



# STATE OF THE ECONOMY

## Contents

I Domestic developments .....	1
II Outlook for 2013 .....	9
Key economic figures.....	12

## Overview:

*During 2012, the Aruban economy was impacted by the suspension of operations at the oil refinery. A strong performance in tourism demand partly cushioned the output loss related to oil refining activities. However, the effects of the indefinite cessation of these activities were still major. Government finances remained on a fragile path, while the balance of payments recorded a surplus during 2012. Meanwhile, monetary and prudential indicators remained adequate. Looking forward, the CBA projects, based on currently available information, the economy to grow in real terms by 2.6 percent in 2013, after the 1.2 percent contraction in 2012. Also, reserves are expected to increase in 2013, supported by the buoyant tourism sector and the ambitious investments planned to be carried out in 2013. In addition, the CBA expects a deflation of 1.5 percent in 2013, associated mainly with major and structural reductions in the water and electricity tariffs.*

## I Domestic developments

### Developments at the refinery setting the economic path in 2012

The overall economic performance in 2012 was impacted by the decision of the Valero Energy Corporation (VEC) to suspend its refining operations in Aruba by the end of March<sup>1</sup>. Efforts to attract a buyer for the refinery were not successful, leading in September 2012 to the decision of the VEC to reorganize its activities from production to transshipment, requiring about only 100 employees. This implied the lay-off of some 495 employees as of mid-November 2012.

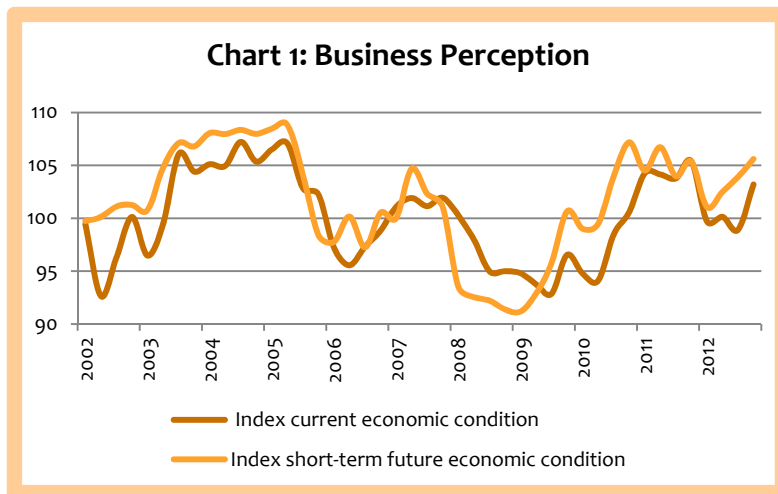
Mentioned layoff had a significant impact on the labor market. According to the preliminary results from the Labor Force Survey (LFS) carried out by the Department of Labor in November 2012, the

<sup>1</sup> Valero Energy Corporation (2012). "Valero energy to suspend refining operation at Aruba". Press release of March 19, 2012.

\* The cut-off date for information published in the State of the Economy is April 25, 2013.

unemployment rate rose to 9.6 percent from 8.9 percent a year earlier. The Department of Labor concluded that these results were mainly due to the direct and indirect job losses following the closure of the refinery. This is highlighted by the fact that the number of employed persons actually went up by 3,703 to 51,661 in 2012 thanks to the growth in the sectors related to tourism. There is anecdotal evidence that several of the employees who lost their refinery related jobs have chosen to temporarily abandon the labor market and explore their options. Some also have decided to emigrate and look for work at oil refinery companies abroad. Some of these companies have also advertised locally for highly experienced and qualified technical staff. Whether and how much this has dampened the increase in unemployment is yet unknown.

The impact of the closure of the refinery probably also affected the perception of businesses. According to the business perception survey (BPS) conducted by the CBA on a quarterly basis, businesses saw a gradual deterioration in the economic conditions in Aruba during the first three quarters of 2012 before a rebound in the fourth quarter. While 33.3 percent of responding businesses indicated



a worsening of economic conditions in the first quarter of 2012, this percentage grew to 51.4 percent in the third quarter before dropping to 20.6 percent in the last quarter of 2012. Moreover, the shutdown of the refinery did not appear to affect many businesses in the survey in terms of their own activities. The BPS results over 2012 indicate that over 50 percent of respondents did not notice any change in the number of employees at their businesses. Furthermore, between 21.6 percent and 35.3 percent experienced an

increase in the number of employees, while between 52.8 percent and 59.4 percent of respondents recorded either a rise or no change in the profitability of their business.

Lower investment spending by the refinery contributed negatively to overall investment in Aruba. Moreover, delays in certain

large projects such as the renovation of the hospital, the Green Corridor, and the moving of the current container terminal to another location (Barcadera) further aggravated investment activities. Nevertheless, other large projects continued in 2012, such as the construction of the Ritz Carlton hotel and the completion of the new production facility at the water and electricity company. However, these were insufficient to reach the level of investments made in 2011. Consequently, the CBA currently estimates overall investments to have contracted by 10.2 percent in 2012 compared to 2011.

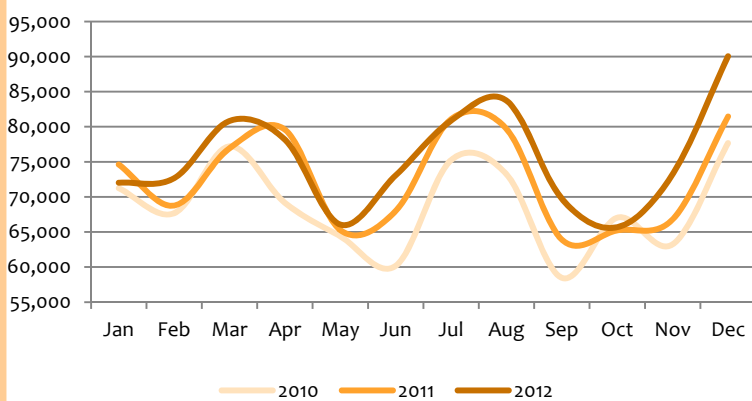
Despite the unfavorable developments surrounding the refinery, private consumption edged up by 0.5 percent, signaled by an increase in turnover tax revenues (+4.0 percent). The outcome for private consumption was supported by the downward adjustment of the tariffs of water and electricity as of, respectively, August and November 2012. These tariff reductions meant an increase in the disposable income of consumers for items other than utilities. In addition, the severance payments to these employees who lost their jobs at the refinery, likely helped maintain private consumption. Public consumption grew by 4.5 percent in 2012, mainly attributed to higher wage costs and increased outlays on goods and services.

The CBA estimates overall exports to have shrunk by 5.3 percent in 2012, primarily due to the shutdown of the oil refinery. The positive contribution of the tourism sector in 2012 was insufficient to offset mentioned impact of the refinery. Conversely, imports went down, i.e., by 5.0 percent, also related to the suspension of activities at the refinery. Moreover, 2012 saw a decrease in the imports of investment goods, which is associated with the large investment projects of the WEB that took place in 2011 (and thus had a base effect when comparing the investment activity of 2012 with 2011). The latter was reflected in the merchandise trade statistics of the Central Bureau of Statistics (CBS), where available data on merchandise imports for 2012 show a contraction of Afl. 88.3 million or 4.2 percent. On balance, merchandise trade activities during 2012 positively impacted the trade balance by Afl. 106.0 million.

The above shows that the fallout of the Valero refinery played a major role with respect to economic growth in 2012. Nominal GDP is estimated to have contracted by 0.2 percent, while in real terms the

GDP fell by 1.2 percent. However, when excluding the estimated direct, indirect and induced effects of the refinery on the economy, the so-called underlying growth paints a different picture. Real terms growth in this scenario reached 5.1 percent in 2012, indicating that the economic activities not related to Valero performed well. Particularly those sectors related to tourism thrived.

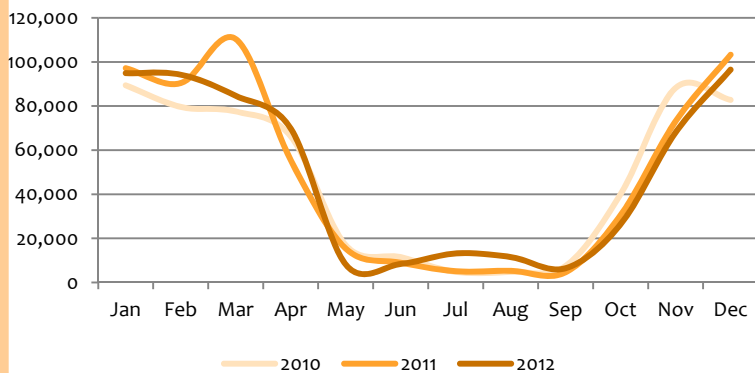
**Chart 2: Stay-over visitors**



### A strong tourism demand in 2012

Tourism performed strongly in 2012 despite growing at a slower rate than the year before. The number of stay-over visitors rose by 4.0 percent to 903,937 tourists during this period (2011: +5.4 percent), the highest level ever achieved in Aruba's stay-over tourism (Chart 2). The Venezuelan market was once again the main contributor to the expansion in stay-over tourism (+21.5 percent), compensating for a flat performance in the U.S. market. However, the latter market has grown in nearly all months since August 2012, the only exception being October when hurricane Sandy affected major parts of the Northeastern United States. Cruise tourism performed less favorably in 2012 (-2.9 percent), but reflected the aftermath of one large incidental increase in number of visitors in the month of March 2011. When correcting for this base effect, cruise tourism increased by 1.7 percent in 2012 (Chart 3).

**Chart 3: Cruise visitors**



Tourism receipts as recorded in the balance of payments showed a 3.7 percent increase in 2012. Estimates by the CBA indicate that prices for tourism-related goods and services increased on average by 1.9 percent in 2012, explaining a fraction of the increase in tourism receipts.

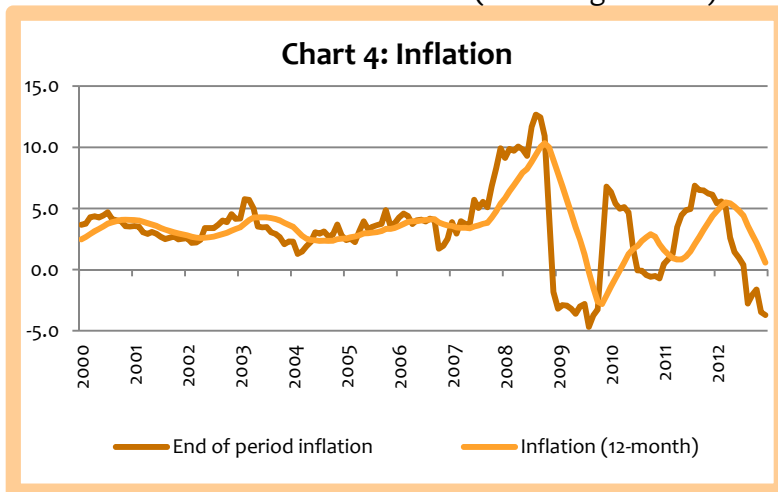
### Inflation slowed down by lower energy prices

In 2012, the increase in the general price level was much less than that of tourism. Average inflation in 2012 stood at 0.6 percent<sup>2</sup>, compared to 4.4 percent in 2011 (Chart 4). Adjustments in water and electricity tariffs in April 2011 (13.3 percent) and August 2011 (12.5 percent) caused a higher general price level in the first seven months of 2012, compared to the same period in 2011. However, the growth in the price level has slowed down since April 2012. The tariff reductions in water (as of August 2012) and electricity (as of November 2012), resulted in

decreases in prices in the final five months of 2012. The average core inflation<sup>3</sup> was only 0.1 percent, down by 1.1 percentage points compared to 2011.

The government is striving to raise the purchasing power of the Aruban households. To this end, the government has implemented a number of measures. For example, the minimum wage was increased by 4.0 percent in 2012, and in 2011 the government introduced the so called “reparatietoelag” a special allowance for

persons earning between minimum wage and Afl. 2,500 per month. These measures are intended to improve the purchasing power of Aruban households, which on itself is a laudable endeavor. However, the government also took measures that had an opposite effect. For instance, the value of properties in Aruba were reassessed in 2012 for tax purposes, elevating the amounts paid on property taxes by property owners, leaving less for consumptive spending. Moreover, increasing minimum wages could lead to higher prices of goods and services in the end, if businesses choose to pass on the cost increase to consumers. This could also disfavor the purchasing power of consumers. Moreover, some of the measures taken place an additional burden on government finances. It is, however, difficult to draw definite conclusions about the recent developments in the average purchasing power, as there is insufficient data available on the income



<sup>2</sup> Average of the end of period inflation of January-December 2012.

<sup>3</sup> Inflation excluding food and energy components (i.e., water, electricity, and gasoline).

of Aruban consumers. Given the average inflation of 0.6 percent last year, the purchasing power of minimum wage earners may have increased, as it was most likely scarcely impacted by the additional taxes to be paid following the revaluation of properties for example<sup>4</sup>.

### **Government finances remain fragile**

The finances of the government remained highly vulnerable despite its efforts to improve its financial position. In 2012, tax revenues increased by Afl. 58.4 million or 6.8 percent, compared to 2011. The higher revenues were primarily the result of an Afl. 29.9 million (+23.9 percent) growth in profit tax. The tax settlement program by the Tax Department has contributed to the higher level of profit tax seen in 2011 and 2012 compared to previous years. In contrast, nontax revenue declined by Afl. 19.5 million or 16.0 percent in 2012.

Total expenditures on a cash-adjusted basis amounted to 30.9 percent of GDP in 2012, up from 28.9 percent in 2011. This is equivalent to an Afl. 87.5 million (+6.6 percent) increase, primarily the result of expansions in the personnel-related expenditure (+Afl. 45.3 million), investment outlays (+Afl. 44.5 million) and expenses on goods and services (+Afl. 12.2 million), which were offset in part by an Afl. 35.1 million drop in items n.i.e.

The government recorded a financial deficit (on a cash-adjusted basis) of Afl. 413.7 million (9.1 percent of 2012 GDP) in 2012, up from Afl. 362.2 million (7.9 percent of 2011 GDP) in the previous year. Note that mentioned deficit includes the financial deficit of the Fondo Desaroyo Aruba (FDA).

Fiscal deficits and economic contraction contributed to a growing government debt burden. A decrease in short-term non-negotiable debt to the civil servants pension fund (APFA) led to a lower government domestic debt, i.e., from Afl. 1,635.7 million at the end of 2011 to Afl. 1,603.0 million at end-2012. Moreover, the government repaid Afl. 144.1 million in maturing foreign loans, but it also issued US\$ 253 million in government bonds on the international capital market. Consequently total foreign government debt in 2012 grew by Afl. 302.0 million to Afl. 1,459.7 million. Total government debt reached Afl. 3.1 billion or 67.2 percent of GDP at end-2012 (December

<sup>4</sup> This tax is not included in the CPI.

2011: 61.2 percent). Taking into account the small size of the Aruban economy, additional short-term measures should be taken to curtail the expansionary pace of government debt with the medium-term aim to stabilize it at more sustainable levels. It is important that the debt position is sustainable to ensure the continuity of government operations and ultimately to prevent unfavorable effects to the economy. With regards to the latter, a recent IMF study (Greenidge et al 2012)<sup>5</sup> found that a threshold exists for the debt-to-GDP ratio of Caribbean countries, where the contribution of debt to economic growth turns from positive to negative. This level is between 55 percent and 56 percent of GDP.

#### **Unexceptional monetary indicators**

In 2012, net foreign assets (including revaluation differences of gold, official foreign exchange and security holdings) grew by Afl. 69.7 million or 4.7 percent to Afl. 1,563.2 million. This outcome was particularly influenced by the receipt of US\$ 253 million (Afl. 452.9 million) from a bond issue by the Aruban government on the international capital market and some large incidental transactions of the oil sector that resulted in a net outflow. Consequently, at the end of 2012, net foreign assets were equal to 34.3 percent of GDP and 45.7 percent of broad money. Both ratios are significantly above the averages for the period of 1986-2011.

Net domestic assets expanded by Afl. 202.8 million (10.8 percent) in 2012, mainly reflecting a rise in net claims on the public sector due to a drop in government deposits (-Afl. 140.9 million). The rise in claims of the banking sector on the private sector also added to the broadening of net domestic assets. This credit growth mirrored increases in business loans (+Afl. 58.5 million) and housing mortgages (+Afl. 38.9 million). The exception was consumer credit, which was lower than a year earlier (-Afl. 19.4 million). Overall, the growth in private sector credit during 2012 was smaller than the credit expansion in 2011 (2012: +Afl. 75.2 million, 2011: +Afl. 89.7 million).

<sup>5</sup> Greenidge, K., Craigwell, R., Thomas, C. and Drakes L., 2012, "Threshold Effects of Sovereign Debt: Evidence from the Caribbean," IMF Working Paper WP/12/157 (Washington: International Monetary Fund)

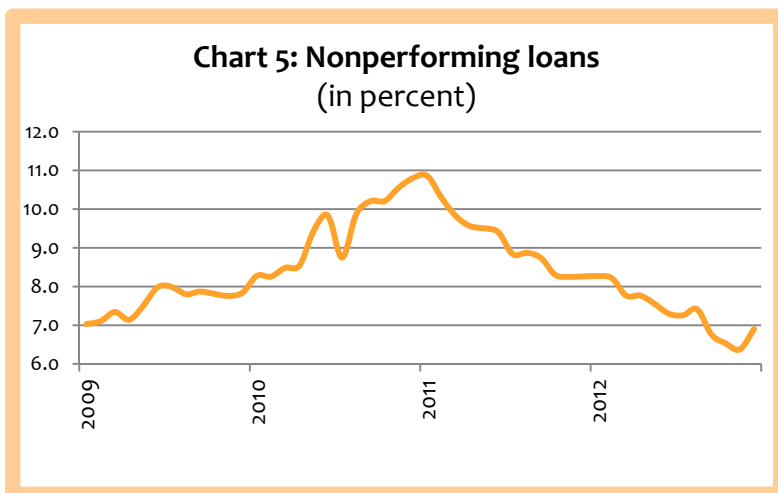


### Sound prudential indicators

The quality of the commercial banking sector portfolio continued to improve, with the nonperforming loans ratio reaching 7.0 percent at end-2012 (Chart 5). This is 3.9 percentage points lower than the 10.9 percent peak reached in January 2011 (Chart 5). Also, the other prudential indicators of the commercial banking sector stayed sound. The banks' risk-weighted capital asset ratio stood at 19.6 percent (required minimum = 14.0 percent) in 2012. The loans-to-deposit ratio was 68.0 percent (maximum= 80.0 percent), while the prudential liquidity ratio of the commercial banks reached an average of 28.3 percent in 2012 (minimum requirement = 15.0 percent). This is 2.2 percentage points higher than the average in 2011 (26.1 percent), and signals a deviation from the decreasing pattern in available liquidity since early 2009. The decreasing pattern has had an upward effect on the interest rates, for example on the average yields of treasury bills.

### Monetary Policy Committee meetings and decisions

In 2012, the Monetary Policy Committee (MPC) of the CBA met six times (February, March, June, July, August and September), and decided at those meetings to maintain the CBA's main monetary policy tool, the reserve requirement, unchanged at 11 percent, while the advance rate was kept at 1 percent. These decisions were based on available domestic indicators and developments in the international economic environment.

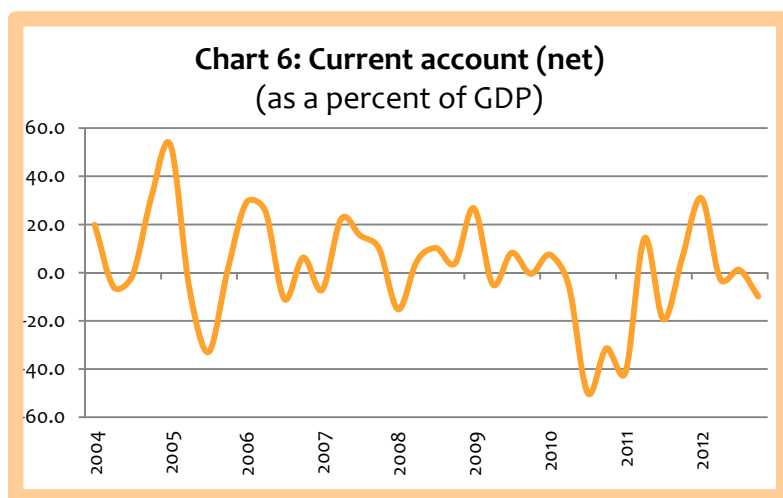




### Oil sector transactions influencing the balance of payments

In addition to the previously mentioned impact, the suspension of the oil refinery had a spillover effect on the balance of payments. The balance of payments recorded an Afl. 56.1 million surplus or 1.2 percent of the GDP in 2012 (2011: an Afl. 23.1 million deficit). The current account was affected by a drop in both exports and imports of goods, mainly related to the external transactions of the oil sector. However, the decline in imports was larger than that of exports, because imports also suffered from decreases in the imports of investment and consumer goods. Meanwhile, exports were buoyed by the positive performance of the tourism sector. On balance, the current account registered a surplus of Afl. 221.8 million (2011: -Afl. 440.5 million) (Chart 6).

Also, the capital and financial account was dominated by the transactions of the oil sector. The trade credit extended to nonresidents by the oil sector, was the main reason for the Afl. 156.6 million deficit on the capital and financial account. The US\$ 253 million bonds issue by the government in September 2012 partly offset mentioned deficit.



## II Outlook for 2013

The CBA expects, based on currently available information, GDP to grow by 2.6 percent in real terms in 2013, with nominal GDP growth estimated at 0.8 percent. However, it should be noted that in absolute terms, the projected real GDP in 2013 is still below the 2008 level.

For 2013, the CBA projects output to be driven by continued growth in the tourism sector. In addition, the CBA expects the significant reductions in the water (as of August 2012) and electricity tariffs (as of November 2012) to cause a decrease in consumer prices in 2013, thereby having a positive impact on the purchasing power of consumers, and, therefore, on real output. This impact is likely to be offset in part by loss of jobs due to the mass lay-

off at the refinery in mid-November 2012. Due to the delays in the execution of a number of investment projects, private investment activities are projected to decline in 2013. Notwithstanding some large investment projects scheduled for the coming years, the Aruban economy will have to manage without the usual level of investment by Valero when the refinery was fully operational. The CBA expects a significantly lower level of investment by Valero related to its transshipment activities. Moreover, the CBA estimates the overall contribution of the transshipment operations by the VEC to GDP to be substantially smaller than the refinery operations.

The CBA projects a continued expansion in the tourism sector in both stay-over visitors and their spending on the island in 2013. Estimates by the CBA currently indicate that the number of stay-over visitors and tourism receipts will grow by, respectively, 3.7 percent and 3.5 percent in 2013. This projection is supported by the planned opening of the Ritz Carlton hotel in 2013 as well as about 200 rooms, currently under renovation, becoming available. The Aruba Tourism Authority (ATA) is also planning to increase its promotion budget in 2013.

The CBA projects that the aforementioned lower tariffs for water and electricity are likely to be maintained throughout 2013. In addition, international oil prices, on average, will probably not change significantly during 2013. Consequently, the CBA forecasts a decrease in the CPI of 1.5 percent in 2013. This would be the second year with deflation in the recent years, as the CPI already fell by 2.1 percent in 2009 due to the drop in energy prices that resulted from the global financial crisis. In the case of Aruba, the negative consequences often associated with deflation, such as the postponement of consumption and investment, do not apply, because the deflation projected for 2013 is due to mentioned one-time reduction in the utility tariffs.

Downside risks to the presented outlook remain. These include possible setbacks in the actual implementation of the planned investment projects in 2013 and further tightening of liquidity in the banking sector obstructing private capital formation. On the other hand, a re-opening of the oil refinery or higher than expected expansion of the world economy could improve the GDP-outcome.

The CBA estimates that the level of international reserves (including revaluation differences) will increase by Afl. 19.5 million in 2013, mainly driven by the transactions of the nonoil private sector. Particularly, continued growth in tourism receipts, a decline in imports and net FDI inflows associated with investment projects are expected to be the main contributors to this growth. In addition, the government borrowing on the international capital market to cover its financing needs for 2013 will likely also support the growth in international reserves. The proceeds from this foreign financing will offset the government's current account deficit (due to among others interest payments). Meanwhile, the contribution of the oil sector to the international reserves is projected to be negative, given that the import of oil products for domestic use will substantially outweigh the revenue from transshipment activities and the sale of jet fuel. On balance, net foreign assets (excluding revaluation differences) are currently expected to reach Afl. 1,391.8 million in 2013. As a result, the import coverage ratio and the current account coverage ratio are projected to increase to 9.6 months and 5.2 months, respectively. Both these ratios indicate that Aruba's international reserves will likely remain adequate in 2013.

<b>Key economic figures</b>						
	2007	2008	2009	2010	2011	2012
Real GDP (percent)	2.0	0.2	-11.3	-3.6	3.7	-1.2
<i>Prices</i>						
Inflation (period average)	5.4	9.0	-2.1	2.1	4.4	0.6
Core inflation (period average) 1]	3.0	3.3	1.8	-0.3	1.2	0.1
Inflation (end of period)	9.9	-1.9	6.8	-0.7	6.1	-3.7
Inflation United States (period average)	2.9	3.8	-0.4	1.6	3.2	2.1
Inflation differential with the USA (period average, percentage points)	2.5	5.2	-1.7	0.5	1.2	-1.5
Core inflation differential with the USA (period average, percentage points) 1]	0.7	1.0	0.1	-1.3	-0.5	-2.0
<i>Tourism</i>						
Stay-over tourism	772,073	826,774	812,623	824,702	868,973	903,937
Cruise tourism	481,775	556,090	606,768	569,424	599,893	582,309
Tourism receipts (in Afl. million)	2,162.4	2,412.8	2,183.6	2,236.2	2,414.6	2,505.0
Tourism receipts in percent of GDP 2]	46.2	49.1	48.8	52.3	52.9	55.0
Tourism price index	107.8	110.6	112.6	108.8	116.0	114.3
<i>Monetary developments</i>						
Money supply (in Afl. million)	2,566.4	2,990.3	3,163.5	3,154.6	3,160.0	3,418.9
Net domestic assets (in Afl. million)	1,849.8	1,721.4	1,688.4	1,845.3	1,873.9	2,076.6
Credit (percentage change) 3]	3.7	4.0	-0.9	1.1	3.5	2.9
Businesses (percentage change) 3]	2.4	7.1	-3.2	-0.5	5.7	5.1
Individuals (percentage change) 3]	5.4	2.3	1.0	2.2	2.4	1.3
Consumer credit (percentage change) 3]	5.8	4.1	-1.9	-2.9	-1.1	-3.5
Housing mortgages (percentage change) 3]	5.1	1.0	3.2	5.8	4.6	4.3
Net foreign assets (Excluding revaluation differences, in Afl. million) 4]	716.6	1,268.9	1,475.1	1,309.3	1,286.1	1,342.3
Net foreign assets in months of current account payments (Excluding oil sector)	3.0	3.7	5.8	6.1	4.7	4.9
<i>Macroprudential indicators</i>						
Capital/risk-weighted assets ratio	13.0	14.7	17.8	18.5	18.9	19.6
Loan/deposit ratio	74.7	69.4	67.1	66.5	71.0	68.0
Liquidity ratio	29.0	34.7	30.1	28.6	26.1	28.3
Nonperforming loans	6.7	6.9	7.9	10.7	8.2	7.0

<b>Key economic figures (continued)</b>						
	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>
<i>Balance of payments</i>						
Current account (net)	461.5	7.7	326.5	-782.1	-440.5	221.8
Current account in percent of GDP 2]	9.9	0.2	7.3	-18.3	-9.6	4.9
Capital and financial account (net) 5]	-398.6	544.6	-120.3	616.3	417.3	-165.7
Net foreign direct investment in percent of GDP 2]	-19.6	0.5	-1.3	6.5	18.2	-5.6
Overall balance (in Afl. million) 5]	63.0	552.3	206.2	-165.8	-23.1	56.1
<i>Government financial operations 6 ]</i>						
Revenue and grants	1,034.0	1,365.1	1,108.9	1,183.9	978.4	1,017.4
Revenues and grants in percent of GDP 2]	22.1	27.8	24.8	27.7	21.4	22.3
Expenditure	1,084.2	1,290.5	1,229.1	1,337.1	1,282.5	1,435.4
Expenditure in percent of GDP 2]	23.2	26.3	27.5	31.2	28.1	31.5
Interest expenses in percent of GDP 2]	2.3	2.8	2.6	3.0	3.0	3.0
Lending minus repayments 7]	21.3	23.1	42.9	35.4	21.1	24.1
Financial deficit (-)	-71.4	51.4	-163.1	-188.6	-325.2	-442.1
Financial deficit in percent of GDP 2]	-1.5	1.0	-3.6	-4.4	-7.1	-9.7
<i>Memorandum items</i>						
Unmet financing requirements 8]	196.4	64.4	63.8	60.1	97.1	68.7
Expenditures (incl. net lending) on a cash-adj. basis	1,142.4	1,181.7	1,271.3	1,368.6	1,340.7	1,430.9
Financial deficit (-) 9]	-108.4	183.4	-162.6	-184.9	-362.2	-413.7
Financial deficit in percent of GDP 9] 2]	-2.3	3.7	-3.6	-4.3	-7.9	-9.1
Total debt	2,140.0	2,049.7	2,226.1	2,394.4	2,793.4	3,062.6
Domestic debt	1,115.9	990.8	1,149.6	1,275.2	1,635.7	1,603.0
Foreign debt 10]	1,024.2	1,058.9	1,076.5	1,119.3	1,157.7	1,459.7
Debt-to-GDP ratio (percent)	45.7	41.7	49.8	56.0	61.2	67.2
Domestic debt to GDP (percent) 2]	23.8	20.2	25.7	29.8	35.8	35.2
Foreign debt to GDP (percent) 2] 10]	21.9	21.5	24.1	26.2	25.4	32.0

Source: CBA; Aruba Tourism Authority; Cruise Tourism Authority; Central Bureau of Statistics; US Bureau of Labor Statistics; Department of Finance; Tax Collector's Office; APFA.

1] Excluding food and energy components.

2] As a percentage of the nominal GDP estimated by the CBA.

3] Compared to December of previous year.

4] Excluding revaluation differences of gold and official foreign exchange holdings.

5] Including items not yet classified.

6] Preliminary figures on a cash basis, including imputed noncash transactions.

7] Includes payment arrears due to loans made and equities purchased from official entities, minus receipts and repayments and equities sold to these entities. A (-) sign indicates that extended loans were less than the repayments received.

8] At the end of the period. The unmet financing requirements comprise all unsettled payment obligations to other sectors, irrespective of the time frame in which they mature, registered by the Department of Finance.

9] Including the change in unmet financing requirements.

10] At end-of-period exchange rates.