Centrale Bank van Aruba

Economic outlook[1]

April 2019

[1] This document includes forecasts that represent assumptions and expectations of the Centrale Bank van Aruba (CBA) considering the information available at end-March 2019. These forecasts involve uncertainties. The actual results may differ from those projected in this document. Consequently, no guarantee is presented or implied as to the accuracy of specific forecasts contained herein. The CBA does not assume any liability for any loss that may result from reliance on this information.

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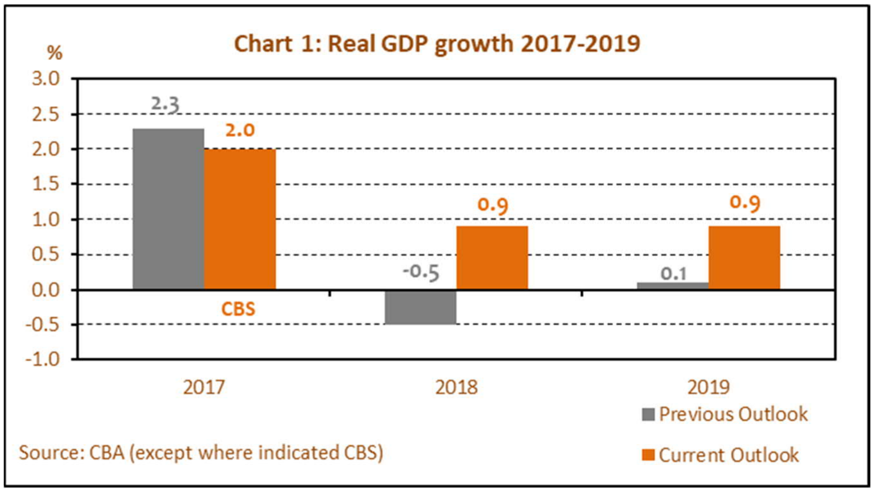
1. Introduction

The Centrale Bank van Aruba (CBA) has revised its economic forecast for 2019 to reflect the most recent developments and available data. The 2018 figures were also adjusted. The 2018 estimate of the real gross domestic product (GDP) growth was raised by 1.4 percentage points to 0.9 percent, due to higher income from tourism and a smaller contraction of investment than previously anticipated. The GDP growth of 2019 is currently expected to increase by 0.9 percent in real terms, up from a previously forecasted growth of 0.1 percent (Chart 1). The previous growth estimate for 2017 (2.3 percent) has been replaced by the National Accounts growth figure (2.0 percent).



2. Economic forecast

2.1 Gross domestic product and its components

The current projections for economic output in 2018 and 2019 are driven mainly by tourism exports and an uptick in investments in 2019 (Table 1). Despite further gains in tourism exports, a contraction in consumption and delays in the planned execution of various investment projects may have hindered output growth in 2018. The introduction of the BAVP tax levy in July 2018 affected real GDP through reduced consumption in 2018 and will continue to do so in 2019. Additional tax reforms will likely also have an effect on consumption and GDP but its magnitude and direction are at this moment uncertain.

Table 1: Growth of real GDP and its components 2017-2019 (in percent)

Indicator	2017 [r] (Source: CBS)	2018 [f]	2019 [f]
Current Outlook (March 2019)			
GDP	2.0	0.9	0.9
Consumption	n.a.	–0.5	0.1
Private consumption	n.a.	–1.7	–0.2
Public consumption	n.a.	2.3	0.8
Investment	n.a.	–0.8	3.9
Private investment	n.a.	–1.9	6.2
Public investment	n.a.	32.2	–42.5
Exports	n.a.	2.1	1.9
Tourism exports	n.a.	2.7	2.6
Imports	n.a.	0.0	2.0
	2017 [f]	2018 [f]	2019 [f]
Previous Outlook (October 2018)			
GDP	2.3	–0.5	0.1
Consumption	1.0	–1.6	–2.1
Private consumption	–0.1	–3.0	–2.1
Public consumption	3.5	1.8	–2.1
Investment	1.5	–3.2	7.0
Private investment	2.9	–4.6	6.4
Public investment	–26.2	36.9	20.1
Exports	2.9	0.4	0.3
Tourism exports	4.5	1.5	0.9
Imports	1.2	–1.6	0.4

Source: CBA (except where indicated CBS) r = realization; f = forecast; n.a. = not available

Tourism

Tourism service exports, the main driver of economic growth, are estimated to have grown by 2.7 percent (real terms) in 2018. This growth is led by a projected rise in tourist arrivals from the U.S. market. Reaffirming the forecasted growth in tourism service exports, the Aruba Hotel and Tourism Association (AHATA) reported an increase in total revenues of 10.3 percent for 2018, while the balance of payments indicated that tourism credit would rise by 8.2 percent (nominal terms). The tourism outlook for 2019 is positive, with tourism service exports growing by 2.6 percent (real terms), spurred mainly by the U.S. market. The tourism indicators for the first months of 2019 support this viewpoint.

Investments

Several large investment projects were planned to be executed in 2018. They include continuation of the renovation of the Dr. Horacio E. Oduber hospital, further implementation of the Watty Vos

Boulevard project, the start of the major upgrading activities at the airport, and various tourism-related investments. However, observed indicators of construction activity, including imports of investment-related goods, the number and value of construction permits granted, as well as observed delays regarding the above-mentioned projects show that actual investment activity in 2018 was higher than anticipated earlier. Nevertheless, total volume of investment was 0.8 percent beneath the 2017-level.

Business sentiments remained pessimistic with the business perception index at 99.0 index points during the third quarter of 2018.[2] The findings of the Business Perception Survey of the third quarter of 2018 reveal that business respondents in the manufacturing, utility, and construction sectors, are pessimistic about the short-term future economic conditions. The only sectors that were optimistic were the real estate sector, the health sector, other community and personal service activities. Nevertheless, roughly 80 percent of the businesses expected to make a profit in the third quarter of 2018, thus suggesting a more nuanced picture of business sentiments.

In 2019, investments are expected to expand significantly. This projected investment surge is mainly attributed to the Gateway 2030 project (expansion and modernization of the airport), significant upgrading by the WEB, and the building of the IMAX cinema.[3] The construction of the Watty Vos Boulevard (to be finished in August 2019) also contributes but its investment is expected to be smaller than in 2018. Projected investment by the Government of Aruba follows the 2019 budget and is estimated to grow in the coming two years.

Consumption

Real private consumption is estimated to have posted a 1.7 percent decline in 2018. This is mainly due to the introduction of the new tax levy in July of 2018. A minor increase in total employment is insufficient to lift private consumption. The Consumer Confidence Index for the fourth quarter of 2018, improved significantly, indicating a relatively higher consumer confidence. For 2019, private consumption is likely to contract, albeit at a much slower pace (–0.2 percent).

The new tax levy (BAVP) is expected to dampen consumption. Its introduction in July 2018 increased the combined rate of turnover tax (BBO), health tax (BAZV), and BAVP from 3.5 percent to 6 percent and is forecasted to have a lingering impact on consumption throughout 2019, more so in light of expected fiscal reforms. Real public consumption, based on the government's budget, is projected to have increased in 2018. A further growth of public consumption is expected in 2019 (+0.8 percent).

Import

As Aruba imports most of its goods, all expenditure components of the GDP influence the development of total imports, estimated at 73 percent of (nominal) GDP. Large investment projects have a high import leakage as all materials are purchased abroad. Also, virtually all consumer goods

[2] The business perception index can vary between 90 and 110. Between 90 and 100 indicates a situation of pessimism, between 100 and 110 indicates a situation of optimism in business sentiments. The same criteria hold for the consumer confidence index.

[3] Note that investment related to the refurbishment of the oil refinery into an upgrader were not included in the investment projections, due to the considerable uncertainties surrounding this project.

are imported. In addition, tourism services heavily impact imports (for example, the food, gasoline, and electricity that tourists use). In line with expected developments in investments and exports, real imports are projected to remain stable in 2018 and increase in 2019.

Inflation

The year 2018 experienced a 12-month average inflation rate of 3.6 percent, 0.2 percentage point higher than anticipated in the previous CBA-forecast. While electricity and water prices remained unchanged throughout the year, gasoline prices have risen gradually. The Venezuelan trade embargo caused food prices to increase in the first quarter of 2018 and the higher BBO/BAZV/BAVP tax rate pushed up inflation by an estimated 0.9 percentage point. For 2019, the higher tax levy will contribute to an anticipated inflation rate of 1.5 percent.

Nominal growth rates

GDP in nominal terms is estimated to have increased by 4.8 percent in 2018 (Table 2). For 2019, a nominal growth of 2.4 percent is foreseen. This expected growth is driven primarily by expected tourism exports and price inflation throughout 2018 and 2019.

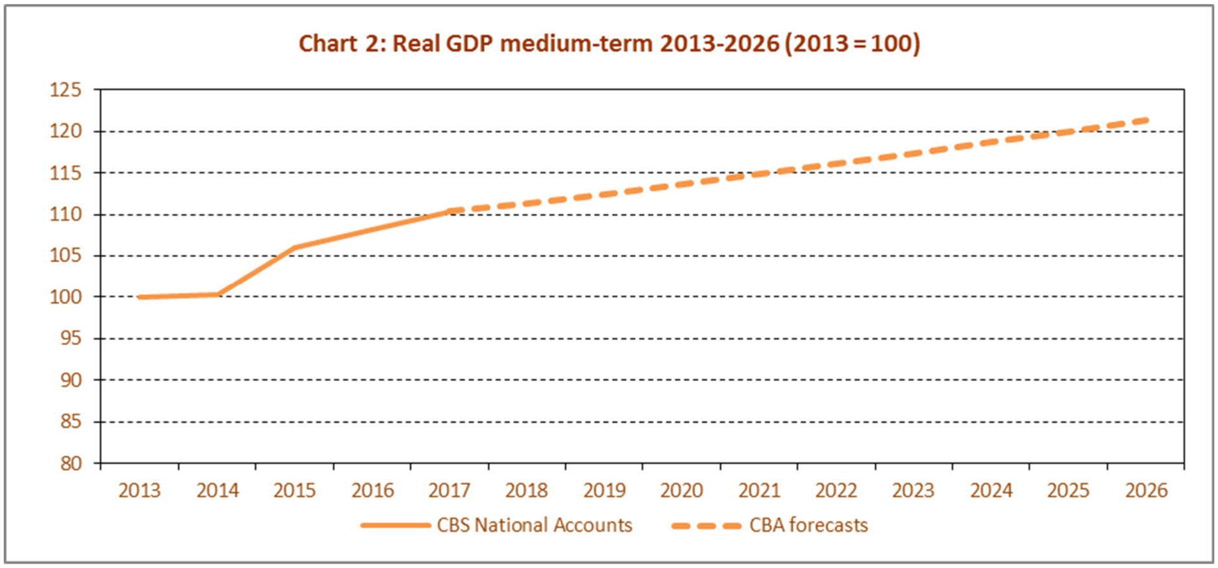
Table 2: Nominal GDP estimates and forecasts 2017-2019

	2017 r (Source: CBS)	2018 f	2019 f
GDP	3.0	4.8	2.4
Consumption	2.2	4.2	1.2
Investment	0.2	2.1	5.9
Exports	6.0	7.5	4.1
Imports	4.2	5.8	3.7

Source: CBA (except where indicated CBS) r = realization; f = forecast

Medium-term GDP

Maintaining and expanding the level of the (real) GDP in the medium term relies on private investment, a strong tourism performance, sustainable government finances, as well as increased efforts to innovate and to improve efficiency and productivity in public and private sectors. The real GDP is likely to grow by an estimated average annual rate of 1.1 percent in the medium term based on information obtained on intended future investment projects, e.g., related to the airport, and several tourism-related projects, which potentially could further expand the number of tourists. In comparison to the period 2013-2019, this projected expansion in the baseline medium-term (2020-2026) suggests a lower economic growth rate, unless structural reforms are geared at economic diversification and innovation, and also that significant labor and technological productivity improvements are realized (Chart 2).



2.2 Balance of payments and net foreign assets

As from 2018, the compilation of the balance of payments has been based on the latest international IMF guidelines.[4] As a consequence, the method used by the CBA to forecast the outcome of the balance of payments and its components must be evaluated and adapted. This publication restricts itself to some qualitative observations of the balance of payments, based upon the expected developments of the tourism sector, consumption, and investment as described in the previous section. An important input is also the 2019 budget of the government, including its intentions in the medium-term regarding debt (re-)financing.

In the medium term, the value of the import of goods is expected to show a structural growth. This increase is induced by an expected increase of the world oil price, stronger consumption demand (from residents and tourists), as well as boosting investment volumes. The development in the tourism sector is anticipated to be less strong and therefore will conceivably generate insufficient incoming currency to fully counteract this development. The financial account will experience a negative shock in the medium term as the government's foreign borrowing needs will decline.

Consequently, there will be downward pressure on net foreign assets going forward. Execution of the plans of the government for the coming years as indicated in the FEM (Financieel Economisch Memorandum 2018-2021), especially in terms of the planned fiscal reform, better control of personnel expenditures, and limiting the financing costs, will have a significant impact on all projections, not only directly but also indirectly through, for instance, its effects on the level of private consumption and inflation.

[4] International Monetary Fund (IMF) – Balance of Payments and International Investment Position Manual, sixth edition (BPM6), January 2010.

The intended policy measures formulated in the FEM are expected to have a downward effect on the net foreign reserves of Aruba of approximately Afl. 470 million between end-2018 and end-2021, especially because of lower foreign debt financing by the government. It should be noted, however, that this projection does not take into account the positive impact of lower government expenditure on the current account, which is likely to offset the negative impact of the financial account on reserves to some extent. In addition, less foreign borrowing by the government will improve the income account because of lower interest payments to abroad in the medium and long term.

3. Concluding remarks

After a solid performance in 2017 (+2.0 percent), the growth of the Aruban economy, measured in real terms, is forecasted to weaken to 0.9 percent in both 2018 and 2019. In nominal terms, the economy is foreseen to grow by 2.4 percent in 2019. The tourism sector will remain the main driver. Both consumption and investment are expected to decline in real terms in 2018, with investment activities picking up in 2019 and consumption remaining virtually stable. Increasing imports will have a negative effect on GDP-growth in 2019. In the medium term, an average annual real GDP growth rate of 1.1 percent is anticipated.

Under unchanged monetary and economic policies, the international reserves of Aruba are forecasted to drop significantly. Especially a lower amount of net foreign borrowing by the government but also increasing imports contribute to this decline.

Aruba is an open economy and its economic progress is therefore also dependent on international developments, especially in the United States. In this respect, it is worrisome that the IMF currently expects that 70 percent of the global economy is anticipated to experience a slowdown in growth in 2019, largely because of rising trade tensions and financial tightening in the second half of 2018.[5] Therefore, it seems that the risks to this forecasts lie mainly on the downside. Additionally, the deteriorating situation in Venezuela can have harmful effects on Aruba's economy.

[5] Christine Lagarde (IMF Managing Director) - A Delicate Moment for the Global Economy: Three Priority Areas for Action. Speech to the U.S. Chamber of Commerce, Washingotn D.C. April 2, 2019.