The Central Bank of Aruba raised the reserve requirement rate by one percentage point as of February 1, 2022, to reduce commercial banks’ excess liquidity

Press Release

During its meeting of January 12, 2022, 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 raise the reserve requirement rate\(^2\) from 13.0 percent to 14.0 percent as of February 1, 2022. 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 December 24, 2021, increased by Afl. 757.2 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) for liquidity support. Meanwhile, official reserves increased by Afl. 521.0 million. Consequently, the official and international reserves reached, respectively, Afl. 2,728.9 million and Afl. 3,113.8 as of December 24, 2021 (Graph 1).

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\(^1\) 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 14.0 percent of their liabilities with a maturity less than 2 years.
Accordingly, the level of reserves remained adequate when benchmarked against the current account payments and the IMF ARA\(^3\) metric (Table 1).

| Table 1: Reserve benchmarks monitored in 2021 |
|-------------------------------|------------------|------------------|-------------------|-------------------|-------------------|-------------------|-------------------|-------------------|-------------------|-------------------|-------------------|
|                               | Jan              | Feb              | Mar              | Apr              | May              | Jun              | Jul               | Aug               | Sep               | Oct               | Nov               | Dec               |
| IMF ARA Metric                | 108.7            | 106.7            | 103.2            | 105.2            | 104.8            | 105.4            | 113.1             | 112.4             | 113.3             | 107.2             | 114.2             | 120.7             |
| CA Coverage Ratio             | 8.3              | 8.4              | 8.7              | 9.2              | 9.0              | 9.0              | 9.5               | 9.3               | 8.9               | 8.9               | 8.9               | 8.6               |

\(^3\) 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.
Credit developments
In November 2021, total credit of the commercial banks contracted by Afl. 145.1 million or 3.7 percent to Afl. 3,819.0 million, when compared to the end of 2020. This decline was caused by the categories ‘other’ (-Afl. 83.7 million/-16.3 percent), ‘business loans’ (-Afl. 32.4 million/-2.1 percent), and ‘loans to individuals’ (-Afl. 29.0 million/-1.5 percent). The fall in the category ‘other’ was primarily the result of a lower amount of government bonds held by the local commercial banks. The drop in the category ‘loans to individuals’ was due to a decrease in ‘consumer credit’, while the category ‘business loans’ was for the most part impacted by diminished current account loans.

Inflation
In November 2021, the Consumer Price Index (CPI) rose by 3.1 percent compared to the corresponding month a year earlier. The twelve-month average inflation rate amounted to 0.2 percent in November 2021, 0.5 percentage point higher than the previous month (Graph 2). The rise in the CPI compared to a year earlier was mainly caused by the upward price movements in the components ‘transport’ (1.8 percentage points contribution) and ‘housing’ (0.5 percentage point contribution). The former was related to the trending oil price hike that coincided with a higher gasoline price, while the latter was due to rising prices of maintenance and repair of the dwelling. The higher prices for maintenance and repair of housing dwellings may have been related to the ongoing global supply shortages.

Graph 2. Inflation based on the consumer price index of Aruba
(Source: CBS, November 2021)
Commercial bank liquidity

The aggregate excess liquidity of commercial banks rose to Afl. 1,295.8 million in November 2021, compared to Afl. 1,107.4 million in December 2020 (Graph 3).

The monthly comparison showed that the aggregated excess liquidity remained unchanged in November 2021 in contrast to October 2021, despite a one percentage point increase in the reserve requirement on the 1\textsuperscript{st} of November 2021. The uptick in the reserve requirement rate was mitigated by a surge in the total liquid funds\textsuperscript{5} held by the commercial banks. Consequently, the level of excess liquidity remained unchanged and significantly above pre-pandemic levels.

The ample excess liquidity is partly the result of the continued subdued credit demand at local commercial banks. Furthermore, the wage subsidy and FASE programs of the GoA to cushion the economic effects of the COVID-19 crisis also contributed to the high level of excess liquidity.

\textsuperscript{5} 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.
Meanwhile, 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 of 37.9 percent in November 2021, far above the minimum required prudential liquidity ratio of 18.0 percent.

Centrale Bank van Aruba
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