Brief Overview:

In the first six months of 2016, the economic activities appeared to have slowed down significantly, based upon available information. Real GDP, as estimated by the CBA, contracted by 1.6 percent due to lower tourism exports, subdued investments and sluggish domestic consumption.

Tourism income, as registered in the balance of payments, decreased by 1.0 percent, in contrast to a 5.3 percent gain in the same period in 2015. This may be largely related to the reversal in the buoyant trend in the Venezuelan market that was evident in the previous five years.

Consumption fell relative to the year before as is reflected in the substantial decline in the proceeds from the turnover tax. Moreover, consumers remained pessimistic during the first half of 2016, despite a slight improvement of confidence by the end of June 2016.

The overall price level stayed on the downward path, pushed down further by lower gasoline prices and utility tariffs compared to the same period a year before, resulting in a deflation of 0.6 percent in the 12-month average inflation rate at the end of June 2016. On the upside, the deflation contributed to an improvement in the real effective exchange rate of the Aruban florin relative to the currency of its main trading partner, the United States.

Total government revenue increased by 0.7 percent during the period under review, mainly due to substantially higher proceeds from taxes on income and profit and taxes on property. Intensified activities by the tax authorities to eliminate the existing backlog contributed to this growth.

Total money supply rose by Afl. 266.3 million end-June 2016 compared to end-December 2015, brought about by a net inflow of foreign funds (Afl. 345.5 million), whereas net domestic assets contracted by Afl. 79.2 million.

Given the economic fundamentals and the adequacy of the current account coverage ratio, which was maintained throughout the period under review, the monetary policy stance of the CBA remained unchanged and the reserve requirement stayed at 11 percent throughout the first half of 2016.

* The cut-off date for information published in the State of the Economy is November 9, 2016.

Data are based on the Statistical Tables for the second quarter of 2016, available on the CBA’s website.

The estimations for the Aruban economy are made by the CBA.
I. Domestic developments

Gross Domestic Product (GDP)

In this issue of the State of the Economy, the CBA presents GDP estimates on a quarterly basis for the first time. These estimations are consistent with the annualized growth figures and are calculated by using the observed developments of realized quarterly indicators such as tourism receipts.

The first results show that real GDP contracted over the first six months of 2016 by 1.6 percent, compared to a growth of 0.3 percent in the corresponding period of 2015 (Chart 1). The performance of both the first and the second quarters of 2016 was below that of 2014 and 2015, mainly because of lower tourism exports.

Tourism

The number of visitors to Aruba grew by 1.3 percent during the first half of 2016. However, the development in the second quarter was significantly different from that in the first quarter. The growth was achieved in a strong first quarter, during which the number of visitors
grew by 5.4 percent, compared to a 3.0 percent decrease recorded in the second quarter of 2016 (Chart 2). Part of this development 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 modest growth in stay-over visitors achieved over the first half year of 2016 was carried by a 2.4 percent hike in the U.S. market. However, this increase masks a significant pattern reversal in the Venezuelan market; this segment shrank by 5.4 percent, probably caused by both new traveling restrictions from the Venezuelan government as well as stricter Aruban immigration controls for Venezuelan citizens.

Taking a long-term perspective, stay-over arrivals essentially doubled in volume over a period of 21 years from 582,136 stay-over visitors in 1994 to 1,224,935 visitors in 2015, an average annual growth rate of 3.6 percent (Chart 3). In that respect and also compared to the growth rates seen in recent years that peaked at 14.3 percent in 2015, a gain of 1.3 percent in the period under review is relatively modest.
The observed development also manifested itself in the number of nights that visitors stayed on the island, which grew by a mere 0.3 percent in the first half of 2016, the result of a 2.5 percent increase over the first quarter and a 2.2 percent decrease over the second quarter (Chart 4).

Cruise tourism registered an expansion of 20.1 percent over the first half of 2016 in terms of number of visitors, resulting from 19 more ship calls (+11.9 percent) during this period than in the same period in 2015. However, it should be noted that 2015 was a particularly weak year for cruise tourism in Aruba (due to the cancellation of a cruise...
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line with weekly berthing) and that the 2016-level still has some space to cover to reach the record height realized in 2013.

According to the Aruba Hotel and Tourism Association (AHATA), in the first six months of 2016, average room occupancy in hotels declined by 0.4 percentage point from 79.4 percent in 2015 to 79.0 percent in 2016. The average daily room rate fell by 5.3 percent to US$250.66 and the average RevPar dropped by 5.8 percent to US$198.06. Consistent with these developments, tourism receipts (in nominal terms) decreased by 1.0 percent.

The tourism developments among Aruba’s peers were generally more positive during the period under review, with the number of visitors growing at an average rate of 4.8 percent. The Dominican Republic and Barbados especially experienced substantial increases in stay-over arrivals during the period under review (+6.5 percent and +5.6 percent, respectively). The less buoyant development in Curaçao was more or less comparable to that of Aruba (+1.5 percent).¹

Investment

The investment activities deteriorated as the first half of 2016 unfolded. Since the second quarter, there are no large projects in the execution phase with the exception of the Green Corridor. This observation is confirmed by the level of cement imports. Although there was an increase of 28.4 percent over the first six months of 2016, it was realized over the first quarter of 2016 (+63.8 percent). The second quarter, however, noted a decrease compared to the corresponding quarter of 2015 (−2.6 percent). The import of machinery and electrotechnical equipment shrank by 5.5 percent over the first half of the year while imports of base metals and derivated work rose by 4.8 percent. In addition, significant declines were noted in the number (−22.7 percent) and value (−37.5 percent) of construction permits granted and the number of new businesses

¹ Calculated growth rates from data published by the Caribbean Tourism Organization (CTO). The growth rates are preliminary as not all tourism destinations have yet reported their half year figures.
registered at the Chamber of Commerce (-10.3 percent) during the first half of 2016, compared to the same period in 2015. These developments were accompanied by a minor decrease of 0.6 percent in business loans in the first two quarters of 2016.

**Consumption**

Although the consumption indicators provide a mixed picture over the first half of 2016, consumption is estimated to have decreased relative to 2015. The proceeds from the turnover tax shrank substantially while consumer credit provided by the commercial banks also declined (Chart 5).

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<th>Chart 5: Consumption-related indicators (percentage change 2016 Q1+Q2 vs. 2015 Q1+Q2)</th>
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On the other hand, consumer confidence (total index, present situation, and future expectations) shows an improvement at the end of June 2016 compared to last year, but overall the consumer confidence index remains below the 100 point level (96.8), indicating that consumers remained pessimistic. In addition, merchandise imports, as registered by the CBS, fell by 3.5 percent. Lower imports of consumption-related goods, such as textile articles, footwear, and leather products, also contributed to this development. The observed
increase in import duties is probably the result of improved tax collection by the customs of Aruba as they currently implement a program of false invoice recognition.

**Consumer Price Index (CPI)**

The 12-month inflation rate became negative, i.e., −0.6 percent at the end of June 2016. A year earlier, it stood at 1.0 percent (Chart 6).

![Chart 6: 12-month inflation](chart)

In June 2016, consumer prices continued their descent into deflationary territory that began in April 2016, due mainly to the lower gasoline prices in 2016. To an increasing extent, reduced utility prices, introduced in January 2016, also are exerting downward pressure on the energy component. In the absence of food price pressures, the 12-month inflation rate was fully imparted by the previously mentioned downward pressure in the energy component. The 12-month core inflation rate (i.e., inflation excluding food and energy components) decreased marginally from 0.7 percent to 0.5 percent during the period under review.

Aruba’s real exchange rate relative to that of the United States dropped by 1.2 percentage points in the second quarter of 2016 in comparison to the fourth quarter of 2015 (Chart 7). Thus, Aruba’s competitive position improved relative to that of the United States.
This follows a pattern of improvements in Aruba’s competitive position that has been visible since 2012.

**Government**

Total government revenue increased by 0.7 percent during the first six months of 2016 (Chart 8). This increase was realized despite a sharp fall in nontax revenues that stemmed from high receipts in 2015 due to SVB debt forgiveness. Of the tax revenue components, only the receipts of turnover tax and taxes on services were lower compared to the first half of 2015 (−3.7 percent and −1.8 percent respectively), while the largest gains, in absolute terms, were recorded in proceeds from taxes on income and profit (+Afl. 43.8 million). These gains were related to intensified efforts by the tax authorities to eliminate the existing backlog. The income growth in taxes on property (+47.0 percent) was largely attributable to higher land tax receipts in the second quarter of 2016 (Afl. 12.6 million compared to Afl. 3.0 million in the second quarter of 2015).

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1 In 2015, nontax revenues were inflated by the processing of an Afl. 60.5 million settlement agreement between GOA and SVB.
In May 2016, the government of Aruba issued two US$ bonds for a total of US$ 179 million with maturities of respectively 8 and 12 years and an interest rates of 6.1 and 6.5 percent).

At the time of writing, detailed data on government expenditure or government debt for 2016 were not processed yet.

**Monetary Survey**

**Overall domestic bank credit contracted by 1.9 percent during the first half of 2016, compared to December 2015.** However, significant variation occurred within the main credit components as consumer credit and business loans fell by 2.0 percent and 0.6 percent, respectively, while housing mortgages by commercial banks increased by 2.3 percent. Housing mortgage lending by other institutions rose by Afl. 4.8 million to Afl. 593.4 million at the end of June 2016, compared to the end of December 2015. This growth resulted mainly from higher housing mortgage lending by pension funds (Afl. 3.6 million) and other financial institutions (Afl. 3.3 million). In contrast, housing mortgage lending by the mortgage banks decreased by Afl. 2.3 million. In terms of the value of new credit...
registered during the period under review, commercial mortgages declined by Afl. 0.2 million, commercial term loans decreased by Afl. 0.6 million, while new individual consumer credit and mortgages picked up by Afl. 7.1 million and Afl. 25.2 million, respectively.

The weighted average interest rate on new loans rose from 7.0 percent in December 2015 to 7.3 percent in June 2016, reflecting higher interest rates on both consumer credit and commercial loans. However, the interest rate on housing mortgages was a notable exception to this development, as it decreased from 6.3 percent in December 2015 to 5.9 percent in June 2016. A long-term perspective on developments in interest rates is provided in Box 1.

Total money supply rose by Afl. 266.3 million in June 2016 compared to December 2015. This increase was brought about by a net inflow of Afl. 345.5 million in foreign funds, while net domestic assets contracted by Afl. 79.2 million. At the end of June 2016, the net foreign assets (including revaluation differences of gold and foreign exchange holdings) surpassed the Afl. 2 billion mark for the first time, reaching Afl. 2,020.2 million, an Afl. 409.3 million increase compared to the end of the December 2015, mainly related to the two US$-bond issues of the government of Aruba. Consequently, net foreign assets remained at an adequate level when benchmarked against the critical norms used by the CBA.

Given the economic fundamentals and the adequacy of the current account coverage ratio, which was maintained throughout the period under review, the monetary policy stance of the CBA remained unchanged and the reserve requirement stayed at 11 percent throughout the first half of 2016.
Box 1: Long-term interest rate margin

The long-term behavior of commercial bank interest rates in Aruba reveals that both the weighted average rate of interests on new loans and the weighted average rate of new deposits have been on a declining trajectory (Chart A1). Up until about 2012, the interest rate margin was increasing, peaking at 8.5 percent. Since then, the interest rate margin came down to about 6 percent and remained relatively stable in 2015 and 2016 (Chart A2). The current average interest rate margin in the second quarter of 2016 stood at 6.3 percent, which is quite high compared to the interest rate margins in the highly industrialized countries. This high spread is partly the result of the oligopolistic market structure of this sector and the diseconomies of scale faced by banks operating in Aruba.
Balance of payments

The current account of the balance of payments registered a surplus of Afl. 167.3 million in the first six months of 2016, compared to Afl. 158.3 million recorded during the same period of 2015. This slight improvement was caused mainly by an Afl. 176.7 million lower import payments of goods by the oil sector in 2016, due to reduced oil prices. The goods import payments of the non-oil sector fell by Afl. 64.6 million, a sign of the weakening local consumption and investment activities. Aruba’s net income from services remained more or less equal, although tourism receipts declined by 1.0 percent. This slight decline was compensated by the lower freight payments (due to the reduced import payments of goods) and lower international travel payments by Aruban residents. The income account of the first six months showed a deficit of Afl. 146.4 million related mainly to higher dividend payments from resident companies. Despite the mentioned contraction, the share of tourism receipts in the current account receipts of the non-oil sector was 74.2 percent, the highest ratio recorded in the last 8 years. Thus, Aruba’s dependency on tourism is increasing and remains very high.

The capital and financial account (excluding banking transactions) also showed a surplus (+Afl. 185.6 million) in the first half of 2016, on balance the result of an Afl. 80.7 million deficit of in the first quarter that was more than compensated by an Afl. 266.3 million surplus in the second quarter. On balance, net inflows from direct investments as well as portfolio investments were partially offset by net outflows from financial derivatives and other investments.

The net inflow in the portfolio investments is largely explained by the two US$ bond issues by the Aruban government (totaling Afl. 179 million). The net direct investment inflows in the first quarter were related to trade credit transactions of the oil sector and in the second quarter to inter-company loans and trade credit transactions of the non-oil sector. The net deficit in the other investment accounts resulted from a deficit in the first quarter together with a (smaller) surplus in the second quarter. This deficit reflects mainly the
development in banks’ currency and deposits of resident holders of notified foreign bank accounts.

**Prudential**

The quality of the commercial banking sector’s loan portfolio improved considerably during the first half of 2016. The average nonperforming loan ratio decreased to 4.8 percent for the period under review from 6.3 percent in the first half of 2015, continuing the downward trend that began after a 10.9 percent peak in 2011. This was attributed to write-off repayments and the restructuring of certain nonperforming loans.

Other prudential indicators remained adequate throughout the first half of 2016. The banks’ risk-weighted capital asset ratio reached 27.6 percent during this period (required minimum = 14.0 percent), up from 25.5 percent in the first half of 2015. The loans-to-deposit ratio was 67.0 percent (maximum = 80.0 percent) in the first half of 2016 down from 71.6 percent a year earlier. Furthermore, the prudential liquidity ratio of the commercial banks strengthened in the period under review, reaching 29.7 percent (minimum requirement = 15.0 percent), up from 26.5 percent during the first half of 2015.

**II. International developments**

According to the October 2016 update of the IMF’s World Economic Outlook, world GDP was estimated at a 2.9 percent expansion in the first half of 2016. This growth was somewhat lower than projected at the start of the year. The developments in global output are attributed mostly to weak activity in developed economies.

The GDP of the United States in the first half of the year resulted in a growth of 1.1 percent. Output was driven by consumption (3.0 percent), which was supported by a strong labor market and expanding payrolls. On the other hand, subdued business

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3 International Monetary Fund, World Economic Outlook, October 2016.
investments and a significant reduction in inventories mitigated the consumption drive. Also, nonfarm labor productivity declined by 0.6 percent in the second quarter of 2016.

In June, the United Kingdom voted to leave the European Union, an event unexpected in most of the world. The Brexit vote pushed the United Kingdom into a potential financial and political crisis and major uncertainties. The country now has to commence, among other things, trade negotiations with the EU. The United Kingdom’s GDP was performing strongly before the vote and weakened somewhat leading up to the vote. Nevertheless, GDP for the second quarter of 2016 resulted in a growth rate of 2.4 percent. Developments after the Brexit vote have been more moderate with the United Kingdom’s GDP projected at an expansion of 1.8 percent for 2016 compared to projections above 2 percent earlier in the year. The 2017 forecast, however, is well below pace (1.1 percent growth) and also below pre-Brexit projections. Much uncertainty exists for the future and future agreements between the United Kingdom and the EU, agreements that will be vital to its future prospects.

Meanwhile, euro area GDP is currently estimated to grow by 1.2 percent in the second quarter of 2016. The spillover effects from the Brexit vote have been moderate so far. More negative effects, if these occur, will happen in 2017, once more depending on the agreements reached with the United Kingdom.

China’s economic growth for the first half of the year was near its target 6.5-7.0 percent growth for the whole year. This growth was supported by, among other things, strong credit growth, consumption, and a shift to a more service-based economy.

Finally, the aggregate GDP for Latin America and the Caribbean is anticipated to contract by 0.6 percent in 2016. Economic growth in South America is estimated to decrease by 1.9 percent while the economy of the Caribbean is likely to grow by 3.4 percent. The projected drop for South America is caused primarily by the Brazilian

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4 OECD, Interim Economic Outlook, September 21, 2016.
economy, which is currently facing, among other things, political crisis, rising inflation, and a decline in consumer and business confidence. The crisis will most likely spill over to neighbors Argentina, Bolivia, and Paraguay. Another reason for the gloomy outlook is that most South American countries are tightening their macroeconomic policy. Furthermore, a drought caused by El Niño has increased food prices throughout the region. The growth in the Caribbean region is pushed by lower oil prices and a stable U.S. growth. However, individual country growth rates vary considerably.5

III. Concluding remarks

Economic activities have slowed down significantly in the first half of 2016. A contraction of real GDP of 1.6 percent is estimated due to lower tourism exports and a subdued investment climate. Aruba has now experienced four subsequent quarters with economic decline.

The tourism sector suffered from the reversal of the buoyant trend in the Venezuelan market that was evident over the previous five years. The growth figures of stay-over tourists from other important markets were unable to compensate for this fall. The number of stay-over tourist numbers are still increasing but, on average, the tourist spends less and stays a shorter period on the island. Cruise tourism blossomed again after a disappointing 2015.

The investment activities deteriorated as the first half of 2016 unfolded. Since the second quarter, there are no large projects in the execution phase with the exception of the Green Corridor. Consumption, as estimated by the CBA, fell as is reflected in the substantial decline in the proceeds from the turnover tax. Moreover, consumers remained pessimistic during the first half of 2016, despite a slight improvement of confidence by the end of June 2016.

Consumer prices continued moving downward, predominantly because of lower gasoline prices and a decline in utility tariffs,

resulting in a deflation of 0.6 percent in the 12-month average inflation at the end of June 2016. The deflation contributed to an improvement in the real effective exchange rate of the Aruban florin relative to the currency of its main trading partner, the United States.

**Total government revenue increased by 0.7 percent during the period under review,** mainly due to substantially higher proceeds from taxes on income and profit and taxes on property. Increased activities by the tax authorities to eliminate the backlog contributed to this growth.