CENTRALE BANK VAN ARUBA

# The Centrale Bank van Aruba increases the reserve requirement to the pre-COVID-19 level of 12.0 percent

Press Release

***During its meeting of November 22, 2021, and after reviewing the most recent economic and monetary data, the Monetary Policy Committee (MPC)[1] of the Centrale Bank van Aruba (CBA) decided to increase the reserve requirement rate[2] from 11.0 percent to 12.0 percent as of December 1st, 2021. This decision was primarily based on the elevated level of excess liquidity at the commercial banks.***

The following information and analysis were considered in reaching this decision:

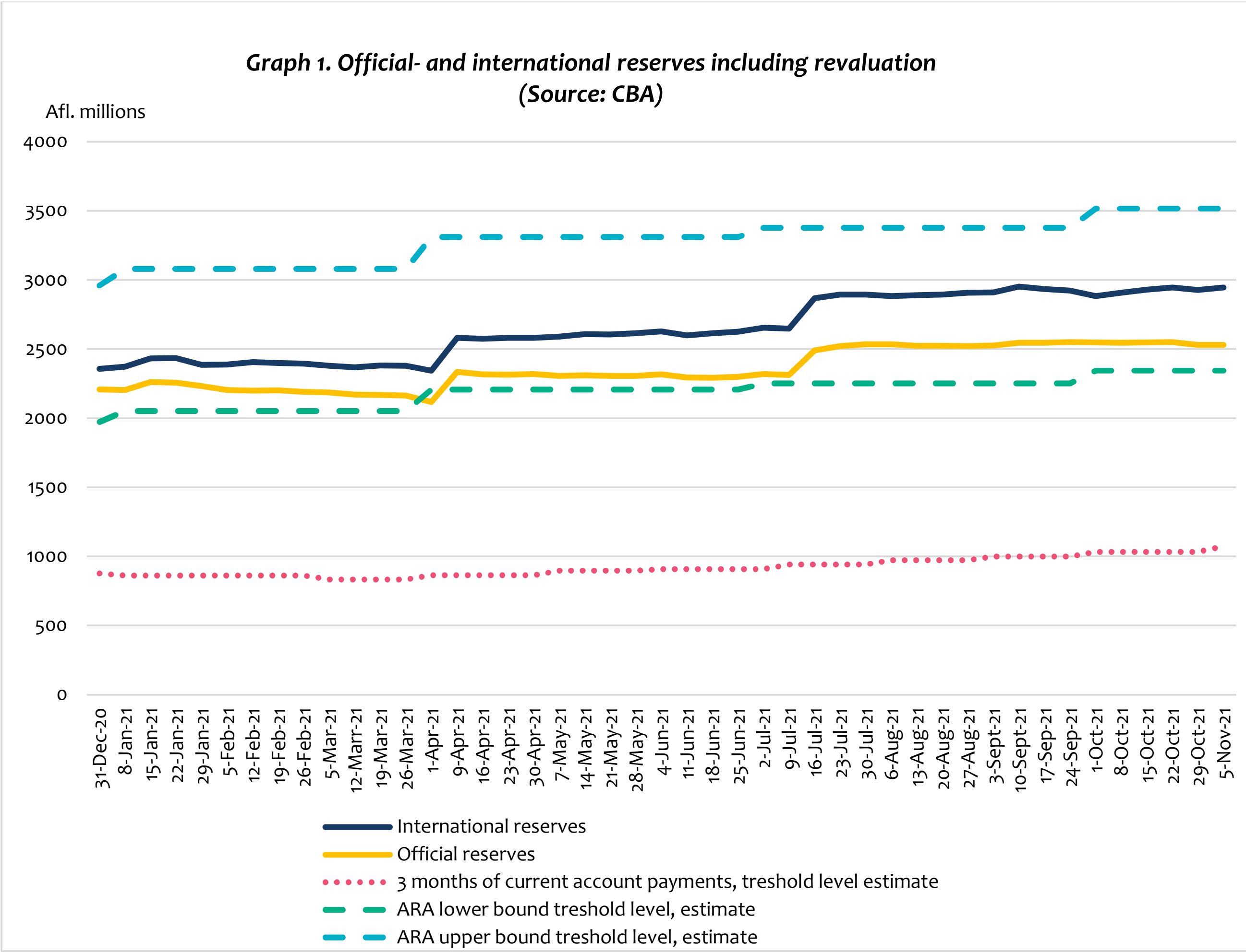
***International reserves***

International reserves (including revaluation differences of gold and foreign exchange holdings), up to and including November 5, 2021, strengthened by Afl. 586.9 million compared to the end of December 2020. The notable expansion in the international reserves was mostly the result of net inflows of foreign exchange reserves attributed to tourism services and loans from the Government of the Netherlands provided to the Government of Aruba (GoA) to improve its liquidity position. Meanwhile, official reserves increased by Afl. 321.3 million. Consequently, the official and international reserves reached, respectively, Afl. 2,529.3 million and Afl. 2,943.6 million as of November 5, 2021. Accordingly, the level of reserves remained adequate when benchmarked against the current account payments and the IMF ARA[3] metric (Graph 1).

[1] The MPC was instituted in May 2010 to periodically evaluate and determine the monetary policy of the CBA. In addition, the MPC aims at improving the transparency of the monetary policy.

[2] The reserve requirement refers to the minimum amount of reserves that commercial banks must hold at the CBA and is (currently) equal to 11.0 percent of their liabilities with a maturity less than 2 years.

[3] The IMF ARA metric refers to “Assessing Reserve Adequacy Metric” from the International Monetary Fund, which measures the adequacy of official reserves by benchmarking these against a weighted average of broad money, intercompany lending, short-term and long-term debt, and export of goods and services.



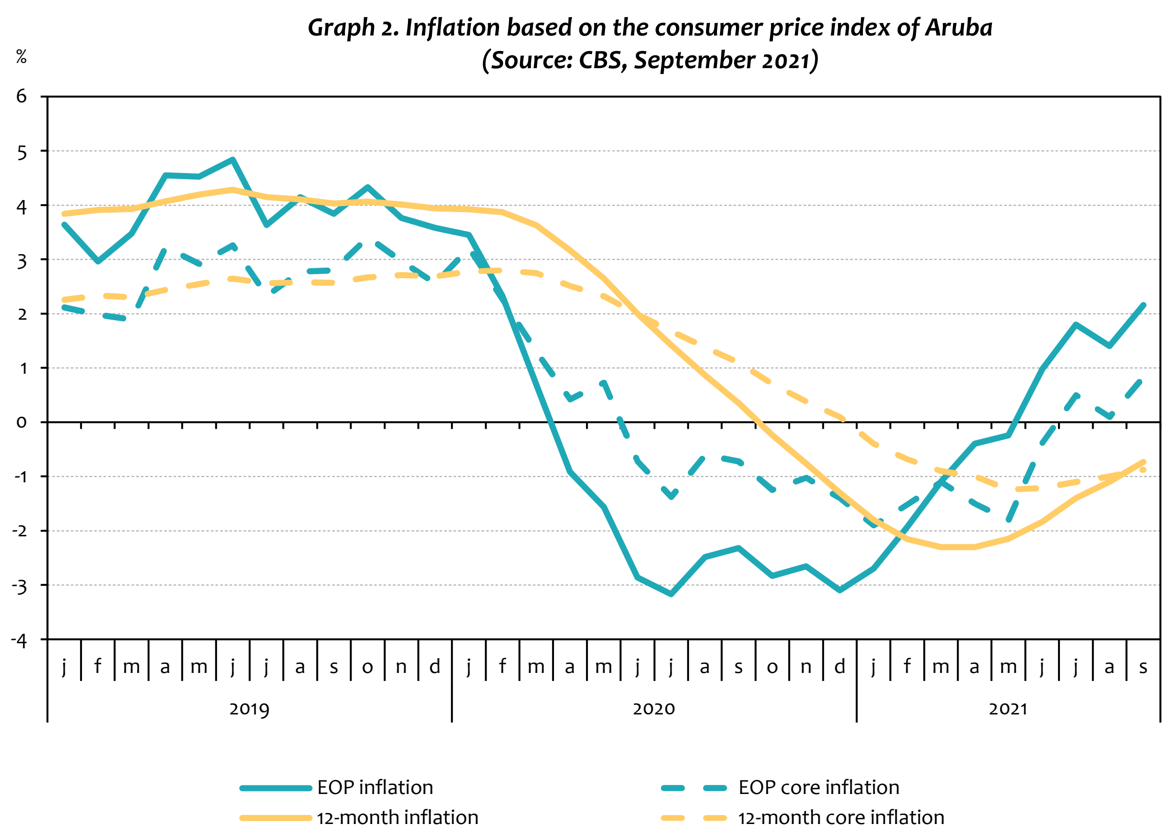

*Graph 1: Developments in official and international reserves*

### *Credit developments*

In September 2021, total credit of the banking sector contracted by Afl. 78.0 million or 2.0 percent to Afl. 3,886.1 million, when compared to the end of 2020. This was driven by the categories 'business loans' (-Afl. 33.3 million or -2.2 percent) and 'loans to individuals' (-Afl. 30.8 million or -1.6 percent). The drop in the category 'loans to individuals' was caused by a decrease in 'consumer credit', while the category 'business loans' was for the most part impacted by less commercial mortgages and current account loans.

### *Inflation*

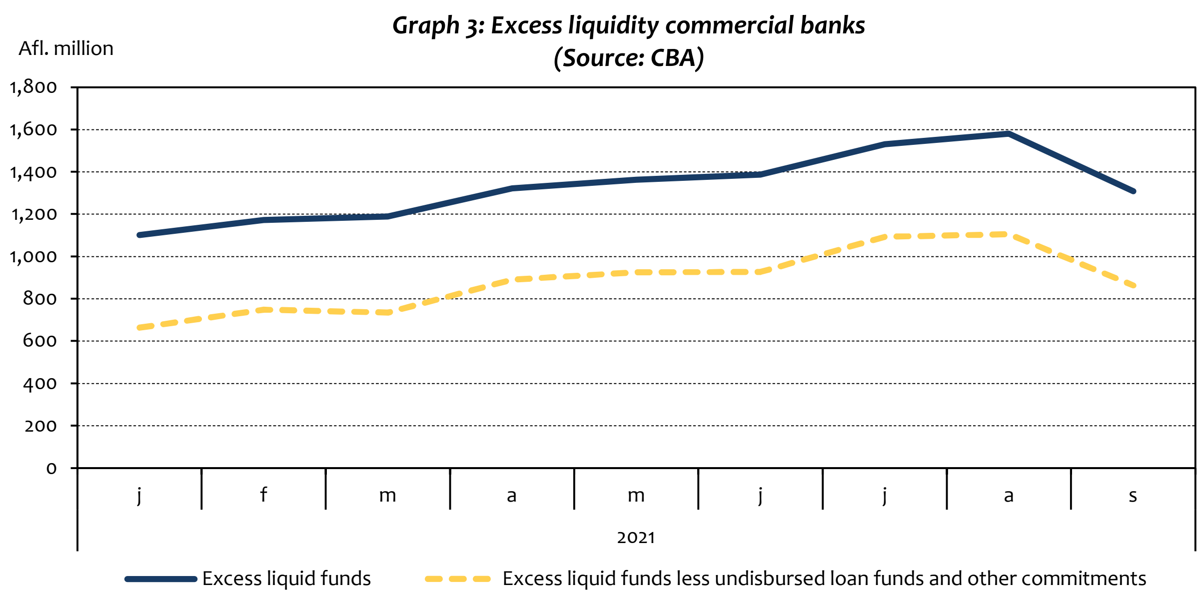
In September 2021, the CPI rose by 2.2 percent, compared to the corresponding month a year earlier (Graph 2). The twelve-month average inflation rate amounted to -0.7 percent in September 2021, 0.4 percentage point higher than the previous month. The rise in the CPI, when compared to a year earlier, was mainly the outcome of upward price movements in the components 'transport' and 'household operation'. The former was related to the trending oil price hike leading to a higher gasoline price, while the latter was likely due to global supply chain issues.




*Graph 2: Inflation*

### *Commercial bank liquidity*

The aggregate excess liquidity of commercial banks rose to Afl. 1,308.3 million in September 2021, compared to Afl. 1,107.4 million in December 2020 (Graph 3).




*Graph 3: Excess liquidity developments*

A monthly comparison showed, however, that the aggregated excess liquidity declined from Afl. 1,508.3 million in August 2021 to Afl. 1,308.3 million in September 2021. This contraction is associated with the rise in the reserve requirement rate as of September 1, 2021, paired with the increase in the prudential liquidity ratio from 15 percent to 18 percent as of the same date. However, the uptick in the reserve requirement rate and the prudential liquidity ratio was mitigated by a surge in the total liquid funds[4] of the commercial banks. Consequently, the level of excess liquidity remained high and is significantly above pre-pandemic levels (see Box A).

| Box A: What is commercial bank excess liquidity and why does it matter? |
|---|
| The aggregated excess liquidity of the Aruban commercial banks indicates the liquidity available in the banking system that exceeds the minimum amount required (i.e., in terms of the reserve requirement and the minimum prudential liquidity). Therefore, the excess liquidity is derived from the total liquid funds (less pledged assets), after subtracting the reserve requirement and the minimum prudential liquidity. |
| Excess liquid funds allow the commercial banks to build liquidity buffers. The latter is used to accommodate demand for credit and acts as a cushion during financial and economic crisis. Nevertheless, an elevated level of excess liquidity may hamper the conduct of monetary policy, as it decreases the effectiveness of monetary policy transmission mechanism due to the CBA's reduced ability to influence the supply of credit of local commercial banks. |

[4] The total liquid funds of the commercial banks consist of the following items: cash, current account and time deposits held at the CBA, demand deposits and time deposits due from other commercial banks, short-term securities, government bonds, and other marketable securities.

The ample excess liquidity is partly the effect of the reductions in the reserve requirement rate and the minimum prudential liquidity ratio as of March and April 2020, forming part of the monetary and prudential policy domains relief measures taken by the CBA to mitigate the effects of the COVID-19 pandemic. Furthermore, the continued subdued credit demand is an additional contributing factor to the commercial banks' excess liquidity, and likely so were the wage subsidy and FASE programs of the GoA to countermeasure and contain the economic effects of the COVID-19 contagion.

Consequently, the prudential liquidity ratio of the commercial banks, which measures the percentage of their liquid assets to their total net assets, remained at a comfortable level in September 2021 (38.3 percent), far above the minimum required prudential liquidity ratio of 18.0 percent.

***Anticipated outflows due to de-escalation initiatives by the CBA***

Despite the comfortable level of official and international reserves, the CBA anticipates a hike in payments to non-residents, attributed to the lifting of the previously introduced foreign exchange restrictions, as per September 2021. The latest forecasts show a total estimate of at least Afl. 252.5 million to flow out by the end of 2021.

Centrale Bank van Aruba
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