Today the Centrale Bank van Aruba published its 2008 Annual Report. The statement by the President, which is also included in this report, is presented below.

The year 2008 was characterized by a worldwide financial meltdown triggered by a massive contraction in available liquidity in the global credit markets and banking system, following record losses in the loan and investment portfolios held by several major financial institutions worldwide. These losses stemmed largely from investments related to the U.S. (subprime) housing market, which collapsed in August 2007. This liquidity crisis led to the (near) failure of some systemic financial institutions in the United States and Europe, which resulted in an implosion of confidence among financial market participants.

The shortage of liquidity in the financial sector quickly spread to other sectors of these economies, resulting in a credit crunch for businesses and households, seriously constraining investments and consumption. This in turn has had a ripple effect on the real sectors of these economies, which are experiencing a long and deep economic downturn despite aggressive monetary and fiscal policy actions. According to the International Monetary Fund (IMF) and leading economists, this recession is the worst the world economy has faced in 60 years.

The international financial turmoil has not left the Aruban economy untouched. As in many other small economies with limited diversification and capital restrictions, the effects were felt first and foremost in the real sector. The uncertainties surrounding the international financial system and deteriorating employment conditions in the United States negatively impacted tourism particularly in the fourth quarter of 2008, lowering the occupancy rates in the hotel sector and output of tourism-related businesses. In addition, tightened international credit conditions brought about a further drop in foreign direct investment (FDI) as the execution of several projects, particularly in the tourism and the real estate sectors, was either postponed or canceled, thereby weakening employment in the construction sector.
Consequently, in 2008 the Aruban economy, measured by its Gross Domestic Product (GDP) in real terms, contracted by 2.5 percent based on preliminary estimates, compared to a marginal expansion of 0.4 percent in 2007. The economic contraction resulted from a significant decline in domestic consumption as well as higher imports of goods largely related to a rise in tourism demand. The latter slightly mitigated the drop in economic activities because of higher exports of tourism services. Investments also recorded a minor improvement in 2008. For 2009, a further diminution in economic output is expected, induced by a fallout in tourism demand and investment as well as a further weakening in domestic consumption.

The lower domestic demand in 2008 reflected primarily a decline in the purchasing power of households, spurred by a record acceleration in the inflation rate. The 12-month average inflation rate rose from 5.4 percent in 2007 to 9 percent in 2008, the highest rate since price measuring was initiated. This acceleration was induced by record high oil prices and other commodity prices, which produced to a steep increase in the utilities tariffs and the price of gasoline as well as food prices.

Fortunately, the inflationary pace slowed down markedly during the last two months of 2008, even recording an end-of-period price deflation of 1.9 percent in December compared to December 2007. Nonetheless, the 12-month average inflation rate differential with the United States widened further to 5.2 percentage points in 2008, indicating that Aruba’s competitive position vis-à-vis this country and other competitors in the region with a lower inflation rate deteriorated significantly.

Following a drop in tourism demand in the last quarter of 2008, overall growth in tourist arrivals slowed down by 4.1 percentage points to 7.1 percent. The average occupancy rate of resorts declined from 77.3 percent in 2007 to 76.6 percent in 2008. In contrast, the cruise tourism industry escaped the perils of the crisis: cruise passenger arrivals jumped by 15.4 percent in 2008 compared to an 18.5 percent drop in 2007.

The expansion in tourist arrivals in 2008 contributed to a 12.8 percent rise in registered gross tourism receipts, slightly increasing their contribution to the current account income of the balance of payments of the rest of the economy (i.e., excluding the oil and free-zone sectors) to 77 percent. This development chiefly influenced the improvement of the current account balance of the rest of the economy, the deficit of which narrowed from Afl. 285.2 million or 6.2 percent of GDP in 2007 to Afl. 162.5 million or 3.3 percent of GDP in 2008.
The capital and financial account surplus of the rest of the economy widened from Afl. 221.5 million or 4.8 percent of GDP in 2007 to Afl. 591.9 million or 12.1 percent of GDP in 2008. This development mirrored closely an incidental Afl. 223.3 million receipt of funds from the Dutch government related to the settlement of the Plant Hotel N.V. issue. Hence, the balance of payments of the rest of the economy turned around from an Afl. 38 million deficit in 2007 to an Afl. 411 million surplus in 2008.

In addition, the external transactions of the oil and free-zone sectors yielded a net inflow of foreign funds of Afl. 143.1 million in 2008. Consequently, Aruba’s overall balance of payments posted an Afl. 554.1 million surplus in 2008, notably raising the level of international reserves to Afl. 1,270.7 million. Accordingly, the 12-month average coverage of merchandise imports (excluding the oil sector) by international reserves climbed to 7.2 months in 2008, and the 12-month average coverage of all current account payments (i.e., payments for merchandise imports, services, income, and current transfers, and excluding the oil sector) rose to 3.6 months.

The principal objective of the monetary policy of the Centrale Bank van Aruba (CBA) is to maintain relative price stability to safeguard the value of the Aruban florin. Vital to achieving this objective is the maintenance of the peg of the Aruban florin to the U.S. dollar. To this end, the CBA closely monitors the flows of foreign exchange payments and receipts to ensure a comfortable level of international reserves to defend the peg. In 2008, the main monetary policy instrument at the CBA’s disposal remained the quantitative credit growth restriction. The drawbacks of this instrument are well-known, but it is generally considered a very transparent and effective instrument.

During 2009, the CBA intends to shift from the current use of the quantitative credit growth restriction instrument to more market-oriented indirect instruments, entailing the active use of cash reserve and liquidity requirements and the re-issue of central bank certificates of deposit to influence the liquidity within the banking system. This shift is also being driven by the need to have monetary instruments that possess more flexibility and adaptability to respond quickly to developments in the financial sector and the economy in general.

Against this background, the CBA agreed with the commercial banks to make 2008 a transition year, such that by the end of 2008, credit ceilings would have been dropped and replaced by market-oriented instruments. In anticipation of this shift, a 5 percent growth limitation was set for overall commercial bank lending for 2008.
However, in view of the rising uncertainties surrounding the impending effects of the global financial and economic crisis on the Aruban economy in the last quarter of 2008, the CBA decided to prolong the transition period through 2009, thereby maintaining a 5 percent credit growth restriction, while gradually moving to a more market-oriented monetary policy. This policy decision also took into consideration the IMF Offshore Financial Center (OFC) evaluation report of September 2008. The report advised the CBA to strengthen its risk-management systems and those of the commercial banks by shifting from a more compliance-based to a more risk-based supervisory system prior to switching to a more market-oriented monetary policy.

The 5 percent maximum permissible aggregate credit growth target for 2009 is subject to periodic revisions depending on monetary and economic developments during the year. An 8 percent penalty rate is applicable when the aggregate credit limitation is surpassed and is proportionally levied on commercial banks that contribute to the excess credit growth. To promote a level playing field within the financial sector, developments within the nonmonetary financial institutions also are closely monitored and discussed with these institutions.

Effective April 24, 2009, the CBA lowered its advance rate by 2 percentage points to 3 percent. This decision was taken based on the slowdown in business activity and decelerating inflationary trends, as well as to bring the advance rate more in line with the domestic liquidity conditions and reduced interest rates on the international money markets.

To proceed with the preparatory works related to the gradual transition to a more market-oriented monetary policy, the CBA will eliminate the monetary cash reserve requirement as of July 1, 2009, and simultaneously introduce a reserve requirement. The reserve requirement will be excluded from the calculation of the prudential liquidity ratio to improve its effectiveness as a tool of monetary policy. The move to a more market-oriented monetary policy also will entail the introduction of a more robust liquidity risk management framework that is well integrated into the bank-wide risk management processes. Therefore, during 2009, the CBA will issue new guidelines on liquidity risk management based upon the revised Basel principles for sound liquidity risk management and supervision.

On the fiscal side, the financial operations of the government showed an improved performance in 2008 when compared to the outcome in 2007. Including the change in unmet financing requirements, the financial balance amounted to an Afl. 182.3 million surplus, equal to 3.7 percent of GDP, in contrast to an Afl. 104.7 million deficit (2.3 percent of GDP) in 2007. Revenues and grants rose markedly by Afl. 331.1 million following the
mentioned incidental receipt of funds from the Dutch government. Part of these funds was used for debt repayment related mainly to the Civil Servants Pension Fund (APFA) and contingency financing of tourism promotion for 2009. The remainder of the funds was earmarked for debt repayment and infrastructural investments.

Government expenditures on a cash-adjusted basis (i.e., including net lending and the change in unmet financing requirements) went up by Afl. 43.9 million. In particular, personnel-related expenses grew by 2.9 percent in 2008, remaining within the maximum growth rate of 3 percent recommended by the National Commission on Public Finance (NCPF). Expenditures on goods and services, on the other hand, rose by 4.5 percent, well above the commission’s recommended 2 percent growth limit. Investment outlays were only 1.6 percent of GDP, below the 2 percent minimum level recommended by the NCPF.

Outstanding government debt contracted by Afl. 89.1 million to Afl. 2,047.2 million at the end of 2008, due largely to the debt repayment financed by the mentioned incidental receipt of funds from the Dutch government. Consequently, the debt-to-GDP ratio fell from 46.6 percent in 2007 to 42 percent in 2008. To further reduce its debt-to-GDP ratio, the government should consider using a sizeable part of the earmarked funds for debt repayment. Furthermore, when these incidental funds are excluded from the government finance, a financial deficit of Afl. 41 million is obtained, which is equal to 0.8 percent of GDP. To realise the required fiscal consolidation on a structural basis and further reduce its outstanding debt, it is critically important that the government make some rather difficult policy decisions.

These decisions relate to three particular issues that pose major risks for government finances, namely, the General Health Insurance (AZV), government personnel, and the APFA. The Monitoring Committee (MC) instituted by the Council of Ministers in November 2007, chaired by the CBA and charged with the monitoring of the progress of the execution of the NCPF recommendations flagged, these issues in its letter of April 2009 to the Minister of Finance and Economic Affairs. This concern is shared by both Fitch Ratings and Standard & Poor’s. These rating agencies recently affirmed Aruba’s current ratings of ‘BBB’ and ‘A-/A-2’, respectively, but warned that failure to address the structural weaknesses in the government budget could potentially affect Aruba’s future rating.

With respect to the AZV and personnel, special advisory committees have been formed to analyze the problems and make recommendations to the government on how to curtail related expenses. Draft reports were submitted to the government for further discussion and possible implementation. In addition, a tripartite committee consisting of
representatives of the APFA, the Department of Finance (DF), and the CBA recently was instituted to advise the Minister of Finance and Economic Affairs on policy actions to restore the financial position of the APFA. The related report will be submitted soon to the Minister.

The government presented its 2009 budget to Parliament on time, again including a summary memorandum with a medium-term budget up to 2013. However, the budget approval was delayed until the beginning of this year. The 2009 budget, which did not include the incidental receipt of funds from the Dutch government related to the aforementioned Plant Hotel N.V. settlement, shows an Afl. 47.3 million financial deficit, compared to an Afl. 50 million budgeted deficit in 2008, related mainly to an anticipated expansion in both tax and non-tax revenues. The estimated increases in personnel costs and expenditures on goods and services are 3.8 percent and 4 percent, respectively. Both increases are above the norm recommended by the NCPF, while the ratio of investment outlays to GDP is 1.1 percent, again below the recommended norm.

To promote close cooperation between the DF and the CBA, monthly high-level meetings are held to discuss key issues related to the government’s operations, including monitoring of financial planning, liquidity management, debt dynamics, and statistical issues. In addition, the execution of the budget on a cash-adjusted basis is reviewed during these meetings.

To date, the impact of the international financial crisis on the Aruban financial sector has been quite modest, mainly because the sector generally has limited foreign exposure. Only three company pension funds supervised by the CBA and the APFA have experienced a setback in their foreign investment portfolios. The three company pension funds are being closely monitored by the CBA and must submit recovery plans that contain detailed information on measures they will take to address the shortfall. To improve the financial position of the APFA, which falls under the supervision of the Minister of Finance and Economic Affairs, structural adjustments in one of its pension schemes are required.

The CBA remains focused on strengthening its supervisory legislative framework and prudential supervision to maintain the stability and integrity of the financial system as well as prevent financial institutions from taking risks that could harm the interests of depositors, policyholders, and other creditors, and/or could endanger the soundness of the financial system. As of February 5, 2009, the State Ordinance on the Supervision of the Credit System (SOSCS), the State Ordinance on the Supervision of the Insurance Business (SOSIB), and the State Ordinance on the Supervision of Money Transfer Companies (SOSMTC) were amended. The major changes in these ordinances are the inclusion of new articles explicitly authorizing the CBA to issue directives in the area of anti-money-laundering and combating financing
of terrorism (AML/CFT) and to oppose the appointment of an external auditor, as well as extending the possibility of imposing administrative sanctions to the SOSCS and the SOSIB.

Also on February 5, 2009, the State Ordinance on the Supervision of Trust Service Providers (SOSTSP) became effective, entrusting the CBA with its execution and the licensing of trust service providers. The SOSTSP is focused mainly on maintaining the integrity of the trust service providers’ sector. In compliance with international standards, the CBA intends to extend its supervisory scope to other sectors to protect both domestic and foreign investors. Its proposal regarding the supervision of (electronic) stock exchanges already has been approved by the Minister of Finance and Economic Affairs and is now in the legislative process. Before the end of 2009, the CBA will also draft a proposal to regulate collective investment schemes and investment advisors.

To enhance the soundness of the banking sector, the CBA further tightened its policy rule on the admission of credit institutions in 2009. A major condition was added that only financial institutions with solid financial strength and reputation and subject to comprehensive consolidated supervision are allowed as a major shareholder in a credit institution established in Aruba.

In May 2008, an IMF mission conducted a follow-up assessment of Aruba’s adherence to the revised Basel Core Principles (BCP) and a factual update of the Insurance Core Principles (ICP) assessment. Its findings were that Aruba is compliant or largely compliant with 26 principles, materially noncompliant with two principles (the risk management process and interest rate risk), and noncompliant with one principle (market risk) of the BCP. The factual update of the ICP found that Aruba had implemented several recommendations of the 2002 OFC assessment.

A Financial Action Task Force (FATF) mission conducted a mutual evaluation of Aruba’s compliance with the 40+9 FATF Recommendations in November 2008. Based upon the preliminary discussions with the FATF mission, it can be concluded that despite the progress made, the AML/CFT framework needs to be strengthened further to fully meet the 40+9 FATF recommendations.

In December 2005, the CBA entered into a Memorandum of Understanding (MoU) with the Reporting Center for Unusual Transactions (RCUT) to exchange general information on AML/CFT issues. The RCUT is entrusted with overseeing compliance with the unusual transactions reporting ordinance and (together with the CBA insofar as it concerns the supervised financial institutions), the ordinance on the identification when providing services. As of February 5, 2009, the reporting obligations to the RCUT have been
extended to include also, apart from the banks, life insurance companies, money transfer companies, free-zone companies, casinos, and the post office, also other service providers, including accountants, lawyers, and notaries, as well as traders in high value products. Meetings between the RCU and the CBA are held at least twice a year to discuss general findings of the examinations conducted in this area.

With respect to external cooperation, it should be pointed out that the CBA further strengthened its cooperation with its sister institutions in the Kingdom of the Netherlands. In July 2008, a trilateral MoU was signed between De Nederlandsche Bank N.V. (DNB), the Bank van de Nederlandse Antillen (BNA), and the CBA agreeing to develop activities throughout the full range of their organizational structures and duties in a framework of mutual cooperation. These activities include the exchange of information, mutual assistance, and provision of technical assistance. The CBA appreciates the cooperation received from these institutions in the areas of technical advice and support.

Also in 2008, the CBA focused on mitigating its exposure to risks when performing its daily operations. Because of the high technology-based environment and the associated risks to the institution, a primary target of attention is the improvement of IT security and data integrity. The CBA has hired an Information Security Manager who is responsible for protecting its information assets and reports directly to the President. The CBA also continued with the design and set-up of the Business Continuity and Disaster Recovery Plan to ensure that its core business functions are recovered as quickly and effectively as possible in case of an unforeseen event that would interrupt normal business operations.

Meanwhile, the CBA continued its review of the administrative processes and procedures of its departments. In 2008, the operations of the Cash and Vault Department were assessed with the technical assistance of DNB. Other departments will be reviewed during 2009, including the Audit Department and the IT Department. In addition, a risk management committee will be set up, while proceedings will be initiated to modernize the Central Bank Ordinance (CBO).

In 2008, the outcome of the financial operations of the CBA again was positive. A profit of Afl. 14.4 million was recorded, which is Afl. 2 million lower than in 2007. The lower profit reflected largely a decline in total gross income (net of interest expenses) to Afl. 29.2 million, mainly the result of a decline in interest rates on the international money and capital markets. Total expenses rose marginally to Afl. 14.8 million. At the end of 2008, the CBA’s balance sheet had expanded by Afl. 424.7 million or 49.8 percent to Afl. 1,276.7 million. This marked expansion was chiefly the result of an increase in foreign currency assets and the revaluation of gold holdings.
On April 28, 2009, the CBA settled a gold option contract, which was entered into in 1999 and extended in 2004, on a net cash basis. The CBA decided to sell part of its gold reserves to finance this transaction and to limit the impact on its financial position. Immediately thereafter, the CBA replenished its gold reserves to the level prior to the sale transaction by repurchasing gold on the international market. Consequently, the gold reserves of the CBA were kept unchanged. As a result of the chosen method of settling the gold option contract, the monetary parameters, including the foreign exchange reserves of the CBA, remained at an adequate level.

In conclusion, Management would like to thank all members of the staff for their continued dedication and valuable contribution in preserving the CBA’s high standard of work.