Centrale Bank van Aruba

STATE OF THE ECONOMY

First three quarters of 2020

ABSTRACT

The Aruban economy experienced an initial, albeit marginal, rebound in the third quarter vis-à-vis the second quarter, yet economic conditions remained anemic. This slight rebound ensued from the lingering COVID-19 pandemic, which was reflected by a plunge in tourism credits and hotel occupancy rates. In addition, consumption and investment indicators were exhibiting adverse economic conditions during the first three quarters of 2020. Similarly, import activities withered across all categories. Initial estimates of quarterly GDP growth pointed to a contraction of 24.7 percent during the first three quarters of 2020.

Centrale Bank van Aruba

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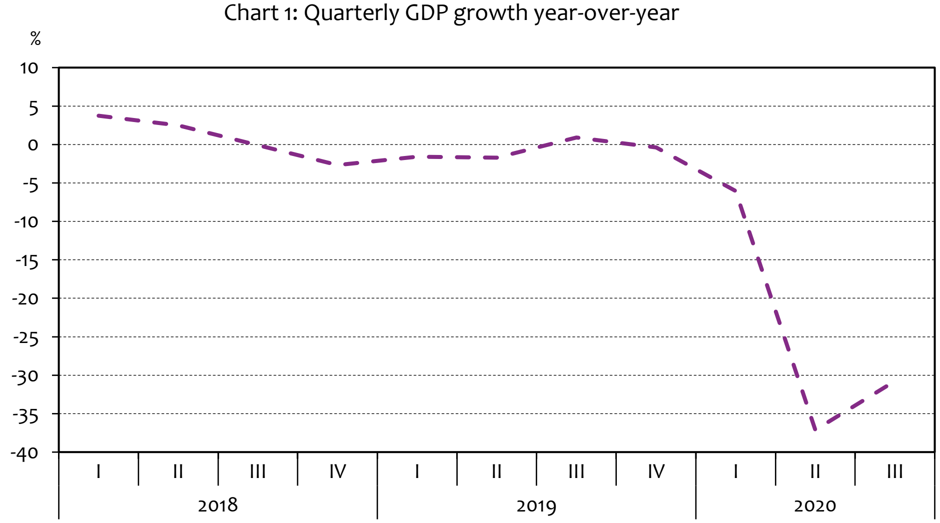
I. Domestic developments[1]

Economic growth

During the third quarter of 2020, the Aruban economy experienced an initial rebound amidst continued uncertainties (Chart 1). The initial 6-month estimate of GDP growth was adjusted downwards by 1.8 percentage points compared to the previously published figure, reaching -21.6 percent. In the third quarter, GDP dropped by 30.7 percent compared to the same quarter

Chart 1: Quarterly GDP growth year-over-year



Calculations: CBA

[1] The cut-off date for information published in this State of the Economy is February 16, 2021.

a year prior.[2] This development was caused mainly by a plunge in tourism income following the COVID-19 pandemic, despite the reopening of the Aruban border to its main markets. In addition, both consumption and investment indicators echoed lackluster economic conditions despite government financial support and social assistance. Similarly, import activities faced a slowdown across all categories.

Tourism

Tourism activity in Aruba plummeted in the first three quarters of 2020. This drop was reflected by downturns in total stay-over visitors (-67.7 percent), cruise visitors (-54.0 percent), and tourism credits at domestic banks (-39.9 percent) when comparing year-to-date September 2020 data to the same period a year prior (Table 1). Furthermore, this development extended to multiple markets with contractions in total stay-over visitors noted in North American (-65.6 percent), Latin American (-82.4 percent), and European (-70.2 percent) markets. This deterioration in tourism sector performance resulted from the COVID-19 pandemic, which culminated in a hesitancy to travel or an inability to travel. The hesitancy to travel can be related to the second wave of COVID-19 in Aruba, which started in August and peaked roughly halfway through September – as measured by the number of active cases. As such, Aruba may have been perceived as a high-risk country, which led to negative travel advice and mandatory quarantine for returning travels from government agencies such as the Center for Disease Control and Prevention. The inability to travel can be linked to the lingering effects of travel restrictions, for example, the 2020 Q2 border closure in Aruba.

Table 1: Tourism indicators for Aruba (YTD September vs. YTD September a year prior)

	2019	2020
Stay-over visitors (growth)	4.7	-67.7
Average length of stay (days)	7.3	8.4
Cruise visitors (growth)	-2.2	-54.0
Hotel occupancy (%)	79.5	13.7
Average daily rate (US$)	214.15	231.46
Revenue per available room (RevPAR) (US$)	170.28	31.65
Tourism credits (growth)	2.9	-47.8

Sources: ATA, AHATA, APA, CTO, STR

[2] Initial estimates of quarterly GDP growth were calculated based on a nowcast model of high-frequency indicators consisting of monetary and nonmonetary data.

September year-to-date downturns in the hotel sector were recorded per data published by the Aruba Hotel and Tourism Association (AHATA). Following the COVID-19 related travel restrictions and significant cancellations, revenue per available room (RevPAR) in the first three quarters of 2020 declined by 81.4 percent compared to the same period a year before. This outcome was brought about primarily by the hotel occupancy fallback, which amounted to 65.8 percentage points. Nevertheless, the pickup in the average daily rate (8.1 percent) was a mitigating factor, insofar as the RevPAR otherwise would have shown a steeper decline.

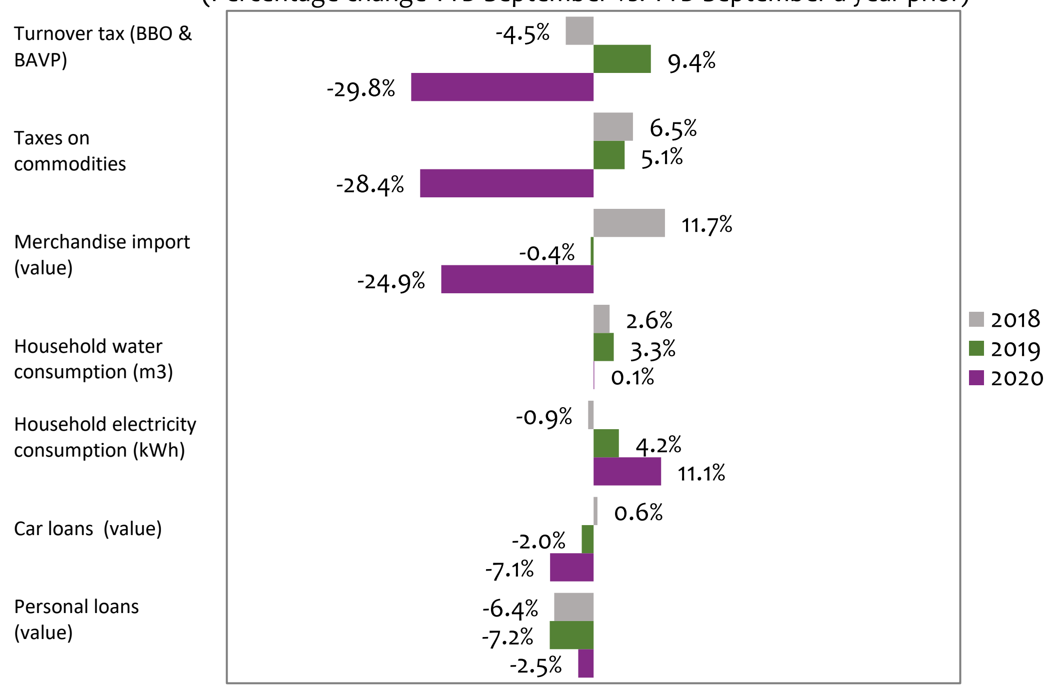
In the first three quarters of 2020, a total of 98 cruise ships made harbor calls. This amounted to 110 fewer ship calls (-52.9 percent) compared to the same period in 2019. Consequently, the total number of cruise passengers decelerated to 255,384 (-54.0 percent). These developments in cruise tourism for the first nine months of 2020 were attributable to the March 14, 2020, 'no sail order' issued by the U.S. Centers for Disease Control, which was replaced by the 'conditional sailing order' whereby ships were prohibited to sail until October. The Cruise Lines International Association, representing 95% of global cruise line capacity, followed suit, maintaining the voluntarily suspension of cruise operations in the United States through December 31.

Consumption

Nearly all consumption indicators signaled a slump up to the third quarter of 2020. Tax Department data denoted a reduction in turnover tax[3] (BBO & BAVP) revenue of 29.8 percent (Chart 2), when the period January-September 2020 is compared to the same period in 2019.

[3] Between 2017Q2 and 2018Q1 the turnover tax consisted of only the BBO (BAZV excluded) and thus stood at 1.5 percent. As of the 1st of July of 2018, the BAVP was introduced at 1.5 percent to bring the total turnover tax rate to 3.0 percent. Accordingly, pre-2018Q2 turnover tax was adjusted to reflect the level it would had been if the rate totaled 3.0 percent.

Chart 2: Consumption-related indicators
(Percentage change YTD September vs. YTD September a year prior)



Sources: CBA, WEB, Tax Collector's Office,

The largest drop transpired in the second quarter of 2020. Similarly, taxes on commodities showed a 28.4 percent cutback during the first three quarter of 2020. Overall, tax revenues are still underwhelming due to frail tourism demand and government measures to contain the COVID-19 pandemic, inhibiting economic activity and, by extension, consumption.

Merchandise imports withered across all categories, amounting to a 24.9 percent drop in the period under review (Chart 2). This retrenchment was ascribable chiefly to fall-offs in other goods predominantly stemming from mineral and vegetable products. Other contributing categories were transport equipment, live animals and other animal products, and food products (Table 2, last column). Table 2 also indicates that while the imports of transport equipment exhibited the largest percentage decrease (-51.7 percent), its share in the total percentage change in merchandise imports was the second largest, at 14.5 percent.

Table 2: Merchandise imports value
Decomposing percentage change YTD September 2020 vs. YTD September 2019

	Weight of component in YTD 2019	Percentage change	Percentage point contribution to total percentage change	Share in total percentage change
Other goods	42.9%	-29.6%	-12.7%	51.0%
Transport equipment	7.0%	-51.7%	-3.6%	14.5%
Live animals and other animal products	9.0%	-31.1%	-2.8%	11.2%
Food products	12.9%	-21.0%	-2.7%	10.8%
Machinery and electrotechnical equipment	14.7%	-9.6%	-1.4%	5.6%
Base metals and derivated works	4.3%	-24.8%	-1.1%	4.4%
Chemical products	9.2%	-6.7%	-0.6%	2.4%
Import of goods (c.i.f.)	100%	-24.9%	-24.9%	100%

Source: Customs Department
Calculations: CBA

Meanwhile, developments in car sales were in line with transport equipment[4] imports, as the former shrunk by 59.5 percent in the first nine months of 2020, compared to the same period in 2019. The onset of this development was noted already in the first quarter, as car sales dropped by 25.5 percent in the first quarter of 2020 consistent with the trend of increasing imports of right-hand drive vehicles seen in recent years. Furthermore, car sales further worsened in the second and third quarters, where plunges of, respectively, 74.5 and 74.5 percent were recorded. This development also was corroborated by the 2020 Q3 Consumer Confidence Survey (Central Bank of Aruba, 2020), according to which more than 75 percent of consumes reported it unsuitable to purchase a car. This lack of consumption can be linked to the concern and uncertainty generated by the COVID-19 pandemic. According to that same survey, consumer concerns manifested predominately in the spheres of job security, government financial position, and economic conditions.

Data on utilities indicated a growth of 11.1 percent in household electricity consumption, while water usage stayed virtually flat (Chart 2). The stronger electricity consumption may have been spurred by more people working from home, which would then give rise to a substitution effect from business to household electricity consumption in the second and third quarters. Business electricity consumption indeed faltered by 14.7 percent (Jan-Sep 2020 vs. Jan-Sep 2019), providing circumstantial evidence of a substitution effect. In addition, the electricity tariff reduction as of January 2020 likely instrumented a hike in electricity usage in the first quarter of the year. Part of the upswing in electricity consumption also was due to increased household connections registered (2.0percent). In contrast, household water consumption

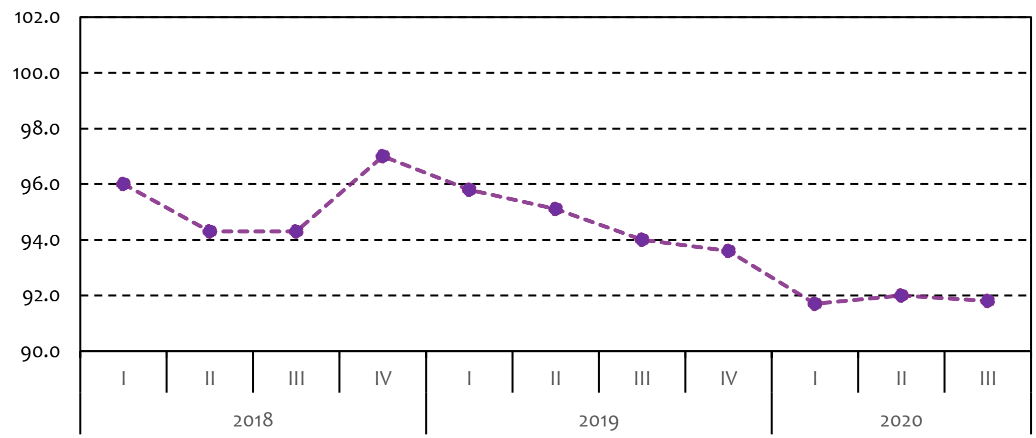
[4] Consisting of the following categories: railway vehicles and mechanical traffic signaling equipment, cars and (motor)cycles, aviation and space travel, and finally ships, boats, and floating structures. This category historically has been driven by cars and (motor)cycles. For instance, based on available 2019Q1 and 2020Q1 data, cars and (motor)cycles encompass, respectively, 96.0 and 98.0 percent of transport equipment.

remained virtually constant. The 2009 crisis supports this conjecture, where vis-à-vis 2008, water consumption edged down by -0.1 percent.

Consumer credit offered by monetary financial institutions slipped by 3.5 percent in September 2020 compared to the same month a year earlier (Chart 2). The lower level of consumer credit is a continuation of the decreasing trend in recent years, albeit at a slower pace. The slower contraction could be due to the loan repayment moratorium offered by commercial banks. For those opting for a moratorium, loan repayments would be deferred, but their outstanding principal would not be reduced. Nevertheless, car loans, personal loans ,and credit cards fell by, respectively, 7.1 percent, 2.5 percent, and 5.5 percent. Likewise, consumer credit data from the nonmonetary financial institutions showed a 4.9 percent reduction. The curtailment in consumer credit was consistent with the 2020Q3 Consumer Confidence Survey in which more than 70 percent of respondents reported that it is unsuitable to take out a loan.

The sluggish consumption indicators confirmed the pessimism of consumers (Chart 3). The pessimism that brewed in the first quarter persisted in the second and third quarters. Specifically, the consumer confidence index inched down from 92.0 in the second quarter to 91.8 in the third quarter. The slightly more gloomy sentiment can be attributed to the more negative future expectations in terms of the duration of the pandemic, mitigated by expectations of smaller price increases.

Chart 3: Consumer Confidence Index



90-100: pessimistic
100-110: optimistic

Source: CBA

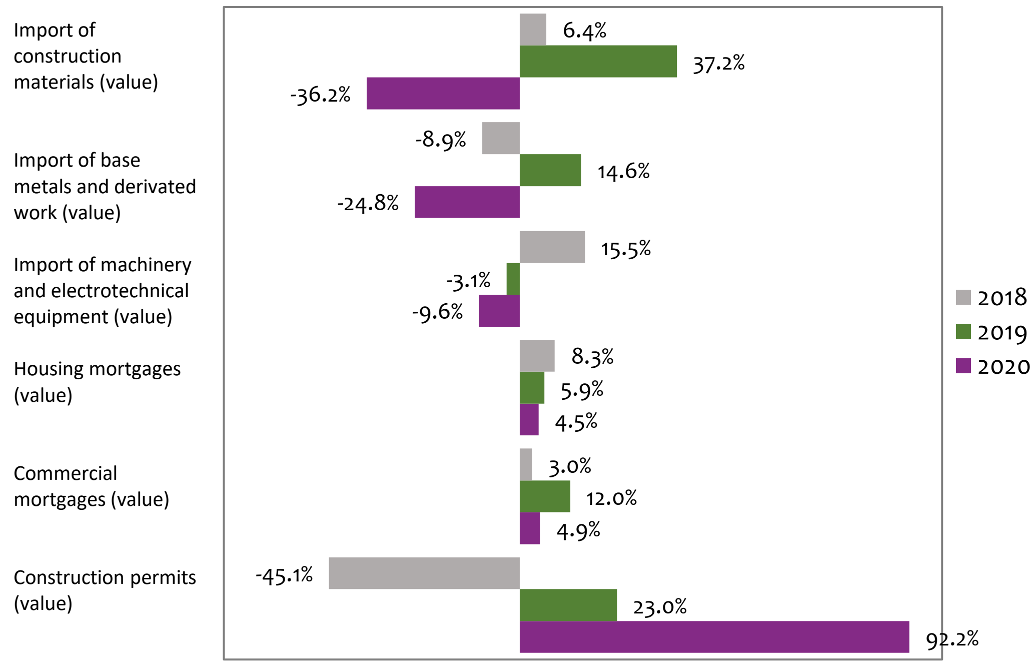
Investment

Investment activities shifted downward during the first three quarters of 2020. Import data for instance, demonstrated that the import of construction materials diminished by 36.2 percent in the period under review, a more rapid pace than Jan-Sep 2019 (Chart 4). Moreover, imports of base metals and derivated works decreased by 24.8 percent. Likewise, the import of machinery and electrotechnical equipment registered a 9.6 percent pull back. These developments were due to large-scale investments being in their final completion stages or delayed, such as the Watty Vos Boulevard and the expansion of the Dr. Horacio Oduber Hospital. In addition, no new large-scale investment projects were initiated, considering the 'shelter in place' measure and the uncertainty caused by the COVID-19 pandemic.

Meanwhile, data on construction permits granted in the first nine months of 2020 attested to heightened investment activities, but cautious interpretation is warranted (Chart 4). The accrued value of construction permits granted jumped by 92.2 percent, more robust than the 23.0 percent hike in the previous year. This surge was tied to the granting of permits for hotel sector projects, yet it does not necessarily imply actual investment cash flows in that period, as for example, the 'shelter in place' set in the second quarter put a halt on construction projects, triggering a 3-month delay. Along those same lines, the uncertainty arising from the COVID-19 pandemic may cause a timing mismatch between a permit granted and actual construction initiation.

Indicators from the commercial banking sector displayed elevated investment activities as commercial and housing mortgages pushed up, respectively, by 4.9 percent and 4.5 percent, although at a diminishing rate compared to a year earlier (Chart 4). Investment activities in housing grew as intensified efforts continued to reduce land permit backlogs. In addition, various consumers and companies made use of the loan repayment moratorium, consequently preventing a downward pressure on mortgages. On the other hand, the diminishing rate is likely grounded in the uncertainty instigated by the COVID-19 pandemic. This uncertainty is reflected in the 2020Q3 Consumer Confidence Survey, in which more than 60 percent of consumers found it unsuitable to take out a mortgage.

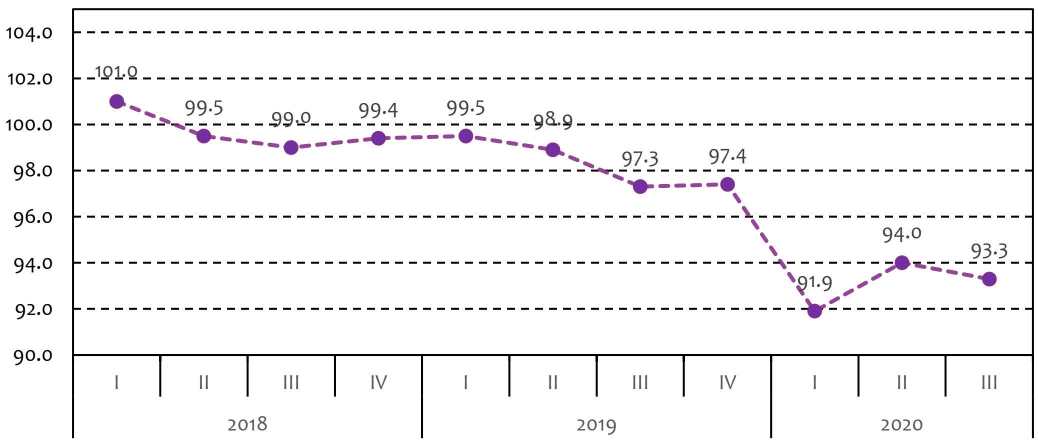
Chart 4: Investment-related indicators
(Percentage change YTD September)



Sources: CBA, CBS, DOW

Business sentiments marginally worsened as the business perception index[5] (BPI) edged down by 0.7 index point to 93.3 in the third quarter of 2020 (Chart 5). This decrease was triggered mainly by the sliding confidence in current economic conditions, specifically in terms of how businesses perceive the economic condition of Aruba, the investment climate, and the number of employees. Another factor conducive to the reduced BPI was the negative sentiment regarding short-term future economic conditions. Overall, the lower current (-0.2 index point) and short-term future economic condition index (-1.5 index point) were

Chart 5: Business Perception Index



90-100: pessimistic
100-110: optimistic

Source: CBA

[5] The index can vary between 90 and 110. Between 90 and 100 indicates a situation of pessimism. An index of exactly 100 indicates that businesses are neither pessimistic nor optimistic, but are neutral regarding their thoughts about economic developments in Aruba. Between 100 and 110 indicates a situation of optimism in business sentiments.

attributable to the mid-August peak in the number of active cases in Aruba and the reinstated curfew at the end of August.

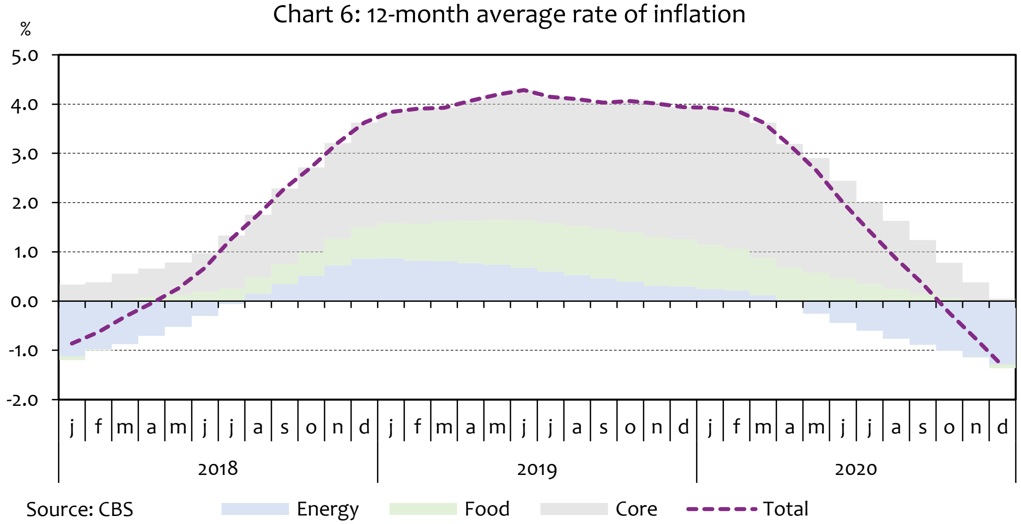
Consumer Price Index (CPI)

The 12-month average CPI inflation maintained its downward path that started in November 2019 with the downward momentum accelerating after February 2020, inching down to 0.4 percent at the end of September 2020 (Chart 6). The deceleration in the inflation rate was due mainly to the energy component, which pushed inflation down by -0.9 percentage point in September 2020, the strongest deflationary pressure to date in 2020. This deceleration resulted from the reduction in the electricity tariff in January 2020 as well as the lower price for gasoline. Moreover, smaller contributions from the food and communication components, as well as the winding down of the impact of the BAVP introduction in July 2018, were conducive to the slowdown in the inflation rate.

However, the aggregated items in the CPI basket not including food and energy, i.e., the core component, offset the downward pressure caused by the energy component, adding 1.1 percentage points to the 12-month average inflation in September 2020. The core component's contribution at the end of September was spread out over several items, with the largest addition coming from the holiday component at 0.3 percentage point. Moreover, the rest of the upward movement in core inflation was due to the components catering services, telephone services, housing rentals, property maintenance and repair, each component adding 0.2 percentage point to core inflation.

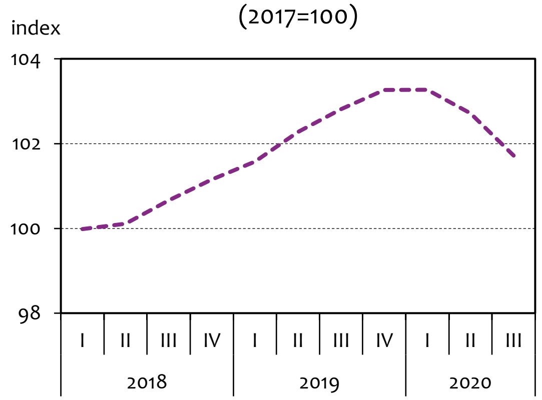
The food component continued its slipping trajectory since November 2019 as it contributed a mere 0.2 percentage point to the 12-month average inflation in September. In addition to the diminishing impact of the BAVP introduction in July 2018, food inflation was tempered possibly because the impact of potential supply disruptions was mitigated by lower oil prices.

Chart 6: 12-month average rate of inflation



Source: CBS

Chart 7: Real exchange rate Aruban florin vis-à-vis the U.S. dollar (2017=100)

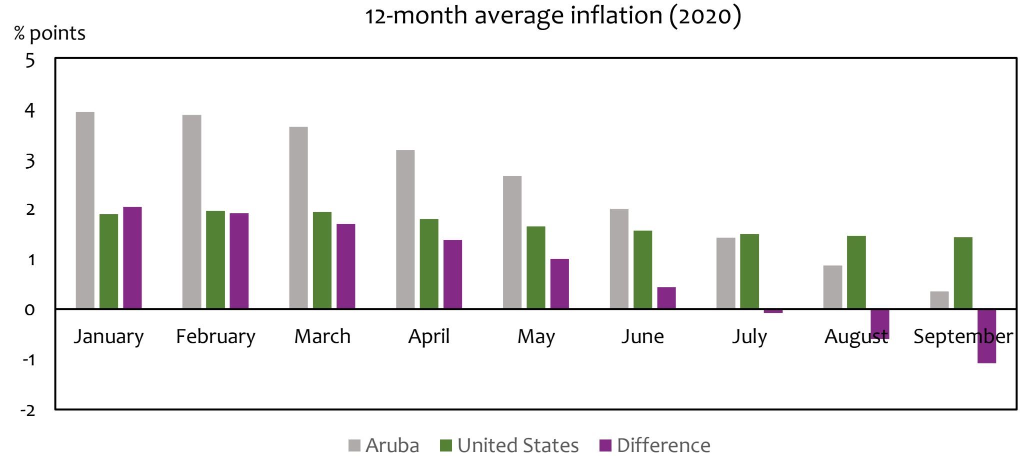


Source: CBA

International competitiveness

The real exchange rate of the florin against the U.S. dollar continued its depreciating trajectory (Chart 7). This trajectory implies a recent ongoing improvement in Aruba's competitive position relative to the United States, attributable to inflation in Aruba falling more than inflation in the United States (Chart 8). The 12-month average U.S. inflation path follows mainly from the deflation in the energy component, which dragged down the mentioned inflation by -0.6 percentage point in September 2020. Still, the core and food components pushed up total inflation by, respectively, 1.5 percentage points and 0.5 percentage point. This finding suggests that the more muted inflation in Aruba, and thus the improvement in the country's competitive position, are ascribable to a larger downward pressure of the energy component in addition to smaller contributions from the core and food components relative to the United States.

Chart 8: Inflation differential Aruba - USA: 12-month average inflation (2020)

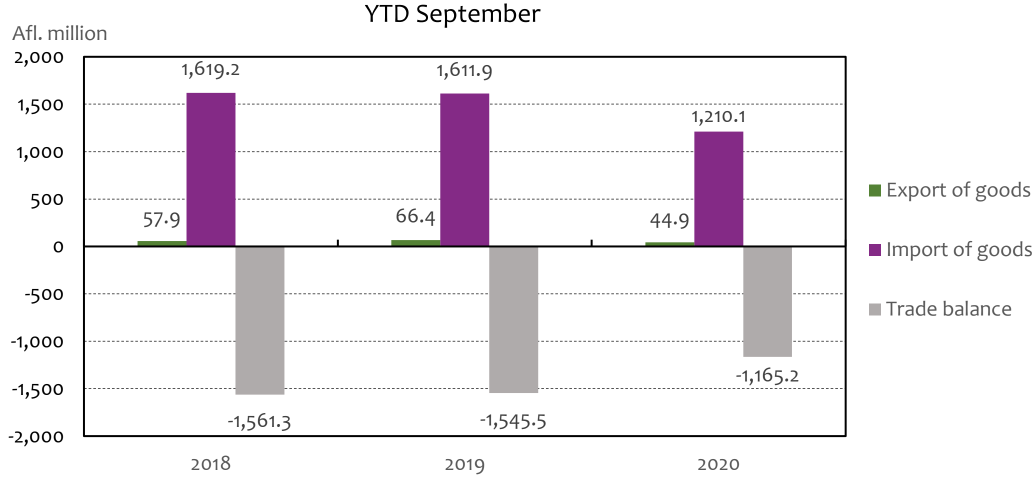


Calculations: CBA

Foreign trade

Aruba's trade balance incurred an Afl. 1,165.2 million deficit in the first 9 months of 2020, representing a 24.6 percent improvement compared to the same period of 2019 (Chart 9). The narrower trade deficit ensued from an Afl. 401.8 million (24.9 percent) contraction in imports, owing essentially to the impact of the COVID-19 pandemic and that of related containment measures on economic activity. However, the export of goods also decreased by Afl. 21.6 million, thus partially mitigating the decline in imports. The recorded downturns were in relation to Aruba's largest trading partner, the United States, with an Afl. 247.8 million (-27.3 percent) fallback in imports and an Afl. 11.2 million (-30.7 percent) drop in exports.

Chart 9: Merchandise foreign trade
YTD September



Source: CBS

Table 3: Balance of payments (in Afl. Million)

	2019Q1-Q3	2020Q1-Q3
Current account	207.5	-420.5
Goods	-1,402.5	-1,035.5
Services	1,871.0	771.9
Primary income	-148.9	-94.5
Secondary income	-112.0	-62.4
Financial account	202.7	-436.8
Direct investment	243.2	-149.0
Portfolio investment	30.7	-301.7
Financial derivatives	-5.7	7.4
Other investment	-41.2	-310.2
Reserve assets	-24.4	316.7

Source: CBA

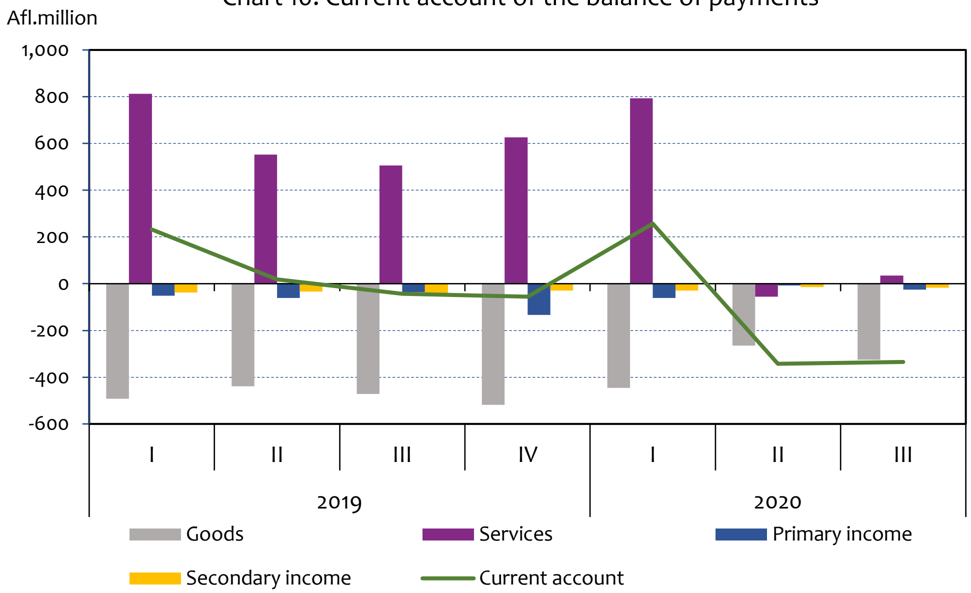
Balance of payments

The current account of the balance of payments reached a deficit of Afl. 420.5 million in the first three quarters of 2020. The observed deficit was mostly the result of shortages recorded in the second and third quarters of 2020, i.e., Afl. 324.7 million and Afl. 334.6 million, respectively. These were the largest deficits recorded since the first quarter of 2011 (Afl. 470.8 million). When compared to the same period in 2019, the deficit in 2020 shows a sharp deterioration of Afl. 628.1 million. This deterioration was triggered mostly by a much smaller surplus on the services account resulting from the contraction in tourism services (-Afl. 1,347.2 million) following the COVID-19 travel restrictions (Table 3; Chart 10).

On the other hand, the goods account in the first three quarters of 2020 noted a smaller deficit compared to the first three quarters of 2019, i.e., Afl. 1,035.5 million in the first three quarters of 2020 compared to Afl. 1,402.5 million in the corresponding period of 2019. This reduced deficit in the goods account partially offset the plunge in the services account. The narrowing of the deficit on the goods account was the result of imports falling by Afl. 410.8 million (-26.0 percent) compared to the same period a year before. It was also 27.7 percent lower than the average of the corresponding periods in 2018 and 2019. This reduction in imports occurred largely in the second and third quarters of 2020.

Specifically, imports of goods plummeted by Afl. 195.7 million in the second quarter of 2020 compared to the second quarter of 2019, and by Afl. 174.5 million in the third quarter of 2020 compared to a year earlier. The imports decline observed during the first three quarters of 2020 stemmed from waning tourist demand and local demand for goods, as a result of the COVID-19 travel restrictions and significant reduction in domestic disposable income. During the same period, the primary income deficit declined further by Afl. 54.3 million (+36.5 percent) to -Afl. 94.5 million, while net secondary income inflow rose by Afl. 49.6 million (+44.3 percent) to -Afl. 62.4 million. The decrease in the primary income deficit was mostly the consequence of plummeting interest and dividend payments (Afl. 55.4 million) to nonresidents related to direct investment. Similarly, the rise in net secondary inflow was related mostly to a drop in workers' remittances to abroad (Afl. 18.3 million).

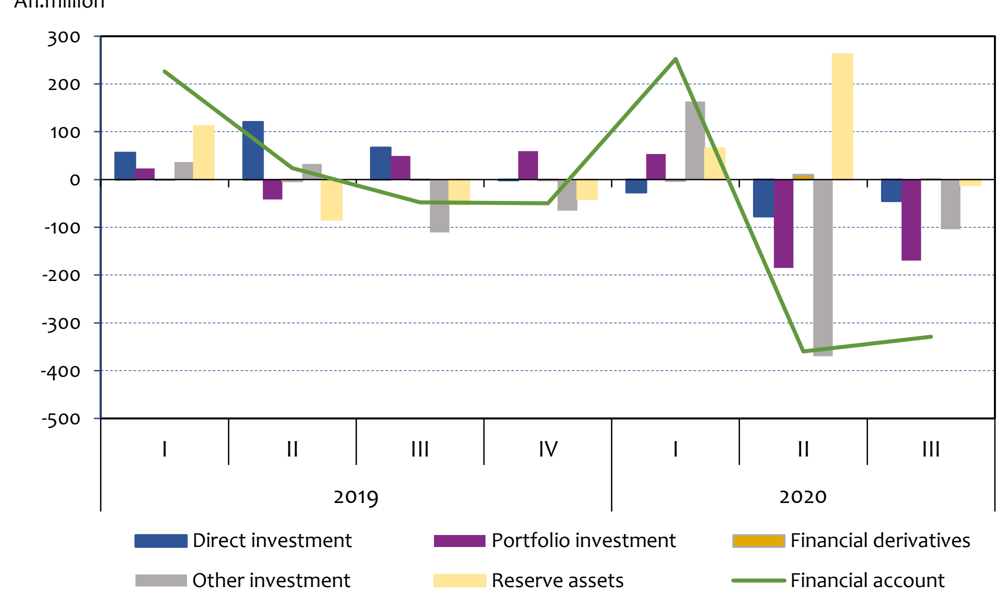
Chart 10: Current account of the balance of payments



Source: CBA

The financial account resulted in a net borrowing of Afl. 436.8 million during the first three quarters of 2020 compared to a net lending of Afl. 202.7 million a year earlier (Chart 11). In the second and third quarters of 2020, the net borrowing on the financial account reached the highest values recorded since the first quarter of 2012 (Afl. 413.6 million). The outcome on the financial account was related mostly to inflows from portfolio investment (-Afl. 301.7 million), other investments (-Afl. 310.2 million), and direct investment (-Afl.149.0 million). In general, the inflows on the portfolio investment and other investment accounts were associated largely with incoming liquidity support from the Netherlands and foreign loans received by the Government of Aruba (GoA). In addition, residents transferred Afl. 187.6 million from their accounts held abroad to their domestic accounts, thus contributing to the inflow on the other investment account. Moreover, the development of direct investment was affected mostly by nonresident affiliated companies providing loans and capital to Aruban subsidiaries. Reserve assets recorded an Afl. 316.7 million inflow, due mainly to inflows on the categories currency and deposits, and securities. These inflows are related primarily to financing received by the GoA.

Chart 11: Financial account of the balance of payments



Source: CBA

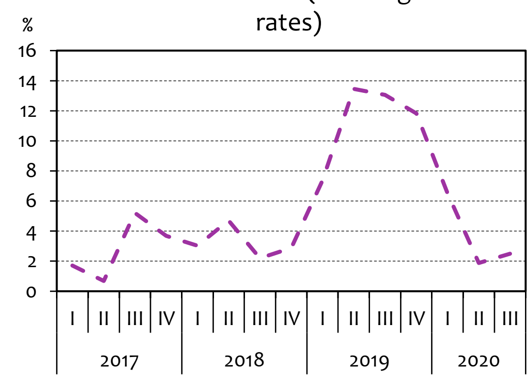
Monetary survey

Broad money expanded by Afl. 75.7 million at the end of the third quarter of 2020 compared to end-2019, reaching Afl. 4,644.5 million. Broad money was pushed up by an Afl. 193.5 million increase in international reserves (excluding revaluation differences), partially mitigated by an Afl. 117.8 million drop in net domestic assets. The significant rise in international reserves during the first three quarters of 2020 was the result of a net inflow of tourism credits (mainly in the first quarter), government foreign borrowings, and financial support received from the Netherlands. Furthermore, a slowdown in imports due to reduced domestic and tourism demand and capital restrictions introduced by the CBA led to less outflow of foreign funds compared to the same period of 2019.

International reserves remained adequate at the end of the third quarter and above the benchmarks monitored by the CBA. The current account coverage ratio increased to 8.6 months of current account payments at the end of September 2020 (5.0 months of current account payments end-2019). Nonetheless, at the end of September 2020, official reserves were below the optimal range of the IMF Assessing Reserve Adequacy (ARA) metric, which serves as a guideline for analyzing developments in the official reserves.

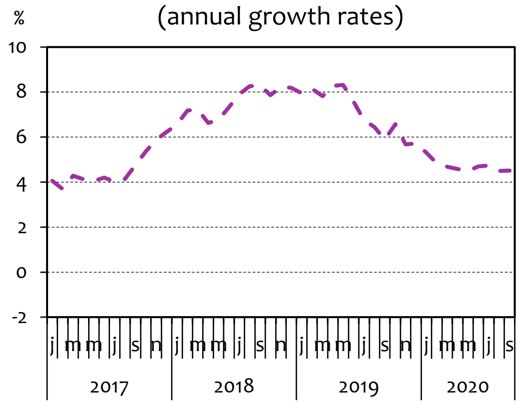
Net domestic assets climbed steadily since the second quarter of 2019 and then started decreasing as of the second quarter of 2020. At the end of the third quarter of 2020, net domestic assets had fallen by Afl. 117.8 million to Afl. 2,738.5 million compared to December 2019. The latter decrease resulted primarily from contractions of Afl. 96.3 million in net claims on the public sector, and Afl. 93.7 million in non-credit related balance sheet items (other items). The fall in net claims on the public sector was due to an increase in government deposits, which rose by Afl. 111.6 million in the second and third quarters, and stood at Afl. 235.5 million at the end of September 2020. The decline in net domestic assets was mitigated in part by an Afl. 72.3 million increase in claims on the private sector. This uptick was driven by an

Chart 12: Loans to enterprises from commercial banks (annual growth rates)



Source: CBA

Chart 13: Housing mortgages from commercial banks (annual growth rates)



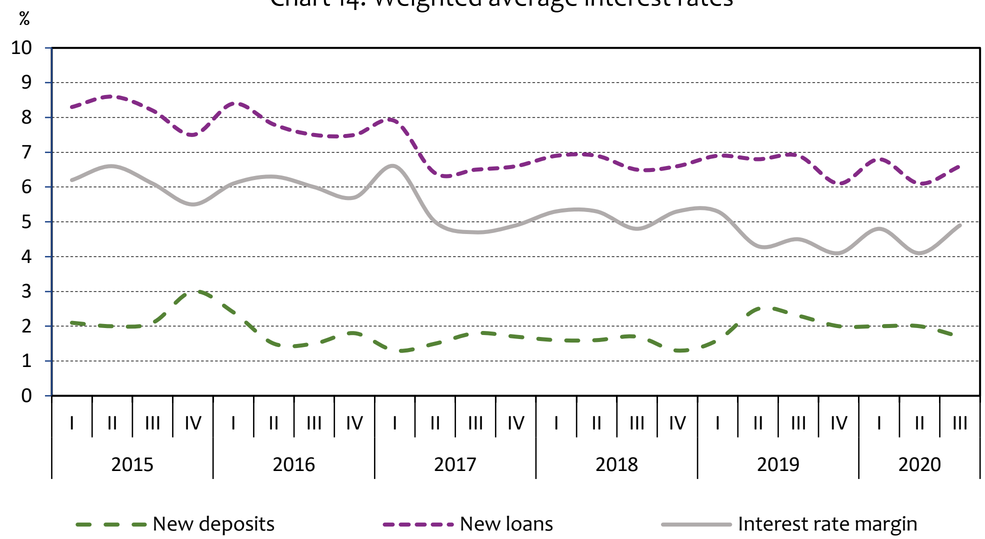
Source: CBA

increase in loans to enterprises (+Afl. 38.5 million) and housing mortgages (+Afl. 44.2 million), although both grew at a slower pace than in the same period of 2019 (Charts 12 and 13). Loans to enterprises particularly recorded a slowdown in growth compared to the same period of 2019 (first three quarters of 2019: +Afl. 162.3 million), as in 2019 loans to enterprises grew at their strongest rate in the preceding five years. On the other hand, consumer credit continued to drop and decreased by Afl. 10.5 million to Afl. 495.4 million at the end of the third quarter of 2020, its lowest level in the past 15 years.

The aggregated balance sheet of the nonmonetary financial institutions stood at Afl. 6,552.5 million in September 2020, an increase of Afl. 200.3 million compared to December 2019. This rise was brought about by growths in other domestic assets (+Afl. 79.2 million) and foreign assets (+Afl. 61.9 million). On the liabilities side, the expansion was related to higher other domestic liabilities (Afl. 95.1 million) and pension fund provisions (Afl. 54.0 million).

The quarterly weighted average interest rate on loans grew to 6.6 percent in the third quarter of 2020, up from 6.1 percent in the fourth quarter of 2019 (Chart 14). The quarterly weighted average interest rate rose in all categories except housing mortgages where it edged down by 0.1 percentage point to 5.5 percent. The category that recorded the most significant increase in interest rates was commercial other loans (+ 0.8 percentage point). Conversely, the quarterly weighted average interest rate on deposits fell to 1.7 percent, down from 2.0 percent in the fourth quarter of 2019. The latter rate declined in the third and fourth quarters of 2019, after which it held stable at 2.0 percent until the second quarter of 2020. The decrease was noticeable primarily in rates for savings deposits, which fell to 1.2 percent (-0.7 percentage point). Consequently, the interest rate margin expanded by 0.8 percentage point to 4.9 percent, its highest level since the first quarter of 2019 (2019 Q1: 5.3 percent).

Chart 14: Weighted average interest rates



Source: CBA

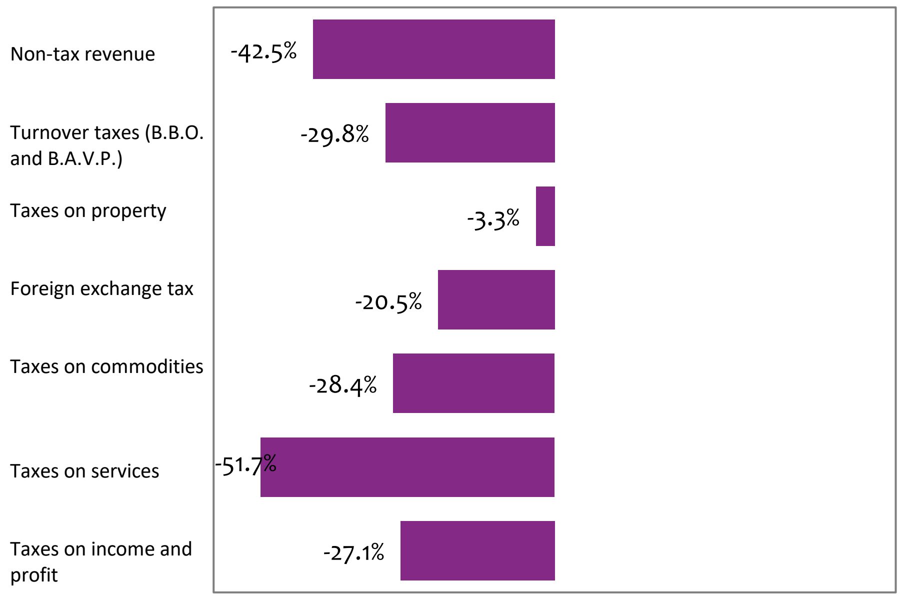
Financial soundness indicators remained adequate throughout the first three quarters of 2020. The capital adequacy ratio inched up by 1.0 percentage point to 32.0 percent at the end of September 2020, remaining well above the required 14.0 percent. Furthermore, the commercial banks' aggregated prudential liquidity ratio (PLR) reached 31.3 percent (minimum required PLR: 15.0 percent), increasing by 2.0 percentage points from end-2019. The widening in both indicators reflects in part the CBA's lowering of the reserve requirement and the minimum required PLR in response to the COVID-19 pandemic. After declining in the first quarter of 2020, nonperforming loans started increasing in the second quarter, reaching 4.1 percent at the end of the third quarter (end-2019: 3.2 percent). Nonetheless, it is likely that the moratorium on loan repayments, which was introduced by commercial banks in March 2020, prevented a larger increase in the NPL ratio. The commercial banking sector recorded negative earnings and profitability during the second quarter and third quarters of 2020, after having turned positive during the first quarter. Return on assets (before taxes) declined by 0.1 percentage point to -0.2 percent, down from -0.1 percent at the end of 2019.

Government

The government's financial situation deteriorated during the first nine months of 2020 compared to the same period of 2019, revealing the profound impact of the COVID-19 pandemic. The financial deficit of the GoA amounted to Afl. 203.0 million during the third quarter of 2020, in comparison to Afl. 38.8 million a year earlier. The financial deficit recorded a substantial jump at the onset of the COVID-19 pandemic in Aruba, moving from Afl. 29.1 million in the first quarter of 2020 to Afl. 301.1 million in the second quarter of 2020. After reaching the largest deficit since the fourth quarter of 2014, the deficit contracted by Afl. 98.1 million in the third quarter of 2020. This contraction was mostly the result of an Afl. 82.4 million decrease in total expenditure, while total revenue rose by Afl. 25.8 million. The significant decline in expenditure was caused in large part by reductions in transfers and subsidies as well as transfers to the General Health Insurance (AZV).

The deterioration of the government's financial situation was attributed to an Afl. 301.2 million contraction in total government revenue (-28.8 percent) and an expansion of Afl. 210.8 million (+19.9 percent) in government expenditure by end-September 2020. The decrease in total revenue was the result of declines in all tax categories as well as in non-tax revenue (Chart 15). In absolute terms, taxes on income and profit registered the largest downturn (-27.1 percent), while most other categories noted double-digit reductions: taxes on commodities (-28.4 percent), turnover tax (-29.8 percent), taxes on services (-51.7 percent), foreign exchange tax (-20.5 percent), taxes on property (-3.3 percent), and non-tax revenue (-42.5 percent). The COVID-19 crisis affected the provision of tourism-related services, which was practically at a standstill in the second quarter of 2020. As a consequence, revenue from taxes on services took a major hit. In addition, the 'shelter in place' measures added further downward pressure on economic activity on the island, lowering revenue from the profit tax, the wage tax, and the turnover tax. The measures taken by the CBA to restrict the outflow of capital further negatively affected revenue from the foreign exchange tax.

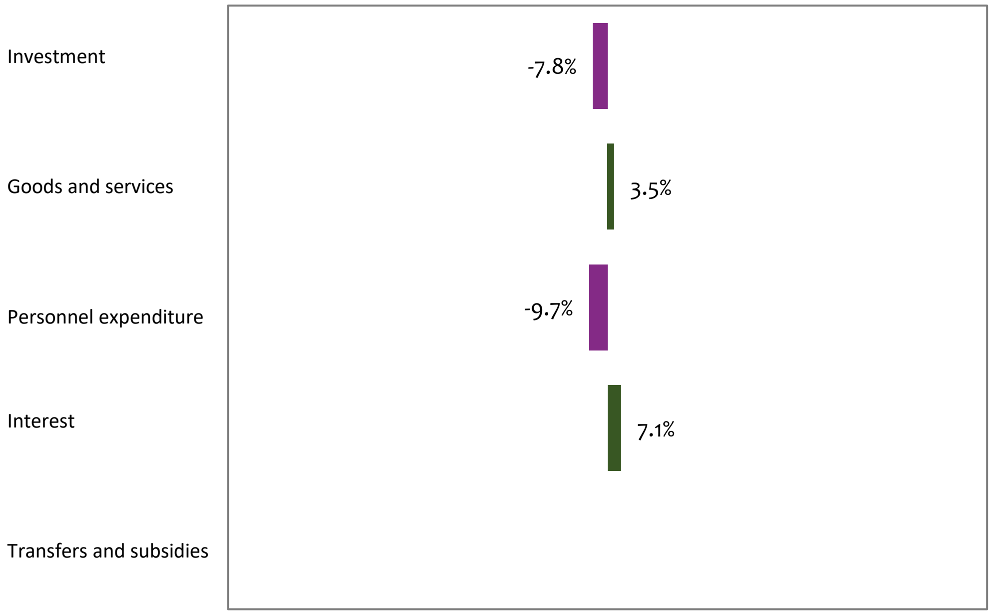
Chart 15: Government revenue
(Percentage change YTD September 2020 vs. YTD September 2019)



Source: Tax Collector's Office

As noted above, government expenditure (on a cash basis) increased by Afl. 210.8 million (+19.9 percent) during the first three quarters of 2020 compared to the same period of the previous year. The growth in government expenditure resulted largely from expenditures related to the COVID-19 pandemic. The first three quarters of 2020 registered higher transfers and subsidies (+127.1 percent), interest expenditures (+7.1 percent), and goods and services (+3.5 percent) (Chart 16). Furthermore, for the first time since 2018, the GoA made transfers to AZV in the amount of Afl. 30.2 million during the period under review to compensate for the loss of premium income, lower BAZV revenue, as well as additional health costs resulting from the COVID-19 pandemic. The above-mentioned expansions in government expenditure components were partly mitigated by contractions in personnel expenses (-9.7 percent) and investment (-7.8 percent). Personnel expenses registered a downturn due mostly to the 12.6 percent cut in wages of civil servants as of May 1, 2020, while investments were limited due to the GoA's liquidity constraints.

Chart 16: Government expenditure
(Percentage change YTD September 2020 vs. YTD September 2019)



Source: Tax Collector's Office

Total government debt surged by Afl. 660.5 million (+15.3 percent) in the third quarter of 2020, compared to the same quarter of the previous year. During the period under review, foreign debt rose by Afl. 390.8 million (+17.0 percent) while domestic debt expanded by Afl. 269.7 million (+13.4 percent). The surge in foreign government debt is due mainly to the liquidity loan received from the Netherlands as a consequence of the COVID-19 crisis. The share of domestic debt (46.0 percent) and foreign debt (54.0 percent) in total government debt, however, remained fairly constant.

II. International developments

In its January 2021 Economic Outlook, the IMF anticipated global economic growth of 5.5 percent in 2021 and 4.2 percent in 2022 after an estimated 3.5 percent contraction in 2020[6] **(Table 4).** The estimate for 2020 was a 0.9 percentage point upward revision from the October World Economic Outlook (WEO) forecast due to the stronger-than-expected recovery on average across regions in the second half of 2020. The growth projection for 2021 was revised up by 0.3 percentage point, reflecting additional policy support in some large economies and expectations of a vaccine-driven strengthening of activity later in the year, which offset the drag on near-term momentum resulting from rising infections, renewed lockdowns, and logistical problems with vaccine distribution. The higher growth projection is particularly predicated on the advanced economies and the additional fiscal support along with expectations of earlier widespread vaccine availability relative to emerging markets and developing economies.

Table 4: Projections for the world economy and selected economies (Real GDP growth, in percent)

	2020e	2021f	2022f
World	-3.5	5.5	4.2
United States	-3.4	5.1	2.5
Euro Area	-7.2	4.2	3.6
Latin America and the Caribbean	-7.4	4.1	2.9

Source: IMF

e = estimate ; f = forecast

The strength of the projected recovery differs across countries. The projections depend on the severity of the health crisis, the extent of domestic disruptions to activity (with larger disruptions in economies with a greater reliance on contact-intensive sectors), the exposure to cross-border spillovers, and the effectiveness of policy support to limit persistent damage.

[6] IMF, World Economic Outlook, January 2021.

Advanced economies, in general, were able to provide ample support to households and firms, and central banks reinforced this with expanded asset purchase programs, funding-for-lending facilities, and, for some, interest rate cuts. Because of the strong policy support and the anticipated widespread availability of vaccines in summer 2021, the projected output loss compared to the pre-COVID forecasts is relatively smaller for advanced economies than for other countries. Within the advanced economies group, recovery paths vary. The United States and Japan are projected to rebound to end-2019 activity levels in the second half of 2021, while activity in the euro area and the United Kingdom is expected to remain below end-2019 levels into 2022.

Emerging markets and developing economies also are projected to experience diverging recovery paths. Recovery in China, where effective containment measures, a forceful public investment response, and central bank liquidity support facilitated a strong rebound, is expected to differ considerably from other economies. Oil exporters and tourism-based economies within the group face particularly difficult prospects considering the expected slow normalization of international travel and the subdued outlook for oil prices.

While employment in some countries generally appeared to have recovered relatively quickly compared to previous recessions, a large number of people remain unemployed and underemployed in many countries. Moreover, the burden of the crisis fell unevenly across groups: workers with less education, women, youth, those in contact-intensive sectors, and those informally employed suffered disproportionate livelihood and income losses. As country-specific labor market circumstances vary, so does the degree of scarring. Economies dependent on contact-intensive industries, commodity exporters, and those where school closures have inflicted large setbacks to human capital accumulation are especially exposed to persistent damages to supply potential.

The global projection is surrounded by exceptional uncertainty. Although new restrictions due to the surge in infections (particularly in Europe) indicate growth could be weaker than projected in early 2021, other factors pull the distribution of risks in the opposite direction. These factors include further favorable news on vaccine manufacture, distribution, effectiveness of therapies, and more fiscal policy support with favorable spillover effects for trading partners. Meanwhile, downside risks include difficulties containing the virus surge, rapidly mounting infections and deaths before the vaccine is widely available, persistent voluntary distancing and lockdowns, and slower than expected progress on medical interventions (vaccine roll-out delays and widespread hesitancy). Moreover, intensifying social unrest and premature withdrawal of policy support could further complicate the recovery. Beyond the pandemic, the agreement reached in December 2020 on the terms of the United Kingdom's exit from the European Union has eliminated a key downside risk.

III. Conclusion

The Aruban economy experienced an initial, albeit marginal, rebound in the third quarter vis-à-vis the second quarter, yet economic conditions remained anemic. This slight rebound ensued from the lingering COVID-19 pandemic, reflected by a plunge in tourism credits and hotel occupancy rates, despite the reopening of the Aruban border to its main markets. In addition, consumption and investment indicators were denotive of adverse economic conditions during the first three quarters of 2020, echoing lackluster economic conditions despite government financial support and social assistance. Similarly, import activities faced a slowdown across all categories. The slowdown in consumption can be linked to the concern and uncertainty generated by the COVID-19 pandemic, with consumer concerns manifested predominately in the spheres of job security, government financial position, and economic conditions.

The 12-month average CPI inflation maintained its declining path that started in November 2019 which gained momentum after February 2020, inching down to 0.4 percent at the end of September 2020. The deceleration in the inflation rate was due mainly to the energy component, which pushed inflation down by -0.9 percentage point in September 2020, the strongest deflationary pressure to date in 2020. This deceleration resulted from the reduction in the electricity tariff in January 2020 as well as the lower price for gasoline. Moreover, smaller contributions from the food and communication components, as well as the winding down of the impact of the BAVP introduction in July 2018, were conducive to the declining path of the inflation rate.

Aruba's trade balance incurred an Afl. 1,165.2 million deficit in the first 9 months of 2020, representing a 24.6 percent improvement compared to the same period of 2019. The narrower trade deficit ensued from an Afl. 401.8 million (24.9 percent) contraction in imports, owing essentially to the impact of the COVID-19 pandemic and that of related containment measures on economic activity. However, the export of goods also decreased by Afl. 21.6 million, thus partially mitigating the decline in imports.

The current account of the balance of payments reached a deficit of Afl. 420.5 million in the first three quarters of 2020. The observed deficit was mostly the result of shortages recorded in the second and third quarters of 2020, i.e., Afl. 324.7 million and Afl. 334.6 million, respectively. These were the largest deficits recorded since the first quarter of 2011 (Afl. 470.8million). When compared to the same period in 2019, the deficit in 2020 shows a sharp deterioration of Afl. 628.1 million. This deterioration was triggered mostly by a much smaller surplus on the services account resulting from the contraction in tourism services (-Afl. 1,347.2 million) following the COVID-19 travel restrictions.

The financial account resulted in a net borrowing of Afl. 436.8 million during the first three quarters of 2020 compared to a net lending of Afl. 202.7 million a year earlier. In the second and third quarters of 2020, the net borrowing on the financial account reached its highest peak recorded since the first quarter of 2012 (Afl. 414.0 million). The outcome on the financial account was related mostly to inflows from portfolio investment (Afl. 301.7 million), other investments (-Afl. 310.2 million), and direct investment (-Afl.149.0 million). In general, the inflows on the portfolio investment and other investment accounts were associated largely with incoming liquidity support from the Netherlands and foreign loans received by the GoA.

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