Today the Centrale Bank van Aruba published its ‘Report 2011: Economic and Financial Developments’. The statement of the President, which is also included in this report, is presented below.

Following two years of contraction, 2011 began with anticipation of renewed growth for the Aruban economy and enhanced labor market conditions. An important reason for this optimism was that the Valero Energy Corporation (VEC), after an unexpected closure in July 2009, resumed operations at its Aruban oil refinery in January 2011. Besides reaching a settlement agreement with the government of Aruba, gains in the United States and other major economies as well as improved refining margins were conducive to the VEC’s decision to restart activities. In line with expectations, the reopening of the refinery positively impacted the Aruban economy. Real GDP rose by an estimated 8.9 percent to approximately Afl. 2.9 billion, with the oil sector responsible for about two-thirds of this growth mostly brought about by the strong rebound in this sector’s net exports.

Estimates by the CBA indicate the refinery’s impact on the 2011 growth in real GDP also reflected to some extent through higher consumption (4.5 percentage points of the GDP growth) and investment (2.4 percentage points of the GDP growth). The lion’s share of the rise in consumption emanated from the private sector. Indicative of increased consumption are a 6.9 percent growth in real terms in the turnover tax, the so called BBO. On the investment side, the hike in private sector’s investments more than compensated for the falloff in public sector’s investment, as many projects either progressed or completed in 2011. These projects include construction of the Ritz Carlton hotel, as well as major renovations at several hotels and the airport. The downside of these pro-growth developments, as well as the hefty expansion in the tourism sector, is that they pushed up imports which had a dampening effect on growth. In the public sector, some relatively large projects were started, including the beautification of the downtown area and other infrastructural projects, as the government embarked on an ambitious investment strategy to support sustainable growth through urban and neighborhood renewal, green energy, and an improved infrastructural network.

The hospitality industry experienced another good year in 2011. Output in both the hotel and restaurant sector strengthened thanks to the vibrant development in tourism. The

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1 Valero Energy Corporation, 10-Q Quarterly report pursuant to sections 13 or 15(d), First Quarter 2011, p. 8.
2 In prices of 1995.
3 Export of refined oil minus import of crude oil. Based on the current account of the balance of payments.
further gain in stay-over tourism came from secondary markets and reflected a payoff of the diversification strategy followed by the newly instituted Aruba Tourism Authority sui generis (ATA). This strategy included allocating extra marketing funds, increased support to tour operators, and raised manpower to these progressively more important source markets (particularly Venezuela). U.S. arrivals recorded a slight contraction after a recovery in 2010, but the 27 percent surge in the Latin American market more than compensated for this lackluster performance, reducing the steady 65 percent market share of the U.S. market of the past four years by 4 percentage points. Visitors from Venezuela, Argentina, Brazil, Colombia, and Ecuador together represented nearly 80 percent of the total growth in stay-over visitors. In this group, Venezuelan tourists apparently more eager to travel and having foreign currency more available played a prominent role, accounting for almost 60 percent of the overall growth in stay-over tourism.

After a slowdown in the previous year, cruise tourism posted an overall growth rate of 5.4 percent for 2011. Influential in this growth were an exceptionally strong first quarter and an unusual spike in cruise arrivals in the month of December. Anecdotal evidence suggests that favorable price discounts by major cruise companies were instrumental in raising demand. Overall, gross tourism receipts expanded by almost 9 percent (Afl. 191 million) to Afl. 2.4 billion (50.4 percent of GDP), the second highest level ever. The CBA estimates that prices of tourism-related goods and services increased by only 1.3 percent in 2011, which explains a small fraction of the increase in tourism receipts.

Availability of adequate and up-to-date labor market information is vital to understanding and managing the economy. Because of a persistent lack of such data, the CBA is a strong proponent of conducting a labor force survey at least once a year to improve labor market statistics. In November 2011, the Department of Labor conducted a labor force survey among a sample of households to assess labor market conditions. The results hereof suggest the labor market improved from the latest investigation (Census 2010). The unemployment rate contracted from 10.6 percent to 8.9 percent, representing some 4,679 unemployed persons in November 2011. This development in unemployment mirrors increases in available jobs, with some 1,400 plus more people employed than in the survey of 2010.

With respect to price developments, the pace of inflation picked up significantly. The CPI rose on average by 4.4 percent in 2011 (2010: 2.1 percent), 1.2 percentage points higher than that of the United States, Aruba’s main trade partner and tourist source market. About 72 percent of this increase came from food and energy items, the latter consisting of water and electricity charges and gasoline price. Outside the highly fluctuating food and energy categories, inflation pressures rekindled. Core inflation (inflation excluding food and energy components) rose from -0.3 percent in 2010 to 1.2 percent in 2011, with an important contribution from telecommunication services. The pace of the domestic inflation rate remains highly dependent on commodity price developments, in particular fossil fuel. However, there is some light on the horizon. The local water and electricity company, the WEB, made substantial investments during 2011 to improve efficiency in water and electricity production to significantly reduce reliance on fossil fuel. A case in point: with the new RECIP
The company will be using up to 35 percent less heavy fuel to produce 1 megawatt/hour of electricity. Over time these positive developments should lead to more stable or even lower tariffs for water and electricity, thereby tempering their volatile contribution to inflation.

The outcome of the balance of payments was again highly impacted by the transactions of the oil sector. The goods and services account of this sector rebounded from an Afl. 800 million deficit in 2010 to an Afl. 11 million surplus in 2011, reflecting the restart of operations at the refinery. The current account of the non-oil sector, on the other hand, recorded its highest deficit (7.1 percent of GDP) since 2006. Increased payments for both goods and services as well as elevated transfers of profit and dividends to nonresidents were the main contributing factors to this negative result, despite the mentioned 9 percent jump in tourism receipts. The current account deficit of the balance of payments (8.8 percent of GDP) was financed by the capital and financial account surplus (8.5 percent of GDP) resulting from trade credit transactions and decreases in foreign claims of resident enterprises on their foreign affiliated companies. Accordingly, the international reserves of the monetary sector shrank by Afl. 23 million, reflecting an Afl. 65 million contraction in the CBA’s official reserves to Afl. 1.3 billion. This contraction was partially offset by an Afl. 42 million rise in the net foreign assets of the commercial banks.

By end-2011 the financial deficit of the government reached 6.9 percent of GDP for the first time ever, despite the positive effects of several imperative measures taken to reduce contributions to the APFA, AZV, and SVB achieved through a series of Social Dialogues. The 2011 deficit was the second year of structurally higher financial deficits, if the 2010 government revenues are corrected for the incidental Afl. 211.6 million net receipt out of the settlement with the VEC. This widening gap between revenues and expenses, observed since 2008, is unsustainable in the medium term, thus posing a serious risk for the economy, as continued large borrowing by the government swells its interest burden on the overall budget. For 2011, total government debt expanded by Afl. 391 million, the largest increase ever recorded, to Afl. 2.8 billion or 57.8 percent of GDP.

To counter further structural weakening of its financial position, the government has put into implementation a financial framework, through which a balanced budget should be attained by end-2016 by reducing the financial deficit each year by Afl. 75 million (2012-2014) and by Afl. 50 million (2015 and 2016). Such commitments, which should become part of a comprehensive fiscal responsibility act, are an important step toward fiscal consolidation and enhancing underlying government finances. However, it will take some time to reap benefits from, for example, increased investments, (tax)efficiency gains, and tax reform initiatives (second phase Social Dialogue: 2012-2013). Deficit reduction is a balancing act where policy makers have to ensure that a cut in government spending does not pose an immediate threat to economic growth. At the same time, a structural improvement in

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4 The RECIP III project consists of 4 engines with a capacity to produce 11 megawatts of electricity.
5 Water en Energie Bedrijf, Awalectra, August 2011, p. 7.
6 The deficit including payment arrears amounted to Afl. 405.9 million, excluding the incidental Afl. 211.6 million net receipt.
government’s financial position would be a clear and positive sign that it is steadfast about its own financial health by achieving balanced budget within the projected financial framework also approved by the Parliament of Aruba.

Despite the ensuing challenges of the fiscal policy pursued by the government for an effective monetary policy, the CBA kept its monetary policy stance unaltered. During its 2011 meetings, the Monetary Policy Committee (MPC) left both the reserve requirement and the advance rate unchanged at 11 per cent and 1 per cent, respectively. Although a downward trend could be observed from August 2010 on, the net international reserves remained adequate when benchmarked against GDP, the money supply, and current account payments. It also remained supportive of the fixed exchange rate regime of the Aruban florin with the US dollar and the resulting relative price stability objective. Besides the level of international reserves, the MPC also pondered other critical indicators like the 12-month inflation rate and the inflation differential with the United States, domestic economic growth, and developments in banking sector credit. Overall, this credit had a weak start in the first five months of 2011 but picked up during the rest of the year, ending with a 2.7 percent growth. Business loans and credit to individuals rose by, respectively, 3.7 percent and 2.1 percent. While growth in housing mortgages peaked at almost 5 percent at the end of the year, consumer credit continued to shrink (0.7 percent), signaling some persistent weakness in this segment of the credit market. The possible consolidation of consumer debt via housing mortgages may also explain part of the contraction in consumer credit. The electricity, gas and water supply sector accounted for an estimated 83.6 percent of the total increase in net loans to enterprises.

The regained strong domestic economic growth during the year was short-lived. Oil price developments on the global market causing a narrowing effect on the price differential between heavy sour and light sweet crude oil put a profitable operation of the Aruban refinery at risk. Subsequently, on March 19, 2012, the VEC announced that it would again suspend refining operations at this refinery, while considering running a terminal and storage operation at the site.\(^8\) With its shut-down between mid-2009 and 2010 and its weakening impact on economic activities still fresh in mind, this suspension is expected to have a contractionary effect on Aruba’s economy in 2012. Partial mitigation could be achieved if the intended take-over of the refinery by the PetroChina Company Limited by mid-year is realized.

The uncertain developments with regard to the future of the refinery pose significant challenges to CBA’s ability to forecast a most plausible outcome for economic output for 2012 and 2013. Prior to the refinery shutdown announcement, it had projected the economy would grow by 3.5 percent in real terms in 2012. However, in the meantime, the CBA produced several scenarios to estimate GDP and their possible impact on government finance. In the most negative scenario where oil refining operations would fully cease, real GDP could shrink by 4.2 percent for 2012. In the most positive scenario, with a restart of the refinery by a new owner by August of this year, the CBA projects a real GDP growth of 1.6 percent in 2012 and 6.7 percent for 2013, while government’s financial deficit in terms of GDP

would reach 6.5 percent in 2012 (instead of the 5.2 percent budgeted) and 4.5 percent in 2013.

Under current circumstances, a refinery restart in the second half of 2012 is not likely to fully reverse the negative economic impact of the temporary shutdown, as tourist arrivals in 2012 are estimated to grow at a slower pace, namely 2.4 percent. This lower than anticipated GDP growth could pose an upside risk for the budgeted fiscal shortfall, which may require additional measures to boost revenue and/or reduce expenditures if the government upholds its target of 5 to 6 percent deficit-to-GDP ratio to keep the debt-to-GDP ratio below 60 percent. While the VEC kept the majority of its employees on its payroll, most subcontractors were released from their duties, again driving up unemployment and negatively impacting consumption. With regard to the latter, some indications suggest that some of these laid-off contractors were rehired for other ongoing projects but at a lower pay.

In the supervisory domain, much-needed progress was made in strengthening the legislative and regulatory framework in the areas of financial sector supervision and AML/CFT during 2011. By doing so, Aruba succeeded in achieving a higher degree of compliance with the international standards in these areas. In the process, CBA’s supervisory mandate expanded rapidly over the past two years making it the sole supervisory authority in the area of AML/CFT, covering institutions beyond the traditional financial sector. In light of that increased responsibility and also to allocate the scarce supervisory resources as effectively as possible, the CBA decided to shift its supervisory approach from a compliance-oriented to a risk-based framework. In 2011, some important steps were taken toward this goal. The CBA appointed a project team to ensure the implementation of an adequate framework for risk-based supervision. Furthermore, a software tool was purchased to be applied in implementing a risk-based approach for all sectors supervised.

In addition, it is striving to incorporate a more pro-active forward-looking approach in its supervisory practices. Important elements of such an approach entail giving more attention to aspects like corporate governance, corporate culture (including tone at the top), and the viability of the business model. Although Aruba’s financial sector weathered the global financial storm quite well, there is no room for complacency. Developments in the financial sector are evolving at a higher pace than previously. Furthermore, the size of the financial sector has increased considerably over the years. During the period 2007-2011, the combined balance sheet of the commercial banking sector grew on average by 3.8 percent.

The Aruban authorities made significant improvements in a very short time toward remedying the deficiencies noted in the FATF Mutual Evaluation Report (MER) of October 2009. As a result, in its meeting of June 2011 held in Mexico, the FATF Plenary decided to place Aruba in the regular follow-up process and requested it report back in June 2012 on the progress made in addressing the remaining deficiencies. Although the action plan drawn up to remedy the deficiencies noted in the MER has not yet been fully executed, it is important to recognize the significant improvements that have been made in such short time, including but not limited to the enactment of the State Ordinance on the prevention and combatting of money laundering and terrorist financing (AML/CFT State Ordinance) in June 2011. This ordinance contains new and comprehensive rules for all financial institutions and designated non-financial businesses and professions (DNFBP’s) in the areas of customer
Due diligence (CDD), reporting of unusual transactions, record keeping, supervision, enforcement, and information exchange.

Another major accomplishment is the issuance of an AML/CFT Handbook for supervised financial institutions and trust service providers in June 2011. This handbook describes the statutory and regulatory requirements and provides guidance on how to achieve compliance with these requirements. Similarly, in July 2011, the CBA released guidance notes for DNFBP’s and other entities regulated (so far) only for AML/CFT purposes for the establishment of policies and CDD measures to risk rate their customer base. Additionally, the CBA significantly tightened its procedures related to the fit and proper testing of key persons (including but not limited to shareholders and directors) and introduced a fully revised personal questionnaire to this effect in May 2011.

In 2011, a draft law was prepared, in consultation with the government’s Legislative Department, to fortify the sectoral supervisory laws and to broaden their scope. In early 2012, this law was submitted to the Minister of Finance to start up the legislative process. In connection with the introduction of the obligatory general pension ordinance in January 2012, some important amendments also were made in the supervisory laws governing the company pension funds and insurers. The main changes to the State Ordinance on Company Pension Funds (SOCPF) are the introduction of fit and proper criteria for key persons, the requirement to have sound and controlled business operations, and the possibility for the CBA to impose administrative sanctions against a company pension fund and/or its directors in case of noncompliance with the stipulations of the SOCPF or the regulations issued by the CBA pursuant thereto. With respect to the State Ordinance on the Supervision of the Insurance Business (SOSIB), it was decided to increase the minimum solvency margin life insurers must maintain gradually by one percentage point each year from 4 percent to 8 percent of the technical provisions. The CBA also continued to firm the regulatory framework for prudential supervision by issuing two revised policy papers in 2011. It distributed an amended policy paper on liquidity risk management and one on business continuity management. These policy papers aim to promote safe and sound practices for liquidity management and business continuity management by setting high level standards in these areas. Additionally, to enhance transparency in the consumer credit market and to provide the public with adequate information on the true costs of these types of loans, the CBA published a revised directive on the publication of the effective interest rate on consumer loans in June 2011.

Furthermore, the CBA, in response to the negative signals received from time to time on possible questionable practices within this sector, decided to reintroduce regulation for pawnshops. To this aim, it circulated a revised dispensation policy for pawnshops based upon section 48, paragraph 1 of the State Ordinance on the Supervision of the Credit System (SOSCS), which came into effect in April 2012. New pawnshops need to obtain a dispensation from the CBA prior to commencing their activities. The already operational pawnshops have received a one-year transitional period to meet the requirements laid down in the aforementioned dispensation policy.

Via periodic onsite examinations and continuous offsite surveillance, which includes, among other things, the close reviewing of the regulatory reports that each institution must submit to the CBA, the financial health of the institutions supervised as well as the main
developments in the sectors are monitored. Another major supervisory challenge is that since January 1, 2011, the CBA has been entrusted with the supervision of Aruba’s civil servants pension fund, the APFA, which coverage ratio lies substantially below the minimum coverage ratio of 100 percent. The discussions with APFA’s main sponsor, the government of Aruba, on the modalities of a recovery plan (to be approved by the CBA) are in the final stages.

Overall, the supervised sectors remained sound; however, the environment in which they operate is generally less favorable than a few years ago. To illustrate: the combined profitability of the commercial banks decreased in the past few years primarily because of required higher additions to the allocated loan loss provisions vis-à-vis the non-performing loans (NPL’s), and increasing operational costs, primarily personnel and IT-related. Although the level of provisioning by the commercial banks against the NPL’s is largely adequate and they have sufficient buffers to absorb additional losses should the economic climate worsen, the still rather high non-performing loans ratio of these banks remains a matter of concern. The same concern exists for banklike institutions. Furthermore, the significant contraction in the overall liquidity in the domestic market, partially the result of the government borrowing over the past three years on the domestic market to finance its financial deficits, requires close monitoring. Moreover, as part of its vigilance concerning developments within the commercial banking sector, the CBA conducts bi-annual stress tests on individual banks to measure the effects of significant shocks on their prudential ratio’s, including their solvency and prudential liquidity ratios. The results of this testing indicate that further strengthening of the prudential liquidity requirements may be warranted. Also, the persisting low interest rate environment, in particular in U.S. financial markets, will continue to pose challenges to the insurance companies and pension funds in terms of their return on investments on fixed income instruments the coming years.

No doubt the year 2011 was again a defining year for Aruba on both the economic and financial fronts. It was a year that started with renewed hopes for a strong sustained economic recovery but ended with concerns on what the immediate future will bring to the island’s economy. While the short-term financial viability of the refinery is one of the biggest challenges that Aruba faces at the moment, other major problems remain on the horizon, like the structural weakness in government finances, the further diversification of the Aruban economy, the relatively high cost of living, excessive household debt, eroding purchasing power, and the rapidly aging population. Though solutions may not exist for all of these issues at the same time, continuous joint efforts to structurally address these important issues should continue unabatedly. In addition to carrying on with the social dialogues, as an important instrument to promote consensus on issues vital to the Aruban community, public debate involving the relevant stakeholders also should remain high on the agenda to provide transparency on the underlying decision making process, as well as the required accountability on how we deploy our scarce resources. The decisions we make today will determine the effectiveness of our contribution to the medium and long term well-being of our community.