves (including revaluation differences) relative to the current account coverage ratio

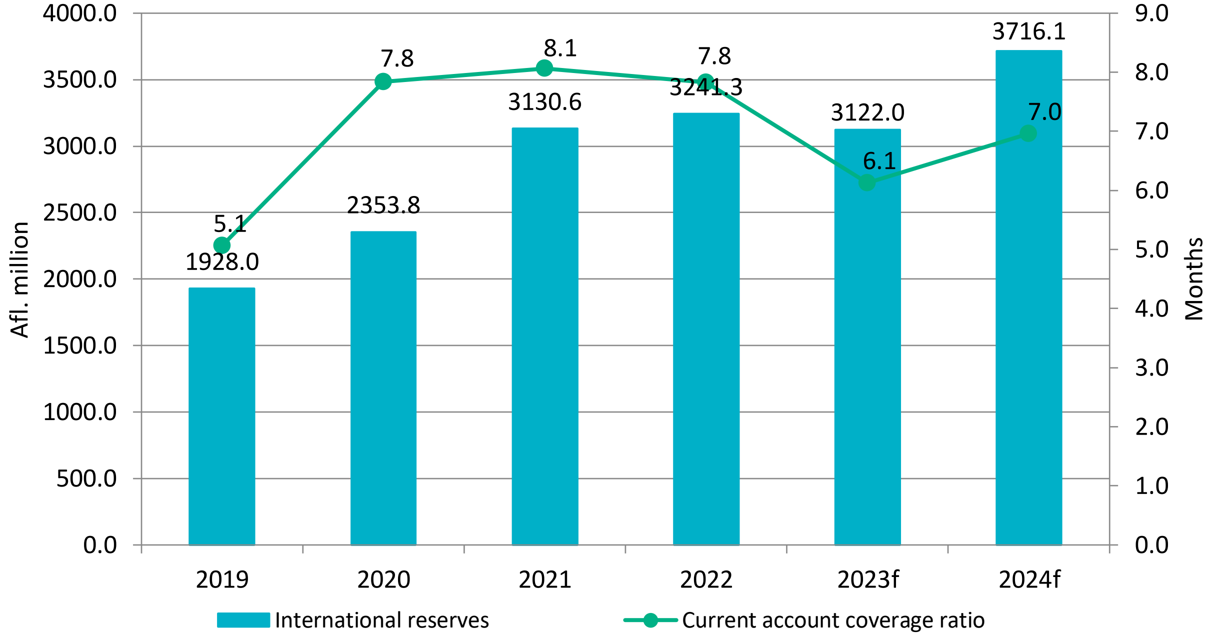
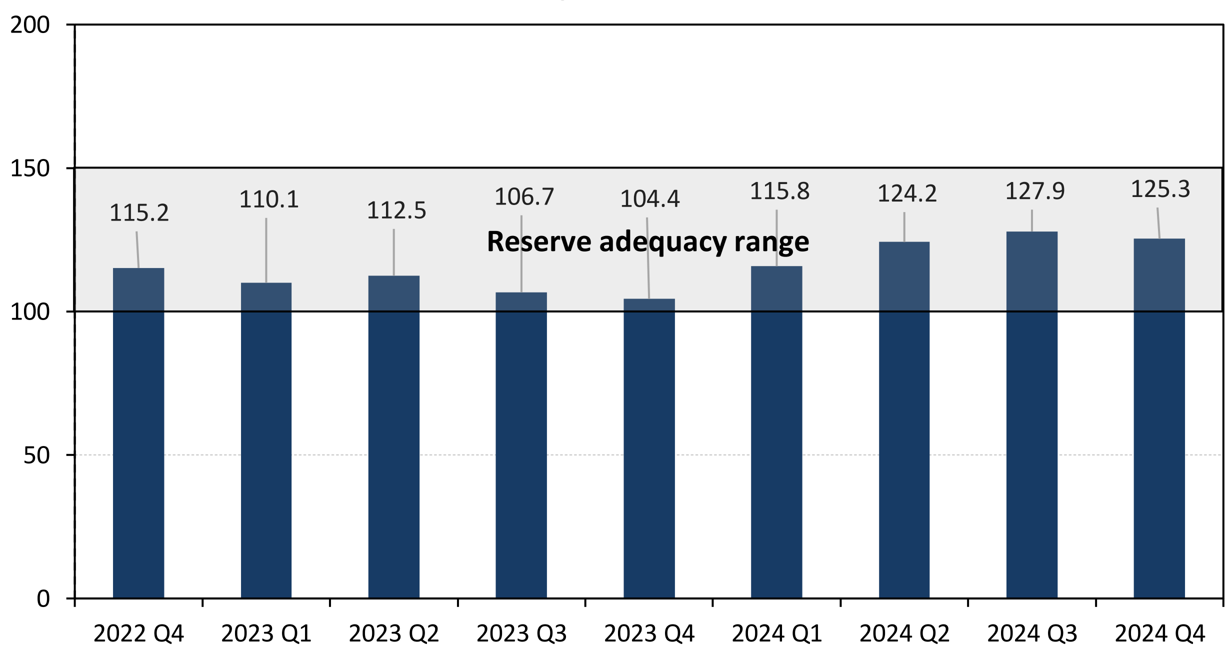


Figure 3: Official reserves (including revaluation differences) benchmarked against the IMF ARA metric



2.3 Medium-term outlook

The CBA anticipates a more modest real GDP growth in the medium term. For the years 2025-2027, real GDP will likely increase by 0.7 percent (2025, 2026) and 2.8 percent (2027). Following the developments in the short term, tourism exports remain the main driver behind the expected medium-term real GDP. Taking into account Aruba Airport Authority (AAA) 's planned capacity expansion for accommodating more visitors, tourist arrivals are foreseen to expand by 2.0 percent per year. Furthermore, higher expected ADR and non-accommodation spending indicate a sustained rise in tourism spending per night. There are various (tourism-related) construction projects that contribute to investment in the medium term, among others, the APA Port City project. Following anticipated lackluster investment in 2024, a boost in investment can be observed in 2025. As these investments materialize, and labor is imported to cater to the new room inventory that comes onboard, private consumption benefits, as can be noted in 2027. Medium-term real import is a function of consumption, investment, and exports. Based on the awaited developments in these components, medium-term import will probably continue to rise. Considering the medium-term tourism export, import and (foreign direct) investment projections together, the CBA anticipates, based on currently available data and assumptions, consecutive BOP surpluses, and, thus, a further strengthening of the foreign reserves.

2.4 Outlook risks

The results presented in this Economic Outlook are subject to various domestic and international risks:

- **Strength of tourism growth.** The assumed volume of stay-over visitors and tourism spending per night significantly impact the forecast results. Any deviation from the presumed propensities to travel and spend, caused by, among others, a potential economic recession, geopolitical tensions and war, as well as the 2024 United States presidential election may affect the forecasted GDP growth and the current account of the BOP.

- **Inflation.** The general level of prices of goods and services will likely normalize in 2023 and 2024. Despite the expected lower level of inflation in 2023 and 2024 compared to 2022, inflation surge constitutes a risk to the forecast. Factors that potentially conduce to the aforementioned risk include the ongoing Russia-Ukraine and Israel-Hamas wars, supply chain disruptions, oil market volatility, as well as climate-related weather events that threaten agriculture and the availability and prices of food items. In addition, the path of US inflation affects the yields on US treasuries. This development impacts the decision of Aruban institutional investors to purchase US treasuries, and has bearing on the gross outflows from the BOP financial account.

- **Investment projects.** The projected results reflect the CBA's conjectures about the timing and construction speed of investment projects. These suppositions entail a source of risk to the GDP, BOP, and foreign exchange projections. The execution of investment projects may be affected by various factors, such as (perceived) red tape, available fiscal space, inflation, labor market conditions, financial market conditions, and the availability of construction materials.

- **Labor.** The CBA assumes a given volume and timing of labor imports to accommodate the projected growth in tourism, as well as the additional room inventory. Furthermore, partial inflation indexation will likely lead to higher wages. However, any departure from the presumed labor market conditions may affect the projected GDP growth rates.

- **Additional government measures.** The GoA implemented two components of its proposed fiscal reform plan in 2023. On January 1, 2023, it raised the BBO tax rate by 1.0 percentage point to 7.0 percent[5], and on August 1, 2023, it introduced the BBO at the border. The implementation 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 abate private and public consumption. Furthermore, the GoA's financial position could affect its foreign borrowing and, consequently, the BOP and foreign exchange outcome.

- **Excess liquidity in the commercial banking sector.** The assumption for 2024 entails less liquidity to locally refinance external maturing loans compared to 2023, causing a smaller net outflow in the direct investment and the other investment accounts of the BOP. Depending on, among others, the CBA's monetary stance, outcomes might deviate.

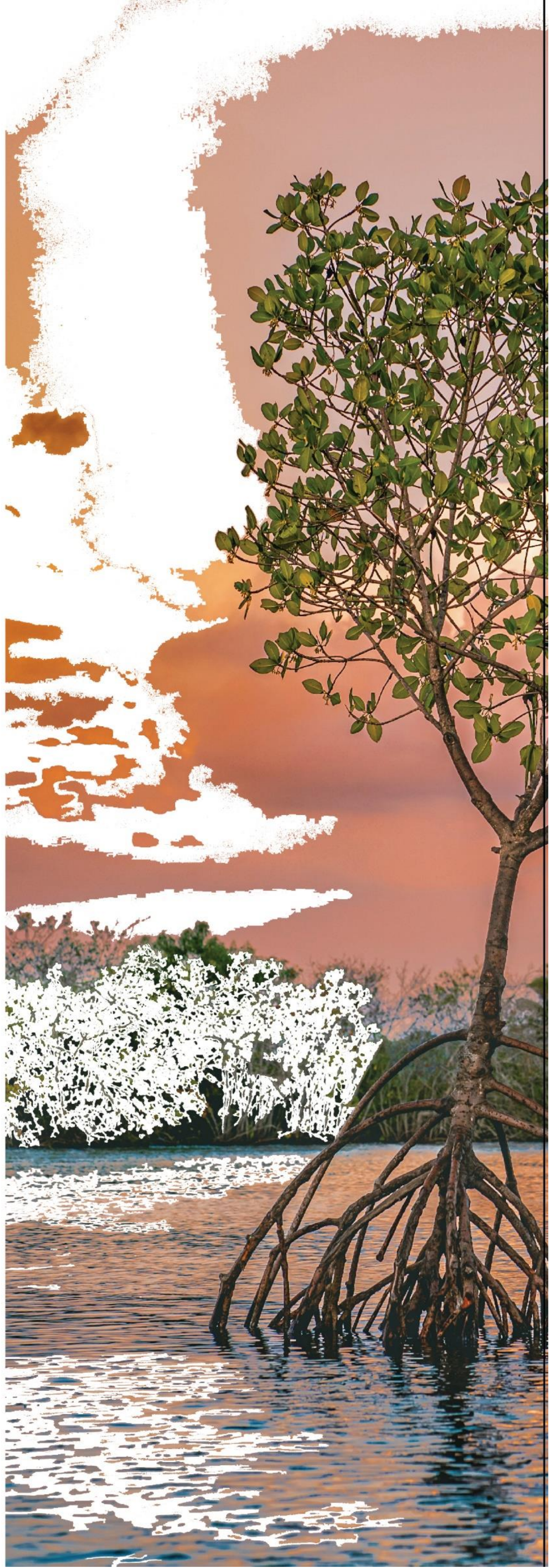
- **External financing conditions.** The ongoing negotiations between the government of Aruba and the Netherlands regarding the refinancing of COVID-19 related debt at lower and interim interest rates, and risks associated with the changing external financing conditions, could impact the GoA's fiscal position. Depending on the persistence of inflation globally, external financing conditions may have a positive or negative effect on GoA's fiscal position.

3. Concluding remarks

The CBA expects the buoyant performance of the tourism sector observed in 2022, to persist in 2023 and 2024. Consequently, tourism remains the strongest contributor to GDP growth in both years. Real GDP growth likely reached 5.1 percent in 2023, driven in large part by tourism exports and private investment. In 2024, real GDP will probably edge down by 0.1 percent, as the anticipated upturns in tourism exports and private consumption are not sufficient to compensate for the forecasted decline in investment. The CBA foresees real GDP in the medium-term to range between 0.7 percent and 2.8 percent, for the most part due to higher tourism exports and private investment (2025).

In 2023, the overall BOP is likely to register an Afl. 156.8 million deficit driven by a large net financial account outflow. The latter is mitigated in part 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. 620.1 million surplus, as the current account surplus outweighs the financial account deficit. Despite tourism growth declining, its anticipated level is robust enough to produce 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 contract.

[5] The 7.0 percent tax rate refers to the combined turnover tax rate, which includes the BBO (2.5 percent), the BAVP (1.5 percent), and the BAZV (3.0 percent).



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