



Centrale Bank van Aruba

STATE OF THE ECONOMY

January-December 2015*

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Overview:

The Aruban economy continued to be driven by the buoyant performance in the tourism sector in 2015. The latter sturdy outcome more than compensated for the lackluster development in consumption and investment. Both private and public consumption shrank further, with the latter affected to meet the targets set in the State Ordinance on Aruban Financial Supervision. Meanwhile, investment activities continued to struggle to gain momentum, due to delays in various large projects.

Government finances remained fragile, although its financial deficit, as measured by the CBA, shrank substantially in 2015. Government total debt edged to Afl. 3,974.1 million at the end of 2015, equivalent to a debt-to-GDP ratio of 82.2 percent.

The 12-month inflation continued its gradual upward trend in 2015, following an increase in electricity tariffs in October 2014. However, inflation pressures remained subdued as a result of the decline in gasoline prices and the sluggish domestic consumption.

Net foreign assets strengthened further during 2015 and stayed at an adequate level, when benchmarked against the critical norms used by the CBA, including the number of months of current account payments covered by the net foreign assets.

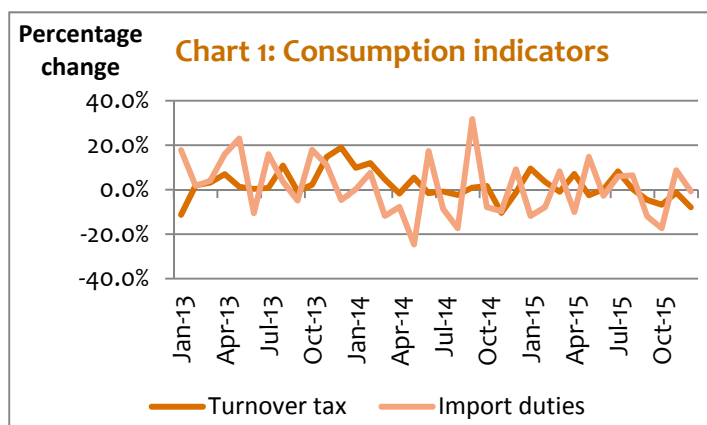
Overall, 2015 was a tepid year in terms of economic activities. Potential economic growth in 2016 will materialize only if investment projects are executed as planned, and tourism activities stay strong.

* The cut-off date for information published in the State of the Economy is July 4, 2016. Data are based on the Annual Statistical Digest 2015 and the Statistical Tables for the first quarter of 2016, available on the CBA's website at www.cbaruba.org.

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I. Domestic developments

The Aruban economy experienced virtually zero growth 2015. Both consumption and investments experienced negative growth. The main engine of economic growth was the tourism sector. During 2015,



indicators for consumption on balance pointed to a decline. Revenue for import duties fell by 2.1 percent, while turnover tax receipts and excise income on gasoline went up by, respectively, 0.5 percent and 2.1 percent, compared to 2014 (see Chart 1).

Consumers turned more pessimistic in their perceptions of current conditions in 2015, while their negative view regarding the future outlook did not change. The

average consumer confidence index for 2015 (current situation) decreased by 1.0 percent to 93.8, while the expectations index remained virtually unchanged at 96.3.

Box 1: Consumer confidence: detailed results of 2015

According to the CBA's consumer confidence survey, an average of 32.2 percent of respondents indicated that their personal financial position had deteriorated compared to six months earlier (average in 2014: 27.2 percent). An average of 53.1 percent of respondents experienced a worsening of business conditions compared to the previous six months (2014: 43.9 percent), whereas 71.1 percent of respondents indicated on average that the job conditions had deteriorated compared to six months earlier (2014: 65.0 percent). Furthermore, an average of 53.5 percent of respondents felt that the government financial position had worsened when compared to the previous six months (2014: 49.2 percent). With regard to their consumption habits, on average 70.2 percent of respondents felt that taking out a loan was unsuitable in 2015 (2014: 63.7 percent). Moreover, in the third quarter of 2015, this number peaked at 75.7

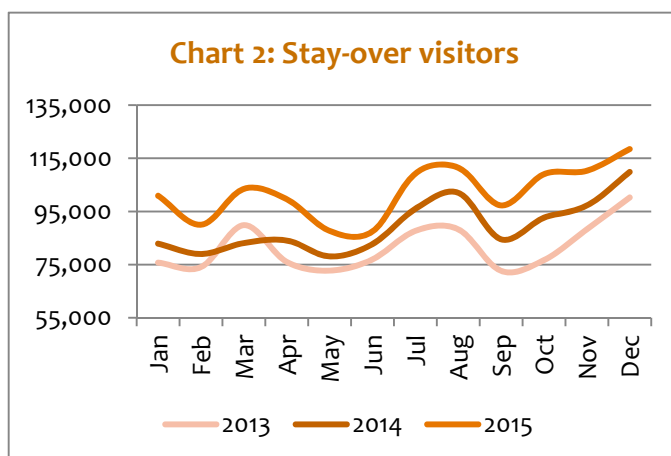
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percent before dropping back to 69.3 percent in the fourth quarter of 2015.

Source: CBA.

Other gauges of consumption provided a mixed picture in 2015. On the one hand, growth was recorded in electricity consumption (2.2 percent), water consumption (3.2 percent), gas consumption (1.1 percent), food imports (0.5 percent), and gasoline consumption as proxied by excises on gasoline (2.1 percent). On the other hand, government expenditures (on a cash-adjusted basis, including net lending) contracted by 11.1 percent in 2015, following decreases in personnel-related expenses and a lower transfer of funds to the AZV to cover its deficit. Another indicator of consumption, namely consumer credit granted by the commercial banks contracted by 0.8 percent in 2015, despite an expansion in car loans of 1.0 percent.

Consumption benefitted from the continued growth in tourist arrivals and occupancy rates, which most likely contributed to additional employment and consequently to increased consumption. However, any gains in consumption were offset by the introduction of the health tax in late 2014 and the increase in the AOV premium at the beginning of 2015.



Tourism related activities continued to expand in the period under review.

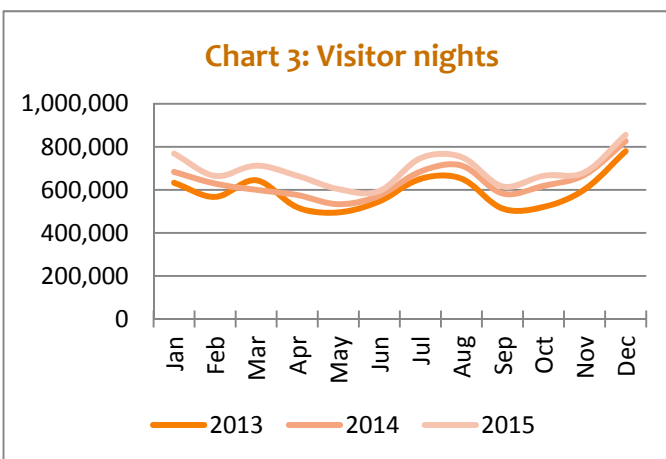
Compared to 2014, the total number of visitors (stay-over and cruise) expanded by 5.3 percent to 1,831,954 in 2015, despite a 9.0 percent drop in cruise passengers. The latter decrease was due to the cancellation of a cruise line with weekly berthing. Growth in stay-over tourism peaked at 14.3 percent in 2015, boosted mainly by the Venezuelan market, which was responsible for 66.3

percent of this growth (see Chart 2). The Venezuelan market's contribution was caused predominantly by a surge in Venezuelan visitors, whose primary purpose of visit was to acquire cash U.S.

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dollars due to a severe shortage in the Venezuelan currency market. This growth increased Venezuela's market share to 28.6 percent, up from 23.3 percent in 2014. The contribution of the U.S. market to the overall growth in stay-over tourism was 29.2 percent (2014: 22.1 percent) as the US economy continued to improve in 2015. Expanded airlift and resulting increased seat capacity supported the positive developments in these two markets.

Visitor nights grew at a much slower pace than that of stay-over arrivals in 2015, expanding by 8.3 percent (see Chart 3). This slower pace was due mainly to a hike in the number of Venezuelan tourists staying only one night in Aruba and then traveling to other destinations. Consequently, average nights stayed per visitor dropped from 7.2 nights in 2014 to 6.8 nights in 2015. In terms of monetary impact, tourism receipts grew by 2.8 percent in nominal terms in 2015, compared to 7.3 percent in 2014.



Despite the rise in stay-over visitors, room occupancy rates, as reported by the Aruba Hotel and Tourism Association, fell to 78.0 percent in 2015, down from 79.3 percent in the previous year. This decrease was due in large part to a growing number of visitors, primarily Venezuelan tourists, staying at other accommodations, i.e., apartments or private homes, rather than hotels.

Investment activities decreased in 2015, owing to delays in investment projects.

Several large projects in the private sector suffered significant postponement in 2015, thereby negatively impacting investment activities. Additionally, some important projects are being executed at a slower pace than anticipated. Examples include the renovation of the hospital and the new container port in Barcadera. Most indicators for investment activities reflected a decline. Cement imports and imports of machinery and electrotechnical equipment fell by, respectively, 5.1 percent and 3.3 percent in 2015 compared to the

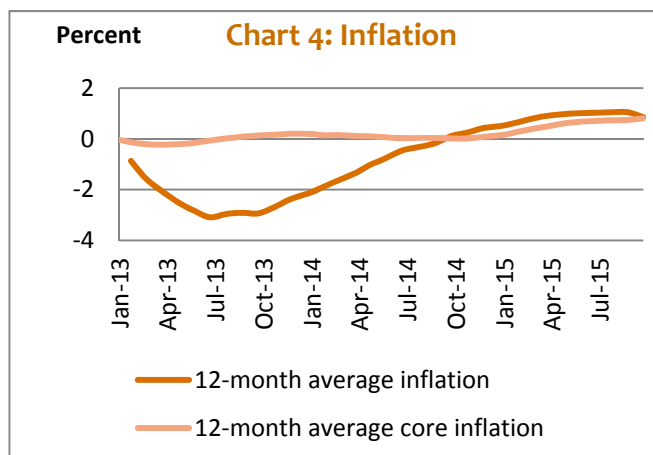
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corresponding period of 2014. On the other hand, imports of base metal works and derivative works increased by 2.8 percent.

The Business Perception index, another indicator of investment activities, fell to 100.1 at the end of 2015 compared to 101.9 a year earlier, due to declines in both the current and the short-term indices (with the short-term index reflecting pessimism). More businesses perceived a worsening of current economic conditions, as the average percentage of businesses that experienced a deterioration increased from 22.5 percent to 28.6 percent in 2015. On the other hand, the companies that foresaw a worsening of short-term conditions dropped from 24.8 percent to 23.5 percent.

The decline in consumption and investment were in part reflected in import data. An example hereof is, the import of goods (excluding the oil sector), as recorded in the balance of payments. It shrank by 4.8 percent in 2015, despite the jump in stay-over visitors mentioned earlier. In addition to the weaker domestic demand, a drop in imports from the free-zone sector contributed significantly to the decline in imports of goods. The free-zone imports' drop is attributed to a fall in the demand for alcohol products from Venezuela, which led the free-zone sector to import less alcohol products for export to this country.

On the other hand, resident travel abroad, measured by the number of resident arrivals at the airport of Aruba, grew by 11.3 percent in 2015, while the growth in residents' payments for travel and tourism purposes accelerated to 5.3 percent in 2015, compared to a growth of 0.8 percent over 2014.



The 12-month inflation rate continued its gradual upward trend during 2015, reaching 0.5 percent, following increases in the electricity tariffs in October of 2014, and in food prices (see Chart 4). However, the decline in gasoline prices and sluggish domestic consumption caused inflationary pressures to remain subdued. Other components in the inflation basket edged up,

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pushing the 12-month core inflation rate (i.e., inflation excluding food and energy components) to 0.9 percent.

The weaker growth of the economy was also reflected in limited credit growth of 0.5 percent. Business loans fell by 4.5 percent in 2015, against a 2.7 percent gain in 2014. Consumer credit shrank by 0.8 percent, reflecting the weakness in consumption, which was also evident in the Consumer Confidence Survey results. These indicated that respondents were hesitant to take on new loans. Housing mortgage continued to show a growth however, rising again, i.e., by 5.0 percent.

Total money supply rose by 9.9 percent in 2015, compared to a growth of 5.1 percent in the previous year. This was brought mainly about by a net inflow of foreign funds (excluding revaluation differences of gold and foreign exchange holdings) (+Afl. 342.7 million). The performance in the tourism sector and external borrowings of the government, along with a smaller outflow of foreign funds by the oil sector and lower imports of goods and services led to the net inflow of foreign funds, and, consequently, to the improvement in the net foreign asset position (NFA). The Afl. 322.3 million NFA expansion (including revaluation differences of gold and foreign exchange holdings) during 2015 is a continuation of an increasing pattern seen since the fourth quarter of 2014, which in turn is a deviation from the downward trend seen since February 2012. As per December 2015, net foreign assets (including revaluation differences of gold and foreign exchange holdings) remained at an adequate level when benchmarked against the critical norms applied by the CBA, including the number of months of current account payments covered by the net foreign assets. The current account coverage ratio (twelve-month average) increased to 4.4 months at the end of 2015, up from 3.5 months at the end of 2014.

The positive developments in international reserves resulted from the transactions as registered in the balance of payments, which recorded an Afl. 342.7 million surplus in 2015. This is associated with

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the surpluses on both the current and the capital and financial accounts of Afl. 195.9 million and Afl. 149.1 million, respectively.¹

The improvement on the current account, from a deficit in 2014 to a surplus in 2015, was caused primarily by an increase in tourism receipts and a smaller deficit on the goods account. The smaller deficit on the goods account was mainly the result of the transactions of the oil sector, which saw a growth in exports, related mostly to re-exports, and a fall in import of goods, largely associated with lower oil prices. In addition, the trade activities of the free zone weakened, which led to a reduction in imports and, to a lesser extent, exports of goods from and to Venezuela. On the other hand, the income account deficit grew, due primarily to increases in dividend payments by domestic corporations to foreign shareholders and interest payments on domestic bonds. The deficit on the current transfers account contracted slightly, mainly reflecting an Afl. 6.2 million increase in current transfer receipts by the non-oil sector, related mostly to insurance claims.

The surplus on the capital and financial account was due mainly to transactions on the other investment account with higher receipts of foreign loans. Moreover, the portfolio investment account registered an Afl. 109.0 million net inflow, attributed to the receipt of the proceeds of a government bond placed on the international capital market. This inflow was partially offset by repayments on domestic debt securities mainly by the government and investments in foreign debt securities. Direct investments recorded an Afl. 65.8 million net outflow, compared to an Afl. 425.8 million net inflow a year earlier, reflecting equity and intercompany lending related transactions by the non-oil sector. Financial derivatives' transactions showed an Afl. 72.4 million net outflow, compared to an Afl. 6.6 million net outflow a year earlier.

The Monetary Policy Committee (MPC) maintained both the reserve requirement and the advance rate unchanged during 2015. The CBA

¹ The difference between the overall balance and the sum of the current account balance and the capital and financial account balance is due to items not yet classified.

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held five meetings during 2015, and the decision to keep the rates unchanged at, respectively, 11 percent and 1 percent was based on developments in the domestic and international economic environment at the time. The committee also took into consideration that net foreign assets continued at an adequate level when benchmarked against the critical norms monitored by the CBA. Other indicators taken into account included GDP growth and money supply. Furthermore, domestic price pressures remained muted, while domestic credit growth was subdued.

The quality of the commercial banking sector's loan portfolio improved significantly in 2015. The average nonperforming loan ratio decreased to 5.8 percent for the period under review from 6.5 percent in 2014, continuing the downward trend since its peak in 2011 at 10.9 percent. The continued decrease was attributed to repayments on nonperforming loans, as well as the restructuring and write-off of certain nonperforming loans.

Other prudential indicators remained adequate throughout 2015. The banks' risk-weighted capital asset ratio averaged 25.2 percent during this period (required minimum = 14.0 percent), up from 23.2 percent in 2014. The loans-to-deposit ratio went down to 71.5 percent (maximum = 80.0 percent) in 2015 from 73.1 percent a year earlier. Furthermore, the prudential liquidity ratio of the commercial banks strengthened in the period under review, reaching 26.5 percent (minimum requirement= 15.0 percent), up from 24.6 percent for 2014.

Despite a reduction in the financial deficit, government finances remained fragile as monitored by the CBA's analytic framework, which deviates from that of the Department of Finance due mainly to different accounting methods. Available data for 2015 show that the deficit including the change in expenditure payment arrears reached Afl. 178.2 million, much smaller than the Afl. 445.2 million deficit recorded in 2014. Total government revenues went up by 8.3 percent (Afl. 92.6 million), owing to an Afl. 60.7 million rise in non-tax revenue as a result of a debt forgiveness received by the government and the receipt of a grant from the European Development Fund. In addition, tax revenues grew by 3.2 percent because of higher profit tax receipts.

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The latter reflected mainly the introduction of a new self-assessment system (VAS) for corporate income, and higher collection of tax arrears. Total government expenditures (on a cash-adjusted basis, including net lending) in 2015 were 11.1 percent (Afl. 174.1 million) lower than a year earlier, due particularly to a reduction in personnel-related expenses and a lower transfer of funds to the AZV to cover its deficit.

Government debt grew by Afl. 89.5 million to Afl. 3,974.1 million at the end of 2015, compared to the end of 2014. This growth in the debt was the result of increases in the foreign debt component during the second, third, and fourth quarters of 2015. Consequently, the debt-to-GDP ratio rose to 82.2 percent at the end of 2015, up from 81.9 percent twelve months earlier.

Despite the reduction in the financial deficit, the government finances remain a cause for concern when taking into account the benchmarks set in the Ordinance on Aruban Financial Supervision, aimed at achieving a financial surplus of at least 0.5 percent of GDP in 2018. This concern has also been voiced by the IMF and the rating agencies Fitch and S&P during 2015. The IMF mentioned in its Article IV Consultation Mission Report of March 2015 that “Without additional measures and steadfast implementation, deficits would remain elevated, and debt would continue to trend upwards over the medium term.” (p. 8).

II. Outlook²

After virtually zero output growth in 2015, the Aruban economy is projected to expand in real terms by 1.1 percent in 2016. As in previous years, the tourism sector is foreseen to make a positive contribution to the economy. Also, unlike the previous three years, private investment is projected to grow by 2.7 percent, thus adding positively to economic activity. In addition to the continuation of the extensive renovation and expansion of the hospital, similar activities in the hotel sector are expected to boost private investment. Moreover, construction work in

² Based upon the CBA’s *Economic Outlook* publication of April 2016.

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the Green Corridor has started and should gain momentum in 2016. On the other hand, public investment is anticipated to decline by 0.7 percent, in line with budgetary restrictions. Private consumption is also foreseen to remain weak and contract by 0.2 percent as consumer confidence is showing no signs of improvement. Moreover, public consumption is projected to drop 0.4 percent as the government targets additional reduction in its fiscal deficits. Given these projected developments, imports are anticipated to increase by 0.7 percent, mainly reflecting higher import of construction materials.

Table 1: GDP growth in real terms, expressed in percentage

	2013 ^e	2014 ^e	2015 ^e	2016 ^f
GDP	4.2	0.8	0.1	1.1
Private consumption	4.0	0.5	-3.1	-0.2
Public consumption	1.9	-8.1	-0.6	-0.4
Private investment	-3.5	-3.7	-1.7	2.7
Public investment	-56.6	16.0	-11.1	-0.7
Imports	0.4	-1.5	-1.8	0.7
Exports	6.0	3.1	1.7	1.8

e = estimate

f = forecast

The balance of payments is forecasted to record an overall surplus of Afl. 111.1 million in 2016 due to the transactions of the non-oil sector.

The overall balance of the non-oil sector is projected at a surplus of Afl. 340.8 million, partially offset by an estimated overall Afl. 229.7 million deficit of the oil sector. The latter deficit is primarily the result of the imports of oil products for domestic use. The overall surplus of the non-oil sector is anticipated to be driven by net inflows related to higher tourism receipts, relatively low import payments and proceeds from government borrowing on the international capital market. The small growth in imports reflects the projected sustained weakness in domestic consumption. The estimated net inflow on the capital and financial account is principally attributed to inpouring funds resulting from the government borrowing on the international capital market.

A moderate increase is expected in the general price level in 2016. Oil prices are generally expected to remain at low levels, thus limiting cost

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push pressures. Consequently, the 12-month average inflation rate is projected at 1.0 percent.

The main downside risk to the economic outlook is the delay in the execution of investment projects. This is a substantial risk, as postponements in large investment projects are a recurring problem. If investment projects are not executed as planned, economic growth could be negatively impacted again, thus leaving tourism activities as the sole contributor to growth. A continuation of the lackluster consumer confidence and related declining consumption pose another risk to economic growth in 2016.

The primary upside risk is related to a possible restart of the refinery as an upgrader of Venezuelan oil. The operation of the refinery by Citgo should lead to substantial investments and additional employment to get the refinery ready as an upgrader. For a more detailed explanation of the economic outlook for 2016, reference is made to the CBA's *Economic Outlook* publication of April 2016.

III. International developments and forecasts

The IMF estimates that in 2015 world output expanded by 3.1 percent (2016: 3.2 percent) in real terms.³ Growth in the second half of the year was weaker than previously anticipated. This increased weakness was due to softer activity in advanced economies such as the United States, Japan, and other advanced Asian economies. Growth estimates among the high income countries are spearheaded by the United States (2015: 2.4 percent) and the United Kingdom (2015: 2.2 percent); in developing countries, India and China are leading with growth estimates of 7.3 percent and 6.9 percent, respectively.

The pace of the global economic recovery is expected to maintain its uneven growth trend in high-income countries and in developing economies in 2016, with the latter providing the lion's share of projected world output. Key elements that presently could impact

³ *World Economic Outlook*, International Monetary Fund, April 2016.

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global growth include the threat of a disorderly reversal of capital flows in emerging market economies combined with growing risks to financial stability, the international fall out of the economic transition in China, increasing strain in oil exporting countries, the effect of tighter financial conditions and financial market volatility on confidence and growth, extended recessions in some emerging market economies, geopolitical risks, and the exiting of the United Kingdom from the European Union.

For Latin America and the Caribbean as a whole, a negative growth of 0.1 percent is estimated for 2015, with a contraction of 0.5 percent anticipated in 2016. The slowdown in 2015 reflects the deeper than expected downturn in Brazil and declining commodity prices that continue to weaken output in the region. The oil price decline has exacerbated domestic macroeconomic shortcomings and intensified balance of payment pressures in Venezuela. The value of the Venezuelan currency has continued to fall, and in the process eroded the real income of Venezuelans. According to a report of the Bank of America,⁴ real wages have fallen by 36 percent over the past two years. Consequently, Venezuela is projected to suffer a deep recession in 2016, i.e., -8.0 percent growth after contracting by 5.7 percent in 2015. Moreover, Venezuelan inflation is estimated to rise close to 500 percent in 2016 after being well above 100 percent in 2015. Considering the results of the December 2015 elections in which the opposition parties won a majority of the Parliamentary seats, some policy changes may be underway, but they will take time to bear fruits.

IV. Concluding remarks

After a strong recovery in 2013 and to a lesser extent in 2014, economic activity in Aruba in 2015 was almost flat. The main contributor to growth was the tourism sector, but the positive performance in this

⁴ Nathan Crooks, *Here's how Venezuela's economy has tanked under President Maduro*, published on www.bloomberg.com, December 2015.

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sector was offset by sustained weaknesses in consumption and investment.

During 2015, the Aruban economy was driven by the buoyant performance in the tourism sector. The growth in the number of visitors and tourism receipts compensated for the lackluster development in consumption and investment. Delays in several investment projects were a continuing problem. While the number of tourists visiting the island continued to grow, the nights and money spent on the island grew at a slower pace. This slower pace is mainly due to the Venezuelan tourism market, which was influenced by the adverse developments in the Venezuelan currency markets.

The 12-month inflation trend continued its gradual upward trajectory, following an increase in electricity tariffs in October 2014. However, inflationary pressures remained subdued as a result of the decline in gasoline prices and the sluggish domestic consumption.

Despite a reduction in the financial deficit, government finances remained fragile. At the end of 2015, government debt stood at Afl. 3,974.1 million with a debt-to-GDP ratio of 82.2 percent, i.e., 0.3 percentage point higher than in 2014. Additional measures and steadfast implementation of the measures are needed to bring down the deficits in line with the Ordinance on Aruban Financial Supervision and to put government debt to sustainable levels on the medium term.

Net foreign assets rose substantially during 2015 and stayed at an adequate level when benchmarked against the critical norms used by the CBA, including the number of months of current account payments covered by the net foreign assets, currently the strictest benchmark.

Based upon its April review, the CBA foresees the Aruban economy to grow at a faster pace in 2016 than in 2015. However, the timely execution of a number of investment projects, in addition to continued growth in tourism receipts, is essential to the realization of this projection.