Overview:

Available indicators for the Aruban economy displayed a weakening during the first quarter of 2016, mirrored primarily by a 1.4 percent contraction in tourism receipts. Moreover, a lackluster credit market, significant declines in revenues from taxes on commodities and turnover tax (BBO) as well as decreases in a number of economic indicators such as construction permits granted, consumer confidence, and food imports further exemplified the slack economic conditions during the quarter under review.

On the inflationary front, the 12-month inflation continued on its downward path during the first quarter of 2016 mostly pushed down by lower gasoline prices. Moreover, a reduction in electricity tariffs (January 2016) and torpid domestic consumption contributed to the ongoing subdued general price level. The underlying price developments remain slightly inflationary, as the core inflation rate (inflation excluding food and energy components) edged up to 0.7 percent.

Net foreign assets strengthened further during the first quarter of 2016, growing by Afl. 145.2 million to Afl. 1,756.2 million. At that height, they more than adequately exceed the critical norms used by the CBA, including the number of months of current account payments covered by the net foreign assets (4.8 months).

Based upon recent CBA estimates, the Aruban economy is expected to expand by 0.4 percent in real terms in 2016, after experiencing negative growth in 2015 (-0.5 percent in real terms). Overall, the first three months of 2016 got off to a slow start in terms of economic activities. Economic growth in 2016 will materialize only if the restart of the oil refinery and related investments are executed as planned.*

* The cut-off date for information published in the State of the Economy is September 12, 2016.
Data are based on the Statistical Tables for the first quarter of 2016, available on the CBA’s website.
I. Domestic developments

The Aruban economy weakened in the first quarter of 2016 compared to the first quarter of 2015 as a number of consumption and investment indicators testify to negative growth. While tourism arrivals still recorded positive growth during this period, tourism receipts contracted by 1.4 percent.

Consumption

Income from consumption-related taxes, comprising of import duties and all excises, declined by 4.0 percent during the quarter under review. The latter decline resulted from a drop in receipts from excises on commodities (−6.3 percent), which were offset mainly by a rise in those from import duties (+3.5 percent) (Table 1). In addition, turnover tax receipts decreased by 8.7 percent during the first quarter of 2016 (Chart 1).

In the first quarter of 2016, consumers held more pessimistic views of current and future conditions than in the first quarter of the previous year (Box 1). Declines were noted in both the present situation (−0.7 index point) and expected situation (−0.3 index point) for the first quarter of 2016, resulting in a pessimistic overall index of 94.5 (first quarter of 2015: 94.8).

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Table 1: Consumption-related taxes (in Afl. million)

<table>
<thead>
<tr>
<th></th>
<th>2015 Q1</th>
<th>2016 Q1</th>
<th>Change</th>
<th>Change in %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Import duties</td>
<td>34.5</td>
<td>35.7</td>
<td>1.2</td>
<td>3.5</td>
</tr>
<tr>
<td>Turnover tax (BBO)</td>
<td>25.6</td>
<td>23.4</td>
<td>−2.2</td>
<td>−8.7</td>
</tr>
<tr>
<td>Excises on commodities</td>
<td>29.0</td>
<td>27.2</td>
<td>−1.8</td>
<td>−6.3</td>
</tr>
<tr>
<td>Excises on liquor</td>
<td>4.7</td>
<td>4.7</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td>Excises on tobacco</td>
<td>2.8</td>
<td>1.9</td>
<td>−0.8</td>
<td>−29.9</td>
</tr>
<tr>
<td>Excises on beer</td>
<td>6.9</td>
<td>5.2</td>
<td>−1.7</td>
<td>−24.1</td>
</tr>
<tr>
<td>Excises on gasoline</td>
<td>14.7</td>
<td>15.3</td>
<td>0.7</td>
<td>4.6</td>
</tr>
</tbody>
</table>

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Chart 1: Consumption indicators

Percentage change
According to the CBA’s consumer confidence survey, 33.7 percent of the respondents indicated that their personal financial position had deteriorated compared to six months earlier (2015Q1: 37.8 percent). About half (49.4 percent) of the respondents experienced a worsening of business conditions compared to the previous six months (2015Q1: 54.8 percent), whereas 70.4 percent of respondents indicated that the labor market conditions had deteriorated compared to six months earlier (2015Q1: 62.9 percent). Furthermore, 54.9 percent of respondents felt that the government’s financial position had worsened when compared to the previous six months (2015Q1: 55.3 percent) while 63.4 percent of respondents felt that taking out a loan was unsuitable during the first quarter of 2016 (2015Q1: 70.8 percent).

Other gauges of consumption provided a mixed picture in the first quarter of 2016. Whereas growth was recorded in household electricity consumption (1.9 percent), household water consumption (6.7 percent), gasoline consumption as proxied by excise revenues on gasoline (4.6 percent), and income from import duties (3.5 percent), decreases were registered in the consumption of household gas (2.6 percent), turnover tax receipts (BBO) (8.7 percent), excise income on commodities (6.3 percent), and food imports (3.7 percent). Noteworthy is that increased consumption levels for electricity and gasoline are likely to be attributed to the lower prices for these commodities.

Overall consumer credit by commercial banks contracted Afl. 9.8 million (-1.7 percent) during the first quarter of 2016, reflecting the lackluster appetite for personal loans, car loans, and use of credit cards. Nevertheless, the commercial banks provided ample amount of new credit (Afl. 38.3 million). This leads to the conclusion that consumers had a very strong focus on repayments of loans.
The number of car sales at dealerships during the first quarter of 2016 rose by 2.9 percent compared to the same period of last year and reflected a shift from the purchase of vehicles within the mini (-31.5 percent) and subcompact (-21.3 percent) segments to the compact SUVs (+65.5 percent) segment.

**Tourism**

Improvements in the number of visitors were overshadowed by a contraction in tourism receipts during the first quarter of 2016, when compared with the same period of the previous year. The total number of visitors, consisting of stay-over and cruise tourists, registered a growth of 15.8 percent to 590,099 visitors. Following double-digit growth in the past six quarters, stay-over arrivals grew by 5.4 percent, totaling 310,255 during the first quarter of 2016 (Chart 2). Bolstered by upturns in arrivals from Venezuela (+13.0 percent or 8,934 visitors) and the United States (+1.7 percent or 2,806 visitors), the first quarter’s results may be attributed to an earlier calendar period for the Easter holiday season, which shifted from April 5 in 2015 to March 27 in 2016. The tourism market diversification grew by 0.01 index point to 0.35, illustrating the tourism market share developments of the United States (-1.9 percentage points to 53.1 percent) and Venezuela (+1.7 percentage points to 25.1 percent).

After registering declines due to cruise ship rescheduling throughout 2015, cruise tourism rebounded during the first quarter of 2016, expanding by 30.2 percent to 279,844 cruise visitors.
With a 2.5 percent growth rate, total visitor nights grew at a much slower pace in the first quarter of 2016 than stay-over arrivals (Chart 3). Consequently, average nights stayed per visitor dropped from 7.3 nights during the first quarter of 2015 to 7.1 nights during the first quarter of 2016. Despite the expansion observed in stay-over arrivals, tourism receipts declined by 1.4 percent, reflecting a disparate development among these indicators likely attributed to a shorter average length of stay by Venezuelan tourists (from 5.1 to 4.2 days) together with less tourism receipts per visitor night.

During the first three months of 2016, average room occupancy declined by 2.8 percentage points to 80.0 percent, compared to the same period in 2015. This drop stemmed from a higher percentage of Venezuelan stopovers (83.2 percent) staying in apartments or private homes rather than hotels.

**Investment**

The investment climate noted a slight improvement, as some investment indicators registered upturns. Double-digit growth was registered in the import of cement (+59.6 percent) and base metals and derivative works (+17.7 percent), likely attributed to the works conducted on the Green Corridor project. However, the import of machinery and electrotechnical equipment fell by 6.7 percent in the quarter under review, compared to the same period of the previous year. Notwithstanding the upturns in the investment-related imports, declines were noted in the number (-9.7 percent) and value (-30.5 percent) of construction permits granted during the first quarter of 2016, compared to this same period in 2015.
In spite of these buoyant developments, business loans registered a decrease of 0.7 percent during the quarter under review. The total volume of business loans at the end of the first quarter of 2016 amounted to Afl. 1,261.3 million, almost 5 percent beneath the volume of the same quarter of 2015. In the years 2011 up until 2014, the amount of business loans expanded continuously with an annual average growth rate of approximately 5 percent.

Foreign direct investment (net) recorded a surplus of Afl. 33.8 million during the first quarter of 2016, which is an improvement of Afl. 74.3 million, when compared to the Afl. 40.5 million deficit registered during the first quarter of 2015. The latter improvement is chiefly related to trade credit transactions.

Imports of goods (excluding the oil sector), as recorded in the balance of payments, decreased by 10.6 percent during the first quarter of 2016, despite the increase in stay-over visitors mentioned earlier. In addition to a weaker domestic demand, a drop in imports by the free-zone sector further narrowed the imports of goods. These developments in imports complement the weakened state of consumption and investment indicators.

**Consumer Price Index (CPI)**

The 12-month inflation rate decreased from 0.8 percent to zero percent at the end of March 2016, when compared to the same month of the previous year (Chart 4). In March 2016, consumer prices continued their descent for the seventh consecutive month, due mainly to lower gasoline prices. The 12-month core inflation rate (i.e., inflation excluding food and energy components) edged up from 0.4 percent to 0.7 during the period under review.
Monetary Survey

Overall credit registered negative growth (−0.2 percent) during the first three months of 2016, compared to December 2015. Business loans had declined by 0.7 percent at the end of March 2016. Consumer credit fell by 2.3 percent, mimicking the weakened state of consumption indicators and the Consumer Confidence Survey, which fell to its lowest position during any first quarter period in the previous four years. On the other hand, housing mortgages partly countered the negative credit developments by recording an increase of 0.9 percent during the first quarter of 2016.

Total money supply rose by 2.5 percent in the first quarter of 2016 to Afl. 3,935.1 million, compared to a growth of 2.4 percent in the previous year. This slight increase was brought about by a net inflow of foreign funds (+Afl. 103.1 million), caused mainly by the registration of a smaller deficit on the financial account of the balance of payments, whereas net domestic assets contracted by Afl. 8.3 million. In spite of the weakened performance in tourism sector exports, the smaller outflow of foreign funds by the oil sector and fewer imports of goods and services were the primary factors that led to the improvement in the net foreign assets position (NFA). At the end of March 2016, the NFA (including revaluation differences of gold and foreign exchange holdings) reached Afl. 1,756.2 million, an increase of Afl. 145.2 million compared to the end of December 2015 following the pattern observed since the fourth quarter of 2014. As a result, net foreign assets (including revaluation differences of gold and foreign exchange holdings) remained at an adequate level when benchmarked against the critical levels used by the CBA, including the number of months of current account payments covered by the net foreign assets. The current account coverage ratio (twelve-month average) strengthened to 4.8 months during the first quarter of 2016, up from 4.4 months during the previous quarter.
Balance of payments

Driven by developments in the tourism receipts component of the services account, the current account registered a smaller surplus of Afl. **175.0 million** at the end of the first quarter of 2016, compared to the Afl. 192.6 million recorded during the same period in 2015. This Afl. 17.3 million decrease resulted mainly from a 2.4 percent decline in service exports, induced by contractions in tourism receipts, construction services, and other services. Conversely, a larger deficit was noted in the income account (-Afl. 27.5 million) compared to the first quarter of 2015 due to higher dividend payments by the hotel sector and interest payments on bonds by the government. The deficit on the current transfers account contracted slightly, mainly reflecting an Afl. 4.5 million decline in payments for nonlife premiums and lower receipts by the government.

The Afl. **63.3 million** deficit on the capital and financial account stems mainly from outflows in the other investment (Afl. **85.7 million**) and the financial derivatives (Afl. **26.0 million**) components of the financial account, which contracted by, respectively, Afl. 103.7 million and Afl. 5.0 million, compared to the same period in the previous year. Flows in the other investment account resulted from a rise in claims of residents for deposits in foreign accounts and a lower inflow of capital recorded. The higher outflow in the financial derivatives account reflected a broadening of the hedging expenses for the acquisition of Heavy Fuel Oil (HFO) due to lower oil prices. These contractions were partly offset by expansions in direct investment (Afl. **33.8 million**) and portfolio investment (Afl. **15.9 million**) arising from trade credit transactions and from higher net sales of foreign equities and debt securities by residents, respectively.

The overall balance of payments recorded an Afl. **103.1 surplus** in the quarter under review, Afl. 14.5 million higher than observed during the same period of last year.
The quality of the commercial banking sector’s loan portfolio improved slightly during the first quarter of 2016. The average nonperforming loan ratio decreased to 4.8 percent for the period under review from 6.3 percent in the first quarter of 2015, continuing the downward trend that began after its peak in 2011 at 10.9 percent. The continued decrease was attributed to repayments on nonperforming loans as well as the restructuring of certain nonperforming loans.

Other prudential indicators remained adequate throughout the first quarter of 2016. The banks’ risk-weighted capital asset ratio reached 26.7 percent during this period (required minimum = 14.0 percent), up from 24.3 percent in the first quarter of 2015. The loans-to-deposit ratio went down to 67.7 percent (maximum = 80.0 percent) in the first quarter of 2016 from 72.5 percent a year earlier. Furthermore, the prudential liquidity ratio of the commercial banks strengthened in the period under review, reaching 28.9 percent (required minimum = 15.0 percent), up from 25.2 percent during the first quarter of 2015.

II. Outlook

After experiencing negative growth (-0.5 percent) in 2015, the Aruban economy is projected to expand in real terms by 0.4 percent in 2016 (Table 2). Unlike previous years, tourism service exports are foreseen to negatively impact economic growth through a decrease in tourism receipts. However, in anticipation of the possible re-opening of the oil refinery in 2016, private investment is projected to add to economic activity with a robust growth of 25.8 percent in 2016. Private consumption is expected to stay subdued with an expansion of 2.0 percent as consumer confidence shows no significant signs of improvement. Given these projected developments, imports should increase by 5.5 percent, reflecting mainly the import of investment materials.
The balance of payments is forecast to record an overall surplus of Afl. 204.4 million in 2016, due mainly to the transactions of the non-oil sector. The overall balance of the non-oil sector is projected at a surplus of Afl. 327.5 million, partially offset by an overall Afl. 123.2 million deficit of the oil sector. The latter deficit would be primarily the result of the imports of oil products for domestic use. The overall surplus of the non-oil sector is anticipated to be driven by net inflows on both the current account and the capital and financial account.

A moderate decrease is expected in the general price level in 2016, thus likely continuing a deflationary trend. Combined with a reduction in electricity tariffs (January 2016), the expectation that oil prices will remain at low levels should cause external cost push pressures to remain limited. Consequently, the 12-month average inflation rate is projected at -0.8 percent.

The main downside risks to the economic outlook are the delay in the restart of the oil refinery, the execution of other investment projects and the ongoing economic crisis in Venezuela, whereas the primary upside risk is related to a rebound of tourism service exports.

Table 2: Economic growth in real terms, expressed in percentages

<table>
<thead>
<tr>
<th></th>
<th>2013(^e)</th>
<th>2014(^e)</th>
<th>2015(^e)</th>
<th>2016(^f)</th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP</td>
<td>4.2</td>
<td>0.8</td>
<td>-0.5</td>
<td>0.4</td>
</tr>
<tr>
<td>Private consumption</td>
<td>4.0</td>
<td>0.5</td>
<td>-4.4</td>
<td>2.0</td>
</tr>
<tr>
<td>Public consumption</td>
<td>1.9</td>
<td>-8.1</td>
<td>5.3</td>
<td>-4.0</td>
</tr>
<tr>
<td>Private investment</td>
<td>-3.5</td>
<td>-3.7</td>
<td>-4.0</td>
<td>25.8</td>
</tr>
<tr>
<td>Public investment</td>
<td>-56.6</td>
<td>16.0</td>
<td>-26.8</td>
<td>-19.3</td>
</tr>
<tr>
<td>Imports</td>
<td>0.4</td>
<td>-1.5</td>
<td>-2.8</td>
<td>5.5</td>
</tr>
<tr>
<td>Exports</td>
<td>6.0</td>
<td>3.1</td>
<td>-0.1</td>
<td>-0.6</td>
</tr>
</tbody>
</table>

\(e = \text{estimate}; f = \text{forecast}\)
III. International developments

In the first months of 2016, the world economy continued a low growth path as a result of the soft expansion in advanced economies, persistent weak commodity prices, and the continued re-balancing to a more sustainable growth model in China. Furthermore, more pronounced downside risks and increased uncertainties, especially with the unfolding of “Brexit”, resulted in a subdued global outlook. The International Monetary Fund (IMF) notes in its most recent update of the World Economic Outlook (WEO) that although better-than-expected euro area growth counterbalanced weaker growth in the United States, productivity growth in most advanced economies remained sluggish and inflation persisted below target in the first few months of 2016. On the other hand, prospects remained diverse across emerging market and developing economies (EMDEs), with some improvements for a few large emerging markets, Brazil and Russia in particular.¹

Additionally, the World Bank states that the divergence in economic conditions between commodity exporters and importers has widened as commodity exporters are struggling to adjust to persistent low commodity prices and importing EMDEs have shown resilience to headwinds.² Furthermore, while global industrial activity and trade have been lackluster amid China’s rebalancing, recent data show some pick-up due to stronger infrastructure investment in China and higher oil prices. The first half of the year has shown better than expected economic activity. However, the “Brexit” vote implies a substantial increase in uncertainty and is projected to have negative macroeconomic consequences. As a result, the IMF has revised its global forecasts downward by 0.1 percentage point for 2016 and 2017 to 3.1 percent and 3.4 percent, respectively. Going forward, longstanding crisis legacies remain looming over advanced economies, while EMDEs face risks relating to rising vulnerability such as lower commodity prices, higher corporate debt and volatile capital flows. Additionally, these risks can be the cause of spillovers that cross

¹ IMF, World Economic Outlook Update, July 2016
borders with greater frequency and force than before. The Managing Director of the IMF, Ms. Christine Lagarde, urges a three-pronged approach to tackle these issues: (1) enact more specific structural reform, (2) enact more growth-friendly fiscal policy, and (3) develop monetary policy supported by the first two approaches.³

In the United States, economic expansion was weaker than expected in the first quarter of 2016, with a downward revision of 0.3 percentage point to 0.8 percent, reflecting slowdowns in residential fixed investment, inventory buildup, and exports.⁴ Nonetheless, advance estimates show a pickup in the second quarter of 2016 of 1.2 percent at an annual rate related to increased personal consumption expenditures and exports, as well as a drop in imports, more or less consistent with fading headwinds from a strong U.S. dollar and lower energy sector investment. Furthermore, the Brexit impact is expected to be muted for the United States, while lower long-term interest rates and a more gradual path of monetary policy normalization are expected to offset larger corporate spreads, a stronger U.S. dollar, and some decline in confidence. The IMF expects a 2.2 percent real GDP growth in 2016, and a slight acceleration to 2.5 percent in 2017.

According to the ECB, recovery in the euro area continues at a moderate pace, supported by domestic demand, while export growth remains modest.⁵ Real GDP increased by 0.6 percent quarter-on-quarter in the first quarter, supported by robust private consumption dynamics as well as continued improvements in investment, whereas net trade contributed negatively. Changes in inventories also contributed positively to GDP growth in the first quarter of 2016. Private consumption has benefitted from rising real disposable income among households, primarily as a result of rising employment and lower oil prices. Given the outcomes in the first half of the year, the IMF revised the 2016 growth projections upwards by 0.1 percentage

³ Decisive Action to Secure Durable Growth; Lecture by Christine Lagarde, April 5, 2016. Bundesbank and Goethe University, Frankfurt, Germany.
point to 1.6 percent. However, the potential negative impact of Brexit on consumer and business confidence has led the IMF to revise its 2017 growth estimates downwards to 1.4 percent (-0.2 percentage point).

Japan recorded better-than-expected first quarter results, although domestic demand remains weak and annual headline CPI inflation declined further into negative territory in May 2016. The announced delay in the April 2017 consumption tax hike to October 2019 bodes positive for economic growth in 2017. However, the IMF expects further appreciation of the yen, a trend in recent months, to take a toll on growth in both 2016 and 2017, resulting in growth percentages of 0.3 percent and 0.1 percent, respectively.

In China, a range of expansionary policy measures were implemented in the second half of 2015, and further policy easing in 2016 has led to an improved near-term outlook. Growth in China decelerated further to 6.7 percent in the first quarter of 2016, reflecting lower exports and slowing investment. Gradual domestic rebalancing from an investment to a consumption model is underway, while the pickup in the services sector has compensated for the sharp slowdown in industrial activity. With the Brexit impact likely limited for China, the IMF expects China’s growth outlook to remain broadly unchanged at 6.6 percent in 2016 and 6.2 percent in 2017.

In Latin America and the Caribbean, overall growth in 2016 is expected to be negative for a second consecutive year (-0.4 percent), with economic activity in 2017 likely to strengthen to 1.6 percent. Venezuela is expected to remain in a deep recession in 2016 amid political uncertainties and low oil prices. Inflation is anticipated to rise close to 500 percent in 2016. On the other hand, consumer and business confidence appears to have bottomed out in Brazil, and the GDP contraction was lower than expected in the first quarter of 2016. As a result, the 2016 recession is likely to be milder, with a possible return to positive growth in 2017. Nonetheless, political and policy uncertainties remain, posing a threat to the outlook.

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6 World Bank, Global Economic Prospects, June 2016.
7 IMF, World Economic Outlook, April 2016.
IV. Concluding remarks

The first quarter of 2016 can be compared to the economic developments that transpired during 2015, wherein economic activity in Aruba was flat. While overall tourism visitors noted upturns, contributions from tourism weakened along with other indicators for consumption and investment. However, the re-opening of the oil refinery in 2016 will likely strengthen the performance of investment indicators and push output in the positive range.

During the first three months of 2016, the Aruban economy was driven by the performance in the tourism sector. Even though tourism receipts declined during this period, the sector’s contribution compensated for the lackluster development in consumption and investment. Delays in several projects continued, so benefits failed to materialize. While the number of tourists visiting the island continued to rise, the number of nights spent grew at a slower pace due mainly to the Venezuelan tourism market, which was influenced by the socio-economic situation of that country.

Consumer prices continued moving downward for the seventh consecutive month since the commencement of their descent in October 2015, predominantly because of lower gasoline prices. Inflation declined to zero percent at the end of March 2016 and is expected to become negative again during 2016 as a result of the decline in electricity tariffs (January 2016) and gasoline prices as well as the sluggish domestic consumption conditions.

Net foreign assets rose during the first quarter of 2016, largely related to a smaller deficit on the financial account, and continued at an acceptable level when benchmarked against the 2016 estimates of the critical levels used by the CBA, including the number of months of current account payments covered by the net foreign assets.

Based upon available information, the Aruban economy is currently projected to record marginal growth in 2016. However, the timely
execution of a number of investment projects is essential to the realization of this projection.