Economic outlook

December 2019

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1. Introduction

Recently the Centrale Bank van Aruba (CBA) revised its economic forecast for the year 2019 based upon economic developments and available data up to and including September 2019. In addition, the CBA carried out its first economic output projection for 2020. Based upon aforementioned data, the Gross Domestic Product (GDP) for 2019 is expected to decrease by 0.7 percent in real terms, down from a previously forecasted growth of 0.9 percent. The downward revision resulted mainly from weaker investment, exports, and consumption figures than previously foreseen. For 2020, a real GDP growth of 0.8 percent is projected (Chart 1). In the medium term, an average annual real GDP growth rate of 1.1 percent is anticipated by the International Monetary Fund (IMF).

![Chart 1: Real GDP growth 2019-2020](chart1.png)

Source: CBA

2. Economic forecast

2.1 Gross domestic product and its components

The current projections for economic output arise because the estimated growth in investment and tourism exports fails to compensate for the apparent weak consumption, the decrease in non-tourism exports, and the continued rise in imports in 2019. The results for 2020 are driven mainly by higher tourism exports and an upturn in private investment (Table 1). For 2019, the growth in private investment is being hindered by significant delays in the planned execution of various investment projects. The negative effects on private consumption of the BAVP tax levy introduced in July 2018 and further amplified by the January 2019 increase in excises on alcohol appear to outweigh the positive effects of the lowering of the income and wage tax.
Table 1: Growth of real GDP and its components 2018-2020 (in percent)

<table>
<thead>
<tr>
<th>Indicator</th>
<th>2018 (source: CBS)</th>
<th>2019 †</th>
<th>2020 †</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Current Outlook (September 2019)</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>GDP</td>
<td>n.a.</td>
<td>-0.7</td>
<td>0.8</td>
</tr>
<tr>
<td>Consumption</td>
<td>n.a.</td>
<td>-0.3</td>
<td>-0.4</td>
</tr>
<tr>
<td>Private consumption</td>
<td>n.a.</td>
<td>-0.1</td>
<td>0.1</td>
</tr>
<tr>
<td>Public consumption</td>
<td>n.a.</td>
<td>-0.9</td>
<td>-2.4</td>
</tr>
<tr>
<td>Investment</td>
<td>n.a.</td>
<td>2.2</td>
<td>0.1</td>
</tr>
<tr>
<td>Private investment</td>
<td>n.a.</td>
<td>1.3</td>
<td>4.9</td>
</tr>
<tr>
<td>Public investment</td>
<td>n.a.</td>
<td>6.5</td>
<td>-78.8</td>
</tr>
<tr>
<td>Exports</td>
<td>n.a.</td>
<td>0.6</td>
<td>2.2</td>
</tr>
<tr>
<td>Tourism exports</td>
<td>n.a.</td>
<td>2.7</td>
<td>2.8</td>
</tr>
<tr>
<td>Imports</td>
<td>n.a.</td>
<td>2.0</td>
<td>0.9</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>Previous Outlook (March 2019)</strong></th>
<th>2018 †</th>
<th>2019 †</th>
<th>2020 †</th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP</td>
<td>0.9</td>
<td>0.9</td>
<td>n.a.</td>
</tr>
<tr>
<td>Consumption</td>
<td>-0.5</td>
<td>0.1</td>
<td>n.a.</td>
</tr>
<tr>
<td>Private consumption</td>
<td>-1.7</td>
<td>-0.2</td>
<td>n.a.</td>
</tr>
<tr>
<td>Public consumption</td>
<td>2.3</td>
<td>0.8</td>
<td>n.a.</td>
</tr>
<tr>
<td>Investment</td>
<td>-0.8</td>
<td>3.9</td>
<td>n.a.</td>
</tr>
<tr>
<td>Private investment</td>
<td>-1.9</td>
<td>6.2</td>
<td>n.a.</td>
</tr>
<tr>
<td>Public investment</td>
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<td>-42.5</td>
<td>n.a.</td>
</tr>
<tr>
<td>Exports</td>
<td>2.1</td>
<td>1.9</td>
<td>n.a.</td>
</tr>
<tr>
<td>Tourism exports</td>
<td>2.7</td>
<td>2.6</td>
<td>n.a.</td>
</tr>
<tr>
<td>Imports</td>
<td>0.0</td>
<td>2.0</td>
<td>n.a.</td>
</tr>
</tbody>
</table>

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

**Tourism**

Tourism service exports, the main driver of economic growth, are forecasted to grow by 2.7 percent (in real terms) (previous forecast: 2.6 percent) in 2019. This growth is led by a projected double-digit rise in tourist arrivals from the United States. Supporting the forecasted growth in tourism service exports, the Aruba Hotel and Tourism Association (AHATA) reported an increase in total revenues of 8.2 percent for the first eight months of 2019. For 2020, the tourism outlook also is positive, with tourism service exports rising by 2.8 percent (real terms), spurred once more mainly by the U.S. market.

**Investments**

Several large investments were planned in 2019: the RECIP project by WEB Aruba NV, the continuation of the renovation of the Dr. Horacio E. Oduber hospital, major upgrading activities at the airport,
continuation of the construction of the Watty Vos Boulevard, and various tourism-related investment projects. However, observed project execution delays suggest that actual investments in 2019 likely will be lower than anticipated in the previous outlook. Nevertheless, real investment still is estimated to record a growth of 2.2 percent in 2019.

**In 2020, total investment is expected to remain practically unchanged due to a large slump in public investment.** For 2020, the projection is for private investment to increase by 4.9 percent in real terms, driven by the kick-off of relatively large projects, such as Gateway 2030, RECIP and SWRO (WEB Aruba NV), and the construction of the St. Regis hotel. The impact of these large infrastructure projects is expected to outweigh the planned completion of the renovation of the Dr. Horacio E. Oduber hospital and construction of the Watty Vos Boulevard. However, a large decrease of 78.8 percent is expected in real public investment, which likely will offset the growth in private investment.

**Business sentiments remained just below the neutral point, with the business perception index at 99.4 index points during the fourth quarter of 2018.** The findings of the Business Perception Survey of the fourth quarter of 2018 revealed that while business respondents became pessimistic about the current economic conditions, they were less negative about future economic conditions.

**Consumption**

**Total real consumption is expected to show virtually no growth in both 2019 and 2020.** For 2019, real private consumption is projected to remain virtually unchanged (-0.1 percent). The factors likely driving this development are the introduction of the BAVP tax levy in July 2018 and the increase in excises in January 2019. The estimated impact of those increases is not fully compensated by the expected increase in the number of jobs. The projection of weak consumption is reflected in the minor growth in both the BBO revenue and the labor market. Moreover, the Consumer Confidence Index, which decreased in the third quarter of 2019 after consecutive declines in the first and second quarters of the year, is indicative of relatively pessimistic consumer sentiment.

**In 2020, real private consumption also is likely to remain virtually unchanged (+0.1 percent), in line with the negligible increase in total real investment.**

**Real public consumption, based on the government’s budget, is projected to decline in 2019.** A further downturn is expected in 2020 (-2.4 percent in real terms). This continuing decline is consistent with the government’s plans to lower expenditures and comply with the budgetary norms.

**Imports**

As Aruba imports most of its goods, all expenditure components of the GDP influence the development of total imports. Large investment projects have a significant import leakage as most materials are purchased abroad. Also, a significant portion of consumer goods is imported. In addition, tourism services heavily impact imports (e.g., the food, gasoline, and fuel oil needed to produce

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2 The business perception index can vary between 90 and 110. Between 90 and 100 indicates a situation of pessimism in business sentiments, and between 100 and 110 indicates a situation of optimism. The same criteria hold for the consumer confidence index.
electricity that tourists use). In line with the expected developments in investments and exports, real imports are projected to grow in 2019 and 2020, albeit at a higher rate in 2019 due to an elevated level of public investment.

**Inflation**

The anticipated 12-month average inflation rate for 2019 is 3.3 percent, 1.8 percentage points higher than assumed in the previous CBA-forecast. The upward revision of the expected inflation rate resulted as the prices of food, alcoholic beverages, and oil were higher than initially projected. While electricity and water prices are likely to remain unchanged throughout the year, the increase in both the BAVP tax rate and the excises pushed up inflation in the current year. For 2020, a significantly lower inflation rate, i.e., 1.2 percent, is foreseen. Note, however, that this rate is based on the assumption of stable oil prices, and no further tax increases are taken into account.

**Nominal growth rates**

GDP in nominal terms is estimated to increase by 3.3 percent in 2019 and by 2.4 percent in 2020 (Table 2). The forecasted growth is driven primarily by expected growth in tourism exports and investment.

**Table 2: Growth of nominal GDP and its components 2018-2020 (in percent)**

<table>
<thead>
<tr>
<th>Year</th>
<th>GDP</th>
<th>Consumption</th>
<th>Investment</th>
<th>Exports</th>
<th>Imports</th>
</tr>
</thead>
<tbody>
<tr>
<td>2018</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
</tr>
<tr>
<td>2019</td>
<td>3.3</td>
<td>0.9</td>
<td>5.0</td>
<td>4.5</td>
<td>2.7</td>
</tr>
<tr>
<td>2020</td>
<td>2.4</td>
<td>0.6</td>
<td>1.7</td>
<td>4.5</td>
<td>2.6</td>
</tr>
</tbody>
</table>

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

2.2 **Balance of payments and net foreign assets**

After revising the balance of payments forecasts, the CBA is now projecting a surplus on the current account for both 2019 and 2020. These projected surpluses are the result of a substantial growth in tourism credits, while the import payments of goods are expected to grow at a slower rate. The capital and financial account (excluding banking transactions and the change in reserves) is expected to record a deficit of Afl. 164.4 million in 2019 due to foreign loan repayments by the government as well as by the private sector. For 2020, an Afl. 20.9 million surplus is anticipated due to a smaller outflow related to portfolio investment (Chart 3).
Current account

The estimated current account surplus is the outcome of inflows growing at a faster pace than outflows (Chart 4). As usual, services receipts are the main contributor to inflows, driven by higher expected tourism income. Tourist spending has grown at an elevated rate in the last few years, and is projected to expand by 5.2 percent and 5.3 percent in 2019 and 2020, respectively. Payments for services also will rise but at a slower pace. Consequently, the net service receipts are likely to increase to Afl. 2.5 billion in 2019 and Afl. 2.7 billion in 2020. In addition, imports of goods are projected to grow at a slower pace than tourism income, i.e., by 1.8 percent in 2019 to a level of Afl. 2.2 billion, driven mainly by expected investment and tourism growth. However, weak domestic demand is foreseen to contribute only moderately to import growth. A further expansion in imports of 2.5 percent to about Afl. 2.3 billion is anticipated in 2020. Growth in export receipts of goods are likely to remain relatively small and will climb to a level of around Afl. 362 million in 2020. The income account and the current transfers will continue to have a slight negative contribution to the current account, due to dividend and interest payments as well as workers’ remittances.
Capital and financial account

Developments in the capital and financial account are anticipated to diverge in 2019 and 2020 (Chart 5). For 2019, recorded inflows from direct investment are heavily influenced by an incidental outflow due to a domestically financed repayment of a foreign loan and withdrawals of equity from nonresidents. Looking ahead to 2020, net inflows associated with investment projects, real estate, and timeshare sales will likely push direct investment inflows to around Afl. 200 million, assuming no large unforeseen incidental outflows related to loan repayments or repurchase of shares by residents as was the case in 2019.

One of the primary drivers for the portfolio account is the net issuance of U.S. dollar bonds by the Aruban government on the international capital market. For 2019, an outflow is projected on the portfolio account, as the government is not expected to issue U.S. dollar bonds. In 2020, the government is assumed to partially meet its financing needs on the external market leading to a net inflow on its portfolio account, thus mitigating the outflow on the overall portfolio account.
Net foreign assets
The net foreign assets (NFA, excluding revaluation differences) are forecasted to decline by Afl. 25.3 million in 2019, before rebounding by Afl. 274.1 million to reach Afl. 2.0 billion in 2020 (Chart 6). Consequently, the NFA is anticipated to drop to a level of Afl. 1,750.9 million at the end of 2019. In 2020, this drop is expected to be reversed, causing the NFA to move to just above Afl. 2.0 billion. The CBA monitors several benchmarks to assess foreign reserve adequacy. These include the coverage ratio of the 12-month average of total reserves to current account payments of (at least) 3 months. Based on the projected development in the NFA relative to current account payments during the years 2019 and 2020, the 12-month average current account coverage ratio (including oil) is estimated to remain stable at 4.7 months in 2019, then climbing to 5.1 months in 2020, reflecting the projected higher net foreign assets at the end of that year.
2.3 Outlook assumptions and risks

Several assumptions based on both the domestic and the international economy underlie this forecast. The main assumptions and risks to this economic outlook are:

- **Government financial position.** In this outlook, it is assumed that the government will execute its plans for the coming years as indicated in the Financieel Economisch Memorandum (FEM) 2018-2021, especially with regard to fiscal reform, better control of personnel expenditures, and limiting the financing costs. This assumption has 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. The assumption that the government will borrow Afl. 150 million of its financing needs domestically is also critical for the BOP forecast. If the government finances a larger part of its financing needs domestically, the effect on the NFA for both 2019 and 2020 will be downward.

- **Tourism.** An important upward risk for both economic growth and the level of the NFA is a stronger than expected performance in tourism, which has been the case in recent years. A stronger than expected performance in tourism could occur, for instance, if global economic growth is more positive than expected or if uncertainty diminishes. On the other hand, tourism service export recorded receipts may be affected negatively by shifts stemming particularly from market changes in the demand side and/or a further worsening of the economic crisis in Venezuela, as well as increasing international trade tensions.

- **Investment projects.** The timely execution of relatively large investment projects weigh significantly on the growth of the investment component (of the GDP), as well as on the projections of gains in consumption and employment and, in turn, on imports. Therefore, any delay in the execution of large investment projects could dampen the growth in investment, consumption, and imports. Moreover, setbacks in these projects also could lower FDI inflows,
while incidental FDI outflows for debt repayment or repurchase of outstanding shares also could have a dampening effect on FDI and, thus, on international reserves. On the other hand, the utility sector’s planned investment in more fuel-efficient equipment potentially could lead to lower imports of fuel oil and thus less outflow of international reserves.

- **Consumer confidence and consumption.** In the first, second, and third quarters of 2019, consumer confidence declined. This downward trend could reverse as a result of positive international and domestic developments, which could lead to a boost in consumer spending. For instance, a rapid implementation of various investment projects could influence consumer sentiments positively and improve overall confidence. Conversely, this rapid project implementation also could push up imports, negatively affecting the level of international reserves. Further fiscal reforms by the government in 2020 could dampen consumption and cause a slow-down in the projected GDP growth.

- **World oil prices.** Oil prices have proven quite volatile over time, leading to significant movements in the domestic inflation rate. Large unexpected upward movements in oil prices potentially could influence local utility and gasoline prices, as well as import prices for goods.
3. Concluding remarks

The growth of the Aruban economy, measured in real terms, is forecasted to be -0.7 percent in 2019 and 0.8 percent in 2020. In nominal terms, the economy is projected to grow by 3.3 percent in 2019 and 2.4 percent in 2020. The tourism sector remains the main driver in both years, aided by investment in 2019. Total consumption is expected to register virtually no growth in real terms in both 2019 and 2020, due to lackluster private consumption and a slowdown in public consumption and public investment in 2020. Total investment activities are expected to pick-up in 2019 and remain virtually unchanged in 2020. 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 by the IMF.

The level of NFA is projected to fall by Afl. 25.3 million in 2019, before rebounding and reaching Afl. 2.0 billion in 2020. The forecasted increase in 2020 is due mainly to an expected continuation of the strong performance of tourism exports, while imports grow at a slower pace. Moreover, inflows on the portfolio account expected to contribute to the NFA as well.

Because Aruba is an open economy, its economic progress also is dependent on international developments, especially in the United States. Thus, the upcoming U.S. presidential election as well as speculation on a potential economic recession add significant uncertainty to the projections. In addition, it is worrisome that the IMF currently expects global economic growth to remain subdued. Therefore, it seems that the risks to this forecast lie mainly on the downside. Additionally, the deteriorating situation in Venezuela can have harmful effects on Aruba’s economy through the inflow of immigrants and the consequent pressure on Aruba’s infrastructure and labor market, as well as the higher prices for imports primarily of food products.

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