Centrale Bank van Aruba

STATE OF THE ECONOMY

January-September 2016*

I. Domestic developments 2
Tourism 2
Investment 5
Consumption.................................. 6
Foreign trade 7
Consumer Price Index (CPI) 8
Government.................................. 9
Monetary Survey 11
Balance of payments 12
Prudential....................................14
II. International developments 14
III. Concluding remarks 17

Brief Overview:

Economic activities in Aruba decelerated in the first nine months of 2016. Lower tourism exports and contracting domestic consumption contributed to this development.

Tourism income, as registered in the balance of payments, decreased by 0.4 percent in contrast to a 3.9 percent gain in the same period in 2015. This decline was likely attributed in large part to the reversal in the buoyant trend in the Venezuelan tourism market evident in the previous five years.

Despite some large ongoing projects such as the expansion and renovation of the Dr. Horacio E. Oduber Hospital and the Green Corridor, investment activities did not really gain momentum, due to the subdued refurbishment activities in the oil refinery.

Consumption statistics were also diverse for the year to date but generally pointed to a further slowdown. Noticeable is that revenue from the turnover tax (BBO) recorded negative growth over the first nine months, while consumer credit, as reported by the commercial banks, contracted further.

As a result of falling energy prices and subdued price developments of food products, inflation was pushed downwards in the first three quarters of 2016. Aruba's real exchange rate relative to that of the United States dropped sharply, i.e., by 1.8 percentage points, in the third quarter of 2016 in comparison to the fourth quarter of 2015, thus improving Aruba's competitive position vis-à-vis the United States.

Total government revenue increased by 2.6 percent during the first nine months of 2016, pushed up by higher proceeds from the profit tax and the land tax. Expenditures grew by 1.4 percent, mostly due to higher interest payments and transfers to the AZV. Total government debt at the end of September 2016 enlarged further to Afl. 4,172.1 million, or an estimated 87.3 percent of Aruba's GDP.

Money supply rose by 6.3 percent in the first nine months of 2016. A net inflow of foreign funds (+Afl. 269.4 million) more than compensated for the Afl. 29.6 million contraction in net domestic assets. The inflow of foreign funds, which is lower than in the corresponding period of 2015, stemmed mostly from higher tourism receipts and government foreign borrowing.

Both the current account and the capital and financial account of the balance of payments registered surpluses, resulting in a significant increase in foreign exchange reserves. Consequently, the import coverage ratio stood at 6.0 months of total current account payments at the end of September 2016.

In summary, domestic economic output appeared to have slowed down in the first nine months of 2016. Tourism activities, the main driver for economic growth, faltered unexpectedly, while local consumers remained cautious in their spending.

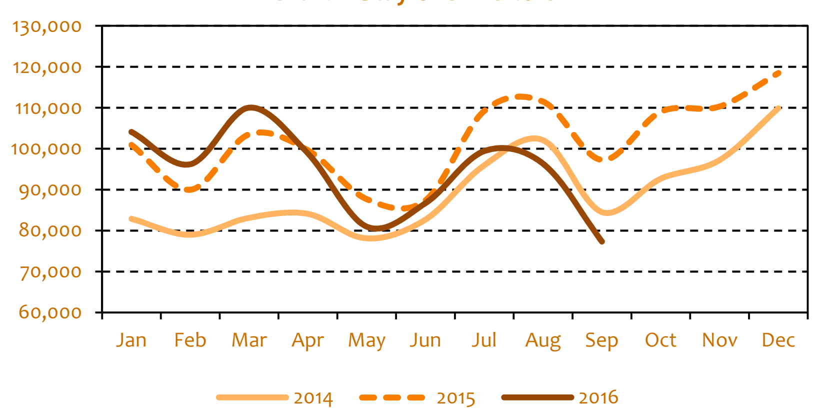
** The cut-off date for information published in the State of the Economy is April 13, 2017.*
Data are based on the Statistical Tables for the third quarter of 2016, available on the CBA's website.

I. Domestic developments

Tourism

Stay over arrivals fell by 4.2 percent year to date September 2016, as the third quarter saw a continuation of the decline in visitors experienced in the previous quarter. This decline not only persisted, but more than quintupled in the third quarter of 2016 (–44,925 visitors) when compared to the second quarter of 2016 (–8,258 visitors) (Chart 1).

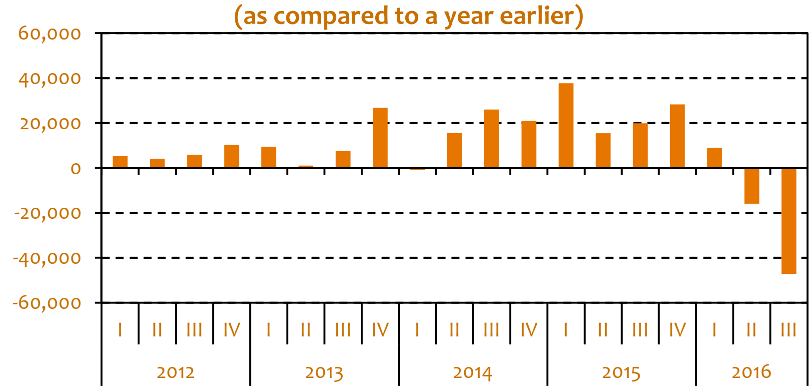
Chart 1: Stay-over visitors



The Venezuelan tourism market was the main reason for the contraction in the number of visitors as the trend reversal intensified, resulting in a 23.5 percent drop in the year to date (Chart 2). This decrease is attributable to Venezuela's deepening economic problems, which led to tighter foreign exchange restrictions by the Venezuelan government.

The U.S. market experienced a slight decline in the third quarter of 2016 (–0.3 percent), the first drop since 2012. As a consequence, the year-to-date growth rate of U.S. visitors fell to 1.5 percent. Although this lackluster development is in line with a much slower general growth rate in U.S. outbound travel to the Caribbean in comparison to previous years (+3.1 percent), Aruba's performance lags behind.[1] On the other hand, the Colombian market reported a significant increase in year-to-date visitors (+39.2 percent), likely the result of additional seat capacity to and from Colombia and the cessation of visa requirements for Colombian tourists.

Chart 2: Growth in stay-over visitors from Venezuela (as compared to a year earlier)



The number of visitor nights for Aruba experienced a similar drop, falling further in the third quarter. This led to a 1.2 percent decline during the first nine months of 2016, against a 9.8 percent gain in the corresponding period of 2015. Venezuelan visitor nights saw a sharp decrease of 22.9 percent year to date, while the U.S. market increased marginally (+0.6 percent). Subsequently, the nights spent in the other accommodations dropped markedly (–4.8 percent), while the number of nights spent at hotel resorts grew slightly (+0.4 percent).

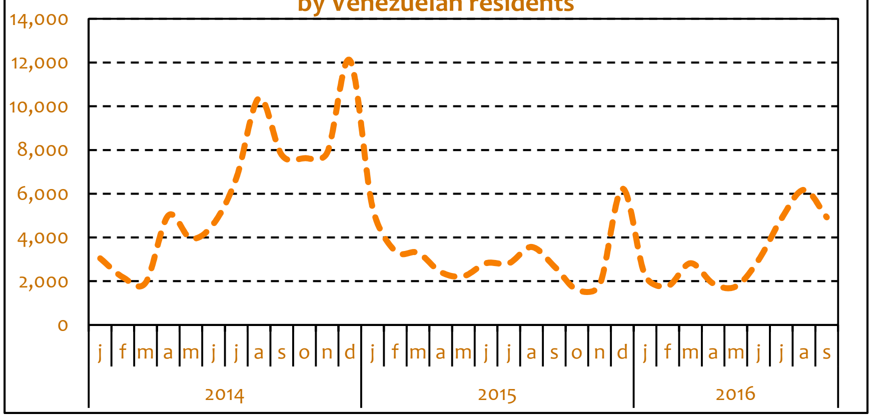
The latter conclusion is corroborated by reports from the Aruba Hotel and Tourism Association (AHATA). Room occupancy rate improved by 1.5 percentage points to 80.2 percent in the first three quarters of 2016, when compared to the same period of 2015. The rise in room occupancy was not sufficient to compensate for the 5.2 percent fall in the average daily room rate (ADR), leading to a 3.4 percent lower revenue per available room (RevPAR). Nevertheless,

[1] The U.S. National Travel and Tourism Office (http://travel.trade.gov) provides statistics on U.S. outbound travel.

total revenue of the hotels strengthened by 1.4 percent to US$ 248 million in the period under review.

Furthermore, a reverse shift was noted towards low-rise hotels, as Venezuelan visitors staying at other accommodations dropped significantly. Recent data show that since June 2016, a significant growth occurred in nights spent by Venezuelan residents in hotels, especially in the low rise area, yet still lagging after two years (Chart 3).

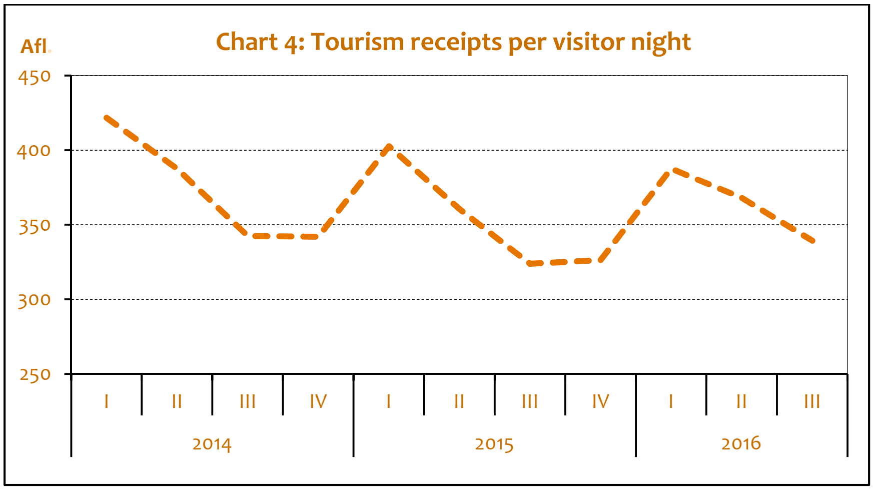
Chart 3: Low rise hotel nights spent by Venezuelan residents



Cruise tourism registered a year-to-date increase of 12 ship calls, leading to a 14.2 percent growth in cruise passengers. Nonetheless, both ship calls and cruise passengers fell in the third quarter of 2016.

Balance of payments data confirm the slack developments in tourism activities previously described: year-to-date tourism receipts declined by 0.4 percent during the first three quarters of 2016. However, the downward trend seen in the first two quarters of 2016 was halted in the third quarter by recording an increase of 0.5 percent in tourism receipts.

The average tourism receipts per visitor nights amounted to Afl. 365 in the first three quarters of 2016, up from Afl. 363 in 2015. The quarterly developments in the last three years are shown in Chart 4.



Investment

Investment activities showed some signs of improvement during the first three quarters of 2016, despite divergent developments in various investment indicators in the period under review. Positive is that cement imports grew by 6.6 percent, while the value of both new individual and commercial mortgages increased by, respectively, 19.2 and 14.5 percent. Additionally, imports of base metals and derivated work rose by 8.5 percent. In contrast, both the number of construction permits granted (–19.2 percent) and the total value of these permits (–35.7 percent) contracted significantly, hinting a possible fall back in short term construction activities. The number of construction permits granted decreased mainly in the houses component (–20.9 percent); however, the value fell sharpest in the others component (–57.4 percent). Furthermore, the import of machinery and electrotechnical equipment shrank by 5.9 percent.

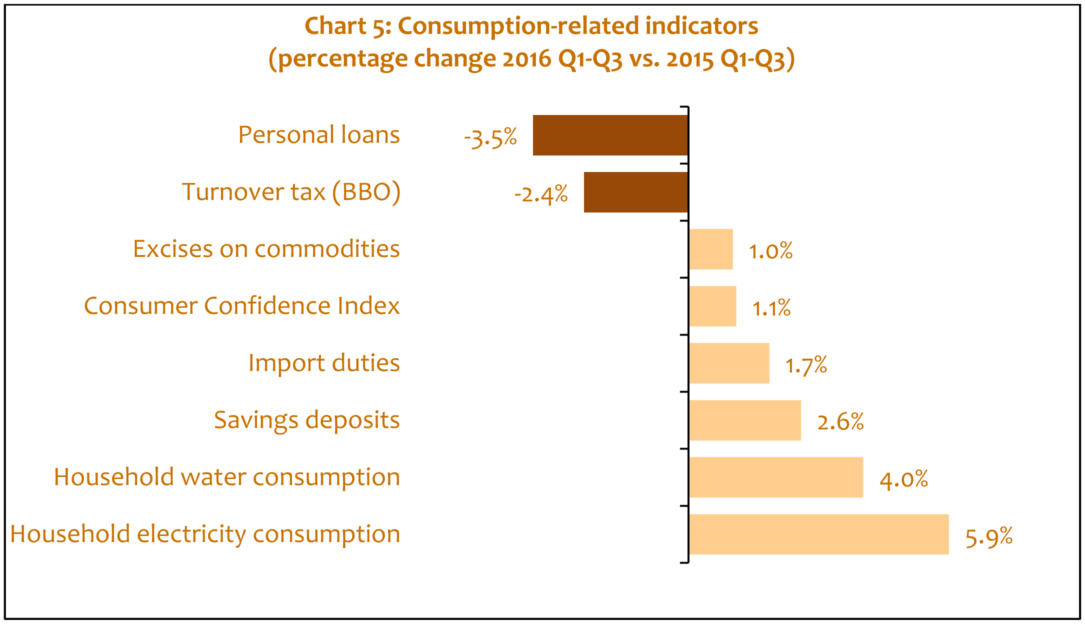
With the planned full-fledge start up in the rehabilitation of the refinery postponed in the third quarter of 2016, other major projects were limited to the expansion and renovation of the Dr. Horacio E. Oduber Hospital and the Green Corridor.

Consumption

Consumption indicators showed a mixed picture year to date but generally pointed to a further slowdown in consumption. The turnover tax (BBO) revenue recorded negative growth (–2.4 percent) over the first nine months, and consumer credit contracted again. On the other hand, income from import duties showed gains, probably because of improved control by the Customs Department, as overall merchandise imports, as measured by the CBS, declined by 6.1 percent. Excises collected on commodities recorded a marginal increase (+1.0 percent). The consumer confidence indicator displayed a minimal improvement at the end of the third quarter of 2016 in comparison to the previous year, mainly related to future expectations. However, the overall index remained significantly below 100, denoting persisting pessimistic consumer sentiment.

Water consumption by households increased by 4.0 percent in the period under review, particularly in the first two quarters. However, this growth is probably related to the limited rainfall this period as Meteo Aruba recorded 20.2 percent less precipitation from January to June than in the same months of 2015. Although household electricity consumption soared by 5.9 percent, this increase did not lead to higher costs as electricity tariffs were reduced by 9.9 percent on January 1, 2016. The lower rate may have been an incentive for higher electricity usage. Also, the slightly higher average temperature in 2016 (+0.4 °C), inducing more use of air conditioning, is a likely cause for the growing electricity consumption. Furthermore, the rise in alternative accommodations most likely had a significant impact on the water and electricity consumption.

The conclusion of a slowdown in consumption is corroborated by 2.6 percent higher total savings deposits in the first three quarters of 2016 compared to the corresponding period of 2015. A summary of the main consumption indicators can be found in Chart 5.



Foreign trade

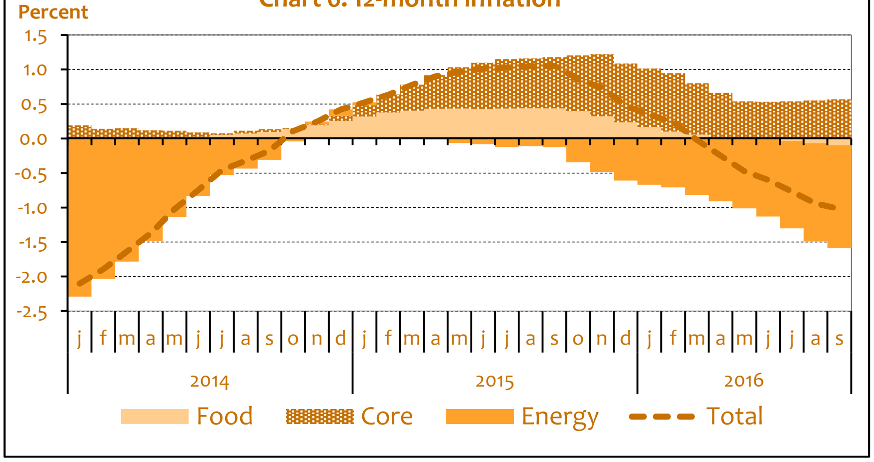
Aruba's trade balance, measured by the CBS, was slightly less negative in the first nine months of 2016. Lower imports of goods combined with higher exports resulted in a trade deficit of Afl. 1,316.2 million (2015Q1-Q3: Afl. 1,381.8 million). Especially imports of nonfood products declined, more specifically electrical and IT products, fuels, precious stones, and jewelry. On the other hand, the import value of vehicles (including parts) increased by 15.6 percent. The total value of imported food products remained largely the same in the period under review.

The total value of exports in the period under review increased by Afl. 19.8 million to Afl. 63.9 million, attributable to higher exports of base materials, precious stones, machinery, and optical instruments. In absolute terms, exports of goods continued to be low while many of the goods exported are not manufactured or produced in Aruba (re-exports).

Consumer Price Index (CPI)

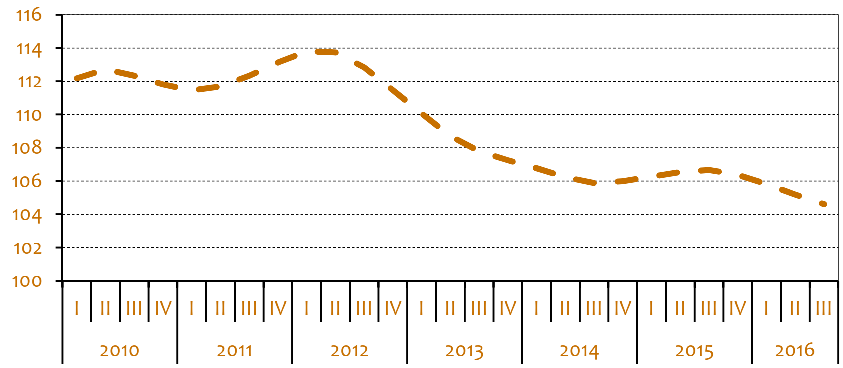
As a result of falling energy prices and subdued prices of food and goods, inflation was pushed downwards in the first three quarters of 2016. The reduction of the electricity tariffs in January 2016 and the continuation of falling gasoline prices put downward pressure on the 12-month inflation, which reached negative territory again last April, ending at –1.0 percent at the end of the third quarter. Marginal price increases in the components *Communication, Recreation and Culture,* and *Restaurants and Hotels* kept the 12-month core inflation above zero, ending at 0.6 percent in September 2016. A year earlier, it stood at 0.7 percent (Chart 6).

Chart 6: 12-month inflation



Aruba's real exchange rate relative to that of the United States dropped by 1.8 percentage points in the third quarter of 2016 in comparison to the fourth quarter of 2015 (Chart 7). The reduced electricity tariffs at the beginning of the year, which pushed Aruba's inflation downwards, helped to improve Aruba's competitive position relative to that of the United States. The foregoing economic development indicate a continued decline in real GDP for the period under review.

Chart 7: Real exchange rate vis-à-vis the United States (1995=100)

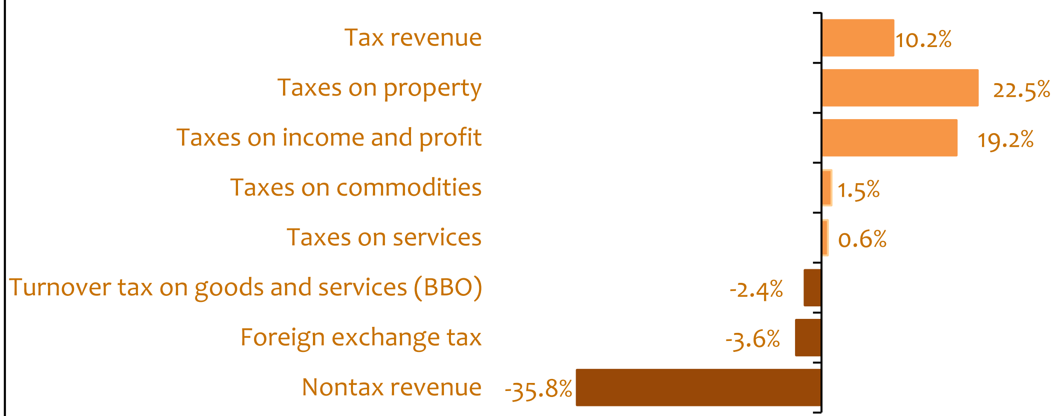


Government

Total government revenue increased by 2.6 percent during the first nine months of 2016. This expansion was realized despite a sharp fall in nontax revenues following Afl. 60.5 million high receipts in 2015 as a result of a debt forgiveness agreement between the government of Aruba and SVB. Tax revenues grew by 10.2 percent (Chart 8) fueled by substantially higher proceeds from profit tax and land tax. Government income from commodity taxes was positively influenced by an improvement in the collection of import duties and excises on liquor and gasoline. On the other hand, the receipts from turnover tax and foreign exchange tax were lower in the period under review compared to the first nine months of 2015.

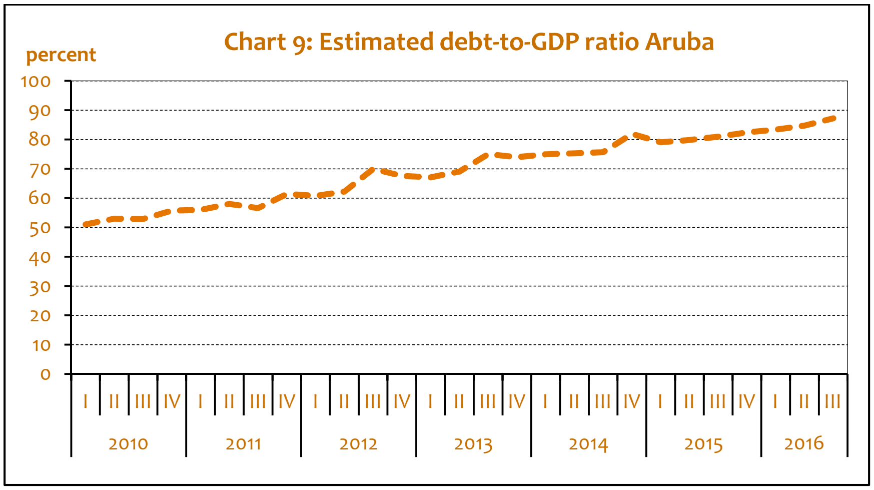
In the first three quarters of 2016, total government expenditures amounted to Afl. 1,021.5 million, i.e., 1.4 percent higher than in the same period in 2015. The main reasons for the recorded growth were interest payments (+7.6 percent) and transfers to the health insurance company AZV (+12.0 percent). On the other hand, personnel-related expenses (wages, employer contributions and wage subsidies) decreased by 2.0 percent.

Chart 8: Government revenue
(percentage change 2016 Q1-Q3 vs. 2015 Q1-Q3)



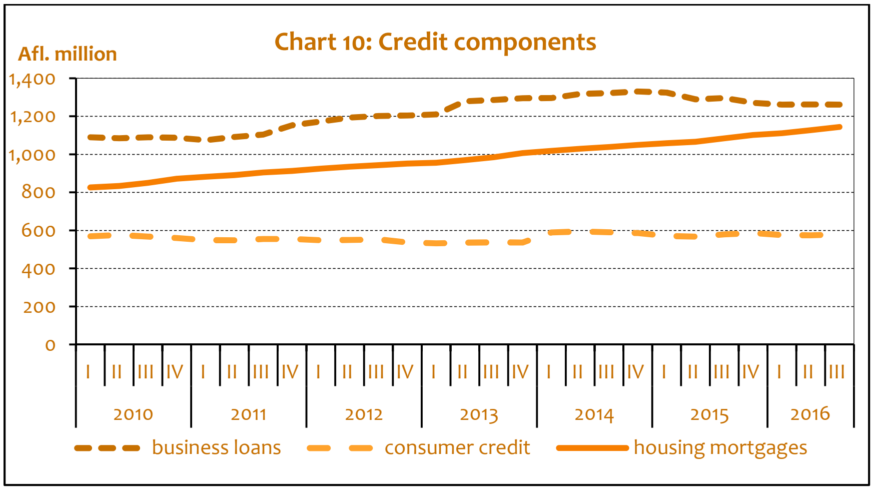
Noticeable is that in all of the first three quarters of 2016, government expenses surpassed revenues. Also, each quarter showed the government had a net lending need. Consequently, the financial deficit of the government totaled Afl. 166.1 million in the period under review.

In September 2016, the government of Aruba issued bonds for a total amount of Afl. 132.2 million on the domestic market. These bonds have a maturity of 10 years and an interest rate of 4.75 percent, largely replacing an expiring bond. A large part of these bonds (46 percent) was bought by nonresidents. Including this bond issue, total government debt stood at a new record of Afl. 4,172.1 million at the end of September 2016. The latter is an increase of Afl. 197.9 million since December 2015, attributable to two large private placements on the international market in May 2016 with durations of, respectively, 8 and 12 years. On balance, domestic debt declined slightly (–0.9 percent), while foreign debt grew by 10.4 percent. With the latest developments, the debt-to-GDP ratio reached an estimated 87.3 percent as of end-September 2016 (Chart 9).



Monetary Survey

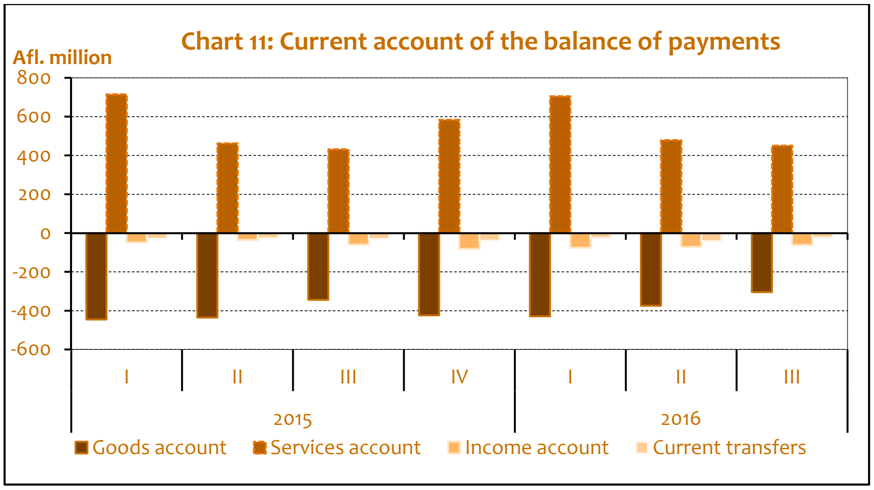
Overall domestic credit to the private sector expanded by a moderate 0.9 percent in the first three quarters of 2016 to Afl. 2,995.0 million, as the previously mentioned weak consumption patterns were visible in certain credit components. Consumer credit contracted by 1.2 percent, continuing its downward trend persisting since 2009 (when correcting for certain reclassifications in 2014). Business loans also shrank further, albeit at a slower pace when compared to the same period of 2015. In contrast, housing mortgages continued their consistent and steady rise, expanding by 3.8 percent, compensating for the declines in both business loans and consumer credit (Chart 10). Forthcoming analysis indicates that the majority of the mortgages amount to Afl. 50,000 to Afl. 200,000, with the average mortgage owner being between 40 and 49 years, and married. The amount of new business loans, new consumer credit, and new housing mortgages granted by the commercial banks all increased over the period under review when compared to the same period of 2015. Net claims on the public sector remained almost flat (+Afl. 0.7 million) over the first three quarters of 2016.



Money supply rose by 6.3 percent in the first nine months of 2016. This rise was brought about by a net inflow of foreign funds (+Afl. 269.4 million), which more than compensated for the Afl. 29.6 million decrease in net domestic assets. The inflow of foreign funds was related mainly to tourism receipts and government foreign borrowing. The latter, along with a fall in imports, helped to maintain the net foreign assets position well above the norms monitored by the Monetary Policy Committee (MPC) of the CBA throughout the period under review. As such, the MPC decided to keep both the reserve requirement and the advance rate unchanged at, respectively, 11.0 percent and 1.0 percent.

Balance of payments

The current account of the balance of payments registered a surplus of Afl. 228.5 million in the first nine months of 2016, compared to an Afl. 156.4 million surplus recorded during the same period of 2015. Lower import payments of both oil and non-oil goods contributed significantly to this larger surplus. Oil imports fell because of the lower world market oil prices while the payments for imports of other goods declined mainly because of lower quantities imported, a sign of the weakening local consumption and investment activities. Aruba's net income from services increased by 1.6 percent to Afl. 1.634.5 million despite a 0.4 percent drop in the income related to tourism. This was more than compensated by 8.4 percent lower freight payments (due to the reduced import payments of goods), 11.6 percent lower international travel payments by Aruban residents, and a 28.5 percent reduction in the payment for international construction services. The income account of the first three quarters showed a deficit of Afl. 207.5 million related to higher dividend payments to abroad from resident companies. The development within the current transfers is mainly determined by the income transfers of the foreign workers (remittances): a quarterly outflow of on average Afl. 30 million (Chart 10).



The capital and financial account (excluding banking transactions) showed an Afl. 44.5 million surplus in the first nine months of 2016. However, an Afl. 139.6 million deficit was registered in the third quarter of the mentioned year due to relatively large net outflows from both direct investments (oil sector and non-oil), as well as portfolio investments and financial derivatives.

The outflows in direct investments were recorded mainly in the oil sector. These were largely credit-related transactions. The outcome in portfolio investments stemmed from net purchases of foreign equity securities (Afl. 15.2 million) as well as from debt securities (Afl. 16.3 million). Additionally, the redemption of part of a 2013 government debt issue was the main reason for a net outflow of Afl. 13.9 million. As in previous quarters, the financial derivatives outflow was related to hedging expenses for the acquisition of Heavy Fuel Oil (HFO).

The surpluses recorded in the current account and the capital and financial account imply that the net banking transactions in the first three quarters of 2016 were negative (–Afl. 53.5 million), while a strong increase took place in the official reserves (+Afl. 215.9 million). Consequently, total reserves (including revaluation differences) stood at Afl. 1,942.2 million at the end of September 2016, while the import coverage ratio increased to 6.3 months.

Prudential

Macroprudential indicators remained adequate throughout the period under review. The banks' risk-weighted capital asset ratio stood at 27.4 percent at the end of September 2016 (required minimum 14.0 percent), up from 26.0 at the end of 2015. The loans-to-deposit ratio fell to 68.1 percent (maximum 80.0 percent), down from 69.9 percent in December 2015. The prudential liquidity ratio of the commercial banks rose to 28.6 percent (minimum requirement 15.0 percent), up from 27.3 percent. In addition, the quality of the commercial banking sector's loan portfolio improved as the average nonperforming loan ratio in the first nine months of 2016 decreased by 1.1 percentage points to 4.9 percent compared to the same period of 2015.

II. International developments

According to the November 2016 update of the OECD's Economic Outlook, [2] **world GDP** was estimated at a 2.9 percent expansion for 2016. Key issues that constrained growth throughout 2016 included weak investment and trade, policy uncertainty, and financial risks.

The GDP of the United States is projected to reach 1.5 percent for 2016. As the new President of the United States has taken office, uncertainty about the new administration's policies continues to

[2] OECD, Economic Outlook No. 100, November 28, 2016.

linger.[3] With the expected interest rate hikes, the already stronger US dollar is anticipated to appreciate further. In the third quarter of 2016, GDP growth of the United States stood at 3.5 percent, 2.1 percentage points higher than in the second quarter.[4] The latter reflects a rise in consumer spending on services and durable goods, as well as the export of goods and services, offset by declines in investment in equipment and in residential housing.[5]

In Europe, despite the United Kingdom's referendum vote to leave the European Union, moderate economic growth is anticipated to be maintained throughout the region. Factors conducive to the expected GDP growth in Europe (+1.8 percent) include the low oil prices, the lagged effects of the euro's past depreciation, the continuation of an accommodative monetary policy, and a more growth-supportive fiscal policy stance.[6] The United Kingdom's GDP is expected to slightly outperform the EU's growth rate by 0.1 percentage point with an anticipated expansion of 1.9 percent in 2016, which leaves unchanged the forecast of the European Commission conducted before the Brexit vote.

While surrounded by risks, a mild recovery is expected in the euro area, where GDP is currently estimated to grow by 1.7 percent in 2016. The main impact from the Brexit vote has been moderate so far and depends heavily on the exit negotiations that are still to come. More negative effect are expected to appear in the medium- to long-term.

China's economic growth for 2016 is anticipated to remain within its target of between 6.5-7.0 percent growth with a forecasted expansion of 6.6 percent. After a turbulent start to the year, China's

---

[3] United Nations, Monthly Briefing: World Economic Situation and Prospects, December 12, 2016.
[4] Bureau of Economic Analysis, National Income and Product Accounts Gross Domestic Product: Third Quarter 2016 (Third estimate), December 22, 2016.
[5] Bureau of Economic Analysis, U.S. Economy at a Glance: Perspective from the BEA Accounts, December 2016.
[6] European Commission, Institutional paper: European Economic Forecast, Autumn 2016. This paper is also the source of the two paragraphs following the footnote in the text.

economy stabilized, following state-led investments to offset the weakness of the private sector.

Finally, the aggregate GDP for Latin America and the Caribbean is anticipated to contract by 1.1 percent in 2016.[7] Economic growth is estimated to decrease in South America (–2.4 percent) and the Caribbean (–1.7 percent), while growing at a slower pace (+3.6 percent) in Central America than in the previous year. The projected decline in South America is caused primarily by forecasted lower growth in a number of South American economies along with contractions in Argentina (–2.0 percent), Venezuela (–9.7 percent), Brazil (–3.6 percent), and Ecuador (–2.0 percent). During 2016, most Caribbean countries noted expansions of between 0 and 4 percent. However, these expansions were completely offset by the contractions registered in Suriname (–10.4 percent), Trinidad and Tobago (–4.5 percent), and Belize (–2.4 percent). The negative economic developments in these commodity-dependent Caribbean countries were largely due to the unfavorable developments on the international oil market.[8]

In 2016, economic development in Curaçao was marked by stagnation, as GDP is estimated to remain flat (0.0 percent) primarily because of a drop in foreign demand counterbalanced by a rise in domestic demand. In St. Maarten, real GDP expanded by a mere 0.1 percent. Both countries experienced a slowdown compared to the 2015 growth figures.[9] A comparison of the autonomous islands in the Dutch Kingdom, including Aruba, shows a convergence in stagnating growth rates for 2016.

[7] ECLAC, Briefing paper: Preliminary overview of the Economies of Latin America and the Caribbean 2016.
[8] IDB, Caribbean Region Quarterly Bulletin: Recent developments and prospects, December 2016.
[9] CBCS, Economic developments in 2016 and outlook for 2017, December 2016.

III. Concluding remarks

Economic activities in Aruba decelerated in the first nine months of 2016. Lower tourism exports and contracting domestic consumption contributed to this development.

Tourism income, as registered in the balance of payments, decreased by 0.4 percent in contrast to a 3.9 percent gain in the same period in 2015. This decline was likely attributed in large part to the reversal in the buoyant trend in the Venezuelan tourism market evident in the previous five years.

Despite some large ongoing projects such as the expansion and renovation of the Dr. Horacio E. Oduber Hospital and the Green Corridor, investment activities did not really gain momentum, due to the subdued refurbishment activities in the oil refinery.

Consumption statistics were also diverse for the year to date but generally pointed to a further slowdown. Noticeable is that revenue from the turnover tax (BBO) recorded negative growth over the first nine months, while consumer credit, as reported by the commercial banks, contracted further.

As a result of falling energy prices and subdued price developments of food products, inflation was pushed downwards in the first three quarters of 2016. Aruba's real exchange rate relative to that of the United States dropped sharply, i.e., by 1.8 percentage points, in the third quarter of 2016 in comparison to the fourth quarter of 2015, thus improving Aruba's competitive position vis-à-vis the United States.

Total government revenue increased by 2.6 percent during the first nine months of 2016, pushed up by higher proceeds from the profit tax and the land tax. Expenditures grew by 1.4 percent, mostly due to higher interest payments and transfers to the AZV. Total government debt at the end of September 2016 enlarged further to Afl. 4,172.1 million, or an estimated 87.3 percent of Aruba's GDP.

Money supply rose by 6.3 percent in the first nine months of 2016. A net inflow of foreign funds (+Afl. 269.4 million) more than compensated for the Afl. 29.6 million contraction in net domestic assets. The inflow of foreign funds, which is lower than in the corresponding period of 2015, stemmed mostly from higher tourism receipts and government foreign borrowing.

Both the current account and the capital and financial account of the balance of payments registered surpluses, resulting in a significant increase in foreign exchange reserves. Consequently, the import coverage ratio stood at 6.0 months of total current account payments at the end of September 2016.

In summary, domestic economic output appeared to have slowed down in the first nine months of 2016. Tourism activities, the main driver for economic growth, faltered unexpectedly, while local consumers remained cautious in their spending.