Today the Centrale Bank van Aruba published its ‘Report 2009: Economic and Financial Developments’. The statement of the President, which is also included in this report, is presented below.

While during 2009 the global economy showed clear signs of stabilization and even growth in certain countries, domestic economic activities shrank noticeably amid falling prices following a pronounced drop in both tourism and local demand as well as a sudden operational shutdown of the Valero-owned oil refinery in mid-year, which in 2008 contributed for about 12.5 percent to the nominal gross domestic product (GDP). Although public investment spending increased, it was by far not sufficient to counteract the downward economic spiral. Both nominal and real GDP growth turned negative, dropping, respectively, from 7.3 percent and 0.7 percent in 2008 to -6.0 percent and -7.6 percent in 2009, the largest contractions since 1985, when the refinery, then operated by Exxon Corporation, experienced its first closure.

A bright spot is that after peaking to a record level in the third quarter of 2008, inflationary pressures abated markedly during 2009, even becoming negative at an annual average rate of -2.1 percent for the first time since Aruba obtained its autonomous status in 1986. The deflationary trend, which began in December 2008 and continued up to and including October 2009, was triggered by falling water and electricity tariffs and gasoline prices that resulted from a steep decline in oil prices on the international markets. In contrast, food prices continued to creep up steadily until mid-year when their rising pace slowed to about 0.6 percent in December 2009. Core inflation, however, subsided but remained positive at an annual average of 1.8 percent, indicative of persistent upward price movements mostly from domestic sources.
As the Valero refinery terminated work with subcontractors, who on their turn laid off their employees in the third quarter of 2009, the unemployment rate estimated by the Centrale Bank van Aruba (CBA) swelled to more than 11 percent at the end of the year, its highest level since 2003. Although Valero employees remained on the payroll awaiting the definitive outcome of the intended sale of the refinery, increased uncertainty about the future, exacerbated by growing unemployment and the parliamentary election in September 2009, negatively impacted both consumer and business confidence. Domestic consumption, measured in real terms, fell by 5.2 percent, as consumers refrained from buying new cars and other durable goods to going on vacations resulting in lower import payments and significantly reduced commercial banking credit growth.

While the construction sector was hardest hit due to depressed private investment, retail businesses, already facing an overcapacity associated with a recent significant expansion particularly in the main tourist area, confronted a difficult year during 2009, as tourists also sharply reduced their expenditures. While only a few thrived under the challenging circumstances, many businesses were forced to drastically reduce costs to improve competiveness and avoid closure. New hirings were postponed and vacancies decreased, causing a sharp decline in new work permit petitions for foreign laborers. Business confidence, measured by the CBA through a quarterly survey, weakened steadily up to the second quarter of 2009, when a slight stabilization was posted. This stabilization was attributed to an improved perception of short-term economic conditions, while that of current economic conditions remained rather bearish.

After a weak start in the first quarter, tourism activities gradually picked up in the remaining quarters of 2009, exceeding the expectations for the year, which were on the downside due to the ongoing recession and the associated increase in unemployment in the United States, the main source of visitors for our island. By the end of the year, Aruba had managed to welcome more than 1.4 million tourists, a 2.6 percent increase compared to 2008. This positive outcome occurred because the 9.1 percent rise in cruise passenger arrivals more than compensated for the 1.7 percent decline in stay-over visitors. The year 2009 marked a record-year for cruise tourism on the island; arrivals surpassed 600,000 for the first time, rebounding from a sharp decline in both 2007 and 2008 in comparison to 2006, when the second
largest peak was recorded. New cruise lines added Aruba on their itinerary, and the ships were much larger, carrying thereby more passengers, on average, per ship.

The negative performance in stay-over arrivals in 2009 was mostly due to drops in the U.S. and the Venezuelan markets (the latter being the second largest source market) of 2.1 percent and 6.2 percent, respectively. While the number of visitors from the Netherlands fell as well albeit quite marginally, that of other European markets incurred a notable increase. Consequently, the market share of the U.S. stay-over visitors in the total arrivals decreased further, for the fifth year in a row, to 65.0 percent. Compared to other islands in the Caribbean, Aruba’s weakened performance in the tourism sector was less far-reaching; its market share within this peer group remained almost unchanged at 4 percent. During 2009 the government poured an additional Afl. 18 million into marketing campaigns, thereby successfully holding off a sharp deterioration particularly in the U.S. market, after launching a fully renewed marketing strategy in the last quarter of 2008.

In addition, the large ownership in time-share units, which represents a majority of repeat visitors and, henceforth, the backbone of the Aruban tourism industry, kept occupancy rate at time-share properties around 77.3 percent on average for the whole year, which is only 3.0 percentage points lower than in 2008. Other hotel properties, accounting for 51.0 percent of total available rooms, experienced a smaller contraction in their average occupancy rate, i.e., 1.2 percentage points to 72.0 percent, while conceding a 4.5 percent decrease in the average daily rate (ADR) to Afl. 321 compared to 2008, when the highest ADR ever, amounting to Afl. 336, was registered. These developments put a downward pressure on the profitability of the hotel sector, which faced a 6.1 percent fall-off in revenue per available room. In conversation with the management of these properties, many reported halting investments as well as new hirings; in some cases labor contracts were not renewed and voluntary lay-off programs were offered.

Whereas Aruba managed to avoid a severe drop in tourist arrivals in contrast to many other regional destinations, visitors spent considerably less. As a large majority of these visitors comes from the United States, this cautious behavior is in line with the low consumer confidence, which affected consumption. In addition, the spendthrifty Venezuelans were kept in
check severely by stringent credit card restriction measures imposed by the Venezuelan government to reduce foreign currency outflows. Consequently, tourist receipts, as registered in the balance of payments, decreased by 8.3 percent in 2009. This decrease negatively impacted many tourism ancillary businesses, particularly restaurants, which at the same time were facing increased competition, after sizeable investments that led to an overcapacity in that sector. In the non-traditional tourism corridors, many businesses fully shut down operations or had to move to more attractive areas to keep their businesses afloat.

Government was not spared from additional challenges in managing its rising budget deficit, largely associated with dwindling revenues, while at the same time dealing with growing unemployment, as well as decreased consumer and business confidence. The abrupt decision of the Valero Corporation to idle the refinery on the island rather than keeping it operational at a loss in mid-July, combined with less buoyant performance in the tourism sector, led to a reduction in economic activities that resulted in lower revenue in 2009 from turnover taxes, wage taxes, and taxes on commodities for the first time in the past eight years.

Total revenue dropped by Afl. 256.2 million to Afl. 1.1 billion, which is equivalent to 23.6 percent of nominal GDP. While total tax receipts declined by Afl. 48.1 million to Afl. 928.9 million, nontax revenue plummeted by Afl. 208.1 million to Afl. 180.0 million, following the incidental large grant received from the Dutch government in 2008 to settle the dispute associated with the ownership of the sale proceeds of the Plant Hotel N.V. Expenditures (including changes in unmet financing requirements) rose by Afl. 67.1 million or 5.8 percent to Afl. 1.2 billion (i.e., 26.1 percent of nominal GDP), due mostly to a rise in the cost of living allowance paid to pensioners through the civil servants pension fund APFA, higher purchases of goods and services, and increased transfer to the General Health Insurance (AZV).

After posting a financial surplus in 2008, an Afl. 159.6 million financial deficit (including changes in unmet financing requirements) was recorded in 2009. Discounting 2008 as an exceptional fiscal year due to the aforementioned large incidental grant, billowing labor costs and high payments related to goods and services as well as to the AZV, accounting for 72.8 percent of total expenditures (including changes in unmet financing requirements), remained a serious cause for concern, giving the government
little room to implement a badly needed anti-cyclical fiscal policy. Consequently, investment outlays (including development fund spending), an important tool to jumpstart the faltering economy, stayed around 6.7 percent of total expenditures or 1.8 percent of nominal GDP. To cover its financial deficit the government borrowed Afl. 275.4 million, which again pushed up total outstanding debt to Afl. 2.2 billion or 46.9 percent of nominal GDP.

The domestic economic prospects for 2010 are dominated by the uncertainties surrounding the future of the oil refinery, an important source of employment and foreign currency earnings although not at the same high levels seen during the Exxon-era that terminated in early 1985. If the refinery does not restart its operations, the outlook for this year is a further contraction in economic activities, measured in real terms. At the same time, inflationary pressures could flare up again largely fueled by higher import prices as commodity prices, including crude oil, are expected to resume their upward path because of increasing global demand, which could reset the stage for significant erosion in the purchasing power of consumers. The aforementioned output contraction is forecasted to be less profound for 2010 compared to 2009, based on the anticipation of a pick-up in tourist expenditures following an increase in visitor arrivals, a less steep fall in domestic consumption, and higher public investments.

If the Valero refinery is back in business at full capacity on renewed favorable prospects related to the recent tax deal with the Aruban government and improved refining margins, the impact will be positive on domestic output, investments as well as consumption, resulting in renewed growth in real GDP. Moreover, because of the mentioned tax agreement with the Valero Corporation, and in spite of the reduction in the turnover tax (BBO) rate as of January 2010, budgeted government income will rise by 5.4 percent. As expenditures are forecasted to exceed income by 13.7 percent, the financial position of the government will remain under strain, incurring an expected financial deficit equal to 3.3 percent of nominal GDP.

According to the recently presented budget plans for 2010, the government intends to introduce measures to reduce personnel costs over the course of the coming years, largely via privatization and increased efficiency. However, from a financial stability perspective it is crucial to attain the desired sustainable government finance on a medium term.
Therefore, the planned measures should be combined with rigid cost-cutting exercises, particularly with regard to the AZV and the APFA.

Sustainable government finance is an important prerequisite for creating the path that would lead towards reducing the government debt to manageable levels, without compromising the envisioned investment catch-up in physical infrastructure and know-how. The attainment of a so-called Social Agreement between the government and organizations representing workers and employers on issues such as the AZV, the APFA, the General Old Age Pension System (the “AOV”), the government finance, and diversification could help pave the path to stability. Important conditions are that actions be based upon realistic financial parameters and a longer term perspective.

Another cause for concern is the relatively high cost of living and of doing business in Aruba. In an environment of growing unemployment, these cost conditions could be harmful to the community. Although there is a significant lack of adequate social statistics, anecdotal evidence also reveals growing signs of financial stress and impoverishment, causing increased indebtedness, higher loan repayment delinquencies, and rising water and electricity disconnections. These signs of stress provide breeding grounds for criminality and other social distress. Higher business costs, which were partially offset by the reduction of the BBO tax rate in January of 2010, will continue to discourage investments as well as new hirings. Also, unless tourist spending improves, businesses servicing this sector will remain under strain, potentially causing a further rise in bankruptcies and unemployment.

The business operations of the CBA were also influenced by the effects of the financial crisis and the recession triggered on the domestic economy. On the policy side, as of the beginning of 2010 the CBA loosened its restrictive monetary stance and removed the credit ceiling, which had been in place since 1988, thereby accommodating recovery in business and consumer lending. Henceforth, in managing monetary growth and maintaining an adequate level of foreign exchange reserves, it relies mostly on the reserve requirement and, to a lesser extent, the issuance of certificates of deposits to withdraw or create liquidity within the banking system. Adjustment in the reserve requirement ratio follows upon recommendation of the monetary policy committee, which on a monthly basis reviews a number of key economic and financial indicators.
Although the impact of the international crisis on the domestic financial sector had been limited, the CBA took several policy measures to enhance soundness within this sector. One such measure was tightening of the admission policy for credit institutions as of January 1, 2009. One important change was that only financial institutions with solid financial strength and reputation, subject to comprehensive consolidated supervision can be a major shareholder in a credit institution established in Aruba. Also, in order to boost capital and liquidity reserves to levels that could absorb unanticipated losses on their loan and investment portfolio as well as sudden cash withdrawals, the CBA increased both the minimum risk-weighted capital asset ratio and the prudential liquidity ratio for commercial banks from 12 to 14 and 15 percent, respectively. The stiffening of the minimum risk-weighted capital asset ratio is also in effect for bank-like institutions.

To summarize, the Aruban business and social community experienced rough times in 2009. The expectation is that there are still many challenges ahead, which need to be tackled effectively. The world economy is forecasted to expand in 2010, though the recovery in advanced economies, including the United States, is anticipated to be sluggish by historical standards. Moreover, the recent debt problems in, among others, Greece and Spain pose a significant threat to the European economic outlook and the euro. On the domestic front, the future of the oil refinery and the quality of the recovery in the tourism sector are major factors affecting the economic outlook, but there are a number of additional issues, including the weak financial position of the government, associated in part with the dilemmas surrounding the civil servants pension fund and the old age pension system, as well as the relatively high personnel costs and the AZV, that require urgent and comprehensive solutions. Only then will the future look much brighter.