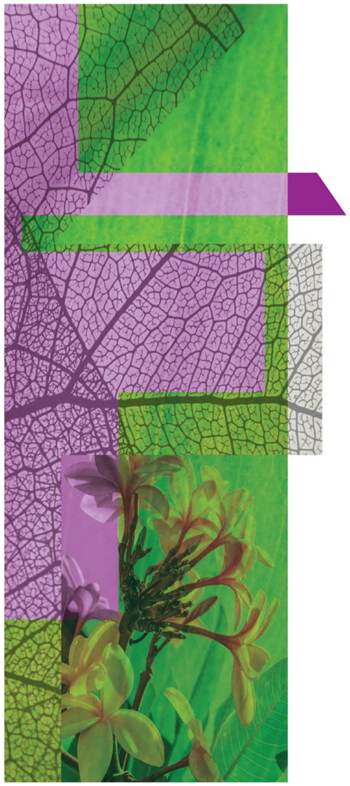

Centrale Bank van Aruba

STATE OF THE ECONOMY

First two quarters of 2020

ABSTRACT

In the first half of 2020, Aruba's economy was severely distressed due to the COVID-19 pandemic. This was reflected in a steep drop in tourism credits and hotel occupancy rates. In addition, despite financial support and social assistance of the government, both consumption and investment indicators pointed to anemic economic conditions during the first two quarters of 2020. Likewise, import activities withered across all categories. Initial estimates of quarterly GDP growth indicate a contraction of, respectively, 4.9 percent and 34.6 percent during the first and second quarter of 2020.

Centrale Bank van Aruba

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I. Domestic developments[1]

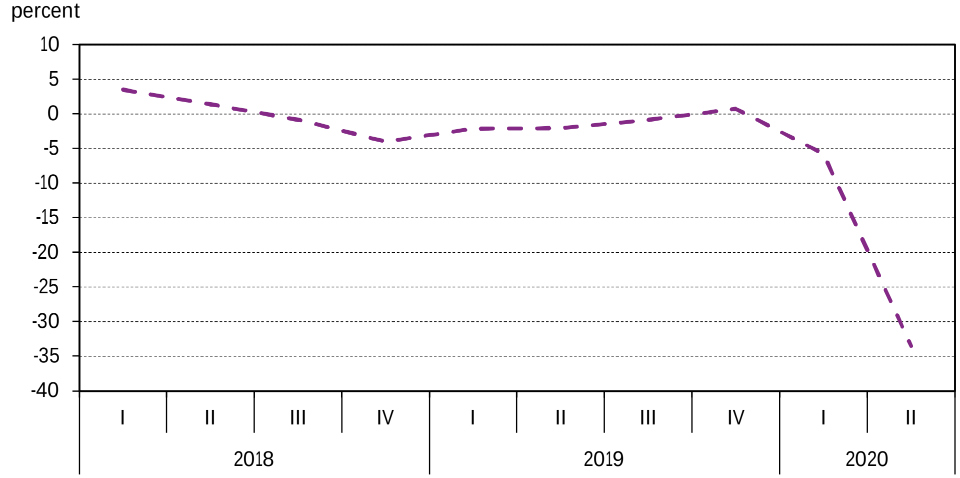
Economic growth

The Aruban economy experienced an unprecedented economic shock during the first half of 2020. Available data and indicators point towards a significant contraction of the Aruban economy during the first two quarters of 2020. This development was mainly driven by a severe drop in tourism income resulting from the impact of the COVID-19 pandemic and the subsequent policy measures to 'lock down' the economy. The latter was in addition to a forerunning trend of softening tourist nights spent on the island during the first two months of the year. Despite financial support and social assistance of the government, both consumption and investment indicators reflected anemic economic conditions during the first two quarters of 2020. Likewise, import activities contracted across all categories. Initial estimates of quarterly GDP growth indicate a drop of, respectively, 4.9 percent and 34.6 percent during the first and second quarter of 2020[2] (Chart 1) .

[1] The cut-off date for information published in this State of the Economy is October 23, 2020.

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

Chart 1: Quarterly Real GDP growth year-over-year



Calculations: CBA

Box 1: Quarterly GDP growth across the Caribbean

Compared to other countries in the Caribbean, Aruba's economy was more adversely affected by the impact of the COVID-19 pandemic. Whereas Aruba's real GDP fell by 19.8 percent in the first half of 2020 (excluding June), Barbados and Belize experienced GDP declines of, respectively, 14.9 and 14.7 percent (Central Bank of Barbados, 2020[3]; Central Bank of Belize,

[3] Central Bank of Barbados (August 2020). Quarterly Economic Review: January – June 2020

2020[4]). The economy of Jamaica was also hit hard, although relatively less so than others, considering the estimated GDP drop of between 8.2 and 9.7 percent (Bank of Jamaica, 2020[5]) . The driving forces behind Aruba's higher GDP vulnerability to the pandemic are greater tourism dependency and trade openness (Table 2), already emphasized in Fostering Economic Resilience: From Roots to Routes (Central Bank of Aruba, 2019).

Table 1: Vulnerability indicators for a selected group of Caribbean states in 2019

	Aruba	Barbados	Belize	Jamaica
Real GDP growth*	-19.6	-14.9	-14.7	-8.2;-9.7
Trade openness (import and export as % of GDP)	149.6	83.7	115.7	89.0
Tourism credits as % of GDP	63.1	24.9	36.6	22.1
Share of tourism employment in total employment (%)	84.3	30.9	39.3	32.8

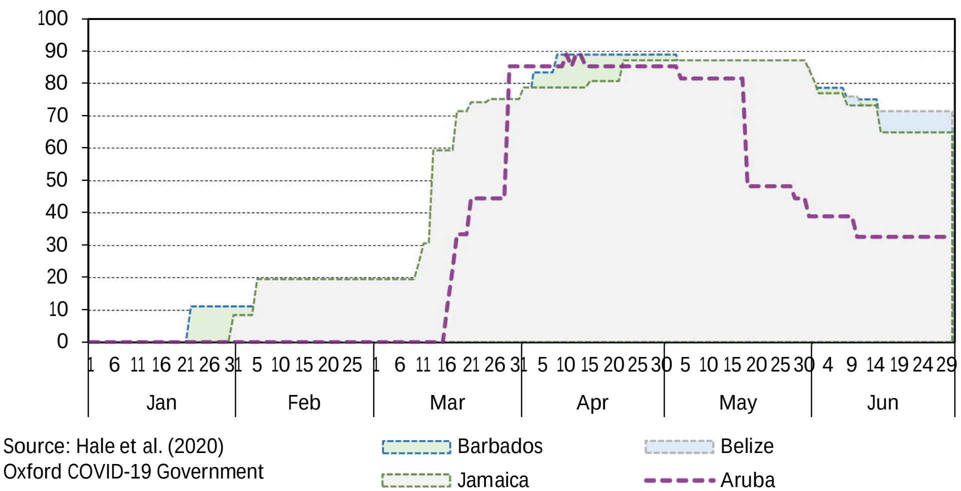
Sources: World Bank (2020), World Travel & Tourism Council (2020) and the Central Bank of Aruba, Barbados, Belize and Jamaica
*GDP growth figures are for first half of 2020.

In the context of COVID-19 responses by the government, the higher vulnerability of Aruba is highlighted by the impact of the lockdown on the tourism industry and tourism foreign exchange earnings. In this regard, the Stringency Index can be utilized to measure the extent of COVID-19 government responses[6]. Given that this index measures the degree of restrictions

[4] Central Bank of Belize (October 2020). Quarterly Review – June 2020
[5] Bank of Jamaica (August 2020). Quarterly Monetary Policy Report: April to June 2020
[6] The Stringency Index is a weighted average of 9 sub-indices for different government responses, ranging from 0-100. These sub-indices include among others, restrictions on gatherings and international travel. The weight of each sub-index is proportional to its ordinal scale and extra weight is given to a sub-index if its associated government response had a general reach, instead of a targeted group.

imposed by the government that hamper economic activity, a higher index indicates more constraints imposed on the economy. For the period under review, this index reveals three stages (Chart 2). First, Aruba lagged behind its peers before the 16th of March, then converging between the 2nd half March and May, and thereafter loosening policies sooner and to a larger degree than the other countries.

Chart 2: Stringency Index for a selected group of Carribean states



Source: Hale et al. (2020)
Oxford COVID-19 Government

The first stage primarily reflects Aruba imposing international travel restrictions later than its peers, even though, in general, they reported the first COVID-19 case later than Aruba. The second stage is characterized by the Caribbean states having international travel restrictions in place and most of them instilling stay at home requirements. The third stage results from Aruba lifting the ban on gatherings and removing the shelter in place on the 28th of May. From the quarterly GDP estimates and the development in the stringency indices, it can be concluded that Aruba's economy was more distressed than other Caribbean countries, despite taking stringent policies later and loosening earlier in the second half of 2020. This outcome mainly mirrors the much larger tourism dependency of the Aruban economy relative to other Caribbean economies.

Tourism

Aruba's tourism sector performance deteriorated in the first half of 2020. Total visitor nights (-59.0 percent) as well as total stay-over visitors (-60.3 percent), and tourism credits at domestic banks (-40.2 percent) registered severe downturns compared to the same period of the previous year (Table 1). This development resulted from a contraction in all markets, mostly due to the March 17, 2020 border closure, associated with measures taken by the Aruban government to contain the spread of COVID-19. In the first quarter of 2020, a decline in tourism sector activity could already be noted, as the number of total visitor nights (-23.4 percent) and total stay-over visitors (-22.2 percent) decreased compared to the same period of the previous year. The initial decline in visitor nights started in the third quarter (2019) with the drop in stay-over visitors following in the next quarter (2019). Aruba's tourism performance was benefitting from tourists seeking alternative holiday destinations after hurricanes Irma and Maria hit the Caribbean in 2017, but started facing increased competition in 2019, following the restoration of tourism services in other Caribbean destinations. During the first quarter of 2020, there was a contraction in the number of visitors from all markets (Latin America: -48.6 percent, Europe: -23.8 percent, and North America: -18.7 percent). During the second quarter of 2020, there was no tourism sector activity, given that borders were closed and travel restrictions were partly lifted only as of July 2020.

Table 2: Tourism indicators for Aruba
(YTD June vs. YTD June a year prior)

	2019	2020
Stay-over visitors (growth)	6.5	-60.3
excl. Venezuela	5.1	-59.9
Average length of stay (days)	7.3	7.5
Cruise visitors (growth)	-8.2	-41.3
Hotel occupancy (%)	85.9	35.5
Average daily rate (US$)	300	358
Revenue per available room (RevPAR) (US$)	258	126
Tourism credits (growth)	5.2	-39.9

Sources: ATA, AHATA, APA, CTO, STR

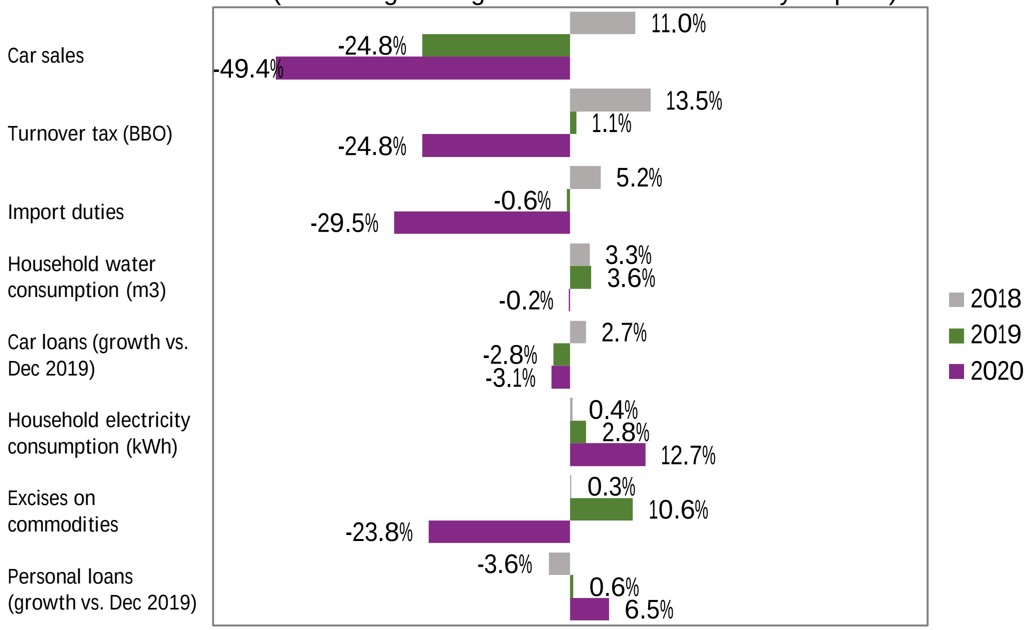
Data published by the Aruba Hotel and Tourism Association (AHATA) revealed a slowdown in the hotel sector, as the impact of the COVID-19 pandemic on the traveling industry unraveled. Following the border closure on March 17, 2020, revenue per available room (RevPar) for the first half of 2020 contracted by 51.0 percent, and average room occupancy rate declined by 50.6 percentage points to 35.3 percent, compared to the same period of the previous year. The average daily room rate (ADR), on the other hand, increased by 19.1 percent. For the first quarter of 2020, revenue per available room (RevPar) fell by 19.3 percent, and average room occupancy rate declined by 18.9 percentage points to 71.2 percent, compared to the same period of the previous year. During this period, the average daily room rate (ADR) inched up by 2.0 percent. Both the RevPar and the ADR rose throughout the year 2019, while the average occupancy rate varied between expansions and contractions. As of January 2020, however, RevPar and average occupancy rates registered decreases, which were amplified as of March 2020 with the border closure to contain the COVID-19 spread. ADR growth, in turn, was positive for the first two months of 2020 but also turned negative as of March 2020 till May 2020, after which ADR picked up again.

In the first half of 2020, a total of 98 cruise ships made harbor calls. This amounted to 69 fewer ship calls (-41.3 percent) compared to the first half of 2019. The total number of cruise passengers also dwindled, i.e., from 435,112 in the first half of 2019 to 255,384 in the first half of 2020 (-41.3 percent). The developments in cruise tourism for the first six months of 2020 mainly reflect the March 14, 2020 'no sail order' issued by the U.S. Centers for Disease Control, as well as the March 17, 2020 border closure as a result of the COVID-19 pandemic. As such, all cruise activity for 2020, thus far, pertain to the first three months of the year. The 98 cruise ships that made harbor calls in the first quarter of 2020 amounted to 20 fewer ship calls (-16.9 percent) compared to the first quarter of 2019. The total number of cruise passengers during the first quarter of the year also decreased, i.e., by 12.8 percent to 255,384, compared to the first quarter of 2019.

Consumption

The consumption indicators pointed to a significant contraction for the first half of 2020. Tax Department data showed sharp reductions in import duties (-29.5 percent), turnover tax (BBO) (-24.8 percent), and excises on commodities (-23.8 percent), as merchandise imports dropped by 23.6 percent during the period under review, with all categories registering downturns (Chart 3).

Chart 3: Consumption-related indicators
(Percentage change YTD June vs. YTD June a year prior)



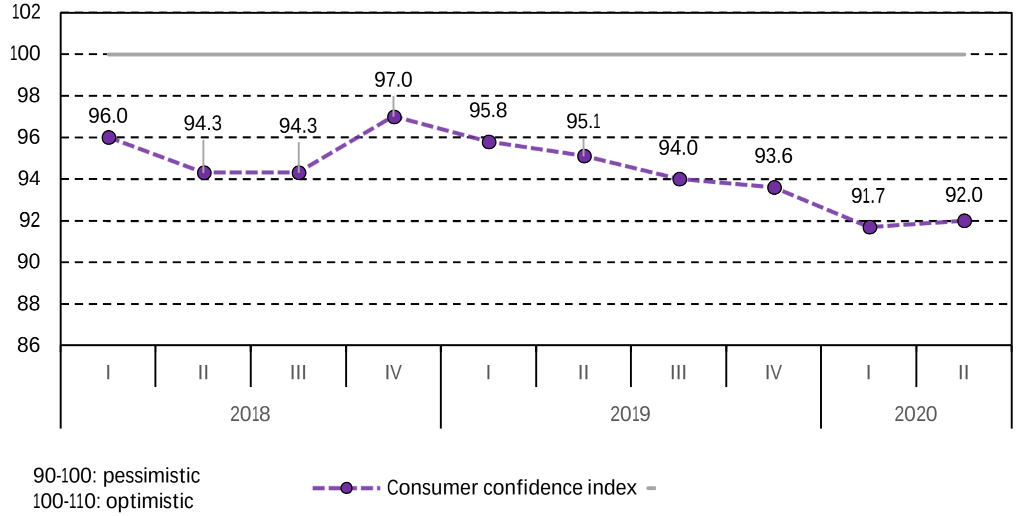
Sources: CBA, WEB, Tax Collector's Office

During the first quarter of the year, revenue from import duties (-8.3 percent) and excises on commodities (-5.7 percent) already noted declines, while that of the turnover tax remained stable. These developments were amplified in the second quarter of 2020, as the impact of measures to contain COVID-19 unfolded, further dampening economic activity and consumption.

During the second quarter of 2020, merchandise imports registered a downturn of 42.9 percent, with the most notable decrease in the category food. The latter was likely related to the fall-off in tourism demand as a result of the border closure. In addition, available data show car sales incurred a steep contraction of 49.4 percent in the numbers of cars sold in the first six months of the year, compared to the same period of 2019. While car sales dropped by 25.7 percent in the first quarter of 2020, a sharper decline of 75.5 percent was observed during the second quarter of 2020. These developments are similar to the developments in the first two quarters of 2019, where the first quarter registered a decline of 4.0 percent, while the second quarter noted a downturn of 39.3 percent.

The larger scale of these negative developments in 2020 corroborate consumer confidence reports of the second quarter attesting significant pessimism (index =92.0) and postponement of large purchases by consumers brought about by the COVID-19 pandemic, even though consumer confidence was slightly less negative during the second quarter of 2020 with the forthcoming lift on border closures (Chart 4). According to data on utilities, household electricity consumption (kWh) increased (+12.7 percent), while water usage (m^3) edged down by 0.2 percent in the first half of the year, compared to the first half of 2019 (Chart 4).

Chart 3: Consumer Confidence Index



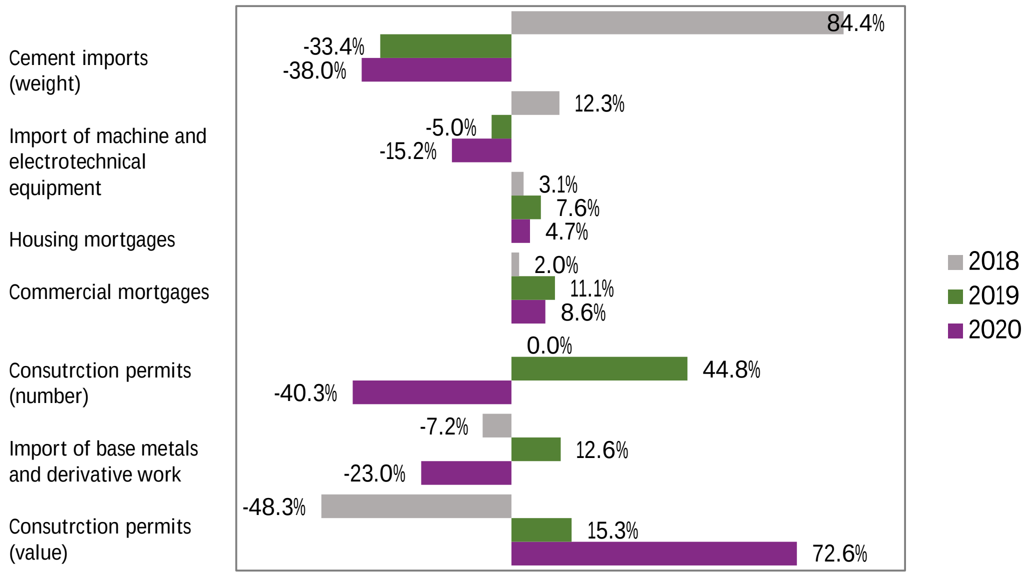
In the first quarter of 2020, electricity consumption jumped by 20.8 percent, while water consumption contracted by 6.0 percent. In the second quarter of the year both electricity and water consumption experienced similar increases, namely 5.9 percent, and 5.6 percent, respectively. Historically, electricity consumption – particularly, residential electricity consumption – increases when electricity tariffs are reduced. The reduction of almost 4 cent per kWh as of January 2020 likely lead to a spike in electricity consumption in the first quarter of the year, which slowed down after March 2020, despite more people working from home once measures were implemented to prevent COVID-19 from spreading. With regard to revenue for excises on gasoline, a reduction of 15.4 percent was registered in the first six months of the year, compared to the same period of the previous year. During the first quarter, these excises went up by 3.3 percent, while a reduction of 34.1 percent was reported in the second quarter of the year, given the slowdown in demand due to the shelter in place measures. It should be noted, however, that excises are paid when gasoline is imported, and not when it is sold.

Bank credit figures also revealed sluggish consumption as consumer credit edged down by 0.2 percent in June 2020, compared to December 2019. The lower level of consumer credit, which has been following a decreasing trend in recent years, resulted from contractions in car loans (-3.1 percent), and credit cards (-2.7 percent), that were almost completely mitigated by an upturn in personal loans (+6.5 percent). In addition, consumer credit data from the nonmonetary financial institutions recorded a 6.5 percent abatement. In the first quarter of 2020, consumer credit was also relatively stable, inching up by 0.2 percent in March 2020, compared to December 2019. During that period, consumer credit was mainly driven by expansions in both personal loans (+1.8 percent) and credit cards (+1.6 percent), which in turn were offset for a large part by a decline in car loans (-2.0 percent). In the first quarter of the year, consumer credit by the nonmonetary financial institutions recorded a downturn of 0.8 percent.

Investment

Developments up to June 2020 suggest that investment activities weakened during the first two quarters of 2020. The scale of relatively large construction projects, i.e., the Dr. Horacio Oduber Hospital and the Watty Vos Boulevard, was substantially smaller in the first two quarters of 2020, compared to the first two quarters of 2019. In addition, there were no new large scale projects commencing in the period under review, partly due to the uncertainty brought about by the COVID-19 pandemic. The 'shelter in place' to contain the spread of COVID-19 in the second quarter of 2020 further contributed to the dip, as all ongoing construction projects were put on a stand-still for a period of 3 months. The above-mentioned developments are reflected in various investment indicators (Chart 2).

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

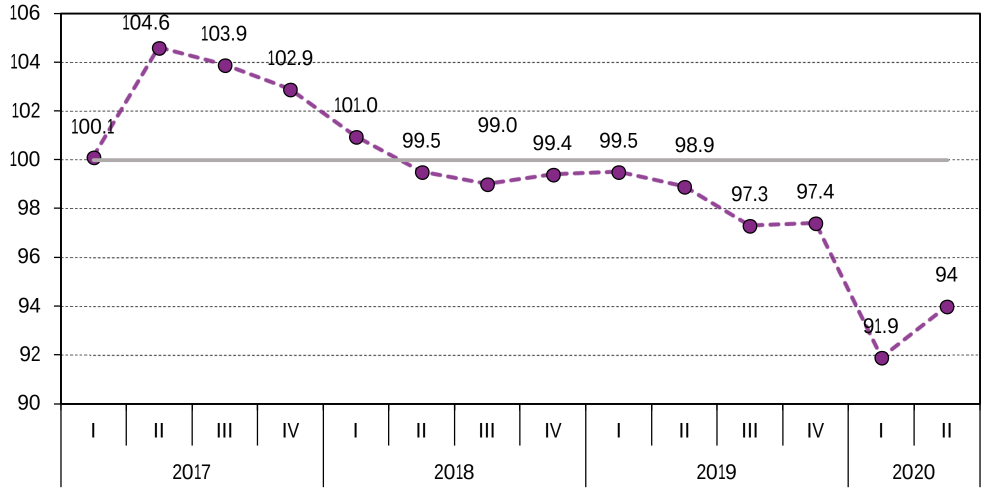


Sources: CBA, CBS, DOW

Import data, for instance, points to a contraction in investment. The amount of cement imported declined by 38.0 percent in the first half of the year, following a 32.3 percent drop in the first quarter of 2020, and a 44.4 percent downsizing in the second quarter of the year. The developments in cement imports in the period under review follow the declining trend evident in the first three quarters of the previous year. Furthermore, imports of machinery and electrotechnical equipment, as well as base metals and derivated works registered reductions of 15.2 percent, and 23.0 percent, respectively. While the import of machinery and electrotechnical equipment registered downturns in both the first and the second quarter (-8.69 percent and -22.4 percent, respectively), the import of base metals and derivated works noted an increase of 10.8 percent in the first quarter of the year, prior to dwindling by 51.1 percent in the following quarter. The downturns in the second quarter of 2020, most probably reflect the approximately 3 months 'shelter in place' period, which among others, halted construction activities. Meanwhile, indicators from the monetary sector indicated growth, as commercial mortgages (+3.7 percent) and housing mortgages (+2.0 percent) strengthened in the second quarter of the year, compared to +0.5 percent and +0.6 percent, respectively, in the previous quarter. It should be noted, however, that housing mortgages have been steadily increasing albeit at a diminishing rate since 2019. In addition, there was an easing in the terms and conditions for obtaining finance, as the interest rates on commercial mortgages (-0.6 percentage point) and housing mortgages (-0.3 percentage point) were lower compared to December 2019. Finally, construction permits data, which are leading indicators of construction activity, provide some insight on expected developments. The number of newly granted construction permits dipped by 40.3 percent in the first half of 2020, suggesting that there was significantly less construction activity planned. The total investment value related to those permits, nonetheless, was higher than of those granted in the first half of 2019 (+ 72.6 percent), mainly due to hotel sector projects. These developments were similar in both the first and the second quarter of 2020, with the number of newly granted construction permits decreasing by 35.7 percent and 45.3 percent, respectively. On the other hand the total value of newly granted construction permits jumped by 23.2 percent and 135.6 percent, respectively.

The business perception index[7] (BPI) moved up by 1.8 index points to 94.0 in the second quarter of 2020, revealing an initial improvement in business sentiments following the sharp drop registered (-5.5 index points) in the first quarter of the year.

Chart 5: Business Perception Index



90-100: pessimistic
100-110: optimistic

Business perception index

Source: CBA

[7] 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 with regard to their thoughts about economic developments in Aruba. Between 100 and 110 indicates a situation of optimism in business sentiments.

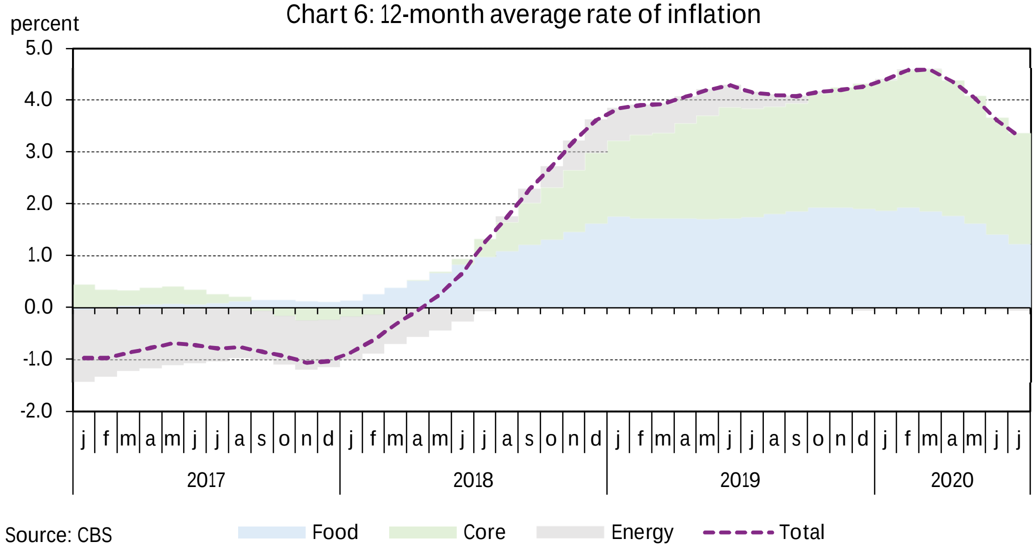
The change in sentiments was largely due to improvements in short-term future economic conditions, as Aruba lifted the shelter-in-place measure and re-opened the border for tourism activities. The number of surveyed businesses disclosing a worsening in investment conditions, however, registered an upturn of 17.0 percentage points. In addition, the majority of surveyed firms expected negative economic growth in the 12 months following the survey. The development in the BPI is contrary to that in the first quarter of the year, when the BPI continued on the pessimistic trend observed since the second quarter of 2018, reaching its lowest point since the inception of the survey (Chart 3). At the time, the BPI, comprising the current and short-term economic conditions, dropped by 5.5 index points to 91.9, compared to the previous quarter. During the first quarter, severe measures to prevent the spread of COVID-19 were implemented and both the short-term future economic condition index and the current economic condition index contracted, by 5.2 index points and 5.1 index points, respectively.

Consumer Price Index (CPI)

The 12-month average CPI inflation stood at 3.6 percent in June 2020, resulting from rising food prices and the increased price of recreation (Chart 7). Food prices contributed to the 12-month average inflation by 1.4 percentage points, mainly due to higher fruit prices. The continued closure of the border between Aruba and Venezuela limited access to relatively cheaper fruits and vegetables, and transportation costs increased as substitutes were shipped over larger distances. Furthermore, as of January 1, 2020 all ships were required to comply with the International Maritime Organizations' (IMO) lower limit for sulfur in fuel oil used on ships. The IMO's regulation added additional upward pressure on transportation costs, given the relatively more expensive price for low sulfur fuel oil. The increase in the recreation and culture component (+1.3 percentage points) was mainly driven by prices for holiday-related transport. Other components that contributed positively to the 12-month average inflation were clothing and footwear (+0.2 percentage point), communication (+0.2 percentage point), education

(+0.2 percentage point), miscellaneous goods and services (+0.2 percentage point), non-alcoholic beverages (+0.1 percentage point), alcoholic beverages and tobacco (+0.1 percentage point), household operation (+0.1 percentage point), and health (+0.1 percentage point). The components housing (-0.2 percentage point) and transport (-0.2 percentage point), on the other hand, contributed negatively to the 12-month inflation rate. These developments in the CPI followed the peak of 4.6 percent in February 2020. The decrease in the

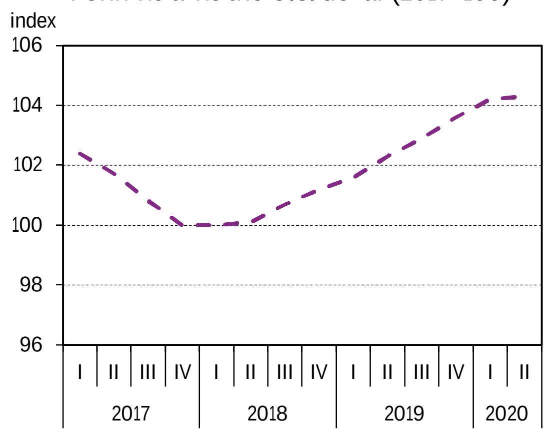
Chart 6: 12-month average rate of inflation



Source: CBS

rate of inflation was partly due to the winding down of the effect of the hike in the BBO (+1.5 percent) and BAZV (+1.0 percent) rates. In addition, the contribution of the food and gasoline components ebbed, which was partly offset by the increase in the recreation component, which was pushed up by higher prices for holiday-related transport. The end of period inflation, which provides a more actual view of developments in inflation, continued the declining trend that was initiated since reaching its peak of 5.5 percent in January 2020 and fell to -0.3 percent (compared to 4.8 percent in June 2019). This drop in the inflation rate was mainly caused by a reduction in the electricity tariff in January 2020, as well as the lower price for gasoline, which had an effect on the housing and transport components. The aforementioned reductions were largely offset by an increase in prices for recreation and culture. Core inflation (end of period) amounted to 1.9 percent in June 2020, the lowest level since August 2019. Compared to June 2019, this means a decrease of 0.7 percentage point. The 12-month average core inflation grew from 2.1 percent in June 2019, to 2.9 percent in June 2020, mainly due to elevated prices for holiday-related transport. The 12-month average core inflation has steadily risen since November 2017, and only edged down in June 2020 after peaking at 3.0 percent in May 2020.

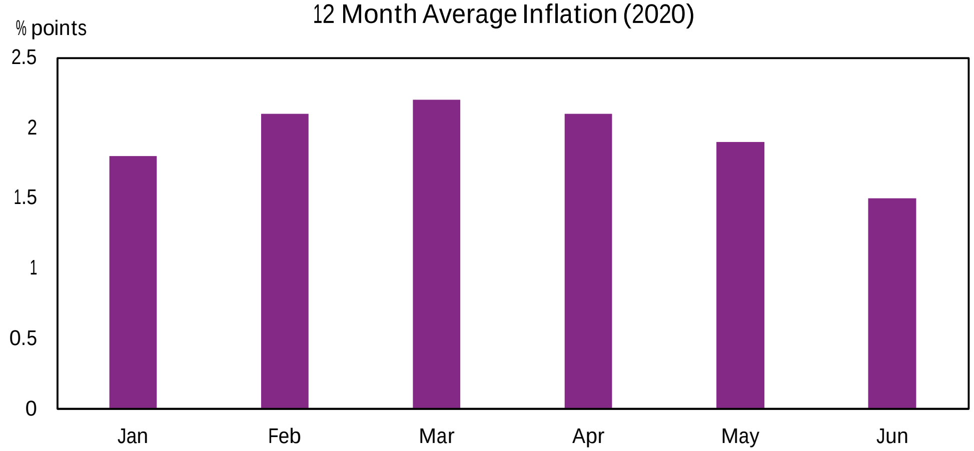
Chart 7: Real exchange rate Aruban florin vis-à-vis the U.S. dollar (2017=100)



Source: CBA

The real exchange rate of the florin vis-à-vis the U.S. dollar showed a persistent increase since the second quarter of 2018, yet was curtailed due to the aforementioned decline in the inflation rate (Chart 8). The constant increase suggested an ongoing deterioration in Aruba's competitive position relative to the United States. The rise in prices fueling this deterioration are partly the result of previous adjustments in fiscal policy, in particular, the upward rate adjustment of the BBO (+1.5 percent) and BAZV (+1.0 percent) as of July 1, 2018, as well as the increase in excise on distilled drinks (+44.0 percent), and higher import duties on distilled and fermented drinks as of January 1, 2019. The apparent deterioration, however, does not give cause for great concern as yet, as the Aruban florin is close to its fundamental implicit value against the U.S. dollar. The long-term difference in inflation between Aruba and the United States, measured on the basis of a twenty-year average, is almost nil, namely 0.3 percent. In addition, the monthly average inflation differential between the aforementioned countries has also fallen by 0.6 percentage point since April 2020 (Chart 6).

Chart 8: Inflation differential Aruba - USA:
12 Month Average Inflation (2020)

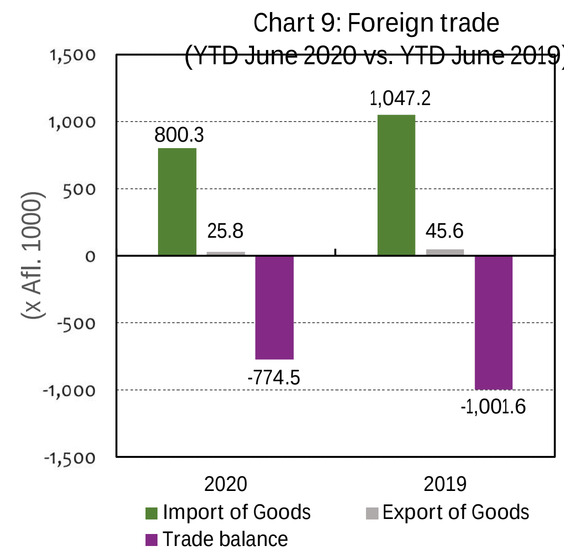


Calculations: CBA

Furthermore, the United States is also the largest source of income from tourism and other trade flows to Aruba. As such, a slight appreciation of the real exchange rate against other trading partners poses little risk to Aruba's competitiveness. Finally, recent market research shows that the average daily rate for hotel accommodations in Aruba is much lower compared to other similar tourist destinations in the Caribbean, namely U.S.$ 255 versus U.S.$ 470[8]. The latter, in particular, subsides concerns about reduced competitiveness.

Foreign Trade

Aruba's trade deficit amounted to Afl. 774.5 million in the first 6 months of 2020, a 22.7 percent improvement compared to the same period of the previous year (Chart 10). The smaller trade deficit resulted from an Afl. 246.9 million (-23.6 percent) reduction in imports and an Afl. 19.8 million (-43.4 percent) contraction in the export of goods. The registered downturns were mainly caused by Aruba's largest trading partner, the United States, with an Afl. 147.6 million (-24.7 percent) decrease in imports and an Afl. 11.9 million (-47.5 percent) decline in exports.



Source: CBS

In the first quarter of 2020, the trade deficit amounted to Afl. 482.5 million, which entailed a 3.4 percent fall-off compared to the first quarter of 2019. This reduction marked the first abatement in the trade deficit since the second quarter of 2019. This development was the result of an Afl. 19.5 million (-3.8 percent) drop in imports, while exports decreased by Afl. 2.6 million (-14.5 percent). It was not until the second quarter of 2020when the impact of the COVID-19 pandemic and related lockdown measures were observed, that an improvement in the trade deficit was noted (Afl. 292.0

[8] Caribbean Lodging Performance (July, 2020); STR (August, 2020).

Table 2: Balance of payments (in Afl. Million)

	2019Q1-Q2	2020Q1-Q2
Current account	250.7	-83.1
Goods	-930.7	-710.4
Services	1,364.6	739.0
Primary income	-112.3	-68.6
Secondary income	-71.0	-43.1
Financial account	250.3	-106.4
Direct investment	176.2	-104.2
Portfolio investment	-18.4	-131.8
Financial derivatives	-4.6	6.9
Other investment	69.5	-205.3
Reserve assets	27.6	328.1

Source: CBA

million). Compared to the same period of the previous year, this encompassed a 41.9 percent decline in the trade deficit. During the second quarter of 2020, imports eased by Afl. 227.1 million (-42.9 percent), and exports tailed off by Afl. 17.2 million (-62.3 percent). The developments in merchandise trade reflected in part a plunge in economic activity and consumption due to 'shelter in place' measures aimed at stopping the spread of COVID-19.

Balance of Payments

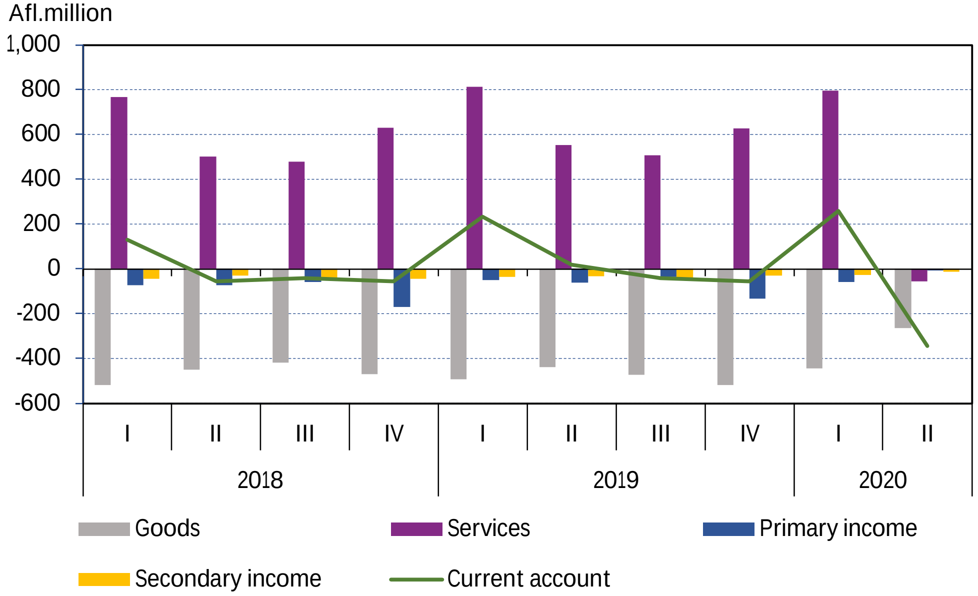
The current account of the balance of payments recorded an Afl. 83.1 million deficit in the first half of 2020. This was the first current account deficit registered since the third quarter of 2018. The year-to-date current account deficit represented a sharp drop-off of Afl. 333.7 million from a surplus of Afl. 250.6 in the first half of 2019 (Table 2; Chart 10). This contraction was mainly due to the surplus on the services account falling by Afl. 625.6 million, following the unprecedented plunge in tourism credits, related to the COVID-19 travel restrictions.

Specifically, tourism credits sunk to Afl. 1,174.0 million, which represents a cutback of Afl. 781.0 million (39.9 percent) in the period under review.

The smaller deficit on the goods account, which amounted to Afl. 710.4 million in the first half of 2020, mitigated the current account deficit, a drop of Afl. 220.3 million (23.7 percent) compared to the same period a year prior. The narrowing of the goods account deficit was principally related to the fall in imports by Afl. 236.2 million (22.6 percent), occurring especially in the second quarter of 2020. To put in recent perspective, second quarter imports plummeted by 48.1 percent relative to the average of 2018Q2 and 2019Q2. The import decline in the first half of 2020 stems from waning tourist - and local demand for goods as a result of the COVID-19 travel restrictions. Furthermore, the year-to-date primary income deficit tapered off compared to 2019, partially offsetting the current account deficit as well. The former reached Afl. 68.6 million in the first half of 2020, compared to 112.3 million a year earlier. The reduced outflow mainly reflected a decrease in outgoing payments related to direct investment income (Afl. 60.9 million; 93.3 percent) to non-residents[9] in the second quarter.

[9] Not to be confused with direct investment from the financial account, which records changes in financial ownership.

Chart 8: Current account of the balance of payments



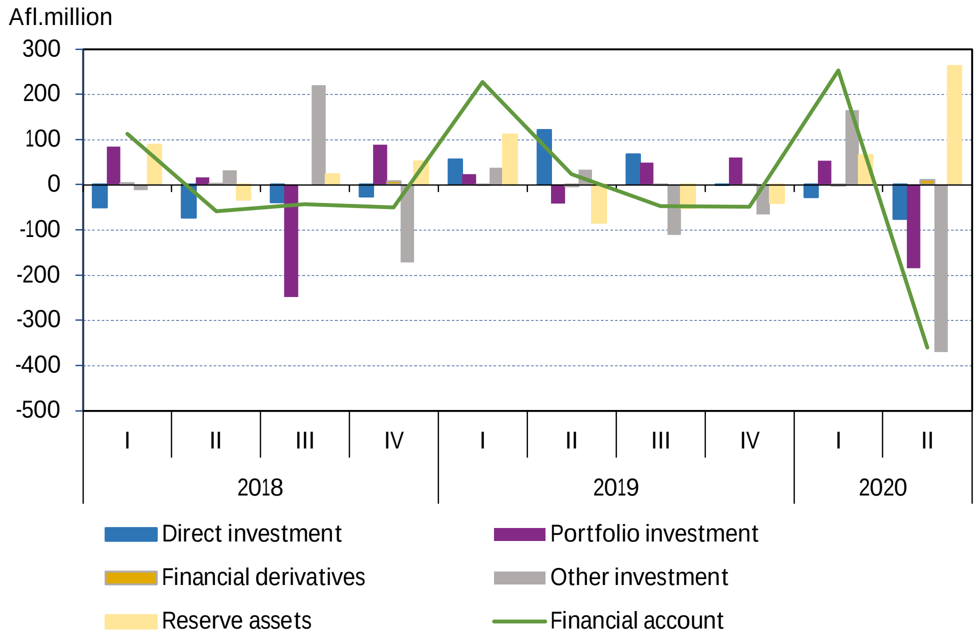
Source: CBA

The financial account resulted in a net borrowing of Afl. 106.4 million in the first half of 2020. The financial account outcome in the period under review was primarily due to a net inflow of Afl. 205.3 million on the other investment account. This net inflow was mainly related to the receipt of tranches of liquidity support from the Netherlands of, respectively, Afl. 92.2 million and Afl. 103.3 million. Moreover, in that same quarter, residents withdrew Afl. 178.6 million from their currency - and deposit accounts held abroad, outweighing the repayment by residents of Afl. 44.8 million in trade credit and advances to foreign third-parties. The net other investment inflow in the second quarter offset developments in the first quarter of 2020 when residents transferred Afl. 93.5 million to foreign accounts held abroad and non-residents withdrew Afl. 73.7 million from accounts held in Aruba.

A net inflow of Afl. 131.8 million on the portfolio investment account also contributed to the net borrowing on the financial account in the first half of 2020. This chiefly ensued from the inflow of the proceeds of government bonds issued in the second quarter (Afl. 213.8 million). In the first quarter however, portfolio investment recorded a net outflow of Afl. 53.5 million, primarily due to repayments by residents.

Additionally, direct investments recorded an Afl. 104.2 million net inflow. Direct investment inflows mostly stemmed from non-residents purchasing domestic equity capital (Afl. 60.0 million) and real-estate (Afl. 36.9 million) in the first half of 2020.

Chart 9: Financial account of the balance of payments



Source: CBA

In contrast to the record inflow in the second quarter of 2020 on the financial account relative to the last two years, outflows from CBA's reserve assets in the first half of 2020 largely subdued those inflows. In particular, outflows totaling Afl. 73.0 million associated with long-term debt securities held by the CBA in the first quarter. In the second quarter, net transfers to CBA's currency - and deposit accounts held abroad reached Afl. 252.5 million.

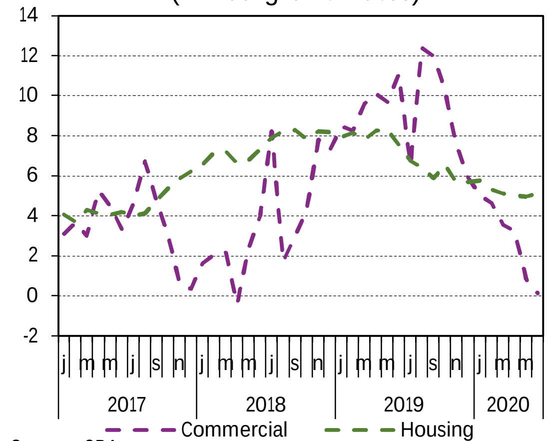
Monetary survey

Money supply stood at Afl. 4,761.5 million at the end of the second quarter of 2020, Afl. 192.7 million higher than end-2019. The expansion in money supply was ascribed to an Afl. 255.2 million increase in international reserves, which was partially offset by an Afl. 62.5 million decrease in net domestic assets. The higher international reserves (excluding revaluation differences) is attributed to revenue from tourism (Afl. 1,174 million), albeit at a much lower level than in previous years (first half 2019: Afl. 1,955.0 million). In addition, liquidity support received by the GOA from the Netherlands (Afl. 195.5 million) contributed to the inflow of foreign funds. Moreover, capital restrictions by the CBA and a sharp reduction in imports (-Afl. 780.7 million led to significantly less outflow of funds than in past years. International reserves remained above the benchmarks monitored by the Monetary Policy Committee (MPC) of the CBA. Additionally, at the end of June 2020, official reserves were in line with 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 reached a peak in the first quarter of 2020 before declining in the second quarter. The decrease in net domestic assets was related to a reduction in net claims on the public sector of Afl 55.2 million, which reflected the repayment of government bonds and an increase in government deposits. The drop in gross claims during the second quarter came after steadily strengthening since the second quarter of 2019.

Banking sector credit to the private sector expanded by Afl. 31.5 million in the first six months of 2020, compared to December 2019. This growth was primarily driven by an increase in housing mortgages, continuing its rising trend, albeit at a slower pace (Chart 10). Loans to enterprises grew slightly by Afl. 4.8 million. On the other hand, consumer credit edged down by Afl. 0.8 million, continuing its declining trend seen since 2015. Overall, housing mortgages (including other financial institutions) reached Afl. 2,005.0 million in the second quarter of 2020, up from Afl. 1979.3 million at the end of 2019. The share of commercial banks in housing mortgages stood at 71.3 percent at the end of the second quarter of 2020 compared to 70.9 percent at end-2019, continuing its upward trend observed since 2013. While the increase in housing mortgages at commercial banks was the main contributor to the overall growth in housing mortgages, a rise at mortgage banks (+Afl. 0.5 million), pension funds (+Afl. 0.2 million), and 'other' (+Afl. 0.4 million) also furthered the net-increase.

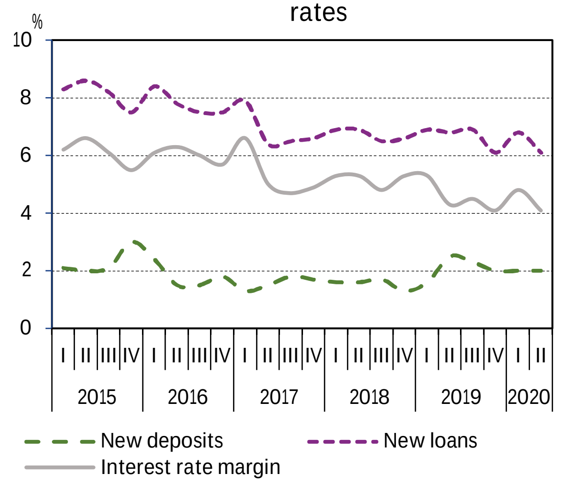
Chart 10: Mortgages from commerical banks (Annual growth rates)



Source: CBA

The aggregated balance sheet of the nonmonetary financial institution stood at Afl. 6,432.3 million in June 2020, an increase of Afl. 80.1 million compared to December 2019 despite a recorded decline in the first quarter. On the asset side, this expansion was mainly due to higher domestic claims (+Afl. 60 million) of non-financial public enterprises and other domestic claims (+Afl. 84.3 million). On the other hand, an Afl. 51.5 million decline in claims on the government, partially offset mentioned increases. On the liabilities side, the expansion was associated with hikes of Afl. 37.9 million in insurance reserve fund, Afl. 36.0 million in pension fund provision, and Afl. 10.6 million in other domestic liabilities compared to end-2019.

Chart 11: Weighted average interest rates



Source: CBA

The quarterly weighted average interest rate on new loans rose from 6.1 percent in the fourth quarter of 2019 to 6.8 percent in the first quarter of 2020, before falling back to 6.1 percent in the second quarter (Chart 11). Meanwhile, the quarterly-average interest on new deposits remained unchanged at 2.0 percent during the first two quarters of 2020. Consequently, the interest rate margin was unaltered at the end of the second quarter of 2020 at 4.1 percent, after initially climbing to 4.8 percent in the first quarter. After a large drop in 2017, the annual average interest rates on new loans were fairly stable, but recent quarters have seen larger fluctuations. Conversely, interest rates on new deposits had been gradually declining until the first quarter of 2019 and picked up again to 2.5 percent in the second quarter of 2019, before coming back down to 2.0 percent at end-2019, where it stayed during the first half of 2020. Consequently, the interest rate margin gradually declined in recent years.

Financial soundness indicators remained solid during the first half of 2020. The capital adequacy ratio marked up by 0.9 percentage point to 31.9 percent during the period under review, while commercial banks' aggregated prudential liquidity ratio (PLR) widened by 3.2 percentage points to 32.5 percent, in part reflecting the CBA's lowering of the reserve requirement and the minimum required PLR in response to the COVID-19 pandemic. Both indicators hung well above the respective minimum required ratios of 14 and 15 percent.

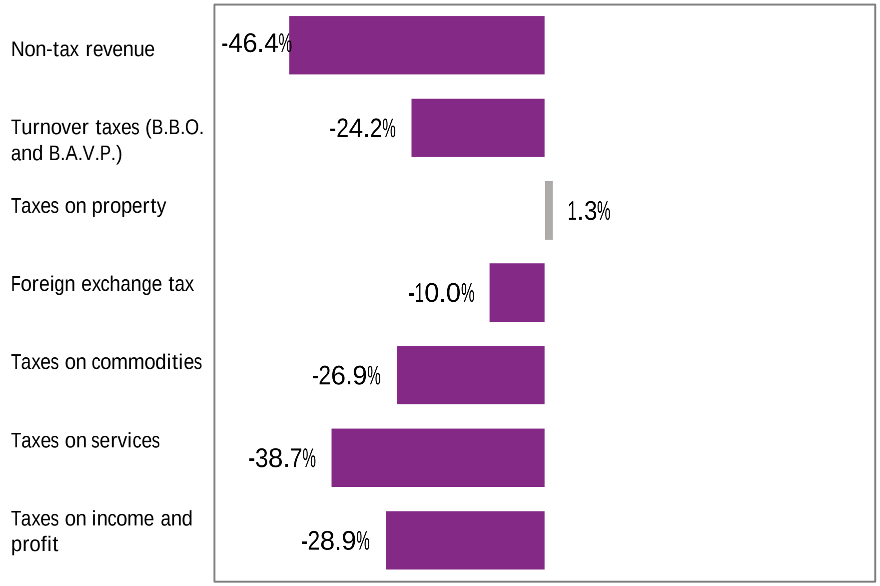
Compared to end-2019, the nonperforming loans (NPLs) ratio in the second quarter of 2020 increased by 0.8 percentage point to 3.7 percent, after remaining virtually unaffected in the first quarter. It is likely that the moratorium on loan repayments, that was introduced by commercial banks in March 2020, prevented a larger increase in the NPL ratio. The profitability of the commercial banking sector was negative as the return on assets before taxes registered -0.1 percent in the second quarter of 2020 for the first time since recording began in 2015.

Government

The government's financial situation worsened during the first six months of 2020, compared to the same period a year before, largely due to the impact of the COVID-19 pandemic. The financial deficit of the Government of Aruba (GoA) reached Afl. 301.1 million at end-June 2020, compared to an Afl. 54.1 million surplus a year earlier. In the first quarter, the financial deficit amounted to Afl. 29.1 million, indicating that the worsening mostly occurred during the second quarter of the year, coinciding with the onset of the COVID-19 pandemic in Aruba. The deficit in the second quarter of 2020 is the largest reached since the fourth quarter of 2014, where it stood at Afl. 206.5 million.

The deterioration of the government's financial situation was attributed to a decrease of Afl. 194.8 million in total government revenue (-27.3 percent), and an expansion of Afl. 152.0 million (+21.9 percent) in government expenditures at the end of the second quarter of 2020. The contraction in total revenues was caused by a drop in all tax categories with exception of taxes on property (Chart 12). Declines were recorded in revenue from taxes on income and profit (-24.8 percent), taxes on services (-38.7 percent), taxes on commodities (-26.9 percent), foreign exchange tax (-10.0 percent), taxes on property (+1.3 percent), turnover taxes (-24.2 percent) and non-tax revenue (-46.4 percent). The steep decline across tax revenue categories mainly reflected the impact of the COVID-19 crisis. Specifically, lower receipts from taxes on income and profit were affected by income declines in wage tax and profit tax, while that of taxes on commodities was impacted by the components excises on beer and liquor and import duties. Proceeds from foreign exchange tax were affected by measures taken by the CBA to restrict the outflow of capital and turnover taxes by the diminishing domestic purchasing power, as well as the drop in import demand. The developments in the second quarter were in stark contrast to the first quarter of 2020 when an increase of Afl. 12.8 million (4.2 percent) was observed in total government revenue compared to a year earlier.

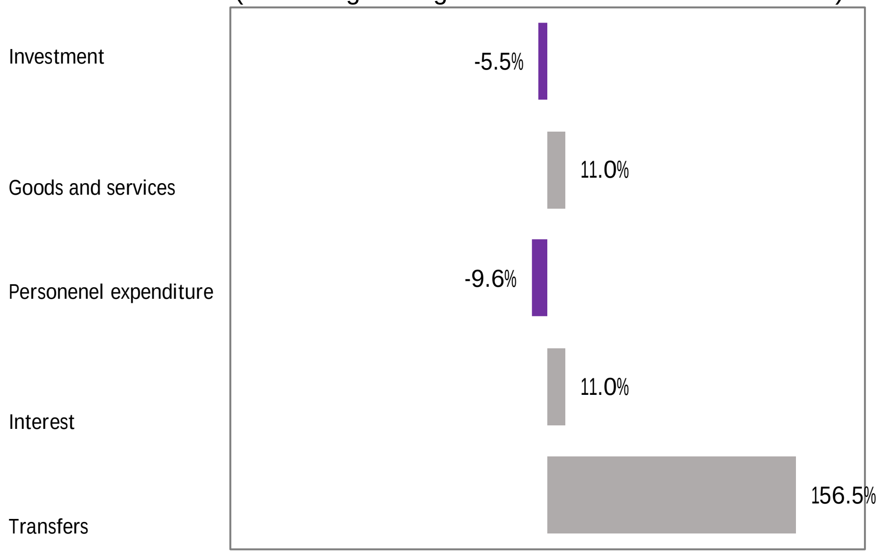
Chart 12: Government revenue
(Percentage change YTD June 2020 vs. YTD June 2019)



Source: Tax Collector's Office

Government expenditures (on a cash basis) registered an expansion of Afl. 152.0 million (+21.9 percent), during the first six months of 2020, compared to the same period in 2019. This upturn was mostly attributed to additional expenditures in response to the COVID-19 pandemic. This is further illustrated by the government expenditures averaging Afl. 346.4 million during the five quarters preceding the second quarter of 2020. During the first half of 2020, there were increases in transfers and subsidies (+130.6 percent), interest expenditures (+11.0 percent) and goods and services (+11.0 percent) (Chart 13). In addition, for the first time since the third quarter of 2018, the GoA made a transfer to AZV of Afl. 26.2 million in the second quarter, in order to compensate for the loss of premium income, the decline in BAZV revenue, and to cover additional health costs resulting from the pandemic.

Chart 13: Government expenditure
(Percentage change YTD June 2020 vs. YTD June 2019)



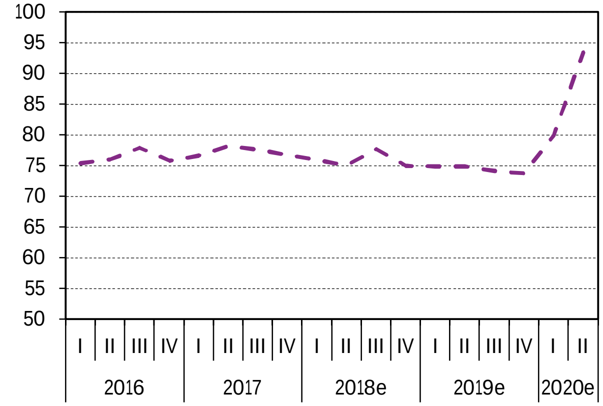
Source: Tax Collector's Office

Contrarily, personnel expenses decreased (-9.6 percent) during the period under review, mainly due to a reduction of 12.6 percent in wages of civil servants as of the 1st of May, 2020. The expansion in government expenditures was almost completely caused during the second quarter of 2020, as the rise in government expenditures at the end of the first quarter compared to the same period a year before amounted to only Afl. 3.6 million (1.1 percent). The slight increase in government expenditures during the first quarter was mainly the result of higher interest expenses, mitigated by a contraction in personnel expenses.

Total government debt rose significantly in the second quarter of 2020, compared to the second quarter of 2019, i.e., by Afl. 327.9 million (+7.6 percent). Foreign debt and domestic debt surged by respectively, Afl. 276.7 million (+12.0 percent) and Afl. 51.1 million (+2.5 percent) during the period under review. On balance, the share of domestic debt decreased (from 46.9 percent to 44.7 percent) and, conversely, the share of foreign debt widened (from 53.1 percent to 55.3 percent) in total government debt, when comparing the second quarter of 2020 to the second quarter of 2019. The significant expansion in foreign government debt is the result of an Afl. 205.6 million liquidity support provided by the Dutch government to the GoA due to the COVID-19 crisis. Additionally, the GoA borrowed an amount of Afl. 237.2 million on the international capital market.

Regarding the debt-to-GDP ratio, this ratio surged from 73.7 percent (2019 Q4) to 93.5 percent (2020Q2) (Chart 14), related to both the significant amount of external financing received and the contraction in GDP resulting from the impact of the COVID-19 pandemic. Compared to the previous quarter (2020 Q1), the ratio widened from 79.9 percent to 93.5 percent (2020 Q2). The adverse pandemic related developments in 2020 reversed the declining trend in the debt-to-GDP ratio that was reported since the third quarter of 2018. The debt-to-GDP ratio reached its highest level ever recorded in the current quarter.

Chart 14: Debt-to-GDP ratio



Calculations: CBA
e = estimated

II. International developments

In its October Economic Outlook, the IMF expects global growth to contract by 4.4 percent in 2020, a 0.8 percentage point upward revision from the June 2020 World Economic Outlook (WEO) update[10] (Table 3). Global growth is projected at 5.2 percent in 2021, and slowing to 3.5

[10] IMF, World Economic Outlook, October 2020

Table 3: Projections for the world economy and selected economies (Real GDP growth, in percent)

	2019e	2020f	2021f
World	2.8	-4.4	5.2
United States	2.2	-4.3	3.1
Euro Area	1.3	-8.3	5.2
Latin America and the Caribbean	0	-8.1	3.6

Source: IMF

e = estimate ; f = forecast

percent into the medium term. The upward revision for 2020 is driven by second quarter GDP data in advanced economies that is less negative than expected, as well indicators pointing to

a stronger recovery in the third quarter. However, the path to recovery is uneven, with emerging and developing economies anticipated to incur a greater loss of output compared to advanced economies. Moreover, recovery was muted while the pandemic continued to spread, and many economies had slowed reopening and targeted shutdowns were being reinstated. Nonetheless, the outturn would have been much worse if it weren't for fiscal, monetary, and regulatory responses. Near-term policies should aim to guide economies to paths of stronger, equitable, and resilient growth.

Activity picked up again in May and June 2020, as economies slowly reopened. The restart was most notable in retail sales, while firms remained cautious with industrial production well below December 2019 levels. GDP outturns for the second quarter were less negative than expected in China where public investment helped boost activity, and the United States and Euro Area with government transfers supporting household incomes. Furthermore, global trade began recovering in June as economies reopened. For emerging and developing economies the outlook is more precarious, reflecting the continuous spread of the virus and overwhelmed health care systems, severely affected sectors such as tourism, and the greater dependence on external finance. Global inflation generally remained below pre-pandemic levels, as weak aggregate demand outweighed the impact of supply interruptions. Additionally, financial conditions continued to ease with equity markets recovering, sovereign bond yields unchanged or declining further, and corporate spreads dropping further.

For 2021, an initial rebound is projected as the recovery is expected to slowly strengthen over 2021. The recovery is likely to be characterized by persistent social distancing until vaccine coverage expands and therapies improve. Local transmission is assumed to be brought to low levels everywhere by the end of 2022. The slower growth over the medium term reflects the scarring from the pandemic that will likely lead to a severe setback in the pace of improvement in average living standards across all country groups. The global projection is surrounded by significant uncertainties, and although upside risks exist, overall risks are significantly tilted toward the downside. Downside risks include virus resurgence and slower health care progress, slower than expected economic activity, possible tightening of financial conditions, and the extent of global spillovers from weak demand. Policies should ensure adequate resources for health care systems and limiting economic damage, while addressing medium-term challenges and ensuring inclusive growth that benefits all.

III. Conclusion

Available indicators echo the sharp contraction of the Aruban economy in the first half of 2020. The onset of this development took place as of the end of the first quarter, continuing into the second quarter, and was mainly driven by a severe drop in tourism income resulting from the impact of the COVID-19 pandemic. This development resulted from a contraction in all markets, mostly due to the March 17, 2020 border closure, due to the measures taken by the Aruban government to contain the spread of COVID-19. Consequently, the hotel sector was hit hard with revenue per available room (RevPar) for the first half of 2020 falling by 51.0 percent, and average room occupancy rate slumping by 50.6 percentage points to 35.3 percent, compared to the same period of the previous year. Despite financial support and social assistance of the government, both consumption and investment indicators pointed to anemic economic conditions during the first two quarters of 2020. Initial estimates of quarterly GDP growth indicate a drop of, respectively, 4.9 percent and 34.6 percent during the first and second quarter of 2020.

The 12-month average CPI inflation stood at 3.6 percent in June 2020, resulting from rising food prices and an increase in the price of recreation. The real exchange rate of the florin vis-à-vis the U.S. dollar had been constantly increasing since the second quarter of 2018.

Table 4: Main economic indicators

	2019 Jan-Jun	2020 Jan-Jun	Change	% Change
Revenue per available room (RevPAR) (US$)	258	126	-132	-51.0
Stay-over visitors (numbers)	575,649	228,752	-346,897	-60.3
Cruise visitors (numbers)	435,112	255,384	-179,728	-41.3
Construction permits (Afl. million)	186.8	322.2	135.4	72.6
Imports of machinery and electrotechnical equipment (Afl. million)	154.3	130.9	-23.4	-15.2
Cement imports (weight)	26,292	16,305	-9,987	-38.0
Import of goods (Afl. million)	1,047.2	800.6	-246.6	-23.5
Import of base metals and derivated work	43.9	33.8	-10.1	-23.0
Turnover tax receipts (Excl. BAVP, in Afl. million)	109.1	82.7	-26.4	-24.2
Taxes on income and profit (Afl. million)	251.9	179.2	-72.7	-28.9
Twelve-month average rate of inflation (percent)	4.3	3.6		-0.7*
Government debt-to-GDP (ratio)	74.9	93.5		18.6*

Sources: CBA, AHATA, ATA, CBS.

* Changes are percentage points

Aruba's trade deficit amounted to Afl. 774.5 million in the first 6 months of 2020, a 22.7 percent decrease compared to the same period of the previous year. The smaller trade deficit was the result of imports falling more than the export of goods. The developments in merchandise trade reflected in part a significant fall-off in economic activity and consumption due to 'shelter in place' measures aimed at stopping the spread of COVID-19.

The current account of the balance of payments recorded an Afl. 83.1 million deficit in the first half of 2020. The year-to-date current account deficit represented a sharp decline of Afl. 333.7 million from a surplus of Afl. 250.6 in the first half of 2019. This contraction was mainly due to the surplus on the services account falling by Afl. 625.6 million, following the unprecedented plunge in tourism credits related to the COVID-19 travel restrictions.

The financial account resulted in a net borrowing of Afl. 106.4 million in the first half of 2020. The financial account outcome in the period under review was primarily due to a net inflow of Afl. 205.3 million related to the provision of financial support from the Netherlands to the government of Aruba.

Money supply stood at Afl. 4,761.5 million at the end of the second quarter of 2020, Afl. 192.7 million higher than the end of 2019. The expansion in money supply was the result of an Afl. 255.2 million hike in international reserves, which was partially offset by an Afl. 62.5 million contraction in net domestic assets.

The government's financial situation (on a cash basis) worsened during the first six months of 2020, compared to the same period a year before. The financial deficit of the Government of Aruba accelerated to Afl. 301.1 million in the first half of 2020, compared to an Afl. 54.1 million surplus a year earlier. The deterioration of the government's financial situation was mainly on account of the impact of COVID-19, which caused widespread decreases in government revenue streams, in addition to surges in government expenditures. Consequently, the debt-to-GDP ratio expanded from 73.7 percent (2019 Q4) to 93.5 percent (2020 Q2).

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